

# Public sector supply chain: risks, myths and opportunities

A New World of Risk  
Executive Summary



## Foreword



Today, local authorities are in the midst of a significant period of change and have a new role and purpose as community leaders. This includes dramatically increasing the level of outsourcing and working with partnerships to deliver on promised outcomes. Indeed, Government policy has moved from encouraging partnerships towards mandating them.

We have, sadly, a very wide range indeed of disasters and embarrassments caused by supplier and partner failure that encourages us to place these risks as topical, potentially catastrophic and urgent. These third parties are very likely to have different agendas, ambitions, stakeholder pressures to satisfy, governance standards, attitudes to risk acceptance, levels of resources to apply to risk management, sensitivities, and often very different business and human resource management cultures. Once these relationships are created, stepping back from them is not easy, especially urgently and when in a crisis.

This paper makes the fundamental point that outsourcing or partnering, whether it is towards back office or front office outcomes, is so much more than subcontracting or logistics management. Never before has outsourcing and its risks, myths and opportunities been such a topical and urgent challenge for public service executive leadership and its managers. This paper sets out to support them in understanding and addressing these issues.

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## Biography

David Kaye is a leading author, lecturer, examiner and workshop leader on risk management and business continuity subjects. He guides a diverse range of companies and public sector organisations on risk related issues around the world.

David started his working life at Eagle Star insurance, becoming CEO of subsidiary insurance companies within the group, living and working in five different countries.

David's latest book, *Managing Risk and Resilience in the Supply Chain*, published by the British Standards Institution in 2008, is a core textbook for universities and business schools. He is the Institute of Risk Management's lead examiner in business continuity and is the author of Chartered Insurance Institute's textbook on operational risk and a standard book on business continuity. David is a Fellow of the Chartered Insurance Institute, a Fellow of the Royal Society of Arts, a Fellow of the Business Continuity Institute, and a Member of the Institute of Risk Management.

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# 1. Backdrop

## The private sector has been struggling for some time to understand and control supply chain risk.

Companies have been working to understand and to manage their exposure to business failure where entire sections of their organisation have been contracted out to a third party organisation. Today, local authorities are in a significant period of change and have a new role and purpose; including dramatically increasing outsourcing and partnerships to deliver promised outcomes.

*“Government policy has moved from encouraging partnerships towards mandating them...”*

Working Better Together –  
Managing Local Strategic Partnerships:  
Audit Commission, April 2009



We have, sadly, a very wide range indeed of disasters and embarrassments caused by supplier failure which encourages us to place these risks as topical, potentially catastrophic and urgent. They range from:

- Countless and huge examples of the loss of sensitive personal data and privacy responsibilities e.g. the £225 million Contact Point, child protection database issues
- Badly managed social care contracts leading to reputational damage and legal challenges
- The National Audit Office that is investigating alleged overspending and overrun of IT contracts worth £18 billion
- The failure or collapse of a number of shared service agreements.

**The National Audit Office in its Good Practice Contract Management Framework, 2008, found that** “while there are examples of good practice, central government’s management of service contracts is not consistently delivering value for money. The report estimated that better contract management could potentially generate savings of between £160 million and £290 million a year across the organisations surveyed through reduced contract expenditure. As well as financial savings, better contract management could bring improvements in the quantity and/or quality of services, the avoidance of service failure, and better management of risk.”

**The essence of these disasters, and indeed so many similar, is that the failed responsibility was fundamental to the very existence of the authority. They created a crisis situation that would hit the desk of the chief executive officer and the most senior management team; threatening not only the service users who have been let down, but the trust, confidence, legality, financial stability, and regulatory compliance of the entire authority.**

A Zurich survey, “Perception and Reality” (2007), asked local authorities, educational institutions, and charities for the risks that concern them the most. A clear first was ‘Managing partnerships with other organisations’ and the following four key concerns each have supply chain risk connotations:

There are lessons too from the private sector; sobering thoughts emerged from some Gartner research (2005) which said that the failure rate of outsourcing contracts to meet expectations is fully 50%.

Metrica, a UK research firm, suggested that the greatest worries for risk managers involved outsourced processes and they were:

- Losing control over the process
- Losing control of customer relationships
- Potential loss of quality
- Threats to brand and reputation
- The operational and financial stability of the supplier.

### Key risks – expert vs public assessments

Expert ranking	Risk	Public ranking
1	Managing partnerships with other organisations	3
2	Funding and good financial management	2
3	Human resource issues	4
4	Crisis planning	8

## 2. Outsourcing and partnership working

This paper makes the point that outsourcing the supply chain and partnership working is so much more than simply subcontracting or logistics management. Outsourcing places what have been entire and core elements of the home organisation, into the hands of third parties. The core elements that are passed over are not only workforces and their skills, it is also the physical resources that are needed to deliver on the promises. This raises a wide range of control and quality issues, but also, other equally vital foundation stones are passed over.

These include:

- a very wide range of intellectual assets
- the ability to remain in control
- risk management processes and attitudes
- legality
- compliance
- information and other security
- the ability to communicate with stakeholders
- and also the vital need to ensure continuing confidence in the Authority itself.

These third parties are very likely to have different agendas, ambitions, stakeholder pressures to satisfy, governance standards, attitudes to risk acceptance, varying levels of resources to apply to risk management, sensitivities, and often very different business and human resource management cultures. Once these relationships are created, stepping back from them is not easy, especially urgently and when in a crisis. Reinstating the home organisation's ability to deliver, and to regain control of vital dependencies, may need them to overcome operational, human, technical, legal and practical problems that, if achievable at all, will in the meantime stop delivery of crucial and urgent services.

Local authorities are now increasingly entering into a broad range of relationships across the public, private and third sectors. Nothing is ruled in – and nothing is ruled out. Many of these relationships underpin the operations and service delivery of the entire local authority; whilst others are outsourcing partnerships focused on achieving the target outcomes laid out in the Local Area Agreement (LAA) and the Local Strategic Partnership (LSP) – and measured by the Comprehensive Area Assessment (CAA). The Audit Commission refers to organisations working together to achieve an outcome as a “delivery chain.”

*“A delivery chain is the complex network of organisations, including central and local government agencies, and bodies from the private and third sectors, that need to work together to achieve or deliver an improved public sector outcome.”*

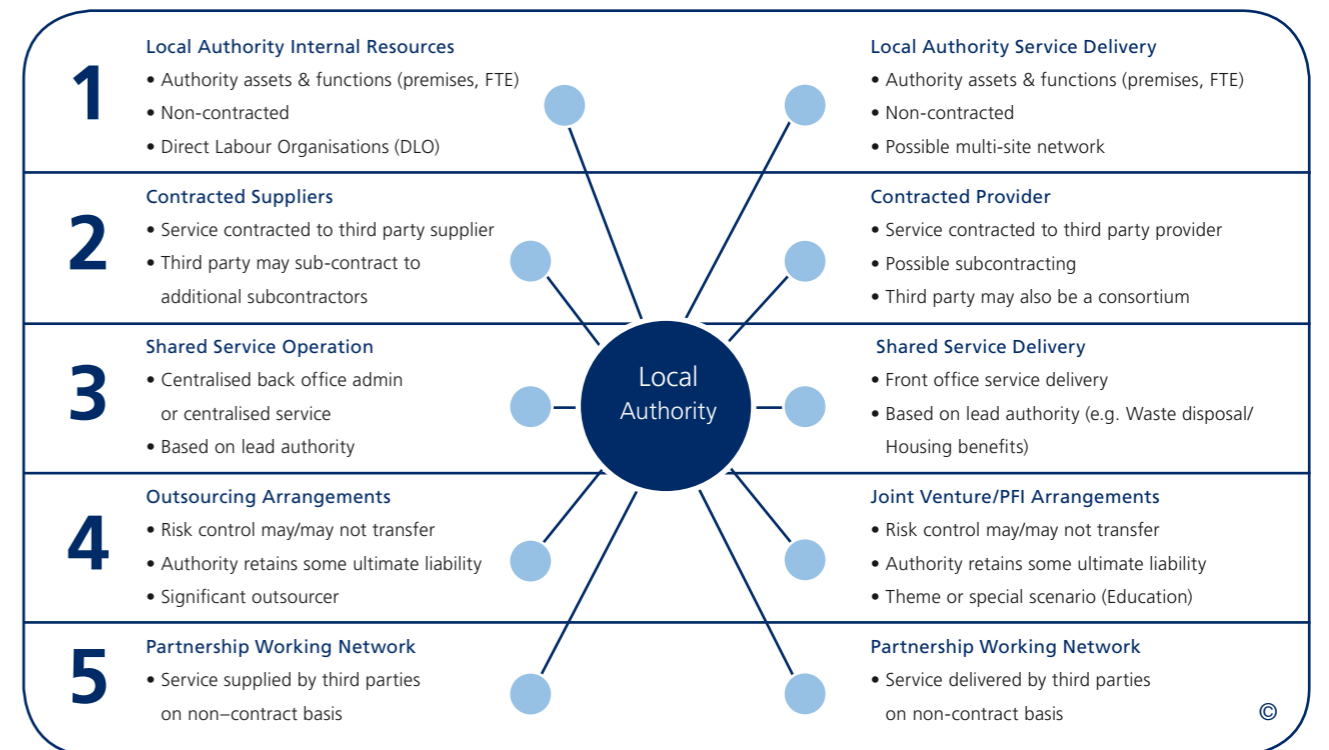
**National Audit Office and Audit Commission, Delivering Efficiently: Strengthening the Links in Public Service Delivery Chains, 2006**

Yet a closer examination of the broad range of relationships that a local authority engages in across the public, private and voluntary sectors reveals an even more complex story. Indeed local authorities are establishing different types of supply chains – each with their own attendant risks and challenges.

### Types of Local Authority Supply Chains

Inbound – back office *Corporate Services*

Outbound – front office *Community Services*



Source: Zurich Municipal ©

We need to remember also that the use of the outsourced delivery model is not necessarily a more risky operational model. The use of a well managed and diverse delivery chain can indeed spread risks effectively and remove single points of total failure. A risk-managed chain can also remove future unpleasant surprises and therefore provide, over the longer term,

much increased levels of cost effectiveness. However, third party supply chains bring their own difficult challenges of relationship management, and of understanding the much more opaque risks of failure within third party organisations.

*In the context of this guide, supply chain management is concerned with the “co-ordination of all parties involved in delivering the combination of inputs, outputs or outcomes that will meet a specified public sector requirement.”*

**Supply chain management in public sector procurement: a guide, OGC 2006**

### 3. The responsibility

The day to day function of risk management realistically must often be delegated but responsibility for failure cannot be so delegated. All risk-measured management therefore needs to include governance and control procedures to ensure that the organisation does not stray unknowingly beyond agreed risk tolerances; now or at any time in the future. Imposing this control environment is the first responsibility of a chief executive; without this the job is unachievable.

In an outsourced delivery model, the chief executive's and the authority's responsibility is not at all diminished. It is however more focused and can effectively be summarised as:

- The effective and risk-aware creation of the relationship
- The retention of statutory responsibilities and in tort
- Ensuring effective monitoring, risk information and audit

- Constantly retaining the ability to be flexible and to manage change
- Ensuring that there is the ability to exit as necessary without failure of responsibilities and in critical service deliveries.

This paper acknowledges and works within government guidelines and requirements; not least Audit Commission requirements and, again, such drivers for outcomes such as the Comprehensive Area Assessment. These include the Key Lines of Enquiry (KLOE) document:

*KLOE: 2.4 Does the organisation manage its risks and maintain a sound system of internal control?*

This individual KLOE has a focus statement that requires that 'the organisation has effective risk management which covers partnership working.'

The House of Commons Public Accounts Committee's 2009 report, **Central Government's Management of Service Contracts**, included the following findings:

The extent to which central government tests the value for money of ongoing services and contract changes is variable. For example:

- 41% of contract managers had not tested the value for money of new services purchased under an existing contract
- Planning and governance is one of the weaker areas of contract management, although there are examples of good senior level engagement
- Less than half the organisations surveyed had an individual with overall responsibility for contract management
- There was no documented plan for managing 28% of contracts
- 56% of contracts did not have a contingency plan in case of supplier failure
- 30% of contracts where suppliers were dealing with personal or security information did not have a risk register
- No commercial director/head of procurement rated the level of resources allocated to the management of their major contracts as 'good'.

### 4. The nine myths and minefields within outsourced delivery

It is unarguable that the delivery of crucial services through a range of third party organisations means that the risks being carried are more opaque than when the delivery is all in-house. To support the understanding of these challenges this paper identifies and explores some commonly held myths about risk, the responsibility for those risks and around risk management itself. These are summarised below:

#### 1. Outsourcing makes life easier with less to worry about as the responsibility for risk can be delegated to others

Whilst an authority may have delegated the delivery process, and even delegated the day to day risk management processes, the responsibility to meet statutory, in tort, political, contractual and other promises has not moved one inch. The further challenge is to bring the wider culture, political, reputational, regulatory, funding constraints and statutory responsibilities into a relationship with a third party who may not be familiar with these additional sensitivities.

A huge risk for a widely outsourced environment is of course the accumulation risk; whereby the failure of one supplier can simultaneously affect the authority in different departments and indeed can affect other, perceived to be separate, suppliers to the authority.

#### 2. Once a relationship is created it will manage itself

Understanding and effectively controlling third parties' risks takes the chief executive and staff well beyond erstwhile silos of risk management. They have in the past been able to consider independently the insurance needs, operational failure, financial risk, governance and legal risk, business continuity planning, project management, co-ordinated incident response, credit risk, and relationship management. Effective supply chain risk management demands that these management silos are brought together to understand just how the holistic relationship and its outcomes expose the authority to failure.

The sheer scale of a relationship may mean that it is impossible to cancel it quickly and regain the ability to deliver back in-house. If so, the relationship needs actively to integrate the authority's own risk management personnel and systems with the counterparty's own staff and day to day control systems.

#### 3. Spending time on an exit strategy is for wimps

All outsourcing where the relationship delivers critical services needs a trusted exit strategy that is pre-agreed by both parties. This exit strategy needs to recognise that circumstances may change, gradually or by sudden failure, and will enable the authority to quickly take back activity or be able to transfer it to another third party whilst continuing to maintain essential services. This is crucial amongst our messages and an entire section of the full Briefing Paper is devoted to this need.

*“Expertise seems to be in short supply and at the centre it is fragmented across several agencies. In particular, there is a need for greater expertise in ..... constructing effective partnerships with the private sector.”*

The Lyons Report 2004; 1.21

**4. Charities and Third Sector (Civil Society) organisations are easier to handle**

Large private sector companies may have the experience, skills and lawyers to set legal relationships that will absolve them from some of the consequences of failure. On the other hand some charities may not have the skills to critically understand their risk of failure; nor the ability to react to threatening incidents. They may need considerable additional support and investment to bring their risk understanding and resilience up to the authority’s minimum standards; without this they are likely to be brittle and quickly exposed to complete failure.

It is for this reason that an entire section of the Briefing Paper is devoted to the additional challenges and opportunities of using third sector organisations as contractors and partners.

**5. No new skills are required to manage an outsourcing delivery**

Understanding and dealing with the much more amorphous and long term risk of a third party’s failure sets new and increasingly difficult challenges for public service employees that are beyond their historical experiences and comfort zones.

Many Risk Managers have in the past been charged with simply managing financial risk through insurance products. Their role not only needs to be significantly widened but the chief executive and the authority have a responsibility to ensure that these new challenges in risk management are adequately skilled and resourced.

**6. Due diligence enquiries provide all the answers**

Sadly, there are no handrails. Lawyers and accountants will indeed advise on the legality and finances of a project proposal. Choosing whether outsourcing is the right way forward, and if so with whom, needs much wider and deeper consideration.

Decision making around tenders needs to be risk-weighted and not just based on price. Price auctions, in whatever form, are very dangerous without clarity on the service level compromises proposed at each price. This is especially important of course in sensitive, mission critical services such as social care of vulnerable people. Project managers, at any stage of the project, may need to suggest that the entire project should be withdrawn or reconsidered; or that any changes to the outcomes need to be risk managed again. Above all, any consultation needs to be a genuine urge to listen to stakeholder views and not be used simply to engineer acceptance.

Too often short term, accountant-measured, cost savings can become future years’ cost overruns, failures and even disasters if the more difficult cost of risk and off-balance sheet liabilities are not measured and brought into the decision making. Any political expediencies need to be managed and not become a reason for bypassing sound operational and long-term outcomes and cost considerations. The bottom line will always be; is this right for us for our operations, our ethics, our cultures, comfort alongside our other operations, our long-term risk tolerances, and above all, our community?

**7. You can best risk manage outsourcing risk once the relationship has been created**

The only fully effective risk management of third party failure is at the time that the relationship is created. The very design of the relationship needs to be risk-aware; and that all risks arising, now and into the future, will be communicated and remain firmly within the authority’s risk comfort levels. It is far too late to consider risk once contracts have been signed. There is need for realism amongst officials and their sponsors to accept that, however carefully the project is created, it could still fail or need to change; and that they need to retain the ability to manage that change; and, if necessary, successfully achieve a closure of the relationship.

Big is not always beautiful and can bring risks in itself. This can only be possible if an alternate market is retained in the product or service. Co-operation between authorities can in effect force a monolithic market place of suppliers that may give short-term gains but close down future opportunities to spread risk.

**8. Information is less important than the things you can touch**

Information, and the ability to mine that information, is at the heart of modern day business models. Massive amounts of this information can be stored in tiny hardware tools from CDs, laptops to hard drives and USB drives. Losing the ability to access that information can instantly bring the whole organisation to a halt. Authorities cannot complain however where they have not set those standards and ensured that the information holder is clearly aware of their importance.

**9. We don’t need risk management, we have insurance**

The greatest damage is unlikely to be just financial; but can, crucially, be when there is a failure to deliver on responsibilities. Insurance products, often the sole agenda in the past of risk managers, remain vital for managing financial exposures. The very nature of modern day business models however means that this is now a part of a much wider need for identifying all endemic risks and impacts; and managing them down to acceptable levels.

This calls for reconsideration of the role and skill levels of some employees currently described as Risk Manager.



## 5. Key questions for local authority leaders

Below are some of the key questions that local authority executives could usefully be asking in supply chain outsourcing arrangements:

- Does the chief executive officer understand that the responsibility for risks and resilience in service delivery rests with that role and cannot be delegated; neither internally nor externally?
- Is the supply chain project sponsorship at the correct and suitably skilled level; and is there a clear, senior level owner of the overall responsibility for risk?
- Does the project design require outcomes that include report on risks within any new framework that is being proposed; and also any new risks that may be introduced into other parts of the organisation?
- Does the project design brief demand an exit strategy and plan?
- Do risk registers embrace the potential loss of intellectual and other assets, losing control over the process itself, data privacy, potential loss of quality of service, ability to communicate, the ability to remain legal, and threats to confidence and reputation?
- Are the supply chain project managers skilled, resourced, or supported adequately to respond to the challenge of understanding outsourcing risk and its effective management? Are they in particular aware of the authority's sensitivities and risk tolerance limits?
- Do the tendering and decision processes actively and consistently expose risks within each of the tenders and ensure that the choice of counterparty is formally risk-assessed?
- Does the project brief demand that the deliverer of services has adequate risk processes; including resilience plans that embrace the authority's own urgencies and sensitivities?
- Are outsourced service promises and liabilities embraced within routine control and governance procedures?
- Does the authority's risk controls embrace important non-financial exposures as well as the financial ones?
- Do the project managers and their sponsors feel comfortable that if they find that unacceptable exposures have evolved that they can suggest that the project may be closed or that at least, some fundamentals need to be reconsidered?

## 6. Summary

In a nutshell, the outsourced business model is much leaner and has much less margin for error. Its ability to absorb surprises is gone for ever, and thus understanding and managing its risks has never been more critical.

Outsourcing a supply chain critical service need is so much more than subcontracting. Contracts may be tiny or huge. They can range from ones that embrace emergency services to emptying dustbins to the management of a community hall. As such, they all demand different levels of risk attention. The priority however is not by the size of the contract but: how much harm will a failure cause? The responsibilities of the public sector, and the consequences of failure, are diverse, serious and wide-ranging. Authorities not only have contractual and legal responsibilities in tort, but crucial statutory and political responsibilities too and these responsibilities crucially need to be embraced by the chosen partner organisation.

The Briefing Paper sets out to support the authority in meeting its responsibilities and the secure delivery of its Local Area Agreement and measured through the Comprehensive Area Assessment; and whilst risk aware management is simply no more than good management, also to satisfy its Statutory, Audit, and other Governance requirements.

As a starting point the chief executive may wish to appoint a senior governance, strategic or risk director to explore the current situation within the authority, prompted in part by the key questions for leaders.

## 7. Objectives of the Briefing Paper

This Executive Summary highlights and introduces some of the key issues affecting local authorities. The full report will be published in June 2009. It sets out, in a practical way, to support chief executives, politicians, auditors and their authorities in meeting these new and testing challenges. The Briefing Paper deals with the particular challenges of delivering crucial responsibilities through large and small contracts with third party providers and also by less informal partnership working.

The paper recognises that there are variations across England, Scotland, Wales and Northern Ireland but the principles, whilst necessarily generalised will, we believe, be of value to all local authorities and all areas.

Managing risk when core responsibilities have been outsourced to a charity or other third sector organisation are covered in its own separate section in the Briefing Paper. This sets out not only to raise, realistically, the additional challenges that they bring, but also to illustrate where effective risk management can enable such a relationship, when it is preferred policy, to become achievable.

*It will be equally of use whether the reader's focus of interest is with managing risk at strategic, programme or operational levels.*



Briefing Paper 2009

As stated in the **Orange Book: Management of Risk – Principles and Concepts. 2004**, we set out in the paper to bring practical advice and prompts to:

- those who are new to risk management and those who are tasked with providing training on risk management in their organisations, both of whom will find it useful as a key introductory document
- those who are concerned with the review of risk management arrangements (such as Audit Committees) as a resource providing a comprehensive statement of principles against which actual risk management processes can be evaluated
- senior staff whose leadership is vital if an appropriate culture is to be generated in which risk management can be effective
- operational level staff who manage day to day risks in the delivery of the organisation's objectives and who will find it a practical support in the actual management of risk; and those who are experienced in risk management, for whom this guidance explores more difficult concepts such as risk appetite.

## 8. A more secure future starts now

Start finding out more today. The full Briefing Paper expands on all these areas to offer deeper insight and helpful guidance for local authorities.

For further information please visit [www.NewWorldofRisk.co.uk](http://www.NewWorldofRisk.co.uk)

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