Going to market
– the role of outsourcing and shared services in housing associations

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Introduction

In 2012 CIH produced its report *Does size matter – or does culture drive value for money?* The publication considered housing associations’ ability to respond to their rapidly changing operational environment, and the impact of various factors on efficiency and performance. One year on, this paper builds on the debate generated by the report and considers the role of outsourcing and shared services in helping housing associations meet their obligations for delivering value for money. Our research explores the continued evolution of the housing association sector and the challenges of delivering front-line and back-office services cost effectively.

This paper is designed to help to inform and develop a conversation within the industry, and to draw attention to the factors relevant to organisations considering outsourcing or shared services. It focuses primarily on housing associations.

Given that housing associations are independent organisational bodies with freedom to formulate their own business plans based on commercial considerations, and are not subject to the same financial and political constraints as public sector bodies, we have not drawn extensively on the lessons and experiences of local authorities and public services.

Methodology

The methodology for this project involved:
- literature reviews on private sector and housing association outsourcing
- detailed interviews and visits to Circle Housing Group and Orbit Housing Group, both of whom have extensive experience of outsourcing arrangements
- interviews with a range of housing associations and key players with experience of outsourcing
- analysis of HouseMark benchmarking data for 2011/12.

Our definitions

For the purpose of this research project we have defined outsourcing and shared services to mean:
- **Outsourcing**: the allocation of specific business processes to a specialist external service provider
- **Shared services**: a collaborative strategy in which a set of functions are concentrated into a semi-autonomous business unit.

Although housing associations continually enter into contracts with other companies to procure goods and services, we do not refer to an association buying ‘off the shelf’ products or services as outsourcing.

Report overview

Findings from the report are presented in three parts:
- **Part 1**: considers the advantages and disadvantages of outsourcing and shared services and draws on the experience of the private sector
- **Part 2**: provides an analysis of the current housing association outsourcing market and the potential for further development
- **Part 3**: highlights the practical aspects to be considered when appraising outsourcing and/or shared service options.
Key messages

The emergence of a mixed market
Housing associations are redefining themselves in terms of focus and operational emphasis and are going to have to work in more commercial ways. We are likely to witness the emergence of a ‘mixed market’ of association structures, partnerships and approaches, in which outsourcing and shared services could play a significant part.

However one of associations’ strengths is that they are a different type of business not focused on profit distribution. Defining what a market orientated approach means in the context of an association’s values, strategy and location will be vital.

Unlocking capacity and building a market
For new outsourcing and shared service markets to emerge and be effective there is a need for a range of potential competitors who have the skills and resources to compete and then deliver effectively. With over 100 associations that have an annual gross turnover of more than £10 million and own more than 2,000 properties, there is potential for significant competition and shared services among and between associations.

Such an approach would require significant cultural change for the industry. It would however mean that any profits could be used for investment in housing provision and services rather than going out of the industry.

Be pragmatic – make your own choices
Outsourcing and shared services should be seen as useful tools to help run the business, and decisions on whether to go down this road or not should be pragmatically arrived at on the basis of what is best for that business at that point in time.

Be practical – be a good client
The strongest practical lesson that arises out of our work for associations considering outsourcing is the absolute importance of good procurement and contracting arrangements and skills. The strength of any contract or partnership is reliant on the effectiveness of the client.

Be efficient – understand your costs
There are considerable differences between associations in terms of costs, a large proportion of which is unaccounted for. Outsourcing can provide an opportunity to reduce costs and deliver a sharper focus on business priorities, but there are risks around loss of skills, degradation of quality and unsustainable savings which should be considered. Ensuring that you have fully considered the potential for reducing costs yourself – before paying an outsourcing contractor to do it for you – is vital.

Be bold – challenge yourself
Associations with mediocre performance or high costs should consider undertaking a real market test by outsourcing their housing management in a portion of their stock to provide a real comparison of costs and/or performance. This may lead to more efficient ways of delivering inhouse, as clear comparisons can be made alongside potential opportunities for innovation.

Be careful – value skills and expertise
Associations need to consider lessons from the private sector in terms of balancing the short term gain of reducing staffing overheads by outsourcing and the risk of a loss of expertise, knowledge and loyalty that cannot be easily replaced. Providing housing for people on low incomes without focusing on the wider viability of the neighbourhoods they live in is likely to result in deteriorating income streams and asset values. Housing associations have therefore invested considerable efforts and resources into developing well-trained professional staff who can cope with these complexities.
1 More commercial – more outsourcing, more shared services?

Today, there are real pressures on housing associations to drive a more robust approach to efficiency, with the potential tightening of revenue arising from the changes to the benefits system and the direct payment of universal credit to tenants, combining with reductions in capital subsidy. These changes mean that if housing associations want to continue doing the things they were set up to do, they need to generate extra revenue to invest in new homes and services. Indeed, many associations may have to spend less or produce extra income just to stand still.

As a consequence, associations are adopting a more market orientated approach to driving efficiency and innovation. Defining what ‘commercial’ means and how this links into an association’s values, strategy and location will be vital. How well placed an association is to deliver its own services, or to consider outsourcing or shared service provision as part of a more commercial approach, are likely to become more common questions across the sector.

This section considers some of the advantages and disadvantages of outsourcing and shared services, drawing on the experiences of the private sector to identify some of the issues which might drive or inhibit moves towards a wider market in outsourced/shared services.

Are there cost savings to be made?

Private sector bodies compete in the open market on cost and are subject to external pressures to deliver at the best price possible. One of the biggest risks a private sector firm faces is getting its cost profile – and therefore its pricing – wrong. A key driver, therefore, for much outsourcing activity in the private sector has been cost and efficiency savings.

Establishing the right cost base, understanding and managing costs effectively, is an increasingly important issue for housing associations. Getting it wrong means valuable resources are continually being used for the wrong purpose.

So what is the current profile of housing association costs?

There are significant variations in costs between associations. If we look at HouseMark’s data on housing management costs per property in 2011/12 (Table 1 below) this illustrates the point. Furthermore, the Homes and Communities Agency (HCA) analysis\(^1\) shows that only part of these cost variations can be explained by factors such as regional wage differences, the amount they have to spend on repairing their stock and the level of deprivation in the areas in which associations work.

### Table 1: Costs per property for English housing associations 2011/12

<table>
<thead>
<tr>
<th></th>
<th>Housing management</th>
<th>IT</th>
<th>Finance</th>
<th>HR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lower quartile</td>
<td>£554.75</td>
<td>£52.75</td>
<td>£31.98</td>
<td>£8.48</td>
</tr>
<tr>
<td>Median</td>
<td>£443.13</td>
<td>£37.54</td>
<td>£20.29</td>
<td>£5.92</td>
</tr>
<tr>
<td>Upper quartile</td>
<td>£364.92</td>
<td>£27.17</td>
<td>£13.80</td>
<td>£3.75</td>
</tr>
<tr>
<td>Mean</td>
<td>£460.27</td>
<td>£42.04</td>
<td>£25.66</td>
<td>£6.81</td>
</tr>
</tbody>
</table>

These variations suggest that there is considerable scope for associations to reduce costs. For associations developing more commercial approaches, using outsourcing or sharing services to help them not just reduce – but also better understand – their cost profiles may be a useful tool.

\(^1\) Understanding unit costs of housing providers – regression analysis. HCA 2012
Costs – the need for clarity

In reviewing the literature on private sector outsourcing it has been acknowledged that cost savings may not be as great as initially envisaged, and that savings may reduce over time. Deloitte’s 2012 Global Outsourcing and Insourcing Survey reported that whilst most respondents are satisfied with their recent outsourcing initiatives:

*Overall, actual cost reductions through the most recent outsourcing experience are lower than expected with 53% of respondents anticipating significant savings (greater than 10% cost reduction), while only 42% experienced significant cost reductions.*

The move to shared service arrangements in government departments has also not led to significant savings; with the National Audit Office\(^2\) saying that ‘Departments have not realised the planned benefits’ and advising that:

*Bodies commissioning shared services and the centres themselves should ensure that the case for shared services is clearly evidenced. They need to clearly define the benefits and costs from shared services.*

Moreover the experience of the recent collapse of a number of repairs and maintenance contractors (see section two) indicates that a rigorous focus on gaining the lowest costs, or failure to accurately understand true costs, has the potential to increase the risk of outsourcing contract failure. This suggests a need for clarity on exactly how cost savings are to be achieved. For example are they really gained as a result of outsourcing or shared services, when all the set up and on-going contract management costs are taken into account?

The short term gain of reducing staffing overheads by outsourcing might lead to a loss of expertise, knowledge and loyalty that cannot be replaced. Many companies appear to have found that initial savings in labour costs were reversed as they had to buy back lost expertise in order to be an effective client and contract manager.

There is evidence from the private sector that outsourcing can be a tool to improve a function that is underperforming – outsourcing to a company that can bring better management skills and expertise to the situation. However, given the complexity and costs involved in procuring and gearing up for outsourcing, associations need firstly to ask if they have the ability to reduce the costs themselves.

So, it is clear that any cost savings have to be worked for. However it is also the case that savings arise not just from trying to outsource at less cost, but also because the contracting process in itself helps provide a better understanding of cost profiles and drivers.

Opportunities beyond a narrow focus on costs?

There are a number of other significant drivers of outsourcing in the private sector, over and above cost savings. Taking a more commercial approach can help in terms of productivity and better use of resources. These include opportunities to:

- **Maintain a focus on the core business**: outsourcing the supporting processes gives the organisation more time to focus attention on its core business activities

- **Enhance complicated back-office functions**: where the size of the business is preventing it from performing back office functions at a consistent and reasonable cost. This may be about small businesses not having the resources to deliver these well or larger businesses not having the time to focus on them as tightly as they should

\(^2\) Efficiency and reform in government corporate functions through shared service centres. 2012
• **Risk-share:** outsourcing certain components of the business process can help the organisation to shift specific responsibilities to the outsource provider. Since the outsourced vendor is likely to be a specialist, they can potentially help to plan the risk-mitigating factors more effectively.

• **Boost speed and expertise:** finding and training skilled staff and keeping up with technological change are major challenges for most organisations. If tasks can be outsourced to specialist bodies that have up to date expertise and/or specialist equipment, then potentially the tasks can be completed faster and with an improved quality output.

When first outsourcing services many organisations effectively procure the methods and expertise of their contractor. Increasingly, as organisations’ approaches mature, many companies move to more tailored models that specifically suit their business. For associations considering the possibility of an outsourcing option, being in control of the process so that it is tailored to your needs will be important.

### Constraints on outsourcing and shared services

The issues above may become increasingly relevant for associations which are innovating and developing new approaches. However, there are still two significant considerations which may sway them towards continued in-house provision:

• **VAT**
  
  Current Value Added Tax (VAT) rules pose a challenge for associations wishing to outsource. Unlike local authorities, housing associations are not able to recover most of the VAT they are charged by suppliers. So where services are provided by another organisation, which is not part of a VAT group with the association, VAT normally has to be charged. Providing services in-house does therefore avoid incurring VAT on the labour element of the service.

  VAT might therefore be considered a key disincentive because it imposes a significant cost on outsourcing as opposed to in-house, or in-group as shared service provision, particularly when the costs of procurement and setting up to be an effective client are also taken into account. Set against this however, VAT does not appear to have been a significant factor in previous activity by housing associations to outsource repairs and maintenance services. This might suggest that VAT is less of a disincentive where there is an established market with a track record of successful contracting.

• **The need for flexibility and control**
  
  Issues of flexibility and control to be potential barriers to outsourcing. These concerns are highlighted by the example of Affinity Sutton below:

### Case study Affinity Sutton

**Affinity Sutton** outsourced most of its financial operations for over 10 years. The arrangements generally worked well within the context which it was let, with the contractor bringing a lot of systems and management expertise.

Affinity Sutton grew significantly in size and geographical spread after the contract was agreed. It became clear that the contracting arrangements did not really provide the flexibility needed for the organisation as it changed. Consequently it took the service back in-house in 2011.
The key reasons for bringing services back in house were:

- a contract arrangement in which changes have to be negotiated is not really commensurate with the kind of flexibility that is now required to allow Affinity Sutton to respond quickly to the changing environment
- the original intention was for the contractor to have operational independence over how it used its staff. This was important to the effective management of the contract by the contractor, but for Affinity Sutton it meant that how staff were being used was not always clearly visible
- Affinity Sutton was contributing to the contractor’s overheads and profits as well as paying VAT on the contract. By taking the finance service back in house and managing it effectively they were able to do more with the same resources
- there are benefits to be gained from having and developing their own finance staff, who are focused only on their business and interacting with other staff. This develops internal knowledge and synergies which would be unlikely to develop from a traditional contracting situation.

The assessment and control of risk was a significant issue for interviewees who had concerns that outsourcing had the potential to decrease their flexibility in mitigating risk and reduce their control to deal with issues as they arise.

This concern is echoed by local authorities. Interserve’s YouGov research carried out last year among local authority chief executives highlighted that seven out of 10 councils believe outsourcing partnerships reduce control and also increase risk.3

Flexibility of approach

As markets for outsourcing are maturing there is increasing recognition of the limitations of a narrow contractual approach to outsourcing. This is particularly the case in relation to being able to respond flexibly to change – both internally and in the market. There is also clear acknowledgement that outsourcing is not a ‘one way street’ but an approach that can be taken or reversed depending on the state of the market and the organisation’s business requirements. This has resulted in two trends.

The first, bringing contracts back in-house: many businesses now see this as a real option. Deloitte’s 2012 Global Outsourcing and Insourcing Survey found that:

‘We are beginning to see more clients contemplating insourcing functions due to vendor non-performance or changes in business strategy.’ Of those who had terminated a contract, 34 per cent had chosen to insource rather than tender and ‘almost all those who insourced are satisfied with the result’.

In relation to private sector call centres this has partly been driven by new developments in media and technology, and the emergence of ‘unsourcing’. This involves companies setting up online communities and networks to enable peer-to-peer support among users. Instead of speaking to a call centre, customers’ problems are answered by individuals who have bought and used the same products or services. This happens either on the company’s own website or on social networks like Facebook and Twitter, and the ‘helpers’ are generally not paid for their efforts. Housing associations may explore how they could utilise existing tenant and community resources in this manner for the future.

The second trend is where outsourcing continues but contracts are refreshed on a regular basis in order to reinvigorate and maintain the momentum for improved performance and strong transformation.

3 Local Government Chronicle, 27 September 2012
Professors Leslie Willcocks and Mary Lacity of the London School of Economics have written that:

*In the 20 years that we have been studying global outsourcing, clients and providers have expressed some persistent challenges about the outsourcing industry. One of these is – how can clients and providers reinvigorate long-standing arrangements to reclaim high performance?*

Their research argues for continuing strong transformation and identifies a range of practices that can reinvigorate arrangements including:

- centralisation and standardisation
- adopting a partnership based arrangement for governance
- focusing on benefits beyond cost reduction
- integrating, empowering and rewarding the provider’s staff
- targeting strategic business outcomes.

Having considered the pros and cons of outsourcing and shared services in this section, neither evidence nor experience demonstrates conclusively that any one approach is more advantageous than another. The debate however shows that decisions around outsourcing may be influenced by a range of factors which include:

- the personal preference of particular managers
- the success of existing relationships and contracts
- current trends within the sector in relation to whether an organisation should ‘make or buy’.
Go to Market – The Role of Outsourcing and Shared Services in Housing Associations

2 Market analysis

Our research has shown that there are both drivers and barriers to the development of outsourcing and shared services. This section of the report considers the current market for back-office and front-line housing services and explores how a future market might develop and what it could look like.

Repairs and maintenance

Repairs and maintenance is the area of associations’ activities that has the most substantial history of outsourcing. This is significant, as routine and planned maintenance and major repairs constitute up to 60 per cent of the expenditure of some landlords.

To gauge the extent of this we looked at whether or not an association has a Direct Labour Organisation (DLO), and is therefore undertaking repairs and maintenance work in-house. HouseMark benchmarking data (2011/12) shows 44 per cent of housing associations have a DLO. For further details see Appendix 2.

Trends in the existing market for repairs and maintenance services have been heavily influenced by the recent collapse of a number of large private sector contractors. The failure of these contractors appeared, in part, to be due to them winning work at unprofitable margins. As a result associations are thinking more cautiously about their approach to outsourcing and risk transfer. Greater evidence of suppliers’ financial solidity and ability to deliver the required quality standard is being pursued more robustly, with some contracts being split into smaller contracts to limit exposure to individual firms. This in turn has opened up the market to greater competition from smaller providers and social enterprise organisations, and increases scope for comparison.

Providing services in-house is more widely seen as a positive option than a few years ago, although with a greater emphasis on effective performance management arrangements and improved methods for comparing performance and benchmarking against other options.

Case study Circle and Orbit: compare and contrast

Both Circle and Orbit have a mixed arrangement of in-house and outsourced delivery of repairs and maintenance services.

Orbit has contrasting models for the delivery of day to day repairs between Orbit East – which has a long-term partnering contract – and Orbit Heart of England – which uses a DLO. This enables Orbit to compare and contrast performance and use of systems and processes.

In Circle’s recent procurement of its repairs and maintenance services they were able to put in place a structure that allows their DLO to deliver across their east region while the services in London and the south are to be provided by external contractors.

For both organisations the knowledge and ability to make a comparison will provide hard evidence to make informed decisions with regard to future provision options.

HouseMark analysis of whether there was any significant difference in performance between associations which had a DLO and those which outsource showed differences to be negligible.

This reinforces the point made earlier in the report that although there is already a mature market in repairs and maintenance outsourcing, there is little evidence that either in-house or outsourced provision has particular advantages per se.
Housing management

A recent report by the Confederation of British Industry (CBI) claimed that management of social housing is an area where there is considerable potential for more competition and outsourcing. Certainly HouseMark's data analysis (2011/12) shows that there appears to be little activity in this area at present, with data showing that out of 210 housing associations only a tiny fraction are outsourcing housing management services.

To supplement HouseMark's analysis we interviewed a number of housing associations which are managing stock for other associations. However, the examples we found are generally small scale, and the choice of service provider is not normally achieved by competition.

Case study Circle

Circle has adopted a policy of considering the costs and asset management potential of groups of properties within its stock, to evaluate a range of options which could include retention, management agreements, swaps or sales.

As a result of this process Circle 'signposted' certain groups of stock into management with local providers. For Circle this has led to the following arrangements:

- Wandsworth (18 homes) with London Borough of Wandsworth (LA)
- Eastbourne (50 homes) with Eastborne Homes (Almo)
- Westminster (41 homes) with City West Homes (Almo)
- Brent and Harrow (65 homes) with Brent Community Housing (RSL)
- Lewisham (18 homes) with Chisel HA (RSL).

In the private sector many organisations outsource parts of the business to specialists, in order that they can concentrate their own efforts more readily on their core business function. It could be argued that ‘housing management’ is commonly considered to be the core purpose for housing associations, and to lose ‘control’ of housing management risks undermining that core purpose. In the words of one interviewee, organisations with a good reputation for customer service – such as John Lewis – do not outsource their key customer interface.

Given the concentrations of stock holdings that social landlords have in many of the poorest communities, their commitment to the sustainability of community and neighbourhood is crucial. Just providing housing for people on low incomes without focusing on the wider viability of the neighbourhoods they live in is likely to result in deteriorating income streams and asset values.

Housing associations have therefore invested considerable efforts and resources into developing well-trained professional staff who can cope with these complexities. ‘80 per cent of the costs of housing management are in staffing’. And this means that the focus of competition between outsourced service providers may well be principally on squeezing staffing costs.

Jeffrey Pfeffer Professor of Organizational Behaviour at Stanford University's Graduate School of Business has written that:

*There are practical reasons why an outsourcer’s service level is seldom as high as what you’ll get from your own people. If outside contractors cut costs, it might be because they’re more efficient. But it’s far more likely that the savings occur because contractors pay their people less, spend less on training, or both. Just as there’s no such thing as a free lunch, there’s no such thing as a free worker who’s been properly trained to do a great job.*

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4 Improving homes, improving lives. 2012
5 John Swinney: Choice and diversity, IPPR 2007
6 The hidden cost of outsourcing, Business 2.0 magazine 2006
It is therefore understandable that associations are not rushing to outsource their housing management function. However, given the differential housing management costs between associations which we identified in part one, outsourcing a portion of stock may offer benefits in terms of market testing cost and performance because clear comparisons can be made alongside potential opportunities to identify innovation. The experience of City West Homes illustrates this:

**Case study City West Homes**

*City West Homes* is the ALMO for Westminster and has the most experience in England of contracting out housing management. It originally tendered 13 housing management contracts. It is now in a fourth phase of contracting which has evolved over time, over which time they have refined their model. They now have one contract for 50 per cent of their stock with the remainder dealt with by the in-house team.

Their move to this situation is principally because when there were several contracts:
- a considerable amount of resources had to be devoted to administration and contract supervision
- it led to a degree of loss of control over quality.

Their aims in developing their current arrangements have been to:
- ensure that there is both a market test for their in-house team and a clear comparison of the contractor on the basis of in-house skills. Their in-house contract has to be at least the same price as the outsourced contract
- move away from a best value performance indicator led quantitative performance model to one that focuses much more on quality in terms of customer outcomes and satisfaction levels
- the focus of the tender for the outsourced contract is on having a fixed price with built in savings being expected over time, but the tender will be judged principally on the quality of service to be provided.

Such an approach need not look to outsource as much as half of the stock, contracting relatively small parts of an association’s stock would give scope for comparisons in terms of cost and quality.

Associations challenging themselves where they can see that costs are high and performance is mediocre should set about applying a rigorous and objective assessment of the quality and range of services, and whether the services really justify the costs.

This might involve different approaches being taken by different associations depending on their situation. So where an association’s benchmarking showed it had low costs but mediocre performance, it might wish to tender at a fixed price and focus the tender on quality. On the other hand an association that had high benchmarked performance and high costs might look to ensure performance standards were maintained whilst focussing the tender on price.

In summary, there is clearly an established market for outsourcing repairs and maintenance but not for housing management services, even though both have high levels of customer contact. This lack of interest may be influenced by factors such as:
- culture, and personal preferences of decision makers
- a belief that housing management is the core purpose for housing associations, and to lose ‘control’ of housing management risks undermining that core purpose
- the absence of a range of market participants with the necessary professional housing skills and expertise.
Back-office functions

Whilst the possibility of developing more of a market in housing management may well develop out of a reshaping of the sector, the more immediate gains may be made from market testing back-office functions. As we saw in Table 1 (see page 4) the differences in cost per property between associations show an even wider relative spread for overhead functions than for housing management.

HouseMark asks its members whether certain functions are provided in-house. The answers given demonstrate that there is a negligible amount of outsourcing for finance, 1.3 per cent for HR and 6.4 per cent for IT services. It is important to highlight that these figures only relate to the areas which HouseMark definitions cover. There are other areas with established arrangements for outsourcing services such as internal audit, staff training and recruitment. Our research interviews also suggest that in areas such as IT and HR, in-house provision is often supplemented by the use of external suppliers.

One of the key aspects of much private sector outsourcing is contracting out the supporting processes to give the organisation more time to focus on their core business. The key functions outsourced are generally the more technical, ‘non-core’ functions such as IT, HR, web design and maintenance, and managing accounting transactions. It is also significant that according to the Financial Times 7 23 per cent of local authority human resources, IT and payroll functions are now outsourced.

Developing the housing association market?

So whilst we have a mature market in repairs and maintenance outsourcing, housing management and back office functions are still being undertaken principally in-house. How might that change and develop?

The current housing association sector has developed with associations delivering broadly the same services to tenants. This is partly the result of the previous regulation and inspection regimes favouring particular approaches. New freedoms mean we are starting to see associations redefine themselves in terms of focus and operational emphasis. This is beginning to lead to some organisations defining their own unique selling points and focussing on specific models and elements of service.

This has some interesting implications:

- it might result in some associations focusing on a particular strength. So for instance, an association might choose to become a first-class asset management company focused on the development and active management of its properties, whilst another might choose to see its development in terms of providing first-class housing management services to its customers. In both cases they might choose to market these services to other organisations

- we may see the development of significantly increased partnership and collaborative working building on the current experience of such approaches within the sector. These may include larger projects including joint-venture companies – often between associations and private bodies – but also smaller scale activity around areas such as support and specialist services for vulnerable people, financial inclusion and family intervention. This may open up the possibility of different specialisms being traded more widely between providers under new structures and partnerships

- more varied approaches could involve the reverse of outsourcing, as associations innovate in terms of the products and services they provide. We have recently seen a number of associations purchase ‘private’ companies to enhance their skills and breadth of approaches.
This includes Accord bringing the domiciliary care and support organisation Direct Health into its group and EMH Group purchasing a social enterprise landscaping contractor to work both on its own properties and sell services to other individuals and organisations.

What we are likely to see emerging is a redefinition of what a housing association is, with the development of a more ‘mixed market’ of structures, partnerships and approaches. The choice whether ‘to make or buy’ in terms of delivering services to their own tenants could well play a significant part in this.

Association to association outsourcing?

One perceived potential constraint on further outsourcing – particularly in terms of housing management functions – is the lack of a range of providers that might form the basis of an active market.8

Previous attempts to introduce competition, such as Compulsory Competitive Tendering, failed to result in strong interest from a wide range of new managers. The assumption is often made that if further competition and outsourcing is to develop it will be from new entrants. But might it not be the case that, rather than just attracting new commercial players, associations innovating and specialising could be the basis for a wider market? After all they have the relevant skills and knowledge of the market and are likely to have a natural alignment in terms of culture and ethos.

Moreover there may be dangers if, say, large facilities companies began competing aggressively within the sector. A recent report The shadow state9 said that ‘In critically important markets, private sector oligopolies are emerging, where a small number of companies have a large share of the market.’ This is a potential issue as with the repairs and maintenance market where the disappearance of three major contractors in recent years has reduced the choice of contractors for associations.

For markets to emerge and be effective they need a range of potential competitors who have the skills and resources to compete and then deliver effectively. With over one hundred housing associations having a gross annual turnover of more than £10 million, and each owning in excess of two thousand properties, there is potential for significant competition among associations, as well as between associations and other organisations.

There is already a limited amount of outsourcing of back office functions, some of which is being undertaken by other associations. This might be expanded if some larger associations become increasingly adept at certain functions and choose to market these to others at competitive rates.

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**Case study Service Matters**

Service Matters is the external brand of Orbit Services, providing back office, transactional and professional services to Orbit and also to 40 housing providers and private companies within its supply chain. It built this up over the past decade and now has a growing customer base with contracts worth over £630,000 this year.

Customers of Service Matters see one of its key strengths as being that it shares the same social values and operating context of the customers it serves. As a result Service Matters has built long-term relationships with its customers by demonstrating a track record of independence, trust and confidentiality whilst bringing the benefits of best practice and thought leadership from Orbit.

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8  A real choice for tenants? TSA 2008 and Choice and diversity, IPPR 2007
9  Social Enterprise UK. 2012
The current portfolio of services provided includes:

- internal audit
- customer service centre
- information governance and data protection
- procurement
- risk management and governance
- business improvement and lean systems
- ICT and project management services.

Such associations may also be able to sell back office services to other bodies outside the housing sector, for example other organisations with a social purpose, which are unable to develop the scale to provide particular services with the level of efficiency they desire.

However, this might not just be about smaller and medium-sized organisations utilising the expertise of larger associations. As smaller associations think through what independence and their vision means, one option is for them to become localised suppliers of services linked to larger associations. If they develop their own specialisms and local strengths then they may well be able to market services to others, including larger associations, as the example in the box below demonstrates.

**Case study Circle**

Circle decided that they wanted to buy in money advice services for customers in Cambridge, given that the location and the level of dispersed stock meant that providing this themselves would not be cost-effective.

To do this they considered who might provide such services against a range of factors, particularly:

- quality assurance of outcomes
- price
- looking for alignment to common aims, objectives and working processes.

The contract was let to Cambridge Housing Society, which now provides money advice to Circle tenants. Cambridge Housing Society have been able to do this by utilising existing capacity, and the additional income from Circle has helped to cover the running costs of providing the service to their own customers.

It would also be the case that, unlike outsourcing to the private sector, developing a more diverse set of market relationships within the sector would mean that any profits could be used for investment in housing provision and services rather than going out of the sector or being distributed to shareholders.

Such an approach would require significant cultural change for housing associations. Competition in the sector has often been about competing for government resources. It would require a different mentality to identify strengths and market these effectively to other service providers. Given the requirement to adapt to changed circumstances however there might be significant gains to be made from such cultural changes.

Interestingly in relation to the example of Service Matters, Orbit believes that the reinvestment of any surplus is not the only advantage of the arrangements. The development of their commercial thinking is equally important, and it is having a positive impact on the services provided by Orbit through an increasing focus on cost, customer outcomes and performance management.
Shared services

The reference to shared services for associations (as echoed in the private sector) is usually used to describe an arrangement for the provision of services within an individual company or group of companies, effectively being seen as a form of ‘internal outsourcing’.

Until now associations wishing to undertake shared services with other associations or partners have had to charge VAT on the services provided. With the recent Cost Sharing Exemption (see box below) this disincentive has potentially been lessened and it may now be possible for associations to collaborate more easily to provide shared services. Further details of the Cost Sharing Exemption 9 (CSE) can be found in Appendix 1.

**Cost Sharing Exemption**

The VAT exemption applies when two or more organisations with exempt and/or non-business activities join together on a co-operative basis to form a separate, independent entity, a cost sharing group (CSG), to supply themselves with certain services at cost and exempt from VAT.

As a result a ‘co-operative self-supply’ arrangement (a term the EU Commission use) is created. The CSG is a separate taxable entity from that of its members. It is therefore able to make supplies for VAT purposes to its members. These supplies will be exempt if the relevant conditions are met.

CSGs will need to be careful when recruiting members as one of the conditions of the exemption is that it does not lead to a distortion of competition. Therefore a CSG must not have the characteristics of an independent operator seeking a customer base in order simply to generate profits.

The cost sharing exemption applies only in very specific circumstances, requiring clear arrangements for governance and staffing. Implementing shared services also incurs a number of risks:

- lack of operational flexibility
- unbalanced power concentration
- unclear service accountability
- cultural difference between the partners.

Moreover this is likely to involve set up costs, a long lead in time and tying the organisation to a particular model over time. Contracting out a function may actually be more flexible and its contractual basis may be less complex than a shared services agreement. However, one benefit from a cost sharing agreement is that it does not have to go through a procurement process.

The advantage of a cost sharing group is likely not to be principally about saving on current VAT payments but about developing new arrangements between organisations which produce efficiency savings and would previously have incurred VAT.

Associations wanting to go down this route will have to be clear that the potential scale of VAT gains merit tailoring their approach to meet the cost sharing exemption, it is likely to be large volume services that are considered.

Experience of shared services at government level does however suggest the need for caution. The National Audit Office has reported that:¹⁰

*The shared services initiative has not so far delivered value for money for the taxpayer… By creating complex services that are overly tailored to individual departments government...

¹⁰ Efficiency and reform in government corporate functions through shared service centres. 2012
has increased costs and reduced flexibility. In addition, it has failed to develop the necessary benchmarks against which it could measure performance.

Whether VAT exemption changes will result in significant increases in shared services between housing associations remains to be seen. However, the example below does suggest new possibilities.

**Case study Devon and Cornwall Housing (DCH) and West Devon Homes**

Devon and Cornwall Housing (DCH) and West Devon Homes are working together in an innovative shared-services partnership specifically constructed to meet HMRC rules on the cost-sharing exemption, which is a complex and still-developing area of EU law.

This arrangement allows VAT-free cost-sharing for housing and maintenance staff who are, in the legislative phrasing, ‘directly necessary’ to the supply of a VAT-exempt activity. They are also achieving further VAT savings through employing staff on joint contracts.

The cost-sharing is taking place through an existing subsidiary company of DCH, which West Devon Homes has invested in and now jointly controls as part of the arrangement.

Shared services may also be driven by improvements in the way associations that operate over wide areas identify properties or areas where they have higher costs or a limited presence with less market knowledge.

There are drivers to sell these properties and gain capital returns. However the process of doing so can be lengthy and expensive and involve further borrowing for the buyer association. When considering the opportunity costs involved, associations might begin to consider a shared service approach as a better option.

Shared services might also be useful where associations have concerns in specific geographic areas (particularly as welfare reform impacts on particular localities) where there are a number of associations operating who are unlikely individually to make an impact in the community.

**A better way?**

In terms of back-office services the current situation with VAT seems rather inconsistent. If associations want to avoid the costs of VAT on becoming more efficient at back-office services, then they have to enter into an arrangement which involves setting up a separate infrastructure. Might it not be better for the government to allow a wider dispensation to associations whereby if associations are selling services to each other and clear savings are being made and are being reinvested in the value driven aims of the business, then VAT will not be charged?
Our work for this project has highlighted three key areas which associations should consider when deciding whether to pursue outsourcing or shared service options.

Valuing values

A significant difference between housing associations and profit distributing companies is that the purpose of housing associations involves a wider set of values and related considerations.

This emphasis on values is central when making strategic decisions about services. If associations are going to operate in more competitive markets but retain a social purpose, part of their strength is that they are a different type of business, not focused on profit distribution. Reinforcing their value-based nature in the public mind may give associations a competitive advantage in the market place. For example, some associations we talked to in this study were considering how arrangements for outsourcing services aligned to their commitments to introduce the London Living Wage.

The Public Services (Social Value) Act 2012

The Public Services (Social Value) Act 2012 places a duty on housing associations to have regard to economic, social and environmental wellbeing in connection with public services contracts. Associations must be prepared to define the social and economic value and impact of the services they offer when tendering for a service from a local authority or another relevant body.

The Act does not have much detail and will need clarification through its implementation, and therefore its overall effect is still to be determined. Further guidance can be found at: www.housing.org.uk/publications/find_a_publication/legislation/public_services_social_value.aspx

A key aspect of an emphasis on social value may be to encourage locally-based social enterprises and smaller businesses to tender for public contracts. The key barrier to this is often the tender process itself, which can favour larger contractors with their in-house bidding skills. Finding ways to overcome this potential bias has the advantage of widening the pool of contractors to ensure effective competition.

Whilst there is clearly a need to take associations’ values into account when contracting, it should be acknowledged that not going to the market may mean that they deliver poorer social and economic outcomes. Given the legal obligation on housing associations to obtain the best possible service as part of any procurement process, is there not at the very least a moral obligation to deliver the best possible service when the decision is taken to retain delivery in-house?

Being pragmatic and strategic

In the private sector decisions on whether a company goes down the road of outsourcing or shared services are pragmatically arrived at on the basis of what is best for that business. It also needs to be clearly within an organisation strategy.
We said in *Does size matter?*\(^\text{11}\) that in relation to making changes to achieve value for money:

*Associations should be clear about their destination, understand the size of the task required, the speed of change needed and have clarity about what they wish to achieve as the end result.*

Decisions about how to deliver services must be seen within the context that there is no perfect ‘one size fits all’ approach. This is equally true of decisions to ‘make or buy’. In terms of how outsourcing and shared services fit into an association’s overall approach to value for money the research for this project suggests the need to:

- be very clear about understanding and being in control of your costs, and in particular how those costs relate to the strategic options which are open to you
- ensure that you have fully considered the potential for reducing costs yourself, rather than paying an outsourcing contractor to do it for you
- consider whether outsourcing certain services or functions might be more cost-effective or will improve performance, and how these benefits can be sustained over time
- clearly establish the skills which the association might lose if a service is contracted out, whether you are happy to lose them and how easy it will be to re-acquire these skills at a later time
- consider whether there are certain functions that would benefit from a level of outsourcing to provide hard information to allow real market comparisons
- evaluate whether shared service options might be an alternative mechanism to outsourcing or delivering in-house.

In considering outsourcing/shared services there are some key questions to ask:

- how important is the service to the organisation?
- has the organisation already done all it can to improve?
- are there sufficient external contractors to make clear comparisons?
- have you identified and understood all of the risks involved?
- what skills will be required to deliver and manage an outsourced contract?
- how will you ensure that quality remains high and that continuous improvement is incentivised?
- is there a risk that too much influence and control over the service will pass to the new provider? How will you retain an appropriate level of control?

When making decisions to ‘make or buy’ it is important to be clear about whether the potential benefits in terms of scale and capacity will outweigh other reputational or local delivery advantages. It is vital to establish what customers think and what is most important to them.

The type of approach that an association might use will be determined by its priorities as well as a focus on cost, quality and risk. The table below gives a necessarily simplistic view of how those priorities operate in relation to repairs and maintenance.

<table>
<thead>
<tr>
<th>Strategic objective</th>
<th>Possible procurement decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Create opportunities for residents and smaller contractors that are likely to be based in the area</td>
<td>Use direct employment through a DLO or smaller contracts</td>
</tr>
<tr>
<td>Improved value for money through economies of scale</td>
<td>Use a single contract with a large contractor/partner</td>
</tr>
<tr>
<td>Save costs by reducing procurement costs</td>
<td>Use fewer, longer contracts covering a wide range of work types</td>
</tr>
<tr>
<td>Avoid risk of over-reliance on a single contractor</td>
<td>Use shorter contracts with different contractors having different types of work</td>
</tr>
</tbody>
</table>

\(^{11}\) *Does size matter – or does culture drive value for money*, CIH 2012
For a housing association looking to market its services to others, then a different set of questions arise:

- does the organisation have existing ‘free’ capacity or will the organisation need to invest in growth to deliver?
- can the marketing costs be justified?
- does the organisation have the marketing skills and capacity to achieve the necessary scale?
- has the organisation compared or market tested its product?
- are services at a high enough standard to deliver to other organisations?

Effective contracting

The strongest practical lesson for housing associations that arises out of our work is the absolute importance of effective procurement and contracting – with the strength of any contract or partnership being based principally on the effectiveness of the client.

**Good procurement – understanding the risks**

This is not just about a good procurement process. Procuring so that the contract can be managed effectively with risks recognised and planned for – for example that the contract may have to be insourced at some point – is crucial.

The risks in terms of setting up the contract include:

- underestimating the scope of the work being contracted out
- a lack of buy in from senior staff in the client organisation
- the client contracting team being too small or lacking in the required skills
- the loss of key skills, knowledge and information by the client
- problems over definitions and organisational values
- failure to ensure clarity about joint data ownership and transfer
- entering into agreements that are not easily scalable, and are unable to cope with development and growth in the client organisation.

Learning from the way repairs and maintenance contracts are being procured, some important trends include:

- ensuring that clear performance management frameworks and expertise are in place
- moving from detailed schedules or key performance indicators to output based contracts
- the use of longer contracts with reviews and break clauses to build flexibility
- incorporating focus on incentives for good performance as well as penalties for poor performance.

**Effective contract management**

Private sector lessons and the experience of repairs and maintenance outsourcing demonstrate some key areas of risk for achieving effective contracting which need to be addressed:

- the client contracting team is too small or lacks the required skills
- an imbalance in knowledge and information leading to the contractor shaping the partnership
- poor mutual understanding of the contract
- the need for transparency so both sides can understand the cost profiles involved
- client and service providers not being operationally or culturally aligned
- processes not being aligned.
Conclusion

Overall, our research shows that outsourcing and shared services are not a panacea which will automatically transform services. Change and improvement can be made in many ways.

The reality is that outsourcing and shared services should be seen as useful tools to help run the business. Decisions about whether to go down this road or not should be pragmatically arrived at on the basis of what is best for that business at that point in time.
Appendix 1: Cost Sharing Exemption

The exemption applies when two or more organisations with exempt and/or non-business activities join together on a co-operative basis to form a separate, independent entity, a cost sharing group (CSG), to supply themselves with certain services at cost and exempt from VAT.

As a result a ‘co-operative self-supply’ arrangement (a term the EU Commission use) is created. The CSG is a separate taxable person from that of its members. It is therefore able to make supplies for VAT purposes to its members. These supplies will be exempt if the relevant conditions are met.

This type of arrangement enables the creation of the same economies of scale for smaller businesses and organisations as larger businesses and organisations naturally enjoy. Thus the more members of a CSG there are, the greater the potential savings and lower the costs per member of operating the relevant CSG.

The cost sharing exemption applies only in very specific circumstances.

It looks in detail at the five key requirements, taken from EU law, to form a cost sharing exemption group:

- there must be an independent group formed
- the members of the group must carry out exempt or non business activities
- the value of the group charges for services must equal their cost
- the services must be ‘directly necessary’ to the members exempt or non business activity
- the services supplied by the group must not cause a distortion of competition.

The exemption only applies to the recharges, at cost, of services supplied by a CSG to its group members. The exemption does not apply to commercial outsourced services.

The CSG is however legally separate from its members. It is established, owned and operated by the members for their cooperative benefit and is independent of any ownership, control or influence outside of the membership.

The CSG does not have to be a limited company. It can take any form provided it is a ‘taxable person’ within the Principal VAT Directive definition of ‘taxable person’.

Each CSG must have two or more members. There is no upper limit.

CSGs will need to be careful when recruiting members as one of the conditions of the exemption is that it does not lead to a distortion of competition. Therefore a CSG must not have the characteristics of an independent operator seeking a customer base in order to simply generate profits.
To gauge the extent of outsourcing for repairs and maintenance we looked at whether or not an association had a Direct Labour Organisation (DLO), and was therefore undertaking repairs and maintenance work in-house. HouseMark asks housing associations whether or not they have a DLO. The question does not specify whether the DLO arrangement applies to response repairs, void repairs, major works or cyclical works. The answers to the ‘do you have a DLO?’ question are simply ‘Yes’ or ‘No’. This does however give us some idea of the extent of outsourced repair and maintenance work.

The results for 219 English housing associations submitting benchmarking data for 2011/12 year and also completing the question about whether or not they have a DLO are:

<table>
<thead>
<tr>
<th>DLO?</th>
<th>Number of HAs</th>
<th>Proportion</th>
</tr>
</thead>
<tbody>
<tr>
<td>DLO</td>
<td>97</td>
<td>44%</td>
</tr>
<tr>
<td>No DLO</td>
<td>122</td>
<td>56%</td>
</tr>
<tr>
<td>Total</td>
<td>219</td>
<td></td>
</tr>
</tbody>
</table>

There are significant differences between associations that arose because of transfers of local authority stock and ‘traditional’ associations. The table below shows that whilst nearly two-thirds (63 percent) of LSVTs have a DLO, less than one in five (19 per cent) ‘traditional’ associations have one.

<table>
<thead>
<tr>
<th>HA type</th>
<th>DLO (proportion)</th>
<th>No DLO (proportion)</th>
<th>Number (sample size)</th>
</tr>
</thead>
<tbody>
<tr>
<td>LSVT</td>
<td>63%</td>
<td>37%</td>
<td>119</td>
</tr>
<tr>
<td>Traditional</td>
<td>19%</td>
<td>81%</td>
<td>93</td>
</tr>
<tr>
<td>Mixed</td>
<td>57%</td>
<td>43%</td>
<td>7</td>
</tr>
<tr>
<td>All</td>
<td>44%</td>
<td>56%</td>
<td>219</td>
</tr>
</tbody>
</table>

The data here is not capable of describing the range of approaches which associations adopt to outsourcing repairs and maintenance services. These include a ‘historical’ approach to contracting out particular services and longer term ‘partnering’ approaches with a contractor. Indeed some associations have gone further by forming a joint venture company with a private sector partner to undertake part or the whole of the repairs service.

The distinction between a DLO and contracting is also complicated by the fact that some associations are using a contractor to actively manage their DLO.

The figures here are however broadly supported by two outsourcing contractors we interviewed who both said that their impression of the overall market was that it was about 60 per cent outsourced and 40 per cent DLO.
Support for the research, development and publication of this report has been provided by Circle Housing Group and Orbit Housing Group.

CIH would also like to thank Ian Hippach and Steve Turner of Xantive Limited for their involvement in the research and practical advice, and HouseMark for their contributions in relation to data analysis and interpretation.

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