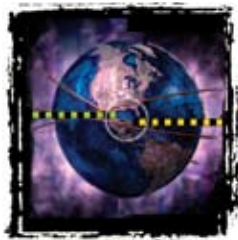


# Optimize Your Contract Labor

***Companies can maximize cost savings and productivity improvement by ensuring that the “right number” of contractors with the “right skills” are the “right match” for the work at the “right price.”***

By Kristen Etheredge, Suzanne Dorf, and Tejal Thakkar



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As companies seek to maintain a flexible workforce and control costs, there's been a growing trend toward hiring third party workers for a period of time (contract or contingent labor) rather than full-time employees. The United States has seen nearly a four-fold increase in the use of temporary, external resources in the last two decades, reaching 4 percent of the total workforce in 2007. In many companies, contract labor spend is a significant portion of the overall third-party spend, often reaching as much as 20-30 percent.

The economic decline of 2008/2009 has resulted in a slight decrease in external labor usage. However, coming out of this downturn managers will be seeking to achieve even greater flexibility in their headcount. For this reason, the contractor workforce will rebound before the full-time employee market does, as companies become very conservative in bringing back full-time employees. As this contract labor strategy unfolds, companies need to ensure the optimal use of these important resources.

Unfortunately, the cost and flexibility benefits from utilizing contract labor are often sub-optimized, as the “right number” of contractors with the “right skills” are not necessarily the “right match” for the work at the “right price.” Contract labor spend is usually undermanaged for a number of reasons, including:

- ***Inadequate strategic planning:*** The

contract workforce often receives little attention from senior leadership, and the strategic make vs. buy decisions on skill sets are not fully explored.

- ***Lack of visibility:*** Confusing and unclear job classifications often lead to the hiring of a contractor without the right skills or a misunderstanding of what skills need to be used where.

- ***Fragmented decision making:*** Decentralized contract labor hiring processes and strong end-user preferences lead to a fragmented supply base.

- ***Inconsistent pricing and quality:*** Ad hoc purchases of contract labor services yield widely varying quality of personnel and inconsistent pricing for similar skill sets.

- ***Lack of enabling support systems:*** Many companies do not have an effective means for managing compliance and exception management with a large contract workforce.

There is a large opportunity to reduce costs and improve quality through comprehensive contract labor optimization. A.T. Kearney experience shows that optimization can yield savings from 10-25 percent of cost by establishing the “right number” of contractors with the “right match” of the “right skills” for the “right price.” Based on the size of spend, these savings can be substantial; one A. T. Kearney client saved over \$100 million by following this process.

In addition to the cost savings, an optimization initiative can lead to higher productivity, improved service level agreements, increased visibility into spend, and tighter governance and controls on third party workers.

We define the contractor work force broadly

to include staff augmentation, agency temporaries, independent contractors, and project-based resources across all functional areas such as IT, HR, and finance. The process begins by monitoring key triggers that signal when it is time to re-evaluate the situation. Applying the following four techniques will assist in ensuring maximum benefit:

- Step 1: Manage the total (Right Number).
- Step 2: Know what expertise is needed (Right Skills).
- Step 3: Pay best market rates (Right Price).
- Step 4: Align resources to the work (Right Match).

### **Step 1: Manage the total (Right Number)**

Hiring a third-party to do work within a company is essentially a make-buy decision. Certain functions and activities do not strategically fit within a company's core competencies; outside resources can be leveraged to do these jobs more efficiently and effectively. It is critical to find the right balance between permanent and contract staff. This should be done on multiple levels from broad company planning to individual project planning.

### **Step 2: Know what expertise is needed (Right Skills)**

Many times companies lack sufficient visibility into their contractor work force to effectively evaluate if managers are buying the right skills at the right price. Building a comprehensive taxonomy (essentially a matrix) with job titles, levels, and descriptions is the solution to this problem. The process of taxonomy building brings together many stakeholder groups who are large buyers of third-party resources and focuses attention on what skills the company needs to achieve its strategy. The change management aspects of this process must be managed closely. It is important to balance the industry standards with the organization's customized needs to facilitate smooth discussion among stakeholders and with suppliers. It's also important to invite early IT involvement to assist in structuring the taxonomy to "fit" into existing or new tools.

### **Step 3: Pay best market rates (Right Price)**

Strategic sourcing is the key to achieving the right price for the needed skills. Suppliers are not recession-proof, and our recent project experience shows that they are being very aggressive in pricing to gain or retain business. It is critical to clearly communicate to suppliers what skills the company has been—and will be buying—based on the taxonomy, and what service levels are expected. One effective practice is to ask suppliers to unbundle their pricing into wage rate and mark-up. This not only provides visibility into the supplier mark-up structure, but also may highlight potential labor retention issues (for example, paying a wage rate lower than market often results in higher turnover of resources).

### **Step 4: Align the right resources to the work (Right Match)**

Over time, it is common for contract resources to drift away from the optimum balance of right skills/right price/right work. For example, well-respected contractors could be moved to new roles where they do not have exactly the right skills. Or the market might change for a given skill, yet the old rate is maintained. Creating the right match ensures that appropriately skilled resources are performing the work and that the market rate is paid. In many cases, the contract resources have become an integral part of the team and may even be the "face" of the company to the customer. Hence, there is a large change-management component to ensuring this "right match." This step can be particularly effective when a strategic sourcing effort has just been completed, as the new supplier agreements can be used as a catalyst for change.

### **When To Start the Optimization Process?**

There are a number of internal and external triggers that indicate the time is right to begin aggressively managing your company's contractor costs. Some examples include:

- Labor costs have increased year-over-year for the last two years.
- Management wants to gain greater visibility into the contractor population to make strategic workforce decisions.
- Your company has announced a strategic shift that changes (or will change) the type or number of contractors you buy.
- The supply market has changed—for example, a new entrant has appeared, a major supplier is in financial trouble, or suppliers are merging.
- The global economy has shifted (similar to what we experienced in late 2008).
- It's been several years since you last evaluated your preferred suppliers.
- Major contractor contracts are expiring or up for renewal.

If a company is experiencing any of the above issues, it is time to review the contract labor spend and supplier base.

Communication to the key stakeholders is especially critical as an organization moves through the four steps outlined above. The difficulties of replacing an embedded contractor can be balanced with the overarching benefits of a properly managed contract labor program—that is, the cost savings and productivity improvement by ensuring that the "right number" of contractors with the "right skills" are the "right match" for the work at the "right price." In these uncertain times, a properly managed contract labor program is critical. A flexible workforce can help your organization navigate through this difficult period and position it to quickly ramp up when business improves.