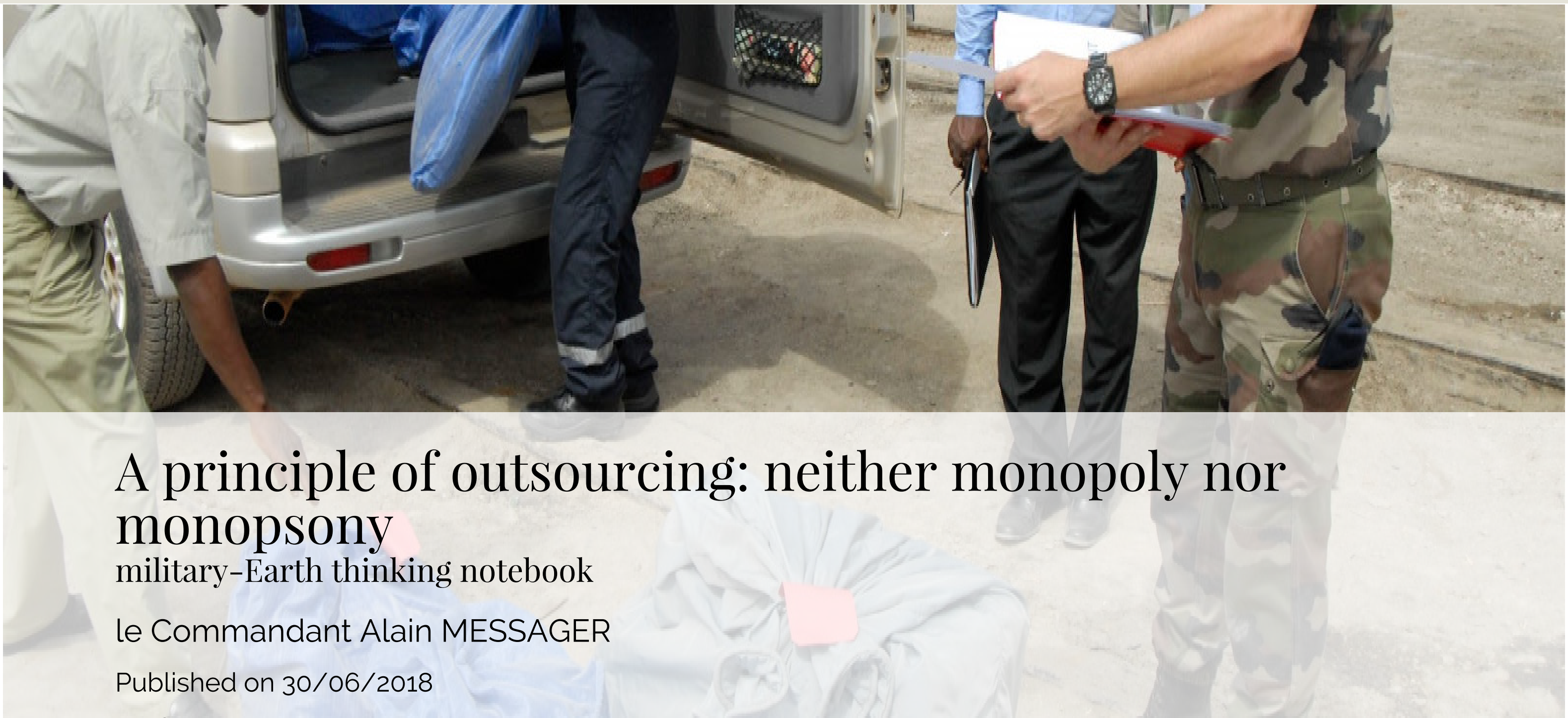

A principle of outsourcing: neither monopoly nor monopsony

military-Earth thinking notebook

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The**choice of outsourcing is still fundamentally guided by a logic of at least cost control, if not cost reduction: why would it be appropriate to outsource a more economical function when it is kept in-house? In this context, this article sets out a simple principle, but it is of course not exhaustive and is not intended to be dogmatic: in order to control costs, outsourcing should not be carried out in a monopoly or monopsonist situation.**

"Messy accounts are the mark of nations that abandon themselves," said Pierre Mendès-France. In the face of increasingly marked budgetary constraints, outsourcing has appeared to be a panacea for putting the public accounts in order.

Yet outsourcing is not a new phenomenon. It is simply the result of a question that any organization - public, private or mixed - may have to ask itself: is it more appropriate to outsource an activity to a third party or to keep it as its own? For example, at the end of the Late Roman Empire, Rome entrusted the surveillance of part of its borders to barbarian tribes, while one thousand five hundred years later Napoleon prevailed.In order to put an end to the maladjustment and corruption of the private actors in charge of stewardship missions, Napoleon decided to internalize his logistics by creating the Train weapon.

The choice of outsourcing can be based on various considerations such as refocusing on the "core business" (with all the difficulty there may be in defining this concept), the notion of public service, the company's organisational strategy or risk sharing. But, in the end, this choice is still fundamentally guided by a logic of at least cost control, if not cost reduction: why would it be appropriate to outsource a more economical function when it is kept in-house? In this context, this article sets out a simple principle, but of course it is not exhaustive and is not intended to be dogmatic: in order to control costs, outsourcing should not be carried out in a monopoly or monopsony situation.

No monopoly

The assertion could be a truism. It is indeed obvious that in a monopoly situation, the seller is in a position to dictate his terms to the buyer. But the monopoly situation is not necessarily so obvious to distinguish.

The most classic cases of monopolies are found in public service sectors or similar sectors requiring massive investment, such as water or electricity distribution or rail transport. If the commercialisation of water, electricity or rail transport can indeed be put into competition, it would seem absurd to spend massively (whether through public expenditure or private investment) to build parallel electricity, rail and water distribution networks [1]. 1] In the end, the distribution operators, who may indeed be in competition, all find themselves dependent on the sole owner of the network, in a de facto monopoly situation. Hence the importance of either keeping the network within the State or subjecting it to particularly restrictive regulations (which may therefore be unattractive to private investors).

However, the monopoly situation is not always so obvious and may result from the implementation of outsourcing itself. It may thus seem attractive to entrust an activity requiring massive investment to an external operator who will then pass on the amortisation of these investments over the duration of the contract to the invoicing of the activity thus outsourced. However, at the end of the contract, it will find itself in a quasi-monopoly situation: having recouped its initial investment, it will be able to propose the renewal of the contract at a much lower cost than a new entrant which will have to make the investment. Imagine, for example, that the state, or a very large company, entrusts the management of its entire computer population (not only maintenance but also the purchase of hardware) to an outside operator on a long-term contract. At the end of the contract, the operator has amortised the massive initial investment of buying all the hardware. It will therefore be able to offer a new contract based solely on the maintenance of this equipment and the associated services without depreciation. On the other hand, any new entrant will have to buy back the IT equipment and will therefore not be able to be truly competitive.

Thus, in order to free itself from monopolies, the German army has been pragmatic in creating, notably in the context of outsourcing its support, companiess in which the State retains a significant shareholding and is thus not in a situation of complete dependence on a private operator. Rather than outsourcing per se, this is "internal outsourcing". Similarly, in France, the State retains a strong hold on the arms industry, which is by nature a monopolistic field[2].

No monopsony

This point might seem less obvious. The question here is to examine the origin of a cost reduction induced by outsourcing.

In the case of the State, a somewhat simplistic reasoning tends to imagine that the operator benefiting from outsourcing, not being subject to the protective statutes of the civil service, will be able to rely on a more flexible and therefore cheaper wage bill. This hypothesis is not obvious. On the one hand, in order not to encourage job insecurity and offshoring, which it also intends to combat, the political authorities often impose social criteria (for example, employees of the outsourced activity taking over the same job and under the same status) which reduce this flexibility. On the other hand, in the case of military personnel, these wage bill savings are much less obvious: while the income and social charges (SCR) of a military member are generally higher than those of a civilian employee with equal qualifications, the former is not subject to the 35-hour working week and does not receive additional income in the case of night or weekend work.

Another relatively questionable commonplace tends to assert that private managerial methods by themselves manage to rationalize an activity previously subject to public methods. But if it is simply a question of changing an organization, before moving to the stage of outsourcing, it will be necessary to consider how to achieve this rationalization internally. In addition, and in the same vein, it is also necessary to clearly define the perimeters that are being compared: if the rationalisation of the activity after outsourcing simply consists in reducing the scope of the activity (for example, by reducing the quality of the product or service), the scope of the comparison must be clearly defined. If the rationalisation of the activity after outsourcing simply consists in reducing the scope (e.g. by reducing the quality of service), then it is not really a question of rationalisation but rather of adapting the service to the real need, which could also have been done internally.

It is clear that cost reductions linked to outsourcing through savings on SCRs and/or rationalisation are highly questionable. On the other hand, if the outsourced operator has several customers, it will be able to achieve economies of scale which the activity, when kept in-house, could not previously achieve. Amortization of investments (as well as profit margins) will thus be spread over several customers, or the purchase of more equipment will make it possible to reduce the unit costs borne by customers. This is the purpose of the outsourcing carried out by the Army's light aviation school, which entrusts the provision of flight hours for the training of its helicopter pilots to Hélidax, which itself rents the same helicopters and provides maintenance services to other customers, enabling it to reduce the unit rates (per flight hour) for its services.

In the final analysis, it appears that, far more than considerations of SCR costs and rationalisation (which must above all be carried out internally), the absence of a monopsonist position is far more relevant when considering outsourcing.

In order to achieve cost-beneficial outsourcing, it is therefore necessary to find an operator that is in a real competitive situation, while ensuring that it can amortise its depreciation over several customers. Neither monopoly nor monopsony: this can therefore be a basic principle for starting to think about outsourcing.

Of course, and especially for the armed forces, this reflection cannot be limited to a cost-based approach. As the Minister of Defence recently stated (Le Monde, 06June 2012), reflections on defence cannot be based on a simple accounting logic, as it is above all necessary to question the operational autonomy of the armed forces.s operational autonomy in the framework of the missions entrusted to them and their ability to react - or even "pro-act" - to possible strategic surprises, both of which could potentially be very strongly affected by outsourcing.

"Only the fool confuses price and value," said Spanish poet Antonio Machado. If an accountant can always assess the price of the military tool in charge of protecting our citizens, the defence of our interests but also, and probably above all, the preservation of our ideals are of inestimable value.

1] On this subject, mobile phone operators are also questioning the relevance of keeping several separate networks, cf. Cécile Ducourtieux, Towards a mutualisation of networksLe Monde, June 13, 2012.

2] The manufacturer of combat vehicles (Leclerc tanks, VBCI, CAESAR, etc.) is entirely in the hands of the State. Within Safran (aeronautics, aerospace), Thales (aerospace, information technologies), DCNS (naval armament), it is a shareholder of respectively 30%, 27%, 64%. Even in the European group EADS, France indirectly holds a 22.5% stake via Sogeade (an aeronautics, defence and space management company) in which it is the majority shareholder. Of the major French groups, only Dassault is not state-owned.

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