March 2021

Contingent Labor

Category Sourcing Guide

- **Contingent labor, at $436 B worldwide, is a major cost item that often gets overlooked.** Large decentralized organizations often have multiple contracts with many staffing agencies at the local, regional and global levels
- **Purchasing's role in managing the category is increasing, but human resources' involvement will remain significant.** Effective contingent labor management requires cooperation across functions and business units, but organizational barriers often lead to conflict.
- **Significant tailwinds help counteract a tight labor market.** Workers Compensation, SUTA, and higher base wages due to legislative action in many states are putting negative pressure on markup rates.
- **Development of cost models is crucial to capture value in a dynamic market.** For example, a $1 increase in hourly wage can cause a 1% (100 basis point) decrease in markup.
- **Contingent labor can be used as a strategic tool, but more often all decision authority is at the local level.** Companies that communicate contingent staffing targets and rationale can increase labor flexibility while managing the long-term costs of overusing contingent labor.
- **Markups of 25 to 30% are achievable in the US.** Traditional commercial levers such as benchmarking, consolidation, and cost modeling are effective in this category.
- **The Affordable Care Act's impact** varies by supplier and state. Existing coverage, base wages, and employers' projected share of premium costs need to be reviewed to determine if any markup increases are necessary.
- **Contingent labor is a useful litmus test for companies trying to centralize purchasing**. Since the category crosses business units, is locally managed, and has low switching costs, organizations trying to showcase the value of a center-led organization can achieve a quick win by deploying cross-functional and cross-business teams.

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Cost and Capital Partners *is a management consulting firm that works with companies to improve cost and capital efficiency. Our client base includes Fortune 1000 companies from the industrial, automotive, electronics, hospitality, process, consumer goods, transportation and white goods industries. We work with clients to improve results and enhance visibility for strategy development. Supplier engagement is a core focus ranging from direct supplier negotiations to market and financial viability assessments. In addition to working with clients to execute sourcing initiatives, we also deliver sourcing training that enables organizations to increase their level of professionalism in supplier engagement.*

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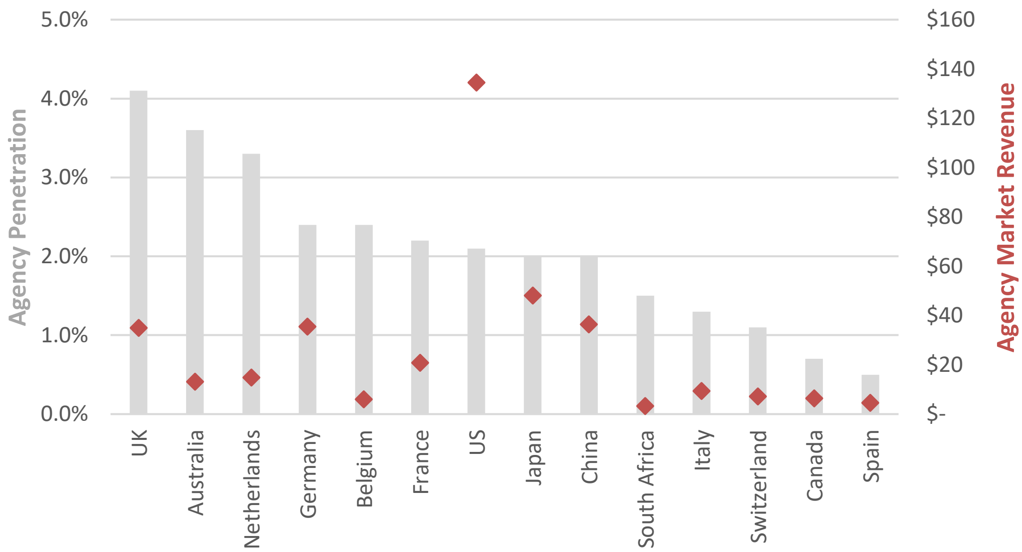
Global Market Overview

Contingent labor[1], defined as provisional employment provided by a staffing agency, is estimated to be a $436 B market globally and includes a range of services such as temporary placement, short term project staffing, temp to hire programs, and some subcontractors. The industry is characterized by a high level of fragmentation, low barriers to entry, and a commoditized product.

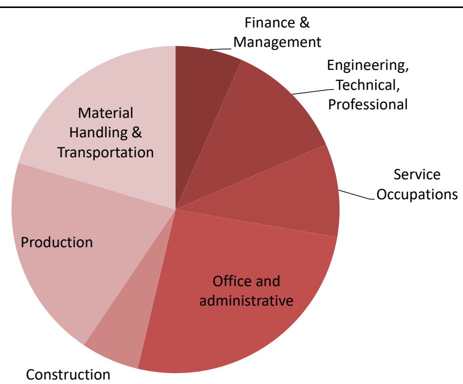
Figure 1: **Contingent Labor Global Market Size**



Source: World Employment Confederation. Spend through staffing agencies.

As seen in Figure 1, European countries are the largest consumers of temporary labor as a percentage of the total labor force. Countries that have rigid labor laws, such as France, are logical markets for contingent labor. In emerging economies, especially China and India, contingent labor is a small but growing part of the workforce. This is due to both the relative flexibility of full-time labor and the restrictions placed on staffing agencies. In China for example, major changes aimed at increasing labor flexibility began in 1986 but the staffing industry was not officially made legal until 1997.[2] Countries have various social costs that are included in the markup rates creating significant variation in rates across countries.

Figure 2: **Contingent Labor Categories, U.S.**



Source: Bureau of Labor Statistics

Staffing agencies try to differentiate themselves based on cost, employee specialization, service and quality, and local relationships. The largest cost factor is the base salary of the employee, which is typically specified the customer's requisition. Staffing agencies then compete on the markup percentage above base pay, continuously undercutting each other in an effort to win business, especially in commoditized categories such as production and material handling. Staffing agencies also try to develop specializations in certain functions or industries, such as finance or engineering (see Figure 2), in an effort to command higher rates. Service and quality include such factors as lead times to fill a

[1] Terms such as temp labor, contract labor, or labor dispatch are for the most part synonymous and often used interchangeably depending on the generation or culture of the speaker.

[2] Feng Xu. *The Emergence of Temporary Staffing Agencies in China*

requisition or the performance of a provided employee. In order to retain business, many staffing agencies rely heavily on their relationships with local HR or line managers and their familiarity with a company's needs.

Decision Authority and Usage

Decision Authority

Before a contingent labor strategy can be developed, decision authority must be established. Since it is a category that straddles purchasing and human resources, two functions not accustomed to working together, the category is often either neglected or mismanaged. 33% of Fortune 500 companies could not report which department is primarily responsible for the category. 21% could not estimate their U.S. contingent labor spend.[3] Since local HR managers often control usage and supplier selection, many senior executives grossly underestimate how much they spend or how many suppliers they have. The head of human resources at a Cost & Capital client was confident that use of contingent labor had been phased out of the organization, when in reality several facilities were systematically spending more than $1 million on the category.

Figure 3: **Purchasing's role in contingent labor**

Source: Workforce Management

When companies do pay attention to contingent labor, it can lead to a power struggle. As costs become increasingly scrutinized, companies are pursuing savings by applying supply chain management techniques to the category (see next section). Purchasing's role has grown, especially when it comes to supplier selection and negotiation (see figure 3). Human resources executives have resisted this perceived loss of control by pursuing a greater role for themselves.[4] While the extra attention on the category is good, the internal conflict that often comes with it must be managed. For example, during a recent Cost & Capital engagement, the executives made a clear delineation between purchasing and human resources responsibilities: purchasing handled supplier negotiations, sourcing decisions, and contracting (with support from legal) while human resources determined usage requirements, employee base pay, and other operational policy (see figure 4).

Figure 4: **Roles and Responsibilities for Contingent Labor Teams (Illustrative)**

Project Stage	Task Description	Purchasing	HR
Pre-Quote Analysis	Determine project scope and strategy	Joint	Joint
	Benchmark spend with existing providers	Responsible	
	Supplier Grow, Fix, Exit Strategies	Support	Responsible
	Analyze Terms and Conditions	Joint	Joint
	Current and Planned Usage		Responsible
	Establish project schedule	Joint	Joint
	Select Steering Committee	Joint	Joint
RFQ and Negotiations	Draft RFQ	Responsible	Support
	Determine bid list	Joint	Joint
	Develop supplier engagement material	Responsible	
	Engage current & potential suppliers	Responsible	
	Send RFQ to potential bidders	Responsible	
	Receive RFQ responses	Responsible	
	Compile RFQ responses	Responsible	
	Identify finalist(s)	Joint	Joint
Evaluate Quotes & Determine allocation	Develop analysis tools	Responsible	Support
	Scenario analysis & Optimization	Responsible	Support
	Draft standardized contract	Responsible	Support
	Supplier Financial Health Review	Responsible	
	Final Supplier Selection	Responsible	Support
	User Communication	Joint	Joint
	Document savings and improvements	Joint	Joint

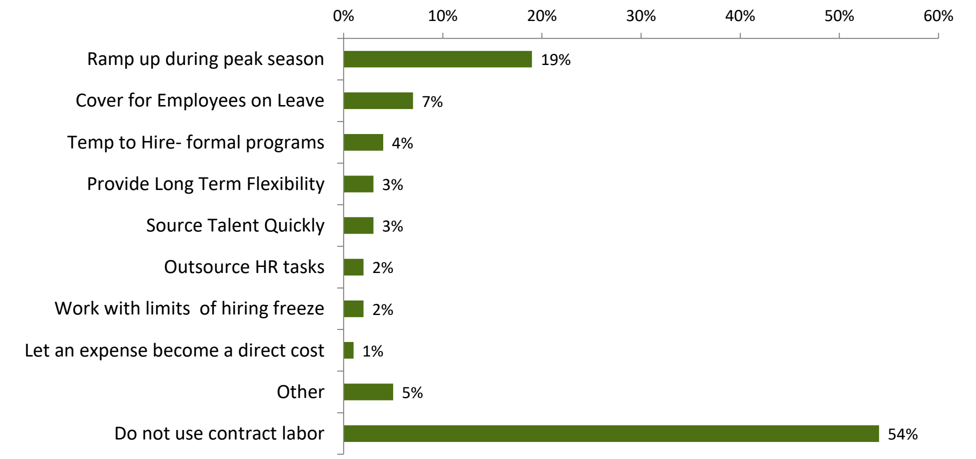
[3] Taleo Research. *2010 Survey of Fortune 500 companies*

[4] Workforce Management. *Who Owns the Temps?*

Usage

With decision authority established, the company can determine if and when it needs contingent labor. Only a third of companies globally and less than half in the Americas consider contingent labor as a "key element of workforce strategy"[5]. Factors that should influence the strategy include volatility of the business, economic outlook, legal environment, and human resources capabilities and strategy. Management should understand the reasons contingent labor is currently used (See Figure 5 – each reason is discussed below) and evaluate if those reasons are justified.

Figure 5: **Reasons for Using Contingent Labor, Global**



Source: Manpower. The Role of Contingent Workers in Workforce Strategy

Ramping up during peak season or covering for employees on leave are the two most commonly cited and most justifiable reasons for using contingent labor. Since the jobs would be temporary by definition, there is a reduced chance of overuse. The alternative is to manage temporary labor requirements without a staffing agency, setting up fixed term contracts directly with the employee. This approach is quite common, especially outside the United States. In China, for example, companies spend less than $6 B with staffing agencies but more than $35 B on non-agency temporary labor, such as independent contractors or temporary workers from an internal pool.[6]

Temp to hire is common, with an estimated 10% of staffing agency revenues coming from the associated conversion fees.[7] It allows the company and employee to ensure a mutual fit. Jobs for which temp to hire might make sense are unionized jobs, jobs with a high burnout rate, or jobs with nuanced skill sets. The manager of customer service at a paint manufacturer pointed out the benefits of temp to hire: "this job is very stressful and employees were burning out. If a temp lasts 6 months, then we are fairly confident he can handle the pressure." Of course, temp to hire programs are not applicable for most situations- only 4% of companies cite it as the primary reason they use contingent labor. Even when temp to hire makes sense, a successful program must be properly managed: contingent employees should be incorporated into the workplace without being embedded too deeply. Proper metrics and evaluations ensure that the trial period is worthwhile. The agency fee to convert a contingent resource to a full time employee should be significantly reduced or eliminated.

Providing long term flexibility often makes sense for companies recovering from a downturn, experiencing sudden growth, or otherwise facing uncertainty. Staffing agencies offer a just-in-time labor force that can be turned on and off very quickly, thereby reducing fixed costs. It also shields the company's employment history, reducing unemployment insurance costs. There are downsides to this model. Companies can end up with an alienated, dispirited work force. Additionally, it increases co-employment risk since courts tend to consider open-ended contract assignments as an employee-employer relationship.[8] A duration limit on contingent workers mitigates this risk, but courts often disregard arbitrarily imposed limits.[9] Too often, a buffer of contingent

[5] Manpower. *The Role of Contingent Workers in Workforce Strategy*
[6] Staffing Industry Analysts. *Global Contingent Market Estimate*
[7] Workforce Management. *Temp-to-Hire Is Becoming a Full-time Practice at Firms*
[8] Levine v. Comm'r, T.C. Memo 2005-86 and Chaplin v. Comm'r, T.C. Memo 2007-58
[9] Burrey v. Pacific Gas and Electric Co, No. C-95-4638DLJ (N.D. Cal. 1999)

workers is indicative of companies that are unwilling or unable to reduce the workforce when necessary or lack a disciplined approach to removing low performers.

The National Labor Relations Board's Browning Ferris decision initially reversed a 30 year standard of how it defines joint employment in August 2015. This ruling was then reversed and vacated in 2017 by the Hy-Brand Industrial Contractors decision, but reinstated by a unanimous decision in 2018 and placed under further review. A final ruling was issued in April 2020, restoring the standard that was applied before the NLRB's 2015 decision. In its original 2015 ruling, the NLRB stated that Browning Ferris was a joint employer of workers provided by a staffing firm. The 2015 decision reversed a ruling from 1984 that stated that companies had to possess the authority to set terms and conditions and exercise that authority over employees. Prior to 1984, a company only needed authority to set terms and conditions of employment to be considered a joint employer. If the 2015 ruling was upheld, it would have had a significant impact on the contingent labor supply chain since it would have made companies responsible for their contingent workforce suppliers' labor violations. It also would have opened the door to require users of contingent workers to participate in collective bargaining negotiations with those workers. Companies that utilize large numbers of contingent workers should continue to monitor the situation as new cases related to 'gig work' are working their way through various courts.

Using contingent labor to source talent quickly or outsource HR tasks might make sense when recruiting for specialized positions, in emergency situations, or during a restructuring. Such outsourcing of human resources functions should be done strategically and should lead to a leaner human resources group focused on their core functions. In the extreme, large portions of the human resources department could be outsourced via services such as professional employer organizations (PEO), administrative services organizations (ASO), and recruitment process outsourcing (RPO).

Working with limits of a hiring freeze or letting an expense become a direct cost are essentially efforts to circumvent budgeting tools implemented by another department or by headquarters. It might be necessary in extreme emergency situations but various departments should work together to avoid the systematic use of contingent labor in this manner. Although only 3% of HR representatives acknowledge this as a primary reason for using contingent labor[10], the practice is likely far more common than that.

Once a strategy has been established, companies should incorporate contingent labor usage targets in their budgeting and periodically review usage that significantly deviates from those targets.

Managing Contingent Labor Costs

Common purchasing tools such as a Request for Quotation (RFQ), benchmarking, and cost modeling are effective in the contingent labor category. Purchasing professionals will recognize the tools outlined in this section and human resource professionals will be familiar with most of the issues. This underscores the point that their combined efforts are necessary for world class contingent labor management.

[10] Manpower. *The Role of Contingent Workers in Workforce Strategy*

RFQ Process and Negotiations

Introducing a simple RFQ process, can yield significant savings, especially if the category has not been actively managed. The process should be repeated periodically to maintain competitiveness.

Managing complexity for multiple sites and job functions requires optimization. A standard RFQ analysis will often miss opportunities to allocate volume and maximize service levels by site. Best in class quote management requires the ability to dynamically allocate volume to adjust for supplier pricing and volume requirements. To maximize the value of contingent labor during the bid process, Cost & Capital Partners developed an indirect spend RFQ optimization tool (Figure 6) that manages multiple supplier responses by region, category and requirement to optimize the sourcing recommendation. Key dimensions such as number of suppliers, supplier capability by location, volume thresholds and supplier risk profile are assessed to generate the best results including savings, consolidation and service levels. This optimization tool allows multiple strategic options to be run and compared by site. It is highly recommended for organizations to develop something along these lines to ensure the best results for the company.

Figure 6: **Cost & Capital RFQ Optimization Tool**

Contingent Labor Optimization

Inputs

Distance to Supplier Limit (miles)	
15	
Favor incumbent %	Optimize
0%	

Eligible Suppliers (List)	Facilities Served (after award)	Current Spend (as of today)
Supplier 1	6	4,206,660
Supplier 2	16	1,679,022
~~xxSupplier 3~~	0	823,053
Supplier 4	2	782,988

Output

Savings	1,000,000
Facilities Reallocating	10
Spend Reallocated	7,500,000
Facilities without Support (due to mileage limit)	2
Spend without Support (due to mileage limit)	0
Facilities with a price increase	7
Suppliers Remaining	17
Suppliers going from <$500k to >$1M	2

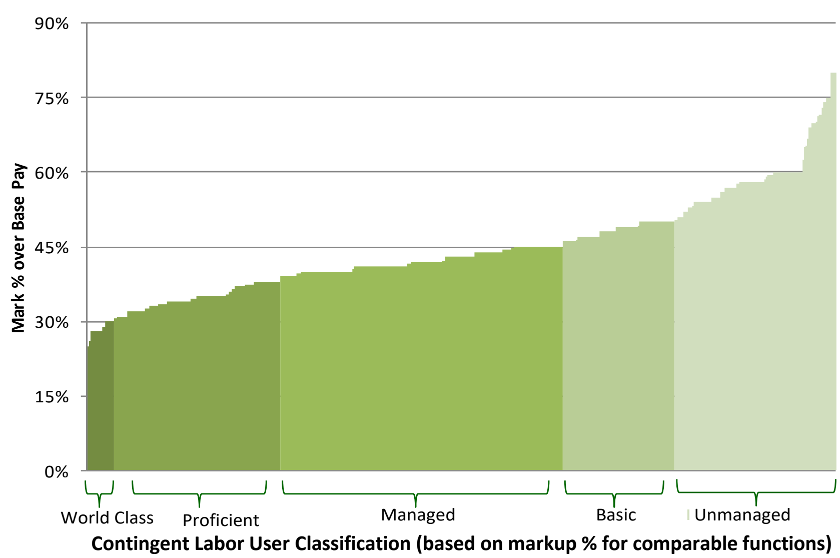
Source: Cost & Capital

Formal negotiations can and should be applied to contingent labor, regardless of who manages the category. An expectation of multi-round negotiations and a readiness to end supplier relationships when necessary must be introduced even though the existing human resources culture may be averse to it.

Price Benchmarking

Benchmarking markup percentages, both internally and externally, is an essential step in comprehensive contingent labor management. It can also be an effective way to identify quick savings opportunities. Though markups vary with factors such as location, base pay, job description, and leverage (see cost analysis below), any Fortune 1000 company should be able to achieve “proficient” markup levels of no more than 30-35% for basic functions (see Figure 7). Note that markup, as used in the industry, is defined as a percentage of base pay, NOT a percentage of the total bill rate. This common misperception can skew benchmarks.

Figure 7: **Contingent Labor Markup Benchmarking – USA Light Industrial**



Source: Cost and Capital Analysis

Consolidation

Supply base consolidation is an effective tool in commoditized industries that have low switching costs, such as contingent labor. Suppliers relish the opportunity to become preferred providers and be able to compete with only a handful of other suppliers. They can gain access to locations and divisions that might have previously been closed to them. In exchange, suppliers will offer more competitive rates or volume discounts. Since volume discounts or rebates can be harder to manage and are not guaranteed, securing improved rates up front is usually preferable. Users sometimes worry about losing variety or about the ability of a reduced supply base to handle a flood of requisitions. These concerns tend to be exaggerated; experience has shown that when competitive suppliers are put in a single source or preferred supplier role, they are able to commit additional internal resources and meet the demand.

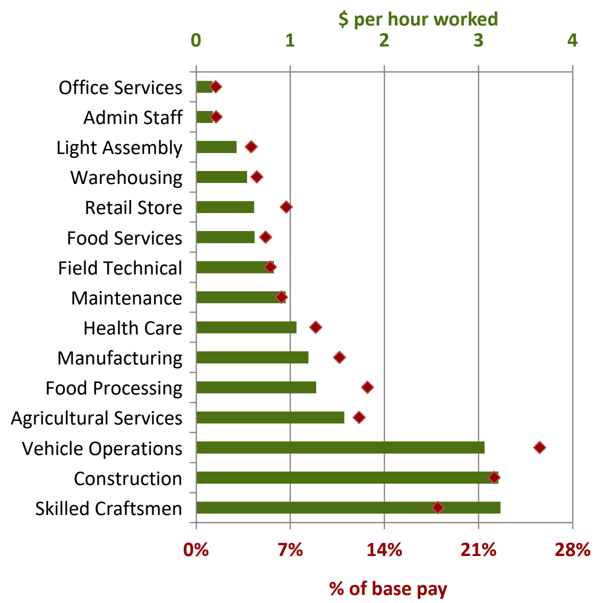
Cost Modeling

Contingent labor suppliers regularly cite costs such unemployment insurance, workers' compensation, recruiting, or benefits as justification for high or increasing rates. Understanding these costs enables customers to objectively evaluate supplier claims and address uncompetitive price components.

One major source of cost variation is State Unemployment Tax (SUTA) rates paid by the employer of record. Every U.S. state establishes a range of SUTA tax rates, and a company's SUTA rate is determined by its employment history (see Figure 9). Companies that have laid off very few employees might pay less than 1% of wages, those that have laid off many could reach the max rate of 14% or more, and those with no SUTA experience might start at a rate of 2%. In addition every state has a limit on "wages subject to tax", after which the SUTA fees no longer apply. Because of the ceiling, staffing agencies can only cite increasing SUTA rates so many times and should eventually see reduced SUTA fees in years of improving employment. Regardless, conservative cost modeling can assume max SUTA rates and still usually identify room for reduced rates.

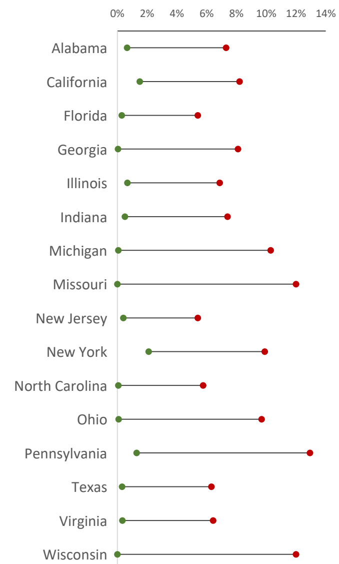
As the global pandemic caused large increases in unemployment, maximum SUTA rates have begun to rise in several states (see Figure 10). It is important to remember though, that experienced employers' rates (i.e. employers that have existed for many years) will likely be different from the maximum rate. Any proposed rate increases should be backed up with the supplier's specific SUTA rate change.

Figure 8: Typical Workers Comp Rates, U.S.



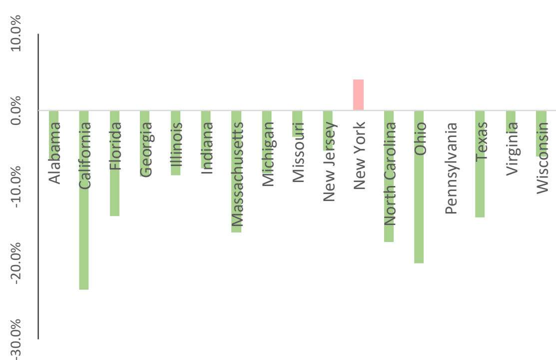
Source: WA Department Labor & Industries. BLS.gov

Figure 9: 2021 SUTA Range, Sample U.S. States



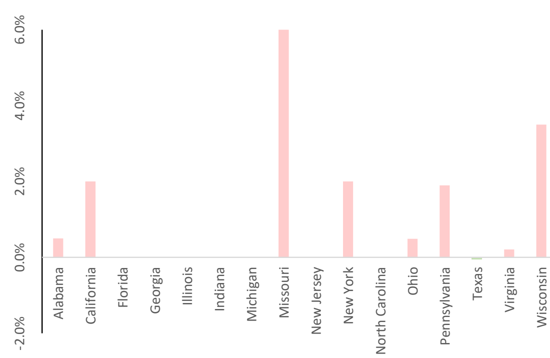
Source: State Employment Agencies

Figure 10: Workers Comp Premium, 2019 vs 2018



Source: WA Department Labor & Industries. BLS.gov

Figure 11: Change in SUTA Rates, 2021 vs 2019



Source: State Employment Agencies

Employers also pay a Federal Unemployment Tax (FUTA). The revenue from this tax is used to pay administrative costs of federal and state workforce agencies, pay the federal share of Extended Benefits during periods of high-unemployment, and provide loans to states with insolvent Unemployment Trust Funds.

Currently, the FUTA rate is 6.0% on wages; up to $7,000 a year. Typically employers, who pay their SUTA timely and in full, receive a 5.4% credit. Therefore, the net FUTA rate is normally 0.6%. However, federal law provides for a reduction in the FUTA tax credit when a state has outstanding federal loans for two years. The net result of the reduction in the FUTA tax credit is a tax increase for the employer. As of 2021, this is only the case for the Virgin Islands, however the number of affected states is at risk of increasing after 2022 due to the high unemployment amounts paid out during the COVID-19 pandemic.

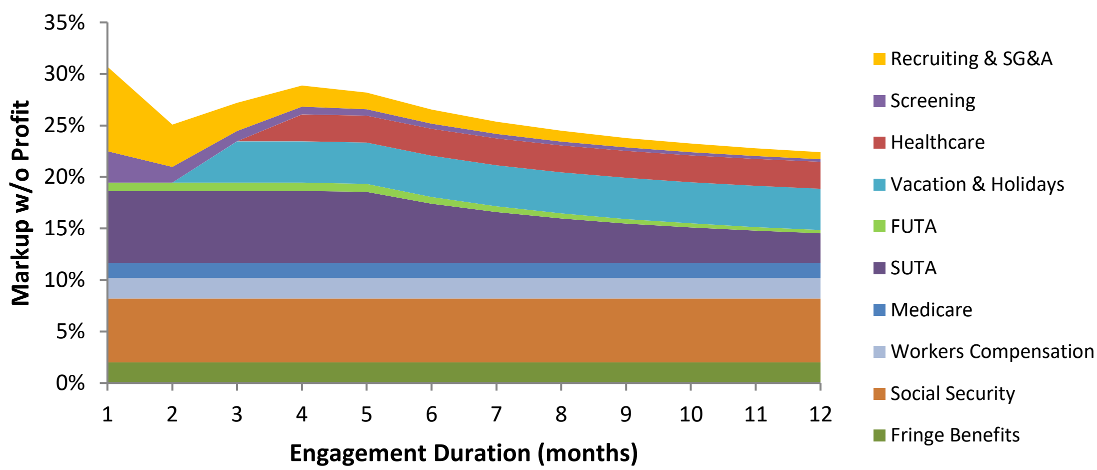
Cost & Capital has seen several staffing agencies turn to their customers with markup increases because of FUTA increases. However in most cases, agencies increase their rates by more than the actual FUTA costs. It is important for customers of staffing agencies to understand those implications and to stay on top of the market situation.

Workers compensation costs can vary not only by state and job function (see Figure 8), but also between staffing agencies providing the same job functions. This depends in large part on the agreement with their insurer and internal policy. Some staffing agencies, in an effort to reduce costs and increase flexibility, have adopted a self-insurance model for workers compensation. Though risky for the agency, this model allows suppliers to reward a good safety record with reduced rates. Even when suppliers use outside insurers, sharing information is effective at mitigating cost: the staffing agency should share the workers' compensation rates for the relevant job functions. The customer can then compare to their internal rates and share safety data (e.g. OSHA logs) to help their supplier reduce that cost with their insurance agency.

Many states use the National Council on Compensation Insurance (NCCI) to help determine rates. Other states, such as California and New York, have their own agencies that set rates. Most states have seen significant declines over the past few years (see Figure 10). For example, California has seen rates decline by over 72% since 2015. Nationally, rates have continued to decline an average of 5% in 2021 vs. 2020. This decline is the result of changes in state laws, a decrease in the number of claims, improved workplace safety, and changes in how states are addressing the opioid crisis. Savings that state funds achieve are passed along to businesses (e.g. contingent labor agencies), which, in turn, should be passed along to customers. Contingent Labor agreements that have not been reviewed in several years may have significant savings opportunities in this area.

Recruiting is a staffing agency's core competency and customers should expect competitiveness on both cost and quality, especially for basic light industrial and administrative positions. For more specialized positions, such as technical or scientific, or when the customer has unique and rigorous requirements, recruiting becomes a significant cost. In these cases, duration of the engagement becomes important: the longer the engagement, the less the cost recruiting represents as percentage of base pay. Cost modeling (see Figure 12) can emphasize this point in negotiations, leading to lower rates and tenure discounts (i.e. reduced rates triggered after an engagement reaches a certain number of months). Additionally, suppliers should always offer a reduced "payroll" function for cases when the customer does the recruiting but wants keep the employee on a contract basis through a staffing agency.

Figure 12: **Cost Model, Michigan Light Industrial Position (*Illustrative*)**



Source: Cost and Capital Analysis. Cost model assumptions: Base pay rate = $11/hr.; Recruiting Cost = $150 (absorbed by staffing agency); Healthcare 'Bronze Plan' starts after 90 Days and employee pays max allowable, Assume Michigan Average SUTA/ FUTA Rate; Workers Comp = 2%; Medicare = 1.45%; Social Security = 6.2%

Screening costs, fringe benefits, supplier-administered training, and equipment are items that should be provided according customer specifications and with a high level of price transparency. They are relatively inexpensive: for example, a thorough drug and background check should cost approximately $55, translating to a less than 1% increase in markup for a typical engagement.[11]

The Affordable Care Act requires companies with more than 50 FTEs to offer affordable healthcare coverage to 95% of their full time employees (i.e. employees that 30 work hours per week) and their dependents or pay

[11] Cost & Capital Research: assumes Federal, State, 2 county background; 7-panel drug test; Credit, SSN, DMV

a non-tax deductible fine of $2,570 per full time employee after the first 30 full time employees. However, if healthcare is offered, but is not affordable or does not meet the minimum requirements, the company would be fined the lesser or $2,570 per full time employee after the first 30 employees or $3,860 per full time employee who independently signs up and receives a tax credit through the Exchange. Since this penalty is the lesser of the two calculations, it might be relatively low if a limited number of employees sign up for insurance on their own, especially now that the individual mandate is no longer in place except in Massachusetts. The employer fine will increases by the growth of insurance premiums.

Affordable insurance is defined as costing an employee 9.83% of their household income or less. Employer sponsored healthcare plans must cover at least 60% of healthcare expenses for a typical population along with ten essential benefits (i.e. outpatient care, emergency services, hospitalization, maternity and newborn care, mental health and addiction treatments, prescription drugs, rehabilitative services and devices, laboratory services, preventive services, and pediatric services). Employees must be allowed to sign up for affordable insurance within 90 days of their start date. Low wage workers (i.e. typically earning $17,236 per year or less) in 38 states may be able to sign up for Medicaid. Ballot initiatives and other proposals are in the works in most of the 12 states that have not yet expanded Medicaid, with the COVID-19 pandemic accelerating efforts in some states. Employers are not penalized if their employees or their dependents elect to enroll in Medicaid or Medicare.

It should be noted that many companies already offer some sort of healthcare to their employees. Any cost increases associated with the ACA should only be a result of implementing plans that level-up to the ACA requirements. If companies find that it is less costly to cancel their existing policy and pay the employer tax penalty, any related price increases should be reduced by the current cost of the healthcare plan (i.e. the current healthcare plan that is to be cancelled should have already been built into their markups and should now be removed). The national average for a Bronze Level plan is around $300-$375 per employee per month. A portion of this cost can be passed along to employees in the form of premiums.

Contract Standardization

Standard contracts control the hidden costs, as well as the risks, associated with contingent labor. Cost reduction terms such as reduced rates on overtime, low conversion fees, free screening, and 60 day payment terms are conditions that suppliers will often agree to, but certainly will not volunteer. Similarly, a standard contract should include risk mitigation terms such as a waiver of subrogation and indemnification, a favorable dispute resolution policy, and policies that minimize co-employment risk.

Sensitivity Analysis

Once the team has a clear understanding of their cost drivers, it is possible to test various scenarios to determine how changes will impact the overall markup. Many cost drivers such as SUTA, Workers Compensation, and Hourly Wages will change each year and should be monitored if a supplier is under a long term agreement. For example, as seen in Figure 13, a $1 change in the hourly rate can impact markup by 1.1% if all other cost drivers remain unchanged. This is especially important to monitor in states that have enacted laws to increase the minimum wage over a period of time.

Figure 13: **Impact of various cost driver changes**

Cost Driver	Modification	Impact	Original Markup	New Markup
SUTA	State's 2021 max rate is 1.2% lower than 2020. Wages subject to tax increased by $300.	(0.7%)	26.3%	25.6%
Workers Comp	State's WC decreased by 16%	(0.6%)	26.3%	25.8%
Screening	Screening Cost decreased from $81 to $45	(0.3%)	26.3%	26.0%
Hourly Wage	Increase Hourly Wage from $10.40 to $11.40	(1.1%)	26.3%	25.2%
Assignment Duration	Increase average duration from 3 months to 4 months.	(0.5%)	26.3%	25.8%
All Changes		(3.0%)	26.3%	23.3%

Source: Cost and Capital Analysis. Cost model assumptions for the Original Markup: Screening Costs of $81, Rejection Rate of 20%, Recruiting and SG&A cost of $500, Hourly Wage of $10.40, Average Duration of 3 months, 4% Workers Comp, Max SUTA for New York, 30 Day Payment Terms, and 3 hours of overtime per temp per week.

Scorecards

The staffing industry has developed some standardized performance metrics. Tracking these are useful to drive performance, identify grow suppliers, and verify claims of superior quality from suppliers or their internal advocates. Agencies typically track these metrics internally and should be willing to share them with clients. Some of the most common metrics:

Delivery %: the percentage of employees that showed up to interview out of the total number of employees requested

On-Time Delivery %: the percentage of employees who were delivered by the original agreed-upon start date out of the total number of employees filled on orders

Satisfactory Performance %: The percentage of employees that the client would be willing to have back if needs arise out of the total employees provided by the staffing agency

Turnover %: The percentage of engagements that end due to employee attrition or due to negative performance.

Fill %: the percentage of positions filled by the staffing agency out of total candidates sent. Note: a low fill rate caused by the customer (e.g. a customer might have too many agencies competing for one position or provide inadequate job descriptions) is a common complaint of staffing agencies. Efforts to improve fill rates, by consolidating the supply base or better communicating requirements, can reduce costs for the supplier and customer.

Third Party Solutions

Users of contingent labor can utilize third party solutions known as managed service providers (MSP) and vendor management software (VMS). A VMS is a software tool that facilitates staffing requisitions, interview and hire process, and timecards and invoicing. An MSP is a third party that manages contingent labor suppliers (using a VMS), with at least a pair, and possibly dozens, of full time resources dedicated to the account. To avoid conflicts of interest, MSPs have mostly adopted a vendor-neutral model, in which the MSP does not recruit directly but tries to find the best suppliers according to a client's requirements. 13% of surveyed U.S. companies use an MSP/VMS combination and another 13% use a VMS independently of a MSP[12].

The **direct costs** for these services are typically a recurring fee that is a percentage of contingent labor spend. For a VMS, these fees range from 0.5% to 3%. The MSP is an additional 1 to 2%. Most VMS/MSP's promote a vendor-funded model, in which they are paid by the staffing agencies. This is marketed as a no cost solution to the customer, but in practice, all the cash flows from the customer and the MSP takes a cut before paying the ultimate supplier. Other options are for the customer to pay the management fees itself or to buy the software from the VMS up front.

Figure 14: **Direct Costs of VMS/MSP**

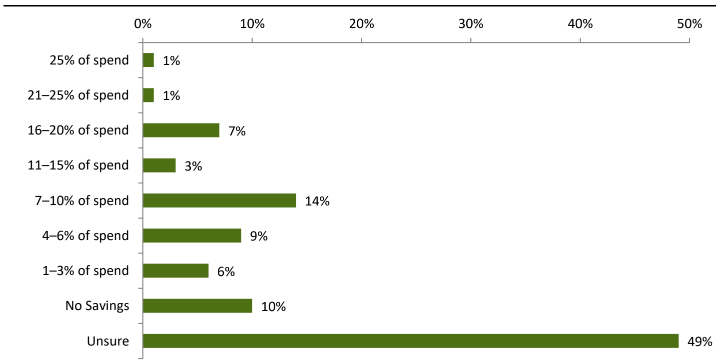
Fee Component	Percentage of Bill Rate
VMS Software Licensing Fee	0.5-4%
MSP Services and Support Fee	1-3%
Implementation Services Fee	No Charge for 8-12 weeks
Total MSP Fee to Suppliers	1.5-6%

Source: Cost & Capital

There are also the **implementation costs.** Much of the appeal of a MSP/VMS solution lies in the vision of a rapid and thorough control of data and process. Providers will often market an 8-12 week implementation period. Of course, this requires significant support from the customers. One VMS recommends that, in order to ensure successful implementation, customers obtain executive sponsorship, collect data (including contracts, rate cards, supplier and personnel lists, and current policies and procedures), engage all the business stakeholders that will be affected, communicate with suppliers, designate IT resources, create a core project team, and ensure the availability of those resources. Implementation costs may sometimes include services consulting fees and retainers from the provider, especially if implementation process is delayed due to "customer fault". Implementation periods longer than a year are quite common.

Users of MSP/VMS have reported some notable **benefits**. With the information centralized, uncompetitive markups (and other cost items) are identified and then can be negotiated. The MSP can support or lead these negotiations. Other benefits are operational improvements made possible by the increased visibility, including managing the amount of contingent labor used, base pay rates, and the duration of temporary engagements.

Figure 15: **Savings reported from users of an MSP**



Source: Human Capital Institute

[12] Human Capital Institute. *The ROI in Enterprise Contract Labor Management*

The main **risk** is that a company, content that it has achieved its goal of implementing a VMS, might not diligently pursue cost reduction or operational improvements. They would have only succeeded in automating an inefficient process. Unfortunately, this is relatively common, with fully half of MSP users unsure if they have realized savings from the solution. Other users report that even once an MSP program has been implemented, maverick spend still occurs[13]. This undermines the benefits of an MSP program as costs are no longer contained and visibility is diminished. Another risk is supplier push back or withdrawal, with some small to medium sized supplier refusing to work through such a system. A well-known VMS acknowledges that rate increases are possible if the customer already has competitive rates.

Overall, a VMS/MSP solution, like many IT projects, should not be considered a panacea or a short cut. The main benefit comes from the standardizing the data and process, and using the improved visibility to pursue savings opportunities. The type of effort required to implement it could enable a company to realize commercial and operational savings on its own using in house IT solutions.

Conclusion

Regardless of whether a company pursues a VMS/MSP solution, world-class contingent labor management requires organizational alignment, process discipline, and assertive supplier engagement. Organizational alignment entails executive awareness, clear delineation of responsibilities, and a project team that represents purchasing, human resources, and the business units. Process discipline entails defining appropriate uses of contingent labor, organizing all relevant data, and tracking usage. Assertive supplier engagement entails a coherent supplier strategy that typically entails consolidation, a formal RFQ process, and supplier negotiations.

Since these steps would be required to implement a VMS/MSP, a company is better off taking them internally. It can then evaluate its ability to handle the category with its in-house IT solutions and determine the need for VMS/MSP solution. If it determines that there is need, many of the implementation steps will have been completed, reducing implementation costs.

The benefits of this approach are increased responsiveness to the market and a reduced cost structure. Additionally, organizations that are centralizing authority across business units will find that the ability to execute a contingent labor strategy is a litmus test for the ability of the team to execute on the center-led vision. One Cost & Capital client prioritized contingent labor for precisely this reason: it cut across business units, was locally managed, and had low switching costs. This forced all business units to pay attention to the centralization vision and see the commercial benefits therein.

[13] Human Capital Institute. *The ROI in Enterprise Contract Labor Management*