

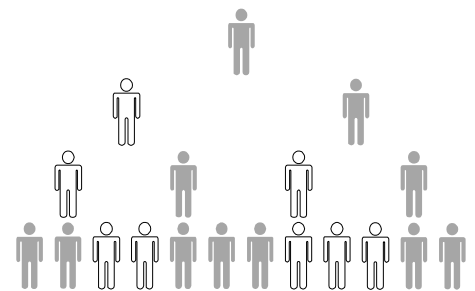
# OUTSOURCING PROGRAM MANAGEMENT

*Summary: Some companies have in-house program managers. Others outsource the work. Many combine in-house and outsourced resources. But all need a smart, experienced and responsible executive who knows how to choose good firms, interlace the processes of design and construction with the owner's organization and evaluate the work products.*

*Some owner organizations become entrenched and inefficient, but so do permanently outsourced organizations. The solution is twofold: first is an in-house executive who can evaluate performance; second is comparative competition—for either an in-house or an outsourced organization.*

*There are four classic approaches to outsourcing work that we nicknamed layer cake, ham and eggs, fruit salad and blue plate. Each strategy has its pros and cons. But there is much to be gained when an owner's organization collaborates with outsourced companies. Each will learn from the other.*

Dr. Nolan Estes, a good friend and advisor, has probably trained more school superintendents in his post-graduate curriculum at The University of Texas than any other educator in history. So he knows lots of school superintendents and has watched their careers. He told me that more school superintendents lose their jobs over a failed building program than a failed education program. With just a few



*More school superintendents lose their jobs over a failed building program than a failed education program.*

changes in names, that story can be repeated for many organizations—public, institutional or private.

Organizations with building programs must control them with capable people or live with debacle, fiasco and calamity.

This chapter is about the issues owners and program managers should consider in setting policies to get those capable people in place and produce happy results.

There was a day when many organizations—public, institutional or private—had large in-house AE and construction capabilities. The U.S. government used its own employees to build all projects until the early part of the 20th century and continued to build many projects with its own forces until mid-century. In 1941, government employees designed and built the Pentagon. The same was true for corporations—DuPont had an in-house construction company for most of the 20th century.

Today, in-house design and construction organizations are uncommon. All the U.S. government organizations we interviewed, or worked with, outsource their construction. Most outsource their design. But managing the program is a different matter. Some organizations have complete in-house groups of program managers. Others outsource the work to AEs, CMs or companies that specialize in program management. Many combine in-house and outsourced resources.

*Some organizations manage their programs with in-house staff; others outsource the work; many combine in-house and outsourced resources.*

## The Arguments for Outsourcing

Remember Harry Truman's classic comment?

*"Every time I ask an economist a question, the answer is 'on one hand, etc., etc., but on the other hand, etc., etc.' What I need is a one-armed economist."*

We carry the dismal science's guilt on this matter of outsourcing. So, we'll present the arguments for both sides—and then drop a few convictions of our own.

Ed Feiner led the Design Excellence program at the U.S. General Services Administration (GSA). Ruminating on his career, he thinks it's not a good idea for an owner to outsource much program management. He says there must be people—employees of the owner's organization—who understand what they're buying and will ensure that the work is done properly, at a fair price, at the right time.

Bob Fraga has been a contracting officer at USPS, GSA and the Smithsonian Institution. He believes you can outsource everything—all program management services—except the fiduciary

*It's hard to outsource fiduciary responsibility.*

responsibility. There must be smart, experienced and responsible people on the owner’s payroll who have the confidence of the owner’s executives and understand how to buy services, evaluate the work products and interlace the processes of design and construction with the owner’s organization.

These two points of view sound different, but there’s no disagreement that “smart, experienced and responsible” people need to understand how to buy and evaluate the services for the owner.

We agree. Strong in-house managers are invaluable—worth far more than their cost. If a manager has the full confidence of the owner’s leadership, he or she is also worth a lot to outsourced design and construction teams. We can personally testify that weak client program managers who can’t control the capricious whims of their leaders produce costly and troublesome projects. Furthermore, the design and construction companies that work for them lose money and deliver compromised results.

*A strong in-house manager with the full confidence of the owner’s leadership is valuable to outsourced teams. Weak in-house managers are bad clients.*

GSA, the Corps of Engineers and the Naval Facilities Engineering Command have complete program management groups in-house.

Target has 600 people developing designs and managing construction. They have a powerful desire to control their brand and drive continuous improvement, but they like a balance of about 50/50 in-house/outsourced for design. Walmart (a similar business) outsources considerably more than Target and is successful with its approach as well. Both have impressive execution strategies.

*Target does most of it in-house. Walmart outsources.*

Hines runs a lean organization. Hines manages a project with a strong regional program manager backed up by fewer than a dozen people in the Conceptual Construction group. They retain consultants on a project-by-project basis to augment their staff.

So what’s right? We struggled with this question and caved in on finding a universal best approach. Invariably, a unique approach was driven by a unique organization.

However, a discussion of the various points of view is useful to raise the questions that may be examined for an individual program. And there were common concepts that reappeared.

## Core Business

The most common argument we hear for outsourcing is that an organization does best what it knows best. Executives should stick to their core business and hire organizations whose core business is managing construction. Managing in-house design and construction groups sidetracks the owner’s executives. It takes time and adds to

*The common argument for outsourcing is that an organization should stick to its core business and outsource to companies whose core business is managing construction.*

administrative chores. If a group isn't essential to the company's core business, it's a distraction. Furthermore, if an executive, no matter how smart, is unfamiliar with the technology and processes of design and construction he or she will make poor hiring choices—the you-have-to-be-one-to-know-one theory.

The argument continues that a core business shapes a company's culture—its reward mechanisms, its authority structure, its network of industry colleagues; how it deals with suppliers, customers and employees; and the things its executives think about at night. If its business isn't design and construction, its culture won't be appropriate for designers and constructors. The best professionals will be inclined to gravitate to a company that has their profession as its core business. The cultural environment, the intellectual ambience of their profession, is important to them. They want to be in an organization where the conversations are about design and construction. And they're interested in leadership in their chosen field, opportunities for ownership and entrepreneurial rewards.

So some owners cherry-pick top-notch consultants or subcontractors who prefer the culture of a design and construction organization. It's unlikely that Michael Graves would have wanted to abandon the design-oriented culture of his company to be an employee of Target. And it's unlikely that Target would have much continuing use for him in the company. But Target could hire him to consult on prototype studies for its stores and design some of the products it sells—to the benefit of both.

Herman Miller has an enviable 50-year record of long-standing, mutually rewarding relationships with great designers such as Charles Eames, Bob Probst, George Nelson and Bill Stumpf. However, these designers would probably not have been comfortable in a corporate manufacturing culture—even Herman Miller, a company that is extraordinarily committed to excellence in design. Among other things, designers are likely to prefer the intellectual stimulation of a large urban environment to that of Zeeland, Michigan. But it seems that no observation on this matter is consistent. Herman Miller did attract some outstanding designers as employees. Alexander Girard was a permanent, long-term employee. (However, Girard came up for cultural air from Zeeland by spending considerable time in the artistically rarefied air of Santa Fe.)

These are all good arguments. However, this core business question isn't as slam-dunk an issue as the rhetoric above would have it.

First, consider the role a building plays in a core business. Although a company's core business may be retail, healthcare or education, its

*Many design and construction professionals want to be in an organization focused on their profession with opportunities for ownership and entrepreneurial rewards.*

*Great designers would probably not be comfortable in a manufacturing environment—or any large bureaucracy.*

*But the core business argument isn't a slam-dunk issue.*

*An organization's buildings may play a vital role in its success.*

buildings may be crucial to success. In many cases, such as housing, a pharmaceutical lab, a restaurant or a theme park, the building makes a material, sometimes a crucial, contribution to the success of the enterprise. The construction professionals may have a satisfying sense of higher purpose and a fulfilling career participating in the organization's mission.

Second, during our interviews we met, and during our careers we've worked with, many program managers who were permanent employees of their owner organization and who were as good as they come. In many cases, repetitive projects gave them experience that made them more expert with their building type than anyone they could hire.

Third, some construction professionals have discovered that businesses other than design and construction can offer larger rewards and more stability than are traditional in the construction industry. And they may offer wonderful opportunities for personal achievement. While Michael Graves didn't join Target, Rich Varda, a talented architect and a fellow of the AIA, did. And Jerry Lea may have more professional satisfaction at Hines than he ever would have had if he had remained a mechanical engineering consultant.

*Some businesses offer larger rewards and more stability than are traditional in the construction industry.*

## Continuous Improvement

Speaking of Lea, if an owner wants to keep polishing the result, even though it's a common building type, the owner is likely to staff internally to do so. Lea runs the Hines Conceptual Construction group that has the responsibility to consolidate Hines project experience. Early in his career as a developer, Gerald Hines decided that he wanted his company to learn from every project. What could make more sense? Most people would agree with that; few organize to do it. But Hines has. Lea's mission is to make the next office building better than the last. And although there are millions of office buildings in the world, and Hines has built about 700, they keep making them better.

*Owners are apt to staff internally if they are looking for a long-term program of continuous improvement.*

Like so many ideas in program management, there are many paths to success. There are cases where an owner has had a continuing relationship with an outsourced firm to push continuous improvement. The Mayo Clinic has worked with Ellerbe (later Ellerbe Beckett and now part of AECOM) for nearly a century.

However, most owners believe that having direct control over at least a small set of in-house employees, to keep polishing the product, is the best strategy for continuous improvement.

## Limited Choices

Sometimes organizations simply don't have much choice—they have to staff up because there is no easy solution for acquiring the service. When Disney started building Disney World, there weren't contractors in central Florida robust or specialized enough to handle the size and complexity of this mega project. Disney developed its own design and construction organization in Florida and imported some talent from its California operations. After the construction industry around Orlando developed, Disney de-staffed most of its in-house construction capability in Florida.

*Disney had little choice.*

## Compensation for Managers Who Control Large Expenditures

Construction professionals control millions, perhaps billions of dollars. Competent construction professionals get paid well. Some owners have an internal problem with that.

*Some owners outsource program management because their compensation policies won't allow them to hire the adequate expertise in-house.*

We've seen this problem repeatedly in school districts that typically live with taxpayer scrutiny and paltry pay scales. Consider a school district that suddenly has a large building program. A seasoned program manager who is experienced with big construction risks is likely to be able to demand more pay than anyone in the school district's administration—including the superintendent. Yet the school board would be hard pressed to pay a director of facilities more than the superintendent. So they sidestep the problem and outsource to a company with the right talent.

(As an aside, it's not uncommon for a university to pay its football coach more than its president. We may see some wise school board do the same for their construction leader—or better yet, pay the superintendent what he or she is worth.)

Some owners simply don't recognize how much money and how much risk their in-house program managers are managing. The owners underpay and then the managers underperform. One of the saddest spectacles is an organization with a low salary schedule that hires low-paid construction professionals to manage big construction projects. To save thousands of dollars in salaries, they mismanage millions in construction.

Another sad spectacle is a company that values the executives who serve the company's core mission and views construction professionals as second-class citizens. So the company hires second-class professionals. The second-class professionals hire second-class firms and produce second-class facilities for first-class prices.

*A sad spectacle is a company that views construction professionals, who manage millions, as second-class citizens.*

(Our own industry isn't free of this kind of internal prejudice. AE, CM and construction organizations are apt to pay their construction people well and then make similar mistakes in underpaying in-house lawyers and accountants.)

## Commodities and Proprietary Processes

Some owners outsource because they think it's cheaper than building their own staff. If a professional service is a commodity, easily available, it's likely they will be right.

*It's unlikely that an owner can build an in-house capability for common tasks as cheaply as what is available from the marketplace.*

If a design, construction or management task is common, it's unlikely that an owner can build an in-house group that will be competitive in cost or quality with what is available from the marketplace. So organizations that watch their bottom line are inclined to outsource a commodity service.

But if owners have proprietary processes, if they must do something unusual, or if they must be prepared for an emergency, they will likely build their own staff. Clearly, the proprietary nature of the production processes in a competitive industry is one of the motivations to have in-house capabilities at a company like DuPont.

*Owners with proprietary or unusual processes will likely build their own staff.*

And when Disney builds a theme park, there is a lot of specialty construction—fake rocks; aged wood; walking, talking, furry mechanical creatures; thrill shows and rides. People experienced in building these things didn't exist in central Florida. So Disney built shops to make their creatures and assembled designers and engineers to design their shows and rides. And if something on one of the rides were to break and children were left in a tunnel or up in the air, Disney couldn't wait for the crew from town to be available.

As the construction industry around Orlando grew, things changed. With Disney as the attraction, other theme parks came to town. They didn't have in-house capabilities, so private sector companies formed to do the work. Soon there were several companies around Orlando making old wood and fake rocks. Disney scaled down its construction company and outsourced some of the work. But Disney kept the shops that did audio animatronics, skins, furs, feathers and character heads and husbanded the unique and specialized talent to design its shows and rides—those wonderfully creative skills that are core to Disney's success.

## Delegating Risk

Some owners have said that delegating work to an outside program management firm will minimize risk. Well, probably not. Ultimately,

*An owner owns all the risk of project delivery. No way around it.*

an owner owns all the risk of project delivery and it's fiendishly difficult to delegate management risk. Here's why. A program management company must always act in the interest of its client—must sit on the owner's side of the table. If an owner assigns risk (cost or schedule guarantees) to its program manager, it moves the program manager across the table—at least a little bit. The collaborative transparency clouds up.

Furthermore, if an executive assigns risk to a program manager and the program manager fails, how do you think the organization will view the executive who made the assignment?

However, it's certainly sage strategy for an owner to farm out work to a program manager with greater expertise and experience in managing design and construction risk than the owner has in-house.

## Resource Leveling

There's a convincing argument for outsourcing to level peaks and valleys in staff requirements. All organizations, particularly public organizations, have difficulty trimming staff when work slows. One public owner told us:

*"I want people I can fire if I need to."*

Conversely, finding good people, training them and getting them in a functional position always lags the demand when the workload grows. So outsourcing is often a good idea.

## Learning from Specialists

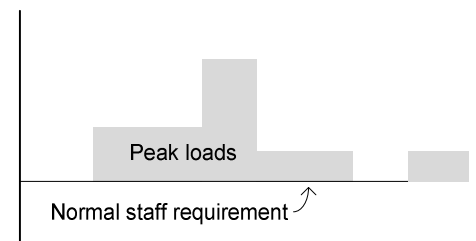
Another argument for outsourcing is that an in-house program management team can learn from outsourced consultants. Any smart owner will realize that it's a good idea to bring in highly specialized talent to deal with specialized problems.

Since our company frequently learned from competitors when we worked in joint venture or from consultants who worked for us, and since we frequently learned from our clients, we buy this argument wholeheartedly.

## Continuity and Competition

Throughout this book, we stress the value of continuity in people, processes and products to a building and maintenance program.

But many owners feel that entrenched in-house groups, untested against the hard anvil of competition, will build empires, become calcified and inefficient. We've certainly seen some groups that fit



*Outsourcing to level peaks and valleys in staff requirements makes sense.*

*Outsourcing for learning also makes sense.*

*Entrenched in-house groups can build empires, become calcified and inefficient.*

that description. The solution to that problem is an owner executive who can judge the productivity of the in-house organization. And the best way to judge is comparison. That means outsourcing some of the work.

Government agencies, institutions, consultants and self-appointed civic action groups often do studies comparing the cost of in-house program management to the cost of outsourcing the work. In our experience, if the study is done by the owner organization, the real overhead cost of the institution isn't properly included. If done by an outside management consultant, the complications of governance are ignored and the compared services are unequal. The evidence is so inconsistent and ephemeral that the conclusion typically favors the researcher's point of view.

But, clearly, continuity is beneficial. The FMI study mentioned earlier (see page **Error! Bookmark not defined.**) reported that owners who concentrated their service providers into a few continuing relationships tended to lower their management costs by 30 percent. We suspect that if FMI had measured performance, it would have improved too.

However, continuing outsourced relationships can get cozy and inefficient as well. So here is the big question: How do you keep a program management group, in-house or outsourced, sharp?

*Outsourced relationships can get cozy and inefficient as well.*

The first requirement is to have those "smart, experienced, responsible" owner executives who can judge the productivity of both their in-house and outsourced organizations.

Second, combining in-house people with outsourced people tends to keep both groups on their toes.

Third, some owners staff their team with people from more than one program management company. One owner said:

*"We want the fewest possible organizations working for us as long as we still have competition. That means two."*

## Integrating an Outsourced Staff

So if you buy the argument that there is value in combining in-house with outsourced staff, the next questions—often overlooked—are these: if you outsource work to a program manager to help manage your building program, and if you have people in your organization who do that work too, what is the relationship between your employees and the employees of the outsourced staff? Who is the boss? Do they work together or are they separate? If separate, how do you divide up the work? If together, how do you arrange teams?

*Who is the boss? How do you divide up the work? If combined, how do you arrange teams?*

There are four classic approaches for outsourcing program management. We gave them nicknames.

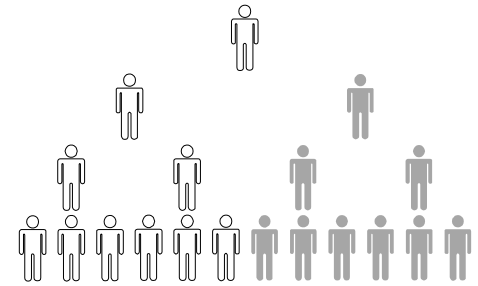
## Ham and Eggs

An owner can retain an outsourced program management company to assume part of an owner’s program, leaving another part of the program to the owner’s in-house staff.

Assume the owner simply carves out a portion of the building program and contracts with a program management company to manage it. Perhaps a school district would assign new construction authorized by a bond program to an outsourced company and assign the program of continuing remodeling and repair to its internal staff. Or perhaps a retail chain that is accelerating its roll-out of new stores might give the accelerated portion of 10 stores to the outsourced company and 10 that are part of a continuing program to an in-house group.

A nice characteristic of this approach is the clarity of responsibility. The program management company can accept specific assignments and report directly to an executive in the owner’s organization. The program management company can use its own systems and procedures and get started quickly. Since the owner’s program management organization is separate from the outsourced firm, the owner doesn’t have to worry about integrating different cultures. Each organization can keep its own ground rules and habits.

However, the separate organizations are intellectual silos—stovepipes that don’t learn from one another. The owner will get different formats for their status reports, and leveling contingency funds across different projects will be harder. The benefits of rotation will be fewer<sup>1</sup> and the ability to make program-specific checklists for project definition will be reduced.<sup>2</sup> There will probably be some responsibility overlap in the program. And it’s likely that someone will compare the performance of the two groups, so it’s more than likely that the owner’s group and the outsourced group will get competitive and cause some grief.



*An outsourced program manager can assume responsibility for a set of projects while the in-house staff manages the rest.*

*Dividing the work between in-house staff and an outsourced company has clarity of responsibility.*

*The separate organizations are intellectual silos.*

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<sup>1</sup> See the chapter on Rotation, Repetition and Refinement, page 41.

<sup>2</sup> See Program and Project Definition, page 63.

## Layer Cake

An owner can retain an outsourced program management company and assign its management to the in-house program managers.

Many organizations with internal program management groups simply ask them to increase their staff for a peak load by contracting with an outsourced company for some of the work. The outsourced company reports to someone at the grass roots of the owner's group. Sometimes the owner's organization retains multiple program management firms.

There is clear responsibility for the assignment. However, the outsourced company is likely to be buried in the client's organization and micro-managed by people in the owner's organization who are project managers themselves. They may expect the outsourced PM to use the owner's procedures and standards and the owner's control and reporting systems (although they may be inferior). Because the outsourced company is unfamiliar with them, it's likely that the owner's staff will feel the outsourced company doesn't perform as well as the owner's own organization.

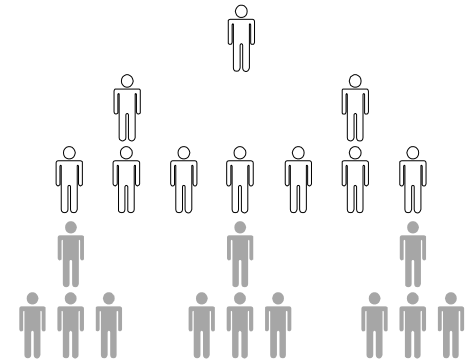
It will be hard to define the division of responsibility between the in-house project manager and the outsourced company. And there will be much finger pointing when the inevitable problems arise.

Of course it *can* work—if the owner's group understands best practices and has the experience and capabilities that are better or at least as good as those of the company they're managing. But we've seen organizations with a board that said something like this:

*"We haven't done much building in the past so I don't think our facilities department has the experience to run our big new program. Let's go out and hire the best firm in the world to manage it. Then they can report to our facilities department and we won't have to worry about things."*

Fat chance! They'll have plenty to worry about. It's nearly impossible for a professional service company to exceed the competence or the vision of its client. It's unlikely that the best firm in the world will do any better than the inexperienced facilities department would have done by itself, because that firm will be taking direction from inexperienced people with narrow concepts who will make the wrong decisions.

Layer cake as an outsourcing concept will perform no better, and perhaps worse, than the bottom tier of people in the owner's organization that controls the services. Of the four approaches, it's apt to be the most troublesome.



*An outsourced program manager can assume responsibility for some projects and report to the in-house project managers. An in-house program manager can retain multiple outsourced program managers.*

*Layer cake will perform no better than the bottom tier of people in the owner's organization would have performed.*

But like most of the points we make in this book, there are always exceptions. An organization with a highly competent facilities group with highly competent managers is likely to use the layer cake approach. If the owner's senior project managers who control the outsourced firms know their business, are willing to teach the outsourced firms the owner's procedures and create continuing relationships, it's apt to work.

The Los Angeles Unified School District (LAUSD) program is, as of this writing, the largest building program in the country. LAUSD combines Fruit Salad and Layer Cake approaches. They cherry pick talent from a number of companies that are working under evergreen contracts and sprinkle it among the program management staff, who are LAUSD employees. Then they assign the design and the construction management of some of their projects to individual firms.