

WHITEPAPER:

UNDERSTANDING THE RISKS AND FINANCIAL CHALLENGES RELATED TO OUTSOURCING





INTRODUCTION

If your company outsources work to contractors, it is not alone. The practice is a growing trend across multiple sectors of the industrial landscape in Canada and around the world.

Should your company self-manage contractors or outsource work to dedicated specialists? What are the risks involved in outsourcing? How does contractor management impact overall company performance? Are hiring organizations responsible for contractor-related accidents? Does external contractor compliance management generate a sound return on investment?

Cognibox addresses all of these different issues. This document briefly introduces the advantages and risks of outsourcing.

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ADVANTAGES AND RISKS OF OUTSOURCING

ADVANTAGES

There exist a number of different reasons why businesses outsource work to external contractors. Outsourcing often represents a welcome shortcut for testing new equipment, experimenting with different techniques or seizing the benefits of complementary expertise.

Additionally, outsourcing enables management to focus on the company's primary mission and core business in place of attempting to manage a thousand and one operations-related tasks.

The latter include activities such as the following: constructing buildings; training and evaluating resources; transporting, lodging and feeding operating teams; maintaining worksites; and, ensuring worksite safety. All are essential but often far removed from core company activities.

The primary reason for outsourcing is to be able to focus on core company activities.

RISKS

Each time contractors set foot in a plant or enter a construction site, the scope of their actions impacts the manner in which the business of the hiring organization is conducted.

The hiring organization's reputation, worker health and safety, and environmental protection represent some of the many aspects that contractors positively or negatively influence.



HIRING ORGANIZATIONS IN DIFFICULTY

ONTARIO — In May 2015, Vadim Kazenelson was found guilty of criminal negligence causing bodily injury and resulting in the death of four workers in a 2009 work-related accident. The accused was sentenced to three and a half years in prison. His employer, Metron, was fined \$750 000 for negligence and violation of provincial labour laws.

BRITISH COLUMBIA — In April 2015, Stave Lake Quarries was found guilty of criminal negligence causing death. Kelsey Anne Kristian, the victim, died after only two days on the job as a truck driver. Her truck overturned in a quarry. The court ruling pointed up insufficient supervision and training.

Some hiring organizations learn the hard way when they hire contractors of questionable competence. Problems range from non-compliance and deficient management to the inability to work to company standards.

Are the contractors that you hire poised to protect you from costly errors which could even land some of your executives in jail?

Were a contractor to cause a serious accident, would your company be able to demonstrate, with supporting documents, that all reasonable action had been taken to prevent the occurrence of such an accident? What would the impact be on your company's reputation?

Some companies have neither the time nor the expertise to properly evaluate the risks associated with outsourcing.

Under applicable federal regulations and provincial legislation in Canada, hiring organizations have the same legal responsibilities towards their contractors as they do towards their own employees. Risk-related liability is therefore incumbent upon both the contractor and the hiring organization.

Accordingly, when contracting out services, the hiring organization must demonstrate due diligence in the matter of risk prevention. Demonstration of "due diligence" means that employers must take all reasonable precautions in the circumstances to prevent injuries and accidents in the workplace¹.

Does your company take the proper means to benefit fully from the advantages associated with outsourcing? How does your company go about ensuring that service providers are competent and poised to carry out the required work well, while decreasing risks?

RISK PREVENTION SOLUTIONS

All companies that hire contractors face these same issues. The most vigilant adopt solutions based on sectoral best practices. The object of these practices is simple: protect the hiring organization and executives against the risks of outsourcing.



“ **RISK IS ONE RESPONSIBILITY**
THAT YOU CANNOT OUTSOURCE. ”

1. Canadian Centre for Occupational Health and Safety. (2015). OH&S Legislation in Canada – Due Diligence, Sourced from <http://www.ccohs.ca/oshanswers/legisl/diligence.html>.



FINANCIAL RISKS AND REPUTATIONAL DAMAGE

COSTS AND CONSEQUENCES OF RISKS

The risks inherent in outsourcing are neither virtual nor theoretical, and accidents involving contractors do not just happen to others.

The cost of a single incident/accident can, in one fell stroke, wipe out a full year of outsourcing-related benefits. Risks and attendant costs are nonetheless difficult to demonstrate until the day the unthinkable occurs: serious accident, production stoppage lasting several hours to several days, or worse yet, the unanticipated bankruptcy of an important supplier.

Businesses invest massively in programs relating to the environment and workplace health and safety. However, they do not always stop to consider the critical nature of outsourcing risks or the costs of potential incidents/accidents.



KEY RISKS

Health and safety

Many companies devote considerable energy and resources to building a culture of safety within the ranks of their organization. That said, it is not uncommon to encounter contractors incapable of understanding hiring organization policies and requirements in this regard, or meeting company standards.

Researchers Underhill and Quinlan¹ demonstrate that the safety records of many contractors fall short of comparable hiring organization records. The causes are multiple, but the absence or insufficiency of proper training, poor team supervision and lacking enforcement of safety standards largely explain the worrying divergences.

Insurance coverage

In the event of a serious accident caused by a contractor – death, environmental disaster, etc. – would your company be able to demonstrate due diligence with respect to supplier qualification, notably in the matter of insurance coverage?

No company can afford to conduct business with contractors having insufficient insurance protection to cover work with which they are commissioned or, worse yet, coverage that has been allowed to lapse!

1. Underhill, E., & Quinlan, M. (2011). How Precarious Employment Affects Health and Safety at Work. *Relations industrielles / Industrial Relations*, 66(3), 397-421.

Cost overruns

It is a known fact that the incorporation of contractors into any working environment can easily lead to a loss of control and cost overruns. The probability of experiencing such a situation increases as contractor numbers swell.

The solution to the problem is simple albeit demanding: contractors must be managed even more rigorously than the hiring organization's regular employees.



Non-compliance

We live in societies in which multiple economic and industrial activities are subject to often complex laws and regulations. Non-compliance with these laws and regulations can lead to added costs for a company and damage the latter's reputation. We refer back to this point a number of different times in this document.

For example, in some instances, a contractor found to be in default of contributions owing to the Workplace Safety and Insurance Board (WSIB) in Ontario or Commission des normes, de l'équité, de la santé et de la sécurité du travail (CNESST, formerly CSST) in Québec can render the hiring organization liable for payment in part or in full of amounts owing.

Financial capacity

When choosing a contractor, the hiring organization must always take into account contractor size, the magnitude of projects undertaken and financial soundness.

Some multinational corporations, for example, impose upon their suppliers terms and conditions of payment ranging from 90 to 120 days, whereas smaller companies honour bills owing within 30 days. It is plain to see that a small entrepreneur invited to conduct business with a larger firm, even if fully qualified for the job, could quickly experience cash flow issues if not financially sound.

The consequences of ignoring information of the like when choosing a contractor can prove catastrophic for there is nothing worse than conducting business with a supplier in dire financial straits!

Quality and client satisfaction

Unsuitable suppliers can cause delays in work execution. Indeed, when work is outsourced, risk of this nature increases. It can not only impact both service and product quality, but also undermine client satisfaction in the process.

As a consequence, businesses must carefully select, qualify and manage each partner to avoid compromising their standards of quality.



DIRECT COSTS

Damage caused by contractors

Contractors sometimes directly cause workplace accidents. Recourse, although possible, often entails considerable delays, leaving the hiring organization no choice but to proceed quickly with repairs following an incident/accident. Costs can escalate significantly, especially in the instance of serious injuries or deaths.

Between 2009 and 2013, claims filed with provincial worker compensation authorities in Canada² totalled close to 800 000, a number which attests to the involvement of numerous contractors.

Lost time and revenue

It is not uncommon that an incident/accident in the workplace leads to interruption of a production process. The situation sometimes means replacing injured workers, shifting displaced workers to other positions, providing emergency training, equipment repair, or other. Situations of the like also require overtime hours by onsite workers.

In short, time is sometimes required before operations can return to normal, thereby representing an additional direct cost for the hiring organization.

A typical North American pulp and paper plant can easily lose up to \$600 000 in revenue as a result of a complete stoppage of operations.

THE DEEPWATER HORIZON CASE ³

In August 2010, the Deepwater Horizon petroleum platform in the Gulf of Mexico exploded, causing the death of 11 individuals and resulting in the largest oil spill in the history of the United States.

In the two months that followed, the value of BP shares plummeted by 55%. In the period from 2010 to 2014, shares traded at a value 27% less than that prior to the accident.

2. The Association of Workers' Compensation Boards of Canada. Sourced from http://awcbc.org/?page_id=9759.

3. Chamberlin, A. (2014, September 10). BP Lost 55% Shareholder Value After the Deepwater Horizon Incident. Sourced from <http://marketrealist.com/2014/09/bp-lost-55-shareholder-value-deepwater-horizon-incident/>.

Fines and penalties

In substantiated instances of non-compliance, penalties imposed by local and international regulatory bodies can prove extremely costly for the companies at fault.

In April 2014, Saskatchewan⁴ adopted a law providing for fines of up to \$500 000 for individual employers and \$1.5 million for large corporations in the event of a serious accident or death resulting from company non-compliance with a law or regulation. In other circumstances, penalties for serious injury or death owing to non-compliance have risen from \$420 000 to \$2.1 million.



Investigation fees and lawsuits

Serious incidents/accidents almost always involve internal and external investigations which can prove costly. A single mortality investigation conducted by an external professional can result in the disbursement of between \$30 000 and \$50 000 in professional fees.

Any serious accident can also entail costly legal proceedings, lead to a trial and involve substantial civil or Criminal Code damages. When one stops to consider that legal fees in some cases can amount to several hundred dollars an hour, one can readily comprehend why no hiring organization wants to be called up before a judge for having failed to manage a contractor properly.

Insurance costs and contribution rates

Insurance rates are based on loss experience. Hence, in the period following a serious incident/accident, a company risks seeing insurance costs rise.

The same is true of contributions to worker compensation bodies. A case in point: Sound corporate health and safety performance for a given sector of reference means reduced or stable contribution levels, whereas a poor record results in substantial increases in contributions.

In Alberta, for example, companies enrolled in the Industry Custom Pricing Program operated by the Workers' Compensation Board benefit from reductions when the number of accidents decreases. However, when the number of accidents rises, they become subject to a poor performance surcharge and contributions may increase by as much as 200% over and above regular contribution levels⁵.

Two out of every three Canadian consumers rank corporate reputation high among purchasing criteria⁶.

4. MacMillan-Brown, H. (2014, September 19). Penalties for Workplace Accident and Fatalities in Saskatchewan: The Landscape Has Changed, Miller Thomson Canadian Labour and Employment Law Blog. Sourced from <http://www.millerthomson.com/en/blog/canadian-labour-employment-law-blog/2014-archives/penalties-for-workplace-accidents>.

5. WCB-Alberta. (2015). Employer Handbook. Sourced from http://www.wcb.ab.ca/pdfs/employers/employer_handbook_2015.pdf.

6. Marcellis-Warin, N.D., & Teodoresco, S. (2010, April). Burgundy Report – Corporate reputation: Is your most strategic asset at risk? CIRANO. Sourced from <http://www.cirano.qc.ca/pdf/publication/2012RB-01.pdf>.

INDIRECT COSTS

Reputational damage

Workplace incidents/accidents can have a detrimental impact on the manner in which the general public perceives a company, a workplace environment or an entire industry.



Even when a contractor is responsible for the incident/accident, it is not necessarily the latter's name which appears on late evening newscasts. In many instances, mention is made of the company where the work was being carried out.

In today's world, social media can annihilate an organization's reputation in a matter of hours without regard for vested notoriety. And there is no more prized asset than a company's reputation.

Consequently, the selection of contractors, management and monitoring of work activity, and quality of relations between hiring organizations and their service providers are of vital, strategic importance for corporate health and sustainability.

Psychological repercussions

Serious incidents/accidents always exert psychological effects on people and their immediate circle of influence. The consequences of these shocks impact not only the individuals themselves but also the families and friends of the persons implicated in situations of the like.

Additional impact: Former employers of incident or accident victims can subsequently experience difficulty in hiring new employees. We live at a time in history when information flows quickly and in great abundance. All companies must recognize this fact and act accordingly.

In 2007, the average cost of workplace accidents in Ontario, according to the province's Workplace Safety and Insurance Board statistics, amounted to \$106 500 per event.

Indirect costs owing to productivity loss, compliance retrofit and human resources represented more than 80% of this amount.⁷

“ DEFICIENT CONTRACTOR MANAGEMENT CAN ADVERSELY IMPACT BOTH COMPANY PROFITABILITY AND REPUTATION. ”

7. Workers Health & Safety Centre Federation of Ontario, (2012, December), Hazard Prevention: A Sound Investment for Business and Society. Sourced from <https://www.whsc.on.ca/Files/Resources/Training-Compliance-Audit/Economic-Cost-of-Inaction-Fact-Sheet.aspx>.



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How to manage outsourcing efficiently.

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ABOUT COGNIBOX

Canadian leader in risk management and contractor compliance, Cognibox offers one of the most flexible, comprehensive solutions on the market. Over 125 customers in North America, including Agropur, ArcelorMittal, Bell, Cargill, Resolute Forest Products and Rio Tinto, use Cognibox to manage contractor risks specific to their sector of activity. The company's solution provides a combination of expertise, software, training, as well as a full spectrum of outsourcing services and administrative support.

The Cognibox community currently boasts over 200 000 members, contractors and employees of contractors, thereby enabling hiring organizations to work with top industry contractors and suppliers in areas such as workplace health and safety, the environment, sustainable development, quality and regulatory compliance. To learn more, visit www.cognibox.com.

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