



Economics without tears

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When and how should museums outsource?

A key decision faced by any museum manager is whether a function should be undertaken in-house or outsourced to a specialist provider – otherwise known as the "make or buy" decision. Whilst the corporate world has developed a range of models to inform that decision, the same decision for the museum director is muddled by ideological positions on the commercialisation (read privatisation) of cultural institutions.

Discussions on outsourcing within the cultural sector often get side-tracked by the ongoing debate over whether or not the public interest is better served through public or private provision. In truth, the real question is whether or not it is more efficient to deliver a service through the effective management of a monopoly or through open competition. The benefit of outsourcing comes not from the fact that a private sector provider is intrinsically more efficient. It comes from the discipline imposed by a competitive market. And there are varying degrees of competition. Is the organisation better served through an in-house monopoly, which it can control? Through a long-term relationship with a single provider? Or through a perfectly competitive environment in which the organisation is free to purchase services from any provider as and when needed?

Another common distraction is the idea that outsourcing is an easy route to cost reduction. This isn't always (or even usually) the case. It can easily cost as much to contract a cleaning service as it does to have cleaning staff on the payroll. This is sometimes obscured by the fact that once a

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service is outsourced it disappears altogether as a budget head (except for a lump sum payment to the contractor). Out of sight, out of mind. But it takes time and effort to manage the relationship, monitor standards and resolve any disputes. Once these costs are considered and properly allocated, the saving on cleaning can be much less than expected.

There can be hidden benefits too. It is probably cheaper to employ one person with an aptitude for managing contracts (be it a catering, cleaning, or maintenance contract) than three people to manage in-house catering, cleaning and maintenance functions. Outsourcing also allows the organisation to focus on 'core functions' (however defined) and therefore generate efficiencies in other areas. I know of one museum director who is the world's authority in her particular field, but spends 90 per cent of her time on routine management tasks like health and safety audits and human resources. By outsourcing these functions she could capitalise on her unique expertise and perhaps generate additional revenue for the museum.

On what basis, therefore, should a museum decide whether a function should be delivered in-house,

contracted out, or simply purchased as needed on the open market? When faced with the "make or buy" decision, one must consider not only the costs of providing the service, but also the nature of the assets in question and the implications of reducing competition for the service.

How does this theory play out in the real world of museums? Consider the case of a museum deciding on whether or not to outsource its restaurant or run it in-house. If the restaurant is a relatively self-contained operation, which does not impact heavily on other museum operations and does not require any specific fitting out or specialised resources, then transaction cost theory would suggest that outsourcing is optimal. The contractor has a strong incentive to drive down production costs (since he captures the benefit of operating efficiently), whilst some measure of competition is retained because the museum is free to contract with a competitor at the end of the contract.

However, the situation is often not so clearcut. The efficiency gains from outsourcing can be outweighed by the potential for opportunistic behaviour by the contractor. This is particularly true when the contractor obtains – either contractually or through its control of the kitchens – a virtual monopoly over the events business in the museum. If there is no convenient space in the museum for an outside caterer to set up a temporary field kitchen, then the museum – if it isn't careful – can find itself beholden to the contractor for a profitable events and corporate hire business. More on this later.

A museum's restaurant is also a fundamental part of the experience and there can be a desire for a restaurateur (rather than a faceless contractor) to integrate with the museum brand. I can think of one recent example where the operator was given excessive licence. The unwritten rule governing the relationship was that the operator had shown tremendous 'goodwill' in subordinating its well-known restaurant brand to the overall museum brand (for example, by allowing the museum to decide on the 'look and feel' and décor of the restaurant). But this isn't goodwill. This is nothing more than a relationship-specific investment in the museum's brand. It can be formally written into a contract in such a way that the museum does not then feel obliged to indulge every whim and folly of the operator.

In a museum context, some services and functions involve clearly independent assets. There is no reason why the museum should be any more productive by owning very high end ICT expertise, so it is more effective to have a regular maintenance and training contract rather than expensive ICT staff on the payroll.

Other areas are more ambiguous. Imagine again the relationship between a museum and its caterer. If the restaurant's and the museum's assets are completely independent, then the theory would suggest that they are better kept in separate ownership (for the reasons mentioned above). In this case, the museum is no more productive by being able to use the restaurant's kitchens, and the restaurant is no more productive through access to the museum galleries.

What happens, however, if there is only one kitchen in the building and the museum aspires to a lucrative events and corporate hire business? In this case, the museum could generate a significant amount of income, provided it can dictate how the restaurant kitchens are used and, in particular, by holding the events diary. Alternatively, the restaurant could be much more profitable if it could use the museum's galleries for events.

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Suddenly the assets don't seem so independent.

In this case, the theory suggests that the two assets are better held in common ownership with one of the actors holding residual rights of control over the assets of the other. Since a museum will never relinquish ownership of its galleries, the implication is that it should retain control over the kitchens.

Strictly speaking, it does not automatically follow that the museum should then run the restaurant, but it does shape the type of relationship the museum should have with the contractor. In this case, the museum should be sure to engage a contractor to provide a catering service. Control over the restaurant's assets should remain unambiguously with the museum. Too often museums will treat catering contractors as partners instead of tenants – especially if the contractor is expected to invest in the fit out of the restaurant – and engage in lengthy, costly and damaging territorial feuds. "This is your space, that space is ours". With clarity of ownership, control and management this would not happen.

Make or Buy? It Depends...

It probably has not escaped your attention that the theories described above can easily contradict each other. You should outsource the restaurant because it introduces competitive market incentives. But you should keep it in-house to ensure that relationship-specific investments are made. Or you should outsource it to put it in the hands of people more likely to invest time and effort into it. But you should keep it in-house to retain ownership and control...

What's the answer? In fact, the "make or buy" decision is one of those questions that economists love because the answer is always "it

depends". The purpose of this article is not to try and answer the question but to raise some of the issues that should inform the decision. These issues are well known to commercial and industrial organisations. There's a small army working in the City on 'mergers and acquisitions', which ultimately boils down to the application of complex formulae for determining who should own, control and manage which firm.

Locum's experience of cultural institutions, however, is that they still approach the question with naïve 'private sector good' / 'public sector bad' (or vice versa) pre-conceptions. Insufficient thought is given to whether or not a service should be outsourced in the first place. Too much weight is placed on what is traditionally done in museums, irrespective of what the particular circumstances of each individual museum may be. Where services are outsourced, not enough attention is paid to the principles of the contract, the structure of the relationship, or the incentives at play. Instead, the bare bones of an agreement are scratched out and the lawyers are brought in (far too soon) to iron out the details. If the principle of the agreement is weak then the devil will most certainly be in the detail.

It's about time that museums paid a bit more attention to the theory. Because you only need to talk to a museum manager landed with the unenviable task of making a bad contract work (they aren't hard to find) to know just how important it is. That's fact.