Staffing Managed Service Providers

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Abstract	3
Staffing Managed Service Provider	3
Contingent Staffing Economics	4
MSP Service Models	4
Rigged Game	6
Rigging the Game	7
Eliminate the Competition	8
Conclusion	9

Abstract

Staffing managed service providers are used by many companies to outsource the management of contingent worker programs, i.e., the employment of temporary independent contractors.

In such programs, one vendor, the managed service provider, is the master contractor paid to administer the program. It, in turn, manages a pool of subcontractors that are staffing agencies which perform the actual recruiting of the temporary independent contractors for the customer.

Relying upon a single master contractor, however, can have severe negative consequences for companies that outsource this function. Customers may find that they are paying more for labor than current market conditions warrant, and that they may not be obtaining the most qualified candidates available.

Advans has been engaged in IT consulting and staffing since 2005. This white paper summarizes Advans' direct experience in participating as a subcontract vendor in contingent worker programs outsourced to third parties, as well as interviews with the employees of other staffing firms, employees of these managed service providers and employees of companies that have engaged the services of staffing managed service providers.

The intent of this white paper is to provide a primer as to how these programs function, the role MSP's play, and to illustrate the unscrupulous business practices that are often used by staffing MSP's and their deleterious effects on their customers.

Staffing Managed Service Provider

A Staffing Managed Service Provider, ("MSP"), like any Managed Service Provider, utilizes on-site supervision or management of a function or department at a client (customer) site on an ongoing, indefinite basis. The goal of outsourcing this function is to obtain the best contractors at the best prices by having the MSP maintain a competitive marketplace of staffing firm subcontractors.

In such programs, the subcontracted staffing firms are only paid if a candidate they submit to the MSP is actually hired by the customer. By having a group of subcontracting staffing firms compete with each other to have their candidate hired, they will present the most qualified candidates they can find at the lowest possible prices so as to make their candidates more attractive than the candidates from competing firms.

The sales pitch used by MSP's is that customers should outsource the recruiting, hiring and payroll functions for contingent labor, as it is not a customer core competency. By doing so, the customer will improve the quality of its workers and lower its labor cost.

It is important to recognize that most of the firms providing staffing managed services, are themselves staffing agencies that generate the vast majority of their revenue recruiting employees and contractors for their customers. Administration of outsourced contingent worker programs represents only a small fraction of the firm's total revenue.

MSP's typically use a Vendor Management System, ("VMS") which is a software application and/or website to manage the recruiting and contractor on-boarding process. As compensation, the MSP will charge a fixed fee, called the "MSP Fee", which is usually between 2% and 5% of the total payroll invoiced by the customer for contingent workers.

Contingent Staffing Economics

Staffing agencies charge their customers a premium or markup to the amount paid to the independent contractor. A typical staffing agency markup ranges from 20% to 40% of the Bill Rate, i.e., the rate the customer is invoiced.

For example, a staffing firm may present, to its customer, a contractor at a "Bill Rate" of $100/hr. This is the amount the staffing agency will bill its customer for the contractor's time. The staffing agency may negotiate with the contractor, a "Pay Rate" of $75/hr. The staffing firm's compensation is the difference, i.e., $25/hr., known as the "Staffing Markup".

- Bill Rate — The hourly rate invoiced to the customer
- Pay Rate — The hourly rate paid to the consultant
- Staffing Markup — Difference between the Bill Rate and Pay Rate

For a contractor that bills 2000 hours annually, the customer will be invoiced for $200,000. Of that, $150,000 is paid to the consultant and the staffing agency's gross profit is $50,000.

MSP Service Models

In an outsourced contingent worker program, the MSP manages a group of staffing firms that source the candidates. These subcontracting staffing firms are usually referred to as "Preferred Vendors." Part of the MSP's responsibilities are to vet staffing agencies that apply for inclusion in the contingent worker program. Once admitted into the program, the MSP distributes customer job requirements to the Preferred Vendors, manages the interview, hiring and contractor on-boarding process, tracks contingent worker's billable hours, issues invoices, and measures the performance of the subcontracting vendors.

There are three models that MSP's use to manage the Preferred Vendors:

1. **Vendor Neutral** – the MSP does not provide candidates for any of its customer's requirements. Instead, only the Preferred Vendors supply candidates. The MSP manages the program and the Preferred Vendors, with its only compensation being the fixed MSP Fee.

2. **Hybrid** – the MSP will utilize subcontractors for sourcing candidates as well as provide candidates of their own. Again, MSP's are almost always staffing firms. If the MSP's candidate is placed in the role, the MSP pockets both the MSP Fee and the Staffing Markup.

3. **Single Source** – the MSP provides all the candidates and is paid the Staffing Markup. Generally there is no MSP Fee.

The Single Source model is not often used, because customers are afraid that a single vendor will be unable to provide the best possible candidates at the best possible prices. Also there is a clear conflict of interest. The more the MSP charges the customer, the more profit it makes. Since the customer is not receiving candidates from other firms, it is not in a position to assess what is a fair rate for each skill set.

This same conflict of interest also exists in Hybrid model programs. Because the Staffing Markup far exceeds MSP Fee, the temptation for the MSP is to direct most, if not all the hires or "fills" to itself. By using various tactics, see "Rigging the Game" below, the MSP can ensure that only the candidates it presents are hired.

Keep in mind, that in staffing MSP programs, the Preferred Vendors are barred from contacting any customer staff. MSP's do not provide contact information for hiring managers or other customer staff to the Preferred Vendors. Furthermore, as listed in the Preferred Vendor's contract, an attempt to contact any customer's staff person will result in removal from the program by the MSP.

As a result, the Vendor Neutral model is the most popular because, ostensibly, the MSP has no vested interest in any candidate. As it is prohibited from sourcing candidates, the MSP is only a neutral program administrator for which it receives a small percentage of the contingent program's cost.

By having a group of subcontractors, managed by the MSP, compete for each placement, the customer should obtain the best qualified candidates at the best prices available at that time. That's the Vendor Neutral sales pitch.

The reality is much different.

Rigged Game

There is a lot of money at stake. For marketing purposes, MSP's portray themselves as program administrators only, having completely separate business units for staffing and outsourced contingent worker managed services.

The MSP, which is a staffing agency, sees every single requirement of the customer, while internal workings of the program are not transparent to either the customer or the Preferred Vendors:

- The customer receives no pricing inputs from other vendors
- Preferred Vendors are not able to communicate with the end customer
- The only source of information for both the customer and the Preferred Vendors is the MSP

In Hybrid Staffing programs, the MSP's claim that their internal staffing group will be treated just like every other Preferred Vendor. Since it is being paid for its administrative function, it has no economic incentive to collude with its own staffing group. However, given disparity between the MSP Fee and the Staffing Markup, the financial incentive is obvious, (see, below).

MSP's in Vendor Neutral programs, are even more opaque.

In this case, the MSP includes, as one of the Preferred Vendors a firm with which it is affiliated. Often that firm is either a subsidiary of the MSP or the parent company of the MSP.

MSP's usually don't disclose this relationship, however, to their customers. The motivation to do this is obvious. In the example of a contractor with a $100/hr. Bill Rate, a Vendor Neutral MSP, may charge 2% of the invoiced amount as its MSP Fee. For 2000 annual billable hours, 2% of the $200,000 billed to the customer equates to a $4,000 MSP Fee. But the Staffing Markup, which is in this case $25/hr., is $50,000 annually.

Whether one of the Preferred Vendors is affiliated with the MSP or just a different business unit, they will want to secure that Staffing Markup for themselves.

This is why large staffing agencies operate their own MSP business units, so they can manipulate the sourcing process to earn both the MSP Fee and the Staffing Markup.

A 25% Staffing Markup is typical of what a smaller, unaffiliated staffing firms charge to be competitive. The big firms that own MSP's generally charge larger Staffing Markups because they have much more overhead, and they are in a position to obscure the current market rate.

Rigging the Game

Directing hires or fills to the candidates sourced by the affiliated Preferred Vendor or business unit is the MSP's goal, given the obvious economic incentive. To do so, the MSP restricts the flow of information between the Preferred Vendors and the customer by prohibiting any contact. Having done that, the MSP then is free to manipulate the Preferred Vendors.

After being vetted and admitted into the program, the MSP tracks various metrics to measure the performance of the subcontractors and will remove subcontractors it deems to be substandard.

These metrics, such as the percentage of requirements a vendor attempts, the number of candidates submitted, the number of interviews and the number of hires a subcontracting firm secures, among other metrics, are reported by the MSP to the customer.

By manipulating the process to distort the metrics, the MSP makes the affiliated Preferred Vendor or business unit the top performer among the Preferred Vendors while the making unaffiliated staffing firms look less capable.

There are a number of ways that the MSP's manipulate the Preferred Vendors:

1. The MSP limits the requirements that the unaffiliated subcontractors can view. By having access to only a subset of the total number of customer requirements, the subcontractor appears to be working on only some of the customer's requirements but not all. The vendor then seems to be unable or unwilling to provide candidates for all the skill sets the customer wants.

2. The MSP refuses to present candidates from subcontracting staffing vendors to the hiring managers.

3. The MSP takes candidates sourced by the Preferred Vendors and presents them to the client as candidates from the MSP's affiliated staffing firm.

4. The MSP delays scheduling interviews for candidates submitted by Preferred Vendors if a hiring manager has expressed an interest in the candidate's resume. Needing a job, the candidate eventually moves on to another position at a different company.

5. The MSP does not initiate background checks or other on-boarding activities if a hiring manager extends an offer to an unaffiliated vendor's candidate. Again, the candidate eventually moves on to another position at another company.

The result is that the customer loses the opportunity to hire the best candidate.

By having few, if any candidates interviewed, the subcontracting firm will appear to be submitting candidates poorly suited to the customer's roles. Alternatively, it may be construed that the subcontractor's candidates are overpriced and do not represent a good value to the customer. Either way, the metrics compiled by the MSP will indicate that the subcontractor is providing poor service.

Generally, subcontractors simply give up recruiting for these programs because their candidates don't obtain interviews or get hired. Even if a subcontracting vendor continues to submit candidates, given the above, the MSP eventually will remove the vendor for "poor performance."

Removed Preferred Vendors are replaced by new ones so that the roster of subcontractors is full, and the marketplace continues to appear competitive.

In a clever twist, the MSP will let an unaffiliated Preferred Vendor fill a position occasionally. Usually this happens when the affiliated firm can't actually find a candidate for a particular role. This is done to spread filled positions over a few vendors because it would be suspicious if all the requirements are filled by the same firm, and provides the appearance of a competitive marketplace. But the large majority of the hires are made to candidates from the affiliated firm or business unit.

Eliminate the Competition

MSP's will also terminate their contracts with unaffiliated Preferred Vendors if the MSP finds that they are capable of filling positions that the affiliated vendor has difficulty sourcing.

Anecdotally, Advans has been terminated from several of MSP programs, soon after filling a position. This has occurred even when Advans has been a Preferred Vendor for only a month or two and has few if any measurable performance metrics. The reason always cited by the MSP was "poor performance." So while Advans did get paid for the candidate that was hired, it may not participate in filling any future requirements.

Clearly, the MSP did not want the competition.

The downside for subcontract staffing firms such as Advans is that allocating recruiting resources to these contingent worker programs, costs money; recruiter's salaries, subscriptions to job sites, phone bills, etc. One or two fills each year are necessary just to break even. Again, a subcontractor is only paid if a candidate they present to the MSP gets hired.

If the MSP manipulates the process so that a Preferred Vendor rarely if ever has candidates hired, then the vendor is losing money participating in the program and will eventually give up trying to fill requirements.

Conclusion

The issues related here are not merely a recounting of unscrupulous business practices, however. There are very real negative consequences for MSP customers when their staffing marketplace is not a competitive one:

- The customer does not hire the most qualified candidate
- The customer pays more for labor than it should

MSP's go to great lengths to maintain the appearance of propriety in their programs. But since the MSP prohibits any contact between the Preferred Vendors and the customer, as well as being the only source of all vendor metrics and Bill Rates, the customer has no means of confirming the veracity of this information.

Having a "Black Box" contingent worker program provides ample opportunity for the MSP to charge higher Bill Rates than what an unaffiliated Preferred Vendor would charge in a competitive situation.

MSP's have been terminated by their customers after getting caught over-charging in this manner. Usually MSP's are discovered because the customer conducts a third-party review of their labor costs. But, it could be years before an MSP is caught, if ever. Bribery of customer employees by MSP's is sometimes involved in such cases.

This situation is so significant, that some companies with MSP's managing contingent worker programs will have managers that work directly with staffing firms outside of the program. Even though these firms are not a Preferred Vendor, because managers don't get qualified candidates from their MSP, these managers seek to circumvent the program.

Adequate MSP oversight is extremely difficult for most companies, however, because contingent labor staffing is not a core competency.

In Advans' experience, the best results usually occur when companies manage their own continent labor programs directly without outsourcing this function to an MSP.

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