



# Sanderson

WHITE PAPER

## INNOVATIONS IN CONTRACTOR SUPPLY

How to get the best out of your contractors  
*and* reduce the risk of accidental employment

This is the first of a series of white papers from Sanderson Recruitment. These are written for businesses that hire professional Limited Company contractors to help them meet the challenges of resourcing in 2006 and beyond.

Produced by:  
Sanderson Recruitment  
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“The UK has the most advanced freelance model in the world. 1 in 7 workers in the UK has chosen to work independently.”

source: Professional Contractors Group

“98.5% of businesses that use contractors engage them on time-based contracts.”

source: Sanderson 2006

‘We need to find methods which motivate quality delivery and protect against accidental employment.’

## The drive for new ways to engage professional contractors

UK businesses benefit from access to a highly skilled, highly mobile and flexible contractor workforce, in areas such as IT, consulting, HR and finance. Whether it is for a specific project, some particular expertise, or to meet a temporary peak in resource requirements, engaging contractors makes good business sense.

From the birth of contracting to the present day the accepted way to engage professional contract resource in the UK has been on time-based contracts. In a recent client survey Sanderson Recruitment found that 98.5% of businesses that use Limited Company contractors engage them on a fixed hourly or daily rate.

There will always be a place for this traditional method of engagement, but as UK businesses becomes more cost conscious and quality focused, hirers are looking for new ways to drive value from their contractors. Similarly, contractors seek new ways to prove their worth and differentiate themselves in today’s highly competitive market.

At the same time, recent legal challenges (where contractors have successfully claimed employment rights) and the Inland Revenue’s IR35 legislation have increased fears and uncertainty about the employment status of contractors. Businesses are looking to minimise the risk of accidental employment of contractors by bringing in measures that clearly differentiate between employed and self-employed status.

These pressures are driving a movement to change the way we engage and use professional contractors. ***This is an opportunity to raise standards and improve the way contracting is organised in the UK.*** Businesses, recruitment agencies and contractors must work together to design and implement new methods which reflect the true nature of contract work, much of which is project based and delivery focused.

This white paper details a range of new contractor supply options which are proven to motivate quality delivery and protect companies against accidental employment claims.

“Demand for IT contractors is at its highest since the dotcom boom.”

source: Giant Group, January 2006

## A brief history of contracting in the UK

### ***The birth of contracting***

The UK's freelance model has evolved over time. Beginning in the early 1970s, the term 'contractor' was coined when IT staff started to offer their skills on a freelance basis. Contractors operated on time-based contracts and many were engaged directly by their clients. As IT gained pace, recruitment agencies became more critical to source skills. Freelancers realised the advantages of personal service companies and the Limited Company contractor model was born. The model spread from IT to other professional sectors and has survived, largely unchanged through periods of boom and recession for nearly 30 years.

### ***Boom time Y2K***

The lead up to The Year 2000 and the Internet Boom heralded an explosion in contracting. Rates escalated rapidly, with many permanent staff transferring to contracting to capitalise on these increases. This influx changed the demographic of the UK contractor community significantly: many new contractors were poorly suited to professional contracting in both attitude and skill.

### ***The arrival of IR35***

At the same time, the Inland Revenue became concerned about tax avoidance by contractors operating through personal service companies. In 2000 it brought in its 'IR35' legislation. This targets 'disguised employees'; individuals working through personal service companies who, but for the tax advantages of using a Limited Company, would be an employee of the organisation they are working for. Many contractors on traditional time-based contracts are now caught in the IR35 net and taxed accordingly, lessening the financial incentive of contracting in the UK.

### ***The bubble bursts***

After 2000, the contracting bubble burst. With oversupply of contractors from Y2K projects, the demise of internet start ups, the increase in off-shoring, recession and lack of investment in IT, the freelance market went into decline. Between 2000 and 2002 there was a 20-30% decrease in contractor numbers, and also in rates.

'In 2006, forward thinking recruitment agencies are spearheading a drive to professionalise the contractor market.'

### ***The market picks up***

Only in the last two to three years has the market improved. With renewed investment in IT systems, contractor opportunities have increased steadily. In 2006, rates are on the rise again. Some reports are even predicting a return to the heady days of high demand witnessed at the end of the last century.

### ***A new drive for quality***

Today, UK businesses are more cost conscious and quality focused than ever. Many hirers realise that traditional engagement methods do not motivate optimum performance from their contractor base. Entrepreneurial contractors themselves seek new ways of proving their worth in a crowded market. Forward-thinking recruitment agencies are spearheading a drive to professionalise the contractor market and create new forms of contractor supply.

### ***Cable & Wireless and Mr P Muscat: the end of contracting as we know it?***

Businesses that use professional contractors are nervous. Fears of accidental employment of contract staff have mushroomed because of recent successful legal challenges.

On the 9th March 2006 the Court of Appeal found that Mr Muscat was an employee of C&W under an implied unwritten employment contract. Mr Muscat was a well paid professional IT contractor operating through a limited company and supplied via a recruitment agency. The supplying agency (at the request of C&W) terminated the contract and in response Mr Muscat filed a claim of unfair dismissal, arguing he had been an employee of C&W. He was awarded all the rights that go with employment status.

Whilst the circumstances of the Muscat case are unusual it has spawned confusion and uncertainty about the employment status of professional contractors. This ruling is fuelling fears that companies will witness increasing numbers of contractors claiming sickness pay, redundancy money and compensation for unfair dismissal.

'Traditional time-based contracts fail to make a clear distinction between the work of contractors and that of employees.'

"Hirers should review their hiring arrangements... Every aspect of the relationship should be reviewed to avoid the perception that an employment relationship exists."

source: Lawspeed, 2006

## Accidental employment and the law

The powerful judgement from the Muscat vs. Cable and Wireless case has serious ramifications for hirers of professional contractor resource. If a worker is treated as an employee it can be expected that he or she will want the benefits. Hirers must take notice if they want to protect themselves against such claims.

### **Case law tests of employment**

Whether a contractor is an employee or self-employed depends on whether he/she falls within the case law tests of employment. These take into account:

- **'Control'** - the degree of control which one party has over the other
- **'Integration'** - how well the individual is integrated into an organisation
- **'Financial Risk'** - the economic reality of the case - whether payment is a wage or salary or whether the relationship is a self-employed one
- **'Substitution'** - is there a right to send in someone else?
- **'Mutuality of Obligation'** - whether there are any mutual obligations to accept work or to provide it
- The **intention** of the parties
- The actual **terms** of the contract

### **The divide between employed and contract status**

Hirers of professional contractors need to make a clear divide between the nature of contract work and that of employees if they want to lower the risk of accidental employment. There are contractual solutions but having a written contract that expressly denies the existence of an employment relationship is not enough. Hirers must also look at the reality of the working relationship they have with their contractors.

The nature of this relationship is paramount:

1. If a client expects a contractor to be under their direction, supervision and control, and if the contractor is obliged to accept and act on all requests for work, is fully integrated into an organisation and unable to send a substitute this could be deemed an **employer/employee relationship** (*i.e. a contract of service*).

'We need methods which reflect the true nature of contract work, much of which is delivery focused and project based.'

'By focusing on defined deliverables, they help contractors to show their worth in a highly competitive market.'

2. If a contractor has reasonable autonomy in how services are carried out, remains independent when on site (e.g. follows separate policies to employees), takes some financial risk, can decline work, and has the right to send a substitute (provided the substitute is suitably qualified) then this is more of an **independent relationship** (*i.e. a contract for services*).

Traditional time-based contracts fail to make a clear distinction between the work of contractors and that of employees. We need to find new methods of engagement that make this distinction and reflect the nature of the work that professional contractors carry out, much of which is project based and/or delivery focused.

## A new range of *deliverable-based* solutions for contractors

UK businesses are working with forward thinking recruitment agencies to develop and implement a range of new options for hirers of contract resource.

These are designed to increase the quality of delivery whilst cutting the risk of accidental employment. By reflecting the true nature of contract work they drive the right behaviours from those managing contractors and from contractors themselves.

We have termed these '**deliverable-based**' solutions. They flow responsibility and ownership from the customer through the recruitment agency to the contractor, making the contractor more accountable for the success of a project.

These new methods are popular with professional contractors. By focusing on defined deliverables, they help contractors to show their worth in a highly competitive market. They also help contractors to prove to the Inland Revenue that they are truly self-employed and so escape the IR35 net and its tax penalties. We believe that increased use of deliverable-based contract solutions will help to encourage a new generation of professional business contractors focused on delivering results.

Case studies are included in Appendix A, showing how a number of UK businesses have benefited from bringing in these methods, both for engaging individual contractors and large contract teams.

## Deliverable based solutions

### 1. Fixed price contracts

**Overview of this method:**

- A contract is set up to reflect the delivery of a specific project
- Often with incentives built in for completing the project on time to the client's satisfaction
- Fixed price with payment due on successful project completion, or the completion of key milestones along the way

**When to use it:**

- For defined projects or pieces of work with clear deliverables and set timescales
- This method is effective for a team of contractors (see case study 1a on fixed price contracts) or for a single contractor (see case study 1b on deliverable-based contracts for an individual contractor).

**Benefits of this method:**

- Ease of cost management
- Incentives drive more performance from the contractors
- Motivated contractors focused on a deliverable and unlikely to be pulled into day to day client business
- Improved chance of project success in terms of quality delivery and timely project completion
- Low attrition rate of contractors as completion bonus motivates loyalty
- Popular with contractors
- Low risk of implied employment status of contractors working under the agreement, as it genuinely reflects a contract of services, rather than a contract of service
- Offsetting project risk to agency and contractor(s)

### 2. Full project teams on consolidated daily rates

**Overview of this method:**

- This is a contract for the delivery of contract resource for a project via a third party supplier/recruitment agency
- Blended/standard rate for all resource provided
- The client establishes a project plan and defines deliverables
- The supplier delivers resource at appropriate milestones in the project
- Resource is ramped up and down as required by the project

**When to use it:**

- For projects which require a varying amount of contract resource through the term of the project
- For organisations which require fixed costs for accurate projection – forecasting/planning

**Benefits of this method:**

- Flexibility to increase or decrease levels of resource through the project at a fixed rate
- Ease of cost management through fixed pricing
- No recruitment overhead for clients and rapid deployment of contract resource
- Focused resource with no 'wastage'
- Low risk of implied employment status of contractors

## 3. Unit Priced / Service Level based contracts

### **Overview of this method:**

- Fixed unit price for a task, level of service, process or product
- Contractors deliver against a work order for a number of units
- Delivery against tight service level agreements
- Can be conducted on or offsite

### **When to use it:**

- Relevant for well defined, repeatable tasks, services, processes or products
- Particularly relevant for support contracts, PC/Network based work

### **Benefits of this method:**

- Ease of cost management
- Keeps headcount and overheads low
- Service levels motivate quality delivery
- Service levels allow measurement of quality
- Low risk of implied employment status of contractors working under the agreement

## 4. Project delivery ownership

### **Overview of this method:**

- Similar to Fixed Price model but customer retains overall control of the project and forges close partnership with a third party supplier
- Third party supplier/recruitment agency partners with a customer to find and deliver resource for a project on a blended rate
- The supplier takes ownership of the provision of resource and the quality of the final deliverable
- The supplier operates to the client's brief so the client retains overall control of the project
- Staged payment against deliverable or fixed rates per day per head

### **When to use it:**

- Clients who wish to maintain control over a project but do not have internal resource available for delivery
- Clients who are considering using traditional consultancies for a project but have concerns over change control, cost and loss of control

### **Benefits of this method:**

- Control with minimal management overhead for the client
- Quality delivery
- Flexible resource
- Ease of cost management
- Frees up internal resource
- Shared risk (appropriate to deliverables) e.g. late payment penalties
- Low risk of implied employment status of contractors working under the agreement

See Appendices for case studies on each of the methods of engagement described above.

'Different business challenges benefit from different contractual solutions.'

## How to select and implement the most appropriate method of engagement

At present, most companies treat all contractor opportunities in the same way. As stated, Sanderson Recruitment discovered that 98.5% of companies engage contractors on a fixed hourly or daily rate.

In the face of the growing drive for quality and accidental employment fears, many commentators now question this 'catch-all' approach. Hirers of professional contractor resource are beginning to realise that different business challenges benefit from different contractual solutions.

Other industries have long recognised this distinction. In the **building trade**, where contractor use is well established, there are two accepted ways to engage skilled labour:

- **Example 1 – fixing a boiler:** the professional heating engineer is engaged on an hourly rate to complete the task – Time and Materials
- **Example 2 – building an extension:** the professional builder is engaged on a fixed price basis to deliver the project, often with a bonus attached if it is completed on time – Deliverable-based

In corporate business too, different challenges require different ways of engaging professional contractor support.

Hirers of contractors and their recruitment partners must work together. They should assess each contractor opportunity at an early stage so that they can select the most relevant method of engagement. The partner recruitment agency will then recruit and engage contractors accordingly.

### Tips for hirers of contract resource

1. Partner with a forward thinking contractor recruitment specialist
2. Draw up a range of contractor engagement options for your business
3. Seek legal advice when writing contracts
4. Analyse each contractor opportunity at an early stage
5. Select the most relevant method of engagement

The table below shows when to select traditional time-based or new deliverable-based contract options, and gives examples:

Contractual option	Relevant for:	Example
<b>Deliverable-based contract options</b>	Projects with clearly defined objectives and deliverables	<p><b>Scenario 1 – professional contractors to complete a defined project</b>  <i>e.g. Windows XP roll out – a company decides to bring in a team of professional contractors to complete the roll out.</i></p> <p>The business brings in a team of contractors to take full responsibility for a whole project. In these situations, <b>deliverable-based contracts</b> are relevant, as they motivate delivery of a defined piece of work. Change control processes become important.</p>
<b>Time-based contracts</b>	<p>Filling a resource gap - business as usual</p> <p>Analysis phase, where deliverables and milestones are yet to be defined</p> <p>Where functionality is continually added or removed</p>	<p><b>Scenario 2 – professional contractors to back fill a resource gap</b>  <i>e.g. Windows XP roll out – a company decides to second internal resource to complete the project, and back fill their day jobs with 'business as usual' contractors.</i></p> <p>The business brings in contractors to temporarily plug a resource gap. In this situation, often known as 'business as usual contracting'; <b>time-based contracts</b> are often the most relevant contractual option.</p>

'If we can get the balance between quality and risk right, UK businesses will continue to gain competitive advantage from a flexible professional workforce.'

'Sanderson: promoting project-based and delivery-focused engagement structures for contractors.'

## Conclusions

The risk of accidental employment is seen by many as a major threat to professional contracting. Whilst this is a serious issue for the contracting industry, it is also a real opportunity to change the face of contracting in the UK for the better.

A step change is needed in the way businesses engage professional contract resource. Agencies, employers and contractors must work together to find and implement new ways of organising contracting in this country.

***By accurately reflecting the delivery focus that is intrinsic for many professional contractors the methods described in this white paper will not only mitigate the risks of employment status, but also improve quality and control costs.***

If we can get the balance between quality and risk right, UK businesses will continue to gain competitive advantage from a flexible professional workforce. Greater use of project-based and delivery-focused engagement structures will improve quality of delivery and motivate a new generation of skilled, results focused, professional contractors.

## About Sanderson Recruitment

Sanderson Recruitment is a specialist recruitment consultancy, providing professional resource in IT, Human Resources and Finance to businesses across the UK since 1975.

Sanderson is the largest independent specialist recruitment business in the country. We are leading a drive to improve quality in the professional Limited Company contractor marketplace.

We advise our clients on all aspects of contractor and permanent recruitment and supply. Our in-house legal specialists advise on issues relating to employment status, and have designed a full package of measures to help organisations using contractors reduce the risk of accidental employment.

### ***Find out more***

For more information and a free assessment of your current contractor engagement methods, contact Sanderson Recruitment on 0117 9706666 or email: [mail@sandersonplc.com](mailto:mail@sandersonplc.com)

## **Appendix A - Case studies**

Case studies are included below showing how UK businesses have tried and tested these new contractor engagement structures in partnership with Sanderson Recruitment:

### 1.a: Fixed price contracts

#### ***A case study showing how a Fixed Price arrangement motivated a team of contractors***

##### ***The Challenge:***

A department of a well-known UK retail bank needed to install a new technology infrastructure. They had operated a static infrastructure state for a number of years and had no internal expertise in the new technology or of such a large implementation. They looked for outside assistance at the start of the project to assess the scope of the work required.

##### ***The Solution:***

They brought in a team of contractors from Sanderson to carry out a fact find and feasibility study over six weeks. This was a distinct project with clear deliverables. Sanderson's team of technical consultants worked to deliver a feasibility report and project plan.

Sanderson took the project on a fixed price basis, paid on successful delivery. This helped the client with cost control and forecasting. Sanderson engaged their team on a reduced daily rate with a substantial bonus for successful and timely project completion. Sanderson owned the deliverable and managed the team to successful project conclusion.

##### ***The Results:***

This fixed price arrangement was an attractive proposition to both client and contractors. The client got a well-motivated team fully focused on the task in hand. Contractors liked this focus and felt a high degree of ownership for the project, often working 12 hours a day to get the job done. When recruiting the team, Sanderson found that this approach caught the attention of a number of highly skilled and entrepreneurial contractors. Consequently, the client had access to first class resource.

There was no risk of accidental employment of contractors working under this method, as their terms were clearly different from those of employees. Contractors did not fall under the IR35 umbrella. The team completed the feasibility study on time and the client accepted the business case. The total cost of the project was 50% less than quoted by large service providers.

## Case study

### 1.b: Deliverable-based contracts for an individual contractor

***A case study showing how deliverable-based contracts work for individual contractors as well as teams.***

***The Challenge:***

The shared services department of a financial services company needed a project manager for a technical architecture project. They had already scoped the project and structured it in 3 phases over 3 months. It was to be delivered using internal resource, but they needed experienced external resource to drive the project. The client offered the arrangement with a 10% tolerance on cost.

***The Solution:***

Sanderson found a skilled project manager who matched the client's requirements. They engaged him on a 3 month contract to deliver the project. They paid him a fixed daily rate with a 10% bonus for the successful delivery of each of the 3 project milestones, based on delivery acceptance. They built in change control mechanisms, for example, if the project terminated, the bonus would be paid pro rata.

***The Results:***

This arrangement was very popular with the client because it passed off some of the risk of delivery to Sanderson and the contractor. The way the contract was set up meant that the contractor knew exactly what was expected of him and focused him 100% on the task. The client felt that this improved the value that they got from their contractor. The client could easily measure performance, and the risk of accidental employment was minimised.

## Case study

### 2: Full project teams on consolidated daily rates

***A case study showing how a client benefited from flexible resource on a blended rate.***

***The Challenge:***

One of the UK's largest insurance businesses was under pressure to resource a major infrastructure project. They had only a short time to get a team up and running. Their technology department was under pressure to use an incumbent consultancy to resource this project: either a management consultancy or an offshore supplier. However, there were problems with both options (the high cost associated with consultancy resource and the long lead times associated with the offshore option). They engaged Sanderson to provide quality contract resource. This option meant lower costs than with a traditional consultancy and also ensured rapid deployment.

Timescales were short. The traditional recruitment cycle, where the client takes responsibility for recruitment decisions, was not feasible due to the time and effort it takes to sift CVs, interview, select and negotiate. Sanderson took full responsibility and recruited a 25-person team in 2 weeks.

***The Solution:***

Sanderson proposed a consolidated fixed daily rate to supply all resource on the project, taking full responsibility for selection and replacement of resource as required. This blended rate made it easy for the client to plan and forecast project costs. Sanderson guaranteed resource (with replacement free of charge), and gave the client the right of refusal if dissatisfied with any contractor in the first week.

This meant that the client could easily flex the team up and down to meet the needs of the project. If the project changed direction and required a different type of resource Sanderson provided this at the same daily rate.

***The Results:***

Sanderson delivered the project team to time and to budget, with an attrition rate of less than 3%. The customer had the burden of recruitment removed from their shoulders, and the fixed daily rate was 20% less than the closest competitive bid from a service provider.

The client benefited from the ability to cost manage, the speed of deployment, focused resource with no 'wastage', and minimal time overhead in managing the team. Again, the risk of accidental employment was minimised because of the nature of the contract.

## Case study

### 3: Unit Priced / Service Level based contracts

***A case study showing how a service provider outsourced a repetitive task to a team of contractors.***

***The Challenge:***

As part of their offering, a technical service provider to schools and colleges had to distribute new applications to their customers. To avoid disruption to day-to-day client work, these tasks peaked in the summer holiday period. Each application had to be tailored/package for the individual customer. This was monotonous, time consuming and repetitive work for an over-stretched technical team. Deadlines were often missed as they had to take on these peaks of demand as well as continue their day jobs.

***The Solution:***

This service provider engaged Sanderson to find and manage a team of technical contractors to take on the tailoring, packaging and distribution of the new applications. Sanderson worked with the client to establish an appropriate price per unit.

Sanderson brought in a team of contractors, each engaged on a unit-priced basis (per package) and operating to a strict Service Level Agreement. This method ensured that the contractors remained focused on achieving the output that the client required.

***The Results:***

This approach enabled the service provider to sell more packages and increase its profits. It freed up the internal team to find new clients and to handle increased demand.

The contractor team often worked 12 hour days with no impact on quality (it is very unusual to see this work rate in a daily paid contractor). This performance-based method of engagement gave the contractors a genuine incentive to work harder. The customer was delighted. This was the first time that packaging projects, which were notoriously problematic, were consistently delivered on time. The contractors enjoyed the project – they felt part of a team with a distinct role, and liked the freedom the set up gave to manage their own workload and work on or off site.

As above, issues with IR35 and accidental employment were mitigated via this approach.

## Case study

### 4: Project delivery ownership

***A case study showing how a partnership arrangement gave a client visibility and control over a project.***

***The Challenge:***

A Financial Services organisation had scoped a large programme of work (1300 man-days) for a full technical upgrade. The project sponsor had completed a project plan and high-level technical design, but had no available internal resource to complete the work. He was keen to retain full visibility and control of the project, and was reluctant to outsource this to a traditional service provider.

***The Solution:***

Sanderson offered an innovative partnership arrangement. Working through the client's internal Programme Manager, they took full ownership for the quality and availability of contract resource to deliver the project. Sanderson's resource was contracted for specific deliverables, with all contractors charged at the same blended rate, irrespective of level of skill.

Sanderson flowed down this arrangement to their contractors. Each was engaged for a specific deliverable at a given standard, with a bonus attached to focus them on successful project completion.

***The Results:***

Sanderson's contractors delivered the project on time with no unexpected system downtime. This arrangement gave the client the benefit of guaranteed resource, guaranteed quality and guaranteed price, whilst retaining visibility and control throughout the project because of the partnership mentality that this method engenders.

This was a popular approach for contractors too. It professionalised what they were doing. They felt a real sense of ownership for the deliverables and enjoyed consulting and performing as a team.

As before, this approach removed any issues with IR35 or accidental employment.

Sanderson - helping UK businesses to get the balance right

