HOUSE OF COMMONS

Public Administration and Constitutional Affairs Committee

Oral evidence: Sourcing public services: lessons to be learned from the collapse of Carillion, HC 748

Tuesday 13 March 2018

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Watch the meeting

Members present: Mr Bernard Jenkin (Chair); Mr Marcus Fysh; Dame Cheryl Gillan; Kelvin Hopkins; Dr Rupa Huq; Mr David Jones; David Morris.

Questions 238-392

Witnesses

I: Michael King, Local Government Ombudsman; Nigel Kletz, Chair, National Advisory Group for Local Government Procurement; and David Simmonds, Conservative leader, Local Government Association.

II: Kerry Hallard, President, Global Sourcing Association; and George McFarlane, Confederation of British Industry.

Written evidence from witnesses:

– Local Government Ombudsman

Examination of witnesses

I: Michael King, Local Government Ombudsman; Nigel Kletz, Chair, National Advisory Group for Local Government Procurement; and David Simmonds, Conservative leader, Local Government Association.

Q238 **Chair:** I welcome this panel to our first session this morning on sourcing and outsourcing of public services and the lessons to be learned from the collapse of Carillion. Would each of our panel identify themselves for the record, please?

David Simmonds: My name is David Simmonds. I am a councillor in the London Borough of Hillingdon and I am the leader of the Conservatives at the Local Government Association.

Nigel Kletz: My name is Nigel Kletz. I am the Director of Commissioning and Procurement from Birmingham City Council and I am also the Chair of the National Advisory Group for Local Government Procurement.

Michael King: I am Michael King. I am the Local Government and Social Care Ombudsman for England.

Q239 **Chair:** Thank you for joining us. We are going to try to ask rather short questions and it is terribly helpful if you could keep your answers as crisp as possible. I may have to pull up you or my colleagues if any of us go on for too long.

Could you say, first of all, what the extent is of commercially contracting out of services in local government in terms of its value and significance?

David Simmonds: I can give you a very brief rundown. We know total public sector spend is around £187 billion and about half is contracted out services. The local government figure is around £55 billion per year on externally procured goods, works and services. To give a rough idea, the two biggest elements of that by far are construction, which is things like road maintenance, highways and buildings such as schools, care homes, that sort of thing, which is around £20 billion, and then health and social care. That is everything from foster care placements, children's homes, adult social care placements and is around £18 billion a year. Another significant element of that includes things like waste, corporate services, legal advice, finance advice and that kind of thing. There is quite a lot on technology, ICT, both the provision of systems and physical goods, hardware, cabling and that sort of thing.

Nigel Kletz: I will give a specific Birmingham angle on that as a snapshot. We have a council budget of about £3 billion and our external spend is £1.1 billion. That is not all outsourced, some of it is procured services, but the major types of services that we have outsourced are our

ICT contract, our highways maintenance and management contract, waste disposal, parks, general grounds maintenance, repair and maintenance of council houses as well as general buildings and care homes. Our public health contracts are outsourced often to other parts of the public sector but they are not delivered. Our children's services, through a trust that will go live next month, are wholly owned companies outsourced. It is not all to the private sector; much is to the public sector or other elements of that.

Michael King: Echoing that in the experience of the public through the lens of complaints, when I joined the Ombudsman Service 14 years ago it was relatively infrequent that outsourcing would be a feature of our investigations. There are very few areas now where we do not see some sort of externalisation of contracts being a feature of our investigation. One of the big dimensions of that that I would highlight is there has been a lot of focus on high-value capital contracts. Where we see the impact of outsourcing is on day-to-day complex personal services, such as school transport, adult social care, services for children with special educational needs. It is very much in the direct delivery of services to the public.

Q240 **Chair:** Perhaps more for Councillor Simmonds and Nigel Kletz, what do you think the advantages are from outsourcing?

David Simmonds: The trend towards outsourcing started with compulsory competitive tendering two or three decades ago and councils initially found significant financial savings to be achieved through an outsourcing process because it tested for the first time the cost of doing things against what the market could provide.

What we have seen since those days is that procurement and tendering commercial skills in the public sector have improved significantly. I would say, as a councillor in a Conservative authority that is not a big outsourcer, that it has particularly provided us with a good sense of what the base cost is of providing a particular service. There have been a number of examples where over time we have outsourced a service, we have learnt from that experience and then we have brought it back in-house for them to deliver it directly but at significantly lower cost, while achieving some of the wider objectives. In particular, there is an element of flexibility that is not always there with outsourced contracts.

The primary driver is to achieve a lower-cost service, especially for those things that are not within the core skills that we have in the public sector, to access capacity in the market that adds value. There are lots of examples of that such as advocacy services for vulnerable children. Think about the personal services that Michael referred to—for people who are accessing adult social care, and adults with learning disability needs. Being able to provide that through either private or third sector organisations that have expertise and a relationship with those residents is a way of improving the quality of the service that they get and potentially doing it significantly more efficiently from the council's point of view.

I think we should be clear that the main advantage has been to achieve the delivery of a service to a particular standard at a lower cost than we have been able to achieve in-house.

Nigel Kletz: I think there are some that complement that as well. Predominantly the main advantage is you get access to expertise that you do not have in-house. You may not have particular expertise and good practices and innovation. The market may be much more innovative or have better experience of delivering services. There is also a sense of scale and that scale can drive better value. It is often cheaper to do it and that can be driven through the expertise the supply market has or the fact that they are doing this for many other people not just for an individual council or a group of individual councils.

Often if it is not strategically important for a council to run a service. The elements of corporate strategy and determining what is outsourced and what is not and managing that is core to keep in-house, but the delivery and the operational aspect of delivering a service can often be delivered to a spec much more effectively.

A key element over the recent years is about applying social value. Procurement is a huge lever for building local social value and local wealth in communities. Through procurement you can require social value or deliver social value, economic, financial, environmental, and it is an aspect of all of our contracts, whether required or not, to do that.

There is also a sense of being able to define the outcomes that you are looking for, procuring to that and let the provider determine how the service is done. We say, "This is what we want as an outcome". We may talk about risks later, but some risks, such as the delivery risk and the financial risk, can be put to the supplier to do. Operationally there are fewer procurement restrictions. If you go to the market to deliver services, you procure that in a regulated way. The supply market has greater freedom in how they provide that. There is also the ability for the market to put investment into services. Often they have easier access to funds as well. Those are some of the advantages.

Q241 **Chair:** Access to private finance, yes, I understand that one. On operational freedom, are there some restrictions that apply to insource services that we should be getting rid of?

David Simmonds: I will give you a bit of a political answer to that. I think, certainly in the early days of CCT, a lot of the concern was around—

Chair: By that you mean compulsory competitive tendering?

David Simmonds: Yes. A lot of the concerns that were expressed in Parliament were about unionised workforces with very specific sets of—

Q242 **Chair:** That is not a regulatory issue, is it?

David Simmonds: That is not a regulatory issue.

Chair: No. I was asking about regulatory issues.

David Simmonds: Some of that will be interpreted.

Q243 **Chair:** What are the regulatory issues that encourage outsourcing that are perhaps artificial?

Nigel Kletz: People still have to deliver to regulatory standards or deliver to the law in doing that, so not all the services that we do are—it is defined in regulation as to how it is delivered. It gives the market freedom as long as legal standards or regulatory standards are met. An example is that we outsource our building regulation management aspect and that can be done more effectively and it allows us to deliver to third parties as well through a wholly owned company in that example.

Q244 **Chair:** Of course an insourced service is not allowed to contract with the private sector—

Nigel Kletz: There are limitations on that, yes. They are not—

Q245 **Chair:** That is fine. I think we have to live with that but what other regulatory constraints are there on what can be insourced or the flexibility of an insourced service?

Nigel Kletz: The example I was giving was of freedom in that procurement. When we award a contract, the supplier will put their own supply chain in place and therefore create a freedom. They do not have to follow the procurement contract regulations.

Q246 **Chair:** I see. The public procurement contract regulations make the organisation of a supply chain to an insource service much more cumbersome and bureaucratic. Is that what you are saying?

Nigel Kletz: Yes.

Chair: That is very interesting.

Nigel Kletz: If we outsource something then the provider has a greater freedom in—

Q247 **Chair:** Would it be constructive if we made a recommendation to suggest that we relax some of the procurement rules in order that there is a level playing field between insource services and outsource services in their supply chains?

Nigel Kletz: I think it would be certainly worth exploring that in greater detail.

Q248 **Chair:** I would be interested if either of you could give us something in writing on that. You also talked about how useful it is to use key performance indicators and making an external contract more accountable. Is that correct? Have I understood that correctly? Why can you not do an internal contract with an internal service provider and be equally open and publish key performance indicators about an internal service?

David Simmonds: I think the same approach would apply equally to both.

Q249 **Chair:** But what is your experience? How often do people publish the key performance indicators of an internally provided service?

David Simmonds: Quite frequently, in my experience.

Nigel Kletz: Yes, we do that all the time. We have KPIs and our performance standards internally. They are monitored monthly or quarterly, depending what they are.

Q250 **Chair:** Some contractors complain that when they are competing with an insource service it is not a level playing field because the producer interests tend to suppress the bad news coming out of an insource service. KPIs are much more rigorously and openly applied to an external service. What is your experience of that comparison?

David Simmonds: I would say from personal experience that tends to be something that works both ways. The insource provider will claim it is the outsource contractor's fault and the outsource contractor will say it is the insource provider's fault. It is the job of local political leaders and senior managers and local authorities to cut through—

Q251 **Chair:** As a rule the KPIs should be applied equally and as a—

David Simmonds: They are. They are visible—

Nigel Kletz: When you are deciding on a split service where some is supplied internally and some is supplied externally through the market, you should measure and procure it with equal balance. Legally you have to do that. With contract management, that is the way it should be done. We have quite rigorous performance management internally and KPIs with our contractors as well.

Q252 **Chair:** The other parts of your answer were about cost and innovation, you can acquire skills and capacity and innovative solutions from the private sector that you do not have in-house. How fair is it to say that the whole point of contracting out is really about acquiring innovation?

Nigel Kletz: It is a key driver. It is definitely a key driver. Often the supply market can be cheaper. That can be because of innovation or not and it largely depends on the maturity of the market. A mature, fully developed market might not necessarily have the scope for innovation but something that maybe has the opportunity for technical development or doing things differently—

Q253 **Chair:** Councillor Simmonds, I will take it that you agree with that.

David Simmonds: I do. I think if—

Chair: If it is one word it is yes. We will press on.

David Simmonds: It is worth adding that the other big factor is the peaks and troughs in public sector spend. There is no value for the taxpayer in maintaining a large public sector, direct labour organisation to build schools at a time when the number of children in the country is falling. At the moment the number of children in the country is growing rapidly so we are all busy paying contractors to build schools for us. At the time when population growth begins to trail off we would not want to find ourselves with a huge population of bricklayers and—

Q254 **Chair:** On the other hand, we are discovering that there is quite an advantage of insourcing your provision of school meals because you get consistency and loyalty from staff and a relationship that is less transactional and more personal. Why is that kind of relationship not available through a private contract?

David Simmonds: I would say from my experience it is and there are many private contractors who do that to a very high standard. If we look at something simple like bins. Bins are generally the most highly rated council service in any local authority in the country. Here in Westminster it is entirely outsourced but the contracted staff who work for a private sector company are regarded with as much affection and as being as responsive to the customer as the in-house bin staff that we employ in Hillingdon who do the same job. It is something that is not related to the nature of the organisation that they work for. It is to do with the management—

Q255 **Chair:** You are a Conservative authority in Hillingdon?

David Simmonds: We are, yes.

Q256 **Chair:** You do not outsource your bin collection?

David Simmonds: No. We employ those staff.

Chair: Some people think it is a religious—

David Simmonds: We have said to them very clearly we want a rise in customer satisfaction every year and we get it.

Q257 **Chair:** Are you some kind of crypto-socialist in disguise?

Dr Rupa Huq: It is something that a west London borough does and it is a Labour authority and their rubbish, the private company has—

Chair: I am joking about this, but of course this is not a religion any more. It is about practicalities and it is about what works in different circumstances.

David Simmonds: Yes. The question is: what is the capacity of the local market; what is the capacity of your in-house workforce; what is the capacity of your management; what is the available resource to provide for it? If you can provide a good service, there is no religious reason, theological reason, why it should be outsourced or should be done in-house. It is not one size fits all.

Q258 **Chair:** Is there any reason to doubt that an outsourced service and their employees should be not regarded equally as servants of the public as an insource contract?

David Simmonds: You would find in many councils that you would not know the difference. If you came to Hillingdon you would not know whether the person you see sweeping the street is an employee of the local authority or an employee of an agency that has been contracted to provide additional staffing capacity. Their job is the same; their line management is the same; the outfit, the livery they wear is the same; and the service standard is the same.

Q259 **Chair:** The other issue about cost is that after 30 years from compulsory and competitive tendering to modern outsourcing practices where everything is, "Let's outsource this and save some money", surely we have reached the end of the road of the idea that you just save money by contracting out.

Nigel Kletz: I think a lot of it is down to the specification of what you are buying. The majority of savings come by the specification, adding in the spec or reducing the spec. If you can do it more efficiently, if you can maybe cluster a few services together and deliver them more locally—

Q260 **Chair:** I suppose I am making a different point. How good an indicator of the quality of the contract is the price?

David Simmonds: It can be quite significant and I think the thing that is not constant is the innovation element. The market is responding. There are firms that are springing up who are offering services that simply were not there 12 months ago, five years ago, 10 years ago. The initial days of compulsory competitive tendering tended to focus on big obvious local authority services but there are small practices springing up that process householder planning applications that did not exist 10, 15, 20 years ago. That is all they do and they do it to a very good standard and very consistently. Many authorities are now outsourcing elements of the work to those kind of specialists.

Q261 **Chair:** How legitimate is it for public authorities to outsource decision-making by public authorities? Are you not—

Nigel Kletz: I do not really see how—I think the decision-making is of strategic importance that has to be retained in-house.

Q262 **Chair:** Yes, but when outsourcing planning applications surely you are outsourcing decision-making.

Nigel Kletz: That will be within a framework.

David Simmonds: It is not necessarily the decision that is outsourced. You are looking at the processing, somebody sending the paperwork, submitting it against the criteria and writing a report that then goes for a decision to be made. Of course there are many things and I can give you the example. We have national offer day for school places and each individual local authority has a legal obligation, going back to 1944, to offer a school place to every child in its local area who wants one. It is done through a London-wide system and effectively outsourced to a collectively owned body that makes the decision. For example, an academy school, which is the decision-maker for its own offers, gives the criteria that it applies to the local authority and says, "You make the decision on the application against the criteria that we have set". There is a huge grey area around many of those processes.

Q263 **Chair:** How often have you seen a local authority or the public suffer for the local authority's decision to take the lowest bid instead of the best bid?

Michael King: Perhaps I could talk about the accountability point here. One of the concerns we have from looking at complaints in this area is that all too often the golden thread of accountability between the member of the public who is receiving the service or the decision is broken. When that functions perfectly it is fantastic but when something goes wrong there is sometimes confusion about who is responsible for putting it right, even how you can make a complaint, and certainly we see examples all the time where the learning from complaints is not escalated back to the council. People's ability to complain to an independent body is masked by the arrangements and sometimes that is not for any ill will. It is just that the arrangements are so complex and so unfamiliar to the public that I think sometimes the traditional accountability mechanisms are not there. Sometimes there is a very different culture in those bodies than there is in the local authority itself. Certainly there is a concern for us about the loss of accountability.

Q264 **Chair:** Forgive me for pressing this question again. How often do you think the public have paid the price for a local authority buying the cheapest contract instead of perhaps the contract that would provide that service?

Nigel Kletz: I am not sure I can quantify how often but the lowest price, or even the most expensive price, is not always the best or worst bid. We evaluate—

Q265 **Chair:** Can you give an example of where you have gone for a higher price?

Nigel Kletz: We evaluate on the basis of quality, social value and price. Those are the three factors we consider and we—

Q266 **Chair:** Can you give an example of a contract that you have let to a more expensive bidder?

David Simmonds: I can. Security is one example of that. We have security contracts in my authority that provide staff to manage interactions with the public at housing benefit offices, libraries, other places where there have been security concerns. That is not the only one. There are many others such as food, meals on wheels, where the quality element of the consideration means that the cheapest bid is not the best bid and that is quite normal practice within procurement regulations.

Q267 **Chair:** Mr Kletz, I can see you racking your brains trying to think of a good example.

Nigel Kletz: I could separately provide a list.

Chair: Please do.

Nigel Kletz: We make decisions, many a day or many a week, on individual procurements and it is quite often the case that it is not purely the lowest price and in fact it would not be right. We often disqualify bidders if we think their price is too low. It is either predatory or we do not think there is sufficient value in their price for them to be able to sustain it, so we risk assess it on that. I will not name the bidders, but I will give some examples separately of where we have awarded against the lower price.

Chair: That would be very useful.

Nigel Kletz: We have also, for example, had occasions where the social value element, which might be only 10% or 15%, has been the determining value in deciding on the allocation of bidders where suppliers can support the local economy or provide some form of social value. It is a blend and each procurement is decided on the mix of social value, quality and price. Price is important but it is by far not the only value.

Q268 **Chair:** Does the concept of best value that is embedded in the legislation, I think since the late 1990s, work? How well does it work?

Nigel Kletz: It is most economically advantageous and part of that is not purely price. It is evaluating the quality elements that we determine when we go to market and the social value element through the Social Value Act. It is not just price. There are some procurements that are just based on price, typically commodity-based things where there is a very clear specification, but any service element has a quality of delivery and quality of management that is going to deliver that.

Q269 **Dame Cheryl Gillan:** Do you include locality? I know my own district council, Chiltern District Council try to encourage local suppliers.

Nigel Kletz: We cannot evaluate purely on the basis of their locality but when we look at social value we look at what they are going to do through the local economy. How many jobs will they create? How will they buy locally? What will they do with local community groups, partnerships, schools, things like that. We cannot legally purely choose a Birmingham supplier but we can encourage that through the social value element or some of the quality elements of that.

David Simmonds: The Social Value Act underpins that, so there is scope for considering those points.

Q270 **Dame Cheryl Gillan:** No, I appreciate you cannot discriminate but it is an important factor surely.

David Simmonds: Yes. Simple, practical things, such as a question of if the supplier is located a long way away and may not have the capacity to respond in an emergency, might be an example of a quality consideration that a local authority would apply.

Chair: The French are rather good at that.

Q271 **Mr Marcus Fysh:** To follow on from what you have just been saying about the different criteria that you use to evaluate, I am trying to get more of an idea as to how you assess when you need to make a decision about whether to outsource or insource. Does it makes a difference how long you are letting the contracts for and, to come back to Cheryl's point, what the geographical scope is? One of the things that I experienced when I was a county councillor was that, for example, to go back to the timeline issues, we had a contract that we had let with a highways manager but it had been let right in the teeth of the recession, so it was very cheap. It was a long cycle that they found very hard to deliver over the course of the signing because it was just too cheap. Then in other situations there were big packages of work let for the whole area, whereas maybe it would have been better to split that up into smaller areas. How do you look at those sorts of issues when you are looking at your criteria of when you choose to outsource or insource?

David Simmonds: Those things are generally a combination of political leadership in the local authority and the managerial leadership that is provided by your senior officials. I think points like duration are significant. If we look at things like recycling and what has happened over the last six or seven years, the value on the secondary market of a lot of recycled materials has fluctuated because of the changes in the price of oil. Six or seven years ago, when Hillingdon outsourced the processing of recycling, we had a whole set of bidders who wanted to buy it from us. When we last retendered that process the question was how much were we going to pay the bidder to take it away and process it because of the shift in the value of those materials.

There are risks that one needs to manage and I think you have highlighted a good one. If the contract is absolutely nailed down to a very cheap price the risk is that the supplier goes out of business. We have seen a number of examples in the field of adult social care where that has become a very much live issue. It is always a balance for the market that is responding. If you are a care home provider, one of the reasons why local authority rates fall and beds are lower is because the local authority will take a block contract. If you are the owner of a 60-bed care home and the local authority will commit to pay for 40 of those for 12 months or two years or five years, that provides you with your base income and you expect to make your profit by selling the additional beds on an ad hoc basis to meet the further 20 beds.

The relative value and the cost of doing those things in the market will determine the nature of the bids that come forward. If you get the management of that right then—am I a crypto-socialist? I do believe saving taxpayers' money is a general beneficial thing and it is a big driver for local councils. If you can reduce the cost of that and run it efficiently that will produce the kind of outcome that you have just described.

Q272 **Kelvin Hopkins:** Does that not suggest the accusation that has been made is correct—that private self-finances in care homes are subsidising the public sector?

David Simmonds: They are, in many cases, providing the profit element for the care home owner because—

Kelvin Hopkins: They are subsidising the private.

David Simmonds: I think subsidy is possibly going a bit far. If you know what the fixed costs for running your care home are at a certain level and that your variable costs relating to those numbers of beds are covered by the contract that you have with the local authority, you are entering into a contract knowing that that will provide for the stability of your business. You expect to make your money, the cash in your back pocket, from selling the additional beds at the prevailing market rate to the people who need them from time to time.

Q273 **Kelvin Hopkins:** Would it not be equitable and fair to have a standard cost for a bed, whether it is in the private sector or it is paid for by the local authority?

David Simmonds: There is often a fundamental difference between what is happening. Where the local authority says, "We will block all of those 40 beds and we will pay for them for the duration of the five-year contract", whether we happen to have placed somebody in them in that particular week or that particular month or not we will get a cheaper price from that supplier than when they are selling to one individual who is saying, "I want a specific combination of services and I want them for this specific period of time and I want to be able to buy them on an ad hoc basis". That is consistent market behaviour across a very wide range of goods and services. There is an equity question about it but that is how the market operates at the moment.

Nigel Kletz: To pick up on your question earlier, we go through what we describe as a commissioning process before we make any decisions. That goes through two phases: largely what is it that we want; what are the outcomes that we want to achieve; what is the service we want to deliver to our citizens or to whoever the target audience is; who else is doing that; what is the available budget; what are our options on delivery? Those options could be: we do it ourselves, we go to the market, we do it jointly or we set up some entity to do that. Once we have done that we start to shape the specification. That is through market consultation.

Part of the determining factor of how long a contract will be is: what is the level of market investment? If the market needs to invest massively in that a three- or four-year contract might not be the best idea. It might be better to do it over 10 years. Once you go over 10 you are seriously thinking about the way technology or the service might move on and your ability to have flexibility over that period of time.

Very generally, every category of contract is very different but there is a series of criteria and we have guidelines and toolkits that help our people, both the commissioners within the service and our procurement people, to work out the specification, engage with the market, do some benchmarking, look at what other people are doing and opportunities for innovation in that. It is a flexible process in the pre-procurement stage, once you are shaping that, and then you can go to the market with an offer that is competitive.

Q274 **Mr Marcus Fysh:** It sounds like a very dynamic process when it is done well.

Nigel Kletz: Done properly, yes.

Q275 **Mr Marcus Fysh:** How would you characterise, in your experience, whether local government has the right amount of capacity of that type of expertise? Dynamic contract management and market analysis and recommissioning is a pretty specialised skillset, is it not?

Nigel Kletz: Part of the work that we do on the National Advisory Group for Local Government Procurement with the LGA is about addressing those capability gaps and identifying the skills that are needed, both defining them and doing some programmes to improve that. We have commissioned some work to build professional capabilities within the industry and there are programmes that run nationally. We do a lot of work regionally, across West Midlands, as well as locally within my team. I think the answer is that it is probably mixed. I think within a lot of the larger top tier counties there is good capability in place. There is probably not the depth because there is generally a shortage of good quality procurement capability and probably less capability exists in districts. It is a continual thing. We are continually recruiting and it is not always easy to find good capability so we tend to grow some of our own and build capability.

If you have the right interpersonal and commercial skills and attitude, you can learn the procurement techniques and then you can learn some of the category knowledge and depth of that. I think it is having the right interpersonal skills. It is one of the key priorities of the current national procurement strategy that we have developed with the LGA—we are developing version 2—and capability is one of the predominant requirements.

Chair: We are going very slowly and I gather one of you wanted to leave at 11.00 am. We will have to go much faster. Have you finished?

Q276 **Mr Marcus Fysh:** I would like to move on to question 5, if that is all right. It is going to flow straight on from there and then we can come back, because it is sort of related. Who ends up being accountable and, therefore, holds the risks for the delivery of these outsourced public services in that environment?

Chair: One sentence each.

David Simmonds: You can buy the skills in the market to make sure that that sits with a provider. Carillion, which I know is the topic today, it is Southern Cross, Connaught, Jarvis; we have a lot of experience of dealing with provider failure, including within the sector. I think you have seen the contract. We manage that in one or two ways: either there is a built-in contingency plan that says, "This is how the local authority will insource it, do it itself", because we have a statutory duty to do it anyway and make sure it happens, or through the procurement of the contract through wages—

Q277 **Chair:** Who is accountable? Let me press the question; it was a "who" question.

David Simmonds: Ultimately, the local authority is always accountable because they are the ones with the statutory duty to do whatever it is they are procuring for.

Nigel Kletz: I agree. We can outsource some of the risks of delivery but ultimately the citizen looks to us and the council is accountable for the delivery.

Michael King: It is absolutely clear, and the law is absolutely clear that the council can outsource the service but it cannot outsource its responsibilities and all too often that link has been lost in the complaints that we look at.

Q278 **Kelvin Hopkins:** I was worried about risk and whether risk has ever shifted from the public sector when it is the public service. Is it just not true that risk is never shifted from the public sector and when things go wrong the public have to pick up the pieces?

David Simmonds: I think both Nigel and I have been absolutely clear and the backstop position is always the local authority. We are the ones who have that duty, but the delivery risk can certainly be shifted and in practice we have seen lots of examples. Let us say you let a contract for the building of schools and they need to be open for a certain time. "Come back next year" is not an acceptable answer when your child needs a school place. One of the contractors is struggling to fit the fire doors on time or whatever it may be and then the contractor, at its own expense, at its own risk, needs to get a different subcontractor to come along and do that work. Where you have an outsource provider who has experience of doing that in all sorts of different settings that certainly shifts a significant risk burden that would otherwise be borne by potentially quite stretched local authority management.

Nigel Kletz: Yes. I would say it is a mixture and it is a negotiable element. The balance of risks within a contract can be negotiated with a supplier, certainly if you are going through a more complex competitive dialogue or negotiation type procurement, and you pay for it. If you want to shift more of the risk to the supplier you will end up paying for that. If you want to take more of the risk as the council you will end up paying a lower price. Again, it is case by case.

Some of the financial risk and delivery risk can be with the supplier but ultimately if the supplier fails and you do not have mitigations or contingencies in place the risk comes back to the council. For day-to-day operational delivery you can shift the risk and anxiety to the supply chain to do that and that is what they are there to do. That is what they are there—

Q279 **Chair:** Do you have examples of where the local authority thinks it has transferred the risk or thinks it has offloaded the risk, which it has not offloaded or it cannot offload, or a contractor takes on a risk that it cannot possibly control, like a regulatory risk?

Nigel Kletz: We are aware of that. I could not necessarily say that every council captures all of them but we have to go in eyes open understanding the balance of risks within a contract and who is accountable for what—

Q280 **Chair:** How do you stop your contracting authorities putting stupid bits into the contract to force companies to take on risks they cannot control?

Nigel Kletz: I suppose that is judgment and experience of what it is that we are wanting to procure and the cost elements of that. If you are giving the supplier too much risk they will have to insure that and they will insure that through—

Q281 **Chair:** What regulates the framework where people are making these decisions on behalf of local authorities? How do you create that framework of expectations that they are transferring the right kind of risks?

David Simmonds: There is due process on both sides. Both sides in that particular debate will have their lawyers, their accountants and so on crawling over whatever the contract is and then it would tend to be a matter of degree. Sometimes it will be quite explicit in the contract where the liability sits, and I think we are seeing some interesting consequences of that going on at the moment with things like housing, where there is a problem with it—

Q282 **Chair:** Okay, but where is it written down about what kind of risks you will expect your local authority to transfer and what kind of risk you expect them to keep in-house?

David Simmonds: I do not think there is any "written" requirement that says this is how is meant to be.

Q283 **Chair:** Where does the answer to that come from then?

David Simmonds: It would be dealt with through the process of procuring the contract. The local authority has its own procurement standing orders that would cover what it is seeking to do. The procurement process would then set out what the elements were that were inconsistent with each contract—

Q284 **Chair:** This sounds rather hotchpot and trial and error, but surely there is a good practice guide or something.

Nigel Kletz: It is built upon experience. We procure contracts and we procure £1 billion a year and we set the risk level for each aspect. In most contracts it is rarely an issue. In some contracts it is a negotiable element that you will explore with the supplier what the transfer of risks will be but in the vast majority—

Q285 **Dame Cheryl Gillan:** Chiltern District Council has a risk management strategy, which sets it at the beginning and the cabinet is responsible for that. Surely most local authorities have that.

David Simmonds: Risk management is absolutely part and parcel of that. I do not think that quite answers the question from the Chair, which is about where would it be written down what the transfer of risk in an individual contract would be. Nigel is right, if you are contracting for the provision of diesel for council bin lorries the risk issues will be slightly different from if you are contracting for assessments for children with high-end special educational needs or disabilities. The contracts will specify a different approach in order to manage those risks appropriately, which may well include—and I go back to the planning example from earlier on—that the decision-making, aside from the processing of the application or the transaction, will fall back to somebody within the local authority so that the risk can be assessed by a professional in each individual case, but it is a matter of degree. It depends on what it is that is being—

Dame Cheryl Gillan: Yes, a district council is different to a county council.

Q286 **Chair:** It sounds as though you rely on the innate experience and common sense of people letting contracts, which suggests that there is an unwritten code of conduct about how you conduct contracting in local government that is perhaps much more developed than in some Government Departments.

David Simmonds: There is quite extensive Cabinet Office stuff relating back to when Lord Maude, Francis Maude, was the Cabinet Office Minister with a particular focus on this, which, for most of us in local authorities, probably came a little bit after the expertise that had been built up over the previous 20 or so years. Government centrally has sought to improve their own procurement and to pass on the learning from that to other parts of the public sector including councils.

Q287 **Chair:** What do you think central government could learn from risk management in local authorities?

David Simmonds: The main thing I would highlight is that local government has a very long and extremely good track record in dealing with supplier failure. It does happen from time to time for a variety of different reasons. That list, Southern Cross, Connaught, Jarvis; it comes back to your question, Chair: how many people have suffered as a consequence of supplier failure? I think what we see in those examples is local authorities that step in very swiftly and ensure that the situation is managed either, in some cases, by a TUPE transfer, they just shift the whole service back in-house, or in others by making sure that a different contractor picks up—

Chair: We will come to contractor failure later. Let us move on to PFI.

Q288 **Mr David Jones:** Councillor Simmonds mentioned skill building a few moments ago. Historically PFI has been quite popular for the construction of skills and other items of local infrastructure. Why was it so popular? Why did so many local authorities opt to use it?

David Simmonds: Government at the time had a view—I think we are going back to the later years under John Major—that private finance structured in this way would sit outside of public sector debt and, therefore, it was a way of spending on capital projects principally in the public sector without that forming part of central government expenditure. I think there are question marks over whether that was the case but that was the route that was used. We have been very clear from housing to education particularly—a condition of that resourcing being made available by central government to fulfil the statutory obligations that are placed on local authorities was usually that that finance was accessed through PFI. It was not so much that local authorities thought, "Shall we do it ourselves or shall we do it through PFI?" It was a case of, "We need £200 million to build these schools and we can get it by that route and it is not available by any other means". I think that was the reason. It was not so much a wholehearted enthusiasm for PFI but it was the only available game in town.

I am speaking as a council. We had some very early school PFI projects where from the end user's point of view it can be a good thing in that in many of those early contracts it was not the end user that met the day-to-day running costs for the building that they were in but under the contract they had a guarantee that it would be well maintained. If you were a head teacher of a PFI school at least you knew that if the light bulbs needed fixing or the computers broke or whatever somebody would come and fix them straightaway, which would not necessarily be the experience in schools that were managed in a different way.

Q289 **Mr David Jones:** Taken as a whole, what is your view of PFI as a method of constructing infrastructure for local authorities?

David Simmonds: It has been troublesome. There is no question about that. Jarvis is a good example of an early provider of PFI projects that went out of business, which then tangled up local authorities. They have been trying to unravel who were the lessors, who were the lenders, because often those things had been seen as investments being sold on to different parts of the market and getting things moved to a position where the end user has clarity about what is happening with their building can be quite challenging.

The big challenge for me, and I speak as a Conservative, is that we should always look for the most efficient way of doing this. I can appreciate there is a view in Government of keeping the size of public expenditure to the minimum. The experience that seems to come back is that PFI on the whole is more expensive than doing it through traditional borrowing, and certainly if we look at the shift that is happening in Government I think that bears that out. Expansion of schools, which is a big-ticket item, is mostly funded by a combination of local authority borrowing at Public Works Loan Board rates, a Government grant that they ultimately borrowed on the markets and then section 106 contributions that come from developers. The experience seems to be that that is a cheaper way of doing it than having a PFI contract.

Q290 **Mr David Jones:** Mr Kletz, would you like to add to that?

Nigel Kletz: To give a local perspective, we have two areas, Birmingham City Council, where we have had PFIs. One was in schools, three rounds, the third one being the Building Schools for the Future initiative, and then in 2010 we had a 25-year highways maintenance and management contract for PFI. They are two very different aspects, but the PFI element was a major investment over five years to improve the quality of the schools. The advantage was that it does give you access to those kind of PFI grants, certainly on the highways element, that we would not otherwise get, so there is a lot of additional Government money coming into that.

The major challenge is that they are complex to manage. Any contract over 25 years things need to change; it is inevitable that what you set out to do will need to change. That is complex because you do not just have the main contracting parties, but you have a series of banks, you have the Government and there are other aspects that mean changing or particularly trying to drive savings in there, which has been a key drive, is really difficult to achieve just because of the complex contractual arrangements, not just us and the primary contractor or the special purpose vehicle we set up. That has been the primary experience that we have had since then. We have not put in place any new PFI arrangements since 2010.

Q291 **Mr David Jones:** I was about to ask you that. To what extent are local authorities generally using a PFI or successors such as PF2?

Nigel Kletz: I personally am not aware of them. It is not something that is in the dialogue of any of our procurement dialogues either nationally or regionally. I do not hear of them. It does not mean that they are not taking place or they are not in existence, unless they are called something very different. There are different ways of structuring contracts and getting investments, and of course local government borrowing is relatively cheap, so often it is better for us to source things.

Q292 **Mr David Jones:** The cost of borrowing in fact militates against the use of PFI?

Nigel Kletz: And the complexity of the contract and, as Councillor Simmonds says, the cost of the transactional element of that as well, setting it up and the change management. It is not something that we regularly think about. We might consider setting up other special purpose vehicles, wholly-owned companies, joint ventures. They are a different game, but PFIs is not something that has been on our council's agenda since 2010.

Q293 **Chair:** Do you draw a distinction between what people call PFI and PFI2?

David Simmonds: In a very technical sense I suppose they are similar. They are based upon accessing private markets borrowing.

Q294 **Chair:** What is the substantive difference in your mind?

David Simmonds: The thing that seems to have shifted is around the contracts management. Nigel is absolutely bang on, it is mainly in the NHS that we are seeing those projects floating around. Local authorities do not use those as a matter of routine.

Q295 **Chair:** Is that because of the borrowing costs?

David Simmonds: Yes.

Nigel Kletz: I am afraid I am not familiar with PFI2.

Chair: Interesting that it has not touched local authorities.

Nigel Kletz: It has not touched our local authority or at least has not touched me in our local authority. I cannot speak more broadly, I am afraid.

Q296 **Dr Rupa Huq:** The question I wanted to ask is to Michael King and it relates to your written evidence. But it did occur to me in the discussion earlier about transferring this risk on that the one contract the London Borough of Ealing had was for its libraries but they did not sign that with Carillion, it was with Laing, the builders, and then when they went under they got subsumed into Carillion. There does feel like a lack of transparency sometimes when these small things get swallowed up. They did not know.

Michael King: Absolutely, and on that point about the transfer of responsibility, I think sometimes it is an illusion that there has been a real transfer. Local authorities remain responsible for the delivery of their statutory functions, whether they are delivered in-house by the third sector or by the private sector. Sometimes this concept that risk and responsibility have been transferred can lead to a dislocation where the local authority think that it is no longer responsible for that and maybe the external partner is not sufficiently connected back into the system, so you get a break in accountability. I think sometimes that is an illusion.

Q297 **Dr Rupa Huq:** Yes, there is a gap there. The question I had for you is in your written evidence you said that, "This inquiry gives us the opportunity to reconcile the requirement for transparency, accountability and redress with contracted-out services". How do you operationalise such a grand thing? How do you think this can be done?

Michael King: I suppose it comes back to the issue of how do you manage risk? You have quite a creative and innovative selection of different means by which you deliver services. Where that goes wrong, what drives failure in this area, is often where there is unclear responsibility, people do not know who is responsible for what, where perhaps when things go wrong the local authority just act as a post box. They do not take the learning from complaints, they just simply pass on concerns, or where sometimes when a local authority gets complaints about a service they just have a blind acceptance of what they are told by their contractor, rather than exercising third-party oversight.

Our point of view on this is that where we see it working well is where the public voice is hardwired into the procurement process. In the contract itself arrangements for learning from mistakes and learning from public feedback will be written in. Also complaint systems will be written into the contract, so it will be absolutely clear if somebody has a problem with that service what role the contractor will play and what role the local authority will play, and there will be a clear line of escalation so that the local authority learns from any customer feedback. Also, the people will not lose their right to come to an independent body like ourselves and, as the example you gave, the people will know if they come to a library in Ealing, whether it is run by Carillion or whether it is run by the local authority, they still have exactly the same rights to raise a complaint with the local authority and ultimately with us as they would have if the authority was delivering that service themselves.

We have seen that sometimes in services where some local authorities are very good at doing this. We were talking about bin services earlier on and I can remember a complaint we dealt with last year where it was a fairly routine matter about a contractor missing bin collections month after month. Sometimes those complaints are badly handled by the contractor, they are not escalated properly. In this case the local authority realised that they could use that as a trigger to look at failings in the contract more widely that were causing them a problem. They took the whole matter through a scrutiny committee and the scrutiny committee looked at how that contract was being managed. On the back of that an action plan was agreed with the contractor to improve the services as a whole. The key point for us is that by putting the public voice in the heart of that procurement process is a very good way of managing not just a risk of wider collapse but it gives you a barometer of the health of the contract and the contractor. Complaints in that way can be a canary in the coal mine about problems that are happening in that area.

Q298 **Dame Cheryl Gillan:** The National Audit Office identified that the increasing trend to larger contractors could bring economies of scale, but of course it reduces the competitive nature of the market and also possibly reduces innovation. How concentrated do you think the market is currently for outsourcing local services and projects?

David Simmonds: It is very clear in buying value that there are five very large suppliers that the public sector, local government is quite dependent upon for a very wide variety of things, and not necessarily things that we associate with the company. BT is a very big supplier. It is a public fact that that is the case, but it has also dipped a toe in the water of contract management and various other things over the years. There are also quite a lot of providers who are not necessarily strictly private sector. The NHS has been mentioned and public health procurement responsibilities.

There are a lot of contracts, including contracts that have previously been let by the NHS that have novated over to local authorities, that have brought with them their own sets of challenges. Those are for things like vaccination programmes, sexual health, smoking; all sorts of different stuff that local authorities have a statutory duty to do. There are companies like Bupa, who may be subcontractors of NHS bodies, that may be delivering individual services as well. It is clear that the market has become more concentrated and firms like Carillion, Capita, Interserve, Serco, G4S have grown by acquiring, by and large, other smaller businesses that specialised in some particular activity from prison guarding through to school meals and moving those things together into conglomerates.

Nigel Kletz: One of the aspects of this is what we do to try to counter that. We had some recent analysis done of our local spend and what happens to that, and from the £1.1 billion spend I mentioned earlier 45% of that is with SMEs, small and medium-sized organisations. We have a key focus and a key drive to share our spend where possible with SMEs and of course with local suppliers. We found that around 68% of it is with local or locally branched organisations, Birmingham-based and slightly bigger if you go for the West Midlands. Our key driver is to try to engage a broader market at the pre-procurement stage, through market days, consulting the local markets to try to stimulate interest, and supporting smaller organisations or local organisations to try to bid for opportunities.

The procurement contract regulations have elements about breaking down lots in procurement, so you do not just cluster it up into one big organisation. We are currently coming to the end of a large 15-year contract with one ICT company that was mentioned earlier. Our re-procurement strategy is to break that down into smaller procurement groupings, either bring some in-house or break it down into smaller lots, so that we will have a more diverse supply market to try to counter that. There is quite a lot we can do to try to counter that. There are some markets where it is more predominant. Construction is an obvious one, but even there you get very complex and very detailed supply chains, so you might have Carillion or former Carillion people who are primary contractors, but they have diverse and broad supply chains around that. While it is concentrated at the top in some areas, there is the opportunity and a lot more that we are doing and will continue to do. We have a lot of local political pressure and, to my mind, that is a positive challenge for us to do that.

Michael King: If I could pick up on a linked point, I do not think market distortions only arise from the dominance of a small number of suppliers. With my Social Care Ombudsman hat on, I think a lot of social care providers would say there is a significant market distortion from local authorities acting as a dominant purchaser. That in itself creates a different form of market distortion. Going back to the comment earlier about what the results in terms of the difference between self-funders and local authority-funded care, we did a report recently on somebody who was paying about £400 as a council-funded resident. That tripled to £1,200 overnight, exactly the same care, just because they had moved from one funding status to another. That is another matter for another day, but there is certainly a distortion in the social care market arising from the fact that you have one principal purchaser.

Q299 **Dame Cheryl Gillan:** Just to check on leading contractors: Capita, Serco, G4S, BT, Virgin, and Interserve?

David Simmonds: They are the big ones.

Q300 **Chair:** How do you balance the risk of letting a larger number of smaller contracts to letting one big contract, and what are the advantages and disadvantages?

Nigel Kletz: The advantage of one is consolidation of spend, so you might get efficiencies of spend. The advantage of several is you are managing the risk of supplier breakdown.

Q301 **Chair:** Do you get more competition if you let smaller contracts?

Nigel Kletz: You can do, and that is really down to our lot structure. Quite often we split our contracts for a lot of services; housing repair and maintenance is a good example. We split it into four quadrants of the city and we tendered against those—just because of the nature of the city, one of them was much smaller—in the hope that we would get SMEs bidding for that. In the end we got larger contractors bidding and looked at the mix of the different quadrants in order to award that differently.

Again it depends what you are procuring. Of course if you split it too much then the cost of managing five suppliers instead of one supplier is disproportionate. We have not really talked about the contract management costs and the importance of investing in contract management in order to make sure you get the contract value that you are procuring, which is a critical element.

Again, it is very much category or commodity procurement determined as to whether you go for one or more. We are seeing, I suppose, a trend to try to break that down. We are re-procuring—and it is a public report to our cabinet—our waste disposal contract and we are looking at six lots instead of one big lot in the future, just because we do not want all our eggs in one basket. You get more competition and different specialisms as well. Quite often if you have one big contractor they cannot deliver all of that, so they will subcontract elements barely touching it and you end up with additional layers of management and overheads in there. It is about understanding the market and understanding what you are doing, and that is the skill of the procurement professional commissioner and the service manager to do that.

Q302 **Dame Cheryl Gillan:** Can I come back on something that Mr King said about the dominant procurer? Does that mean that the trend towards unitary authorities also could be contributing to a lack of competition?

Michael King: I do not want to speak on behalf of social care providers but many of them come to me expressing concerns that they are effectively given a price by the local authority based on what the local authority can afford, rather than being a contract negotiation about what would be the cost of that care. That effectively means that they do not have a great deal of choice, just one purchaser for their product, and there is not much of a negotiation about what the cost of that is. I have seen examples in recent years where some social care providers have handed back contracts for home care and residential care because they simply say they cannot provide the quality of care and the standard of care for the price that is being dictated to them.

Q303 **Dame Cheryl Gillan:** Moving to unitary authorities can drive down the standard that is offered in the community?

Michael King: I am not sure that would necessarily create a significant difference. Where you have two-tier authorities the social care procurement would be done by the top tier authority anyway. In the case of social care, I do not think that creating a unitary authority would have a significant difference and it would be the county council anyway procuring that service.

David Simmonds: To be clear, the combined authorities that are under discussion with Government do not have social care responsibilities. It is something they potentially could bid for in the future, but none of them do.

Q304 **Dame Cheryl Gillan:** That was the whole point. If you went for a combined authority as opposed to a unitary authority, you would be creating a slightly smaller unit than a unitary authority but still something that was capable of much more accurate procurement, and potentially the right standard and quality of procurement, because it is not this great leviathan dominating the market.

Nigel Kletz: As part of what we call "category strategies" we look at whether the supply market is local, regional or national and whether we should procure something on that basis. One example of a national supply market is energy. There are a small number of providers and we look at that on a very national basis. For other things we may look across our West Midlands region or we may look locally or sub-locally where it is down to particular wards and neighbourhoods. It really is case-by-case and experience and guidance. Through that we have another series of national procurement strategies and national category strategies that we worked with the LGA on that give advice and guidance on those specific areas.

Dame Cheryl Gillan: I should perhaps declare an interest because there has been a minded-to decision on Buckinghamshire to turn it into a unitary authority, just yesterday in fact, whereas the other alternative was a South Bucks and Chiltern District Council combined and I will put that on the register.

Q305 **Kelvin Hopkins:** Mr Simmonds and Mr Kletz, how significant was Carillion as a contractor for local government in terms of the value of the contracts you had and the significance of those contracts for local services?

David Simmonds: There were 450 public sector contracts with Carillion, of which 350 were either local authority or NHS for partnership things. There were 30 councils across the country who were directly affected by the collapse of the company on contracts relating to a variety of different things. In addition to that there are 220 schools in total, of which 150 were local authority maintained and the remaining 70 were special schools or academies. In all cases essentially what has happened is that the local authority has stepped in either to resolve the issue directly or to engage with the contractor about what will happen to that contract because another part of a consortium is due to pick it up.

Q306 **Kelvin Hopkins:** It would be interesting to know how much foresight they had about the collapse of Carillion. What contingency planning did local government undertake with the Government for Carillion's collapse before January this year?

David Simmonds: The LGA has been in touch about Carillion since last July. There have been a number of things that have been going on relating to their share price performance, and just general gossip in the market really, about what was happening with the business. Throughout that process there has been sharing of what local knowledge is coming up to the LGA and also what Government were aware of, in order to manage the situation. That might have been a rescue of the company and going on to a better future, which was what they were talking about at one stage very publicly, or what has transpired, which is collapse.

Nigel Kletz: I can give you some real case studies of the impact with our own contracts and in Birmingham as well. I would almost put them into three categories. There were those contracts that we had directly with Carillion, and at the time we had only two contracts with them for various aspects of repair and maintenance, electrical testing and Legionella testing. We received good intelligence from the Cabinet Office, the Crown Commercial Service and through the LGA of the profit warnings and risk to this. We were in dialogue with directors of Carillion directly about that and we put contingency actions in place. Luckily, in those situations it was one of those contracts I described earlier where we had regional north and south contracts. We were able to ready the alternative suppliers to take that on board and we did that in the autumn through the advice and advance warning that we had. Cometh the day we were able to transfer staff and transfer work quite easily with minimum disruption and minimum loss of jobs to the people concerned. That was a bit of foresight and a bit of advance notice that we had.

One of the other examples is not a council contract but activities within the city. There is a major redevelopment taking place in the centre of Birmingham and Carillion was the prime contractor for that. The council is not the contracting authority but it is a partner in that. In a sense, because of the supply chain and tiered supply chains, we were able to go or the contracting body authority were able to go directly to the second tier. After a short delay, continuity of supply was able to be maintained.

Q307 **Kelvin Hopkins:** In a sense, you saw a long way ahead that there might be problems with Carillion?

Nigel Kletz: We were advised that that was the case. The third element, and probably the more pressing element, is the impact locally on jobs and apprenticeships and local organisations. With Carillion being a West Midlands-based organisation in Birmingham, a West Midlands group and a Birmingham group task forces have been set up. I had a briefing from the Birmingham task force that met yesterday and, interestingly, the majority of apprenticeships have been picked up and transferred into other roles locally. They are targeting and supporting displaced apprenticeships, redundant employees, supporting local businesses. What they are finding is in a general sense—and there are some statistics available—most of those people have been able to land other apprentice roles or other jobs. In the situations where there are creditors of Carillion who have not been able to be paid there is support from local banks to try to extend credit facilities.

Q308 **Kelvin Hopkins:** What advice did the Cabinet Office request from local government about contracts with Carillion? It seems that the Cabinet Office did not want to know about the real difficulties and were hoping against hope that it would all turn out okay.

Nigel Kletz: There was a broadcast message about the difficulties and prepare to take contingencies. Once it failed, we had requests from the Cabinet Office on what our contractual arrangements were and what we were doing about that. The DfE asked what schools had been impacted, where they had a direct contract, and we provided information to the LGA, who compiled that. That was after the event, to find out what we were doing. It was almost too late to help then, but we had had that advance information and we do get briefings. Briefings are available from the Cabinet Office on what they call their watchlist of suppliers. I think it is just pulling together public information. There is no inside secrets, but it is pulling together public information.

Q309 **Kelvin Hopkins:** That is effectively my next question. We recently had before us the Chief Executive of Carillion and he said he thought that the Cabinet Office found it, in his terms, quite challenging to draw together all the public sector entities involved in Carillion's collapse. Does this fit with your experience?

Nigel Kletz: I cannot speak for central government at all. Bear in mind there is 300 or 400 local authorities and we are all separate, autonomous contracting bodies. We do look at spend with common suppliers and try to work that through relationship management bodies. Some of the other organisations that have had profit warnings recently we have met through the LGA to try to co-ordinate responses and share information. Inevitably, when you have 300 or 400 contracting organisations in local authorities, let alone health and all the central government, it is not just one big body that can naturally do that. Maybe there is some kind of database or sharing or improvement that we can do on that. There is the role of the Crown Representative and we have spoken recently to Crown Representatives on other contracts, other companies not relating to Carillion, to share information. We are exploring, as part of our national procurement strategy, how we can share information better between local authorities. The scale of it is naturally going to give us a challenge.

Q310 **Kelvin Hopkins:** Someone somewhere must have thought this was going to happen and quietly said, "Prepare for the worst because it's going to be serious problems for everybody"?

Nigel Kletz: Well, the profit warnings. Carillion gave their own profit warnings, as have other organisations recently. Therefore, we act on that information.

Q311 **Mr David Jones:** Mr Kletz, as part of your due diligence procedures what sort of information do you use on prospective suppliers and where do you obtain that information from?

Nigel Kletz: As part of the supplier qualification stage at the start of a procurement, we go out to market and people submit an interest. As part of our supplier qualification we will look at the financial viability of the organisations that are bidding and we are not able to, through the procurement contract regulations, disqualify people on finances alone, but we can see warning signs on that. That is maybe something that we need to look at if we want to improve our contract regulations.

Q312 **Mr David Jones:** What sources generally would you use to obtain that information?

Nigel Kletz: We would be getting information directly from the organisations and we can look at what publicly available information there is through Companies House, although that is out of date often, and other sources.

Q313 **Mr David Jones:** Are there no database that you can access to obtain this sort of information?

Nigel Kletz: Public sector databases?

Mr David Jones: Yes.

Nigel Kletz: There are credit agencies but they do not necessarily benefit from being fully transparent. They have their own mechanisms for calculating that, and if we were to base procurement decisions significantly—

Q314 **Mr David Jones:** Is there one consistent method that you could access to obtain this information?

Nigel Kletz: To get financial information? There is publicly available information from the companies and there is what the companies submit themselves on that. If it is a particularly long procurement, the financial situation may have changed from the point at which they bid to the point at the end, and so we can reserve the right to look at that. There is a kind of self-declaration, part of PCR15, Procurement Contract Regulations 15. It is a self-declaration, so suppliers self-declare what their information is and we look and validate the winning bidder on the presumption of accuracy and truth, if you like.

Q315 **Mr David Jones:** Councils similar to you have given us an indication of the level of public sector exposure to Carillion. Are you able to say how many contracts were awarded after Carillion issued its first profit warning in July last year?

David Simmonds: The LGA is aware of only one. That was after advice was taken, a discussion was had and essentially the same situation applied in central government. There was a view that to stop a contract being awarded, that had been won under due process, would probably be unlawful but also potentially would put the viability of the business at risk. Government at that time were trying to assess the scale of the issue across Carillion, which clearly was a very complex business with lots and lots of different bits doing all sorts of different things on different scales. That is the only one that I am aware of.

Q316 **Mr David Jones:** You were having a conversation with Government at the time that it would be unlawful to exclude Carillion. How did you feel about that?

David Simmonds: It was not my local authority that was involved with it directly, so I cannot comment on the specifics.

Q317 **Mr David Jones:** More generally, how do you feel about that you are precluded from excluding it in that situation?

David Simmonds: From personal experience, there are a number of different ways of managing that situation. One of those particularly is that when a procurement process is undertaken it may well be some time before the final legalities are concluded after a procurement decision has been made. Clearly, if new information comes to light that calls that decision into question, as a local authority you would need to reflect on the magnitude of that and whether it was sufficient that you needed to consider whether you could, in all good faith, award that contract at that point.

Q318 **Mr David Jones:** There were, of course, two profit warnings in the case of Carillion. According to evidence we have had, the Government was advising that it would still be unlawful to exclude Carillion. Mr Kletz, do you have any view about that?

Nigel Kletz: That is the Procurement Contract Regulations, so they need to change or reflect that.

Q319 **Mr David Jones:** Do you think the regulations are wrong?

Nigel Kletz: We would have to explore further or there would have to be a piece of work done as to exactly at what point you could exclude somebody from a contract. If you have a dispute with someone, if there is significant failure, there are rights for exclusion within the regulations. They are laid out; financial aspects as per Carillion were not. Maybe that limit needs to change.

Q320 **Mr David Jones:** Is it fair to say that you think those regulations should at the very least be reviewed?

Nigel Kletz: I think it would be useful to review that aspect of them.

Q321 **Mr David Jones:** Would you agree, Councillor Simmonds?

David Simmonds: Yes. I do think, in fairness, there is a chicken and egg question. If you were a business that felt that your winning of a particular contract was going to restore your profitability and commercial viability and you were denied it on the basis that there were concerns about your viability, you might have a legitimate grievance, particularly if you felt you had been taken through every stage of due process and you had earned the right to win that contract. That element of fairness to all sides clearly does need to be taken into account.

Q322 **Mr David Jones:** The Minister told the House that its policy was to ensure continuity of services on the ground. Is it your experience that that continuity was provided?

David Simmonds: Yes.

Q323 **Dame Cheryl Gillan:** Were you involved at all in discussions about what should happen to Carillion's public sector contracts? Do you think that the Government have the right powers when dealing with a company with public sector contracts that has gone into liquidation like Carillion?

Nigel Kletz: We were advised of the issues and were advised to prepare some mitigations. We had dialogue, when they were in liquidation, with PwC about continuity of supply. They were constructive and helpful, trying to help us to ensure continuity. We did not have discussions directly with Government at that stage but, as I have indicated, our contracts were not the largest and most significant and we had mitigations in place. We were not in need of help, but I can only speak for myself rather than more broadly.

Q324 **Dame Cheryl Gillan:** Do you have a broader knowledge, Mr King?

Michael King: No, not particularly. I do not think many of the Carillion contracts have impacted on the public that relates to us. I think that may be one of the distinctions worth drawing in learning lessons from this event. Many of the contracts, as Mr Kletz has said, were big capital projects that do not necessarily touch the public. We have certainly seen it in the past where you have significant problems with service delivery, much more about direct delivery of high volume services in real time to the public, which can quite quickly lead to a very different problem that we have not seen in this example, which is a collapse in public service delivery.

In the early 2000s the biggest peak of complaints we have ever seen in our 40-odd year history came from exactly that scenario. A number of local authorities had outsourced processing of revenue benefits. Complaints went up 10% every year for a number of years driven solely by the small number of authorities where the revenue benefit processing was not working properly. Individual authorities might have had 900 complaints with us: 100 would have been their normal work; 800 would have been about housing benefit. One dimension that we have not seen with Carillion, but we should be alive to in other scenarios where contractors are much more involved in dealing directly with the public, is there is another contingency that needs to be in place, which is how do you deal with service failure on a significant scale?

Q325 **Dame Cheryl Gillan:** Basically what you are recommending is that Government need to look at this in a hurry just in case it is repeated, but in something that has much more exposure directly to the public?

Michael King: Absolutely. I think that is the point. The lesson that we will not necessarily learn from Carillion but we need to be alive to is that a different type of provider might have a very different range of threats that would impact very differently.

Q326 **Dame Cheryl Gillan:** That is something good that can come out of a

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disaster, because we need to really up our game on this as far as governmental powers and Government are concerned.

David Simmonds: To answer your specific question, local authorities have contingency plans in place to manage service failure, partly because of past experience. We are not a party to central government contracts and central government is not party to local government contracts. It does seem that some of those larger, more complex central government contracts are just so large that the challenge of managing them is a different order of magnitude from a local authority contract to provide school meals or build a road.

Nigel Kletz: I think a critical aspect of any significant outsource contract is having a capable and competent client function inside that manages it, good contract management skills, and part of that is a risk management plan. Things may be unlikely but you at least have some contingency in place if a company fails or if something goes wrong or if there is a significant performance aspect that requires an intervention. That is part of the whole package of designing, procuring and managing contracts. It is an essential part of it and, if there is performance failure, what I found interesting from the Ombudsman's report was that good contract management should learn from and prevent a lot of the aspects that are identified in there. That is critical.

Chair: Thank you very much indeed. Your answers were much too long but were also extremely interesting and all of you have contributed a great deal to our knowledge on this and we are very grateful to you. Thank you very much.

Examination of witnesses

II: Kerry Hallard, President, Global Sourcing Association; and George McFarlane, Confederation of British Industry.

Q327 **Chair:** Welcome to our two new witnesses. Please could you identify yourselves for the record?

Kerry Hallard: Kerry Hallard, President of the Global Sourcing Association.

George McFarlane: I am George McFarlane. I am the Director of Sectors of the Confederation of British Industry. In my role, I run the CBI's policy on public procurement.

Q328 **Chair:** Have either of you worked in contracting?

Kerry Hallard: No, I haven't.

George McFarlane: No.

Q329 **Chair:** No, so you are analysts, you are commentators. We will not overtax you on the experience questions then. We have to be done by 11.30 am because we are expecting the spring statement in the House of Commons and colleagues will want to be there. 12.30 pm, I am sorry. Such is my enthusiasm. Can we go quite quickly and crisply?

What in your view are the advantages of outsourcing services for construction projects?

Kerry Hallard: We do research on this on an annual basis and the rationale for outsourcing is changing quite significantly. It has always been cost. Cost has been by far the greatest reason for companies to outsource. That is changing now, so cost is still the number one reason and, therefore, the number one advantage for outsourcing, but service improvements is a very close second. There is a move towards looking at what value-add the outsourcing community can deliver and that is coming to the fore a lot more now. Other advantages, as you have heard from the previous panellists, are increased productivity, ability to focus on what is core, access to talent—we believe the outsourcing community can give access to talent on a global basis, not just on a local or national basis—and investments in technology refresh and benefits like that. Those are the main advantages and rationales for outsourcing at the moment.

George McFarlane: I agree with everything that has been said. What I would add is that the CBI currently has a survey in the field of its membership to understand experiences about procurement. This is showing us, although only preliminary results, that the cost in the short term has absolutely come to the fore in commercial decisions. Some 70% of our members have said the procurement teams are influenced by the lowest bid cost in their decision-making. Moreover, 75% disagreed or strongly disagreed that procurement is driven by innovation. I would agree with everything that my colleague has said. I would sum it up as investment and innovation, if done properly, but in truth we are seeing a driver to reduce short-term costs coming to the fore more and more.

Q330 **Chair:** How much do you believe that we have reached the end of the road of cost reduction as a primary driver of contracting out?

George McFarlane: There are areas in which the low-hanging fruit is gone, that is true. Colleagues earlier on made clear that outsourcing, as we have been discussing it today, has been around for 30 or 40 years, since CCT was first introduced. That does not mean that there are not opportunities that still exist to save money, but it does mean that in other areas it will become more and more difficult. There is a need for more sophistication, greater transformation and greater innovation rather than a short-term cost focus, which again our data suggests we are seeing more and more of.

Q331 **Chair:** Anything to add, Kerry? Have we reached the end of the road?

Kerry Hallard: Yes, there is a distinction between the public sector and the private sector here and our association represents the interests of both the public and private sector. I think it depends which vertical sector you are in as well. The banking and financial services industry is a very mature sector and we are on the third and fourth generation outsourcings. The cost savings are significantly lower than they used to be and there is much more focus on innovation, transformation and projects like that. In the public sector at the moment, there is a constant focus on still striving to drive costs further and further, so we are still seeing this whole talk of a race to the bottom happening far too much in the public sector with not enough focus on the value-add that can be brought to the taxpayer.

Q332 **Chair:** That leads to the next question: what are the disadvantages of outsourcing as opposed to insourcing?

George McFarlane: The question should be what the customer is looking to buy, in our view. We both had a stab at the benefits of outsourcing and I summed it up as investment and innovation. The danger is when the customer is not clear on what they are buying when outsourcing is done by default, just as insourcing can be done by default or purely based on a short-term cost focus. That means there is not a clear goal and it is more difficult to run a procurement that drives value in the long term. The disadvantages of outsourcing would arise if there is not a clear reason for it to happen—it is as true with insourcing as it is with outsourcing.

Kerry Hallard: Further to that, there is the risk of knowledge loss. If you do not have a clear understanding of how you can possibly bring it back in-house and you lose all of that knowledge, that is a risk to not outsourcing well. I think that is probably the main one, and we always say do not outsource a problem. In addition to what George was saying about knowing what outcomes you are trying to achieve, you also have to understand if you have a problem. If all you are trying to do is throw that over to somebody else without explaining that you want them to fix that problem, that is a recipe for disaster.

Q333 **Chair:** How consciously do you think that Government makes a decision or Departments make decisions to insource or outsource?

George McFarlane: Not consciously enough. It is a very complex market. We know that around 200,000 different companies and charities deliver to the public sector across the country. According to the National Audit Office, that is £242 billion a year, about one-third of public spending, so it is difficult to come up with general rules, given the market is as complex as that. Of course, we do not hear about many things that work well on a day-to-day basis within that envelope.

Chair: Take that as read, I am afraid.

George McFarlane: Excellent. We will have to. The decision is motivated overwhelmingly by cost. We heard in the evidence earlier on where outsourcing is almost entirely on the basis of cost saving and there is an assumption that it will save money. Of course, it can and in many cases it does. We have literature that points towards that as a baseline of 10% to 30% cost saving, but given the nature of what Government do, the diversity of public services in the country and the different goals that they have, there is a need for sophistication. There is a need to focus on what the customer is buying, as I mentioned earlier. Is it new technology; is it the latest business practices; is it the ability to redeploy staff; is it the management of complexity? Without clarity on the strategy for the purchasing authority and what is needed from a partner in order to deliver that, outsourcing is nothing more than a knee-jerk response, and the same is true for insourcing.

Q334 **Chair:** Kerry Hallard, what should a Department be asking itself before it decides whether to tender outside or inside, or should it be axiomatic that it is always doing both?

Kerry Hallard: What does "good" look like, what are they trying to achieve, is a fundamental business question from the get-go.

Q335 **Chair:** That is very clear. When should the Government avoid outsourcing?

Kerry Hallard: When it has a problem, if it is not clear about communicating what that problem is, and when it does not know what "good" looks like, and when it does not understand its own business, its own processes.

Q336 **Chair:** You say you should not outsource if you do not know what you are doing, but that is quite often when the Government outsources something: because they do not know how to solve a problem.

Kerry Hallard: That is when it goes wrong.

Q337 **Chair:** That is a very strong message from you.

Kerry Hallard: Yes.

Q338 **Chair:** Does the CBI agree with that?

George McFarlane: I do agree with that. There is something around understanding the problem and then working in partnership to develop a solution. This is when we get into the need for flexibility in contracts. For the avoidance of doubt, I do not think either of us is suggesting that the solution must be fully formed, that Government, or the procuring authority more specifically, must have a finely detailed plan for every month or every year of what can often be a long-term contract. The important thing is flexibility, understanding a shared problem, or what could become a shared problem, and then what each partner brings to the table, what capability the Government or the public procuring authority has put in to help them address that.

I would like to say something about risk. No one has mentioned it yet, although we have alluded to it. It is clear that there is a growing focus on short-term cost reduction in procurement. There is also a growing focus about transferring risk, or another way of referring to that more helpfully, perhaps, is uncertainty. There is uncertainty in all forms of public contracts. In our conversations with our member companies, there is a growing sense that partnering with a business is an opportunity to transfer that uncertainty, almost wholesale, to an extent that was not the case five, 10, 15 years ago. That is something that is coming to the fore.

Kerry Hallard: Can I add on to that? George mentioned the word "partner" and that is where the whole outsourcing industry is going; it is all about collaboration and partnering and having mutually-aligned objectives from the get-go. It is grown-up conversations of understanding what is in it for both sides. I think something that is fundamentally lacking in public sector outsourcing at the moment is understanding why the service provider is going for this contract, as well as why it has been contracted out in the first instance. It is working to mutually-aligned objectives and having grown-up conversations.

Then relationship management is important. Research from the GSA shows that when outsourcing fails—and, on the whole, outsourcing is a tremendous success—in 85% of cases it fails due to poor relationship management. One of the biggest failings in public sector outsourcing at the moment is the softer skills, the relationship management side of things, rather than seeing this as tribal "them and us" and, "We are buying a commodity service". We are not, we are engaging in complex service arrangements that have to have a strong degree of give and take in them.

Chair: That seems so obvious to someone from outside.

Kerry Hallard: I know.

Q339 **Chair:** Does the relationship break down because the contract is going badly, or does the contract go badly because the relationship is breaking down?

George McFarlane: I have heard it summed up as contracts can be used as either a sword or a shield. They can be used as a tool to punish or pass problems to a partner or they can be used to avoid accountability for a problem. That does rest, in relationships, in the softer skills that Kerry was setting out, but it is also about the clarity and flexibility of the contract, to ensure that it commands, in a consistent way through the life of the contract, the confidence of both partners.

Q340 **Chair:** Which comes first, the breakdown of the relationship or the breakdown of the contract?

Kerry Hallard: Breakdown of the relationship.

Q341 **Chair:** Brave. Agreed?

George McFarlane: Yes.

Q342 **Chair:** Very good. Sometimes the Government finds themselves as a monopoly buyer; in fact, quite often. What impact does that have?

Kerry Hallard: It is absolutely a monopoly buyer and, yes, it is making it very difficult for other service providers to come into the marketplace. If I look at our portfolio of members, I have a degree of members who fully refuse to bid on public sector contracts now because it is so difficult for them to enter into this market. They have either retreated or they refuse to enter into it because the Government are seen as a very difficult customer to do business with.

George McFarlane: I would agree with that. I would not attribute that to Government's role as a monopoly purchaser, or as the main purchaser in these markets, and the same could be said for local authorities procuring the services they are responsible for across the marketplace. The market is becoming less competitive and is becoming more consolidated. We have pretty significant concerns about this; it is not good for taxpayers or the delivery of services. There are reasons for it. Again, I would not attribute it to Government's role as a monopoly purchaser. If anything, that is an opportunity to drive change where that is necessary. That is a statistic I did notice in other written evidence presented to the Committee: Spend Network has said that from 2012 to 201717 there was a 476% rise in single-bid tenders, which is a very striking figure, I am sure you will agree.

There are a few reasons for this: first of all, the focus on short-term cost reduction and transfer of risk leading to, to use a phrase from the National Audit Office a "less attractive" client. An intelligent client is one thing; producing in an intelligent way, running a good negotiation and having an attractive proposition for companies that have choices of where to work is a separate issue. It also speaks deeply to the bidding behaviour of companies and how that is changing.

It is true that at the complex end of the market there is a relatively small number of companies; Government have 27 what they define as strategic suppliers. We hear from these companies that they are okay, generally speaking, with tight profit margins. They generally regard that in many parts of this market as the cost of doing business; it is taxpayers' money, after all. The challenge, however, comes around risk and uncertainty, the lack of certainty around what costs will ultimately arise through that contract.

Q343 **Chair:** Thinking about, for example, the Carillion prisons contract, there are four suppliers of prisons facilities management in this country: G4S, Serco, Sodexo and Her Majesty's Government. How does the Government benchmark the value of a bid to just three companies?

George McFarlane: There are a few challenges here. First of all is lack of information about in-house delivery, so what is the true cost of public sector delivery of a service, because that provides, or would provide, the benchmark that you mention. Secondly, it is structuring a good level of competition. In every case it is not perhaps necessary for there to be seven, eight or a dozen competitors in procurement, particularly when it is a complex service that relatively few are able to bid for, but there is a growing number of examples where the number of bidders has dropped to two or three or even lower than that.

I can provide a few examples for the Committee if that is helpful. For example, the Ministry of Defence's military flying training tender in 2016 was awarded to a single bidder after two others withdrew due to concerns about the commercial and technical requirements. That was an example of where you had a relatively niche capability, I would imagine—I am not an expert in military flying training myself. A relatively few number of companies would be able to help Government meet those objectives, and an already tight competition was reduced even further by the commercial terms presented in that tender.

Q344 **Chair:** More benchmarking of internal services to make comparisons; is that what we are saying here? Have I understood that correctly, Kerry Hallard?

Kerry Hallard: There is a huge lack of centralised intelligence for the entire use of outsourcing.

Q345 **Chair:** I do not think it about centralised intelligence. Is it about particular capacity or contract, or process?

Kerry Hallard: Both would be good, yes. Where it comes to price, performance, understanding innovations and how different service providers are performing, it would be good if that could be shared within functions and in a much better way. A CIPFA round table a couple of weeks ago discussed the introduction of what was codenamed a

Domesday Book, which was an overall repository of all the outsourced contracts for the public sector, and then monitoring and measuring the performance of the service providers. The feedback from everybody in the room was that was a very nice idea to be able to do but logistically completely and utterly impossible to get off the ground within a 10-year period.

Q346 **Chair:** Who would hold the Domesday Book?

Kerry Hallard: It is just a notion that has been put forward by a number of academics at the moment—

Q347 **Chair:** Is that not what the Cabinet Office is meant to be doing already?

Kerry Hallard: That is not happening. I do not know of any particular register of performance of service delivery.

Q348 **Chair:** Would you like to see the Government hold such a database?

Kerry Hallard: There should be a better sharing of information. A type of Domesday Book that is open for public scrutiny I think is probably a step too far, but better sharing of information and intelligence within central government and across local authorities would be hugely beneficial.

Q349 **Chair:** What about contractors being obliged to hold, in respect of each contract, a stock of information that could be taken off the shelf in the event of some catastrophe or financial disaster, so the Department can instantly know all the data about that contract that is held internally by the contractor?

George McFarlane: I would expect in most cases that information already exists, certainly with complex contracts. There have been proposals recently: the CBI first made the suggestion a number of years ago of the concept of living wills in contracts so that measures for continuity of service could be thought out ahead of time. The same could apply to the Chair's suggestion.

Kerry Hallard: I agree. We are looking at developing some new contracting models at the moment ourselves.

Chair: We are doing very well. Nice, quick answers; thank you very much. Cheryl Gillan?

Q350 **Dame Cheryl Gillan:** It is suggested that possibly the independent Competition and Markets Authority could do a report on the competitiveness of the marketplace. Is that something you would both support?

Kerry Hallard: Yes.

George McFarlane: Yes. Similar work has been attempted historically; further editions are always welcome. I would go back to my point earlier on about the complexity of the market. We are not talking about a market here, given—

Q351 **Chair:** Do you have evidence of collusion: "You go for that contract and we will go for this contract and we will split it up between us"?

George McFarlane: No. I am certainly not aware of any evidence of that kind.

Kerry Hallard: There is no evidence of that.

Q352 **Dame Cheryl Gillan:** There has to be some co-ordination between contractors because, when you look at the HS2 contracts, for example, they were putting together a consortium to bid, so when Carillion went down, unfortunately two others got left holding the baby.

Kerry Hallard: Yes. They will sometimes work in a competitive landscape, other times they will work in a partnering environment. Each contract is going to be different and the amount of intel they are willing to share will obviously be different.

Q353 **Mr David Jones:** On that last point, to what extent do the other potential bidders take into account the financial wherewithal of the party with which they are effectively entering into a joint venture?

Kerry Hallard: Sorry, I did not hear the last bit of that.

Mr David Jones: To what extent do the co-bidders—you mentioned the issue of the joint bids—take into account the financial wherewithal of their co-bidder?

Kerry Hallard: I don't know the answer to that.

George McFarlane: I don't know. The answer, I would imagine, is I would hope it is a significant part of their consideration, given the complexity of what they would be committing to take on, in many cases.

Q354 **Mr David Jones:** The reason I mention it in this particular case is that it was common knowledge that Carillion was in difficulty but, nevertheless, they were joint bidders for certain very large contracts. It does seem to me, as an outsider, very odd that somebody would willingly want to tether themselves contractually to a company that was clearly not particularly strong.

George McFarlane: We know from documents that have emerged, through the number of parliamentary inquiries that quite rightly are now under way in relation to Carillion, that certain accounting practices were used and described, to say the least, as "aggressive" in presenting Carillion's financial health. If that has been the case externally, there is a need to understand at the time exactly how Carillion's business was working, yes.

Q355 **Mr David Jones:** Indeed, but there must have been alarm bells ringing, and I find it very odd, to repeat, that another company would wish to tie its future to a company such as Carillion that it is notorious is in difficulty. Maybe someone has an answer to that.

George McFarlane: It is not something I have looked at myself, but Carillion is a lesson in the consequences of short-termism.

Kerry Hallard: There is also a lot of contingency put in with some of them. Some of the more recent ones have been well passed over to the partners that were within those alliances. I do not know the insights, but I would imagine there was a degree of contingency planning, if anything went wrong, where it got transferred to.

Q356 **Dame Cheryl Gillan:** Surely, yes. Following on from what Mr Jones is saying, surely the other two partners in the trio of partners with Carillion would stand to make better profits if Carillion went under. In a way, they were hedging their bets.

George McFarlane: Not necessarily. Again, it is complex. Every contract would be different. It is not something—

Dame Cheryl Gillan: But it is a possibility.

Kerry Hallard: There is a possibility, but it also could have been incredibly expensive for them to do the transition and take those on. It just depends how the contract was. I do not have the full visibility of that.

Q357 **Dame Cheryl Gillan:** How would one get the full visibility of that without having access to the commercial contracts in full, or investigating it? We would not, but it is a possibility.

Kerry Hallard: Of course, there is a possibility; it could go either way, yes.

Q358 **Chair:** Could we move on now to the public sector commissioners of these contracts? How would you describe three attributes of a competent commissioning or contracting public authority?

Kerry Hallard: Understanding. You have to have acute commercial awareness, but it is going to be a willingness to work in a partnership in a collaborative environment. It is not purely negotiation skills, understanding of risk. All of those things are vital, and good negotiation skills are key, but it is much more a different mentality. I know it sounds a bit crazy, it is the soft skills, but it is that sort of mentality of being willing to adapt to change, willing to take some hits in return for some gains, and be able to work to these mutually aligned objectives that I talked about before. It is not pure hardball contract management skills that are required.

Q359 **Mr David Jones:** These are very sophisticated attributes that you are describing. To what extent would you say that the British public sector, generally speaking, possesses these skills?

George McFarlane: There has been an improvement in commercial capability, particularly in central government, since 2010, and it is widely felt by business working particularly with central government. The question, though, is how the capability is being used. The National Audit

Office has defined positive attributes of a customer as an attractive client but also as an intelligent client: an attractive client in understanding the commercial drivers behind potential partners to ensure there is a good competition; and intelligent client in ensuring that the ultimate deal constitutes good value for money for the taxpayer, that the bids are priced appropriately, and that the margins are reasonable.

We are increasingly seeing, as I have mentioned, an overwhelming focus on reducing short-term costs and transferring risk to external partners. That could, in a sense, qualify, in some ways of understanding it, an intelligent client, insofar as they are in the short term securing for themselves a good deal, but the test I would use would be the long-term health and sustainability of that agreement. We do not see enough emphasis there; we do not see that capability being deployed consistently enough in that direction.

I would make a comment specifically about local government, particularly given the Committee has just had evidence from local governments. One of the authorities on the panel before us was a large established unitary authority, which has £1 billion, I believe, of spend with external partners they mentioned. They also alluded to the diversity in local government with the scale and capacity of organisations that exist. In our experience in local government, less so than capability, it is capacity that presents a challenge, when teams can be just too hard pressed to think about the complexity of the issues, which is where scale and collaboration can become really important.

Q360 **Mr David Jones:** The National Audit Office reported in 2014 that the public sector was at a permanent disadvantage with commercial capability. Would you agree with that?

George McFarlane: It remains very mixed, is my view. I think there are examples we can point to where there has been sophistication on the Government side. An example is that as a general rule the Ministry of Defence is felt to be quite capable in relation to the services outsourcing aspects of its operations. I would attribute that to—I am picking up on some comments my colleague made earlier on—clarity as to the Department's goals, a clear understanding of its own core business and how that relates to what is being purchased. There are good examples, but it does remain mixed, both in terms of the level of capability and how that capability is being deployed.

Q361 **Mr David Jones:** One would expect that degree of capability in the Ministry of Defence, but in, for example, a small rural county council, presumably you would expect less capability. What sort of assistance should local authorities in that position seek to enter into contracts?

George McFarlane: The capability, in my view, would need to be proportionate to the level of ambition the council has for these forms of partnership. This is where it comes back to the question of what are the goals the council wishes to deliver. I would wager that a small district authority is not in many cases—if you know examples, please do correct me—trying to let a complex multi-year contract with high degrees of uncertainty. If it is, we would suggest it should be partnering and trying to drive scale across local governments and partnering with other authorities who might have the scale and capability to let that contract.

Q362 **Mr David Jones:** What assistance is available to small local authorities who may lack that sort of capability? Is there any structured assistance available?

Kerry Hallard: I do not know whether the commercial passporting goes into the local authorities or not, but obviously that has been a big initiative that has helped move things forward a little bit. Going back to the whole skills issue, we do believe there is a significant skills deficit in the commercial management of outsourced public services at the moment. One of the concerns is their high level of churn, so we see an unfeasibly high level of churn. Big steps have been made in attracting the talent to come on into these positions, but the ability to retain senior positions is proving to be quite dire.

Q363 **Mr David Jones:** In central government?

Kerry Hallard: In central government, yes.

Q364 **Mr David Jones:** Is there a sufficient pool of talent overall?

Kerry Hallard: There is a war on talent in our industry but, yes, there is a growing capability in our sector all the time, which is—

Q365 **Mr David Jones:** What do you mean by a war on talent?

Kerry Hallard: Just the entire delivery of outsourcing services. Trying to get the best people to work, whether they are for the service providers or whether they are in-house, is a constant demand for the best people. Whether that is here in the United Kingdom or globally, having good people to work in the services industry is proving a challenge. Having good people to work in managing these services is an issue at the moment. We are seeing, from our membership base, dissatisfaction with the overuse of consultants to help manage these commercial contracts, and the costs that usually get involved with those. In some instances, even law firms are being brought in to manage these commercial contracts. There has been progress, but not enough progress.

In 2012 we ran an APPG on outsourcing and shared services, and we put forward a paper with 10 clear recommendations on how the Government could become a more intelligent customer of outsource services. I have recently put it to my membership base as to how well they thought the Government had performed. I suggested it was a 5% improvement and they said they thought I had been rather generous in giving it that.

I do not want to be too negative because a lot of this has been driven by the austerity drive and the different challenges that have come, and stopped the focus being on relationship-based outsourcing, to moving much more on to cost-cutting focuses, and transactional relationships have come back to the fore. Steps were moving forward beforehand, austerity has come in, and that has taken steps back.

Q366 **Chair:** A very interesting perspective. My colleague implied that large Government Departments, like the MoD, are less commercially disadvantaged than, say, a local authority. What evidence do you have to support that?

Kerry Hallard: I do not have any, I am sorry.

George McFarlane: I hope to have some quantitative evidence I can share with the Committee in due course. I mentioned earlier on that we are currently undertaking a survey that asks questions of a nature that the Chair has raised. What I would say more anecdotally, based on conversations that we have with our member companies, is that the more mature the customer is, based on its track record of attempting outsourcing activities, the more effective it is as a partner.

Colleagues from local government mentioned earlier on that running a good procurement was mostly based on experience of teams and individuals in the authority institutionally. That is indeed the case. There is an argument to be made for not simply relying on experience, but greater not only guidance but potentially an even more influential commercial centre of Government that can hold to account the wider public sector, and the rest of central government where necessary, on commercial terms that might be inappropriate.

Kerry Hallard: As a short addition to that, the consensus that I feel from our membership base is it is sometimes a lot easier to deal with the local authorities. The lines of accountability and decision-making are more condensed, so it is sometimes easier to work in that way.

Q367 **Kelvin Hopkins:** My question has been touched on in earlier questioning, but how extensive is open-book accounting in respect of central government contracts?

Kerry Hallard: I don't believe it is extensive. There are lots of different reasons why open-book accounting probably has not taken off. There is an opportunity to do more work in open-book accounting, but we have to be realistic as to how far we go with it. Where open-book accounting starts shaping a market, gives away competitive intelligence, that will change the market shape. I do not think that is where we want to go but, in terms of visibility of what good can look like, sharing more intelligence, then we should be willing to do more of that.

Rupert Soames from Serco came out and said Serco was willing to look at forms of open-book accounting. It is just how far that information goes. Having grown-up conversations between the service provider and the customer about what profit margins they are working out and how they are getting those should absolutely be being had on a relationship basis.

George McFarlane: I would go a little bit further than that. We feel strongly there should be a presumption in favour of open-book accounting in public contracts. It is an example of a good idea that is not being taken up widely enough and something that has been encouraged, to my knowledge, by the Cabinet Office and it is not being used widely enough. For avoidance of doubt, the vast majority of major suppliers I speak to are very comfortable with it being included in their contracts.

Q368 **Kelvin Hopkins:** One would guess that they would be reluctant to show their hand too much in contracting. What effect would it have on contract management if we did have open-book accounting in general terms?

George McFarlane: It would enable, alongside other bits of information, a more sophisticated understanding of how the contract is developing over time, of how risks and uncertainties that have emerged are affecting the viability of the partnership, and would also provide quite useful information for any changes that needed to be made to the contract. It would have a positive effect.

Kerry Hallard: There are additional benefits of bringing SMEs in with open-book accounting so that you have complete transparency of supply change and how they are comprised.

Q369 **Kelvin Hopkins:** There was a suggestion earlier on that there might be collaborations in companies sharing out contracts. Open-book accounting hopefully would stop that, if it exists.

George McFarlane: We both feel we have not seen any evidence of that.

Q370 **Chair:** Kerry Hallard, you are a little less enthusiastic about open-book accounting. Is there a mixture of views in your industry?

Kerry Hallard: No, I think it depends to what degree we are talking about open-book accounting. If there is open book with a customer, we completely agree with that. It is just how far does that information go and how much information becomes competitive intelligence to other parties, how much might go into the public domain, and what level of scrutiny comes on into the industry that can shape the industry. In some cases, pricing mechanisms, the way that something is priced, are a company's intellectual property. Making that in the public domain can be detrimental.

Q371 **Chair:** Some of your members are very reluctant to open their books in that way.

Kerry Hallard: Most of them are more than happy to open them to some of the given customers, or to their given customers. It is just how far it goes into the public domain.

Q372 **Chair:** In the United States "commercial in confidence" does not exist; it is all public information. Why should we have it here?

George McFarlane: There is an important distinction between transparency to the customer and transparency to the public. Our view is you can achieve both of those goals through the terms of the contract. Apologies, I did take the question as referring to open-book accounting to the customer, so revealing to a customer the margin a supplier would be making. The companies that we speak to and that we represent are very comfortable in virtually all cases with it being written into a contract that they would divulge to their customer, both through that process and live through a contract.

Q373 **Chair:** That is fine, but it did not answer the question I asked, which is: why is it okay in the United States and not okay here?

Kerry Hallard: I do not know the detail of what is allowed in the US, so if you can detail that that would be helpful.

Q374 **Chair:** That everything is public information in a contract: the details, the terms, the prices, the margins; everything in a contract is public information. They do not have this term "commercial in confidence". How do they manage?

George McFarlane: The companies we speak to are very comfortable with that sort of information being released if it is written into their contract and agreed ahead of time. For us, transparency, and it is not just for us, is a mixture of push and pull.

Q375 **Chair:** It is just a cultural change we need to go through, it is just how it is, isn't it?

George McFarlane: It is a cultural change the companies, for the most part, are open to.

Q376 **Chair:** Who does it help to keep things secret?

George McFarlane: For avoidance of doubt, there is little to no information that I am aware of that, if it were written into the contract for a company to release, that a company would not wish to be released.

Q377 **Chair:** It might protect Government Departments, Ministers and civil servants from being held accountable.

George McFarlane: I would say that in many of the cases where we hear of information not being released, it is the public contracting authority that has held that information back.

Chair: That is a useful comment. Thank you very much.

Q378 **Dame Cheryl Gillan:** What do you think of the skills and skillsets of people in central government responsible for procurement?

Kerry Hallard: We have covered that one already, haven't we, that the commercial passporting is a positive step forward? Retaining the team is proving to be a challenge. The default position can often revert to blaming a service provider, but yes, I thought I had covered that.

Q379 **Dame Cheryl Gillan:** Leading on from that, why do you think that contracts need to be entered into where the contractors often appear to take on contracts that are based on, what shall we say, inaccurate costings, poor data, and are immediately at risk of running at a loss?

George McFarlane: I made a point earlier on about capability in central government having improved, but I raised a question about how that capability was being deployed. Our sense is that capability has been deployed to drive more assertive, more aggressive commercial negotiations, so to lower price and lower margin. We do not get a sense that capability is being deployed consistently to create partnerships that are sustainable for the long term.

As an example of that, you might have mentioned due diligence; that is an interesting example. Just off the top of my head, there was a company that was taking on the management of some housing stock and in the contract that company would have been required to keep the housing stock to a certain quality standard. They were not allowed to inspect the housing before they took on the contract. They were having to price in housing at a certain level of quality when they took it on and, unfortunately perhaps predictably, when they did take on that housing stock it was in very poor state. They had to put in additional investment to address that problem.

Q380 **Dame Cheryl Gillan:** All of this has been brought about because of what happened with Carillion. Do you think that Government should be doing a historical analysis of all their major contracts and a review to see that there are no other big mistakes on the horizon?

George McFarlane: We have recommended a strategic review into the health and sustainability of Government contracting. That is not to establish whether there are—and there is a phrase that has been used—"any more Carillions". Government have stated there are currently no more Carillions and we certainly have no reason to think otherwise.

What we do feel is important, though, is market concentration and the competitiveness of the market, because that speaks to many of the issues that have been raised. If it is continuity of service failure, for example: who would those contracts go to, or if there are fewer players in the market, there are few other players to take on that contract. It speaks to value for money: if there is less competition in a bid then it more difficult to assure value for money. For us, that speaks to commercial capability but also the sorts of terms that are being deployed and how that commercial capability is being used.

Q381 **Dame Cheryl Gillan:** There is a perception that there is such a shortage of people in certain areas, for example in the construction area, that key personnel are moving smoothly between Government, arm's length body and contractor, for example CH2M had to pull out of an HS2 contract because there was a conflict of interest. How dangerous is that to the value for money for the taxpayer, that we have people in a limited pool in which we are fishing for certain areas, for example in the railways or construction?

Kerry Hallard: More work needs to be done on upscaling across the board, without a doubt. Going back to your previous question, I do not know how much historical research would be required but in the current review, I completely agree with George that we should be looking at that. I would go one stage further in looking at the procurement process a bit further as well.

What we are seeing is lots of companies not willing to even enter the procurement process, as I have said before, and for those that are bidding we are seeing an increased number of challenges from the organisations that are losing bids. Doing research into why that might be happening as well would be valuable.

Q382 **Chair:** Sometimes contractors seem to take on contracts that are based on entirely inaccurate costings, totally poor data, and they find they are immediately running a contract at a loss. What should be done about that? How should Government prevent that?

Kerry Hallard: One of the things that we have put forward in our industry code of conduct is that you should not take on any contract where it is going to be clearly loss-making, or the margins are going to be wafer thin, or wherever any change requests could quite easily force that into a loss-making contract.

Somewhere else within our code of conduct is the transparency of providing the correct information for basing the contracts on in the first place; stronger due diligence on understanding the figures before going in, but for this whole mutually-aligned understanding of agreeing what sort of profits margins are reasonable within the arrangements before entering into them.

Q383 **Chair:** That suggests we need open-book contracting so that people can know.

George McFarlane: That is one thing that we think should happen. There are dangers of short-termism both on the industry side and on the Government's side. The answer to your question is that it requires industry to ensure that its bids are viable for the long term, so that contracts are not loss-leaders, which is a phrase that has been used, or are not overly optimistic. It requires public authorities that are purchasing services to focus on more than just the short-term cost reduction and transferring of uncertainty and risk, and to understand what they are trying to achieve over a period of time. It is to be able to go to a competitive marketplace that benefits from a benchmarking of what good looks like in order to make an informed decision.

Q384 **Chair:** What reasons are given for withholding publication of key performance indicators?

George McFarlane: From the industry side, it is typically because they are not permitted to by their procuring authority. From the public sector side there are some contracts that are related to national security but, beyond that, it is very difficult to envision a reason why that should be the case. The two reasons that have been used, are used or reported on as being used for withholding information are security and commercial confidentiality.

I have considerable sympathy for the first reason. It is very difficult in a business sense to think of specific reasons why the second reason would be the case. The only one I would suggest to the Committee would be in a situation where a company does not just deliver public contracts but works for the private sector as well, as many Government suppliers do. There could be some functions or aspects of the company that do not relate to those public contracts and, for competitive reasons in other markets, those might need to be protected.

That is quite a specific reason and it should not be beyond the wit of man that, if it is in a contract, a reasonable schedule cannot be worked out to release information proactively on KPIs. Some contracts use an annual report, for example once a year the departments publish proactively, "This is how we are doing", but also to set out how the public can request information.

Q385 **Chair:** Kerry Hallard, do you agree with all that?

Kerry Hallard: Yes, virtually all of that; certainly on the security piece, but on commercial confidentiality you have to be careful not to stop organisations from wanting to innovate. As soon as you start making all of this information to the public domain on exactly how they are managing to improve efficiencies and drive productivity, what technologies they are using and all of these things, you are hampering innovation for UK plc, is my addition to that.

Q386 **Chair:** Thank you. Finally, on Carillion and the collapse of it, on a scale of one to 10, how well has the Government done handling the crisis?

Kerry Hallard: I do not know if I would give a point, but on the whole I think it has been handled pretty well from what I have seen. Hearing the guys from the local authority talk about it, the contracts that I am familiar with seem to have been passed over without major public service disruption. It depends what the metrics are, but if it is on the level of public service disruption, we have not witnessed huge disruption.

George McFarlane: I would agree. The continuity of service has been impressive and striking. One must not forget that, as of yesterday, my understanding is that 1,500 people have lost their jobs—that is a tragedy for those concerned—and 45% jobs have now been saved. Government have had a very proactive role in that, for example guaranteeing apprenticeships through the Department for Education stepping in, in some cases, to run contracts. The market has also stepped in, in some cases beyond what their contractual terms required them to do, in joint venture partners. In those cases it would not necessarily follow that it would be commercially beneficial to them in the short term and could involve some cost. It has been a real collaboration across the public and private sector.

Kerry Hallard: I am going to go slightly off tangent here but it is a follow-on with that. The handling of the collapse and continuity of service has been great, but the media backlash against the outsourcing industry has been catastrophic. One of the things that is dear to my heart is how important the outsourcing sector and industry is to UK plc. It is not just for the delivery of public services but we are the global market leader in this industry, yet our Government continues to not applaud the sector and the media continues to backlash against the sector.

We have this opportunity to be the global strategic hub. We beat the United States in the deals that we do. We are far advanced in the use of technologies that drive the sector forward, but outsourcing remains a very dirty word. That is only inhibiting us as an economy nationally. As a counter to it, one thing that has not been handled well is the constant backlash and bashing of outsourcing.

Q387 **Chair:** What lessons do your members take from the Carillion collapse?

Kerry Hallard: Rupert Soames summed it up particularly well: we are driving it, we are doing an industry call to arms and we have had strong support, that the outsourcing industry needs to showcase its brilliance but at the same time it needs to make some changes in its code of conduct, and in transparency.

Q388 **Chair:** What do you think the principal lesson for Government is from the Carillion collapse?

George McFarlane: I think the lesson for both industry and Government is fundamentally the same: we need to avoid short-termism and how we approach public contracts. For industry, that means sustainable bidding behaviour; for the Government that means championing the industry, because that does matter. Market entry and exit does relate to reputation and public confidence, and the political championing of the industry does matter. It is also upskilling, driving capacity and capability through the public sector and, finally, potentially having a more influential commercial centre through the Cabinet Office to challenge commercial terms that are inappropriate.

Q389 **Chair:** Where do the principal short-term pressures come from?

George McFarlane: The short-term drive to reduce cost at the expense of other considerations. Our colleagues earlier on—

Q390 **Chair:** Where does the short-termism of outsourcing companies come from?

Kerry Hallard: Maintaining market share. If you look at the big service providers, the reason they are taking some of these deals, which they know are not going to attribute decent margins to their businesses, is the shareholder pressure to win some of these.

Q391 **Chair:** Shareholder pressure?

Kerry Hallard: I believe a degree of it will be, yes.

Q392 **Chair:** How should we educate shareholders to take a more long-term view? I think that is one for the CBI.

George McFarlane: I am happy to write to the Committee.

Chair: Thank you very much indeed for being with us today. You have both been super witnesses and have given us a lot. Thank you very much indeed.