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 27 March 2018

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Watch the meeting

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

Questions 393 - 494

Witnesses

I: Professor Gary Sturgess; Nick Davies, Institute for Government; and Professor Colin Haslam, Queen Mary University of London.

Written evidence from witnesses:

– Professor Gary Sturgess

Examination of witnesses

Witnesses: Professor Gary Sturgess, Nick Davies and Professor Colin Haslam.

Q393 **Chair:** May I welcome our panel of witnesses to this session on sourcing and outsourcing and the lessons to be learned from the collapse of Carillion. Could I ask each of you to identify yourselves for the record, please?

Professor Sturgess: Gary Sturgess.

Professor Haslam: Professor Colin Haslam, Queen Mary University of London.

Nick Davies: Nick Davies from the Institute for Government.

Q394 **Chair:** Thank you all very much for being with us today. We have a lot of questions. We are going to be here for a very long time unless we are fairly crisp, so if anybody asks a long question or gives too long an answer, I may pull you up. Please can everyone concentrate on being crisp and short?

I will start. What are the advantages and disadvantages of outsourcing? Professor Sturgess?

Professor Sturgess: I must start by saying, I struggle with the word "outsourcing", or contracting out, and always have, because the word "out" implies that there is a particular outcome that is going to happen. I think that the evidence shows that the naive and old answer to this—that the private sector was somehow inherently superior to the public sector—is not generally a particularly useful answer. Rather, it is competition, or more particularly contestability, which is the credible threat of competition rather than actual competition, and the contractual device, or the contractual tool, that seems to make the difference—when it makes a difference.

There are, and have been over the years, many examples of good contracting—it is not all bad—and when it works, as I say, it works not particularly because the private sector is better, but rather because, when the conditions are good, those conditions enable managers to do things that often cannot be done within a traditional public service arrangement.

Q395 **Chair:** Asking for evidence that one type of outsourcing is better than insourcing is futile?

Professor Sturgess: No. There are places where some research has been done—nowhere near enough. When I was living in the UK and running a think tank for Serco, the first piece of research that I commissioned from one of my staff was to interview a group of contract managers who used to do a similar job in Government—these are the same people doing essentially the same job, but in a different model. Their response was things like, "I have much greater clarity about what success and failure look like. I have more authority to get on and make decisions in order to deliver that, but I also feel personally more accountable for whether or not we actually deliver those results". There were a set of conditions there that these people were describing as a before and after—a comparison before and after. Therefore, there is some insight into a contract; in that case, we are looking at what difference a contract makes.

There are other differences that contestability makes, and that is things like challenge. You can challenge management to do better, and you can offer them a predictable set of conditions under which they can expect to be disciplined and eventually replaced if they cannot perform. Of course the point of the exercise is not to fail them; the point of the exercise is to help them succeed. You made the point about outsourcing and insourcing. That kind of a framework can be and has been applied successfully to publicly delivered private services. The framework can be used to improve public delivery, as well as for good contracting.

Q396 **Chair:** You have given us some very comprehensive evidence, and you have also given us a very comprehensive report, "Just Another Paperclip?", that, to me, encapsulates some of the futility of Government processes. You say there needs to be more research. What does this research need to be into?

Professor Sturgess: The State Government in New South Wales, in Australia, where I live and where I have been doing most of my work—

Q397 **Chair:** You were Cabinet Secretary there as well?

Professor Sturgess: I was Cabinet Secretary there quite some years ago. I am now an academic, but I am chairing a committee in corrections—in prisons. We have had a market test of a publicly delivered prison with an in-house bid, where the in-house team won. We are about to begin a piece of research on that, but we had a very interesting condition, where there was a challenge given. The public sector had a chance to compete and, honestly, in a fair process, won. We are now seeing a set of changes to the relationship between those who provide authority and funds to those who deliver. We are going to study that in real time and observe the changes that are taking place in the delivery of that public prison—both better quality as well as lower unit costs.

It is much more difficult to do large-number studies because each contract differs. If you take prisons, no two prisons are quite alike, so it becomes difficult to compare and contrast. You can do—

Q398 **Chair:** Basically, the only research that is worthwhile is case studies?

Professor Sturgess: I think so.

Chair: Moving on, Professor Haslam.

Professor Haslam: I would start with a general response to the question that was asked. The arguments for outsourcing public sector contracts are that they will capture value for money and transfer risk to the private sector. In terms of value for money, there is, it is argued, the expertise of private providers and their capacity to provide both infrastructure and allied services at lower costs than the public sector—the value for money argument—and there is risk transfer, because the contracts are assumed to act as a disciplinary power over the private sector through the service-level agreements attached to those contracts and the incentives and penalties that are embedded in those contracts. That is, the private provider takes on board the financial risk attached to these contracts. This is the stereotypical position: value for money on the one hand—lower costs, more efficient use of resource—and, on the other, a transfer of risk from the public to the private sector.

It is those two elements—the value for money element and the transfer of risk element—which make up the argument that there are contestable spaces in relation to not just the contract transfer but the bundling of many contracts into large conglomerates, large companies.

Q399 **Chair:** Thank you. Nick Davies, do you have anything to add?

Nick Davies: Not much on that kind of textbook answer, which I would wholeheartedly agree with. Just to pick up on the question of the quality of the evidence and what type of goods and services we are talking about. I do not think anyone is realistically talking about insourcing the provision of goods. The idea of outsourcing production of tables, chairs, hospital beds and so on is perfectly reasonable, but goods make up a very small proportion of total Government outsource expenditure. The big question is around different types of services and works. I think there is where the evidence is a lot patchier.

What evidence there is does seem to suggest that, for simpler, more transactional services, like waste management, for example, outsourcing has worked very effectively, and that costs have been driven down well. Where it gets particularly complex is for complex relational services, where you are dealing with the infinite variety of human need, and where it can be very difficult to specify exactly what you are looking for from a contract. As mentioned, it can be very difficult to effectively measure the outcomes and then to attribute those to the work of any one provider. That is where the biggest questions have been.

Q400 **Chair:** Would it be a mistake to widen this debate into the provision of utilities to homes and businesses, because in some parts of the United Kingdom, for example, water has not been privatised? We do not weep over that, we Conservatives. In fact, Scottish Water is a very well-run organisation. It has a very high customer satisfaction rate. Should we regard the provision of essential services like water, electricity and gas as one of these state-provided services, albeit contracted out to privatised utility companies?

Nick Davies: I would draw a slight distinction there with regard to public funding, public financing and public ownership. In those cases, those major utilities, as well as things like telecommunications, for example, are all now in private ownership and are funded through user fees rather than taxpayers' money. I would see that as quite different from where this debate usually is, around taxpayer-funded services.

Chair: We will confine our argument to that, and that way we might be able to avoid railways as well.

Q401 **Kelvin Hopkins:** Could I make an important point? Some of these—apparently contracted out to private companies—are actually contracted out to foreign Governments, and that is rather different, I think.

Nick Davies: Indeed. Picking up on the point on railways, effectively, the tracks are in state ownership, then the train operators are private companies, and then the rolling stock is normally leased from separate private companies so that is—

Q402 **Chair:** The difficulty with railways is that large parts of the network are reliant on significant public subsidy. Certainly, the contracting experience— West Coast Main Line, East Coast Main Line, Southern Rail—seems to show many of the same complexities of outsourcing public services. Anything to add on that? Are there lessons to learn from this?

Professor Haslam: I will come back to the earlier point about waste management. If we look at Liverpool, which has re-municipalised or maintains in-house waste management operations, versus Manchester, 17 miles away, which has outsourced its contracts to Viridor, the cost per tonne of household waste management is double that in Manchester compared to that in Liverpool. Manchester has cancelled its contract and is bringing it in-house, learning lessons from Liverpool, 17 miles down the road.

That relates to the point that I will come to later, which is that contracts are important but, if the contract is embedded in a private provider, which has leveraged its balance sheet relative to a public-sourced activity, that leverage has to be passed on one way or another through the levy. We find that, increasingly, the corporates that are containing these contracts are having to inflate the price of their services, so I would disagree with the point. We need case studies, obviously, but we need to think about the way in which these contracts are consolidated.

Professor Sturgess: If you look at water throughout its history, to take that as an example, it begins—all of these utilities begin—in the private sector. They begin with huge technological innovation, and that is the reason why the private sector is intimately involved in the creation of each of these municipal public utilities. There was huge financial risk involved in raising capital—there was a very weak stock market in the country at that time. There was huge technological innovation around things like metal pipes, which, subsequently, we look at, and it is hard to imagine that being a cutting-edge innovation.

There comes then a long period of time where the risks are essentially around environmental issues and, certainly in the Australian context, the construction of very large dams, where the state has a huge advantage. It then tips back again so that, with the emergence of membrane technology and some of the new environmental edges to this, water becomes much more entrepreneurial. The French water companies, who had always remained private, had a huge technological advantage, particularly with membrane technologies and that sort of shift that occurred.

As you look at the history of that industry—which is one industry where I have done a longitudinal look—the arguments for and against private and public dominance and their different roles shift, based on the nature of the risk that is involved. In some places, either municipalities or the state has a natural advantage, and at other times the private sector has had a natural advantage. We are dealing with things that are monopolies in some form, and they are complex. It is always difficult to engage private monopolies; public monopolies are a problem too, but private monopolies perhaps more so because of their profit incentives.

Q403 **Chair:** Distilling all this conversation before moving to the next question, two elements seem to come out. One is that we are after innovation; whatever we are doing with a service, we are after getting innovation and improvement. The other thing is that we should not be anxious about things swinging backwards and forwards from the private sector, into the public sector and then back out to the private sector. We should not be anxious about that if that happens. We should not decide, "This is for the private sector, and that is for the public sector". There is no dividing line.

Professor Sturgess: No. There are also cultural differences. The Danes have no difficulty at all in having a private for-profit company do most of their fire and emergency services, and they have done since the 1920s. In fact, it was the socialists who began that for particular reasons. But the Danes have real difficulties having the private sector run prisons, whereas, in the UK and Australia, there is no particular difficulty in having the private sector run prisons. There is a huge barrier: in neither country would it be considered acceptable to have the private sector run fire and emergency services, and I could give you a lot of other examples.

Therefore, some of the differences are simply based on our national histories and our national stories, the things that we think need to be delivered by the state and close to the state, and the things that can just as easily be—

Chair: If there were any other international comparisons that you think we should be looking at, could you put that in a note to us—any particular international experiences that you think would inform our inquiry.

Q404 **Mr David Jones:** Briefly on the question of emergency services. Of course, an important emergency service in this country is not run by the state, and that is the lifeboat service, which is run by a charity and has been for well over 100 years. Would you say that it is not necessarily true that there is an inherent cultural aversion in this country to emergency services being operated by anyone other than the state?

Professor Sturgess: No. I guess just the foreign ambulance. Yet, of course, this country was pioneering in the concept of the ambulance, and it was private not-for-profit providers—and St John's, very heavily—who led that. That is one of those things where it is worth going international to look at the differences. Some of the countries in Europe, on the continent, that we think of as inherently social democratic and much more statused in their models of delivery, have involved and do involve non-Government providers much more than, for example, the UK.

In Australia, it would be mind-boggling if I was to put the proposition to Australians that our lighthouses and seamarks should be run by a not-for-profit corporation, but, of course, you have done that for 400 or 500 years. For the Americans, this is a very challenging idea. We think of the

Americans as a bit free-booting on this stuff, but if you put the proposition to the Americans that their lighthouses and seamarks should be done by a private entity, it would be confounding. Some of this is definitely based on our historic journey—our historic experience. That does alter the way we perceive it.

I do think it does change over time as well, and obviously it depends, based upon the maturity of our models. You can have a not-for-profit running your seamarks because you have a very established institution. We have no private capacity in Australia to do that.

Chair: The Princess Royal is really in charge. Moving on, the next question.

Q405 **Dr Rupa Huq:** Local government has recently begun to insource services back in-house. In England, the libraries were run by Laing, and then that was swallowed up by Carillion. Now they are coming back in-house. Apparently Slough has done the same with waste services. Should this be considered by central Government too and, if so, in relation to which particular services?

Professor Haslam: There is an interesting case to be made. We talked about the difference between Liverpool and Manchester, and Manchester re-municipalising its waste services. The argument I want to try to develop here is that the logic for that is probably to do with localising the control, and localising the network relationships through the SME networks that predominantly provide the support mechanisms for these types of contract. They are hidden when they are consolidated within large organisations like Carillion, but become visible again once you have to re-municipalise the contract. This is an important process that we can start to learn from, using different cases and examples—library services, waste management services and so on. It seems to me that this is part of re-building the foundational economy and the foundational networks around the provision of essential services.

Q406 **Dr Rupa Huq:** Is there a role for central Government to step in?

Professor Haslam: We need to maybe differentiate between the sorts of contract that we are thinking about: at the level of Government—Government offices, MOD contracts, that type of contract—NHS trusts, infrastructure contracts, and PFI contracts, and then down at the level of local government, around local government outsourcing contracts. If I were to say, "Is this something that central Government can learn something about?" the answer is, yes, in terms of benchmarking the costs of particular services when they were outsourced and when they are re-municipalised.

Q407 **Dr Rupa Huq:** What would you say the challenges are facing Government, in the event of bringing back something in-house that for a long time has been outsourced?

Professor Haslam: If we look at, say, waste management challenges in Manchester and Liverpool, it is about learning from Liverpool, which, in a sense, re-municipalised over the last few years, and about Manchester learning from those local experiences. It is about exchange of information and networking—that is, learning from those that are doing it, and experimentation around that.

Q408 **Dr Rupa Huq:** To what extent does the Government take a strategic view about what it insources and outsources, and does it vary across Government Departments?

Professor Haslam: At a strategic level, rather than focus on the contract, maybe displace this now to the companies that Government are contracting with. There is a need for stress-testing of those organisations within which those contracts are to be located, first of all. There is very little work being done within Government to stress-test the organisations, the large companies, within which these contracts are being located.

Nick Davies: With any level of Government, the number one concern when considering contracting—whether outsourcing or insourcing—should be value for money. I think there is broad agreement that there is probably not a hard line about what should be insourced or outsourced, but there are certain services that are more likely to be able to be outsourced successfully, or that may be more likely to be delivered in-house successfully. Again, there can be poor management by Government-run services. There can be poor management by private-run services and so on, so value for money should be what is being focused on at all times.

We have set out 10 questions that we think the Government should ask themselves when considering contracting or, indeed, insourcing, because at the moment we don't think that a particularly strategic approach is taken. It tends to be that you continue doing what you have always done.

Q409 **Dr Rupa Huq:** Or you get forced into a position by circumstances, like the libraries in England.

Nick Davies: Yes, indeed. I will not go through all the questions that we asked, but the key ones that we would consider were, is it difficult to measure the value that is being added by providers? Are service outcomes highly dependent on the outcomes of other services? Is the service characterised by high demand, uncertainty or high policy uncertainty? Does the Government have enough information about cost and quality to measure provider performance? I am happy to send a note to the Committee with those full questions afterwards, if that would be helpful.

Chair: That would be very helpful.

Nick Davies: On the question of insourcing—and it has already been mentioned—particularly the local voluntary sector in many areas will be locally based. It will be staffed by, and it will have trustees and so on, from the communities in which it is serving. It might, therefore, have the expertise and ability to reach communities that parts of Government will not. So when considering insourcing, I certainly would not want that to mean that the Government or parts of Government were not seeking to understand demand from expert bodies that are already based in those communities. It might be that they then have a different relationship to them, rather than the kind of contractual relationship currently. There is a lot of expertise out there, and part of the problem is procurement decisions have been made without being part of a wider commissioning process or starting with an understanding of demand and the capacity to meet that.

Q410 **Chair:** When you say "demand", what do you mean?

Nick Davies: I suppose that could mean many things. It could mean that there are particular medical conditions, it could mean that there are particular language conditions, or it could mean that there is a particular loneliness problem in the area—the many ailments and concerns that constituents will come to MPs with regarding help. Obviously that will differ in different parts of the country, and sometimes it will be community and local area-specific. It could be very difficult for someone in Whitehall or someone in a town hall to fully understand exactly what demand there is or how that has changed recently. That is not unreasonable—you should not expect that—but there are organisations out there that are of those communities, and that will often have a greater insight.

Q411 **Dame Cheryl Gillan:** I am going to pick up on the libraries point. Isn't it often the case that the local authority is perhaps not aware of all the different business models and the opportunities? For example, in my own constituency, Little Chalfont Library—when Bucks County Council was withdrawing its support because it was trying to save money—set up a fantastic business model. It is now run by the community. That was taken up in Chalfont St Giles and also Chalfont St Peter, and we now have three thriving libraries functioning much better, but actually run by the community, with a very small amount of seed money from the county council. I am not sure that people are aware of those models that exist when they make the decision in other parts of the country to outsource, say, libraries to a private contractor.

Dr Rupa Huq: The only reason the libraries went to Laing in the first place was for cutting costs. People are forced to do that when their budget is 60% gone.

Professor Haslam: I would come back to the point that the value-for-money case must have been made, in the sense that Carillion bundled up 400 or 500 contracts, so some of them must have been value for money. The point is the second issue, which is the risk transfer, and the risk transfer did not work, because the company went bust. That is the point. It comes back to your responsibility to find solutions—creative and innovative solutions no doubt—but that is the risk element, and those are the two sides to the argument I am making: one is the value for money and cost saving out of the contract, and then there is the risk transfer, which is a second element, and that isn't functioning.

Chair: Professor Sturgess, one sentence.

Professor Sturgess: There is an issue of co-production in some of these services, in terms of engaging with the community and getting the community to contribute, so, as it were, the consumers contribute to the production. In terms of that process in the commodification of a service, which can too often happen when we are just driving for lower cost, we miss this engagement, and good policymaking has to build that into what is happening.

Chair: There is a lot in this. Nick Davies, very briefly.

Nick Davies: Yes, to pick up on a couple of points, the relationships point is important. One thing that has happened, as local authorities have lost staff, is that a lot of the understanding that commissioning and procurement teams might have had of particular providers and their expertise has been lost.

I agree that the seed money can be important. Often a public funder might not know, when they withdraw what might seem like a small amount of money, that that has been the basis on which a charity has been able to draw in funds from elsewhere.

On the library point, although there have been cases where communities have come together and been able to produce their own services, in many others, unfortunately, services have basically been dropped on a community group without the support, without any expectation, or without any business model that would enable them to run it.

Q412 **Kelvin Hopkins:** One has to avoid generalising from particular cases. Both sides will put the case, no doubt, on particular cases, but there have been some pretty damning examples of massive cost increases when things have been contracted out. I will just quote one, if I may, and ask you what you think about it. You touched on railways earlier on. Just recently there has been a report published in the *Rail Engineer* magazine contrasting the cost of electrification undertaken under BR—British Rail—in the public sector, in-house, 28 years ago, with electrifying the East Coast Main Line. Stripping out inflation, this analysis suggests that electrification now costs seven times what it did in those days. That is taking out inflation, and since privatisation, with a heavy reliance on contracting out. The Government has cancelled a lot of electrification contracts, and we now have one of the most expensive railways in Europe. That is not marginal; that is quite damning. What are your thoughts on such examples? I can give other examples if you wish.

Nick Davies: I cannot beat the contracting point, but on electrification, a big problem has been a major failure of Government appraisal. The initial estimates that were made were far too optimistic, and the initial forecasts were not put under the scrutiny they should have been. That underpins a wider point about the lack that there is of an evidence base, both for major construction projects and for outsourcing generally, and about a lack of Government inquisitiveness in trying to secure that data in any systematic way, analyse it and use it to inform future decisions.

Q413 **Kelvin Hopkins:** Just one more question about that. Some 15 years ago, it emerged that the cost of rail track maintenance had risen by four times since privatisation and contracting out. The problem is that although they brought that back in-house, they brought back in-house the bad practices that had caused the rising costs. As well as whether it is in-house or out-of-house, we have to look at what the practices are both inside and outside privatisation.

Nick Davies: Yes. The key challenge is driving improvement, whether it is delivered privately or publicly. Sometimes the question of "public good, private bad" or vice versa is a bit of a distraction from that.

Kelvin Hopkins: I could go on, but I have done enough. Thank you, Chair.

Q414 **Dr Rupa Huq:** Your list of 10 indicators—you are going to supply us with that—reminds me of Serco and John Tizard, who have suggested that there should be a standard evidence-based process for deciding whether to make or buy in a service or project. What do you think of that? Is that similar to your 10 points?

Nick Davies: This is not a yes or no. It is, "If you have 'yes' to a number of these questions, you should seriously consider if it is wise to". There are measures you could take to reduce the chances that that would go wrong. The problem is that Government at all levels has tended not to do that and has tended to rush into outsourcing approaches without fully considering how to mitigate potential risk associated with that. I do not know the specific question or test you are referring to, but I certainly think that decisions should be more systematic, strategic and based on set questions than they currently are.

Professor Haslam: That proposition is more problematic when what you are trying to do is encourage innovation rather than just deliver the same at a lower cost, because with innovation it is, by its nature, much harder to predict what is going to be offered or what is going to be brought. I know everyone has forgotten these stories, but when I lived here for quite some years and used to visit very often, I spent a lot of time looking at prison contracting. In the early years, that was done exceptionally well. Yes, there were some savings, but the really interesting thing that was happening was that Labour were using contracting to drive what they called their "decency agenda". There were a set of innovations that emerged in the contract prisons that were new and additional.

It is much harder to have accounting methods when what you are hoping to achieve through contracting is people coming up with radically different ways of thinking about solving problems and improving services. I know, in this country, you have been overwhelmingly grappling with the cost question in the last five or seven years, but there was a time when contracting in this country was being used much more on the innovation question. I think it is harder.

Q415 **Dr Rupa Huq:** So innovation rather than evidence? It need not be a checklist?

Professor Sturgess: It is in the nature of innovation that you do not necessarily know in advance, particularly when it is innovation in management. One of Serco's contracts won the Guardian Public Service Award some years ago in health. I spoke to the woman who was running that contract—she had been a deputy governor in the public sector—and I said, "What do you do? What is it you have done there?" What struck me in her answer was that she was trying lots of different little things to make a difference. It was the sum total of a lot of little experiments to do things differently that made the difference, rather than some huge, radical innovation that had been developed in a theoretical sense first, in a lab. The nature of management innovation tends to be much more experimental and therefore harder to document in advance. That is not to say we should not document it in retrospect, but it is a different kind of process we are a going through. Now, if it is about cost savings—if we want the same but at a lower cost—perhaps that can be counted in advance in the way that has been suggested.

Neil Davies: Innovation is inherently risky, and one of the problems when you transfer lots of risk to providers through contracts is that they become quite risk-averse. They already have quite a lot of risk anyway, so the last thing they want to do is try something new on the off chance it will work, when most likely it will not. If you are funding the voluntary sector, in particular, grants, for example, can be a very low-transaction-cost way of investing in an organisation to innovate without transferring the risk to them.

Q416 **Chair:** It has been suggested to me by a senior figure in Whitehall in relation to IT that, in fact, what Francis Maude was trying to do was bring more IT expertise into Government so that the Government itself would control and understand innovation and the high-value-added end of the IT spectrum, and that contracting out should basically just be for the commodity stuff. If you try to contract out the high-end innovation and high added value, you are just losing control. How much do you think this is a rational analysis—that if you are looking at a slope on a graph, you want the Government to be at one end and the public or private sector to be at the other end, or can you not generalise?

Professor Haslam: I do not think you can generalise. You find interesting cases of innovation within the context of austerity, when it is outsourced or insourced. You discover that through case study work, interviewing people and seeing what is being done. I do not think innovation is the preserve of one thing or the other. It is certainly driven by individuals who have a deep knowledge of the history of what has been done in the past and how we learn and roll things forward, but it is not something that is specific to one thing or another. Innovation itself, within what you might call foundational sectors—the preserve of, say, public services—is very dynamic and should not be underestimated.

Professor Sturgess: GDS is a good example of where the boundary has shifted and the Government has taken on itself some additional risk. There are some preliminary reports showing that GDS is making some mistakes and taking some risks at the taxpayer's expense, not all of which have come off, but it is a good example of the fact that there is a boundary and if you pull it too far back, the Government does not have the capacity to procure a contract intelligently; if you draw it too far down, the Government is taking on some innovation risks that Government may not be best positioned to handle. That boundary will probably shift over time.

Nick Davies: If I could quickly add one quite interesting case study, it was not central Government but TfL that developed the technology behind Oyster Cards in-house, rather than outsourcing that to a private firm, and they have subsequently been able to sell that technology to New York. That is an example where innovation internally has led to a future revenue stream.

Chair: Very good.

Q417 **Mr Marcus Fysh:** How competitive is the market for Government contracts, and how and why do you think that has changed over, say, the last 20 years?

Professor Sturgess: I do not think it needs to be competitive. Contestability theory in economics says you do not need actual competition; all you need is low entry barriers and a credible threat of competition. Traditional economic theory said you need lots of suppliers and perfect competition. Contestability theory says that you do not need that. You can have one supplier or a very small number. As long as the barriers to entry are low and there is a credible threat of competition, the monopolists will act in a competitive manner. In some of these tendering base markets where the bid costs are very high, you simply cannot take 10 companies through to the final procurement, because the costs of that are cripplingly high and companies will not spend that money unless they have a reasonable prospect of winning—one in three or something.

When you speak to economists about that, I find a lot of quite loose thinking. As I said earlier, we are working with some examples in Australia where the public sector is delivering services and improving efficiency and innovation because of a contestability position—because there is the credible threat. Some people regard that as an unfortunate term, but it is the reality that if we as a management team cannot imagine a situation where we might be replaced because we are not performing well, we are not going to do well.

In a sense, I am saying it is the wrong question. Whether public or private, the question is, is it contestable? Is there a challenge? Can this player possibly be removed readily if they are not performing well? It is that question, rather than competition per se.

Q418 **Mr Marcus Fysh:** Do you have any other comments on that? Professor Haslam?

Professor Haslam: Over time the environment within which the contracts are contested has changed from a relatively large number of firms competing for those contracts to relatively few firms competing for those contracts, as those firms consolidate through M&A deals. The process of consolidation into larger and larger companies, with more and more contracts bundled into that, reduces the scope for contestability.

Nick Davies: Yes. If you look at what data there is, the big household names for outsourcing companies have a relatively small proportion of the market overall, but in some sectors and some geographic areas they will be quite dominant. As has been said, there does seem to have been a move in recent years towards an aggregation of services into a smaller number of larger contracts that has in part been driven by public bodies reducing the size of their commissioning and procurement teams—it is easier to manage a smaller number of large contracts. For example, data from the voluntary sector is better than the overall data. The National Council of Voluntary Organisations data suggests that super-major charities—those with a turnover of over £100 million, of which there are about 40—have seen a significant increase in their income from the public sector since 2010, whereas smaller charities have seen quite big cuts in some cases. I suspect that is representative of what has happened in the wider market as well.

Q419 **Mr Marcus Fysh:** Professor Haslam, you have written before about a dependency relationship that you think might have arisen in some areas. Could you say a little bit more about what you mean by that in the context of what we have just been discussing?

Professor Haslam: I think that the concentration of a large number of contracts within large corporates creates a dependency in a number of different ways. One is that the expertise is lost in terms of your ability to negotiate and monitor the contracts. The resources within the public sector in terms of substituting for those contracts have been lost as well, so there is a natural dependency relationship. Also, there is a moral hazard for Government resorting to this type of arrangement, whereby the large corporates that are consolidating those contracts have power and control as governing agents over Government through a fait accompli relationship— "If we hand back the keys, the service still has to be done".

Professor Sturgess: Can I disagree with that? I just think that is fundamentally untrue.

Mr Marcus Fysh: I was going to ask you what you thought.

Professor Sturgess: Yes. I was over here 18 months ago and interviewed a lot of senior people—public, private and union—across a number of the companies, and then, on three companies, I interviewed deep. Clearly you cannot have the industry in the position that it is in at the moment and in the position of telling Government what is going to happen. It is quite the contrary: they are getting margins that are utterly unsustainable—commercially unsustainable—at the moment. That has happened because Government has, frankly, abused its market power. I am not excusing the companies; they were stupid, in my view, to have gone ahead and entered into contracts in circumstances where they could not control the risk or price they were taking on, but this is a Government supply chain. If Ford stresses its supply chain and is having to do major product recalls, that that is Ford's problem. It is a bit the same with Government.

Even the biggest of these firms tremble when, as I indicated in my report, a Minister calls them in and demands money from them. The evidence shows that they had no legal obligation to do it, but they handed that money over. That does not suggest to me that this is an industry where the companies are telling Government what to do. This is an industry where they are utterly beholden to Government, so much so that they have signed stupid contracts for probably five to seven years now.

Q420 **Chair:** Can you clarify? When did that occur?

Professor Sturgess: Those meetings were in 2010, I think it was. It was just before I went back to Australia.

Q421 **Chair:** Who was involved in those meetings?

Professor Sturgess: It was one of the central Government Ministers who met with them.

Q422 **Chair:** Lord Maude? Francis Maude?

Professor Sturgess: Yes, it was, and I have spoken to three of the individuals who attended those meetings.

Q423 **Mr Marcus Fysh:** Can I just ask what impact you think there might have been on that process of the financial crisis itself in 2008 and 2009? I know from my own area in Somerset that some of the contractors at that point had offered some amazing rates, effectively, to the local government there, which, over the course of the cycle, were not deliverable as the economy recovered. Do you think some of that might have been what you were just describing?

Professor Sturgess: With John Tizard I helped to set up an industry association inside the Confederation of British Industry, which was 15 or 20 chief executives of mostly the larger providers. There were some SMEs. I continued on as financial adviser through the global financial crisis, so I was interacting with most of those chief executives on a fairly regular basis. I did not detect any of those concerns. It is really only about 2010 that that shift occurs that I was observing in conversations with senior people across a number of leading players at the time. I certainly was not observing that response quite that early. There is no doubt that, within a year or two, that begins in earnest. There is a process of what, in retrospect, we can only say were extremely unwise decisions.

Q424 **Mr David Jones:** Professor Sturgess, could we return to your point about abuse of power by the Government? You gave us an example. To what extent would you say that the Government understands that it has this dominant position that enables it, in your terms, to abuse its power?

Professor Sturgess: One can answer that at several levels. Generally there has not been a good understanding of the nature of the systems with which we are dealing. There is no good literature to help policymakers on the question of contracting and contract management generally. There has not been sufficient awareness of the difference between being a buyer and being a market regulator. Part of the problem that I am alluding to, and referred to in my "Just Another Paperclip?" report, is that it is, if you like, the umpire doing some tackling. It is confusing the role of a buyer, and essentially a monopolistic buyer, with the other role that Government must have as Government, which is as umpire or the market steward. There is that confusion as well.

Q425 **Mr David Jones:** Would you say that there was a deliberate attempt by Government to distort the market? I remember that shortly after the coalition Government came to power, Philip Green was drafted in to prepare a report about how the Government should use its position in the marketplace.

Professor Sturgess: The title of my "Just Another Paperclip?" report refers to a particular problem, which is the inclination to view these markets or these services as commodities. My argument is that even a lot of support services, and certainly a lot of frontline services—say probation, prisons, or social care—are quite complex human services and are not commodifiable in quite that way. There was definitely a deliberate strategy pursued of bringing people in from the City and the private sector who had experience with very commodified buying—buying widgets or things where the market is commodified. I see this continuing to this day. There is this belief that reasonably complex services can be reduced to units that can be bought by clicking on a computer screen. I think that human services, and some of the important supports to others in the delivery of human services, are simply not commodifiable in that way. There was definitely a time when the central agencies—and, following them, some of the line agencies and local government—set about to commodify in the interests of saving money. There was a deliberate choice made to do that. It was considered to be a good thing.

Q426 **Mr David Jones:** Do you think that the Government at that time understood the effect that its actions would have on the market? If they did not then, do you think they do now?

Professor Sturgess: No, I do not think then, and I do not think now. Some of this arises out of the difficulty that policymakers and those who provide public funds have in understanding the world of delivery. Some of the strangeness of the conversation between policymakers and the companies that deliver services under contract is the oddness of the relationship between policy and delivery. Delivery is, of its nature, messy, untidy and judgmental.

My first piece of research when I returned to Australia was interviewing the public managers of frontline public services. We interviewed about 80 of them. I remember that at the end of an interview with the chief executive of a large hospital in Sydney, I said to him, "What is the difference between your world and the world of policy?" He said, "My world is dirty. My world is full of people who vomit, bleed and have a drug-induced fit, all at the most inconvenient moment, and theirs is not". I think some—not all but some—of what we are describing is the nature of the relationship between policy and funding, and the people out on the front line who have to deliver complex, messy public services in difficult situations. It is a problem, to some extent, for public delivery as well. Contracting adds an additional distortion or component to that.

Q427 **Mr David Jones:** Professor Haslam, would you like to add to that?

Professor Haslam: I agree with Gary to some extent on the arguments there, but we cannot just focus on Government as the powerful negotiator. We also need to look at the other side of the equation in terms of the recipients of those contracts. It is not necessarily the case that if a contract is onerous in terms of the original agreements and the negotiated arrangements, a corporate or a company cannot sweat profit or cash out of those arrangements in different ways: by bundling contracts, selling contracts on, sweating working capital, taking deferred tax credits to improve the profit margin and so on. It does not seem to me that there is a simple case that, on the one hand, Government, as a monopoly negotiator, is sweating the contracts to the extent that the corporates cannot make something out of it. The corporates are very adept at financial engineering out of these contracts, and we should be aware of that as well.

Q428 **Mr David Jones:** Are you saying that you are not persuaded by Professor Sturgess's views as to the impact of Government actions on the market?

Professor Haslam: It is clearly the case that, in an era of austerity, Government will be looking to put pressure on costs and arrangements through its contracts, but it is also the case, on the opposite side, that those recipients who are pooling those contracts and corporatising them will seek innovative ways to financially engineer and obtain leverage from that in different ways.

Nick Davies: I do not think there was any plan to shape the market, other than to try to reduce the costs associated with service delivery. As has been discussed, that has led to the application of quite transactional methods to services that do not at all lend themselves to that. That is why you now have things like reverse auctions for care places, which is not going to encourage the type of quality service that is potentially going to lead to cost savings in the long run. Clearly, underpinning this, there has been an improvement in the Government's commercial capability in the last 10 years or so. Some of that has been applied to inappropriate services, but more generally the Government has been getting better at striking deals. That is partly one of the reasons that has driven down the margins of some of these larger providers.

However, I do not think that the Government is very good as acting as a market steward. We have a market stewardship framework that I would be happy to send to the Committee. For example, we think that all Departments should be identifying who is responsible for ensuring users make an informed choice, and who is responsible for clarifying how provider failure will be managed and ensuring that the relevant organisations have the capability and capacity to do that. We think that all Departments should have capability maps. We think that there should be senior responsible officers not just for individual projects but for market areas as well, to have oversight of that.

Q429 **Chair:** Capability maps?

Nick Davies: Accountability maps, identifying who within a Department is responsible for oversight of particular parts of markets and particularly who is responsible for it if things go wrong.

Q430 **Chair:** Is that going to be atomising accountability rather than creating a joint and several accountability, a team accountability, which, in the end, is the only accountability that works?

Nick Davies: Clearly it is the team as a whole. Having a named person, though, is certainly a good way of concentrating minds and ensuring that there is proper oversight of these issues. For example, we have senior responsible officers for major projects now, which has been a positive innovation. We provide quite good training to them, for example through the Major Projects Leadership Academy, and I do not see why that model could not be applied to market areas as well.

Q431 **Chair:** Do the other panellists agree?

Professor Sturgess: I certainly think there is a question of capability here, at several levels. I have three. One is contract design. We have obsessed about procurement, and, give or take, we have improved. There is a prior question, which is contract design. What is the problem I am dealing with, what kind of system do I need for that and what kind of procurement would be appropriate for that? Certainly there has been a lot of focus on contract management in recent years, but it is very commercial. It basically thinks that the way you manage contracts is by whacking people with financial penalties. Management is much more than that, and there is a lot more of the human side of contract management.

Then this question of system design. I struggle with the word "market". The trouble with the word "market" is that we shut our thinking down and we imagine that it is a free market floating out there, which we can lightly regulate. Most of these things are really just Government's supply chain. It is a complex system for delivering public services. We don't really have expertise around, and we would not know how to judge at the moment—how to hold accountable good design and stewardship of these systems. For all we have done, we are actually quite immature in a number of the capabilities we really should have.

Professor Haslam: The emphasis is on the value-for-money element within the contractual relationship, in terms of monitoring, evaluation, follow-up, audit and so forth. The risk management aspect of that dimension has not been covered really at all in terms of stress-testing the organisations that are delivering these contracts in terms of their financial serviceability and sustainability, especially when many of these contracts are long-term contracts.

Nick Davies: Let me finally add that there are some examples where Departments have made quite significant efforts to try to understand the markets they are responsible for. For example, DFE has commissioned research into the shape and stability of the children's residential care market. Other Departments should be doing that type of thing much more often, to try to understand where the weaknesses are in, as has been said, what are essentially their supply chains.

Q432 **Dame Cheryl Gillan:** Picking up, Mr Davies, on your point, it is all very well having a major project leadership authority and training up people, but on major projects it is surely the continuity of the senior staff that is also important. What we are seeing in major projects—because they are long term, they are huge and have risks attached to them—is that the turnover for senior people is much, much higher than is good for the project. Would you agree?

Nick Davies: Yes, absolutely. That is a problem with civil service routes of progression more generally. In general, people tend to move every two years when, as you say, these projects last much longer than that. We think SROs should probably be in place for five years in order to provide some continuity.

There is also an issue that within the civil service the policy profession is still regarded as the best route to the senior civil service, whereas there needs to be much more respect given to other routes, with project management being seen as a really important skill that should be represented at the senior leadership levels of Departments.

Q433 **Dame Cheryl Gillan:** Even when it is pushed outside the civil service with an arm's length procurement body—such as my favourite project, HS2 Limited—you still see a high turnover of senior staff that are responsible to the Government Department. It is a real problem, isn't it, when it comes to procurement?

Professor Sturgess: It is a peculiarly British problem—in the English-speaking world certainly. I teach at a commissioning academy in Canada every year and have seen their system. They do not have the same turnover, and nor do the Australian public services. For some reason, it is a particular problem that has emerged here and does not appear in quite the same way in the other Westminster systems.

Q434 **Dame Cheryl Gillan:** Why is that?

Professor Sturgess: I don't know.

Q435 **Dame Cheryl Gillan:** Are you about to look at this problem?

Professor Sturgess: I lived here for 10 years and spent a lot of time visiting in the years when I was not living here. I have thought about it often. I do not know—I can't explain why you have wound up there and we have not. Presumably it is cultural—something people think they need to do for their career progression.

Q436 **Dame Cheryl Gillan:** Any speculation on it, Professor Haslam?

Professor Haslam: I have nothing to really add on that.

Q437 **Dame Cheryl Gillan:** That leads me nicely on. What do you think of the suggestion from the Global Sourcing Association that there should be an investigation into Government procurement by the Competition and Markets Authority or a similar independent body?

Professor Sturgess: Academia has not been a great help in this regard. The academic literature in this space really is, I think, quite infantile and quite theoretical. The thing that has baffled me—given you have a history of bringing science to policy, and this country has prided itself on that since the war, I suppose—is that, for all the years when so much contracting was being done here, and increasingly sophisticated contracting, nobody was really studying it. There are some very good NAO reports over the years, but for some reason they do not have a lot of impact. In my report I was able to look at year after year after year of NAO reports identifying some of these problems, and it did not really change. There is something missing in the nature of the conversation about this. There should be a serious investment in it by either Government or academia, and I would have thought the private sector could meaningfully be contributing to this too—it should not just be Government. We just see pockets of it. The major projects work at Oxford has begun to focus on that particular problem, which is a related but different problem. I agree.

Q438 **Dame Cheryl Gillan:** It is not necessarily a transparent process. For example, when the Major Projects Authority produces a report on a project, Government then withholds that from public examination. How can lessons be learnt? If we cannot access what is going on, surely that is also a weakness in the system?

Professor Sturgess: I would agree.

Nick Davies: I completely agree, broadly. Slightly in defence of the IPA, there is a project called "Project X", whereby it has started sharing with academics some of its data that is not publicly available, so they can do some of the analysis that has not been done. However, more broadly, I completely agree that the quality of the data that is publicly available is extremely poor. Government has not sought to collect it or, where it has collected it, to ensure that it is published in a consistent and systematic way so it can be used by armchair auditors like ourselves to assess it.

Q439 **Dame Cheryl Gillan:** Basically, we go back to what Professor Sturgess was alluding to—that Government is abusing its position. They have the wherewithal to analyse what is going on in procurement, with the National Audit Office reports, and they have something like the Major Projects Authority, which analyses what the risks are, but they do not make it public in case it puts people off the project to start with. They do not allow that co-ordination. We probably have all the information there, but Government are quite wilfully trying to keep all of those things in their boxes, rather than having a real look at it all together and learning what happens.

Professor Sturgess: They have some of the information. There are a lot of these problems and conundrums associated with contracting for complex services, where we have not particularly developed good tools for analysing.

I will give you one simple example. One of the great benefits of competition in contracting is that it introduces discontinuity. Even when the in-house team bids and wins, as we did in New South Wales with this prison, there was a lot of discontinuity. It was forced to radically rethink how it would deliver a long-term remand prison and deliver rehabilitation services. That was a really great effect.

However, there are a lot of places and things where you want continuity—where continuity matters in a service. If you have caseworkers working with vulnerable individuals, you do not want a lot of discontinuity in the relationship with the caseworker. In a lot of places, you have corporate memory, and it is important to preserve that. That particular problem is actually one of the intriguing things we come across quite frequently in contracting.

However, nobody looks at that and explores the conditions under which you want a bit more discontinuity, the places where you want to keep continuity, and the tools you might use to get an interesting mix of those. I use that as one example of the fact that we still do this in extraordinarily naïve ways, without the benefit of insight and exploration

Q440 **Dame Cheryl Gillan:** Briefly, because all of you have partially answered this with your responses earlier on, do you think Government are capable of reconciling their market stewardship role and being the buyer of services?

Professor Sturgess: Yes, I do. This is part of the genius, I suppose, of separation of powers, and checks and balances. Governments have over the years created different institutions, which create a level of separateness within the public framework. Independent central banks are a particular phenomenon that has developed around the world in order to create a level of professionalism and independence from day-to-day politics on the question of maintaining stability in the money supply and managing inflation. Governments developed a set of institutions that are under the umbrella of Government, but at slight remove, in order to reassure investors that the currency would not be debased.

Dame Cheryl Gillan: Do you both share that view?

Nick Davies: Yes, I do share that view.

Q441 **Dame Cheryl Gillan:** Lastly, Mr Rupert Soames of Serco proposed a code of conduct for Government and companies to sign up to, and an independent arbitrator. What is your assessment of that?

Professor Sturgess: You have had some recent experience with codes of conduct under the umbrella of the Carillion problem that suggest they do not always work. I certainly think there are normative elements to this and not just, if you like, contractual or legal ones. It is possible and important that we develop a predictability about behaviours. Sovereign risk is a good example of this. Parliament, of course, can retrospectively vary contracts, or wipe contracts out of existence—it has that power. The consequence of doing that is that nobody really wants to invest in the country anymore—it creates sovereign risk. There is a self-denying ordinance, which Western legislatures have generally practised, of not doing that, because it is not a smart thing to do. That is a normative rule; it is a self-denying ordinance. Therefore, I do think there are normative dimensions to this.

The extent to which you should have some other kind of tribunal, other than the courts, is problematic. It would depend on what that institution was and what its relationship with the courts should be. It is an idea that has been talked about, and I was actively involved in these conversations from 2000 onwards in this country. It was talked about for a long time—the idea that there should be somebody to whom you could go. The Crown Commercial Service does act, to some extent, in that way now. It is an idea where I think the devil would lie in the detail rather than in the generality.

Q442 **Dame Cheryl Gillan:** The Crown Commercial Service is really advisory, isn't it?

Professor Sturgess: Yes.

Q443 **Dame Cheryl Gillan:** Does everybody else agree with that?

Professor Haslam: I agree with those points. It is back to the earlier point about a more open disclosure of information to the public around contractual negotiations and also the financial conditions attached to those relationships, which are very difficult to get hold of.

Nick Davies: Yes, I would be open-minded about a code of conduct. As you said, the devil's in the detail. I would need to know exactly what it was and how it would be enforced. It is worth bearing in mind that contractors are subject to the Nolan principles. Certainly in the case of Carillion, I would suggest that probably all seven of those have been broken in one way or another. Similarly, all of these companies will tend to have grand statements about their ethics, and even training in-house, but it is one thing to have that and it is another thing to have a culture of ethical practice, and that is very difficult to build.

Q444 **Mr Marcus Fysh:** I wanted to jump in and ask, when it comes to the analysis of these different areas and the efficiency or effectiveness of the procurement process, are there any countries we can look to and say they do this particularly well? That is my first question.

I wondered, as a second question, what implications this discussion has for the concept of potentially opening Government procurement up more in a process of trade deals around the world. Are there any particular examples that we should be following or wary of?

Professor Sturgess: Can you unpack the second question a little bit more for me?

Mr Marcus Fysh: One of the suggestions has been that, in future trade deals, Government procurement is a potential area where one could think about doing a deal. Are there any particular things we should watch out for? I presume we would have to have a fairly good idea of what our opportunities were domestically before we could realistically think about assessing to what extent that should be part of a trade deal or not.

Professor Sturgess: Trade deals are not an area of my expertise. However, let me say this as an outsider. I am somebody who lived here, took up citizenship and has great affection for this country, but I am essentially an outsider.

The fact is that you led the world, and have led the world, in public service contracting. The Americans introduced prison contracting and did it very badly. The UK moved several years later and, in reality, the world began to adopt the British model and the British companies because it was a much easier model for people to accommodate. If I speak from an Australian perspective, the goodwill associated with that model was enormously important.

In road management, the New South Wales Government moved several years ago to contract for not just maintenance but management of the ongoing use of the roads. It went to New Zealand, who had done a little bit more, and came to the UK, and it invited British companies into the market. British companies were bringing expertise that Australia simply did not have. There would be lots of other examples.

It beggars belief to me, having that competitive edge, that—wittingly or unwittingly—a great deal of harm has been done to that model. The UK plc brand in the public service space is still quite strong in Australia and New Zealand but, nevertheless, there has been some measure of damage done to that.

During the PFI years, I used to attend meetings in the City about selling PFI. It was essentially selling finance skills overseas. I tried to explain, and there was some interest, but we could never get interest within Business—DTI it originally was—around the fact there was this service management expertise, a great capability developed in this country. There are huge potentialities around that. It always seemed to me it should have been a source of great pride that there was a whole new industry emerging here, where you had something new to bring to the world and in the services space. We know the future is going to be overwhelmingly services.

In terms of where you look elsewhere, it is mixed. Australia is, in some ways, behind the UK, but we have done some things better. America, likewise, has some very awful, ugly and, in some cases, quite old-fashioned forms of contracting, but also has some remarkably sophisticated contracts and contracting models. At different times and at different places, it has studied it well. However, I think it too has a problem and has not studied as well as it might have.

Q445 **Mr Marcus Fysh:** Would you be able to give us some information about the good examples that we might be able to look at with the American experience?

Professor Sturgess: To give you one example, the American GoCo model—Government-owned, contractor-operated model—was developed at the end of the Second World War to manage scientific laboratories. That was copied here briefly in the 1990s. They have drifted a bit; some of the big laboratories are being market-tested again at the moment, and it has become a bit more commodified. However, that was a really important learning. Some of these extraordinarily complex American defence system-of-systems contracts—they have made some big mistakes too—have gone very well. There is much to be learnt from them.

Then you have to go into specifics. There are some places where, in particular slices, it is done exceptionally well, and other places where you would not want to learn

Q446 **Chair:** Can I just return to the question of how we promote ethical behaviour, which, Mr Davies, you rightly say is very difficult? Isn't that the point of a code of behaviour? Not to create another layer of regulation against which you measure, reward and punish, but to have a code of behaviour that people talk about, discuss, explore and understand. How much conversation goes on about ethical behaviour in contracting at the moment?

Nick Davies: I certainly think there is a lively conversation within the voluntary sector at the moment about ethical contracting and about the relationship the voluntary sector has with Government. It is certainly the case that some smaller charities would say that some of the larger charities have perhaps acted in quite a commercially sharp-elbowed way, while it has been perfectly legal, it perhaps has not been entirely in keeping with their public benefit duty. I certainly think there is an active conversation there.

I do not know the extent to which there is a conversation happening in the private sector about that, beyond the kind of warm words there normally are.

Q447 **Chair:** We have all seen Carillion's report and accounts, which were full of all of the wonderful words. What is the answer to this, unless we have something to promote the right conversation, like a code of conduct?

Nick Davies: I think a big part of it is about incentives.

Q448 **Chair:** That suggests these ethics are something to be contracted. You cannot contract ethics.

Nick Davies: Perhaps. However, I certainly think if you incentivise people to always bid at the lowest price then that is going to—

Chair: That is a different point; we will come to that. The other two?

Professor Sturgess: From what I was observing within Serco—I was not deeply connected to the business; I was offline, but I saw some of it in conversations I have had with Serco colleagues since—I have no doubt at all that the conversation Chris Hyman had with the Cabinet Office Minister at the time was deeply shocking to him and led to a change in attitude. It was apparent they were now dealing with one customer, not a multitude of customers, across central Government and that there was a ruthlessness to the relationship. They grappled for some time to try to work out how to cope with this new environment.

I do think Government have a huge responsibility in the ethical tone that is set for any particular market. We should not underestimate the seriousness of that.

In terms of procurement, when one of the bidders comes forward and offers 30% lower on a service that has already been competed several times, I have had conversations with senior civil servants who said that even though they knew that was probably not doable, they thought they had an obligation to accept that price. That produces an air of utter unreality into the conversation. How do you begin to then have a conversation about ethics when you have set up that kind of utter unreality?

Q449 **Chair:** The code of conduct is messaged towards the people who are writing the codes of conduct—it is resetting their own attitudes. Is that not something we need?

Professor Sturgess: A code of conduct without a normative adjustment on all fronts—without a change in behaviour and a change in the nature of relationships—will not work.

Q450 **Chair:** Professor Haslam, how do we get that change in behaviour and change in relationships?

Professor Haslam: I do not think you are going to get it by blaming Government, which is the one-sided position we have just heard here. We also need to think that the corporates that are bundling these contracts are not innocent in this.

Q451 **Chair:** That is not entirely reasonable, is it? You either play by the Government's rules or you do not play.

Professor Haslam: Exactly. However, the way in which those engagements are operating is not simply one-sided through Government's negotiation practices. There is an opposite case to be looked at, which is the behaviour of corporates in terms of the custody of those contracts and how, surrounding those contracts, other things are going on in these organisations—not simply managing the contracts.

Q452 **Chair:** Somehow the contracting companies have to set their boundaries around the Government and hope that the Government conform with their boundaries. If the Government do not conform with their boundaries, they do not play. Do I have that right?

Professor Haslam: Yes. With Carillion, only half the revenue coming into the company was from Government contracts. It is doing other things. The mixture of those other things, and responsibilities around that, are conflictual and can undermine the commitment to Government contracts in terms of serviceability and continuity.

Nick Davies: I certainly agree that providers need to set their own standards. Indeed, we have talked quite a few times about Rupert Soames. That is one of the things he has effectively done to put Serco on a more sustainable financial footing. He has decided that it, basically, will not bid for contracts where there is not a margin of 5% or 6%. That means it has withdrawn from quite a few potential opportunities. It also means they are making a relatively healthy return, are not too fragile and can withstand some taking on of risk.

Q453 **Kelvin Hopkins:** The Treasury's Green Book says that, "Risks shall be borne in the terms by the organisation that is best placed to monitor and manage it". What do you think this means?

Nick Davies: The Green Book guidance is very good on this. Indeed, it has not really changed in the new Green Book.

Kelvin Hopkins: What does that phrase mean? It is too vague for me.

Nick Davies: It basically says there should not be an approach to maximise risk transfer but to put it with whichever actor is best able to manage that. For example, there is some risk that cannot be reasonably priced by the private sector—effectively, catastrophe risk, policy change or even inflation risk—and that is probably better held within Government. A niche example is the Thames Tideway Tunnel that is now being built to carry sewage. The Government have effectively provided a guarantee that for certain catastrophes—for example, if drilling happens to flood the Underground—it would be Government that would take on that risk, because that risk cannot be sensibly priced within the private sector.

Q454 **Kelvin Hopkins:** Aren't there a whole lot of risks that cannot be priced in the private sector, such as expensive treatments in hospital, looking after difficult patients with dementia in care homes and so on?

Nick Davies: In some of those cases, the risk can be pooled. Obviously in some cases it cannot be. You are right there is not an active insurance market for adult social care because, again, there is a tail risk—some people might be liable for £1 million cost, whereas most people might average only £20,000. That is probably the type of thing that the Government need to insure. Indeed, that was the basis on which Sir Andrew Dilnot made his recommendations—that if the Government took out the catastrophe risk then an insurance market could develop for, say, up to £100,000 that might be incurred by people.

Q455 **Chair:** What about Caledonian MacBrayne, which was forced to take a contract for the provision of ferry services that included the risk of the regulatory environment changing? This rule seems to be honoured in the breach.

Professor Sturgess: As I say, I am 18 months out of date, but when I did my interviews 18 months ago, there were lots of those examples. I have seen Rupert Soames publicly talking about this. It would appear that it continues.

Q456 **Chair:** We went recently on a visit to Cardiff. The Cardiff Bay Barrage contract was let, and the company building the barrage had to underwrite the risk of water table rise for the entire area of Cardiff Bay. There has been absolutely no damage to buildings as a result of water table rise. How much did we pay for that? Was it a risk worth offloading? How do we stop the Government thinking they have been frightfully clever by offloading these risks?

Professor Sturgess: When PFI was being launched, I was coming over here regularly and had just left government. I spoke to Sir Steve Robson, who was Second Permanent Secretary of the Treasury, who pretty much developed the PFI system. I said to him, "Why is Treasury driving this?" He gave me three reasons. One of the reasons he gave was, "We will begin a debate around risk allocation". He said, "It will take years to play out because we are just not very good at this in the public sector". Conceivably, we are in a period when there has been this mad swing in that direction, but I think the underlying question is—PFI has run into its own difficulties—how do we frame an intelligent conversation and how do we learn from this and improve our capabilities around such questions? To some extent this is presumably normative, since central Government cannot mandate what happens up in Scotland.

Q457 **Kelvin Hopkins:** In broad and general terms, what evidence is there that the Departments follow and implement their own guidance—the Government's guidance?

Professor Sturgess: Eighteen months ago, when I was doing the interviews, at the same time as the Crown Commercial Service was issuing some guidelines that said very much what the Green Book said, the MOD was moving, still and quite firmly, in the opposite direction, in practice. There is, I think, this problem that even some of the large central Government agencies have been not necessarily paying a great deal of attention to what the Green Book or Crown Commercial Service guidance were saying. There is an interesting question about how you make these things take effect.

Q458 **Kelvin Hopkins:** I have to say I am a serious sceptic about risk transfer from Government to the private sector, but what risks can really be effectively transferred to contractors, and which risks do you think should always remain with the commissioning authority? Dividing risk is something I am sceptical about.

Professor Sturgess: The ultimate performance risk cannot be shifted. If a prison fails, and there are riots, the Government is going to wear that, but there is a lot of intermediate risk, lots of intermediate management risks, that can be shifted, so you can give them targets in terms of safety, security, decency, reducing reoffending—we are beginning to explore that—and you can have a series of measures and then a series of disciplines that, in the early stages, are meant to improve capability but, ultimately, will result in more serious interventions. There is lots of evidence to show that we can shift those intermediate risks, but, yes, if a prison's performance decays to the point where you wind up with riots or other severe internal—

Q459 **Kelvin Hopkins:** Escaping murderers?

Professor Sturgess: Yes—whatever it may be. But there are lots of intermediate risks that we can shift, and have successfully shifted, through contracts. It is just that, at the end of the day, it is Government's supply chain.

Q460 **Kelvin Hopkins:** But there are consequences of inappropriately transferring risk to contractors, obviously.

Professor Sturgess: Yes.

Kelvin Hopkins: Pretending you can outsource a risk when, actually, you cannot.

Professor Sturgess: Yes, but I am less inclined to draw the public-private distinction here. I think there are also consequences from not adequately transferring enough risk to the managers of frontline services—public or private. We have to find this balance. On the one hand, yes, the Prison Service as a system owned this and will wear it, but equally we have to work out how to shift responsibility and authority for managing a particular prison to people who are going to make those decisions day in and day out.

Q461 **Kelvin Hopkins:** A phrase that is used quite a lot is, "Government keeps the risk, and the private sector makes the profits".

Professor Sturgess: Well, it is not making a profit. That is the problem at the moment.

Q462 **Kelvin Hopkins:** It is starting to crumble, we know, but that is what has happened in the past.

Professor Sturgess: As you know, my views are that things have not gone as well lately, but, historically, we were looking at margins for the typical managed services of 5% to 6%. That order of magnitude is reasonable for the level of risk that was involved in, say, running a prison, to stay with that example.

Chair: This is an absolutely fascinating evidence session, and we are getting a huge amount out of it, but we are miles behind. That is my fault, because I am a hopeless chairman, and I am far too engaged with what you are saying, but we either carry on with all our questions, or we take some questions out. Could we have short questions and short answers for the rest of the session, unless you have something really important to say? That applies to me as well. We will press on.

Q463 **Mr David Jones:** On the question of pricing, which we have been discussing at length this morning, and several of the witnesses to this inquiry have criticised the question of pricing, to what extent is it possible or desirable for the Government to establish a price in these markets? If it is, how should they go about doing so? Professor Haslam?

Professor Haslam: There is good evidence that Government do, through the National Audit Office reports and various benchmarking exercises—you have mentioned the issue of elderly care—try to undertake benchmarking on unit costs for, for example, elderly care in the voluntary sector, charities, private sector providers, Southern Cross and others, and local government provision. There is evidence, and we do have evidence, for pricing out and establishing benchmarks within which negotiations for contractual relationships are to be established. There is good evidence that we are doing it; it is just that we are not pooling the information and sharing it.

Q464 **Mr David Jones:** And yet we have heard, of course, of aggressive action by senior Ministers, which has had the effect of driving down prices even further. I wonder why contractors accept risky contracts. For example, we have heard about the prison facilities management contract. Why would they accept a contract of that sort?

Professor Sturgess: I have a list of about a dozen in my "Just Another Paperclip?" report, which I probably should refer you to, but there probably was an assumption that self-interest would kick in and that companies would not take on price or risk that was undoable. But there are a number of conditions under which companies will in fact do precisely that. It is an important area for closer analysis. I could give you a dozen examples, but I will give you just one; it is a problem of sunk cost.

If I, as a private company, think that this bid is going to cost me £1 million and that it will take 12 months, and then we get to 12 months or nine months in, and they say, "Procurement is going to take another six months, not another three," and then it rolls on for another three months, at each occasion, when I make the decision, "Shall I stay with this and spend that additional £0.5 million, or shall I walk away?" it is perfectly rational to stay in, because I have already spent that money, and the number of other players is now relatively limited. At each decision point, it is perfectly rational for me, as a private sector provider—as the bidder—to stay in the game, but if you had asked me at the beginning, "Will you pay £2 million for this bid, instead of £1 million?" I would have said no.

I use that as one example of how it is possible to construct a game, if you like—a set of rules—where it is, overall, not rational to do this, but if I make the decision slice by slice, it is perfectly rational to keep spending the money.

Q465 **Mr David Jones:** You are effectively in it too deep to pull out.

Professor Sturgess: Yes. If they have down-selected, and there are only three of us in the play, my odds of winning are now much higher than if I go back and start again at another game. There are a number of other examples I could give, but they are in my report.

Nick Davies: Historically, a lot of these companies have been able to do land-and-expand—that is, win a contract that might not be particularly profitable, with the expectation that they can negotiate specifications, changes or add-ons that will make the contract more profitable in the long run. They have not been able to do that any longer, and, indeed, in some cases have been asked to make in-contract cuts. I suspect, and it certainly appears to have been the case with Carillion, that there was also a requirement to keep up their cash flow, which I think is something that Professor Haslam—

Q466 **Mr David Jones:** But an experienced contractor, surely, would be able to assess the contract that is being presented and make a decision as to whether or not there is scope for that sort of activity.

Nick Davies: Indeed, and I think historically there probably has been more scope for that than certainly there was post-2010. Perhaps they were caught out by the changed circumstances.

Q467 **Chair:** How ethical is land-and-expand?

Nick Davies: It depends how you go about it.

Q468 **Chair:** It is an exercise in misleading the client, surely.

Nick Davies: On the basis that it is the client who has specified the contract, but you get in there and it turns out that there is more work to be done, you could argue that that is a failure of the client to properly specify the contract, but I do agree that, in some cases, it was probably done unethically, suggesting work that perhaps might not have been entirely required.

Q469 **Chair:** Is it ethical for a contractor to exploit the ignorance of the client?

Professor Sturgess: Variation games, in my view, are unethical, although there are plenty of private markets where both players tolerate them.

In other examples, it is a case of first-mover advantage, where companies were prepared to risk a low margin on one contract, because they believed that would enable them to develop knowledge and expertise that would enable them to more successfully win more contracts going forward. I could give examples, and I think I do in my original report, of where companies did that and the extra opportunities never turned up, so they were just left with a loss-making, early contract. There are ethical versions of that, and there are also unethical versions of it.

Q470 **Chair:** Trade is meant to be about enjoying mutual advantage, not exploiting one over another.

Professor Sturgess: The private construction industry has, around the world, engaged in some quite predatory behaviours on both sides, and yet it keeps going on. The motion picture industry is all about contracting; it is lots and lots and lots of contracts, and it is quite an aggressive contracting industry, and yet we keep seeing movies made, year after year. Some industries can arrive at a sort of stasis around a quite aggressive model. I don't think that is how Government contracting should work, but—

Q471 **Chair:** That is a very interesting comment about the motion picture industry, reflecting on some of the private and unwritten contracts that have recently been exposed.

Professor Sturgess: Yes, well, those are normative behaviours.

Q472 **Mr Marcus Fysh:** What scope do you think there is, given what you were saying earlier about the transfer of risk, for us to use our very big, deep and large expertise in insurance markets in London? Is there more scope for Government to think about working with insurance markets in a different way, to be able to slice and dice some of these risks in a more efficient and effective way?

Professor Sturgess: The answer is yes, but it has to be done experientially. In the insurance industry, and indeed the banking industry, there are lots of problems with PFI, but there are some very interesting insights out of the role that the banks played in PFI in nailing down—beginning to nail down—some of the risks and to push back and manage them, including performance risk, but it takes time for that learning to occur. I do think that if you were to structure the emergence and development of an industry and those sets of engagements over time, there would be huge opportunities to benefit from that strength in the City.

Chair: We need to move on to skills. Cheryl.

Q473 **Dame Cheryl Gillan:** The NAO looked at the MOJ and the Home Office and said that they had inadequate capability, and that leads to the question: what skills does the civil service need to properly outsource services and projects, and which of those skills does it currently lack?

Professor Haslam: I would start with my own area of research and work, which is on the financial stability and viability of the large organisations that are consolidating these contracts—that understanding of stress-testing these organisations in terms of financial evaluation, especially in a world where those organisations are increasingly financialised, where, in the case of Carillion, the distribution of profits was six times the total cash earnings. That is a huge distribution, and it undermines the condition of the balance sheet. Any asset damage, in terms of contracts, forward-looking or goodwill impairments on the balance sheet, or working capital impairments on the balance sheet, will feed its way into the shareholder equity, which is thinned out and hollowed out in these organisations because it has either been distributed or it has been damaged by, in the case of Carillion, pension fund liabilities as well.

We need a new form of stress-testing that takes these mark-to-market adjustments that are taking place in accounting practice into account, and we need to assess and stress-test the organisations within which we are locating these contracts. I think that knowledge is lacking in terms not of the basic 101 accounting ratios of liquidity and so on but of how accounting standards interact to change the balance sheet structure and how the operating structures of the business in terms of its margins are interacting with its balance sheet. We need much more work in that area.

Q474 **Dame Cheryl Gillan:** Much more sophisticated due diligence on contractors?

Professor Haslam: Absolutely.

Q475 **Dame Cheryl Gillan:** Anything to add, Mr Davies?

Nick Davies: As I mentioned earlier, I think the Government have made quite positive steps with their commercial skills in recent years, particularly around recruitment, routes for progression and so on. There is still work to do there, particularly in ensuring that those commercial skills are at the top levels. Where there is probably still a weakness is around the actual commissioning skills, rather than contract agreement skills and the market steward roles. Obviously, the Government did create the Commissioning Academy, which was mentioned earlier, and subsidised the places of civil servants from across the public sector. It subsequently spun that out with the expectation that all places are now paid for entirely by those who are attending. I think it could do more to fund and support the building of commissioning skills.

Q476 **Dame Cheryl Gillan:** What about risk assessment capability?

Nick Davies: Yes, I think it could do more there as well.

Q477 **Dame Cheryl Gillan:** Anything to add, Professor Sturgess, or do you agree with that?

Professor Sturgess: Just generally?

Dame Cheryl Gillan: No, on skills. You would agree?

Professor Sturgess: As I said earlier, I think contract design is part of the commissioning skills. I do most of my work on commissioning, and I am just as interested, in fact probably more interested, in the public-to-public commissioning than I am in the public-to-private commissioning. But there is the same underlying set of prior questions. I just think there is a missing discipline in Government. We do sometimes commission, but we almost do it by accident. I think there is a need for that conversation between policy and funding and delivery. Those commissioning skills and capabilities, I think, are quite fundamental. It is not only about the levers; it is about the place to stand. The people who are the custodians of commissioning need to have the authority to help broker honest conversations, and that is between public and private, and between public and public. It is, as I say, not only levers, capabilities or skills; it is also the authority to hold that particular relationship—that conversation.

Q478 **Dame Cheryl Gillan:** And a safe space in which to have it?

Professor Sturgess: Yes.

Dame Cheryl Gillan: I think we touched on this a bit before, but how effective do you think Government are at using their own internal data to make—

Q479 **Chair:** Before you make the skills point, can I ask a supplementary? In terms of the other jurisdictions in which you are lecturing—the Canada School of Public Service, the Australia and New Zealand School of

Government—how do you think we teach this stuff here without equivalent institutions? We have abolished our National School of Government.

Professor Sturgess: I think several things. The UK, a couple of decades ago, removed from the civil service a space where civil servants can talk to each other about civil service issues. The Australia and New Zealand School of Government was the equivalent of your National School of Government, which does not exist anymore, and institutes of public administration also still exist across most of the rest of the English-speaking world. Part of this is a space where civil servants can speak to each other about their craft. I think that is important.

Additionally—and we are just about to do some more detailed work on the commissioning side within the Australia and New Zealand School of Government—I do think that there is a need to develop the space between thinking and doing. This is partly about bringing the thinkers across to engage with practical doing problems, but it is also encouraging the doers to take time out from the day-to-day pressures to reflect on what they are doing. That is what ANZSOG is meant to be. The Australia and New Zealand School of Government is meant to be a space where we bring thinking and doing together. I do think that much more could be done in this country to populate that space where there is, in an applied way, a much more active reflection on what we do now.

As I say, the National Audit Office does some great work, but, for reasons that I do not fully understand, it does not seem to translate into tools that people can take into their daily job. There is something to be done still to help the development of tools that people can use in the day job.

Q480 **Dame Cheryl Gillan:** I think it is fair to say, just carrying on from the Chairman, that this Committee has regretted the passing of the National School of Government and is very keen that we have a replacement. To continue with my question on the use of internal data, do you think that Government use their internal data successfully in making those decisions about contracting out and managing those outsourced services?

Professor Sturgess: I am a little out of date, and I drilled down again about 18 months ago. My observation would be I do not think they collect enough data in a form that would enable them to then crunch it and analyse it. There is lots of information around, I just do not think it is in a form that would enable you to work it and understand insights as a result of that.

Professor Haslam: That is right. I am not really clear that the Treasury is collecting outturn data and using that to reflect upon and self-criticise its contractual relationships.

Nick Davies: I would completely agree with that. We are not even publishing, for example, terms of contracts, transaction costs, performance, prime versus subcontractors. The Government are even missing some quite basic data architecture that you would need to do this well, in particular unique open identifiers that can be used for buyers, sellers and for the contracts. I think Government are trying to make progress in this area, but it is moving quite slowly. Its commitment to, at least in some services, use the open contracting data standard is very positive, but unfortunately it is not systematically collecting that data.

In terms of performance data, often due to the contracts that we have with providers, Government do not necessarily have legal access to that data. I think we should be building transparency clauses into all of our contractual agreements so that Government can request the data that would enable them to make a fair assessment of performance. Then I think a body perhaps like the IPA could be aggregating that data and analysing it in order to assess and provide advice to Departments on future decisions.

Q481 **Dame Cheryl Gillan:** Is it possible to quantify that on certain areas and projects? If they are not learning from their mistakes and learning from, say, very similar projects, like an HS2 phase 1, and then making the same mistakes on HS2 phases 2 and 2A, could you put some quantification on this as to the cost to the taxpayer?

Professor Sturgess: Just before I went back to Australia, KPMG constructed a data club in hospital support services. I think it was focusing heavily on cleaning at that time. What they did is they basically had a group of academics that were brought together who were the custodians, if you like, and the analysts of the data. This included public as well as private sector. Each of the players would get information showing where they stood against a data set, but they would not know the identity of the other players in the data set. You created a process for a trusted relationship, where data was being gathered, you were analysing performance and that was being shared quite broadly but in a way where people were not learning secrets about their competitors.

I just use that as an example of the kind of technique that can be used to produce information that is not only useful to Government, but actually hugely useful to the private players, but you did it in a way where confidences and so on were not being breached. I think there are lots of those sorts of techniques that could be used to generate much richer numerical understanding.

Professor Haslam: From my perspective, in terms of changes in accounting regulations, particularly in public sector accounting, which bring the risk back into the public sector—so things like IFRIC 12, where if the public agency that is contracting has control over the services or ultimately owns the assets, those assets and liabilities have to come back on the public sector balance sheet—it would be interesting to know, as a result of those changes, what the risk implications are and some assessment of that, and we are not getting that either.

Dame Cheryl Gillan: Thank you very much. I have further questions, but in the interests of brevity we need to move on.

Q482 **Mr Marcus Fysh:** Very quickly, I just wondered what role you think our Parliament can have in developing the scrutiny of this process around public procurement and contracting. You have talked a bit about the NAO and so on, but are there things that you think we should be doing to help try to set up or manage the institutional arrangements? Obviously, in this country we have the civil service. It is supposed to be a continuity institution. We have the common law, which of course is another major thing. Are there things that you think we as a parliamentary system should perhaps be using our Parliament to do in particular?

Professor Sturgess: I suppose the Committee system is an awfully good start. I think it is important that there is an element of bipartisanship around these issues. Obviously, there will be differences from time to time, but if some of the fundamentals are not broadly understood and broadly agreed, I think it comes back to sovereign risk. If there is not a set of broad understandings about some fundamentals, then it becomes very difficult. It is people making long-term investments—and these are long-term investments—including inviting people in from overseas.

It is certainly something that, again within the Australian context, I have seen more of recently—that there is a band of issues on which both sides of politics are broadly comfortable. Labour has, for example, been led on to voucher-based markets or individual choice markets—one in disability services, and one in technical and further education. Both were crafted by Labour in a form where the other side of politics were going to be able to accept and take forward that agenda.

I do think that, in thinking about the setting of these spaces—and history would suggest that, whatever happens, there is going to be a mixed economy—the private sector may be more or less involved, but the not-for-profit sector is certainly going to be deeply involved. The long history of this would suggest that that is so. Getting some general understandings around some fundamental settings I think is very important, and I would have thought Parliament has that continuity. As you all know, behind the headlines, in fact, there is a great deal of mature deliberation and development going on within Parliament.

Professor Haslam: I would pose a grander sort of project, I suppose—just to throw it out. It relates to this idea of common law and company law. The Government are a major stakeholder in many of these activities through their contractual relationships—the idea here being that limited liability and corporate law were simply in the interests of not purely the shareholder investor but a broad group of stakeholders. Government was a major stakeholder in Carillion. What does that mean in terms of not simply the contractual relationship, which is a distant capillary power relationship, but of how we can have a more direct relationship with these organisations through the law?

Nick Davies: I do not think it is realistic to expect Select Committees to provide live scrutiny of individual contracts, given that there are so many and they are incredibly legally complex in some cases. I do think Select Committees could focus on ensuring that Government has the structures in place, particularly around the publication and release of high-quality data, first, so you can ensure that Government have the data necessary to provide the scrutiny but, secondly, so that the many external bodies that have an interest in that can also provide scrutiny and then can potentially provide that advice to Select Committees. I do not think all of that expertise needs to be within Select Committees themselves. There is a lot of expertise out there, but they just do not have the information they need to do that job effectively at the moment.

Mr Marcus Fysh: I hope you will excuse me. I am sorry I have another meeting.

Q483 **Chair:** We are running out of time, so I am very glad you are leaving. Thank you very much.

The last set of questions is about the Carillion aftermath. How well do you think the Government have managed the crisis?

Nick Davies: I think, inasmuch as the Government seemingly have managed to maintain the delivery of the services that they were paying for with not a huge amount of disruption, that that does seem to be relatively successful. The big question there, though, is at what cost that has been achieved. I don't think we will know that for some time. The other big question is we know broadly what has happened to Carillion, but what we do not know is what has happened to the many thousands of its subcontractors. I suspect many of those are in a lot of financial trouble, given that, largely, they were waiting on payment in arrears by four months, so we do not know what has happened to the quality of that supply chain.

Professor Haslam: I agree totally with that. We need to understand more about what is happening to the supply chain. It was a major component. Some 80% of Carillion sales revenue was paid out to the suppliers, and we need to know what is happening to the supply chain—the mechanism by which these services are being delivered locally for many people. On top of that a review of the process is required in terms of stress-testing Government response to these types of collapses, because they may happen again.

Q484 **Dame Cheryl Gillan:** Professor Haslam, I know hindsight is a wonderful thing, but were you surprised that the Government continued to contract with Carillion after last July, when the City was obviously flagging up problems with its financial arrangements?

Professor Haslam: From an external point of view, very surprised—but not surprised if you were maybe in the internal workings of the relationship, which is, "We are desperate for cash. We need to keep the business going. How do we survive on a day-to-day basis in terms of liquidity?" New contracts being offered do not roll in the liquidity quick enough, and your suppliers have been sweated so much on the working capital. And banking arrangements around factoring working capital are just not delivering enough for you either. New contract arrangements are not going to feed you enough liquidity to survive.

Yes, very surprised in terms of issues around the robust condition of the business: profit margins have been falling for the last five to six years, cash flow going from positive to negative, balance sheet looking really shaky. Why are you still contracting with the organisation?

Q485 **Kelvin Hopkins:** There is a certain amount of public concern, even outrage in some circles, that the big fish at the top did not lose out financially but the small fish at the bottom have done or will do.

Professor Haslam: Also, an organisation whereby the capital paid in, let us say, £200 million, and £1.4 billion was extracted out of the business in the last 15 years. It is a vehicle for value extraction, hollowing out the equity and increasing the risk in the balance sheet. We need stress-testing to evaluate the quality of the companies within which many contracts reside.

Q486 **Chair:** Some contractors would say that the Government conduct their stress-tests and analysis of these companies very effectively. What is your experience, Professor Sturgess?

Professor Sturgess: I do not have enough visibility on what has been going on recently and the nature of the conversation between central Government and these large contractors. I know there have been conversations. I know they have been talking to investors, but I do not have information on the nature of those conversations—sorry.

Could I say this? Two years ago, I was researching my report, and I wrote in a report that was published 12 months ago that, of the five big companies, only one seemed to be making any profit. Some of that was based on public information, some on private information. The fifth one was Capita, which it turns out was not quite as well off as it seemed at the time. Government could have known that. It does confound me as to why they were not privy to something that somebody who came in from Australia and sat down and did a series of interviews—admittedly intense interviews—was able to pick it up. People were talking to me about the nature of the stress. It does baffle me as to why Government was not aware of the extent of the stress. I can comment at that level.

Q487 **Chair:** That is a more general question, isn't it? Everything we have talked about this morning has been self-evident in one way or another for quite a period of time. Your report, Professor Sturgess, is two years old. Why do you think it has been so difficult for Government and civil service to hear this?

Professor Sturgess: Some of it, I think, is that it is the market stewardship point. I observed this when I was living here. There is a lot of talk of market engagement, but market stewardship is a different proposition. If you think about the social care market, that is obviously a market under deep stress and has been for several years now, and I referred to that in my report. No part of Government seems to have the view, "I have responsibility for the sustainability of a market or a system, and if it falls over, a whole lot of very vulnerable people are going to be badly hurt". Something in the way that this problem is thought about here means that no one in Government says, "That is me"—it is partly the point about an SRO—"but as a Department, as the head of this Department, we are responsible for trying to work with the various stakeholders to make the social care market sustainable."

Q488 **Chair:** This brings me back to the accountability map because, with an individual contract, I can see quite a simple accountability map and who is carrying the risk and is accountable for the risk. But when you have very large companies right across the public sector, how do you draw an accountability map that provides for that accountability for the stewardship of the market?

Nick Davies: I think that is part of the reason why we now have Crown representatives, and it is obviously notable that there was not one for Carillion for a number of months.

Q489 **Chair:** I do not think that is very relevant, because Carillion was very much the centre of attention from July onwards, whether there was formally a Crown representative or not. What about the more complicated area? We can talk about aggregating risk in the Cabinet Office and concentrating that in central Government, but who takes stewardship of the care market that is all run by local authorities?

Professor Sturgess: This may be an Australian perspective, but I do not think it needs to be. We have a federation, so you have to have all sorts of complex conversations between two levels of sovereign government—that is the nature of a federation. When private equity funds began to turn up as major players in the social care market, it seems to me someone in Government should have been worrying about that, because their business model is premised upon quite a different set of incentives from the kinds of people one would expect would be making the best contribution to people in need of care. I think that, while the nature of the conversation with local governments would necessarily be complex, nevertheless it is possible there is both leverage and there is jawboning. You can talk about these issues, and coming out of a federal system, I wound up doing a lot of work on intergovernmental relations and national co-operative models, so I am not talking about something I am not familiar with.

Professor Haslam: I totally agree with Gary on this point. The objective is to review the business model within which these critically important social services are being located.

Q490 **Chair:** It is a policy issue rather than a regulatory issue.

Professor Haslam: It is a policy issue informed by investigations around not simply the contract level, but investigations as to the viability of the organisations within which those contracts are being formed.

Q491 **Chair:** If there is a Secretary of State who is accountable for the state of the care home market and the social care industry, it is the Secretary of State for Health, and there should be a unity in the Department that is monitoring the health of the industry and making policy recommendations?

Professor Haslam: Exactly.

Nick Davies: I think it is a question about the geographic level you do these things. Clearly some markets are national, some are regional, and some are local, and that will therefore have an impact on where that responsible person should be. Underpinning all this, I should say, is that it is very difficult to understand the market if you do not have the data available to do that, and in many cases Government simply does not. That is why, either through proactive publication of data in an open data format or through investigation of particular markets on a regular basis, they need to be trying to seek that out.

Q492 **Chair:** Is there a case for a new public body to do this?

Professor Sturgess: If I give you another example, in the welfare-to-work market they had a one-off, whole-of-market procurement all at once. That is best not to do. It is useful if you get to make your mistakes on a little scale and learn, but when the welfare-to-work market came in, the companies at the top of the list that had won most were, with one exception, companies who were new entrants into the market and knew very little about it, or companies for who this was their only business model, and if they did not win these contracts, they were in deep trouble.

I said at the time that if I were in charge of that market, that result would terrify me because the companies who had most experience and who had other places to go bid the most conservatively, and they got the least business. The people who had to take the biggest risk or who had the least knowledge came up the top. If I were responsible for that—and somebody was responsible for that one—I should have looked at that and gone, "Wrong result. This is not going to turn out good", because, either through ignorance or lack of alternatives, the risk takers were up the top.

Even if you do not have the complexity of local government being the delivery arm—and I do think there are ways that central Government can work with local governments around these things—in terms of the things that central Government owned, somebody was not thinking about this as a system, what kind of a system it was, how it might work and what risks were being taken.

Q493 **Kelvin Hopkins:** Is the problem not with the politicians? A few decades ago, there was a change of view about the world. A new zeitgeist came in and some politicians were driven by dogma, ideology and whatever.

Others fell in with what the line was, and when things started to go wrong, nobody was prepared to take the blame or lose face. Politicians cannot bear to lose face and say, "I got it completely wrong. You should have done the opposite". This is my view. I speak from the left, and I am not being party political, because my Government drove the care homes into the private sector, effectively.

In my own constituency—just a quick story—three superb local authority care homes that were loved by the residents, loved by the staff and loved by the care professionals were driven into the private sector and closed down—in many cases with the land sold off for profit for whatever. This is what went on. At some point, some politicians have to say, "We had it wrong. We have to do something different. Some things we did in the past worked, and we should do them again."

Nick Davies: I certainly think Governments of all stripes have rushed into major outsourcing processes without fully considering it. An obvious one we are currently struggling with is the transforming rehabilitation reforms to probation. That was a massive structural reform to how probation was delivered, while also trying to deliver a significant cost saving. At the pushing of the Secretary of State, that was done far more quickly than it should have been done, even when many of the experts were highlighting that problems were going to arise, and those problems have subsequently arisen. There was certainly a case for moving more deliberately and carefully and trialling things before going for these big-bang outsourcing approaches.

Q494 **Chair:** We need to think about how the system thinks about the system. It seems to me that that needs to be an awareness point across the system, rather than something you can put into an institution and forget about. It has been a very interesting session.

I have one final point. Serco Chief Executive Rupert Soames suggested that all public contracts should require that the contracting company keeps a kind of living will—an off-the-shelf bundle of papers that somebody else can grab hold of in the event of a crisis and use to carry on running the contract. How practical a suggestion is that, because that might have been quite helpful in the Carillion situation?

Professor Sturgess: I understand the sentiment, and it has some logic to it. It would, in practice, I think, be extraordinarily burdensome to do it. I can remember when I was on Serco's board many years ago trying to get across to contract managers that if you talk to your customer and you agree on a variation—because in practice that was not working, and we are just going to adjust it—document it. Write it down. Yet I know that companies have been caught in that repeatedly.

I think it is in the nature of complex service delivery, whether support services or front line, that there is lots of change and flex, and in practice it would be difficult to document all that flex that was going on, but I recognise the point he is making and agree with the sentiment. Just how practical it would be, I do not know.

Professor Haslam: I think it is important that Government have a major slice of the revenue of a company through their contractual relationships and should have a rescue package available to them too. Why not enshrine that in the relationship with these organisations through the Government as a major stakeholder? If the risk falls back to us then we need a rescue plan, and it has to be under cover.

Nick Davies: It is an interesting idea and definitely worthy of further exploration. As has just been said, certainly Government need to have a plan in place for how they will deal with provider failure if that were to happen.

Chair: Thank you very much indeed. It has been a great session, and I am very grateful to all three of you.