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 8 May 2018

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Watch the meeting

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

Questions 611 - 727

Witnesses

I: Rupert Soames, Chief Executive, Serco, and Phil Bentley, Chief Executive, Mitie.

II: David Walker, The Guardian, Matt Dykes, Senior Policy Office for Public Services, TUC, and Karl Wilding, Director of Public Policy and Volunteering, NCVO.

Examination of witnesses

Witnesses: Rupert Soames and Phil Bentley.

Q611 **Chair:** May I welcome our two witnesses to this further evidence session on lessons from the collapse of Carillion for the Government and for the sector? Could I ask each of our two witnesses to identify themselves for the record, please?

Rupert Soames: Rupert Soames, chief executive of Serco.

Phil Bentley: I am Phil Bentley. I am the CEO of Mitie.

Q612 **Chair:** Thank you very much indeed for joining us today. We will jump straight in, but we will ask fairly crisp questions and hope that the answers are also not too extemporising, otherwise I may have to pull you up in order to get through all the questions to you and our next session as well.

What are the main advantages that the Government get from outsourcing?

Phil Bentley: I am new to the world of outsourcing. My career was spent in some of the largest companies in the UK—in BP, and I ran British Gas for seven years. My last job was the CEO of Cable & Wireless. I joined the outsourcing world just over a year ago and it is a tough industry, but you have to understand the constraints of the outsourcing business: you have specialist companies; you have those that just specialise in providing support to Government; you have construction companies. You have a variety of services that are offered, and I think the key is to understand the model of each one, and when you do that you then get a better feel for the transfer of risk—do we understand the risk, and how do we price the risk as we transfer it from the Government to private suppliers? Do you understand the expertise of the company that we bring? Do you understand the focus and the skills that we have, the innovation that we have and that we bring to the party? When you understand the scale of some of the companies in the outsourcing world, you would accept that Government gets good value for money and real expertise from outsourcing. If you look at the size, the Government spend is over £200 billion on outsourced providers, so you have to dig into the detail to understand which is which. It is something that I think provides Government good value for money.

Q613 **Chair:** It is a value for money proposition?

Phil Bentley: Yes. That goes into what we mean by value for money, because it is not just about price. When we get into some of the learnings about Carillion I think you will see—

Q614 **Chair:** It is not just about price? Leave Carillion out of it for the moment. The benefits of outsourcing are value for money and—

Phil Bentley: I think technology, innovation, the scale that companies like ours bring to Government Departments.

Rupert Soames: If I can just amplify some of that, I think if you flipped it around the other way you could say, "What would an alternative world look like where only Government would supply public services?" Would that be a good idea, where it was a monopoly provider, but also a monopoly provider of services? You would lose a huge amount of choice and you would lose a huge amount of innovation. As Professor Sturgess said in his evidence, "It is not just a matter of competition, it is a matter of contestability. It is a matter of being able to test the proposals to run a service and to work out how best to deliver it and for that you need choice". For that, you need to see how it could be provided by Government, how it could be provided by charities, how it could be provided by private companies. I think it is about contestability, innovation and choice, and that then drives higher-quality, lower-cost public services. It should do.

Q615 **Chair:** Are there any decisions that should automatically default to insourcing? What should not be outsourced?

Rupert Soames: I wrote in my evidence to you that first of all I think policy making should. Clearly there is a difference between policy development and policy delivery. I think that within the world of delivery nature does not draw lines—she smudges them, because outsourcers do some phenomenally complex and secret stuff and we deal with the nation's most secret secrets. I think there is an important line somewhere in taking decisions about people's lives, standing in judgment on people or applying law, but we are still going to give people parking tickets. We are applying the law, but not on a big scale. Generally speaking, I think there is a line where you are taking decisions over citizens' lives that should be mainly the prerogative of the—

Q616 **Chair:** Incapacity tests for qualifying for incapacity benefits: that would be on what side of the line?

Rupert Soames: I would say that the performing of the tests to a specification set out by the Government can easily be performed by qualified private companies. I think that the judgment of the results from those tests about whether you get the benefit or not should be a function of Government.

Chair: Mr Bentley, do you have a view on that?

Phil Bentley: Yes. I think I would probably agree with that. A lot of it is public policy, and if you take the health service, for example, you have a mixture of public and private activities going on there. We provide meals, we clean hospitals, we maintain essential equipment in those hospitals, but obviously other elements of the NHS service are delivered by those working directly in the public sector, and I think that is why the overall mix generally works well. I think it is up to Government Departments to establish what it is they are good at and what they want to focus on, and maybe let companies like ours deal with some of the things that they are not necessarily experts in.

If you take even PFI schools, which you may get on to, we maintain the premises, we ensure their roofs do not leak and the boilers are working and allow the 100,000 kids we look after to get on and learn in a safe and well-lit environment.

Q617 **Sandy Martin:** Just briefly, you were talking about benefits tests, Mr Soames. Do you believe that it is easy enough for the Government to take back a contract if they do not think it is working?

Rupert Soames: On the whole it is about the way they write the contracts. On this thing about services that we have taken decisions about, when I say nature smudges lines rather than draws lines, let us all pause for a moment and just reflect that essentially the entire primary healthcare of this country is delivered by private entrepreneurs through GPs. These are private companies operating in the public sector, taking decisions about people's health on a daily basis, and it works pretty well.

Q618 **Sandy Martin:** I have to say, that was not what I asking you about. I was asking about a situation where you have tests for eligibility for benefits being carried out by private companies, in particular Serco, and they have been carried out by previous private companies that have failed to apply those tests effectively. We have situations such as in Ipswich with the citizens advice bureau, where 96% of the benefits test cases that they take to appeal they win, which seems to me to show that the tests are not working. They have not worked in the past. Why do you think the Government have not taken these tests back in hand?

Rupert Soames: Just to be clear, Serco does not do those benefit tests.

Sandy Martin: Okay, good.

Rupert Soames: But I feel strongly about this, because if you go back historically I think that Government have found it quite convenient to get private companies to go and do work that they knew would be controversial and difficult, and then they could say to companies like Atos and Capita, "Look what a terrible job you are doing of the thing", when in fact what they were struggling to do was probably being asked to do the impossible. Certainly the criteria for those are laid down rigidly by Government, which is why private companies can do it.

I think it ill behoves Government to then go and run away from suppliers they are asking to do a difficult job. We are asked to do a difficult job; it is called running prisons. It is called looking after asylum seekers. We have an expectation that our customer, be it the Home Office or the MoJ, will not run away and hide behind us if things get difficult, because we are all running in the same system.

Q619 **Sandy Martin:** You believe that the way that some aspects of Government have been hived out enables the Government to cut the funding for those services far lower than they would have done if they had to keep it in-house?

Rupert Soames: No. That is an area of policy. What is certainly true is that I believe that that sort of assessment work—tens of thousands of people attending assessments up and down the country—is perfectly suited to being performed by a private company. You do not have to be a member of UNISON or of Unite and paid for by the Government in order to deliver those services. Private companies, properly contracted, properly supervised, can do that work. The point of the appeal system is that having done that work, having your score, the decision, in my view, should not be taken by somebody in private employ, but by somebody in Government employ, because that is a decision about somebody's life.

Chair: Shorter answer, if possible.

Rupert Soames: Yes, sorry.

Q620 **Chair:** The Cabinet Office says that the Government make evidence-based decisions on whether or not to contract out. What evidence do you have of this evidence-based decision-making?

Phil Bentley: If you look at the Green Book, all 123 pages of it, you will know there is a whole set of rules around how Government procurement should happen, and maybe we will get on to some of the learnings that I have seen—

Chair: But whether or not to contract out.

Phil Bentley: I think there is a whole set of assessments around value for money, how consistently strategic—

Q621 **Chair:** How consistently do you think they make those assessments?

Phil Bentley: I think on the whole they do. I think there are some improvements that could be made.

Q622 **Chair:** What are those improvements? I am afraid we are only interested in the criticisms and not the compliments.

Phil Bentley: How long do you have? I think there is a big one about data. Are we sharing data? Is data freely available?

Q623 **Chair:** How does that affect a make or buy decision?

Phil Bentley: Because if you do not quite understand what the data is telling you and what the risk is around the contract, you may find that you have kept the risk that you did not want to and that another company could have taken away from the Government or vice versa. I think with data it is about ensuring that Government understand what it is exactly you are outsourcing.

Q624 **Chair:** Can you give an example of a contract where the Government have not had the data? Can you give an example of where the Government have finished up letting a contract where it did not have the data to decide—

Phil Bentley: No, but I think there has been inaccurate data. Certainly you would—

Chair: Can you give an example?

Phil Bentley: Serco with immigration, asylum and accommodation would be a classic example of where the data on the expectation of the number of asylum seekers was massively underestimated, but the data was not warranted. I think in time the Government have understood better that it is better to share more of the data, and if we find that the data throughout a contract is not what we thought it was, then there ought to be a discussion around how we deal with that change. I think the new procurement policy note tries to get into that. A collaborative approach to managing change is very much part of the dialogue that we would expect to have.

Q625 **Chair:** Mr Soames, how well does the Government produce evidence to decide whether or not to contract out?

Rupert Soames: As you know, in the evidence I submitted I think that this is an area of significant lack of transparency and opaqueness. It is a concern I share. I noted that Sir Amyas Morse said the same thing—"In any commercial company you have quite rigidly set out make or buy decisions". For every major act of Government commissioning I think there should be a documented process that goes through right at the beginning to make a make or buy, or whether you are going to have a mixed provision, and I think it should be for ministerial accountability to go and make that determination. We never see the grounds for that—it is shrouded in opaqueness, on what grounds the Government decide to put something out or not. I think that that should be a transparent process and I think it should be auditable by the NAO. I think a Minister should sign off on it, and if a Minister decides that they want to ignore the advice of the make or buy decision, they should be held accountable for it.

Q626 **Mr David Jones:** Mr Soames, you mentioned the issue of competition. What is your assessment of the nature and extent of competition in this market?

Rupert Soames: The NAO has done a series of reports, because there was concern that there was too much concentration in the market among the four or five major providers. The last time they looked, the five major providers—Atos, Capita, Serco, G4S and Mitie—accounted for less than 2% of the market for Government services. If you get particular specialisms like prisons, there are not many companies that run prisons, so you can get narrow individual markets. I think that the important thing, again coming back to the Sturgess report, is about contestability. It does not matter whether there is one competitor or two competitors or three. What is important is that people have to believe that they can win or lose a contract.

I think that this thing about concentration is only important when it comes back down to the "too big to fail" argument, which is that you can get large companies running very large parts. How you solve that is by having living wills and making it easy for Government to remove contracts from people.

Q627 **Mr David Jones:** Do you disagree that the market has become more concentrated over recent years?

Rupert Soames: I think it has become a bit more concentrated. I think it is going to become even more concentrated, because the discouragements to doing the business with the Government are big and have grown bigger. There are two: there are the structural ones—generally speaking, doing business with Government is a hard task. The bidding is complex, it is expensive, it is long-winded, contract management is inflexible and there are whole range of structural things that are peculiar to doing business in Government.

There is then a situational aspect, which is that over the last three or four years large numbers of well-run and well-respected companies have lost hundreds of millions of pounds doing business with Government, which comes from the fact that Government has started transferring unmanageable amounts of risk into the private sector.

Chair: We will come back to that risk question later.

Mr David Jones: Mr Bentley, do you want to add to that?

Phil Bentley: Yes. Two thirds of our revenue is in the private sector, so we are less exposed to Government generally, but within the sector as a whole, we are the largest outsourcer of the services we provide and we have a 4% market share. If I contrast that with my BP days and my British Gas days, this is the market with the least concentration. It has low margins and low barriers to entry, and if you are a cleaning company or a security company or an engineering services company, there are hundreds—thousands—of providers who can provide that service.

I think the issue from a Government contracting point of view is that if you have strategic assets, like Sellafield or Aldermaston or some of the strategic Government agencies that we look after, you do not want anybody just turning up on your site, so it naturally favours the larger companies that can provide continuity of service delivery. But this is very much a very competitive market, the most I have ever worked in.

Q628 **Mr David Jones:** Would you agree or disagree that incumbency is an advantage in bidding for Government contracts?

Phil Bentley: We just won a contract off Capita recently, a Government contract, so that clearly was not the case there. We were hoping to win another contract at Brooke House, if you are familiar with that situation. No, I think the question is, does an incumbent provide real advantage? Not if we are coming up with innovation, with ideas of where we can look to save money. A lot of our saving proposals come from better IT systems and better sharing of information, so if we understand the whole of the elephant we can get a better picture, rather than just the trunk of the elephant. I think the wider the conversations can go initially with the contracting Department, the better.

It was interesting in the procurement policy—it just came out in December—that it said, "Effective pre-market engagement is now expressly permitted", which implied that it was not permitted before that, the point being that only through dialogue and understanding what the client wants, in my view, do you get a better solution delivered, and that is not necessarily from the incumbent.

Q629 **Mr David Jones:** What effect, Mr Bentley, has the collapse of Carillion had on the market for facilities management services?

Phil Bentley: That is quite a long question. Obviously it is very sad to see the numbers of people losing their jobs in the company. As I understand it at the moment, 2,257 have lost their jobs, but this was in a company that had 19,500 jobs in the UK. The vast majority have now been transferred to other providers, either within the Government agencies—MoD would be one—or other suppliers have stepped up. For example, we have a number of contracts as well.

The first point is that with the outsourcing element of the Carillion piece, the supply chain was available and ready to take on these contracts. There are very few examples I am aware of of disruption to essential services—none that I am aware of. The issues, which we will come on to, I am sure, have been around the construction element of the company of Carillion, and where the difficulties arose was not in the outsourcing.

Q630 **Mr David Jones:** That is why I asked you the question about facilities management services.

Phil Bentley: For services management the supply chain stepped up. Essential services were preserved, as were jobs in the main.

Q631 **Dr Rupa Huq:** Certain financial difficulties of Government providers have become more publicised—not just Carillion, but the rights issues with Serco and Capita. I just wondered what problems arise from the UK Government's market power in public sector outsourcing, the tension between the practice of customer and—

Rupert Soames: It is astonishing what has happened within this market. I have never seen, not even in the banking crisis of 2008, so many very large companies having to refinance themselves. The good news is that with the exception of Carillion they have all succeeded. In our case we raised £1 billion, and what they have raised the money for is to go and fulfil their obligations that they have to Government. I think that this shows that having large companies that have balance sheets that can take knocks and can take risk is quite important, as long as they stand by their promises, but it is a symptom of a couple of things.

It is a symptom of management. Let us not fudge about—a lot of this is management's fault. There are many failures on behalf of the private sector, but it is also a Government that is a monopoly buyer. It cannot stand idly by and say, "Nothing to do with me, guv". They have to accept some part of accountability or at least be concerned about what has been a massive disruption in the supply side, the like of which I have never seen, where you have had £8 billion written off, a whole sector's worth of value, with hundreds of millions—billions—of pounds having to be raised to recapitalise companies, all of which have one thing in common, which is they are major suppliers to Government.

Phil Bentley: We have not had to raise any capital, and part of the reason for that goes back to this point about risk diversification, because two thirds of our revenues come from the private sector and we are not exposed to any one company or any one division.

I take a slightly different view from Mr Soames. I do agree that management has signed off these contracts. They have assessed the risk. They have looked at the price and the return and thought, "This is a good contract", and their board or management committee have approved it. We should not ever forget that. That is how companies work. They take risks.

I think the point that Rupert makes, though, is that it has been historically about whether the data was warranted and accurate, and I do sense that there is a sea change in the way Government Departments are contracting. John Manzoni wrote, "Effective partnership is based on trust, clarity of accountability and shared understanding of purpose and outcomes". I think if that is the watchword for Government contracting, then companies should not get themselves into difficulties, but I think where you have seen these difficulties—I am sure we will eventually get on to Carillion—it has been a concentration of risk, where a company has therefore not had the balance sheet to take the hits. If you get five or six hits at the same time you need a strong balance sheet. Certainly in Mitie we have been reducing our debt for that very reason, because we do not know what is going to happen. We hope we have priced risk correctly. We are not exposed to any one contract, but we always have to expect the unexpected.

Q632 **Dr Rupa Huq:** Rupert Soames, you have argued that there should be a code of conduct, an independent arbitration model. How would that work?

Rupert Soames: We have put forward four principles: a transparency principle, a fairness principle, living wills and an orderly exit principle. The fairness principle is this: it is not unknown for Government to behave quite badly and in the position as a monopoly buyer, it is also the regulator and the referee and the giver-out of business. Just as within Government the Cabinet Office finds it hard to make its writ run within other Departments, so it is difficult here. There is nowhere you can go if you think that there is a Department behaving badly or doing something wrong. A PIN notice that has gone out, saying how purchasing should be regulated in Departments, how Departments should behave and what it is reasonable to ask companies to do is widely ignored in Departments. It goes to this thing of the SRO saying, "It is my Department. I am responsible. I have to give value for money, and frankly I do not have to take instruction about whether I am going to deal with suppliers in a fair way and with a sensible transfer of risk".

Phil Bentley: I might add to that, if I may. I have seven Government learnings, as it were, and maybe we will get to some of them, but one would be to try to find a win-win, and I do think the CCS has a role to play in that, almost like a non-executive or a governance oversight as to how that particular Department has contracted. I think that would be a good place to go, because when decisions are made we are on the receiving end of them, and sometimes you look at them and think, "How did that decision get made?" These are decisions around contracting—we have been bidding on a contract for nearly a year, and in the last week it was cancelled and postponed for two years. How did that decision get made?

I think there is some scrutiny—and it is almost like an independent view, like a non-executive would be—in saying to a contracting Department, "Before we cut this contract, have you explored the win-win? Are you sure about this data? Are you confident about the pricing of the risk, and is it fully understood?" On that basis I think we would get good contracts, which companies would not lose their shirt over, but frankly, in my view, if they do, they only have themselves to blame, because no one put a gun to their head to sign those contracts.

Q633 **Dr Rupa Huq:** The Global Sourcing Association suggests that it should be the Competition and Markets Authority that does an inquiry now. What do you think of that?

Phil Bentley: CMA is much more about effective workings of markets, supermarket mergers and concentration of powers. I do not think it is necessary. I think the sort of changes that I would propose can improve the way we contract. I am not sure what CMA investigation would do, because I am not sure they are qualified to look into what is essentially a competitive market and suppliers and outsourcers making theoretically rational decisions to contract with the Government.

Rupert Soames: The startling thing is how much consensus there is about what needs to be done. It may all come out in a slightly muddled way, but the TUC issued a statement a couple of weeks ago that we support 90%. What Sir Amyas Morse was saying last week to you in evidence I would support 100%. This is not a huge problem. It is a problem that needs to be addressed, but it is not a problem that is going to be hard to find a solution to.

Phil Bentley: I think this is the point about going back to Carillion, because Carillion got into difficulties on construction, not on outsourcing. All these conversations have been about outsourcing, but I think we have to go to the root cause of why Carillion collapsed, and construction was a big part of that story.

Q634 **Chair:** Is there a consensus about where Government has "behaved badly", in your words, Mr Soames?

Phil Bentley: You have a different view from me. I did not see any bad behaviour. I just think there are things we can improve. Innovation often is taken out of a bid because everyone wants to fight. The whole OJEU contracting rules, if you are familiar with them, are all about it being economically advantageous to create an OJEU level playing field. If your bid is more technology and you are asked to take it out and dumb down your bid to a level standard, I would change that and try to bring more judgment into the decision rather than trying to equalise the way contracting is done. That would be one point.

There is always a concern in contracting Departments that they could be subject to a legal challenge from a failed bidder, and I think that drives behaviour to be defensive and find the cheapest price and find ways that are not criticised, so that you end up not necessarily choosing the best solution but the one that you have the least criticism for awarding.

Rupert Soames: The example I would give is where Government asks for things that are completely unreasonable to provide. It is asking contractors to accept 10-year change of law risk. We are going through Brexit. We are about to go and change all of our laws, and the Government says to a contractor, "You have this contract and if there is any change of law, that is on your book". How can you manage that? When a Government turns around and says, "We, the Department, will put penalties on you if another part of Government does not perform their statutory duties", how you manage that? We will turn around to you and say, "Here is a bid. We want you to bid for it, and here is some information that you should base your bid on, but by the way, if the information is wrong, tough". I call that bad behaviour.

Q635 **Chair:** Why do you not just refuse the contract?

Rupert Soames: You could, but that is not the object of the thing, because if everybody refuses a contract you will not get anybody to do the work.

Phil Bentley: That is exactly the point, because if everyone did, it would not take a change of law. There is a change of law around the national living wage—it is a law and there is obviously rightly a step-up in the national living wage. We would expect our Government contract to accept that change of law and allow for that increase in our contract terms, and generally we do. Maybe, to use your word, it does behove our industry to say, "We will not accept these things". I think the point though is that the Government is getting the message.

In the old days you used to have what was called "termination for convenience". At any time a Government Department might go, "Do you know what? We have changed our mind here, and we are going to cancel the contract without payment of penalties, without fair notice". In a contract we are just signing at the moment we have a 12-month period, and we have acceptance that we should be reimbursed for our past investments, and that feels like fairer contracting terms.

Q636 **Chair:** What happens when the Government comes along and says, "We are just paying too much; we are going to cut the price; we are going to cut what we pay you"?

Phil Bentley: In theory they cannot do that, because we have signed to a binding contract.

Q637 **Chair:** Is that what you mean by behaving badly, Mr Soames?

Rupert Soames: No. I personally think that Governments should be able to get out of contracts as long as the supplier can as well and as long as there is pre-agreed compensation for doing that, because things change over a 10-year period. Policy changes, a new Government comes in, they want to change something. They should be entitled to do it, but it could be within a framework where it was agreed up front what the compensation would be either way.

Chair: We will come back to pricing and risk transfer later.

Q638 **Dr Rupa Huq:** Is there a danger that the public sector can historically tend to trust contractors too much? Dr Chris Lonsdale has put forward this argument—if we are to rebuild trust between the public and private sector, how do we prevent the public sector from being exploited?

Rupert Soames: I think it is all about transparency. I am greatly in favour of much more transparency than we have at the moment, and particularly transparency about performance on contracts and KPIs, which I think should be public information unless there is some security consideration.

What I would reflect on is that the degree of transparency the Government gets of the performance of private contractors is vastly greater than they get of their own performance when they are doing work. If you go and look at a hospital that we are cleaning, we will have 150 different measures we have to report on. If you go to a hospital that is cleaned by in-house staff, they have far fewer KPIs and less accountability in terms of performance of a contract. I do not agree with that. I think that you have to take the view that at their best public services are magnificent and at their worst they are terrible, and the same applies to the private sector. At their best they are good, but you then can get horrible situations and they are done badly. It is kind of the world we live in.

Q639 **Dr Rupa Huq:** But the fact that they are quite unprofitable, these public services, means that these companies come in and say, "We will sort it all out".

Rupert Soames: They should. Let us talk about a fair return. What companies like us look for is that we decide that long-term there is going to be demand for prisons and hospitals and health services and transport for decades. We also operate around the world so that we can allow for changes in the political zeitgeist in any one country or another. I do not think that there is anything structurally that says that the private sector cannot be trusted to go and deliver good services, because quite patently and obviously we do deliver good services most of the time. Most of the £200 billion that the Government spends with private companies works just fine.

Q640 **Kelvin Hopkins:** We have talked about risk before, but what is your view of the Green Book guidance that "risk is borne by the organisation that is best placed to monitor and manage it"?

Rupert Soames: Unarguable: it doesn't happen.

Kelvin Hopkins: I have to say that is rather opaque as far as I am concerned, but there we are. If we can move on to—

Chair: Mr Bentley, do you agree with that?

Phil Bentley: That it is unarguable? Yes. I still think we have to make our own judgment about what a risk is in any contract. I do not buy this point that if I bid for something and I get it wrong, I should have the out of saying, "You know what, I got it wrong and I would like it rebid", and that is slightly Rupert's proposal around the orderly exit principle. If you have been the underbidder on that contract and it was won by somebody who mispriced it, I would be saying, "You just stick to what you committed to".

There is a price for risk. We may get it wrong occasionally, and that is what management and good judgment is all about. Where risk is being transferred it is up to us, as suppliers to the Government, to determine if we are prepared to take that risk for that return. It is as simple as that. If I can take an example of where—maybe this is a sort of segue back to your point, Rupert, about trust—we can save Government agencies significant amounts of money, with something like the forensic medical examination in police custody or sexual assault areas, we now provide nurses rather than doctors. They are seen as more sensitive, they are more available, they are far cheaper and we offer a far better service than waiting for a GP to turn up on a Saturday night. I think there are areas where we will take on that risk and we will come up with solutions that give value to Government Departments.

Q641 **Kelvin Hopkins:** How successful are the Government in implementing their own guidance?

Rupert Soames: My argument, having seen the Cabinet Office produce some perfectly acceptable guidelines and then having seen them completely ignored by Departments, is that I think it is hard, but those Departments have a responsibility to go and save a whole lot of money. It is a curiosity to me, coming as an outsider into the system. I thought that what the Cabinet Office said was what happened, and the truth is that is not the case.

Phil Bentley: That goes to my point as well—maybe we should have the CCS as either a point of dialogue between the Department and the outsourcer or even a non-executive on the board that makes those decisions, just so that they do have a little more influence. If you have read—and I have sure you have done—procurement policy note 10/16, it is all about the importance of accuracy, data, value for money, managing risk, a collaborative approach to managing change, and effective pre-market engagement. These are all the right words; let's just make sure that the actions in the Department—

Q642 **Chair:** There is an elephant in the room that we are not mentioning here. There is more than one Government Department trying to make rules. The Green Book belongs to the Treasury, doesn't it, not the Cabinet Office?

Phil Bentley: No. I think the Green Book is very extensive. It is trying to set down a set of rules around investment decisions across all Departments.

Q643 **Chair:** But the Crown Commercial Service is an emanation of the Cabinet Office; the Green Book is an emanation of the Treasury, and in the end Departments look over their shoulder at the Treasury. Is this part of the problem, competition between two Government Departments?

Rupert Soames: We are not privy to such things.

Chair: I will take that as a yes.

Rupert Soames: Where we work, I think there is an issue that several Departments fiercely guard their own independence, saying "We are responsible for our budget and this is for us to manage". Frankly, I think that that is not always a great sentiment, because the Crown Commercial Service is now much stronger. It has far more resources at its disposal than it used to, and for a mere citizen coming from the outside and watching this, I am slightly perplexed, because in any commercial body you would expect the Cabinet Office to be able to hold sway with a Department.

Phil Bentley: John Manzoni was an ex-colleague of mine when I worked at BP years ago. Ask him what he thinks. I think he would say that there is not the consistency across all the Departments and that certainly we as outsourcers would like to see a little bit more consistency.

Chair: We are used to the Government presenting to us a seamless consistency across Government, which is what they want to present, but it is not necessarily the case.

Q644 **Kelvin Hopkins:** In the pure private sector, risk is borne by the company, by the investors. What are the risks that private companies should not be reasonably asked to manage?

Chair: I think you have mentioned some of those already.

Phil Bentley: I think Rupert covered that, didn't he?

Rupert Soames: I think change of law risk is very specific, because the Government can change the law and a lot of Government contracts are very long-term. Everybody is prepared to take a change of law risk.

Q645 **Chair:** We have that. Anything else you would like to add to that over what has been given? If not, can I move on your margins? How do you think the margins compare in your contracts, on the labour you employ, compared to the Government's margins on the labour they employ?

Rupert Soames: We do not know what the Government's margins are. I am not sure that they think of them that way. I think the problem now is that everybody should appreciate that Government outsourcing contracts of the type that Phil and I do should not be licences to print money. I think there should be more transparency. I think we should make sensible margins, given the fact that we have a customer who is not going to go bust and all those other good things, and long-term demand.

The proposition at the moment has gone too far. The proposition is that you can make 5% or 6% margins if it goes well supplying Government, "But if anything goes wrong, we can bankrupt you because we have unlimited liability." We have consequential loss. We have change of rules. We have all these things that allow us to take huge losses, and if you look at the companies that have lost, whether it is Carillion or Interserve or whatever, it is very large losses that have created the problem. I do not think there is a problem of reward. I think there is a problem of the risk that is associated with that.

Phil Bentley: On the concept of what is a Government margin versus an outsource margin, I am not quite sure how I would do that calculation, but I would compare the business that we do with Government agencies with the private sector. Two thirds of our revenue comes from the private sector, and there is a difference in overall margin between when we contract with a Government Department and when we contract with a Lloyds Bank or a Vodafone or a Sky or a Rolls-Royce. You can think that the Government is quite tough in terms of negotiating—so are commercial clients, so we are pretty used to that. There is no difference in the way that we contract.

One thing that Rupert called for in the transparency principle was transparency in operating service level agreements, which I agree with. I do not necessarily agree that you need to go into every line item of cost and say, "You are making 15% margin there and 2% margin there and 1% there". I do not think that works, because it inevitably drives behaviour focused on the inputs, the costs, rather than the outputs and the social good and the value that we provide.

Q646 **Chair:** The public sector has to focus quite a lot on certain inputs like gender diversity, for example, and the gender pay gap. Are you measured on your gender pay gap in the same way as we measure the public sector on the gender pay gap?

Rupert Soames: I think both Phil and I are in the happy position of having very low gender pay gaps. Ours was, I think, 12%, which compares quite favourably with the rest of Government, and yours was lower than that.

Phil Bentley: Yes, I cannot remember the exact number. I think this comes on to the code of conduct, because it is a question of how you value the contractor's governance, and that goes into pension deficit. Are they running a large pension deficit? Are they paying huge amounts of dividends to shareholders and not necessarily looking after their supply chain and their subcontractors? I am all up for a code of conduct that sets good governance for corporations as to how we can be a good citizen. Maybe it goes to your point, Rupert, about rebuilding trust. You know that if you are doing business with a Mitie or a Serco you are dealing with a company that has been weighed in the balance of good governance and found to meet the right standards.

Q647 **Chair:** How often do you win bids for UK Government contracts when you have not submitted the lowest bid?

Rupert Soames: In the four and half years that I have been running Serco, I know one occasion.

Q648 **Chair:** Can you tell us what one it was?

Rupert Soames: It was Barts NHS, funnily enough against Carillion, who I think were cheaper than us. I think you have to put yourself in the position of the Government purchasing view, and particularly—

Q649 **Chair:** We are very sympathetic, but that suggests they are not making the right judgment in enough cases.

Rupert Soames: What the purchasing people want to do is to drive everybody to a point where they say, "Everybody technically can do it" and then have a price shootout. I think the problem is, on the one hand, that the Government is not sufficiently granular in being able to understand technical differences between bids. The second thing is, it does not take into account other things. One of the things I noticed coming in from the outside is that when you are dealing with Government there are no benefits to good behaviour and there are no penalties for bad behaviour. Every procurement sets off on its own thing, and the fact that you behaved badly on the last one and you did not deliver the work counts for nothing in terms of new procurement, whereas on the other hand, if you behave well, if you have good gender diversity, if you have gone and helped Government with their SME criteria, it does not matter at all in the next one. Again, in the commercial sector you get a feeling that people like their suppliers to behave well.

Phil Bentley: I have not been around long enough to see lots of bids that we have not won or been awarded that we have won on price. Generally price is pretty important. I think it goes to my point that in the private sector there would be more judgment, there would be more flexibility, there would be more strategic input around the IT and the big picture, but the OJEU rules driving towards equalisation, and the existence of legal challenge of award of contract, make it harder to apply a set of judgments as to why you would pay more for a service. I am afraid the Green Book does not give you an out on that. People used to say, "You never got fired for choosing IBM". If you are in Government contracting, you never get fired for choosing the lowest bid.

Q650 **Sandy Martin:** On most of the services that you are contracting with the Government the main cost, or certainly one of the main costs, is going to be wages. The TUC has said that in its opinion outsourcing has a detrimental impact on the pay, terms and conditions of the outsourced workforce. What is your take on that?

Rupert Soames: I would vigorously deny it. I just do not think it is true. With the Barts contract that we were talking about, we agreed the London living wage for all of our employees there. Most of our employees in the health service will be on the NHS Agenda for Change policy. Within the Prison Service our pay is either equivalent or better, but the employment terms are much more flexible. We are much more flexible around when people can turn up for work and rostering. Where I think the savings are is not in the terms and conditions. It is much more in the number of people we employ, because I think we do a better job of organising them to do it. We will typically run our prisons with fewer people than public prisons do, but the prisons run to, on the whole, a higher standard than public prisons, and I would put that down to the fact that that is what private companies do. We specialise in organising our people well.

Q651 **Sandy Martin:** Sorry, can I come in on that? You say "more flexible". Does that flexibility include zero-hours contracts?

Rupert Soames: Vanishingly few. I will tell you an interesting fact. People in Serco who are on zero-hours contracts get paid more on average than people who are on permanent contracts. We have five leisure centres each running as a separate leisure centre. They will have one zero-hours contractor—we do not know what particular contractor—but they are vanishing. I am talking about a couple of hundred out of 24,500 employees, and they all tend to be more highly skilled people or people who are working across two or three contracts. It is not how the rumours would have it, and the other thing is that they are not exclusive.

The really bad thing about zero-hours contracts were there were zero hours, but you could only work for one person. It tends to be—

Q652 **Sandy Martin:** But you would accept that that is not necessarily the case across all companies that are contracting with the Government?

Rupert Soames: I absolutely would. Both Phil and I would have quite strong views about companies that try to apply exclusivity to zero-hours contracts, but in some circumstances it is quite useful both for the employee and for the—

Chair: Mr Bentley, anything to add? You do not have to.

Phil Bentley: There are some Departments that will pay London living wage and there are some that will not, so let us call it what it is, and you will obviously need to determine which ones are which.

Chair: We regard that as a policy issue.

Phil Bentley: It is about affordability. I can also mention the Scottish living wage. I have been engaged in a number of conversations with the GMB in Scotland, and most of our clients that do not pay Scottish living wage are in the public sector; that is the point about affordability. There is a point there, but the quid pro quo on the other side would be that if you work for Mitie you would probably get better training, and you have potentially a career. You could work in a Government contract. You might be working in Sainsbury's another time, or on a Rolls-Royce contract. We can develop careers and in time provide better equipment to do the job, I believe.

I think you have to balance it up. I think there is no question that public sector pensions are not the same as private sector pensions. I think we should call it what it is, look at where there are differences and weigh up whether there is a fair employment trade-off in terms of career progression. I think that is worthy of further investigation.

The other point is that we end up with certain Government contracts where we have the same flat rate of pay whether it is in the north of England or the south of England. We struggle to recruit in the south of England, but we cannot flex pay, so that would be another example of where just trying to have a more grown-up conversation with the contracting Department would help.

Q653 **Sandy Martin:** But given that you almost always only win a contract from the Government on the lowest financial bid, doesn't that make it very difficult to pay the levels of pay that you think you need to pay in order to get the staff in?

Phil Bentley: We recently won the detention and escorting bid on the immigration contract, where we know our bid—I believe it is a matter of public record—was higher than the previous contractor, so that does not always follow. I think the Home Office have been pretty supportive about good conditions for security officers and treating them well through their career progression. Different Departments look at it very differently. I know that goes to the point about how we would like to think that through the Cabinet Office every Government Department does the same thing, but it does not.

Q654 **Kelvin Hopkins:** What is your view of the PFI model of infrastructure?

Phil Bentley: Again, I am new to it. Rupert, do jump in after me, but I quite like the PFI, because the way the PFI works is that we take over a school and essentially when we hand it back it has to have been maintained to standards such that it is the same condition as when we took it on. That means the painting, the flooring, the windows—in the old days a school could not afford a new boiler because it did not have a CapEx budget—we take all that risk. If the roof blows off the school, we pay for that, and in return the school gets great premises, well maintained, so that they can get on and focus on teaching our kids.

If you follow the "Educating Greater Manchester" TV programme, which is a PFI school in Salford, Drew Povey is the headmaster there and we work hand in hand with him. He went to the kids and said, "Look, if we stop breaking windows, guys, we will be able to build a basketball court", and so there is a contract whereby we look to try to save the headmaster money to do better things and let him focus on what he does and let us fix the broken loo seats. We think it is a contract that works.

Rupert Soames: I think it is rather a paradox that just as we got to the point of virtually perfecting the PFI contracts with PFI2—because inevitably they were new and there were issues around the financing of them in the early days—and other countries around the world are picking up PFI2 lock stock and barrel and implementing it in their own countries very successfully, it would be a terrible shame for our Government if it went out of fashion somehow. The essential point is this: you get a building that is well maintained for 30 years.

Some of us are old enough to remember what the hospitals looked like that were not being properly maintained, how shabby they had become in times of austerity. What the PFI has produced is hundreds of hospitals and hundreds of schools that are being well maintained through their life. We know that under PFI1 some of them, because they did not use Government funding, did not represent great value for money in terms of the financing of them, but that has largely been changed now.

Q655 **Kelvin Hopkins:** But they are false comparisons between an unmodified hospital and a modern hospital, and nevertheless PFI has effectively died out now. There are no more PFI schemes coming through now. In my own constituency we have direct comparisons between the PFI schemes for public buildings and non-PFI schemes done in the traditional way, which were much cheaper and equally good—I would argue better—in terms of quality. Clearly PFI schemes in the early days were a licence to print money. Government has realised that now and has squeezed down on them a bit, and they are disappearing. Does that mean that PFI was historically a nonsense and should never have been introduced in the first place?

Rupert Soames: We are not invested in any PFIs. I do not have a dog in this fight. We supply services to PFIs. I just think that the reason why they became a licence to print money was because of the way that the Government chose to finance them, not because the people running the PFIs made egregious profits out of running of the services. I am delighted that your non-PFI hospitals are all being well maintained, but the fact is that in times of austerity the first thing that gets cut is very often the maintenance budget.

Phil Bentley: We look after four schools in your constituency, Challney School for Girls, Ashcroft High School, Lea Manor High School and Lealands High School, and I will wager that they are better maintained than those that are not. I would love to visit them, perhaps with you, and we will compare notes.

Kelvin Hopkins: We could discuss this at length, but we do not have time now. I think it is a long debate, but it is over now.

Q656 **Chair:** What would you say to the school that complained to me in my constituency that they wanted to put up some shelves to display the school prizes, and to screw the shelves to the wall an exorbitant charge was going to be made by the PFI contractor, so they decided not to do it?

Phil Bentley: It was not a Mitie school, I can assure you.

Q657 **Chair:** How do we get rid of those kinds of stupidities? Have they been got rid of?

Rupert Soames: No.

Chair: We need to get rid of them.

Rupert Soames: Yes. There is still a hangover of the old, typically early PFI contracts. They were not ideal. One of the ways they would make money was by charging large amounts for extra add-on services. It is not the way to do 30-year contracts.

Q658 **Chair:** What about the very large, complex PFIs like, for example, the big garrison projects, where land swaps, housing developments and release of commercial land are all mixed into one massive contract? How do we measure the value for money in those PFIs?

Rupert Soames: With great difficulty. Looking at the track record, those very big land swaps have proven to be questionable bets. I personally think, if not "small is beautiful", that the huge ones are not a great idea. The Government is now much more into doing regional contracting. You split the country into five regions so that you are not putting all your eggs into one long-term basket. You will know better than me whether those large contracts, particularly the very large MoD contract—

Phil Bentley: That was a Carillion contract, and from what I hear from servicemen and servicewomen the quality of the housing that we provide them is pretty poor in places. Rupert is right, one large contract for thousands and thousands of properties is probably not the right way forward.

The Government has an option there. Essentially it has taken some of those services in-house. At some point—this is not a political point—it would make sense for it to look at whether somebody else could provide a service. Maybe breaking it up into smaller tranches is the right way. Is the MoD the best procurer of bricks and loo rolls, for example, compared to an outsourcer? I think the answer would be no. At some point I would argue that these should be brought back into a bidding opportunity for outsourcers in the hope that we can improve things.

Q659 **Sandy Martin:** Would there not be a case that if the MoD is not capable of procuring loo rolls, it probably is not very good at procuring major contracts?

Phil Bentley: It now has that responsibility, let me put it that way, because it is taking it in-house.

Q660 **Kelvin Hopkins:** Would it not be sensible at this stage to find a way to bring the PFI schemes back into the public sector in some way, to renationalise them in a sense, make them more accountable and cheaper and save billions for the public purse?

Rupert Soames: I think it would cost billions to the public purse, and you do not need to do it because a lot of them are coming back anyway in the coming years. A lot of those early PFIs are maturing anyway. It would cost the Government a fortune to go and break out of them. If I was the Government, I would wait for them to mature and then, at the point that they end, insist that what the Government gets back is what it has paid for, which as Phil said, is a school or hospital in the same state that it took it on 30 years ago. That is real value. Patience may be a virtue.

Kelvin Hopkins: I would like to carry on with this, but I am happy to move on, Chair.

Q661 **Mr David Jones:** On the issue of capability, which you gents have just touched on, what capability does the Government require in order to procure from the private sector and then to successfully manage contracts?

Rupert Soames: A lot of stuff it does procure quite successfully. We keep having to remind ourselves that most of the stuff that it buys it buys well and the operation is fine. There are inherent risks in those very long-term contracts, be it 10 years, 20 years or 30 years, of building yourself a rigid structure that you cannot change to reflect changed circumstances. I am not a fan of these very long contracts. They may look cheaper because people are able to get 30-year financing, but they become very inflexible. You get the problems you are talking about where in year 25 you are longing to get out of it. It should not be like that. There should be more flexibility built into these contracts.

Phil Bentley: I do not think it is about capability, I think it is about some of the structures that make it harder for judgment to be applied. There is always this drive to the lowest price as the easiest answer. It is not about capability, it is about making sure that there is more engagement earlier on, there is more pre-market engagement and a more collaborative approach. That way we will end up with a win-win. That is certainly how private sector negotiations work. You give a bit, you take a bit and you end up with a pot that has more value in it.

That is where I would be focusing the capability of the procurement Departments—let’s maybe make these legal challenges post-award less onerous on the decision that was made. Let’s not dumb down technology to create an undue level playing field. Let’s drive innovation and value innovation, because in the next five to 10 years, strategically we are going to get a better outcome. Let’s be driven by outputs, not by price inputs. That is not a capability issue. It is almost a will and a policy issue.

Q662 **Mr David Jones:** Do you notice any differences between Government Departments in terms of capability? You were quite critical of the Ministry of Defence and its ability to procure loo rolls, for example. Are there some Departments that do this better than others?

Phil Bentley: I hope I was not critical of the MoD, because we do not do any business with the MoD but I would not want that to be the case always.

It is interesting. I was with a large Government Department last week and they said to me—I wrote it down because I nearly fell off my chair—"We want to be the best client we can be". That is a really good statement for a Government Department to lay out there, because it—

Q663 **Mr David Jones:** When they said "we", were they talking about the Department?

Phil Bentley: The Department was asking, "How can we as a Department work more effectively with you as a subcontractor?" That was unusual, let me put it that way. I had not heard that before. There are certainly some Departments that get that this collaborative approach is a better way to create value than just driving down solely on price.

Q664 **Mr David Jones:** Mr Soames, you deal with a number of Departments. Do you find that some are better than others?

Rupert Soames: Yes. It tends to be situational, and I will not name names. You get some procurements that are particular trouble. It is very dependent on the quality of the team that you get doing the procurements. Sometimes you get high-class teams doing really well who are outward-looking and engaging, and sometimes you get very poor teams. I would not bring it down to one Department or another. I do not think that is particularly helpful.

I would also say that very often the civil servants doing this are struggling themselves. It is not that they do not give us data because they do not want to, it is because they do not have it. They are trying to run very large and complex procurements with very thin resources and often with changing—and very difficult—political judgments about how things should be done. They have a difficult task.

Q665 **Mr David Jones:** What is your opinion of the skills capacity of the Crown Commercial Service?

Rupert Soames: It has become much better. Following John Manzoni's efforts to rebuild, supported by Gareth Rhys Williams, it has become noticeably more sophisticated with noticeably more capable people. They have done assessments that, bluntly, have weeded out some of the people who should not have been there in the first place. They are doing all you could ask them to do, but it does take time. At the end of the day, Government Departments must be prepared to listen to user expertise. In the frameworks that sit in the centre there is this push, and it is one that in a few areas has had a noticeable impact.

Phil Bentley: We may get on to Carillion in a minute, but with Carillion the contracts were transferred over effectively without a break in service. I think the Crown Commercial Service had a lot to do with that pre-planning, and that was a positive.

Q666 **Dr Rupa Huq:** There is something of a clash between the desire for parliamentary scrutiny and transparency and the way that private companies are cautious about releasing things that might show their competitive intelligence to other parties. They are protective of intellectual property. What information would you, as companies, be happy to release?

Rupert Soames: If I may disagree with your premise, certainly in my case we are gagging to release more information about our operational performance. It would be helpful for the public to see how we do. It would be helpful for us to see how our competitors are doing. Most of what should be released is not intellectual property. What we are talking about is saying, "How well are you doing on delivering prisoners to court on time? How well are you doing in terms of violence in prisons? How well are you doing cleaning the floors?" I speculate that the reason why Government is slow to adopt what seems to me to be a pretty obvious idea is that they know that it will lead to even more questions and even more freedom of information requests.

Q667 **Dr Rupa Huq:** Performance stuff and balance sheets as well?

Rupert Soames: Balance sheets are all published anyway. The critical thing is whether you are going to publish the performance of private companies, and also of public operations, in performing their contracts.

Q668 **Dr Rupa Huq:** What information would you be happy to release?

Phil Bentley: Rupert has covered that, mentioning what I would regard as output measures, a measure of what we did and not what it cost.

You raised a point about balance sheets. They are obviously disclosed under the accounting standards, but it is interesting that when Carillion went bust it had over £300 million of invoice discounting instruments that were so-called off-balance-sheet. When you are getting into good governance of companies in the outsourcing space, understanding some of these off-balance-sheet instruments and the usage of them would not be a bad idea. Essentially banks have had to swallow that, including the £2 billion hit that they took, but also suppliers were being pushed back and not being paid on time. There is over £1.2 billion owed to 30,000 SMEs. I am absolutely certain that some of those SMEs will have gone bust now. Understanding the totality of the relationships is something that we definitely should be learning out of the Carillion situation.

Q669 **Dr Rupa Huq:** What information would undermine your commercial position should it be released? Is anything off limits?

Rupert Soames: I personally am in favour of open book accounting, done properly and done as it is in the US, against very rigid accounting rules. It would certainly undermine our business if our competitors were to know what our margins were, but it would not undermine our business for Mitie to know how good we were at cleaning the floors at our hospitals as against their hospitals. In fact, it would set up some healthy competition to see who could have the cleanest floors.

It is the operational things we want to worry about. The bits that are sensitive are precisely whether you are making a 2.5% margin or a 3.5% margin, because people will use that on rebid.

Q670 **Dr Rupa Huq:** Rupert, you said that everything should be comparable between public sector and private contracts. What would that mean for the scrutiny of companies?

Rupert Soames: If you start from the basis that you should make rational make or buy decisions and you say, “We are going to have this service delivered by the public service”, that does not mean to say that the public service should not be then accountable for the delivery promises that it has made to the commissioning authority in delivering that service. Those too should be made public. In this world, I cannot see what the problem is with showing the taxpayer the value that they are getting and how people are performing against the promises that they made.

Q671 **Sandy Martin:** Once a contract with the Government has been signed, do either of you believe that the contract itself should be put in the public domain so that people can scrutinise the operation of the contract?

Rupert Soames: They already are.

Sandy Martin: They already are?

Rupert Soames: They may have parts redacted, like price or something like that, but it is standard procedure to go and put a freedom of information request together to get them published. Most of the contracts are.

Phil Bentley: Again, it is the output measures that indicate the ongoing performance. That is really where we could provide more information, league tables and the rest of it. We all like a bit of healthy competition. I think that would be a good suggestion.

Q672 **Sandy Martin:** Speaking as somebody who has attempted to gain access to a contract not with the Government but with a county council, I can tell you that there are plenty of places where, even if you put in a freedom of information request, you will be told, “No, this is not available because it is commercially confidential”. Even if they are theoretically in the public domain they are not necessarily—

Rupert Soames: I am sorry, I was referring to central Government. I think different local authorities have different approaches to this.

Q673 **Chair:** Interesting. Finally, we have touched on Carillion all the way through this conversation. If there is anything in particular you want to add about Carillion, please do so.

Phil Bentley: There is, if I may. Carillion was a construction company with some Government outsourcing contracts on the side of it. I contrast that with Mitie. It has two thirds of its contracts with the private sector. It is a different model. Essentially the Carillion problems began through construction cost overruns with the Royal Liverpool Hospital—

Chair: I think you have made this point already.

Phil Bentley: It was the perfect storm of all of them happening at the same time and not having the balance sheet strength to deal with them. It was not a failing of the outsourcing contract of services from Government central Departments. The very fact that contracts were taken on almost seamlessly would suggest that those were good contracts, otherwise no one would have picked them up.

Rupert Soames: The Government has done really well on Carillion. I know this is an unfashionable view. They got in there early and they worked out a contingency plan for what would happen when it went bust so that when Carillion tried to put a gun to their head and said, "You have to back us", the Government knew what would happen if they went into receivership. I know of not a single story of a hospital floor that has been left uncleaned or a school meal that has not been delivered, because Government did its contingency planning.

Q674 **Chair:** While praising them to the skies, what do you think has been learned and should be done better next time?

Phil Bentley: You have to understand the model of outsourcing. An outsourcer that has large construction contracts alongside it is a very different model from an outsourcer that just does security.

Chair: I understand that. An answer to my question?

Phil Bentley: I have forgotten what your question was. What would the learnings be?

Chair: What do you think the Government should learn from and do better next time?

Phil Bentley: Do not contract with companies that have huge construction risk if you are outsourcing.

Chair: Right. Mr Soames?

Rupert Soames: Mixing a construction-style business model. It does not matter if your builder goes bust, because you get another builder in to finish. It does matter if the company supplying your school meals goes bust, because you will not get your school meals on Monday morning. The Government needs in its mind to differentiate, and I am not entirely—

Q675 **Chair:** This is the living wills proposal?

Rupert Soames: That would be a living wills proposal, yes.

Q676 **Dame Cheryl Gillan:** Mr Soames, you say the Government has done terribly well, but the Government was warned about Carillion, particularly from the perspective of HS2, long before it entered into the construction contracts. Certainly the City was betting against Carillion at that stage, but the Government went ahead and awarded a very large contract, which happens to cover my constituency, to Carillion and two other companies. Is that a particularly clever thing for the Government to have done? Now the risk is higher to the taxpayer, as it is concentrated in the two remaining companies delivering the most expensive infrastructure project in Europe.

Rupert Soames: It is a fair question. Let me give a fair answer to it. The Government is in a position in these circumstances where it is damned if it does and damned if it doesn't. If the Government gives out messages to the market saying, "We do not trust Carillion to contract with them", it is the most surefire way to collapse the company.

Dame Cheryl Gillan: The market was giving messages to the Government.

Rupert Soames: Let me tell you, I was extremely well-informed about the Carillion situation. I completed a transaction to go and buy one part of their business. Throughout all of last autumn I thought I had really good insight into what was going on. I did not think the banks would let it go down. Nobody knows until it happens, because it is impossible to predict. If every time a company said, "We are falling 5% short of our earnings" it could not win any Government contracts, it would be a disaster.

The second thing that has worked well is packaging these large construction contracts into joint ventures with joint and several liability. That contract is still in place. The two other partners have had to stand up to stand Carillion's corner. Sometimes they have had to raise capital to do it. That has worked quite well. Here is a company that was employing 27,000 people in the UK. Government cannot just turn around and say that because of some analyst in the Treasury or because someone in the City goes and writes an article saying, "Carillion are weak" and the share price goes down, they cannot award any contracts to Carillion.

Q677 **Dame Cheryl Gillan:** You make a fair point as well, but most of the hedge funds were betting against Carillion back in July last year before this contract was entered into, and there were other bidders that would perhaps have been better placed and in a more stable position financially to take up those HS2 contracts.

Rupert Soames: I don't know. What I do know is that HS2 procurement took perhaps four or five years. They take a huge amount of time. They are very difficult to amend. My understanding is that what the Government did, understanding that there was a risk with Carillion, was to write to the other two joint venture partners saying, "You do understand that if this goes wrong you are jointly and severally liable?" Their boards wrote back saying, "Yes, we do".

Q678 **Kelvin Hopkins:** On HS2, you said that the Government would be damned if it did and damned if it didn't. If the Government decided to cancel HS2 and put all resource into the rest of the railway sector, which is desperately in need, would that not be sensible and would that not be helpful?

Rupert Soames: As long as it went to the Caledonian Sleeper I would regard that as being entirely appropriate.

Q679 **Chair:** Is there anything the Government should have known about Carillion that they did not know? Asked in another way, does the Government discover all it should know about these contracting companies?

Rupert Soames: I have been on the receiving end of forensic Government attention on our operations. It is extremely burdensome, frankly, and Carillion got it big-time. I am often critical of Government, but you have heard that I think they did really well on this. They had accountants in early. I happen to know for what I believe is a fact that they had a better cash flow model of Carillion than Carillion did. That is why the Government started getting worried.

Q680 **Chair:** What about their understanding of the sector as a whole and how risk has rebounded to the public sector because of the way the Government has tended to treat the whole sector?

Rupert Soames: If I was Government I would take lessons from this. The first is that contingency planning works. Get stuck in there early. Secondly, have big JVs. Thirdly, I personally think they will be more cautious now about marrying critical Government services that are delivered on a daily basis with a large construction company.

Q681 **Chair:** That is an easy thing for you to say.

Rupert Soames: Last year 12,500 companies went bust in the UK. Of those 2,500 were construction companies. Just ring-fence them, ring-fence the two—services and construction.

Phil Bentley: I do not know—Rupert, you may do—the extent to which they understood the losses, the cost overruns, the combination of all of them at the same time and what that might do. I understand they went into the service delivery contract of the outsourcing, but not necessarily the construction in the same level of detail.

The other point, Chairman, that I would maybe take issue with is that you say the risk rebounded into the public sector. I am not sure it did. It is the equity holders who have lost the money. It is the banks who have lost the money. In a way, you could argue it is better that this was not in public hands, because it would have been the taxpayer paying for the cost overrun of the Royal Liverpool Hospital and the Aberdeen bypass. In fact, the investors in Carillion and the banks have had to pick up the tab.

I am sure there are learnings there. You have to look at the risk in construction. These things can go offside very quickly. When you are cleaning, securing and maintaining premises, if you are not refuelling a nuclear power station, the risk profile is very different. Construction has big risks.

Q682 **Chair:** Thank you very much indeed to both of you. We have had you on the rack for nearly an hour and a half and it has been a very informative conversation. I hope you will look forward to our report, and do submit any further reactions or comments in written evidence to us if you feel they would be helpful for us to have on file. Thank you.

Examination of witnesses

Witnesses: David Walker, Matt Dykes and Karl Wilding.

Q683 **Chair:** Welcome to the continuation of this session on the lessons of the Carillion collapse for sourcing and outsourcing. Could I ask each of you to identify yourselves for the record, please?

David Walker: I am David Walker. I am a contributing editor to *Guardian Public*.

Matt Dykes: Hi, I am Matt Dykes and I am a senior policy officer leading the work of public services at the TUC.

Karl Wilding: Hello, I am Karl Wilding and I am the Director of Public Policy and Volunteering at NCVO, which is the National Council for Voluntary Organisations.

Q684 **Chair:** I must apologise in advance—this end of the session has become a bit squeezed. We will let you do the talking and ask very short questions, but if you could keep your answers short and crisp as well, that would help us.

I will start. What are the benefits of outsourcing?

David Walker: The great promise in austerity was that outsourcing would reduce cost. It has turned out that the benefits from cost reduction that may have been there in the 1980s and 1990s have tailed off. The innovation and the improvement in quality that was meant to be part of the package has not, in aggregate, been delivered. Recently, in addition, we have seen that the promised transfer of risk from public to private sector has not materialised.

Matt Dykes: Yes. We heard from our previous panellists what the perceived benefits are. I would say you could flip them around to identify the disbenefits. We have seen the marginalisation of expertise, whether it is public sector expertise or indeed those of charities, in favour of large, generic conglomerates, we have seen ineffective risk transfer and we have seen market concentration reducing choice and contestability.

Q685 **Chair:** Before we go on, how fair would it be to say that both of you are therefore against outsourcing in principle?

David Walker: The public sector buys a huge array of goods and services. It would be dogmatic to say at any given point that there is a hard and fast division. Clearly there is an array of core services, public-facing services, that in my opinion should as a default be publicly provided.

Matt Dykes: We would say that as a matter of principle, public services are owned by us, funded by us and have a set of expectations that derive from that that make them very different from the private sector. In some respects there are matters of principle, where the profit motive is seen as incompatible with those aims. Equally, there is a set of pragmatic and practical considerations around the principal-agent relationship you get between the public and private sectors in the commissioning process that means that outsourcing is often ill-suited to public service provision. There is a set of principles that we raise, but also a set of pragmatic considerations.

Q686 **Chair:** Can I go back to my original question? Neither of you are saying that outsourcing is always wrong. What are the benefits of outsourcing?

David Walker: In principle, an outsourcer can bring specialist expertise. I give a very brief example: pest control. You would not expect a small district council to have the capacity to control pests. That is done, for example, by Rentokil Initial. It would seem to me reasonable if Rentokil Initial were to sell its services for pest control to an array of district councils.

Q687 **Chair:** What about building a hospital, running a street cleaning service or rebuilding a garrison? You have not given that kind of example.

David Walker: Again, my default position is that those services could and should be provided by the public sector. If there is for some reason an incapacity, then clearly it has to go out.

Matt Dykes: I would agree that there are capacity issues, but the way around that is to have a very strong public interest case for each outsourcing example. In terms of building a hospital you are buying in capacity and expertise in building the bricks and mortar. Whether you choose private financing as the most effective route or whether you tie that up into a 30-year repayment and service maintenance contract is another thing, but in terms of building I would say that is probably an area where you would bring in external expertise.

Chair: Mr Wilding, the benefits of outsourcing?

Karl Wilding: Some of them have been rehearsed already. Cost: sometimes it can be done more cheaply. Choice: there is greater choice for users, sometimes involving other organisations. When it comes to human services, the sorts of services that involve relationships at the centre of them, it strikes us that quite frequently involving service users in the delivery and design of those service users brings significant benefits in terms of better outcomes. Possibly not cheaper, though.

Q688 **Chair:** Mr Walker, in your report you say that outsourcing leads to service fragmentation. Can you explain?

David Walker: An obvious area to look at would be criminal justice. If you give over probation to private profit-seeking companies there are incentives, almost by definition, to collaborate with local authorities providing housing, with the Prison Service, with other companies in the Prison Service, and with an array of voluntary bodies providing services for the rehabilitation of offenders. The motivations are there. That would be a good example of how outsourcing has increased fragmentation, which was—let us face it—already a problem.

Matt Dykes: Can I come in on that point as well?

Chair: On probation services?

Matt Dykes: No, particularly on fragmentation, just to bring in two other examples. First, the rail industry. The Government's own commissioner, Roy McNulty, led a report into GB Rail that found it was the operational misalignment of multiple players and fragmentation that was preventing reform of the industry and the collective good.

Secondly, there is the NHS, where the Five-Year Forward View is trying to find ways to integrate services further across health and social care on models of collaboration and mutual benefit, and competition is getting in the way of that. We saw that in the vanguard projects that were brought in in the health service. Many of the leaders—both commissioners and NHS providers—involved in those vanguards appealed to the Department for Health and Monitor, as it was then, to suspend the requirement to competitively tender services because they felt it was getting in the way of collaborative endeavours to improve the service and integrate better.

Karl Wilding: Mr Chairman, that is not a problem of outsourcing per se. We know that sometimes there are problems in the way things are outsourced that lead to fragmentation. You talk about the NHS. We have this idea of referral ping-pong where people are just batted about between different bits of the service. Ultimately you increase cost because of what you might call "failure demand". However, we also know that if you can commission in a different way that involves collaboration, not just competition, you do not need to experience these sorts of fragmentation problems.

Q689 **Chair:** In respect of charities, you have argued that there should be alternatives to competitive tendering, such as competitive grant making.

What are the advantages of using grants rather than contracts? Obviously there is a spectrum in between grants and contracts, because you would not get a grant with no indication of what outcomes you expect.

Karl Wilding: Both the National Audit Office and the NHS have said that given the right services, grant making offers value for money. You can involve a wider range of smaller organisations that are increasingly excluded from procurement processes because the contracts now are too big. You can still have good-quality monitoring and evaluation processes in place without the sort of performance management spaghetti that lots of organisations are currently dealing with in contracts.

Q690 **Kelvin Hopkins:** One quick question. Isn't the best example of fragmentation causing a massive rise in costs in the rail industry, where we have seen the cost of electrification over the last 30 years—taking out inflation—go up by seven times?

Matt Dykes: Yes, we would agree.

Chair: Some of us might argue there are other factors. The railway is much safer than it used to be.

Matt Dykes: I have one other point on the rail industry. It is the way that the role of private sector operators in the rail industry has acted as a barrier to innovation. We heard in the previous panel that the private sector brings innovation. You could argue that the single biggest innovation in modern public transport for the benefit of passengers is smart ticketing, yet it took over six years of painful negotiation to get any of the private train operators to engage with the Oyster card scheme that was promoted by the public service in London through London Underground and Transport for London.

David Walker: You asked about fragmentation. Just briefly, another example—which your colleagues on the Public Accounts Committee have reported on more than once—is nuclear industry decommissioning, where you have a series of outsourcers and providing companies and, to use the technical term, it is a mess.

Q691 **Kelvin Hopkins:** In your view, why do Government authorities insource contracts, and what evidence is there than insourced services perform any better than outsourced services?

Matt Dykes: There is a range of research on that. Some work has been undertaken by APSE, the Association of Public Service Excellence, which is a local government-based consultancy and membership service. They have now undertaken three insourcing surveys. The latest had responses from 211 tier 1 authorities and found that 73% of those authorities were considering insourcing services. Over 50% of them already had. Of the 50% that had insourced services, large numbers reported greater flexibility, greater efficiency, the ability to flex their workforce to meet changing needs and requirements, which we might come on to later, and longer-term cost savings.

Q692 **Kelvin Hopkins:** Going beyond that, how capable do you think the UK public sector would be of insourcing services much more widely?

Matt Dykes: In many respects there has been some hollowing out, in some local authorities almost literally, like in Barnet and Northamptonshire. That is a problem. With long-term outsourcing the parent body loses capacity. It is transferred, sometimes irreversibly, to the outsourced sector. It would be a significant challenge, for example, to insource social care. The reason is that so much of it is now outsourced, but also because the assets themselves are in the private sector. The public sector simply does not have the homes and the infrastructure in place to achieve that.

Kelvin Hopkins: National health service, 1948. I will leave that as a comment.

David Walker: Just before we move on, one of the problems with outsourcing is the potential for transferring knowledge and understanding of the service that you then, as a public body, have lost. That is a principal critique of outsourcing that is recognised by the private sector. There is a quote here from General Electric, "We had given up a lot of our intellectual property. We did not understand our own business processes". That is a real risk with outsourcing, that you lose something that is very difficult to reacquire and certainly to reacquire in a political cycle.

Matt Dykes: Can I just emphasise that there are local authorities in England now doing this? It is not impossible. Across Europe there has been remunicipalisation of everything from buses to the water supply. It is possible. We would not want to overstate that case.

Q693 **Kelvin Hopkins:** Finally, how dependent is the public sector in the UK on a stable market for outsourced services?

David Walker: By "stable" you may mean "concentrated". You heard from your previous witnesses just how concentrated the market is for the provision of large contracts.

One of the things that has always worried me about the outsourcing market as it has gone up is that it involves companies, and I am afraid Serco is a good example, which have no identifiable USP. What was Serco before it became this mega-supplier to the public sector? Identifying what Serco is and what it does—similarly Capita—is a real issue. Clearly there is some competition, although there was remarkable amity between Mitie and Serco in your previous session. Identifying what these companies actually are, beyond suppliers to the public sector of a variety of different services, is quite difficult. They did not have a prior body of expertise that they have imported into the provision of public services.

Karl Wilding: I would say, however, that does not apply to charities and voluntary organisations. They do bring something different and unique.

They are trusted. They are of the community. I think they deliver high-quality outcomes based on their experience as users.

Q694 **Sandy Martin:** These are going to be questions about how far you think the Government is capable of making a rational evidence-based decision on whether to outsource in the first place. The buzz phrase is "whether to make or buy". In particular, to start off with Mr Walker, you said in your written evidence, "The Government does not make decisions about contracting because the Government has no strategy or general approach to outsourcing". On what basis do you say that?

David Walker: We have heard some praise this morning of the Crown Commercial Service. It only has oversight over 15%, I think, of central Government's contracting. The rest of it is done within Departments. We have heard already this morning that those Departments often behave in what you might call an autarkic fashion, without any real regard to the bodies of knowledge that the Cabinet Office and the Crown Commercial Service may have supplied. Meanwhile, in the NHS you have trusts making individual contracting decisions, you have local authorities making a range of decisions and you have arm's-length bodies making decisions, none of which are necessarily cognisant of or joined up with any of the other decisions.

One of the points we were trying to make in the evidence was the absence of evidence. You can make a rational make or buy decision if you know about the performance of the company, if you know about the market and if you know about the previous relationships that the contracting body may have had. That information simply is not collected on a rigorous long-term basis. Even if it were, it is never made available as a precondition before the contracting decisions are made.

Q695 **Sandy Martin:** We have heard quite a lot of evidence about the process that is followed through for making outsourcing decisions. Where along that process, in your opinion, should the decision be whether to outsource at all?

David Walker: The first decision should be—I am sorry to use a piece of jargon—"Is this a commodity? Is this piece of activity by the public body a commodity, such that it can then be parcelled up in a contract?" Many public bodies—I generally mention environmental services—have fallen into a trap of assuming, for example, that bin collection in and of itself must be available for outsourcing. You could arrange environmental services in a local context in a variety of ways, none of which necessarily have to be available for outsourcing. A prior decision is how you organise your services. Then if you were to move down the road of contracting, you need an array of evidence that I am arguing is simply not available.

Again, I am sorry to personalise this for the Chairman, but his local authority, Tendring, has rolled over an environmental services outsourcing contract with Veolia, a major supplier. That is not necessarily a bad decision, but it says that maybe the inertia factor in having a large contract is such that you do not want to get into the difficult business of amassing the information you would need if that contracting were genuinely to be competitive.

Q696 **Sandy Martin:** How much do you think the British Government or indeed local authorities have learned from the problems they have had with contracting since the 1980s?

David Walker: I fear far less than they ought to have done. That applies in Whitehall, it applies in the NHS and it certainly applies in local government, where if you went to the Local Government Association you would not get from them the kind of endeavour to pull together the information and make it available to local authorities before they make make or buy decisions.

Matt Dykes: I have two points on that. First, at the very outset the policy decision to outsource should be informed by a very strong, evidence-based public interest case. I am not sure that is always the case. Even if a public interest case is made, I am not sure it is always very well evidenced. I have not talked to anyone yet who has explained to me the public interest case for outsourcing probation services.

Beyond that, it is very interesting to reflect on the Institute for Government's report on when to outsource or when to tender. They have 10 questions there that every commissioning authority should ask itself. They flag up, "Is there demand uncertainty? Is there policy uncertainty? Is this an area that will be impacted by other Government Departments?" All these questions are exactly the kinds of risks that Serco this morning, by their own admission, said that they are unequipped and unable to manage. If there was evidence that Government Departments, local authorities and NHS trusts were following those 10 questions, I think we would see far less outsourcing and far more decisions to make rather than buy.

Q697 **Sandy Martin:** Mr Wilding, do you believe that the third sector is taken seriously when people are looking at decisions whether to outsource or not?

Karl Wilding: It would appear that there is not much strategic overview in terms of thinking about involving the third sector or the voluntary sector. A good example of this is payment by results. Sticking with the issue of transforming rehabilitation, the NAO's framework from 2015 provides a good yardstick to decide whether or not to use PBR, but there is little evidence, from what we can see, about whether or not that framework is used.

This morning Clinks, who are the umbrella body for organisations working in criminal justice, have produced a report on transforming rehabilitation. They have been tracking that. Despite the warm words about involving more voluntary organisations in rehabilitation, that has not come to pass. They continue to use mechanisms like payment by results, poorly designed outcome and payment measures, and the prime and sub model, which means that it is very difficult for small organisations to get involved. That is repeating the mistakes that the Work programme was making a number of years ago, so there is little evidence of learning or strategy.

Q698 **Dame Cheryl Gillan:** We now know the market for Government outsourcing is absolutely vast and cuts across many, many sectors. How has that market for public sector contracts changed over the last 10 years in particular?

Karl Wilding: From our perspective, broadly speaking the amount of money flowing into the voluntary sector has increased, and that has mostly been for delivering contracts. The money that comes into our sector has shifted from around 50:50 grants and contracts to now about 80% contracts and 20% grants. What has been happening is that small grants that have enabled small organisations to get involved in service delivery are being rolled up into larger contracts. It is now very difficult for small organisations to get involved, so you have a few large organisations that are delivering public services.

The second thing that we have seen change over the last 10 years is the shift towards payment by results type contracts. For the avoidance of doubt, we are absolutely clear that you should fund organisations that are impactful and that do good business, but the use of payment by results contracts is shifting risk on to the organisations in the system that are least able to bear it. Again, talking about prime and subcontract models, we know that being a subcontractor in one of those systems now brings with it a huge amount of risk.

The other thing that we have seen change over the last 10 years is the capacity of commissioning bodies, and broadly speaking we think that they have less capacity. It is leading to situations that David talked about where more contracts are just rolled over because it is the easiest and quickest option.

To end on a note of optimism, we think especially at local level with health bodies and local authorities there is more experimentation now around co-production and designing services together that involve some of the pre-procurement type dialogue that the previous witnesses talked about. It is in some of those activities at the local level that we think there might be an emerging model for how we can do this better.

Q699 **Dame Cheryl Gillan:** Would it be fair to say that the climate is more hostile towards smaller charities than it was 10 years ago?

Karl Wilding: The climate is quite hostile towards smaller charities and that has always been the case. If you were to ask me about the last couple of years, I think what is changing is that large charities now are starting to walk away from contracts. Large charities, in fact all charities of all sizes, are being asked to subsidise contracts with their donated income. Work by the Charity Finance Group suggests that a small group of large-scale charities delivering contracts are losing on average 11% on those contracts. Just in the same way it is not working for the private sector, it is also not working for even large charities in our sector and they are walking away.

David Walker: As you know, the curve of spending on outsourced services has continued to rise. The paradox is that the increase has not been accompanied by what we might call "mind" applied by Government to the activity. This Committee and its predecessor have reported often on the absence of a strategic capacity at the centre of the Government. That strategic capacity might have looked at this burgeoning sector and said, "Are we equipped as a state, NHS, local government and central Government, to manage this phenomenon? Do we know enough about contractors?" and ask the various questions that you have been asking. That did not happen. Yes, there have been marginal improvements with the enhancement of the Crown Commercial Service and so on, but we are still in a situation where this massive body of public sector activity has been transferred to the private sector almost in a fit of absence of mind.

Q700 **Dame Cheryl Gillan:** Why do you think it has changed like this?

David Walker: People got religious about outsourcing. This was patently true under the Labour Government. Ten years ago, almost to the day, Gordon Brown received a report from DeAnne Julius that said, "Theoretically we can outsource 100% of Government activity". That is a kind of dogmatic, religious belief, but it was prevalent and has remained prevalent in certainly the bosoms of some Ministers, if not all. They have said, "By definition, private sector markets will always deliver better; therefore we will promote it". Certain Departments under certain Ministers have been good examples of that almost dogmatic commitment to the increase in outsourcing.

Q701 **Dame Cheryl Gillan:** Is this diminishing flexibility in the way Government view this area?

David Walker: It seems that often, again paradoxically, there is a lack of concern for what might happen. We are living through—it is a cliché—a period of huge turmoil in our institutions and policies precisely when flexibility in the delivery of public services is absolutely necessary, and yet so much now is locked into longer-run contracts that cannot be broken except at great expense.

Q702 **Dame Cheryl Gillan:** Anything to add, Mr Dykes?

Matt Dykes: The only thing I would add is to reiterate a point Mr Soames made earlier that the market is tending towards concentration, particularly certain different public service markets and sub-markets. There is concentration in the hands of large suppliers, largely from the private sector, but also in some cases concentration of the share ownership of those companies as well. Not only are certain markets in the hands of a small number of large providers, but those large providers are owned by smaller and smaller numbers of institutional firms.

Q703 **Mr David Jones:** In the wake of Carillion, how sustainable would you say are the large private sector providers?

David Walker: Analysts in the City tell us not very. They have identified Capita and Interserve as problem companies; problematic not just because of their exposure to public service, but because they are companies that do not really know what they are doing. It is not me saying this; this is what the conventional wisdom in the City is. They have grown by taking on often low-margin public sector contracts and they simply do not have, as companies, a strategy.

I think the answer to your question should be a real degree of anxiety on the part of account representatives and on the part of the Cabinet Office about the beast that is being created and how it is, in a sense, now to be properly controlled and managed.

Q704 **Mr David Jones:** Mr Bentley drew a distinction between a company that was providing facilities on the one hand and another that was providing contracting services on another. What is your view about the point that he made on that?

David Walker: If I may say so, I think he slightly shot himself in the foot. The evidence that the private sector provides, as it were, bog-standard facilities management any better—except in terms of lower labour costs, and there are all sorts of things one could say about that—is not great. Yes, he is right that the construction industry does have a cyclical, volatile element, and that is one reason why the state needs to be vigilant when it gives over large building contracts to private companies that historically have not been as stable as they might. That is the situation partly with Carillion. People have said it was not just public sector contracts that exposed Carillion's risks, but in giving building contracts to any company the public sector should be vigilant.

Matt Dykes: I think the Commons Library Briefing on the collapse of Carillion, which is a really great document, made the point that, yes, it was the £845 million write-down in profits in the construction sector that broke the back of Carillion, but it was the decision making over the previous two years that left it exposed to that instance that led to its demise. Those decisions were largely about taking on high levels of debt, prioritising shareholder dividends at all costs and maintaining that model through aggressive tendering and acquisition of contracts.

That levering against the future, if you like, is also seen across a number of the other major strategic suppliers. I draw your attention to the work of Adam Leaver at the University of Sheffield. He has undertaken his own risk analysis across a group of major competitors. Worryingly, he found that Capita was probably the most exposed in terms of the proportion of its net present value that is made up of goodwill and future protections of cash flow in comparison to its actual current assets.

While it is true that Carillion had the weakest balance sheet—and therefore was more exposed than others—that kind of business practice and the risks associated with it are not unique to Carillion. Even though Carillion had that construction element to it, its actual business model is not unique.

Karl Wilding: Charities clearly do not have the same problems that Carillion had in terms of debt or dividends or having huge amounts of goodwill on the balance sheet. That is not an issue for us. Clearly I cannot sit here and say that every charity that contracts with the Government is going to be infallible. This Committee has heard evidence in the past from at least one that has failed, which you will no doubt recall. I think the risks to the charities and therefore to the system here come from, again, the style of procurement. Margins are very, very thin, if indeed margins exist. I have said already some charities are being asked to subsidise contracts. There is risk as well of supply chain failure. A big challenge lots of organisations have is that they are subcontractors, they are expecting a certain volume of work, and that work then never occurs from the prime contractor.

Again ending on a positive note, we know that organisations are mission-driven and they are very reluctant to back out of delivering these services. Quite often they will find ways of delivering them that make up for some of the other weaknesses that they may have, such as greater involvement of volunteers, for example.

Q705 **Kelvin Hopkins:** In relation to these large private sector providers, what does the Government prioritise in its procurements from these companies?

David Walker: One thing it needs to know is who owns them, particularly anything to do with security. If the ownership structure of a company is opaque it could be the Russians, it could be the Chinese, and these are issues that any Government should surely be aware of. Even if it is the French, it is something that should be known, yet that knowledge base across contracting is—this is what I am trying to say—inadequate.

Q706 **Kelvin Hopkins:** There is a question that I want to put to Karl Wilding, but also to others, possibly. How do these large contractors relate to their subcontractors? I have a quote here from an academic submission sent to us by a group of academics saying that both debt and equity finances, specifically PFIs, had little appetite for holding risk, and they prefer to diffuse these to others through a complex web of subcontracting arrangements and insurance mechanisms. They shuffle off the risk to the subcontractors; that is what they are saying. This is what their findings are. What do you think about their relationship?

Karl Wilding: It varies. There are some good relationships, but there are also some pretty poor examples of supply chain management. Again, I am sure this Committee will be familiar with these practices, such as creaming and parking, where the most difficult clients are fawned off to the subcontractors because they are more expensive. Other examples of things going wrong are where you were promised a certain level of business, you gear up to deliver that business, then nothing ever appears, and it turns out that you have just been used as bid candy in applying for that contract. They are the bad examples.

There are also good examples, and again, other organisations are clearly working much closer in partnership and have an alignment of values.

Q707 **Kelvin Hopkins:** A question for Matt Dykes and David Walker now. You have both claimed that the large contractors have undermined the pay and conditions of low-paid employees. What evidence is there of this?

Matt Dykes: There are several reports and academic reports looking at the impact both across sectors and across countries. What they tend to find is that the cost risk that is borne by contractors is usually mitigated through cost reductions in three main ways, mostly through better utilisation of technology, headcount reduction or suppression of pay and terms and conditions. Putting that together in an actual evidence base is difficult. The evidence tends to be patchy and anecdotal.

We commissioned Landman Economics to look at the labour force survey, and we picked 10 types of occupation that can be seen across the public, private and voluntary sectors. A care support worker would be one, for example; a cleaner another. We looked at a range of metrics about the employment standards and compared them across sectors. What we found was that of those 10 occupation types, nine out of 10 had longer hours in the private sector, all 10 occupation groups had shorter job tenure, eight out of 10 of the occupation groups had a higher proportion of agency workers in the public sector, seven out of 10 had shorter-term contracts in the private sector, and all 10 occupations had lower median pay than the private sector. That was our analysis of the labour force survey.

It is interesting that Mr Soames made reference to the Prison Service, because the Prison Service pay review body's own evidence shows that in every single grade across the prison service, private prisons pay lower on average, apart from senior managers.

The final thing I would say is that it is not just about pay, as Serco said this morning, but it is also about workloads and headcount. While Mr Soames is right that Serco's employed workforce at Barts trust were pegged to the real living wage, you will be familiar with the fact that they had industrial action at Barts. That was largely about job cuts at Whipps Cross Hospital, but also the way staff were treated, excessive workloads, and what were seen as punitive local management systems—what Mr

Soames probably calls, "us better organising the workforce". I think that was his term.

Kelvin Hopkins: That is a very comprehensive answer.

David Walker: I am tempted, if you will forgive me, to make an ad hominem point in response. One of your witnesses was Gary Sturgess. Gary spent his early years as a keen advocate of outsourcing as a direct means of reducing cost; reducing cost because you spent less on your workforce, first by paying them less, and secondly by employing fewer of them. Gary, perhaps like Rupert Soames, has had a Damascene conversion of late, and now his point is that outsourcing is a badge of quality, not cost reduction.

The case for outsourcing since the early 1980s, for 25 years, has rested squarely on the assertion that, "You can employ us, a private firm, because we will manage labour better, meaning we will employ fewer members of trade unions and employ fewer people, and those we do employ, we will pay them less".

Q708 **Dr Rupa Huq:** I want to return to PFI. To the three of you, I wonder what your view is of the success of PFI and the son of PFI—PF2—if there is any success at all of these two.

David Walker: I will just focus on the flexibility part, which again you have sort of addressed this morning. The core of PFI is a long-run commitment to a given supplier of a service, whether it is the building or the maintenance of that building. Circumstances change. As you well know, a school intake may flop from one September to another. Public bodies have to have the flexibility to deal with changes in public demand and public need. Long-run PFI contracts by their very nature cannot accommodate the necessary flexibility that public service providers need. There are many more points to be made, but I think that is a very important one.

Matt Dykes: If I was pushed, I would point perhaps in the short run to at least a political success, and it got an awful lot more stuff built while maintaining the perception, at least, of staying within some sort of fiscal rules. I would say that there is evidence to suggest that risk was effectively transferred in the construction phase, but that risk was overpriced and the public sector, for the reasons David just mentioned, is probably better equipped to deal with that long-term demand and policy uncertainty.

Q709 **Dr Rupa Huq:** I know you said that it politically got big bang for buck quickly, but in the long term are there any types of projects where PFI, PF2 or a similar structure might be appropriate?

David Walker: I am going to give you another negative example. In the constituency of one of your colleagues who is not here today, they have a PFI waste incinerator. The incineration of waste depends upon local authority policies on recyclables and so on. Local authority policies change—for example, we had elections last week—in response to change in political control. Again, you have to have the capacity to flex. Most PFI contracts, particularly PFI1 contracts, simply could not tolerate that degree of internal flexibility.

Q710 **Dr Rupa Huq:** I think the NAO has found no discernible difference between PFI and PF2.

David Walker: No, none of the markets have, because the number of PF2 contracts let since George Osborne announced it can be counted almost on the fingers of two hands.

Dr Rupa Huq: Anything else?

Matt Dykes: I think the evidence is disputed about how innovative the build and design was as well. If you look at the reports by Mark Hellowell at the University of Edinburgh, he argues quite convincingly that the nature of senior debt financing in PFI projects means that at the outset of the design/build part of the projects, those projects tend to err on the side of caution and conservatism, because that is where most of the risk is loaded in the schemes. I think the Audit Commission looked at a range of PFI and traditionally procured school buildings, for example, and found no discernible difference in quality or innovative build.

Q711 **Mr David Jones:** What is your assessment of the Government's capability to contract successfully both with the private and charitable sectors?

David Walker: If I may underline this question of the Government's own fragmentation, again, something that you on this Committee have thought about for years is why Departments don't speak to one another and share experience. Why don't Departments listen to expertise that has been, to some extent, now built in at the centre in the Cabinet Office? Why do the Cabinet Office and the Treasury not share information? We have heard citations of the Green Book. It is a great book. It has loads of aphorisms that Departments should absorb, but clearly they do not. Treasury does not seem, as an institution, terribly interested in outsourcing. I think if central Government could get their act together more, their capacity to let contracts would be much better; they would get better prices because they would deal as a unity rather than as a series of different commissioners.

Matt Dykes: I think there seems to be a consensus that things have improved, but it depends what measurement you are using for being a successful commissioner. In terms of controlling price and perhaps transferring risk or having a more rigorous approach to risk assessment, you could argue that Government Departments have got better. In terms of implementing social value procurement or social value commissioning, I think its capability has barely increased at all.

Despite the fact that the Crown Commercial Service, for example, is producing documents about how you can achieve broader environmental employment and social objectives for your procurement, evidence from Social Enterprise UK, for example, found that only 24% of local authorities currently have a social value procurement strategy in place, and of those only 10% of their tender evaluation is made up of social value assessment. In some respects probably capability has got better, but in other respects it is nowhere near good enough.

Q712 **Mr David Jones:** In terms of central Government, to what extent is social value increasingly reflected in procurement?

Matt Dykes: I do not see the evidence for any great improvement.

Q713 **Mr David Jones:** Notwithstanding the Green Book?

Matt Dykes: No.

Karl Wilding: David makes a very good point about fragmentation of commissioning. This is something that is not just happening in central Government. It is also happening with police and crime commissioners, local economic partnerships, clinical commissioning groups and local authorities. It is difficult to build capability when commissioning is taking place in so many different places.

Secondly, I think the issue is not just capability, it is also capacity, which we talked about before in the sense that there are literally fewer people involved so contracts are more likely to be rolled over. For us the most important thing, probably, is about culture and a sense that this relentless focus on price over and above anything else—and social value being the obvious point—there is very little take-up of the Social Value Act. We would like to see the provisions in the Act to ensure take-up is strengthened.

David Walker: If I may add to that very briefly, it is not just about social value. Again, to quote the fabled Green Book, the Treasury says that these decisions should only be made in favour of outsourcing de facto if relevant costs and benefits are those for UK society overall, not just the originating institution. The decision should include costs and benefits to households and individuals. If a contractor were deliberately to reduce the pay and conditions of the workforce to get the contract, that should be precalculated, because there would be a knock-on cost for DWP and the Government's budget in total.

Q714 **Mr David Jones:** We have heard from Sir Amyas Morse that the Government lack the capability either to run services directly or to take on the role of prime contractor. What is your view on that, Mr Walker?

David Walker: I think the point Amyas was making was more that austerity has hollowed out capacity. Again, you know full well from your deliberations that Whitehall still has—it is the 50th anniversary this year of the Fulton report—major problems with recognising expertise; technical services require expertise. If you do not have it and you do not prize it, you are not going to be able to do it.

One of the questions obviously you are thinking about is whether expertise in commissioning is now sufficient given that we do so much commissioning. Clearly Amyas has to be right; within the short run many services could not overnight be switched back. But there are a number of services, local government and the health service, facilities management, and cleaning where a simple TUPE transfer would take care of it, and if—a big if—the public sector had the managerial capacity such services could immediately be switched.

Matt Dykes: Yes, I would agree with much of that. I will just reiterate the point I made before—there are local authorities that are insourcing. There are NHS trusts that are winning bids and delivering services. There is a hollowing out, but it is possible. I would caution against over-optimism about the ability for the public sector to bring a national social care service publicly owned from day one.

Karl Wilding: We talk about the extent to which charities depend on Government funding, but actually, if anything, it tracks that the public sector is extremely dependent upon charities and volunteering. Just look at the health service: 300,000 people at the moment are volunteering in health and social care at the moment. I would slightly challenge the point that it is desirable that you would want to suddenly insource this wholesale from where voluntary organisations are delivering it, because I think quite often they are doing a really good job.

If anything we should be thinking a bit more about how we do things like asset transfer right so that we can get services into the hands of communities and put the assets with them, whereas at the moment we do not seem to be doing that very effectively. We seem to be very good at transferring liabilities rather than assets.

Q715 **Sandy Martin:** All three of you have called in the past for more transparency in contracting. What additional information do you think companies should have to disclose?

David Walker: I would underline the point I made earlier about ownership. I will just give you an example. There was an IT software company called Northgate that apparently has 95% of United Kingdom local authorities as its current customers or has had them as customers. Who owns Northgate? Northgate was owned by a UK company called Cinven. Cinven was taken over recently by the Japanese company, NEC. There may be no problem with Japanese ownership of a major supplier of software to the UK public sector, but that knowledge should be in the system and deployed as necessary. I think knowledge about ownership structures is particularly necessary and often lacking.

Q716 **Sandy Martin:** Yes. Presumably that would extend to which organisations and hedge funds or whatever—

David Walker: In social care, which we spoke of a moment ago, the fact that Four Seasons—a large hedge fund—is, very, very unhappily, the owner of a large chunk of social care provision in local England is surely a big issue.

Matt Dykes: I think we need information around pay ratios and information around where organisations are registered for tax purposes. There are issues around what we want from individual companies, but it is much more about knowing, at least beyond a certain threshold, who owns what and how much public money is going into those organisations across the piece. There is analysis undertaken of where central Government contracts, and maybe local government, but it is not brought together in any one place.

I find it astonishing that from National Audit Office reports through to other organisations, it still seems to be guesswork as to how much of this £200 billion is going on buying aircraft carriers and paperclips and how much of it is going on actual public service outsourcing. We still have to make a guess at that. It just seems astonishing to me that even the National Audit Office cannot put an accurate figure on how much money—taxpayers' money—is being spent on service provision as opposed to buying goods.

Q717 **Sandy Martin:** Mr Walker, you have talked about some of these large companies as being parastatal bodies. Can you expand on that a bit and explain what special accountability measures you think need to be put in place for these parastatal bodies?

David Walker: I know that as expert MPs, your bedtime reading is the whole of Government accounts, this annual production. It is a great book. It is well worth reading. In preparing the whole of Government accounts the Treasury worries about how you define bits of the public sector that do not themselves directly receive a large amount of public sector funds. Network Rail is a case in point; it is a complex relationship, how you classify it. When you have a company—Capita, Interserve—where 50% or 30% of its revenue has come from the public sector, it does have many of the attributes of bodies that are already on the register as public bodies and whose accounts are consolidated into the whole of Government accounts.

For that reason, an accounting reason is one requirement, but clearly the other one is political accountability. If a company is so dependent on the flow of public funds, you, as representatives, the Executive, should be across them as entities, but because they are private companies there is a veil that prevents them from being seen to be as much part of the public sector—hence the word "parastatal"—as they are.

Q718 **Sandy Martin:** Would you consider ownership of those companies and the directors of those companies as being legitimate parts of the public interest as well?

David Walker: You do not have to want to take back control not to want to know that your railway is being run by the Dutch Government, the

German Government, the French Government, by international entities—that sort of knowledge surely is critical, whatever your feelings about ownership at large. You need to know who owns what, and it has been the case that outsourcing has grown without corresponding growth in our knowledge base.

Q719 **Sandy Martin:** Indeed, we may be more worried about Governments other than the Dutch Government, the French Government or the German Government.

David Walker: When you see attempts by a Chinese company—whose directors we know include members of the Chinese Communist Party, because all Chinese companies do—getting involved in the preparation of IT that is then going to be used by UK forces, that is an occasion when you might think outsourcing has gone too far.

Q720 **Kelvin Hopkins:** A quick question. Would it not be sensible, particularly for those dealing with national internal entities, to have a Government stake in those companies and put Government representatives on the boards of those companies?

David Walker: That is one way. The alternative is to have a market in which the state is present, like the railways, where if the Government ran the franchises, that would generate comparative performance information of a kind that the regulators would be able to use. We seem to be in a situation where it is all or nothing. Either the Government buys into a company or the Government is present in the market as a player itself and its performance can then be compared and contrasted.

Q721 **Kelvin Hopkins:** East Coast Main Line in public ownership was a brilliant success.

David Walker: Whether it was or not, it generated information about the performance on a major intercity franchise that was useful and would have continued to be useful had it remained as a public entity.

Karl Wilding: Two quick points on transparency. First of all, it is still incredibly difficult to work out who gets the money. I worked at the National Audit Office in 2007 on a report called "Working with the Third Sector", and they recommended at that time that Government should track how much money goes to the third sector. That report has still not been implemented. The Crown Commercial Service is doing better, but there is still some way to go.

There is a second type of transparency that I think is important. We are starting to hear from a couple of charities that in their contracts, clauses are being inserted that say things like, "You are not allowed to talk about this work in a way that might harm the confidence of the public". I would argue to you as a taxpayer it is important that if there is something going wrong with a contract, whether it is a private company or a charity, you should be able to talk about that without fear of recrimination. That is something that I think we should be interested in.

Q722 **Chair:** Can I interject? I would suggest that what will enhance the confidence of the public is that you are going to talk openly about the shortcomings of the service that you are contracted to the Government to provide, otherwise the public will not have much confidence in anything you say or the service you are providing.

Karl Wilding: I would agree.

Q723 **Chair:** Finally, Mr Dykes, you are claiming that the Government's approach to strategic supplier risk management has failed dramatically in the case of Carillion. Can you explain why you are saying this?

Matt Dykes: If you assume that risk management is a way of ensuring that one of your largest strategic suppliers does not go belly-up, leaving 450 public service contracts in the air and 19,000 workers facing uncertainty, then it clearly failed. It also failed in that while the Crown representative system may well have kept tabs on the performance of Carillion across the central Government Departments it was supplying to, clearly—or perhaps not clearly—the evidence suggests that it was not taking into account the risk of exposure of Carillion across the board.

Also there is a point that was raised this morning. Mr Soames said that the Government is damned if it does and damned if it doesn't, and I have a certain degree of sympathy with that. However, clearly in its risk management plan, it does say that where a company is in financial distress it should not be receiving ongoing Government revenue. The fact that the contracts continued to be awarded, as Dame Cheryl suggested this morning, was against the spirit of that risk management plan.

Q724 **Chair:** What is the definition of financial distress?

Matt Dykes: It is stated in the management plan as an episode of a profit warning or other public announcements from the company, but I think it should go deeper than that. The Government were aware that it was being shorted at the time. They saw the adverse market reaction to the company. Through their dialogue with the company, you have to presume that they were getting information about the financial distress that the company was in.

David Walker: Apart from *The Guardian*, the greatest British newspaper is of course *The Financial Times*. Some readers in politics throw away the second section of *The Financial Times,* but if they did not, they would see that the answer to your question is surely that early warnings will appear in the business section of the *FT,* where you get analysts saying they are worried about this or that. "It may not be a profit warning, but we can smell something." The information is around.

Q725 **Chair:** But at exactly that point, that is when Mr Soames was explaining that you are damned if you do and damned if you don't. If the Government had announced they were not going to let any more contracts to Carillion at that point, say six months before it collapsed, or even earlier, that would have been the end of Carillion.

David Walker: But the conclusion you might draw from that accurate observation is that this kind of contracting is, in and of itself, too complicated, and that is why a default of in-housing is the policy one should pursue, because there are such—

Matt Dykes: It demonstrates that ultimately it is the public sector that holds the risk.

Q726 **Dame Cheryl Gillan:** Can I come in here? It would be fair to say that the Government do not have to explicitly say they are not awarding any contracts to any company. They merely do not award the next set of contracts coming up.

They say if you want to keep a secret, you announce it on the Floor of the House of Commons. Warnings were made on the Floor of the House of Commons about the fragile state of Carillion's finances, but it still did not seem to register, because it was not just one contract that continued to be awarded to Carillion; there were others. I think I agree with Mr Dykes on that, but surely Government have a duty to the taxpayer to look at alternatives to those companies for that period of time, until they are in financial recovery or financial stability is returned to the company.

Chair: Can you respond to that?

Matt Dykes: I would agree that there is some merit in the idea of living wills for those companies. I am less sure that it is down to the Crown Commercial Service and contingency planning, but I do think that the role that the Official Receiver has played in keeping the public services running and getting contracts placed with alternative contractors has been quite successful to date. I would not say it is as successful as was depicted this morning. The other day I met with Carillion workers—or ex-Carillion workers, as they are now—down at the British Museum, who still do not know whether they are coming in to work next month and still do not know who their next employer is going to be, and quite frankly feel that they are still in the dark.

I am not sure, therefore, that that contingency transfer has been as successful as was said this morning, although there have been some quite good relationships. The role of the national taskforce should be commended as well. It brought key players together, including the TUC, and on the basis of that we have been able to facilitate much better liaison between the seven unions representing Carillion workers, the Official Receiver and Carillion's human resources department.

Q727 **Kelvin Hopkins:** If Carillion had been allowed or had decided to sell off bits of its more valuable components at an earlier stage, then it would have been better for the public purse and better for everybody than what happened in the end, which was a fire sale of the assets, where they were bought for virtually nothing by some companies. I talk from personal experience.

Chair: Any comment on that? It might be the last comment you get.

David Walker: I would simply say that we must not be naive. These companies are involved in politics. They are the recipients of public policy; they do seek to influence political decisions; they employ consultants; they employ public affairs companies. One index of a company being in trouble would be the volume of public affairs activity it was contracting for here in the House of Commons. That would indicate that they were worried and wanted to get onside with influential MPs.

Chair: On that note, I would observe that I hope that balance of witnesses we have had this morning shows that we are taking an ecumenical view on these matters and that procurement should be beyond ideology. Perhaps on that note I can have the final word. Thank you very much.