

**‘Managing Service Delivery under a Performance Regime:  
40 Years of Experience’**

by

Gary Sturgess, Executive Director, The Serco Institute

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## **1. Introduction**

My great, great grandfather, James Sturgess, made his way to Australia in 1847 with government assistance (as my grandfather once expressed it). He was arrested at the age of thirteen and transported to the colonies for seven years for stealing books.

So it is perhaps unsurprising that I have developed an interest in the system of contracting through which convicts were transported to the Australian colonies.

Those of you who have read Robert Hughes’ *Fatal Shore* may recall that he makes some harsh criticisms of the convict contractors, comparing the First Fleet – which he says was government-run and where very few prisoners died – with the Second Fleet – which Hughes says was contractor-operated and where around 40% of the convicts eventually died.

In fact, Hughes is mistaken. Both fleets were contractor-operated. The differences lay in the design of the contract – the evaluation criteria, the performance regime and the contract monitors.

The First Fleet cost almost £55,000, a price that caused a great deal of consternation in Treasury and resulted in the contract for the Second Fleet being let to the lowest bidder, at less than half that cost. Unfortunately, the lowest contractor was a slave-trader.

The contract monitor on the First Fleet was Arthur Phillip, the Governor of the new colony. He simply refused to let the ships leave Portsmouth until adequate food and provisions were on board, and insisted that they stop three times on the voyage out.

By contrast, the contract monitor on the Second Fleet was a junior official, ‘an ineffectual hack of questionable competence’ (as historians have described him). He ignored concerns about the quality of the food raised by some of the officers and the ships’ surgeons and it was suggested that the principal captain may have plied him with excessive quantities of alcohol for much of the voyage.

Finally, there were extremely heavy penalties for escapes, so that the contractor kept the prisoners in heavy slave shackles while they were in port.

And the contractors were allowed to sell all unused food and provisions when

the ships arrived in Sydney (and in fact, they made a fortune). As one of the military officers commented: 'the more they can withhold from the unhappy wretches, the more provisions they have to dispose of at a foreign market.'

There is perhaps no more dramatic example of the principle that you get what you measure and what you pay for.

## **2. Serco's interest in performance management**

Serco has been delivering public services for more than forty years now, under a range of different performance regimes.

Performance management is integral to how we do business – if we fail to deliver on our commitments, we fail to make a profit – so you can imagine that this is a subject that exercises our minds often.

We manage Local Education Authorities at Bradford and Walsall; the Atomic Weapons Establishment at Aldermaston and the National Physical Laboratory at Teddington; Docklands Light Rail and Manchester Metrolink; Merseyrail and now Northern Rail; five prisons from Bristol to Glasgow and around half of the country's home detention scheme; the Manchester Aquatic Centre, and 50 other leisure centres across the country.

We also provide key services for the nation's traffic management system, the ballistic missile early warning system, and police engaged in the fight against serious organised crime. We support the joint services staff college at Shrivenham, NHS hospitals at Norwich and Wishaw, and local authorities at Winchester and Woking.

At each of these contracts, our management is driven by a performance regime that determines whether our shareholders receive a dividend, and whether the public gets the quality of services it deserves.

So it was against this background, that I was invited here today – a relative outsider – to offer some insights into managing service delivery under a performance regime.

## **3. The contribution of contracting to performance assessment**

There has long been a close association between contracting and performance management within government.

The origins of performance measurement in the UK can be traced to Jeremy Bentham, who argued in the early nineteenth century for a separation of the controlling and inspection functions of government from delivery and execution.

Many of Bentham's ideas about performance incentives were worked out in the context of his 'Panopticon' project – a grand proposal for contracting the management of a new prison on the Thames where the Tate now stands.

'Make my contractor's [financial penalty] large enough,' he wrote of prison management, 'and you need not doubt of his fondness of these his adopted children.'

And he wrote in his *Constitutional Code* that:

Jealousy is the life and soul of government. Transparency of management is certainly an immense security; but even transparency is of no avail without eyes to look at it.

I may be wrong, but I think Bentham was saying that politicians, the media and the public at large should be natural enthusiasts for the contracting model, since it results in greater transparency and creates incentives to expose how well services are being delivered.

Compulsory competitive tendering in local government during the 1980s was deficient in a number of ways. But it did much to improve public accountability. Kieron Walsh's 1991 study for the Department for the Environment found:

Competition has led to major changes in the monitoring of service, with explicit inspection processes being introduced, and a clear emphasis on standards. Public complaints are also being more widely used in monitoring contracts. Contract performance is increasingly being monitored against written standards rather than visual judgements.

And in recent years, we have seen the Prison Service introduce a 'weighted scorecard' and a system of key performance targets for the entire prison estate as a direct result of its experience with contractual performance regimes.

In short, there is a great deal that government has learnt about performance management from its experience in contracting for public services.

#### **4. Recent trends in performance measurement**

With that in mind, let me outline some of the recent trends in performance measurement – as we have experienced them.

These comments are based on a study that the Serco Institute has undertaken over the past 12 months of the performance regimes in some 33 of our contracts.

(i) There has been a significant increase in the use of performance measurement by the public sector and increasingly this impacts on those of us delivering public services under contract.

This is particularly noticeable in the education and prisons sectors, where our financial returns and our reputations are affected, directly or indirectly, by these external performance regimes.

(ii) There has been a distinct shift from measuring inputs towards measuring performance (outputs and outcomes).

In general, this has been a positive change. Measuring outcomes allows for greater flexibility and leaves more room for innovation. Performance contracts focus on results, not processes.

I would caution, however, that in some cases – in newly-contracted services and where there are unknown variables – there may be very good reasons for contracting for inputs.

In services marked by complexity or uncertainty, input measures may actually leave more room for learning and innovation.

(iii) There has been increased emphasis on finding ways to measure quality. Recent contracts tend to include more qualitative benchmarks and assessment mechanisms, such as customer surveys, peer review and stakeholder forums.

(iv) We have also observed a noticeable increase in engagement of end-users in the process of performance assessment.

Serco's contract with Woking Borough Council is regarded as a leading example of this trend. How much we are paid under this environmental services contract is heavily determined by levels of public satisfaction, as measured by an independent survey of local residents.

(v) We are also seeing responsibility for delivery cascading down through the contracting organisation. In one of our major defence contracts, individual members of staff are assigned responsibility for ensuring delivery against specific performance measures.

These developments have changed performance measurement, mostly for the better. But they have also brought new challenges and over the past 12 months we at the Serco Institute have been looking at some of the emerging issues.

## **5. Four key messages**

The results of that work are too detailed to be presented here in full, although they will be published over the next few months.

But let me draw out four of the key insights that might be of some value to those of you charged with implementing and managing performance regimes:

*(i) Effective performance measurement is a tool for delivery.*

Performance measurement is a tool for delivery, not a certificate of compliance. It is capable of driving results, facilitating improvements and securing desired outcomes. But it will achieve little if it is merely used for ticking boxes and shifting blame.

Successful public services are flexible and dynamic – which means that performance measures cannot be prescriptive. They must allow room for the service provider (public or private) to innovate. Service providers must also have room to adapt as priorities change and lessons are learned.

*Case Study 1:* The LEA services we manage at Bradford and Walsall are two of our most challenging contracts. We have agreed to work with local authorities and the DfES in turning around the performance of two of the most difficult education regions in the country.

Walsall has delivered excellent improvement in key stage two results for English and Maths, as the Minister for School Standards publicly acknowledged in August. In Bradford, there have also been significant reductions in the number of schools in special categories, and improvement in educational performance at a faster rate than the national average at every key stage. However, this LEA is more challenging.

The performance measures at Bradford have been changed so that they are now benchmarked against national standards. But this followed a report by Ofsted which concluded that in some areas the previous targets had been unrealistic.

The approach taken by auditors and monitors can be just as important as the performance measures themselves. No contract, no performance regime is perfect or immune to external variables that are beyond the control of the service provider.

Of course, there must be consequences for failure, but it is also important that performance targets are managed intelligently and constructively.

Service improvement is what performance measures are meant to deliver, not *schadenfreude*.

*(ii) We still have lessons to learn about performance measurement*

We are getting many things right about performance measurement. But we are getting others wrong. Performance measurement has evolved but there is scope for further improvement.

For example, some duplication has developed between the different systems of measurement. Where the public sector has introduced its own performance regimes to match those used to monitor contractors, private service providers

have sometimes been obliged to comply with multiple layers of inconsistent measurement.

This problem developed when the Prison Service first introduced its KPTs, weighted scorecard and standards auditing – although this overlap and duplication has been addressed to some extent with the recent round of contractual refresh.

*Case Study 2:* In the heavy rail sector, the highly fragmented system of contracts and franchises (that is currently under review), encouraged monitoring by each of the parties and this encouraged an adversarial relationship.

The remuneration regime effectively hinged on what could be proven by the different players, as Network Rail, train operators and track maintenance contractors sought to allocate responsibility for performance failure.

On a more positive note, at Merseyrail, senior executives working for the customer have been given pagers that operate on the same network as the service provider. This allows both parties to follow what is happening on the network simultaneously, avoiding the need for multiple monitoring and minimising the scope for misunderstanding.

Failure is not always the fault of the service provider. The performance regime itself sometimes makes it difficult for the supplier to successfully control the standard of service delivery.

*Case Study 3:* In a tender to deliver a passenger transport service, the customer proposed measures of ride quality and noise levels that were so difficult to set and assess that the monitoring and enforcement costs would have far exceeded the benefits to the public. A compromise was eventually reached.

*Case Study 4:* In an attempt to cope with an ever-changing environment, in one of our large defence contracts, the service provider is responsible for identifying and selecting the performance measures (in agreement with the customer).

The performance targets reflect the strategic business plan, which is amended year by year, so that the measures are developed each year to complement it. The advantage of this is that performance requirements (and assessment) are dynamic enough to reflect changing service needs and incorporate scientific and technical advancements.

This example illustrates the degree of sophistication that has begun to emerge in some of the contractual performance regimes, but in other places, we are still making basic mistakes. For example, raw performance data may reflect a single serious incidence and not adequately take into account improvements in service levels overall.

This has been a problem in the past with self-harm measures in prisons, where (for example) an individual prisoner with a record of persistent self-harm may have an adverse impact on measured performance, even though the institution in question has exceptionally good self-management practices.

*(iii) Ownership of the performance regime rests with the purchaser*

Those who lay down the policy outcomes and the performance measures need to accept that they are the ultimate owners of the regime, and the way in which performance is managed.

They must understand enough about the contract and the service model so that they can amend the regime if it is contributing to poor performance. And they should take a reasonable and constructive approach to performance assessment, to ensure the best overall outcomes.

*Case Study 5:* A positive case study – in the recent competition for the electronic monitoring of prisoners on home detention, the customer prepared a risk register on the operational solution of each of the bidders, and provided them with an opportunity to deal with those risks that were likely to prevent them winning the bid.

Instead of engaging with us in an extremely formal and legalistic manner at the BAFO ('Best and Final Offer') stage, they entered into a dialogue with all the bidders.

This enabled us to understand the customer's requirements properly, rather than being forced to guess. And it enabled the customer to understand the details of our service solution, in part by enabling us to submit discussion papers explaining the implications of particular elements.

Quality should take precedence over price. We all understand the ongoing pressure to deliver efficiency savings, but artificially low prices can result in an overly-contractual approach, which may affect the provider's capacity to deliver the required service.

There are limits to how much risk can be transferred, particularly in long-term service contracts. Commissioning authorities need to have realistic expectations, otherwise they may drive up the cost of services unnecessarily, fail to deliver improvements in service delivery and inflict reputation damage on both sides.

*Case Study 6:* In a recent re-bid, the customer asked us to commit to 100 percent performance against measures which we knew from previous experience could only expect to deliver, on average, around 95 percent. The customer was unwilling to negotiate on the measures, despite being shown the data to confirm that the proposed performance targets would be unattainable. The outcome was that the customer paid a higher price to

accommodate the risk of performance failure.

And finally, except in cases of extreme failure, assessment should be constructive. It is in the interest of service providers to ensure that services deliver. In the case of private sector firms, delivering a good service is what we are paid for; it is how we deliver a return to our investors.

But if commissioners take the right approach, it helps us to perform at our best. That means understanding what incentives work best under different circumstances. It means encouraging cross-sector sharing of best-practice on the design of performance regimes. It includes having an active dialogue with operational experts when developing and reviewing contractual performance measures.

Whether a service is contracted wholly or in part, ultimate ownership for the delivery of that service must remain with the commissioner. The commissioner specifies the service that it requires. It chooses the organisation that it wants to deliver that service. It must ensure that the desired service and performance standards are actually delivered.

*(iv) Performance measurement is only part of the performance regime*

Performance management lies at the heart of what we do. We're paid to deliver a service to specified standards.

But it doesn't all turn on the contractual performance measures. Beyond the contract, we are audited, monitored and inspected by clients, by independent regulatory bodies and by financial institutions.

We are also scrutinised in parliamentary committees, meetings of local authorities, and the media, and increasingly by end-users who tell us what they think through customer surveys, comments and complaints.

If we fail to deliver, there are numerous means of redress other than withholding financial payments. In the case of extreme failure, the customer can intervene to terminate the contract, with the potential for reputation damage.

But we also face qualitative audits in a number of sectors, which are not part of the formal contractual process. For example, in the custodial sector, we are subject to audit by the Chief Inspector of Prisons, whose reports have no direct impact in terms of financial penalties, but which are, nevertheless, taken very seriously because of their reputational impact.

*Case Study 7:* For a variety of reasons (not all of them ours), the Young Offenders Institution at Ashfield was failing to meet performance levels. This resulted in direct intervention by the customer and a highly critical report by the Chief Inspector of Prisons. Of course we responded to the financial penalties, but equally as important was the potential for reputation damage from ongoing criticism by the Prisons

Inspectorate. Fifteen months after the Chief Inspector's report, she inspected the facility again, reporting that they had 'found an establishment that had made so much progress that it bore comparison with some of the best-performing young offender institutions we have inspected.'

It is also possible for customers to use reputation to create positive incentives and thereby to get a great deal more out of the service provider than the performance targets require.

*Case Study 8:* In one of our public transport contracts, we have a wide range of performance targets, but they do not extend to graffiti levels at stations. Why, when the contract is silent on the issue, would a contractor bother to clean the graffiti away? Because the contract is regarded as a national benchmark and we regard it as a matter of contractual pride and customer service.

*Case Study 9:* Another Serco contract has made an arrangement (outside of the formal contract) where both customer and contractor feed any bonus or penalty payments received back into the service. In this way, both sides show that they have a shared objective of making that service work, and any penalties received or bonus payments awarded do not take resources away from the service.

## **5. So what?**

So what? You have established performance targets. They have been communicated to providers. They have been cascaded down through their organisations, allocating responsibility for delivery.

The NAO (or the Audit Commission or the Prisons Inspectorate) has monitored their performance and reported publicly and, perhaps if the report was sufficiently critical, it has been given some attention in the media.

Consultants have been appointed. They have reported. New management has been installed. But still the service in question fails to deliver against agreed performance targets.

What happens next? What does government do about persistent failure to deliver against agreed performance measures?

I will tell you what happens when the service is delivered under contract. Financial penalties are imposed. If the report is particularly adverse, the share price will fall and management will come under pressure to undertake fundamental change.

If it is a PFI contract and financial institutions have their own money at risk, then they will appoint their own performance monitors, with the implied threat of intervention and termination. If there has been a breach of the law, then a prosecution might well be commenced.

But what does government do about persistent failure when the services are delivered in-house? As you know, this is a question for which there are no simple answers.

Some of the answers may lie in another piece of research that the Serco Institute has been undertaking. Over the past few months, we have interviewed a number of our contract managers who used to perform similar jobs inside the public sector, and asked, 'What's different?'

Part of the response to that question was that they enjoyed much greater managerial autonomy – they could respond more quickly to address problems when they arose.

Another was that they personally felt much more accountable. Indeed, in listening to their responses, it was almost as though they thought of themselves as managing their own small businesses.

The accountability lines associated with this modular form of service delivery are very clean. Contract managers feel that they will be personally held to account if there is a service failure.

And they reported that in the public sector, with a layered system of managerial authority, it had been more difficult to assign responsibility. As one of them said, 'I think in the [public sector], you're just one of the many layers and it's very easy to blame the layer above you or the layer below.'

Lest I be misunderstood, I am not suggesting that the solution lies in opening up all public services to competition from the private sector. What I am saying is that the public sector might benefit from borrowing even more from the contracting model.

One way of closing the performance management cycle may lie in developing a quasi-contractual model for the public sector – a cleaner separation of inspection and execution, of control and delivery; greater managerial autonomy and stricter accountability for delivery units; and a firmer expectation that there will be deep intervention in the case of persistently failing services.