

**Written evidence by Serco to the Public Accounts Committee inquiry into Strategic Suppliers
June 2018**

Serco is a Strategic Supplier to the UK Government. We are a British company, quoted on the London Stock Exchange, employing over 50,000 people across the UK, North America, Europe, the Middle East, Hong Kong, New Zealand and Australia. We specialise in supplying services for Governments in the fields of Defence, Justice & Immigration, Transport, Citizens Services and Health. About half our business is in the UK, where we employ about 24,000 people, and of these around half are former public servants. We have contracts with, amongst others, the MoD, DWP, Home Office and Ministry of Justice, as well as the Scottish Government, many Local Authorities and the NHS. In 2017, our UK revenues from Central Government were approximately £636m out of total UK Revenues of £1.2bn; the balance of revenues came from Local Government, Scottish Government, Agencies and the NHS.

This evidence is submitted by Rupert Soames, Group Chief Executive of Serco.

What is the Government's role in the market and to what extent does Government use its unique customer status to optimise value for money and effective delivery?

Government is the largest buyer of goods and services in the UK, spending each year some £200bn with the private sector (which in this evidence is taken to include mutuals, charities and other not-for-profit organisations). There are over one million people employed by the private sector delivering services to Government, and the vast majority of the work they do is delivered to a high standard. It is inconceivable that all this work could be taken back in house and a million people be forced to become employees of the state. It is, therefore, critical to the national interest that Government be good at buying goods and services and managing its suppliers.

In this context, we believe that "good" means: -

- Delivering best value to taxpayers by buying products and services which represent the optimum combination of quality, assurance, resilience and price. This does not mean the highest quality, nor does it mean the lowest price; it means the combination which delivers the best long-term value.
- Building a vibrant, sustainable and competitive supply base, which makes enough money to attract the funding to be able to invest in delivering high-quality services and innovation in the long term.
- Setting standards of professionalism as well as responsible and ethical behaviour for both itself and its suppliers, and being a customer who suppliers can trust to treat them fairly and objectively.
- Dealing straightforwardly with suppliers.
- Delivering through its purchasing wider Government objectives such as encouraging small businesses, and other social and economic outcomes.

And Government has a right to expect suppliers to:

- Maintain standards of professionalism as well as responsible and ethical behaviour for both themselves and their sub-contractors, and being a supplier who Government can trust to treat them fairly and objectively.
- Recognise that they owe both service users and taxpayers a duty of care.
- Deliver on their commitments, and do no harm.
- Be straightforward in their dealings with Government.
- Be a good employer and a fair customer to sub-contractors.
- Manage their businesses and their finances responsibly to ensure they are resilient.

Other than when buying commodity goods and services, the Government has “unique status” as a buyer in a number of respects:

- It is delivering services to the public, and spending taxpayers’ money, so its business comes with a wrapper of politics and public accountability unseen in the wider commercial market place.
- It is a large market, with a customer who will not default and generally (but not always) pays on time. However, many private sector companies and not-for-profits shy away from dealing with Government because of its reputation as being bureaucratic, price-driven, unpredictable, capricious, complicated and inflexible.
- Government is an expensive customer to work with; bidding for contracts is complex, long-winded and expensive; delivering services demands levels of assurance and overhead not required in the commercial market place.
- Government is a monopoly buyer for some types of goods and services, and sometimes uses that position less than responsibly. Only governments buy weapons of war, prisons, railway operations, and care of asylum seekers. In dealing with suppliers of these highly-specialised services, Government can – and does – use its market power to impose terms and conditions and transfer risk that would not be possible if suppliers had a choice of customer. It is a very powerful, but not always wise, customer, which has a tendency to use its market power for short-term gain.
- Its reputation as a customer has been badly damaged in recent years by the massive losses, amounting to hundreds of millions of pounds, incurred by a number of major suppliers of services to Government. These losses have most commonly been caused by one or both of the following factors:
 - If Government itself cannot properly define what it is buying, or provide accurate information upon which the contract will be based, but proceeds nevertheless to roll out vast programmes, putting all the risk on suppliers. Recent examples would be the NHS Primary Care Support Services and the MoJ Community Rehabilitation Contracts.
 - Government has transferred unmanageable risk to suppliers, which then crystallises. Examples would be the COMPASS contracts for asylum seekers, the Prisoner Escorting Contracts and the introduction of the Apprentice Levy and National Living Wage.

It is a common refrain of critics of private contractors who have lost money as a result of accepting unmanageable risk in contracts that “well, you were not forced to sign the contract”. This is not a sensible point because:-

- Government is often the monopoly buyer of services and it does not hesitate to tell suppliers whose business is serving Government: “accept these terms or you will be excluded from bidding – take it or leave it”. In practice Government is able to bully suppliers who are dependent on them into accepting contract terms which are unreasonable and unfair.
- It should not be the objective of wise and responsible Government to set terms of business that are so penal that only the dumb, the desperate and those with no choice want to bid for business.

It is a common misconception amongst civil servants and politicians that the way to optimise value for money and ensure effective delivery by the private sector is to adopt a confrontational “treat them mean and keep them keen” approach; that the cause of any failure must be that Government has been “too soft” or “too cosy” with suppliers; that the cure for any failure must be tougher penalties and harsher terms.

Experience in the private sector on major projects is the reverse: that the best outcomes come from building close partnerships between customer and supplier; where there is give-and-take; where contracts adapt through their life to changing circumstances. Of course there are times when

customers and suppliers fall out and fight, but large and successful contracting companies recognise when dealing with key partners that “jaw-jaw is better than war-war” and that the best outcomes are delivered by collaboration, mutual respect and trust and working constructively to adapt to changing circumstances through the life of a contract. Government finds it extremely hard to work this way due to: a pervasive fear – in our view an overblown one – of procurement challenge, even years after a contract has been let; by an unhelpful division within Departments between operational teams and the commercial / legal teams; and by the thought that they might be criticised by the Public Accounts Committee for being “soft on suppliers”.

How effective is the Cabinet Office management of Strategic Suppliers?

Cabinet Office has built a strategic supplier management system which compares very favourably in sophistication, structure and process with that used by large buyers in the commercial sector. It works very well in times of crisis. However, outwith crises, it is in effect a supplier oversight process, rather than a supplier management process, and accordingly Government does not get the full return on the very considerable investment it has made. The reason why the system is limited in its effectiveness is because it is very difficult for Cabinet Office to influence the behaviour of major suppliers as in practice it can neither punish poor, nor reward good, supplier performance or behaviour. This is for three reasons:

- Departments regard compliance with Cabinet Office guidance as voluntary. Departments vigorously defend their independence and their ability to manage their own contracts and suppliers themselves; SROs use the justification of their personal accountability to Parliament as a reason to maintain their distance from Cabinet Office and their own fiefdoms.
- Gilded procurement regulations mean that tenders for new contracts are treated as standalone exercises, and good or bad behaviour on other contracts across Government or even within the same Department, is not taken into account.
- It is not Cabinet Office who decides who wins contracts: it is Departments.

We believe that two changes could be made to the system which would improve the effectiveness of the strategic supplier management programme, should Government wish to do so:

- Make Cabinet Office guidance in regard to contracting matters the default approach across Central Government with Departments having to formally “comply or explain”.
- Incorporate a measure of a supplier’s status under the Cabinet Office Red-Amber-Green ratings into all Central Government tender evaluations. This will mean that a supplier will be disadvantaged in future contract awards if they are rated Red, and advantaged if they are rated Green.

Implementing these two changes would greatly improve the Cabinet Office’s ability to manage supplier behaviour and drive value from the Strategic Suppliers programme.

As far as Suppliers are concerned, being a Strategic Supplier imposes a significant burden of cost, reporting and effort, with little tangible benefit.

The role of Crown Representatives

The role of Crown Representatives is in our view being given undue weight in current commentary, which seems to expect them to be intimately involved in every aspect of a company’s affairs, including those which have nothing to do with Government. Instead, they should be seen as one part of a multi-layered supplier management system; they are not full-time executives, or business analysts or accountants, or indeed specialists in company turnarounds. Their role is non-executive, and their main purpose is to provide a two-way channel of communication at senior level between supplier and Government. It is a role that generally works well; it gives Government insight into

suppliers that customers would not normally have, and they can add oil to the squeaking wheels of the customer-supplier relationship.

In terms of our daily engagement with Cabinet Office, we deal on a very regular basis with a nominated Strategic Partnering Manager, who helps us at an operational level and acts as a proactive bridge between Departments, Cabinet Office and Serco. Again, we think this role works well alongside the Crown Representative, engaging frequently and focusing on resolving challenging operational situations.

The problem remains, however, that if Departments will not accept the advice of Cabinet Office, the Strategic Supplier programme will fail to achieve its full value for either Government or Suppliers, except in times of crisis.

What information do you provide to Cabinet Office and does Government have sufficient information to monitor contracts?

We submit monthly, quarterly, and annual reports covering our business with Central Government, including contract performance, key performance indicators and commentary to Cabinet Office; on contracts where it is required, we submit information on contract profitability. Annually, there is a “One Government Day”, which we do not attend, where all key Government stakeholders in the Serco relationship meet privately to review the relationship, and we have formal meetings every six months, chaired by the Crown Representative, between the Cabinet Office, major Government stakeholders, and Serco. During this meeting our Red-Amber-Green rating is discussed. We do not get copies of Cabinet Office status reports on us, which is disappointing. We believe that Cabinet Office has more than enough information to operate a Strategic Supplier programme.

Government contracts are famously over-burdened by performance measurement. It is not uncommon to have 200 Key Performance Indicators on a contract, each of which have to be reported on monthly, and only a tiny proportion of which actually pertain to the quality of the service experienced by the service user. The problem for Government is often too much information, not too little.

The ability of Government to predict supplier failure

Government buys over £200bn of goods and services every year from the private sector, and the vast majority of transactions work well, delivering good value for the taxpayer. It is extremely rare for Government suppliers to go bankrupt, but it is an inevitable part of dealing with the private sector; each year, about 12,500 companies become insolvent. It should also be recognised that supplier failure also happens in the public sector; was Mid Staffordshire NHS Trust not supplier failure? Is Liverpool prison not an example of supplier failure?

In the case of Carillion, as has been well documented, their Board and advisers, market analysts and most investors failed to recognise the issues that were ultimately to destroy the company. As the NAO report notes, their July 2017 profits warning came as a surprise to Government, but it was also a surprise to everyone else, as evidenced by the sharp drop in their share price, and it is unreasonable to think that Government should have been able to see through all the accounting issues which auditors did not.

Outwith a crisis, Government, like any other customer, has to rely for financial information from publicly available, and audited, accounts. It is worth noting that the visibility that Government has of publicly-quoted companies, which have to comply with all the accounting and reporting regulations is significantly better than they have with smaller companies.

The ability of Government to manage supplier failure.

If a supplier gets into difficulty, Government is able to deploy significant capability and gain information and insight which is not publicly available. We guess that over the last four years at least five Strategic Suppliers have been subjected to enhanced Government scrutiny, one of whom was Serco. Whilst access to insider information is helpful in terms of allowing contingency planning and giving Government insight, it also puts Government into a “damned if you do, damned if you don’t” position in that the slightest sign of lack of support from Government, who banks and suppliers know has access to better information than they do, could immediately lead to them withdrawing support and drive a company into bankruptcy.

Government does not, and should not, intervene in the management of their suppliers; neither do they lend them money. At times of corporate stress they are therefore observers rather than actors but with the asymmetric capacity to do enormous harm and very little good, other than to ensure it has contingency plans in case the worst happens. When a Government supplier is in distress all stakeholders have a special responsibility not to carelessly or recklessly endanger jobs and services.

As far as Carillion is concerned, we believe that Cabinet Office has managed what was an extremely complicated and fast-moving situation, in which it could not control the outcomes, impressively well. The existence of the Strategic Supplier Management Programme, with its associated processes and expertise, showed its value at this time of crisis. As detailed in the NAO report, during the six months ahead of the liquidation, Cabinet Office put in place detailed contingency plans and in our view their performance should be judged by the fact that no services have been disrupted, and nearly all of Carillion’s Government contracts, including those let after the first Carillion profits warning, have been successfully reassigned.

Is the relationship between Government and Suppliers too cosy?

In our experience the relationship has never been cosy. The Committee needs to ask itself what adjective it would like to see. Confrontational? Co-operative? Flexible? Aggressive? Close? Distant? We suggest the best adjectives are “Professional and Responsible”. Government rightly expects suppliers to act professionally and respect the fact that serving the taxpayers brings special responsibilities. Suppliers rightly expect Government to recognise that it needs to behave fairly and to be an intelligent customer.

Both Government and suppliers need to remember that markets can only exist where there are willing buyers and willing sellers. Whilst sellers need to remember that Government only deals with them with political permission, politicians should disabuse themselves of the notion that there are long queues of capable companies wanting to take the taxpayers’ shilling. A sustainable and high quality supply chain is a valuable, but fragile, thing and wise customers take a great deal of care sustaining them.

How healthy is the Government’s supply chain?

Government’s stated ambition is to have a vibrant and competitive supply chain. In some parts of the market, it may have this, but in others – particularly those where Government is a monopoly buyer – it no longer does so. The willingness of suppliers to participate in the market has diminished in the face of hundreds of millions of pounds of losses on contracts, due in many cases to Government’s penchant for transferring unmanageable risk to suppliers. This has also had a knock on effect into a reduction in the number of new suppliers entering the market. It can also hardly be encouraging to small companies, when big companies have lost so much money in this sector in recent years.

What should Government do to encourage small businesses to participate in Government contracts?

Whilst politically appealing, the mantra “small companies good – big companies bad” is dangerous, wrong-headed and damaging. It is naïve to suggest that small companies are small because they want to be – owners of small companies want to grow their companies to be big companies and make themselves indecently rich in the process. Big companies are small companies that have been successful (both Capita and Serco started their lives as management buyouts in 1987). Small companies may be more innovative, flexible and fast-moving than big companies, but they also fail far more often, destroy almost as many jobs as they create, can lack financial, management and operational resources, find it much harder to deal with the risks Government seeks to put on suppliers, and cannot fund the multi-year, multi-million pound investments required to bid for public contracts. Government cannot have its cake – rigorous procurement, effective contract management, extensive risk transfer, world-class suppliers who are dependable and have deep resources and capability – and eat it – beating up on big companies and imagining that small suppliers can fill the gap. The Commercial function of Government, with some 4,000 people, is stretched enough with the current supply chain; to split all the “large company” business and give it to small companies would require thousands of additional civil servants to manage the supply chain.

Serco is a very large company which has had its share of criticism, some of it deserved, but it has also stood by every one of its contracts, employs some 24,000 people providing services to Government in the UK alone. Over the last four years Serco has paid over £790m in taxes and rates to HMRC and Local Government and has spent £430m more delivering UK Government contracts than it has been paid by the tax payer. 54% of our UK supply chain are Small & Medium-sized Enterprises (SMEs), amounting to 3,800 different suppliers, who are paid on average in 26 days. That is not, in our view, a contribution to the economy and to public finances which deserves to be derided or belittled.

The best way to enable small companies to participate in Government contracts is to encourage, or even mandate, large companies to subcontract to them, rather than expecting small companies to deal with the behemoth of Government purchasing or the huge risks inherent in Government contracts.

What can be done to improve the performance of Strategic Suppliers on major contracts?

We have given extensive evidence to the Public & Constitutional Affairs Committee on what we believe have been the causes of the malaise that affects the market for Government services, and suggested solutions for improvement. We believe that there are Four Principles which should be the basis of contracting on major services contracts between Government and suppliers:-

The Transparency Principle: we strongly support increasing the degree of transparency in Government contracting, including the presumption of:-

- Rigorous and documented processes to determine the most efficient form of service delivery of Government programmes, be it fully state-provided, mixed state and private sector, or fully private sector.
- Open-book accounting, combined with collars and caps on profits, ensuring that suppliers make neither excessive profits nor catastrophic losses on large and important taxpayer-funded contracts.
- Publication every six months of Key Operational Performance Indicators on major service delivery programmes, both in-house (i.e. public sector) and contracted to the private sector.

The Security of Supply Principle: we believe that suppliers on critical national programmes should maintain “Living Wills” being documentation and details of their operation such as would make it

possible for Government to seamlessly take back in-house or transfer to others the delivery of a contract.

The Early Exit Principle: we believe that both Government and Supplier should have the ability, on payment of a pre-agreed fee, to exit a contract at pre-determined points during the life of a contract.

The Fairness Principle: we believe that suppliers and Government should agree a code of conduct setting out standards of behaviour which each should be able to expect of the other. This would involve the Government agreeing not to impose punitive or unfair terms and conditions, or transfer unmanageable risk; and suppliers would agree to maintain certain metrics of financial stability; pay their sub-contractors in a timely fashion; and adequately fund their pensions. We think it would be important to have a process of independent arbitration built into the code of conduct to ensure that there is some way of calling to account those who do not abide by the code, including Government.

In addition, we note that some of the most egregious failures on projects, both in-house and contracted to the private sector, are due to Ministers demanding the implementation of complex and sensitive programmes in totally unrealistic timescales driven by politics rather than operational considerations. We therefore propose that (a) it should be the default position that pilot trials should be run on any major new service delivery programmes and (b) SROs should certify that they believe the timescales and resources allocated for a project are realistic, failing which they should seek Ministerial letters of direction.

Does Government have the right skills and resources to design, negotiate and manage contracts effectively?

There is little doubt that Government's commercial capability has improved greatly over the last two to three years. However, we question whether they can ever be truly effective when:-

- Departments routinely ignore Cabinet Office advice and best practice guidance.
- The long shadow of gilded procurement regulations and over-blown fear of challenge render Departmental legal and commercial functions almost incapable of exercising judgement and flexibility in contract management.

How does Government seek assurances on delivery of public services from Strategic Suppliers and how does it hold suppliers to these assurances?

Government contracts are famously over-burdened by performance measurement. It is not uncommon to have 200 Key Performance Indicators, each of which have to be reported on monthly, and only a tiny proportion of which actually pertain to the quality of the service experienced by the service user. Holding suppliers to these KPIs is generally done by a penalty regime which is often out of all proportion to the damage caused; by way of example, Serco's failure to fix a £200 boiler on a property housing two asylum seekers in Glasgow within 24 hours incurred a penalty greater than the value of the flat.

Very often, on long-term contracts, KPIs become irrelevant, and perverse. Again, by way of example, on most prison contracts, written at the time when mobile phones were the size of bricks, there are swingeing penalties for finding them, on the basis that management would be pretty incompetent to have let them in. Now that phones can be swallowed or smuggled in people's rectums, it would make much more sense to incentivise operators to find phones, rather than penalising them. There are hundreds of examples of perverse incentives, and contract clauses which everyone, Departments and Suppliers alike, know have outlived their usefulness and which could be exchanged for meaningful measures adapted to new realities which would improve service delivery and value for money.

However, the twin shadows of the purported risks of legal challenge from unsuccessful bidders and the fear of being accused by the Public Accounts Committee of being “soft” on contractors, and “letting them off the hook” make practical, sensible and value-added changes to existing contracts almost impossible.

If there is any one factor which calls into question Government’s ability to successfully manage major projects using private sector suppliers, it is this: the immense difficulty Government has in adapting contracts to new realities over the life of a contract.