

Lecture by Rupert Soames, Chief Executive of Serco, to the Business Services Association

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When I was an eight-year-old, I developed an affection, which I have found hard to shake off, for lavatorial humour, and one of my favourite school-yard ditties went as follows:-

*'Twas a dark and stormy night,  
The lavatory light was dim,  
Crash – Bang – Wallop,  
Somebody's fallen in.*

When I think about the situation in which our industry finds itself today, this ditty keeps coming back into my head, with ever more far-fetched and absurd claims to relevance to the current moment.

The conditions in our market are certainly dark and stormy; there is no clear light to give us a sense of direction; many of us in this room clean lavatories for a living; every six months or so, one of us trips up and falls in. When someone does fall in, the consequent publicity makes a lot of a noise.

I suppose this might be called gallows humour, because I do feel our industry, being the supply by private companies of public services, certainly as far as the UK is concerned, faces some really serious challenges. But to understand these challenges, I think we have to remind ourselves of context. I am afraid that the next ten minutes are going to be rather depressing .... But those who do not learn from history are doomed to repeat it.

I think the first point we have to remind ourselves of is that we who take the taxpayers' shilling operate only with political permission; it is not we who created our market.

Our industry was created by an act of political will, supported by four pillars.

The first pillar was a belief in a small, rather than large state, inspired by economic philosophers such as Hayek and Friedman.

The second pillar was a practical observation that privately owned utilities such as AT&T and Hong Kong Telecom provided a better service than the then Post Office.

The third was the pressing need to attract private capital for infrastructure investment which the state needed but could not finance.

The fourth pillar was the arrogance of the public-sector unions who felt that they could create misery without consequence, and ineffective management of nationalised businesses such as British Rail who delivered lousy service; between them, management and unions lost the support of public opinion which had been firmly on their side since the nationalisations of the Atlee

Government in the late 1940's. As a consequence, politicians could safely revolutionise the delivery of public utilities and services by handing them to the private sector.

These four pillars supported a sustained and highly successful re-allocation of the delivery of public utilities and services away from the state, the more remarkable because the policy, conceived by Margaret Thatcher, was enthusiastically supported by Tony Blair for thirteen years.

It saw the creation of great wealth for the owners and managers of the privatised utilities, delivered billions of pounds of investment in our infrastructure, and spawned companies such as Capita and Serco which rose from nowhere to being in the FTSE-100. It saw 2 million jobs transferred from the public to the private sector and public service employment drop from 30% of the workforce in 1970 to 16.5% now. It reduced the Civil Service from 732,000 employees in 1979 to 400,000 now, and resulted in hundreds of thousands of jobs being created for outsourcers.

Moreover, it established the reputation of the British way of modern Government and public service delivery in many countries around the world, who adopted in one form or another privatisation, outsourcing and PFI's. The UK was to Government what Silicon Valley was to IT.

Let us compare and contrast that with the current situation in the UK. The far left of British politics has always opposed privatisation and outsourcing, but the political mainstream and the senior ranks of the Civil Service have always been solid in their support. There has been a consensus of the centre and centre-right that private companies can deliver public services and utilities effectively and well.

But now I fear that this powerful consensus has begun to fray. The voices of the left who call for renationalisation, or for taking services back in-house, are no longer seen as political nutters in thrall to public-service unions. Public opinion now cocks an ear in their direction, when they call for "taking back control" of water and rail companies; when they suggest that outsourcers cannot manage "people services"; when they talk of "taking back our NHS". And the centre and centre-right of politics seems to lack the will to spend political capital defending their creation. As a result, we are in danger of losing the political permission to take the taxpayer's shilling and serve the public.

Why so?

Our industry's complacency is one reason. John Maynard Keynes, in his book *The Economic Consequences of the Peace*, published in 1919, talks of the complacency of the prosperous middle class in London in August 1914, who assumed that their comfortable way of pre-war life was:

*"normal, certain, and permanent, except in the direction of further improvement, and any deviation from it as aberrant, scandalous, and avoidable."*

The fat-cats of 1914 did not see what Keynes described as *"the serpent to this paradise"* being militarism, imperialism, monopolies, exclusion and racial and cultural rivalries, which were to cause the deaths of 16 million people.

We – by whom I mean not just we outsourcers but the privatised utilities with whom we are inevitably conjoined in the public mind – have been complacent in believing that the arguments about state vs private provision of public services, once won, could not be lost. We been blind to the clue on the label on the tin marked "public services" that it needs a conscious act of thought

and will to believe that public services should be delivered by private companies. The arguments for private delivery of public services – innovation, value for money, contestability – maybe true but they are not self-evident to the voter, they have to be argued for and evidenced.

And neither are they self-evident to Members of Parliament. Of the 101 Conservative MP's newly-elected in 1983, with small-state philosophy and privatisation coursing through their veins, only 10 still serve. The average tenure of MPs is about 9 years, and because the consensus has been around for so long, few of them have had to give much thought to questions of public vs private service provision. And being politicians, when they do give it thought, they naturally see it through voters' eyes.

And what do voters see? Do they see the billions spent upgrading our electricity, telecoms, rail and water infrastructure? Do they associate the modern hospital or school with its clean floors and well-maintained air-conditioning system with private companies and well-run PFI's? Do they appreciate the huge success of rail franchises in growing passenger numbers? Do they see noticeably more efficient and cost-effective management of public services?

Or do voters think they see fat-cattery and levels of pay that seem out of all proportion; misleading accounts and sleights of company reporting; exploitation of utility customers' reluctance to change suppliers; hours added to peoples' daily commute by the inability of Train Operating Companies to manage timetable changes; horror stories of mishandled disability assessments and of the taxpayer being charged to monitor people who are dead or in prison?

In our hearts, we know what they see.

It is clear that two trends are at work: the first is that most voters in this country have only dim or no memory of what a ghastly service nationalised industries delivered. I am 59 now, and I can remember – just – the 3-day week and the Miners' Strike; but 75% of the population will have no memory of these events.

Second, we are to an extent victims of our own success. As the number of services provided by private companies has increased, so the number of scandals and examples of alleged incompetence have increased pretty much inline.

We have not delivered the miracle of quality and performance improvement seen in the airline industry, who in the last 45 years have seen the number of people travelling on scheduled flights increase 12-fold. If the fatality rate was the same now as it was in 1970, 30,000 passengers a year would be dying on commercial flights, the equivalent of about 3 A380's crashing a month. Instead, last year was the first year nobody was killed on a scheduled flight. The airline industry has grown so fast because it has vastly improved the safety and quality of its service.

In the private provision of public services, this has not happened. Public services are hard to deliver and by their nature, and, quite properly, subject to scrutiny; I remember being asked by Kamal Ahmed of the BBC why he kept on hearing of Serco messing up contracts. I replied that if we mess up the delivery of a major software upgrade to a commercial client, the only people who cared were the client and us, whereas if we short-paid a teacher or a fireman it was the headlines in the Lincolnshire Echo and Radio Lincoln for a week, and on Google for eternity. As the industry has got larger, and as the Parliamentary Committee system has matured, so the frequency of reports of our failings has increased pretty much in line with volume. And of course, any failing of service gets added political spice if it can be laid at the door of profiteering private companies.

I suggest that our industry has forgotten that it operates by political permission and has neglected to talk to its customers, who are the taxpayers and the politicians who represent them, and as a consequence the political support on which we depend may start to seep away.

At the same time, the relationship between industry and the Civil Service is becoming ever more fractious and difficult. The early gains of first generation outsourcing have been banked; the 20-30% savings, the improvements in productivity and service quality have been delivered, and forgotten. Too often what is left is 3<sup>rd</sup> generation services operating at razor-thin margins, and surly and nit-picking suppliers whose reaction to any customer request is "it'll cost you". And Civil Servants so terrified by procurement challenge that no adaptation to new circumstances, however sensible and advantageous to supplier and customer, is possible.

We forget at our peril that our customers have been on their own journey; whilst we talk of our much vaulted abilities to deliver transformation, we should not forget the fact that our customers have got pretty good at it too. They are running the country with half the number of civil servants they had 20 years ago; they have maintained standards of integrity and probity and delivered a workplace that is far more diverse than most of us can boast.

And they have got better – much better – at purchasing. Too good for their own good, in fact. They have discovered the power that being a monopoly buyer in a market gives them, and they have set to with a vengeance, imposing terms and conditions which are iniquitous and unfair. When in March we challenged the Cabinet Office that their guidance on onerous contract conditions and risk transfer was being simply ignored by Departments, they asked for examples. We produced an analysis of 12 inflight or recently awarded tenders from across Government.

Of the 12, 8 had what I call the "Bully-Boy" term: accept all of our terms and conditions without reservation or we won't even consider your bid

All 12 had the "Not our Fault Guv" clause: you should use information we the customer give you to prepare your prices, but if the information we gave you is wrong, then that's your problem. As Debbie White correctly observed in front of the PAC – if the data is wrong, the price is wrong.

7 of the tenders had the "We will bust you" clause – unlimited liability.

All 12 had the "We make the rules" clause – the supplier takes the risk that its customer, Government, will change the law through the life of the project.

The unfairness and unreasonableness of these terms and conditions defy description, and it staggers me that they dare ask for them, or that we as suppliers sometimes accept them, but that is what being a monopoly buyer allows you to do.

And as they struggle to deliver their departmental promises of saving, increasingly there seems to be a tendency to take the lowest price come what may. We worry that technical evaluations may be fudged to allow technically poor, but cheap, bidders, to continue in a competition simply because the customer is desperate for the saving.

And what of us, the supply side? The past two years have seen flocks of chickens coming home to roost. Huge contract losses have been revealed, sometimes because we have meekly accepted the transfer of unmanageable risk, sometimes because we have simply not costed contracts properly.

Accounting practices long suspected, in particular the manipulation of cashflow conversion by using supplier and customer invoice factoring, have been uncovered. As a consequence the publicly quoted companies in this sector have seen their valuations decimated. Not long ago Capita's share was over £10; it is now £1.50; Serco, now £1.00 was not long ago over £3.00; Interserve used to trade at over £6.00, and is now around 70p. Nobody has been untouched, and these are destructions of a sector's value not seen since the Global Financial Crisis.

So, let's bring this together: as an industry we have neglected to explain to our customers, the taxpayer and voter, why they should pay us billions of pounds. Our intermediary, being politicians, don't feel inspired to defend us. The balance of power in the market has shifted to our customers, whose agents, the Civil Servants, are in the thrall of lawyers whose only concern is to transfer all the risk in a contract, however unmanageable, to suppliers. Investors have reacted appropriately to these circumstances, and have wiped over £8 billion from the value of the sector. Many suppliers are also reacting appropriately by abandoning the sector.

What to do?

I suggest we remind ourselves of the approach of one of the greatest Generals of the last century – General Ferdinand Foch, who sent a message to Marshal Josef Joffre during the First Battle of the Marne in 1914:

*"My centre is giving way; my right is retreating. Situation excellent, I am attacking".*

None of this is unrecoverable, a slide into irrelevance as services are taken back in house is only inevitable if we allow it to be. Our fate lies in our hands.

We know the truth: that our industry delivers high quality services and good value to the taxpayer. That outsourced contracts deliver far greater levels of accountability and visibility of performance than their publicly-delivered counterparts. That we have delivered innovation, flexibility and quality in public services that the public sector never could have done. That contestability of contracts and choice of supplier drives higher standards and better value. That with the sole exception of Carillion, all the suppliers who have suffered major losses have stood behind their losses, which have in some cases run into tens of millions of pounds. Just yesterday Capita confirmed it had so far lost £140m on the NHS contract.

These things we know to be true.

We also know that unless Government modifies its approach to contracting by ceasing to impose terms and conditions which are downright unfair and unreasonable, and stops transferring unmanageable risk to suppliers, the huge losses on contracts we have seen in recent years will continue. And if the business model of Government outsourcing is 5 years of modest profits followed by a catastrophic loss, we know that our shareholders will force us to abandon the sector.

These things we also know to be true.

The challenge is to convince others of these truths. If voters, tax payers, service users and politicians do not believe we can deliver high quality services and deliver value to taxpayers, demand will shrivel. If Government cannot be convinced that they need to rebalance risk and reward, suppliers will simply take their services elsewhere and supply will evaporate.

If, on the other hand, we can reconnect with our customers, if we can reset our relationship with Government, our industry can start growing once again and contribute greatly to the country's future prosperity.

So what to do?

I suggest we need to have two objectives:-

- First, we need to secure our political permission to operate by re-establishing in people's minds why private companies have a vital role to play in the delivery of public services.
- Second we need to reset the relationship between industry and Government to create a business proposition which is investable for our shareholders and which provides Government with a vibrant and diverse supply chain.

I say "we" because we have to realise that these tasks need collective action. Competitive juices run strong in all of us; our instincts urge us to try and go it alone, to differentiate ourselves from others; but our problems are collective problems and will only be solved by a collective approach to solving them. Nobody is interested in what an individual company thinks.

But people will perhaps listen to an industry that employs a million people, if we can find a voice and a narrative which taxpayers, politicians and commissioners of public services will listen to. And that means we need to have a voice which is convincing, credible, and which puts the public interest at the heart of its narrative. It needs to provide expert commentary, and rigorous analysis, and to be unafraid of calling out bad behaviour by either customers or suppliers. It needs to have facts by the thousand and access to international comparators. It needs to be able to point to best and worst practice in both private and public sector delivery.

Over perhaps five or ten years, such a voice could re-establish in people's minds why private companies have such a vital role to play in the delivery of public services.

As to the second objective – resetting our relationship with Government – I think we have a great opportunity right here, right now, as Government is listening and is open to new ideas. Some incredibly intelligent people work for Government and they know that all is not right; they see the decimation of stock market valuations; they see shorter lists of companies bidding for Government business. And the collapse of Carillion has brought to the fore questions about Government's management of Strategic Suppliers. Secretly, in the depths of the night I think Government knows it has a problem.

So the ground is fertile for a rethink which, if conducted properly, should benefit both Government and us the suppliers. Serco has suggested Four Principles which we think could form the basis of a reset relationship, and in coming up with these principles we have tried to strike a balance between the interests of the customer and the supplier. Inevitably these principles reflect most particularly our own experience, but I hope they are more generally applicable.

The first is the Transparency Principle: we strongly believe that increased transparency will benefit everyone. We believe that Government sourcing should include:-

- 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. In other words, Government will have to be accountable for making rational

and logical make/buy decisions. This will, we believe, have the effect of increasing the number of programmes opened up to the 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. To many suppliers, showing your margins to your customers is anathema, but the fact is that for most major Government contracts open-book accounting is mandated in any case, and on ones where it is not (for instance on framework contracts) the market is so competitive that margins are unlikely to be highly divergent. And in our principles, the “give” of open-book accounting and caps on the profitability of contracts comes with the “take” of collars which would allow contracts to be renegotiated if they become seriously unprofitable.
- Perhaps the most controversial area of the Transparency Principle for Government is the proposal that on each contract certain key operational KPI’s should be published every six months. Government’s whole experience of transparency is that it causes work and trouble, and that answering one question only leads to others. I think there are several reasons why publishing measures of operational delivery is a good idea, the most important of which it will allow taxpayers to see how well we deliver; it’s their money, why should they not be able to see how it is spent? We all deliver well, and demonstrating that should help build confidence in our ability to deliver public services. Second, if private sector contracts publish KPI’s, why should not in-house contracts? If we are half as good as we say we are, we should be confident that our contracts will stand comparison with Government self-delivery.

The second is the Security of Supply Principle: one of the biggest concerns of politicians is the “too big to fail” arguments. Actually, failure is vanishingly rare, but as Carillion showed, it can happen, and Government needs to have confidence that it can seamlessly transfer operations to another supplier. So we propose 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 next principle is the Early Exit Principle: for good reason, Government believes it needs the right to terminate for convenience. During the life of a long-term contract, it may need to change direction. That is fair enough, but it can be equally the case that a supplier can find itself trapped in an impossible position not of its own making, or losing very large amounts of money. We therefore believe that the right of early termination should be mutual, at pre-determined intervals in the life of a long-term contract, and subject to symmetrical penalties. This is best thought of as a pre-nup agreement, where both parties who want to get married take the precaution of agreeing what should happen if it all goes horribly wrong.

Finally, the Fairness Principle: being a supplier of public services and taking the taxpayer’s shilling brings particular responsibilities and expectations of behaviour. We likewise believe that suppliers should be able to expect high standards of fairness and behaviour from Government. I believe it would be helpful if Government and suppliers were to 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.

So, in summary – we have to acknowledge that the conditions in our market are dark and stormy; the lavatory light is dim; in HSE speak, we are in an environment with many trip hazards.

I truly believe that there is a fierce urgency for action to rebuild confidence in the ability of the private sector to supply public services; that we have to develop a coherent and credible voice to address these issues; and that any new settlement between suppliers and Government has to involve give and take on both sides.

I think the BSA has a critical role in trying to develop that voice. Mark and his team are highly experienced, and know the landscape well. They have recently written an important letter to David Lidington on our behalf; having had to deal with the Carillion issue on his first day in office, the Secretary of State is alive to the issues we face, and I believe regards them as important. I am hopeful that some of the BSA's points will be reflected in a speech which the Secretary of State will be making in the next few weeks.

But in my view we, as BSA members, are probably underfunding the Association, and being insufficiently ambitious for what it could do for us. I want to throw down a challenge to Mark and his team: do you agree with the analysis I have just presented, and if so, what should we, the BSA membership, be asking you, and funding you, to do? How would you propose to be our voice over the next five years?

Thank you for listening to me so patiently, and I much look forward to taking your questions. Before that, let me return to earth by reminding everybody of the words of the Civil Servant's prayer:

*Oh Lord God, in thy mercy, let me achieve moderate change, in due course.*