

Briefing 13-58

National Audit Office Report:- The Role of Major Contractors in the delivery of public services

Key issues

- The national audit have recently issued a memorandum to Parliament in respect of Government contracting
- The memorandum explores the role of major contractors in the delivery of public services
- Whilst the report is based on central government contracts many of the issues raised in the report are pertinent to local authorities

1. Introduction

The National Audit Office has a legitimate role in ensuring the public money is well spent. They do this in a number of ways but predominantly in reporting the results of audits to Parliament. The NAO is able to hold government departments and bodies to account for the way they spend public money and this is a way of safeguarding the interest of taxpayers. The NAO workstreams are also helpful to public service managers to improve performance and service delivery. A number of the issues raised in this latest report are pertinent to the local government sector albeit the report is based on Government contracts.

Key themes from the report considers:-

- Whether there is sufficient competition?
- Can we see whether contractors profits reflect a fair return?
- How can we know whether contractors are delivering?

2. Background

A number of recent high-profile cases have driven public interest in the use of private sector contractors on public service contracts. For example the debacle over the G4S contract for security at the Olympic Games and the over-charging issues relating to prisoner tagging

contracts by Serco and others which have been the subject of an investigation by the serious fraud office.

The report considers in detail the activities of Atos, Capita, G4S and Serco. However there is no suggestion that these contractors stand out from others but simply that understanding these four contractors would help the NAO understand other contractors and cross-cutting issues across the sector. They are also amongst the most well-known of the private sector contractors operating public service contractors.

Of the annual £187 Billion spend on public services around half of this figure is spent through contracting in private providers to deliver services. The four contractors within the NAO report account for around £34 billion of that figure with £3 billion of this spent by central government.

3. Achieving the intended benefits of contracting-out

The NAO report suggests that there are a variety of reasons across government and the private sector, to contract out services, but generally because the contracting authority believes that it will help improve value for money, reduce costs and improve the quality of the service. There are generally a number of ways in which contracting out is [reported by the NAO] intended to help improve public services. The NAO suggests these could be considered to be as follows:-

- Getting a specialist in to deliver services can free up the client to focus on policy, strategy and stakeholders, and also deliver economies of scale. It can often provide access to skills that are difficult to retain in-house; contractors can provide clearer career paths for specialists and are not restrained by more rigid public sector pay structures.
- Involving a private sector partner can help to do things that are difficult to do within the way the public sector manages itself, such as facilitating 'spend to save' risk investment, using commercial incentives, and providing operational flexibility.
- Differentiating between the commissioner and the provider can help stimulate the reform of public services, particularly through the rigour of defining services through a contract, stimulating the search for new ways of providing the services and establishing a more rigorous performance regime.

The NAO argues that for these benefits to be achieved there is a reliance upon competitive markets, aligned incentives and sound accountability regimes. This led the NAO to consider a number of critical questions as it is clear that in the context of the current market the reported benefits of outsourcing are not as readily identified and critical success factors such as genuine competition can be undermined by how the market is currently operating.

4. Critical questions

The report identified a number of critical questions. Each is considered in more detail below.

Is there sufficient competition in contracted-out public services?

The NAO identifies that maintaining competitive pressure through the different stages of the contract cycle can be difficult. This is effected by a number of factors. Complex contract models can risk diminishing competition - in other words such contracts may be of interest to a limited number of companies. Whilst a competitive approach may be present, at the early stages of a tendering arrangement, once operating the use of contract variations can become expensive. A further reason for lack of competition is that when a contract comes up for renewal the existing providers may have an inbuilt advantage with them being perceived as an easier and safer option than engaging with a new provider.

Is the rise of a few major contractors in the public interest?

Whilst larger suppliers can potentially bring economies of scale and expertise and are less likely to suffer corporate failure they could also come to dominate specific types of public services. Larger contractors can also acquire smaller businesses consolidating the market and thus reducing innovation and also play a part in effect through reducing competition within certain sectors.

Can we see whether contractors' profits reflect a fair return

The NAO highlights public concern at the perceived profits of private companies and lack of transparency over the rewards which contractors make. In part this is because company accounts do not distinguish from the revenues and profits from public sector work. Equally it is not clear how overheads are apportioned within the accounts of the business and this means it is difficult to assess whether a profit is a fair reflection of the risks and rewards. Therefore there is a high degree of uncertainty about the whole issue of profits being a fair return for risk.

How can we know whether contractors are delivering?

The standards for public service providers should be driven by honesty, impartiality, openness and fairness. The NAO suggests that the public interest is served by high ethical standards. However securing these aims in a contracted out environment can be difficult and the NAO has highlighted the role of transparency when considering the performance of contractors. The NAO suggests that this should not just be about reporting against key performance indicators but also ensuring that there is openness to public scrutiny, whistle blowing policies amongst staff, and that they report problems up the supply chain in large companies as well as accommodating user feedback.

The NAO additionally explores the need for government to ensure that it is in the contractors' financial interests to exercise rigorous controls within their business. Corporate governance within large contractors are likely to be driven by value to shareholders but there is a different balance in the delivery of public services, which can be excluded by the usual corporate governance structures, within the private sector. For government to better intervene the NAO considers that contractual entitlements must be better utilised such as the right to audit and inspection, or banning certain contractors from competition.

5. APSE analysis

The use of the tool of competition in public service markets is cited within the NAO report as a means to drive forward public service reform. However APSE would add to the many concerns raised within the NAO report and indeed would refer to the paucity of evidence on many of the assumptions made, around marketization, as a means of reform.

Firstly, the report whilst correctly identifying the development of an oligopoly within the public services market, repeats the orthodoxy that a commissioner / provider split will create a more robust process and generate efficiencies in public service delivery. APSE would dispute this assumption. Attempting to reform public services, through purchaser / provider splits embeds contract monitoring costs into the long term contract arrangements for the client public sector body. Experience within local authorities suggests that many in-house services have restructured away from hard client / contractor splits and have evidenced savings on frontline service costs on this basis. The costs saved through integrated and responsive service delivery have enabled funding streams to shift away from hard contract

arrangements into frontline services. This is more difficult to replicate in outsourced contractors. The development of 'thin client' models are often cited as a means to avoid this cost overload on contracts, however such models are unproven and are of concern since the public sector is under a clear, and indeed legal obligation, to safeguard public money, including payments to contractors; therefore it is not always the case that 'thin client' models are in the public interest or are workable. For more detail on client / contractor splits in service delivery see APSE briefing 12-51 (Traded services and client / contractor splits in service delivery).

APSE is equally concerned by assumptions that commissioning models are able to deliver a more rigorous performance regime. Whilst performance management is critical in the context of outsourced services it is difficult to gain traction within these arrangements as a means to develop service improvements. APSE has always advocated the use of performance data is not simply about the albeit important information about service cost, quality, productivity and customer satisfaction measures, but about identifying where improvements can be made within services and savings achieved. Whilst outsourced contracts can be geared to generate 'top-sliced' year on year reductions generally any savings achieved from service improvement are subsequently delivered to the contractor through increased margins or profits, not back to the public sector client. Holistic approaches to public sector performance management should in fact allow for the on-going achievement of savings to be delivered back to the public purse and through improved public services, not just monitoring an external contractors' performance.

Many APSE member authorities have also reported that the current fiscal situation has not been helpful to those authorities tied into long term public sector contracts. This is because the portion of budget to support those contracts is generally fixed by the contract payments, and variation payments, which must be made to contractors, leaving any budget reductions to fall disproportionately on other services. Even if the scale of reductions to those areas of service contracted out does not enjoy political support it becomes a financial necessity given the contractual obligations on the client public sector body. In this sense the NAO report, whilst tacitly identifying the need for services to be responsive does not fully explore how contracting out services can fetter the ability for elected members to make democratically accountable budget and service level decisions. The contract 'lock' can in reality place a fetter upon elected members intervening in future service delivery options and budget decisions.

The NAO report is nevertheless a good point of reference for local authorities considering alternative service delivery models as it highlights important factors to be considered. APSE Solutions service works with local authorities on service delivery models and more details about this service can be accessed at www.apse.org.uk or [through this link](#)

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