



ETHICAL COMMERCIALISM

Reforming Public Service Markets

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About Localis

Who we are

We are a leading, independent think tank that was established in 2001. Our work promotes neo-localist ideas through research, events and commentary, covering a range of local and national domestic policy issues.

Neo-localism

Our research and policy programme is guided by the concept of neo-localism. Neo-localism is about giving places and people more control over the effects of globalisation. It is positive about promoting economic prosperity, but also enhancing other aspects of people's lives such as family and culture. It is not anti-globalisation, but wants to bend the mainstream of social and economic policy so that place is put at the centre of political thinking.

In particular our work is focused on four areas:

- **Reshaping our economy.** How places can take control of their economies and drive local growth.
- **Culture, tradition and beauty.** Crafting policy to help our heritage, physical environment and cultural life continue to enrich our lives.
- **Reforming public services.** Ideas to help save the public services and institutions upon which many in society depend.
- **Improving family life.** Fresh thinking to ensure the UK remains one of the most family-friendly places in the world.

What we do

We publish research throughout the year, from extensive reports to shorter pamphlets, on a diverse range of policy areas. We run a broad events programme, including roundtable discussions, panel events and an extensive party conference programme. We also run a membership network of local authorities and corporate fellows.

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Any errors or omissions remain our own.

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Advisory Panel

This research project was supported by an advisory panel, whose members are listed below. Advisory panel members provided one-on-one advice, attended an editorial roundtable and provided comments on reports drafts. They may not necessarily agree with every analysis and recommendation made in the report.

- Michael Burton, Editorial Director, The MJ
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- Richard Harrison, Managing Director, C.Co
- Sandy Hopkins, Chief Executive, East Hants District Council and Havant Borough Council
- Melanie Maxwell-Scott, Director of Policy, Business Services Association
- Becky Shaw, Chief Executive, East Sussex County Council
- Geoff Tucker, Sales and Marketing Director, Norse Group

Executive Summary

Since Compulsory Competitive Tendering was first introduced in the 1980's, local authorities have been encouraged to deal with service delivery in a commercial way, prioritising value for money. The following few decades brought the Best Value regime and a steady increase in commercialism across the public sector. The underlying idea is that businesses can deliver for councils in the most efficient way and help councils save money, while maintaining good service quality and high levels of public satisfaction. However, in recent years, rising tensions around quality of service, risk transfer and executive pay - to name but a few contentious issues – have led the public to question the ethics of outsourcing as a practice. This report aims to reframe the tripartite relationship between the local state, the private sector and the people and communities they both ultimately serve.

Making the case for reforming the public service market

The state of the public service market is much more precarious now than in the past, with a number of major government contracts being either cancelled or bailed out at taxpayer expense. With concerns over profitability mounting and contracting bodies seeking to meet stringent savings' targets, margins for failure have become perilously narrow. As profitability becomes more difficult to attain, firms risk getting 'locked' into a cycle of revenue-chasing. Operating in a high-pressure market where mistakes become seemingly inevitable, structural and systemic factors compound the pressures on government outsourcing.

However, we argue that the public services market is one worth sustaining. Firstly, because the public sector cannot afford a rapid collapse in the public service market. In many instances contracts are multi-generational and have been delivered by private sector providers for decades, meaning public sector expertise in these sometimes critical service areas has migrated out. Secondly, contracts tend to be long term to ensure that financial benefits accrue over a period of many years – spanning electoral cycles and spending review periods. Terminating contracts early could cost, and have already cost, local authorities millions of pounds – often cancelling out or exceeding in expense any intended savings.

Trust should be the focus of reform

Public perceptions of involving private companies in delivering public services are increasingly negative. This is exacerbated by public ignorance as to which companies are delivering local services for their community on behalf of councils. Political resistance is increasing, heightened by the Labour Party's adoption of a markedly sceptical approach to big business and a stated desire to revert to the 'democratic public ownership' of key public services. It is popularly felt that even if local government does have to go down the outsourcing route, councils should contract with Small and Medium-sized Enterprises (SMEs). However, the public procurement process is long and expensive. For local authorities to make real

savings from contractual arrangements, companies need to have built up capital behind them. Most SMEs would struggle to achieve this at the scale required.

To ensure fruitful and meaningful commercial agreements, it is essential that trust is rebuilt through improved accountability and greater transparency. It is also in the interest of private companies which are struggling to maintain profitability within existing contracts to reform market terms and conditions.

The role of local government

With such large quantities of public money being paid to the private sector to deliver local public services, it is essential that the public service market upholds honesty, integrity and transparency. We argue that an 'ethical' approach to commercialisation is the key to saving public services, not just on an ideological basis, but also on a pragmatic basis. Drawing up procurement agreements is often difficult, time-consuming and complex. It is incumbent, therefore, upon local authorities to take it upon themselves to change the procurement culture and ensure public service deals are more focused on innovation and environmental concerns, and that contractual agreements offer greater social value to residents in localities.

A rigid contract of the type deployed in local government service delivery can create barriers to common-sense, plain-dealing, leading to an adversarial relationship developing. Strategic direction must be developed for procurement, under which objectives for public service contracts should be agreed at the earliest possible stage – before they are codified in contractual obligation.

The role of the private sector

The private sector, in particular the large firms who act as major strategic partners to all branches of government, clearly has a lead role to play in restoring trust and changing the culture of suspicion. Part of this is related to the public image of outsourcing, which is in dire need of improvement. For large private sector companies, tax transparency and executive pay disclosure must be seen as part of the price of doing business with the public sector. In addition to this, large private sector firms can use their knowledge of supply chains to act as a conduit for government business to many thousands of small and medium-sized businesses. Through involvement in setting a strategic direction for public service contracts, private companies can agree with local authorities quotas for participation by local SMEs, ecological sustainability and driving innovation.

The role of the citizen

Citizens need a clearer and more developed role in the appraisal of commercialism in government. We call on central government, in collaboration with the Local Government Association, to develop a single, comparative tool for citizens to access information about the contracts and associated performance in their local authority. Currently, there is no such single platform: councils are obliged to publish waste contract details somewhere on their website, although there is no need to inform people if waste is handled in-house. Contract registers are provided, but there is a shocking lack of uniformity to the way the data is presented. Often a contracts register will be a spreadsheet featuring each individually-procured service and data spread over multiple columns, with little to no contextualising information. Through services like Nomis UK, the ONS data explorer and Public Health England's 'Fingertips' tool, citizens can now access clearly presented information on a range of public data. The same is needed for the outsourcing market, which must be brought into the light if it is to be trusted.

Recommendations

We summarise below our recommendations to central and local government.

- Local authorities should develop procurement strategies in collaboration with neighbouring authorities and the private sector to outline the key goals for service delivery, sustainability and innovation
- Local authorities should co-brand all contracted-out services with the service provider to stress partnership and promote knowledge of the everyday effectiveness of many contracted services.
- Local authorities should be encouraged and incentivised to employ relationship managers on the demand-side, in recognition of the importance of long-term relationship building to developing mutual trust.
- Relationship managers should be given leeway to overrule the need to publish all contracts on ContractFinder - under conditions where awarding an existing provider would work to strengthen the bond between the provider and the local area.
- Cabinet Office guidelines for procurement should be refocused away from rigidity and towards flexibility, giving both sides greater room to manoeuvre.
- The Local Government Association should oversee the development of a single platform for local government contracts data – using as a basis for imitation Nomis UK, the ONS data explorer and Public Health England’s ‘Fingerprints’ tool.
- This platform should also be inclusive of any relevant Key Performance Indicators of the service.
- When Britain leaves the European Union, local authorities should be allowed to give preferential treatment to employers paying the living wage in their area.

Chapter 1 – Introduction

It has become fashionable to argue there is a crisis of trust in our institutions. We are more atomised, we're told, by technology, the easy flow of information (and disinformation), by consumerism and by politics. Newspaper surveys regularly cite our falling trust in a range of professions. Evidence suggests this is now happening across all sectors and of particular note is the falling trust in industries which have traditionally been considered honest, such as charities¹². Wherever you look, it seems trust is a commodity in short supply. Nowhere does this seem more evident than the UK's public service market.

The assumption in 2010 was that austerity would result in an outsourcing bonanza³. To an extent this view was borne out. In the first four years of coalition government public sector outsourcing spend doubled compared to the previous four of the Labour government⁴. The areas in which private providers were engaged also grew, with justice, welfare and employment seeing considerable rises in private sector involvement. Firms who had built a reputation and relationships across the public sector working in mature and more commoditised markets found themselves in prime position to take on contracts in these new and more complex service areas. Unfortunately, downward spending pressure and a poorly-designed procurement system would turn many of these contracts into "ticking time bombs"⁵.

The collapse of outsourcing and construction firm Carillion earlier this year made visible to a much wider audience the perilous state of the UK's public service market. Opponents of private sector involvement in public services argue this is not only a "watershed" moment but suggested the whole model of public private collaboration has been exposed as faulty⁶⁷. This view is not without fair concern. A number of major contracts have been cancelled in recent years, many are losing money and some large firms have chosen to exit the UK market entirely⁸. A recent spate of profit warnings have raised further concern the market is under pressure as many major outsourcers have seen their share value tumble in recent years⁹. Even if the public service market isn't moribund, it seems fair to conclude that it suffers from significant deficiencies.

Any single report would struggle to address every deficiency, or make recommendations on the reform of a market which, at its widest, encompasses products as diverse as aircraft carriers to printer paper. We can, however, create a new space to talk about the future of the public service market. We can begin

1 Harvard Business Review (2017) Survey: People's Trust Has Declined in Business, Media, Government, and NGOs

2 Charity Commission (2016) Public trust in charities has fallen, reports Charity Commission

3 The Guardian (2010) Austerity drive will hand billions to private sector

4 Financial Times (2014) UK outsourcing spend doubles to £88bn under coalition

5 Interview response

6 The Guardian (2018) It's not just Carillion. The whole privatisation myth has been exposed

7 BBC (2018) Carillion: Watershed moment for privatisation debate?

8 BSA (2017) Just Another Paperclip? Rethinking the Market for Complex Public Services

9 The Telegraph (2018) Santander warns UK outsourcing under 'stress' after Capita profit warning

small and locally with a conversation which is honest about the role public and private have had in creating a market which isn't working well enough. A conversation in which self-delusion and arrogance are set aside in the interests of mutual cooperation. At the heart of this conversation should be the issue of trust without which there can be no functioning market¹⁰. No contract is ever a complete guarantee.

1.1 A market worth preserving

We assert the public services market is worth saving not for ideological but pragmatic reasons. Those who argue the choice to contract with the private sector is driven by politics may well be correct. Since the first PFI deal in 1992 both Conservative and Labour governments have pushed to deepen the private sector's role in public services. If politics does lay behind the decision to increase private sector involvement in the state then it is far more generational than partisan, however. In an era of steady and increasing growth, manageable deficits and cheap money, politicians from all sides could convince themselves a third way between the ethos of the public and innovation of the private sectors had been found. After seven years of downward pressure on public spending and increasing complexity in contracts, as outsourcing and reform have become symbiotic, fundamental weaknesses have been exposed in public private collaboration which had previously been papered over by easy efficiencies and a growing tax base.

However, the public sector can't afford a rapid collapse in the public service market. Firstly, many contracts are now multi-generational, with different iterations occurring with the same provider or switching between providers. This means many services across a variety of local areas have, in varying degrees, been in private hands for decades. These more mature service markets tend to be lean, with multiple rounds of efficiency having driven cost out in the shape of reducing staff count, new technology and reformed management practice. As a result, expertise has migrated towards the private sector and the capacity to deliver in-house has slowly diminished. This is not to say in-house services aren't possible or good quality, rather that large scale 'insourcing' will be highly complex and in certain places simply not possible in a time scale commensurate with a continuity of service residents, politicians and the law would deem appropriate.

Secondly, because of the long-term nature of contracts, many public sector organisations have the projected financial benefits these deals generate 'baked in' to their own spending plans. A provider handing back a service or collapsing completely would force an insource or retendering of a contract and with it a significant financial burden. However, the latter poses the question; why would a private provider be prepared to take on a contract which another provider had been unable to deliver at profit? Allied to this is the significant penalty costs associated with early termination of a contract.

10 Cass Business School Trust – the glue in effective collaborations

Example compensation to external provider (as percentage of contract value)	Possible cost (if compensation applied nationally to all insourced contracts)
10%	£3,023,200,000.00
20%	£6,046,400,000.00
30%	£9,069,600,000.00
40%	£12,092,800,000.00
50%	£15,116,000,000.00

Source: Local Government Financial Statistics England 2016 (for data from 2010-11 to 2013-14)

The Labour Party has advocated the policy of a general insourcing of local public services but the likely cost of this will be huge¹¹. The average outsourcing contract signed by councils in recent years has been worth £37.8 million and will last 66 months¹². Taking the 2014 figure for expenditure on external contractors by English local authorities – £30.2 billion – we have calculated the possible variations in penalty cost of insourcing council services above. A policy of forced insourcing puts billions of public money at risk. One could wait until a contract is finished and bring the service back in-house then, but as we have already noted, the capacity and capability may not be available, and given the average contract length (more than a parliamentary cycle of five years) there could be significant political or legal change before that time lapses. With tight controls expected on public spending in the medium-term and private providers now ubiquitous in service delivery the public sector, whether it ideologically agrees with it or not, needs a well-functioning public service market.

Private providers also desperately need the market to reform. A narrowing provider group, tighter margins and contracting public spending have all had an impact. Taking a sample of five of the largest firms (Capita, Serco, Biffa, Kier and Balfour Beatty) working with local government across a range of services we can see below our five firms, on average, trailed the FTSE index and their respective sectoral indices in terms of price growth. The UK may be the “Silicon Valley” of public private partnership, but it doesn’t have the share price to match California’s tech giants.

11 Business Insider (2016) Jeremy Corbyn says he will spend £500 billion on infrastructure and introduce rent control

12 Arvato (2015) UK Outsourcing Index 2015

Figure 1: Change in average share price for major public service providers vs. sectoral and FTSE 100 indices



Source: London Stock Exchange

Concerns over profitability are rising

To counter this, many large providers in recent years have sought work across multiple service areas in both public and private sectors. However this means failure in one area risks contagion spreading to another¹³. Secondly, as contracting bodies seek to meet savings targets, margins have been driven down to unstable levels leaving little room for the provider in the case of delivery failure or poorly-priced risk¹⁴. To an extent private providers have been complicit in this. Concerns over new entrants' knowledge of the market and their ability to price risk have been raised. "They create an artificial floor which means everyone else either drops to that level and figures it out later or chooses not to win. But the latter isn't really an option for many companies"¹⁵. A similar concern is noted by Sturgess who states government can also encourage this instability through a belief there are many more firms waiting to enter the market through an unrealistic sense of its profitability¹⁶.

For many, the market has become something of a Chinese finger trap. Each winning bid another tug serving, only to tighten the grip the market has on the firm. As profitability has become more difficult to achieve, firms have become locked into a continuous cycle of revenue-chasing. The impact this situation has on the decision-making and behaviour of individual executives has a significant bearing on the bidding and management of contracts and this is "subject to the limitations of the human condition"¹⁷. In short, in a high-pressure market where one bad news story could wipe half your share price or one lost bid could do the same, mistakes are going to happen. Structural and systemic factors compound this problem such as "sunk costs, a perception of first mover or last survivor advantage, unexpected changes to customer behaviour in a sudden shift from relational to transactional contracting, the bias to deal-closure embedded in bid teams, the inclination even amongst operational managers, to become caught up in 'bid fever', investor expectations of growth."¹⁸ One experienced former

¹³ This is what happened with Carillion where a small number of contracts forced the business down

¹⁴ Reuters (2017) Political squeeze changes landscape for Britain's outsourcing sector

¹⁵ Interview response

¹⁶ BSA (2017) Just Another Paperclip? Rethinking the Market for Complex Public Services

¹⁷ Ibid

¹⁸ Ibid

private sector executive interviewed for this research described the market as “increasingly resembling a Ponzi scheme”.

1.2 A basis for reform

Both public and private sectors have strong incentives to reform the public services market. The question is where to begin?

Local government as testbed

As suggested by Professor Gary Sturgess, reform in the public service market should start with one or two areas from which lessons can be drawn for the wider procurement and commissioning landscape. The natural area to pilot ideas and begin a new conversation is at the local level. Councils spend approximately £69bn on third party providers and have been contracting out services since the 1980s¹⁹. Local government is arguably the most mature public service market in the country. With its vision of competition, privatisation and individual freedom Nicholas Ridley’s ‘night watchman state’ has its origins in local government²⁰. A multitude of private providers, a mix of established brands and new entrants provide back office, front line, support and advisory services to councils. And because of this it has also suffered from the challenges experienced by the wider public service market. This makes it a suitable base from which to test and build future reform.

Trust should be the focus of reform

The shift from relational to transactional contracting has mirrored a perceived decline in trust in the public services market²¹. In simple terms this means contracts have become more specified and services more commoditised - hence ‘transactional’. This notionally minimises the delivery risk to the client as contracts make clear the exact quantum of service to provide and how it will be measured. Providers accepted this shift because public spending remained buoyant and “based on years of previous experience, company executives did not believe that government would interpret such clauses (new contractual clauses) strictly.”²² However, after a sustained period of downward pressure on public spending, a number of high-profile market failures and a general pessimism toward the market, many providers now consider this more transactional approach to have had a detrimental effect²³²⁴.

Specifically, it has reduced trust in the marketplace. By aggressively specifying every aspect of a contract, from controlling the means of delivery through to outcome, commissioners and procurers have eroded the natural obligations which govern human interactions. In this instance, namely not to deceive. Private providers have been complicit in this decline. Poor levels of transparency, weak governance and a series of provider failures based on poor executive management decisions, e.g. under-bidding contracts and then descoping or dropping contracts which had been won but subsequently could not be delivered.

We are not without hope, however. Both public and private sector executives talk often and positively about *relationships*. “When it does work well it’s because we know and trust one another.”²⁵ And there are numerous examples of happy clients, high-performing providers and profitable contracts. We know it can work when there is trust. The question is how to address it?

19 NAO (2016) Government and Commercial Contracting: an overview of the NAO’s work

20 CPS (1988) The local right: enabling not providing

21 BSA (2017) Just Another Paperclip? Rethinking the Market for Complex Public Services

22 BSA (2017) Just Another Paperclip? Rethinking the Market for Complex Public Services

23 BSA (2017) Just Another Paperclip? Rethinking the Market for Complex Public Services

24 Localis (2016) A New Public Service Ethos

25 Interview response

Challenging a culture of suspicion

More trust won't solve every problem but there can't be any long-term solution without it. Therefore, this report will focus on the ways in which trust can be improved, the contractual models which better encourage it and the policy actions needed to facilitate it. Trust, therefore, should provide the basis for more wide-ranging reform efforts beyond this report. The first step then is to frame the challenge in such a way that policy makers, practitioners and the market are able to engage. To this end we believe the best way to build trust is to address the public service market's *culture of suspicion*.

At the heart of this effort should be improved knowledge and transparency. For procurers and commissioners this means reappraising their understanding of what drives provider decision-making, during a bidding process and subsequent delivery. Similarly, a much deeper knowledge of the ownership structure, share position and debt gearing of providers should be a feature of due diligence. Allied to this should be a more detailed understanding of the market's profitability, a key bellweather to its sustainability. Sturgess notes within government there is an artificial sense of the market's health because of a misplaced belief that there are many more firms waiting to enter the market and an unrealistic sense of the profitability of the market²⁶. The knowledge and skills deficit in the public sector on procurement and commissioning is as unacceptable as it is widely noted. Particularly as there are examples of good practice which can be drawn from.

For private providers poor transparency, particularly around the importance of profit, has led to a negative image of the public services market. Similarly, executive salaries and the terms and conditions of delivery staff have been inadequately explained. In particular executive pay and increasingly tax transparency are considered "drags" on the reputations of the UK's large businesses²⁷. When placed alongside poor transparency (2015 polling by Survation suggests 67% of people in the UK want outsourcing contracts made public²⁸), providers can too easily be characterised as lacking accountability and motivated by greed. Recent history suggests this view is not without merit and unfortunately we might not be able to rely on private providers to arrest this concern. As Sturgess notes, "self-interest may not be enough to prevent self-harm" when it comes to private companies trading in the public services market²⁹.

Finally, a practical benefit of framing the challenge as one of a *culture of suspicion* and not a *crisis of trust* is that both sectors are well versed with culture change as a concept. Also, it has the added value of not having the severe and panicked cachet of a *crisis*. Trust takes time to build and, like an upturned hourglass, as it increases, suspicion decreases.

1.3 What we are not doing

We are not offering a wholesale reform programme for the public services market. Nor are we focusing on technical or legal changes to the procurement system beyond suggestions for the broad direction of contracts. We may, on occasion, refer to specific pieces of legislation or technical aspects, but only to provide context and background information. While this report's messages will have relevance to central government procurement, the basis for our analysis is largely drawn from local government. Naturally some aspects may be less relevant than others if taken outside of that context. We will draw on the work of academic experts in our definitions and frameworks for assessing trust and apply these to the public service market. We will not be conducting an in-depth

26 BSA (2017) Just Another Paperclip? Rethinking the Market for Complex Public Services

27 Edelman Social Media on Notice as Public Calls Out Insufficient Regulation

28 We Own It (2015) New polling shows the public wants a say over outsourcing contracts

29 BSA (2017) Just Another Paperclip? Rethinking the Market for Complex Public Services

historical analysis into procurement, preferring instead to use 2010 as a starting point for our data analysis. We will, however, make reference to historical (pre-2010) events, facts and quotes of relevance. Finally, we offer no value judgement on individual private providers or public sector organisations.

1.4 Structure of the report

Following this introduction the report is structured into three subsequent chapters.

Chapter 2, what's created a culture of suspicion? Here we explain our definition of trust in the context of the public service market and explain the behavioural and policy pressures acting against trust.

Chapter 3, model behaviour. In this chapter we examine which contracting models build trust and assess their usage in two sample markets. We also explore how accountability and transparency can be improved.

Chapter 4, changing a culture of suspicion. Finally we make recommendations for reform to government and the market.

Chapter 2 – What’s created a culture of suspicion?

For some, trust is an instant gift. For others it is built up over time, the combined result of many small decencies. As such it is an amorphous concept, expanding and contracting to fit our personalities, needs, tastes and urgency. Therefore, crafting policy to influence trust as if it were an aspect without differentiation from person to person, or circumstance to circumstance, is very difficult.

If public and private are to increase trust between them, we need a definition of trust which can be broken down into features which can be addressed via policy, behaviours and relationships. We need to make it less amorphous. Extensive research suggests *trust* has three components; competence, honesty and benevolence³⁰. We have adopted this definition for this report.

Competency, honesty and benevolence

To trust someone’s competence is to believe they have the ability to deliver to the standard demanded. To collect the bins without missing any streets or maintain the roads without undue disruption. Honesty is reflected in your sense that someone is not, nor will they deceive you. You trust a contract can be delivered at a particular price, or that a change in political control won’t force a change in that contract. Benevolence is the belief that someone has your best interests at heart and cares about you as a partner, customer or client³¹. Trust is built or destroyed via these components.

“Many councils have discovered that contracts they may have signed with a view of saving money no longer represent good value for money. You have to appraise that and say, well, can we do it better ourselves?”³² Such a comment wouldn’t raise so much as an eyebrow were it from Jeremy Corbyn or a Labour council leader. After all, we’re often told the question of public private partnerships is really about ideology and has a distinctly “partisan character”³³. That it came from Cllr David Simmonds, when Conservative group leader at the Local Government Association, should give us pause for reflection. While it’s reasonable to assume a Tory shire would be more open to a conversation with the market than a Labour Met, to argue partisanship is a defining feature of public private collaboration at present is to ignore what is actually happening in town halls across the country. Whether Labour or Conservative, north or south, local commissioners have become increasingly sceptical of the market’s ability to

30 Kellogg Insight (2016) Cultivating Trust is Critical – and Surprisingly Complex

31 Ibid

32 The Guardian (2016) Why have councils fallen out of love with outsourcing vital services?

33 Smith Institute (2018) Out of contract: Time to move on from the ‘love in’ with outsourcing and PFI

deliver. If we are to make recommendations which will improve trust in the public services market, we need to understand why.

2.1 Low public sector confidence

In 2016 Localis polled 1,400 public sector workers from across local government and the NHS on their attitudes to the private sector. Specifically, we asked them to identify the values most associated with ‘public service’ and then rank the effect private sector involvement has had on those values over time. The results were a wake-up call to private providers. In every region of the country local public sector workers had a net negative view of private sector influence on public service values.

Region	Average effect of the private sector on the qualities associated with public services we tested for ³⁴
North East	-0.14
East Midlands	-0.23
London	-0.35
West Midlands	-0.35
Scotland	-0.36
East of England	-0.37
North West	-0.37
South West	-0.4
Yorkshire & Humber	-0.42
Wales	-0.47
South East	-0.48

Source: A New Public Service Ethos (2016), Localis

The most sceptical part of the UK was the South East, ostensibly the most politically Conservative. One council leader from the region cited the view amongst elected members that private providers had not delivered the flexibility they would have expected nor the “levels of innovation they purport to provide”³⁵.

2.2 Political resistance

The Labour Party’s recent shift leftward under Jeremy Corbyn has broken a two-decades’ long consensus on the public service market. In a way this has been mirrored by the Conservatives under Theresa May, who has adopted a sceptical tone toward big business and its treatment of the consumer. The market is being pressed from both left and right with both sides wanting reform.

In the public services market, manifestation of this pressure fits with traditional political caricatures. Labour’s transition from the Blair/Brown years of outward positivity to private sector involvement, to the studied intellectual critique of Ed Miliband, has finally reached a level of declared preference against the private

34 The qualities we tested for were accountability, career advancement, community responsibility, creativity, customer service, efficiency, entrepreneurialism, integrity, pay and benefits, and social justice

35 Interview response

sector with Jeremy Corbyn, who openly refers to outsourcing as a “racket”³⁶. Conservative scepticism has been more recent and nuanced. However, the Open Public Services White Paper made reference to a number of issues which reinforce a lack of trust such as a narrow pool of providers, contract size and local accountability³⁷.

2.3 Small versus large firms

The political rhetoric is often in favour of small to medium-sized businesses but the reality of public sector procurement in recent years has been less so. The relationship between big providers and their supply chain is poorly understood by commissioners, procurers and the public alike. There are both structural and perception issues. On the former, to name but a few, the procurement process is long and expensive. Only companies with a certain size of overhead and ready cash to hand can weather the bidding period. Many contracts also require upfront capital, something which SMEs would struggle to access at the scale required. Similarly, the liability threshold is too great for many SMEs. On the latter, few commissioners and procurers have detailed knowledge of their providers’ supply chain. The view of the market being dominated by a small number of large firms misses the extensive role played by SMEs in private provider supply chains. As Rupert Soames has noted regarding Serco’s own contracts, “37% of the revenue paid to us by the government goes out to SMEs and it’s actually quite a good model. Rather than government saying ‘we want SMEs’, this pipe dream that government can suddenly become SME-friendly...I think one of the roles we can play is being that bridge.”³⁸

Public spending

Across the public spending settlement between 2010-11 and 2016-17, local government saw a real terms reduction in funding of 49.1%³⁹. Non-social care services saw a reduction in local authority spending of 32.6%; planning, housing, transportation, cultural and environmental services have all seen double figure reductions in spending. Many councils have sought to bring in the private sector to make services more efficient and help them hit savings targets. As the following section lays out, there have been some severe missteps in this effort.

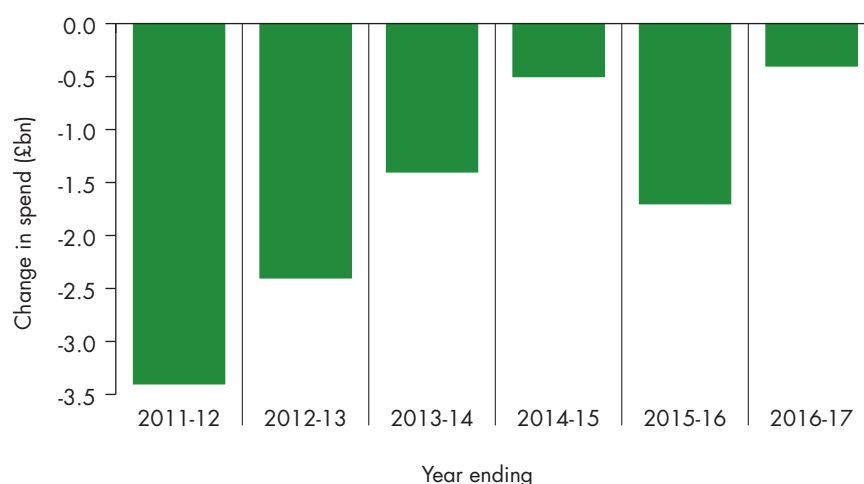
36 The Guardian (2018) Corbyn on Carillion: we’ll end outsourcing ‘racket’ in rule change

37 HM Government (2011) Open Public Services White Paper

38 Quote from IFG Event

39 NAO (2018) Financial sustainability of local authorities 2018

Figure 2: Reduction in service spend of English local authorities



Source: National Audit Office

2.4 Unethical Commercialism

Local government paid £65 billion in 2014/15 to suppliers, of which a large proportion was for service contracts⁴⁰. With at least 25 upper-tier councils holding major contracts with Carillion, the behaviour of other contracting firms is in the spotlight. Although many contractual agreements have enabled local government to save money and deliver efficient services, some companies are still generating profit while maintaining poor standards of service delivery. It is important to understand that the backlash against outsourcing embodied in the Labour comments cited above did not emerge from a vacuum. If the public services market is to be saved it must become more ethical. In order to do this we have to understand and accept what *unethical* looks like in this context. Below are some examples of where poor practice has led to negative outcomes for the public and the public sector.

Birmingham City Council for instance, agreed a 'Service Birmingham' IT contract with Capita, costing the council up to £120 million a year⁴¹. Part of this service involved a call centre which charged the council by call volume. This became increasingly costly and incentivised the return of frustrated repeat callers - because those calls would be more profitable than someone whose problem was solved first time. Less than half of Birmingham's citizens were satisfied with the Capita call centre with 41% finding staff were unwilling to help⁴². This level of failed services motivated Birmingham City Council to end the contract. Since taking it back under the control of the local council, customer satisfaction has risen from 49% in 2014 to 69% in 2018⁴³. Additionally, the council has managed to save £4 million a year since taking the service in-house from 2014⁴⁴.

The Yorkshire Purchasing Organisation (YPO), a procurement body owned by

40 The Smith Institute (2018) - Out of Contract: Time to move on from the 'love in' with outsourcing and PFI

41 Birmingham Post (2017) - Council's controversial Service Birmingham IT company to be wound up in January saving £3 million over four years

42 Birmingham Live (2014) - Birmingham City Council's Capita call centre slammed by users

43 Birmingham Live (2018) - Birmingham's council run call centre £4 million a year cheaper than under private operator - and people are happier

44 Ibid.

local authorities in Yorkshire agrees mass deals with suppliers – aggregating demand through bulk purchasing to reduce costs. The YPO recently agreed a £600 million deal with Amazon to distribute supplies to local schools across Yorkshire. This model is familiar in the United States of America where about 1,500 public agencies and jurisdictions—including counties, cities and school districts—have signed onto a procurement contract awarded to Amazon Business by U.S. Communities, a buying cooperative for tens of thousands of agencies.

However, Amazon has been criticised in the past by the House of Commons Public Accounts Committee for diverting sales and profits to complex corporate structures overseas to minimise tax exposure. And despite increasing its profits from £24.3 million to £72.3 million this year, Amazon’s tax payments decreased from £7.4 million to £4.6 million⁴⁵. Despite these concerns and allegations of poor working conditions for its warehouse staff⁴⁶, local authorities have chosen to drive public procurement through large multi-national companies like this rather than local SME’s⁴⁷.

Against these complaints, it could be argued that Amazon has the full commercial capability to deliver on its contract, providing cost-efficient services to participating councils due to its economies of scale and strong existing logistical mechanisms to transport large supplies to a wide area across Yorkshire. But the decision to land the contract with Amazon raises ethical concerns about what fair competition looks like in the public service market.

Unfortunately, there may be cases where private companies exploit the government’s lack of knowledge in procurement and management of projects. Atos has faced many IT failures and the government has had to review contracts worth £500 million⁴⁸. This included delays for assessing disabled people for personal independence payments. Many payments were delayed by more than six months, causing some claimants to be admitted to hospital due to stress and being unable to afford medically prescribed diets⁴⁹. Additionally, a review by the National Audit Office (NAO) heavily criticised Atos for their role in the design of an IT system that would allow for the extraction of data from GP practice systems and concluded that Atos did not show duty of care to the taxpayers⁵⁰. Private companies have also been known to drain money from localities by exploiting contractual agreements unnecessarily. For instance, a Panorama investigation found that Kingdom Services, a company contracted out from Maidstone Borough Council, were offering staff bonuses to those enforcing fines for littering in the area⁵¹. This resulted in excessive litter fines, with incidents such as members of the public being fined for accidentally dropping orange peel on the street. The contract worth £240,000 was subsequently reviewed by the council⁵².

Another concern with outsourcing, is the ability of private firms to live up to their promises and contractual agreements. This was evident in the dispute between Southwest One and Somerset County Council. SouthWest One (SWO) the outsourcing company, delivered less than the anticipated £180 million savings over 10 years. In consequence, Somerset decided to terminate the contract a year early. SWO disputed the decision and then launched legal action against Somerset⁵³. SWO argued they complied with their contractual obligations and were on target with the long-term savings plan. Somerset ended up paying £5.9 million to settle the contract dispute, illustrating how complex contracts can

45 BBC News (2018) – Amazon tax bill falls despite profits leap

46 Business Insider (2018) - Amazon accused of treating warehouse staff ‘like robots’

47 Examiner Live (2018) – Amazon contract to supply Kirklees Council, police, fire and NHS branded a ‘joke’

48 Guardian (2016) – Government to review £500m-worth of Atos contracts after IT failure

49 Guardian (2014) – Watchdog attacks the government’s handling ‘fiasco’ of disability payouts

50 National Audit Office (2015) – General Practice Extraction Service - Investigation

51 Kent Online (2017) – Maidstone Borough Council suspends litter wardens after Panorama investigation into Kingdom Security

52 Ibid.

53 BBC (2012) – Southwest One sues Somerset County Council

result in costing councils more than they expected to save⁵⁴. This is particularly pertinent as the council was in disagreement with SWO over the quality of the procurement service provided, while SWO felt they delivered on their side of the agreement.

The question is, how can local councils enter into these seemingly 'ethical' and commercially viable plans and then ensure that the private companies deliver?

2.5 Aggressive risk transfer

A criticised feature of the public service market before 2010, poor practice in relation to risk transfer has further deteriorated in recent years⁵⁵. Government's longstanding position is risk should sit with those best placed to manage it⁵⁶. However, recent experience suggests this is often not the case. Sturgess suggests procurement teams aggressively seek to maximise risk transfer⁵⁷ and Rupert Soames argues it is this push for ever more liability to reside with the private sector that is creating the most difficulty in the market, not the sector's push for a higher margin. Recent insistence by government on unlimited liability has forced some providers out of the market and is still a live concern for those who remain⁵⁸ – "At some point in the past fifteen years government started outsourcing contracts to private companies on the basis that it was transferring risk"⁵⁹. At the same time Government's own commercial operating standards remained unchanged, on paper at least⁶⁰, leaving transferred risk like "hand grenades sitting in contracts"⁶¹.

Drawing on the work of Professor Gary Sturgess and interviews conducted for this research we list the variant forms of risk transfer which can become excessive in the context of local public services. The below list is not exhaustive but represent the most common forms:

- 1. Policy and political risk** - private sector providers assuming the risk of legal or policy changes and changes in political leadership. In many circumstances the contracting body will also be responsible for making those changes.
- 2. Data risk** - where a private sector provider is expected to take on the risk of poor quality data upon which the contracting body has based a set of outcomes, costs or volumes.
- 3. Outcome liability** - the provider takes a significant proportion of their fee based on the achievement of specific outcomes measures.
- 4. Capital risk** - private sector providers are expected to make a significant capital investment at the outset of a contract. This becomes a particular problem when contracting bodies insist on shorter contract lengths.

Given the difficulties associated with risk transfer it is reasonable to consider why both public and private persist in letting and bidding for contracts. Partly this can be explained by the legacy of contracting; traditionally for non-complex services where the risk is largely based on delivery. In such circumstances a contracted provider, should they find themselves for whatever reason unable to deliver, has greater flexibility. The understood priority between public and private is *continuity of service* and in this situation it is clear how a provider can be flexible to ensure it. Many contracts are still let on these terms and their relational

54 BBC (2013) – Southwest One contract dispute cost council £5.9m

55 BSA (2017) Just Another Paperclip? Rethinking the Market for Complex Public Services

56 Government Commercial Operating Standards

57 BSA (2017) Just Another Paperclip? Rethinking the Market for Complex Public Services

58 Interview response

59 Rupert Soames speaking at IfG event (March 2018)

60 It was noted the MoD have made changes to its procurement guidance to reflect changes in risk transfer practice

61 Rupert Soames speaking at IfG event (March 2018)

aspects (personal relationships, flexibility, etc.) are highly valued. However, in recent years contracts have become more complex, encompassing a broader range of services and addressing multiple needs. In such contracts outcomes can be difficult to define, meaning it is harder to establish the precise nature of the risk being transferred. When combined with downward spending pressure on public services, the relational aspect has diminished and contracts have become more transactional. This creates a paradox; as contract complexity increases and the benefits of flexibility with it, the same complexity is designing flexibility out of the system.

Ultimate risk sits with the state of course. When a contract can't be delivered and a statutory service may not be provided because of it, the buck stops with government. In this insistence the Carillion experience should be a lesson to politicians; even if the private provider carries all the risk on paper, in the event of failure or poor performance, it is politicians who receive the difficult questions and must face the public. Aggressive risk transfer is at the extreme end of transactional behaviour and as it becomes more dominant in the contract, the space where natural obligation should reside diminishes.

2.6 Negative public image

When placed alongside poor transparency (polling by Survation suggests 67% of people in the UK want outsourcing contracts made public⁶²), private providers can often be characterised as lacking accountability and motivated by greed. Recent history suggests this view is not without merit and unfortunately we might not be able to rely on private providers to arrest this concern. At Sturgess notes "self-interest may not be enough to prevent self-harm" when it comes to private companies trading in the public services market⁶³. If the state has been too aggressive in seeking to transfer risk, private providers have too readily accepted poor terms and deliberately bid for contracts they knew they would struggle to deliver.

It is unlikely there will be a collective response from private providers because there are many disincentives to this sort of activity. Laws preclude organisations from pre-bid collaboration and the state has been guilty, via its own behaviour, of gaming private providers in order to drive down cost, which turns procurement into a 'race to the bottom'. In terms of publicity the best kind is usually none. Contracting bodies rarely want to advertise a deal for fear of political and public resistance. Conversely, private sector companies "are aware of their reputation with the public and some companies have it worse than others"⁶⁴. Providers are unlikely to want to be associated with a firm with a bad or worse reputation than their own. This means there is a relatively small amount of information in the public domain regarding the public services market despite it constituting approximately a third of all government spending⁶⁵.

This lack of information has resulted in many misconceptions and a negative perception of the public service market persists⁶⁶. For example the mistrust of Private Finance Initiatives (PFI). "They (PFIs) are now what the public thinks of when they hear the word outsourcing but it just isn't the case."⁶⁷ PFI contracts have become synonymous with disengaged private providers and poor value for money. However, in spite of the significant media coverage devoted to it, according to the National Audit Office (NAO), "PFI and PF2 has been used

62 We Own It (2015) New polling shows the public wants a say over outsourcing contracts

63 BSA (2017) Just Another Paperclip? Rethinking the Market for Complex Public Services

64 Interview response

65 Best Practice Group (2017) How does our government spend £242bn of our public money a year? NAO report reveals all

66 Localis (2016) A New Public Service Ethos

67 Interview response

much less in recent years"⁶⁸. Or take the issue of profit and margins, according to Sturgess, of the five largest public services providers between 2011 and 2016, only one made a commercial return⁶⁹.

2.7 Is profit beautiful?

As contracts have become more transactional the relational aspects have slipped from view. Relationship and behaviours which drive negative behaviours need to be managed. In the case of the public services market the behaviour of individual executives has a significant bearing on the bidding and management of contracts and this is "subject to the limitations of the human condition"⁷⁰. In short, we all make mistakes. As we have noted earlier, when dealing with poor or incomplete information and working to tight deadlines, decisions still need to be made and errors will occur. Structural and systemic factors compound this problem such as "sunk costs, a perception of first mover or last survivor advantage, unexpected changes to customer behaviour in a sudden shift from relational to transactional contracting, the bias to deal-closure embedded in bid teams, the inclination even amongst operational managers, to become caught up in 'bid fever', investor expectations of growth."⁷¹

One might argue the public sector should not be concerned with the profitability of private providers but this would be a mistake. As we have already noted, ultimate risk always sits with the state. As both buyer and regulator, government should see procurement and commissioning designed with fair risk *and fair profit* in mind. Similarly, there is clearly a role for private providers in explaining the role profit plays in a healthy market. Profit is beautiful. It drives many of the behaviours the public sector contracts out for and this needs to be better understood.

To summarise, the key issues we have identified driving trust down are the following;

- Low buyer confidence in the market to provide
- Political uncertainty around legislation, regulation and policy
- Poor understanding of the role large providers play in the wider economy, specifically curation of their own supply chain
- Declining public spending
- Aggressive risk transfer
- A poor public image of major private providers
- Poor public knowledge about the use of profit in the market

2.8 Accountability, transparency and obligation

Working measures

It is hard to come by success stories in the media where public procurement has worked flawlessly. The lack of an incentive to report on its successes is understandable. Reporting on how local residents' bins have been routinely collected for the last year in Three Rivers District Council, owing to a successful public private partnership, is not an eye-catching headline. A lack of media coverage does not make the myriad successful instances of public procurement any less of a reality. There are issues that need to be addressed but the fact remains that it is working across the country on a daily basis and makes savings

68 NAO (2018) PFI and PF2

69 BSA (2017) Just Another Paperclip? Rethinking the Market for Complex Public Services

70 Ibid

71 Ibid

of 11%⁷² on average. In chapter three we present two different areas of local public service outsourcing and the different options available to gauge their cost-effectiveness.

Failing measures

Carillion's fall has once again brought up the growing public discontent with the functionality of government outsourcing and where to draw the line. Beyond this recent failure there are plenty of examples, such as G4S' security failure at the 2012 Olympics⁷³ and the abandoned NHS IT upgrade⁷⁴ exposing flaws in the current procurement procedure. While it is also widely accepted that public outsourcing and contracting will not be going away anytime soon, there is a crisis of confidence emerging once again in the sector. Within the procurement procedure, there does not seem to be a high level of accountability or transparency, which leads to high levels of mistrust as discussed above. Another aspect that plays into recent failings in the outsourcing sector starts from the phase of writing the contract itself. As the NAO's Joshua Reddaway has noted, there does not appear to be a defined standard for what 'good' is⁷⁵. Rather than both parties entering the contract taking their relationship as flexible and relational, what actually tends to happen is that structures and expectations are set in rigid terms from the beginning, which arguably sets the whole arrangement up for sadness and disappointment from the outset. Speaking of conditions that correlate with poor outsourcing results, Ed Welsh⁷⁶ discusses how service requirements in a contract can become complex to the point of being hard to explain in clear language. These requirements are then put forth in the contract, resulting in divergence of thought and understanding on what exactly is required and needed of each party.

Creating the space for obligation

As one advisory panel member told us for this research, "contracts often act as a barrier rather than an incentive to joint working". A rigid contract of the type often deployed in local government service delivery – particularly in an area where real-time data collection could be difficult such as kerbside waste collection – can create barriers to common-sense, leading to an adversarial relationship developing.

Objectives for public service contracts should be agreed at the earliest possible stage, before they are codified in contractual obligation, and should give space for renegotiation. The Cabinet Office recently ran a consultation for strategic suppliers (holding contracts of over £100m with central government), acknowledging that a more collaborative approach is necessary. Too much rigidity can lead to companies "trying to make a project appear successful rather than...delivering a successful project".⁷⁷

New Approaches

It is important to note that there are new models emerging within public procurement that, if handled and publicised correctly, stand to improve the public view of outsourcing by delivering innovative services, ensuring high-quality employment growth and promoting ecological sustainability. These approaches are expanded and elaborated upon in chapter four.

72 Gareth Williams speaking at IFG event.

73 The Guardian (2012) London 2012 Olympics: G4S failures prompt further military deployment

74 The Guardian (2013) Abandoned NHS IT system has cost £10bn so far

75 Joshua Reddaway speaking at IFG event

76 Ed Welsh speaking at IFG event.

77 Cabinet Office (2018) – Strategic Suppliers

Procuring for innovation

What is now clear is that there needs to be a radical restructuring regarding our approach to public procurement and government outsourcing. An area that can serve as a new approach is Public Procurement for Innovation. This has been defined by OECD as:

*'Any kind of public procurement practice (pre-commercial or commercial) that is intended to stimulate innovation through research and development and the market uptake of innovation products and services'*⁷⁸

There are two different possible impacts that can come out of innovation-led procurement. Firstly, the constant demand for improving services and good by the public authorities can lead to a renewal in innovation by private firms bidding on these contracts. Secondly, once these products and services are delivered they are expected to improve the productivity and proficiency of public services⁷⁹. In the UK context, the main vehicle for procurement of innovation is the Small Business Research Initiative (SBRI). The programme is run by Innovate UK and provides the chance for companies to engage with the public sector in developing responses to policy and operational challenges⁸⁰.

Procuring for high-quality growth

An emphasis on job quality within public contracts is needed to ensure the long-term viability of outsourcing for those whose life depends on working these contracts. There appears to be a developing 'normative consensus', at the EU level at least, in regard to the public authorities' obligation to ensure good work and fair working conditions⁸¹. The state still plays an important role in influencing the domain of job quality when they outsource certain aspects of their functionality. This can be at the level of the write up or maintaining of the contract. An example of this is ensuring a Local Living Wage in the tender.

Procuring for ecological sustainability

Green Public Procurement is another viable new approach to outsourcing. It has been defined as 'purchasing which reduces environmental impacts across product or service life cycles'⁸². Placed within the overall context of Public Procurement of Innovation, it is attempting to find new eco-friendly innovative answers to emerging societal and ecological challenges that reduces environmental impacts of products⁸³.

78 OECD (2017) Public Procurement for Innovation: Good Practice and Strategies

79 Ville Valovirta (2015) Public Procurement for Innovation

80 OECD (2017) Public Procurement for Innovation: Good Practice and Strategies

81 Jaehrling (2014) 'The state as a 'socially responsible customer'? Public procurement between market-making and market-embedding'

82 Rainville (2017) 'Standards in green public procurement – A framework to enhance innovation'

83 Ibid

Chapter 3 – Model behaviour

Before moving onto recommendations to improve trust, it is worth providing some context on the procurement decisions faced by local government. Outlining the different models available and stressing the often negligible difference in cost between in-house and outsourced helps to dispel assumptions on why local government does or does not outsource. As our brief analysis shows, there is little difference in the price between outsourced and in-house services, as local authorities will normally choose whichever is most pragmatic and cost-effective, rather than make a decision based on the ideologically desirability of the one or the other, regardless of cost or efficacy.

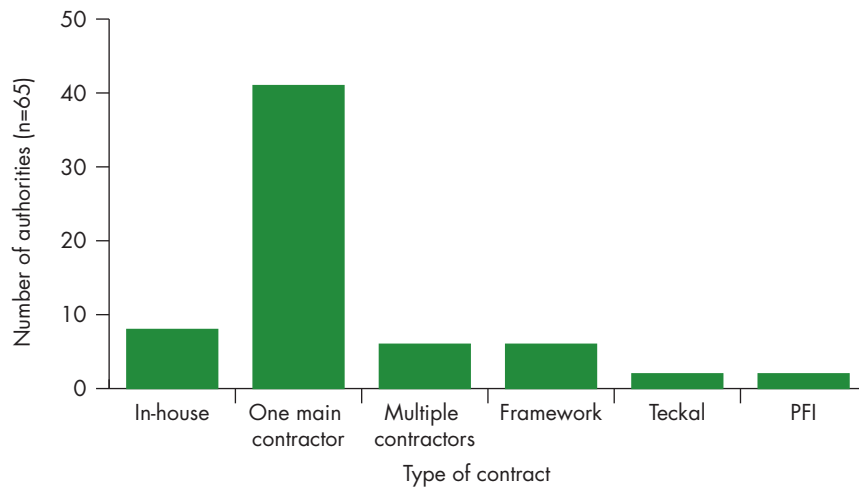
The clearest outcome of our survey of a sample of two types of local government contracts, however, was the hugely disjointed and asymmetrical adoption of the local government transparency code. Local government contract data is hard to understand and spread across a range of formats and platforms. For the 'armchair auditor', the accessibility challenge this presents may well be insurmountable. Given the public's clear scepticism regarding outsourcing of public services, this is not a politically desirable state of affairs. This chapter presents our analysis of the contracts and criticisms of the transparency.

3.1 Focusing on two public service markets

In trying to gauge the effectiveness of public service markets, we have conducted a data review of two important local services: road maintenance and waste collection. Waste collection is handled at district/unitary authority level; road maintenance at county/unitary. We took a sample of 98 waste collecting authorities and 65 road maintenance authorities, looking at whether or not their services are outsourced and to what degree.

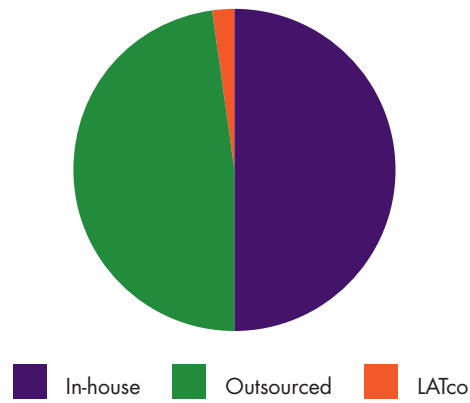
Both of these areas see significant outsourcing: road maintenance is mainly outsourced while waste collection is majority in-house by a very slim margin. As the graphs below illustrate, there is more variety in the models for road maintenance contracting than waste collection.

Figure 3: Types of road maintenance contract



Source: Localis analysis of public contracts data

Figure 4: Provision of waste collection services



Beyond the “in-house/outsourced” distinction, there are a number of different ways to go about procuring public services, the box below details these pathways for the case of highways:

3.1.1 Models of Procurement (Source: Highway Maintenance Efficiency Programme)

In-House

The traditional model, which for road maintenance and waste collection amounts to the local authority owning its vehicles and directly employing the staff who man them. An authority may also opt for an ‘In-house + top-up’ model, where a contract with a private provider is used to plug gaps in the service, for example in staffing of certain aspects of delivery.

Framework

The framework model of procurement is based around ‘mini competitions’, where one or more local authorities set a framework for a works programme and contracts out to multiple suppliers based on the guidelines and requirements laid out. Perhaps because laying out a framework and running the mini-competitions requires a significant degree of planning and enough market competition to warrant it, this seems to be most popular in very large authorities (like Cumbria) or among metropolitan boroughs (some Greater Manchester authorities, for example).

Multiple Providers

An outsourcing model based around multiple providers involves the local authority making cost-effectiveness decisions on a service-by-service basis (i.e. street lighting) and contracting it out to a private provider where appropriate. This model will leave the authority with more tactile control but is also more labour-intensive and potentially expensive.

Single/One Main Provider

The single provider model is one where all or the majority of a service area is transferred to a private provider to manage. The local authority will, as a client, retain performance management responsibilities and some of the contract management. This type of contract is exemplified in the kind of arrangements companies like Balfour Beatty, Ringway and Amey have with local authorities.

Private Finance

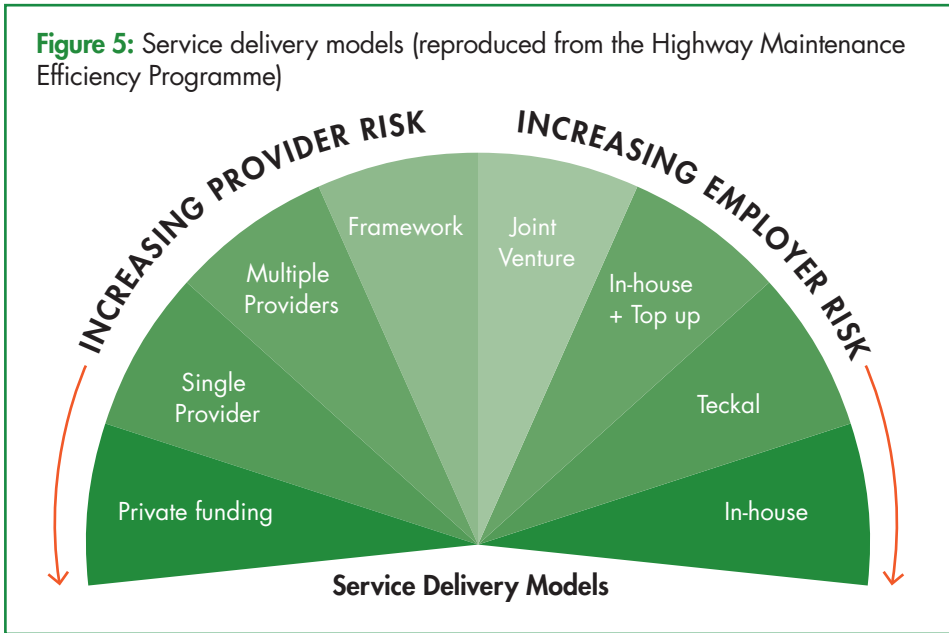
For privately funded arrangements, long-tenure contracts transfer asset and service responsibility to a private provider in return for capital injection. Although the ‘PF11’ deals are no longer an option for local authorities, there are some with PFI deals still in operation, for example the Island Roads PFI in the Isle of Wight.

Teckal/LATco (Local Authority owned companies)

The so-called Teckal Exemptions allow local authorities (often as a joint venture) to establish a public sector company to provide the services in its stead. These companies can then undertake work as part of public service delivery, although this must make up the vast majority of the company’s operations and the local authority or local authorities must retain 100% ownership. The waste collection company Ubico was founded by Cheltenham and Cotswold districts councils and now provides services to several other local authorities in the wider area.

The infographic below displays the differing risk profile of these models:

Figure 5: Service delivery models (reproduced from the Highway Maintenance Efficiency Programme)



Source: HMEP

3.1.2 Types of Contracting
(Source: Tony M Porter – Trends in the Procurement Model for Highways Maintenance)

Input Driven Contracts

Input driven contracts are those which focus specifically on the “what”. What a contractor is to do in the form of a Works Instruction and a specified payment plan, normally on a per-hour basis. These contracts are inherently low-risk for the contractor due to their specificity, the majority of the risk remains with the authority commissioning the work.

Output Driven Contracts

Output driven contracts specify the desired outcomes and focus on the criteria for intervention and performance standards. Most outsourcing contracts in the UK for areas like waste collection and road maintenance are of this kind. More risk is moved onto the contractor with this type of contract, due to the inclusion of standards and criteria for operation.

Outcome Driven Contracts

Uncommon in the UK but increasingly used internationally are outcome driven contracts, where the authority specifies outcomes like ‘levels of service’ and ‘key success factors’. Some of the more ambitious PFI deals could be construed as outcome-driven contracts, for example PFI Hospitals where the private actor built and operated the hospital.

Single contractors are the most popular form of outsourcing

For both areas of service provision, a single contractor is the preferred outsourcing method, with the markets each showing concentration in major providers - but not total market dominance by any one company.

3.2 Measuring the cost effectiveness of different models

The two boxplots below demonstrate the similarity across most of the models of outsourcing described. The notable exception being PFI, which has fallen from popularity since the early 2000s and is not considered a viable option by most councils today.

The boxplots show the median per-head expenditure on road maintenance and waste contracts with the bold line in the centre, with the top and bottom of the boxes showing the 25 and 75 percentiles. The 'whiskers' on either side of the box represent the ten and ninety percent points. The bulk of all 65 road maintenance contracts examined fall between £20-£40 per head of population, regardless of model. The story is similar for waste contracts, with little discernible difference for the bulk of in-house or outsourced services.

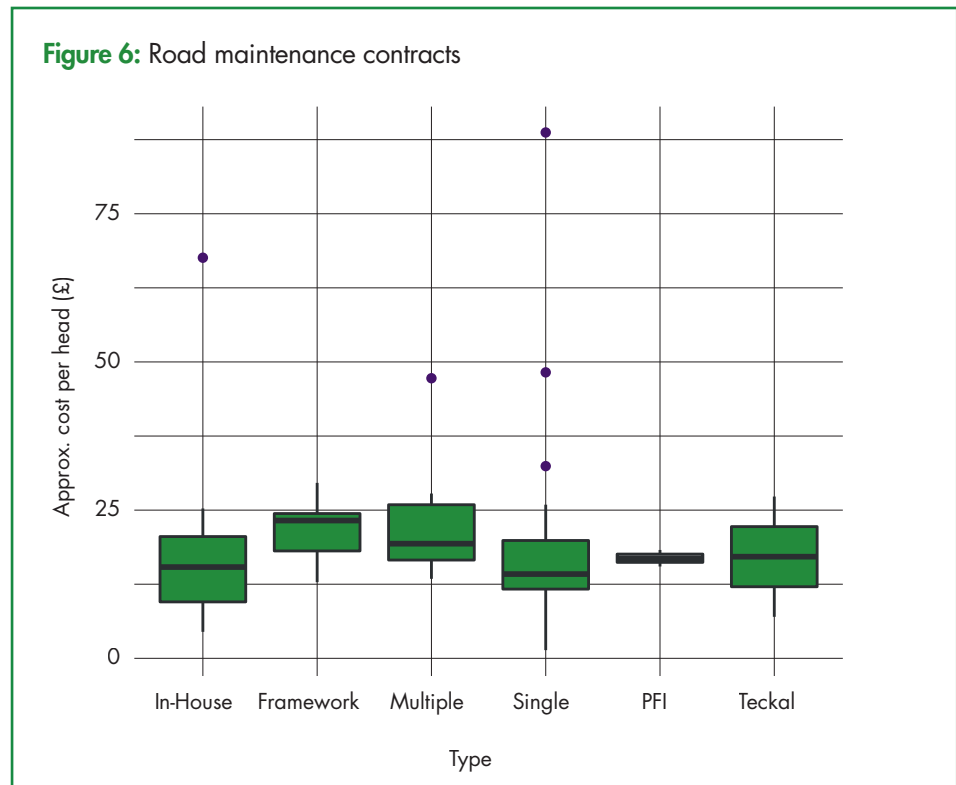
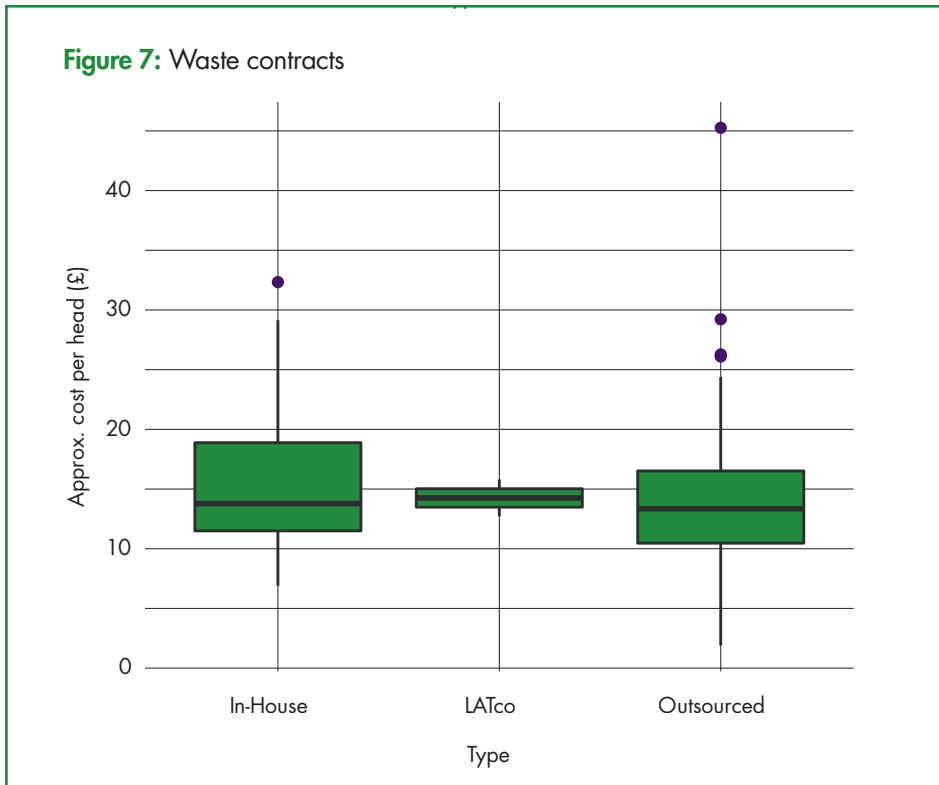


Figure 7: Waste contracts



Source: MHCLG Revenue Accounts, public contracts data and ONS population estimates

Although there seem to be fewer outliers for in-house road maintenance, this may well be down to the smaller number of in-house providers, as for waste collection, there is slightly greater variation for in-house provider costs than for outsourcing.

3.3 No silver bullet

Our data review provides some interesting insights into the composition of public service markets, but it does not provide an easy answer for those looking to prove or disprove the efficacy of outsourcing. Clearly, there is more to the media and public interest in outsourcing than can be explained by price alone. Any attempt to survey the market must therefore audit perceptions as well as contractual data.

Model	Type/Risk Profile	Example
In-house	Input (if using top-up)	East Riding of Yorkshire (Road Maintenance) Newham (Waste Collection)
Framework	Input or Output (depending on framework and service contracted)	Sunderland (Road Maintenance)
Multiple	Output – although more risk on authority than single provider	North Lincolnshire (Road Maintenance)
Single/One Main	Output	Wiltshire (Road Maintenance) Mid Suffolk (Waste Collection)

Private Finance	Output/Outcome (depending on the service provided and terms), risk overwhelmingly on the provider side with these deals as they may be locked in.	Portsmouth – Colas PFI (Road Maintenance)
Teckal	Output (although arms-length, the risk is still greater for the authority than with an independent private company)	Via Nottinghamshire (Road Maintenance) Liverpool Waste Management (Waste Collection)

3.4 Transparency in local government contracts

Local government is under-resourced and under increasing financial strain. Time and energy of capable officers are in short supply, as are the officers themselves. This caveat must be stressed before making any point which hinges on them doing more. Nevertheless, the fact remains that the state of transparency regarding local government contracts is poor and must be improved if trust is to be restored. Widespread coverage of outsourcing failures damages trust, which in turn causes scepticism about outsourcing in general – this amounts to a cycle of outsourcing being viewed with increasing suspicion and failures picked up with ever-more voraciousness.⁸⁴ An individual sceptical of outsourcing, one who views it as a process shrouded in shade and unaccountability, is highly unlikely to have their belief disproved by an attempt to investigate the current arrangement.

The local government transparency code of 2015 ostensibly ensured that the contracts register for all local authorities be publicly available - and this has been adhered to. Nevertheless, these registers are provided on a range of different portals – some for a single authority, some for multiple – each with differing syntax and structure. We question the legibility of these systems for ordinary people who may wish to know what their council is spending, who they are spending it with, and how this compares to neighbouring areas. In the next chapter, we make the argument for why this issue – which may be seen by some as trivial – is crucial to injecting some much-needed trust into the contracting-out process.

Sharing performance data

Beyond knowing the details of who holds contracts, it is also important for public trust that people know how well the service is being delivered. Key Performance Indicators (KPIs) are often far too numerous in public contracts, but with a streamlined approach which identifies one or two main metrics as crucial, a public portal for comparative analysis would be relatively simple to produce and use. Continuing with the waste collection example, while it is difficult to accurately know exactly when each kerbside collection is made without adding another layer of bureaucracy to the process, a simple time quota for when collection is expected by for a whole ward could be logged by refuse teams without too much time spent. Shared with the public, this data could let people know how their council is doing but also how their experience lines up with other parts of their local authority and the wide region and beyond. Simple, broad metrics are increasingly hard to find in local government, but they are easy for workers to log and people to digest, and their publication can aid in the restoration of trust in the system.

⁸⁴ Van de Walle et al (2003) 'Public Service Performance and Trust in Government: The Problem of Causality'

Chapter 4 – Changing the culture of suspicion

4.1 Bringing trust to the fore

What has become abundantly clear is that things are not working out the way they should, and change is required to regain trust in the market and to better serve the British public. Yet, how is this to be done? As we have argued, policies with new approaches to the way in which public procurement is facilitated need to focus on trust. Trust between government and the private sector, public trust in government and the process of procurement. Additionally, the government needs to be honest with the public about what, when, why and how they use procurement in delivering public services. New approaches that focus on ‘better contracts’, in and of themselves, cannot be the answer to the problems that the sector is facing now.

The problem won’t be solved by contracts. It will be solved by the behaviour of the stakeholders and mutual trust, by increasing visibility of what they are doing and agreeing on new strategies that they can work towards together. Very important within this is a need for the public to regain its sense of faith in the market, to see that it is working for their benefit. An over emphasis on contractual terms and their consequences are not to the benefit of the public consumer. People want to see things, in practice, working for them in their day-to-day lives. The idea that there is a need for a shift away from a focus on rigid contractual terms in PPP is something that is also gaining traction in academia as well⁸⁵. A 2016 study undertaken at the Erasmus University Rotterdam on the impact of contract characteristics in PPP showed that contrary to previous and widespread thought, there is no substantive correlation between differing characteristics in the contract and improvement in performance or increased innovation. In fact, a bigger indicator of better performance the authors highlighted was trust between the partners in procurement procedures.

We need to remember to keep the public in mind not only when thinking of performance, but also thinking of appearance and perception. Both sides can do this by rebuilding a solid foundation of trust and working on new strategies and approaches to better deliver public services in a way that will be in line with the needs and concerns of the public and will be more visible to them in their day-to-day lives. This chapter aims to consider some of these approaches.

4.2 Improving transparency and clarity

What companies are my local council dealing with? Who collects my bins, and how much are they paid for it? When I call the council to report a pothole, who is my message passed on to? How does all this compare to the borough

85 Hans Klijn et al (2016) ‘The impact of contract characteristics on the performance of public–private partnerships (PPPs)’

next-door? These are not unreasonable questions. Yet, for the citizen seeking to answer them, there is no single place to go. Councils are obliged to publish waste contract details somewhere on their website, although there is no need to inform people of the lack of such a page if waste is handled in-house. Contract registers are provided, but there is a shocking lack of uniformity to the way the data is presented. Often a contracts register will be a spreadsheet featuring each individually-procured service and data spread over multiple columns, with little to no contextualising information.

It should not be this hard to ascertain whether Veolia or Biffa are collecting your wheelie bin. It should not be hard to see a list of the names, logos and websites of the principle suppliers for your local council. The fact that it is difficult is a huge advantage to political arguments for the total end of outsourcing, as it can be presented as being proof of these arrangements taking place in the shade. In reality, the lack of uniformity and poor presentation is more than likely down to a lack of coordination attached to the central edict that is the local government transparency code, and a lack of resources in local government itself. Nevertheless, if we are to be serious about rebuilding trust, the current state of affairs around clarity and transparency must change. Through services like Nomis UK, the ONS data explorer and Public Health England's 'Fingerprints' tool, citizens can now access clearly presented information on a range of public data. The same is needed for the outsourcing market, it must be brought into the light if it is to be trusted.

4.3 Improving public perception through new approaches

Along with increasing the visibility of outsourcing, trust can also be elevated by improving the impact of public sector contracting-out. A number of new approaches are being developed here and abroad to do this. A strategic rather than specifically contractual focus on these approaches, well-publicised, can help lift the perception of commercialism in government. This section explains the three approaches outlined in section 2.7 as guiding principles for a procurement strategy which can lead to a local procurement process capable of improving places in ways beyond the scope of the contracted service itself.

4.3.1 Social Value Procurement

Social Value Procurement (SVP) is a concept that in many ways underpins all the new approaches discussed in this chapter. This type of procurement aims at encouraging commissioning bodies to factor in considerations pertaining to the environment, societal benefits, and economic benefits such as job quality. Moreover, the reason why SVP is all-encompassing is owing to the fact that in order to achieve these benefits there need to be high levels of innovation and eco-friendly strategic frameworks in place. In the UK, the focus on SVP and wider societal considerations in procurement procedure was legislated on in 2012 under the Social Value Act. It 'requires commissioners to consider economic, social, or environmental benefits when buying services above the OJEU threshold', and 'can be seen as a tool to promote the wider uptake of a particular approach to commissioning for best value, namely social value ... the Act can be a tool to save money in the context of severe public procurement cost saving pressures'⁸⁶.

86 Cabinet Office (2015) Social Value Act Review

Social Value in East Sussex

One, perhaps less obvious, approach to social value is the commissioning of services related to public health. In East Sussex, a significant sum has been spent in the community through grants.

Developing a school health improvement plan has received widespread engagement from schools, with over 183 primary and secondary schools putting forward their own initiative ideas and participating to change their health approach. Embedding whole school health improvement activities include:

- School food menu redesign
- Participating in food activities and cooking
- Daily interventions in physical activity such as the Daily Mile
- Promoting active play and playground development
- Investing in staff to deliver high quality health and wellbeing
- Engagement with parents and the wider community

A first round of grants were conditional on ensuring the pupil's voice were heard in school plans, and as a result of priorities identified by children a second round has been introduced. The second round of funding prioritised mental health and wellbeing, with an extra £196,000 aligned to support whole school plans. Nurseries have also been engaged in making a change with over 90% of nurseries in Eastbourne, Hailsham and Seaford CCG and Hastings & Rother CCG signed up to the nursery transformation programme which provides an evidence informed framework to enhance dietary and physical activities.

Identifying the economic impact of primary and secondary prevention interventions have been taken from a variety of models and tools such as the PHE cardiovascular disease prevention tool. Other measurements have considered the impact outside of health and care for instance local productivity and benefits to the local economy. East Sussex is continuing to build on the success of the 2016/17 transformation programme by embedding approaches as part of everyday activity, including the second round of school grants and the development of a health improvement grants programme for community pharmacy.

Local authorities show higher awareness of the Act and willingness to take it on in their procurement procedures than central government, yet at the same time having awareness of it is quite separate to having a developed strategy incorporating it, which many do not⁸⁷. The Act has provided a 'competitive advantage' for smaller organisations in terms of boosting social value to local areas. An example of this, taken from the Social Value Act Review, is that of Station Taxis. The firm, who have been contracted by Sunderland Council, help safeguard University of Sunderland students by allowing them to use their student cards to take a taxi back to accommodation even if they do not have money to ensure their wellbeing. In addition to this, they provide a number of apprenticeships, and facilitate maths and English courses for a number of their drivers amongst a number of other things⁸⁸. The Act is a necessary and important step in bringing the concept of social value into the wider context of public procurement.

87 Ibid

88 Ibid

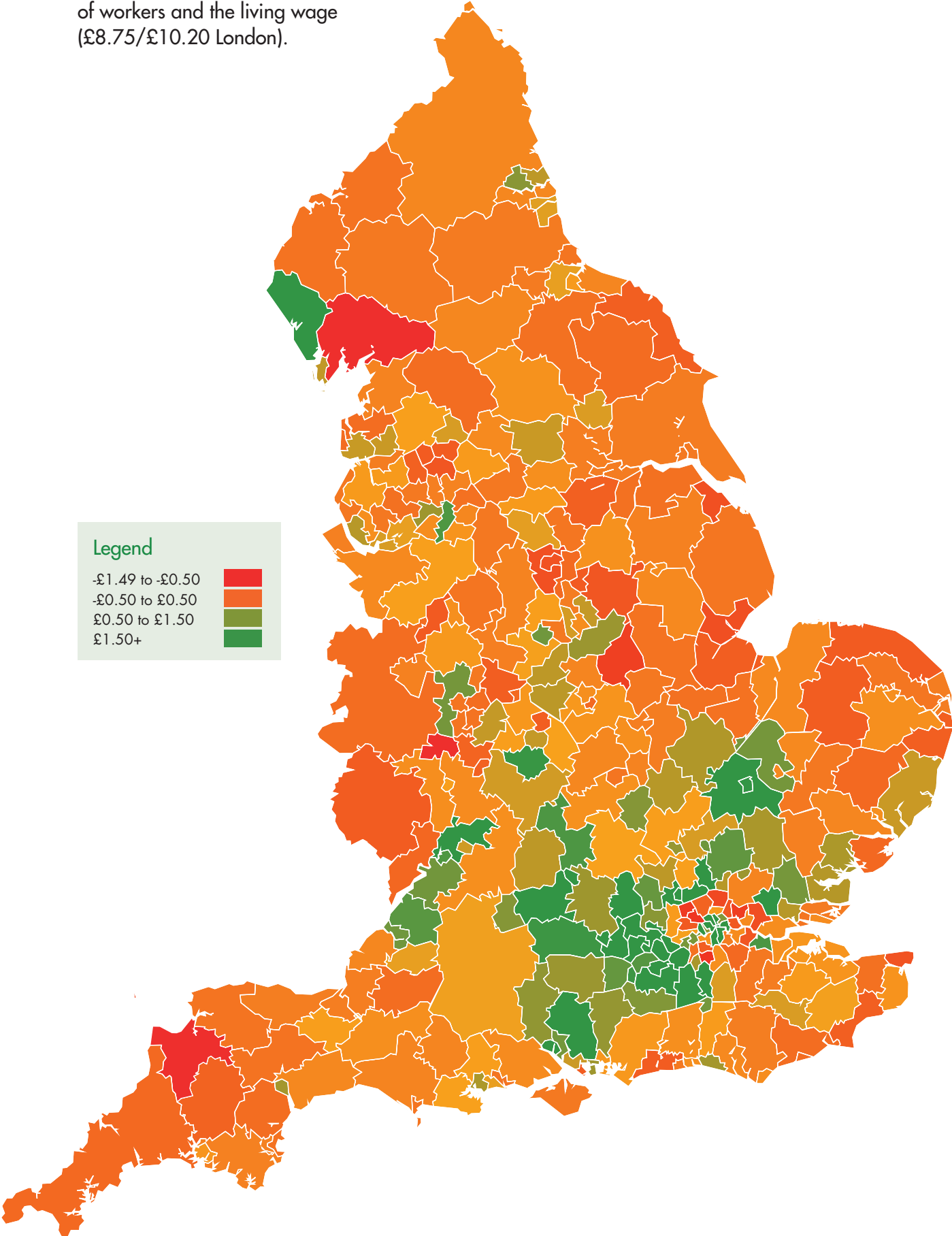
In a more general sense, a manifestation of social value procurement is the ability to provide decent job quality, especially in terms of payment. If we accept the idea that a necessary condition for a flourishing society is workers having good quality wages, then it would make logical sense for public procurement guided under the principles of social value to strive for this condition. Karen Jaehrling argues that for public procurement to work in such a manner and be able to ensure good work wages and conditions, it would need to be seen as a 'market embedding tool'⁸⁹. Specifically, this means creating space within the public procurement market for facilitating and providing conditions to meet these values that society is aspiring to. Viewed from this standpoint, public authorities hold major power in their ability to influence working conditions when it comes to outsourcing. This is especially true for setting the conditions that must be met when writing the contract in the tendering and bidding process.

The issue of adequate wages and job quality is something that has been discussed in our recent report, 'The Delivery of an Industrial Strategy', where we highlighted the need for local industrial strategies to address the geography of poor-quality employment by finding ways to provide better quality and greater quantity of jobs. For local authorities to redress this issue within the setting of public procurement, it is entirely conceivable for them to write strict pay clauses for potential employees within the contract being put out for tendering that the bidding private companies will have to commit to in order to win. Additionally, in order to ensure that workers are sharing in and enjoying the prosperity of their local area, local authorities should strive to fix Local Living Wages for their areas that can then be written into these contracts. Currently, while National Minimum Wage is law, the same cannot be said about the National Living Wage. Here, leaving the EU can provide an opportunity for changing this and enforcing it legally, as current EU Treaty guidelines to guarantee the right of freedom to provide services have in the past either restricted legislation or made doing so very difficult⁹⁰.

89 Jaehrling (2014) 'The State as a 'socially responsible customer'? Public procurement between market-making and market-embedding'

90 Public Sector Blog (2015) "Living wage" provisions in public procurement contracts

Figure 8: Difference between max. hourly wage of lowest-paid 20% of workers and the living wage (£8.75/£10.20 London).



Source: Annual Survey of Hours and Earnings/Living Wage Foundation

4.3.2 Innovation Procurement

The UK is seen as a 'first mover'⁹¹ in terms of public procurement of innovation (PPI). Indeed, the period of 2000 – 2010 was marked by a renewed push for this agenda with the launch of reports and strategies in the UK and EU to focus on using procurement as a method to promote innovation. Throughout this period, there were a number of reports published including from the Department for Trade and Industry in 2003, 'Competing the Global Economy: The Innovation Challenge', and the former Office of Government Commerce's 2004 report 'Capturing Innovation' that set out the need, the obstacles facing the public sector, and the methods through which they can be at the forefront of innovation through public procurement.

As previously touched upon, one of the UK's strategic frameworks through which PPI and Pre-Commercial Procurement (PCP) can take place is the Small Business Research Initiative (SBRI). It is a competition-based innovation programme that provides the opportunity for companies to interact with the public sector in creating innovative solutions to societal and policy challenges. It provides full Research and Design funding, and the company is then able to keep full intellectual property rights to market the product later on more widely⁹². At the same time, the SBRI is considered a policy mechanism that supports development through all stages that ends with the commercial availability of the product. Furthermore, it is run under EU rules for Pre-Commercial Procurement and can be mapped to the 'Procurement of Innovation Framework' that is used throughout the EU. This means that all organisations of all sizes throughout the EU can apply for a SBRI contract⁹³.

With the UK's impending withdrawal from the EU in March 2019, the ramifications and subsequent direction of Brexit on public procurement of innovation for the UK are yet to be seen. A briefing paper from the House of Commons library on Brexit and Public Procurement⁹⁴ states that immediately following the withdrawal day all EU directives, from which the UK derives its procurement regulations, will continue to apply for a period of time. At the same time, the British government is working to join the Government Procurement Agreement, which is governed by the World Trade Organisation, as an independent country.

The SBRI has put the UK at the forefront of PCP in Europe for a while⁹⁵, and the EU rules surrounding this allow for public procurers at all levels to engage with the initiative. Under the EU public procurement directives 2014/24/EU, 2004/25/EU, 2009/81/EC, local authorities fall under the definition of contracting authorities that are governed by public law and are therefore capable of outsourcing⁹⁶. Therefore, local authorities in the United Kingdom, who are responsible for their own procurement decisions, are free to use the SBRI as a tool in their procurement procedures. In their report⁹⁷ 'Encouraging Innovation in Local Government Procurement' the Local Government Association (LGA) highlighted the fact that there are only a few SBRI projects in local authorities, possibly owing to a lack of widespread knowledge of the initiative or PCP as a market making tool as a whole. Given the UK's departure from the EU, and how all aspects of PPI, PCP and procurement procedure in general are tied up in EU legislation, it is difficult at this point to give concrete advice on how best local authorities can apply PPI in the future. This is because the legal framework through which this is currently facilitated is subject to be changed in the coming

91 Uyarra et al (2013) 'UK Public Procurement of Innovation: The UK Case'

92 OECD (2017) Public Procurement for Innovation: Good Practice and Strategies

93 Ibid

94 House of Commons Library (2018) Brexit: Public Procurement

95 Supra note 90

96 Defined Term (2015) Public Procurer

97 LGA (2016) Encouraging Innovation in Local Government Procurement

years. This uncertainty has the potential to provide a point of renewal for PPI and local government, because we will have the capacity to reimagine the relationship between the two.

Within the same report the LGA drew on the need for a stronger top down leadership to overcome 'risk aversion, reject the comfort of existing solutions and embrace innovative opportunities'. In this regard, there needs to be a change in attitude in local political leadership: a shift to being open to innovation and the process of stimulating new ideas to meet the demands and challenges that come with an evolving world at the local level. While the report recognises the commitment of many local authorities to changing procurement culture to be more innovation focused, it still recognises that 'innovative procurement practices could be better integrated into social value delivery with specific social value outcomes and measures'.

Despite the fact that the UK is going to be leaving the EU, which will have inevitable, and yet unseen, consequences on procurement policy, Britain will remain a leader in best commercial practice. The fact that the UK as a whole has been a PCP pioneer in Europe is reason to have hope that we can continue to be a torch bearer for the rest of the continent. The report shines light on the way that local authorities have failed to seize the advantages of PPI as well as central government has, and provides a large overview of what needs to happen. A policy of 'wait and see around' future procurement innovation after the UK's departure from the EU would better serve the national interest than a rush to action.

4.3.3 Green Public Procurement

During and beyond Brexit, the UK is expected to follow the principles of Green Public Procurement (GPP), described as 'an initiative where environmental considerations are taken into account within the procurement process'⁹⁸. Government Buying Standards (GBS), which are a set of 'product specifications for public procurers ... set at 'mandatory' and 'best practice' levels'⁹⁹ are closely aligned to the European Commission led GPP programme. The policy framework, set by the Commission, aims to guide public authorities within the EU on how to reduce environmental impact and stimulate innovation in environmental technology¹⁰⁰ through setting measures which require 'having clear, verifiable, justifiable and ambitious environmental criteria for products and services, based on a life-cycle approach and scientific evidence base'¹⁰¹. The 2014 fact sheet on GBS and GPP produced by the Department for the Environment, Food and Rural Affairs (Defra) details the relationship between the two - wherein one crucial distinction is highlighted; while the GPP criteria are simply advisory, the GBS are mandatory for all central government departments and related organisations. Moreover, the UK has joined all other 27 Member States in agreeing to the EU proposal that '50% of all tendering procedures should be 'green', where 'green' means 'compliant with endorsed common 'core' GPP criteria ... The percentage would be expressed in both number and value of green contracts as compared to the overall number and value of contracts concluded in the sectors for which common 'core' GPP criteria have been identified'¹⁰². The extent to which this will be incorporated into UK law after March 2019 is yet to be seen, as Defra has not produced any position papers on the matter so far.

There are concrete examples of councils across England that have been trying to engage with more sustainable procurement in a way that also adds an element

98 Department for Environment, Food & Rural Affairs (2014) EU Green Public Procurement programme – Key facts

99 Department for Environment, Food & Rural Affairs (2014) Sustainable procurement tools

100 European Commission (2016) Public Procurement for a Better Environment

101 European Commission (2018) GPP Criteria: Background and Approach

102 Supra note 98

of social value to the local area. For example, Hackney Council¹⁰³ has a list of purchasing policies on their website that detail three conditions that heavily influence the procurement process. These include the need for goods and services to be environmentally and ethically sound, help boost and add value to the local economy, and be based on the best value with pricing, quality performance, availability, environmental sustainability, and safety conditions. In today's society it is quite hard not to pay attention to issues of environmental sustainability, given a renewed and heavy focus on the topic of climate change. Given this, local government can apply this in a number of ways - and not only in a structured, top-down, policy driven manner. Just as with the case of Hackney, councils across the country can incorporate sustainability and social value considerations for the local community into their procurement procedures.

As they are public authorities, local authorities and councils are considered public procurers who can engage with the EU's GPP policy. This can be seen with the case of East Ayrshire Council whose case has been exemplified by the European Commission as the UK's first example of their GPP policy in practice¹⁰⁴. The Hungry for Success initiative aimed to promote healthy eating and nutritionally enriching school meals in the area through changing the council's procurement practices to reflect Soil Association guidelines on sustainable food¹⁰⁵. The procurement objectives 'were to transform the menus on offer to reduce reliance on processed food and ensure good nutritional standards. At the same time, reductions in packaging and a switch to organic produce were intended to reduce the environmental impact of school meals'¹⁰⁶.

In practical terms of the criteria used, the contract was divided into nine different areas dealing with the supply of meat, fish, poultry, vegetables, milk, dried goods, fruit, cheese, and eggs. Furthermore, within the technical specifications of the tendering process, bidders are required to submit detailed specifications regarding their approach to organic certification, compliance with animal welfare standards, clear details of sourcing, production and transport arrangements. In the award criteria, 'use of resource' accounted for 10% of the consideration in the most economically advantageous tender. 'Use of resource' refers to the supplier's proposal for reduction in environmental impacts, contribution to sustainable development, and contribution to recycling amongst other things.

The results of this showed this approach by the council meant that 'for every £1 spent through this approach brought up to £6 back to the local community through employment, environmental, health and social benefits...The uptake of school meals has also increased since the introduction of the strategy – contrary to a national trend downwards'¹⁰⁷. The example of East Ayrshire Council shows a working example of a council in the UK that applies GPP policy to their procurement procedures, which has brought widespread benefit to the local community, businesses, and environment. Clearly, the situation of each council is different, but the example is indicative of it being run and working well by and for local councils in the country. Engaging in these practises and keeping the public well-informed of their existence can boost local patriotism and perceptions of the council and its suppliers.

103 Hackney Council (2016) Purchasing Policies and Standards

104 European Commission (2012) GPP: A Collection of Good Practices

105 Food for Life (2018) Whole Setting Approach

106 Supra note 102

107 Ibid

4.4 Recommendations

We summarise below our recommendations to central and local government.

- Local authorities should develop procurement strategies in collaboration with neighbouring authorities and the private sector to outline the key goals for service delivery, sustainability and innovation
- Local authorities should co-brand all contracted-out services with the service provider to stress partnership and promote knowledge of the everyday effectiveness of many contracted services.
- Local authorities should be encouraged and incentivised to employ relationship managers on the demand-side, in recognition of the importance of long-term relationship building to developing mutual trust.
- Relationship managers should be given leeway to overrule the need to publish all contracts on ContractFinder - under conditions where awarding an existing provider would work to strengthen the bond between the provider and the local area.
- Cabinet Office guidelines for procurement should be refocused away from rigidity and towards flexibility, giving both sides greater room to manoeuvre.
- The Local Government Association should oversee the development of a single platform for local government contracts data – using as a basis for imitation Nomis UK, the ONS data explorer and Public Health England’s ‘Fingerprints’ tool.
- This platform should also be inclusive of any relevant Key Performance Indicators of the service.
- When Britain leaves the European Union, local authorities should be allowed to give preferential treatment to employers paying the living wage in their area.

About The Norse Group

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