

Government outsourcing

What has worked and what needs reform?

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About this report

The role of external suppliers in delivering services to the public and to government has been expanded significantly over the past 40 years. This report assesses where outsourcing has worked and where it has not, and why, and makes recommendations on how to improve the way government contracts out services.

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Summary

Government outsourcing is at a crossroads. Government spends tens of billions of pounds a year on services delivered by external suppliers. Yet a string of high-profile failures has put Britain's outsourcing model under intense scrutiny. The Labour Party has called for a wide range of services to be brought back into government hands.

But in some areas, outsourcing has delivered substantial benefits, saving money and improving services. Instead of preferring public or private on ideological principle, government should base contracting decisions on what has worked and what has not, and why.

Outsourcing, which we define as the private or voluntary sector delivering services to the government or the public after a process of competitive tendering,^{*} has been expanded over the past four decades. Beginning in local government with services such as waste collection, successive governments have extended outsourcing to areas including front-line services and major information technology (IT) projects.

They have done so with a largely consistent rationale: that applying market mechanisms and private sector expertise to the work of government can reduce costs, raise quality and achieve wider benefits such as innovations and improved public sector efficiency.

In this report, based on more than 50 interviews with current and former government officials, suppliers, academics and industry experts, we assess whether outsourcing has met those aims.^{**} We review the evidence in 11 service areas: waste collection, cleaning, catering, maintenance, back-office human resources (HR) and IT, prisons, health care, employment services, adult social care, private financing of construction^{***} and probation.^{****} Our judgment of each is presented in Table 1 (we include a full summary of each service area in Chapter 2).

^{*} This excludes the procurement of goods, such as paperclips or information technology (IT) hardware, and works, such as construction projects (although we include the financing and maintenance of construction projects, which are services).

^{**} We judge success as meaning that outsourcing has improved the cost per unit of quality of delivering a service or delivered wider benefits, including introducing innovations or improving performance elsewhere in the public sector.

^{***} Financing is a service that companies provide to government. It is also a method of outsourcing that is used across different areas, unlike the other service areas we have assessed. We have included it because it meets our definition of outsourcing and it has played a crucial role in the extension of the role of the private sector.

^{****} There are many other areas of outsourcing, but we selected these to cover the largest and most important services that government buys.

Table 1: Has outsourcing in the UK worked?

Sector	Rating*
Waste collection	Green
Cleaning	Green
Catering	Green
Maintenance	Green
Back office (HR and IT)	Green/Amber
Prisons	Green/Amber
Health care (clinical services)	Amber
Employment services	Amber
Adult social care	Amber
Private financing of construction	Amber/Red
Probation	Red

* **Green:** there is consistent evidence of savings, quality improvements or wider benefits, including innovations, as a result of outsourcing or competition; **Amber:** the evidence is mixed, with some studies showing no difference, others showing cost or quality improvements and others showing increased costs or lower performance or quality; **Red:** there is consistent evidence of cost increases or lower performance or quality.

Outsourcing has worked best in 'support services' that are relatively simple to contract for and deliver: waste collection, cleaning, catering and maintenance. When these services were first outsourced in the 1980s and 1990s, it delivered large savings, often around 20% of annual operating costs, mostly while maintaining levels of quality. Companies therefore achieved significant efficiencies, although some savings were driven by paying staff less.

Over time, the public sector has become more efficient in these areas, meaning the comparative advantage of the private sector has got smaller or disappeared. This has led some contracting authorities to bring services back in-house. But that does not mean outsourcing has not worked – early savings have effectively been 'banked', and improving public sector efficiency was a key motivation for the exercise. It is doubtful that if provision were returned entirely to government hands it would deliver the levels of efficiency currently achieved while competitive pressures remain from private services.

For front-line services, the picture is more mixed. Private prisons are cheaper to run and have introduced innovations, including in how staff treat prisoners. They perform better on some quality metrics and worse on others, but the introduction of competition has improved performance in public prisons. Outsourcing has provided extra capacity in the NHS and, in some cases, improved the performance of public hospitals, but there is a lack of comparable data on cost and quality and some case studies show damaging failures.

Probation is an exception: outsourcing has failed on every measure, harming ex-offenders trying to rebuild their lives. The heavy costs show why government should be cautious about extending outsourcing of front-line services and only do so when it is confident it will work.

Outsourced IT services, on balance, appear to have often been more efficient and modern – despite multiple well-reported failures. Private financing of construction projects, on the other hand, has been more expensive while achieving unclear benefits.

Politicians and senior officials often cite 20%–30% savings when making the case for outsourcing services today.¹ But while this was possible for some services outsourced in the 1980s and 1990s, we found little evidence that such savings are available today, whether for services outsourced for the first time or on second- or third-generation contracts. Where there is more recent evidence of savings, they are typically of around 5%–10%.

Across these areas, we found that government lacks the evidence it needs to inform current decisions on how to deliver services. This includes a paucity of evidence on the cost and performance of services that the public sector delivers in-house, not just those that are outsourced.

Of course, public or private is far from the only determinant of success or failure. Management, funding, staff capabilities and much else matter – whether a service is outsourced or not. But government should understand, as best it can, where outsourcing has worked, and what benefits it can deliver.

It must also understand why different outsourcing projects succeed or fail. The Institute for Government [has previously showed](#) that there are several conditions that make outsourcing more likely to succeed.² Above all, these include:

- the existence of a competitive market of high-quality suppliers
- the ease of measuring the value added by the provider
- the service not being so integral to the nature of government as to make outsourcing inappropriate.*

Successes tended to meet these conditions. For example, successful IT contracts have drawn on a strong market of good suppliers and established robust governance metrics. Failures breached these conditions. In probation, there was no market and officials could not adequately define quality or measure performance. The decision to outsource was wrong.

In addition to these characteristics in service types, we found that four other key themes came up consistently in case studies of contracts that failed or worked less well, and which were avoided in contracts that worked.

First, government did not always engage with the market early in running procurements or establish a sufficient understanding on both sides about the service that were being outsourced. This often led to problems over the lifetime of a contract, such as disputes and cost overruns.

Second, an excessive focus on the lowest price and an insufficient assessment of quality in selecting bids undermined many contracts. While outsourcing can reduce costs, government must balance this against the minimum level of quality it needs in a service. Too often, it has outsourced services in pursuit of unrealistic savings and without a realistic expectation that companies would deliver efficiencies.

Third, large contracts have failed when government has transferred risks that suppliers have no control over and cannot manage, rather than those which suppliers can price and manage better than government. Government should also not think that it has outsourced risks that will revert to it if a supplier fails – as the provision of public services will always do.

* We noted that where these conditions are not met, there are challenges for in-house provision too, but that applying contractual mechanisms will create more acute risks.

Fourth, even when government negotiates and writes a good contract it often does not secure the outcomes it should as a result of weak contract management. Contract managers must have the capabilities and information they need to ensure good performance.³

Recommendations

In areas where outsourcing has failed, bringing services back in-house could improve them. But bringing swathes of services back into government hands by default risks throwing away the significant benefits that outsourcing can deliver.

Public support for such a policy is likely to increase if government continues to suffer repeated failures. Government must therefore address problems in the areas of weakness that we identify in this report: the decision to outsource, market engagement, bid selection, risk transfer and contract management.

In February 2019, the Cabinet Office published the *Outsourcing Playbook*.⁴ It sets out best practice, including in these areas. If this is fully implemented, it would be a major step towards addressing the persistent problems that we describe in this report.

But several of its stipulations were policies already and have been routinely ignored, partly because government departments have lacked the capabilities or incentives to implement them. Setting out best practice alone will not be enough to change behaviour and culture that is ingrained.

We make recommendations on how to ensure that the key problems we identify in this report are addressed. We assess the *Outsourcing Playbook* and set out what is needed to ensure that it is translated into the practical changes that are required. We make recommendations on resources, staff capability, commercial skills and improving scrutiny and accountability. In addition, we set out how to improve the evidence that underpins contracting decisions.

First, we make recommendations on how to ensure that the Cabinet Office and other government departments have sufficient resources to oversee implementation of the *Outsourcing Playbook*:

- **At the 2020 spending review, the Treasury should ensure that the outsourcing team in the Cabinet Office has sufficient long-term funding to implement the *Outsourcing Playbook* and train contract managers.**
- **Permanent secretaries should work with commercial directors and HR directors to ensure that officials have the time and resources they need to implement the *Outsourcing Playbook*.**
- **The government chief commercial officer should commit to publishing an annual progress review of the *Outsourcing Playbook*, beginning in 2021, assessing the extent to which different measures have been adopted and the performance of complex outsourcing projects.**

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- **All public bodies, including the NHS and local authorities, should adopt relevant policies from the *Outsourcing Playbook*, based on consultation with the Cabinet Office.**

Second, we make recommendations on the commercial skills and capabilities officials need to improve the way government outsources services:

- **Permanent secretaries should work with commercial directors and HR directors to ensure that contract managers are involved in contract negotiation.**
- **All public bodies, including local authorities, should ensure that they have up-to-date 'commercial blueprints' identifying where they lack skills and experience.**

Third, we set out how to improve scrutiny of, and accountability for, outsourcing decisions to ensure ministers and officials are accountable to Parliament and the public for the way they decide to deliver public services, and government collects the information needed to support this.

- **The Treasury should issue a 'dear accounting officer' (DAO) letter to all accounting officers to remind them of their responsibility to publicly challenge outsourcing plans that are unfeasible, poor value for money or where the timescales or technical requirements pose a serious risk of poor performance.**
- **The chief executive of the civil service and the government chief commercial officer should ensure that the approvals process for outsourcing projects is a rigorous assessment of departments' compliance with the *Outsourcing Playbook*.**
- **The Cabinet Office should adopt a 'comply or explain' approach to the *Outsourcing Playbook*, with the minister for the Cabinet Office providing political support to officials if departments do not adhere to it.**
- **Select committees should ensure that they scrutinise plans for significant outsourcing projects, before they begin, against the principles in the *Outsourcing Playbook*.**
- **Select committees should recall ministers and officials who have subsequently left their post to answer questions about the decisions made during the inception of a project, especially where subsequent under-performance or failures have resulted in harm to the public.**
- **The Cabinet Office should mandate clear standards for the collection of data on the performance of outsourced contracts in line with the Open Contracting Data Standard. This should include key quality metrics and any contract amendments. It should provide guidance on how access to performance data should be written into contracts.**
- **The Cabinet Office should establish a team with the capacity to analyse data on the outcomes of complex outsourcing projects and produce insights to inform**

best practice. This team should also be responsible for producing the annual progress review described above.

- **Government should update freedom of information (FOI) laws to ensure that the public has access to key information about services delivered by external suppliers, such as who holds contracts and how they are performing, while including a reasonable threshold for exempting small suppliers.**
- **The Cabinet Office should set more ambitious targets for improving its procurement data, drawing on the recommendations in the Institute for Government’s [previous report](#) on government procurement.⁵**

Fourth, we make recommendations on how to improve the evidence that underpins contracting decisions:

- **Ministers and senior civil servants should ensure that their claims about the impact of outsourcing on the cost and quality of services are based on rigorous evidence.**
- **The Cabinet Office should set out a detailed strategy for how it will address fundamental gaps in evidence on the outcomes and effectiveness of outsourcing.**
- **The Cabinet Office should assess how departments plan to collect evidence and evaluate future projects as part of the approvals process. Where a service is being outsourced for the first time or with a new delivery model, plans should include ensuring that there are reasonable public sector comparators in order to evaluate performance.**
- **The Cabinet Office should collate information centrally and ensure that all departments use it to enhance reference class forecasting on outsourcing projects.**
- **Contracting authorities should work with suppliers and external experts to develop rigorous case studies of contracts, including in areas where outsourcing has worked.**

1. How has outsourcing evolved?

From front-line services to back-office functions and IT systems to financing infrastructure projects, outsourcing has become a core part of how government operates. But following a series of high-profile contract failures and the failure of two of government's biggest suppliers, the outsourcing model has come under intense scrutiny.

Outsourcing has grown to play a huge role in the British state

Private and voluntary providers have always played a role in providing a wide range of public services. Until the late 19th century, public services such as education and welfare were provided by an ad-hoc mix of private, voluntary and local authority providers. In many areas, voluntary organisations created and funded services before they were delivered publicly.¹ Even as the state took on responsibility for services, and governments expanded many of them significantly after the Second World War, independent providers continued to play an important role. For example, since the NHS was formed in 1948, GPs have operated as private businesses.²

Yet at the end of the 1970s, most of the functions of local government, central government and public bodies were still delivered overwhelmingly by the public sector, including activities such as human resources (HR), finance, recruitment, customer management, facilities management, maintenance and waste collection – as well as a range of front-line services including prisons, welfare and social care.³ Local authorities had largely ignored earlier attempts by central government to encourage them to outsource,^{4,5} which we define as the delivery of services to the public or the government following a process of competitive tendering.

The Thatcher government, elected in 1979, set out to change this. It argued that the public sector had grown too large and the trade union movement too powerful, and that this was contributing to the UK's poor economic performance.⁵ Britain had been called the "sick man of Europe" in the 1960s and '70s as a result of high inflation, sluggish growth and industrial strife.^{6,**} Thatcher saw introducing competition as a way to lower costs, reduce the size of the public sector workforce and counter strikes.^{7,***}

* Harold Macmillan attempted to open contracts to competition in 1959, and the Local Government Act 1972 gave local councils further powers to outsource services, but few had taken these up.

** In 1979, 29m working days were lost to strikes.

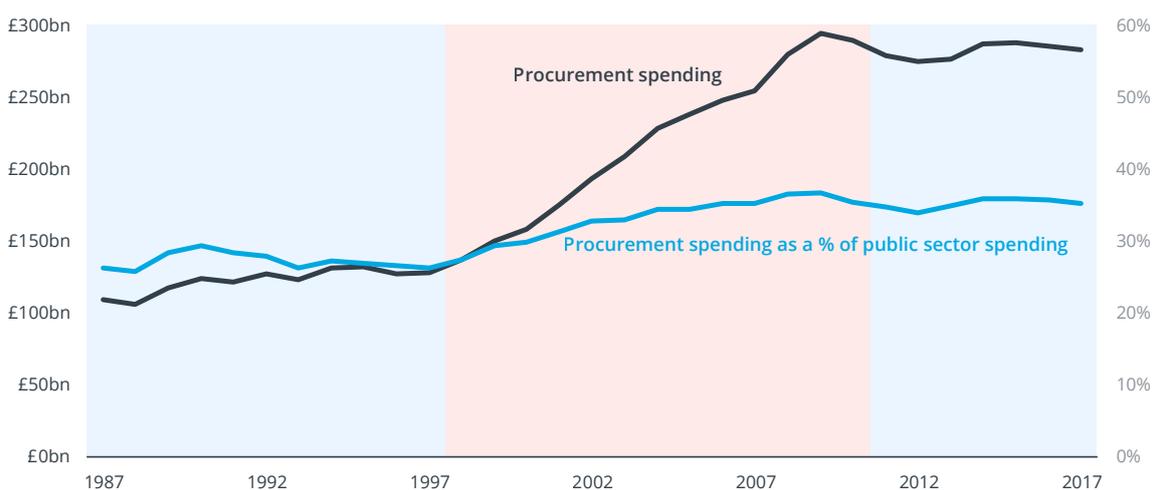
*** The number of people employed in public sector corporations fell by more than 1.5m between 1979 and 1991, as parts of the state were either privatised or outsourced.

Forty years on, external suppliers now undertake a huge range of activities on behalf of government:

- They operate prisons, deliver probation services, assess benefits claimants, provide employment training, offer routine NHS operations and deliver social care.
- They provide immigration enforcement and accommodate asylum seekers.
- They provide catering in schools and collect waste for more than half of Britain's local authorities.
- They run the information technology (IT) systems that government relies on to collect taxes, pay pensions, look after savings and manage medical and criminal records.
- They are responsible for Britain's largest infrastructure projects, building hospitals, schools and roads.

Government now spends £292 billion (bn), more than a third of all public spending, on procuring goods, works and services from external suppliers, up from £112bn in 1987, the earliest year for which there are comparable figures (see Figure 1).^{*} A significant proportion of this spending, particularly in the earlier years, is accounted for by procurement of goods and works, which falls outside our definition of outsourcing; however, it is not possible to accurately disaggregate spending on services in the procurement data.⁸ Most of this spending is with private companies, with around 4% accounted for by voluntary organisations, although the proportion is slightly higher for front-line services.⁹

Figure 1: Public sector procurement spending, 1987–2017



Source: Institute for Government analysis of data from the Office for National Statistics' Blue Book dataset. Figures are shown in June 2019 prices.

^{*} £292bn is for 2018–19 from HM Treasury, PESA (Public Expenditure Statistical Accounts) data.

Outsourcing has been extended under successive governments

The growth in government outsourcing had three phases. The Thatcher and Major governments began by outsourcing services that were relatively simple to contract for and deliver, such as waste collection and IT support. They compelled local authorities, and later central government departments, to open more services up to competition through the extension of compulsory competitive tendering. They also started to use private providers to deliver front-line public services, opening the first privately managed prison, HMP Wolds, in 1992.

The Blair government more than doubled public procurement spending in a decade, extending the role of private providers, particularly in areas such as health and welfare.^{10,*} It continued to pursue efficiency improvements, but also emphasised using 'choice and competition' to incentivise better performance across the public sector and modernise how services were delivered. This was accompanied by large increases in spending on public services.

New Labour also greatly expanded the use of Private Finance Initiative (PFI) contracts – complex, long-term financing arrangements for public sector projects including schools and hospitals – from a handful of contracts a year before 1997 to an average of 55 a year.¹¹ In 2007, a government review of the UK outsourcing industry called it the “most advanced in the world”.¹²

The coalition government continued to extend the role of outsourcing, opening new markets in areas such as probation and increasing the use of private providers in health care and welfare.¹³ However, this was part of an austerity programme, which sharply reduced overall public sector spending, and overall spending with external suppliers decreased compared with the previous decade. While the coalition government saw outsourcing as a tool to help achieve spending reductions, it also initiated a programme to curb the profits of some large suppliers, particularly IT companies, which it deemed excessive.^{14,**}

Interviews with suppliers, industry experts and former government officials we carried out for this report suggest that companies' view of working with government changed over this period. In the early decades, government was viewed as a very attractive customer offering good profits, growing markets and the opportunity for early entrants to expand quickly. In some areas, companies appear to have benefited from government's commercial naïvety, such as when new models such as PFI were first introduced (many interviewees from government and industry told us that the companies “made out like bandits” on early PFI deals).

* Turnover of the more narrowly defined 'public services industry', which excludes spending on the procurement of goods, also more than doubled between 1996 and 2008, from an estimated £42bn to £79bn in real prices. This estimate is based on HM Treasury, Public Expenditure Statistical Accounts (PESA) data; the split of procurement spend into goods and services was estimated using Office for National Statistics' National Accounts Supply-Use Tables, and Oxford Economics conducted further analysis to adjust the data.

** The Cabinet Office led a programme of renegotiations, which led to suppliers handing back tens of millions of pounds on existing contracts. Suppliers accepted this, partly because government indicated that it would influence whether they won further work.

But, as the industry grew, markets became more competitive and, over time, governments have become more commercially savvy. Since 2010, outsourcing markets have become less attractive, with a dedicated effort from government to reduce costs and squeeze excessive profits and, in some areas, transfer risks that the private sector struggles to price and manage.*

There was consensus among interviewees that, in some areas, levels of profits were too high. For instance, the coalition government found that some IT companies' margins with government were 5% higher than with their UK private sector clients for the same service, despite government being their largest customer.¹⁵ Controversial at the time, addressing these excessive profits was necessary – and several private sector chief executives have agreed that they should not expect to make really large profits on public sector work.¹⁶

Governments have sought to benefit from competition and private sector expertise

While the emphasis has changed under different governments, a consistent rationale runs through the outsourcing experiment: that applying market mechanisms and private sector experience to the work of government can reduce costs and raise quality by improving efficiency, bringing in external expertise and acting as a spur for innovation.

Advocates of outsourcing argue that competition is a powerful tool for lowering costs because companies are incentivised to find efficiencies, although there has been debate over whether competition is an efficient mechanism across all government work.^{17,**} Politicians and industry experts – including Professor Gary Sturgess, who conducted a review of the UK outsourcing sector in 2017 – have also said that the 'threat of competition' can have a positive effect on the quality of existing services in the public sector.¹⁸ In many cases, politicians have cited poor existing services in the public sector as a reason to outsource.¹⁹

More broadly, advocates argue that private sector companies have expertise and structural advantages that enable them to deliver more efficient or better services.²⁰ In some areas, such as IT, companies already provide a range of services to the private sector and have developed significant expertise and made investments, such as in new technologies. In other cases, such as many support services, like catering, companies can draw on economies of scale. Government has also chosen to outsource activities because it believes the private sector can price and manage risks better or more cheaply, or to free up management time to focus on core activities.

Private companies have more flexibility than public sector organisations over how they employ staff. Advocates argue that this enables them to manage their workforces better and improve efficiency, for instance by offering performance incentives. Critics argue that companies cut costs by reducing pay and pension entitlements.²¹ While regulations introduced in 2006 ensure that staff transferred from the public sector to

* We discuss government's approach to risk transfer in more detail in Chapter 3.

** There has been debate throughout this period about how far competition should be extended in the public sector: some argue that the benefits of the market could apply to almost any area of government activity, while others argue that in certain areas the market is in fact an inefficient mechanism, which does not deliver the best outcomes.

the private sector have their rights protected, outsourcing companies taking on new workers still have considerable scope to make changes.^{22,*}

Outsourcing has come under intense scrutiny

However, after four decades of growth, the UK's approach to outsourcing is facing intense scrutiny. Repeated failures on individual contracts have damaged public trust. The liquidation of one of government's largest suppliers, Carillion, and the 'pre-pack administration' of another, Interserve, in the past two years have also highlighted wider problems in government's outsourcing markets.

A series of high-profile contracts have failed, damaging public trust in outsourcing

Figure 2 (overleaf) shows a string of recent failures on high-profile contracts, which we define as where outsourcing has led to an unacceptable reduction in the quality or reliability of a service. These have damaged the reputation of some outsourcing companies and prompted questions about their ability to deliver services well, particularly in sensitive areas.

These contract failures – including in services that vulnerable people rely on, such as welfare assessments, prisons and probation – appear to have contributed to falling public support for outsourcing. Asked in a 2014 poll whether they trusted outsourcing companies to deliver public services, almost two thirds of the public said they did not, with a further 15% saying they did not know.^{23,**} A survey by Ipsos MORI showed that the proportion of people who think that private companies should not be involved in delivering public services in any circumstances increased from a quarter in 2001 to a third in 2018.^{24,***} A 2015 study showed two thirds of people thought contracts should be more transparent.²⁵

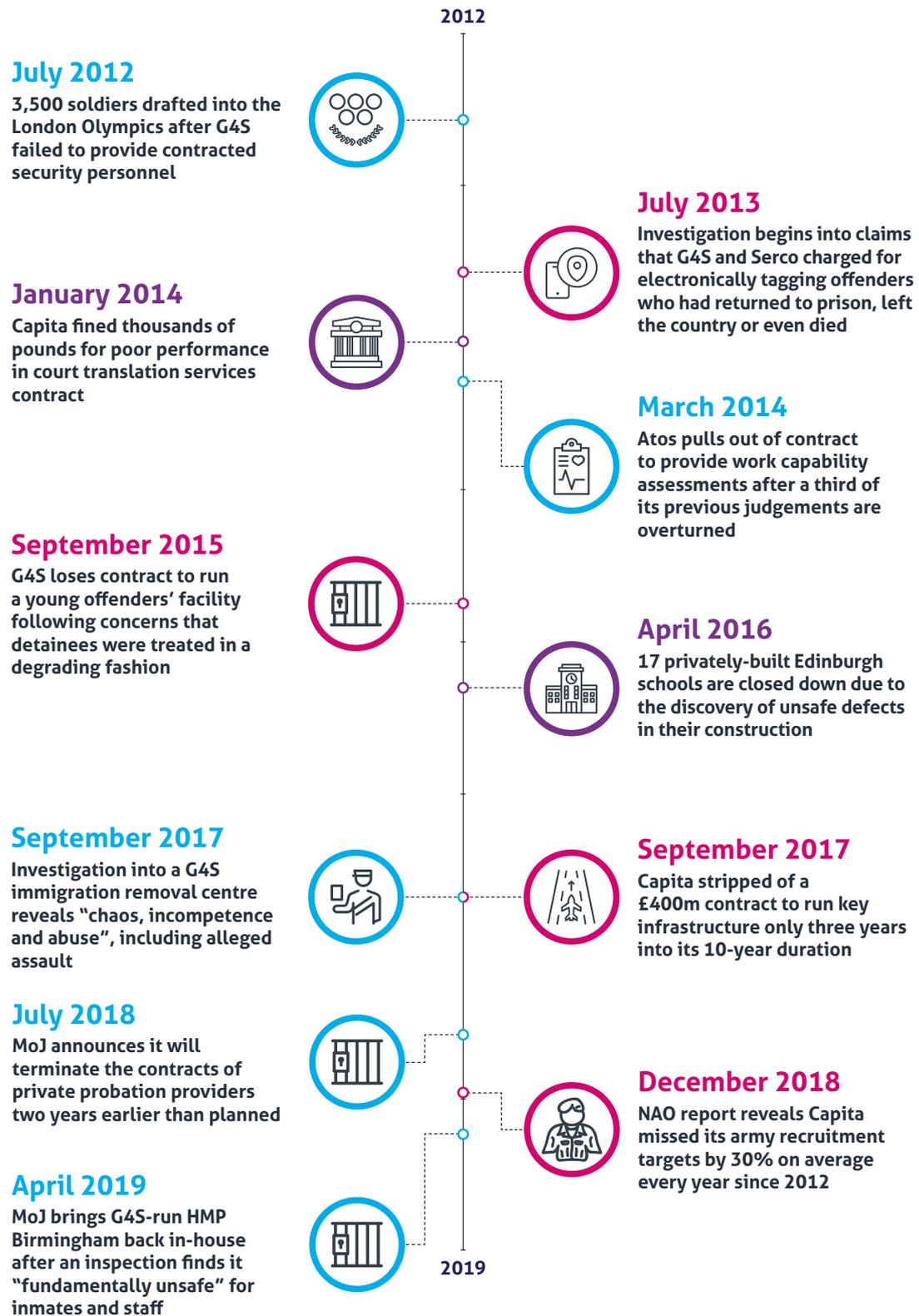
The government itself has acknowledged that “outsourcing is under intense scrutiny”.²⁶ This scrutiny is justified, although it would be wrong for voters to conclude that outsourcing has failed.

* The Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) state that when an employee is transferred to a new company through outsourcing, their employment rights are maintained and can be enforced. But TUPE does not apply when services are fundamentally not the same.

** We found no more recent polling on this question.

*** The latter poll only covers 2000–08 as the question was not asked in later surveys.

Figure 2: High-profile contract failures, 2012–19



Source: Institute for Government analysis.²⁷

The failure of two suppliers has highlighted wider problems in the market

In addition to failures of individual contracts, government has also been faced with two of its largest suppliers – Carillion and Interserve – entering liquidation and administration respectively, which has highlighted wider problems with outsourcers' business model and government's stewardship of the market.

In January 2018, Carillion – the UK's second largest construction and services company with 18,000 employees in the UK, global revenues of more than £5bn and hundreds of government contracts including for High Speed 2 (HS2), Army homes, schools and prisons – collapsed.²⁸ The services Carillion provided to the public continued uninterrupted with other suppliers taking on the contracts. But some construction projects were terminated* and the company's liquidation cost taxpayers an estimated £72 million (m).^{29,**}

At the time of its collapse, the firm also owed around £2bn to 30,000 of its suppliers, subcontractors and short-term creditors,³⁰ most of whom lacked trade insurance against its default.³¹ As most of its assets went to secured creditors during liquidation, many subcontractors suffered.³²

In March 2019, Interserve – Britain's largest provider of probation services, which also cleaned and maintained schools, hospitals and train stations – entered 'pre-pack administration'. This means it arranged to sell its assets to a buyer before appointing an administrator to facilitate a sale, allowing it to continue to provide services under the ownership of its banks.³³

Companies failing is a normal part of any well-functioning market but these two companies are not alone in facing problems – in fact, the wider market is showing signs of weakness. As Figure 3 shows, some the UK's largest outsourcers*** have seen their overall profit margins fall since 2010, while several companies have experienced large fluctuations as a result of fines on specific contracts or impairment of goodwill.**** These figures include international and private sector work, but these companies carry out a significant proportion of their work for UK government.*****

* Two PFI hospital construction projects were stopped. Liverpool Hospital has still not been completed. See: National Audit Office, *Investigation into Government's Handling of the Collapse of Carillion*, National Audit Office, 2018.

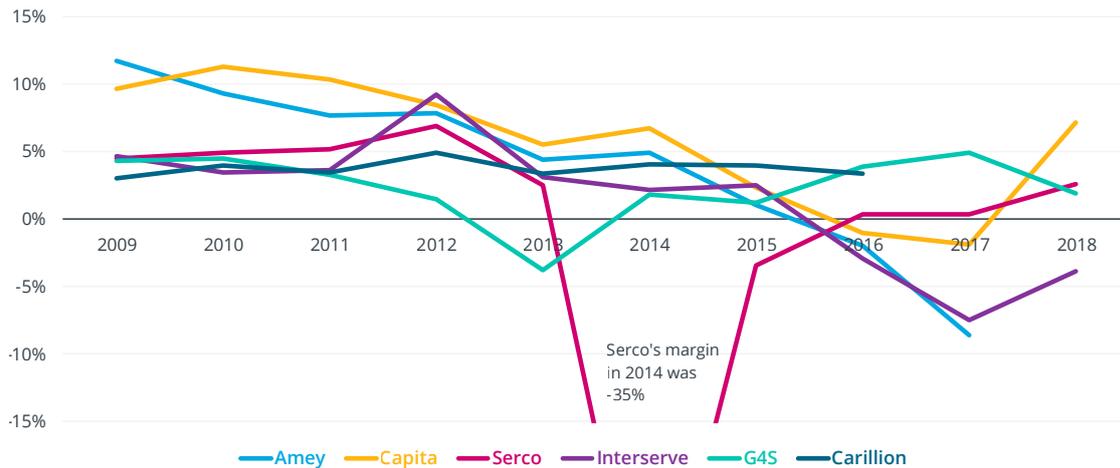
** The National Audit Office originally reported £148m but the Official Receiver provided an update in December 2018, saying that the figure was actually £72m.

*** We have selected companies that do a large proportion of their work for government across a range of areas of government outsourcing. Other companies, such as IT companies, may have larger government spend, but they do most of their work for the private sector, and we are unable to distinguish government from private sector work in their accounts.

**** Investopedia defines goodwill as being "recorded after a company acquires assets and liabilities, and pays a price in excess of their identifiable value Goodwill impairment is an accounting charge that companies record when goodwill's carrying value on financial statements exceeds its fair value."

***** Companies do not always clearly separate UK government revenue in their annual reports and accounts. The UK government accounted for around 40% of Serco's and Carillion's most recent revenue figures, and it is Interserve's largest customer. Capita generated 92% of its 2017 revenue in the UK and 46% of its revenue was from the public sector. G4S generated around a third of its 2018 revenue from UK work and 21% from public sector work. Amey's annual report does not disaggregate public sector revenue, but its Highways, and Facilities Management, Justice and Defence divisions represent around 45% of total revenue.

Figure 3: Profit margin for selected large UK outsourcing companies



Note: The profit margin given is pre-tax profit after expenses (including interest, depreciation and amortisation) as a percentage of sales. There are considerable fluctuations due to exceptional charges such as penalties and impairments to goodwill. Carillion did not file accounts after 2016.

Source: Orbis analysis of annual reports and accounts for selected companies.

There are several key reasons for these companies' volatile or declining profitability, including the nature of the sectors they operate in and company executives making poor management decisions and pursuing risky growth strategies. But government's approach to outsourcing and market stewardship has also played a role.

The construction sector, which several of these companies operate in, is inherently volatile, while profit margins have also declined across the general contracting sector since 2012, not only in public sector outsourcing. The contracting process carries significant risks (whether government is the client or not), as demonstrated by some of the exceptional charges outsourcing companies' accounts have carried.

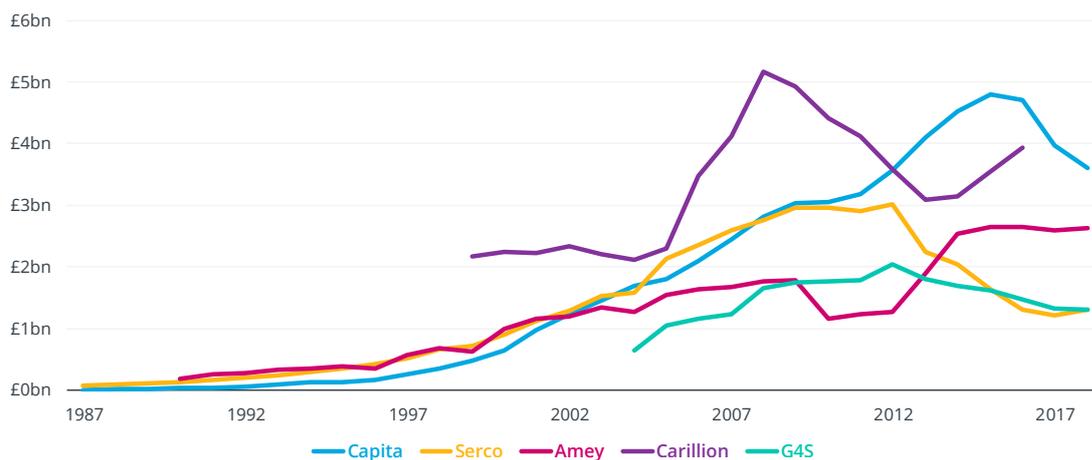
Carillion's downfall was mostly caused by poor management decisions and project management, including taking on risky contracts in the UK and abroad.^{34,*} A dispute over payments on large contracts in Qatar and big losses on the Royal Liverpool Hospital and Battersea Power Station destroyed the company's cash flow, which fell from £512m in December 2016 to £29m a year later.³⁵ A joint parliamentary inquiry found that it disguised its problems with aggressive accounting practices, which were allowed to persist too long as a result of weak checks and balances.³⁶

Interserve's problems were largely the result of its decision to take on contracts in the UK energy sector – an area in which it had insufficient expertise, according to Debbie White, who was appointed as its CEO in September 2017.³⁷ It also held loss-making contracts in probation, where it also had little prior experience, and facilities management.³⁸

* A joint inquiry into the collapse of Carillion by the Business, Energy and Industrial Strategy and Work and Pensions Select Committees placed most of the blame on the company, calling it "a story of recklessness, hubris and greed". The report also argued that Carillion's collapse signalled the failure of a wider system of checks and balances, including the company's non-executive directors, its auditors, the key regulators (the Financial Reporting Council and the Pensions Regulator) and the Government's Crown Representative. However, another inquiry, by the Public Administration and Constitutional Affairs Committee, placed Carillion's collapse within a wider context of government's approach to risk transfer.

These two companies were not alone in pursuing overly ambitious growth strategies – in fact, such an approach has characterised the outsourcing sector. Many outsourcing companies grew extremely large in a short period of time (see Figure 4), arguably pursuing revenue growth at the expense of operational control. Often they expanded by spinning out into new areas in which they had limited experience, either by winning contracts or acquiring companies. For example, between 2007 and 2011, Capita made 69 acquisitions costing £1.0bn.*

Figure 4: UK revenue of selected major outsourcing companies, 1987–2019 (£ billions)



Note: Figures are shown in June 2019 prices.

Source: Annual reports and accounts for selected companies.

Companies have often got into trouble over contracts, including on government work, because their bidding processes were not sufficiently robust.** They signed contracts for work at a price they have proved unable to deliver and took on risks they were unable to manage. Several have recently begun to retrench by focusing on a narrower range of core activities and being more selective in the contracts for which they bid.^{39,***}

Nonetheless, the approach of successive governments to outsourcing, particularly since 2010, has contributed to the present situation. Government has played a role in creating markets that have become increasingly low-margin and high-risk – and encouraging risky behaviour from suppliers. It must take some responsibility for the outcomes this has produced, particularly in areas where it is the only buyer.

While profit levels may have been excessive on some early outsourcing contracts, most interviewees we spoke to, including industry experts and former government officials, agreed that the process of squeezing suppliers' profits had gone too far, not

* These included a company called Applied Language Services, which had just won a contract for court translation services with the Ministry of Justice. See: National Audit Office, *The Role of Major Contractors in the Delivery of Public Services*, National Audit Office, 2013.

** For example, Serco and G4S have both said they regret signing the first Home Office Asylum Accommodation contract, on which they each lost more than £100m. See: House of Commons Home Affairs Committee, *Asylum Accommodation: Twelfth report of session 2016–17*, HC 637, The Stationery office, 2017.

*** For example, Capita is focusing on "digitally-enabled services and software", while Serco has pulled back from bidding for clinical work in the NHS, which it deems too risky.

least because government has also increasingly transferred large risks that companies struggle to price and manage.*

For some large contracts this was done through a targeted programme to reduce what government saw as excessive profits, as described above. But it has also happened more widely as a result of a shift towards government selecting the lowest-price bid, even when this was unrealistic. This has encouraged suppliers to bid low and make up their costs (and profits) elsewhere in the contract.⁴⁰

Of course, suppliers underestimating the costs of delivering a contract and supplier failure are natural risks in any procurement market. But government's approach has made these more likely. Behaviour on both sides has created what Ed Welsh, former executive director at the Cabinet Office, described as a "dishonest conversation about costs".⁴¹

The result in some areas is what's known as a 'winner's curse' market, where there is a "tendency for the winning bid in an auction to exceed the intrinsic value or true worth of an item".⁴² Due to lack of information or miscalculation, a supplier signs a contract that it is unable to make money on. It may be that suppliers expect to be able to make a contract profitable in the long run, or believe that markets will once again become profitable, so it is worth maintaining their position.

It is noteworthy that none of government's three largest suppliers in 2016/17 – Capita, Carillion and Amey – made a profit that year, despite all winning more government work.** Another large supplier told us it hadn't made a profit on UK central government work for five years.

Thin margins mean companies have little buffer should they make large losses on one or two large contracts, as has occurred in several cases.*** Several told us they expected government to renegotiate contracts that became heavily loss-making when circumstances changed, but that it had refused.

While some argue that getting companies to take on large risks on low margins represents government getting a good deal for taxpayers, failing contracts and collapsing companies show this view is short-sighted. Risks always return to government, with service users and taxpayers suffering in the long run.****

These problems, caused by behaviour on both sides, have contributed to declining competitiveness in some of government's outsourcing markets. Companies are increasingly refusing to bid for contracts that look too risky or are unprofitable. In 2018, 23% of all public sector contracts awarded went to the sole bidder, up from

* There is consensus among suppliers and industry experts that government has sought to transfer more risk, and often risk that suppliers struggle to manage, in the last 10 to 15 years (see Chapter 3), for example, demand for a service or 'catastrophic risk' on a construction project. Government has acknowledged that its approach to risk transfer requires improvement.

** This is according to published spend, which is necessarily an incomplete picture. See: Davies N, Chan O, Cheung A, Freeguard G and Norris E, *Government Procurement: The scale and nature of contracting in the UK*, Institute for Government, 2018.

*** For instance, G4S and Serco each lost more than £100m on the Home Office's COMPASS contract, while Amey was recently fined £58.5m by Birmingham City Council.

**** We discuss risk transfer in Chapter 3.

15% in 2016.* In May 2018, the Scottish government awarded an eight-year contract for escorting prisoners in Scotland worth £238m to the only bidder after G4S and Serco, which both have experience running similar contracts, pulled out.⁴³ Only one non-incumbent firm bid for the Home Office's £4bn Asylum Seeker Accommodation and Support services contract, also tendered last year.⁴⁴

In addition, the market appears to have become more concentrated and government increasingly reliant on its largest suppliers, despite successive governments expressing an ambition to diversify their supplier markets. Institute for Government research found that spending with strategic suppliers – those that have central government contracts worth more than £100m a year – accounted for a fifth of published procurement spend in 2016/17, up from an eighth in 2012/13.⁴⁵

Labour's outsourcing policy would end 40 years of continuity

Citing some of the problems described in this chapter, the Labour Party has decided on a policy that, were it elected, would end four decades of continuity between successive UK governments.

It has said that there is "not a shred of evidence" that outsourcing has improved the cost or quality of services.⁴⁶ It has also expressed opposition to outsourcing on principle, arguing that contracting out services always carries the risk of supplier failure, for instance due to suppliers underbidding in order to win work or reducing levels of service in order to maximise profits.⁴⁷

It would instead establish a presumption in favour of in-house delivery for local government and has said it would extend this to central government and other public bodies. This would see a wide range of services brought back in-house, including any that involved "significant contact with 'at risk' groups", which would include all front-line services.** To maintain outsourced provision, authorities would have to demonstrate that they lacked the capacity to bring services in-house or that risks would be better mitigated by outsourcing.

But while outsourcing has suffered a string of recent failures, the evidence does not support the view that outsourcing overall has failed. In fact, the picture is mixed: outsourcing has delivered substantial benefits as well as suffering failures, as we describe in Chapter 2.

* Part of this change was accounted for by an increase in the number of low-value contracts. See: Plimmer G, 'Sole outsource bidders win more public sector contracts', *Financial Times*, 13 January 2019, retrieved 24 May 2019, www.ft.com/content/0ecee894-15a5-11e9-a581-4ff78404524e

** This definition is vague, but it would appear to cover most front-line services (such as welfare assessments, prisons, probation, NHS care and social care) as well as some other services. The announcement also highlighted Capita's British Army recruitment contract, which suggests it could extend further, for instance to people using court translation services, those calling the various telephone helplines that private companies run for government, or cleaning, catering and security in prisons and hospitals. Labour has set out this policy for local government but suggested it will extend this to central government and the wider public sector. See: Labour Party, *Democratising Local Public Services: A plan for twenty-first century insourcing*, Labour Party, 2019.

2. Where has outsourcing worked?

Private companies provide a huge array of services for the government. In this chapter, we set out the extent to which outsourcing has worked or not worked in 11 service areas.

We assess whether outsourcing and competition have delivered cost savings or quality improvements, based on a review of the available quantitative evidence. We also draw on National Audit Office (NAO) reports, case studies of individual contracts and interviews with sector experts to understand whether outsourcing has met wider aims, such as introducing innovation and improving performance in the public sector.

Outsourcing has delivered the greatest cost savings in support services, such as waste collection, catering and cleaning. In front-line public services, the record of outsourcing in the UK is more mixed, with evidence that outsourcing has improved services on some measures and worsened them on others. In IT and back-office services, one of the largest areas of government outsourcing, we found mixed evidence, and some major case studies of failure – but on balance IT companies appear to be able to deliver savings and quality improvements.

We consider two service areas in construction. We exclude the actual construction of buildings, because we define outsourcing as the delivery of services and not works. But we do consider the maintenance and financing of construction projects. The former is a service that is relatively simple and easy to contract for, and the evidence points towards outsourcing having worked relatively well. The latter has, on balance, been less cost effective than alternative (public) financing models of construction projects.

Whether a service is public or private is clearly not the only factor that determines success or failure. In order to succeed, services need, among other things, good management, sufficient funding and staff with the right capabilities. Publicly delivered projects fail when these are absent, too. Yet the question that we address in this chapter – of whether introducing competition and transferring services from the public sector to the private sector has, on balance, worked – remains a vital one for government to answer.

In several areas, we found that government lacks the evidence it needs to inform current decision making. In many areas, there appeared to be limited access to the price and performance data required to make a comparison between outsourced and in-house services. Where there was data, comparisons were often hampered by difficulties in isolating the impact of private ownership from other factors. In other areas, a naïve cost comparison seems to indicate large savings from outsourcing, but these effects get smaller or disappear entirely with more robust study designs.* We set out how government should address the paucity of the evidence in Chapter 4.

* For example, studies that control for differences between public bodies that outsource and those that keep provision in-house. The more robust studies we found use panel data, and have fixed effects, which means they are looking at what happens when provision *changes* from in-house to outsourced, rather than simply comparing costs in cases where the service is outsourced with ones where it is not.

Box 1: Method

To assess whether outsourcing has worked in each service area, we used the following rating system:

- **Green:** there is consistent evidence of savings, quality improvements or wider benefits, including innovations, as a result of outsourcing or competition.
- **Amber:** the evidence is mixed, with some studies showing no difference, others showing cost or quality improvements and others showing increased costs or lower performance or quality.
- **Red:** there is consistent evidence of cost increases or lower performance or quality.

We based our judgment on two main sources. First, we conducted a review of the rigorous quantitative evidence on the impact of outsourcing, and the wider impact of competition, on the cost and quality of services over the past 40 years. We gathered evidence using online searches and academic libraries (our full methodology is described in Annex 1). We primarily used academic evidence from the UK to inform our judgments, but we also drew on international studies to support our understanding of the evidence in each service area. We focused on studies that robustly compare the difference between public and private provision, controlling for other factors.

Second, we reviewed case studies of individual contracts, drawing on evidence from the NAO, parliamentary select committees and others (a full list of the case studies is provided in Annex 2). In some areas, individual case studies account for a large part of the experience of outsourcing in a service area in the UK: for instance, Transforming Rehabilitation in probation. In other areas, such as health, individual contracts may be one of thousands in a service area. We have given the former more weight.

We also conducted interviews with sector experts, suppliers and former government officials.

Table 1: Has outsourcing in the UK worked?

Sector	Rating
Waste collection	Green
Cleaning	Green
Catering	Green
Maintenance	Green
Back office (HR and IT)	Green/Amber
Prisons	Green/Amber
Health care (clinical services)	Amber
Employment services	Amber
Adult social care	Amber
Private financing of construction	Amber/Red
Probation	Red

Waste collection

Waste collection was one of the first services government outsourced. Competitive tendering for waste collection was made compulsory with the Local Government Act 1988. Around 40% of local authorities in England outsource waste collection to private providers, at a cost of £468m in 2017/18.¹

Studies from the UK up to the late 1990s showed significant savings – in the vicinity of 20% – from competitive tendering and private provision. These studies found that councils that opted to hold competitive tenders for waste collection achieved savings, whether in-house teams or private providers won the contract, but the largest savings were achieved by private contractors.^{2,*} Studies from Europe and North America produced similar results.³

While UK local authorities will have made significant savings since they began the competitive tendering of waste collection, authorities outsourcing today are unlikely to achieve such savings compared with in-house provision. In fact, the bulk of more recent evidence (from Europe and North America) shows insignificant cost differences between public and private providers.^{4,**} Some researchers have speculated that this is because the public sector has become more efficient (spurred by the threat of competition from the private sector).⁵ Other evidence suggests that, once a contract is let to a private provider, costs increase over time, eroding initial savings.⁶

We did not find any rigorous evidence about differences in quality between public and private provision.^{7,***}

Cleaning

Cleaning was another of the services to be outsourced early in the UK. In 1983, the then Department of Health and Social Security instructed health authorities to introduce competitive tendering for all support services.⁸ The Local Government Act 1988 introduced compulsory competitive tendering for a wider range of bodies, which led to more widespread tendering of cleaning contracts to external providers by local authorities.⁹ Cleaning is now one of government's most frequently outsourced functions; it spent £1.1bn on cleaning services in 2013.¹⁰ Despite its ubiquity across the public sector, the robust evidence is almost exclusively within the health care sector.

When cleaning was first outsourced or competitively tendered, it produced large savings. For example, a prominent study from the mid-1980s of UK hospitals found that competitive tendering of cleaning services resulted in 34% savings when won by private providers and 22% savings when won by the public sector.¹¹ Another study from the mid-1990s examining outsourcing across multiple sectors in Australia found

* For instance, Domberger, Meadowcroft and Thompson (1986) showed savings from outsourcing of 22% compared with authorities that had not held a competitive tender. Szymanski and Wilkins (1993) found savings of around 20% from competitive tendering and contracting out. Szymanski (1996) found that authorities that let contracts to private contractors achieved significantly higher cost reductions than authorities that let contracts to direct service organisations (that is, a department of the local authority).

** This evidence is drawn from Continental Europe and North America, so it is not possible to be definitive about whether earlier savings have been sustained in the UK.

*** There is some anecdotal evidence about poorer outcomes under contracted services.

that, despite significant reductions in price, competitive tendering of cleaning services either improved or had no discernible effect on quality.¹²

More recent evidence also shows cost savings. But while some studies find savings in excess of 25%,¹³ the most robust study designs find savings in the region of 7.5%–10%.¹⁴ The cost savings achieved also appear to depend significantly on the extent of competition at the tendering stage: the magnitude of this saving is between 2.5% and 3.0% per additional bid, and applies regardless of whether the final contract was awarded to a private or public provider.¹⁵ A 2016 study also demonstrated the surprising permanence of such savings in cleaning, with private providers in particular achieving greater and lasting cost savings even into the second or third round of tendering.¹⁶

There is also some evidence that cost savings are achieved by employing fewer staff (which is associated with lower-quality cleaning).¹⁷ This may be reflected in a recent study, which found evidence of higher rates of MRSA infection (28% higher incidence) in hospitals with outsourced cleaning.¹⁸ A less robust study of Scottish hospitals also found a slight decrease in quality with privately provided cleaning.¹⁹

The need for particular areas of hospitals to be cleaned to a very high-quality standard may have made outsourcing, without sufficient control of quality, a poor choice. But the substantial savings achieved suggest that outsourced cleaning more widely results in better value for money.

Catering

Catering was first outsourced by health authorities in 1983, when they were instructed to introduce competitive tendering for all support services.²⁰ The Local Government Act 1988 introduced compulsory competitive tendering for catering for welfare and schools, as well as general staff catering, which led to more widespread tendering of contracts to external providers.²¹

On balance, most evidence suggests that outsourcing catering services has achieved some cost savings but it is unclear how it has impacted on quality.

When catering was first outsourced, it produced clear cost savings. One of the earliest NAO reports on outsourcing, in 1987, found that outsourcing of catering within the NHS had achieved 10% annual savings by 1986, although this figure was partly post-redundancy costs and pre-added costs due to putting contracts out to tender.²² A 1996 case-study-based assessment of competitive tendering for catering services in the NHS found that although there were some minor savings, contractors did not improve drastically on NHS catering units, which were already run rather efficiently.²³

More recent evidence on the cost and quality of outsourced catering services is surprisingly poor and very sparse. Many studies on this relied on self-reported expenditure – some found that outsourced providers were more expensive,^{24,*} while others found that they were cheaper or did not identify significant differences in cost.²⁵

* For example, a 2005 NAO survey found that external catering teams consistently reported spending more than in-house teams on a basket of 12 common items – 53% more on average.

Only one recent study that we identified adopted a more robust empirical design, which found that, in a simple comparison, outsourced catering services in the Scottish NHS were cheaper – but this was not statistically significant after accounting for differences between hospitals with outsourced and in-house catering.²⁶

Maintenance of construction projects

Very little construction capability is retained in-house and government has not had significant direct involvement in construction for decades. There are thus virtually no recent studies directly comparing the private and public provision of construction, as there are very few modern examples of the latter.

An exception to this is the repair and maintenance of capital assets and public infrastructure. On balance, the evidence suggests that outsourcing maintenance services has led to cost savings. Two studies we identified compared the cost of the private provision of maintenance with in-house provision; both found that greater private involvement led to savings of between 2% and 7%,²⁷ even after controlling for quality.²⁸ An Australian survey from the late 1990s found that public sector 'clients' who outsourced infrastructure maintenance reported savings of 6.8%, although the authors noted the difficulty of making such estimates confidently.²⁹

One study also found that increased competition in bidding for maintenance contracts did not reduce cost (although this may have been due to saturation of the market being studied).³⁰ On quality, a less robust study found an improvement in the perceived quality of privately provided highway maintenance services compared with public provision.³¹ But there is not sufficient evidence on quality to come to a firm judgment.

There is also a paucity of recent evidence on the success of asset maintenance outsourcing in the UK. A 2009 NAO report³² examined the contractual model then used by the Highways Agency (the central organisation responsible for operating and maintaining England's motorways and major roads, now replaced by Highways England). While the report painted a mixed picture in terms of the impact of contractual changes on the cost and quality of maintenance, it also noted the difficulty of making comparisons with public or other forms of contractual provision due to changing expectations of standards and the inclusion of new services within road maintenance.

Back-office outsourcing (HR and IT)

The outsourcing of back-office business functions such as HR, legal and IT – also known as business process outsourcing – is a relatively recent development,³³ and an area the UK has taken a lead in.³⁴ Here we focus on two areas that have been on the rise in recent years, namely HR and IT outsourcing, ranging from IT support to large-scale technological transformation.*

By the mid-1990s, the outsourcing of government IT to private companies had led to contracts worth £2bn – excluding the initial cost of designing and building the infrastructure.^{35,36} Spending grew as government entered more ambitious contracts

* Many of the back-office functions that are outsourced – including HR – feature elements of IT as they require specific digital infrastructure.

with outsourcing companies, for instance to deploy digital systems at the borders of the UK, or to manage HR and payroll. Around 2007, the UK public sector spent an estimated £12.4bn on IT outsourcing and £5.3bn on the outsourcing of other back-office functions.³⁷

However, the appetite for large IT contracts in central and local government diminished after 2011,^{38,39} with some departments taking greater responsibility of their IT through insourcing, which resulted in lower spending with some of the largest IT suppliers.⁴⁰ Local government spending on IT and other back-office technology-intensive functions such as HR and payroll declined from a peak of £708m in 2012/13 to £535m in 2015/16.⁴¹

HR and IT outsourcing appear to have delivered some savings, although in some instances the evidence is mixed, suggesting modest savings or even cost increases. The impact of outsourcing on quality is less clear, partly because it is difficult to make precise comparisons. Case studies show that companies modernising systems have been able to deliver substantial benefits, although others show that major IT projects have cost taxpayers dearly when they have gone wrong.

The rigorous quantitative evidence is fairly limited, partly because it is difficult to make comparisons as services change as a result of outsourcing, particularly in IT. Some anecdotal evidence suggests that outsourcing HR in the public sector could lead to 20–30% savings,^{42,43} as could setting up shared services^{44,*} or re-engineering business processes.⁴⁵ Other estimates suggest that outsourcing functions such as procurement, finance and IT could result in 25–50% savings.^{46,47,48}

However, these estimates tend to be based on private sector experience or industry-backed reports, and it is not clear how they were derived or whether such savings can be achieved in the public sector. Several other studies of IT outsourcing reported savings of 5–35%, although in many other cases savings were 'moderate', not quantifiable or costs had increased. One large-scale survey of the public sector reported increases of 8.6% from IT outsourcing, in contrast to the 15.3% saving it estimated from outsourcing finance and accounting services.^{49,50,51,52,53} There is little quantitative academic evidence of the impact of outsourcing back-office functions on service quality.⁵⁴

Case studies support the view that, where it has been done well, IT outsourcing has delivered benefits, including large operational savings. For instance, National Savings & Investments (NS&I), a government agency, cut its operational costs while improving service delivery by outsourcing all of its IT, transactional and customer-facing functions to Siemens Business Services through a competitive tender in 1999.⁵⁵ The NAO concluded that NS&I saved £176m, partly due to outsourcing.⁵⁶

But other case studies show that, done poorly, IT outsourcing can lead to significant cost overruns. For instance, HMRC's Aspire contract did help to reduce operating costs

* Shared service centres – set up to perform certain functions such as HR centrally on behalf of several public authorities – are sometimes used to outsource business processes. There is little academic evidence on these centres, but what is available from case studies suggests that they have not always delivered the promised results, with high-profile examples such as Southwest One and Tri-Borough being disbanded.

but saw the department spend far more than planned on commissioned work.^{57,58} And the National Programme for IT in the NHS cost £11.4bn but was disbanded after the contractors failed to deliver a fully functioning care record system to a single NHS trust.^{59,60,61,62}

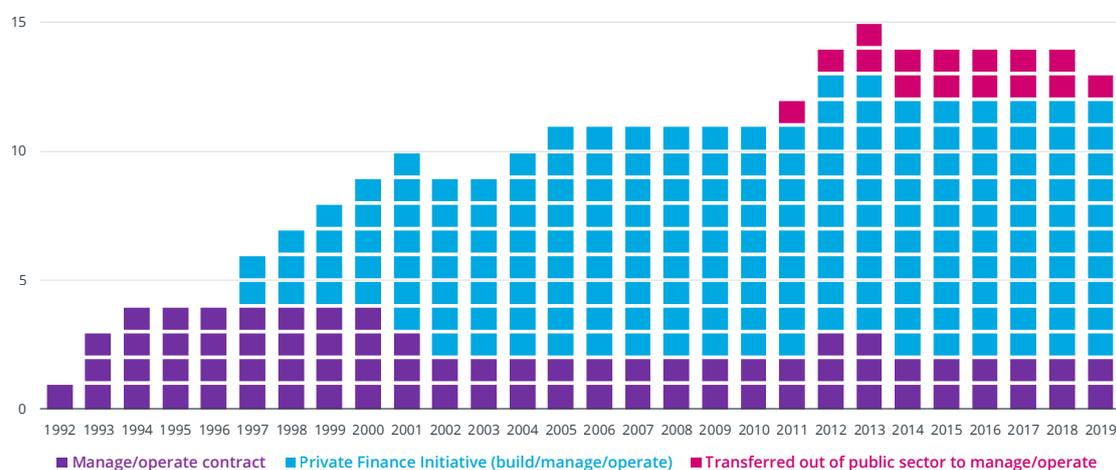
It is difficult to assess precisely what proportion of IT and HR contracts are successful. A survey of customers in the IT sourcing sector by Whitelane Research in 2019 suggests that the majority were satisfied that contracts were delivering on cost and quality targets, although a significant minority felt that performance could be improved.⁶³

Prisons

There are 121 prisons in England and Wales, of which 13 are run by the private sector,⁶⁴ housing around 19% of the prison population.* After the first private prison, HMP Wolds, was established in 1992, a string of new Private Finance Initiative (PFI) prisons were built in the 1990s and 2000s (see Figure 5), with the government emphasising the need to accommodate a growing prison population and drive up standards.⁶⁵

The coalition government opened existing public sector prisons up to competition, transferring two prisons in 2012–13, but no more have been transferred since then, and one (HMP Birmingham) was brought back in-house in 2019 as a result of high levels of violence and poor standards.⁶⁶ The Ministry of Justice (MoJ) is continuing to use private providers to run new-built prisons, and announced a competition for two new prisons in 2018.⁶⁷

Figure 5: The number of private prisons in England and Wales, 1992–2019



Note: This chart breaks down private prisons as follows: prisons that were publicly constructed and then immediately leased to a private operator; prisons constructed and operated under a private finance contract; and prisons originally operated by the public sector that were later transferred to a private operator.

Source: *Financial Times*' analysis of National Offender Management Service data.⁶⁸

* Private prisons tend to be considerably larger than public prisons. See: Andrews E, Atkins G, Campbell L, Tetlow G and Lilly A, *Performance Tracker 2018*, Institute for Government, 2018, retrieved 4 September 2019, www.instituteforgovernment.org.uk/publications/performance-tracker-2018

On balance, the evidence suggests that private prisons cost less to run than public prisons, but it is unclear to what extent this is due to efficiencies or other factors, such as private prisons being newer. The evidence on the impact on quality is mixed but introducing competition appears to have improved the performance of public sector prisons.

Despite prisons having been outsourced in the UK for more than 25 years, we found only four comparative studies of costs, conducted by the Home Office in the late 1990s, which reported a 13% saving in cost per prisoner, but the studies did not control for the age of the prison.⁶⁹ More studies have been conducted in the US, and while many do report that private prisons cost less than public ones, some of this effect disappears once important factors such as prison size and age are controlled for (privately run prisons tend to be both larger and newer).^{70,*} It is difficult to disentangle these factors since the private sector has built and operates most of the new prisons in the UK and the US.^{71,**}

Private prisons tend to pay prison officers and support staff considerably less than public prisons (15% and 22% respectively).^{***} But there is evidence that lower costs also derive partly from greater competitive pressure and genuine increases in productivity, which reduce the number of staff required per prisoner.^{****} For instance, case studies show that private prisons in the UK adopted flatter management structures and improved performance management, reducing sickness leave.⁷²

They also introduced new technologies, such as new IT systems, CCTV cameras, magnetic keys and in-cell phones and computers.⁷³

There is some evidence from the UK and elsewhere that lower costs in private prisons have been accompanied by equal or better quality in some areas, including improved staff–prisoner relationships and increased safety.⁷⁴ An Australian study found reduced costs while quality remained the same or improved.^{75,*****} However, in other areas – especially those that are less easily measured and managed, like levels of order or ‘quality of life’ dimensions such as wellbeing – private prisons in the UK perform worse.⁷⁶

The introduction of competition to UK prisons appears to have improved the performance of public sector prisons, which was often unacceptably poor. They have reacted to benchmarking by finding efficiencies and adopting new technologies, construction techniques and approaches to pay and staffing.⁷⁷

A 2016 book written by Julian Le Vay, a former finance director of the HM Prison Service, provides the most detailed overall assessment of the impact of competition

* The US studies are summarised in a 2002 meta-analysis, which found six robust studies of which five found cost savings in the 10–15% range. However, two further meta-analyses and a literature review were more sceptical about these savings once other factors were controlled for.

** Overcrowding has also been more prevalent in private prisons in the UK, which can make them appear cheaper on some measures.

*** However, private prisons tend to pay managers and directors more.

**** A Home Office review said that “private sector management still appears to offer an advantage by focusing on the core tasks and delivering higher productivity than in the public sector”. See: Andrews C, *Contracted and Publicly Managed Prisons: Cost and staffing comparisons 1997–98*, Home Office, 2000.

***** The 2016 study of two private prisons by the Queensland Auditor General found that they had cost 19% less to operate compared with public sector prisons while delivering comparable levels of quality.

on the prison sector.⁷⁸ It concludes that while there has been no significant, consistent difference in performance between public and private prisons, introducing competition has, on balance, delivered benefits.

Health care

A wide range of NHS activity is outsourced. Over £9bn, or 7.3% of the Department of Health and Social Care's (DHSC's) day-to-day budget, was spent on NHS-funded health care purchased from the private sector in 2018/19.^{79,*} This is in addition to services such as hospital cleaning and catering.

Private provision has a mixed record in the NHS, with well-documented failures in some areas, but cost savings and reductions in waiting times in others. However, beyond individual case studies, we did not find good-quality, systematic evidence about the relative cost and quality of clinical services provided by non-NHS providers. While government agencies publish inspection reports, these do not account for important differences between public and private providers.

Independent sector treatment centres are an example where, on balance, outsourcing worked. One study suggests that private providers delivered a quality of service that was broadly on a par with their NHS counterparts, with differences in outcomes small or insignificant after accounting for preoperative patient health.⁸⁰ But their introduction led to significant wider benefits, such as allowing the NHS to reduce the price paid for ad-hoc purchases for services from private providers. Independent sector treatment centres were controversial when they were introduced because they were paid an average of 11.2% more than the equivalent cost to the NHS.⁸¹ But sector experts we spoke to felt the benefits outweighed these costs.

Other case studies, however, show that the outsourcing of health care services has not delivered benefits. For example, in its inspection in 2015 of Hinchingsbrooke Hospital in Cambridgeshire, the first NHS hospital to be transferred to the private sector, the Care Quality Commission found that the hospital was delivering inadequate-quality services and failing to deliver the intended cost savings.⁸²

Employment services

The Work and Health Programme is the latest in a series of employment services programmes delivered by the private and voluntary sectors over the past two decades.** The programme is projected to cost £130m a year by 2019/20.⁸³ On balance, outsourcing employment services does not appear to have led to markedly better or worse outcomes for jobseekers.⁸⁴ Several evaluations of mixed-provision programmes under the Labour government failed to find that one provider type was consistently more effective than the other.⁸⁵

* A further £1.6bn was spent on services purchased from the voluntary sector and £2.9bn from local authorities.

** The Work Programme (2010–17) was the first time employment services were delivered exclusively by non-government providers (at a cost of £416m in 2015/16. See: House of Commons Library, *Work and Health Programme*, briefing paper no. 7845, House of Commons Library, 2018). The Blair and Brown Governments ran multiple employment programmes, each targeting different cohorts of jobseekers. Some were delivered solely by government, some only by non-government providers (for example, Employment Zones) and others by a mixture (for example, Pathways to Work).

However, most of the UK evidence base is not particularly robust, due to the difficulty of comparing public and private providers operating under different economic conditions, scheme designs and performance measurement regimes.* There have been a small number of robust empirical studies elsewhere in Europe showing little difference between public and private providers' success in finding jobs for their clients.⁸⁶

We did not find robust evidence about the cost of outsourced employment services relative to in-house provision, although this should improve with the forthcoming impact evaluation of the Work and Health Programme, which includes a public sector comparator in four districts.⁸⁷

Despite our overall conclusion, the case study of the former Work Programme shows that the most disadvantaged jobseekers were not served well by the 'payment by results' model used because providers were incentivised to focus time and attention on easier-to-place (and thus more profitable) jobseekers.**

Adult social care

Private residential care*** has existed since at least the 1950s.⁸⁸ Beginning in 1980, means-tested board and supplementary benefit allowances became available for residents of private sector homes. This encouraged the number of private sector care homes to expand from 18,800 in 1975 to 119,900 in 1990.⁸⁹ According to The King's Fund, in September 2015, the NHS or local councils provided less than 10% of social care.⁹⁰ The private sector makes up by far the largest share (74%), with voluntary providers accounting for 18% and public providers 8%.⁹¹

Private residential care is on average less expensive than care provided in public homes.⁹² Voluntary care has also been found to be less costly⁹³ or not significantly different in cost from publicly provided care.⁹⁴ While there is little consensus on the magnitude of the differences in cost between different types of providers, several studies suggest that private homes make the majority of their savings through lower staff-to-resident ratios.^{95,****}

Although evidence on quality is somewhat mixed, most studies suggest that private homes provide a lower quality of care,⁹⁶ with several drawing a connection between this finding and the lower cost of provision.⁹⁷ While some studies have found no significant difference in terms of quality between public and voluntary homes,⁹⁸ others have found that voluntary homes provide significantly higher-quality care.⁹⁹ But care quality can be measured on a number of different dimensions, and other studies have found that private homes do better than public homes on some measures of

* The NAO has acknowledged the difficulty of making comparisons with earlier schemes. See Comptroller and Auditor General, *The Work Programme*, Session 2014–15, HC 266, National Audit Office, 2014.

** Typically referred to as 'creaming and parking'. See for instance: Comptroller and Auditor General, *The Work Programme*, Session 2014–15, HC 266, National Audit Office, 2014.

*** Adult social care includes services apart from residential care, such as community and domiciliary care provided in people's own homes.

**** Stolt and others (2011) found that private providers employ 9% fewer staff per resident. As staff costs account for an estimated 80% of total costs, this amounts to a total cost saving of 7.2%. However, Bergman and others (2016) found that opening up to private competition reduced cost per resident in a Swedish municipality by 1.7%.

quality.^{100,*} Although lower-quality care is often attributed to lower staff-to-resident ratios, one study found that private homes surpass public homes on certain procedural measures of quality.^{101,**}

Overall, the evidence suggests that private care, while likely cheaper, may not provide better value for money than public provision since it is also associated with a slight decrease in quality. There is some evidence that voluntary care is of a higher quality yet not substantially more costly than public provision. However, private provision dominates the social care market, implying that there is only some evidence that the outsourcing of social care overall (to both private and voluntary providers) has succeeded in providing value for money.

The evidence on the effect of increasing competition in an area on all types of home is mixed. A UK-based study found that a 10% increase in competitiveness was associated with a 2.2% decrease in prices.¹⁰² Another study using different quality measures found no significant difference between areas where homes were exposed to competition and areas where there was no such competition.¹⁰³

Private financing of construction projects

The growth of Private Finance Initiatives (PFIs) has been the most significant contractual change in government construction over the past 30 years. Under the PFI, the private sector is responsible for the financing, design, build and operation of an asset (such as a road, hospital or prison), for which the government pays an annual charge over the lifetime of the contract (typically 25–30 years). The private sector thus also takes on the risk associated with the project. Although PFIs were first introduced across the public sector in 1992,¹⁰⁴ there was a major boom in their use in the early 2000s, spurred on by the New Labour government.

Much has been written about PFIs, including at length in a previously published [Institute for Government report](#).¹⁰⁵ Here we briefly summarise the evidence.

A direct comparison is difficult, but overall the evidence points towards PFIs in construction being more costly on average than alternative procurement methods.^{106,**} This is unsurprising given that the public sector can borrow more cheaply than the private sector. The higher cost of finance in PFIs¹⁰⁷ means that these projects need to be built and maintained for less money, or provide additional benefits, if taxpayers are to get better value for money than conventional procurement methods.

Our previous research¹⁰⁸ showed that decisions to use the PFI were driven at least in part by accounting rules, which meant that these projects were 'off balance sheet',

* Bergman and others (2016) found that contracting out elderly care to private providers reduced mortality rates by 1.6% in the affected population (increasing longevity by an estimated four weeks).

** The study found that, although private care homes had lower-quality 'inputs' (such as 9% fewer staff per resident), they managed to better public care homes on procedural measures of quality such as meal provision and engagement with residents.

*** Blance-Brude and others (2009) estimate that public–private partnerships involving a finance contract are on average 24% more expensive than those without; meanwhile Petersen (2019) surmises, from a review of 21 studies, that the PFI is on balance more expensive than traditional procurement.

and therefore did not add to the national debt, even though they may have been more expensive and represented worse value for money.

While a common finding is that PFI projects suffer less cost and time overruns during construction than conventionally procured projects,¹⁰⁹ there is reason to think that contractors charge a premium for this increased reliability¹¹⁰ and this does not take into account other differences between PFI and other projects.

For example, PFI contracts are often signed at a later stage than in non-PFI projects, when the scale of the project is often better defined, and costs and schedules can be more accurately estimated.¹¹¹ As a result, studies likely overestimate cost and time overrun savings when relying on estimates used in PFI and non-PFI contracts. There is also scant data on the whole-of-life costs of PFI contracts, and present comparisons using projections often rely too heavily on assumptions about discount rates, the cost of government borrowing, and optimism bias in publicly financed construction.¹¹²

There have been specific examples of PFI contracts being unsuccessful or overrunning. For example, Carillion's contract with Royal Liverpool and Broadgreen University Hospitals NHS Trust to rebuild the Royal Liverpool University Hospital resulted in the trust terminating the contract as it was "unviable".¹¹³ And the Building Schools for the Future programme, which was a long-running project intended to build 250 schools a year,¹¹⁴ was scrapped in 2010 after consistently failing to build as many schools as planned. While other contracts have run on time and to budget, this does not necessarily mean they represent good value for money compared with a publicly financed alternative, for the reasons outlined above.

Overall, higher costs and limited evidence of benefits suggest that the government's decision in the 2018 budget to move away from private financing was the right one.¹¹⁵

Probation

In 2015, under a programme called Transforming Rehabilitation, the MoJ outsourced the management of medium- and low-risk offenders in England and Wales to 21 regional community rehabilitation companies. The rationale for introducing competition and outsourcing was that, despite increased spending on prisons and probation, re-offending had remained stubbornly high.¹¹⁶

Community rehabilitation companies supervise 150,000 medium- and low-risk offenders, and some of the 40,000 extra short-term prisoners who previously had not been managed in the probation system. They also provide some services to high-risk offenders managed by the National Probation Service. The contracts were for seven years but the MoJ decided in 2018 to terminate the contracts in 2020, two years early. In 2019, it announced that the management of offenders will be brought back in-house, although private companies will continue to provide "innovative" drug and rehabilitation services.¹¹⁷

The case study of Transforming Rehabilitation shows that the outsourcing of probation has not worked in the UK. Quality has been unacceptably poor. As chief inspector

of probation, Dame Glenys Stacey concluded that the outsourcing of probation was “irredeemably flawed” after she found 80% of community rehabilitation companies to be inadequate in at least one key quality area, and many in several, including delays and poor-quality assessments.¹¹⁸ Support provided by the public sector’s National Probation Service for high-risk offenders performed better on every metric.¹¹⁹

Outcomes are also generally poor. The proportion of offenders who re-offended decreased slightly but the number of re-offences per offender, and the number of prisoners recalled to prison for breaching their licence, both increased for medium- and low-risk offenders,^{120*} while the rates for high-risk offenders (for whom probation remained in-house) saw no such increase. But interviewees questioned how much providers could be held responsible for these outcomes – even though they are partly paid on the basis of them – given they depend significantly on other localised factors such as the police, magistrates and judges.

Nor does the outsourcing appear to have delivered the intended cost savings. The MoJ has had to invest at least £467m more than was required under the contracts because the contracts were not delivering a good-quality service.¹²¹ This is still less than was initially anticipated at the outset of the reforms, but as the NAO has said the department has made little progress in transforming rehabilitation.¹²² One industry expert speculated that the programme had probably cost roughly the same as the previous programme, while dealing with more offenders, but it is not possible to confirm this.¹²³ An audit of the contract in 2019 concluded that it had provided “poor value for money”.¹²⁴

Unfortunately, it is not possible to rigorously compare the cost and quality of probation services before and after they were outsourced. We found no rigorous comparative evidence, in part because outsourcing in this area is only a recent phenomenon, but also because of changes in the service and problems accessing data held by suppliers. We found no comparable evidence from other countries, because probation has not been outsourced in most countries.**

Announcing in 2018 that the services would be brought back in-house, the MoJ itself recognised that outsourcing had not worked as it had hoped.¹²⁵ Sector experts agreed. We set out the reasons why the outsourcing of probation hit so many problems in the next chapter.

Government needs better evidence on outsourcing

This chapter has shown that in a range of areas, outsourcing has, on balance, worked. In services that are simpler to contract for and deliver, such as waste collection, catering, cleaning and maintenance, outsourcing delivered large savings when the services

* Re-offending rates increased by 22% between 2011 (when services were delivered in-house) and 2017; while the number of prisoners breaching their licence increased by 47% between January 2015 and September 2018.

** In a handful of US states, private providers deliver probation services but the model is very different, with providers being paid directly by service users. In any case, we found no robust studies of the cost and quality of services in the United States. See: Human Rights Watch, *Profiting from Probation: America's offender-funded probation industry*, Human Rights Watch, 2014.

were first contracted out. In other areas, the record is more mixed. In probation, where services were contracted out recklessly, outsourcing has clearly failed.

But it has also shown that government lacks the evidence it needs to inform current decision making on outsourcing. Politicians and senior officials often refer to large cost savings and quality improvements when making the case for outsourcing.

In a speech in June 2018, David Lidington, then chancellor of the duchy of Lancaster, said that “research commissioned by the previous government has shown that outsourcing delivers savings of some 20 to 30 per cent, compared with bringing services in-house”, and that outsourcing creates “high-quality, effective services”.¹²⁶ Oliver Dowden, minister for implementation, wrote in *The Times* on 11 July 2018 that “academic research has shown that outsourcing delivers savings of 20 per cent” and “quality public services”.¹²⁷

In an appearance to the Public Administration and Constitutional Affairs Committee in 2018, John Manzoni, chief executive of the civil service, argued that outsourcing could deliver 10%–20% cost efficiencies.¹²⁸

But while such savings were made historically in specific areas and have reduced costs permanently, there is little evidence that such savings can be achieved in newly outsourced services now, or across the range of services government outsources. Outsourcing appears to still be able to deliver cost savings in some areas, but these are smaller, and not always directly attributable to efficiencies rather than reductions in labour costs or other factors. The evidence on quality tends to be even weaker.

We make recommendations on how government should address this evidence gap in Chapter 4. But as well as understanding where outsourcing has worked or not, government also needs to understand why. In the next chapter, we describe the reasons why specific contracts succeeded or failed.

3. Why has outsourcing succeeded or failed?

In this chapter, we describe key reasons why outsourcing succeeded or failed in meeting its aims of reducing cost and improving quality, based on more than 25 case studies of individual contracts. These point to some common characteristics that underpin successful government outsourcing.

The Institute for Government [previously showed](#) that there are several conditions that make outsourcing more likely to succeed, including three key ones:

- the existence of a competitive market of high-quality suppliers, without which government opens itself to supplier opportunism and risks poor service performance
- the ease of measuring the value added by the provider, without which it is difficult to write and price contracts and monitor performance
- the service not being so integral to the nature of government as to make outsourcing inappropriate, for instance when a supplier has to make key policy decisions.¹

We argued that where these conditions were not met, government should avoid outsourcing unless it had a clear strategy to mitigate the risks that contracting out would create. In reviewing the case studies, we found successful contracts in areas that met these conditions, while others, which did not meet these conditions, had been undermined by failing to address risks.^{2,*}

In addition to these characteristics in service types, we found four other key themes in our research for this report that consistently came up in contracts that failed or worked less well (and were avoided in contracts that worked):

- a failure on the part of government to engage with the market early and be clear about what it is buying
- an excessive focus on price and an insufficient assessment of quality in selecting bids
- the transfer of risks to suppliers that they are unable to price or manage well
- contract managers lacking the capabilities and information they need to ensure good performance.

These themes in government's approach to outsourcing overlap with the conditions we previously identified. When a service is by its nature difficult to outsource,

* We noted that where these conditions are not met, there are challenges for in-house provision too, but that applying contractual mechanisms will create more acute risks.

government is more likely to find it difficult to engage with the market, select bids, write contracts and manage contracts well. For example, when it is difficult to measure the value added by a provider and monitor the quality of performance, it is more important that government avoids focusing narrowly on price, which could risk a supplier cutting costs by reducing quality in areas that are difficult to measure.

The government's *Outsourcing Playbook*,³ a guide for officials published in February 2019, sets out steps to address some of these problems (as we discuss in Chapter 4).

Outsourcing has worked best where there is healthy competition – but hit problems where government has lacked a competitive market of adequate suppliers

Competition is one of the key reasons policy makers outsource services in the first place: they believe it can put a downward pressure on costs, encourage providers to meet customer needs and allocate resources more efficiently, and act as a spur for innovation.⁴ The evidence we highlighted in the previous chapter, in areas including prisons, waste collection and cleaning, supports this view, while other studies also demonstrate the benefits of competition.^{5,*}

In most areas we cover in this report – including support services, IT, HR, maintenance and some front-line services such as health care – government has been able to purchase services from an existing competitive market of suppliers. Those suppliers have experience providing similar services to the private sector, and often have structural advantages – such as expertise, economies of scale or new technologies – that enable them to deliver efficiencies.

For example, when government initially outsourced IT and other back-office services, a Treasury review recognised that it often had low capabilities in-house and was able to procure from a market with much more expertise.⁶ Companies such as Microsoft and Siemens were quickly joined by UK competitors such as Capita in what became a highly competitive market for government work. Case studies suggest that this market delivered efficiencies and quality improvements for government.

For instance, as noted in Chapter 2, National Savings & Investments (NS&I) – a government agency that offers savings and investment products to the public – cut its operational costs while improving service delivery by outsourcing all of its IT, transactional and customer-facing functions to Siemens Business Services through a competitive tender in 1999.⁷ Siemens took on more than 4,000 staff, with just 130 staff remaining at NS&I to manage the contract.⁸

* For example, a US study of the procurement of construction services found that increasing the number of bidders from two to eight led to savings of 12–14%, and suggested that in those procurements between six and eight bidders are needed to achieve the highest level of competitiveness. Another study, based on a survey of public–private partnership contracts, found that more competitive methods of contractor selection yielded greater savings. A report by the Local Government Association identified a range of examples where competitive procurements helped to identify innovative solutions to local problems, such as social isolation. A study by the OECD concluded that competition in public procurement achieves lower prices, better quality and innovation – but only when companies genuinely compete in rigorous processes.

The National Audit Office (NAO) found that Siemens improved customer service and saved money by modernising services, concluding that NS&I “saved the taxpayer £176m thanks in part to Siemens Business Services”.⁹

A more recent example shows how suppliers in the IT outsourcing market can use new technologies to deliver efficiencies. Her Majesty’s Courts and Tribunals Service (HMCTS) have a contract with Liberata, a business services provider, to manage its payment systems.¹⁰ Liberata had already invested in developing software and technology behind payment systems. In 2017, it implemented a new system which, HMCTS said, made it quicker for ‘bulk users’ such as solicitors, local authorities, police forces and utility companies to make payments and other transactions digitally, easier for the agency to process payments and made the service more reliable.¹¹ The system has been rolled out to 450 sites and has freed up staff time and resulted in significant savings.¹²

But in several areas, including electronic monitoring and probation, government has outsourced services without a well-functioning market and has paid too little attention to generating competition.¹³ As we highlighted in [earlier work](#), this not only jeopardises the potential gains of competition described above, it also increases the likelihood of opportunism from suppliers and risks problems with service performance.¹⁴

The outsourcing of the electronic monitoring of offenders, where the market has been dominated by two suppliers (G4S and Serco), demonstrates how an uncompetitive market risks supplier opportunism.¹⁵ In 2013, when the Ministry of Justice’s (MoJ) contracts with the two companies came up to be re-tendered, it discovered “significant anomalies” in billing practices: both had charged the department for tags that had never been fitted.^{16,*} In the summer of 2013, Serco and G4S withdrew from the tender process for the electronic monitoring contract. In December 2013, interim arrangements were put in place for Capita, the remaining supplier in the bidding process by the end of the financial year when the contracts were due to expire, to take on the contracts. G4S subsequently won a further contract for the provision of tags.

Such uncompetitive markets are liable to suppliers abusing their power – and the exit of one or two suppliers can leave government in a poor position with limited bargaining power. The NAO found that the contracts failed to deliver promised quality outcomes, while it is unclear whether projected cost savings were achieved.¹⁷

Several subsequent attempts at procurement hit problems partly because the market was not sufficiently competitive.¹⁸ Interviewees suggested that there was an early assumption in government that reputational risk would ensure that private providers performed well, but that has not proved to be the case – and in many cases where markets are weak, suppliers win further contracts soon after serious failures.

The outsourcing of probation services shows how outsourcing without a well-functioning market contributes to poor service performance. While some probation service providers had provided specific interventions, the full management of

* The story attracted national media coverage because the companies were found to have charged for tags on people who had died.

offenders had not been outsourced before in the UK, or anywhere else using the model the UK adopted.¹⁹ At the time, the Institute for Government and others warned that the absence of capable suppliers, combined with the difficulty of contracting probation services, made outsourcing a poor choice.²⁰

Interviewees told us that major outsourcing companies issued similar warnings – and late in the procurement process the department struggled to ensure that it had enough bidders for contracts in some regions and had to approach suppliers directly to encourage them to step forward. By requiring that organisations bidding to be one of the 21 ‘prime contractors’ had a ‘parent company guarantee’ – effectively taking on financial risk – the department excluded voluntary sector organisations and social enterprises with experience in this area from bidding to become prime contractors.²¹ Many of the companies that won contracts had minimal prior experience, which in some cases contributed to the widespread failures to provide a quality service.

The lack of a well-functioning market of suppliers does not predetermine failure. In other areas, such as waste collection, government has created healthy markets where they did not exist before. But failures are much more likely where there is not a competitive market and government does not take adequate steps to create one, for example, through early engagement and piloting, and properly assessing how contracting out will work in practice.* When the market is weak and suppliers are inexperienced, government will often need to be willing to accept dips in performance during a transitional period, which may for some front-line services create public and media opposition that ministers are unwilling to bear.²²

There is evidence that the lack of a well-functioning market is becoming a more common problem in several of government’s outsourcing markets. As we highlighted in Chapter 1, there has been an increase in the proportion of contracts won by the sole bidder and markets are increasingly dominated by government’s largest suppliers.²³ This is not a problem in all markets – the latest facilities management framework saw an increase in the number of suppliers.²⁴ But in 2018, David Lidington, the head of the NAO and others agreed that market concentration was an issue in some UK public service markets.²⁵

Both government’s approach to negotiating individual contracts and its broader stewardship of markets are contributing to poor competition. Several suppliers we interviewed told us that they are increasingly pulling out of bidding for contracts, or putting in bids that effectively price them out, because the level of risk and profit on government contracts looks unattractive (we highlight several examples of these contracts below). In addition, government is often not taking a strategic approach to market stewardship to identify where markets are uncompetitive and take actions to address it, such as lowering barriers to entry for new firms or smaller providers, and reducing the size and length of contracts.²⁶

* This is particularly the case for complex public services, which are inherently more difficult to contract out successfully and require government to demonstrate how a successful contract and market will work.

We highlighted in earlier work that improving procurement data is crucial to this: if government knew how many bidders it had for every contract and how this had changed over time, it could better identify procurement categories or geographical areas with low competition.²⁷ Evidence from around the world shows that publishing more contracting information increases competition and reduces prices.²⁸

Outsourcing has been more successful when officials can clearly measure the value added by providers

Government needs to be able to measure the value added by the supplier in order to outsource services effectively.²⁹ It is hard to do this when government cannot tell good performance from bad, for instance because outcomes are dependent on a large number of factors beyond a supplier's control.³⁰ In these cases, officials find it hard to write, price and monitor contracts, making them vulnerable to opportunistic behaviour by suppliers. Conversely, suppliers may also find themselves making losses due to circumstances over which they have no power.

In some areas, such as catering and waste collection (which are simpler to contract for and deliver), it is relatively easy to measure the value added by providers. For instance, some grounds maintenance contracts specify outputs such as the minimum and maximum length the grass should be cut in public spaces, while in cleaning contracts parties agree clear specifications about which areas should be cleaned, how often and to what standard.³¹ In addition, contractors can draw on defined outcomes – such as residents' levels of satisfaction with cleaning or waste collection services – that are relatively straightforward to collect in order to inform the way they manage the contract.

The Department for Education's outsourcing of the IT and administration of the Teachers' Pension Scheme to Capita in 1996 is an example where measuring performance was key to the contract's success. In total, 470 staff transferred over to Capita to deliver the contract, which covered maintenance of member records, pensions payroll, accounting and customer management. The contract was re-awarded to Capita in 2003. By 2008, a government review concluded that through "strong governance" and "robust performance metrics" – including customer satisfaction and response times – Capita had reduced operating costs by 48%, from around £17m to £8.9m, while maintaining a high-quality service, winning an award for 'Best Administration' at the UK Pensions & Investment Scheme awards.³²

In some more complex services, such as prisons and some health care services, it is also relatively easy to measure a supplier's value. Prisons are, by definition, highly monitored environments. There are a wide range of quality metrics – such as frequency of violence, hours outside of cells and number of educational activities offered – which can be used to assess performance, and these largely do not depend on factors beyond the control of the organisation managing the prison. The ability of government to assess and compare performance has been crucial to managing private prisons and generating benefits from competition across the wider prison estate, which we outlined in the previous chapter.

The introduction of independent sector treatment centres – privately run ‘surgical factories’ that provide routine, planned operations to NHS patients – is another example of where outsourcing, on balance, succeeded because government was able to clearly measure the value added by providers and define what it wanted in a contract. Independent sector treatment centres were first commissioned in 2002 to provide routine operations such as joint replacements, cataracts, hernias and varicose veins, along with a range of diagnostic procedures.

They were introduced to increase capacity, provide competition for NHS hospitals and undercut the premium prices that the existing private hospitals were charging the service for NHS procedures. By 2011 there were 25 centres – and a study published that year found that patients attending the centres recorded outcomes as good as, or slightly better than, NHS patients for certain types of surgery.^{33*} Another study found that NHS hospitals with an independent sector treatment centre nearby shortened the preoperative length of stay considerably.³⁴

Independent sector treatment centres were highly controversial as they were designed to take the ‘easier’ patients and because they were eventually paid many millions of pounds for operations that did not in fact take place, due to receiving guaranteed patient volumes. Their wider effect, however, which saw most of the UK’s private hospital groups adapt their business models to take NHS patients at NHS prices, produced long-term savings that will have easily outweighed the centres’ extra costs. One reason they succeeded, according to interviewees, was that it was possible in the contracts to clearly define outputs and outcomes – for example the number of operations and levels of patient satisfaction – and, eventually, to compare those to services provided by NHS organisations.

In other front-line services, however, government has struggled to measure the value added by providers, which has made it difficult to write contracts that define (and incentivise suppliers to deliver) an adequate level of service. In the case of the Work Programme – a £2.8bn scheme that ran between 2011 and 2016 to help unemployed people back into work – a NAO report found that the contracts were not well constructed to measure and reward performance, or to incentivise providers to assist the most disadvantaged jobseekers.³⁵

Suppliers were partly paid on the basis of employment outcomes that were heavily influenced by other factors, including an individual’s motivation, improvements in the economy, the buoyancy of regional labour markets and levels of investment in adult education.³⁶

The Department for Work and Pensions (DWP) tried to address this. It introduced differential payments for different groups of jobseekers to try to encourage suppliers to give greater focus to the most difficult cases. But the high payments were not enough for the level of disadvantage experienced by the ‘hardest-to-help’ jobseekers.

* These outcomes were adjusted for pre-operative differences. The better outcomes recorded for hip and knee replacement were small and the authors said that they could potentially be attributed to differences in case mix not fully taken into account.

Suppliers were still found to be 'creaming and parking' – directing resources towards the 'easiest-to-help' jobseekers and minimising the amount of time advisers spent with those less likely to re-enter work – in order to protect their income.

In 2015, the Work and Pensions Select Committee found that providers did not secure long-term work for 70% of their clients and concluded that the programme was not working well for people with multiple barriers to work.³⁷ The difficulty of measuring performance meant that the department had to make incentive payments even to the worst-performing providers.³⁸

In probation it has proved similarly difficult to measure the value added by providers, which has made it hard for MoJ to define an adequate level of service quality in the contract. Like employment outcomes, rehabilitation outcomes depend on a large number of organisations and environmental factors, including the police, courts, housing, welfare and other local services, as well as levels of criminal activity in particular areas. Up to a fifth of suppliers' payments was based on outcomes such as reducing re-offending, with around four fifths based on other contractual requirements, such as completing sentencing plans.³⁹

This meant that most companies faced large deductions when they missed targets, which created a market where suppliers focused on gaming the system to avoid financial penalties – for instance [marking sentence plans as complete without having met offenders](#). Fundamentally, the contract did not codify a good-quality service. In her final report in March 2019, Dame Glenys Stacey, the chief inspector of probation, said that "probation is a complex social service and it has proved well-nigh impossible to reduce probation services to a set of contractual requirements".⁴⁰

Where outcomes are harder to measure and attribute to providers, there are steps that government can take to reduce the risk of failure. For instance, it can generate data to underpin robust counter-factual models, or try to write detailed contracts that specify proxies for performance that do not create perverse outcomes and monitor provider quality through inspections, although this is difficult.⁴¹

There are also emerging methods that seek to develop approaches to procurement or commissioning more suited to complex services, for instance by focusing on collaboration and learning rather specifying outputs and outcomes.⁴² For example, in 2019 Plymouth City Council commissioned services for vulnerable adults through an 'alliance contract',* in which the organisations agreed core service principles and activities as the basis for how the service will function, with the expectation that the details of service provision will continue to adapt.⁴³

* An alliance contract is "an agreement between two or more individuals or entities stating that the involved parties will act in a certain way in order to achieve a common goal". See: LH Alliances, 'What is alliancing', LH Alliances, no date, retrieved 7 August 2019, <http://lhalliances.org.uk/what-is-alliancing>

Government should not outsource services that are integral to its own purpose without oversight

A third key factor that we identified in earlier work was that outsourcing works best when the service is not integral to the purpose or reputation of government. While it is difficult to draw precise boundaries, we argued that some services are inherently governmental, including those that involve:

- making key policy decisions such as on regulation, tax and spending
- applying coercive authority to maintain law and order
- making decisions intimately related to the government's duty to protect the public.⁴⁴

Contracting out services with these characteristics reduces government's control over its core functions.⁴⁵

We found few examples of outsourcing that breached the first two conditions.^{46,*} However, we found significant concern over government outsourcing decisions about people's eligibility for services or the safety of highly vulnerable people, without proper oversight and the ability to ensure an adequate service.

The DWP's outsourcing of assessments for the Personal Independence Payment (PIP) is a good example. PIP is the main benefit to support people who are disabled or have long-term health conditions. It has been gradually rolled out since 2013 to replace the Disability Living Allowance (DLA) and currently covers around 1.6m people.⁴⁷ The department makes decisions about whether claimants receive PIP or not, and at what level, on the basis of assessments carried out by two private providers, Atos and Capita. But the performance of the private providers has been mostly poor – and the department has struggled to raise it to a consistently acceptable level.⁴⁸

Between 2013 and 2017, each contractor regularly failed to meet the quality thresholds for assessments – some by a considerable margin.^{49,**} For 290,000 claimants of PIP and Employment and Support Allowance (ESA)^{***} – 6% of all those assessed – the right decision was not made first time.⁵⁰ An independent review of PIP in 2017 found that 65% of those who appealed against rejected claims had their decision overturned, which eroded claimants' trust in the system.⁵¹ The Work and Pensions Select Committee concluded that outsourcing had failed in its aim – introducing efficient, consistent and objective tests – and concluded that, with low public trust and weakening market interest, assessments should be delivered in-house.⁵²

* We found no examples that involved the outsourcing of the ability to make decisions on regulation, tax and spending. While private prison operators apply coercive authority, they do so only based on decisions made by judges. Some local councils have hired so-called 'private police forces' – security firms that supplement stretched police patrols in rural or wealthy urban areas – but these do not have coercive powers and remain very small in scale.

** The companies said that there had been an improvement in performance in 2018–19 and government statistics show this, although we were unable to access data for individual companies. Department for Work and Pensions, *Personal Independence Payment: Official Statistics*, 12 September 2019, retrieved 13 September 2019, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/807652/pip-statistics-to-april-2019.pdf

*** ESA is another benefit that supports people who cannot work because of illness or disability.

In 2018, DWP extended the PIP contracts by two years to ensure a “stable transition” to new provision but it noted that there was “still more work to do to deliver the high quality service those on PIP rightly expect”.⁵³

The failure of the outsourcing of benefits assessments is due in part to other factors identified above: a weak market and difficulty incentivising good performance. But it also highlights why outsourcing core government responsibilities – such as making or informing decisions that affect people’s eligibility for services or involve highly vulnerable people – is particularly problematic, especially when government loses the ability to guarantee acceptable performance levels. In 2014, the government abandoned plans to expand the outsourcing of child protection services, which would have involved companies making key decisions about children’s lives, after a consultation revealed widespread opposition in the sector.^{54,*}

In areas such as this, poor decisions can have huge consequences, causing significant hardship and eroding public trust. Rupert Soames, chief executive of Serco, has argued that where decisions “materially affect people’s lives”, government should be cautious about outsourcing unless there is a robust oversight and appeals mechanism.⁵⁵ Government should clearly specify criteria and carefully oversee decisions.

The Labour Party has proposed a presumption in favour of government provision for all services that deal with vulnerable or at-risk people.^{56,**} There are clearly examples, including probation and benefits assessments, where outsourcing has harmed vulnerable people. But as the previous chapter showed, there are other case studies from service areas that would also fall within this definition, such as prisons and health care, where competition and private provision have improved services for vulnerable people. A blanket approach risks throwing these benefits away. It appears unlikely that taking back services into government hands on a large scale will improve service quality or save money in areas where competition has delivered benefits.

Outsourcing failed when government did not understand what it was buying

In several examples we assessed, outsourcing failed because government did not talk with suppliers early enough to ensure there was common understanding about what it wanted from the service and how a supplier could deliver it. For more complex outsourcing projects, early engagement provides a crucial forum to discuss the deliverability of specific requirements, challenges and risks, and the potential for alternative options and innovative solutions.⁵⁷

This is particularly important in cases where there is a weak market or difficulty measuring the value added by suppliers. But we found several examples, particularly in complex IT projects and front-line services, where insufficient market engagement caused problems.

* It barred profit-making organisations from taking contracts but has allowed children’s social services departments that are failing, such as in Birmingham and Doncaster, to be taken over by independent not-for-profit trusts, which have played a valuable role in turning services around.

** It has initially proposed this for local government but appears to favour it for central government too.

In 2012, the British Army signed a £495m 10-year contract with Capita for all its recruitment. The aim of the contract was to recruit the number and quality of soldiers the Army needed, while cutting recruitment costs by using new recruitment techniques and marketing approaches. However, the NAO found that neither the Army nor Capita tested these new approaches or understood the complexity of the transformation they were trying to deliver.⁵⁸

The Army did not engage with the market sufficiently in advance to understand how different solutions might work. The Public Accounts Committee (PAC) called the Army's approach to the procurement "naïve" and said it and Capita should share the blame for the project's "abysmal" performance.⁵⁹ Capita failed to recruit the number of regulars and reserves that the Army required every year between 2013 and 2018, with the shortfall ranging from 21% to 45% (although both Capita and the Army have stressed that great efforts had been made to turn the contract around and the NAO has recognised that performance has improved in 2019).⁶⁰

As a result of financial penalties, Capita said it expects to make considerable losses while the PAC expressed scepticism that the Army would achieve its forecast savings.⁶¹ In January 2019, the Army was 7% below its required strength and set to miss its 2020 target of 82,000 soldiers and 30,000 reserves.⁶²

The Home Office's 2007 contract with Raytheon to provide digital border services (known as 'e-borders') is another example of a major IT project that was undermined by insufficient market engagement. The NAO found that the Home Office had fixed the price and the deadline without having a clear idea of how the company could actually deliver the contract.⁶³ The Home Office and Raytheon could not agree on how the contract could be delivered and in 2010, three years into the delivery of the project, the Home Office terminated the contract, claiming that Raytheon had "failed to deliver against milestones".⁶⁴ After a lengthy legal dispute, Raytheon was awarded £224m plus legal costs.⁶⁵

A lack of early market engagement was also a problem in several of the case studies of front-line services we assessed. For instance, the procurement of probation services was rushed, which contributed to the lack of a proper assessment of the deliverability of the requirements, the adequacy of suppliers or the risks involved.

Bill Crothers, who was chief commercial officer during the coalition government, argued in 2015 that departments typically spent too little time on pre-market engagement and, as a result, too much time negotiating the contract, because officials and suppliers had not established a common understanding about the service being outsourced.^{66,*} The Cabinet Office developed plans to improve pre-market engagement, but suppliers told us that these efforts had led to limited improvements.

* Interviewees noted that such tenders can be especially damaging because there is often a pressure on officials to sign a contract – "to get a deal over the line" – even when the negotiations have been unsatisfactory.

Too narrow a focus on price over quality in selecting bids has contributed to failures

An excessive focus on the lowest-price bid has been a key factor in some of government's biggest outsourcing failures. It distorts the procurement process by encouraging suppliers to put in unrealistic bids and it often leads to contracts that deliver poor quality. The NAO has criticised several departments for focusing on the lowest price on projects, from front-line services to IT contracts.⁶⁷

Although there have been initiatives to measure value and quality and look 'beyond cost', several large suppliers told us that "it always comes down to price". Political priorities appear to be driving the focus on price, as well as an inability in some areas to properly assess quality in bids, and the problem has become more acute since 2010.

Serco's contract for providing out-of-hours GP services in Cornwall is a good example.⁶⁸ In 2011, Serco won the five-year contract, worth £32m, after other suppliers dropped out because they could not submit a bid within the cost ceiling that the Kernow Clinical Commissioning Group had set.⁶⁹ Serco's bid was £1.5m below that of the local GP co-operative's bid, but when it came to delivery, the company repeatedly failed to meet both its performance targets and national quality requirements, as it struggled to ensure that it had enough staff available, and a whistle-blower revealed that the company falsified performance data.⁷⁰ In 2014, Serco agreed to terminate the loss-making contract, two years early.⁷¹

The NHS's 2015 contract with Capita for providing support services to health practitioners is another example where the contracting authority selected a bid that promised unrealistic savings – and shows how this is often coupled with a lack of understanding about how a supplier can deliver a project, as described above.

NHS England contracted Capita to provide services to up to 39,000 GPs, dentists, opticians and pharmacists, including processing payments, administering pensions and managing medical records. To achieve a projected 35% cost saving, Capita's bid depended on a major transformation in how services would be delivered.⁷²

However, the NAO found that neither party "fully understood the complexity and variation of the service being outsourced".⁷³ NHS England did save money and Capita has said that contract performance improved after initial problems, but overall the contract has failed to meet objectives, with delivery falling "a long way below the acceptable standard", delaying an estimated 1,000 GPs, dentists and opticians from working with patients.^{74,75}

Other examples include:

- In 2014, the Home Office re-tendered the contract to run Yarl's Wood Immigration Removal Centre and awarded it to G4S and Serco, which promised savings of around 25%, but the NAO subsequently found that the assumptions in the contract were unrealistic and the facilities were understaffed.⁷⁶

- Social care suppliers have failed to meet quality requirements on contracts that have pushed for unrealistic savings, and this problem has got worse as funding for social care places has failed to keep pace with rising costs.^{77,*}
- A strong focus on the lowest price in selecting bids for work on the Work Programme stretched the financial viability of contracts and encouraged suppliers to cut corners.⁷⁸

A strong focus on the lowest price was prevalent across the areas of government outsourcing we looked at. However, it was particularly problematic in complex services and transformation projects where it is more difficult to measure the value added by a supplier, which means suppliers can cut costs by reducing quality in areas that are not measured.

Of course, saving money is one of the primary objectives of outsourcing. Encouraging competition on price is an important tool for achieving value for money and played a key role in achieving the savings identified in Chapter 2. However, price should be balanced against an assessment of the minimum level of quality a contracting authority wants and whether a bidder is realistically able to meet that.

When government focuses too narrowly on the lowest-price bid, suppliers are more likely to underbid and look to make costs up elsewhere by reducing quality, charging government penalties for contract variations or relying on adding additional services (often referred to as 'land and expand').^{**} This means that the 'saving' that government is getting in the first year is often not a good indicator of the overall lifetime cost of the contract.^{***} Ed Welsh, former executive director in the Cabinet Office, has argued that suppliers often end up hiding costs elsewhere in the contract, which has led to a "lack of honesty" in many relationships.⁷⁹

A narrow focus on price leads to several further problems:

- Lower quality can lead to extra costs springing up elsewhere, for instance problems with outsourced probation services have led to increased pressure on prisons.⁸⁰
- Awarding contracts to unrealistic bids can damage the competitiveness of markets by causing suppliers to withdraw from the market or consolidate, undermining value for money in the long term.^{81,****}
- Government does not outsource services where suppliers can add value – for instance, because they can draw on expertise, economies of scale or new technologies – but instead where suppliers offer unrealistic savings.⁸²

* In the case of social care providers, this is also due to private equity investors.

** This was the view of a range of interviewees as well as other experts, including Ed Welsh. See: Maddox B (chair), 'When does government outsourcing work?', Institute for Government event, 19 March 2018, retrieved 27 August 2019, www.instituteforgovernment.org.uk/events/when-does-government-outsourcing-work

*** For instance, interviewees told us that suppliers often insist that the key circumstances have changed, which means they cannot deliver the contract in later years for the price they did in year one.

**** This arguably happened with probation.

In some cases, quality is given prominence over the lowest-price bid. For instance, Birmingham City Council highlighted three recent procurements – for contracts in construction, housing and employee assistance – where the lowest-price bid was not selected because it failed to meet quality thresholds.⁸³ But these appear to be rare.

The evidence suggests that this problem has been getting worse since 2010, following a programme of public sector spending cuts. In a 2016 review of the UK outsourcing industry, the academic Gary Sturgess said that while “the bias in favour of low-price bidding has long been a feature of public sector procurements”, it is becoming more common. He found a growing number of examples of departments hoping to make 25%–30% savings on services that had already been outsourced, which he branded unrealistic without a technological breakthrough.⁸⁴

Chapter 2 of this report supports this, showing that there is little evidence that such savings are possible in 11 major areas of outsourcing. Interviewees agreed with the view that the focus on the lowest price has been getting worse, arguing that under austerity, ministers or senior officials were increasing putting pressure on those negotiating contracts to negotiate lower prices.* However, the Cabinet Office has argued that government has learnt from past failures and is now less likely to focus excessively on price.

In addition to recent spending pressures, however, officials lacking the ability to conduct a robust assessment of quality is also driving an excessive focus on price in selecting bids. One large strategic supplier explained that the majority of procurements it submitted bids for had only a superficial test of quality metrics. “Quality matters in the first round but once you get through that the lowest price wins every time,” they told us.⁸⁵ John Manzoni, chief executive of the civil service, said that the civil service allows companies to “bid low just to win contracts... in part because we have not had the sophistication internally to do much other than go for price”.⁸⁶

Interviewees highlighted several factors that contribute to a limited ability to judge quality, including a lack of commercial skills and experience, procurement regulations and procurement methods. Assessing quality in bids requires judgment and experience in a service area, but often officials are relatively new in their role. While past performance can be an important indicator of quality, the Public Contract Regulations state that it cannot be used to exclude companies from a bidding process. This does not mean that past performance cannot be considered, but there appears to be some doubt among officials about where it can be applied.^{87,**}

In addition, government has at times used procurement methods unsuited to assessing quality, such as competitive price-based tenders or online auctions, in areas where they are inappropriate.*** Several interviewees highlighted the first COMPASS asylum

* Some interviewees also highlighted the role of management consultancies in suggesting that high levels of savings were achievable.

** A 2015 procurement policy update stated that past performance could be included in procurements worth more than £20m in the areas of technology, business process outsourcing and facilities management. However, interviewees told us that it often was not included because contracting authorities are nervous about legal challenge.

*** Methods that involve greater dialogue about how a contract will be delivered, quality will be ensured and outcomes will be measured would be more appropriate.

accommodation contract, signed in 2012, which was procured through an online auction. Rupert Soames said of the procurement: "I have to say that a system of reverse Dutch auction conducted over the internet may not be the best way to establish pricing for a contract to provide care to tens of thousands of people."⁸⁸

Private companies manage some risks well, but large contracts have been undermined by poor transfer of risk

Transferring risk to the private sector has been an important motivation for government outsourcing. There is evidence that private companies can price and manage some operational risks better (and more cheaply) than government – and profits are partly a reward for managing these risks. However, a range of contracts have been undermined by government transferring risk that the private sector cannot reasonably price and manage, rather than sharing risk appropriately, as the Treasury's *Green Book*⁸⁹ prescribes.*

Government often transfers or allocates risks successfully. There are some types of risks that the private sector is well placed to manage, such as day-to-day operational delivery risk.⁹⁰ For example, if a private company agrees to build a school by a certain date but its sub-contractor falls behind on part of the construction, it must get another sub-contractor to do the work at its own expense.⁹¹ Private companies may end up facing heavy costs as a result of taking on risks such as these, but that is the purpose of government paying them to manage risks it does not want to manage itself.

The Thames Tideway Tunnel is an example where government apportioned risks appropriately. The construction consortia who won the contract in 2015 were responsible for operational risks but the Department for Food, Environment and Rural Affairs (Defra), working with the Infrastructure and Projects Authority, agreed that it would take responsibility for 'catastrophic risks', for example if drilling flooded the London Underground, because the private sector could not price it sensibly.⁹² This made the cost of financing the project cheaper, resulting in savings for customers.^{93,**}

However, outsourcing has been less successful when government has transferred risks that are beyond suppliers' control. This includes risks around levels of demand. For example, in the Home Office's COMPASS contract for accommodating asylum seekers, suppliers agreed to provide a service with no control over the level of demand and no right to renegotiate terms if demand changed. The contracts, worth more than half a billion pounds over five years, were awarded to G4S, Serco and Clearsprings Group in 2012.⁹⁴

However, the Home Office significantly underestimated the level of demand for asylum accommodation: in 2012, it predicted there would be 20,000–25,000 asylum seekers, but in 2016 the companies were accommodating more than 38,000.^{95,***} The

* *The Green Book* states that "risk should be allocated to the organisation best placed to manage it whether in the public or private sector". See: HM Treasury, *The Green Book: Central government guidance on appraisal and evaluation*, HM Treasury, 2018, p. 98.

** The final cost of capital for the Thames Tideway Tunnel was less than 2.5%, which the NAO estimates will reduce the projected annual impact on household water bills from £70–£80 to £20–£25.26.

*** The average time people were staying in asylum centres also increased as the Home Office struggled to process decisions. See: House of Commons Home Affairs Committee, *Asylum Accommodation: Twelfth report of session 2016–17*, HC 637, The Stationery Office, 2017.

companies struggled to deal with this extra demand and, in many centres, standards were found to be unsafe, but they were tied into providing accommodation to all asylum seekers. Serco and G4S each made total losses of more than £100m on the contracts – and the government received a poor-quality service.⁹⁶

Demand risk was also a problem in the case of Hinchingsbrooke Hospital.⁹⁷ In 2012, the NHS East of England Strategic Health Authority signed a 10-year franchise for the operation of Hinchingsbrooke Healthcare NHS Trust with Circle, a health care provider. Circle became the first private company to run an NHS hospital. But the contract transferred all demand risk and £5m of financial risk to Circle and the NAO warned that the authority's assessment of Circle's capacity to manage these risks was limited.⁹⁸

In 2015, Circle withdrew from the contract, saying it was unable to deal with levels of patient demand and could not make the contract sustainable.⁹⁹ The Department of Health (now the Department of Health and Social Care) admitted that taxpayers would have to cover the costs of the cancelled contract.* The NAO has highlighted poor risk transfer in a range of other large contracts, including a carbon capture and storage programme in 2012, a rural broadband programme in 2013 and a military training programme in 2015.¹⁰⁰

In several front-line services – including employment services, probation and asylum accommodation – poor risk transfer was tied up with the pricing mechanism. In the case of both employment services and probation, outlined above, companies' payment was linked to factors beyond their control. Payment by results programmes like these have proved particularly problematic – and the NAO has called on government to better understand providers' capacity to take on risks when using these mechanisms.¹⁰¹

Construction contracts offer another example of government transferring risks beyond suppliers' control, including 'catastrophic risk' or 'ground risk' (what happens when you dig up the ground). While the collapse of Carillion was largely the result of poor management practices, as we described in Chapter 1, several interviewees suggested that government transferred or priced risk poorly on some of Carillion's contracts. For example, its contract with Royal Liverpool and Broadgreen University Hospitals NHS Trust to rebuild the Royal Liverpool University Hospital failed due to problems including the discovery of asbestos and cracks in concrete beams.^{102,103}

Carillion signed a contract that made it responsible should risks like these materialise; however, it proved unable to manage them (the contract was causing annual losses of £83m in 2017).¹⁰⁴ The Trust ultimately terminated the contract, calling it "unviable".¹⁰⁵ Several industry experts we spoke to argued that risk could have been allocated more appropriately (although other interviewees noted that the government did not have to pay for the half-completed hospitals).

* A final figure for the costs to the taxpayer has not been published. The Department of Health said that taxpayers would have to cover the costs should the hospital's deficit exceed £5m. In 2015, when the PAC reported on the contract, the deficit was set to exceed this by a significant amount.

Some argue that if government can get private providers to take responsibility for significant risks at a low price, then it represents a good deal for taxpayers – and it is the fault of private providers for signing the contracts. In the examples given above, the supplier may well agree it made a mistake in signing up to the terms of the contract.

But this view of government’s relationship with private companies is short-sighted. Risks that the private sector cannot manage often ultimately have to be borne by government, in delays, policy failures and having to step in if projects or companies collapse, all of which can harm the public or cost money. The hospital that Carillion was building in Liverpool, originally due to open in March 2017, has still not been built and there have been repeated problems with the standard of asylum accommodation in England and Scotland.¹⁰⁶ As the NAO has argued, there has often been “a lack of recognition that risks will always return to government when things go wrong – the full risk cannot be allocated to the contractor”.¹⁰⁷

In several cases, suppliers told us that they expected government to renegotiate when circumstances changed or long contracts locked them into unfavourable terms, but government refused. In addition, suppliers complain that government still lets contracts with unlimited liability, or imposes high levels of liability without commercial justification – even when decisions are beyond their control.¹⁰⁸ It also insists that suppliers take on ‘change of law’ risk for 10 years or more, meaning that suppliers are vulnerable to the decisions of future governments.¹⁰⁹

There is a widespread view among suppliers and industry experts that government has got worse at allocating risk in the past decade, although some interviewees noted small improvements on recent procurements. A Confederation of British Industry (CBI) survey in 2018 found that 37% of businesses that work with government said that “government’s handling of risk had deteriorated since 2015”, with almost half saying there had been no improvement.¹¹⁰ Companies reported that financial, political and demand-side risks were not always allocated to parties best able to manage them and government often retained the ability to change service levels and financial incentives with little or no consultation.

At an Institute for Government event, Rupert Soames said that “huge amounts of completely unmanageable risk have been transferred into the private sector” and that this was the “key change [in government’s approach] over the last 10 or 15 years”.¹¹¹ In its inquiry into the collapse of Carillion, the Public Accounts and Constitutional Affairs Committee (PACAC) concluded that the government had “deliberately promoted an aggressive approach to risk transfer to the private sector”.¹¹²

We heard competing explanations of poor risk transfer. Some, including the PACAC, have argued that it has been a “deliberate” policy to transfer risks that government does not want, even when officials know that the private sector will struggle to manage them.¹¹³ Several interviewees said that over the past 20 years this has often appeared to be government’s consistent approach, even if it has not been official policy.

But if this was the case, government has clearly recognised the problems it caused and changed its de facto policy. The other explanation is that officials have not properly understood the risks they are asking companies to take on. This is more difficult to address, as we discuss in the next chapter.

Poor contract management has undermined a range of outsourcing projects

While the reasons why some outsourcing projects succeed or fail are decided before delivery begins, effective contract management remains crucial to ensuring good performance. Government has often struggled in this area, with officials lacking the information, skills and experience they need, made worse by a lack of continuity between those negotiating the contract and those managing it.

While government often focuses on negotiating cost savings in the contract, it has often not invested enough in the contract management needed to secure these savings – and ensure that services are of sufficient quality. Too often, relationships with suppliers have become adversarial, with a lack of trust and an unwillingness on both sides to adapt to changing circumstances. While government has launched initiatives to improve contract management, which have had some success, the evidence suggests that this remains an area of weakness.

Often officials lack the information they need to manage contracts properly. For example, the MoJ only discovered anomalies in billing practices on its electronic monitoring contracts when they came up for re-tendering in 2013 and a former G4S employee-turned-whistle-blower approached it and the NAO to raise concerns. The MoJ did not have an independent source of data to monitor tagging and had relied on suppliers' information.¹¹⁴ An audit of Universal Credit similarly found that the DWP had "poorly managed and documented financial governance, and insufficient review of contractor performance".¹¹⁵

A review of 73 contracts by the NAO found that government was often too reliant on suppliers' data.¹¹⁶ Interviewees said that one reason for this is that government officials are often too coy when companies claim 'commercial confidentiality' as an excuse for not sharing data that is crucial to understanding the performance of the contract. Information about how much companies spend on delivering public services, and therefore how much profit they are making, was available on less than a third of government contracts the auditors assessed.¹¹⁷

Another clear problem is the lack of continuity between procurement and contract management, which reflects a broader division between policy design and delivery that the Institute for Government has [previously identified](#).¹¹⁸ According to interviewees in government and industry, in many cases none of the officials involved in negotiating contracts have a role in contract management. This means officials managing the contract do not fully understand how earlier decisions were made, leaving them vulnerable to suppliers behaving opportunistically, for instance around contract variation charges.

And it means that those who know about the challenges of managing the contract are not in the room to influence its design and specifications, including access to key performance information. In the case of UK Trade & Investment's 2014 contract for specialist services with PA Consulting, the lack of involvement of the contract management team in the procurement stage prevented them from spotting problems with the pricing mechanism, which ultimately led to the contract being terminated in 2016 because it was not good value for money.¹¹⁹

There is evidence that government's management of its suppliers has increasingly shifted from approaches based on partnership to more adversarial relationships focused on compliance, enforcement and penalties.¹²⁰ Several of the problems identified above have contributed to this, including the lack of clear agreement about what the contract specification means and what Ed Welsh called the "lack of honesty" in conversations about costs that can happen as a result of focusing on the lowest price, with neither side being upfront about their true expectations.¹²¹

In addition, interviewees argued that procurement regulations and the transparency expected of the public sector can tie the hands of civil servants and prevent them from developing trusting relationships in the way the private sector can when it enters contracts.

Birmingham City Council's road maintenance contract with Amey is an example of a contracting authority and supplier getting caught in a highly damaging relationship, with poor outcomes for both. In April 2019, the council fined Amey £48.5m (£58,000 a day) for a two-year delay in repairing bollards needed to stop motorists from swerving to avoid speed bumps on a residential street.¹²² The fine came at the end of a long battle between the council and the contractor over a PFI contract, which the council felt unable to afford. The council argued that Amey was putting the public at risk while the contractor argued that the work was non-urgent, and so should have resulted in a much smaller fine.

Some interviewees saw the council's behaviour as an opportunistic attempt to profit from a supplier; however, others noted that Amey had rejected the council's repeated efforts to renegotiate and the contract, signed in 2010, had become increasingly unviable for the council following large cuts to local government funding.

Based on a study of multiple countries, the International Association of Commercial and Contract Management has argued that 'relational contracting' – when parties are "aligned on their objectives and in their commitment to on-going management and governance" – can deliver better results by adapting to the changing requirements of contracts.¹²³ By contrast, it found that poor contractual relationships, for instance due to disagreements over scope or performance assessments, can cost contracting organisations an average of 9.15% of their annual revenue.¹²⁴

The evidence suggests that while government has often lacked the skills and experience it needs to manage contracts effectively, it is taking steps to address this.

In recent years, several large spending departments, including DWP and MoJ, have improved the governance of contracts and the Cabinet Office has created a set of commercial standards that senior officials should be assessed against.¹²⁵ In 2019, the Cabinet Office said that it would make training available to around 30,000 staff responsible for managing contracts, most of whom do not consider themselves commercial staff. Suppliers noted an improvement, but suggested that contract management remains a weakness.

Government should learn from what has worked

This chapter has set out clear factors needed to make a success of outsourcing: the existence of a market, the ability to measure performance and define an adequate level of quality, early market engagement, thoughtful approaches to bid selection and risk transfer, and strong contract management. Contracts that demonstrated these have delivered significant benefits and improved people's lives.

But we have also identified a range of contracts that have wasted money and harmed service users where these factors have not been met. Several fail on multiple areas, such as probation, suggesting that the initial decision to outsource was wrong. Other examples show that government has outsourced services for the wrong reasons – in pursuit of unrealistic savings and without a reasonable expectation that companies have the expertise, economies of scale or new technologies that would enable them to deliver efficiencies or quality improvements.

While there has been an improvement in government's commercial skills, there remain problems in how contracts are procured, how they are written (especially how risk is allocated) and how they are managed. These are not new problems – government has identified them in the past but struggled to tackle them. In the next chapter, we discuss its current efforts to address them, and make our own recommendations for improving the way government outsources.

4. How to improve government outsourcing

The UK has reached a crossroads in its 40-year outsourcing project. Used well, outsourcing has delivered benefits. But used poorly, outsourcing has caused harm and waste. Government should improve the way it decides whether to outsource services and, when it chooses to use an external provider, how it engages with the market, selects bids, and writes and manages contracts.

It should also improve the evidence it uses to make contracting decisions. If it fails to address current problems with outsourcing, there is a danger of throwing the good out with the bad.

This report has shown that a wholesale programme of taking services back into government hands would risk losing substantial gains – cost savings, efficiencies, innovations and higher-quality services – that, in some areas, outsourcing and competition have delivered. Yet support for such a policy is likely to increase if government continues to suffer repeated failures in important projects that the public cares about.

The government therefore needs to urgently address the causes of the persistent problems that we have identified. The prize for doing so will be great:

- Making the initial decision to outsource more robust will help government focus on areas where outsourcing delivers benefits and avoid flawed projects that end in costly failures.
- Improving market engagement will make procurement easier and improve competition.
- Balancing cost and quality, and allocating risk more intelligently in contracts, will help to deliver genuine value for money.
- Strengthening contract management will help government to get more out of its suppliers.

In February 2019, in response to the collapse of Carillion and wider problems in the sector, the Cabinet Office published the *Outsourcing Playbook*.¹ It was written in consultation with industry and sets out best-practice guidance on how to outsource services, including in the areas of weakness we have identified.

If these and the other policies in the *Outsourcing Playbook* are fully implemented, it would be a major step towards addressing the problems we have described. But implementation will not be easy. Several of the policies in the *Outsourcing Playbook* have been in place for several years but have been routinely ignored. Setting out best

practice alone will not be enough to change behaviour and culture that is ingrained; six months on from its publication, several suppliers said not much has changed.

In this chapter, we make recommendations on how to ensure that the key problems we have identified in this report are addressed. We assess the proposals in the *Outsourcing Playbook* and set out how to ensure that they are translated into the practical changes required. We make recommendations on resources, staff capability, commercial skills and improving scrutiny and accountability.

In addition, we set out what is needed to improve the evidence that underpins contracting decisions. It is vital that the government takes these further steps – or there is a risk that progress in tackling problems will stall and the *Outsourcing Playbook* will be forgotten as ministers and political priorities change.

Government must address the persistent problems that undermine outsourcing

Government should get better at deciding when to outsource

Where outsourcing has worked, it has delivered substantial benefits. But when government has contracted out services in areas where it was inappropriate to do so – for instance, because there was not a market of good-quality suppliers, the difference between good and bad performance could not be measured or an acceptable level of quality could not be codified in a contract – it has resulted in harmful failures. Probation is the clearest example of this; it failed on each of these criteria, yet still it went ahead, harming efforts to rehabilitate offenders.

The *Outsourcing Playbook* sets out several measures intended to make the initial decision on whether to outsource more rigorous. Central government departments will have to conduct a “thorough make vs buy assessment before deciding to outsource a service”,² including a detailed analysis of the costs and benefits of each option. Where a service is being outsourced for the first time, there will be a presumption that a pilot should be run. All complex outsourcing projects will now be required to go through a ‘project validation review’, a short independent peer assessment that takes place between policy formation and delivery, which is currently used for approving major projects.

If these proposals are fully complied with by ministers and implemented by departments, it should prevent cases like probation from happening again. But several further steps are needed to support implementation as, in many areas, the current evidence base is too weak to make a rigorous ‘make vs buy’ decision; departments have often not conducted such assessments because outsourcing projects are rushed through on short timescales; and the process through which central government departments review and approve outsourcing projects has also been too weak.

The requirement to conduct pilots should prevent departments from outsourcing complex projects at national scale without a clear idea of how they will work, although interviewees highlighted that the Cabinet Office would have to be wary of departments gaming the assessment, for instance by describing historic projects as pilots for new plans.

Departments should ensure that officials engage early with suppliers

Successes demonstrate the importance of officials developing a strong understanding of what they want from the service before outsourcing – but many contracts have hit problems because government has not talked with suppliers early enough.

The *Outsourcing Playbook* encourages better market engagement and sets out clear expectations: all central government departments will be expected to publish their pipelines of upcoming procurements, and officials should assess the health and capability of the market early on in all outsourcing projects. This is welcome. But there has been “a requirement to carry out significant levels of pre-procurement market engagement with a diverse range of prospective suppliers, including SMEs [small and medium-sized enterprises]” since 2012, yet early market engagement remains a widely recognised weakness.^{3*}

Our interviews suggest that limited pre-market engagement is often caused by officials lacking time, resources and sector expertise. In addition, several interviewees questioned whether officials have the confidence, or are given enough encouragement by managers, to have open and frank conversations with suppliers before letting contracts.

Government should improve the way it assesses price and quality in selecting bids

A key reason many of the outsourcing projects we looked at failed was that government focused narrowly on securing the lowest price with an insufficient assessment of quality.

The *Outsourcing Playbook* recognises that “on occasions there has been a bias towards low cost bids rather than the best value for money in terms of cost and quality”.⁴ It states that for complex outsourcing projects, departments must produce a ‘Should Cost Model’ – a total estimation of the cost of delivering a service – as part of the ‘make vs buy’ decision. In addition, it requires departments to refer any abnormally low bid (one that is more than 10% lower than the average of all bids or the ‘Should Cost Model’) to the centralised assurance team in the Cabinet Office.

These are important changes. If they are fully implemented, they should help to prevent government from selecting bids based on an unrealistic projection of costs, which often results in difficult contractual relationships and poor service outcomes.

Alongside this, the government has also announced that it is doing work to develop more sophisticated approaches to measuring quality in bids. Since the late 1990s, successive governments have aimed to do this,⁵ but the evidence we have seen suggests these efforts have made little progress. The political priority to reduce spending since 2010 has contributed to this. But it has also been caused by other factors, including:

* Bill Crothers, who was chief commercial officer during the coalition government, argued in 2015 that departments typically spent too little time on pre-market engagement and, as a result, too much time negotiating the contract, because they had let tenders poorly. See: Smith P, ‘The end of an era – looking back at Bill Crothers’ time as the UK Government’s Chief Commercial Officer (part 3)’, blog, *Spend Matters UK/Europe*, 15 January 2016, retrieved 27 August 2019, <http://spendmatters.com/uk/crothers-part-3>

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- officials lacking the judgment and experience to assess quality
 - departments not knowing which quality metrics to use or not having access to the information, for instance about past performance, they need to enable this
 - officials not selecting the right procurement method for the type of service being outsourced, as with the first COMPASS asylum seeker contract.⁶

Government should get better at allocating risk

Poor risk transfer has undermined a range of outsourcing contracts and suppliers identified it as their biggest concern. The *Outsourcing Playbook* says officials will have to ensure that risks “sit with the party best able to manage them”⁷ and sets out several measures to achieve this:

- Departments will be expected not to ask suppliers to take on unlimited liabilities.
- Pricing and payment mechanisms will be subject to greater scrutiny.
- All outsourcing projects will comply with a minimum standard when assessing the risk of a supplier going out of business during the life of a contract, including suppliers providing management accounts, financial projections and evidence of previous contracts.⁸

The requirement that departments do not offer tenders with unlimited liability should be easy to implement: one supplier told us they had already got the terms of a contract changed by reporting a tender to the Cabinet Office.

But other measures will be more difficult. Government reviews dating back more than 20 years have identified risk transfer as a key weakness.⁹ The *Outsourcing Playbook's* requirement that departments allocate risks to “the party best able to manage them” was established as a principle in the Treasury’s 2003 *Green Book* guidance, yet suppliers and industry experts have said that government’s approach to managing risk appears to have further deteriorated since then (although some interviewees noted recent improvements).^{10,11}

Often, poor risk transfer has been caused by an insufficient understanding, on the part of both government and supplier, of the service being outsourced and the risks being transferred, which requires investment in skills and capabilities.

Government should strengthen contract management

In some cases, perfectly good contracts do not deliver better or cheaper services because they are managed poorly. The *Outsourcing Playbook* states that departments must ensure there are thorough contract management mechanisms in place, and that they are able to effectively measure the performance of service delivery.

The Cabinet Office has started a programme to train 30,000 contract managers across government. In many cases, contract managers have previously had little or no

commercial training. This training could be hugely important but there is a danger that it will not be sufficiently funded or committed to by departments. The Cabinet Office has struggled to get departments to identify which members of their staff manage contracts and require training.

Government must ensure that the *Outsourcing Playbook* is fully implemented

The government should secure the funding and resources and commit to transparent progress assessments required to ensure the *Outsourcing Playbook* is fully implemented – and avoid proposals being ignored, as they have been in the past.

The Treasury should ensure that the commercial team in the Cabinet Office has the budget to support implementation

The outsourcing team in the Cabinet Office needs the resources to support implementation of the *Outsourcing Playbook* and delivery of necessary training. This programme will only require a budget of between £7m and £9m a year for the next two years and £5m a year thereafter to provide ongoing support to departments. But this funding is not secured. As we have shown, a single failed contract – such as the Home Office’s ‘E-borders’ contract with Raytheon – can waste several times this annual budget.

- **At the 2020 spending review, the Treasury should ensure that the outsourcing team in the Cabinet Office has sufficient long-term funding to implement the *Outsourcing Playbook* and train contract managers.**

Permanent secretaries should ensure departments adopt best practices

Departments must also commit to adopting these changes. For example, they will need to identify and support key officials to complete training and ensure that knowledge is passed on when officials leave. They will need to give officials the time required to meet the standards set in the *Outsourcing Playbook*, such as completing more rigorous ‘make vs buy’ assessments and conducting sufficient market engagement. This will particularly be the case when ministers put senior officials under pressure to outsource services quickly, without proper testing, and to achieve certain outcomes, such as short-term cost reductions.

- **Permanent secretaries should work with commercial directors and HR directors to ensure that officials have the time and resources they need to implement the *Outsourcing Playbook*.**

The Cabinet Office should commit to publicly assessing the implementation of the *Outsourcing Playbook*

The Cabinet Office will be constantly assessing implementation of the *Outsourcing Playbook* through the approvals process for complex outsourcing contracts. But it is not yet clear how the government will publicly judge whether policies are being followed for these contracts or the larger number of less complex contracts. In our experience of observing many other civil service reform processes, this creates a risk that the policies will be forgotten among other priorities, or as ministers and senior personnel change.^{12,13} To prevent this from happening, the Cabinet Office

should publish an annual assessment – including a Red/Amber/Green (RAG) rating and a narrative explanation – of complex contracts as well as a summary of how successfully policies are being adopted more widely. The annual report published by the Infrastructure and Projects Authority (IPA), which assesses progress on all major projects in the government’s Major Projects Portfolio, provides a good template.

- **The government chief commercial officer should commit to publishing an annual progress review of the *Outsourcing Playbook*, beginning in 2021, assessing the extent to which different measures have been adopted and the performance of complex outsourcing projects.**

Local authorities and public sector bodies should adopt relevant policies from the *Outsourcing Playbook*

The *Outsourcing Playbook* states that it is aimed at “Commercial, Finance and Project Delivery professionals across central government”;¹⁴ however, many of its principles are equally applicable to local government and wider public sector bodies – including the NHS – that suffer from similar problems. As yet, it is unclear how the *Outsourcing Playbook* will be applied more widely: the Local Government Association’s most recent procurement strategy, published before the *Outsourcing Playbook*, identifies many similar problems but does not commit local authorities to any of the *Outsourcing Playbook*’s policies.¹⁵

- **All public bodies, including the NHS and local authorities, should adopt relevant policies from the *Outsourcing Playbook*, based on consultation with the Cabinet Office.**

Government should continue to strengthen commercial skills

Addressing most of the problems we have identified in this report will rely on continuing to strengthen commercial capabilities. For example, improving the way officials assess quality in selecting bids or allocate risks in writing contracts depends on developing their experience and judgment. Successive reviews in recent years have identified government’s commercial capabilities as a weakness.*

Since then, government has made clear progress – in particular by hiring experienced commercial experts from outside government and establishing a rigorous assessment centre that all commercial staff have to pass through.

Since 2016, the Cabinet Office has encouraged departments to conduct ‘commercial blueprints’ – assessing the projects they have and identifying the staff and the skills, experience and grade mix they need to deliver them successfully.¹⁶ It has recently extended this to arm’s-length bodies.

But problems persist. Interviewees suggested that skills in central government remain patchy between departments, while in public bodies and local government there

* In 2013, Institute for Government research found patchy capability in procurement, contract management and commissioning. In 2014, a review by the NAO found that contract management was often weak. In 2016, the Civil Service said that commercial skills in government remained “scarce”.

appears to be a significant skills gap.^{17*} Rapid turnover means that commercial staff often do not stay long in post and can have limited experience in the sector they are working in. Contract managers are often not involved in contract negotiation. And senior commercial staff also appear to lack influence early in the policy making process, which prevents a 'golden thread' of personnel and rationale from policy design to contract negotiation to contract management.^{18,**}

- **Permanent secretaries should work with commercial directors and HR directors to ensure that contract managers are involved in contract negotiation.**
- **All public bodies, including local authorities, should ensure that they have up-to-date 'commercial blueprints' identifying where they lack skills and experience.**

Government should improve scrutiny of outsourcing and accountability for it

Scrutiny of outsourcing project plans is too weak

We have highlighted multiple outsourcing projects – in central government, local government and the wider public sector – which should not have been signed off because the projected cost savings or timescales were unrealistic, or the contract model or suppliers were unproven and unlikely to work. That they went ahead suggests that the checks and balances in place – whether it is officials raising concerns, scrutiny of plans by central government departments or scrutiny by external bodies – are not working as they should be.

The outsourcing of probation is perhaps the clearest example, highlighting the weakness of scrutiny and accountability at each stage of the process. Rupert Soames, the chief executive of Serco, has rightly argued that officials should have asked for a ministerial direction due to the impossible timescales – and that officials should use directions more often to challenge unworkable outsourcing plans.¹⁹ Our analysis of the 70 ministerial directions issued since 1990 shows that they have rarely been used on outsourcing projects; never on the contracting out of front-line services and only in a handful of infrastructure projects on value-for-money grounds.²⁰

The Treasury's guidance sets out specific conditions, including value for money and feasibility, where accounting officers should seek guidance, including on outsourcing decisions; however, this guidance is not being followed.²¹ The *Outsourcing Playbook* is already referenced in the latest update to the Treasury's *Orange Book*²² and it should also be incorporated into the *Green Book*²³ when it is next updated, but a further step is required to emphasise the importance of raising concerns.

* Our case studies, which show multiple failures in local government and public bodies, and our interviews support this.

** Joshua Reddaway, Head of Commercial and Contract Management VFM at the NAO, questioned "commercial staff's ability and prestige to influence within the civil service", asking, "are they in the room?". See: Maddox B (chair), 'When does government outsourcing work?', Institute for Government event, 19 March 2018, retrieved 27 August 2019, www.instituteforgovernment.org.uk/events/when-does-government-outsourcing-work

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- **The Treasury should issue a 'dear accounting officer' (DAO) letter to all accounting officers to remind them of their responsibility to publicly challenge outsourcing plans that are unfeasible, poor value for money or where their timescales or technical requirements pose a serious risk of poor performance.**

But it is not only up to officials in the department. In the case of probation, the Public Accounts Committee (PAC) criticised the Treasury, the Cabinet Office and the Major Projects Review Group (MPRG, a group of senior civil servants and private sector experts convened by the IPA)^{24,*} for providing insufficient challenge of unrealistic plans pushed through by a determined minister.²⁵

In this report we have highlighted other examples where similar failings occurred.^{26,**} The *Outsourcing Playbook* has called for the approvals process to be beefed up by including commercial staff; however, interviewees were unconvinced of how much difference this would make. Officials also need the right capacities and incentives in place to provide and accept challenge.

- **The chief executive of the civil service and the government chief commercial officer should ensure that the approvals process for outsourcing projects is a rigorous assessment of departments' compliance with the *Outsourcing Playbook*.**
- **The Cabinet Office should adopt a 'comply or explain' approach to the *Outsourcing Playbook*, with the minister for the Cabinet Office providing political support to officials if departments do not adhere to it.**

Accountability for the outcomes of outsourcing is also limited

Ministers and officials are also not sufficiently accountable to the public, due to insufficient scrutiny in Parliament, poor collection of information about the performance of outsourced contracts and limited access to data held by private companies.²⁷ This undermines the public's right to know how their money is spent on delivering public services.

In Parliament, outsourcing projects are often not scrutinised sufficiently early by select committees. Our [previous research](#) identified that select committees often do not assess projects when things are starting to go wrong, and argued that there are additional sources of information, such as feasibility assessments, which they could use to do this better.²⁸

Officials and ministers also often move on quickly and are rarely called back to face questions about historic decisions.²⁹ This is crucial as it means ministers can push

* The MPRG is co-chaired by the chief executive of the civil service, John Manzoni and the second permanent secretary to the treasury, Charles Roxburgh. The head of the IPA attends most of the panels for continuity and to support the chairs. The MPRG scrutiny panel for each review consists of (usually) three or four individuals selected from a pool of senior government and private sector experts.

** For instance, the NHS's agreement with Capita to provide primary care services contained no clear understanding of how the supplier would achieve huge savings. The Kernow Clinical Commissioning Group's contract for out-of-hours GP services with Serco was not sufficiently scrutinised given Serco had limited experience in delivering such services. The PACAC has highlighted a range of other examples where services have been rapidly contracted out because of ministerial decisions and challenges have not been sufficiently raised.

through unworkable plans with little fear of repercussions and officials have little incentive to challenge contracts that will not work. In the case of probation, which cost £467m more than was required in the contract and disrupted services for tens of thousands of offenders, both the minister and the senior responsible owner were promoted before the full consequences of the project became apparent.

- **Select committees should ensure that they scrutinise plans for significant outsourcing projects – before they begin, and against the principles in the *Outsourcing Playbook*.**
- **Select committees should recall ministers and officials who have subsequently left their post to answer questions about the decisions made during the inception of a project, especially where subsequent underperformance or failures have resulted in harm to the public.**

Poor data collection also undermines accountability.* Data on the performance of contracts is often not collected, is of poor quality or is held by suppliers and not accessible to government. A lack of performance data was identified as a barrier in almost all of our interviews and at a public debate held at the Institute for Government in May 2019; local authority chief executives have also raised it.³⁰ As we and others have highlighted, data on the performance of in-house services is also often poor – and should be held to the same standard as outsourced contracts.³¹

The Cabinet Office recently set out plans to publish key performance indicators for outsourcing projects and has developed a system, the Contract and Spend Insight Engine (CaSIE), to enable better analysis of contract information. These measures are welcome, but they should be accompanied by a clearer strategy for how price and performance data is used to develop insights.

- **The Cabinet Office should mandate clear standards for the collection of data on the performance of outsourced contracts in line with the Open Contracting Data Standard. This should include key quality metrics and any contract amendments. It should provide guidance on how access to performance data should be written into contracts.**
- **The Cabinet Office should establish a team with the capacity to analyse data on the outcomes of complex outsourcing projects and produce insights to inform best practice. This team should also be responsible for producing the annual progress review described above.**

* Assessments of performance are patchy. In a handful of areas, such as probation, prisons and health care, independent inspectorates produce reports that assess the performance of services. But in most areas, measuring performance is down to officials managing contracts, yet officials lack information. The NAO has a mandate to assess value for money of government spending; however, it only has a limited role in judging the performance of outsourced services on various quality metrics. In several areas, the public have only discovered that contracts were failing as a result of investigative journalism. See: White A, *Shadow State: Inside the secret companies that run Britain*, Oneworld Publications, 2016.

In addition, the public do not have the right to information held by external suppliers, including outsourcing companies. Freedom of information (FOI) law has not kept up with dramatic changes in how public services are delivered over the past 40 years.

In January 2019, the Information Commissioner's Office laid a detailed report before Parliament calling for FOI laws to be extended to cover external suppliers, with a threshold to exempt small companies for whom this would be too onerous.³² It highlighted Carillion, where the public had little access to information about which contracts the company held, and the Grenfell fire, where the tenant management organisation refused requests for access to fire safety reports written 12 years before the fire, as examples where there was a "serious gap in the public's right to know".³³

The government rejected this suggestion,³⁴ but [as we said at the time](#) the arguments against extending FOI are weak.³⁵ Large outsourcing companies themselves have said they would be happy for the law to be extended to cover them.³⁶

- **Government should update FOI laws to ensure that the public have access to key information about services delivered by external suppliers, such as who holds contracts and how they are performing, while including a reasonable threshold for exempting small suppliers.**

Government also needs to continue to improve its wider procurement data. In 2018, the Institute for Government [published a report](#) that showed that government currently lacks sufficiently high-quality data about what it is buying, from whom and for how much, and argued that this hinders its ability to make good spending decisions and to outsource services well.³⁷ It also undermines accountability – as in the case of Carillion, highlighted by the Information Commissioner's Office.³⁸

We called on government to improve the quality of its procurement data and publish more of it openly, and to set out necessary steps to achieve this, some of which government was already committed to.³⁹ Since then, the government has acknowledged poor data quality* and in April 2019 the Cabinet Office published the *Open Government National Action Plan 2019–21*, which includes targets for improving procurement data.⁴⁰ We welcome progress in this area; however, these targets could have been more ambitious.

- **The Cabinet Office should set more ambitious targets for improving its procurement data, drawing on the recommendations in the Institute for Government's previous report on government procurement.**⁴¹

* At an event at the Institute for Government, Gareth Rhys Williams acknowledged problems with government's data and said that it was taking several measures to address it, including publishing procurement pipelines, developing a new computer system for registering tender opportunities and working with IT providers to update the way data is collected. See: Institute for Government, 'The extent of government procurement', Institute for Government event, 13 December 2018, retrieved 27 August 2019, www.instituteforgovernment.org.uk/events/extent-government-procurement

Government should improve the evidence on outsourcing

In a range of key service areas – including prisons, health care and IT – government lacks good recent studies on the comparative cost and quality of public and private provision. This means officials are unable to give ministers rigorous advice on whether to outsource a service, and what benefits outsourcing might achieve. It also means government spends billions of pounds a year on services that the public relies on, with little idea about whether they will be effective and good value for money.

Ministers and senior civil servants should be accurate when describing the benefits of outsourcing

Ministers and senior civil servants should improve the way they publicly communicate the benefits of outsourcing. As we have shown, there is little research to support the frequent claim that outsourcing services today can deliver 20%–30% cost savings – either in first-generation contracts (in areas that have not previously been outsourced), or in later-generation outsourcing (in areas that have).

Where there is recent evidence, outsourcing services today appears to be able to deliver savings in the range of 5%–10%. Repeating inaccurate claims puts officials under pressure to deliver unrealistic savings, where the real potential benefits may be in achieving innovations, quality improvements or contestability. It also misleads the public.

Where the evidence base is weak, ministers and senior civil servants should be transparent about the uncertainties and honest with the public about their reasons for outsourcing, for instance a lack of in-house capacity or expertise. A better understanding of the evidence on outsourcing within Whitehall should facilitate better communication.

- **Ministers and senior civil servants should ensure that their claims about the impact of outsourcing on the cost and quality of services are based on rigorous evidence.**

The government should develop evidence about what works

Several factors underpin the lack of evidence on outsourcing.

First, there is a lack of performance data, as highlighted above, and the fact that those working outside of government, such as academics, have limited access to data. For major projects, the IPA has established Project X, a collaboration that enables academics to work with sensitive government data, having signed non-disclosure agreements; however, there is no similar project for improving evidence on outsourcing projects. A new programme, Administrative Data Research UK, is helping government and providers to increase access to sensitive data by working with departments and the Office for National Statistics to provide secure access.⁴²

Second, in many cases, government has not embedded a thorough approach to evaluation at the start of contracts. As Chapter 2 showed, meaningful comparisons are often hampered by the difficulty in isolating the impact of private ownership compared with other factors. For example, it has been difficult to find reasonable comparators for new-build Private Finance Initiative (PFI) prisons because there are

so few conventional prisons newly built by the public sector. This is a key reason for limited evidence on prisons, despite 25 years of outsourcing.

The *Outsourcing Playbook* has mandated that all new outsourcing projects should conduct pilots, and plans for collecting evidence on complex outsourcing projects should be agreed at the approvals stage. But they should go further to ensure proper evaluation, using comparators wherever possible. The Department for Education did this for its Priority School Building Programme – but it should be done more widely.⁴³

Third, there are barriers in academia. Evaluating outsourcing projects requires interdisciplinary teams – bringing together public administration, economics, accounting and other disciplines – but research funding and academic career incentives often do not support interdisciplinary work.⁴⁴

Fourth, there are no dedicated organisations stimulating evidence on outsourcing: the government rejected PACAC’s recommendation to set up a ‘What Works Centre’^{45,*} to develop evidence on contracting without explaining how it would address the absence of evidence.**

- **The Cabinet Office should set out a detailed strategy for how it will address fundamental gaps in evidence on the outcomes and effectiveness of outsourcing.**

This should include: establishing a collaboration between academics and government to work on outsourcing data, drawing on the success of Project X for major projects; working with Administrative Data Research UK to design secure access to contractual data for a larger number of academics; ensuring that better evidence on contracting is a priority in relevant departments’ areas of research interest; and working with UK Research and Innovation to ensure that there is funding available for research.

- **The Cabinet Office should assess how departments plan to collect evidence and evaluate future projects as part of the approvals process. Where a service is being outsourced for the first time or with a new delivery model, plans should include ensuring there are reasonable public sector comparators in order to evaluate performance.**

While government must ultimately aim to develop evidence on the comparative cost and quality of public and private provision, it should also ensure that its estimates of the costs and benefits of outsourcing projects are as accurate as possible.

As we showed in [our previous work on financing decisions for major projects](#), governments around the world, including in the UK, suffer from systematic cost underestimation.⁴⁶ We highlighted three main causes:

* What Works Centres act as hubs that commission research, synthesise evidence and conduct experimental trials in specific policy areas. There are nine What Works Centres in the UK, covering areas such as health care, educational attainment and crime.

** The Cabinet Office argued that existing processes and initiatives were broadly sufficient, but said that it was “considering options to provide further analysis on the benefits of outsourcing”.

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- strategic misrepresentation, where analysts understate costs to make a project look good and push it through the approval process
 - 'optimism bias', a systematic tendency to underestimate the time and costs of a project
 - 'anchoring and adjustment', the difficulty that people face with adjusting away from an initial – usually low – estimate (the 'anchor' number), and subsequent tendency not to adjust their estimates far away enough from it.⁴⁷

Reference class forecasting – a way of improving accuracy by adjusting forecast project costs and benefits using data from similar past projects – is a useful tool for preventing cost underestimation. Government has adopted guidance for using it on major infrastructure projects.⁴⁸ Some departments and agencies have started to adopt reference class forecasting, for instance Highways England has used it to improve its estimates for road-building schemes.⁴⁹ But it is not the norm on major infrastructure projects, often because departments lack data from similar past projects to enable them to do it. The same is true for outsourcing projects.

- **The Cabinet Office should collate information centrally and ensure that departments use it to enhance reference class forecasting on outsourcing projects.**

Beyond evidence on outcomes across a service, we found that there is a serious gap in terms of rigorous analysis of case studies, particularly for contracts that have been successful. While the NAO, select committees and others rightly focus on analysing contracts that fail, it is much more difficult for officials to learn from contracts that work. A key barrier, according to suppliers, is that government is often unwilling for information about specific contracts to be made public. One told us that contracting authorities in other countries were more willing to recognise and learn from successes.

- **Contracting authorities should work with suppliers and external experts to develop rigorous case studies of contracts, including in areas where outsourcing has worked.**

5. Conclusion

The UK has led the way in applying market mechanisms to the work of government. Outsourcing has produced significant benefits: saving money, modernising systems and improving the lives of service users by making services quicker and easier to use.

Contracting out waste collection, cleaning, catering and maintenance in the 1980s and 1990s led to significant savings – and in-house providers have become more efficient as a result of competition. While the evidence is more mixed in front-line services, it is clear that opening up prisons to competition has led to innovations and competitive effects, which have improved the lives of prisoners. No government should want to throw these benefits away.

But done poorly, outsourcing has caused harm and waste. Some of the people most in need in society – jobseekers, benefits claimants, ex-offenders – have been let down by government outsourcing services poorly. Large contracts have gone badly wrong, resulting in significant overspend, while a string of failures has damaged public trust and led to calls to bring swathes of services back in-house.

That would be the wrong lesson to take from examining the record of the past 40 years. Instead, governments should base decisions on whether a service is delivered publicly or privately not on ideology but on what most benefits the public.

They must outsource for the right reasons – where private providers benefit from expertise, economies of scale or new technologies that enable them to deliver services better or more cheaply, or where competition can improve performance. They should not outsource where there is no reason to think it will work, as with probation, or in pursuit of unrealistic cost savings. They must develop better evidence to inform these decisions.

When government chooses to outsource, it must do it better: understanding what it is buying, choosing bids that deliver sufficient quality and value for money, allocating risks intelligently and managing contracts effectively. Such purpose and rigour will be key to government navigating its way out of the wider problems it currently faces, including low trust in contractual relationships and declining competition.

By publishing the *Outsourcing Playbook*, the government has made an important first step towards addressing the problems we have identified in this report. But there is a real risk that it will not improve practice on the ground. It must be accompanied by the resources, skills, capabilities and accountability required to deliver change.

Annex 1: Reviewing the literature on competition and outsourcing

This annex sets out how we assessed the strength of the evidence on the impact of competition and outsourcing on different services.

Retrieving and reviewing the evidence

Having shortlisted 11 service areas for inclusion in this report, we developed search terms for each area. We then combined these service-specific terms with key words such as outsourcing, competition, contracting or tendering, and ran searches on three platforms: academic databases, Google Scholar and Google.

We then reviewed the titles and abstracts of the first 100 results from each search. Inclusion criteria were as follows:

- Does it focus on government or the public sector (in the UK or internationally)?
- Does it contain relevant data on cost or quality (as opposed to theoretical models)?

In some circumstances we included studies that did not meet these exact criteria but provided useful insights. We included studies on both competition and outsourcing.

We focused on retrieving academic studies, but we included non-academic work such as studies from the NAO, parliamentary select committees and other official bodies or research organisations.

Assessing studies

The Red/Amber/Green (RAG) ratings used in this report to assess whether outsourcing in the UK has worked are explained in Chapter 2.

To reach a judgment on each service, we took a view of the robustness of the academic, empirical evidence available. To assess the robustness of studies, we considered the data collection method, the extent to which the study featured an experimental design (for example, the degree of randomness in selecting data points) and whether relevant control variables that are likely to affect cost/quality were included in the analysis, among other factors. We prioritised evidence from the UK, and used evidence from abroad to inform our wider understanding.

We moderated assessments of each service area to agree final RAG ratings.

Making sense of the data on competition and outsourcing

There are several reasons why it is difficult to draw firm overarching conclusions from the existing evidence:

- **The academic studies available unevenly cover many front-line public services or support services to government.** There is more evidence on transactional services such as catering or maintenance, and less on complex services such as mental health or welfare, or even public sector back-office support services such as HR or IT.
- **The evidence on competition and outsourcing is based on observations from a range of countries.** Much of the evidence focuses on the US, the UK and Australia, with more recent work looking at countries in Europe and beyond. In addition, the studies examine services at different levels of government (states, regions, counties or cities), which hampers comparison.
- **The quality of the data varies significantly.** Experts rely on different methodologies to estimate savings and the impact on performance and quality. Some studies are based on a single case study, while others rely on government databases, which include thousands of observations or participants. Similarly, some rely on surveys or document reviews, while others use sophisticated analysis, controlling for several variables, or quasi-experimental approaches. In addition, the robustness of the evidence or study designs may have changed over time, leading to differences in the impact recorded.
- **Many meta-analyses include studies focusing on competition rather than outsourcing specifically.** This includes instances where contracts were subjected to competition but awarded to the in-house team as opposed to outsourced to an external (private or third sector) supplier. This makes it difficult to consistently assess the impact of outsourcing.

Measuring the impact of outsourcing on cost and quality

Estimating cost savings and quality improvements presents challenges. Like-for-like comparisons – for instance between contracting authorities that have kept provision in-house – are rare. This also applies to before-and-after comparisons, since some services were not specified or costed in detail before competition was introduced.¹

There is less data on the impact of outsourcing on performance or quality than on cost. For example, Petersen and others, in their 2018 meta-analysis of 49 studies, found that around half did not measure impact on quality.² Our interviews suggested that there is a relationship between how easy it is to contract a service, and how much evidence is available on it. This is particularly true of data on quality and impact. Challenges include:

- **Defining quality standards in contracts and monitoring them.** Quality is a multifaceted concept, and can mean compliance with standards, exceeding customer satisfaction targets or meeting other subjective measurements such as cleanliness.³ Measuring quality is even more challenging in complex services dealing with human needs, as our interviewees highlighted.

- **Attributing improved results to a specific supplier.** For instance, in employment services, government could pay a supplier for an outcome (such as jobseekers' employment), which could in fact be affected by wider economic trends rather than that specific intervention.⁴
- **Focusing on outcomes rather than outputs.** For example, in some complex services such as elderly care, measurable outputs like the frequency of visits may not translate into actual health benefits to the patients.

Has the comparative advantage of using the private sector declined over time?

There is a debate on the comparative advantage of using private (compared with public) sector suppliers over time. There is very little data tracking savings over time, and the evidence on savings in second or even third generations of contracts is sparse and mixed, with some showing smaller savings in some areas, while others show increased savings.⁵

Several studies from the 1990s onwards indicate that there is no significant difference between the costs of providing a service publicly or privately, which suggests that the cost-benefit of using private provision has decreased.⁶ In their 2018 review, Petersen and others found that service delivery by the private sector was 8.5% cheaper on average than service delivery by the public sector in studies published between 2000 and 2004, but only 0.4% cheaper in studies published between 2010 and 2014.^{7,*}

On the whole, more recent evidence indicates that the benefits of outsourcing could be driven by both the effect of competition and private sector effectiveness,⁸ with some arguing that competition, rather than outsourcing, makes the most difference.⁹

There are a variety of explanations for why the difference in costs between public and private provision appears to have narrowed over time:

- **The public sector has become more effective since outsourcing began.** The UK government has significantly improved its commercial skills, particularly in recent years through the government commercial function, setting standards for commercial professionals, and deploying senior commercial experts across Whitehall.¹⁰ Officials with improved skills are able to secure better value for money when signing new contracts or renegotiating existing contracts. In addition, the cost of in-house provision can fall as a result of competition, as noted above. At the same time, it is possible that in-house provision has become cheaper as providers have learnt from the private sector, adopting some of their methods and innovations, thus becoming more efficient.^{**}

* These figures are based on 25 studies (11 published between 2000 and 2004 and 14 published between 2010 and 2014) comparing different services and geographical areas and using different data, and should be interpreted in this context.

** There is evidence of this happening in prisons. See: Le Vay J, *Competition for Prisons*, Policy Press, 2015.

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- **It is challenging to sustain significant savings over time.** Professor Gary Sturges has highlighted that it is “madness” to expect services that have been subjected to competition several times to deliver two-digit savings of the same magnitude as when a contract was first tendered – in the absence of significant technological change.¹¹ Some interviewees pointed out that while two-digit efficiencies can be found with relative ease when outsourcing is first introduced, savings can be much harder to come by in the next iterations of a contract.
 - **Decline in the number of suppliers.** It is theoretically possible that a gradual decline in the number of suppliers, resulting in lower competition for government contracts, could have outweighed the initial benefits of involving private suppliers.¹²
 - **Information asymmetry:** at times, both government and suppliers lack information on the true costs of running a service when initially tendering or bidding for government contracts – a view confirmed by some interviewees. When re-tendering occurs, this might lead to higher, more realistic bids from suppliers. On the other hand, the seeming narrowing of costs may also be due to suppliers initially underbidding to enter new markets and to establish credentials.¹³

Finally, very few studies take the transaction costs of outsourcing into account, which undermines the accuracy of estimated savings, and the degree of savings realised. These costs can vary depending on the length of the contract, or the complexity of the service, but include investigating the market of suppliers (or in some cases creating it), managing the procurement process (writing the contract; negotiating with bidders) and managing the contract over its lifetime. Such costs will arise in all contracts but will be particularly high in complex contracts where process and outputs, let alone outcomes and measures of success, are less easily defined and measured than in transactional services.

There is little reliable evidence on transaction costs, which some studies suggest can range from 3%–11% of the total contract value.¹⁴ Hodge’s 2000 meta-analysis of competition and outsourcing in simple and complex services incorporated these costs and found estimated savings of 6%–12%,¹⁵ which is somewhat lower than the often-debated ‘20% rule’, which suggests higher savings based on earlier studies.^{16,*}

* The ‘rule’ that outsourcing generates savings of around 20% is derived from well-documented savings in areas like waste collection, such as the 1986 study by Domberger, Meadowcroft and Thompson on the impact of competitive tendering on waste collection in UK local government. It found that costs were reduced by 22% when the contract was awarded to a private firm, and 17% when the contract was awarded in-house; the average became the so-called ‘20% rule’.

Annex 2: List of case studies

In addition to interviews and a high-level review of the evidence available on outsourcing and competition in different services, we relied on case studies to draw conclusions.

These were based on desk research and, where appropriate, interviews with the suppliers involved or with external experts.

- Amey and Birmingham Council's road maintenance PFI
- Carillion's contract to rebuild the Liverpool Royal University Hospital
- Circle's 2012 contract to operate Hinchingsbrooke Hospital
- G4S and Serco's electronic tagging of offenders
- HM Courts and Tribunals Service's contract with Liberata to manage payment systems
- HMRC's Aspire contract
- Independent sector treatment centres
- National Savings & Investments' (NS&I's) business outsourcing to Siemens
- New Labour's Building Schools for the Future programme
- Outsourced cleaning in NHS hospitals
- Plymouth City Council 'alliance contract' for vulnerable persons
- Privately operated prisons
- The Department for Education's outsourcing of the Teachers' Pension Scheme to Capita in 1996
- The Department for Work and Pensions' Personal Independence Payment assessment contract with Atos and Capita
- The Department for Work and Pensions' Universal Credit contracts
- The Department for Work and Pensions' Work Programme
- The Home Office's 2007 contract with Raytheon for digital border services
- The Home Office's Commercial and Operational Managers Procuring Asylum Support Services (COMPASS) Programme

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- The Home Office's contract with G4S and Serco for Yarl's Wood Immigration Removal Centre
 - The Ministry of Defence's recruitment contract with Capita
 - The Ministry of Justice's Transforming Rehabilitation reforms
 - The NHS and Serco contract for out-of-hours GP services in Cornwall
 - The NHS's contract with Capita for primary care provider support services
 - The Thames Tideway Tunnel
 - UK Trade and Investment specialist services contract with PA Consulting

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Chapter 3: Why has outsourcing succeeded or failed?

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