

OUT OF CONTRACT

A TOOLKIT FOR LOCAL AUTHORITY CONTRACTING

Written by: David Walker and John Tizard

New Economics Foundation

www.neweconomics.org

info@neweconomics.org

+44 (0)20 7820 6300

@NEF

Registered charity number 1055254

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INTRODUCTION

Public managers and elected members have extensive experience of procuring goods and services and contracting for supply from private firms and charities. This toolkit does not propose to reinvent the wheel. But it's worth noting the new mood.

If it ever was, competitive contracting for public services can no longer be the default. Awareness of the risk in handing over public business to firms has grown. Major contracting companies are in commercial difficulties, under pressure from the stock market and lenders; prudence requires public bodies to assess the viability of existing contracts.

Local authorities have already responded to altered political and business circumstances and public attitudes. Some, including Conservative-led councils, are applying local, empirical tests to their contracts and finding them wanting are actively 'inhousing' services.

These notes are offered as revision takes place during and after the local elections in England in May 2018.



BACKGROUND

DATA AND DEFINITIONS

Public procurement is not always well defined. We lack good evidence and there are troubling gaps in the data. Public bodies buy in large amounts of goods and services: UK local government spent £65bn (net) in 2015. But that total includes council contracts with other public bodies and services from the charitable and voluntary sector, as well as private business.

‘Outsourcing’ describes public services undertaken by a private company or charity that remain a continuing responsibility of the council. Bin emptying and parks maintenance are local examples; benefits assessment and search and rescue are examples from national government. These services are received directly by the public, who come into contact on the front line with companies’ instead of public sector staff. The logo on the van says ‘working in partnership with ...’. Staff doing the repairs or checking the number plates are employed not by the council but by a firm; they answer to different bosses, who have different priorities.

Services out of the public’s line of sight are harder to delineate, for example in IT, payroll, property and facilities management. For some of these, the council gives a company use of a publicly owned asset (through a lease). Some of these services are ‘technical’ and have never or hardly ever been provided by directly employed staff – for example legal advice. Other services used to be, for example cleaning and catering.

Outsourcing has a distinct history. It has been the stuff of party political strife. From the early 1980s, councils were compelled to tender certain services. But they have since recovered some discretion. Once a decision has been taken to tender a service, strict rules apply to the procurement process.

GROUND ZERO

Say you are the new town or county hall leader – or are returning. New councillors will be asking: do we have an accurate map of council functions, coloured by who carries them out? Has the council been ‘hollowed out’? What do we know about the reliability of incumbent contractors after Carillion’s collapse and City anxiety about Capita, Serco, Interserve and the rest?

Councillors may have participated in debates over individual contracts or have responded to residents’ complaints about a contractor and so on. But they may lack a *cross-council picture*. How much of its functioning has been externalised and can’t be changed, at least in the short run or until after a contract is renegotiated? Can an aggregate figure be put on the proportion of total council spending that goes to companies providing services? Or to charities working on

a contract? And how many grant-aided charities also provide valuable services? Grant aid is often the best way of supporting charities and the voluntary and community sector (VCS).

In the past contracting may have been left to procurement specialists leaving few officers or members to take the *all round view*. In some councils, contracting has become a default, something the chief finance officer automatically recommends because – literally – they have ceased to think about it as a controversial or problematic issue. Councillors cannot be content where this is the case.

DATA GAP

Councillors may need to press officers who themselves may not regularly survey and sift available data on contracts. Information is important not just for elected members also residents and, indeed, local party members. Does the local public grasp the extent to which services have been contracted? Can they find out the arrangements for a particular service? Does the council have a contracting database that can be readily interrogated?

Procurement and contract data may exist but have been presented haphazardly, for example as an undifferentiated list of invoices, or by date of contract renewal with no indications on how well contractors have performed. How far do invoices match the service provided?

Officers should be sifting this information to distinguish:

- a) functions where contracting is most prevalent;
- b) principal suppliers, with a note on their size and nature of their business;
- c) service performance
- d) duration of contracts and terms on which they could be ended or renewed;
- e) contractor performance;
- f) any additional material about the contractor, for example performance on other public contracts, governance changes and record on such 'criterion' matters as gender pay gap, apprentice recruitment.
- g) does the council hold 'lessons learned' workshops after previous bidding rounds, collating experience and noting the costs of competition?

PUBLIC ACCESS AND UNDERSTANDING

Councillors will be anxious to carry the public with them, so the public need to be well informed. Can citizens look up the council's contract with a contractor and examine costs,

performance and conditions? Are there good reasons – any reasons – why the contract should not be transparent? Increasingly contractors are themselves asking for ‘open book’ accounting. It has to include internal transfers within a contracting company, for example payments from a subsidiary to headquarters.



INVOLVING OTHERS

INVOLVING THE PUBLIC

Having amassed and disseminated what is known about contracting, councillors should welcome debate about the council's contracting profile, seeking views from residents.

In an informed public conversation around contracting citizens should be able to distinguish the effects of austerity – cuts in council grants and restrictions on council tax revenue -- from contractors' performance. How far might reductions in service quality stem from cuts in departmental budgets or local authority grants, regardless of whether the service was contracted? For example the performance of private contractors in prisons in England and in assessing social benefits claimants needs to be separated from jail overcrowding and policy decisions to restrict Personal Independence Payments (PIP) or Employment Support Allowance (ESA). Even if environmental services were still a directly-provided function, would the council be able to maintain the frequency of bin emptying and recycling collection; how far are what the public perceive as unwelcome service changes the product of contracting, which has been resorted to because of financial pressure?

How do residents and citizens view the contractor; has dealing at arm's length with the council affected the quality of civic life? It is legitimate, indeed recommended, that councils factor in the effects of service delivery plans on subjective wellbeing, for example community cohesion, children and families.

INVOLVING THE LOCAL GOVERNMENT SECTOR

If the next-door council hasn't been down the same road, then colleagues across the conurbation probably have. Yet councillors and officers may not have swapped notes or shared experience. Local government has huge internal intelligence but does not always share it. Networks, party conferences, professional associations can be pressed into improving generic local government knowledge of companies and contracts. Other councils may offer shared services and joint supply arrangements; council-owned companies already provide energy and back office. Other councils' experience with a contractor is deeply relevant. Fair procurement allows – demands - consideration of past performance; contractors should be able to provide references from other local authorities.



CHANGE IS POSSIBLE

AVOIDING BUSINESS AS USUAL AS A DEFAULT

Having let contracts in the past does not mean service status cannot be changed. Some people are under the impression that once a service has been externalized, that's it – further contracts must be let. Councils can decide to abandon competitive tendering, if they cease to tender a service; they can reconfigure services. Competitive procurement rules only apply after a decision has been made to isolate a body of work and seek tenders.

For major services, the default option should be in-house public management.

The perennial question for each and every public body has to be: how can we best meet our statutory duties and other ambitions we set for ourselves, including our stewardship of place, community and local economy? The *how* of public service embraces direct provision – the inhouse option. Or individual households and communities might be persuaded to behave differently, reducing the need for a service (by recycling more, say). Information campaigns and 'nudging' are also part of the council's service offer.

Have we asked residents, citizens what they want, and what they are willing to pay for, either directly or through taxation? How far might they take charge? Are we as clear as we can be on the respective duties and responsibilities of public bodies, citizens and community groups? What do we know about how services are organised in other councils?



STRUCTURES AND SERVICES

SERVICE REVIEW

Before the question of contracts arises, councils should think about the structure of services and departments, perhaps conducting an exercise similar to zero-based budgeting. Can functions be broken down into 'contractable' elements -- some people use the word 'commodified'? Or, alternatively, should services be less differentiated and better integrated? This involves looking through and beyond existing departmental structures, even though they may have existed for a long time and may rest on deep professional and bureaucratic foundations.

For example, councils might consider their multiple points of contact with a single household. Staff emptying bins may be the most regular and personal contact many residents have with the council. Should they be recognised for their 'ambassadorial' role? Environmental services staff contribute to community wellbeing and social stability. They are, potentially, eyes and ears on vulnerable members of households. How tightly should roles be defined? Ditto parking control: how far should the role be narrowed to enforcement, how far widened to embrace community transport needs and opportunities?

REVIEW MUST BE COMPREHENSIVE


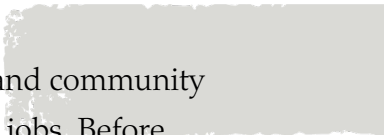
Any move to change service delivery must analyse costs and benefits as comprehensively as possible. This is much more than a technical exercise that can safely be left to the finance department or procurement officials: it involves judgements about values and will in some measure be political. It must be undertaken within a political framework.

Outsourcing may have unintended consequences. The cost calculus cannot be confined to a single organisation's balance sheet. Public bodies are under intense short-term financial pressure, which may blind them to full longer run costing and opportunity.

A contract which means staff are paid less (or that there are fewer of them) may benefit council accounts but:

- a) have effects on the quality of public interaction with the council and;
- b) have the effect of reducing family income, even pushing families into poverty.
- c) are there externalities with costs falling on other public bodies?

Cutting employment opportunity and income can diminish household and community wellbeing by causing unemployment or moving people to less well paid jobs. Before



contracting, wider 'environmental' consequences such as these should be modelled and appraised. Social effects may not be immediately measurable but can be appraised and estimated on the basis of previous experience. It is legitimate to bring political judgement to bear and draw on elected members' personal experience, derived from the doorstep and meetings.

RELEVANT COSTS

The Treasury's 'Green Book' manual on financial decision-making insists on an all-round view.

"Relevant costs and benefits are those for UK society overall, not just to the public sector or originating institution. They include costs and benefits to business, households, individuals and the not-for-profit sector. Assessing the costs and benefits across all affected groups matters".

This means, for example, counting redundancy costs on the liabilities side of the contract balance sheet. Also, appraisals should extend over the whole life of a contract, including transaction costs at the beginning and end of the contract, together with costs of managing a contract during its life. Public bodies should see the 'jar as half empty' and include all potential risks, as well as benefits. The Treasury actually recommends adjusting cost estimates by a 'pessimism' factor, derived from previous experience. Other public bodies' experience should be consulted.

An important dimension here is public revenue. Would letting a contract lead to a net reduction in tax and National Insurance being paid, harming public revenues? The tax position of a contractor would need intense scrutiny. Overall costs and benefits would have to adjust for a company that sequestered earnings in a tax haven or repatriated profit out of the UK.

Sustainability and the environment should also figure in the 'all round' view councils should take on contracting. Might a contractor use resources or transport in a way that has identifiable and negative environmental effects (for example by reducing air quality). What effect would a decision to contract have on 'human capital', meaning the stock of skills and capacity within the council and within the community?



STRATEGY AND RISK

STRATEGY

The National Audit Office (NAO) distinguishes the broad strategy for a public body – what it wants to be, where it wants to go – from its commercial strategy. The latter involves planning relations with suppliers, markets and private firms. A council might want to encourage smaller, local businesses or local cooperatives. Commercial strategy meshes with ambitions for the local economy, including employment, training and development opportunities for local residents. Does the council have a strategic rationale for contracting – for example promoting local business or, in another direction, maintaining a skilled council workforce? How might letting a contract affect the council’s strategy for equalities?

How does any move towards contracting meet those strategic objectives? The NAO (in its publication *Commercial and contract management insights*) feared “that many of the problems we see across commercial and contracting activities result from a failure to plan how best to achieve operational requirements through commercial arrangements. In other words, departments jump to buying without developing a full commercial strategy.”

No contract exists in isolation. A commercial strategy should link up how a proposed deal fits into the wider portfolio of contracts to buy goods and services. Key to this is staffing, both what the council needs if it provides a service in house and the people and skills needed to manage contracts.

Councils should ensure that their procurement policies and procedures are aligned with their political objectives especially place shaping.

Some councils have accidentally or deliberately separated out contract management, depriving other officers and councillors of closer knowledge of arrangements and of contactors. Contract management should be integrated with policy, operations and feed directly into what councillors know and debate. Are contract specialists advisers or do they ‘own’ contracts?

RISK

Central to strategy is calculus of risk. Central to any decisions around contracting is whether risk is being – can ever be – transferred from the council to a private company. Poor performance or failure on the part of a company will always tend to default to the carriers of political responsibility. A key question is whether a private company will be

able to manage the risks associated with the service more effectively than the council. In reality, as the collapse of Carillion showed, the public sector cannot avoid the ultimate risk of the contractor fails.

Systematic evaluation of risk will include, among other things, public perception. If the public are, often, unaware of arrangements for a service as long as it is carried out, questions are asked as soon as there are gaps or breakdown. A company may present as robust and well capable of bearing financial and service risk but, within a short period of time, lose resilience under pressure from shareholders or lenders, or change executives or suffer from weak corporate governance. Suddenly its performance is at risk.

The Treasury recommends that “risk assessment should also cover any major financial and operational risks that could affect the private partner over the life of the project.” How likely are variations during the life of the contract; how far into the future can service demand be projected; what happens if demand falls or rises? Who carries the contingent liability of cancellation or early contract termination?



THE DECISION MAKING PROCESS

MAKE OR BUY

The steps to decisions about services include:

- The default is inhouse: only deviate from this when there is an overwhelming and demonstrable public interest in so doing.
- What is the best means of securing quality, achieving flexibility, ensuring decent employment terms and conditions for staff?
- Is this a stand-alone service or is it closely involved with other services?
- Where does this service fit in the council's strategy for the area and/or for its relationship with suppliers?
- Is this a service that can be 'commodified' or broken down into elements that can be written up in a commercial contract?
- How does this service compare with other council activities?
- Do we fully understand what drives the costs of this service and the balance between quality and cost?
- How has this service been managed in the past, with what degree of oversight?
- Has the service got a 'political' profile, with implications for reputational and party risk if the service is interrupted, fails or quality falls.
- What is the skills profile for the service: are these skills the council possesses or could acquire through TUPE (Transfer of Undertakings (Protection of Employment) or otherwise? Such capacity and expertise will be required if services are outsourced and should be costed into the decision.
- Would outsourcing ensure long-term value for money for the public sector as a whole (including impact on taxes and benefits) not just the outsourcing body?



WHAT YOU WILL NEED

CONTRACTING *REQUIRES* RESOURCES

Does the council have the capacity to run the service; might running the service at arm's length through contractors be *more demanding*? How much knowledge needs to be retained in-house, in order to measure and evaluate contract performance, especially in technically difficult areas? Does the council have or could it recruit sufficient numbers of specialists? What is its track record on contract management? Has contract management been regarded as a central, important function within the council hierarchy? The question is the obverse of that relating to contract management: if the service were outsourced, does the council or could the council recruit people able to challenge and hold the contractor properly to account? What insights emerged from previous contracting experience about this service and how it should be managed: is there any prospect of risk transfer? What are the costs of understaffing contract letting and management?

Can the council afford to 'externalise' (lose) knowledge about the area and its people because it no longer provides a frontline service?

The NAO says public bodies "need to commit sufficient resource to effective long-term contract management, including monitoring performance and managing any service variation requirements or other contract delivery issues over the project life."

KNOWLEDGE

Through contracting would the council lose intelligence, precious understanding of a service or area or people or place? Is the council transferring knowledge of how to assess risk? What is the intellectual property account – would the council acquire intelligence and information from the contractor that could be used to improve service delivery? How much does the council need to know in order to monitor performance and, critically, reconsider a contracting arrangement (either moving the service in-house or seeking another tender)?

Monitoring means knowing enough to judge whether a contract is being delivered, which implies maintaining in-house capacity. How much a public body needs to know is a critical judgment call. Even before a contract is signed, public bodies need to be thinking about its end. The NAO reports puzzling variation in termination rights. What can be learned from the contract and how will this be captured? What information and data will be needed so that a subsequent supplier could take over?

WHAT YOU NEED TO BE AWARE OF

COMPANIES AND MARKETS

Companies can be volatile. In examining an individual company, councils will need to be aware of sharp and sudden movements in stock prices (if it is a public company) can affect management and performance, for example leading to the departure of known executives. A company's history can often be a poor guide to its present and future – to the likelihood of its being merged or acquired, for example. Who owns the company? If it is private equity, councils need to be aware of a tendency to short-run profit taking and reluctance to invest; will the contractor be tempted to fail to invest in assets and infrastructure because its interest is short term? If it is a multinational, what do we know of how the UK and UK profitability fits corporate strategy? Does the company have attested expertise in the service area – or technical capacity of a kind that could not be nurtured in house? Does the company have a track record in delivery and can it present testimonials from other public sector commissioners? Will the contractor sub-contract and on what terms and conditions; how much do we know about possible subsidiary arrangements?

“Public sector organisations should not engage in, or connive at, tax evasion, tax avoidance or tax planning. If a public sector organisation were to obtain financial advantage by moderating the tax paid by a contractor, supplier or other counterparty, it would usually mean that the public sector as a whole would be worse off.” (Treasury: Managing Public Money)

MARKET INTELLIGENCE

Is the market for this service competitive; has it been subject to examination by the Competition and Markets Authority; is there data on average profit margins (as a proxy for competition)? Is it a market with a handful of players tending to oligopoly? Has the incumbent contractor acquired too much inside knowledge, putting the company in an unfair position if retendering goes ahead? How much would it cost the council to try to intervene in the market and ginger up competition; is the council capable of such intervention?

If preferred or likely providers are smaller and medium and/or local firms, how onerous are contract specifications; is a lighter-touch competition regime better fitted for smaller companies? We continue to have concerns about the level of competition in some vital areas of public service delivered through providers – even where competition exists it can often be a thin market. We have sometimes seen departments disappointed by how

difficult it is to generate interest, bidders withdrawing during procurement and suppliers seeking to terminate contracts early.

WHO GAINS AND WHO LOSES?

Calculating the net value of contracting out a given function or service should include detail on distribution – who gains and who loses. Councils are subject to the Public Sector Equality Duty and so should be their contracts. Decisions should be accompanied by distributional analysis, meaning identification of who gains and who loses, whose welfare and wellbeing might be affected by contracting or in-housing. How do the interests of different groups stack up against one another? Fewer or extra pounds have different values, depending on the income of a household and these ‘weights’ should be factored into analysis of the effects of a decision to contract, leading to changes in employee pay, terms and conditions. How might the contract affect different parts of the area being serviced?



THE CONTRACT IN STEPS

Timing

Before any contract is signed, councillors need to be assured about the circumstances in which it could be terminated. Has the calculation of costs factored in end-of-life expenses and reasonable contingency provisions?

Quality

Does reduced cost trade off against diminution in service quality?

Measuring performance

Are performance metrics and reporting built in? Does the contract specify penalties for disruption and/or failure if the contractor cannot deliver? How far can councils safely rely on self-certification by contractors?

Contract iteration

Can performance indicators be altered during the contract to reflect needed changes in incentives, to remedy lack of information?

Review

Regular review allows the council to consider whether indicators remain relevant.

Insurance

Is the council covered against contractor negligence or liability; does the council retain residual liability and if so has the cost been factored into the contract?

Transparency

How will contractor managers be rewarded – if they receive incentive payments or bonuses, they may try to game the metrics.

Conditions

Require contractors to demonstrate ethical tax policies, remuneration standards, excellent governance, exemplar employment practices, etc. and to ensure that this applies throughout their supply chains

Contingency

If a service were to be in-housed in the future, how much residual capacity needs to be kept?

Consultancy

If consultants have been involved in decisions about contracting, do they retain any interests in the successful bid?

