

# Response to the Public Administration and Constitutional Affairs Committee Sourcing Public Services Inquiry

## Executive Summary

The fallout from Carillion's collapse resonates with the experience of contracting for small and local charities over many years and is the biggest signal yet of the failure of current systems of public service outsourcing. Work by Lloyds Bank Foundation for England & Wales has examined at depth the cause and nature of the challenges presented by commissioning. It helps to demonstrate why Carillion's collapse should not be considered a 'one off' but indicative of further closures and a system falling in on itself. This response draws on our work in this area and is focused on services commissioned that support people facing multiple disadvantage.

- Carillion's collapse has highlighted the problems brought about by underpricing, growing pension deficits and the risks in supply chains that stem from a broken system. These systemic problems resonate across a range of sectors and demand a thorough review of outsourcing processes.
- A lack of understanding by commissioners is the underlying cause for many of the problems brought through commissioning, whether this is a lack of understanding about needs, how to address them, how much this costs and which services can best meet needs.
- Commissioners do not need to be experts in all the areas for which they are commissioning services but they must work with those who are experts, with meaningful consultation throughout.
- Targets based on short-term costs and lower numbers of contracts is detrimental and can drive up long term and transaction costs. There needs to be more emphasis on long term value, quality and social value and processes should be chosen to best meet need rather than process driving decision-making.
- Funding small and local charities can bring less risk. As the collapse of Carillion highlights, risks are far higher and consequences far more severe when services are wrapped up into single high value contracts.
- The whole system of public sector outsourcing needs a thorough review. This includes the commissioning and procurement of services as well as the practices within those who respond (whether private sector, social

enterprises or charities), particularly where the system allows and encourages unrealistic pricing structures and poor treatment of subcontractors. It needs to move to a system focused on quality, social and long term value that uses proportionate processes and recognises the value of specialisms and small charities.

- Where effective small and local charities are already delivering services, they should be funded to do so rather than local authorities delivering everything in-house. These charities have the skills, knowledge and experience to reach and respond to local communities.
- More use should be made of grants. They provide flexibility and reduced transaction costs whilst still enabling funders to be discerning and minimise risk.
- Commissioners should monitor contracts more effectively. They should also make more use of the information being generated by services and what this can illuminate about emerging needs.

## Introduction

- I Lloyds Bank Foundation for England & Wales is one of the leading community grant makers. An independent registered charity funded by the profits of Lloyds Banking Group, the Foundation invests in charities supporting people to break out of disadvantage at critical points in their lives, and promotes approaches to lasting change. In 2016 the Foundation awarded **total funding of £12.7m, directly supporting 1,231 small and medium-sized charities**. This equates to supporting **99,967 individuals facing multiple disadvantage** whether that is due to unemployment, homelessness, mental ill-health, domestic abuse or the asylum system for example.
- II Having supported small and medium-sized charities in every region of England and Wales for more than 32 years, the Foundation is built upon the knowledge and experience of locally based charities, with locally based Grant Managers visiting applicants and grant holders and providing an avenue for identifying patterns and issues faced by the sector. The Foundation also conducts and commissions research specifically focused on the experiences and concerns of small and medium-sized charities, particularly those with an income between £25,000 and £1m.
- III Our response is centred on the experience of charities tackling multiple disadvantage which are embedded in their local communities and were developed in response to an unmet need. They typically have an unprecedented ability to reach and engage individuals and communities due to

their trusted nature in the locality.<sup>1</sup> The role of these charities is of growing significance – their trusted position has never been more important for reaching people that other agencies have failed to engage and in developing responses to local needs that grow from the bottom-up. It is clear that these charities are vital to Government achieving its stated ambitions to reduce homelessness and tackle domestic abuse. This response also draws specifically on work we have carried out over the last three years to better understand the challenges presented by commissioning, seeking to support an improved approach to ensure those facing multiple disadvantage can access the support they need. The evidence we have gathered through this work is of particular relevance for this inquiry, as the problems surrounding the Carillion contracts reflect those experienced by small charities over a number of years and bring to a wider audience the extent of the system problems inherent in current outsourcing practice.

## 1.0 Does Government make effective decisions on how to source the delivery of public services?

- a) What framework should the Government use when deciding what the most appropriate approach to sourcing a function or service is? Are decisions made systematically and consistently?
- b) Do policy makers have the right skills, information and incentives to make sourcing decisions effectively – including do they have the operational and commercial expertise to be able to understand what is deliverable
- c) Does the public sector have the capacity to deliver services in-house when that is the most appropriate route?

1.1 Carillion’s collapse has widely been reported as the ‘tip of iceberg’ in terms of the system problems associated with public service outsourcing. The practice that this system has encouraged and the subsequent growth in a small number of large organisations has repercussions far beyond the Carillion experience. Warning signs have been triggered over a number of years, not least in the charity sector where the system has led to large organisations’ rapid demise in recent years (such as 4Children and Lifeline Project), while research by Charity Finance Group indicated that the 100 largest service delivery charities were making an average 11% loss on their public sector contracts.<sup>2</sup> All the evidence points towards a system that is not sustainable.

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<sup>1</sup> [Too Small to Fail: How small and medium-sized charities are adapting to change and challenges, 2016, IPPR North](#)

<sup>2</sup> [Charity Finance Group Benchmarking Data, 2016](#)

- 1.2 In 2016 Lloyds Bank Foundation for England & Wales published *Commissioning in Crisis*, a report which brought together evidence from 120 tenders to analyse why the commissioning process was resulting in problems for so many smaller charities, and consequently, individuals needing support. The report shone a light on the scale of poor practice in commissioning and identified core areas where problems persisted. The underlying issue centred on a lack of understanding. This included a lack of understanding about needs, how to address them and who would be best placed to meet that need.<sup>3</sup> This is critical because it is this understanding that should drive the selection of appropriate processes – instead, processes drive the system which are unable to meet needs effectively. While the study was focused on the experience of small charities, the principle of needing a thorough understanding resonates across all public service contracting.
- 1.3 It is recognised that Government is under increasing strain to meet rising levels of demand with decreasing capacity. It is not uncommon for one commissioner to now be doing a job which may previously have been covered by a number of people. As such, it can be difficult for the commissioner to be an expert in the field of all the needs they are required to commission services to meet. Those working for government do not have to be experts in all fields but they *do* need to consult with those who are. In too many cases commissioners fail to carry out meaningful consultation due to a misguided fear of breaking competition laws or because they do not prioritise an activity which is pivotal to their role.
- 1.4 Often, poor practice is incentivised by setting targets based on short term cost and reductions in number of contracts. Yet perversely this can drive up long term costs and transaction costs. There are many examples of charities losing out on contracts where they have delivered that work successfully for many years, with the contract awarded to a big organisation from out of area that puts in a loss-leading bid that cannot cover the quality of support required. It should be remembered that local charities bidding for contracts are not doing so to make a profit. They submit costings based on their experience of delivering support. While there are many problems arising from the race to the bottom on costs, two core challenges that it presents are:
- Big organisations win contracts on values that do not allow them to deliver an effective service
  - Some small and local charities try to compete with these big organisations and in doing so, have to supplement the cost of carrying out the contract with voluntary income which should be used to deliver the additional, wrap-around the support that is needed

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<sup>3</sup> [Commissioning in Crisis: How current contracting and procurement practices threaten the survival of small charities](#), 2016, Lloyds Bank Foundation for England & Wales

- 1.5 There are real dangers in this approach. Locality's *Saving Money by Doing the Right Thing* discusses the failure demand that results from contracts awarded to big organisations that have driven down the costs too much.<sup>4</sup> That is, they are unable to provide an effective service which means that individuals need to continue accessing support for longer or need to access additional support elsewhere, driving up the actual cost of delivering a service. Similarly, where local charities are losing out on essential funding, they are at risk of closure and with that local people are at risk of losing the only services that are accessible and understand their needs.
- 1.6 Public service contracting has encouraged this race to the bottom on pricing, regardless of the impact on services or the sustainability of the system. The danger of such a short term approach has been highlighted by Carillion's collapse. When this is applied to services for those most at risk, the impacts are even more severe. We know that small charities will do all in their power to continue delivering services even where they are not paid to do so, but this cannot be continued indefinitely: reserves will run dry and if underfunding continues, it will inevitably lead to further closures and crises.
- 1.7 Some Foundation grant holders have also reported challenges arising from local authorities taking services in-house, meaning that there is no statutory funding available for the local charities. In delivering services to people facing multiple disadvantage, the nature and complexity of the support needed should not be understated. An evidence review by IPPR North of the value of small and local charities showed that these charities have unique characteristics that are important when delivering services to people facing multiple disadvantage, most notably because of their:
- Local knowledge and understanding that comes from being embedded in their communities
  - Ability to boost local social capital, building and nurturing networks
  - Ability to work with complex needs due to their trusted nature in the community and person-centred approach
  - Innovation in service delivery, enabling them to adapt to changing needs.
- 1.8 The Foundation believes that where effective, small and local charities are already supporting local people facing multiple disadvantage, they should be supported by government to do this rather than all services being taken in-house.

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<sup>4</sup> [Saving Money by Doing the Right Thing: Why 'local by default' must replace 'diseconomies of scale'](#), 2014, Locality

## 2.0 What lessons need to be learned from the collapse of Carillion about how Government and the public sector manages the risk from suppliers throughout the life-cycle of outsourcing a public service?

- a) Is the supply side of the market for outsourced public services too concentrated? What are the risks and benefits of a concentrated market?
- b) What steps has, and could, Government taken to maintain a competitive market amongst suppliers? Does Government have the right skills to be able to procure and manage contracts with SMEs? Should contracts or tenders be structured differently? Are there other steps it can take?
- c) Does the Government effectively monitor and manage risk for its largest suppliers, and does it have effective failure regimes in place? Does Government understand the public sector's cumulative exposure to individual contractors? Is there effective co-ordination between different public sector bodies in managing contractors?
- d) Do current procurement rules and policies allow risks to be managed effectively?
- e) Does the public sector have the right skills and resources to manage and monitor contracts with suppliers effectively?

2.1 There are many lessons that can be taken from the collapse of Carillion that resonate with arguments the charity sector has been making for years about the state of commissioning. Experiences that have been reported over a number of years and which are typified in Carillion's collapse demand systemic change in the approach to public sector outsourcing, in terms of processes and practices within government and commissioning authorities as well as the practice within the large providers that have grown dangerously in response to the current system.

2.2 It is often reported that commissioners are reluctant to work with small providers because they are 'too risky'. Over recent years the Foundation has been making the argument that working with smaller providers is actually 'less risky', because if a provider does collapse, this does not mean that all services collapse. Carillion aptly demonstrates the dangers of scale and how, indeed, bigger providers can be more risky because the impacts when they do fail are far more severe. The significant growth in outsourcing of public services has largely been to the benefit of a small number of large organisations that dominate their markets, whether in the private, social enterprise or charity sectors. Within the charity sector, this is reflected in data from the National

Council for Voluntary Organisations which showed that income from government for the biggest charities (those with an income over £100m) grew by 38% between 2008/09 and 2012/13, while that for smaller charities shrank by 38%.<sup>5</sup> Consequently, a significant proportion of outsourced services and power are held in a relatively small number of providers. The wide-reaching impacts of these few providers failing present a very real and wide-reaching risk.

- 2.3 As the Foundation's *Commissioning in Crisis* report makes clear, working with smaller providers can actually be much simpler. There are already provisions within EU law that enable much simpler grant processes to be used that are far less resource-intensive than complex competitively tendered contracts. Grants should not be seen as 'too risky' either. As a funder with over 32 years' experience of providing grants, we can confirm that it is still possible to be discerning and you can safeguard against losses by splitting payments – which can all be achieved without implementing restrictive and unhelpful payment by results systems. Furthermore, grants allow flexibility in service provision that cannot be achieved through strict contract specifications. This flexibility allows services to respond to changing needs which is particularly important as demand for services continues to rise and become more complex, requiring charities to innovate to continue to meet needs.
- 2.4 There is ample evidence from the charities funded by the Foundation which indicates that many commissioners do not effectively monitor contracts, nor do they learn from them. Charities report that where large providers have won contracts yet are failing to deliver (as evidenced by people being signposted to their own, unfunded, service), the relevant authorities fail to monitor effectiveness. Similarly, where charities have been included in tenders as 'bid candy', name-checking local charities to add credibility to their bid, in too many cases funding fails to reach these same local charities. There is no accountability and no monitoring on the side of the commissioning authority to ensure practice within supply chains reflects that which was specified in the bid.<sup>6</sup>
- 2.5 We know from our own grant monitoring that there is a lot to be learnt from those who are funded, not only in terms of due diligence to ensure they are delivering upon what was expected but also the insight these providers' work gives into emerging issues. Such learning should be informing commissioners' and government as a whole's work. When too much emphasis is only placed on issuing the smallest possible number of contracts at the lowest possible price, government is missing out on valuable information that could inform future practice and ensure money is spent in the best way to achieve long term value.

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<sup>5</sup> [Navigating Change: An analysis of financial trends for small and medium-sized charities](#), 2016, NCVO

<sup>6</sup> [Expert Yet Undervalued and on the Frontline: The views and voices of small and medium-sized charities](#), 2015, Lloyds Bank Foundation for England & Wales

3.0 Given the concentration of outsourced public sector contracts into a small number of large companies do the rules on oversight and accountability of public services need to change?

4. Are there limits to what can be outsourced?

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4.1 The question is less about *what* can be outsourced and more about *how* things are delivered, including how decisions are made about outsourcing at all levels and the processes undertaken. It needs to be recognised that the processes used to commission and procure services have wide-reaching impacts not least on the behaviour it allows and encourages in providers, as the case of Carillion makes clear. Carillion's collapse is not the unfortunate consequence of one company's mismanagement, it is indicative of practice across different sectors that is supported by a broken and unsustainable system. The warning signs have been growing over a number of years and the impacts will not cease with Carillion's demise. Evidence suggests we can expect to see more businesses and charities collapse as a result of an unrelenting drive to reduce short term costs in an unsustainable system. Whole system reform is urgently needed that cuts across all forms of public service contracting. As our research demonstrates, these problems are not isolated to large construction companies but reach as far as services supporting people facing homelessness, dementia or domestic abuse for example and affecting the lives of individuals in communities right across the country. *How* this is done is critical. We need to move to a system that can balance cost against quality, recognising the importance of social and long term value. We need systems that are proportionate to the service being outsourced and we need to challenge poor commissioning and poor practice by service providers no matter which sector they are working in. As the recommendations in *Commissioning in Crisis* make clear, reforming commissioning in a way that simplifies processes, reduces risk, encourages better practice and which results in sustainable services is possible.<sup>7</sup> Government must take action to implement these changes and drive out the poor practice that has dominated public service outsourcing for many years.

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<sup>7</sup> [Commissioning in Crisis: How current contracting and procurement practices threaten the survival of small charities](#), 2016, Lloyds Bank Foundation for England & Wales



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