

The State of the State 2014-15: Implications for private sector outsourcers Maximising opportunities through effective collaboration

Key points

- The role of the private sector in the delivery of public services is likely to get considerably bigger and more complex over the next five years compared with the last decade.
- The UK is half-way through a radical fiscal consolidation that will have a profound impact on public services – and the toughest decisions are yet to come. But the UK's public sector is a leader in reform, and governments around the world are watching as it seeks to carve out a more affordable model for the modern state.
- The acceleration of Government's austerity programme means that the way the public sector operates will change profoundly in the next five years. It is clear that this transformation needs to go far beyond the predominantly tactical reforms seen so far.
- Supporting this significant shift and balancing the books will be government's primary challenge. Growth in the volume and value of services contracted out to the private sector will continue to be rapid. But in delivering future public sector services more efficiently, more radical solutions will be needed.
- This paper outlines the recent trends in the role of the private sector in public sector outsourcing and determines that there is much more that can be done. This transformation presents significant opportunities for government, the private sector and others but only if the right decisions and actions are taken now.
- In the short term, there are clear efficiency gains to be realised by the public sector in collaborating with private sector contractors. In the medium to long term, potential benefits can be maximised through the right discussions with stakeholders. And, these benefits could ultimately provide better value for money to the taxpayer and better outcomes for the economy and society as a whole.
- The private sector needs to be proactive in exploring, prioritising and seizing future opportunities.

Contacts

Byron Griffin

Partner, Business, Infrastructure and Professional Services Leader
020 7007 1548
bmgriffin@deloitte.co.uk

Mike Turley

Vice Chairman, UK Public Sector Leader
020 7303 3162
mturley@deloitte.co.uk

Oliver Hemming

Partner, Consulting
020 7007 9140
ohemming@deloitte.co.uk

Thushani Lawson

Senior Manager, Business, Infrastructure and Professional Services Insight
020 7007 8733
thlawson@deloitte.co.uk

Ed Roddis

Senior Manager, Public Sector Insight
020 7007 2920
eroddis@deloitte.co.uk



Context

Austerity acceleration and the role of the private sector

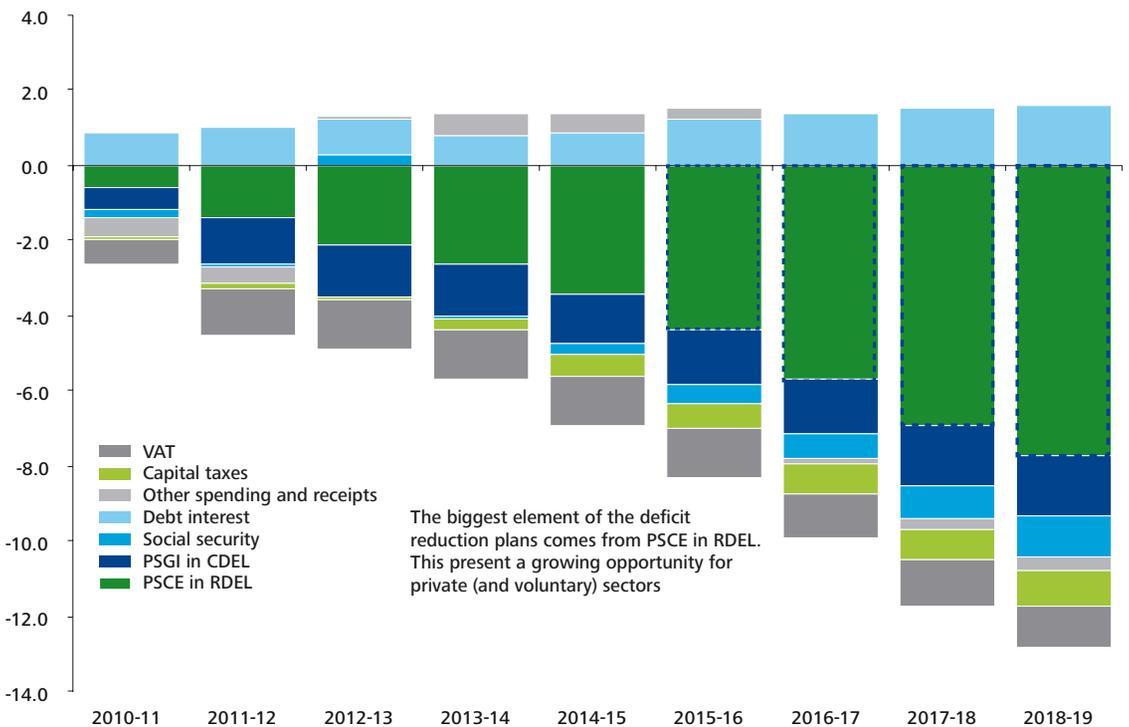
Findings from *The State of the State 2014-15*, a recent report by Deloitte and Reform, have profound implications for the private sector.¹ This paper sets out key implications of future change and challenges that private sector outsourcers need to face.

The State of the State 2014-15

The UK is half-way through a radical fiscal consolidation that will have a profound impact on public services – and the toughest decisions are yet to come. The second half of the programme will be substantially more challenging than the first.

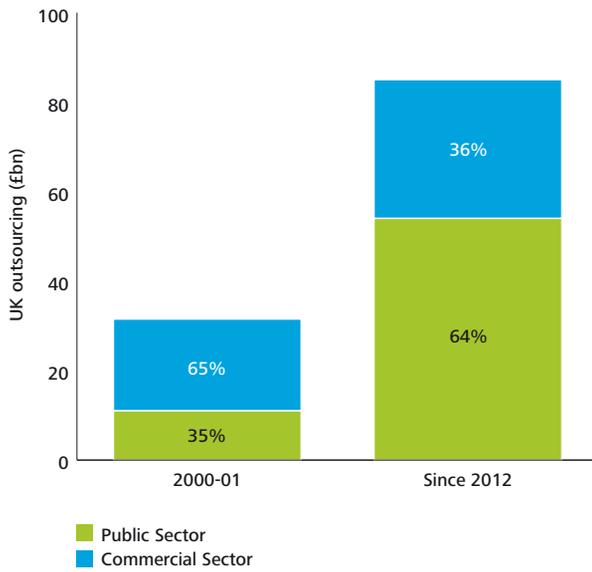
As the cuts reduce budgets, public sector organisations are likely to alter the way they operate, the services they provide and the outcomes they deliver. In local government, for example, councils are likely to focus on services targeted towards people in particular need and move away from services they are not legally required to provide such as leisure facilities. Departments are also already devising plans. For instance, the *Five Year Forward View*² developed by NHS England outlines how, with the right reforms, the health service can operate more cost effectively without affecting services provided.

Figure 1. Where is deficit reduction coming from?
Cumulative changes as a percentage of GDP



Source: Economic and Fiscal Outlook, Office for Budgetary Responsibility. March 2014

Figure 2. UK outsourcing, total contract values (£bn)



Source: Information Services Group

Those faced with particularly deep budget reductions will need to drastically rethink how they operate, the services they provide and the outcomes they deliver.

While the first half of the consolidation period has seen public sector organisations cut costs and deliver tactical improvements, the second half will see many redefine themselves and move to lower-cost models to cope with the next wave of budget reductions.

Figure 1 illustrates the Office for Budget Responsibility’s (OBR) official view of how the Coalition has reduced the deficit since 2010-11 and how, according to its plan, it is expected to keep reducing until it delivers a surplus in 2018-19. The figure shows that 80 per cent of the entire austerity programme is to be achieved by cuts to public spending. The dark green sections are Public Sector Current Expenditure elements of Resource Departmental Expenditure Limits (PSCE in RDEL) described by the OBR as “day-to-day spending on public services and administration”.

Cuts will need to be made, sustained and substantial. The target for the reduction in PSCE in RDEL for 2018-19 is almost quadruple the reduction achieved in 2012-13. Interestingly, the remaining cuts to public service spending and administration will need to be made in a 2015 Spending Round by the next government.

The role of the private sector

For many years government (both the current coalition and previous governments) has encouraged outsourcing as a means to reduce cost, reform public services and improve value for money.

Figure 2 shows how the contract value of outsourcing has soared over the past decade, and is now well over double the value in 2000.³ Growth in outsourcing spend has been driven by public sector contracts, which now account for around two-thirds (64 per cent) of the total.

According to recent data published, spend on outsourcing in the UK has doubled to £88 billion under the Coalition Government.⁴ The National Audit Office estimated that contracting out accounts for around half of the £187 billion that the public sector spends on goods and services each year.⁵

The *Open Public Services White Paper 2011* set out the Coalition Government's approach to reforming public services.⁶ Initiatives already underway can be built on and learnt from. Some examples of this new approach include:

- the innovative Payment by Results model which was applied in a number of areas, including housing services for older adults, employability, drug recovery and offender rehabilitation. Government will need to continue working with suppliers to develop outcome-based commissioning, especially through evaluation and best practice
- the mutuals programme which works across the public sector. The number of mutual spin-outs including joint ventures from the public sector has grown from nine in 2010 to 100 in 2014, delivering £1.5 billion of public services. While short of the Cabinet Office aspiration for one million public sector workers to form mutuals, the UK Government has fast become a global 'trailblazer' for social innovation in the public sector
- work with private sector experts to create and implement innovative processes and enhance employee skills and culture such as partnerships with the Royal Navy and NHS.

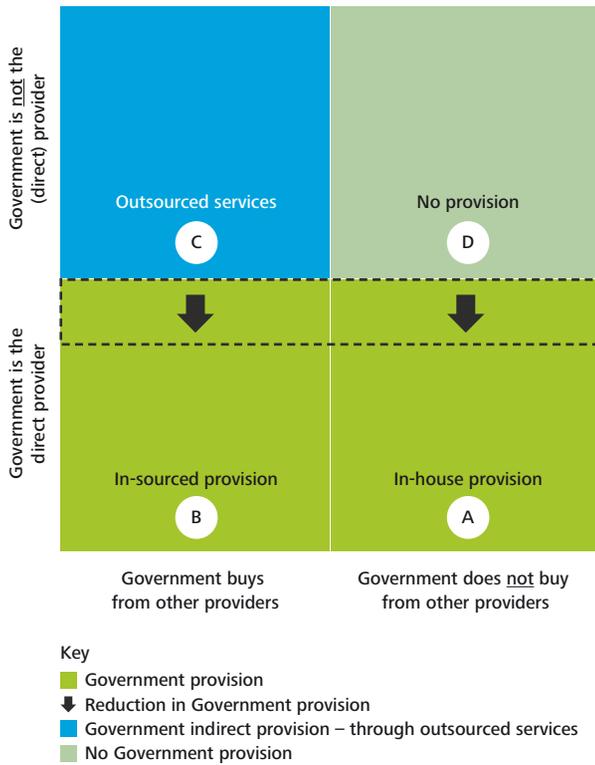
More broadly, the Government has identified the importance of strong partnerships between the professional and business services sector and the public sector. The Professional and Business Services Industry Council was set up to support UK growth and reinforces the benefits of working together.⁷ The importance of partnering, combined with potential scenarios for public services provision (discussed subsequently), has a number of implications for the private sector.

Scenarios for public services provision

Government needs to reduce the cost of providing public services in future. *The State of the State 2014-15* outlines a range of indicators to measure government's success.

At a broad conceptual level, government has a supply consideration in terms of the public services it needs to provide. Where there is a need for government provision, there is also a question around whether it should be sourced from another part of the public sector or outside the public sector – from the private, voluntary or social.

Figure 3. Government choices, conceptual framework



On this basis, the broad choices include:

- A. to continue providing the same public services offering but in a more cost effective way. However, this short-term, ‘quick win’ cost-cutting approach has been mostly exhausted
- B. to continue to explore provision through in-sourcing arrangements – where services are provided by a particular part of government, a local authority for example, so that resources can be rationalised
- C. to make more use of private, voluntary and social enterprise sector contractors to deliver public services more cost effectively
- D. to opt out of, reduce or discontinue provision. This will require rebalancing demand for public services. Transitioning to this may include facilitating ‘self-help’ type solutions. Alternatively, this may involve reducing or discontinuing non-statutory services.

Figure 3 presents a conceptual framework of these potential options for government in seeking to reduce public sector spending in future. These are hypothetical choices which are not necessarily mutually exclusive. Indeed, we are already seeing some innovative hybrid models emerging. The dotted line represents the required reduction in government provision of public services.

Public sector bodies will need to consider whether these services should still be owned by government but provided by the private sector. For instance, is there a ‘public good’ rationale which means that government needs to continue with provision, is there scope to reduce supply and still achieve desired outcomes, or could government supply be removed completely?

Implications for the private sector

The opportunity for private sector contractors and the need for radical change are significant given the required scale of public sector budget rationalisation.

Key implications for the private sector include:

- **Dealing with increasingly complex contracts.** The profound changes that are required mean that public sector outsourcing contracts will cover more complex work. This has started already. For instance, the Ministry of Justice is transferring core probation services to the private sector and Staffordshire's healthcare trust plans to outsource frontline cancer services. This will also mean that it may be harder to reach commercial agreements. However, there is a significant opportunity for dealing with these complexities in creative ways. For instance, the private sector can support government in reorganising existing assets to provide multiple solutions for local authorities.
- **Demonstrating value for money for government.** Government sees value in private sector businesses running public services through identifying and supporting efficiency savings. However, there are improvements that private sector firms need to make relating to better management of public services contracts. There is significant scope for improvement here with only one-third of contracts currently on an open-book accounting basis.⁸
- **Demonstrating value for money for the UK citizen.** There should also be recognition of responsibilities to the tax payer. For instance, where outsourced services are delivered directly to the 'end consumer', UK citizens may need to be engaged through feedback and even co-design services to make sure the services are responsive to customer needs.
- **Increasing demand and expectations from society.** Demographic pressures, such as the UK ageing population, mean demand on public services will increase. Therefore, to meet the needs of society within budget constraints, innovation and demand management approaches are critical. Transitioning to 'provision opt-out' or discontinuing non-statutory services may require a rebalancing of demand expectations.
- **Application of new business models to succeed in the evolving procurement process.** Small and medium-sized enterprises (SMEs) are currently excluded from this process given the significant bureaucracy and bidding costs involved. However, there is a drive from government for greater involvement of SMEs. Greater competition may also be introduced to deal with the worry that some contractors are 'too big to fail'.

Developing future collaboration

Maximising opportunities and mitigating risks

To maximise opportunity and mitigate potential risks in future the private sector should consider the impact of the potential scenarios.

Opportunities

With the right strategies and support, many of the risks outlined can be turned into opportunities. For instance, there are best practice methods that can be applied from examples of past failures as well as successes.

Some key opportunities include:

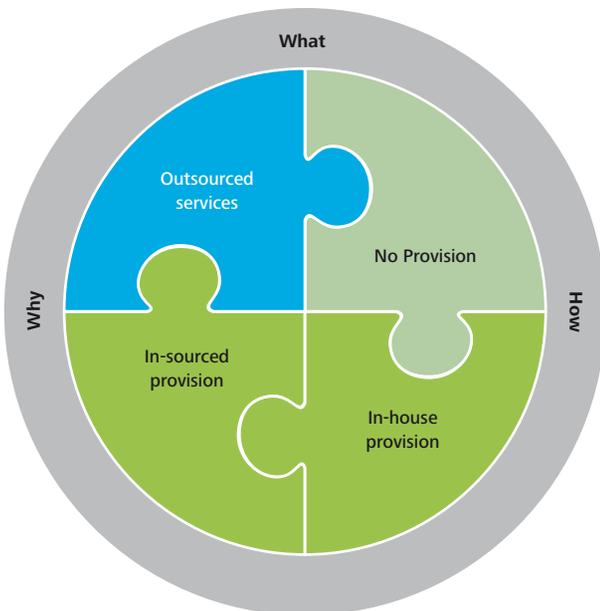
- **greater use of digital services.** Deloitte research suggests that 88 per cent of UK citizens are open to conducting more of their interaction with the state online and the Government Digital Service (GDS) continues to push the Digital by Default strategy forward. Government has more to gain from embracing digital than any other sector

- **supporting government and businesses through a culture change in procurement and management of contracts.** There is a recognised need to develop capabilities among staff and better processes to ensure effective collaborative working
- **collaboration and new business models to support reconfiguration of public sector.** Government should build on successful partnering models to manage the public sector's assets and services
- **supporting productivity improvements.** In the public sector, productivity gains in the areas of talent, policy, processes and technology have significant potential for future reform and there is a role for the private sector to support this.

Figure 4 illustrates that the private sector can play a role in supporting government beyond the provision of outsourced services. The private sector has a role in supporting government in identifying services that could be moved out of direct government provision.

To maximise these opportunities, private sector organisations should consider the need to deliver services in the context of the public sector ethos. It is not just about *what* services need to be delivered, but *why* (the need for government intervention to ensure optimal supply of a 'public good') and therefore *how* (to provide the best outcomes for the economy and society). It is also not just about private sector provision of services but also how the private sector can support the transition to new business models.

Figure 4. Maximising the role of the private sector



Barriers to change

Given the changing nature and complexity of services that may be outsourced there are a number of risks that should be carefully considered. Although government will be involved, contract delivery risks will lie with the private sector provider. Some key risks include:

- **fully understanding and meeting contractual obligations.** Lead outsourcers will need to take on responsibilities for health and safety and will incur reputational damage and fines if service provision is not of the appropriate standard. In addition, local level contracts may be commissioned on behalf of multiple clients to gain economies of scale, with implications of complex stakeholder management
- **a change in social and economic circumstances.** This includes factors which may lead to a crisis. Some claim that local and departmental politics create barriers to ambitious initiatives
- **establishing a change in working practices and culture.** The Cabinet Office Talent Action Plan represents a significant step towards a government talent management agenda, but there is more to be done in supporting the radical change in culture and ways of working that may be required in future
- **change in government priorities.** The approach to the consolidation programme and the Government elected in May 2015 will face an immediate choice to continue the programme or offer an alternative, credible routemap to improve the public finances. This may also have a knock-on impact on the services provided by private sector outsourcing firms.

Conclusions

The next five years will be historic for the UK government and the wider public sector as well as its suppliers. Government will be forced to continue to explore the role of alternative delivery models and public sector delivery by non-public players. Therefore, significant opportunities exist for the private sector which can be maximised by making the right decisions now.

The size of the opportunity is growing for all. In the short term, there are clear efficiency gains to be realised by the public sector in collaborating with private sector contractors. In the medium to long term, potential benefits can be maximised through the right discussions with stakeholders. And, these benefits could ultimately provide better value for money to the taxpayer and better outcomes for the economy and society as a whole.

The private sector needs to be proactive in exploring, prioritising and seizing future opportunities in order to support the creation and delivery of a credible routemap to improve public finances.

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Endnotes

1. *The State of the State 2014-15*, Deloitte and Reform, October 2014.
2. *The NHS Five Year Forward View*, October 2014. See also: <http://www.england.nhs.uk/ourwork/futurenhs>
3. Data recreated from data sourced to Information Services Group.
4. Financial Times News and Information Services Group data, July 2014.
5. *The role of major contractors in the delivery of public services*, 2013. See also: <http://www.nao.org.uk/wp-content/uploads/2013/11/10296-001-Delivery-of-public-services-HC-8101.pdf>
6. *Open Public Services White Paper*, 2011. See also: <https://www.gov.uk/government/publications/open-public-services-white-paper>
7. *Growth is Our Business: A Strategy for Professional and Business Services*, Department for Business, Innovation and Skills, July 2013.
8. House of Commons Committee of Public Accounts, *Contracting out public services to the private sector*, February 2014.

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