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The Structure and Future of the UK Public Services Market: A look at the supply side.

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Contents

Executive Summary

The public service industry in the UK – that part of the market made up of non-government suppliers – accounts for almost 6 percent of GDP and employs some 1.2 million people. However, virtually nothing is known of the supply side of this market.

Categorised by Business Model

One way of approaching this question might be to break it down by business model, analysing whether providers take market risk, whether they are primarily focused on support or front-line services, whether their value proposition is based on economies of scale or economies of scope, how large or small they are, whether they come from the public, private or voluntary sectors, what range of public service sectors they cover, what proportion of their business comes from the public sector, and how international they are.

However, the Julius Review categorised the market in six ways:

- Managed services, supplied directly to users, which represented some 44 percent of the industry;
- ICT services, where total public expenditure on the building and management of systems represented more than £12bn;
- ***Business process outsourcing***, which has a total spend of £5.3bn in 2007 (although this included some IT elements);
- Construction services, valued at £2-3bn;
- Facilities management, which in the public sector represented around £5bn; and
- Professional services, including consulting and advisory services. Consultancy alone was estimated to be worth £2.8bn in 2008.

Categorised by Market Sector

This paper sought to analyse the supply side by market sector, drawing on public information to understand the structure of the market in each case, along with the shape of the supply side where possible. It is not feasible to summarise that information here, however, a number of patterns have emerged:

1. There is a wide range of different market models. At one extreme are the monopsonistic markets where a single government client manages a small number of key suppliers that have been awarded a term contract following a competitive tender (prisons is one such example). At the other end are those markets where approved private or voluntary sector suppliers contract directly with end-users, some of whom may receive government financial assistance (residential care for the older people is one such).
   While different market models suit different suppliers differently (because of different business models), for the most part, the question of market design is a matter for government. There is evidence in some markets of a progression towards market models based on user choice and individual budgets.

2. Market instruments can be employed at different levels in different markets.

For example, in social housing, there is virtually no competition in ownership, limited contestability in management, but much greater involvement of independent providers in maintenance.

3. There is also a wide variety of business models, and suppliers do seek to influence policymakers in the adoption or extension of policies that are more favourable to those models where they have competitive advantage.

   However, companies also adapt their business models to take advantage of changes in market settings. This has been evident with defence equipment manufacturers, IT companies and construction firms developing service offerings as governments have placed greater importance on through-life support.

4. Some markets (such as waste management) are characterised by concentration in the hands of a few small suppliers, while in other markets (such as social care), supply is highly fragmented, with many small and medium enterprises, and even sole practitioners (in the case of general practice and homecare for the disabled) playing the leading role.

5. This brief analysis has identified several drivers of market development that seemed to recur across a number of sectors – central mandates (evident in defence support services, compulsory competitive tendering in local government and health, and the private finance initiative); technological innovation, particularly communications technology (evident in defence and local government, among others); the movement from spot contracts to block purchase (evident in the health sector).

6. Over time, there has been a tendency for services to be increasingly integrated, with new sources of value improvement being pursued both through economies of scale and economies of scope. Shared services, strategic commissioning, outcome commissioning, case management and streetscene contracts are all examples of service integration.

7. Public providers have been severely constrained in the past as to the variety of business models that they could employ. Liberalisation of the commercial constraints on public providers is leading them to explore new models, in some cases in joint venture with private and voluntary sector organisations.

8. A number of private sector suppliers have been created as spinoffs from public sector agencies. This is a pattern that has been observed in the private sector (for example in the BPO sector).

Issues Confronting the Sector

The issues confronting the public service market, supply side and demand side, are the same ones that have characterised the sector for decades. However, the urgency and the complexity of the current economic and political environment creates new pressures and makes it more difficult to interpret the trends.

- *Will we or won't we?* – the financial crisis and the forthcoming political contest (that will be closely fought) will make the debate more ideological in nature.

Given the state of public finances, it is likely that increased competition in public services will be part of the solution, however, this is by no means certain.

- ***Price vs quality*** – in the current climate, we should expect customers to give greater weight to low price procurements and/or maximisation of risk transfer.
- ***Scale vs scope*** – simplistic arguments for 'economies of scale' solutions are likely to be given a better hearing in the current environment, and yet a number of major initiatives based on 'economies of scope' are still being actively pursued.
- ***Control vs risk transfer*** – the fluidity of the external environment, and the loss of trust in market institutions should give customers an interest in pursuing models that give them greater control and flexibility. And yet we are still seeing customers experimenting with models involving significant risk transfer.
- ***Competition in or for the service?*** – on both sides of politics, there is active interest in market models where suppliers sell their services direct to end users and carry market risk.
- ***Coping with a maturing market*** – the maturation of the mixed economy for public services has created new challenges for policymakers, such as competitive neutrality, and the creation of employment models suited to the flexible new models that are emerging.

1. Introduction

“£7bn - Spent in 2007/8 by the UK government on the procurement of services”

In 2007/08, the UK government spent £79bn on the procurement of services from private and independent suppliers. The public service industry – that part of the market made up of non-government suppliers - accounts for 5.7 percent of GDP and employs some 1.2 million people. Measured in terms of value-added, the industry is significantly larger than the ‘feed, beverages and tobacco’, ‘communication’, and ‘electricity, gas and water supply’ sectors. It is larger than aerospace, automotive and pharmaceuticals sectors combined.

Over the last 12 years, this sector has grown at an average annual rate of 5.4%, although the rate of growth slowed somewhat in the last four. As a share of GDP, the public service industry in the UK is slightly larger than that of the US, and almost double that of France and Spain. Australia and Sweden are slightly larger at 6%.

As a result of the Julius Review, we now have a clear picture of the size of the public service economy, or at least that part represented by private and independent sector providers. We know much less about the structure of this market – the variety of market models that have been used, the scale of these sub-markets, the range of services provided, the market share accounted for by private and voluntary providers, and by large, medium and small scale providers.

There is virtually nothing available of the supply side of the market, in part because of the diverse range of market models and the different ways in which providers have structured themselves to meet demand.

With that in mind, this paper attempts to describe the structure of the public service economy in the UK. It is incomplete, in large part because of the paucity of information, but also because of the constraints of time and space. Another way of analysing the supply side might have involved an analysis of a variety of different suppliers, exploring the diversity of business models; again, that was not feasible given the resource constraints, and must await a future study.

We conclude with a brief analysis of some of the issues confronting the market over the immediate future.

2. Supply Side by Business Model

One way of analysing the supply side would involve us classifying providers according to their respective business models. Very little work has been done to break the sector down in this way, and classification would be extremely difficult because of the diverse and hybrid business models that have developed. Nevertheless, we would suggest that the companies might be categorised according to the following characteristics:

- The extent to which they assume market risk – some providers sell direct to the public (such as rail companies) or to government agencies (suppliers operating in spot markets), without the predictability of a term contract;
- Back office vs front office – in the prison industry, private companies provide the full range of public services, including custodial and professional services; by comparison, the facilities management sector is largely back-office;
- Scale vs scope – some providers base their value proposition on a narrow range of services delivered on a large scale; others focus more on the integration of a wide range of functions within a single facility or service, pursuing economies of scope;
- Transactional vs relational – in some public services, management can be conducted at arm's length; in other cases, government needs to have a much closer relationship with its suppliers, resulting in a different partnership model;
- Large or small – how much is a sector dominated by a small number of large suppliers?
- Public, private or voluntary – or some combination of these three?
- Range of sectors – to what extent are capabilities specific to one sector, and to what extent has the business model been extended across a range of public services;
- Proportion of public sector business – some providers earn the vast majority of their revenue in the private sector, while others are almost wholly committed to the public sector;
- Proportion of international business – some international companies will have very little exposure to the UK market;
- Origins – insights might also be gleaned by studying the origins of the organisations in question: whether they have come from large public or private sector organisations through spinoffs, from specialist providers (such as the consulting, construction, ICT or security industries), the voluntary sector, or overseas countries.

The Julius Review did provide some estimates as to the range of services provided to government by the independent sector (based on a model developed by PwC in the local government market):

- *Managed Services* – services supplied directly to users – accounted for 44 percent of the public service industry;
- *ICT Services*: building and management of IT and communications systems. Total public expenditure was estimated at around £12.4bn;
- *Business Process Outsourcing* had a total spend £5.3bn in 2007 but this included some IT elements. (The 2009 Operational Efficiency Programme estimated that £2-3bn is already outsourced and/or shared);
- *Construction Services*: £34bn was spent on public sector construction and

£11bn in PFI/PPP in 2006. Julius estimated that the service component to be around 5 percent of construction spend, i.e. £2-3bn in PSI turnover;

- *Facilities Management*: This includes support services, building operating and maintenance services, environmental services and property management. The public sector accounts for around £5.2bn;
- *Professional Services*, including consultancy or advisory services in human resources, financial, legal and general management consultancy. In 2008, the public spend on consultancy was estimated at £2.8bn.[1]

[1] Dr Deanne Julius, Understanding the Public Services Industry, London: Department for Business Enterprise & Regulatory Reform, July 2008, pp.20-24.

3. Supply Side by Market Sector

For the most part, this paper seeks to understand the variety of market structures (and hence the diversity of supply side arrangements) in a somewhat different way, by exploring the various public services provided by government.

3.1 Healthcare

a) Primary care

General Practice: In Britain, there are around 35,000 publicly funded General Practitioners, of whom around 85 percent are independent contractors, with the remainder salaried employees. Some are employed directly by their local Primary Care Trust but since 2004 it has been possible for alternative providers such as companies and social enterprises to contract with Primary Care Trusts for delivery of primary care services and to employ GPs directly. Most of these companies have been set up by or in association with GPs. A survey of independently managed practices at the end of 2008[2] showed the following results:

New Market	No. of GP Practices
GP-led	146
Corporate	10
Social Enterprise	2

As of October 2008, the leading provider of general practice services was a national GP-led business with 38 clinics. The next two largest, both GP-led, operated 11 clinics in the north-west of England, and nine around Liverpool. The largest corporate practice operated five in different parts of the country.[3]

Although the numbers are still small, one of the notable developments in recent years has been the decline of sole and small group practices and the emergence of GP-led health centres or polyclinics open 12 hours a day, seven days a week. All 152 PCTs in England have been required by the Department of Health to commission at least one polyclinic in their area: as at January 2009, out of 54 polyclinics tendered, 14 had been won by corporate providers, the rest by GP-led companies, not-for-profit social enterprises and GP cooperatives.[4] Since 2000, 93 nurse-led walk-in centres have also emerged with similar opening hours to polyclinics. Eight of these are operated by five independent sector organisations.

New models are also emerging out of new arrangements for out-of-hours services. Following re-negotiation of their national contract in 2004, 90 percent of English GPs and 95 percent of Scottish GPs opted out of delivering out-of-hours services in exchange for a small proportion of their income. (Previously, GPs either pooled resources locally in co-operatives or sub-contracted their services themselves.)

In England, in-house PCT out-of-hours providers make up 28 percent of this market

[2] Health Service Management Centre, Birmingham University, 2008.
[3] Jo Ellins, Chris Ham and Helen Parker, 'Opening up the primary care market', BMJ, 4 April 2009, pp.798-800.
[4] Pulse, 'One in four GP-led health centres won by private sector', 19 January 2009, http://www.pulsetoday.co.uk/story.asp?storycode=4121659

(by revenue). GP co-operatives and larger community benefit societies operate around 45 percent and commercial providers each have a 20 percent share. NHS Direct operates 18 percent of the awarded contracts but these only amount to around 4 percent of total revenue.[5] In Scotland, NHS Boards took over the areas where practices dropped out and created rotas to cover out-of-hours periods using local GPs who now provided services on a sessional basis and also directly salaried employees.[6]

The services of private GPs (or self-pay general practice) represent about 3 percent of consultations, valued at around £450m per year. Private surgeries are more common in the City and West End of London, managed by self-employed doctors or private companies (e.g. BUPA), although there are some (mainly self-employed) private GPs outside the capital. NHS-contracted GPs are restricted from doing private work and private GPs cannot refer to NHS secondary care.[7]

Managed Care: It is widely recognised that proactive management of high-risk populations, such as patients with chronic illness, will become an increasingly important element of healthcare. Managed care (also referred to as coordinated or integrated care, and chronic disease management) was pioneered two decades ago by US Health Maintenance Organisations. Elements of this approach have been incorporated through the GP Quality Outcomes Framework, a performance management approach, which provides incentives for GPs to screen and refer patients with chronic problems, whilst PCTs have focused on co-ordinating primary and secondary care more efficiently.

Two PCTs have entered into partnerships with healthcare providers to manage chronically ill patients more closely in order to improve patient well-being and reduce the rate of hospitalisation. In 2007, the London Borough of Newham contracted for a new information system on patients affected by chronic illness and the provision of a team of community matrons who visit patients at home, with an explicit objective of reducing hospitalisation rates. A partnership between Birmingham East and North PCT, Pfizer and NHS Direct was introduced in 2006 which created a dedicated telephone line staffed by nurse care managers along with the development of personal health indicators to track each patient. In April 2009, the Department of Health announced 16 integrated care pilots to be delivered by a mixture of PCTs, GP groups and private sector providers.

Infrastructure: Many GPs premises are non-purpose built facilities maintained in residential housing. Traditionally, GPs own or lease the building themselves and are responsible for its maintenance. The Local Improvement Finance Trust (LIFT) allows local NHS to enter into joint ventures with the private sector to build new purpose-built offices. The LIFT company then finances, designs, builds and operates the building for 20-25 years which is leased to the GP. Since 2001, 220 new facilities have been built by 47 LIFT companies.

b) Secondary care

Hospitals: There are 170 acute and 60 mental health NHS trusts in England. Of these, 121 have been given foundation status similar to a public interest company. As a result they are permitted to exercise greater operational and financial independence to tailor their services to local communities. Government's objective is to convert all acute NHS trusts to foundation trusts.

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[5] National Audit Office, The Provision of Out-of-Hours Care in England, 2006
[6] Audit Scotland, Primary Care Out-of-Hours Services, 2007
[7] IPPR, Private Spending on Healthcare, 2008

There appear to be around 1,600 public and 300 private hospitals in England, although the latter tend to be smaller than public hospitals – public hospitals average around 100 beds, while private hospitals typically have around 40-50.[8] The average daily number of public NHS beds in England last year was around 160,000 (down from more than 240,000 in 1991/92), with a further 9,000 in private hospitals, and another 2,000 in NHS private patient units (located in public hospitals). PPUs typically have around 10-12 beds per unit.

The majority of elective surgery is provided by NHS acute trusts but for some years they have purchased additional capacity from private hospitals through a spot market. Although this provided flexibility, it was an expensive solution. The first NHS-run elective treatment centre was opened in 1999, however, in 2002, the Department of Health introduced a programme of Independent Sector Treatment Centres based on block-purchase in order to stimulate competition, reduce costs and generate a mixed economy.

According to the NHS, the independent sector proportion of elective care was expected to grow from less than one percent (2005/06) to around ten percent by end of 2008 (and to 20 percent in diagnostics).[9] However, the CBI estimated in 2008 that only 5 percent of elective surgery would be provided by the independent sector.[10] As of September 2008, Department of Health figures showed that there were 28 independent treatment centres offering diagnostic and elective procedures and seven regional diagnostic contracts over various sites, with one more to commence in November 2009. The third wave of procurement, due to start in 2007, was abandoned and Primary Care Trusts were given the responsibility of commissioning directly based on local needs.

Secure Mental Health: The independent sector provides around 40 percent of medium secure mental health beds, with the NHS providing the rest. The NHS is the sole provider of high security beds through three hospitals in England and one in Scotland. There are five major independent sector providers that account for 84 percent of their sector's share.

From 1999 to 2003, the number of medium secure mental health beds more than doubled while the independent sector share rose by only 15 percent. There is anecdotal evidence to suggest that some commissioners seek to maximise their use of NHS beds before they turn to the independent sector, in part because of the higher costs associated with spot purchase. In recent years, however, there has been increasing use of block purchase.[11]

Pathology Services: Following an NHS review of pathology services in 2006 a number of Trusts have looked into merging their services or putting them to tender. There are around seven major independent pathology service providers in the UK. However, with ongoing pressure for consolidation, at least one leading hospital has established a joint venture with a private support services company, with the intention of marketing its services to other hospitals.

Facilities Management: Hospital cleaning and catering contracts were a key feature of 'compulsory competitive tendering' introduced in the 1980s and these services still account for 29 percent and 13 percent respectively of all contracts. Since 1996, however, there has been a shift towards combined service contracts with around 60

[8] The NHS has no idea how many hospitals it owns and operates.

[9] NHS Information Centre website, 'The role of the independent sector role in NHS funded care' http://www.ic.nhs.uk/services/independent-sector-information-programme/news/the-role-of-the-independent-sector-in-nhs-funded-care

[10] CBI, NHS and ISTCs: Sticking Plaster or Real Reform, 2008

[11] Max Rutherford and Sean Duggan, Forensic Services: Facts and Figures on Current Provision, Sainsbury Centre for Mental Health, 2007, and industry sources.

percent of all contracts awarded in 2002 involving some combination of services. According to Unison, this has tended to reinforce the position of large catering and cleaning firms. Unison has also estimated that the private sector had penetrated around 35 percent of the total NHS market in soft facilities management.[12]

Infrastructure Services: Except in Wales, PFI became the dominant financing model for the modernisation of healthcare facilities in the NHS, especially with large projects. In the UK there are currently 139 projects which have reached financial close with a capital value of over £12bn. Ninety percent by capital value is in England.

It is difficult to obtain information on the value of the service element of this market, however the top ten FM providers based on capital value account for 85 percent of the total. Four of these were hard FM only, two were soft FM only, while the remaining four were mixed.[13]

3.2 Schools

Ninety percent of schools are publicly-funded state maintained schools, with 10 percent independently funded through pupil fees.[14] Since 1988, parents have had the right to apply across local authority boundaries for admission to state schools, although in practice, shortage of places in the better schools means that choice is limited. Selection based on ability is only permitted in the small number of grammar schools that remain (representing five percent of the market). However, some state schools have the autonomy to manage their own admissions and thus may practice covert selection. Around 20 percent of schools have a religious character. Any new faith schools must have the agreement of parents and the local community and be approved by the local authority. Most faith schools are voluntary aided. Faith schools admit pupils on religious affiliation but many admit those who are not of the school's faith.

a) Secondary schools*

56 percent of all secondary schools (public and private) are community schools where the Local Authority employs the staff, owns the school's land and buildings and decides the arrangements for admitting pupils. Other schools which enjoy some measure of independence (and thus might provide the basis for a future diversification in the supply side) include:

Foundation schools (15%): The governing body employs the school's staff and has primary responsibility for admission arrangements. The school's land and buildings are owned by the governing body or by a charitable foundation.

Voluntary aided schools (13%): The governing body employs the school's staff and has primary responsibility for admission arrangements. The school's land and buildings are normally owned by a charitable foundation. The governing body contributes towards the capital costs of running the school. About 90% are church schools (which in other countries are classified as part of the independent sector, even when partially state-funded).

Independent schools (10%): Most are set up as standalone charitable organisations and funded by parents' fees and investments. One education charity operates ten schools while a subsidiary sponsors 15 academies (and as such is the largest

* For reasons of space, we have focused exclusively on secondary schools.
[12] Unison, NHS Market Report, April 2003.
[13] Based on a proprietary market survey.
[14] Department for Children, Schools and Families, The Composition of Schools in England: Statistical Bulletin, 2008

sponsor of academies). There are also several private companies which operate less expensive independent schools, one of the leaders operating 39 schools, and another 11.

Voluntary controlled schools (3%): In this case, the local authority employs the school's staff and has primary responsibility for the admission arrangements. Land and buildings are normally owned by a charitable foundation. About half are church schools.

Academies (1.3%): These are all ability schools established by sponsors from business, faith or voluntary groups working in partnerships with central Government and local education partners. Sponsors and the Department for Children, Schools and Families (DCSF) provide the capital costs for the academy. Running costs are met in full by the DCSF. Each academy is set up as a company limited by guarantee with charitable status and has a board of governors responsible for the governance and strategic leadership of the school. Some academies are sponsored by independent schools. There are currently 133 Academies operating with a target of 200 by 2010. The current government is committed to establishing 400 across England.

City Technology Colleges (0.3%): These take the form of a charitable company limited by guarantee. The sponsors constitute an educational trust and will own or lease the college and appoint their representatives to the board of Governors. The members of a CTC will consist of nominees of the sponsoring company and the Secretary of State. When a CTC is opened it will be registered as an independent, non fee-paying school.

b) Infrastructure services

The government has initiated a huge school building programme using private finance to a great extent. There are currently 154 Primary and Secondary Education PFIs, 17 of which are not yet operational. No information is available on the service element of these projects or the make-up of the associated suppliers.

Building Schools for the Future: A government plan was launched in 2004 to rebuild 50 percent of secondary schools in England, structurally remodel 35 percent more and refurbish the remaining 15 percent, at a cost of around £55bn over 10-15 years. It introduced a new model of infrastructure financing whereby the local authority took an equity stake in the project. However, it has fallen behind schedule. Two hundred were supposed to have been completed by the end of 2008 but only 42 had been finished. Expected completion is now set for 2023.

Local authorities are in charge of delivering the programme, and were encouraged to form 10-year Local Education Partnerships (LEPs) with a number of private companies so as to procure a flow of projects structured as joint ventures with the companies. Central programme management is provided by Partnerships for Schools, and consulting by Partnerships UK.

Seven billion pounds has been earmarked to rebuild or refurbish half of all primary schools by 2023, a programme announced in November 2008. Procurement will be made through LEPs or other BSF funding vehicles where they exist or to consider other partnership models where this does not exist.

No information is available on the service element of these programmes.

3.3 Justice and Immigration Detention

a) Police

Infrastructure services: There have been 23 signed PFIs in the policing sector, covering station buildings, training centres, air support, custody suites and stables. Over time PFI service contracts have grown in scale and scope, incorporating cleaning, portering, catering, custodial, medical and interpreter services. Two projects, in Warwickshire and Scotland, brought together police, probation, social services and courts in integrated justice centres.

Support services: In the 1980s the Home Office encouraged forces to employ civilian staff in specialist functions such as financial management, legal services, personnel, research and analysis and forensic services in order to achieve better value for money. Since the mid-1990s, contracting has been used for custody services, fleet management, support services, air support and evidence storage, both in PFI deals and as part of straight outsourcing arrangements. Specialist police recruitment agencies have also been used to provide experienced professional support when required.

Forensic services: Scene-of-crime officers are now mostly civilian specialists. Police forces also spend around £170m on external laboratory analysis. Seventy percent is provided by the Forensic Science Service (since 2005 a private limited company owned by the Home Office), and 30 percent by private labs.

Investigation: Civilian investigators have been employed to provide support in taking witness statements and administrative tasks. To date, these appear to have been sole practitioners brokered through recruitment agencies.[15]

b) Prisons

There are 140 prisons and young offender institutions in England and Wales, of which 11 are managed under contract (nine of them under PFI), representing 11 percent of prisoners. In Scotland, two of the 16 prisons (or 16 percent of prisoners) are privately managed under PFI, although the competition for a third was terminated by the new Scottish government. Three private companies account for the vast majority of these services. In addition, three public prisons are operated under service level agreements, which are quasi-contractual in nature.

In England and Wales, the industry is awaiting announcement of tenders for two further PFI prisons, and five more are to be built, three under PFI and two under public management; two underperforming public prisons are to be market-tested in 2009, and three public prisons presently operated under service level agreements are due to be re-competed over the next two years to 2011.[16] The Youth Justice Board is to conduct a competition for the management of a new facility to be built for young offenders. There are also four purpose-built Secure Training Centres in England for the detention of under-17 year old offenders, built and operated under PFI.

The private and voluntary sectors also provide a range of support services in public prisons, including drug rehabilitation and education and training, although there is no consolidated information about this part of the industry.

[15] Alexis Sotiropoulos, Making Time, London: The Serco Institute, 2008.
[16] Ministry of Justice, Capacity and Competition Policy for Prisons and Probation, 2009

c) Offender management

Probation: There are 42 Probation Boards in England and Wales, while in Scotland, probation is the responsibility of local social services. Traditionally this market has been very fragmented: supervision of offenders is currently provided by public staff, whilst other post-release resettlement services are delivered by a mixture of probation, health, social services, and third sector organisations.

Private and third sector organisations help to deliver accommodation, employment, training and substance abuse/testing services. In Bristol, a private company operates a probation hostel. And in the east of England, a regional pathfinder project employs a private-voluntary sector partnership to place offenders into sustainable employment. In London, the Criminal Justice Board is currently commissioning an employment initiative for young people post-release, with a focus on the transfer of outcome risk.

In England and Wales a new commissioning-based model of end-to-end offender management was introduced with the proposed integration of prisons and probation under the National Offender Management Service. Non-mandatory targets for sub-contracting were set at 5 percent in 2006/07 and 10 percent in 2007/08. This was successful in some areas at increasing participation by private and third sector organisations. Probation boards will be required to achieve Trust status by proving high performance. Those that do not achieve this may be merged with successful neighbouring trusts or services will be competed in the open market. A Best Value framework was also introduced in 2008 to allow review of value-for-money in a number of services. Community Payback and Victim Contact are priorities for 2009 with at least 25 percent of these services to be competed in the open market.[17]

Home Detention/Electronic Monitoring: Following a trial in 1989, the Home Office introduced Home Detention Curfews in 1999 and let three contracts for England and Wales. When it was re-tendered in 2005, this was reduced to two. One five-year contract covers Scotland.

d) Prisoner escort

Prior to the creation of the Prisoner Escort and Custody Service, responsibility for escorting had been divided between the Prison Service and policing agencies. PECS originally tendered contracts in eight court areas in England and Wales which ran between 1993 and 1999. In 2004, the contracts were amalgamated into four regional contracts which were won by three companies. The Scottish Prison Service contracted its entire prison escort service to one company in 2003.

e) Immigration detention

There are 11 immigration removal centres in the UK (one in Scotland). Eight are privately managed and three are managed by HMPS on behalf of the UK Border Agency under service level agreements. Of the four private companies involved in this sector, one manages four facilities, one two and the other two, one each.

[18] Prof. Martin Cave, Every Tenant Matters, Department for Communities and Local Government, 2007.

3.4 Social Housing

The most significant trend since 1980 has been the decline in the stock of social rented homes, mainly due to the 'right to buy' policy which has transferred a large portion of the social housing stock to private ownership. Investment in new social housing is made through a mixture of local authority grants to housing associations and raising of private finance (the accepted ratio is £1 of public money to £2 of private finance). There are also 38 PFI schemes and since 2004, public funding can be accessed by private sector organisations accredited by the Housing Corporation.

Provision: Local authorities provide around four million homes as social housing. Almost 50 percent of social housing has now been transferred to registered social landlords (RSLs), generally known as housing associations. The total UK payments for social housing outsourced to housing authorities in the UK is over £2bn. The private rental sector (for social housing) provides around 90,000 homes (mostly in a spot market), which are used by local authorities for temporary accommodation.[18]

Management: The management of social housing involves allocations, rent collection and repairs management. The supply of social housing management is divided as follows:

- Local authorities directly (23%);
- Arms length management organisations (ALMOs) of local authorities which are companies limited by guarantee and managed under contract. Since 2001 around 60 have been set up. Some ALMOs are also considering opportunities to develop and own properties. (25%);
- Housing Associations (or RSLs), which are independent, non-profit distributing organisations. There are over 1000 small HAs with less than 250 homes and 60 large HAs with more than 10,000 (48%);
- Tenant Management Organisations which rely on a combination of tenant, private and local council resources (0.02%);
- Private Sector (0.01%) since 2004 private for-profit organisations have been able to compete for public funding to develop social housing.

Competition in social housing management began in the late 1980s but less than two percent has been outsourced and this tends to be concentrated in certain local authorities and PFI contracts. No major housing association has market-tested its management function.[19]

Maintenance: The maintenance of social housing stock is separate from management, although it is included as part of PFI projects. A market has existed for some time but the top ten private providers only have 17 percent of the market between them and some estimates suggest that two-thirds of the market is still provided in-house (i.e. local authorities, ALMOs or aousing associations). Private market share has however grown since 2000 when the Decent Homes Initiative was announced by the government requiring the condition of two million homes to be significantly improved as well as the Gershon government efficiency reviews recommendation that social landlords find 2.5% year on year savings.[20]

[18] Prof. Martin Cave, Every Tenant Matters, Department for Communities and Local Government, 2007.
[20] Pinnacle, Empowering tenants, improving quality and reducing costs: The case for contestability in English Social Housing, 2008.

3.5 Social Services

a) Residential care

In 2004 there were around 157,000 care homes for older people providing roughly 450,000 places across the UK for 410,000 residents at an estimated annual value of £8bn. The NHS provided around 30,000 long stay medical places for older people.

Capacity has fallen by 15.5 percent from its peak in 1996 while demand has fallen by 12.4 percent. About three-quarters of places are in the private sector, whilst the rest are evenly split between local authorities and the third sector. The local authorities' share has declined over the past decade: the number of local authority places almost halved in the decade to 2004, from 85,000 44,200.

Providers of care homes vary from large for-profit companies to small businesses and voluntary organisations to local authorities. The market is highly fragmented; in a 2005 survey by the Office of Fair Trading, 54 percent of providers reported being single home businesses and 8 percent were part of a small business owning two homes.

Around 40 percent of places provide nursing care and some provide for specialist care e.g. dementia, learning disability, mental disorders, physical disability, alcohol and drug dependence. The average care home has 30 beds but this ranges from two or three to over 100.

Residents can be self funders, funded by someone else, residents funded by their pension/benefits or partly by a local authority, residents who are topped up by a third party or entirely NHS funded. The vast majority (97 percent) of homes for older people accept both self funded and authority funded residents. Thirty-two percent are self-funded, 44 percent have no third party contribution and 25 percent have a third party contribution. Self funded residents may sometimes pay more than authority funded residents.[21]

b) Home care

Overall levels of home care purchased by health and social services rose by 75 percent between 1993 and 2003. The rise was due almost entirely to an increase in the use of independent services; during the same period the number of hours of home care provided by in-house local authority services fell by 38 per cent.

The shift to independent provision led to a rapid increase in the number of providers throughout the 1990s: in 2004, there were more than 3,000 registered home care providers. The market is fragmented, with relatively few large providers and many small ones. The majority (82 percent) of independent providers are in the private sector, half of these being sole traders or partnerships, and half private or public limited companies. Only around 40 percent supply home care exclusively. Many services developed from nursing agencies and some from care home providers.[22]

Individual budgets: Direct cash payments have existed since 1997 but there has been a variable uptake and there were restrictions on who could receive payments. 'In Control' projects also gave people with learning disabilities more control over the support they received and how they received it. Individual budgets are designed to be more flexible in their use and wider in scope. Thirteen individual budget pilots were set up in England by the Department of Health to run between 2006 and

[21] Office of Fair Trading, Care homes for older people in the UK, OFT780, May 2005.
[22] Kings Fund, Understanding Public Services and Care Markets, 2005

2007. The available evidence suggests that the supply side of this market is highly personalised and thus highly fragmented. (In a 2007 study of direct payments in Tower Hamlets, only two service users out of a sample of 30 purchased services from an agency[23]).

3.6 Children's Services

a) Childcare

Childcare has been traditionally dominated by the private and voluntary sectors operating nurseries, crèches or out of school schemes with little government intervention and limited local authority involvement. There was significant growth in the 1990s when several major new businesses and a large number of individual nurseries or smaller chains entered the market and investment levels were high. Fee levels in private and voluntary sectors were rising due to undersupply.

The 1998 National Childcare Strategy introduced measures to increase capacity, improve market management and responsiveness (e.g. a duty on councils to commission sufficient childcare to meet needs of working parents, better information for parents, capacity targets). Increased government provision or co-ordination of childcare services via initiatives such as the Neighbourhood Nurseries program, the children's centre programme, the free early entitlement for three and four year olds and extended schools agenda have both stimulated demand for childcare and acted to fill geographical and affordability gaps in supply.

The private, voluntary and independent sectors see the 3-4 year age group as a key addressable market as the margin per child is higher due to a need for fewer carers. The Dedicated Schools Grants which gives free places for 3-4 year olds, allows all providers to register to receive grant support and thus brings more parents to the market. However, it also allows schools to compete with other providers and provides them with something of a competitive advantage.

It was estimated in 2006, that there were 1.5m places in 100,000 registered settings. The rate of growth was slowing possibly due to market saturation in affluent urban areas. Full daycare was the largest and most rapidly growing care sub-type (one-third of total places). Out of school care and childminding accounted for about a quarter each. Sessional daycare accounted for about 17 percent of places and had been declining.

The private sector (including single-owner nurseries) is the largest supplier of childcare offering about 60 percent of all places. Voluntary/community organisations provide 25 percent and local authorities 15 percent. Within the private sector, provision is very fragmented. The top 40 providers have a cumulative market share of only 10 percent; the top provider has a 1 percent market share. There are no national chains in this sector.

Funding for childcare comes from individual contributions (45 percent), private companies contributing for employees (2 percent) and the rest from government. In the private nursery market 77 percent of funding comes directly from parents, 12 percent from employers and 7 percent from government.[24]

b) Residential children's care

The number of children in residential care fell steadily by about 1.1 percent a year

[23] Claire Frew, 'Making choices in social care: Service users' experiences of the Direct Payments Scheme', London: Queen Mary, University of London and Tower Hamlets, March 2007.
[24] PricewaterhouseCoopers, The Childcare Market, Department for Education and Skills, 2006

over the five years to 2004. There are 5,000-6,000 children in care (20-40 per local authority) which presents difficulties in predicting demand and in 2006, there was an oversupply of places.

The market is highly fragmented with the largest provider operating only 50 out of 1,200 privately managed homes. Private providers manage about 50 percent of beds, local authorities about 35 percent and voluntary organisations about 10 percent. Some local authorities were beginning to benefit from over-supply as providers were forced to compete on price.

In February 2008 the largest provider, with 65 properties, went into administration, following downturns in its profits due to local authorities increasing their use of foster care. Fifteen of the homes were sold directly to a competitor. Children in a number of the remaining homes were moved within five days and placed in alternative accommodation.

Occupancy is a key factor that affects pricing especially for private providers who are exposed to market risk. Profitability is high when occupancy is over 80 percent. Private providers have absorbed most of the reduction in demand. Private sector occupancy may be as low as 50 percent, whilst in-house provision is 80 percent (with an average for the sector of 60-70 percent).[25]

c) Foster care

There are over 40,000 children in foster care and demand has been rising. The main supplier is the foster carer who must be approved by a fostering agency which can be operated by a local authority or by voluntary and independent organisations. The agency acts as an interface between the commissioner and carer. Local authorities can act as both agency and commissioner simultaneously. Agencies take referrals, help to match care and child, manage recruitment and payment of carers, employ and provide supervising social workers and other support for carers. External arrangements require fee negotiation.

About 33 percent of independent agency carers surveyed in 2002 had switched from a local authority. Independent agencies tend to offer higher payments and greater levels of support. Traditionally local authorities have preferred to use in-house or not-for-profit provision but the independent sector has accounted overwhelmingly for expansion in the availability of fostering placements, in response to undersupply. The market is very fragmented with few players holding significant shares. The largest provider has about 1200 children in its care and this represents about 3 percent of total share. There are some national agencies but also many small local providers.[26]

3.7 Local Government

a) Local authority services

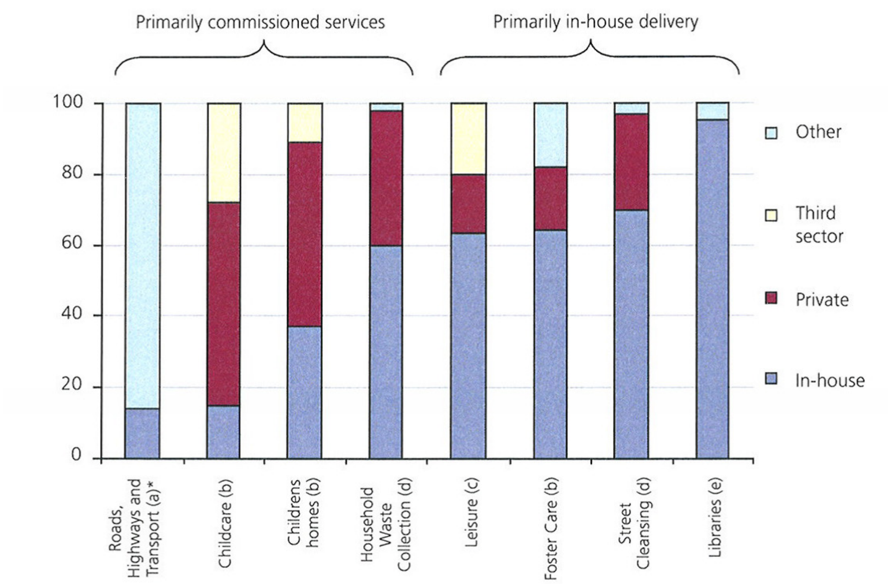
Contrary to mythology, the contracting of municipal services had commenced prior to the introduction of compulsory competitive tendering in 1988 – by 1985, 75 local authorities (out of 410) had already subjected some services to competition. CCT was directed to deepening and widening this market, so that by 1992, 551 contracts had been let, concentrated heavily in grounds maintenance, building cleaning and a range of other blue collar services. At that stage, the tendency was for local authorities to let contracts for single functions.[27]

[26] PricewaterhouseCoopers, Children's Homes and Fostering, DfES, 2006
[27] Kieron Walsh and Howard Davis, Competition and Service: The Impact of the Local Government Act, London: HMSO, 1993, Chapter 7.

In the early 1990s, the programme was extended to white collar services such as the management of revenue and benefits, however, the proportion of spending undertaken with external providers declined from a height of more than 50 percent in 1998 to somewhere around 45 percent in 2004.[28] In a 2007 survey of more than one thousand local authority executives, 38 percent reported that outsourcing was a major part of their council's approach to service delivery, with 45 percent saying that it was not.[29]

However, by this stage, the range of services that had been put to market had broadened considerably. Communities and Local Government divided the local authority services market into corporate support, education and children's services, social services, housing, leisure & culture and environmental services. A 2006 report by PwC into the market for local government in the UK documented the variations in the use of the market across different local services.

Overall Trends in Procurement Expenditure in Local Government[30]



In 2005, 61 percent of local government's external procurement is spent with SMEs, compared with 39 percent with large businesses.[31]

b) Waste management/streetscene services

Municipal waste collection and grounds maintenance were two of the earliest markets to develop – in some local authorities, since well before the introduction of compulsory competitive tendering. Over the last two decades, the market has matured, towards the integration of a range of associated services – either vertically to include transfer and disposal, or horizontally to include a variety of what are called 'streetscene' services – including street cleansing, removal of abandoned vehicles and even the eradication of graffiti.

The municipal waste management market has been estimated at around £2bn p.a., with evidence of significant self-supply in both collection (60 percent) and disposal (40 percent). The market is mature, and dominated by a small number of large

[28] PricewaterhouseCoopers and Department of Communities and Local Government, Developing the Local Government Services Market to Support a Long-Term Strategy for Local Government, 2006, p.31.
[29] Clive Grace et al, Making and Managing Markets, Final Report to the Audit Commission, Cardiff University, November 2007, p.46.
[30] PricewaterhouseCoopers and Department of Communities and Local Government, Developing the Local Government Services Market to Support a Long-Term Strategy for Local Government, 2006, p.32.
[31] Ibid., p.33.

suppliers, who account for around one third of the market. Overall, the waste and recycling sector in the UK comprises around 850-1000 organisations, but only two organisations have been found from the voluntary or community sector. The demand side of the market is also highly fragmented, with responsibility divided between 273 Waste Collection authorities and 82 unitary authorities.

Those organisations that concentrate most heavily on disposal appear to have the highest profitability, perhaps because of the control of strategic facilities, and/or substantial capital investment. These companies appear to have a competitive advantage, at least over the medium term, because of pressures on landfill sites and recycling targets.

A 2006 study by PwC reported that the market for the somewhat wider range of services that made up the 'streetscene' sector was 'relatively mature, although frequently organised around "silo" services'. The grounds maintenance market, for example, was highly concentrated, with the top four providers accounting for 73 percent of the market in 2003. Nevertheless, while streetscene contracts constitute a small proportion of the market overall, this model had shown strong growth, with new market entrants offering new models of integration.[32]

c) Leisure

Of local authority leisure facilities, around 60 percent were managed in-house, with 17 percent operated by the private sector, and around 20 percent by not-for-profit trusts. Over recent years, the proportion managed by private contractors has remained constant, while leisure trusts have expanded at the expense of in-house provision. Leisure trusts aside, the supply side is relatively stable, with a small number of established providers. The largest of the leisure trusts operates more than 40 facilities.

While private providers have adapted to compensate for this new source of competition, they have also protested at the unlevel playing field created by not-for-profit providers operating under a commercial model whilst enjoying preferential tax treatment.

There has been a great deal of expansion in this area in the last 10 years from lottery funding and PFI although this seems now to be drying up. To November 2007, there were ten PFI projects for leisure centres and swimming pools, with a capital value of £140m.[33]

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[32] Office of Fair Trading, More Competition Less Waste, 2006; PricewaterhouseCoopers, Working Paper on Neighbourhood and Steetscene Services, 2007

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d) Corporate support

This sector cuts across local and central government. The 2009 Operational Efficiency Programme review by HM Treasury found that there were no accurate cross-government figures for the amount spent on back-office functions but it was estimated that this is around £18bn (HR, Finance, Procurement, Marketing and Communications, Estates). A rough estimate suggests that around £2-3bn is or shortly will be shared and/or outsourced.

Much of the outsourcing in this sector is IT-enabled, and with local government estimated to have spent more than £3bn on IT goods and services in 2006, this is a sector deserving of much closer analysis. However, this is another extraordinarily complex sector, with a range of competing business models, and virtually no analysis of the various elements of the supply side. A 2007 report for Communities and Local Government written by PwC identified three elements:

- Facilities management of IT operations;
- Change management programmes; and
- Functional outsourcing – procuring partners to undertake key functions such as human resources or the management of Revenue and Benefits, along with the responsibility for the associated technology.

Given the trend towards shared service contracts and strategic partnerships, this is another sub-market where integration is a central theme.[34]

e) Infrastructure services

Over the decade to 2007, local government construction accounted for some £4.6bn of PFI credits, although this probably included some functions addressed under other headings (such as education). The local authority estate (including social housing and schools) has been valued at £140 to £383bn.

PwC concluded that ‘the asset management and construction services sector is highly fragmented in terms of both supply and demand. The size distribution of the industry is consequently highly skewed towards small size firms and contracts.’[35]

3.8 Employment Services

From 1998, the government introduced a series of programmes focused on assisting the long term unemployed into sustainable employment. In most of the country, these were delivered by the public sector provider, Jobcentre Plus, however, in several policy areas, there was a conscious attempt to engage the independent sector, resulting in a complex patchwork of over 600 public, private and third sector suppliers.

Pathways to Work was a mandatory programme for recipients of incapacity benefits (since replaced by Employment Support Allowance). Jobcentre Plus conducts the initial interview, however, the core work-focused interviews are delivered by Jobcentre Plus (in 40 percent of the country) and the private and voluntary sector (60 percent). Thirty-four contracts were let in 30 areas distributed over 12 different

[33] Mintel, Leisure Centres and Swimming Pools Intelligence, 2008
[34] PricewaterhouseCoopers, ‘Working paper on technology and transformation services’, DfES, March 2007.
[35] PricewaterhouseCoopers, ‘Working paper on local government asset management and construction’, DCLG, February 2007.

for-profit and social enterprises. The largest provider was a specialist private welfare-to-work provider with six contracts.[36]

Employment Zones: From 2000, pilots were rolled out, experimenting with contracting complete programmes for the long-term unemployed. Initially 15 contracts were let to three organisations with a public-private-voluntary sector hybrid winning 11 and two private companies winning the others. Further competition was subsequently introduced and there are currently 24 contracts shared amongst seven providers (15 of these contracts were won by private companies). Of these, eleven were with recruitment companies whilst thirteen were with specialist welfare-to-work providers.[37]

New Deal for Disabled People: A voluntary programme which was introduced in 2001 following several local pilots, for intensive job broker support which is located outside the Jobcentre Plus network and can be delivered by public, private and voluntary sectors. There are seven private, not-for-profit and third sector providers with more than 50 contracts.

Progress to Work pilots: These involved employment services for recovering drug addicts, alcoholics, homeless and ex-offenders, which were rolled out between 2002 and 2003. These are delivered by a range of providers although most are from the voluntary sector.[38]

Flexible New Deal: The Flexible New Deal begins in October 2009 and brings together the New Deal programmes for the long-term unemployed, except those for lone parents and disabled people which will continue separately.

Under Phase One, 14 regional contracts were competed and 24 prime contractors have been announced as preferred bidders. In ten of the regions, contracts are to be awarded to two providers who will compete between themselves for market share based on outcomes. The prime contractors will be responsible for co-ordinating delivery through a broad network of public/private/third sector organisations. Eleven contracts have private companies as preferred bidders and seven have not-for-profit social enterprises. Dudley Borough Council was selected for its local contract, a public-private-voluntary organisation was selected for four others and a social/private special purpose vehicle also was chosen for another.[39]

3.9 Defence

The supply of defence equipment in the UK is wholly privatised, albeit heavily supported by state projects. Shrinking defence budgets and the need to secure competitive advantage in international markets have driven a rationalisation of the defence manufacturing industry over the past two decades, with the result that in some sub-sectors there may only be one supplier.

In 2007/08, the Ministry of Defence placed just over 22,900 contracts with a collective value of around £14.4bn. Of the total value of MOD HQ contracts placed in 2007/08 around 47% were priced by competition.[40] The market for support services is currently valued at around half of this, with around 10 percent of this delivered in-house.[41]

[36] Indus Delta, Pathways and POEM feedback, http://indusdelta.co.uk/story/pathways_and_poem_feedback
[37] A list of employment zone providers can be found here (11 March 2009): http://www.dwp.gov.uk/supplyingdwp/what_we_buy/notice_to_providers_star_rating1103.pdf
[38] Richard Dorsett, Maria Hudson and Karen McKinnon, Progress 2 Work Evaluation, DWP Research Report, 2007; http://www.dwp.gov.uk/asd/asd5/rports2007-2008/rrep464.pdf
[39] DWP website, List of Phase One Flexible New Deal – Preferred Bidders; http://www.dwp.gov.uk/supplyingdwp/what_we_buy/fnd_preferred_suppliers_final.pdf
[40] Defence Analytical Services and Advice, UK Defence Statistics , Chapter 1: Finance, Ministry of Defence, 2008.
[41] Authors' own provisional estimate, based on private consultations.

The UK defence sector has long acquired some services from the private sector, most notably in vehicle and aircraft maintenance, although these were mostly defined in terms of labour inputs rather than service outcomes. The origins of the modern defence support industry probably lies in the contracts let for the installation of and ongoing technical support for communications facilities constructed in the 1960s and 1970s, followed by a programme of privatisation and centrally-mandated outsourcing in the 1980s.

As these services have been re-competed over time, the contracts became larger and more complex, as the MoD sought greater efficiencies variously through economies of scale and scope. The supply side now consists of a variety of original equipment manufacturers, technology support companies, property managers and FM providers who have adapted their models to meet MoD requirements.

Over time, the Ministry of Defence has outsourced an increasing proportion of support services. Many defence equipment manufacturers which supply equipment and platforms also now provide through-life maintenance to sustain the systems such as training, IT support and repair, which extends project life spans and requires greater co-operation with the military. Manufacturers have also begun to sub-contract support services to 'tier two' specialist service providers. MoD also contracts directly with support service providers.

Through-life maintenance is also included in 49 PFI projects with a capital value of £8.7bn. These mainly cover building and accommodation projects but also some transport, equipment, ICT and training projects.

In-house support and maintenance services are provided by three MoD civilian units with a combined turnover of around £600m. The Defence Support Group, was launched in 2008 as a wholly owned government trading fund following the merger of separate army, air force and naval support agencies. It employs 3,500 staff providing repair, maintenance, overhaul and upgrade services for through-life support of military systems.

3.10 Science

The science market is small but strategically important, and in the pursuit of commercialisation, government has used a variety of different models.

Around 1995, a number of DTI laboratories, such as the Laboratory of the Government Chemist, were privatised as LGC, with the business continuing to perform core functions on behalf of the state. The National Physical Laboratory (NPL) was restructured under a government-owned and contractor-operated (GOCO) model, with all scientists and laboratory technicians employed by a management company owned by the contractor. The National Weights and Measures laboratory was left as an executive agency whilst the National Measurement Accreditation Service was broken off from NPL and launched as a non-profit distributing company.

In 2001 the Ministry of Defence split its Defence Evaluation and Research Agency into two separate organisations. One part was privatised as Qinetiq though a partnership with a private equity firm and was subsequently floated on the stock market in 2006 with the MoD holding a golden share. The research that remained sensitive to national security interests was retained within a new executive agency, the Defence Science and Technology Laboratory, (DSTL) let a 15 year contract, beginning in 2005, with a private sector partner to manage their facilities including lab set-up.

The Forensic Science Service became an executive agency of the Home Office in 1991 and was then made into government owned company in 2005 with the Home Secretary as the sole shareholder. LGC also has a forensics division which competes for work from police forces.

4. Issues

In the current climate of political and economic uncertainty, it is particularly difficult to interpret the signals from the public services market. In both the public and the private sectors, outsourcing has remained strong; however, there is evidence that market structures and business models are changing, often in contradictory ways, so that summarising these trends and projecting them forward is, in some places, virtually impossible.

Nevertheless, the key issues facing suppliers in the public service market appear to be the ones that have been around for decades, albeit with the stress in somewhat different places.

4.1 Will We or Won't We?

One possible outcome of the current financial crisis might have been a fundamental ideological shift throughout the industrialised world – a turning away from the Anglo-Saxon model towards public ownership and direct control. If the 'green shoots' flourish, we are unlikely to see a major paradigm shift of this kind, although this does not mean that the centre of gravity has not changed. The renewed debate in the US over what functions are 'inherently governmental' confirms that the debate has acquired a more ideological air. The pressure on public finances in the UK will create pressure to prioritise, which might also give the debate a more ideological air.

In the case of PFI, we are seeing a renewed attack from the Left, at the very same time as an assault from the Right. PFI is a relatively small part of the public services market in the UK, but it has been the ideological battleground over the past decade, and a campaign that inflicted severe damage on the reputation of PFI might well have implications for the market more broadly.

Some Labour Ministers give strong support to the mixed economy, while others are more opportunistic. However, if the Conservatives win the next election, we can expect strong support for public service markets, albeit using different models in some areas. Among other things, this will open up a vigorous ideological debate. However, between now and the election, we must expect a great deal of political uncertainty surrounding public service markets.

Many commentators argue that the nation's public finances are so bleak that competition and contracting must be a central part of the solution. While this is the most likely outcome, the situation is not quite so clear. One alternative interpretation is that 'trillion is the new billion', and that, based on past experience, it might take some years to get the deficit spending genie back in the bottle. Others argue, based on their experience with private sector clients, that there will be a lag of 12 or 18 months while cruder tools are used to slash costs, before customers turn to outsourcing.

4.2 Price vs Quality

This has long been one of the underlying tensions in the use of competition in public services, however, in the current climate, we should expect customers to give greater weight to low price procurements and/or increased risk transfer. Of course, it is possible that customers will give out confused messages on this question, with those at the front end of the procurement process emphasising quality and those at the back end focusing on price.

There is anecdotal evidence supporting both these trends, with some customers seeking to renegotiate existing contracts. The danger for suppliers (and ultimately for government customers) is greater because of the potential in such a climate for a winner's curse, as some bidders are willing to assume significant risks in the interest of increasing turnover.

4.3 Scale vs Scope

The oscillation between scale-based contracting and scope-based contracting is not new: indeed, the Ministry of Defence has shifted back and forwards between scale and scope over several decades, as it has searched for new sources of value in competition and contracting.

However, the belief in scale economies sometimes acquires an ideological tone, and never more so than when there is pressure for significant savings. Many of those who argue for greater use of 'shared services' speak in terms of economies of scale.

On the other hand, outcome commissioning is largely about economies of scope, in the sense that it relies on providers having control over a wider range of related service elements. And strategic commissioning also bears many of the characteristics of scope-based contracting.

4.4 Control vs Risk Transfer

One of the most obvious consequences of the recent financial crisis has a massive decline in trust of financial institutions. Contractual partnerships rely heavily on trust, and there is the potential for the public service sector to suffer by association, most obviously in PFI contracting, where the link to the finance sector is strong. However, the collapse of Satyam Computer Services in India confirms that the support services sector is quite capable of generating trust issues of its own.

Trust in market institutions more broadly has also been shaken. As Robert Reich (Bill Clinton's Labor Secretary) recently wrote: 'When the economy is in severe crisis, the public wants government intervention – it distrusts the private sector more than it distrusts government.'

We are seeing a new spirit of interventionism, particularly in North America, and in public service markets, this will be manifest as a shift towards input-based contracting, with increasingly detailed specification. (Indeed, in a report several months ago, Deloitte recommended to government agencies that they make greater use of 'reward for delivery' mechanisms, such as supplier performance bonds.)

While the external environment remains fluid, we should expect customers to give greater weight to management flexibility. One can understand why there might be some scepticism about 30-year contracts under these conditions. And it is understandable that there could be a renewed emphasis on transparency over the months and years ahead.

There is certainly evidence of increased demand for control and flexibility – customers seeking to renegotiate the contract terms (such as the attempt to introduce a standardised 'core day' in UK prisons); shorter contract periods (evident in the IT sector in the US, but apparently not in the BPO sector in India).

On the other hand, we are seeing ongoing experimentation with outcome commissioning in employment services, and the Conservatives have signalled that they propose to push towards the transfer of recidivism risk in offender management. The fact that such models are still being pursued in the current economic environment confirms the underlying strength of the UK public service market.

4.5 Competition in the Service vs Competition for the Service

On both sides of the political spectrum, policymakers are looking to direct purchase models, where members of the public use money or money's worth to purchase public services direct from approved suppliers. Neither side wants to use the term, but simply expressed, these are 'voucher' models.

In the next couple of years, we will certainly see this model explored in the education sector, and possibly in the health sector. However, there is a plethora of smaller voucher schemes being pursued at present across the country.

This will be profoundly challenging to existing public service providers who have built their business based on public sector procurement, with little market risk. And these models will create profound challenges for politicians and policymakers as they develop a fair and sustainable market environment.

4.6 Living with a Mixed Economy

The creation of a mixed economy, where public, private and voluntary sector providers compete and collaborate has been a key feature of government policy in the public service sector over the past decade or more. This is now becoming a reality. However, government policy has not always adapted to cope with the changes that this entails.

Regardless of the model employed, the creation of a market where public, private and voluntary sectors compete and collaborate brings with it the challenge of ensuring that there is a level playing field between different classes of provider. One of the dangers of failing to do so is that those categories of provider that are at a competitive disadvantage due to deficiencies in government policy, will withdraw from the market. It is also important to avoid perverse incentives in the creation of new forms of social enterprise and public-private-voluntary sector hybrids.

Several central government departments currently have this issue under review, and while HMT has played an important role in encouraging those reviews, Treasury is still largely in denial about the largest of the market neutrality issues – public sector pensions and VAT.

One of the most encouraging features of the UK's public service market over the past couple of years has been the emergence of new models, tailored to the unique characteristics of the service in question. This is what we would expect of a mature market. However, this creates challenges for policymakers who have built their regulatory models based on familiar models (such as simple outsourcing or PFI).

The transfer of management and staff back and forwards between the public and private sectors, and the design of employment models appropriate for public-private joint ventures, are current examples. Government has encountered difficulties with the 'retention of employment' model and is pulling back to more traditional solutions at a time when the market had begun to employ it flexibly to resolve such problems.

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