

## Mutual dependence or state dominance? Large private suppliers and the British state 2010-2015

### ABSTRACT

As public outsourcing has grown the need to understand Government's relations with supply side actors has become more important for public administration scholars. The paper analyses the role of a small group of large contractors in the British outsourcing system during Britain's Coalition government. These 'public service conglomerates' have thus far received little attention in the public administration literature. The paper compares two approaches for understanding the role of these corporations and analyses why the corporations faced sometimes severe disruption during the Coalition period in the form of multiple contract problems, conflict with ministers and financial problems. Over the period, the corporations became the objects of policy debate and what had appeared to be a stable set of arrangements started to fracture. The case shows the value of analysing the political and organisational foundations of contracting arrangements.

## INTRODUCTION

Public outsourcing reforms aim to bring a commercial, if not always competitive, logic into the delivery of government functions. The analysis of outsourcing has applied economic ideas drawn from the transaction cost or contract theory literatures and combined them with ideas from public administration research to explain what is outsourced and how, often taking account of market characteristics and government level variables (e.g. Brown and Potoski 2003; Carr et al 2009). The analysis in the current paper adds a focus on firms and their roles in outsourcing. In the context studied here, large private corporations operated multiple public contracts and

played an important role in the attempt to transform public functions. Over the period studied the large corporations experienced multiple contract problems leading to a shift in their position and to their gradual politicisation.

The empirical setting for this paper is the period of the British Coalition Government, 2010-15. The outsourcing arrangements that the Government inherited featured a small group of large corporations. 'Public Service Conglomerates' (PSCs), to use Bowman et al.s (2015) label, are large private organisations which substantially rely on selling a set of services and functions to governments; services which might otherwise be (and may previously have been) provided directly by the public sector. At any one time a PSC will be managing a collection of often quite large contracts, some extending over long-time horizons, which may span diverse policy functions. By 2010, such firms were playing important roles in the delivery of public functions in Britain, according to a newspaper headline one such PSC was 'the company that is running Britain' (Harris 2013). The growing role of the PSCs led to concerns that Government had become dependent on large contractors 'who were too big to fail' (NAO 2013a:10) but equally that the firms were overly dependent on public contracts

for their future profitability. The role played by these organisations and the pressures they face have so far attracted limited attention in the policy or public administration literature (e.g. Crouch 2011, 2016; Froud et al. 2017; Wilks 2013).

From the perspective of productive efficiency the existence of PSCs is puzzling. Conventional wisdom suggests that, in the absence of production synergies, there are economic advantages to specialisation but the PSCs sometimes operate in diverse policy areas and it is not always clear where the synergies are. One possible explanation from within the transaction cost approach is that difficulties of contract enforcement give an advantage to reputable firms holding multiple contractual relations with Government. From this perspective the PSCs' corporate form is based on the mutual benefits it allows contracting parties to achieve. A less sanguine view, from a political economy perspective, sees the PSCs as organisations which are especially skilful at winning public procurement competitions (Crouch 2003) and whose development reflects misaligned incentives on both sides of the market (Bowman et al. 2015).

The PSCs are distinctive organisations and by 2010 they had become important public policy actors. The focus is on three of Government's most prominent service suppliers during the Coalition, Serco, Capita and G4S and how they fitted into the Government's broader outsourcing arrangements. Each of these PSCs was a FTSE100 company during the study period, and each had multiple and sustained relations with the public sector. Before the 2010 election, the outsourcing sector and its large corporations were expected to do well from impending austerity policies but by the end of the Coalition two of the PSCs had incurred significant financial and reputational damage and the outsourcing arrangements faced greater scrutiny. The weaknesses of the arrangements were revealed in a series of contract failures, conflicts with ministers, and financial problems which prompted greater political and media attention. The case study shows how the position of the PSCs shifted as negative events related to particular contracts led to a general tightening of the scrutiny of contracts held by the organisations and how outsourcing and the PSCs became the subjects of media and parliamentary attention. Outsourcing public services, in this instance, did not depoliticise them but instead changed the nature of politics around them (Burnham 2001; Flinders and Buller 2006; Mulgan 2006).

The existing literature on outsourcing is not naïve about public contracting. Public administration scholars have long recognised that 'real world' outsourcing at best approximates the classic model of multiple operators competing for a contract. Nor does the literature ignore politics, studies of municipal outsourcing often test for the effects of political leadership and administrative structure (e.g. Hefetz and Warner 2012). However, in the first section I suggest that the existing literature cannot easily account for the organisational integration across functions embodied in the PSCs. The paper then sets out two accounts of the PSCs and the consequences of their organisational form. The case study assesses these ideas in a changing context in which both the Government's outsourcing arrangements and the PSCs were put under stress.

The case study shows that in this context, contracts were not isolated exchanges but were linked together by the organisational structures of the PSCs and that these connections became more apparent in the aftermath of a series of contracting problems. The first task of the paper is to understand where such organisations fitted

into the outsourcing arrangements which were developing at the beginning of Coalition and what benefit the PSC's organisational form conferred. The second task is to provide an account of how the position of the PSCs changed and why. There is some support from the case study for the theoretical ideas set out below but there are also lacunae. Ultimately, the companies and the system were vulnerable to a change in Government stance and a gradual politicisation.

## OUTSOURCING AND PUBLIC SERVICE CONGLOMERATES

The research on outsourcing has provided a sophisticated view of public contracting and catalogued multiple empirical deviations from a naïve model of competitive markets (Boyne, 1998; Brown et al. 2006; Grimshaw et al. 2002; Hefetz and Warner 2004). Research has shown that the market context in which a government operates affects the way that it contracts (e.g. Girth et al. 2012), for example, evidence from US municipalities has revealed that competition is often thin (Warner and Hefetz 2012). Even in markets which initially feature robust competition, processes of concentration can occur (Dijkgraaf and Gradus 2007). Lack of competition is not the

only challenge that governments face. Contracts can be inflexible, monitoring performance is sometimes difficult, and political pressures from citizens and media can influence contractual relations. Johnston and Girth (2012) conclude that 'market management' is a key public administration task, that the administrative and opportunity costs of managing markets can be large and are rarely recognised and that public managers' attempts to induce competition are often futile.

Diverse market conditions have led to a variety of arrangements in public contracting. Design issues include the length of a contract and whether the work is split into lots (Carpineti, et al 2006), if there is a small pool of suppliers governments can use concurrent sourcing (Hefetz et al. 2014) in which some tranches of work are retained inhouse and some are outsourced to allow public managers direct access to cost information and to retain a credible threat of insourcing. Hybrid organisations, part owned by a government part owned by a contractor offer greater information to public managers and also direct control over operations (see Vining et al. 2014 for an overview). These various contracting strategies can be observed in British public outsourcing. The contract for immigration removal was fully outsourced to G4S until



2010; disability welfare eligibility assessment was split between contractors across regions; prison contracting resembles concurrent sourcing, some of the prison estate remains under the control of public authorities and some prison management is outsourced; the Atomic Weapons Establishment (AWE) maintains Britain's nuclear deterrent and is a type of hybrid arrangement in which the government holds a golden share and has closer oversight of its operations as a result.

Other research has explored how national political and institutional contexts shape outsourcing markets. Comparative cross-national studies have revealed different outsourcing approaches for similar services (Warner and Bel 2008; Bel et al. 2010).

Dunleavy et al.'s (2006) analysis of cross-national variation in government IT outsourcing is an example that considers variation in market concentration and how the strategies of government buyers shape the supply-side.

In the literature discussed above the primary unit of analysis is usually the service level contract or the government-service dyad. This choice is often sensible but may obscure an additional level of organisational connection between Government and

supplier in which service level arrangements are nested. The organisations that are the subject of this paper have long histories with Government and sell to the public sector across a broad range of policy areas and in different market contexts, ranging from quite competitive, to markets where there are few suppliers. The frameworks that are used to analyse contracting in particular markets are not designed to explain organisational forms that spread across different services and the current public administration literature has so far had little to say about this aspect of outsourcing and its consequences.

The remainder of this section discusses two potential frameworks for understanding why the PSCs spread their work across a broad range of services. Both frameworks put weight on how large private suppliers and government outsourcing strategies influence each other. The first of these frameworks remains within a broad transaction cost approach to understanding the governance of economic exchange, the second is a political economy approach which presents a much more negative interpretation of the co-dependence between Government and PSCs.

*Contract enforcement and political economy*

The transaction cost approach (Coase 1937; Williamson 1981) holds that the attributes of a transaction determines its governance structure. A combination of two attributes makes market exchange problematic: i. asset specificity – suppliers' need to invest in assets which cannot be easily transferred to other functions; and, ii. contract incompleteness – explicit contracts cannot adequately cover the salient aspects of the service to be provided due to the uncertainty in the task or the difficulty of measuring service quality (Tadelis and Williamson 2013). The second of the attributes makes it more likely that unforeseen matters of dispute will arise and makes contracts difficult to enforce in court, and the first attribute makes it costly for parties to simply withdraw if dispute does arise. Under such conditions outsourcing is problematic and the service should be retained inhouse.

A cursory scan of the practice of public contracting identifies many instances of transactions with the features that should indicate inhouse production but which are in fact delivered by contracting. An informal solution to contract enforcement, in the context of asset specificity and incomplete contracts, is a 'relational contract' (Baker

et al. 2002, see Bertelli and Smith 2009 and Brown et al. 2016 for application to public sector). Forward linkages through time (the expectation of repeat contracts) and lateral linkages across functions between contracting parties make the maintenance of an overall relationship more valuable for both parties and increase the incentives for both sides to act cooperatively. This helps to smooth any necessary renegotiations when the production context is uncertain and where contracts are difficult to formally enforce, but the threat of retaliation in response to opportunistic behaviour must be credible. Coviello et al. (2018) describe the operation of forward linkages in governments' repeat contracting with the same suppliers for public works in Italy. Desrieux et al. (2013) provide evidence of lateral linkages, showing that French municipalities often contract with the same private organisation for multiple functions. Multiple and repeated contracts make the supplier-buyer relationship more valuable and gives contracting parties the incentive to honour the spirit of the contract even if it cannot be enforced or is costly to enforce.

A second informal solution to the problem of contract enforcement is a reputational mechanism which works by doing generalised damage to a company's commercial standing with other potential contracting partners. Governments may prefer to procure from a company with a prominent reputation both because of what a firm's reputation says about the firm but also because governments will expect the firm to be motivated to preserve its reputation by acting co-operatively (Tadelis 2012; Brown et al. 2016). Together relational and reputational mechanisms take us some way towards an explanation for why government contracting may favour large private sector organisations, and why repeat contracting with the same organisations across different functions is observed.

The mechanisms rest on three problematic assumptions which may limit their applicability to public contracts. First, there needs to be a degree of discretion in public procurement decisions to allow for the reputation of suppliers and their past conduct to affect their chances of winning additional contracts. However, legal and regulatory constraints tend to make public procurement more formal than in the private sector as a guard against favouritism (Kelman 1990; Mozoro and Spiller

2012). For example, procurement principles such as non-discrimination make it difficult to use reputational and relational mechanisms. The second problematic assumption is that public and private managers will maximise the interests of their organisation when contracting. An example where this assumption fails is the weak performance monitoring that is sometimes found in public contracts (Warner and Hefetz 2012). A lack of commercial capacity in governments may also lead officials to adopt sub-optimal strategies when designing public procurement. On the supply side, the internal control exerted by the top management may weaken as companies grow and diversify making it more difficult for a company to maintain good commercial relations and protect its reputation. A final problematic assumption is that Government's contractual relations will remain a solely commercial and not a political issue. However, where a policy or service is sufficiently salient, opposition politicians, advocacy groups and public sector unions may use public fora to raise issues about contractor conduct and service quality.

Recent work has proposed an alternative political economy analysis of PSCs (Bowman et al. 2015). A point of contrast with the contract enforcement framework is

that the political economy approach argues the co-dependence between Government and the PSCs is based on distorted managerial incentives. It argues that on the supply side, opaque balance sheets mean that shareholders have imperfect control over managers, who see it as in their interests to grow the company by bidding aggressively for new contracts or by diversifying through acquisition. On the demand side policymakers are happy to 'abdicate' (2015:18) responsibility for difficult tasks. These misaligned incentives have allowed PSCs to grow based on public sector contracts without tight enforcement of performance: 'a co-dependent government which can only keep the show on the road by not pressing value for money or risk transfer' (2015:19). Crouch proposes a related argument, that PSCs are skilled at the process of winning contracts even if they have no production advantages 'such firms have no initial expertise and therefore no particular substantive value added to offer within a new field' (Crouch 2003: 16). The political economy accounts emphasize limited competition, opaque relations between organisations, contractors over-diversifying beyond their expertise and consequent problems in contract delivery.

A weakness of this approach is the relatively thin account of public sector behaviour. Little explanation is offered for why policymakers are willing to go along with poor contracting outcomes. For example, is the problem a lack of public sector capacity or skill or is there a more structural incentive problem which explains public managers' unwillingness to challenge suppliers? In a recent study the imperatives of inter-elite relations are hypothesized to shape officials' strategies but it is not clear why this leads to a tolerance of poor contract performance (Froud et al. 2017). Without a more compelling explanation for public managers' strategies it is unclear how secure the position of the PSCs will be in this framework.

In summary, the structure of PSCs is a puzzle if considered from the perspective of productive efficiency. However, large and multi-functional organisations may be well adapted for a system of informal contract enforcement based on multiple contacts with government. They also have prominent reputations to defend which makes them attractive partners when contract monitoring is difficult. There are problems with applying these ideas to the public sector: regulation limits the discretion of procurement officials; managers might not pursue their organisation's interests; and,



contracting can become politicised. In this framework if poor performance occurs we should expect to see negative consequences spread beyond the specific service, affecting the chances of a supplier winning new contracts with the same buyer and public criticism damaging the supplier's reputation more generally. The 'political economy' account is less sanguine than the contract enforcement perspective about the role of PSCs and the close relations they have with Government. It portrays these relations as a sort of tacit (or inadvertent) collusion between managers on both sides. This approach would expect poor performance by PSCs to be tolerated or subject to only symbolic criticism and it would also expect problems to arise from companies diversifying into novel areas of work.

There are some shared weaknesses with the frameworks. Neither is well suited to offer an account of how the system can change, although the political economy framework can explain periodic crises due to PSC's over-diversification these are not expected to lead to permanent changes in relations between Government and PSCs. Both frameworks model outsourcing as a closed and technical matter largely for

managers. As the case study shows the system was both somewhat destabilised and opened to greater political scrutiny during the research period.

## PUBLIC SERVICES CONGLOMERATES: A CASE STUDY

Case studies are useful for testing multiple ideas using multiple observable aspects of a case (Toshkov 2016; Gerring 2008). This study is a within case analysis of a period of stress for Britain's outsourcing arrangement and for its major corporations.

The two goals of the research are to construct an account of the role of the PSCs within the outsourcing arrangements and to explain how these arrangements changed in response to pressure. During the Coalition Government (2010-15) the outsourcing arrangements shifted from being apparently stable in the first half of the period, when it appeared that the PSCs would be crucial to Governments' reform agenda, to a more uncertain situation where all three PSCs had experienced multiple contracting problems and two of the companies had experienced significant disruption. The case study relies on material from official documents, media reports and parliamentary debates to construct an account of this period. The first

subsection of the case characterises the nature of the outsourcing arrangements as they developed from 2010, and describes the position of the PSCs and the new Government's reform agenda. The next subsection recounts the anomalies with contract performance that started to arise in the second part of the period, these include high profile problems that attracted newspaper and parliamentary attention and contributed to a process of politicisation of the outsourcing system and the PSCs. Time series of media and parliamentary attention are used as indicators of the companies' changing salience in political and policy debate. The concurrence of the contracting problems was interpreted by policy actors as a sign of underlying problems in both the Government's approach to outsourcing and in the operation of the PSCs. This interpretation was supported by the range of problems which occurred in different service areas and with different contract designs. The case study then recounts the administrative responses provoked by the problems: tightened monitoring, some shift in what would be outsourced and interventions into the management of the affected PSCs. The problems also generated a political response that put the legitimacy of the outsourcing arrangements and the PSCs in

question. The negative consequences for two of the three large PSCs were immediately significant.

The discussion section highlights the implications of the events for the two theoretical frameworks reviewed earlier. Government did punish perceived opportunism as would be expected by the contract enforcement framework and the multiple exposures of the companies to the public sector made the punishment more severe but an explanation is required for why the threat of relationship breakdown did not deter poor performance. The dysfunction that the political economy approach expects to observe gains a great deal of support but the approach predicts that government would attempt to minimize disruption to relationships, instead the reaction of ministers to contract problems was quite robust.

### *Capita, G4S and Serco*

The National Audit Office (NAO 2013a) estimated that Government spent approximately £40bn with third parties in 2012-13 and a quarter of that with 40 'strategic suppliers.' Not all these strategic suppliers specialised in the public sector

but the three companies studied here were prominent specialists in selling to Government. The NAO (2013a) estimated that in 2012 a third of Capita's annual £3.4bn revenues came from the British state, a little over a third of Serco's £4.9bn and a little under a tenth of G4S's £8bn.

The three companies grew substantially during the first decade of the century (NAO 2013a). Table 1a. gives an indication of the range of major services that the three companies operated for British Government as the 2010 election approached and shows varying degrees of functional diversification. G4S was the company that fitted the PSC category least well. It was the most focused, concentrating on security and justice functions and facilities management and was also the least exposed to British Government for contracts. During the early part of the Coalition it did win contracts outside its core service expertise such as labour market interventions and housing for asylum seekers. Capita's work was typically 'white-collar', usually included some IT element but had spread beyond back office contracts and Serco, the most diversified, was involved in a wide range of functions.

## TABLE 1

Before the 2010 election there was a broad consensus among policymakers about the goals and assumptions of the contracting arrangements. The leaderships of the main parties agreed that austerity would be needed and that outsourcing to private corporations would be an important part of the strategy. For the Conservatives, who would go on to be the senior coalition partner after May 2010, outsourcing was part of the 'post bureaucratic state' agenda (Cameron 2011). While this idea acknowledged a role for smaller enterprises in public contracting, the rapid reform of services would require the engagement of large private corporations. The Labour leadership was also content to outsource significant public sector functions to large corporations; the PSCs had grown under Labour governments (1997-2010), each of the three studied here entered the FTSE100 during the 2000s substantially as a result of public contracts let under Labour. The consensus was also shared on the supply side, the anticipated positive impact of austerity on the PSC's business could be found in newspaper commentary and in company reports (Capita 2009; Serco 2009; White 2010). The industry presented itself as an instrument for delivering cost

savings while at least limiting damage to quality through a transformative approach to public service delivery.

### *Developments in outsourcing arrangements*

For current purposes, the Coalition administration can be divided into two periods.

Policy development in procurement from May 2010 - June 2012 was a matter of technocratic adjustments to the existing arrangements, together with the expansion of the scope of contracting. An Efficiency Review (HMT 2010) highlighted price variation between departments for the same services and identified as priorities for reform: the collation of data; the co-ordination of procurement across departments; and, the improvement of commercial skills. The Cabinet Office established the Efficiency and Reform Group, increased its role in procurement processes and sought to make Whitehall act as a single buyer. In July 2011 the Government published its Open Public Services White Paper (HMSO 2011) which set out a general framework for increasing diversity of provision in public services. The two key policy ambitions were to expand the range of services open to private provision and to strengthen the ability of Government to manage outsourced contracts through

capacity building and centralization. The new government did pay attention to relations with strategic suppliers for example by naming a crown representative for each strategic supplier who would help manage the relationship with the supplier across departments.

Significant procurement projects were being developed in this first period. The prison system had involved private providers since 1992 but the extent of private involvement was expected to increase (Panchamia 2012), for example the first transfer of an existing prison from public to private sector was in 2011 when Birmingham Prison was taken over by G4S (previously private prisons had been limited to new builds); further expansion of outsourcing in law and order was expected in police support services, probation (MoJ 2013a) and courts services; ambitious outsourcing projects were being planned by the Ministry of Defence the most prominent being for the management of Defence Equipment and Support procurement (MoD 2013) there were also plans to partly outsource its military recruitment process; private providers played a significant role in labour market policies such as the Work Programme and welfare policy more broadly (WPSC



2011). The three companies gained notable contracts in the first half of the Coalition (Table 1b), for example, Capita gained contracts to provide court translators (via acquisition), to provide training to the civil service, for Army recruitment and to administer Personal Independence Payments eligibility tests; Serco won contracts on the Work Programme and to provide business services to the Ministry of Defence; G4S won Work Programme contracts, contracts for provision of security to the London Olympics 2012 venues and a contract for support services for Lincolnshire Police and more policing contract opportunities were expected in 2013-14; G4S and Serco both won 'Compass' contracts to provide housing for asylum seekers.

In this first period there was some evidence of contracting problems but they did not add up to a systematic pattern. Two significant events relating to our firms did occur, one was the death in October 2010 of Mr Jimmy Mubenga as he was being deported by G4S and which was later ruled to be unlawful killing by a coroner's inquest (Lewis and Taylor 2010) [1]. The second was a public row between Serco and the Cabinet Office about the treatment of Serco's supply chain (Tyler 2010). A third problem with

Capita's delivery of translation services for courts was becoming apparent towards the end of 2011 and would become more severe over the following two years.

The second period starting in July 2012 was marked by a steady series of contracting problems. Policymaking in this period developed in the shadow of two prominent scandals. The first and the one which received greater media attention, was G4S's inability to provide the contracted number of guards for London Olympics venues in 2012. G4S informed the Games organising committee about the shortfall just over two weeks before the opening ceremony and so triggered two weeks of intense media criticism of the firm (HAC 2012). A second major contract problem involving G4S and Serco became apparent in July 2013 and was more consequential for future contracting arrangements. An audit of the companies' invoices for monitoring offenders wearing electronic tags revealed that the companies had sometimes continued to charge for monitoring after a subject had left the scheme (NAO 2013c). The Serious Fraud Office was called in to investigate what turned out to be substantial apparent overcharging (these two events are studied in

more detail in Greasley 2017), this led to further consequences for the firms as discussed below.

Over this period other contracts also started to reveal problems Table 2 indicates when they began to attract public attention. In 2012-3, a Serco run out-of-hours doctors service was found to have staffing problems and had misreported some performance data (NAO 2013b). Serco and G4S made significant losses on the Compass contract (to house asylum seekers) having underestimated the increase in demand and overestimated the supply of appropriate housing (NAO 2014b). Serco was also accused of overcharging on a prisoner escort contract (MoJ 2013b), and there was a series of negative media stories about treatment of women held at the company's Yarls Wood immigrant detention centre which prompted criticism in Parliament. As mentioned earlier Capita experienced major problems on a contract to provide translators to courts (NAO 2014a), also a contract to run regular and reservist recruitment for the Army (NAO 2014c) and problems with the administration of the Personal Independence Payments eligibility tests for disability benefit (NAO 2016a). G4S was accused of overcharging on a courts facilities maintenance

contract (MoJ 2013c). Some of these problems were short intensive crises, but many persisted over longer periods and were indicative of more systematic problems with IT systems, performance data, workforce management and misestimation of demand for services.

#### TABLE 2

The problems that accumulated from mid-2012 began to be interpreted as evidence of underlying weaknesses with either the Government's outsourcing arrangements or the culture of the companies. Until 2012 the operation of contracting out had received limited media or parliamentary attention and political scrutiny of the PSCs' performance had been fragmentary. This fed into the prevailing view that outsourcing was an apolitical part of government. Over the second half of the period the PSCs were treated to more systematic public scrutiny from the press, by select committees and by the National Audit Office.

#### *Media and Parliamentary Scrutiny*

The emergence of the outsourcing system, and the PSC model, as a policy problem was reflected in greater press and parliamentary attention. Measures of attention, such as newspaper articles and parliamentary mentions of an issue, event or actor are often used as indicators of their political importance in various venues (e.g. Baumgartner and Jones, 1993). Figure 1 provides an indicator of newspaper attention to the three firms. The data is a three week moving average of press article counts referring to the companies (the titles used are in the appendix). The series is shaped by high profile events and shows increased attention to G4S (grey line) from the Olympic contract problems in mid-2012 onwards and to Serco (dashed line) from the tagging scandal onwards. Serco's coverage in 2013-14 (the height of the tagging crisis) was more than double that of 2010-11. The attention was sustained by events' repercussions, for example government criticisms, select committee reports and financial impacts. There was little change in the attention to Capita (black line) which avoided high profile bad news. As problems with contracts accrued newspapers' attention did expand beyond specific events and occasionally addressed broader questions about the quality of company leadership and the limits of private provision (e.g. Pratley 2013, Watkins 2013), however it remained mostly event driven.

## FIGURE 1

Figure 2 shows data on the changing parliamentary attention to the companies measured as mentions in the Commons, the Lords or Westminster Hall (the data are logged and so the larger spikes in attention are reduced). Parliamentary attention also increased from the summer of 2012 driven by specific events for G4S and Serco. In contrast to the media coverage, Capita received similar levels of attention in Parliament as the other companies [2]. The Parliamentary interest in Capita was driven by three problematic contracts, none of which were high profile media stories – the disability benefits assessment contract (PIP) was raised by MPs whose constituents were having their benefits withdrawn or seriously delayed; the army recruitment contract which affected MPs' constituents and was also part of a significant attempt to restructure the British Army; and, earlier in the period the court translation services contract which gained attention as trials started to be disrupted by problems with translators' non-attendance or their lack of suitability.

## FIGURE 2

The increased level of parliamentary attention to the firms was sustained and was not solely due to a high number of mentions in a few debates. The changes in newspaper and parliamentary salience are indicative of how the PSCs' profile and the outsourcing policy was changing. Starting from a low base, by the end of the period the companies had higher newspaper and parliamentary profiles. High profile events drove the increased salience in the newspapers while in Parliament chronic, lower profile failures also received attention.

### *The PSC Model in Question*

The negative events and increased salience had consequences for the companies' leadership, for the Government's approach to contracting and commercial relationships, for companies' opportunities to bid for new business and ultimately for the companies' valuations. They also led to diminished political support for PSCs and outsourcing. Both Serco and G4S removed senior executives because of the contracting problems, G4S' chief executive had already resigned the month before the tagging overcharging was revealed (after a profit warning) and Serco's chief executive left in November 2013; both companies also lost their chairs. Financial

settlements were agreed with Government for the Olympics contract (G4S), for overcharging on tagging and other contract problems (G4S and Serco).

The more substantial cost for each firm was the damage done to relations with Government. The changes in corporate leadership was in part a response to ministers' demands, in the wake of the tagging overcharging scandal, that the companies 'purge themselves' of managers who may have acted inappropriately (Warrell, 2013). Ministers also insisted on a wider intrusive intervention into the operation of the two companies under the label 'corporate renewal' (Cabinet Office 2017). Reviews were conducted of large contracts held by the two firms across Whitehall (Cabinet Office 2013) and in the Ministry of Justice (2013). Some pervasive issues with contract management were identified especially with the use of self-reported performance indicators and the monitoring of post procurement contract changes. Companies were sometimes perceived to be bidding aggressively to win contracts and then trying to recover margins by negotiating hard when changes were needed (Cabinet Office 2017: 5.6). In response, attempts were made to strengthen contract oversight and commercial skills in departments. Government



had already been trying to reform procurement rules to better account for previous company performance and this was further developed in new procurement regulations (Public Contracts Regulations 2015). On specific services, attempts were made to attract smaller companies, for example, in the new round of tagging contracts.

A threat of exclusion from future contracts was used as leverage to gain compliance with the demands of Government. A comprehensive bidding ban was legally questionable, but the companies were unable to bid for either the retendered tagging contract or for the probation service contracts and Serco's consortium withdrew from the competition for the Defence Equipment and Support project (which was subsequently abandoned). The companies also lost business opportunities either because the public sector chose not to outsource (for instance, some police authorities stopped projects after the Olympics) or the companies did poorly in bidding competitions. Although officials denied there was a link between the two, G4S did not win any contracts in a round of prison outsourcing held soon after the Olympics contract problems (Travis 2012). Serco was more exposed to the public

sector than G4S and experienced considerable financial problems from 2013 and through 2014 as it dealt with other underperforming contracts, notably in Britain, the lossmaking Compass contract to house asylum seekers. The company issued profit warnings in November 2013, January, April and November 2014. Both Serco and (temporarily) G4S fell out of the FTSE100 and Capita followed after the 2015 election.

There were also indications that senior politicians were becoming more sceptical about the role of large PSCs. After the Olympics the then Defence Secretary described the events as 'informative' about some of the limitations of the private sector and the advantages of the public sector (Wright 2012) and later in the wake of the tagging scandal the Lord Chancellor Chris Grayling criticised Serco and G4S for their performance and conduct (Warrell 2013). One consequence of the political criticisms of outsourcing was that the Labour Party went into the 2015 election promising to unpick specific projects such as probation services procurement and to reform prison and police outsourcing. The party's developing scepticism about

outsourcing was outlined in a think tank seminar by a Labour shadow minister (Trickett 2014).

## **Discussion**

At the start of the period the PSCs looked like they would be a growing part of the transformation and delivery of public services for the foreseeable future. In 2010 the outsourcing arrangements were not a matter of party contention, austerity was seen as inevitable and was expected to lead to a greater volume of contracts. In the first two years of the period the boundaries of outsourcing were expanded and attempts were made to increase Government's commercial capacity to manage contracts and the need to achieve consistent management of the PSCs across departments was recognised. The PSCs won new contracts and were positioning themselves to bid for large projects such as the outsourcing of probation services. These developments and the PSCs attracted limited media or parliamentary attention during the first period.

Cracks in the system appeared with the Olympic security contract (2012). The challenges faced by the PSCs and outsourcing after 2012 were systemic and not simply the result of high profile problems: multiple lower profile contracting problems also came to light around the same time, some of which were ongoing and difficult to resolve; the problems were not only about austerity, the PSCs' charging practices on the tagging contract had been problematic (from Government's perspective) since the mid 2000s; problems were revealed across a range of services with various types of contractual arrangement and involved each of the PSCs discussed here.

The electronic tagging scandal generated persistent disruption for the companies involved. One consequence was that the affected companies became politicised and featured more frequently in the press and in Parliament where the companies became emblematic of outsourcing concerns. Newspaper attention was driven by high profile events but Parliament also responded to lower profile contracting problems. The new visibility of the PSCs led a select committee to recommend the extension of Freedom of Information law to public contracts (PAC 2014a) and some writers argued that the firms operated in a constitutional gap which needed to be

filled by a special type of status for the firms (Johal et al. 2016). This new visibility meant that ministers and officials were aware that their decisions in letting and managing contracts would receive greater levels of scrutiny from press, select committees and the National Audit Office.

In response to the tagging scandal ministers were publicly critical of the relevant PSCs, and insisted on leadership change and a process of corporate renewal. Ministers intervened in the private companies in a manner that was analogous to how they might intervene in a public agency. That the Government could not simply replace the contractors is indicative of a degree of mutual dependency but the balance of power between supplier and Government was severely asymmetric and the financial consequences for the firms revealed how vulnerable they were to changes in Government strategies.

The case study provides some evidence on the theories introduced earlier. Aspects of the empirical record fit with the contract enforcement framework – in response to perceived opportunism the Government punished the outsourcers by partially limiting

future work which amplified financial consequences because of the companies' dependence on public contracts. However, the obvious point is that the incentive to cooperate did not prevent conflict from occurring. One potential problem with relational contracting is that the discretion of Government to retaliate is limited by regulation, however, the case study shows that ministers were able to respond robustly to perceived opportunism on the part of suppliers. The relational and reputational mechanisms also rely on the assumption that managers will act rationally in their organisations' best interests. This assumption appears not to have been satisfied. On the government side, lax contract management and a reliance on self-reported performance, were blamed in the contract reviews for allowing poor performance to go unchecked across multiple contracts (Cabinet Office 2013; Ministry of Justice 2013). It also seems likely that the PSC leadership lost control of elements of their organisations, were unaware of how contracts were being managed and did not put in place the necessary monitoring systems. Finally, once the problems occurred and became public knowledge the PSCs and the outsourcing system became politicised in the sense that ministers became more involved in direct management and the system attracted broader attention. These additional pressures

are likely to make the challenge of managing Government's commercial relationships more difficult.

The general point of the political economy approach that the commercial relations between Government and its large suppliers were dysfunctional is hard to dispute after the experience of 2010-15, but aspects of the case study do not fit the story.

One problem for the approach is that the major contract problems did not come from corporate over-diversification. Instead, the Olympics contract was G4S's core business and both G4S and Serco had long-term involvements in electronic tagging.

There is evidence that over-diversification did add risk, Capita misjudged the court translation contract and PIPs, Serco and G4S made misjudgements on the Compass contract to house asylum seekers.

The Government's lax monitoring as evidenced in the Government's contracting reviews is consistent with the political economy view of PSCs. However, this approach would expect contract problems to be dealt with through inter-elite negotiation rather than Government putting them so forcefully into the public domain.

Cabinet Office and the Ministry of Justice were willing to disrupt the relationship with the PSCs and this suggests that the PSC position was less secure than presented by the political economy approach.

By the end of the Coalition important aspects of the outsourcing arrangements were under strain, the legitimacy of the PSCs was challenged, the system was garnering more critical political attention, ministers had demonstrated a willingness to escalate conflict with suppliers and two of the PSCs faced financial problems. Ultimately, an explanation for these reversals must rest on the asymmetric power between Government and contractors and how it is used. The shared weakness of the two theoretical frameworks is that they don't fully recognise this asymmetry but the Government side only fully used its power once the question of PSCs became politicised and ministers became involved.

## CONCLUSION

The paper has analysed a distinctive set of private corporations which have co-evolved with the British outsourcing system. PSCs had become a feature of British



public policy in the first decade of the century and as the 2010 election approached they seemed well placed to increase their value and expand their operations during a pro-business and austerity government. The paper has argued that what appeared to be a position of strength for the PSCs was in reality contingent on the stance taken by Government.

The broader conclusion of this paper is that in some circumstances an inter-organisational perspective is an important supplement to a contractual perspective for understanding public outsourcing. A second point is that the supply side of a market is not simply given but is partly created in response to a government's outsourcing approach. Finally, particularly where it involves large corporations, outsourcing will not necessarily remove the political problems of service delivery from governments but instead transform them and create new political issues relating to the suitability of suppliers to work on public functions or the competence of governments to manage contracts.

## FOOTNOTES

[1] The guards were later found not guilty of manslaughter

[2] During this period Capita was involved in two scandals relating to their private financial services arm, these were removed from the data.

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**Figure 1: Newspaper Salience of PSCs, 2010-15  
(3 week moving average)**

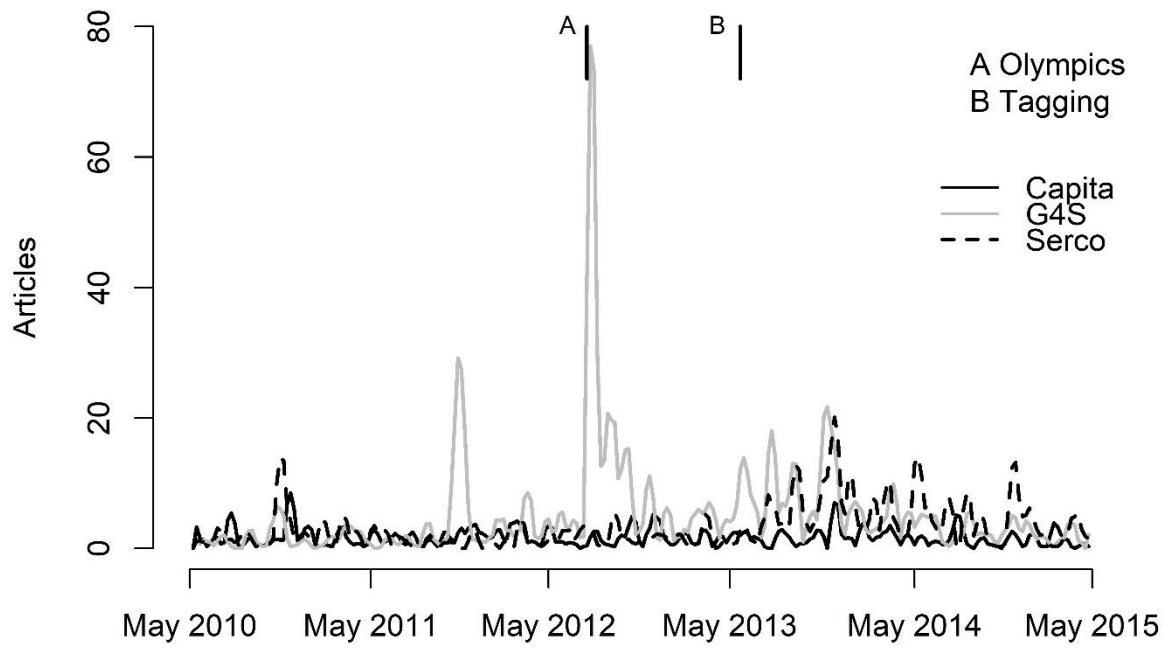
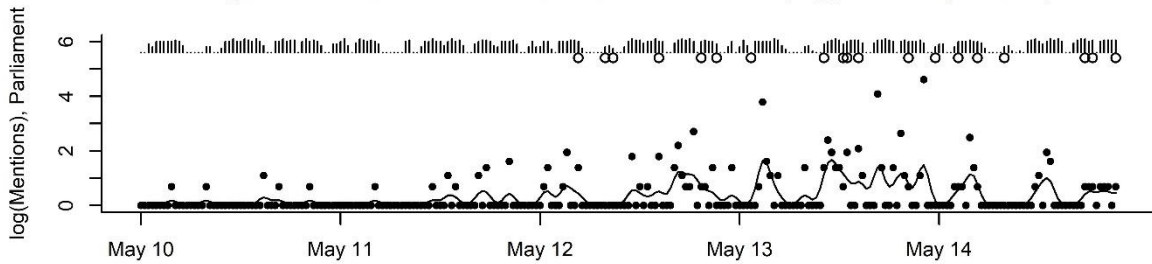
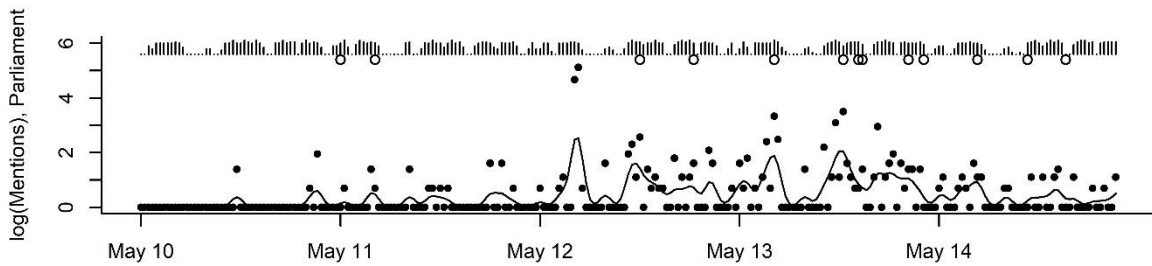


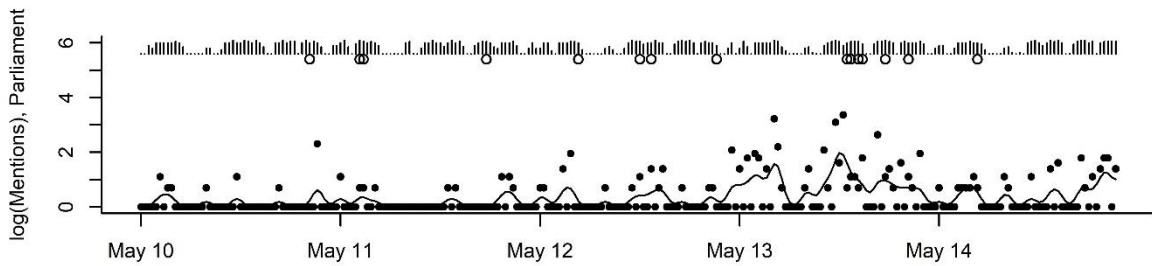
Figure 2: Salience of PSCs in Parliament, 2010-15 (logged weekly counts)



Capita: Parliamentary Attention, Weekly



G4S: Parliamentary Attention, Weekly



Serco: Parliamentary Attention, Weekly

**Note:** Line is smoothed to show broad changes, circles indicate the timing of written statements relating to the firms, lines along the top indicate how many days parliament sat.

**Table 1 Selected Areas of Operation (Capita, G4S, Serco)**

Capita	G4S	Serco
<b>a. Major pre-2010 public service operations</b>		
<ul style="list-style-type: none"> <li>• London congestion charge (IT and debt management)</li> <li>• Criminal Records Bureau checks</li> <li>• Local government – back office services, finance, tax collection</li> <li>• Education support service</li> <li>• Civil service pension administration</li> <li>• Individual Learning Accounts</li> </ul>	<ul style="list-style-type: none"> <li>• New build prisons</li> <li>• Youth offenders institutes</li> <li>• Immigration removal</li> <li>• Immigrant detention centre</li> <li>• Electronic monitoring</li> </ul>	<ul style="list-style-type: none"> <li>• Rail franchises</li> <li>• Atomic Weapons Establishment</li> <li>• Emergency Planning College</li> <li>• National Physical Laboratory</li> <li>• NHS Pathology Lab</li> <li>• RAF &amp; Royal Navy operational support</li> <li>• Electronic monitoring</li> <li>• Prisoner transfer</li> <li>• New build prisons</li> <li>• Immigrant detention centre</li> <li>• Health services</li> <li>• London cycle hire</li> <li>• School inspections</li> </ul>
<b>b. Selected public contracts, awarded during the Coalition</b>		
<ul style="list-style-type: none"> <li>• Civil service training</li> <li>• Language services (courts)</li> <li>• Army and reservist recruitment</li> <li>• Personal Independence Payments (assessments)</li> <li>• Teachers pensions</li> <li>• Car tax debt management</li> <li>• London Fire Brigade emergency call centres</li> <li>• Migrant refusal pool</li> <li>• Defence estates management</li> </ul>	<ul style="list-style-type: none"> <li>• Olympic security</li> <li>• Police support services</li> <li>• Courts maintenance - cleaning, security, catering</li> <li>• Work Programme (out of work support)</li> <li>• Asylum seeker housing</li> <li>• Army training</li> <li>• Prisons</li> </ul>	<ul style="list-style-type: none"> <li>• Community sentencing (London)</li> <li>• Work Programme (out of work support)</li> <li>• Asylum seeker housing</li> <li>• Prisons</li> <li>• Defence Business Services</li> </ul>



**Table 2 High Profile Contracting Problems 2010-2015**

<b>Contract</b>	<b>Nature of problems</b>
Immigrant removal (G4S) Oct 2010	Death of detainee during deportation Contract lost Nov 2010, guards acquitted Dec 2014
Court translation (Capita) Dec 2011-	Unreliable provision of service, disruption of criminal trials (NAOa 2014a)
GP out of hours contract (Serco) May 2012	Understaffing, performance mis-reporting, (NAO 2013a) Contract ended May 2015
Olympics security problem (G4S) July- Aug 2012	Understaffing and allocation of staff (HAC 2012)
Compass contract (G4S & Serco) Sept 2012-	Underestimation of demand, shortage of appropriate property (NAO 2014b)
Army recruitment (Capita) Aug 2013-	Administrative failures, under-recruitment, problems partly attributed to MoD (NAO 2014c)
Electronic monitoring (G4S & Serco) May 2013	Alleged overcharging, SFO enquiry, contract removed Nov 2013 (NAO 2013b)
Prisoner escort (Serco) Aug 2013	Alleged overcharging, police investigation ended 2014 (no evidence of criminal activity)
Personal Independence Payments (Capita) Dec 2013-	Backlogs in assessments, quality of assessments (NAO 2016a)
Courts maintenance (G4S) Dec 2013	Alleged overcharging, Passed to SFO
Yarls Wood (Serco) Sept 2013-	Mistreatment of female detainees allegations

## APPENDIX

Newspapers (source Lexis-Nexis):

Daily Mail, Mail on Sunday, Daily Telegraph, Sunday Telegraph, The Times, Sunday Times, Financial Times, Independent, Independent on Sunday, The Guardian, The Observer.

For a period the Lexis-Nexis database returned both The Guardian and Guardian.com articles. If these were duplicates one was discarded.

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