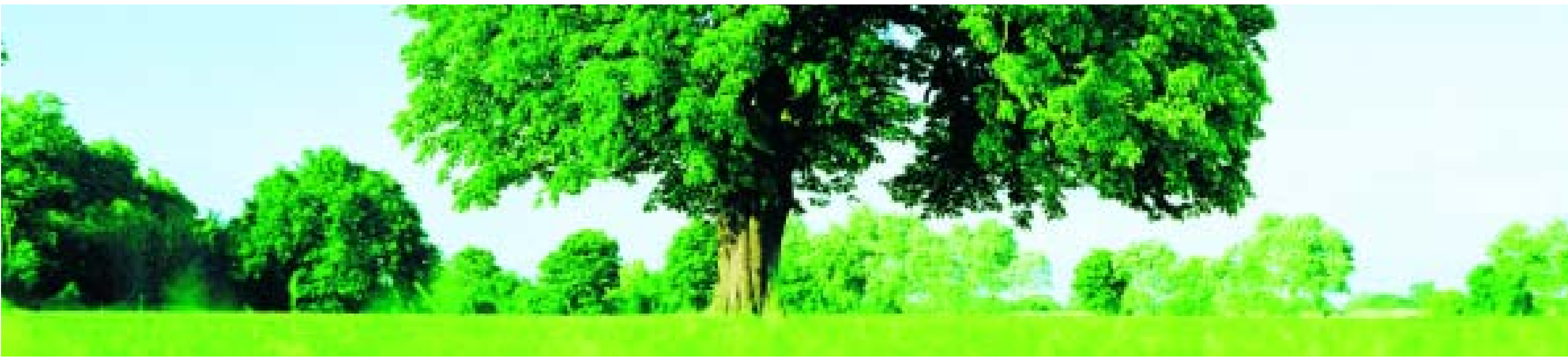
PPP in practice:

National Savings and Investments' deal with Siemens Business Services, four years on



REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
HC 626 Session 2002-2003: 8 May 2003

LONDON: The Stationery Office
£9.25

Ordered by the
House of Commons
to be printed on 6 May 2003

executive summary

1 In April 1999, National Savings & Investments (NS&I) transferred its operations to Siemens Business Services (SBS)[1], in one of the largest outsourcing operations ever undertaken by a UK Government Department. In May 2000 we published a report[2], "National Savings Public-Private Partnership with Siemens Business Services", which concluded that NS&I had secured a very good deal with SBS and that the partnership was capable of delivering significant benefits. The Committee of Public Accounts'[3] conclusions on the deal are shown in **Figure 1**.

1 Conclusions of Committee of Public Accounts on the deal

"**The partnership appears to be good value for money**. NS&I estimated that the cost of the partnership would be £158 million[4] less, over the life of a 15-year contract, than retaining the operational service in-house. The entire operational service had been transferred to SBS, which planned to invest in new technology leading to new ways of working and a substantial reduction in staff numbers. As part of SBS's wider strategy to expand its operations, 500 former NS&I staff have so far been re-deployed on third party work allowing continuity of employment at the three sites, though a similar number of staff had accepted voluntary redundancy. This outcome resulted from a well-managed procurement process that took account of the interests of customers, employees and the Treasury. At 8.7 per cent before tax, the return SBS expects to make over the life of this contract is significantly lower than the average return on other PFI deals.

Nevertheless, **this remains a high-risk project for SBS and NS&I**. In modernising the operational service, SBS is dependent on the gradual introduction of a relatively small but crucial amount of new technology. If SBS fails to deliver, the significant improvements in quality of service for customers envisaged by NS&I will be delayed. SBS considers that the risk of failure is reduced because it has more control over this project than over past public sector projects in which it has been involved.

NS&I must therefore remain vigilant. To ensure that the partnership works as intended, NS&I and SBS have put in place a joint governance structure. Within this structure there are two key elements which need to be managed with particular care. First, NS&I should continue to ensure that the operation of the performance management regime, and in particular the penalties for poor performance, is transparent and promotes continuous improvements in performance by SBS. Second, successful implementation of a process to benchmark SBS's performance and costs against the market will be essential if good value for money is to be maintained throughout the life of this long-term contract."

Source: Committee of Public Accounts Report. HC 566 1999/00

2 The contract is into its fourth year and this report examines its progress, with particular reference to the Committee of Public Accounts' previous recommendations. The methodology we used is set out in Appendix 1.

1 *A division of Siemens AG, the German parent company of the Siemens group.*
2 *HC 493 1999/00.*
3 *HC 566 1999/00.*
4 *Net Present Cost Value.*

The deal has delivered much (Part 1 of the Report)

3 SBS is modernising the business to focus on customers and improving customer service by streamlining processes across the business at its three sites, Blackpool, Durham and Glasgow. SBS's work on identifying the holdings of each customer, a single customer view, will allow NS&I to better understand and target its customers and thus improve its cost effectiveness. The measure of NS&I's cost effectiveness is demonstrated by how much it adds value for the taxpayer. In 2001/02 NS&I saved the taxpayer £176 million, meeting its annual target of at least £120 million. Value Added will also be increased in the future as a consequence of cost reductions being delivered by SBS today.

4 NS&I could not have achieved as much without SBS. The latter's bid offered savings to the taxpayer of £158 million (net present cost) compared to NS&I's Public Sector Comparator. SBS has benchmarked aspects of NS&I's operations, such as its call centre and its automated processes, which compared favourably to leading edge organisations in similar areas of service provision. But SBS will need to continue to benchmark NS&I's operations and take action to ensure benchmarking provides the potential for a reduction in SBS's and NS&I's costs and improvements in service delivery despite those reductions in cost.

5 SBS has significantly increased productivity without compulsory redundancies through reducing the number of staff transferred to it from 4,100 to some 2,000, although the volume of work has remained the same. It has reduced the level of absenteeism to close to the national average of 3.1 per cent, compared to eight per cent when it took over the business. SBS has re-deployed 650 of the 2,100 staff, no longer required for NS&I work, on third party work. Of the remainder no longer employed on NS&I work, 1,200 took Voluntary Early Release and 250 were released through natural wastage.

6 Despite SBS not reducing the costs of running NS&I's operations as much and as quickly as it planned, for example through not achieving the early launch of low cost sales channels, there has been no or little short term impact on NS&I or its customers. The earlier launch of low cost sales channels could have benefited NS&I by increasing its ability to add value and save the taxpayer money and benefited its customers by enhancing their options, but late delivery has otherwise had little or no impact.

Many of the risks have crystallised (Part 2 of the Report)

7 Although SBS's bid was eight per cent lower than the other final bidder's, it expected to make a return of 8.7 per cent on the contract. It was prepared to accept more risks and take on the critical risk of re-engineering NS&I's business processes. To introduce NS&I's Individual Savings Account product to a very tight timescale, SBS chose Thaler, a commercially available banking IT platform. After it discovered that NS&I's in-house programme would not deliver a re-engineered IT system and the Individual Savings Account product was successfully introduced, SBS selected Thaler as the IT element to re-engineer NS&I's operational processes.

8 Key risks accepted by SBS under the contract have crystallised. SBS is unlikely to make its projected returns on the project as it was unable to deliver the full business transformation as soon as it had planned. It has incurred more capital expenditure than planned and although it has increased productivity, it has failed to reduce staff numbers in line with its original plans and has not created as many third party jobs as planned, only 650 against an expectation of 1,200. It is also spending more than planned on the upkeep of the three sites at Blackpool, Durham and Glasgow.

9 SBS underestimated the challenge of transforming NS&I's old business and found existing processes were complex and difficult to change. It encountered a number of problems when it began to transfer NS&I products from legacy systems to Thaler, and as it took a long time to find solutions, weaknesses in the migration process continued. NS&I expressed its concern at the situation and SBS is now developing solutions before it transfers the remainder of NS&I products, including Premium Bonds, to Thaler.

10 NS&I requires SBS's operational performance to meet high and increasingly challenging standards. Although SBS had not completed the business transformation by the target date, it continued to bear the risk of delivering services to the required standards. In the first three years of the contract, SBS achieved 98 per cent of the targets NS&I set and incurred performance deductions of £2.1 million.

All parties have learnt valuable lessons (Part 3 of the Report)

11 NS&I, SBS and Siemens AG have all learnt lessons from their experiences on this deal. NS&I chose the best partner, but at the start of the contract it and SBS had not moved sufficiently away from a traditional customer and supplier relationship. Both parties failed to recognise the influence NS&I could have on SBS's operational costs and each failed to adequately challenge the other's actions and behaviour.

12 They learnt that parties to a PFI contract need to adopt a whole business approach, where decisions are based on what is best for the business as a whole rather than what is best for NS&I or for SBS, if each is to achieve its respective objectives. NS&I revised governance arrangements for the contract accordingly to achieve the modernisation of its operations.

13 Siemens AG and SBS discovered that this contract was more challenging than they originally thought. They did not employ sufficient management resources, nor make sufficient use of existing knowledge within the business. Siemens AG rectified this through bringing in new managers, predominately from its own organisation, who were known deliverers of change. Despite the problems SBS has faced, Siemens AG remains committed to the deal. In case of any failure of delivery NS&I has detailed contingency plans in place.

The deal has been modified without increasing the unitary charge (Part 4 of the Report)

14 To ensure continuation of service and achievement of the partnership's objectives, NS&I, with SBS, has developed a programme to support SBS's actions to improve its financial position. As part of this programme, NS&I has realigned contract terms to ensure the contract is clearer, less ambiguous, fairer and is a driver for a low cost operation through discouraging non-partnership behaviour by NS&I and SBS. In particular, NS&I has refined the Key Performance Indicators regime and it will share in the costs of developing new products and channels whilst both parties are incentivised to minimise development costs. A new set of milestones have been agreed which SBS is now delivering against on schedule. The contract realignment does not materially change the allocation of risk as the key risks of costs of operation, modernising the business and delivering the service remain with SBS.

15 Despite SBS's financial position, NS&I has not increased the unitary charge agreed in the contract and SBS has continued to deliver. Siemens AG is acting as a guarantor for SBS's obligations under the contract and has liability to pay NS&I up to £250 million in the event of default.

Lessons learned

16 In our first report, we concluded that NS&I had secured a very good deal with SBS and that NS&I's experience underscored some important lessons which should be borne in mind in negotiating public-private partnerships. This study shows that NS&I and SBS have learnt valuable lessons in the operation of the project, which are again pertinent to other public and private sector partnerships.

a) Adoption of a whole business approach

The public and private sector partners should not enter a customer/supplier relationship, but need to take a whole business approach, if they are to achieve current and future strategic objectives. Such a relationship is evidenced by the public sector partner:

- recognising its requirements may lead to its private sector partner not adopting the most appropriate method of delivery that is best for the business;
- recognising its actions can have an unwarranted impact on its private sector partner's costs; and
- having access to the private sector partner's income and expenditure forecasts and not just actuals.

And by the public and private sector partners:

- challenging the actions of each other to establish that proposals are in the best interest of the whole business; and
- demonstrating their willingness to change the contract as it is a dynamic document and their interaction through governance procedures.

b) The private sector needs to recognise the management challenge that PFI represents

Private sector contractors need to recognise the management challenge that complex PFI projects with tight timescales represent and employ and manage appropriate resources effectively to achieve the public sector partner's and their own objectives.

c) Parent company guarantees are essential

The existence of a substantial parent company guarantee has been instrumental in ensuring that SBS has stayed with the project as it places the onus on the private sector partner to take action to improve a poor financial position. Such a guarantee ought to incentivise the parent company to recognise the management challenge its subsidiary faces and to take sufficient due diligence.

d) There are alternatives to bailing out the private sector

The public and private sector partners can consider other actions which preserve the original allocation of risk, besides increasing the unitary charge, which will assist the private sector partner to improve a loss making position. Such action can also lead the private sector partner to seek improvements in the business. If public sector partners do provide additional work for their private sector partners, they must demonstrate that variations to the contract represent value for money through, for example, benchmarking of prices, and ensure their decisions are fully auditable.

e) Contingency plans should be in place

Public sector partners should have contingency plans in place ready and up to date to use if their private sector partners default. Such plans should be drawn up and maintained even where default is unlikely.