



National Audit Office

Memorandum

for Parliament

Cabinet Office

Managing government suppliers



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Report by the Comptroller and Auditor General

Ordered by the House of Commons
to be printed on 11 November 2013

This report has been prepared under Section 6 of the
National Audit Act 1983 for presentation to the House of
Commons in accordance with Section 9 of the Act

Amyas Morse
Comptroller and Auditor General
National Audit Office

8 November 2013

This memorandum covers the Cabinet Office's progress in improving how the government manages its relationship with its strategic suppliers.

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Printed in the UK for The Stationery Office
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2602923 11/13 PRCS

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The National Audit Office study team consisted of: Matt Barnes, Emma Cole, Jessica Colville, Shelagh Dale, Andrew Denney, Richard Lewis, Leena Mathew, Joshua Reddaway and Beverley Thorne, under the direction of Keith Davis.

This report can be found on the National Audit Office website at www.nao.org.uk/2013-contractor-performance

For further information about the National Audit Office please contact:

National Audit Office
Press Office
157–197 Buckingham Palace Road
Victoria
London
SW1W 9SP

Tel: 020 7798 7400

Enquiries: www.nao.org.uk/contact-us

Website: www.nao.org.uk

Twitter: @NAOorguk

Key facts

£40bn

estimated central government expenditure with third parties in 2012-13

40

strategic suppliers to government, as identified by the Cabinet Office

£10bn

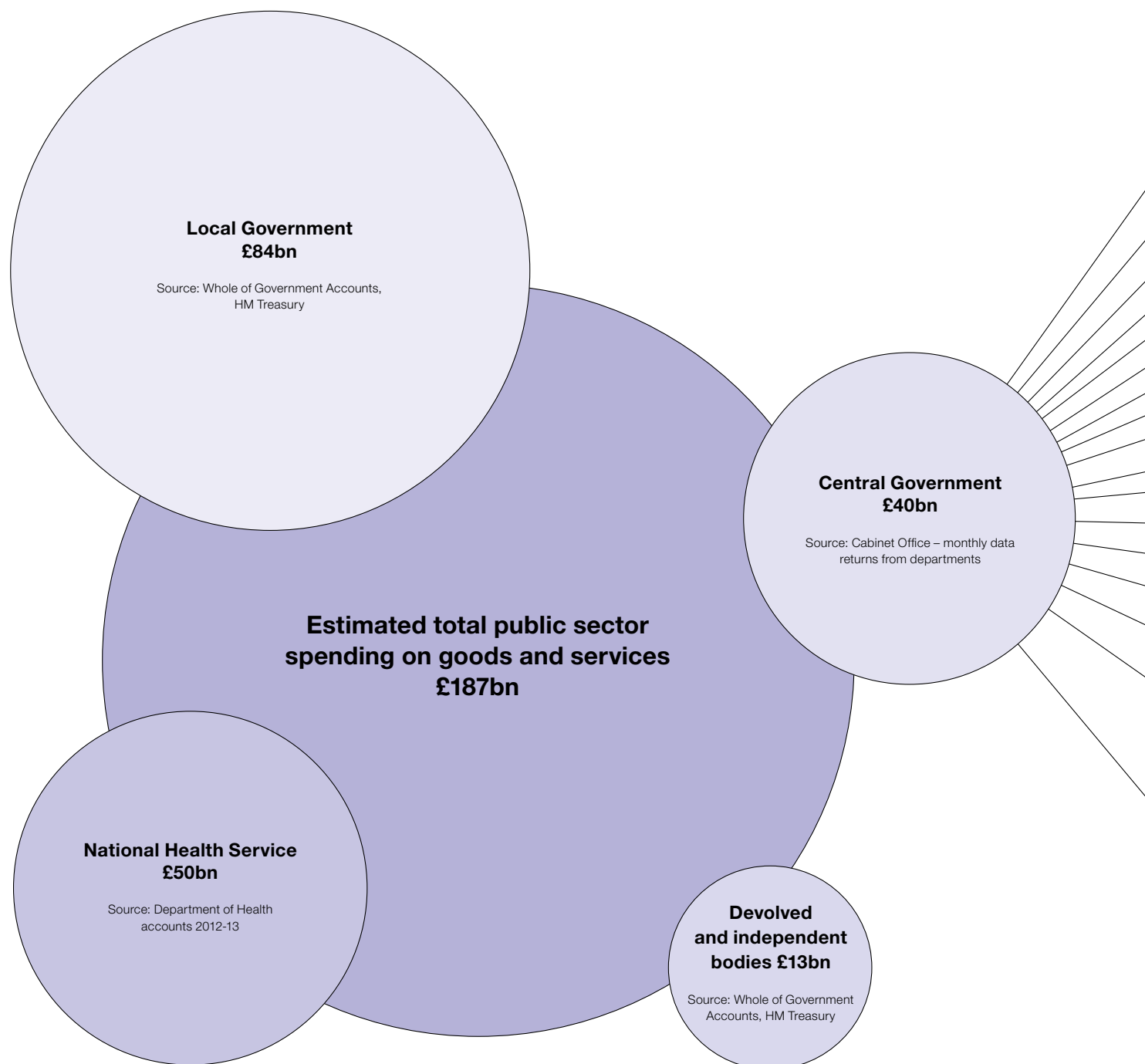
estimated central government expenditure with strategic suppliers in 2012-13

25 per cent estimated proportion of central government spending with strategic suppliers

£840 million savings reported by the Cabinet Office with strategic suppliers in 2012-13

Figure 1

Estimated expenditure with third parties across the public sector



Notes

- 1 Cabinet Office – monthly data returns from departments: The Cabinet Office estimates that departmental returns cover approximately 90 per cent of central government expenditure. Data taken from department returns to the Cabinet Office include direct expenditure only. For full details see Appendix Three.
- 2 Whole of Government Accounts: figures are for financial year 2011-12. The remainder of expenditure shown is for 2012-13.
- 3 NHS: This is a combination of NHS trusts, foundation trusts, Strategic Health Authorities and Primary Care Trusts
- 4 The total figure of £187 billion is the sum of different sources and should be seen as an estimate only.

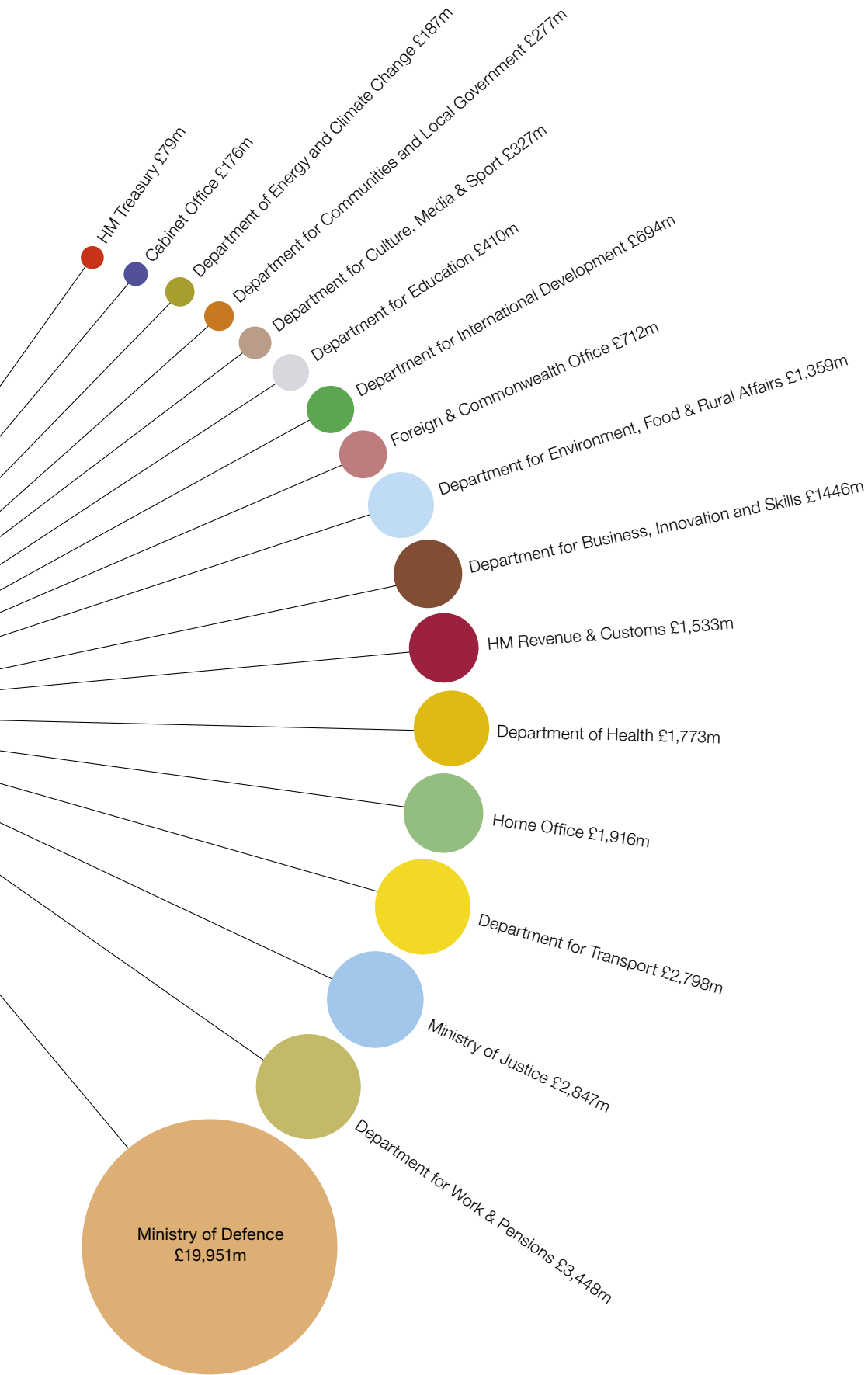
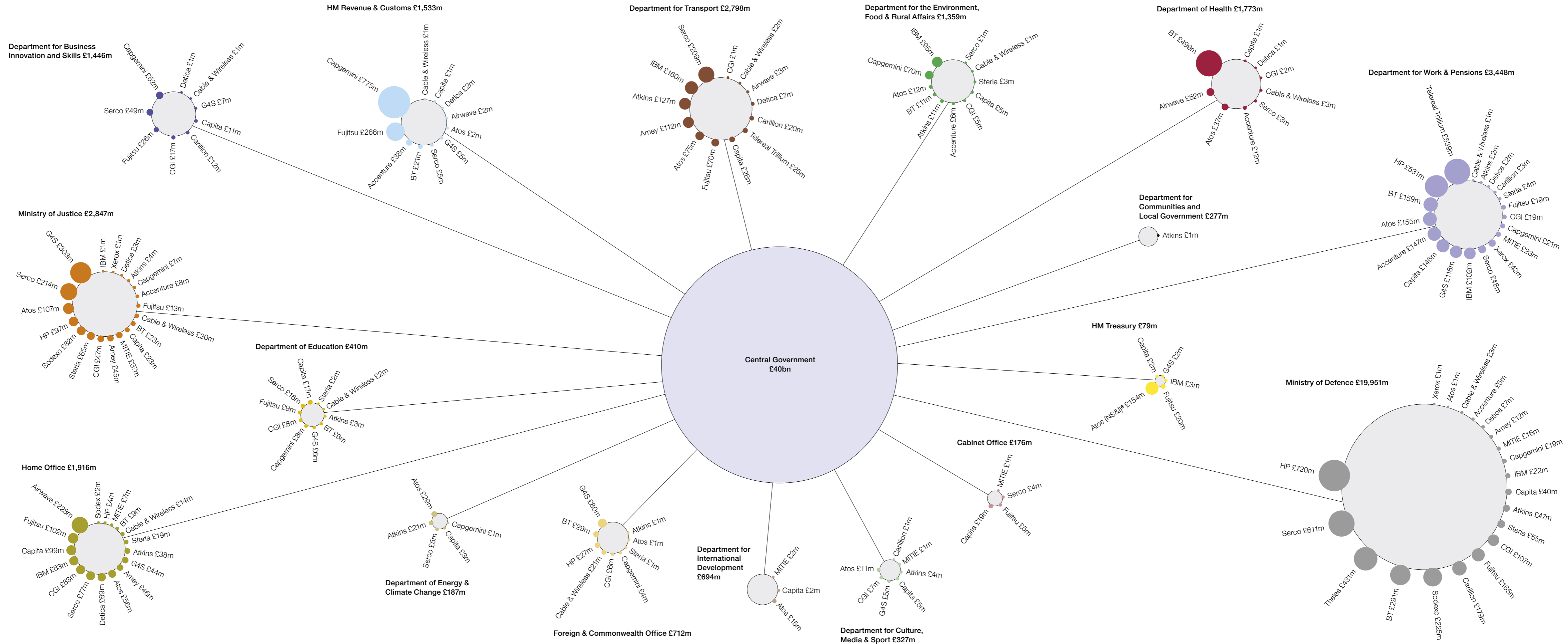


Figure 2
 Estimated central government expenditure with third parties, showing strategic suppliers



Sources and notes to Figure 2

Sources

Source for department totals: Cabinet Office – monthly data returns from departments: The Cabinet Office estimates that departmental returns cover approximately 90% of central government expenditure. Data taken from department returns to the Cabinet Office include direct expenditure only. For full details see Appendix Two.

Source for strategic supplier expenditure: Cabinet Office quarterly data returns from strategic suppliers 2012-13.

Notes

- 1 Supplier revenue figures have not been validated by departments and may differ from departmental published information.
- 2 Supplier expenditure data includes direct revenue and revenue earned through subcontracting. There may therefore be some double-counting across different suppliers.
- 3 There may be some misallocation of supplier revenue where arm's-length bodies have been incorrectly assigned to a departmental family.
- 4 Suppliers are not expected to report on low value contracts. In some cases, suppliers have included information on smaller value contracts in aggregate form. Where this has been allocated to a department, this has been included.
- 5 Some expenditure from within the wider health system could be included in the Department of Health expenditure figures.
- 6 Atos revenue of £154m against HM Treasury is a contract with NS&I. NS&I is a non-ministerial department of HM Treasury and this figure is not included in HM Treasury's total expenditure
- 7 Atos, Capita, G4S and Serco revenue from other central government bodies are shown in Figure 5.

Summary

The government's commercial relationships strategy

1 Government uses private sector providers for a range of purposes, from procuring basic commodities to providing front-line services to the public. Many of government's suppliers work across different departments and agencies, with suppliers dealing independently with a number of contracting authorities.

2 Since 2010, the Cabinet Office has tried to establish a firmer grip on supplier management across central government. Its main objectives are to gain control over spending in departments, to share intelligence on suppliers across departments and to make savings. The Cabinet Office focused on 40 '**strategic suppliers**', selected based on the extent and profile of expenditure across central government. It has introduced a number of initiatives with these suppliers to achieve its objectives:

- **Renegotiated key contracts** with suppliers, identifying immediate savings and agreeing memoranda of understanding.
- Established the **Crown Representative** role – senior government officials responsible for leading the government's relationships with a portfolio of strategic suppliers.
- Implemented a new **spending control**, which requires Cabinet Office approval for new contracts, extensions and major changes to contracts with strategic suppliers.
- Developed a system of **strategic supplier performance management**, collating performance information from departments, agreeing overall supplier performance ratings and introducing new policies such as formally designating poor performers as 'high risk'.
- Collected a range of **management information** on strategic suppliers to inform its understanding of activity across government.

Two NAO memoranda on government contracting

3 The NAO is today publishing two memoranda to Parliament on government contracting (**Figure 3**). This memorandum covers the Cabinet Office's progress in improving how the government manages its relationship with its strategic suppliers, including:

- considering the challenges for government in managing its suppliers, setting out the initiatives put in place by the Cabinet Office, and examining how it has organised itself to deliver them (Part One); and
- assessing whether the government is getting value from its suppliers in terms of performance and savings, as well as by managing markets and delivering the government's wider commercial aims (Part Two).

4 The second memorandum gives an overview of four particular contractors to illustrate questions about the risks of over-dependency, ensuring profits reflect a fair return, and securing appropriate standards of delivery.

Figure 3

The two National Audit Office memoranda

How the issues covered by each memorandum relate to the overall themes

Theme	The role of four contractors in the delivery of public services	Managing government suppliers
Managing the relationship with strategic suppliers	Is there sufficient competition in contracted-out public services?	What is government doing to manage its suppliers more effectively?
Getting value for money from contractors	Can we see whether contractors' profits reflect a fair return?	Is government securing value from its strategic suppliers?
Managing contractors' performance	How can we know whether contractors are delivering?	Does government have an overall view of supplier performance?

Source: National Audit Office

Main findings

5 The government has not traditionally behaved as ‘one customer’, and has not made the most of its collective buying power to get maximum value from its suppliers. It makes sense for the centre of government to have a role in overseeing relationships with suppliers who are providing goods and services to a number of departments. Before 2010, government did not have central oversight of its business with suppliers, which is in stark contrast to the way suppliers manage their own business with the public sector. A central overview of the government’s portfolio of contracts allows for an understanding of the government’s dependence on particular suppliers, and comparative analysis of prices, incentives and performance. It also has the potential to improve supplier performance more generally.

6 We welcome the Cabinet Office’s focus on improving the way the government manages suppliers. It is right that the Cabinet Office should use the government’s strong negotiating position to get more value from these relationships, and it has made progress towards this. Specifically, the Cabinet Office’s actions have:

- **Enabled the government to get greater value from contracting.** The Cabinet Office now has a far better idea of what government is spending and with whom, and has put in place senior commercial individuals to lead the government’s relationship with strategic suppliers. This central overview and enhanced capability means it can identify savings by bringing the government’s collective pressure to bear in renegotiating existing contracts, and by challenging departmental bids for new work. Through the controls process, the Cabinet Office can challenge departments on factors such as the way contracts are let, the size of contracts, and the commercial reasons for extending contracts. It can also ensure that other commercial priorities for government have been considered. The Cabinet Office reported £840 million of savings in 2012-13, and previously reported £437 million for 2011-12 and £806 million for 2010-11 as a result of the commercial controls process and contract renegotiations led by the Cabinet Office and departments.
- **Sent signals that government is willing to be tough on underperformance.** The Commercial Relationships Board enables the Cabinet Office, departments and Crown Representatives to share information about suppliers, discuss performance issues on particular contracts, and agree overall supplier performance ratings. There are agreed actions to bring about improvement or influence supplier behaviour, and if they cannot be dealt with at that level, there is a clear process of escalation towards designating a supplier as ‘high risk’. This formal process has real consequences for the supplier’s future business with government, and its market position. Recent high-profile allegations of poor performance on some contracts have highlighted weaknesses in government’s ability to manage contracts, but the new processes are providing greater visibility of these issues.

7 This is a large and complex area and the Cabinet Office is still in transition to a new system of cross-government supplier management, so it is to be expected that its approach will not yet be fully developed. However, having gained some initial benefits in terms of savings and oversight of government spending with suppliers, the Cabinet Office now faces a number of challenges in developing a more mature approach. Tackling these issues is important given the Cabinet Office's ambitions to take greater control of procurement and bring commercial activity and decision-making into the centre of government from departments. This is illustrated by its plans to merge its commercial function with the Government Procurement Service to become the Crown Commercial Service.¹ In order for this approach to be successful, there are a number of issues the Cabinet Office needs to address:

- **There is some tension and uncertainty between the Cabinet Office and departments.** Central oversight and control, such as interventions through the controls process and management of supplier relationships, challenges existing accountability structures. Departments and suppliers are currently unclear where accountability lies and this has placed a strain on some relationships. It may be necessary to challenge traditional structures in order to change the system, but longer-term goals may be at risk if departments are not on board. To achieve its ambitions, the Cabinet Office will need to have clearer accountability with departments for its own performance. Clarifying the operating model for the centre and departments will also allow departments to determine how their own commercial functions should operate.
- **The Cabinet Office's commercial relationships strategy is currently focused on short-term savings, which could pose a risk to value for money in the longer term.** Its primary aim so far has been to reduce costs. In doing this, it has taken a robust approach with departments and suppliers which has yielded short-term results in terms of savings. However, this approach will become harder over time and risks missing out on longer-term value through innovation and investment. There is a balance to be struck between tough negotiations and maintaining relationships with suppliers in the longer term. Unless the risks are understood and mitigated, this may have implications for competitiveness in certain markets if it leads to suppliers exiting areas of public sector business, or deters new entrants.
- **There is a risk that the Cabinet Office's ambitions for the centre of government are not matched by the right resources, capability and information.** Taking on more responsibility at the centre creates an obligation to perform. The Cabinet Office does not currently have the right resources in place, with gaps in commercial experience and expertise below senior levels. This has restricted the extent to which the Cabinet Office has been able to build industry knowledge, and limited its credibility with departments and suppliers, who tell us that their working level contacts do not fully understand their operating environment. Focusing on 40 strategic suppliers is a sensible start but information and knowledge on this group of suppliers is inconsistent and incomplete, and scaling up this approach in future will require greater discipline.

¹ Available at: www.gov.uk/government/news/new-whitehall-central-buying-service-to-save-more-for-taxpayers

8 In implementing its commercial relationships strategy, the Cabinet Office has challenged the status quo with departments and has pushed suppliers hard in negotiations. This has created tensions, but may have been necessary to shock the system and start the process of change. However, the issues outlined above are very real risks to the government's relationships with suppliers, to the competitiveness of the market for public sector business in the long term, and for how the Cabinet Office works with departments to achieve greater benefits for government as a whole.