



After Carillion

The Future of Outsourcing

The events surrounding Carillion could have marked the collapse, not just of the company, but of outsourcing itself¹. The benefits that the model offers to taxpayers, small businesses and the public sector alike were largely ignored.



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¹Carillion's collapse raises awkward questions about contracting out, *The Economist*, 18 Jan 2018

Executive summary

When Carillion collapsed in January 2018, the model of public outsourcing was put in jeopardy.

Voters considered a Labour opposition that pledged it would pull public services from private contractors. When The Economist suggested that the mistakes that caused the company's demise were common to the outsourcing industry as whole, industry suppliers became nervous. The events surrounding Carillion could have marked the collapse not just of the company, but of outsourcing itself². The benefits that the model offers to taxpayers, small businesses and the public sector alike were largely ignored.

This year, Interserve has been hit by rising debt and mismanagement, putting an already vulnerable supply chain and potentially thousands of jobs at risk. Interserve has managed to avoid a devastating collapse like Carillion's through a pre-pack administration deal, helping to protect jobs and make sure that services, including thousands of government contracts, will continue to be delivered.

Despite the blow that the latest news from Interserve dealt to an industry still smarting from the collapse of Carillion, this report demonstrates that the public still believe in the benefits that responsible outsourcing can bring to the public sector and taxpayers. It can speed up the delivery of services, offer savings, and improve standards. There are other benefits too – including strong levels of engagement with Small-Medium Enterprises (SMEs) and microbusinesses, keeping spend within the local area, creating jobs, training and apprenticeship opportunities. Responsible companies will offer strict minimum standards of fair payment for suppliers to ensure the smooth functioning of complex local supply chains.

Our research, which involved surveying not only the opinions of leaders in the complex construction supply chain, but also 1,000 members of the public, shows that the contracting marketplace remains robust. The model works, but there is more we can do to protect our supply chain and the SMEs that are the bedrock of the UK construction sector.

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Introduction

In January 2018, construction giant Carillion collapsed, leaving almost 3,000 workers without a job.

However, the damage was not limited to the company itself, it led to financial losses for 27,000 pensioners. Our research also shows that the average SME working with Carillion lost £5,000, with additional losses in terms of time and resources even greater still. Carillion put public outsourcing and our complex supply chains in jeopardy. Lord Adonis, who was chair of the government's own National Infrastructure Commission, called for nationalisation of the outsourcing industry, transferring the services it provides from private to state ownership or control³. At the time, Jeremy Corbyn argued that this represented a 'watershed moment' for capitalism⁴.

This report seeks to demonstrate that those assessments were wide of the mark, that the model of complex outsourced supply chains remain robust and that it continues to offer benefits to the taxpayer and small businesses alike.

3,000

workers without jobs

27,000

pensioners saw financial losses

£5,000

the average amount lost by SMEs working with Carillion

The aftermath

Our research demonstrates that the public still has faith in private firms delivering public services. In a poll of 1,000 adults living across the UK, 51 per cent agreed that the collapse of Carillion lends support to a policy of nationalisation.

However, when asked about the risks associated with large construction projects, the same group were clear that **they did not want to see these risks borne by the taxpayer**. Four times as many people would prefer that risks and costs associated with large, expensive public sector projects sit with the private sector rather than the public sector. Indeed, only one in ten of those polled (11 per cent) disagreed with that statement.

This makes sense; the collapse of Carillion was an example of how a failure of contracting is better than a failure in the public sector. Its losses were borne chiefly by the company's shareholders and creditors, rather than taxpayers⁵.

Furthermore, twice as many of our respondents thought that competition between private firms for public sector contracts, if properly handled, **drives up quality and drives down prices**, than those who disagreed. Less than one in five of the people we spoke to (19 per cent) opposed the idea that competition drives up quality and drives down price.

The assertion that the nationalisation of services that have been outsourced to the private sector is supported by the general public is not correct, there are subtleties at play. The British public understands the fundamental benefits of taking the delivery of these projects out of the hands of the state and that means the outlook for outsourcing remains positive, despite Carillion's collapse.

Now more than ever, the public needs to be reassured that the model is sound and that **lessons have been learned from Carillion's collapse**. The solution is not to nationalise, but to make sure that the parties involved are the right ones for the job. The suppliers the government use must be the right ones for the job. They need to be championing fair payment, operating transparently and delivering local economic benefits. The people procuring these projects must be equipped with sufficient knowledge to compare contracts, overall value for money and the embedded social value they deliver.

51%

agreed that the collapse of Carillion lends support to a policy of nationalisation

4x

as many people would prefer that risks and costs associated with large, expensive public sector projects sit with the private sector rather than the public sector

³Carillion collapse: Five urgent questions the Government must answer, Independent, Ben Chu, 15th Jan 2018

⁴The scale of the Carillion scandal can't be ignored, Telegraph, Liam Halligan, 26th March 2018

⁵Carillion's collapse raises awkward questions about contracting out, The Economist, 18 Jan 2018

Why did Carillion collapse?

A year later, it is clear that the collapse of Carillion was not due to fundamental problems with the outsourced model it employed, but due to very specific issues within Carillion itself.

The way Carillion operated

Some media commentators blamed the culture within Carillion for the collapse.

The joint report from two select committees highlighted Carillion's business strategy:

“a relentless dash for cash, driven by acquisitions, rising debt, expansion into new markets and exploitation of suppliers as the cause.”

The suppliers that we spoke to (whose livelihoods were put at considerable risk by collapses like Carillion's), agreed wholeheartedly that Carillion's downfall was due to debt mismanagement, acquisitions, long payment terms and expansion – with fifteen times as many agreeing (64 per cent) than disagreeing (4 per cent).

Many senior executives fall into the trap of chasing revenue rather than profit. This sees them pursue new markets, services and industry sectors that provide the opportunity to grow and increase revenue, but in the long-term, this strategy does not always translate into a financially sustainable business. However, for Carillion **there was more to the collapse than just poor management.**

The public view is that the executive board's actions were also questionable. Carillion's directors redrew the rules on executive bonuses, so that they could not be claimed back except in the event of misconduct. We asked the public if they thought this suggested the directors had some concerns about their company's future. Two-thirds agreed (62 per cent) while only one in nine (11 per cent) disagreed.

Accounting policies

The aggressive accounting policies at Carillion are also believed to have played a part in its downfall.

When we asked suppliers if they thought Carillion's finance director – “the architect of Carillion's aggressive accounting policies” – discharged his duties in good faith, 51 per cent said they didn't think he had.

SMEs reported similar views – none of those surveyed thought Carillion's finance director acted in good faith and over half (55 per cent) said he did not. Meanwhile, twice as many of the suppliers we surveyed agreed that the collapse of Carillion was facilitated by ‘dodgy accounts’, than disagreed.



none

of the SMEs surveyed thought Carillion's finance director acted in good faith

Auditors and regulators

There were also wider issues that compounded Carillion's problems.

The Sun blamed the close relationship between **Carillion** and **KPMG**, their long-standing auditors, for the collapse⁷. 93 per cent of the suppliers we surveyed thought the relationship between KPMG and Carillion was ‘too cosy’.

When we asked whether a shake-up of the ‘big four’ auditors, including KPMG, is needed, most suppliers (57 per cent) said they believed it was. Only 4 per cent disagreed. The Competition and Markets Authority has called for companies to split their operations into separate businesses to reduce conflicts of interest in the marketplace⁸.

Additionally, three quarters of the suppliers we surveyed (76 per cent) thought that the **Financial Reporting Council (FRC)** – responsible for auditors and accountants – was too timid in challenging questionable financial information, while only a tenth (9 per cent) disagreed. Amongst SMEs, these feelings were stronger still, with 83 per cent agreeing and only 4 per cent disagreeing. Furthermore, our poll showed that many suppliers felt the FRC was ‘**wholly ineffective**’ in taking auditors to task with 57 per cent agreeing and only 4 per cent disagreeing (with similar findings across SMEs).

The industry also feels the **Pensions Regulator**, which is set up to make sure employers can fulfil their duties to scheme members and protect the UK's workplace pensions⁹, **was at fault**.

Carillion operated 13 final salary pension schemes in the UK, with around 27,000 members, more than 12,000 of whom are already claiming a pension. **They reported a pension deficit of £587m**, however, independent pension consultants warned that the real hit to the **Pension Protection Fund (PPF)**, **could be closer to £800m**¹⁰. Under PPF rules, not all Carillion employees will receive their full pension. Those yet to reach retirement will typically have seen cuts of between 10 and 20 per cent. 60 per cent of our respondents felt the regulator had ‘**clearly failed**’ in its statutory objectives to safeguard Carillion's 27,000-member pension scheme. Only one in 25 (4 per cent) disagreed.

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76%

of suppliers surveyed thought the FRC was too timid in challenging questionable financial information

83%

of SMEs surveyed thought the FRC was too timid in challenging questionable financial information

£800m

The potential pension deficit

⁷Carillion bosses must face justice over £7billion loss – it's the taxpayers who are footing the bill, The Sun, Liam Halligan, 22 Aug 2018

⁸Competition watchdog recommends accountancy market overhaul, BBC, 18 April 2019

⁹<https://www.thepensionsregulator.gov.uk/>

¹⁰Carillion collapse: will pensions still be paid? Daily Telegraph, James Connington, 16 Jan 2018

Why did Carillion collapse? continued

The government's response

Other respondents thought the government was at fault, asserting that our political representatives have a responsibility to safeguard the supply chain against mismanagement and unfair contracts.

When we asked representatives of the supply chain if the government **“lacked the decisiveness or bravery”** to address the failures that enabled Carillion to become an unsustainable business, the majority agreed (52 per cent) rising to 65 per cent of SMEs.

However, the suppliers we surveyed were not wholly critical of the government's response. Three quarters of them thought that letting Carillion collapse (rather than rescuing it) was the right course of action, while less than a tenth (9 per cent) disagreed (15 per cent weren't sure) with similar responses from SMEs.

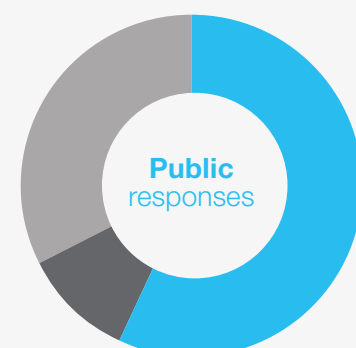
The British government did not rescue Carillion, either partially or totally, as it had previously done with Rolls Royce in 1971, British Leyland in 1975, Railtrack in 2002 or Bradford & Bingley, RBS, Northern Rock and HBOS-Lloyds TSB in 2008. The public had a similar view to the suppliers we surveyed, with 57 per cent saying that **not rescuing Carillion was the correct course of action**.

The report from the Commons Public Administration and Constitutional Affairs Committee¹¹ carried out in the wake of the Carillion collapse concluded that if there is a problem with the government's approach to outsourcing, it is their determination to economise as much as possible on public spending, while compelling the private sector to take on **unacceptable levels of financial risk**. We found that 80 per cent of suppliers and 85 per cent of SMEs surveyed agreed.

65%

of SMEs thought the government **“lacked the decisiveness or bravery”** to address the failures that enabled Carillion to become an unsustainable business

Q: Was the Government's decision not to rescue Carillion correct?



Yes 57% No 11% Don't know 32%



Yes 76% No 9% Don't know 15%

Only 2 per cent of the supply chain representatives surveyed thought that the government should accept bids that are far beneath a realistic assessment of cost and risk, while 94 per cent disagreed. All the SMEs polled disagreed.

In our view, accepting unrealistic bids is not a problem with the model – it is the nature of capitalism. Companies should be free to bid for a job at a low fee, however they must be under no illusions that **they will be held accountable for their actions**.

However, the government is not entirely blameless in this story either. They accepted Carillion's bids in the first place, which were clearly under-priced. Public sector procurement professionals need to consider a range of factors as well as price when selecting suitable suppliers. Unrealistically low bids can not only lead to collapse, but also to poor deliverables in terms of **project quality, investment in the local economy and a fair deal for suppliers on the ground**.

Although industry-wide efforts have been increased to standardise fair payment practices, late payments are still being seen in the industry and, in Carillion's case, withholding payment enabled the true extent of the company's debt to be concealed.

Despite being signatories of the prompt payment code, standard payments at Carillion were often 120 days.

A decision to set payment terms at four months was an interpretation of two flagship government payment initiatives introduced under David Cameron¹². Suppliers suffered as a result of the government's actions and Carillion's business strategy. Many suppliers who are uninsured against the risk of collapse, will never recoup their share of the estimated £1.2bn loss¹³.

The public sector should not be accepting bids without making informed decisions based on **wider cost benefit analysis** or clear evidence of **ethical supply chain engagement**. If these points are not considered, the government simply cannot wash its hands of responsibility when companies collapse.

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¹²Government payment drives questioned as BIS distances itself from Carillion's 120-day payment terms, Luke Cross (Construction News), 27th March 2013

¹³Most UK suppliers uninsured against Carillion's collapse, Carolyn Cohn (Reuters), 25th January 2018



One possible solution

A logical step forward is to restore the public's faith in the model – rather than simply tearing it up. But how can that be done?

In August 2018, the UK's largest union, UNITE, called for a **public inquiry** into the collapse of Carillion. Four-fifths of our respondents (81 per cent) agreed that this should happen, with only 4 per cent disagreeing. This indicates that the public want to be reassured and see evidence that lessons have been learned and steps have been taken to safeguard against a similar collapse in the future.

Although ex-Carillion directors face questions over pension claims, **they have not appeared in court.** Our survey respondents were overwhelmingly in favour of prosecution, with two-thirds (66 per cent) thinking it's necessary, while only 6 per cent disagreed.

Shifting the focus to celebrating best practise contractors and demonstrating that the mistakes which caused Carillion's demise were not common to the whole industry will also help to restore the public's faith in outsourcing.

For example, by procuring significant volumes of projects and services over a defined period via a framework, SMEs can be protected via mandated and monitored fair payment terms. A responsibly procured and managed framework offers them greater access to large schemes via tier 1 contractors, which they would otherwise stand little to no chance of directly engaging with, as well as **opportunities for learning, development and sustainable business growth.**

Ethically-managed frameworks offer subcontractors the **certainty of a reliable pipeline of work from a reputable provider.** Given that SMEs are the lifeblood of the economy, the sustained growth and prosperity of local businesses should be a key priority for the public sector.

A fully-integrated performance management culture within frameworks can also improve payment terms for SMEs. As Carillion showed, it is critical that all suppliers and subcontractors are paid within a minimum of 30 days, and ideally much quicker still¹⁴. 82 per cent of SMEs we spoke to said payment terms of reputable framework providers offer them more protection than those offered by Carillion.

Frameworks also provide opportunities in terms of **upskilling workforces, sharing skills and expertise, and building strong working relationships** that support future pipelines of work. Three-quarters of SMEs (75 per cent) think their team has more opportunities to develop and learn by working on projects with reputable framework providers while 93 per cent say they think it benefits the professional standing of their organisation. Finally, they also offer clients the opportunity to nominate specific SMEs to work on projects, provided they are then approved by the tier 1 contractor.

To date, we have engaged with over **36,000 SMEs and microbusinesses** across the UK through our frameworks. **Using local labour and local spend, we have generated £1.6bn**, not only boosting local economic growth but supporting the wider UK economy.

We are proud to play our part in helping to raise the profile of construction among young people and secure a diverse workforce that is fit for the future, through school visits, work experience placements and apprenticeships.

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30,000
school visits



7,000
work experience placements



27,000
full-time apprenticeship hours

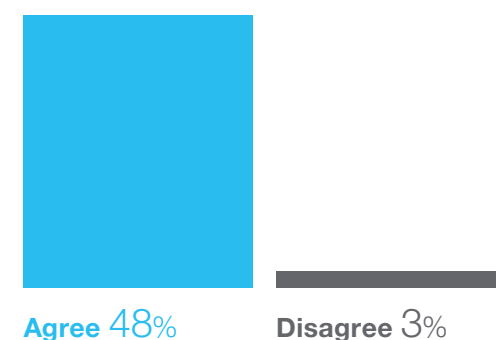


SME spotlight

Responsibly outsourcing services can have many benefits. The public want to see large providers delivering these services with the associated benefits in terms of social value and tangible community benefits, too. They do not want providers that only deliver low-cost solutions.

Almost half the public respondents we surveyed (48 per cent) agreed that third-party providers should be **investing in the local community, working with SMEs, offering opportunities for disadvantaged people or improving staff well-being**. Public sector commissioners need look no further than their nearest social enterprise to consider how procurement and project delivery could improve the social, economic and environmental well-being of their areas.

Q: The best third-party outsourcers should deliver social value



If the public is to continue enjoying these benefits, **the outsourced model of complex supply chains must be defended**. There are companies that understand and are highly capable of managing complex supply chains, whose best practices should be celebrated and adopted across the board.

Support from government will also reassure contractors, suppliers, potential suppliers and the general public that the model has a future. If suppliers drop out of the supply chain, the public sector will suffer as market forces ease, SMEs will miss out on vital opportunities that well-managed larger projects offer them, the chances of attracting investment will fall and economic growth will be stunted.

There are companies that understand and are highly capable of managing complex supply chains, whose best practices should be celebrated and widely adopted across the board.

The SME perspective

“We have worked on a variety of public sector projects – in education, health, blue light services, and housing schemes – via Scape’s frameworks, providing project management and quantity surveying services.

Major frameworks provide pipeline certainty for SMEs, and the transparency in the way Scape operates enables us to invest, grow and compete on large contracts in our own right. If being part of the Scape team didn’t work for us as a business, we wouldn’t be doing it. The marketplace is big enough for frameworks to co-exist with other procurement routes, and the choice given to clients ultimately allows them to achieve best value, which is vital for the public sector.”

Clive Sayer, director
BAQUS Construction & Property Consultancy¹⁵





Conclusion

A year down the line, the nation, the public sector, and its supply chain think the outsourcer's collapse was not due to fundamental problems with the model – but due to problems at Carillion.

In the eyes of industry experts, the collapse was down to Carillion's business strategy – a **“relentless dash for cash, driven by acquisitions, rising debt, expansion into new markets and exploitation of suppliers”** as the joint report from two select committees said. Interserve came dangerously close to repeating history since then, after finding itself in a similar position due to borrowing, debt and an unsustainable business model.

Carillion's relationships with their auditor KPMG and the Financial Reporting Council (responsible for auditors and accountants) has been blamed too. **The Financial Reporting Council was too timid in challenging questionable financial information.** The industry feels that the government demonstrated a lack of decisiveness and should have addressed the failures in corporate regulation that allowed Carillion to become a giant, unsustainable business.

Equally, Carillion collapsed because the bids that it won were under-priced – in future, the government must accept that price alone should not be the only factor in choosing a supplier. Contractors must be selected on their ability to deliver social value and community benefits. Carillion's suppliers were treated poorly; unfair payment terms meant that the company's collapse had devastating consequences that were felt throughout the supply chain.

Price alone should not be the only factor in choosing a supplier. Contractors must be selected on their ability to deliver social value and community benefits.

Naturally, the public does not want to see the risks associated with large construction projects borne by the taxpayer. They think competition between private firms for public sector contracts, if properly handled, drives up quality and delivers competitive pricing.

The public want to see contractors operating **responsibly, with mandated and monitored fair payment terms to protect supply chain partners.** They should afford SMEs the opportunity to work on larger schemes, bringing with it the predictability of a long-term pipeline.

So, the model of complex outsourced supply chains should not be damned by Carillion's collapse. When done correctly, the model delivers sustainable benefits in terms of efficiency and time savings, minimising risks to the taxpayer and safeguarding supply chains. While many SMEs had their livelihoods effected by the collapse of Carillion, **the security provided through performance and framework management, rigorous governance processes and embedded risk management** should not be forgotten.

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Methodology

We surveyed over 50 senior managers across a range of suppliers and subcontractors delivering built environment services, with questions about the stability of the supply chain in the wake of Carillion's collapse.

Those polled included contractors who provide construction and civil engineering services, consultancies who support the public sector and facilities management providers. This survey sought the opinion of tiers 1, 2 and 3 of the public sector supply chain. **We would like to extend our thanks to our national delivery partners and their supply chains across the UK for contributing to this research.**

We also carried out a consumer poll of 1,000 adults in the UK this was undertaken by research agency, OnePoll. The survey was conducted using an online interview administered to members of the OnePoll panel who have agreed to take part in surveys. The fieldwork was undertaken between 19 December – 21 December 2018. OnePoll are members of ESOMAR and employ members of the MRS.

About Scape Group

Scape Group is a public sector organisation, dedicated to creating ongoing efficiency and social value via the built environment. Scape and its subsidiaries offer fully managed frameworks, property services, innovative design solutions, community investment opportunities and joint ventures.

By bringing together the strongest teams from the public and private sectors, Scape's rapidly deployed, highly measurable and collaborative approach delivers value for money and quality buildings while stimulating local economic growth and community enrichment. Scape operates with a buying capacity of **£13bn** and has helped to deliver **over 12,000** public sector projects with more than **1,800** currently in progress. For the past three years, Scape Group was named the 'Best Client to Work With' at the annual Construction Enquirer Awards.

£13bn

buying capacity

Over
12,000

public sector projects delivered

1,800

live projects at any one time



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