**THE BETTER GOVERNMENT INITIATIVE**

**Executive Committee Meeting**

**10:15 - 12:00, Tuesday 5th April 2016**

**Fabian Society, 61 Petty France SW1H 9EU**

**AGENDA**

1. Apologies.
2. Minutes of the meeting on 23rd February 2016.
3. Matters arising.
4. Updates:

* The blog “One man two governors: Accountability in the Modern Era” was posted on 1stMarch; Richard Mottram wrote to Amyas Morse to draw it to his attention and received an acknowledgement without comment.
* Amyas Morse’s reply to Paul Britton's letter about the third sector referred to his recent report to the PAC on Government spending with SMEs, which covers some of the same ground as the BGI's paper. He has agreed to a meeting, but neither this nor the meeting with Stuart Etherington has yet been fixed. Copies of Amyas Morse’s letter and the report’s summary are attached as Annexes A and B.
* We will be contacting Tom Watson’s secretary after the Easter recess about dates for the twice-postponed meeting.
* On Short money the government has now largely backed down on its proposed cuts, with the Leader of the House announcing minor changes agreed with other parties. PACAC had in parallel launched an inquiry with a request for evidence by 12 April. It remains to be seen if this comes to anything. Richard Mottram is preparing a revised version of our submission more clearly tailored to the questions now posed by the Committee.
* Richard Mottram wrote to the organisers of the Gulbenkian dinner on 29 February. A copy of his letter is attached as Annex C and of the sole response at Annex D.
* Richard Mottram is writing to Jeremy Heywood to suggest a meeting.
* Mark Fisher has said that he would welcome a meeting with Paul Britton and Leigh Lewis but suggested that this might best take place once the Cabinet Office are more advanced in their own thinking on the future relationships between government and the third sector.
* The “Omnipresent Osborne” blog was re-tweeted when Iain Duncan Smith resigned.
* Philip Rycroft, Head of the Cabinet Office UK Governance Group, has suggested a catch-up chat. Richard Mottram and Peter Owen will be meeting him on 7th April.

1. Follow-up to the Gulbenkian dinner (to be raised orally).
2. Arrangements for the meeting with the Kerslake review team (to be raised orally).
3. Constitution Society project on “The Boundaries of the State” (to be raised orally).
4. Request for evidence on the Grimstone Review (EC0405n1)
5. Any other business.

1st April 2016

**ANNEX A**

Dear Sir Paul,

**PROVISION OF PUBLIC SERVICES BY THE THIRD SECTOR**

Thank you for your letter and for sharing with me the paper prepared by the Better Government lnitiative.

A number of the issues you raise chime with the findings of my report on Government's spending with small and medium-sized enterprises, which was published last week. The report identifies commonly-cited benefits of using SMEs (including third sector bodies) to deliver public sector contracts, such as increased innovation and specialist expertise. It acknowledges that government has a long-standing ambition to make greater use of these providers and has introduced several initiatives meant to reduce the barriers SMEs face when seeking to compete for public sector contracts.

However, government bases its approach on the assumption that more SMEs will win government work if there are fewer barriers to them being able to bid. This does not reflect the fact that wider trends in government contracting mean that SMEs may not be suitable to deliver the contracts. For example, trends towards greater use of government's collective buying power and pressure to reduce headcounts and find savings are leading to a smaller number of large contracts, where SMEs are unable to bear the risk expected of the provider.

Given these issues, the report recommends that government identify areas of spending where a greater diversity of providers (such as more innovative businesses or third sector bodies) would deliver the most benefits for the public sector. Government should then take a more focused approach to ensuring that procurement approaches and contracts in these areas are shaped to allow these providers to be able to compete effectively.

I enclose a copy of the report, which you may be interested in reading, and I would be happy to meet both you and Sir Leigh to discuss this further. I will ask my office to arrange this. You may also be interested to know that the Public Accounts Committee will be discussing the findings of my report on 21 March.

AMYAS C E MIORSE

**ANNEX B**

**Government’s spending with small and medium-sized enterprises**

**Summary**

Each year, the government spends around £45 billion on goods and services supplied by non-public sector organisations. Increasing the proportion of this spending that reaches small and medium-sized enterprises (SMEs) was a key priority within government’s procurement policy over the past five years. In 2010, the government announced an aspiration for 25% of the spending to go to SMEs by 2015. In August 2015, the government announced that it would extend this target to 33% by 2020. The target covers both direct contracts with SMEs and spending that reaches SMEs indirectly (where the government’s contract is with a larger provider that subcontracts SMEs as part of its supply chain).

The Department for Business, Innovation & Skills (BIS) estimates that there are currently 5.4 million SMEs operating in the UK. Most are private sector businesses, but the definition includes many voluntary, community and social enterprise (VCSE) organisations. Government uses the European Commission’s definition of an SME, which defines it as an entity engaged in economic activity that:

* employs fewer than 250 people; and
* has annual turnover less than or equal to 50 million euros (£39 million); or
* has a balance sheet total of less than or equal to 43 million euros (£33 million).

The Cabinet Office’s Crown Commercial Service (CCS) is responsible for the government’s commercial policies. This includes leading on government’s SME procurement policy. By increasing government’s use of SMEs, the CCS aims to increase competition and innovation for public sector contracts. It intends to do this by:

* monitoring government’s spending with SMEs, against its target; and
* identifying and removing barriers that SMEs face when bidding for government contracts.

Individual contract awards are decided by the government department awarding the contract. By identifying and removing the barriers faced by SMEs across government, the CCS aims to make it easier for SMEs to do business with government. As this becomes easier, the CCS expects more SMEs to bid for government contracts, increasing competition for work and leading to better value for the public sector.

**Scope of this report**

This report looks at what government is doing to make the public sector marketplace more accessible to SMEs. It focuses particularly on the action government took to achieve its aspiration of 25% by 2015 and early plans to achieve the 2020 target. The report sets out:

* central government’s progress in increasing the government’s use of SMEs;
* efforts to remove the barriers that SMEs face when bidding for government contracts; and
* the challenges for government of realising the benefits of using SMEs.

We did not audit the value for money offered by SMEs compared with other providers for individual contracts. Appendix One explains our methodology.

**Key findings**

The government’s use of SMEs

For many years, government has sought to harness the potential benefits of involving SMEs in the public sector marketplace. The departments we met agreed that SMEs can offer a number of benefits to the public sector, compared with other providers. For example, offering more flexibility, innovative approaches and better value for money due to lower overhead costs. The Cabinet Office told us that SMEs, particularly VCSEs, can offer value in terms of local investment and improved social outcomes. Although government set its first target for spending with SMEs in 2010, the underlying policy is not new. Government has sought to increase its work with SMEs for similar reasons since the 1990s (paragraphs 1.5 to 1.9 and Figure 1).

In order to track performance, the CCS has made improvements to the understanding government has about its spending with SMEs. The number of bodies involved and different data systems have made it difficult to develop reliable estimates of government’s spending with SMEs in the past. The CCS has worked with departments to improve the quality of government’s information about SME spending. For example, it introduced a survey of large suppliers in 2011-12, in order to develop an indicative estimate of the amount government spends with SMEs through the supply chain. It has continued to refine the methodology each year up to 2015 (paragraphs 1.18 to 1.20).

In February 2015, government reported that it had met its 2010 SME spending target a year early. The Cabinet Office estimated that 26% of government spending reached SMEs in 2013-14, surpassing its 2010 aspiration of 25%. It estimates that government further increased its spending with SMEs the next year, to 27% of total procurement spending. The CCS reported that departments spent £4.9 billion directly with SMEs in 2014-15 and that a further £7.3 billion reached SMEs through supply chains (paragraphs 1.10 to 1.15 and Figure 2).

However, we cannot be certain that the amount government spends with SMEs has increased over the last Parliament. The reported annual increases in spending with SMEs happened in parallel with the CCS’ work to improve government’s understanding of its spending with SMEs. As a result, we do not know how much of the reported increase is due to the changes in approach and how much is an actual increase in SME activity. For indirect spending, the Cabinet Office has surveyed a larger group of providers each year since 2011-12 so annual figures are not comparable. The CCS’ methodology for direct spending has not changed since 2011-12, but we cannot be certain that numbers are directly comparable due to the structure of the underlying data (paragraphs 1.6, 1.16 and Figure 3).

Increasing SME spending further by 2020 will be challenging. The government has set a new target for 33% of spending to reach SMEs by 2020. Whether it reaches this will depend heavily on the Ministry of Defence (MoD), which is currently responsible for 44% of central government procurement. In 2014-15, 19% of the MoD’s procurement spend reached SMEs. The other 16 departments collectively reported 33% of spending reaching SMEs. The MoD told us it will be challenging to increase its SME spending further by 2020. It has already committed large proportions of its annual spending and is unlikely to be letting many further large contracts during the current parliament (paragraphs 1.21, 1.22 and Figures 2 and 4).

Progress in removing barriers SMEs face when bidding for contracts

The government has introduced initiatives to reduce the barriers faced by SMEs when bidding for public sector work. In 2011, the Cabinet Office launched a package of measures aiming to make sure that SMEs were better able to compete for government contracts. The Cabinet Office identified barriers such as the poor visibility of opportunities and burdensome pre-qualification requirements. It has launched initiatives aimed at reducing these barriers. For example, government has abolished pre‑qualification questionnaires for low-value contracts and departments are now required to use Contracts Finder (a portal for advertising government tenders, first launched in 2011). Furthermore, the Social Value Act 2012 requires commissioners to consider wider social, economic and environmental benefits in procurement processes, which is often thought to benefit VCSEs in particular (paragraphs 2.2 to 2.21 and Appendix Three).

But SMEs still face barriers. SMEs told us the government initiatives had resulted in positive changes but, in practice, are still not sufficient to ensure that more work flows to SMEs. For example, the centrally-led initiatives depend on individual commissioning teams in departments choosing to implement them. The barriers most commonly cited by SMEs – and echoed by government departments – have not significantly changed. They include:

• Transparency of information: SMEs struggle to find contracting opportunities and have difficulty identifying where to go to for support.

• Departmental appetite for risk: Commissioners may be wary of using SMEs that have no financial track record or parent company guarantee.

• Disproportionate bidding requirements: SMEs often do not have the resources to complete lengthy tender documentation.

• Capability of commissioners: Commissioners who lack commercial expertise can be more risk averse. They are less likely to seek out innovative approaches or take social value into account.

• Delays in payments: SMEs are less likely to have the financial capacity to absorb delays in payment and may struggle to manage their cash flow (paragraphs 2.26, 2.27, Figure 6 and Appendix Three).

Achieving the benefits of using SMEs in delivery

Commissioners must balance the government’s aspirations for using SMEs with other conflicting priorities. Most contracting decisions are made by commissioners across government, rather than by the CCS. The SME agenda is only one part of significant ongoing changes in the way the government does business with its providers. Some of these trends may make it harder for SMEs to win contracts as commissioners seek to balance different government priorities in decisions about contracts, including:

Reductions in commissioner capacity

Our recent reports have highlighted gaps in government’s commercial capability. Most government departments plan to make further cuts by 2020, which is likely to affect capacity in commercial teams. Departments’ efforts to improve the way they manage contracts has focused on larger contractors. Government has not yet set out how it will manage smaller contractors. Departments may rely on larger contractors (prime contractors) to manage supply chains on their behalf so commissioners only have one contract to manage rather than many. In recent years, government has extended this model to new areas of spending, such as estates management and learning and development. This trend is likely to continue if spending cuts reduce the capacity of commissioning teams to manage a larger number of contracts (paragraphs 3.4 to 3.8).

Greater use of government’s collective buying power

In many areas of government, particularly for common goods and services (such as office supplies and training), government is increasingly merging the spending of different departments and using its collective buying power to simplify procurement and cut costs. This allows it to standardise products and services so providers compete on the basis of price rather than quality. Providers of these products and services can no longer rely on their pre-existing relationships or specialised nature of their product or service to win contracts. This can limit opportunities for SMEs that rely on their specialist services to secure business. While the CCS has shown that SMEs can win contracts even when government merges its spending, the move towards greater price competition and standardisation changes the type of SME that is likely to win these contracts. This reduces the likelihood that SMEs will bring innovation or niche expertise (paragraphs 3.9 to 3.12 and Figure 8).

Pressure on departments to make savings

Government’s austerity policy means departments will need to achieve further cost savings by 2020. With reduced budgets, departments are less able to absorb the cost of projects overrunning or exceeding budgets. When delivery is outsourced, commissioners can seek to transfer most of the financial risks of delivering the contract to the provider, by agreeing a fixed price at the start of the project. However, it means providers must be willing and able to take on financial risk. SMEs often do not have the resources or financial support (eg from a parent company) to be able to do this so commissioners may perceive them as more risky than larger providers (paragraphs 3.13 to 3.15).

Consequently, most SMEs working on government contracts are part of the supply chain and it is not clear that this will lead to increased competition and innovation. These SMEs make up 60% of government’s annual £12 billion estimated spending with SMEs. They work for larger prime contractors and may not compete directly for government contracts. In most areas, government has limited knowledge of these supply chains, as prime providers appoint, set contract terms for, and manage the supply chain directly. These SMEs can bring other benefits and subcontractor roles can help them increase their capacity and experience, to be better able to compete for future work. However, the Cabinet Office has no way of knowing whether it is making progress towards its overall aim of increased competition and innovation. Prime providers will also take a management fee, which either reduces the income received by subcontractors or increases the cost to government of delivering services (paragraphs 1.7, 1.15 and 3.26 to 3.28).

Some parts of government have identified categories of spending where SMEs can have the most impact on delivery. The CCS expects all departments to try and increase their use of SMEs. We found some examples of commissioners identifying areas where they could make greater use of SMEs. For example, sectors where SMEs are already thriving (eg digital services) or where government is keen to support SMEs to grow (eg construction). Commissioners have developed plans to reduce barriers to bidding in these areas, and make contracting arrangements more SME friendly. For example, Highways England has reduced the lot size for some construction contracts to make them accessible to SMEs (paragraphs 3.16 to 3.25 and 3.29).

The fractured nature of government procurement systems makes it harder for the CCS to pursue a more targeted approach for government as a whole. An underlying theme of this report is that government lacks an integrated digital platform for procurement. We reported in 2014 that individual departments do not have systems that integrate information on contracts, payments, and contractor performance. In areas not covered by CCS frameworks, this makes it harder for CCS to assemble information on cross-government spending or contracts and identify areas in which SMEs are making significant contributions to the delivery of government services or have the potential to have a greater impact. Contracts Finder holds information on some of government’s contracts, but it depends on public bodies uploading information to it that is currently held in over 200 different procurement portals and the CCS has limited oversight of this data. Since July 2015, the CCS has begun to carry out a small number of spot checks to confirm that public bodies are using Contracts Finder to publicise their contract opportunities.

**Conclusion**

Over the last five years, the Government has had a clear and sustained focus on the involvement of SMEs in government contracts. Government reported that over 25% of its spending reached SMEs in 2014-15. It now aims to increase this to 33% by 2020. However, we cannot be certain that the amount government spends with SMEs has increased since it set its original target in 2010. As it seeks to increase it further, government needs to think carefully about the full range of risks and opportunities that contracting with SMEs presents, compared to working with larger providers.

Government will be more likely to harness the potential benefits of using SMEs if it takes a more focused approach. It currently bases its approach on the assumption that more SMEs will win government work if there are fewer barriers to SMEs being able to bid. However, wider trends in government contracting mean that, although SMEs can bid for work, they are often not suitable to deliver it. If the government is serious about increasing its use of SMEs, it will need to focus on those areas where SMEs can deliver real benefits. This will take a more concerted effort not only to remove barriers to bidding, but to ensure that what and how government procures achieves the desired benefits of using SMEs.

**Recommendations**

To support the CCS in developing its strategy to meet government’s 2020 target, we make the following recommendations to the CCS:

Taking a more focused approach to achieving the benefits of using SMEs

The CCS needs to move from a generic approach of lifting barriers to SMEs bidding for contracts to an approach that involves working with departments to identify areas where different types of SME can bring the most benefit. It should:

* Stop changing its basis for estimating SME spending

The CCS should settle on a methodology for 2015-16 and ensure that any subsequent years’ data can be compared with this 2015-16 baseline.

* Identify those areas of government where different providers can bring the most benefits

The CCS should ensure that, as departments develop plans to meet the 2020 target, they are identifying areas of spending where SMEs can have the most impact and the types of providers they would like to encourage in those areas (such as innovative businesses or VCSEs).

* Use best practice to inform future decisions

The CCS should identify where departments are effectively harnessing the benefits of using SMEs and VCSEs. It should disseminate these across government to help departments to shape their procurement and contracts to maximise the benefits from using these providers.

The CCS should also use this evidence to review the impact of SMEs on the public sector marketplace, to inform its own decisions about the quantitative target and central initiatives.

* Identify where government needs to have oversight of the relationship between prime contractors and their subcontractors

Government should identify areas where the majority of SMEs will continue to operate within a supply chain. In these areas, it should ensure prime contractors’ behaviour does not prevent subcontractors delivering benefits for the public sector. For example, by introducing codes of conduct for prime contractors, or project bank accounts to ensure prompt payments

In addition, there is a need for greater visibility and transparency of government’s procurement, so the CCS should work with the Cabinet Office and the Government Digital Service to:

• Assess the feasibility of an integrated cross-government procurement platform to support its commercial strategy

This might be built of many systems with compatible data or a single system. This will require leadership from the centre of government now if it is to be achieved during this Parliament.

* As a first step, improve the quality of data in Contracts Finder

The CCS should ensure there are clear lines of governance and accountability for the use of Contracts Finder, particularly enforcing the requirement for public bodies to use it to advertise opportunities.

**ANNEX C**

29 February 2016

Dear Andrew and Paul,

I am writing to thank you for inviting Robin, Leigh and me to join you for your discussion on 22 February about how philanthropy is adapting to a new world of blurred boundaries between the public, private and charitable sectors.

We much appreciated Andrew’s hospitality and learned a great deal from the discussion. I hope we were able also to give you and other attendees at least a flavour of the work of the Better Government Initiative (BGI).

As it turned out, our recent discussion paper on ‘Provision of Services by the Third Sector’ provided a timely contribution to the discussion. In that paper we recognised that the third sector has had a poor press in the last year or two because of criticism of some of its fundraising methods and of the remuneration enjoyed by the chief executives of some of the leading charities (picked up again in yesterday’s *Sunday Times*, together with the E.ON saga). We also noted that the collapse of Kids Company has raised issues around public funding, governance, and financial control. Its demise has also proved embarrassing to ministers, which may not help the cause of the sector.

Our paper recognised that there is much scepticism in the sector about whether departments want a better relationship and that any attempt to extend its use in service provision would need to start by rebuilding trust. Nevertheless we were struck by the extent and the depth of the disillusionment expressed at the meeting, and in its margins, about the government’s attitude to the sector. Obviously this in part reflects concerns over the government’s ill thought out new grant rules. But we were not I think expecting to hear such strongly expressed comments about the attitudes of Cabinet Office ministers.

As we in the BGI try to keep in close touch with the Cabinet Office at both ministerial and senior official levels, these were important messages. If you or other participants have further examples of problems in your dealings with central government you want to draw to our attention, we would be pleased to receive them, as part of our further consideration of how we might help to build a more constructive relationship between government and the third sector.

Again many thanks for inviting us to join you.

I am copying this letter to the other attendees, and to Paul Britton of the BGI (and formerly of the Cabinet Office), who was the lead author of our discussion note working with Leigh Lewis.

Yours ever,

[*Richard* ]

**ANNEX D**

Dear Sir Richard,

It was a real pleasure to attend the dinner last week and take part in a lively debate on an important issue.

If you don't mind, there were just two points I didn't get the opportunity to make on the night that I think are important.  One builds on what I was saying about departmental culture - some being very open to dialogue with the sector and to taking on board its ideas and others adopting a more 50s style isolation.

There is a risk of throwing baby out with bath water.  The Government has, on the whole, had a relatively productive relationship with the sector in recent times.  However, the rhetoric used to voice Governmental displeasure at the style of campaigning of some of the bigger charities has been too broad and all-encompassing and has served to undermine confidence in the sector as a whole, especially around its influencing activities.   'Sock puppets' has been used as a term of abuse and a former minister for civil society has recommended that the sector 'sticks to the knitting'. These are but two examples of many I could quote. This sort of talk cannot fail to have an effect on how much weight is given by senior civil servants and those around Government towards involving charities in consultations and 'critical friend' activities.  They set a tone which then can go on to define the culture, exacerbated obviously by other negative stories about charities.

Secondly, my experience of funding quite a lot in this area is that the quality of advocacy organisations that contribute to Government thinking varies wildly.  I have met excellent chief executives and policy officers who can be trusted to provide knowledgeable and evidence based input to Government thinking while I can think of some who have no legitimate constituency and are removed from the issues on which they purport to speak with authority.  Sometimes, it pays for ministers and civil servants to look beyond the 'usual suspects' - towards people on the ground who routinely have both a closer 'hands on' working knowledge of the issues and a strategic head on their shoulders.  I wonder whether foundations, with no axe to grind,  may have a role in helping Government navigate what can be confusing landscape.

Thank you for listening and I wish you well with your work.

Kind regards

John Mulligan

Senior Grants Manager

Esmee Fairbairn Foundation