Privatisation of Public Services
and
The Role of Social Enterprises

An Overview

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Privatisation of Public Services and The Role of Social Enterprises

1. Introduction and History

This paper focuses on privatisation during the 1980s to the present day, with special emphasis on the role of the social enterprise in the area of commissioning. Privatisation momentum is often cited as having attained its peak under the leadership of Ronald Regan in the USA and Margaret Thatcher in the UK. However, as Megginson and Netter[1] point out, it should be kept in mind that although it is tempting to conclude the debate on the economic and political merits of government versus private ownership by looking at the past two decades, such a conclusion would be flawed. This is because 25 years ago supporters of state ownership could just as easily have concluded that their model of economic organisation was winning the intellectual battle with free market capitalism after only surveying the post-war rise in the number of state-owned enterprises.

Governments took a more active role in the ownership, production and delivery of different goods and services following the Depression, World War II and the break-up of colonial empires.

However, the first large-scale ‘denationalisation’ programme of the post-WWII era was in the Federal Republic of Germany in 1961. This involved selling a 60% stake in Volkswagen in a public share offering to 1,500,000 Germans[2]. This was followed by an even larger government offering of shares in Vereinigte Elektrizitäts und Bergwerks (VEBA), a coal, chemicals and electric power giant. Although both offerings were received favourably, after the first cyclical downturn in stock prices, the government was forced to bail out many small shareholders[3].

In the UK, under the Labour government of 1974-79 some of the state’s shareholding in the petroleum company BP was sold. However, this sale was driven primarily by budgetary pressures and did not reflect a belief within government that state industries should be privatised[4].

It was not until years after this that privatisation became established as a basic economic policy in the UK. Britain’s privatisation experiment started out cautiously. Privatisation was not cited in the Conservative’s manifesto of 1979[5] and was strongly opposed by unions and the opposition party at the time[6].

In November 1984, the largest UK privatisation was launched. British Telecom was successfully privatised through an initial public offering for a 50.2% stake. The remainder of the shares were sold by the government in two further tranches, in December and July 1993[7].

This was followed by larger share issue privatisations (SIPs) during the 1980s and peaking in the early 1990s under the Conservative governments of Margaret Thatcher and John

[1] Megginson and Netter, 2001
[2] West Germany: Denationalizing, Time Magazine, 1964,
[3] Megginson and Netter, 2001
[4] Parker, 2004
[5] Parker, 2004
[6] A whole world sold on sell-offs, 22/11/2000, The Guardian
[7] Parker, 2004

Major. Over 18 years, the contribution of state owned enterprises was reduced from over 10% GDP to almost nothing by 1997[8]. The table below shows a timeline of the privatisation of major state owned enterprises in the UK from 1981 – 1990.

Organisation	Sector / Product / Service	Date of Privatisation
Cable & Wireless	Telecommunications	October 1981
Amersham International	Science based products	February 1982
Britoil	Oil	November 1982
Associated British Ports	Transport	February 1983
Enterprise Oil	Oil	February 1984
Jaguar	Automotive	July 1984
British Telecom	Telecommunications	November 1984
British Gas	Utilities	December 1986
British Airways	Transport	February 1987
Rolls-Royce	Automotive	May 1987
British Airport Authority (BAA)	Transport	July 1987
British Steel	Steel	December 1988
Regional water companies	Water	December 1989
Electricity distribution companies	Electricity	December 1990

TABLE 1 - TIMELINE OF BRITISH PRIVATISATIONS - 1980 - 1990[9]

Please see the Appendix for a summary of privatisation activities worldwide.

8 Megginson and Netter, 2001
9 A whole world sold on sell-offs, 22/11/2000, The Guardian

2. Theory

The general argument for privatisation of state owned enterprises is that free market competition forces lead to the more efficient delivery of products and services. It is argued that the incentive of having to compete for customers leads to more choice, lower prices, improved quality, less bureaucracy and quicker delivery.

Parker[10] summarises two of the main economic theories that provide a strong rationale for privatisation as follows:

"Principal-agent theory and its implications for effective corporate governance suggest that in privately-owned enterprises management faces superior incentives to drive out waste and maximise productivity. While public choice theory maintains that within government, as elsewhere in the economy, self-interest is the dominant motive, with the result that state ownership is associated with empire building, gold plating of public investments, over-manning and, in general, economic waste. Together, principal-agent theory and public choice theory provide a powerful theoretical rationale for privatisation."

The general goals of privatisation can thus be summarised as follows[11]:

1. Raise revenue for the state
2. Promote economic efficiency
3. Allow for specialisation in production
4. Reduce government interference in the economy
5. Promote wider share ownership
6. Provide the opportunity to introduce competition
7. Subject state owned enterprises to market discipline
8. Develop the national capital market
9. Lessen demands on tax payers through reduced public spending
10. Allow for production to be more responsive to needs
11. Bring in more entrepreneurialism and skills[12]

For analysis about whether the UK achieved these economic goals, see the Appendix for a summary of the review of empirical studies of the impact of UK privatisations on economic performance by Parker[13].

There are many different types of privatisation, below are summaries of the main types[14].

1) Privatisation through the sale of state owned assets – this is where the government trades ownership for an explicit cash payment. Within this category, there are usually two approaches:
   a) **Direct sales** of a state owned enterprise or part of to an individual, corporation or group of investors.

[10] Parker, 2004
[11] Megginson and Netter, 2001
[12] Several studies highlight the need to bring new entrepreneurial management into privatized firms to maximize performance improvements. See Megginson and Netter, 2001
[13] Parker, 2004
[14] See Megginson and Netter, 2001 and Poole, 1996

b) **Share Issue Privatisation (SIP)** - sale of the government's shares in a company are sold to a private investor through a public share offering.

Both of these divesture forms of privatisation allow the government to receive a one time windfall from the sale.

2) **Mass/Voucher Privatisation** – vouchers are issued for free or at nominal cost to citizens who are able to use them to bid for shares in a company or asset. This method of privatisation has been used primarily in transition economies in Central and Eastern European economies.

3) **Long-term Franchises –** a private sector organisation provides infrastructure that would otherwise be owned by the government, for example, an airport or bridge. This allows an investor to raise funds through capital markets to build a facility. This means that no public spending is required for the capital and private investors bear the risk rather than taxpayers should a project not succeed.

4) **Competitive Contracting/Outsourcing** - the government puts contracts for services out to tender to the private and third sectors. Examples include UK Local Authority competitive outsourcing of services such as street cleaning, janitorial services and grounds maintenance. In order to win a contract, the provider has to be produce services efficiently which should lead to innovation, lower prices and higher quality services than if a state (or private) monopoly is held over the services.

5) **Public Private Partnerships (PPP)** – any arrangements that involves joint working between public bodies, local authorities or central government, and private companies to deliver a public project or service. PPPs have been adopted across a wide range of public service industries, including defence, education, health, the environment, justice and housing.

6) **Private Finance Initiative (PFI)** – the public sector contracts to purchase services on a long-term basis in order to take advantage of private sector management skills incentivised by having private finance at risk. The private sector partner takes on responsibility for providing a public service, including maintaining, enhancing or constructing the necessary infrastructure and the public sector specifies a level of service in return for an annual payment, called a unitary charge[15].

Further information about PPPs and PFIs can be found at the Partnerships UK website[16]. Partnerships UK is responsible for:

- Supporting complex procurement projects
- Developing procurement and investment policies
- Supporting individual infrastructure projects
- Developing public service commissioning models
- Investing in projects and companies

[15] PFI/PPP Factsheet, PPP Forum, www.pppforum.com
[16] www.partnershipsuk.org.uk

3. Third Sector Provision of Public Services

In more recent years, and particularly during the recent global financial crisis, attention in the UK has turned to the delivery of public services by the third sector[17].

Although under the Conservative governments from 1979 – 1997 state ("council") housing was sold off, privatisation of other welfare services, especially health and education, was seen politically as a step too far[18], the policy objective, under the Labour governments since 1997, has been to transform the UK's £79 billion public service market by widening choice, lowering cost and improving service delivery[19].

3.1. Developments in Third Sector and Government Relationships

The Compact on Relations Between Government and the Voluntary Sector was introduced in 1998 and is an agreement to improve relationships between government and the voluntary sector to mutual advantage. The commitments in the Compact apply to all central government departments and agencies, including non-departmental public bodies, regional government offices and local public bodies[20]. The Compact recognises the independence of charities and voluntary organisations from government, and their right to exercise that independence irrespective of funding.

Although the Compact is not a legally binding agreement, all public authorities should acknowledge and adhere to its principles. This is important to commissioning of public services from the third sector as the Compact's codes of practice specify public authorities should cover the full cost incurred by a charity that it is purchasing a service. This means that a charity is empowered to negotiate for more funding, reduce its service or reject the funding agreement if the funding offered by the government does not cover the costs of service delivery[21].

Indeed, now, all political parties now have recognised that involvement of the third sector in public service delivery is another way to make progress on reform[22]. Building on the support for the Compact and the increased momentum in third sector public sector service delivery, The Social Enterprise Coalition has set out its Social Enterprise Manifesto[23] in the run up to the next UK general election in 2010. It calls for social enterprise to be the choice for transforming and revitalising underperforming public services, for reconnecting with service users and rebuilding trust.

[17] The term 'third sector' is used to represent organisations such as charities, social enterprises, co-operatives and voluntary and community groups. The UK's Office of the Third Sector defines third sector organisations' characteristics as:

- non-governmental
- value-driven
- principally reinvest any financial surpluses to further social, environmental or cultural objectives

[18] Parker, 2004
[19] Mills, 2009
[20] Rocket Science UK, 2008
[21] Charity Commission website: http://www.charity-commission.gov.uk/publications/cc37.asp
[22] Hopkins, 2009
[23] Social Enterprise Coalition, 2010

Not only is the delivery of public services being offered to the third sector, but also assets held by the state. The Community Assets Programme, launched in 2007, is a £30 million programme that aims to "*empower communities by encouraging the transfer of underused local authority assets to local organisations. The fund provides grants for refurbishment of local authority buildings, to ensure that high-quality spaces and facilities are transferred to third sector ownership*"[24]. Local authorities were given the legal right to sell assets at "less than best value" if transfer will improve environmental or social wellbeing[25]. In June 2009, it was reported that a total of 38 buildings were expected to be transferred from local authorities to charities and community groups under the scheme and a further four by 2011[26]. An evaluation of the success of the Community Assets Programme is expected to be completed in late 2010.

3.2. Why Use the Third Sector for Public Service Delivery?

Proponents of third sector provision of public services tend to focus on the premise that by being closer to the service users, the third sector should be able to deliver more user focused services. It has been argued[27] that private companies operating in competitive markets generally pursue purely economic ends and focus on fulfilling the needs of a contract agreed with the public sector – which, in order to be measurable, are often output-based – rather than focusing on the outcomes for the user and the wider community. The emphasis is placed on the user even further by taking public service provision out of the hands of politicians and policy makers.

However, as with the privatisation of state owned enterprises in the 1980s, there is little evidence of the long term outcomes of allowing third sector organisations deliver public services.

Prominent opponents such as Unite, the two million member trade union, have spoken out against social enterprise provision of public services as another form of privatisation where services (the NHS in particular) are divided up for the benefit of private profit[28].

Where there have been studies into third sector effectiveness in delivery of public services, results have been mixed. As Hopkins[29] indicates in the results of research into 1,231 user experiences in three areas of public service delivery – employment, domiciliary care for older people, and social housing – covering organisations from the public, private and third sectors:

"Based on reputation, third-sector providers should do well on delivering factors such as dignity and respect, sorting out problems properly and acting on comments. But our research shows that they do not always excel.

For example, in social housing third-sector providers are no more likely than public sector landlords to treat tenants with dignity and respect. In more personalised services, such as

[24] Office of the Third Sector website: http://www.cabinetoffice.gov.uk/third_sector/community_action/community_assets.aspx
[25] "Community Assets programme launched" Third Sector, 06/09/ 2007
[26] "Thirty-eight buildings to transfer to charities, Angela Smith reveals", 26/06/2009, Third Sector
[27] Bland, 2009
[28] Health B4 Profit Campaign, Unite website http://www.unitetheunion.com/sectors/health_sector/health_b4_profit_campaign
[29] Hopkins, 2009

domiciliary care, more than three-quarters of service users said they were good. But the private sector came out even better. Third-sector providers did, however, stand out in employment services, where nine out of 10 service users said they were treated with dignity and respect.

[...] Crucially, consumers wanted to feel they could trust public service providers and wanted more sense of a community – a factor on which third-sector organisations were no "better" than private or public providers."

Hopkins concludes that *"The third sector does best where it is providing services that focus on particular groups and getting an insight into their needs, for example in employment services. But the third sector does not have a monopoly in providing a human touch. In fact private providers of domiciliary care for older people do better in this respect. And there are other instances where the third sector does not stand out at all from public-sector providers, for example in social housing."*

This demonstrates that often public services may be best coordinated and delivered by the state, the private sector and the third sector depending on the skills, experience and infrastructure that exists and can be developed.

Access to finance is cited[30] as a major barrier to entry for many third sector organisations in the delivery of public services. Commercial banks' cultural misunderstanding of third sector organisations, slow payment of services by government and banking products that are geared towards the private sector often form barriers for third sector organisations to secure loan finance from banks[31]. Steps are being taken to improve the finance options for third sector organisations, for example the establishment of the Social Enterprise Investment Fund that invests in social enterprises that provide health services (see the Appendix for more details).

Private financing for third sector organisations to deliver public services is also being explored by some organisations, through social impact bonds. As with PFIs between the private sector and the public sector, social impact bonds require a contract to be negotiated with the government. Once the contract is in place, investment is raised from non-government investors. This investment is used to finance a range of interventions to improve the target social outcome over the contract period (around 5 years). If the interventions are successful and the social outcomes improve, government pays investors a reward based on the pre-agreed payment schedule. The risk of financing is therefore borne by the private investor[32]. See the Appendix for a comparison between social impact bonds and the more traditional outcomes based commissioning that the third sector currently uses.

In addition, further evidence of achievements and improvements is needed in the third sector in order for the staunchest of opponents to be convinced. Steps to collecting such evidence are being taken for example through establishing methodologies such as calculating social

[30] Mills, 2009
[31] Palmer, 2009
[32] Social Finance, 2009

return on investment[33] and the creation of research centres such as the government funded Third Sector Research Centre which opened in 2008.

3.3. Private Sector and the Third Sector

Of special interest is how the private and third sectors are working together to deliver outcome focused services on behalf of government. .For example, the government's commissioning strategy in some instances seeks to establish longer (5-7 years) and larger contracts, contracting with what are known as Prime Contractors. In many cases these are private sector companies; sometimes they are consortiums where one partner is the lead contractor acting on behalf of a number of providers in partnership.

The Prime Contractors in turn subcontract some of the service delivery to third sector organisations, managing the payment and performance of the sub-contractors. The Prime Providers are required to sign up to a Code of Conduct and to provide letters of intent from their main sub-contractors.

Organisations usually go through a PQQ process that assesses the bidders capacity and capability to deliver the service and includes a quality and financial assessment. The next step for those invited is to submit a full tender and to participate in a negotiated process and a number of evaluation steps which may lead to de-selection. The successful bidder then is awarded the contract. Typically the process may take 78 weeks from publication of the PQQ to the contract going live.

There are number of challenges to third sector sub-contractors. New skills are needed, pricing based on full cost recovery plus needs to be in place, robust monitoring and performance measurement are essential, and cash flow is an issue. They have to be able to identify and negotiate with the Prime Contractor. Issues such as cultural differences and the potential of conflicting ends – triple bottom line vs. profit maximisation – need to be addressed and managed. It is important to note that this is in effect a marketing and sales process, essentially commercial in nature.

[33] See New Economics Foundation's website (www.neweconomics.org) and publications, including "A Guide to Social Return on Investment" (2009) and "A Bit Rich" (2009) for further information on social return on investment methodologies and examples.

4. Issues/Risks

Studies have indicated that on the whole, privatisation of state owned enterprises is successful. Divested firms almost always become more efficient, more profitable, increase their capital investment spending, and become financially healthier[34]. However, there are many opponents to privatisation of state owned enterprises and of welfare services. These include trade unions, consumer groups and politicians. Below are some of the risks and issues that arise in the discussion of privatisation.

Pursuit of profits – opponents to privatisation argue that in a competitive market, private companies must charge the highest price that the market can bear in order to achieve productive efficiency and profits, which is not compatible with social goals of services such as education and health. Essential parts of a service may be cut if they are not deemed profitable, for example providing paid for healthcare services in deprived areas. The example below demonstrates some of the undesirable effects that competition and the pursuit of profits can have on previously state controlled industries.

National Express[35]

In 1980 inter-urban coach services were opened up to competition with some resulting success in terms of lower fares and improved services. However, National Express, originally state owned, maintained dominance in the sector assisted by its entrenched position operating out of Victoria coach station in London. In 1992 National Express was floated in the stock market. In 1985 local bus transport was also liberalised (except for services in London) and tenders for routes were organised. The overall results were less positive. A number of towns faced a concentration of services on the profitable routes, some saw unruly competitive practices such as cutting in front of competitor buses to reach passengers first, and experienced other practices aimed at driving out rival operators. During the late 1980s many local bus services were privatised and, while total costs per passenger journey fell, fares rose and the long-term trend of a decline in bus passengers continued outside of London The industry quickly consolidated and the UK competition authorities on a number of occasions investigated anti-competitive practices in the industry, especially the suspected use of predatory pricing.

Accountability – although it can be argued that there is greater control and accountability in a private firm as it has to account to its shareholders, there is also a lack of accountability to the public. The public (through the government) therefore has less/no control over the actions of privatised state owned enterprises.

Job Losses – Job cuts are often the most publicised area of privatisation. Reduced employment is generally a means to reduce costs and increase efficiency in a company. Indeed, research shows that in most cases, employment in privatised firms falls but whenever employment is cut, there is almost always a large compensating performance improvement[36]. If an enterprise is not profitable, further job cuts are likely as private enterprises is likely to close if losses are made, whereas if in state hands, government

[34] Megginson and Netter, 2001
[35] Extract from Parker, 2004
[36] Megginson and Netter, 2001

subsidies could keep them open[37]. Job losses in the short run can cause living standards to fall and poverty to rise if large sections of a community were employed by a state owned enterprise.

Concentration of wealth – wealth that is created by a privately owned company will be distributed to its shareholders. Whereas in a state owned company, profits are received by the government and therefore distributed to the wider public.

Long term outcomes – the UK's privatisation programme, although extensive, has only been in progress over 30 years. In that time, some industries have flourished under competition, bringing in better and more services and lower costs for consumers, for example in telecommunications. In other cases, such as British Rail (see below for more details), consumers have suffered from poor service, safety concerns and high prices. As mentioned above, more recent developments to allow non-governmental organisations to run public welfare services have not yet produced concrete results to prove the benefits overall. In the case of PPPs for example, it is unknown as yet what the long term cost savings to taxpayers as may raise capital more cheaply than the private sector[38].

The case of the long term PPPs between the government and the private sector for London Underground is an example of how the outcomes of PPPs are not always beneficial and can lead to large government spending to bail out failed companies.

Transport for London and Metronet PPP[39]

Before the Tube was transferred to Transport for London (TfL), and despite TfL's concerns about the Public Private Partnership (PPP) structure, the Government adopted the PPP as its preferred solution for investing in the Tube.

Under the 30-year PPP contract, three infrastructure companies (infracos) were responsible for the maintenance and renewal of London Underground's (LU's) assets - its rolling stock, stations, tracks, tunnels and signals.

The Tube network is divided into three infraco groupings. Tube Lines remains responsible for the Jubilee, Northern and Piccadilly lines (JNP) under the PPP contract.

This requires that they deliver a certain level of daily asset performance, and that they upgrade the assets to deliver improved capability in the longer term. They are subject to financial incentives or penalties based on their delivery against the performance levels set out in the contract.

In May 2008 the two Metronet infracos transferred to Transport for London (TfL) following a period in Administration after costs for its projects spiralled out of control. Subsequently all Metronet staff transferred to London Underground (LU) in December 2008.

The Mayor and Secretary of State for Transport confirmed in October 2009 that LU would remain responsible on a permanent basis for the maintenance and renewal of the former Metronet lines.

In 2009, The National Audit Office investigation revealed that the collapse of Metronet cost the taxpayer between £170m and £410m[40]

[37] For example, in 2002, UK Coal (the company that took over most of the UK coal industry when it was privatised) announced the closure of the Selby coal mine due to combined losses of £35m. This caused job losses of 5,000. See: "UK Coal to close Selby with 5,000 job losses", 15/07/2002, The Independent
[38] Parker, 2004
[39] Transport for London Website: www.tfl.gov.uk unless other sources quoted.

5. Examples of Privatisation

5.1. Privatised State Owned Enterprises

5.1.1. British Telecom (BT)

During the 1980s, the telecommunications sector in the UK experience fast technological change, such as optical fibre cables, new switching gear and wireless-based technologies. These advances reduced the earlier monopoly position that BT had in the market. It also required large-scale investment to meet the anticipated increase in demands for services such as data transmission and mobile phones[41]. The UK government, suffering from a budget deficit felt that it would be unable to meet these investment demands.

In 1983 the decision was taken to privatise BT. British Telecom was successfully privatised through an initial public offering for a 50.2% stake in 1984. The remainder of the shares were sold by government in two further tranches, in December and July 1993[42].

As the UK government was concerned that the London stock market would not absorb what was then the largest single flotation in the market's history, it mounted a campaign, including TV and press advertising, to attract the small investor. The result was an outstanding success demonstrated by the oversubscribed IPO.

The Office of Telecommunications (OFTEL), a regulatory body, was set up to protect consumers from monopoly abuse until competition developed. As Parker (2004), notes, this privatisation was a landmark in the UK's privatisation 'experiment' as:

"Firstly, the sale of BT established the principle that the public utilities could be sold-off in spite of their size; secondly, Oftel became the regulatory model for later sector regulatory offices for gas (Ofgas), water and sewerage (Ofwat), electricity (Offer) and the railways (ORR); and thirdly, the sale proved that small investors could be attracted if the shares were sold at a discount."

On 5th March 1991, the Government issued its White Paper 'Competition and Choice: Telecommunications Policy for the 1990s'. This effectively ended the duopoly which had been shared by British Telecom and Mercury Communications in the UK since November 1983 and built up to privatisation. The new policy enabled customers to acquire telecommunications services from competing providers using a variety of technologies, making it fairer and more open. Independent 'retail' companies were allowed to buy telecommunications in bulk capacity and sell it in packages to business and domestic users[43].

Overall, it was reported[44] that the BT privatisation was a success in that the average annual rise in labour productivity was around 15%. However, this was at the cost of reducing the

[40] "Collapse of tube contractor Metronet could cost taxpayer £410m", 05/06/2009, The Guardian
[41] Parker, 2004
[42] Parker, 2004
[43] BT website, www.btplc.com
[44] Parker, 2004

labour force - BT employment declined from around 238,000 at privatisation to 124,700 by 1999[45].

5.1.2. British Rail

Interestingly, British Rail was created due to the nationalisation of four British railway companies in 1948. Between 1948 and 1996 it was the main operator of rail transport in the UK. In 1991, the EU Directive 91/440 - legislation that sets out a framework and requirements for railways in the EU to allow open access operations on railway lines by companies other than those that own the rail infrastructure – came into force. Although this does not state that any part of the railway system has to be privatised, the Major government set about dividing up the UK's railways and selling off the constituent parts.

These parts were: an infrastructure operator, Railtrack (responsible for lines, signalling and major stations), 25 passenger train operating companies, 6 freight service companies (three were merged into one to facilitate a successful sale), 3 companies leasing rolling-stock (known as Roscos) and numerous rail maintenance businesses and other specialised activities[46].

Initially, Railtrack was successful. It made profits and had a high share price. However, soon after privatisation, its weaknesses became apparent. Railtrack's Board only had two engineer members and the company relied on buying in skills and expertise as it needed them – acting as an uninformed buyer of others' knowledge and technology and becoming dependent on external consultants at a huge cost. Railtrack also adopted a policy of replacing assets only when necessary rather than at fixed time intervals meaning that there was no comprehensive database of the conditions of tracks[47].

Railtrack subsequently suffered from a series of fatal rail accidents in Southall, Ladbroke Grove, Hatfield and Potter's Bar. The fragmentation of the rail system and the neglect of the tracks by Railtrack caused many to wonder if privatisation had led to this fall in passenger safety. Passenger numbers fell as speed restrictions were introduced onto the lines which cost the company cost an estimated £641 million[48].

In addition, it is argued that the profit motive of the private company led to a lack of investment into the rail system. Railtrack's objective was to be able to finance its activities, including the returns required by the capital markets. With direct government grants and subsidies, Railtrack was estimated to have received £10 billion of government support from 2001 to 2006 (about 70% of its total income). Furthermore, Railtrack chose to distribute dividends to shareholders (amounting to £709 million between 1995–1996 and 2000–2001, which was equal to 41% of the total operating profits and £134 million in 2001). This was seen as a major cash leakage and was made at the cost of further investment into the industry[49].

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[45] Parker, 2004
[46] Parker, 2004
[47] Compton and Jupe, 2007
[48] Compton and Jupe, 2007
[49] Compton and Jupe, 2007

In October 2001, the government placed the Railtrack into administration, and shortly afterwards announced that its successor would be a not-for-profit company limited by guarantee, Network Rail.

As Crompton and Jupe conclude, Railtrack did not work as a privatised company as "*the normal conditions for the proper functioning of capitalism were not present. These were a clear product to sell, in competitive conditions, with investment rewarded by greater output and higher profits. On the railways, in contrast, capacity was limited and the cost of expanding it was prohibitive. The supplier could not be allowed to go bankrupt and the taxpayer picked up the bill when things went wrong.*"

5.2. Public Private Partnerships[50]

5.2.1. Skynet 5

Skynet 5 is a £3.6bn project which provides satellite communication services to the MOD. Signed in October 2003 and running until at least 2020, it includes the design, build, and operation of three new satellites which went in to orbit during 2007 and 2008. Skynet 5 is now fully operating and is playing a crucial role in the British Military's activities in Afghanistan and around the world. Skynet 5 is not only the largest satellite project in Europe, it is also the only military satellite project in the world run by the private sector.

Paradigm, which is 100% owned by EADS (the European Aeronautical Defence and Space Company), is responsible for delivering the project, controlling the satellites, managing the network and implementing all upgrades throughout its life.

The key components of Skynet are the three Skynet 5 satellites, which were designed, built and launched by EADS Astrium for Paradigm. They are the most powerful military satellites launched to date by any European nation.

It is estimated that Skynet 5 has two-and-a-half times the capacity of Skynet 4, allowing British Forces to transmit much more data, faster between command centres. For example Skynet 5 enables the transmission of real time video images which has allowed RAF personnel to use Reaper, a robot surveillance plane system, in the Afghanistan conflict with some considerable success.

As part of the PFI project Paradigm has also taken on the operation of the 6 satellites which make up the Skynet 4 programme, which had previously been owned by the MOD and which are expected to be operational until around 2012. The project also involves the replacement and updating of (earth-based) control centres, as well as antennas and terminals installed on planes, ships and land vehicles.

To help meet the challenges posed with maintaining satellites, Paradigm has a specialist team of 220 and another 100 or so full-time sub-contractors.

The original plan for Skynet 5 was to launch only two satellites. However the premiums quoted to insure against loss on the two satellites were prohibitively expensive and

[50] For further details and case studies, see PPP Forum website: www.pppforum.com

Paradigm realised that it would be cheaper, and achieve the same objective, to launch a third satellite financed by money that had been set aside for insurance. Having cleared this with the Mod, Paradigm launched the third satellite in June 2008.

The PFI procurement route made it possible for Paradigm to use this cheaper way of protecting the Skynet 5 satellites against loss which, in the event, has the added benefit of significantly adding to the capacity of the project through the addition of an extra satellite. Malcolm Peto, the Managing Director of Paradigm, believes that this would not have been possible if the project had been procured conventionally.

Paradigm guarantees the MOD a proportion of the satellites' bandwidth and any spare capacity can be sold to any nation on an approved list of predominantly NATO countries. Currently Paradigm are selling capacity to the US, Portugal, Holland, France, Germany and Australia for which the MOD receives a gain-share when certain levels of income are achieved.

5.1. Third Sector Provision of Public Services

5.1.1. GLL[51]

GLL is a charitable social enterprise that manages 70 leisure centres in London in partnership with thirteen London Boroughs. It states its mission as: "*The provision of leisure and fitness facilities at affordable prices. It is our aim to ensure financial viability of GLL, meet our charitable objectives, increase employee participation, maintain and expand our services. We will endeavour to continually exceed our customers' expectations".*

In 1993 Greenwich Council faced severe rate capping, and proposed an additional 30% cut in the funding of leisure centres. The service impact of this was the closure of two or three leisure centres and a 28% loss of permanent staff.

A review instigated by Cllr Bob Harris, Chair of Leisure Services Committee (in London Borough of Greenwich), recommended a not–for–profit organisation to manage the Council's leisure facilities with continued influence rather than control from the council.

A Society for the Benefit of the Community, registered under the Industrial & Provident Societies (IPS) Act, was recommended and adopted. This structure held particular appeal due to the ability for staff of the Society. The existing seven leisure centres were transferred to the new organisation – Greenwich Leisure Limited (GLL) in July 1993.

The new organisation quickly proved to be a great success in the London Borough of Greenwich. Instead of cuts, new jobs were created and new services delivered in the existing centres. In addition three new facilities have been built since 1993 – two leisure centres and a health and fitness centre.

Expansion since 1993 has seen GLL working in partnership with the London Borough of Barnet, Camden, Ealing, Hackney, Hammersmith and Fulham, Lambeth, Merton, Newham, Sutton, Tower Hamlets and Waltham Forest as well as working with Epsom and Ewell

[51] www.gll.org

Borough Council, Reading Borough Council, Bellingham Community Project, London Development Agency and the London Playing Fields Foundation and currently operating over 65 leisure facilities.

GLL is co-owned by its staff and reinvests its profits into the business to help economically and socially disadvantaged people access leisure facilities. It trains young people through its academy programme to develop skills to become leisure managers in the future.

Membership levels across GLL have also risen from an initial 7,000 at the time of the transfer (1993) to around 250,000 total memberships in 2006.

5.1.2. The Bromley by Bow Centre[52]

The Bromley by Bow Centre is a community organisation in East London. It works in one of the most deprived wards in the UK to support families, young people and adults of all ages to learn new skills, improve their health and wellbeing, find employment and develop the confidence to achieve their goals and transform their lives.

The Bromley by Bow Centre was established in 1984 after the Reverend Andrew Mawson came to this area as the Minister of the local United Reformed Church. He found a dwindling, elderly congregation, and recognised that if the Church was to survive it needed to adopt a different approach. After opening up the building to the local community, the Church started a nursery, helping to meet the need for good quality childcare in Bromley by Bow. This helped set the pattern for the development of the Centre: responsive to the needs of the community, and using the buildings and facilities in imaginative and resourceful ways.

Today, the Bromley by Bow Centre is an organisation with a turnover of more than £3m a year and over 100 staff. It is the third largest provider of adult education in the Borough of Tower Hamlets and has launched numerous spin-off businesses.

5.1.3. HCT Group[53]

HCT Group is an award-winning social enterprise, delivers transport services across London and in Yorkshire. Hackney Community Transport was founded in 1982 by a number of local community groups in the London Borough of Hackney with the aim of providing affordable community transport services for the use of local voluntary organisations, charities and community groups. Today, HCT Group is a successful social enterprise delivering a series of innovative public and community transport and training services.

HCT's community transport services have expanded through a merger with Lambeth and Southwark Community Transport and the expansion of its existing services from London into Yorkshire. Its training services help to raise employability levels in London. HCT is now one of the suppliers of red bus services for Transport for London (the local government body responsible for most aspects of the transport system in Greater London).

[52] www.bbbc.org.uk
[53] www.hctgroup.org

HCT's trading arms are incorporated as Community Interest Companies which employ over 400 people and generate a turnover of more than £15m. Profits generated from the company's activities are re-invested in the development and provision of its services.

5.1.4. Central Surrey Health[54]

Central Surrey Health (CSH) not-for-profit organisation that provides community nursing and therapy services to the people of central Surrey in South Eastern England. Initially operating from within the East Elmbridge and Mid Surrey Primary Care Trust, the organisation is now a separate body which exists to serve the local community. CSH is co-owned and run by the nursing and therapy teams it employs.

In January 2005 the East Elmbridge and Mid Surrey Primary Care Trust (PCT) began to review the options for the future provision of nursing and therapy services in mid-Surrey. The review covered nursing and therapy staff working in the community, in patients' homes, in community hospitals and in acute hospital teams. The review took place against a background of important national developments.

Developing government policy suggested a change in the balance of PCTs' activity away from providing services themselves towards commissioning more services from a wide range of other providers including organisations in the public, private, voluntary, charitable and not-for-profit sectors. At the same time, the Department of Health encouraged the development of more treatment and therapy services in or close to patients' homes.

The review examined all possible options including models such as care trusts, community trusts, children's trusts, partnership arrangements with local GPs and private sector companies. The review demonstrated that patients in this area would be best served through the establishment of a not-for-profit, limited liability company owned by (and employing) local nurses and therapists. This approach, coupled with a commitment to organisational investment in the community, is sometimes referred to as a social enterprise model.

An outline Business Case was presented to the PCT Board in July 2005 where it received support in principle. After three months operating in shadow form within the PCT Central Surrey Health was formally established on 1 October 2006.

Central Surrey Health is the first organisation of its kind so in many ways the blueprints have been drawn up around it. It has drawn on the talents of therapists and nurses to develop an organisation which will be more suited to the challenges ahead.

Central Surrey Health employs around 650 staff who formerly delivered community nursing and therapy services from within the PCT. They are:

- District nurses
- Community hospital nurses
- School nurses
- Specialist nurses
- Health visitors
- Nursery nurses

[54] http://www.centralsurreyhealth.nhs.uk

- Physiotherapists
- Podiatrists
- Dieticians
- Speech and language therapists
- Occupational therapists
- Support and administrative assistants

On transferring to Central Surrey Health all staff were presented with a single share in the company. As co-owners, they are responsible for delivering patient services and shaping the company's future.

6. Summary

The process of privatisation of government services is still growing in the UK with private companies and third sector organisations being involved; sometimes in competition with each other, sometimes as service delivery partners. Third sector involvement in privatisation or commissioning has been growing in recent years to the point where it is 39% of social enterprise income and over 50% of charity income.

The paper outlines the different types of privatisation and some of the benefits such as raising revenues for government, potentially creating efficiencies and reducing public expenditure, and if done properly bringing in more entrepreneurial culture and skills; as well as pitfalls such as the inherent conflict between maximising profit and ensuring public good, a lack of societal accountability, job losses, and the concentration of the financial benefit to shareholders in the long term as opposed to the general public through government. Sometimes, government has found it necessary to bail out the private sector provider.

It is important to note that social enterprises in the UK are performing better than the private sector during the current recession. In addition, third sector organisations may grow to very large sizes, inherently capable of competing with the private sector.

There are inherent risks to government and the corporate and third sectors in the process and careful study and business planning should be part of the evaluation process and once in place a transparent approach to privatisation is essential. Ensuring the measure of outcomes and not just outputs is but one way to manage the risks.

The role of the third sector in public service delivery is explored. Some are against this for ideological reasons, others opposed because it may not always be effective or efficient. Many are supportive of this approach, especially when compared to private sector involvement as the ends of the charity and the government in solving particular social problems are similar, not generally creating a conflict between meeting shareholder need to maximise profits and returns and the social need being met by government and the third sector. In the case of third sector organisations the ‘profits’ are invested back in the community.

However, for third sector organisations there are issues that should be addressed in any process of privatisation. For example, having available financing is crucial. Cash flow is an issue. In the UK the social investment market is growing and any government planning to privatise should consider this so that there is a level playing field.

Some examples of various sizes are described in the paper to demonstrate the various approaches and models.

In summary, much is to be learned from the experience in the UK and other countries. Benefits may be achieved. However, there are major risks to be recognised and managed. The debate continues as to the efficacy of privatisation and to what services it is best applied and by whom.

7. Appendices

7.1. References

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7.2. Summary of Privatisation History Worldwide

Extract from: Section 2 of Megginson and Netter, 2001:

The perceived success of the British privatization program helped persuade many other industrialized countries to begin divesting State Owned Enterprises (SOEs) through public share offerings. Jacques Chirac's government, which came to power in France in 1986, privatized 22 companies (worth $12 billion) before being ousted in 1988. The returning Socialist government did not execute any further sales, but neither did it renationalize the divested firms.

Beginning in 1993, the Balladur government launched a new and even larger French privatization program, which has continued under the Jospin administration. The Socialists, in fact, launched the two largest French privatizations ever, the $7.1 billion France Telecom initial public offering (IPO) in October 1997 and the subsequent $10.5 billion seasoned France Telecom issue in November 1998.

Several other European governments, including Italy, Germany, and, most spectacularly, Spain, also launched large privatization programs during the 1990s. These programs typically relied on public share offerings, and were often launched by avowedly socialist governments. Privatization spread to the Pacific Rim, beginning in the late 1980s. Japan has sold only a relative handful of SOEs during the past 15 years (usually relying on SIPs), but many of these have been truly enormous. The three Nippon Telegraph and Telephone share offerings executed between February 1987 and October 1988 raised almost $80 billion, and the $40 billion NTT offer in November 1987 remains the largest single security offering in history. Elsewhere in Asia, governments have taken an opportunistic approach to SOE divestment, selling pieces of large companies when market conditions are attractive, or when money is needed to plug budget deficits. It is unclear how the economic difficulties that gripped the region during the late 1990s will impact privatizations in the future.

Two Asian countries deserve special attention. These two countries are already the world's second and fifth largest economies on a purchasing-power-parity basis, and promise to become even more important over time.

The People's Republic of China launched a major economic reform and liberalization program in the late-1970s that has transformed the productivity of the Chinese economy. While there have been numerous small privatizations, there have been relatively few outright sales of SOEs, thus the overall impact of privatization has been limited. Though the government recently reaffirmed its commitment in 1999 to privatizing all but the very largest state enterprises, the fact that Chinese SOEs are burdened with so many social welfare responsibilities suggests that it will be extraordinarily difficult to implement a privatization program large enough to seriously undermine the state's economic role.

The other special Asian case is India, which adopted a major economic reform and liberalization program in 1991, after being wedded to state-directed economic development for the first 44 years of its independence. India's reform program shares two key features with China's: it was adopted in response to highly disappointing SOE performance and privatization has thus far not figured prominently in the reform agenda.

On the other hand, Latin America has truly embraced privatization. Chile's program is particularly important, both because it was Latin America's first and because the 1990 Telefonos de Chile privatization, which used a large American depository receipt (ADR) share tranche that was targeted towards U.S. investors, opened the first important pathway for developing countries to use to directly tap western capital markets.

Mexico's program was both vast in scope and remarkably successful at reducing the state's role in what had been an interventionist economy. Rafael La Porta and Florencio López-de-Silanes (1999) report that in 1982 Mexican SOEs produced 14 percent of GDP, received net transfers and subsidies equal to 12.7 percent of GDP, and accounted for 38 percent of fixed capital investment. By June 1992, the government had privatized 361 of its roughly 1,200 SOEs and the need for subsidies had been virtually eliminated.

Several other countries in Latin America have also executed large divestment programs. For example, Bolivia's innovative "capitalization" scheme has been widely acclaimed. However, the most important program in the region is Brazil's. Given the size of Brazil's economy and its privatization program, and the fact that the Cardoso government has been able to sell several very large SOEs (CVRD in 1997 and Telebras in 1998) in spite of significant political opposition, this country's program is likely to remain very influential.

Privatization in sub-Saharan Africa has been something of a stealth economic policy. Few governments have openly adopted an explicit SOE divestment strategy, but Bennell (1997) shows that there has been substantially more privatization in the region than is commonly believed. For example, Steven Jones, William Megginson, Robert Nash and Jeffry Netter (1999) show that Nigeria has been one of the most frequent sellers of SOEs, using public share offerings, although they were very small. The experience of the African National Congress after it came to power in South Africa also shows the policy realities that governments with interventionist instincts face in this new era. Though nationalization and redistribution of wealth have been central planks of ANC ideology for decades, the Mandela and Mbeki governments have almost totally refrained from nationalizations, and have even sold off several SOEs (though use of the word "privatization" remains taboo).

The last major region to adopt privatization programs comprised the former Soviet-bloc countries of Central and Eastern Europe. These countries began privatizing SOEs as part of a broader effort to transform themselves from command into market economies. Therefore, they faced the most difficult challenges and had the most restricted set of policy choices. After the collapse of communism in 1989-91, all of the newly elected governments of the region were under pressure to create something resembling a market economy as quickly as possible. However, political considerations essentially required these governments to significantly limit foreign purchases of divested assets.

Since the region had little financial savings, these twin imperatives compelled many — though not all governments throughout the region to launch "mass privatization" programs. These programs generally involved distributing vouchers to the population, which citizens could then use to bid for shares in companies being privatized. These programs resulted in a massive reduction of state ownership and were initially popular politically, they became unpopular in many countries (especially Russia) because of the largely correct perception they were robbery by the old elite and the new oligarchs. The net effects have been disappointing in some cases but have varied widely.

7.3. UK Privatisation Performance Studies

Summary of findings from studies – table extract from Parker, 2004.

Author(s)	Industry(s)	Main Performance Measures Used	Findings
Hutchinson (1991)	17 UK firms in several industrial groupings	Labour productivity, profitability and technology mix	Privately-owned firms outperformed comparable state-owned firms in the 1970s and 1980s in terms of profitability only. Less certain whether privatisation had improved performance.
Bishop and Thompson (1992)	9 privatised enterprises across a range of UK industries; including BT, British Gas and electricity supply	Labour productivity and TFP, 1970-80 compared with 1980-90	There was higher growth in labour productivity in BT but the growth in TFP fell in the 1980s. In British Gas labour productivity grew at the same rate in the 1970s as the 1980s, while the growth of TFP declined. Electricity supply saw a fall in both labour productivity and TFP growth.
Haskel and Szymanski (1993)	12 privatised firms between 1972 and 1988, including BT, British gas, electricity supply and water	Estimates of productivity growth (output per employee)	In the main productivity has grown faster in the 1980s. Competition is the significant causal factor.
Burns and Weyman-Jones (1994)	Electricity distribution	Multiple input, multiple output model of before and after privatisation using mathematical programming techniques	The 12 electricity distribution companies have been more efficient since privatisation, but this continues a long-term historical trend. There is also a greater diversity of performance amongst the 12 since privatisation.
Parker (1994)	British Telecom (BT) 1979/80 to 1993/94	Productivity and employment costs in total costs. R&D expenditures	Labour productivity grown faster since privatisation, but the record for TFP is much less impressive. Employment costs have declined as a percentage of all costs, continuing a trend that dates back to before privatisation. R&D expenditures as a percentage of turnover have fallen, but this result is difficult to interpret because it may reflect a more efficient use of resources.
Bishop and Green (1995)	6 privatised enterprises including British Gas and BT	TFP and financial data 1989-94	Competition rather than ownership is important. Growth in TFP in BT was in part due to technical change.
Waddams Price and Weyman-Jones (1996)	Gas industry, 1977/78 to 1991	Malmquist indices of productivity growth	Post-privatisation productivity growth was around 5-6per cent per annum compared with 3per cent a year before privatisation in 1986. However, differences remain in technical efficiency amongst British Gas's regions.
Newbery and Pollitt (1997)	Electricity generation	Various	Labour productivity has more than doubled since 1990, mainly due to shedding labour. Real unit costs have declined.
Shaoul (1997)	Water industry	Cost and output data	Greater efficiency gains, meaning lower costs relative to output, occurred prior to privatisation

Author(s)	Industry(s)	Main Performance Measures Used	Findings
Saundry and Turnbull (1997)	Ports	Traffic and financial data including capital expenditure, mainly for the 1980s.	The UK's privatised ports did not perform better than trust ports and municipally-owned docks. Service improvements have came mainly from employment de-regulation (the abolition of the so-called Dock Labour Scheme).
Martin and Parker (1997)	11 privatised organisations studied including British Gas and BT. Years before and after privatisation included.	Labour productivity, TFP, various financial ratios and data envelopment analysis (DEA)	Mixed results with labour productivity growth evident but TFP growth lagging behind.
O'Mahony (1998)	Sectors of UK economy including electricity, gas and water	Labour productivity and TFP in the UK relative to US, France, Germany and Japan	Productivity gap declined in 1995 compared to 1989; but evidence of a closing gap from the 1970s except relative to France.
Parker and Wu (1998)	UK steel industry compared to steel producers in 6 other countries.	DEA analysis of relative input- output efficiency and productivity figures.	A large improvement in relative performance occurred in the British steel industry before the privatisation. Privatisation was followed by a decline in relative performance.
Parker (1999b)	British Airports Authority – largest airport operator in the UK privatised in July 1987	DEA analysis of the relative performance of BAA pre and post-privatisation and the relative performance of its individual airports compared with other airports in the UK privately and publicly owned	No evidence that privatisation had a significant effect on performance. Performance improvements were a continuation of a longer-term trend.
Harris, Parker and Cox (1998); Cox, Harris and Parker (1999)	Procurement practices in 28 privatised companies	Questionnaire and case studies	Evidence of improvements in procurement efficiency after privatisation, but some firms progressing faster than others and few close to achieving best practice.
Saal and Parker (2000, 2001)	Water and sewerage industry in England and Wales.	Labour and total factor productivity and cost function.	Privatisation led to no obvious rise in productivity or lowered costs of production. Higher productivity and lower unit costs came when the regulatory price caps were tightened in 1995.
Pollitt and Domah (2001)	Regional electricity companies in England and Wales	Social cost-benefit analysis using a counterfactual	Privatisation did yield significant net social benefits, but these were unevenly distributed across time and groups in society. Government gained £56m in sales proceeds and taxes, but consumers did not begin to gain until 2000. Producers benefited from large increase in after-tax profits.
Pollitt and Smith (2002)	Britain's railways	Social cost-benefit analysis using a counterfactual	Major efficiencies have been achieved and consumers have benefited from lower prices. Increased government subsidy has been largely recouped through privatisation proceeds. Output quality is not lower.

Author(s)	Industry(s)	Main Performance Measures Used	Findings
Florio (2002)	Social cost-benefit analysis of UK privatisations in aggregate	Labour and total factor productivity, employment, prices and abnormal returns to investors. Econometric analyses of structural breaks in GDP growth and changes in welfare.	Privatisation has had no noticeable effects in terms of trends in productivity, employment and price levels at the firm or sector levels after allowing for changes in technology and input prices, nor on GDP growth and productivity at the national level. Overall household expenditure on utility services including coal and transport remained remarkably stable at around 8% of the total value of consumers' expenditure: 'Our overall result…..[is]… that taxpayers suffered a loss of £14bn., but this was cancelled out by the equivalent transfer to shareholders, workers' welfare was probably slightly negatively affected, but overall this impact was negligible, consumers enjoyed a perpetual discount in prices worth less that £1,000 for each British citizen…. Apparently, far from being a "revolution", the great divestiture was a reshuffling of relative positions of various agents, probably a regressive one, with a rather modest impact on aggregate economic efficiency'.
Shaoul (2003)	National Air Traffic Services (NATS)	Financial analysis	The resulting PPP is not financially viable given revenues, costs and investment needs.
Florio (2003)	BT's long-term performance over 40 years	Output, prices, revenues, costs, employment, productivity, profits and investment.	The rate of growth of output was higher before privatisation. Prices fell with business users and international calls the biggest gainers. There was evidence of capital for labour substitution, while R&D expenditures fell as a percentage of turnover. Operating profits were stable before and after privatisation and privatisation had little discernible effect on productivity trends before 1991, when the introduction of more competition and new regulatory pressures led to large gains.

7.4. Social Enterprise Investment Fund (SEIF)

The 2006 UK government white paper, 'Our Health, Our Care, Our Say'[55] identified social enterprises as key means of delivering high quality health and social care services tailored to the needs of communities. It included a commitment to establish a SEIF.

The SEIF was set up in 2007 by the UK government to stimulate the role of social enterprise in the provision of health and social care. It aims to provide investment to help new social enterprises start up and existing social enterprises grow and improve their services.

By enabling social enterprises to deliver health and social care services, the Social Enterprise Investment Fund aims to improve the quality of services for patients.

Social enterprises that can apply to SEIF include:

- Multi-agency partnerships, particularly voluntary and community groups wishing to use their expertise to provide services across health and social care
- Existing social enterprises looking to expand into health and social care
- Groups of professionals, such as nurses or therapists, seeking to form a social enterprise to deliver their services using the right to request
- All social enterprises who apply would be expected to have a not for profit status.

[55] See: http://www.dh.gov.uk/en/Healthcare/Ourhealthourcareoursay/DH_065882

7.5. Social Impact Bonds

Extract from "Social Impact Bonds: Rethinking Finance for Social Outcomes", Social Finance, August 2009

Outcomes Based Commissioning	Social Impact Bonds
Poor access to working capital Service providers, particularly those in the third sector, often lack financial reserves and cannot access the working capital from banks or investors that they would need to work within a framework in which they are paid in arrears on a contingent basis.	**Service provider costs are covered by investors upfront** Social Impact Bonds are used to raise a fund to address a clearly defined social need in a specified geographic area (e.g. reducing reoffending rates in the West Midlands). Throughout the duration of the contract (around 5 years) proceeds are used to fund a range of interventions that address the target outcome. In this way Social Impact Bonds transfer the risk that an intervention achieves an improvement in the target outcome away from service providers to investors. This risk transfer should enable even small third sector providers, that would otherwise be excluded, to participate in outcomes-based contracting. Furthermore, by providing revenue to effective service providers, Social Impact Bonds should foster greater competition and innovation driving improvements in both the effectiveness of interventions and the cost of service provision.
Payment schedules create perverse incentives Currently, outcomes-based payment schedules tend to be binary – i.e. success is rewarded when a specified outcome threshold is reached, but not above or below this threshold. Alternatively, service providers are rewarded for each incremental improvement in the target outcome, but at a fixed rate - i.e. the reward payments do not take into account the increasing marginal cost (and benefit) of each subsequent improvement in the target outcome. As a result, service providers are incentivised to 'cherrypick' the easiest individuals within the target group and, in the case of binary payment, to stop providing the intervention once the payment threshold has been reached.	**Outcome payments are proportionate to success** Outcome payments are made annually in arrears in proportion to the outcomes achieved according to a pre-agreed metric of success (e.g. the proportion of prison leavers that reoffend within 12 months of release). The value of the outcome payments, linked to the corresponding cost savings to Government, is agreed at the beginning of the contract period. To disincentivise 'cherry picking' of the easiest to work with individuals from the target population, outcome payments may increase with successive percentage point improvements in the target outcome in recognition of the increasing marginal cost (and benefit) of each incremental improvement.
Contracts tend to be made with single providers In contrast to commissioning for outputs, where a single provider can commit to providing a specifi ed number of outputs (e.g. training course places or hours of home-based care), the complex nature of many social problems, means that it is rare that a single service provider can provide an intervention that, alone, achieves signifi cant improvements in a given outcome (e.g. employment rates or acute hospital admissions). Outcome-based contracts with single providers implicitly assume a 'one size fi ts all' solution and are therefore plagued by a high likelihood of over-attribution of impact to a single intervention. This also creates an absence of incentives for other statutory and non-statutory service providers that interact with the contracted provider to achieve the target outcome, and a tendency for commissioners to over-specify the means by which the outcomes are achieved. This is very likely to restrict the potential for such contracts to signifi cantly improve outcomes for communities given the widely recognised value of fl exibility and innovation in effectively addressing social problems, especially in contexts of economic and demographic flux.	**Investment will fund a portfolio of interventions** In recognition of the fact that most social and community needs are complex, and rarely is there a 'one size fi ts all' solution, Social Impact Bond investment will fund a fl exible portfolio of locally-tailored interventions that address the target outcome. Social Impact Bond funded interventions will be coordinated and aligned with existing provision in order to leverage maximum social change. This will be facilitated through local partnership councils that include representatives from a broad range of local service providers, the voluntary sector and the local community.

7.6. Papers Prepared by Aperio

- Achieving Your Dreams Success with Unreasonable People Encouraging Support for Social Entrepreneurs; Aiding with Growth of Their Social Enterprises 2009
- A Guide to Revenue Diversification for Directors of Non-Profit Organizations 2003
- A Review of Leadership Theory and Practice 2006
- Being Responsible Approaches to Governance and Leadership in the Third Sector A Background Paper 2007
- Being Responsible: Third Sector Governance, Transparency and the Obligation of Leadership From the European and North American Perspectives (Pepin et al) 2009
- Bibliography of Key Social Enterprise Documents 2009
- Choices Have Consequences: Collaboration Strategic Issues, Process and Benefits Some Preliminary Thoughts Updated 2009
- Choices Have Consequences Collaboration Strategic Issues, Process and Benefits Some Preliminary Thoughts 2006
- Corporate Governance in the UK: Requirements and Best Practices 2004
- Cost Cutting/Margin Enhancement Whilst Generating Income 2009
- Data Is More Than Information, It underpins Performance Management 2008
- Expressing CSR Through Social Enterprise Support and Capacity Building Some Initial Thoughts (Pepin et al) 2009
- Good Results Will Be Addictive High Engagement Giving/Venture Philanthropy: Future Trends 2005
- Growing Your Trading and Enterprise Profitability: Enhancing Your Financial and Social Return 2007
- Existing Venture Philanthropy Funds Characteristics: A Preliminary Overview 2008
- In-House Charity Based Venture Philanthropy Social Equity Fund (SEF) An Approach to High Engagement Giving Concept Development and Discussion Document 2004
- Key Organisations Supporting Social Enterprise in the UK and Potential Partners 2009
- Maximising Income Generation Quick Tips for non-profits to achieve sustainability through trading, earned income, social enterprise and commercial ventures 2007
- Mentoring A Process To Improve Non Profit Organizational Effectiveness
- Performance Management – Must Have or Nice to Have? JPA Insight's Experience and Learnings Applying Tested Corporate Sector Data Management Approaches to the Third Sector 2008
- Privatisation of Public Services and The Role of Social Enterprises An Initial Overview 2010
- Responsibility, Trust and Accountability Integrating A Culture Of Business Some Preliminary Thoughts 2003
- Risk Management Holdings – A Structural Approach 2004
- Senior Management Teams Emotional Capacity Aids in Organisational Effectiveness 2002
- Sharing Without Merging 2005
- Enterprise Activity In The UK A Preliminary Overview 2005
- Social Enterprise Activity In the UK: A Preliminary Overview Updated 2009
- Social Enterprise Legal and Organisational Issues February 2006
- Social Enterprise/Trading: Legal and Organisational Issues Social revised 2007
- Social Investment Market in the UK: An Initial Overview 2010
- Social Sector Entrepreneurship and Innovation Booklet revised 2007
- Spinning Off: Creating a New For-Profit Spin-Off Effective Transitions, Lesson Learned 2004
- Succeeding With Social Enterprise - Quick Tips For Building Sustainable Non-Profit Organisations Through Earned Income Booklet 2004
- Success with Unreasonable People: Encouraging Support for Indonesian Social Entrepreneurs; Aiding with Growth of Their Social Enterprises 2009
- The Social Investment Market in the UK: An Initial Overview 2010
- Venture Capitalists and Entrepreneurs Become Venture Philanthropists Revised 2004
- Venture Philanthropy Funds 2008