We need a smarter approach to supply management

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We pay money to companies to care for children and we also pay money to companies to build schools and lay tarmac on our roads.

These are fundamentally different activities and they require us to understand and manage very different supply markets.

A good deal of local government services are delivered through external suppliers. One way that local government can save money is to manage its suppliers more smartly. The current emphasis on service commissioning enables councils to focus on the nature of supply markets. It therefore rightly encourages councils to put the outcomes for service users above the 'producer needs' of service providers. But councils should not be blind to the sustainability of the suppliers with which they work. Providers matter, whether they are in in-house or external.

Councils provide very many services by employing staff directly. But almost as many services are provided through contracts or partnerships with either private sector or social sector providers. Unfortunately, the sourcing and management of supply is too often shrouded in arguments about the pros and cons of 'outsourcing'. This is understandable given the prominence of high-profile service failure among some private sector providers of public services nationally. But service failure occurs in all sectors.

In late 2013 the National Audit Office produced an insightful report on the previous and current governments' records in outsourcing services to a few large providers. Nationally, this resulted in an over-reliance on four service conglomerates: Capita, Serco, G4S and Atos. Of course in the government this issue is highly skewed by the scale of defence procurement, which amounts to £20bn out of the £40bn government total. By contrast, the Department for Communities & Local Government is one of the smallest service purchasers among government departments, spending just £277m annually.

In local government, most of external service purchase is done by the 150 top-tier councils, ie those that have social care responsibilities. Indeed social care services are the biggest services that are procured externally. Adult social care budgets comprise one-third of unitary councils' total spend but half of their overall spend with external providers. In respect of other services, there are some purchasing consortia but other than notable examples such as the West London Alliance these tend to be specific consortia for certain categories of spend, such as energy, ICT, or children's care placements.

Local government learned a hard lesson three years ago with the collapse of Southern Cross care homes across the UK, which provided for 30,000 elderly people in residential care. Individual councils may have been watching their local supply markets eagerly. But they missed the fact that, in this case, the overall business had become a 'zombie', with liabilities greater than its assets, because the company had altered its operating model by dividing its business into a property company and an operating company. This mirrored the demise of Woolworths, which had collapsed three years earlier after adopting the same operating model. The lesson of Southern Cross is that councils need to take account not just of a supplier's track record but of its future sustainability.

The key characteristics of different supply markets include:

- **The extent to which scale economies dominate the supply market**
- **The nature of competition in the market (the numbers of competitors, dominance ratios, etc) and the intensity of competitor rivalry in the supply market**
- **The prevailing business models that are used by dominant suppliers**
- **The degree of commodification of the main costs of supply**
- **The degree of interdependence between different service providers that supply 'linked' or 'like' services (and are suppliers vertically integrated or regionally organised?)**
- **The prospect of disruptive service change through the action of new intermediaries, services or products.**

The way that competition and innovation works in the housebuilding industry is different from how they work in, say, the care sector. Many contracts involve labour-only services but others require the provider to finance substantial capital investment in plant, technology or the like. The key to a successful contract is whether the provider is reliable, creative and innovative and whether it sufficiently empowers and motivates its staff. Tightly managed contractors who focus solely on the bottom line may deliver short-term fiscal gains but they are unlikely to generate long-run public value.

Councils need a smarter approach to supply management. They need to have a corporate approach to supply just as they need a corporate approach to demand management. Retreating into strategic commissioning is no good if commissioners lose sight of the detail of how providers function. We need approaches that differentiate between types of supply markets, that understand the dynamics and pulse of competition in these markets and that place provider sustainability as high on the agenda as innovation and service outcomes.

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