

Tussell Strategic Suppliers Update September 2019

Public procurement is a market worth 10% of UK GDP, making the government the largest and most influential customer in the country. The Spending Round in early September 2019 announced measures that will actually increase the size of public spending as a proportion of GDP for the first time since 2010. With both main parties talking up investment in infrastructure and an end to austerity this looks set to continue into 2020 and beyond.

Despite this market potential, the last two years have been a turbulent time to be a major supplier to government. From the collapse of Carillion to a number of high-profile IT contract failures, many questions have been raised over the model of outsourcing and large contractors have often been in the news for all the wrong reasons.

In a climate of public controversy, media scrutiny and investor scepticism about suppliers to government, it is easy to lose sight of the facts. Without them, it is impossible for firms to navigate a shifting market, for government to monitor value for money, or for the media to scrutinise public spending.

That is why we think it's more important than ever to monitor the Strategic Suppliers: the 34 firms deemed so vital to the functioning of public services that the Cabinet Office centrally manages the government's relationship with them.

This report is the latest in our series monitoring government spend with the Strategic Suppliers. In it we analyse the performance of the 34 firms in the government's last financial year and examine the very diverse strategies these firms employ to survive and thrive in the public sector marketplace.

Key Findings:

- Central & Local Government spent more than £10bn on the 34 Strategic Suppliers in the 2018/19 financial year.
- However their strong market positions are under pressure – their market share declined by 15% year on year.
- There is considerable variance in the go-to-market strategy of the Strategic Suppliers, even those operating in the same sector.
- While Central Government is the main source of revenue for the Strategic Suppliers, Local Government appears to be under-penetrated by several of them.
- Four Central Government departments are responsible for three quarters of all spend with the strategic suppliers – the MoD, DfT, Home Office and DWP.
- Looking ahead, while some of the Strategic Suppliers face risk of revenue attrition from upcoming contract expirations, others have seen particularly positive rates of revenue replacement from new contracts won.

Our report shows that the government's policy of diversifying its direct suppliers in order to reduce over-reliance on a core group of companies is broadly achieving its goal. While this is good news for public services – a more diverse supply chain is more competitive, innovative and efficient – it also means that the Strategic Suppliers are operating in an increasingly challenging environment. These firms cannot take their relationship with the public sector for granted and will have to continue to evolve their strategies and to improve their execution in order to defend – let alone build on – their strong market position.

More than half of public sector spend on Strategic Suppliers goes to construction and engineering firms

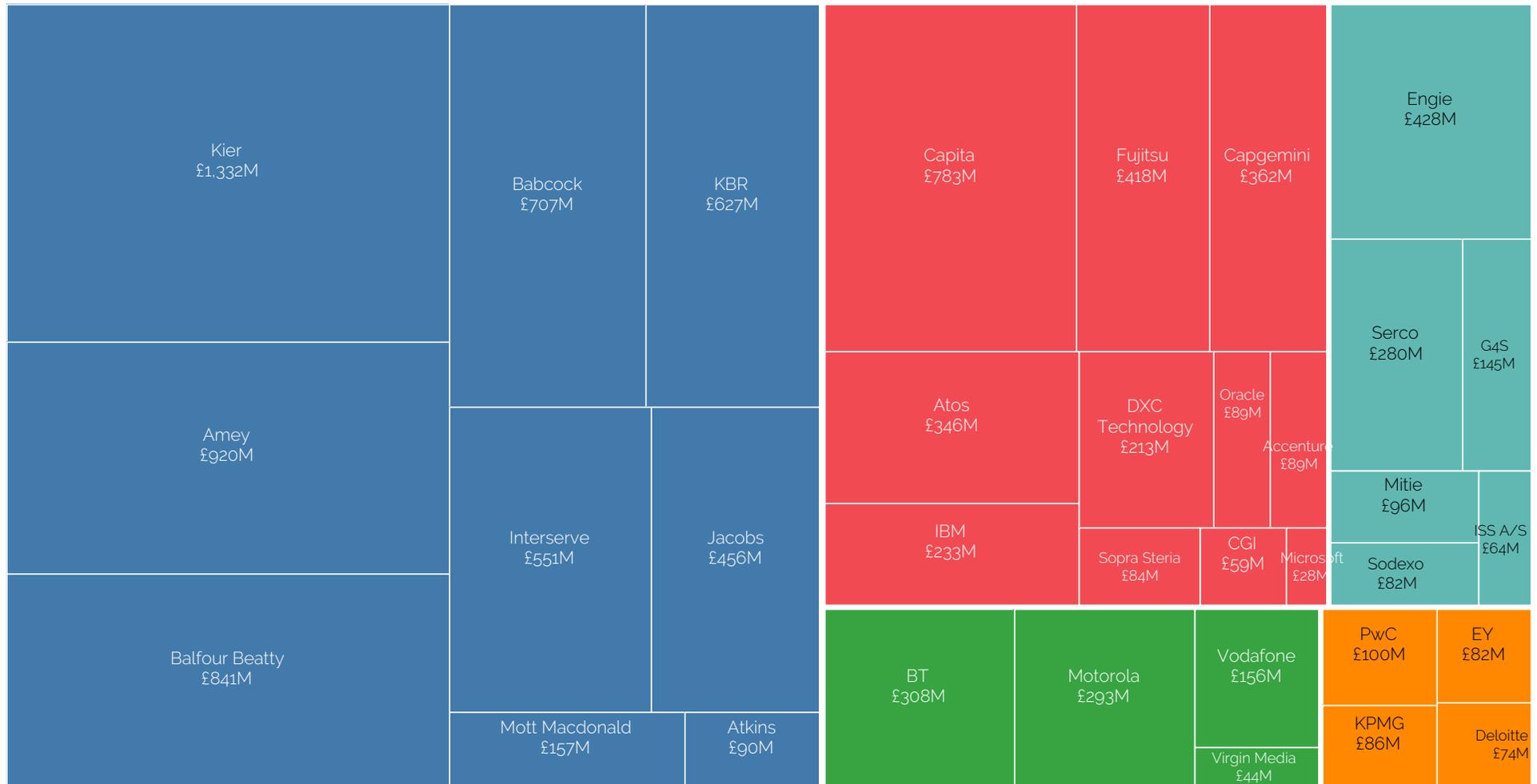
Central and Local Government authorities spent more than £10bn on the Strategic Suppliers in the last financial year alone. The majority of spend went on suppliers in the construction and engineering industries – the same as was spent on IT, outsourcing, consulting and telecoms combined.

In contrast to other sectors, spend on the major consulting firms is fairly evenly split amongst the firms.

Market intel: Who are your competitors top public sector customers?

Public sector spend on the Strategic Suppliers in 2018/19

- Construction/Engineering
- IT
- Telecoms
- Consulting
- Outsourcing/Facilities

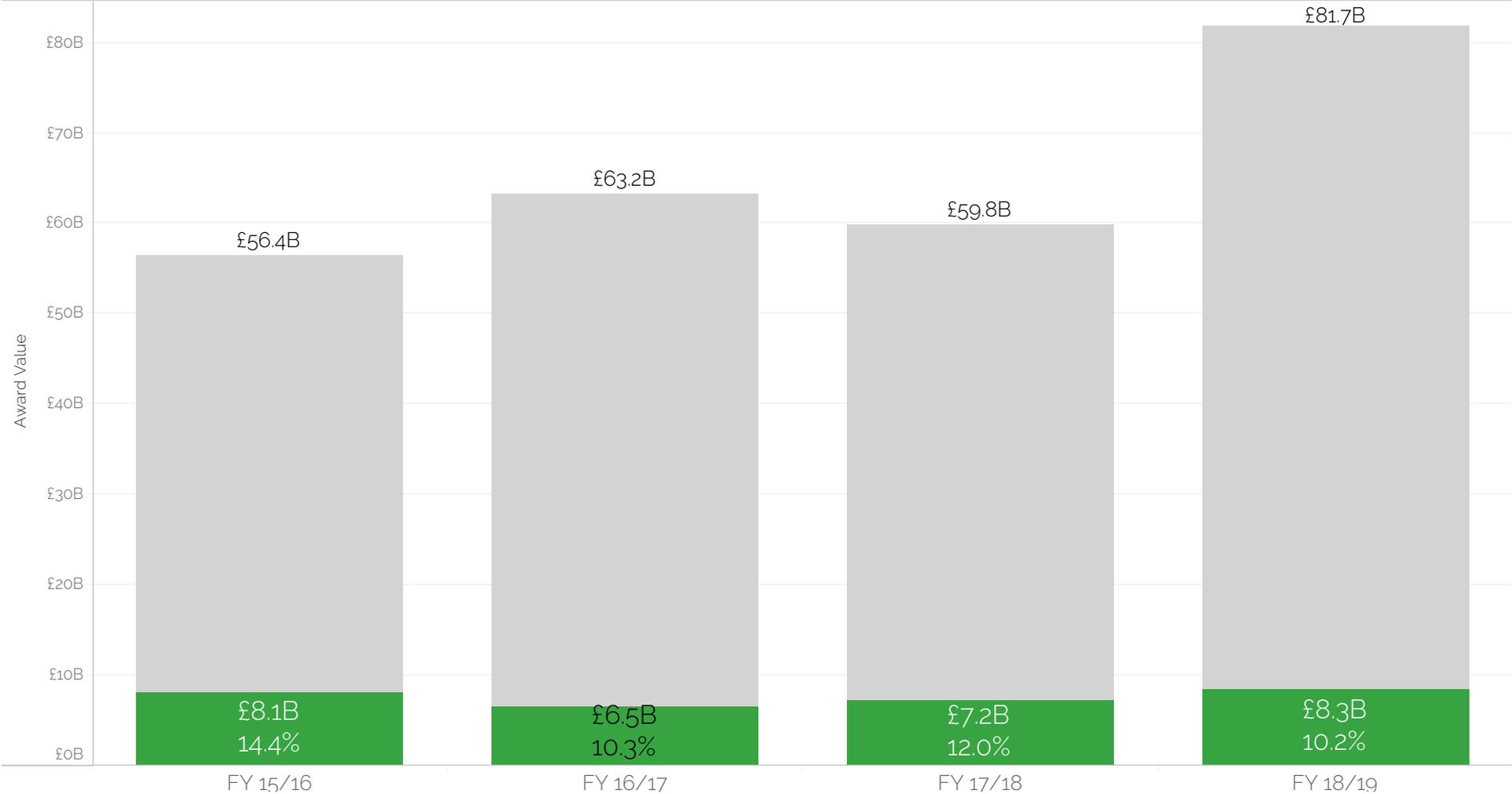


Strategic Suppliers' dominance waning

Last year the Strategic Suppliers won contracts worth £8.3bn - over £1bn more than in the year prior. Despite this, faster growth in the value of contracts awarded to all other suppliers meant that their overall market share actually shrank by 15% year-on-year - down from a high of 14.4% in 2015/16 to 10.2% in 2018/19.

Market intel: Who is winning (and losing) from this erosion in market share?

Year-on-year market share of the Strategic Suppliers since April 2015 by proportion of total public sector contract award value

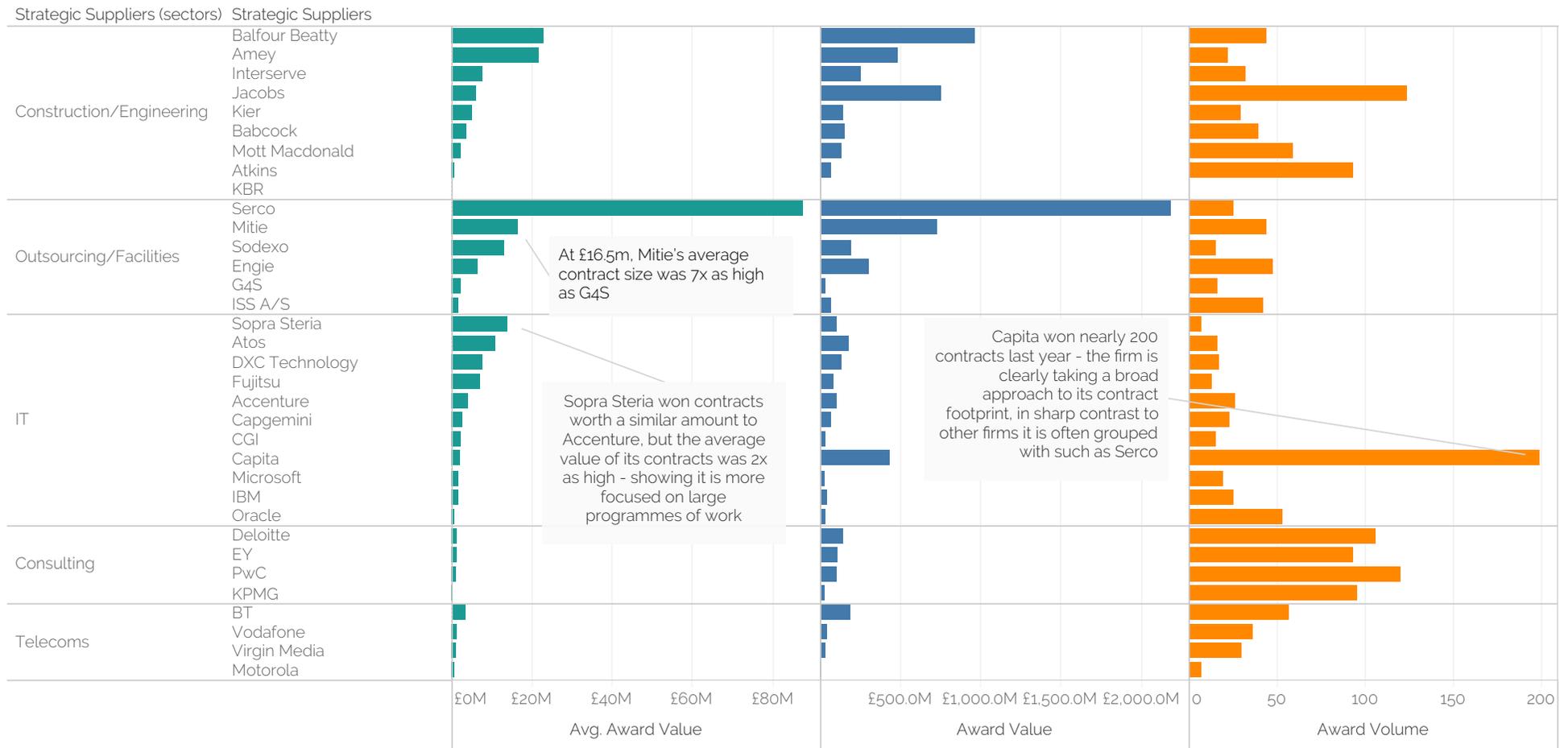


Companies adopting diverse public sector strategies

If it's safe to say the government is actively managing its over-reliance on the Strategic Suppliers, then it appears that the companies are adapting to this environment in different ways. Some companies focus on large cornerstone contracts, while others build a portfolio of smaller pieces of work.

Market intel: How exposed are your competitors to individual contracts?

Strategic Supplier average and total contract award value and total award volume in 2018/19



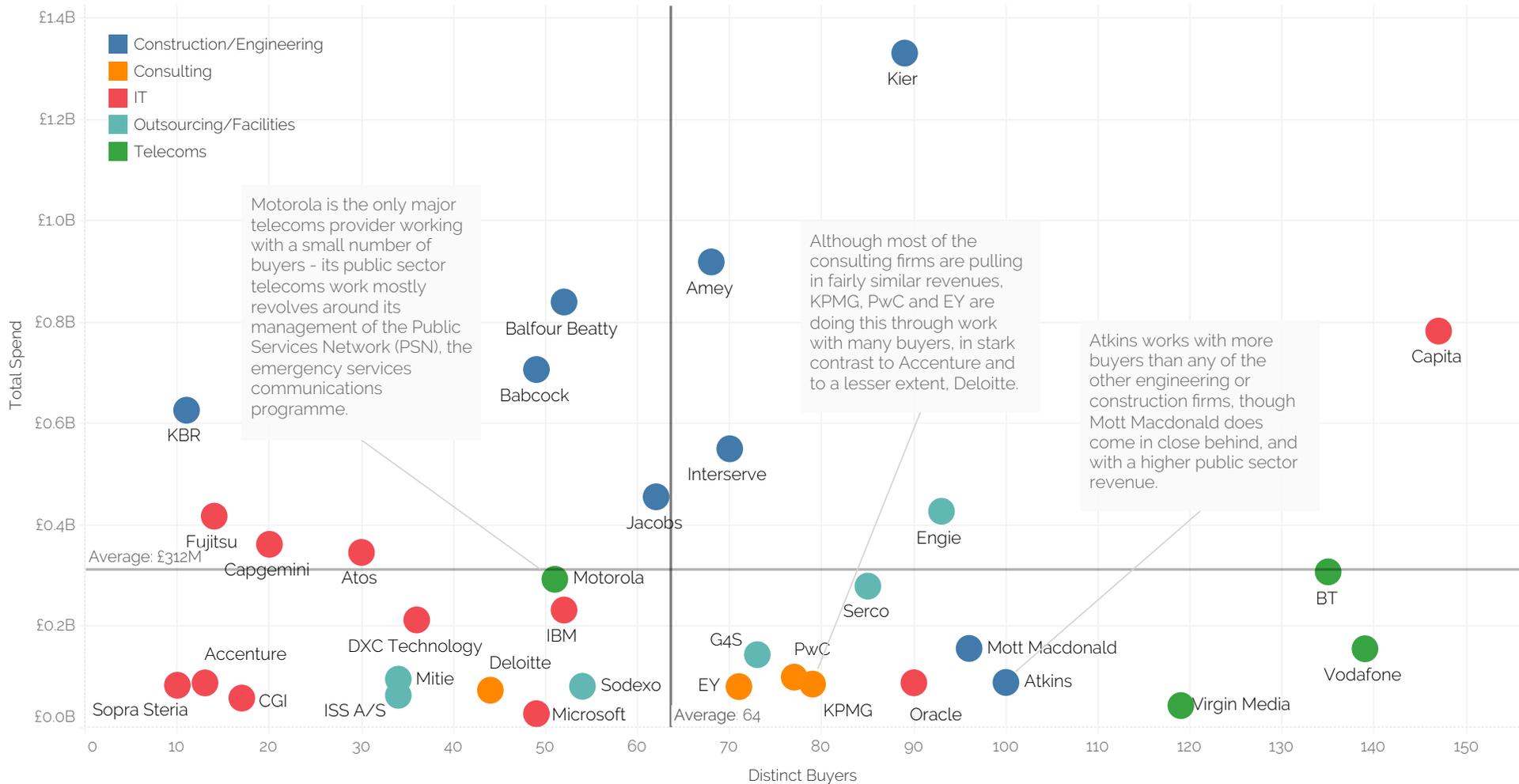
* Rail franchise contracts have been excluded from this report, but it should be noted that last financial year Amey, through a joint venture with Keolis, won a £5bn rail franchise contract to manage the Welsh Borders trains.

Wide disparities in customer concentration

Following on from the point above, it's interesting to note the wide disparities in customer concentration - even within the same sector. Strategic Suppliers in the Telecoms sector, for example, have a large number of smaller public sector clients (with the exception of Motorola), while companies in the IT sector have much higher customer concentration (with the exception of Capita).

Market intel: How does your go-to-market strategy compare to your competitors?

Strategic Supplier - customer concentration (total spend vs. distinct buyers) in 2018/19



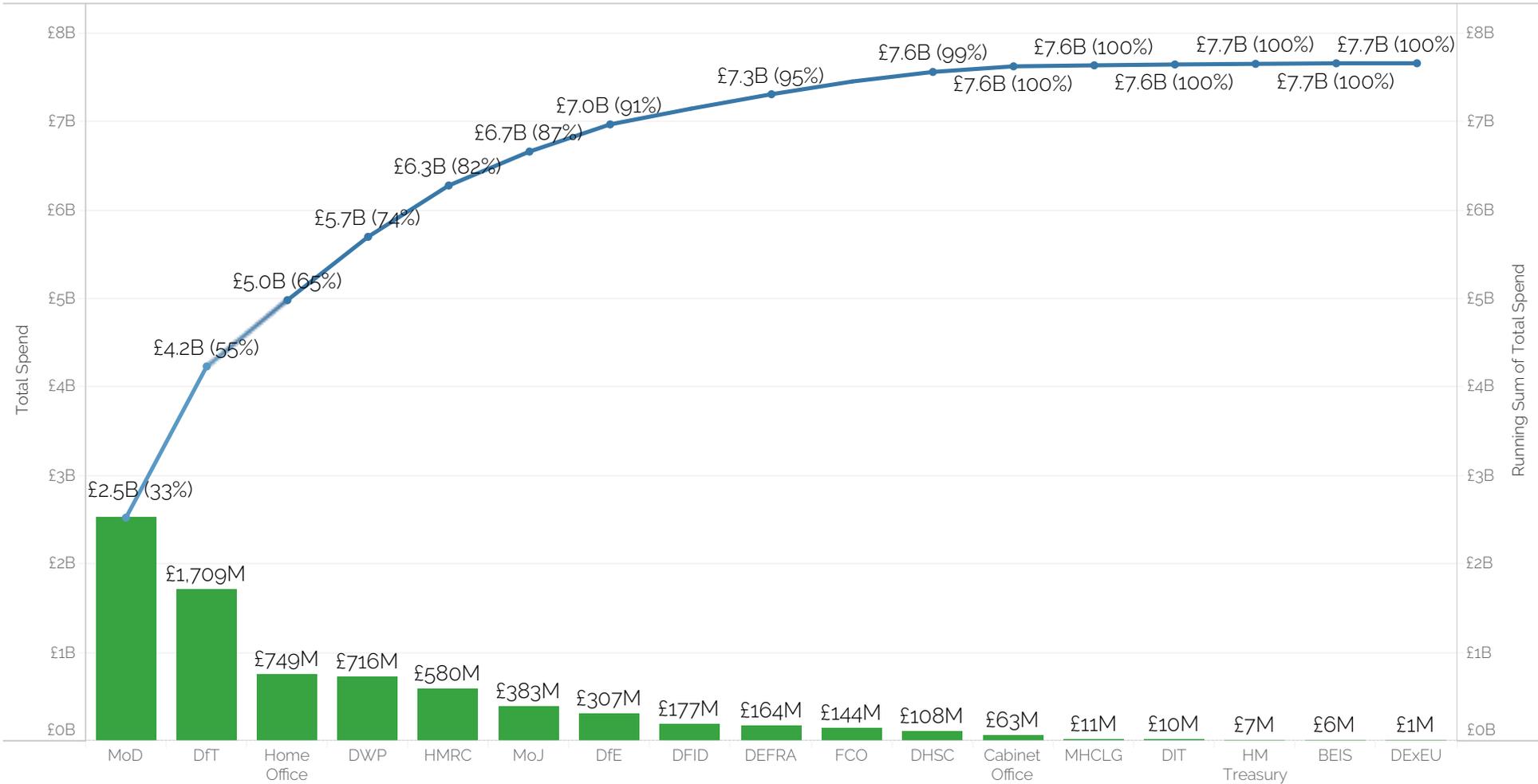
75% of all Central Government spend came from just four departments

Just four department (and their arms lengths bodies) are responsible for 75% of all Central Government spending on the Strategic Suppliers - MoD, DfT, Home Office and the DWP. These four departments spent £5.7bn on these firms in 2018/19.

Cuts in defence spending, or the cancellation of HS2, would have a major impact on suppliers reliant on the MoD and DfT respectively.

Market intel: Which suppliers would be most exposed to a post-election reallocation of departmental budgets?

2018/19 spend on the Strategic Suppliers by Central Government department - absolute and running total

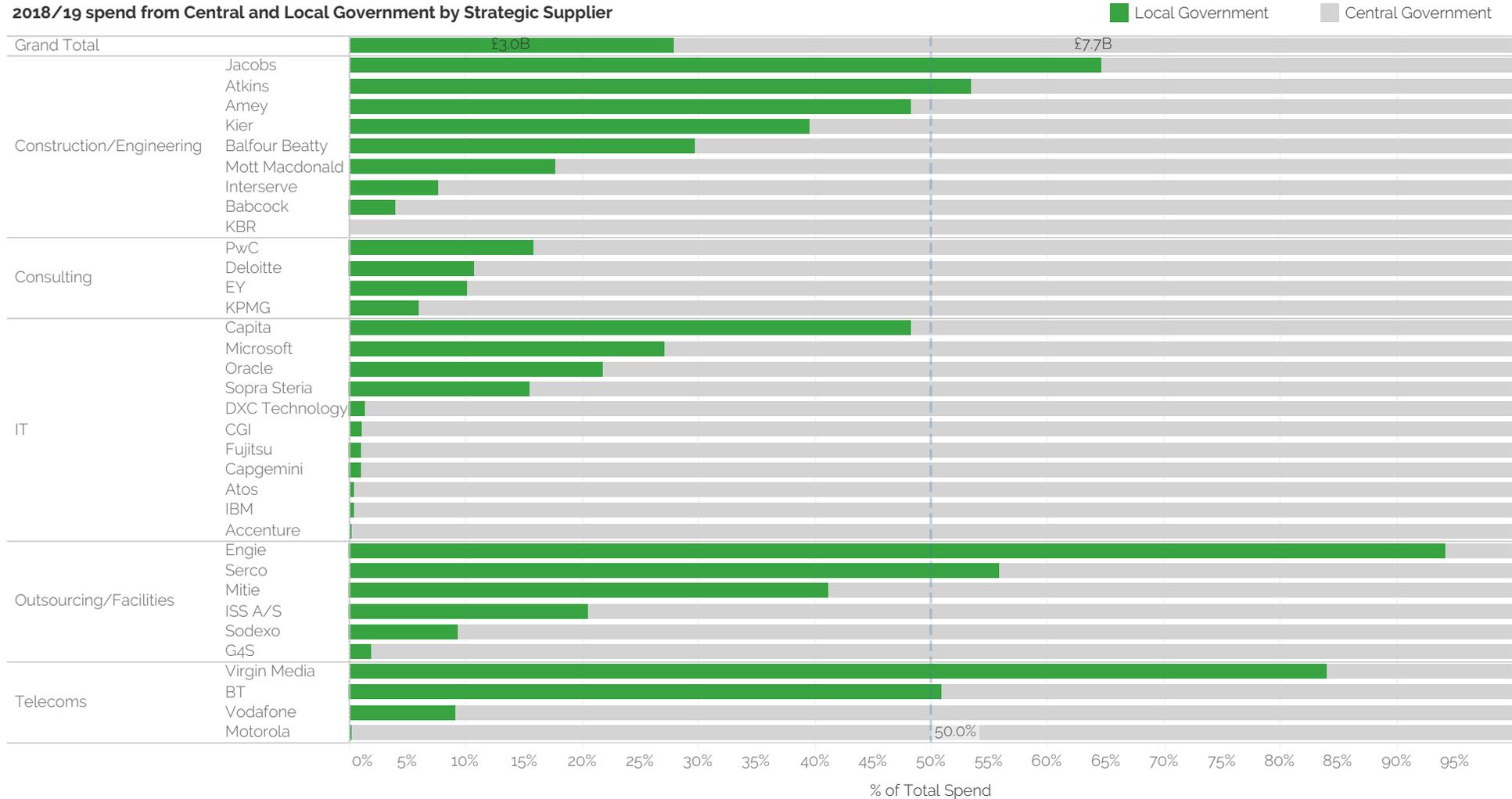


Missed opportunities in Local Government

Last year only six Strategic Suppliers earned more public sector revenue from Local Government than from Central - most notably Engie, for whom revenue from Local Government was 16x that of Central. A number of firms had little or no presence in the wider public sector. For example, of firms with highly repeatable business models, Vodafone stands out as a company that isn't penetrating Local Government to the extent it could.

Market intel: Are there attractive adjacent markets that your business could enter?

2018/19 spend from Central and Local Government by Strategic Supplier



Serco's £2.1bn asylum contract by far the biggest contract won by a Strategic Supplier in 2018/19

In 2018/19, only half of the top contracts won by the Strategic Suppliers were from Central Government – emphasising the market opportunity in the wider public sector.

Only four of the largest contracts do not relate to Construction, Engineering or Repair & Maintenance - Serco's £2.1bn asylum contract, Mitie's £514m prisoner escort contract, Capita's £225m contract with the Department for Education to run test services and Atos' £135m digital transformation contract with DEFRA.

Market intel: Is your business engaging early enough with potential new customers?

Largest contracts won by the Strategic Suppliers in 2018/19

Contracting Authorit..	Contracting Authority ..	Date Award..	Contract Title	Strategic Suppliers	Subsidiary	Award Value
Home Office	Central Government	08/01/2019	Asylum Accommodation and Support Services Contract (AASC)	Serco	Serco Limited	£2,109M
Cheshire East Council	Local Government	03/10/2018	16 009 Highway Design, Maintenance and Construction Services	Jacobs	Ringway Jacobs Limited	£600M
Home Office	Central Government	30/04/2018	Provision of In-Country and Overseas Escorting, operation and management of Short Term Holding Facilities and Holding Rooms and related services	Mitie	Mitie Care And Custody Limited	£514M
Transport for London	Local Government	16/02/2019	Track Programme Delivery Partner	Balfour Beatty	Balfour Beatty Rail Limited	£440M
Highways England	Central Government	05/10/2018	Area 10 Maintenance and Response Contract	Amey	Amey OW Limited	£326M
Department for Education	Central Government	11/07/2018	Test Operations Services (TOPS)	Capita	Capita Business Services Ltd	£225M
University of Edinburgh	Other	22/02/2019	EC0789 Main Contractor EFI Quartermile	Balfour Beatty	Balfour Beatty Group Limited	£154M
Central Bedfordshire Council	Local Government	19/03/2019	CBC-0841-T-LS Housing – Daily Repairs	Engie	Engie Regeneration (FHM) Limited	£145M
Department for Environment, Food & Rural Affairs	Central Government	19/06/2018	Defra – UnITy Programme – Hosting and Application Support	Atos	Atos IT Services UK Limited	£135M
University of Edinburgh	Other	14/06/2018	Main Contractor New Biology Darwin Tower	Balfour Beatty	Balfour Beatty Group Limited	£130M

£0B £2B £4B

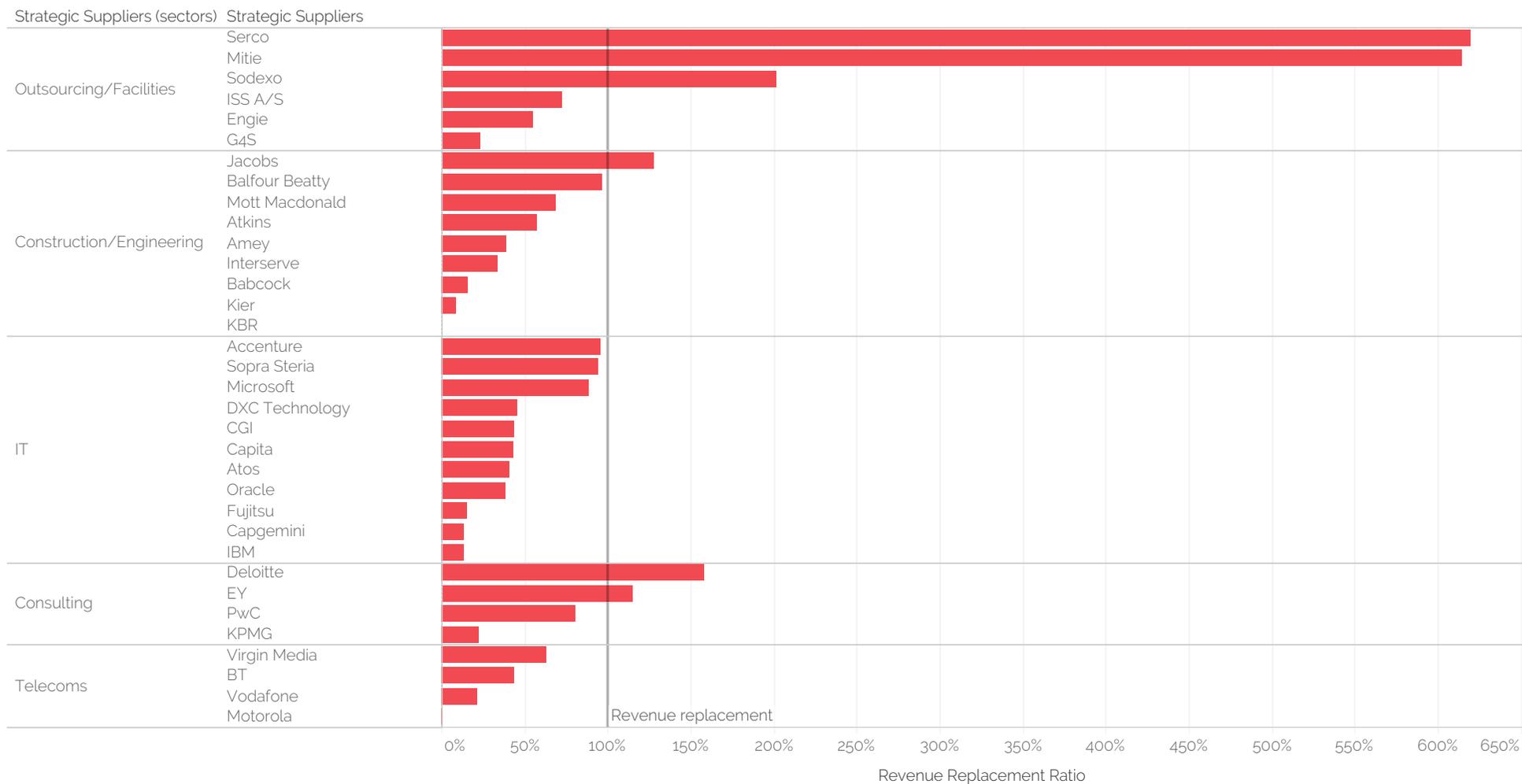
Award Value

Serco and Mitie growing at a faster pace than peers

For most of the Strategic Suppliers, public sector revenue is higher than the value of new contracts they won last year. This makes intuitive sense, as revenue is derived from contracts awarded any time in the past. For some companies, however, the value of contracts won last year exceeded their revenue - an indicator of the rate of revenue replacement and shows Serco, Mitie, Sodexo and Jacobs outperforming their peers.

Market intel: Are you competing in the sectors with the fastest rate of revenue replacement?

Ratio of public sector spend on Strategic Suppliers in 2018/19 against contracts won in 2018/19



Some Strategic Suppliers exposed to risk from contracts expiring in the near term

Companies in the IT and Consulting sectors look particularly exposed to cancellation risk from contracts expiring by the end of 2020. This is a particular threat in the IT sector, where the government is actively seeking to disaggregate large contracts. Interserve, Babcock and Sodexo, on the other hand, all have secure, predictable cashflows extending to 2021 and beyond.

Market intel: When are your competitors key contracts due to expire?

Proportion of live contract value expiring before December 2020 by Strategic Supplier



Conclusion

The last couple of years have undoubtedly been a difficult time for companies that are heavily reliant on the government, characterised by public controversy over the outsourcing model, intense media scrutiny and investor scepticism over the viability of some of the main players.

Despite this, we at Tussell are generally bullish on the outlook for firms with heavy exposure to government. Whatever the outcome of Brexit and its impact on the UK economy, both main political parties seem intent on increasing in public spending. The Strategic Suppliers look well-placed to capitalise on this trend, as do many other companies with significant exposure to government although they are not on the Cabinet Office's list.

Some of the Strategic Suppliers, however, appear to be better placed commercially than others. As this report has shown, their public sector contract footprints and their respective government growth strategies vary significantly, even amongst firms operating in the same sector. We have called out material differences in:

- Revenue growth
- Trajectory of market share
- Contract and customer concentration
- Future risk from expiring contracts

Next Steps

Given the diverse approaches taken by the Strategic Suppliers towards the public sector, developing a clear strategy and understanding its strengths and weaknesses compared to your competitors is vital.

Throughout this report we have flagged a number of key questions that all major suppliers to government should be asking themselves when developing their own public sector growth strategies. There is ample data on public sector spending, allowing forward-thinking suppliers to be analytical and strategic in how they approach the market.

Get in touch with Tussell for evidence-based data and custom research to answer questions like:

- What is your firm's market share relative to competitors?
- Which high-spending customers are you not yet doing business with?
- When are your competitors' contracts due to expire?
- Are you engaging early enough on upcoming contract opportunities?
- Are there attractive adjacent markets that your firm could break into?
- How does your go-to-market strategy compare to the competition?
- Are you (or your competitors) at risk from regulatory changes and/or new government policy objectives?

Who are the Strategic Suppliers?

Strategic Suppliers (sectors)	Strategic Suppliers	Crown Representative	
Construction/Engineering	Amey	Phil Brookes	November 2012
	Atkins	Ann Pedder	November 2012
	Babcock	Luc Bardin	November 2012
	Balfour Beatty	Mervyn Greer	November 2012
	Interserve	Phil Brookes	November 2012
	Jacobs	Sir Robert Walmsley	April 2019
	KBR	Robin Hughes	October 2018
	Kier	Phil Brookes	October 2018
Consulting	Mott Macdonald	Ann Pedder	April 2019
	Deloitte	Boris Adlam	January 2016
	EY	Nick Griffin	January 2016
	KPMG	Nick Griffin	January 2016
	PwC	Nick Griffin	January 2016
IT	Accenture	Nick Griffin	November 2012
	Atos	Beverley Tew	November 2012
	Capgemini	Nick Griffin	November 2012
	Capita	Meryl Bushell	November 2012
	CGI	Beverley Tew	April 2014
	DXC Technology	Vincent Kelly	November 2012
	Fujitsu	Meryl Bushell	November 2012
	IBM	Lan O'Connor	November 2012
	Microsoft	Myron Hrycyk	November 2012
	Oracle	Myron Hrycyk	November 2012
Sopra Steria	Lan O'Connor	November 2012	
Outsourcing/Facilities	Engie	Jane Bristow	May 2016
	G4S	Ann Pedder	November 2012
	ISS A/S	Jane Bristow	September 2015
	Mitie	Robin Hughes	November 2012
	Serco	Sir Robert Walmsley	November 2012
Telecoms	Sodexo	Mervyn Greer	November 2012
	BT	Sean Collins	November 2012
	Motorola	Meryl Bushell	November 2012
	Virgin Media	Vincent Kelly	September 2015
	Vodafone	Jay Chinnadorai	November 2012

As of April 2019, 34 firms are subject to the Cabinet Office's regular monitoring and thus designated 'Strategic Suppliers'. The programme to monitor these firms started in 2012, and there are 22 firms that were once part of the list but are no longer (for various, and not always entirely clear, reasons) - these include Carillion, Royal Mail, DHL, BAE Systems and Lockheed Martin amongst others.

The current firms are listed in the table on the right. Each firm is allocated a 'Crown Representative', who acts as a focal point and ensures the government acts as a single customer, communicating a consistent message to its suppliers and co-ordinating procurement issues.

Of the 34 current suppliers, 20 have been in the list since November 2012. In April 2019, four new suppliers were added to the list - engineering firms Jacobs and Mott Macdonald, construction firm Balfour Beatty (which was first named in 2012 but dropped out from 2015 - 2019), and the last of the Big Four EY - again originally named in 2016 but dropped for three years until April.