

## CBI response to the Work and Pensions and BEIS Committees joint report into the collapse of Carillion

**Carillion acted irresponsibly, and their actions serve as a stark lesson in the dangers of short-termism.**

Carillion's business model prioritised winning contracts at the expense of the company's overall sustainability and the health of its supply chain. This was wrong, and deeply irresponsible.

The severe impact of Carillion's failure includes the 2,354 jobs lost so far, and the almost £7bn owed to creditors including pension schemes and suppliers. From the taxpayers' perspective, the government has had to spend around £150m keeping essential services running.

Given the extent of these failings and their consequences for customers, suppliers and staff, working together government and business must do everything possible to avoid another Carillion. This means learning lessons and putting them into practice whenever necessary across the economy.

**Responsible firms give due regard to their long-term performance and social impact, and targeted action by business and government can encourage this approach across the economy.**

Companies that have, and act on, a long-term vision for their social and economic impact are more likely to deliver sustainable growth and behave responsibly in the interests of staff, customers and supply chains. This behaviour can also focus investment in drivers of prosperity that will be key to their success and that of the UK overall, such as the skills and technologies needed as the world of work changes.

In short, doing good is good business, and when the public see companies operating in this way it builds people's confidence in the value of business to the UK. This is especially important for companies in receipt of public money and delivering vital services and infrastructure – they rightly have even higher expectations placed upon them in terms of their business practices.

Carillion fell far short of this vision, and the CBI believes there are several areas where action can be taken by business and government to help minimise the likelihood of this happening again. We set out in detail in this response our views on a number of these, including prompt payment, corporate governance and public procurement. In addition, the audit market is also under scrutiny. The CBI will input in more detail to this, but our early thinking is that any review will want to consider the scope and expectations of audit, how to increase choice and competition, and whether more could be done to further reduce potential conflicts of interest.

### **1. Increasing transparency to drive improvements in payment performance**

Carillion's payment practices, which included extending terms of up to 120 days and charging a fee for early payment, were indefensible. They enabled Carillion to hold on to cash for longer, but transferred the financial risk to its supply chain, putting smaller firms under pressure.

That Carillion was a signatory of the Prompt Payment Code shows that there is much more that payment guidelines need to do to drive improved payment practices. The overwhelming majority of firms recognise that paying on time is a cornerstone of good business and already act accordingly. Yet with small and medium size businesses' late payment debt sitting at £14.2bn<sup>1</sup>, there is no doubt that payment practices can and must improve.

This requires action by business – not just because of the social and economic impact of late payment, but more importantly because paying promptly is the right thing to do. Government can help make these necessary changes in behaviour happen by driving greater transparency of payment performance, inspiring businesses to raise their game.

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<sup>1</sup> BACS, 'Late payments costing smaller UK businesses more than £2bn a year', 11 July 2017

Greater use of data in measuring a company's payment performance would create the transparency needed to allow businesses to benchmark, monitor and improve their performance. Companies would be assessed against their peers, by their clients and by their customers, and which would in turn drive businesses to improve their payment performance or explain how they intend to do so over time.

By making best use of existing measures such as the 'Duty to Report' to underpin performance and the Prompt Payment Code as guiding principles of good practice, government has the framework available to use data as a force for positive change. Where there are firms who need to show a marked improvement in payment practices, they should be supported in addressing issues on their journey towards best practice – a journey in which each company should be an active participant.

A further lever which the CBI supports is the consideration by government of a company's payment performance in tendering processes for public contracts. Government can use its purchasing power to drive improvements in behaviours, ensuring payment performance is considered when assessing potential suppliers to government, and that transparent publication of payment data is available to drive improvements.

As one of the biggest clients across the UK economy, government also has an opportunity to lead by example in displaying the behaviours of a 'responsible client'. By ensuring government suppliers receive payment in a timely and transparent manner, those businesses can in turn deliver payment through the supply chain faster.

## **2. Reforming corporate governance requirements to enhance scrutiny and hold leaders to account**

Focusing on a company's behaviour by increasing accountability for corporate governance practices is a vital step in ensuring all stakeholders, from shareholders and investors to employees and suppliers, are appropriately engaged in the direction of a business. Carillion could and should have been subject to greater scrutiny earlier. It is clear that despite the legal duties placed upon both directors and non-executive directors, those on Carillion's board were unable, or unwilling, to provide the levels of challenge that might have compelled the company to shift its focus onto fixing problems it was facing before it collapsed.

Responsible leaders have a duty to run their business with a view to its long-term success. Action is already underway to make such behaviour more widespread. The new Companies (Miscellaneous Reporting) Regulations will build on the existing Section 172 duties for directors as set out in the Companies Act 2006. Listed companies will also be guided by a revised Corporate Governance Code from July, which emphasises obligations towards stakeholders and requires large privately-owned firms to disclose corporate governance arrangements.

Company directors will be obligated to review the appropriateness of their existing corporate governance standards in a meaningful way, and it's anticipated that improvements will be made as directors identify and remedy any poor practices that exist. These reforms benefit from an added degree of flexibility for firms to apply the new rules in a way which best suits their business. This is welcome because businesses collectively employ a vast number of management and operational structures, and a 'one size fits all' approach would be impractical.

These latest reforms will come into effect at the beginning of 2019, and many firms are already considering how to make changes to reflect these new requirements. If this improvement is found not to have been as effective as hoped, government should work with business to establish additional standards to shine a spotlight on areas of unsatisfactory business practice.

Independent challenge and the benefits of diverse and wide-ranging experience cannot be underestimated as a critical component of decision-making at board level. Shareholders also play a critical role, for example, and efforts to align the revised UK Code and the Stewardship Code could help ensure shareholders and company directors share the same vision of effective corporate governance. Companies that get this right will be motivated to monitor, benchmark and improve performance.

### **3. Focusing public contracts on long-term value and the outcomes that matter to the public.**

Government is a significant client in many sectors and has substantial purchasing power. Carillion was a key player in this marketplace, consistently winning large contracts. Yet losses on key schemes, for example, defective beams at the contractor's Royal Liverpool University Hospital scheme and delays to a bypass in Aberdeen, were associated with the company's collapse.

Carillion was particularly exposed to such issues because it relied heavily on bidding at low prices in order to win work and generate revenue. It too readily accepted the financial risk that this could pose further down the line should delays, disputes or unforeseen problems arise.

Suppliers to the public sector need to bid responsibly for contracts, be prepared to challenge bad deals, and walk away from opportunities that wouldn't yield long-term value. They also need to be clear about what constitutes their core business, and disciplined in bidding for opportunities that are a good fit. Carillion, by contrast, was short-sighted in its pursuit of unsustainable growth.

Government, for its part, should encourage companies to bid on the strength of the overall value they can provide for taxpayers, including their social and environmental impact, commitment to local supply chain engagement, and spend on R&D – not just on price.

There have been positive developments. David Lidington MP recently spoke of the need to 'repair and rebuild' trust between the public and private sector – and in doing so, increase the public's trust in government and business working together.

Yet the CBI's recent survey on public procurement practices found that there is more to do: 60 per cent of companies believe government awards work primarily on a basis of lowest cost. Rarely would this present the 'best mix of quality and value for the outlay' as Crown Commercial Service guidelines call for. Similarly, 37 per cent said government's handling of risk has deteriorated since 2015.

Changing bidding behaviours requires giving business the confidence that wider factors will have a meaningful impact on their opportunity to win contracts, and for government itself to more rigorously identify quality and value in its contracts. Driving adoption of commercial guidance across the wider public sector would help. Crown Commercial Service guidance on standard terms and conditions for smaller contracts is frequently ignored, despite the efficiencies that bidders and procurement teams would benefit from. Other guidance says risk should not be inappropriately transferred to suppliers.

If it fails to change the signals it's sending to suppliers, government runs the risk of responsible firms exiting the market, reducing the level of competition for major contracts and diminishing the value for money taxpayers ultimately receive. The need for action is illustrated by Spend Network evidence showing a 476 per cent<sup>2</sup> rise in single-bidder tenders between 2012 and 2017.

#### **In seeking to learn the right lessons from Carillion's collapse, it's important to maintain a sense of perspective – the vast majority of businesses do act responsibly**

Carillion acted irresponsibly and provided a harsh lesson for business in the dangers of short-termism. Yet as the Committee has acknowledged, it's crucial to maintain a sense of perspective on the value of business to the UK.

Business is a major force for good in the UK. The CBI's *Everyone's Business* research revealed that the public recognises the important role that business plays. The survey found that 65 per cent thought the reputation of UK business was good or very good, with the top reason being a perception of the high quality of UK services and products. The research also highlighted an improvement in positive views of business among 18-34 year olds, suggesting younger people are strongly engaged in the role business plays in shaping the UK's economic future.

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<sup>2</sup> <http://www.telles.eu/blog/2018/2/26/the-risks-arising-from-single-bidder-tenders-in-the-uk>

When it comes to public contracts, more than 200,000 organisations supply the public sector, and these businesses bring investment and innovation to the public services and infrastructure that communities rely on across the UK's regions and nations. For each one that makes headlines for the wrong reasons, there are many more that are working well.

But this is undermined by a clear disconnect between what most businesses do and what people believe. Business must engage with and respond to the public's concerns – only action focused on what the public really cares about will enhance public trust in business as a force for good.

However, that Carillion was exceptional should in no way diminish the commitment in business and government to learn the right lessons and do everything possible to prevent this happening again.

For its part, the CBI is committed to championing progressive action on related issues. We have recently set up a new Public Sector Partners Council, which brings together suppliers from across the spectrum of industry to establish how government and business build better partnerships. In addition, the CBI's Construction Council is exploring underlying issues affecting the ability of the UK's construction industry to operate sustainable business models and invest in the UK's future needs.

**CBI**  
**July 2018**