

Damian Hind | November 2015

# WHITEHALL RULES!

Improving pay and performance in the Civil  
Service

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A Policy Exchange Research Note

## About the Author

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## Summary

One of the most effective ways to improve Civil Service performance is to recruit and retain the best talent. When today's Government faces enormous competing pressures, it is more important than ever that the Civil Service has the skills and expertise to deal with the challenges of modern Government.

At present however the Civil Service cannot compete in the war for talent. HR policy too often treats Civil Servants as a cost to be managed rather than a strategic asset. Significant headcount reductions had to be made over the last five years as the Civil Service had grown excessively in size prior to 2010. And both the pay and recruitment freeze has saved significant amounts of money from the Civil Service paybill. However the administration of these reductions has come at a price. Departments have been unable to properly link pay to performance, and talent has been lost as a result. The whole workforce is now on average older and more top-heavy in terms of management than it was in 2010, increasing annualised salary costs. In part this is because promotion has been the only way for Civil Servants to achieve a pay rise but it is also because longer-serving employees, who have benefited from automatic pay increases, cost more to let go. The management of staff exits has also been poor. The majority of exits have been voluntary as departments have lacked an accurate mechanism for separating out people for compulsory redundancy. This will have undermined performance as the people most likely to leave voluntarily are those high-performers with the best prospects for employment outside the Civil Service.

This paper argues that the management of the Civil Service workforce needs to change over the course of the next Spending Review period. The HR budget clearly needs to be deployed more effectively than currently. The Civil Service has the financial clout to compete for the best talent – it spent £15.7 billion on staff in 2014/15 – but it needs to deliver better value for money. The paper puts forward six proposals that will enable the Civil Service to recruit and retain talented staff:

- Devolve paybill control to departments, giving individual managers greater flexibility over how they choose to deploy their HR budget to meet their organisational needs. This will force departments to think more strategically about what they need in terms of skills and capability, and over multiple years.

- Reduce the use of consultant and agency staff; make permanent recruits where needed to plug longstanding gaps in capability and reduce staff costs over the long-term.
- Continue to reform redundancy pay and make it easier to separate out employees who are genuinely redundant, for example poor performers and people who no longer have the skills that the Civil Service needs.
- Better align workforce resources with departmental objectives by carrying out a zero-based review of each Whitehall department, putting the best workers in strategically important positions, creating a flexible pool of talent and strengthening the link between individual activity and the department's outputs.
- Reallocate spending on training to recruitment. It is difficult to convert average workers into high-performing ones; the Civil Service should prioritise investments in attracting and assessing the best external talent.
- Reallocate funding for the Fast Stream away from generalists and towards specialists to build a pipeline of talent in areas where there is currently a shortage.

## Introduction: Why hire the best?

*“If you’re committed to transforming your team or your organisation, hiring better is the single best way to do it.”*

Laszlo Bock, Senior Vice President of People Operations at Google

Significant reductions in the size of the Civil Service have been made over the last five years. This was much needed. Civil Service employment rose significantly from 1997 to the mid-2000s, increasing from 476,000 full time equivalent staff (FTEs) in 1997 to a peak of 524,000 in 2004, before decreasing again to 484,000 in 2010.<sup>1</sup> But despite the sharp fall in numbers since 2010 – employment is now down to 406,000 (FTEs)<sup>2</sup> – the Civil Service appears to have held up reasonably well. In the absence of evidence to show that workloads have fallen significantly or that the quality of decision-making has worsened, Civil Service productivity must have improved over the last five years.<sup>3</sup> The machinery of government, with its durable functions and processes, has clearly helped to maintain a stable environment for policy-making and delivery.

But in a world of constant change, where businesses and communities have to adapt to survive, the Civil Service too often appears bureaucratic and slow.<sup>4</sup> The institution itself has not fundamentally changed since the 19th Century.<sup>5</sup> It is now widely accepted that the Civil Service needs to become smaller and more capable if it is to deal with the major challenges of modern government:

- **Fiscal Consolidation:** the Government’s commitment to restore the public finances to a sustainable path means less money is available for public spending. Total fiscal consolidation between 2010/11 and 2015/16 will be £121 billion, with £98 billion coming from spending reductions, primarily departmental budgets.<sup>6</sup> To achieve a surplus by 2019/20, a further £37 billion of consolidation measures will be undertaken, with £20 billion coming from departments.<sup>7</sup> A substantial proportion of this money is spent on staff – public sector pay makes up over half of departmental resource spending.<sup>8</sup> Although the Civil Service accounts for just 9% of the total public sector workforce, it will clearly need to become smaller and more intelligent in order to deliver value for money to the taxpayer.
- **Devolution:** further powers will be decentralised to City Regions and Local Authorities during this Parliament, and as it continues so will Whitehall’s need to self-examine the most appropriate level of financial and decision-

making power that it holds. Budgets and policy programmes across a large number of Government Departments – transport, skills, housing, and taxation among others – are expected to be devolved to more parts of the country over the coming years. For example, Local Authorities will be able to retain 100% of their Business Rates by the end of this Parliament. The demand for talent and skills within the Civil Service will need to evolve as it delivers less directly from the centre and takes on a more strategic role.

- **Technological change:** new technologies and big data are transforming the way people live their lives. These changes are bringing enormous benefits to citizens but also an element of instability. Our institutions are too large, unwieldy and lack the skills to adapt to these changes. The care.data initiative, plagued by a lack of trust in our public institutions to manage health records, is a good example of a missed opportunity to dramatically improve public services through new technologies. Universal Credit, a programme intended to radically simplify benefits for recipients, has been mired by IT failures; up to £303 million of IT development is likely to be written off due to wasteful commissioning.<sup>9</sup> Without an injection of new talent, opportunities for radical public service reform from technology will be missed and it will be harder to ward against the risks they pose.
- **Public expectations:** As people consume goods and services in new ways, through smartphones and online, expectations of government services will continue to change. Unless the Government keeps pace with innovations that are being driven by the private sector then the gap between citizens' expectations of public services and actual performance will widen significantly. The Civil Service will need to recruit people who can exploit these new tools to deliver public services to a standard of comparable quality with a typical private sector organisation.

The ability for the Civil Service to recruit and retain talented people will ultimately determine whether or not they can successfully address these challenges. In both the academic and the business world there is a growing recognition that people, rather than organisational structures and processes, matter much more for improving organisational performance.<sup>10</sup> In the Civil Service, by contrast, the whole system is heavily biased in favour of process and hierarchy. This inhibits the freedom and creativity of the entire workforce. The grade structure, for instance, is an outdated management structure that treats people as interchangeable, devalues role-related knowledge and puts the focus of

activity on process rather than outcomes. The performance management system is also a problem; it does not properly reinforce accountability for outputs, making it very difficult to identify the best and worst performers. So changing the management structures in the current system is clearly important for improving performance and many of the reforms put forward in this paper will help to address these issues. Ultimately however, one of the most effective routes to Civil Service reform will be to recruit people with the skills, experience and values who can drive performance improvements from within – experienced commercial leaders, first-rate HR professionals, experienced project managers, and digital experts. This paper explains how, in spite of its constrained resources and a unique operating environment, the Civil Service can compete for this talent.

This paper looks at the recruitment, retention and performance of Civil Service staff in the context of these challenges. The focus of our analysis and recommendations is primarily on the Civil Service; the 444,000 people who work across 24 Ministerial Departments and their arms-length bodies. It does not cover pay and performance in the wider public sector such as the NHS, Local Government and Education. We assume the same institutional role for the Civil Service: serving the Government of the day with integrity, honesty, objectivity, and impartiality. We take as our starting point the principles set out in the Government's 2012 Civil Service Reform Plan that the organisation needs to become more open and flexible, doing fewer things better, and with staff who have the tools to work in a way that achieves faster results.<sup>11</sup> It makes no explicit judgement about the type of talent or skills that the Civil Service needs to recruit in the future, other than recommending that the organisation recruits talented people and continues its drive towards greater professionalism through the twenty-five recognised professions.\* The rest of this report is split into three sections: Section 1 outlines the main trends in talent and performance management; Section 2 examines the impact of pay and recruitment reforms since 2010; and Section 3 puts forward six recommendations for improving pay and performance in the Civil Service.

\*There are 25 recognised professions in the Civil Service: Corporate Finance; Communication Service; Economic Service; Finance; IT; Knowledge and Information Management; Legal Service; Occupational Psychology Profession; Operational Research Service; Planning Inspectors; Planning; Property; Security; Science and Engineering; Social Research; Statistical Service; Tax; Veterinary; Human Resources; Intelligence; Internal Audit; Medical; Operational Delivery; Policy; Procurement; and Project Delivery.

# 1. What do we mean by talent and performance management, and what should it aim to achieve?

In practical terms, talent and performance management encompasses those HR activities that help organisations achieve their objectives through the attraction, engagement and retention of high-quality people. Conventional wisdom on talent and performance management has changed frequently over recent decades. However, organisations generally employ one or more of the following HR tactics when looking to recruit:

- **Build:** Companies use internal management programmes – for instance executive coaching, 360-feedback, job rotation schemes and high-potential programmes – designed to develop talent in-house. This was particularly popular during the era of life-time employment, and when moving jobs was considered a failure (e.g., 1950s, 60s, and 70s).<sup>12</sup>
- **Buy:** Companies hire experienced outsiders – taking talent from their competitors – rather than primarily developing it in-house and use pay and reward systems to retain existing workers. This was popularised in the early 1990s when the business environment led to large layoffs, a demise of life-time employment, and winding down of internal development schemes.<sup>13</sup>
- **Borrow:** Companies bring in external employees on a temporary basis to perform a certain task or help complete a project. For example, many companies temporarily bring in legal expertise to draw up a contract after completing a deal. Borrowing is popular because it enables firms to access high-performing talent for a fixed period, bringing in new ideas and better managing risk. In some industries, like Oil and Gas, up to 77% of the workforce now reportedly resides outside the core organisation.<sup>14</sup>

None of these are mutually exclusive. At different levels of any organisation you need to deploy different strategies. Few organisations can afford to exclusively buy or reliably try and build it all. The Civil Service uses all of them with varying degrees of success. It has several development schemes like the Fast Stream (Build), recruits experts from outside to fulfil certain posts where it lacks capability (Buy), and brings in specialists to fill gaps in policy-making and delivery (Borrow).

A number of more recent trends are beginning to change the way that organisations think about recruitment and retention.

- **The rise of the star workers:** The knowledge economy has created large numbers of highly complex and non-scripted jobs that do not restrict variance in performance like older factory-system style work. This has given rise to star workers – people of exceptional talent that massively outperform average workers and have a disproportionate impact on an organisation’s overall performance.<sup>15</sup> Many industries are littered with examples of talented individuals that generate enormous amounts of value. In Silicon Valley, for instance, it is thought that one top-notch engineer is worth 300 average ones.<sup>16</sup> In technical terms, the rise of star workers reflects the power law distribution of production: rather than a massive group of average performers dominating production, a small group of elite performers seem to dominate through massive performance.
- **Strategically important positions:** Certain job positions or business areas have a disproportionate impact on an organisation’s performance.<sup>17</sup> The most talented workers are therefore only going to be really effective if they are deployed in positions that are essential to the delivery of the organisation’s business objectives. Good talent management recognises the need to place the very best people in strategic positions as these create the largest star effects.<sup>18</sup> Equally important are systemically important jobs, such as Finance, where upside performance offers no competitive advantage but downside performance has the potential to destroy the whole organisation.
- **Co-creation and an on-demand workforce:** An increasing number of jobs favour sporadic but critical project work rather than long-term, open-ended careers.<sup>19</sup> This reflects the fact that in the knowledge economy ideas and innovation is a company’s primary source of competitive advantage. Diversity of skills, experience and knowledge can support innovation and improve outcomes. Co-creation ways of working, for example, bring together people with different levels of expertise to work on a project for as long as needed to complete the task.<sup>20</sup> It also helps to ensure that every business activity delivers value for money by encouraging activity-based costing.

Given the above changes to the current business environment and nature of work, an effective HR strategy should look to accommodate the following:

- Compete to attract star workers – understand how to identify who they are; how to maximise their performance; and how to make them stay at your organisation.
- Identify the jobs that are most important to your organisation’s objectives and fill them with your best performers.
- Start to use HR as an operational tool that can bring together people with different specialist skills to meet the organisations changing objectives.
- Create a work environment that organises and encourages time-limited projects rather than a set of permanent business activities.

These points will be reflected in the rest of the paper as we examine the Government’s approach to HR.

## 2. Civil Service Pay and Recruitment Policy 2010-2015

It is a widely held view that public sector pay restraints hinder the Civil Service's ability to attract the most talented staff. However, this narrative is slightly misleading. For some senior management positions, the evidence does show that pay levels in the public sector are lower than their equivalents in the private sector.<sup>21</sup> But it is not as if the Civil Service doesn't have the financial resources to compete for the most talented staff in senior positions – payroll expenditure totalled £15.7 billion in 2014/15.\* The problem is that the sheer size of the Civil Service means that the HR budget is divided up between around 440,000 employees.

A smaller Civil Service would be able to deploy its HR budget more effectively, paying higher salaries to a smaller number of more talented people. But before explaining how the Civil Service can achieve this, it is worth examining the various reforms that have been introduced since 2010 and their impact on pay and performance.

### Pay and recruitment policy 2010-2015

Given the size of the total public sector paybill – £164 billion in 2013/14<sup>22</sup> – cutting staff costs has been an important part of the Government's overall efforts to reduce public spending. They have pursued this strategy in three ways:

- A freeze on public sector recruitment for both permanent and temporary positions covering all Ministerial and non-Ministerial departments, Executive Agencies and Non-Departmental Public Bodies (NDPBs). Exemptions to the freeze were allowed for the Fast Stream, Apprenticeships, vacancies resulting from dismissal for poor performance, and if there is an urgent front-line need or the role is business critical.
- A two year pay freeze followed by a 1% annual increase (except for departments with multi-year pay deals). The Spending Round 2013 also announced plans to end automatic progression pay in departments by 2015/16.

\* Estimate based on Policy Exchange analysis of Department's Quarterly Data Summaries. The figures presented cover only the 17 main Government departments, as the NAO does when it analyses Central Government staff costs.

- Aggregating departmental expenditure on the use of consultant and contingent labour (agency workers, specialist contractors and interim managers) to lower the costs of hiring temporary staff.

Staff costs in the Civil Service, which accounts for 9% of the public sector workforce, have reduced significantly as a result of these measures. In 2013/14, the annualised paybill for Central Government was £2.49 billion lower in real terms than 2009/2010.<sup>23</sup> The recruitment freeze accounts for 90% (£2.29bn) of these savings as the number of new entrants declined from an average of 9,400 per quarter in 2009-10 to only 2,800 in 2011-12.<sup>24</sup> The pay freeze, as well as recent efforts to remove progression pay has reduced annualised salary costs by £191 million between 2010 and 2014, while departmental expenditure on temporary agency staff and consultants is, according to Cabinet Office figures, now £1.6 billion lower in real terms than in 2009/10.<sup>25</sup>

### The unintended consequences of pay and recruitment policy

Although these changes have helped to reduce public spending, there have been some unintended consequences:

- **Retaining talent:** At senior levels the pay freeze has made it difficult for departments to attract, motivate and retain new talent. An independent review of talent management, commissioned by the Cabinet Office, found that Senior Civil Servants who have been recruited from outside the Civil Service cited pay levels as a reason to leave.<sup>26</sup> While levels of base pay have for a long time been a barrier to recruiting talent in highly sought after roles, the pay freeze has caused added inflexibility. There are examples where departments have lost talented people because they have been unable to match improved offers of even 10% pay increases.<sup>27</sup> Internal competition for talent (between departments) adds to these problems as some departments pay substantially higher amounts at certain grades.
- **External competition:** The freeze has meant that only a small number of vacant positions have been opened up to external competition outside the Civil Service. This will have limited central departments' ability to find the best talent. And given the mediocre quality of Civil Service training,\* it is

\* A 2013 survey by Civil Service World found that 52% of civil servants who responded thought that training had deteriorated in the previous 3 years.

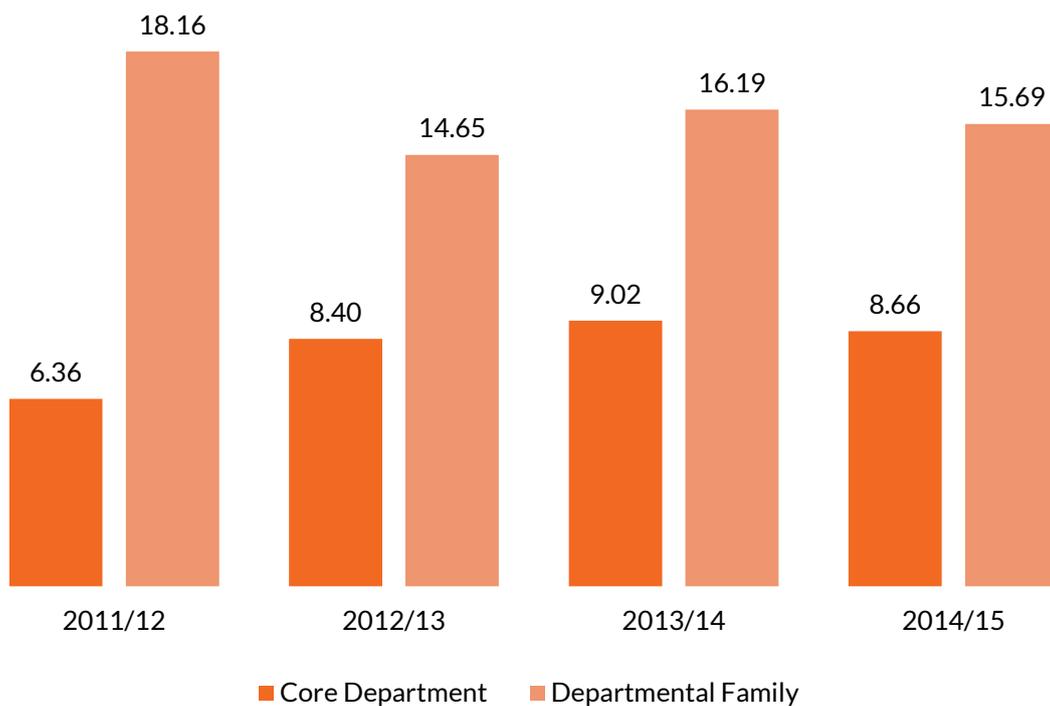
fair to assume that the composition of skills within the organisation will not have changed dramatically since 2010.

- **Aging workforce:** The freeze has created a generational gap between young and old workers. The number of 20-29 year olds as a proportion of the entire Civil Service workforce reduced from 14% to 9% between 2010 and 2014 while the number of 50 to 59 year olds increased from 26% to 31%.<sup>28</sup> Although it is difficult to say what impact this has had on performance, it heightens the risk of skills gaps appearing.
- **Grade inflation:** Departments have become more senior in grade, increasing the average cost per head of Civil Servants. The proportion of staff in administrative grades reduced from 46% to 40% between 2010 and 2014 while the increase in middle management grades increased from 26% to 30%.<sup>29</sup> Despite the headline salary savings, the changes in grade mix resulted in additional annualised salary costs of around £292 million in 2014 compared with 2010.<sup>30</sup> The pay freeze may have contributed to this as promotion has become the only way to get a payrise.
- **Strategic planning:** The central management of pay awards and external recruitment has stopped Departments from taking a strategic approach to workforce management. Staff numbers have been cut by stopping low-priority activity and cutting junior staff, while decisions that require a more strategic approach have been deferred. For example it is very difficult under the current system for a department to recruit ten digital experts with the skills to transform an entire public service, while simultaneously making redundant hundreds of others working in business units that are no longer needed post-transformation. Both the generational gap and grade inflation could also show how reductions have been driven by cost considerations rather than capability as longer serving Civil Servants are more expensive to let go. Moreover, the basis on which redundancies have been made is questionable as most departments do not have a good understanding of the skills within their own organisation.<sup>31</sup>

Further reductions in the number of Civil Servants are necessary if the Government is to meet its target of a budget surplus by 2019/20. However the way these reductions are managed needs to change over the next Spending Review period. Current pay and recruitment policies do not provide departments with the flexible resources they need to strategically manage their workforce.

Moreover, it is not clear from our own analysis of the Government's workforce data that pay and recruitment freezes have lowered HR costs across all parts of the Civil Service. Using data provided by the Government Interrogating Spending Tool (GIST), our analysis shows that the annualised paybill for the Civil Service has fallen, in nominal terms, by £2.5 billion between 2011/12 and 2014/15, similar to the estimates provided by the NAO. However the annualised paybill for core government departments (excluding their arms length bodies) has increased by around 36%, in nominal terms, over the same period from £6.36 billion to £8.66 billion. A number of factors could explain why this has happened. It might potentially reflect the fact that departments have brought additional services into the Ministerial department as public bodies within the wider departmental family have been cut.

**Figure 1: Payroll Departmental Expenditure (£ billions)**



### 3. Paybill reforms for a smaller and higher-performing Civil Service

While the present fiscal environment limits the size of departmental HR budgets, we believe that there are six changes to pay and recruitment policy that the Government could introduce to sustain lower operating costs and improve performance.

#### 1. Devolve control over the paybill to departments

In the last Spending Review the Civil Service paybill was largely controlled by the Treasury via the freeze on external recruitment and average pay awards. This essentially removed the incentive for departments to manage their workforce reductions in a strategic and responsible way, giving full consideration to the mix of skills and talents that they need in the future. The average pay awards has given managers limited freedom to increase or lower pay at their own discretion, and in line with individual performance. The push for voluntary, rather than compulsory redundancies means that departments are likely to have let their highest performers leave. And it is difficult to know what impact all of this has had on performance as departments do not have sufficient information about capability within their organisation.

In this Spending Review, there is a very strong case for delegating control over the overall paybill to departments, giving them much greater responsibility and flexibility over how they choose to deploy their HR budget to meet their organisational needs. Autumn Statement 2013 announced the launch of a Pilot Paybill Control Scheme with the Intellectual Property Office and Department for Environment, Food and Rural Affairs.<sup>32</sup> This has involved the setting of an alternative financial control by the Treasury to keep the organisation's paybill within a pre-determined budget. It has replaced both the 1% cap on pay awards and the freeze on external recruitment for the departments involved.

This paybill pilot control scheme offers a number of benefits over the current system:

- With full responsibility for a pre-determined paybill, set over multiple years, Departments will be forced to think more strategically about what they need in terms of skills and capability. The paybill covers all staff-related expenditure, including off-payroll staff, so departments will be

forced to make a decision between recruiting permanently and borrowing short-term expertise; or paying off poor performers and replacing them with more capable staff. Under the centrally managed system, departments can reallocate more of their overall budget to staffing costs, providing less of an incentive to plan strategically over the long-term.

- The removal of the 1% pay freeze will give departments, and individual managers, the freedom to significantly increase the salaries of their best performers and peg back pay increases for average and underperforming staff. Fairness in pay must mean that reward is commensurate with contribution.<sup>33</sup> As explained in Section 1, wide variations in pay are needed to reflect the power law distribution of performance. In the Civil Service however pay is linked to length of service rather than contribution. And for new entrants, the grading system means that people at similar levels are paid the same irrespective of the contribution they make. With a devolved paybill, managers will be better placed to link pay to performance rather than length of service or seniority, and be more accountable for the recruitment decisions they make. They will also have the flexibility to reduce pay for poor performers. Over the long-term, this pay flexibility should remove the stranglehold that the grading system currently has over the management of talent.
- Departments will be in a stronger position to hire talented specialists. By removing the headline pay awards for certain grades, Departments can independently set the salaries of Civil Servants, paying the going market rate in order to attract people who have the right mix of skills and experience for the job.
- Departments can reallocate a larger proportion of the non-consolidated pay budget to help with recruitment and retention. Central Government Departments spent £35 million on staff bonuses in 2014/15; £365 million if you include Department's Executive Agencies and Non-Departmental Public Bodies. Under the current system Departments can only reallocate 50% of this money to meet specific recruitment and retention pressures. With devolved control, this money is added to the predetermined paybill pot, allowing Departments to freely choose how to spend it, potentially releasing an additional £365m for recruitment and retention.
- The incentives within the current system for Civil Servants to change jobs in order to obtain a payrise will be eradicated. Departments can reward

high-performing and experienced Civil Servants with a significant payrise to keep them in the job.

Delegated paybill pilots offer considerable advantages over the current system for managing pay and performance. For this reason, we recommend that the Government steadily devolves paybill control to more Government departments with larger workforces over the course of the next Spending Review period. Decisions over when and to whom to devolve the paybill should be based on the results from the earlier pilots.

## 2. Reduce the use of consultants and agency staff

*“I’m not one of those who takes the view that the answer to every problem is to bring in outsiders... that whenever there is anything difficult you need to get in management consultants to solve it ... actually civil servants find that quite offensive.”* Francis Maude,<sup>34</sup> former Minister for the Cabinet Office and Paymaster General.

In appropriate circumstances, consultants and interim staff can improve organisational performance. And in many circumstances, contractors can be cheaper than permanent recruits because employers do not have to pay for entitlements reserved for full-time employees, such as pension contributions. In communications, for example, it might cost less to recruit contractors to work on a time-limited Government campaign programme, rather than permanent staff. But their use should generally be the exception rather than the rule: temporarily injecting new capability into an organisation to support the completion of new or complex projects. The Civil Service, in contrast, spends significant sums of money on consultants and interims every year using them as a substitute for proper workforce planning.

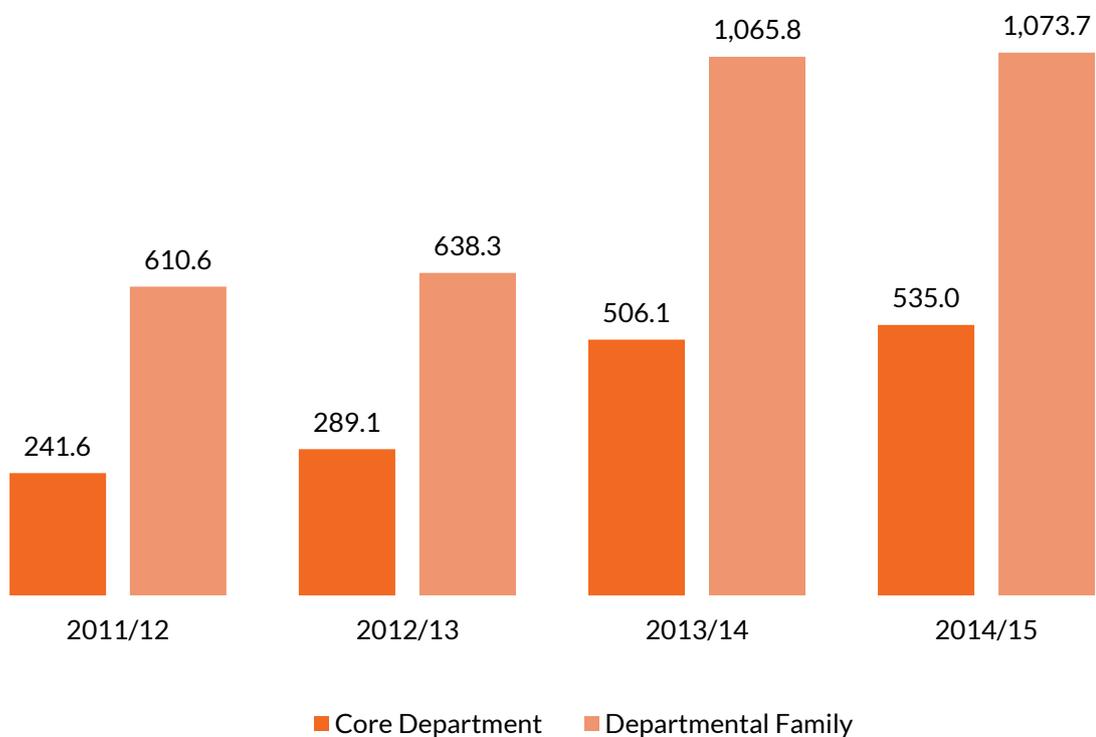
The Coalition Government made significant progress in reducing the use of consultants and interim staff. Central Government (including arms-length bodies) spent £1.5 billion on consultants in 2009/10<sup>35</sup> and consultancy spending has reduced significantly over the previous four financial years. More recently however it does appear that there has been a rebound in off-payroll expenditure.

In 2014/15 Central Government departments spent £535 million on non-payroll staff. £211 million was spent on consultants and £324 million was spent on interim staff (agency workers, specialist contractors and interim managers).<sup>36</sup> Including department’s Executive Agencies and Non-Departmental Public Bodies, the amount spent on non-payroll staff totalled £1.1 billion, as shown in Figure 2

below. That is the equivalent of £4.2 million spent every working day on contractors.

Between 2011/12 and 2014/15 annualised departmental spend on off-payroll staff increased from £241.6 million to £535 million in nominal terms. Including their arms-length bodies, annualised off-payroll expenditure has increased from £610.6 million to £1.1 billion between 2011/12 to 2014/15, in nominal terms. Cumulatively core departments have spent around £1.6 billion on contractors in the last four financial years; £3.4 billion if you include their arm's-length bodies.

**Figure 2: Off-payroll Departmental Expenditure (£ millions)**



The money spent on contractors reflects both the lack of strategic workforce planning in departments but also the flaws within the Government's overall HR system. Departments are permitted to recruit off-payroll staff to 'meet short-term needs for specialist advice and interim services'<sup>37</sup> but it appears that departments have been using these contractors as a substitute for longer term workforce planning and to camouflage gaps in capability. As the figures reveal, departments have continued to cut large numbers of Civil Servants at administrative grades only to then replace them with off-payroll temporary agency staff when the need arises. And given the poor information systems

departments hold about their workforce's skills,<sup>38</sup> it is highly likely that consultants have been recruited despite the fact that the capability to do the job is already in-house or held centrally within the Civil Service. The Department for Business Innovation and Skills, for instance, has recently hired consultants from McKinsey to advise the department on how to make efficiency savings in the Department and its partner bodies.<sup>39</sup> This is despite the fact that the Civil Service has its own internal experts in the Cabinet Office's Efficiency and Reform Group. Consultants are also frequently brought into to carry out cost-benefit analysis to support business cases when there is already sufficient analytical capability among Civil Service economists to do the job.

There are other performance-related reasons for reducing the amount spent on interim staff and consultants. Firstly, at a fundamental level, recruitment should be a binary decision: anyone who does not draw a regular salary from an organisation is likely to be fundamentally misaligned to the objectives of the organisation. Consultants, for instance, are biased to claim value in the near term but not help create more in the future.<sup>40</sup> Secondly, the extensive use of contractors, particularly management consultants, is damaging to the morale of intelligent generalist civil servants who are capable of carrying out similar work. Finally, the persistent use of contractors prevents the Civil Service from investing in skilled and experienced new recruits which is crucial for moving to a more sustainable operating model. As John Manzoni, Chief Executive of the Civil Service, has argued, 'in many cases to get more efficient and more effective, we [the Civil Service] have to move from where we were outsourcing a lot of our skills and capabilities to bringing it inside again.'<sup>41</sup>

To be clear, interims and consultants are sometimes needed given the specialist expertise they can bring into the Civil Service and the demand-driven nature of Government activity. However a portion of the money that the Government currently spends on contractors would clearly be better spent making targeted recruitments in permanent and specialist staff (project managers, digital engineers, commercial buyers, and HR professionals). The claim that it is cheaper to hire specialists on a temporary basis is discredited by the large sums that the Civil Service persistently spends on off-payroll workers.

HM Treasury and the Cabinet Office should ensure that departments redirect a proportion of their annual paybill expenditure on contractors towards recruitment and retention either as part of a devolved paybill or under the

current system. Reallocating just 25% of the money spent on non-payroll staff could add around £250m to the paybill budgets of Whitehall departments. To put that into perspective, £250m would cover the annual costs of recruiting 1,250 new Fast Stream economists, 400 Commercial Directors, 300 Chief Technology Officers, 250 Finance Directors, and 150 high-quality HR professionals.<sup>42</sup> If departments spent 25% less on contractors compared to 2014/15 then the Government could save £1 billion over the next four years.

### **3. Make further reforms to redundancy pay and identify genuinely surplus staff**

Flexible exit payments are a crucial part of any organisation's ability to maintain performance and react to changing circumstances. Firms need adequate financial resources to pay off workers who are no longer needed while offering better wages to the high-performers who remain. In the Civil Service, the backloaded structure of public sector redundancy payments, which reward long years of service, has made it more difficult to let people go. Going forward, further reforms to redundancy pay will be needed if departments are to have sufficient flexibility to restructure and reform.

The Coalition introduced the Civil Service Compensation Scheme (CSCS) in 2010 which caps compensation pay at 21 months salary for voluntary redundancies and 12 months for compulsory terms. The costs of redundancy have since been around 40-50% lower than they would have otherwise been under the older scheme. However despite these reforms the Government has still spent around £4.7 billion on Civil Service redundancies since 2010/11.<sup>43</sup> Moreover the levels of redundancy within the wider public sector (not just the Civil Service) have remained significantly below the private sector.<sup>44</sup> This is partly a consequence of pay restraint and partly because of the heavily backloaded structures of exit packages.

Of the redundancies which have been made, there is a clear deadweight loss. While voluntary redundancy schemes are more palatable politically, they carry a cost: high performers are often the first to leave because they have the best prospects for employment outside the public sector.<sup>45</sup> Compulsory redundancies, which are both cheaper and arguably more important for improving long-term organisational performance, have only accounted for 20% of Civil Service exits since 2010.<sup>46</sup>

Further changes to the terms of exit payments are still needed. In 2013/14, 38% (£0.7 billion) of the cost of Civil Service exit packages (£1.8 billion) was made up of packages worth over £50,000; 56% of the bill (£1 billion) was made up of packages worth between £10,000 and £50,000; only 6% of exit packages were less than £10,000.<sup>47</sup> Although these figures include voluntary exits and their associated pension packages, it is worth stating that the average redundancy settlement across the whole of the UK in 2011/12 was £11,951.<sup>48</sup>

In an attempt to bring costs down further, the Government intends to cap exit payments across the public sector at £95,000. This is a positive step forward. However, there is a risk that this cap will inadvertently become a target for compensation during negotiations rather than a maximum allowance. Some survey evidence, for instance, shows that companies with a maximum and minimum severance package end up paying larger sums to middle and senior management, compared with firms who don't.<sup>49</sup>

Ultimately, however, the best way to bring down the cost of redundancies is to make it much easier to identify those Civil Servants who are genuinely surplus to requirements as compulsory exits cost much less compared with voluntary exits. To do this, departments need a better understanding of the skills and individual contributions that each Civil Servant makes and how that supports their organisation's objectives. This will enable them to confidently and accurately separate out employees for compulsory redundancy – both poor performers and people who no longer have the skills that the department need. Undertaking a zero-based workforce review, as explained in recommendation 4, is the best mechanism for achieving this.

#### **4. Use HR as an operational tool to align the workforce with departmental objectives through a zero-based review**

In any organisation workforce planning is essential for optimising HR costs and improving performance. Theoretically the Spending Review is an opportunity to align HR with each department's key objectives. In reality however decisions about workforce reductions are made from a cost point of view, looking exclusively at headcounts and neglecting wider considerations about talent. This is not just an issue in the public sector: a survey by Harvard Business Review found that just under half of the corporates believe their workforce plans to be driven by finance.<sup>50</sup> In the Civil Service a big problem is that the HR function does

not have the same data and analytical capability as the finance function. Civil Service HR leaders do not appear to have basic information about the skills and talents within their departments.<sup>51</sup>

To improve workforce planning, the HR function needs to assume a much stronger role. Strategic workforce planning is very different from headcount forecasting. It requires asking fundamental questions from a zero-base about the size, shape and role of the organisation. It asks questions like: what should the department do and what should it not do? And how should we prioritise resources against the things that we should do?

There is already an exemplar within Government for carrying out a strategic workforce review. The Department for Education (DfE) carried out a review of the whole department in 2012 to ensure that administrative resources matched Ministerial and statutory priorities, and that these were being deployed as effectively as possible. It found that only 20% of what the Department does is strictly mandatory, with the other 80% being driven by historical commitments or ministerial priorities. Only 3% of staff worked in flexible teams with clearly defined projects and end points. The review freed up resources by identifying surplus activity and enabled the DfE to deploy its workforce more flexibly – 30% of staff are now deployed on a flexible basis. And much greater consideration is now given to the specific capabilities needed in each business unit.<sup>52</sup>

Over the course of the next Spending Review, departments must ensure that the HR function has much greater parity with finance. Those departments that have not already done so should carry out a zero-based review, making sure that workforce resources are aligned with the departments' key objectives. Strategic and comprehensive workforce planning will improve each department's understanding of the professional qualifications, skills and experience within their organisation. This will enable them to:

- put the highest performing civil servants in the most strategically important positions;
- identify where they need to make permanent recruits rather than bringing in temporary agency staff or interim managers;
- make use of in-house expertise before hiring external consultants;
- separate out employees who are genuine candidates for compulsory redundancy.

One issue with devolving the paybill to departments is that it reduces their flexibility: they have to make workforce projections up to three years ahead when some of their activity is demand-driven. By conducting a zero-based workforce review, resources can be freed up, providing Departments with a flexible pool of talent that can be deployed in response to changes in demand. Increasing the number of people who work on a flexible basis offers other performance advantages as well:

- Creates a work environment that is organised as a series of critical and time-limited projects. Departments will be able to deploy Civil Servants with different skills to work on specific projects and this cognitive diversity should improve performance and innovation.
- Reduces the number of standing policy teams that act as a drag on performance. Permanent units typically try to find unnecessary work to do and do not have a work until completion culture because deadlines are infrequent or indefinite.
- Sharpen accountability and better link individual performance to the whole organisation. A workforce review will bring greater clarity about who does and doesn't need to be involved in decision-making and create a stronger link between individual activity and the organisation's outputs. This will help to increase the effectiveness of performance management reviews.

For these reasons, we recommend that all departments undergo a zero-based workforce review over the next Spending Review period, regardless of whether they enter a devolved paybill settlement.

## **5. Reallocate spending on training to recruitment**

Most organisations want to hire the best person for the job available. However the way they allocate their HR budget means that they typically spend more money on training existing staff than they do recruiting new ones. The Department for Education, for instance, spent £2 million on training staff in 2014/15 but spent just £240,000 on recruitment. The Department for Culture, Media, and Sport spent almost four times as much (£254,872) on training existing staff compared to recruiting new ones (£69,855).<sup>53</sup> At Google, by contrast, people investment is frontloaded: the majority of the time and money they spend on HR is invested in attracting, assessing and cultivating new talent.<sup>54</sup>

Consistently spending more money on training than recruitment is a mistake. It is very difficult to convert average employees into high-performing ones. Some experts go so far as to say that 90% of training does not result in a sustained improvement in individual performance or behavioural change among employees.<sup>55</sup>

The quality of Civil Service training, in particular, is highly questionable. The generic courses provided by Civil Service Learning (CSL) cover things that Civil Servants should either already know ('Time Management' and 'Effective Communication') or areas that are entirely unsuitable for remote testing and can only be gathered on the job ('Business Acumen', and 'Commercial Awareness').

Remote desktop learning may be suitable in some circumstances, for instance, learning a new calculus model,<sup>56</sup> but it is no replacement for learning on the job, seeing first-hand how people with commercial skills operate with suppliers. There is also no measure within Government about the impact these courses can have on performance. The 2014 Civil Service Reform Plan progress report, for example, showed that 47,000 civil servants had completed commercial skills courses over 9 months in 2013/14.<sup>57</sup> However no further information is provided about these Civil Servants so it is impossible to know whether or not they actually work in roles that require commercial skills or what affect (if any) it has had on their performance since.

Between 2012 and 2016, the Government has spent up to £250 million on centrally provided training through Civil Service Learning (CSL). CSL was introduced by the Cabinet Office in 2011 to save money by centralising training development and procurement across Whitehall via a 4 year contract with Capita.<sup>58</sup> The actual amount spent by Central Government on training every year is likely to be much larger as the administration budgets for many directorates within departments includes money for learning and development.<sup>59</sup>

The Civil Service's approach to training needs to be reformed. Outsourcing learning and development is not always the best thing for organisations to do: professional trainers and academics tend only to have theoretical knowledge while consultants have shallow or third hand knowledge.<sup>60</sup> The best trainers are actual practitioners, people with real-life examples of how they have used their knowledge and skills effectively. The Treasury, a department which consistently has high levels of external demand for its staff, already delivers its training programme in-house, rather than sub-contracting to external providers.<sup>61</sup>

The Government should explore the alternatives to Civil Service Learning. We recommend that responsibility for training civil servants should be passed to experienced specialists who already work within the Civil Service. Doing so could release up to £250 million; money which would be put to better use bringing in world-class HR professionals who can identify and bring in the experts and skills the Civil Service needs. Without high-performing HR, even the most carefully designed reforms will prove ineffective in boosting organisational performance.

## **6. Reallocate funding for the Fast Stream away from generalists and towards the specialist streams**

The Civil Service Fast Stream takes the crop of best and brightest graduates in the country, moving them up quickly into Civil Service leadership roles within 3 to 5 years through rotation schemes and tailored training programmes. It is consistently ranked in the top ten of the Times top 100 graduate employers. Traditionally the Civil Service has run two types of scheme: the generalist stream recruiting policy advisors and the analytical stream that recruits economists, statisticians and social researchers.

Despite the continued popularity of the Civil Service Fast Stream, the programme does feel dated. It is essentially a factory-style system of recruitment placing bright graduates into a pre-defined corporate structure in return for a stable and open-ended lifetime career of public service. More significantly however the current scheme does not bear any relation to the actual HR needs of Whitehall departments: it is run every year with new recruits typically starting at the same time and a place being guaranteed for all applicants to the Corporate Fast Stream who achieve a pass mark at the assessment centre.<sup>62</sup> The scheme is also heavily geared towards the recruitment of generalists rather than specialists. Of the 2,342 Fast Streamers working in Government as of March 2014, half of these were members of the Generalist Fast Stream and 41% of all Fast Streamers worked in policy roles.<sup>63</sup> And these figures do not include the former Fast Streamers now working in middle management positions.

The Coalition made a number of changes to the Fast Stream. For example, the scheme is now organised centrally by the Cabinet Office and has been simplified to four rotating six month placements, followed by two 12 month placements. Recognising the need for greater professionalism and specialist skills within the Civil Service, the number of different professional schemes has also been

expanded to include Commercial, Finance, Digital and Technology, and Project Delivery.

These reforms, while a positive step forward, will take some time to come to fruition. In the short-term, given the significant imbalance between generalists and specialists within the Civil Service, there is a strong case for reallocating funding for the Fast Stream away from generalists and towards the specialist graduate schemes such as the economic, finance and commercial Fast Streams. Minimising recruitment to the Generalist Fast Stream for two years could unlock over £100 million additional funds that could be reallocated to recruit graduates into the new specialised schemes.

## Conclusion

The six reforms outlined in this paper should enable the Civil Service to deploy its HR resources more effectively – helping departments to attract and retain the best talent while moving to a sustainable long-term operating model. In summary, these reforms will:

- Give departments control over a pre-determined paybill, set over multiple years, incentivising them to think more strategically about how they manage workforce reductions and give them new freedoms to better link pay to performance.
- Reallocate a portion of the money spent on external contractors to help plug longstanding gaps in capability, particularly specialist roles, where it delivers value for money.
- Lower the cost of redundancy payments still further, giving departments' greater flexibility over how they restructure.
- Better align HR resources with departmental objectives. This will help to improve data on internal capability; better match star workers to strategically important positions; create a flexible pool of talent that can respond to changes in demand; and reinforce accountability.
- Bring training in-house, devolving responsibility for provision to experienced high-performers who already work in the Civil Service, and freeing up new resources which can be put to better use in attracting and assessing external talent.
- Reallocating spending away from the generalist Fast Stream to the new specialist streams to build a pipeline of talent in areas where there is currently a shortage.

Although each reform would be worth pursuing individually, they are clearly more effective as a package. The devolved paybill, for example, will force Finance and HR directors to plan ahead and think more carefully about whether or not to recruit permanently for a position or use a contractor. Carrying out a zero-based workforce review will more effectively separate out employees for redundancy, thereby lowering the cost of exit payments. Unlocking additional resources to recruit and retain the best talent will deepen the skills and expertise within the Civil Service and in doing so improve the quality of in-house training. What is clear however is that the HR function will need to assume a much stronger role in future if the Civil Service is to realise a step-change in performance.

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