



# Social value and the prosperity agenda in defence



# Introduction

The government has set itself the goal of using its spending power to improve the everyday lives of those that have been 'left behind'. In addition to price and quality, nearly all government competitive tendering will now include a social value test when deciding who wins a contract. The new test is intended to link spending decisions to priority social goals such as job creation, climate change and improving the diversity of the workforce.

In this report we analyse the social value test and discuss its limitations. We look at alternative ways of measuring the defence contribution to the UK economy and consider whether a more direct approach might be a better way of delivering prosperity to the communities that rely on defence work. We suggest that government needs to provide tangible outcomes to measure progress towards its social value goals.

The report is structured as follows;

- **Section 1:** What is the social value test?
- **Section 2:** What are the limitations of the current design?
- **Section 3:** The defence tax premium and other direct interventions.
- **Section 4:** Promoting innovation.
- **Section 5:** Measuring impact.

Extending the criteria for awarding contracts to include a social value test potentially opens the door to a more active industrial policy that promotes jobs in defence. Our report highlights those aspects of the policy that need to be developed further to deliver this goal.

<b>Introduction</b>	<b>2</b>
<b>Section 1: What is the social value test?</b>	<b>3</b>
<b>Section 2: What are the limitations of the current design?</b>	<b>5</b>
<b>Section 3: The defence tax premium and other direct interventions</b>	<b>7</b>
<b>Section 4: Promoting innovation</b>	<b>9</b>
<b>Section 5: Measuring impact</b>	<b>10</b>

Prospect is a trade union representing over 11,000 scientists, engineers and managers across the defence industry in both the private and public sectors.

# Section 1: What is the social value test?

Government spends £290 billion a year buying goods and services from external suppliers. How it chooses to exercise its spending power can have a significant influence on the structure of these external markets. Under existing procurement rules the main consideration for suppliers providing a service is the price. The procurement rules started to change when other social objectives started to emerge as part of the discussions around the implementation of the millennium development goals. Procurement rules were amended by international bodies, such as the WTO and the EU, to allow governments to set some limited conditions which address social objectives.

In 2013 the UK government introduced a social value test which was intended to encourage suppliers to provide evidence of economic, environmental, and social well-being when making a bid as part of the tendering process. Initially the test was aimed at a narrow strand of

public spending delivered by charities and social enterprises in local government and the health sector. In 2018 the government extended the social value test to a much broader proportion of the public sector as a way of restoring faith in the procurement process following the collapse of Carillion. The coverage was extended further in December 2020 following Brexit, which means that a social value test will now apply to nearly all government spending.

The social value test is any benefit identified in the tender that is over and above the core deliverable/s of the contract, for example the creation of new apprenticeships. The policy objectives are intended to make a positive contribution in some way beyond the narrow confines of the contract. The tests may include a number of different objectives, the government has set out its social value priorities, which are shown in the table below.<sup>1</sup>

## Social value criteria options

Themes	Policy outcomes
<b>Theme 1 – COVID-19 recovery</b>	<ul style="list-style-type: none"><li>• Help local communities to manage and recover from the impact of COVID-19.</li></ul>
<b>Theme 2 – Tackling economic inequality</b>	<ul style="list-style-type: none"><li>• Create new businesses, new jobs and new skills .</li><li>• Increase supply chain resilience and capacity.</li></ul>
<b>Theme 3 – Fighting climate change</b>	<ul style="list-style-type: none"><li>• Effective stewardship of the environment.</li></ul>
<b>Theme 4 – Equal opportunity</b>	<ul style="list-style-type: none"><li>• Reduce the disability employment gap Tackle workforce inequality.</li></ul>
<b>Theme 5 – Wellbeing</b>	<ul style="list-style-type: none"><li>• Improve health and wellbeing Improve community cohesion.</li></ul>

<sup>1</sup> <https://www.gov.uk/government/publications/procurement-policy-note-0620-taking-account-of-social-value-in-the-award-of-central-government-contracts>

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**“The success of the social value test will be judged on whether the behaviours of those awarding contracts is changed so that the quality of the jobs created is as important as the price the contract.”**

When assessing different bids, the MoD will score each bid against a set of criteria, with price and quality still accounting for the majority of the weighting score. In future bids will now include a social value weighting of 10% of the overall score.

A bid may include more than one theme in a single bid, these will then be weighted. MoD has issued guidance that bids that include their priority themes should be weighted as follows, tackling economic inequality 5%, climate change and equal opportunity 2.5% each. These weightings can be adjusted where there is a case for alternative proposals, for example, some suppliers, particularly in the supply chain, may be unable to deliver against some policy objectives such as recruitment, but may be able to deliver against other priorities such as climate change.

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<sup>2</sup> Key Performance Indicators (KPIs) for government's most important contracts – <https://www.gov.uk/government/publications/key-performance-indicators-kpis-for-governments-most-important-contracts#history>

Contract outcomes are monitored through the Contract Management processes. Key performance indicators (SV KPIs) are set to measure outcomes against the proposed objectives in a simple matrix; good, approaching target, requires improvement and inadequate. If a contract fails to meet its objectives the MoD can take action by imposing a penalty or cancelling the project.

There are regular reports of progress against contract KPIs for the most important government contracts on the Cabinet Office website, these will now include SV KPIs.<sup>2</sup> This provides information by department of; the contract title, the supplier, the relevant KPI and the current rating. Currently there are no SV KPIs visible on this website, it is not clear whether they will be recorded separately from other KPIs.

The success of the social value test will be judged on whether the behaviours of those awarding contracts is changed so that the quality of the jobs created is as important as the contract price.

## Section 2: What are the limitations of the current design?

Given the importance attached to cost and quality there is a risk that the social value test will not have sufficient cut through to make a difference. The landscape for procurement has been shaped by four decades of outsourcing and competitive tendering. Price is an easy concept to understand and so will continue to be decisive when contracts are awarded unless there is a compelling case to use other selection criteria. Value for money is not intended to mean simply the lowest price. The Defence and Security Public Contracts Regulations 2011 already gives a choice between the “lowest price” or the “most economically advantageous tender” bid, (so-called MEAT criteria). But even with this option available there is considerable pressure to award

contracts to the lowest bidder. All procurement decisions are considered within the context of a tight financial envelope for defence spending. Prior to the latest spending settlement, the National Audit Office described the equipment plan as unaffordable. Public scrutiny of the department’s performance means that other considerations will be less important than price when contract decisions are made.

To deliver the government’s prosperity agenda the social value test will need to be clearly defined with outcomes that can be measured in a transparent way.<sup>3</sup> Although there has been some experience of using a social value test in other contexts it is not clear how the test will be applied in the defence sector. In local government the early experience of using the test was mixed. Both clients and suppliers had little understanding of the concept, as a result far fewer contracts applied social value criteria than was expected.<sup>4</sup>

Similar problems have been found in the infrastructure sector. A roundtable of contractors convened by the Institute of Civil Engineers found that price was still the key driver in contract decisions and that there is a gap between social value policies and the incorporation of these objectives into the procurement processes. As the roundtable concluded;

**“The weighting of the social value test sends a message to industry that price is still the most important criteria when making contract decisions. To embed a culture change government should increase the weighting of social value criteria in the bidding process.”**

<sup>3</sup> Maximising social value from Infrastructure projects, 2020, ICE [https://usefulprojects.co.uk/wp-content/uploads/2020/01/Maximising\\_social\\_value\\_from\\_infrastructure\\_projects\\_v1.1.pdf](https://usefulprojects.co.uk/wp-content/uploads/2020/01/Maximising_social_value_from_infrastructure_projects_v1.1.pdf)

<sup>4</sup> Reappraising the UK social value legislation, 2017, Boeger, N <https://research-information.bris.ac.uk/ws/portalfiles/portal/91354213/PMMrevised.pdf>

“To have greater impact, social value needs to become fully embedded in organisational strategy, culture, processes and decision making.”<sup>5</sup>

The weighting of the social value test sends a message to industry that price is still the most important criteria when making contract decisions. To embed a culture change government should increase the weighting of social value criteria in the bidding process.

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5 Maximising social value from Infrastructure projects, 2020, ICE, p8

# Section 3: The defence tax premium and other direct interventions

The UK has the most open defence market in the world, which means that a higher proportion of taxpayers money is used to buy military equipment from overseas when compared with other nations with similar sized defence sectors. At present the Green Book does not allow tax revenues to be considered as part of the evaluation process when comparing different bids.

“Costs to government of raising funds (either through taxation or borrowing) are not a decision variable because the planned level of public spending is decided in advance when the budget is decided. It is at this macroeconomic stage that borrowing costs are considered.”<sup>6</sup>

By not considering the positive contribution of taxpayers money to economic prosperity the government may be undervaluing the contribution of the defence sector to macroeconomic performance. Research by Oxford Economics found that procurement in the sector generates an increase in gross output more than twice the initial investment.<sup>7</sup> The Dunne report recommends

**“Government needs to show the political will to ensure that the social value test is meaningful in shifting more spending towards UK based firms.”**

academic research into these claims.<sup>8</sup> But even if the Green Book is not amended there are other policy changes that the government could adopt to support industry.

The UK government has been less willing than other EU countries to exercise exemptions from procurement on the grounds of national security.<sup>9</sup> This has become particularly contentious in relation to the Fleet Solid Support contract which is under threat from a consortium led by an overseas contractor rather than the bid led by Team UK. The decision to invest in Sheffield Forgemasters shows that strategic assets can be protected if they are identified as critical to UK defence programmes.<sup>10</sup> It is disappointing that government is not doing more to extend the scope for using contracts to secure national economic interests.

The Australian government has adopted the Mandatory Minimum Indigenous Participation Requirements (MMR), which sets targets for awarding work to Australian based firms up to a

6 <https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-government/the-green-book-2020> para 5.4

7 The economic case for investing in the UK defence industry, [https://regmedia.co.uk/2009/09/01/oxford\\_economics\\_dic\\_report\\_2009.pdf](https://regmedia.co.uk/2009/09/01/oxford_economics_dic_report_2009.pdf)

8 Growing the contribution of defence to UK prosperity, 2018, Dunne. P, p54

9 <https://www.tuc.org.uk/blogs/no-eu-rules-won%E2%80%99t-stop-us-building-uk-ships-uk-shipyards>

10 <https://www.gov.uk/government/news/uk-government-to-acquire-sheffield-forgemasters-international-limited>

certain threshold.<sup>11</sup> Defence accounts for half of the contracts awarded under these regulations. To be effective the social value test will need a similarly clear objective.

A further threat to UK based firms is the recent spate of corporate takeovers which is reducing the size of the defence footprint; GKN, Cobham, and more recently Meggitt and Ultra Electronics have all been targeted by overseas companies and it is less than a decade since BAE Systems was subject to a takeover bid by EADS, which eventually fell through because of opposition by the German government.<sup>12</sup> It is against this background that the government is introducing the National Security and Investment Act,

which comes into force on 4 January 2022. The Act gives the government powers to intervene in business transactions, such as takeovers, to protect national security.<sup>13</sup>

While the shift towards a more active industrial policy is welcome, at the moment other countries are doing more to defend their own national interests. The government has many levers it can use to shape the defence sector. As Oxford Economics show there are wider benefits from using taxpayers money to invest in UK based firms.

Government needs to show the political will to ensure that the social value test is meaningful in shifting more spending towards UK based firms.

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11 <https://www.niaa.gov.au/indigenous-affairs/economic-development/indigenous-procurement-policy-ipp>

12 <https://www.bbc.co.uk/news/business-19897699>

13 <https://www.gov.uk/government/collections/national-security-and-investment-bill>



# Section 4: Promoting innovation

Added value in defence relies on smart design, complex systems and the development of intellectual property. Basing development work in the UK provides opportunities for future export growth. The sale of the Type 26 design to Canada and Australia shows the potential for this type of activity. The subsidiary work which often accompanies complex military equipment such as support, maintenance and training, will be important in enabling the UK to retain its position as a leading defence nation in the future. This underlines the importance of developing a rounded skilled workforce.

There is a global competition for skilled labour attracted to companies engaged in innovation. The MoD have recognised that it is difficult to recruit and retain specialists in defence.<sup>14</sup> Designing contracts that encourage innovation will require employees able to recognise the best solutions during the procurement process. Framed in this way, the social value test will also be a measure of the government's capability as an intelligent customer.

In the private sector defence companies also face competition for these workers from other sectors. The nuclear sector will need to recruit up to 60,000 people by 2030 in order to address a combination of replacement and expansion demand.<sup>15</sup> Engineering UK estimates that there

**“To encourage an innovation culture, social value needs to include performance metrics that measure the growth of UK-based design innovation.”**

is a shortfall of between 37,000 and 59,000 in meeting the annual demand for core engineering roles.<sup>16</sup>

Engineering offers high value well paid work, but as it is currently framed the social value test will not do enough to deliver against these challenging goals. To attract the smart engineers of the future government needs to invest in innovative firms. Creating a culture that encourages investment in new technologies will be an important part of the design of the UK's procurement regulations.<sup>17</sup> As the Dunne report warns the government is risk averse and too slow in delivering new technologies. To encourage an innovation culture, social value needs to include performance metrics that measure the growth of UK-based design innovation.

14 Letter from MoD Permanent Secretary Stephen Lovegrove to the Public Accounts Committee, 25/3/20  
<https://committees.parliament.uk/download/file/?url=%2Fpublications%2F746%2Fdocuments%2F4287&slug=letter-from-stephen-lovegrove-regarding-follow-up-on-question-from-11-march-committee-session-on-defence-nuclear-infrastructure-25-march-2020pdf>

15 <https://www.nssguk.com/media/2018/nuclear-workforce-assessment-2019-full-report-final.pdf>

16 <https://www.engineeringuk.com/research/data/2019-excel-resource/>

17 <https://www.gov.uk/government/publications/growing-the-contribution-of-defence-to-uk-prosperity-a-report-for-the-secretary-of-state-for-defence-by-philip-dunne-mp>

# Section 5: Measuring impact

The social value test is being introduced to make a difference, however, as it is currently presented the test is not well defined and so there is a risk that outcomes will fail to deliver against expectations. Government should develop impact indicators that measure the contribution of social value towards the prosperity agenda.

The MoD will provide regular reports on the progress of SV KPIs, but this will not necessarily show the impact on communities where contractors are based. In health and social care a range of tools have been created to measure the impact of social value.<sup>18</sup> These range from spreadsheets which log and record outcomes to more sophisticated modelling which have been developed using the principles of social accounting and cost-benefit analysis to calculate the social return on investment (SROI).<sup>19</sup>

The SROI is an attempt to provide more rigour to social value measurement, however some have questioned the validity of these tools because of the subjective nature of this type of assessment.<sup>20</sup> By simplifying the reporting the government has avoided this challenge but this highlights a problem with the current reporting system, how will stakeholders be able to judge whether social value has made a positive contribution to a wider prosperity goal.

No one would disagree with the importance of any of the themes prioritised by government, but a possible concern is that there are too many competing goals which may dissipate the impact of the test overall. The government has said that it will engage with suppliers to gauge what the market can supply and may adjust the model, or its application, depending on the outcomes that are delivered.<sup>21</sup>

This type of engagement suggests that government hopes to leverage a number of policy objectives through the social value test. The Dunne report suggests that the MoD should give clearer practical guidance to help industry understand which objectives are most important.<sup>22</sup> This guidance should outline the impact indicators that government will use to show how the social value test is contributing towards the prosperity agenda. This would provide some clear and transparent metrics that measure the impact of the test and may prompt action if government is not meeting its own objectives.

18 <https://www.hact.org.uk/>, <https://socialvalueuk.org/>, <https://www.seratio.com/home>; <https://socialvalueportal.com/>

19 <https://socialvalueuk.org/resource/a-guide-to-social-return-on-investment-2012/>

20 Measuring Social Value, 2010, Mulgan. G [https://ssir.org/articles/entry/measuring\\_social\\_value](https://ssir.org/articles/entry/measuring_social_value)

21 <https://www.techuk.org/resource/social-value-dsf-all-industry-session-questions-answers.html>

22 Dunne, p.23

## Possible impact indicators

Themes	Policy outcomes	Impact indicators
<b>Theme 1 – COVID-19 recovery</b>	<ul style="list-style-type: none"> <li>• Help local communities to manage and recover from the impact of COVID-19.</li> </ul>	<ul style="list-style-type: none"> <li>• Year on Year measure for the increase in direct and indirect work in defence.</li> </ul>
<b>Theme 2 – Tackling economic inequality</b>	<ul style="list-style-type: none"> <li>• Create new businesses, new jobs and new skills. Increase supply chain resilience and capacity.</li> </ul>	<ul style="list-style-type: none"> <li>• Breakdown of jobs created by occupation.</li> <li>• New businesses created, and contracts awarded to the supply chain.</li> </ul>
<b>Theme 3 – Fighting climate change</b>	<ul style="list-style-type: none"> <li>• Effective stewardship of the environment.</li> </ul>	<ul style="list-style-type: none"> <li>• Reporting on CO<sub>2</sub> emissions in sector.</li> <li>• Adoption of green technologies.</li> <li>• Waste reduction.</li> </ul>
<b>Theme 4 – Equal opportunity</b>	<ul style="list-style-type: none"> <li>• Reduce the disability employment gap.</li> <li>• Tackle workforce inequality</li> </ul>	<ul style="list-style-type: none"> <li>• Monitoring of the defence workforce by gender, ethnicity and disability. Breakdown by occupation/profession.</li> <li>• Equality based pay gap reporting.</li> <li>• Employment by disability.</li> </ul>
<b>Theme 5 – Wellbeing</b>	<ul style="list-style-type: none"> <li>• Improve health and wellbeing.</li> <li>• Improve community cohesion.</li> </ul>	<ul style="list-style-type: none"> <li>• Monitoring of stress in the workplace.</li> <li>• Reporting of health related illness in the sector.</li> </ul>

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