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Scrutinizing third parties: A matter of compliance and reputation

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History always has a funny way of repeating itself, but we can learn from the past so it doesn't have to repeat.

History shows us that contracting services, whether as customer or supplier, require strong processes and trusting relationships. Here we look at some of the dangers of not knowing your supplier or having the wrong contract in place and guidance on what effective third-party due diligence looks like.

A tale of two contracts

Over a period of 80 years, around 160,000 British and Irish convicts were transported to the Australian colonies under public service contracts. While expensive, the first fleet of convicts sent to Botany Bay in 1787 was an outstanding “success” in that 3% of the convicts died on the way—a remarkable figure given that only a few European ships had visited Australia before. The second fleet, operated by a different contractor under a different contract, lost 40% of the people it transported and came to be known as the Death Fleet. The difference between these two outcomes lies entirely in the design and management of their contracts.^[1]

The first fleet was contracted under a “cost-plus” or “cost-reimbursement” arrangement as there was uncertainty about the length of the voyage and the cost of provisions along the way. This was an expensive solution costing around £50 million in today's values. Consequently, when the second tender was issued, it was under instruction from the home secretary that it be “with the least expense to the public.” The second fleet was therefore awarded to the lowest bidder, without regard to the contractor's background or reputation.

The selected contractor of the first fleet, William Richards, a humanitarian and an evangelical Christian, cared about the treatment of the convicts. He also belonged to a community that would have judged him badly if it were known that the convicts were not well treated. The first fleet was also under the direction of an experienced naval agent and surgeon who ensured the health of the convicts. There was a requirement to stop three times on the journey so prisoners could roam freely. For the second fleet, however, the government chose Camden, Calvert and King, the largest firm of slave traders in London with a reputation of using whatever methods appropriate for the sake of efficiency and bringing with them practices familiar to those in the slave trade. This fleet was put under an inexperienced young naval agent who showed no care for the convict's health.

Given it was a cost-plus agreement, performance management for the first fleet was largely developed by the naval agent, but for the second fleet, performance management standards were embedded in the contract and applied within the agreed fixed price per prisoner of £17, seven shillings and a sixpence. The contract specified provisions on the level of accommodation, security, and rations with the captains required to submit their journals to a government monitor at the end of the voyage. However, the contract also provided heavy financial penalties for escape, with the result that most were kept in shackles for much of the voyage. There were no specified stops, so to keep costs down and within the fixed price, they only stopped once. In addition, the captain was allowed to sell any unused food and supplies at the end of the voyage; not surprising then that there were

complaints of prisoners being underfed. The phased payments were based on the delivery of the stores and not on the number of prisoners who were safely delivered. All of these factors contributed to the crew's reduced incentive to care for the convicts.

In short, the second fleet ran on a fixed-priced contract that had been let to a low-cost bidder with the wrong reputation and qualifications, and this was undermined by weak contract management and the introduction of performance measures that created perverse incentives. The resulting death rate caused a scandal that stopped the government from using Camden, Calvert and King again.

The first fleet contractor, William Richards, having criticized the government's decision to accept the lowest bidder, was subsequently employed to transport two more shiploads at a fixed price with a bonus for each convict landed alive. On his next voyage, only one convict died.

What gets measured gets done.

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