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2020 Lessons for Private Equity in 2021

What lessons and insights does this astonishing year offer private equity and portfolio companies as they look to 2021?



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We have had one of our busiest years. Many clients have had to re-evaluate the political and regulatory risk facing existing and potential assets. They are uncertain as to which changes in 2020 will prove to be short-lived, and whether the extraordinary responses to COVID-19 will become the 'new normal' and direction of travel under the Johnson Government post-Brexit. For instance, will the fiscal expansionism and massive growth in government intervention herald a lasting move away from the traditional free-market, Conservative approaches?

We believe there are ten main themes investors and executives should consider when they assess risk and opportunities and new investments in 2021.

1. Private sector participation in public services

While media and political scrutiny of the private sector during COVID-19 seems largely negative (and focused on central government COVID-19 contracts) the truth on the ground is that the private sector has provided essential extra capacity, in particular in the health service.

Private hospital groups report attitudes towards them being 'totally transformed' as waiting lists – already too long before the pandemic – have stacked up. This dynamic is set to continue to bring in NHS business for private providers in the years ahead as elective and routine surgeries and appointments resume in earnest.

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In education, the new National Tutoring Programme is bringing private tutoring and supply teacher agencies into education delivery. Though the longevity of this programme is unclear, it nonetheless demonstrates a favourable attitude towards the private sector in Government.

There has been renewed scrutiny of private provision of children's services over recent months – including a damning report by the Children's Commissioner. The Government is set to review the sector (a key development for those with an interest in this market), but the role of the private sector remains entrenched in children's care at a time when in-house local authority capacity to deliver services will become more constrained.

We expect private provision to increase in some areas but the Government will be keen to avoid politically sensitive areas.

2. Procurement

We are likely to see major change in public sector procurement, with more CCS (Crown Commercial Service) Frameworks and a shift away from closed systems and programmes that benefit big incumbents, to service delivery and procurement models that encourage innovative and flexible SMEs.

The promotion of SMEs is a central theme of December's Green Paper Transforming Public Procurement, which aims to cut red tape and create 'more resilient, diverse and innovative supply chains.' The new approach and processes could be highly beneficial for government suppliers, especially SMEs, but the Government's objectives will only be full realised if public sector bodies design projects and specify tenders in a way that encourages innovation and a diverse range of suppliers. SMEs also feature strongly in the important but overlooked September government guidance on social value in procurement, which makes social value (social, economic and environmental impacts) a much more important factor in contract award criteria. It also shows that the Government sees procurement as a way to stimulate employment and growth opportunities in the light of COVID-19.

3. Levelling-up

Despite criticism over what were seen as heavy-handed and inequitable COVID-19 restrictions in Northern cities, in other areas of policy the commitment to 'levelling-up' is evident. The drive is backstopped by the increasingly sophisticated group of 'Blue Wall' Tory MPs, who feel they have little to lose from pushing the Government hard on its election pledges.

This year the Government has conducted a review of the 'Green Book' which provides guidance on cost-benefit appraisal for public projects. Importantly the new guidance will give more weight to whether a project is in line with the Government's social policies, with the hope that this will end the systematic preference for projects in areas that already have high levels of economic activity. This change should be particularly notable in the North and Midlands, which are set to benefit from major road and rail infrastructure investment.

4. Green economy

The Johnson administration's vision of a hi-tech, AI-assisted and 'green' economy to power the UK out of combined COVID-19 and Brexit slumps has been crystallised by the recent Spending Review, along with the '10 Point Plan' for climate change and a new National Infrastructure

Strategy. Multi-year capital allocations have been made for infrastructure projects in road and rail, as well as for superfast broadband roll-out.

Creating and supporting jobs is a key theme here, for example for the 60,000 people the Government says will be involved in quadrupling the amount of offshore wind power produced in the UK.

5. Digitisation and other drivers of public sector transformation

COVID-19 has shown that many public services can be delivered or supported remotely without large back offices in town halls or regional outposts of the civil service. This has huge potential to deliver much-needed efficiency savings, but typically demands cloud-based rather 'on-premise' solutions.

Most public sector bodies have shown themselves remarkably flexible, effective and fast in adapting to dramatically different circumstances this year - so there should be greater openness to longer-term commitments to changes in how services are delivered. Access to high-speed internet is a possible roadblock here, making it all the more important for the Government to deliver on full fibre rollout pledges.

6. Public funding resilience

The impact of COVID-19 on revenues and the profile of grants awarded by the Treasury have created clear winners and losers across the public sector.

While defence, transport infrastructure, the NHS and to some extent schools have been looked on favourably this year, local authorities and the services they provide have been hit hard. These variations indicate that we will not see a rerun of the 2010-2016 austerity programme of widespread and severe public funding cuts. Instead, spending will be strategically delivered in line with political priorities.

COVID-19 has undermined key local government revenue sources (e.g. for district councils that get a high proportion of revenue from parking and other fees) at a time when central Government is in the process of pushing councils to be more financially self-sufficient.

As a result, non-discretionary services including adults' and children's social care will continue to be prioritised, with funding going primarily to the most acute needs.

7. Tax

The looming fiscal crisis means that we expect significant changes in taxation that would not have been countenanced by the Conservatives a year ago. Several consultations and inquiries

indicate the likelihood of major change in business rates, Capital Gains Tax, Council tax and a wide variety of tax exemptions. Underpinning the shift in the Conservative party's thinking is the finding that their changing voter base (and the electorate as a whole) is increasingly in favour of raising taxes, especially on wealth and corporations. The loose fiscal stance from the Treasury at the Spending Review is not sustainable, as many Conservatives and commentators recognise, and tax hikes will be on the agenda at the Spring and Autumn budgets.

8. Centralisation

COVID-19 underscored the extent to which this Government is willing – despite a lot of decentralisation rhetoric – to direct and control from the centre – an attitude that remains unshaken, despite high-profile failures in delivery during the pandemic.

Next year, the Government plans to abolish Clinical Commissioning Groups (CCGs), handing their commissioning powers to Integrated Care Systems (ICSs), which will oversee resources for populations of a million or more. The move effectively undoes localising reforms brought in by successive Labour and Conservative governments, reducing councils' influence over healthcare policy.

On education, a shift to the centre is also apparent. The rollout of the new National

Funding Formula (NFF) will remove councils' role in allocating schools funding, while the expected resumption of the academisation programme following its COVID-19 hiatus will further diminish the decision-making power of England's local authorities.

9. Devolution

The Government's centralising tendencies are likely to bring it into conflict with local government and the devolved administrations.

Although the Johnson administration talks a good game on its desire to “level-up” regions, this seemingly only extends to providing funding from the centre. The creation of more combined authority areas (CAAs) and metro mayors is firmly off the agenda for the time being.

Similarly, the Government wants to “hold firm” on further national devolution – and is prepared to adopt a more stridently unionist tone than previous administrations (as demonstrated by the provisions of the Internal Market Bill). This has only fuelled secessionist sentiments in both Scotland (where pro-independence advocates are now in the majority) and Wales (where support for independence is at a record high).

Such tensions between the centre and the peripheries look set to become an entrenched part of political life.



10. Labour markets

The gig economy agenda – like so many others – was not put on hold in 2020 but its profile suffered, even though COVID-19 exposed how vulnerable many gig economy workers (indeed, all casual and freelance labour) are during downturns. The Government has committed itself to improving labour market enforcement, and while the IR35 reforms will be implemented from April 2021, the Government has shown flexibility in its most recent (November) guidance.

The reality of Brexit in 2021 will complicate matters further, but – as ever – political and regulatory risk should be regarded as an inevitable but manageable fact of life – and as a potential area of huge opportunity. We doubt that 2021 will be as disorienting and surprising as 2020 – but the landscape will continue to shift rapidly. And much will depend on whether and how Boris Johnson will take a more active role in defining and driving his vision for Britain in 2021 – a subject to which we will return in the New Year.

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