

Chief Executive Officer's review

Our transformation is on track



“Our operating model is our single biggest lever of change. It’s the blueprint for how we run the company and makes the reforming Capita real for all stakeholders.”

Jon Lewis, Chief Executive Officer

It’s now been more than a year since I joined Capita and the company has achieved a considerable amount.

We have launched a multi-year transformation process and are rebuilding the organisation. Our mission is to become ‘One Capita’, an integrated and refocused business, successful and sustainable, with stronger client relationships. We want to make a positive, responsible contribution to society and be a force for good. From the financial perspective, the business will be more predictable, more profitable and sustainably cash-generative.

This has meant going back to fix the fundamentals and devising a new strategy, underpinned by a company-wide purpose and clear new operating model. We are continuing to execute our strategy – to simplify, strengthen and succeed – and have made real progress on remedying many of the basics. Over the past year, our thousands of people, in the UK and abroad, have proved very resilient. Important work has been done every day, aimed at delivering better outcomes for all stakeholders – our people, shareholders, clients, suppliers and the communities we serve.

Fixing the basics

As outlined in last year’s Annual Report, Capita had become overly complex and inefficient, focused on short-term performance, characterised by a lack of long-term planning and investment, and challenged by execution issues on several major contracts.

We made a strong start in 2018 to turning the company around and are on track with the execution of our transformation plan. We started to rebuild, redefining the divisions and creating robust, accountable and centralised functions which define how we do things company-wide.

Further top-level talent has been recruited to senior leadership positions, and a clear sense established of what Capita is and should be, and of how it can succeed. We have introduced a purpose-driven and values-based culture, alongside our operating model. It provides managerial discipline and a corporate blueprint, and is designed to deliver the highest standards of service, delight clients and deliver value for all our stakeholders.

We raised, with shareholder support, £701m gross proceeds in a rights issue, and £408m from disposals; we have de-leveraged our balance sheet. We delivered on our cost-competitiveness initiatives. We agreed a pension deficit reduction plan. We have updated our payment terms for suppliers in the UK and Ireland to build better relationships with our partners.

Our corporate risk profile has stayed largely the same as in 2017. However, we are continually improving the way we manage our risks; effective risk management will be key to the successful delivery of Capita's strategic objectives.

It's a mark of good management teams that they deliver what they said they would deliver, and I'm pleased with our achievements over the past year. We are fundamentally in a much better place. At the end of year one of our three-year turnaround, we are where we expected to be and have a clear plan laid out for 2019.

Purpose and operating model

We recently unveiled Capita's purpose – 'we create better outcomes' – allied to a refreshed set of values and behaviours. For the first time, the company's true purpose has been defined. It is the single reason we exist; it directs and motivates all of us; and shapes all our decisions and actions. Capita never had this before – that is why we had to change, swing the pendulum, and provide direction and clarity.

Cultural and behavioural changes will inevitably take time to become fully integrated into the organisation. But our new purpose and re-emphasised values will be the driving forces behind Capita's transformation into a collaborative business, founded on robust governance. As a responsible business, we've refocused our approach to addressing the most material challenges that we and society face.

How Capita carries out its purpose and delivers better outcomes is now defined by our new operating model. It constitutes the blueprint for how together we run the company – underpinned by a clear strategy, an organised structure, stronger governance and controls, and well-defined accountabilities.

I believe our operating model represents the single biggest lever of change the new leadership team has introduced at Capita. It's truly self-reinforcing, joins everything together corporately, and makes the reforming Capita real for all stakeholders.

Despite being a major step forward, the operating model will also take some time to become truly embedded. I don't expect everything to happen easily. But what I do expect is for every leader and everyone in the company to start making the changes that will reform Capita as a truly purpose-led, values-driven business. This is the journey we are on together and I'm committed to seeing us get there.

Financial performance

For the full year ending 31 December 2018, Capita reported adjusted revenue¹ of £3.9bn. Revenue declined year-on-year, due to the limited benefit from contract wins being outweighed by contract losses and scope and volume changes in Government Services, Customer Management and Specialist Services, including the re-shaping of our Defence Infrastructure Organisation (DIO) contract and Home Office escorting, on which we chose not to re-bid. There was also a decline in transactional revenue in People Solutions and IT & Networks.

Adjusted profit before tax¹ of £282.1m was slightly ahead of our expectations. As expected, we had a free cash outflow in 2018, before rights issue and disposal proceeds.

Net debt was £466.1m, down from £1,117.0m in 2017, reflecting the completion of the rights issue, the receipt of the proceeds from disposals and the free cash outflow. The adjusted net debt to adjusted EBITDA ratio¹ at 31 December 2018 was 1.2 times. More details about our financial performance can be found in the Chief Financial Officer's review on pages 15–20.

Cost competitiveness

Capita has identified a significant, multi-year opportunity to reduce costs and improve operational efficiency, including:

- Reductions in general and administration, IT and property expenses.
- Centralising more of our procurement and driving value from our ~£1bn external spend with suppliers.
- Operational excellence, increasing the use of offshoring and automation, and improving the consistency of our operations.
- Adopting lean methodologies and being smarter in terms of how we work.

We made a strong start on executing these cost competitiveness initiatives in 2018, delivering in-year savings of £70m. We plan to accelerate the realisation of savings from our programmes, and now expect to realise £175m of cumulative savings from these initiatives by the end of 2019. We will invest some of these savings in building our capability to drive growth. The cost of achieving these savings was £55m in 2018 and is expected to be £95m in 2019, making a total of £150m which is included as part of the total restructuring costs.

¹ Refer to alternative performance measures on pages 197–198.



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Targeted investments

Since April, we have formed an investment review committee, chaired by me, for capital allocation. It is part of the disciplined system put in place to ensure more predictable outcomes. The committee supports our goal of investing a total of up to £500m over three years, addressing historical under-investment and, increasingly over time, facilitating organic growth.

We have subsequently approved a number of investments including:

IT systems and infrastructure

- An organisation-wide customer relationship management (CRM) system, giving a holistic view and understanding of our customers, providing robust and granular data to better predict future sales and monetise customer relationships.
- A new human resources system, to improve engagement and development opportunities for all our people.

Services and products

- Software – completing the development of the next version of SIMS (School Information Management System) for secondary schools; an education software parental engagement app; the creation of a cloud-based public safety platform for emergency services products to facilitate new sales opportunities; an initial investment in a payment facilitation solution for Pay360 and the re-platforming of our Retain resource management software to a new SaaS-based (software as a service) solution.

- People Solutions – next generation of the candidate portal; automation of our pre-employment screening system; and the development of a digital on-boarding product to complement our suite of 'hire to retire' services.
- Customer Management – a new digital, omni-channel contact platform to support webchat, automation and messaging.
- Government Services – developing business processing as a service capabilities to provide scalable, replicable services to a wider customer-base. Targeted investments in robotic process automation (RPA) and machine-learning technologies to support the execution of contracts.
- IT & Networks – modernising and strengthening our IT infrastructure; developing new products for cloud services, cybersecurity and workspace agility; automating and improving IT service desk customer experience.

The above are in addition to our ongoing investment in the upgrading of our financial system – to improve our reporting, processes and controls.

Challenging contracts

I have talked previously of three 'problem' contracts which continued to present Capita with some challenges in 2018. But we have made encouraging progress with fixing the performance of these contracts and are delivering against more of the key performance indicators. It is part of how we have introduced a more disciplined, company-wide contractual process.

First, we've completely rebuilt Capita's relationship and partnership with the British Army, and re-set our Recruiting Partnering Project (RPP) contract. We remain committed to making a success of RPP and, thanks to great work being done by our partnership, the contract is starting to show signs of improvement. The number of regular soldier recruitment applications are at a five-year high and we're working hard to reduce the amount of time it takes to join the Army. We have been open about mistakes made in the past and we know there is still a lot for us to do to deliver on our commitments. But RPP is a critical public service to the Armed Forces and we're determined to get it right.

Second, we took firm action towards the end of 2018 over issues relating to our Primary Care Support England (PCSE) contract with NHS England. This followed the discovery of delays in the issuing of cervical screening correspondence, which forms part of the PCSE contract, to thousands of women. We apologised to all the women affected by this administrative error and, following an investigation of the managerial handling of the matter, appropriate internal disciplinary action was taken. We have improved quality processes, and other operational service delivery levels on the contract continue to be stable.

Finally, the transformation of our seven-year customer services contract with mobilcom-debitel – one of Germany's largest mobile, internet services and telecoms products providers – is now progressing well. All revised transformation milestones have been met, including the launch of IOS and Android mobile customer-service apps.

Executing and delivering on our commitments to simplify, strengthen and succeed

2018 – fix, stabilise and set direction

- Rights issue completed
- Strategy in place
- Leadership and governance strengthened
- Disposals executed ahead of plan
- Pension deficit addressed
- Delivered £70m cost-out
- Operating model launched and purpose, values and behaviours defined

2019 – build momentum

- Increase investment
- Build organic growth engine and start shift to consultative selling
- Acceleration of cost competitiveness
- Accelerate offshoring and automation
- Technology and procurement
- Launch our purpose and embed operating model

2020 – deliver our targets

- More consistent and predictable
- Double digit EBIT margins
- +£175m of cost savings
- At least £200m sustainable free cash flow

The aggregate financial loss from these challenging contracts reduced from over £50m in 2017 to around £30m in 2018. We plan to generate an aggregate profit on the contracts in 2020, including reaching break even on the PCSE and mobilcom-debitel contracts by the end of 2020.

Sales and growth

Our transformation programme will continue through 2019 and, in fact, be intensified. All six Capita divisions now have clearly defined value propositions, a simpler set of offerings and, in some cases, a fresh methodology by which to create growth opportunities. While there are early signs that we can make real progress in 2019, there is still much more to do; and we must demonstrate that we can again grow organically.

Transformation of our growth function under a new Chief Growth Officer will be a crucial factor in how we will pivot to growth. We need to become more agile in our thinking, approach and skill-sets.

I have personal experience of running consulting businesses in software tech and the oil and gas industry. At Capita, we already have consulting services – providing insight and expertise in our chosen markets – but they have been run in silos and not leveraged across the business. I am convinced that a stronger consulting capability at Capita is going to remove our revenue dependency on tenders and help create new growth opportunities with existing and new clients. A stronger consulting capacity will also provide opportunities for consultative selling.

A shift to consultative selling, based on industry knowledge, will transform Capita in the sales and marketing area – and leave no-one in any doubt that what we now have instead is a modern-day growth function.

The performance assessment of our existing sales resources and the establishment of a focused customer account management structure, with well-honed consultative selling skills, is helping change how we engage with clients. We are aiming to understand our clients better and build stronger, long-term partnerships, providing the best of Capita to create better outcomes and realise growth opportunities.

This has already seen progress, including in our partnership with Transport for London (TfL). Core to this is the London congestion charge zone, low emissions zone and enforcement contract which involves service provision from five Capita divisions – Government Services (to run the contract), IT & Networks (the underlying IT infrastructure and network provision), Customer Management (customer accounts and enquiries), Software (payment platforms) and Specialist Services (document services). This contract led in turn to the opportunity to provide ultra-low emissions zone charging. More widely, we provide core network, asset, workplace and enforcement services to TfL, as well as infrastructure consultancy. It shows how we can work successfully across divisions and functions, and is a good example of getting account management right.

In 2018, we formed a new pre-bid contract review committee, which is operating well. The committee reviews all contracts above certain financial thresholds, evaluating the risks and commitments to ensure complete alignment with our operational and financial goals. We strike an appropriate balance between delighting the customer, growing operating profit and the risk profile.

Order intake in the year was £1.8bn, largely comprising contract wins and renewals in Customer Management, which won a £300m extension and expansion of our existing contract with Germany's largest integrated telecommunications provider, and in Software.

We also announced a number of new contracts, some of which were delayed from earlier in the year, which are discussed in more detail in the divisional performance section on pages 21–33.

Capita's order book at 31 December 2018 stood at £7.1bn, compared with £8.2bn at 31 December 2017, reflecting that order intake was lower than revenue recognised in the year and low levels of bid activity in 2017. The decline in our order book in 2018 was driven by two parts of the business:

- Life Insurance, which is running off and was impacted by the loss of Prudential.
- Local government, where the market has structurally changed and clients are shifting from long-term multi-activity contracts to buying processes as a service.

The order book for the rest of the business – largely digitally-enabled services and software – was stable. This part of Capita operates in growth markets and includes higher value-added services that we are investing in and want to grow. I expect to see these trends continue this year, as Life Insurance and local government continue to decline and our investment in core propositions begins to bear fruit. Capita continues to plan for a return to year-on-year organic growth in 2020, driven by digitally-enabled services and software.

Digital capabilities

Getting back onto a growth trajectory, and optimising our portfolio, are part of our multi-year transformation process, which we have clearly set out for all stakeholders. The focus of the leadership team at Capita remains firmly on delivering that transformation and prosecuting our strategy of simplify, strengthen and succeed. But we will also need to look ahead carefully to the Capita of the future, based increasingly around our digital capabilities.

The lion's share of the contracts we have today involve a deep understanding of the business processes of a client and the use of technology to provide insight, reduce risk, drive productivity and produce a superior experience for clients' customers. Digitally-enabled transformation is a common thread running through all this.



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It's why we are investing more in digital technology and entering into strategic IT partnerships. For example, we agreed a five-year strategic partnership with Microsoft for the use of Azure, its cloud computing service, to support the roll-out of our cloud services, particularly in our Software and Customer Management businesses. This will help facilitate the roll-out of the next version of our education software SIMS8 and make it easier to internationalise the business.

We have significantly increased the capacity of our Indian digital development centre in Pune, near Mumbai, which now employs more than 1,100 people developing standardised software, alongside more than 500 colleagues there in IT & Networks. We also agreed a digital partnership with McKinsey to accelerate our analytics and digital transformation capabilities.

There are big opportunities in a fast-changing world – with digitally-based services being purchased in a much more flexible way – which Capita is well equipped to take advantage of. But we need to make sure that our tech solutions are designed and marketed to provide clients and their customers with superior experiences and better outcomes. We have to identify the nature of clients' work, and define the potential for them and us from new digital technology, data and analytics-focused solutions, based on deep industry knowledge.

Investment in our people

Capita is a people-focused business and the leadership team is committed to putting our people at the very centre of how we operate, and on respecting and valuing all of them. We are determined to instil a much stronger commitment to how we attract, develop, reward and retain our talented employees; and for them to start to really experience the positive changes taking place within the business. We want our people to feel part of the company's success, and to be excited and motivated to work hard to help achieve it.

This is why we appointed a Chief People Officer for the first time to run the new people function. We are investing in training and development, and succession and talent management, and have – for the first time at Capita – introduced a performance management and assessment system. Such moves are reflective of being a responsible business and constitute a vital part of how we will succeed.

I am disappointed that our gender pay gap increased in 2018; this is simply not good enough, but we are taking steps to understand and eventually eliminate the gap. We're investing in activity to improving gender and pay equality through our people and responsible business strategies. At the same time, I am very proud that our ranking in the Hampton-Alexander Review of the FTSE 250 has improved, up from 219 in 2017 to 110; it represents progress, though there is clearly still a lot of work to do.

As the Chairman has highlighted, we are also very serious in the leadership team about widening diversity. We want a workforce that is inclusive and reflects the diversity of our communities – as shown by the imminent appointment of two employee directors to the Board, the first such move by a FTSE 250 company since the late 1980s. But, as I have stated previously, this is not a case of gesture politics: employees on the Board does not feel radical to me; it's just the right thing for our company to do.

At a leadership level, we have further strengthened the executive committee to support the delivery of our new strategy. As well as a new Chief Growth Officer, we now also have a Chief Digital Officer; these new growth and digital roles are enormously important in underpinning our strategy. Our Chief Financial Officer joined us in January to form part of our world-class new leadership team, which also includes a Chief General Counsel and leads for the new transformation, corporate development and corporate affairs functions. We now have a mature and disciplined team running Capita in a responsible, sustainable way – with stronger controls and risk-management, and improved quality and assurance.

Global perspective

Capita is clearly not a multinational company in the conventional sense, but we do have an international dimension that I think has been underestimated in the past. While we are the UK's largest business processes outsourcing provider, we also have a growing international operation and sales focus.

Almost 20,000 of our people are based outside the UK and we have employees as far afield as the United States, Ireland, Germany, Poland, Switzerland, India and South Africa. We have myriad capabilities within our global network, with more than 8,000 employees in India and 3,000 people in Cape Town.

Indeed, our workforce in South Africa – where we've been winning new work – is set to expand over the next two years. We currently deliver services including customer service, sales, debt collection and technical support from two centres in Cape Town. South Africa represents a new and exciting services destination, offering a unique combination of talented people and commercial advantages. It also has a mature domestic market and an attractive investment climate – with strong public sector support and excellent telecoms infrastructure. South Africa is a people-centric culture; and our presence there is reflective of how we are helping facilitate social mobility.

Overall, our aim is to evolve into a digitally-enabled services, software and consulting business with an increasingly international footprint, which delivers for all its stakeholders and values all its people, whatever their roles and wherever they work.

Responsible business

The transformation of a purpose-driven Capita must be placed in the context of our becoming a truly responsible business.

I've talked about our new strategy, the sense of a refreshed culture and values, and our initiative to put two employees on the Board. The phased £176m pension deficit reduction plan, agreed with the trustees, was in line with a commitment we made in January 2018 and is an important milestone in Capita's transformation. It's a reflection of the importance we place on good corporate responsibility.

We have been working with the Cabinet Office to develop reforms on how the Government partners with the private sector to provide public services. We have welcomed the opportunity to work openly towards the development of a practical framework and approach to procurement and delivery that brings real value to all concerned.

We need to make sure we continue to focus on minimising operational issues and must ensure we are effective in engaging with our new ways of working and operating systems.

However, there is a fresh sense of a reforming Capita with a leadership team that is properly accountable to all its stakeholders, focused on fulfilling contractual obligations, meeting expectations, cultivating better relationships with clients and delighting our customers.

We've also refocused our approach to how we are responding to the most material challenges that our business and society face – youth unemployment, digital exclusion, gender equality, climate change, business governance and ethics.

We are calling our approach responsible business, as it defines how – true to our purpose – we operate, serve society, respect our people and the environment, and deliver a fair return to our investors. We have, for example, recently launched two new charity partnerships with Teach First and Young Enterprise where we aim to empower 100,000 young people to progress into the world of work. Our social credentials are outlined in more detail in the responsible business section on pages 39–43.

But we must improve in these and many other areas, if Capita is to become a genuinely accountable leader within UK plc and help set the agenda for responsible business. The country is grappling with low productivity, slowing economic growth, an ageing population and limited social mobility. Business will have to step up and be part of the solution, be it through technology, including that designed to enhance productivity, innovation, training apprentices and graduates, or by simply providing good jobs.

However, a legacy of the financial crisis is that big companies are still treated with suspicion at best, outright hostility at worst. Business won't get a seat at the table to shape these solutions unless it is trusted and takes its broader role in society seriously, approaching challenges with honesty. I want to show how and why Capita – and big business in the UK – can actually be a force for good in society, and start to change public perceptions.

The way ahead

Overall, I'm pleased with how far we have come at Capita on our transformation journey. After the first of three years, we are on track.

Looking forward, Capita has a clear plan for 2019, including embedding our first ever operating model which defines the way we work as 'One Capita', accelerating our cost-competitiveness programme and investing more in the business to support sustainable growth. These are important stepping stones as we work towards a return in 2020 to organic growth and sustainable cash generation.

Capita still faces a number of challenges; the political and economic environment and trading and market conditions clearly remain uncertain. Yet my confidence in Capita remains undimmed. We want to become a more profitable, sustainable and responsible business, creating long-term value for shareholders – and external challenges will only serve to intensify our attention on the task ahead.

As a more simplified and strengthened company, Capita will be well prepared to take advantage of the opportunities that lie before us in a fast-moving world. I am confident we will maintain our reforming momentum over the coming year – and am excited about the prospects for a successful, technology-driven, digitally-enabled Capita.

