



National Audit Office

NATIONAL AUDIT OFFICE
PRINCIPLES PAPER

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Delivering public services through markets: principles for achieving value for money

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This report can be found on the National Audit Office website at www.nao.org.uk

Summary

1 In the recent White Paper *Open Public Services* (July 2011), the Government states that its preferred way of delivering public services is through user choice and provider competition. This delivery method relies on market mechanisms: users choose which products or services best meet their needs from a range of providers. When markets function well, they are generally considered effective at promoting efficient outcomes. However, markets can fail for a wide variety of reasons, for example, if users do not have good information on the range of providers, quality and prices in the market, or if providers collude to keep prices artificially high. Left to their own devices, markets may also not be effective at delivering wider policy outcomes such as equity and universal services.

2 The government therefore often intervenes in markets, usually to remedy a market failure or to mitigate the risk that its policy objectives will not be achieved. This is particularly the case in public services markets, (for example care services) and services where there is a public interest, (for example energy). Intervention takes many forms, including setting prices, putting continuity regimes in place when providers fail and setting rules to ensure public service outcomes are achieved. The responsibility for overseeing, and if necessary intervening in, markets has generally rested with the competition authorities, or with the sector regulators in regulated network industries such as energy and telecommunications. This is in line with both domestic and European legislation.

3 UK governments opened aspects of healthcare and education provision to market-type mechanisms from the early 1990s. The *Open Public Services* White Paper outlines the areas where the Government intends to establish a framework for choice in individual services, enabling individual users to choose from a range of providers, where possible. These include adult care, education, skills training, early years, other children's services, family services, and health and social housing. In personalised services, individual service users make their own purchasing decisions (though usually without knowledge of the price of the service they are purchasing). This is different from the traditional ways that the government uses taxpayer funding to provide services, such as employing staff to deliver them directly or purchasing them, on behalf of the taxpayer, from the private or not-for-profit sectors. It therefore requires government departments and agencies to possess and deploy a very different skill set suitable for a commercial market environment, and brings a new set of risks to achieving value for money.

Achieving value for money from markets

4 There are risks and opportunities to achieving value for money from delivering services through markets, as there are with any service delivery method. Markets present opportunities for services to become more personalised, responsive, efficient, diverse and innovative. Evidence from international and national research suggests that, under certain conditions, competition can deliver higher quality services and improve efficiency while maintaining equity.

5 The audit evidence, however, also highlights some of the risks that need to be understood and managed to achieve value for money. For example, markets can lead to fragmentation, potentially reducing the capacity of individual delivery units and increasing the overall costs of the system. They can also lead to over-concentration of provision and hence higher costs to users, if competition is ineffective. It is therefore important that the additional costs of using provider competition and user choice to deliver public services, in particular the need for providers to make profits, is justified by efficiency gains. Private markets can promote efficiency, but may not naturally provide universal services or equity of provision. Also, they will not offer services if the cost of doing so is uneconomic, unless financial incentives are provided. Personalisation of services can help meet individual users' needs, but where users receive direct cash payments it may increase the risks of error and fraud in the system. Moreover, when markets are used to deliver public services, the government typically retains a reversionary interest if services fail, yet it has much less ability to intervene than when it delivers services directly.

6 Securing value for money when public services are delivered through markets, therefore, requires clear oversight of several key areas and a set of associated skills to exercise that oversight effectively (**Figure 1**). This paper gives examples from the work of the National Audit Office of how these areas have been addressed to date across different areas of service delivery. Examples include both services that are purely user funded (such as energy and telecoms) and those where there is a high level of public funding (such as health and social care). Departments and local authorities with oversight responsibilities will need to assess their existing capabilities and identify skill-gaps and areas of expertise they need to develop and fill if they are to undertake effective market oversight.

Figure 1
Skills required for oversight of public services markets

Area of oversight	Skills required
Establishing rules, policing, enforcement and redress	Commercial and consumer law and litigation skills: including knowledge of, and capability to enforce, competition and consumer law; awareness of ways to encourage compliance; and understanding of redress mechanisms.
Demand-side effectiveness	Consumer insight and information skills: including developing information systems that facilitate user choice and enable user feedback; mapping demand for new services; understanding product/service characteristics; and behavioural insights, both for users and intermediaries.
Supply-side effectiveness	Commercial, economic and analytical skills: including an understanding of actual and potential barriers to market entry, expansion and exit, particularly those faced by smaller businesses and third sector organisations; facilitating new entry of providers; shaping and sustaining markets to deliver the services users want; and understanding how to set tariffs/prices that represent value for money.
Continuity regime and financial monitoring	Financial and business analytical skills: including designing continuity regimes to limit risks to the taxpayer; an understanding of administration and insolvency law; financial analysis of provider viability; and business review.
Evaluation of market outcomes	Evaluative and economic skills: market and economic analytical skills; and evaluation of user outcomes.

NOTE

1 This is not intended to provide an exhaustive list of the skills requirements for oversight of public services markets but to give a general indication of the types and areas of expertise and skill that are likely to be required.

Source: National Audit Office

7 Based on this empirical evidence, we set out ten principles that the government needs to consider if it is to achieve value for money when using markets to deliver public services. The paper is intended as a guide for policymakers and officials with responsibility for introducing and overseeing the greater use of choice and competition in public service delivery, both in central government and in local authorities.

Key findings

8 All public services markets need rules to ensure their orderly operation, both to enable effective competition between providers and to protect users. Competition law can apply to activities that public bodies engage in, and it can be challenging to enforce effectively. Other rules to help secure government's intended public policy outcomes may also need to be specified when registering or licensing providers in the market, for example circumscribing certain types of discriminatory market behaviour such as 'cream-skimming' (refers to the business practice of providing a service to only the high-value or low-cost customers). Many public services are delivered in pluralistic markets, some overseen by local authorities. It is important that there are oversight arrangements in place, including regional coordination where necessary, to ensure that rules are properly enforced in these local markets to prevent anti-competitive or discriminatory practices, where the active oversight by national competition authorities may be more limited.

9 Users need to be empowered to make good choices, but to do this the information and support provided to them needs to take account of their capability and willingness to act. One reason why public services markets need oversight is to ensure they function as intended. Service users need to be aware that they have a choice and to be genuinely able to exercise that choice as far as is practicable. Providers must believe that users will switch to another provider if they are not satisfied with the service. Oversight bodies need to ensure that users have reliable and useable information about the choice and quality of services and the quality of outcomes (where available). This is a complex task in public services markets. The goods and services being purchased, such as hospital services, school places or social care, may be relatively complex and outside users' normal domains of expertise. In addition, there may be relatively high proportions of vulnerable users who need support to access and understand the information and responsibilities underpinning their choices, for example personal budget users who choose to employ carers.

10 In order for public services markets to deliver innovation and quality in service provision, new providers need to be able to enter the market, successful providers to expand and ineffective providers to exit, while ensuring service continuity and avoiding harm to users. Public services markets need oversight to encourage growth and diversity of provision when the existing provision is limited. Differences in factors such as regulation, taxation or pensions treatment that might favour some kinds of providers over others can inhibit development of the market. Oversight bodies need to assess what factors potentially act as barriers to entry or expansion in markets – for private, as well as for 'not-for-profit' providers. They also need to assess whether there is scope for reducing these to encourage new entry.

Conversely, the consequences of a provider going out of business and exiting the market can potentially have major consequences for service users. Effective oversight requires monitoring of the financial health of providers based on an assessment of the risks they represent to service continuity for users. Absolute clarity is needed about the arrangements in place to ensure service continuity in the event of provider failure and/or exit, as this is likely to impact negatively on users (particularly vulnerable users) and public policy outcomes. Additionally, it is important that oversight bodies collect and analyse financial and market information to ensure that the prices for services are efficient and reflect costs.

11 It is essential for government departments to monitor whether the market mechanisms are delivering their policy objectives and to have in place the necessary powers, tools and capabilities to intervene if necessary. Competition authorities and economic regulators monitor markets and collect market intelligence to provide an early warning of market problems. They routinely carry out market reviews to explore possible causes of consumer harm (such as the unfair treatment of users), whether competition problems exist (such as market dominance by a few large providers) and how these may be resolved. With the significant extension of choice and competition in public services, local and central government bodies that oversee public services markets need to strengthen their market oversight capacity. They need to assess the analytical and commercial skills and expertise they require to keep the functioning of the market and its outcomes under careful scrutiny. Skills and capabilities gaps should be addressed early so that they are in a position to monitor and assess effectively whether the public services market is developing and functioning well and – as importantly – delivering the required outcomes. Finally, if after the market has operated for a period, it is not delivering cost-efficient outcomes that represent value for money, the oversight body may wish to consider ways it can move away from a market delivery mechanism.

The ten principles for delivering value for money from public services markets

12 The introduction of market mechanisms into public service delivery does not remove the role of government. In fact, it puts the onus on government at all levels to develop an effective understanding of markets, including the practical and commercial considerations of making their market work effectively. They should suitably equip themselves to monitor and assess what a healthy market should look like and the risks that exist to delivering value for money in commercial market environments.

13 Based on the evidence in this paper, we have developed ten principles for obtaining value for money from public services markets. We would expect the government to give serious and early consideration to how these principles apply whenever user choice and provider competition are used to deliver public services. We have grouped our principles into four categories, each of which is covered in a separate part of the paper.

Rules for ensuring a competitive market (Part Two)

Principle One: There are rules to ensure the effective operation of the market.

Principle Two: The rules of the marketplace are enforced if necessary.

Enabling users to participate actively in the market (Part Three)

Principle Three: Users are empowered to make appropriate choices.

Principle Four: Users have effective mechanisms for redress.

Promoting healthy competition between providers (Part Four)

Principle Five: There is a level playing field for all providers, whether public or private.

Principle Six: Providers can easily enter the market, expand and exit.

Principle Seven: There are arrangements to ensure service continuity where provider failure could result in harm to users.

Ensuring the market is delivering the public policy objectives (Part Five)

Principle Eight: Market oversight is based on good quality financial monitoring and market intelligence.

Principle Nine: The oversight body has sufficient expertise to understand the market and will intervene, if appropriate, to remedy market failures.

Principle Ten: The body responsible for delivery of public policy regularly reviews whether public service outcomes are being delivered.

Part One

Introduction

Markets in the public sector

1.1 The use of market mechanisms (user choice and provider competition) is now a key part of public service delivery in the UK. From the early 1980s the government sought to create a market of private sector providers by privatising public services that had formerly been provided by the state (initially telecommunications, then water, gas, electricity and railways). At the same time, economic regulators, such as the Office of Gas and Electricity Markets (Ofgem), were established to protect users from, and promote efficiency in, the monopolies that privatisation created.

1.2 The government also required public authorities to put contracts out to competitive tender and, from the late 1980s, achieve ‘best value’ for service users and funders. The concept of choice has existed for a long time in education, and in the early 1990s the government introduced an ‘internal’ market into the NHS. More recently, user choice has been introduced into other services provided by the public sector. For example, since 2006, patients have had the right to choose the hospital where they have their operation for a limited range of elective procedures in the NHS.

The *Open Public Services* White Paper

1.3 The Government’s recent White Paper *Open Public Services*¹ sets out its commitment to increasing choice in public services ‘wherever possible’, and opening up service provision to a range of providers in areas such as adult social care, education, skills training, early years, other children’s services, family services, and health and social housing.²

“Opening public services to competition and providing more freedom to innovate will improve the choices available to service users, as well as delivering better value for money for the taxpayer.”³

Delivering value for money from choice and competition

1.4 In theory, if markets work effectively they tend to promote social welfare by allocating scarce resources efficiently among competing needs. Consumers provide incentives for firms to lower prices, improve the quality of goods and services and develop new products to suit changing needs. Firms that fail to deliver what consumers want more efficiently than their competitors eventually lose market share and are forced to exit the market.

1.5 When markets are used to deliver public services, government, on behalf of taxpayers, wishes to create the conditions for them to work effectively – empowered and well-informed consumers, and a diversity of providers competing keenly for business. The taxpayers’ interests are different from those of businesses, whose primary objective is maximising profit. Businesses may pursue their commercial interests by seeking to reduce the level of competition they face in the market, for example by seeking to monopolise the market, or by reaching commercial agreements that carve up markets.

¹ HM Government, *Open public services*, Cm 8145, July 2011, paragraph 1.9.

² *Ibid.*, Cm 8145, paragraph 3.3.

³ *Ibid.*, Cm 8145, paragraph 6.3.

1.6 There is a risk that, having established markets in public services, government departments and local authorities lack the capability to ensure that they operate in the interests of the users and the taxpayer, rather than in the interests of the providers whose profits are funded by users and taxpayers. The government therefore needs to develop, or seek access to, new skills that lie outside the traditional mainstream skills of public service delivery. The types of skills and expertise found in the economic regulators and market oversight bodies are similar to the capabilities that government bodies need to possess in order to oversee effectively the risks to value for money from the delivery of public services in commercial market environments.

1.7 In practice, most public services markets are complex and pluralistic; they can be local, regional or national in scope. User choice might be relatively straightforward or require choices to be framed to help users make the most appropriate choices, and some users may need professionals or representatives to inter-mediate on their behalf. **Figure 2** indicates how some public services markets can differ in terms of the type of market and the type of user choice.

1.8 Generally speaking, public services markets differ in two key respects from commercial markets:

- public services typically have to be **universally available**, so markets in public services may have rules prohibiting providers from discriminating against certain users (known as 'cream-skimming'); and
- they may use **quality rather than price** as the parameter on which providers compete when services are funded by taxation and users do not directly pay each time they use a service⁴ (this arrangement for purchasing services is known as a 'quasi-market').

These features make their oversight by government potentially very challenging. Moreover, public and private markets may be intertwined, such as in health and social care, which can lead to one impacting on the other.

The focus of this paper

1.9 There is a clear policy imperative to offer more choice and personalisation to public service users, and hence to open up the supply side of public services to greater competition from a diverse range of providers. There is some evidence that market mechanisms can work if certain conditions are fulfilled. It is the purpose of this paper to set out some of those conditions.

1.10 However, there is still a need for more empirical evidence on how to achieve value for money from this delivery model. There is currently limited published guidance for departments, agencies and local authorities on how they should:

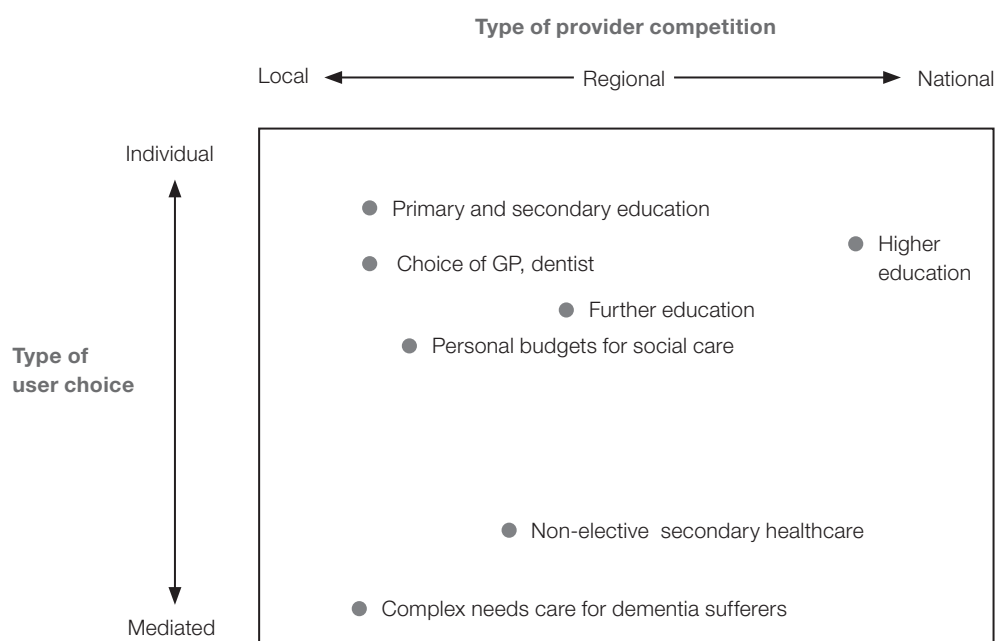
- manage the shift away from existing direct delivery, or procurement functions, towards acting, in the context of a commercial market, as market facilitators and oversight bodies;
- monitor the market's operation and assess whether it is delivering effective services and outcomes; and
- ensure arrangements exist to ensure service continuity for users in the event of provider failure.

⁴ For example in health, competition on price may have disadvantages to competition on quality (with a fixed price) as the former may lead to deterioration in quality, particularly when quality is difficult to observe. This consideration has driven much of the structure of competition in secondary healthcare. A recent publication *Report of the Office of Health Economics Commission: Competition in the NHS* January 2012 explored the available evidence of where competition at regulated prices benefits patients.

Figure 2

Types of user interaction with markets

Public services markets can differ in terms of the type of market and the type of user choice

**NOTE**

1 The position of the points are intended to be indicative only.

Source: National Audit Office

1.11 We have, therefore, produced this paper as a guide for policymakers and officials with responsibility for introducing and overseeing the use of choice and competition in public service delivery, both in central government and in local authorities. The paper sets out a framework of principles that the National Audit Office considers should guide government oversight of public services markets. It draws on empirical evidence from our work to date in examining service delivery in quasi-markets. The paper also builds on an evaluative framework for choice and competition in public services developed by the Office of Fair Trading (OFT),⁵ but with a specific focus on obtaining value for money for the users and taxpayers who fund these services.

5 Office of Fair Trading, *Choice and competition in public services: a guide for policy makers*, OFT 1214, March 2010.

Part Two

Rules for ensuring a competitive market

2.1 This section examines the applicability of competition law to public services markets, and the other rules and mechanisms that may be used to set parameters for competition in a market. It also examines how those rules are policed. It shows that:

- Establishing the rules of engagement in a market is a vital prerequisite to introducing choice and competition.
- There is still much uncertainty about the applicability of competition rules in various markets for public services.
- Competition law does not apply to all public services markets, and even where it does apply it can be challenging to enforce. This can favour the use of alternative means of resolution and redress.

Principle One: There are rules to ensure the effective operation of the market

The operation of competition law in the private and public sectors

2.2 Competition law governs competition in commercial markets across the European Union. It enshrines two main types of prohibition to ensure fair and effective competition:

- agreements, decisions and concerted practices that have the object or effect of preventing, restricting or distorting competition (such as price-fixing, market-sharing and bid-rigging); and
- the abuse of a dominant position (such as excessive or predatory pricing, or foreclosure by denying access to essential facilities).

2.3 In the UK, the OFT is the primary body for enforcing competition law. The OFT has recently updated its guidance on applying competition law to public bodies.⁶ The guidance advises that competition law applies to the conduct of an ‘undertaking’, and that public bodies will fall under the definition of an undertaking where they carry out an ‘economic activity’. The guidance makes clear that it is the nature of the particular activity being conducted that is key as to whether competition law applies or not, and not the public or private status of the body that carries it out.

2.4 Where competition law does apply, the development of case law and establishing legal precedents is an essential means of clarifying principles, ‘rules’ and key points of law. In new and immature public services markets, or markets with not-for-profit providers, promoting an awareness and understanding of competition law and providing guidance for market participants, for example on what behaviour the law prohibits, is an important mechanism in promoting compliance. In addition, it can also help to inform providers’ behaviour in the market, so they are not inhibited from pursuing certain activities that they might otherwise have been deterred from taking. The market oversight body will need to reach its own judgement as to the right balance between enforcement-led and compliance-led approaches, as noted in a National Audit Office report into the OFT’s competition work (**Figure 3**).

⁶ Office of Fair Trading, *Public bodies and competition law: a guide to the application of the Competition Act 1998*, OFT 1389, December 2011.

Figure 3

Enforcing competition in markets

“The OFT is already making use of some options. However, it is yet to fully explore others such as the balance between hard enforcement (formal investigations leading to a decision), formal commitments, and compliance activity (providing advice and informal case resolution). [There is a] range of education, compliance and enforcement options available to a competition authority.”

Source: Comptroller and Auditor General, Office of Fair Trading: Enforcing competition in markets, National Audit Office, November 2005

2.5 However, the development of a rich body of case law can be a lengthy, complex, resource-intensive process, and case outcomes can be unpredictable. A National Audit Office review of the experience of sectoral regulators’ use of competition law found that the regulators had used their competition powers sparingly, and often preferred to use less risky, more certain routes to remedy problems in their markets (**Figure 4**).

2.6 In theory, there is no minimum threshold of market value for the application of competition law. However, in practice, for the reasons outlined above and given finite resources, the national competition authorities are unlikely to be able to pursue and resolve all potential competition disputes in the many low value and small public services markets.

2.7 In private markets there are mechanisms over and above competition law to resolve disputes. The Office of Communications (Ofcom), for example, has powers enshrined in the Communications Act 2003 alongside its competition powers to help resolve commercial disputes in communications markets (**Figure 5** overleaf).

2.8 Public bodies should be aware that their conduct may also (or alternatively) be subject to other laws within the field of competition law, including public procurement, merger control and/or state aid laws.

Figure 4

Developing a body of case law

A National Audit Office review of the UK’s competition regime found that the body of Competition Act 1998 case law in the regulated sectors remained under-developed, and sectoral regulators had made limited use of their competition powers. There were three main disincentives against the use of competition powers:

- “the potential duration of Competition Act cases;
- the difficulty of proving an infringement and the resource commitment this requires; and
- the impact on their own limited resources when compared to using regulatory powers.”

The review also found that these factors may encourage greater use of regulatory powers (for example licence modifications) which, rather than competition powers, could potentially deliver remedies more cost-effectively and in considerably less time, but which can hinder the development of a clear ‘set of rules’ under competition law.

Source: Comptroller and Auditor General, Review of the UK’s competition landscape, National Audit Office, March 2010

Figure 5

Ofcom's dispute resolution powers

Under the Communications Act 2003, communications providers can raise a regulatory dispute with Ofcom in such a way that the regulator has to use its regulatory powers rather than its competition powers. The Act sets a four-month statutory deadline for the regulator to determine a dispute. Parties to a dispute have a right of appeal against the regulator's decision.

Source: Ofcom

Other rules for effective markets

2.9 To aid the effectiveness of competition, government has also put in place other rules or financial incentives to sit alongside competition law. These may, for example, be intended to ensure minimum standards or equity in provision, or to discourage certain types of discriminatory practice by market participants, for example 'cream-skimming' by schools to attract the pupils most likely to achieve high grades.

2.10 Such policies may take the form of rules, for example on school admissions criteria. They may also take the form of financial incentives, for example to encourage healthcare providers to take all types of patient (not just those who cost less to treat), and provisions that discourage contractors in welfare-to-work schemes from focusing on easier-to-help claimant groups rather than supporting other, harder-to-help, groups (**Figure 6**).

Figure 6

Financial incentives in welfare-to-work programmes

The National Audit Office report on this welfare-to-work programme found that "the unprecedented levels of performance and high price discounts promised by prime contractors increase the risk that they will be tempted to 'game' the contract. ...the Department needs to focus on monitoring whether its management regime is detecting effectively any gaming, such as focusing on easier-to-help claimant groups."

Source: Comptroller and Auditor General, *The introduction of the Work Programme, Session 2010–2012, HC 1701, National Audit Office, January 2012*

Principle Two: The rules of the marketplace are enforced if necessary

2.11 To be effective, market rules need to be enforced, whether they arise from competition law or from other requirements laid down as part of registering or licensing service providers. Enforcement action can help deter market participants from infringing rules and encourage compliance. Use of formal enforcement powers may also be supplemented by less formal and potentially less lengthy interventions aimed at bringing a swift end to specific problems (such as injunctions) and/or raising awareness of competition law. In addition, competition law can be enforced through private legal actions but to date there have not been large numbers of such cases.

2.12 The OFT has a wide remit to protect consumers, which extends to users of public services. The OFT can impose significant financial penalties and even criminal penalties (for hard-core cartels), as well as lesser sanctions such as director disqualifications.

2.13 Experience of enforcing competition law in public services markets has been very limited to date. In addition, in practice there can be disincentives to using competition enforcement powers (as illustrated earlier in Figure 4). There may be scope to establish an alternative means of dispute resolution for public services, where a regulatory framework exists, which could operate alongside, but separate from, competition law.

2.14 The introduction and development of choice and competition for public markets raises a number of issues over who will enforce competition rules, and how:

- It is likely that most providers in public services markets – including small businesses, voluntary sector and public sector providers such as social enterprises – will have had very limited or no previous experience of competition law (**Figure 7**).
- The OFT inevitably has limited resources, and the sheer scale and potential complexity of public services markets in certain areas such as health and education may support the idea of a concurrent regulator model with in-depth knowledge of the sector being given competition enforcement powers. (For example, the new Health and Social Care Act 2012 gives Monitor, the existing regulator of foundation trust hospitals, new powers to enforce competition law in the publicly-funded health market.)
- Competition case law in UK public services markets is virtually non-existent; case law and precedent that help to clarify the rules of engagement in a market can take many years to develop (there is a body of European Union case law in public services which is also applicable in the UK, however, the portability of this case law to public services markets in the UK has rarely been tested).
- There may be scope to establish an alternative means of dispute resolution for public services where a regulatory framework exists, which could operate alongside, but separate from, competition law.

Figure 7

Social enterprises competing in markets

The National Audit Office highlighted the “risk that some social enterprises will struggle to survive when the contracts they have with Primary Care Trusts are put out to competition”. It recommended that “Primary Care Trusts or their successors should have contingency plans on how to react in these circumstances, and should evaluate any action they take carefully to ensure that they do not infringe competition and state aid rules”.

Source: Comptroller and Auditor General, Establishing social enterprises under the Right to Request programme, Session 2010–2012, HC 1088, National Audit Office, June 2011

Part Three

Enabling users to participate actively in the market

3.1 Where user choice is the preferred route to deliver public services, the actions of users are a vital determinant of value for money. This section examines:

- the importance of awareness and access to good-quality information in empowering users to make good choices and how, for certain markets and some types of user, intermediaries can perform a key role in interpreting information to help users; and
- the importance of effective means of redress for users who experience poor service.

3.2 It shows that costs can potentially fall on the taxpayer if users make poorly informed decisions or choices for users are poorly framed. It also illustrates that switching might not be a straightforward option for users of public services, and the scope that may exist for ombudsmen schemes.

Principle Three: Users are empowered to make appropriate choices

3.3 To stimulate competition and realise its benefits in markets, consumers need to be able to make informed choices about the services they receive. An essential component of an effective market in public services is well-informed, active users or customers where 'transaction costs' for users exercising choice are minimised (**Figure 8**).

3.4 Our work and that of the Committee of Public Accounts has highlighted three requirements for user empowerment:

- Users need to be able to access information to inform their decisions.
- The information needs to be framed in a way that is accessible and relevant to all service users; and users also need to be aware they have a choice.
- An intermediary may need to work with the user to assist them in making an effective choice.

Figure 8 User choice in higher education

In their report on value for money in higher education, the Committee of Public Accounts concluded that:

"Students will need information to assess and compare the value of studying at different institutions, and to make an informed choice. ... The Department must ensure that students are provided with relevant and reliable information which is accessible and easy to use and which will allow them to make informed judgements in time for applications for the 2012-13 academic year."

Source: HC Committee of Public Accounts, Regulating financial sustainability in higher education, Thirty-sixth Report of Session 2010-12, HC 914, March 2011.

Accessible good-quality information

3.5 Ensuring that consumers have sufficient knowledge to make informed choices can be particularly challenging in public services markets. This is because services often have ‘experience’ or ‘credence’ characteristics, where it is difficult – or impossible – for the user to ascertain what the service is like until it has been experienced.

3.6 In education, comparative information on the performance of providers is an important input for students and their parents to make an informed choice. Recent National Audit Office and Committee of Public Accounts reports have highlighted the need for access to good-quality comparative performance information to inform student choices (**Figure 9**).

3.7 In social care, where care services can be of a more personal nature, we found that users may rely more heavily on feedback from other users, the advice of local user groups, or word of mouth to help inform their choice but these mechanisms are not available for all users (**Figure 10**). In addition, in order to exercise their choice an increasing number of personal budget users employ a personal carer to help meet their care needs, thereby taking on much greater responsibilities as an employer than if they chose to continue to receive their care provision from local authority commissioned providers.

Figure 9

Student choice in education of 16 to 18 year olds

In their report on value for money in education for 16 to 18 year olds, the Committee of Public Accounts concluded that:

“Information to measure the performance of providers is not comparable, making it difficult to assess the value for money they offer and inhibiting the operation of a market driven by student choice. The Department has plans to improve the comparability of information and to make it more accessible to students. It should require all providers to compile and publish comparable performance information to support the assessment of value for money. The information should be sufficient for prospective students to use in choosing the right course, thereby improving student engagement and retention.”

Source: HC Committee of Public Accounts, Getting value for money from the education of 16 to 18 year olds, Forty-second Report of Session 2010-12, HC 1116, August 2011

Figure 10

User choice in social care

A National Audit Office report on user choice and provider competition in care markets reported:

“Users had difficulty judging the quality of service in care homes until they were resident, and the lack of information on alternative providers meant they had little option but to stay with a provider, regardless of the quality of the service provided.”

Customer feedback mechanisms for providing information on user experience to other users were relatively undeveloped.

Source: Comptroller and Auditor General, Oversight of user choice and provider competition in care markets, Session 2010–2012, HC 1458, National Audit Office, September 2011

Framing choices

3.8 As well as having access to appropriate information, our evidence shows that users need information that is presented or framed in a way that allows them to make an informed judgement on the quality and appropriateness of the service. Furthermore, different users are likely to require different information to make the best choice.

3.9 For example, a recent National Audit Office report on debt advice found that the government needs an understanding of the users in order to frame the choice appropriately.⁷ The report found that those who were most capable of dealing with their own debt problems were the most likely to choose face-to-face advice – the most expensive form of provision. By contrast, the heavily over-indebted, whom the government most needed to choose face-to-face advice, were far less likely to choose that option.

3.10 Similarly, a National Audit Office report on the oversight of various regulated markets found that some electricity users had switched to a more expensive tariff because the information available was not effective at helping them to understand the different choices properly.

3.11 In markets such as healthcare, the lack of information available to patients on quality outcomes, or limitations in their ability to interpret it, can mean there is an important role for commissioners of services to arrange services and frame choices to ensure that high-quality, integrated treatment is provided. Intelligent commissioning can also play an important role in developing and shaping the choices available to users⁸. This can include helping to identify and encourage, where sufficient demand exists, the provision of new services and sustaining competition between a range of providers in markets.

3.12 In complex areas of public policy such as occupational pensions, where users may struggle to make a well-informed decision, governments may decide to limit or frame choices where the state has a long-term financial interest in people making prudent decisions that also help to minimise the future call on the taxpayer. Research by the OFT⁹ has found that behavioural insights have helped in framing choices to reduce the risk of poor decision-making and potential future taxpayer liabilities by changing the default option on employees' pensions from opting in to opting out (**Figure 11**). The National Audit Office published a guide to auditing behavioural change which sets out relevant factors to be considered.¹⁰

Figure 11

Framing choice in occupational pensions

Governments in many countries have made concerted efforts over the years to persuade people to save more in private pensions for their retirement. Most efforts, including offering significant additional information spelling out the benefits, have been largely unsuccessful.

In the United States, however, evidence suggests that one change can have a dramatic effect – a change to the default option. Employees are automatically enrolled in the company pension scheme; experience has shown that most employees do not exercise their choice to opt out.

Source: Office of Fair Trading, Choice and competition in public services: a guide for policy makers, OFT 1214, March 2010, p.13

7 Comptroller and Auditor General, *Business, Innovation and Skills, Helping over-indebted consumers*, Session 2009-10, HC 292, National Audit Office, February 2010.

8 The National Audit Office has published guidance on commissioning on its 'Successful Commissioning Guide Homepage' at www.nao.org.uk

9 Office of Fair Trading, *Choice and competition in public services: a guide for policy makers*, OFT 1214, March 2010.

10 National Audit Office, *Auditing behaviour change*, August 2011.

3.13 Service users also need to be aware that they have a choice, and be given the opportunity wherever practicable to make choices about the services they receive. Awareness can be an issue when choice has recently been introduced into an area of public services where traditionally users have been accustomed to having little or no choice. For example, in the case of health, patients may be unaware they have the right to choose their GP, or the hospital (or treatment centre) for certain non-urgent, elective treatments (**Figure 12**).

Figure 12

Awareness of patient choice

While there is strong evidence that patients value choice in healthcare, a survey in 2008 found that only half of the surveyed patients were aware that they could exercise choice over hospitals.

Source: Office of Fair Trading, Choice and competition in public services: a guide for policy makers, OFT 1214, March 2010

The role of intermediaries in informing choice

3.14 Users may need support in making effective choices in complex areas, for example the user may look to inform their decision by relying on specialist knowledge and judgement where it is available. In other areas where the service is less complex but its quality may be difficult to observe or can only be determined once it has been bought, OFT research found that consumers often trust the views of other consumers. The use of qualitative feedback on consumer experience can help make complex decisions and comparisons easier.¹¹

3.15 Some people may need additional support, particularly vulnerable groups who have, for example, mental capacity issues. In our report *Oversight of user choice and provider competition in care markets*¹², the National Audit Office found that personal budget users who had received support from a brokerage service to help them in meeting their care needs, valued the support they received. In addition, we found that some users preferred to choose from a more limited range of services commissioned by the local authority rather than to take on the responsibility of choosing and arranging their own care.

Principle Four: Users have effective mechanisms for redress

3.16 A healthy market needs an effective means of redress for individual users who have received poor service. In the first instance, complaints are the responsibility of the provider. However, even if there is a complaints system, this might not work as well as it should, and switching providers without suffering personal detriment may not be a realistic option for users of public services who have received poor service (**Figure 13** overleaf).

¹¹ Office of Fair Trading, *Empowering consumers of public services through choice-tools*, OFT 1321, April 2011.

¹² Comptroller and Auditor General, *Oversight of user choice and provider competition in care markets*, Session 2010–2012, HC 1458, National Audit Office, September 2011

Figure 13

User experience in social care markets

A National Audit Office report that examined the experiences of personal budget users found that “less than 50 per cent found it ‘easy’ or ‘very easy’ to complain, choose their services or change their support”.

In addition, consumer research commissioned by the Office of Fair Trading suggests that “the number of care home residents who switch provider is very low, and that this is considered to be a last resort by most residents. [Research has also shown that switching homes can] adversely affect the health of residents, who are typically vulnerable and frail”.

Source: Comptroller and Auditor General, Oversight of user choice and provider competition in care markets, Session 2010–2012, HC 1458, National Audit Office, September 2011

3.17 Redress mechanisms empower users and help to ensure that they are treated fairly by providers and that their complaints are taken seriously. It is, therefore, important that the users have another effective route of redress against their provider. For example, in social care if the care provider does not resolve a complaint to the user’s satisfaction, they can ask the local government ombudsman to investigate.

Part Four

Promoting healthy competition between providers

4.1 This section covers:

- the importance of a level playing field (also called ‘competitive neutrality’) between all providers in a market, and how undue financial advantage can undermine effective competition;
- the need for new entry and innovation as a means of encouraging existing providers to compete more vigorously; and
- issues that may arise from provider failure.

4.2 It shows that the effectiveness of competition to drive good outcomes depends on freedom of entry, expansion and exit from the market. Furthermore, the process of exit of providers can potentially create uncertainty and disruption for users, in particular for vulnerable people, given the essential nature of most public services. Arrangements for continuity of services are often therefore required.

Principle Five: There is a level playing field for all providers, whether public or private

4.3 ‘Competitive neutrality’ is the concept that there are no undue advantages to any particular providers as this may restrict competition in the market. The OFT summarises¹³ the main barriers to a level playing field between providers as being:

- differences in regulation, taxation and pensions treatment between different types of providers;
- incumbency advantages enjoyed by existing firms, such as access to information, pre-qualification and bid criteria, and transition costs; and
- lack of clarity in the application of competition law.

To these could be added the advantages in bidding for contracts of large or well-established firms already in the market but not providing the service concerned. In addition, large private operators may be able to access capital or credit facilities far more readily than some other providers, for example not-for-profit social enterprises, which may limit the extent to which these organisations can compete on level terms in the same market.

4.4 The National Audit Office has found that where barriers to competition arise the position of incumbents is strengthened and users may experience less choice.¹⁴ Together with the Committee of Public Accounts, we have highlighted concerns in relation to any support the Department of Health makes available to hospitals facing financial difficulties. There is potential for the treatment of these debts – that is, whether or not the government allows them to stand – to distort competition in the market (**Figure 14** overleaf).

¹³ Office of Fair Trading, *Competition in mixed markets: ensuring competitive neutrality*, OFT 1242, July 2010.

¹⁴ Comptroller and Auditor General, *Establishing social enterprises under the Right to Request programme*, Session 2010–2012, HC 1088, National Audit Office, June 2011.

Figure 14

Tackling the financial problems of challenged trusts

“The Department should set out its contingency arrangements to ensure the supply of services in areas where trusts cannot meet the criteria to become trusts. This should include clarifying the roles of Monitor and the Care Quality Commission in such cases. The Department will need to make arrangements for handling PFI debt in a way that allows all (hospitals) to operate on equal terms in the marketplace”.

Source: HC Committee of Public Accounts, National Health Service landscape review, Thirty-third Report, Session 2010–2012, HC 764, April 2011.

“Interventions using public money to increase aspirants’ apparent viability would also risk distorting competition and undermining the policy objective to increase hospitals’ financial sustainability”.

Source: Comptroller and Auditor General, Achievement of foundation trust status by NHS hospital trusts, Session 2010–2012, HC 1516, National Audit Office, October 2011.

Principle Six: Providers can easily enter the market, expand and exit

4.5 Research shows that in private markets at least half of the increase in productivity over time arises from the exit of less productive firms and the entry of new and more productive firms.¹⁵ Assuming they meet the essential standards required for operating in the relevant public services market, new providers entering the market may offer a different, innovative service, or provide a service that better meets particular needs. Competition from new entrants is also an incentive for existing providers to drive up the quality of their service or face exit.

4.6 In some types of public service, potential new entrants may face difficulties trying to enter the market. Also, only weak incentives may exist for high-performing existing providers to expand. In addition, there may be difficult trade-offs between creating supply-side flexibility (potentially important, for example, in making competition effective between schools in an area), and controlling public spending during periods of budgetary constraint.

4.7 Furthermore, we have found that some small providers may be put off by what they perceive as disproportionate requirements to meet existing accreditation and regulatory criteria. An example of the type of regulatory and administrative barriers that can face potential new entrants is provided in **Figure 15**.

4.8 New entry and countering barriers to entry may be achieved through a variety of means, including price setting and spinning services out of the public sector which are discussed in the next two sections.

¹⁵ Office of Fair Trading, *Choice and competition in public services: a guide for policy makers*, OFT 1214, March 2010, pp.57–58.

Figure 15

Barriers facing small and micro-providers in social care markets

The National Association of Adult Placement Services found that, while start-ups were essential to increasing provider diversity in social care, the smallest and least traditional providers continued to face significant barriers, in commissioning approaches and due to:

- a lack of awareness among the relevant professionals of how to set-up and sustain social enterprises;
- concerns about risk and quality, leading to the imposition of local quality assurance systems which duplicate regulator activity and inadvertently exclude non-traditional or micro-enterprises;
- outdated commissioning approaches and procurement rules which limit choices; and
- lack of understanding of the conditions necessary to stimulate and support local enterprise of all kinds.

Source: National Association of Adult Placement Services

Price regulation and ‘tariff’ setting

4.9 In some public services markets government, or in certain sectors the independent economic regulator, sets a price or national ‘tariff’ to determine the price that providers are allowed to charge for the service in question. This enables competition to take place on the basis of quality rather than on price, which otherwise may risk inadvertently resulting in worse outcomes.

4.10 We have examined several areas where government uses price or tariff setting as a way to encourage new entry, set a price that reflects local market conditions or maintain a diversity of types of provider that may not be possible otherwise, for example:

- where a regulator is encouraging new entry to a market by setting an appropriate price that the incumbent provider may charge for access to certain parts of a network – this mechanism is a common feature of the regulated utilities markets (**Figure 16**); and
- in a market where the state may exercise significant market power, it may wish to encourage diversity by helping third sector providers fully recover their costs in specialist areas, such as the national tariff that is set for specialist palliative care.

Figure 16

Setting feed-in tariffs for solar photovoltaics

The government has encouraged the installation of small-scale low carbon energy generation by setting up a tariff scheme. “The scheme provides for energy suppliers to pay low carbon generators based on the amount of electricity they generate and further payments for any energy they do not use and ‘export’ to the electricity grid. ... The tariff levels have an important influence on the rate of return that investors can receive and therefore the level of take-up of the scheme.”

The National Audit Office found that, in practice, “the take-up of tariffs for solar photovoltaics has been considerably higher than predicted in the Department of Energy and Climate Change’s original analysis. The Department took steps to limit the take-up of tariffs... by reducing tariff levels.”

Source: National Audit Office briefing for the House of Commons Environmental Audit Committee and the Energy and Climate Change Committee, ‘The modelling used to set feed-in tariffs for solar photovoltaics’, November 2011

4.11 Tariff setting is used in the NHS to set the prices of several hundred individual services for publicly-funded healthcare. The government uses this mechanism partly to try to control the prices charged by providers in the market, but also because it wishes providers to compete on the basis of quality rather than price in healthcare.

Spinning out public sector organisations

4.12 Government may also seek to create market entry by ‘spinning out’ public sector bodies to form social enterprises, for example, as in the Department of Health’s Right to Request programme where Primary Care Trust staff join together and leave the NHS to form social enterprises. We found that there are many factors to consider when spinning out an organisation, and it is important to have a view on how the organisation will eventually compete in the market.

4.13 For example, our report on the Right to Request programme¹⁶ found that the comparatively short length of contracts was considered by some of the social enterprises as a threat to their sustainability (**Figure 17**).

Exit of poor performers

4.14 Competition in public services is more likely to be effective if the incentives for providers are strong, rewarding success and penalising poor performance. The risk of going out of business can act as a powerful incentive on providers to perform well.

4.15 In certain public sector markets such as social care, where private and third sector provision is well-established, most entry and exit of smaller providers from the market occurs without causing significant disruption. In other public services such as education, the exit of a poorly-performing provider may not be acceptable, for example in areas where there is little or no alternative provision within a reasonable distance. In its 2011 report on the education of 16 to 18 year olds, the Committee of Public Accounts¹⁷ concluded that in the event of failure there was a lack of clarity about the circumstances under which intervention should take place, and it recommended that the Department should clarify how it would address failing providers in future (**Figure 18**).

4.16 Publicly-funded bodies may be protected from having their funding cut significantly in response to poor performance, because of concerns that this could lead to even worse performance – an outcome that would conflict with equity in provision. The approach that is commonly used to deal with poorly performing providers, particularly in health and education, tends to be either:

- to replace the existing management; or
- to allow another provider to merge with, or take over, its running – the education and health sectors have had significant experience of this (**Figure 19**).

4.17 However, the exit of a provider may not always be caused by poor management. It may be due partially or wholly to the need for a more fundamental service reconfiguration, such as where it is necessary to consolidate or rationalise existing providers in an area. In these circumstances, replacing the leadership of the provider is unlikely to be effective.

4.18 The Committee of Public Accounts has noted that mergers and reconfigurations are increasingly likely to happen where NHS hospital trusts are unable to meet the stringent criteria for foundation trust status (**Figure 20**).

¹⁶ Comptroller and Auditor General, *Establishing social enterprises under the Right to Request programme*, Session 2010–2012, HC 1088, National Audit Office, June 2011.

¹⁷ HC Committee of Public Accounts, *Getting value for money from the education of 16 to 18 year olds*, Forty-second Report of Session 2010–12, HC 1116, August 2011.

Figure 17**Barriers facing social enterprises in health sector**

“The Department of Health has supported Primary Care Trust staff joining together and leaving the NHS (‘spinning out’) to form social enterprises. ... These have become independent bodies delivering services, previously delivered in-house, under contract to the Primary Care Trust”. The National Audit Office found that “the comparatively short length of contracts under Right to Request placed the sustainability of spun out social enterprises at risk. Both Primary Care Trusts and social enterprises interviewed by the National Audit Office thought that three- and five-year contracts were not long enough to enable them to get sufficiently established to become sustainable by securing additional sources of income and being able to compete on an equal footing with other providers”.

Source: Comptroller and Auditor General, Establishing social enterprises under the Right to Request programme, Session 2010–2012, HC 1088, National Audit Office, June 2011

Figure 18**Dealing with provider failure in education of 16 to 18 year olds**

The Committee of Public Accounts found that “there is a lack of clarity about when and how the Department for Education requires intervention in the event of failure. For a market to be effective, poor providers must be allowed to fail. Some poorly performing providers continue for too long before action is taken, with potentially serious consequences for their students. The criteria for intervention are clearer for colleges than for schools, with action to tackle poor sixth forms in maintained schools at the discretion of the local authority. The Department should clarify how it will address failing providers, whether they are school sixth forms or colleges, and the criteria that will determine the extent and timing of intervention.”

Source: HC Committee of Public Accounts, Getting value for money from the education of 16 to 18 year olds, Forty Second Report of Session 2010-12, HC 1116, August 2011

Figure 19**Mergers in higher education**

“The Funding Council may support institutions ‘at higher risk’ to resolve their problems through merger, but institutions have achieved only limited success through this approach. In recent years, merger has helped one institution ‘at higher risk’ and is expected to help another.”

Source: Comptroller and Auditor General, Regulating financial sustainability in Higher Education, Session 2010-11, HC 816, National Audit Office, March 2011

Figure 20**Trusts that fail to meet foundation status**

The Committee raised the “particular concern of what will happen to trusts that are unable to achieve foundation status but nevertheless provide an essential service to local people. In most of these cases, mergers and reconfigurations will be inevitable. The Department should require each trust in difficulty to provide the local community with a clear explanation of the problems it faces and what the proposed changes will mean for patients”.

Source: HC Committee of Public Accounts, Achievement of foundation trust status by NHS hospital trusts, Sixtieth Report of Session 2010-12, HC 1566, December 2011

Principle Seven: There are arrangements to ensure service continuity where provider failure could result in harm to users

4.19 Public services such as health and education are essential to many people's lives, so, where appropriate, the government needs to ensure continuous provision of these services. However, if the government provides explicit or implicit guarantees to support providers that fall into financial difficulties, it risks weakening the incentives on providers to manage their businesses well and maintain financial viability. The government therefore has to balance the need for poorly-performing providers to exit the market with the need to protect users by ensuring continuity of service.

4.20 The failure of a large-scale provider with significant market presence in a number of regions, as happened in the case of Southern Cross in early 2011, can lead to significant disruption. Our report on the Government's oversight of care markets found that the Department of Health did not have arrangements in place for dealing with the failure of a large-scale provider at that time. The Committee of Public Accounts has also drawn attention to similar concerns should an unexpected failure occur in the higher education sector (**Figure 21**).

Figure 21

Dealing with provider failure: higher education sector

The Committee of Public Accounts found that "a market-based environment is designed to provide opportunities for existing institutions to expand and for new providers to enter the market. At the same time, some institutions may shrink and possibly close or even fail ... The Department and the Funding Council must, by the start of the 2011-12 academic year, develop contingency plans for protecting students, and the taxpayer, should an unexpected failure occur."

Source: HC Committee of Public Accounts, Regulating financial sustainability in higher education, Thirty-sixth Report of Session 2010-12, HC 914, June 2011

Potential continuity arrangements

4.21 We have found various different approaches to ensuring the continuity of public services, for example:

- special administration regimes;
- contractual contingency arrangements;
- bond/mutual risk-sharing schemes; and
- establishment of a provider/supplier of last resort.

Special administration regime: foundation hospitals

4.22 In its report on the proposed reforms to the NHS in the Government's Health and Social Care Bill, the Committee of Public Accounts highlighted the need for arrangements to be put in place to deal with provider failure and to protect patients (**Figure 22**).

Figure 22

Dealing with provider failure: foundation trusts

“The Government requires all hospitals to become Foundation Trusts by 2014 (*authorisation may now extend to 2016*) or cease to exist as independent entities. They will compete with non-NHS providers. Competition law puts the focus on protecting services rather than providers. This has serious implications for the less competitive NHS hospitals, particularly those with expensive PFI contracts. It is imperative that the Department puts in place clear and transparent policies for dealing with failure of commissioners or providers to ensure patients are protected and value for money is assured.”

Source: HC Committee of Public Accounts, National Health Service landscape review, Thirty-third report of Session 2010-12, HC 764, April 2011

4.23 The Health and Social Care Act 2012 provides for Monitor to appoint a special administrator who would be responsible for recommendations on how to secure services. Monitor would be responsible for recommending to the Secretary of State options for providing these services in the longer term, and have the power to raise finance through a levy on providers and purchasers to meet the costs of operating the regime. Similar administration arrangements may apply to non-NHS providers.

Contractual contingency arrangements: regulated utilities

4.24 In some private sector markets, including regulated sectors, contractual contingency arrangements may exist to ensure continuity of provision. This is where a regulator or market oversight body has powers to require another provider to take over the activities of a failed provider (**Figure 23**).

Figure 23

Continuity regime – licensing conditions

Suppliers are required by their licence to have clauses in their contract to ensure that, should they fail and their supply licence is revoked, their contract with the customer will terminate,

In such a case, if an energy supply company fails, the energy markets regulator (Ofgem) has the power to revoke the supplier’s licence and to require other licensed energy suppliers to take over the supply to those customers. Ofgem has established a process to allow other suppliers to submit the terms upon which they would supply these customers. Ofgem would then decide which supplier or suppliers will take on these customers. If a subsidy is required to cover a shortfall in the costs of the new supplier, Ofgem has the power to levy the costs of such a subsidy on network operators, who will recover these costs through general network charges.

Source: Ofgem

Mutual risk-sharing pool schemes

4.25 A risk-sharing pool into which all providers pay a levy acts as a bond in the event of problems. These schemes require providers to make funds available up front which can be used in the event of provider failure so the members of the sector suffer the financial consequences if it fails (up to a limit). Examples are the Pension Protection Fund, the Financial Services Compensation Scheme and the Association of British Travel Agents (ABTA) and Air Travel Organisers' Licensing (ATOL) schemes used in the package holiday industry.

Provider/supplier of last resort

4.26 Ultimately the government may step in if a service provider fails, as demonstrated recently with the nationalisation of banks and building societies during the credit squeeze of autumn 2007 and the financial crisis of 2008.

Part Five

Ensuring the market is delivering the public policy objectives

5.1 This section shows that:

- Financial and market intelligence can underpin measures to prevent a market failing to deliver required outcomes.
- Government departments will need different skills and capabilities to oversee markets in public services effectively, and to ensure value for money is achieved.
- Market reviews are used by competition authorities to look at markets and to explore causes of consumer detriment, to investigate whether competition problems exist and how these may be resolved.

Principle Eight: Market oversight is based on good quality financial monitoring and market intelligence

Financial monitoring

5.2 Market oversight bodies need financial information on larger providers, since their financial viability may be essential to ensure ongoing services for users. This can be particularly relevant when providers adopt high-risk business plans that make them vulnerable to downturns in the economy, or when providers have a certain level of market penetration (where their exit would cause significant disruption).¹⁸

5.3 In a report by the Committee of Public Accounts into the withdrawal by National Express from the East Coast mainline franchise, it recommended that in future the Department for Transport should take greater care when assessing the financial strength of a company, and specifically avoid letting franchises to heavily indebted holding companies (**Figure 24**).

Figure 24

Letting the Intercity East Coast Passenger Rail Franchise

“Unlike other train operators, which continued to bear losses during the economic downturn, National Express did not have the resources or the inclination to fulfil the terms of its contract. The holding company had accumulated more than £1 billion in debt and needed to refinance this debt following the downturn. Part of the company’s solution to this was to avoid heavy forecast losses on the East Coast franchise by negotiating with the Department to leave the contract. The Department should in future take greater care when assessing the financial strength of a company to ensure it will be able to support any of its franchises that get into financial difficulty. Specifically, the Department should avoid letting franchises to heavily indebted holding companies.”

Source: HC Committee of Public Accounts, The Department for Transport, The Intercity East Coast Passenger Rail Franchise, Thirty-ninth Report of Session 2010-12, HC 1035, July 2011

5.4 The oversight body or regulator may, however, find it difficult to gain an accurate and up-to-date picture of the financial health of such providers, especially where companies are not publicly listed and the oversight body or regulator has no power to request that they provide the information.

5.5 It may, therefore, be appropriate to set up a formal mechanism to require providers to make key financial information available, for example by means of a registration or licence condition. Such arrangements need to balance:

- the commercial interests of the provider, as confidentiality would need to be observed; and
- the interests of commissioners and users, who could reasonably be expected to be warned of potential or impending financial problems.

5.6 A concept used by some utility regulators, such as in the water and energy sectors, is the 'financeability' of undertakings, which means that providers are required to have a minimum credit rating in order to be able to raise sufficient equity to remain a going concern and prevent insolvency.¹⁹ In a report on economic regulation, the National Audit Office found that sectoral regulators aimed to ensure that efficient companies could maintain a robust credit rating.²⁰ Similarly, Monitor, the existing regulator of foundation trust hospitals, currently has the power to exercise proactive financial oversight over foundation trusts at the time of authorisation and on a continuing basis.

5.7 Some local agencies adopt their own financial monitoring procedures. For example, Birmingham local authority asks potential providers of care services to open their books to show that their business is sustainable in terms of occupancy rates, cash flow, volumes and transparent accounts.²¹

Market intelligence

5.8 Monitoring the market and developments in it are also important to ensure that there continues to be healthy competition in the market. This can include analysis of market trends such as consolidation and concentration ratios at the national level as well as at regional and local levels, monitoring rates of new entry and exit from the market, and significant merger and acquisition activity.

Principle Nine: The oversight body has sufficient expertise to understand the market and will intervene, if appropriate, to remedy market failures

5.9 In the utility sectors of the economy such as water, energy and rail, the government has set up regulators to oversee the market. This is done through a combination of introducing competition into relevant parts of the sector, and price-regulating those elements in which competition is impracticable because of natural monopolies. The sectoral regulators have expert knowledge of their sectors. In addition to their other duties, they apply their specialist knowledge to:

- the licensing of providers;
- making arrangements for ensuring service continuity;
- monitoring the markets they regulate;

¹⁹ Kings Fund, *Economic regulation in health care*, November 2011, p.29.

²⁰ Comptroller and Auditor General, *Pipes and wires*, Session 2001-02, HC 723, National Audit Office, April 2002.

²¹ A Bawden and A Benjamin 'Private equity and care: a sector propped up by debt', *The Guardian*, 1 November 2011.

- enforcing sectoral competition and consumer law; and
- undertaking market reviews to assess the effectiveness of competition and seeking redress where consumer detriment exists.

5.10 The Government's *Open Public Services* White Paper signals that developing open public services, along with the wider decentralisation of power to the local level, has profound implications for the role of both central and local government in the future.²² It envisages that the role of central government will, over time, increasingly focus on several key roles including:

- identifying areas of market failure that disadvantage particular groups and require state intervention;
- ensuring sufficient protection for individuals and communities so that they have a fair and genuine choice of quality providers for decentralised services; and
- removing barriers to entry and ensuring a level playing field where elected politicians have decided to open up public services.

5.11 Central and local government bodies that oversee public services markets need an effective market oversight capability to ensure value for money is achieved. They should undertake an assessment of the analytical, legal and commercial skills and expertise that they need to scrutinise the functioning of the market and to monitor its outcomes. Skills and capabilities gaps that exist should be addressed promptly in order to be in a position to monitor and assess effectively whether the public service market is delivering the required outcomes in a way that represents good value for money.

Principle Ten: The body responsible for delivery of public policy regularly reviews whether public service outcomes are being delivered

Monitoring and reviewing market outcomes to evaluate whether user or taxpayer detriment exists

5.12 For the purposes of public accountability, an oversight body should evaluate the delivery of public services through markets to ensure that policy outcomes are being delivered and that value for money is being achieved.

5.13 A recent National Audit Office report on adult apprenticeships highlighted the need for the Department for Business, Innovation and Skills to monitor and review the operation of the market effectively and to address weaknesses in its operation (**Figure 25** overleaf).

Figure 25

Monitoring market outcomes: adult apprenticeships

The National Audit Office report found that: “the National Apprenticeship Service does not identify itself as a regulator of the market for apprenticeship training, and it lacks information on whether the market is meeting employers’ needs. For example, it does not know whether providers (mainly private firms and further education colleges) are incentivised through competition or price to offer a sufficiently wide range of training frameworks. The Service also lacks data on whether employers (i.e. the ‘users’ in this market) are receiving the information they need to make informed decisions”. ... “It could do more to systematically monitor how well the market meets the needs of employers”. ... and “it should review the range of provision on offer, whether it matches employers’ needs, and whether sufficient information is available to employers, potential apprentices, and the provider network.”

Source: Comptroller and Auditor General, Adult apprenticeships, Session 2010–12, HC 1787, National Audit Office, February 2012

5.14 A Committee of Public Accounts report on the communications market found that, while outcomes for consumers in communications markets have been broadly positive, the Committee was concerned that the industry regulator, Ofcom, needed to do more to tackle consumer switching problems (that is, the ‘transaction costs’ for users involved in switching providers), and competition in fixed-line telephony (**Figure 26**).

5.15 The OFT and the sectoral regulators have powers to review markets and make recommendations to address market problems or imperfections that create consumer detriment. Where they have significant concerns, they can also decide to refer a market to the Competition Commission for a more in-depth investigation.

5.16 Departments that have oversight responsibilities for market delivery of public services may adopt a presumption that they should actively review their public services market on a periodic basis. Such a review could involve the OFT or a body with similar powers to refer the market, so that if the results of the review suggest that significant user detriment exists, the market may be referred to the Competition Commission for a more in-depth investigation. Alternatively, the oversight body may decide it would be more cost-effective to pursue its own remedies, where the full rigour of a referral and a lengthy in-depth investigation is considered disproportionate.

Figure 26

Communications market

The Committee noted that “outcomes for consumers in communications markets, have been broadly positive. However, we are concerned that:

- it is too difficult for consumers to switch telecoms providers; and
- the level of competition in fixed-line telephony is relatively limited – this is understandable to a certain extent given, for example, the nature of the infrastructure, but we believe that consumers could be getting a better deal than they are.”

Source: HC Committee of Public Accounts, Ofcom: the effectiveness of converged regulation, Twentieth Report of 2010-11 Session, HC 688, February 2011

Relevant reports

By the National Audit Office and the Committee of Public Accounts

Health and social care

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Where to find out more

The National Audit Office website is
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If you would like to know more about the NAO's work on oversight of user choice and provider competition in public services markets, please contact:

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