

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

There are risks and opportunities to achieving value for money from delivering services through markets, as there are with any service delivery method. The use of markets presents opportunities for services to become more personalised, responsive, diverse and innovative and competition can deliver higher quality services and improve efficiency while maintaining equity. However, there are risks that need to be understood and managed to achieve value for money. Markets can lead to fragmentation, potentially reducing the capacity of individual delivery units and increasing overall costs, or can lead to over-concentration of provision and hence higher costs to users if competition is ineffective.

The National Audit Office has identified ten principles, in four key areas that require clear oversight to secure value for money when public services are delivered through markets.

Rules for ensuring a competitive market

In order to introduce choice and competition in a market it is first necessary to establish the rules of engagement as 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 service markets, and even where it does apply it can be challenging to enforce.

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

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

- Agreements, decisions and concerted practices that have the effect of preventing, restricting or distorting competition; and
- The abuse of a dominant position.

The OFT is the primary body for enforcing competition law and has recently updated its guidance to public bodies. It advises that it is the nature of the particular activity being undertaken that is key to whether competition law applies or not, and not the public or private status of the body that carries it out. 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 is an important mechanism in promoting compliance.

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

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. Many providers in these markets, such as small businesses, voluntary sector and social enterprises, will have very limited previous experience of competition law. Enforcement action can help deter infringements 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 or raising awareness of competition law. The OFT has a wide remit to protect consumers, which extends to users of public services.

Enabling users to participate actively in the market

Where user choice is the preferred route to deliver public services, the actions of users are a vital determinant of value for money. Ensuring that consumers have sufficient knowledge to make informed choices can be particularly challenging in public services markets, as it may be difficult for a user to ascertain what the service is like until it has been experienced.

Principle Three: Users are empowered to make appropriate choices

To stimulate competition and realise its benefits in markets, consumers need to be able to make informed choices about the service 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. There are three key 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 need to be aware they have a choice.
- An intermediary made need to work with the user to assist them in making an effective choice.

Principle Four: Users have effective mechanisms for redress

A healthy market needs an effective means of redress for individual users who have received poor service, and complaints should be the responsibility of the provider. However a complaints system may 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.

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 through a mechanism of oversight, such as that provided by the local government ombudsman to matters arising in social care.

Promoting healthy competition between providers

The effectiveness of markets to drive good outcomes depends on freedom of entry, expansion and exit from the market. Arrangements for continuity of services are required to ensure that the exit of providers does not create uncertainty or disruption for users.

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

There should be no undue advantages to any particular providers as this may restrict competition in the market. The main barriers to a "level playing field" between providers according to the OFT are:

- 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

Additionally there are advantages in bidding for contracts of large or well-established firms already in the market but not providing the service concerned and large private operators may be able to access capital or credit facilities more easily than, for example, not-for-profit social enterprises. This may limit the extent to which organisations can compete on level terms in the same market. Where barriers to competition arise the position of incumbents is strengthened and users may experience less choice.

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

New providers that are capable of meeting the essential service standards required by the relevant public services 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. In private markets it is estimated that 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.

Barriers that small or not-for-profit organisations may face include:

- 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.

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

Public services are essential to many people's lives so often the continuous provision of these services needs to be ensured. However, the existence of explicit or implicit guarantees to support providers that fall into financial difficulties risks weakening the incentives on providers to manage their businesses well and maintain financial viability. It is therefore necessary to balance the need for poorly-performing providers to exit the market and the need to protect users by ensuring continuity of care.

There are a variety of different approaches to ensuring the continuity of public services, including:

- Special administrative regimes;
- Contractual contingency arrangements;
- Bond/mutual risk-sharing schemes; and
- Establishment of a provider/supplier of last resort.

Ensuring the market is delivering the public policy objectives

Measures to ensure that markets continue to function, deliver the required outcomes and achieve value for money should be underpinned by financial and market intelligence. Commissioning and oversight roles of public services delivered through markets will require different skills and capabilities. Competition authorities can use market reviews to examine markets and explore causes of consumer detriment as well as 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

Market oversight bodies need financial information on providers, since their financial viability may be essential to ensure on-going services for users. This is particularly relevant where providers adopt high-risk business plans that make them vulnerable to downturns in the economy, or when providers have a level of market penetration such that their exit would cause significant disruption. It may be appropriate to set up a formal mechanism requiring key financial information is made available, balancing the commercial interests of the providers against the interests of commissioners and users.

Monitoring developments within the market ensures there continues to be healthy competition within it. This can include analysis of market trends, 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

Central and local public bodies that oversee public services markets need an effective capability to ensure value for money is achieved. Skills and capabilities within the body should match an assessment of the analytical, legal and commercial skills and expertise that is needed to scrutinise the functioning of the market and to monitor its outcomes.

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

For the purposes of public accountability, and 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.

The OFT and other regulators have powers to review markets and make recommendations to address market problems 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.

Source: [National Audit Office, *Delivering public services through markets: principles for achieving value for money*, June 2012](#)