Briefing note – 06 October 2010

Oliver Letwin MP and David Burrowes MP

Critique of tender-based commissioning in the drug and alcohol treatment system and proposals for creation of a retail-style market

Problem

It costs Swanswell c£10,000 to create a tender for a drug/alcohol treatment service. This is not particularly elastic – the cost of tendering doesn't vary in line with the value of contracts.

We know that we price our bids competitively and that the market expects to see a contribution (not net profit – contribution to fixed costs and thereafter to surplus) of, at most, 10%.

So, for a £600,000 contract (which is what we tend to bid for – anything less is too small to risk our bid costs on and there are few bigger packages coming to the market) we can expect to win with a contribution of £60,000. Not bad, but....

We would have to achieve a win rate of 1 in 6 to break even (actually, we'd have to do better than this because we're talking about contribution, not profit, of 10%).

We're not winning at a rate of 1 in 6. Even though we create eye-wateringly good tenders, we're in a highly competitive market, the specifications leave no space for innovative solutions, price is not terribly variable between providers, so the reasons for choosing a bidder (as fed back to us) are more subjective and based around risk-aversion, familiarity and trust.

So unless we have an existing relationship with a commissioner, it's very difficult to decide to bid. We are making more and more no-bid decisions, even though we are an excellent provider with a 40 year track record.

If we add outcome-based, payment by volume or payment by result contracts to this model, the risk/return equation prices itself out of the market very quickly.

In conversation with an official from the Ministry of Justice recently, he admitted to concern that he couldn't generate sufficient interest in contracts that he needs to let. I told him I'm not surprised and enlightened him with the maths that explained why we would be likely to make a no-bid decision for his work.

Looking at this conundrum through the lens of the third sector as a whole, using the example of a contract of £600,000, there are bound to be more than 6 bidders. So, assuming that all the bids cost the same as ours, the total cost of bidding, to the sector, is more than the return to the sector. This should lead the third sector as a whole to decide not to bid. Not least of all because, for charities, our charitable objects do not include expending funds in pursuit of contracts for negative return before we've even delivered a service. So there is a question to be answered as to whether, given these odds, Trustees are acting in breach of trust by allowing charitable funds to be expended in this way.

Certainly the fund raisers and philanthropists who provide funds to charities might feel that their donations aren't being put to good use. And – let's face it – they'd be right.

The outcome of this process, in our market, is third sector money spent on bidding instead of on service delivery and – more often than not – contracts awarded to existing providers. Particularly statutory sector providers. In our experience it's almost impossible to displace a statutory sector provider, so we don't bother bidding against them. This is borne out by many specifications that seek to replicate NHS based delivery models.

As I mentioned before, there's little scope for innovation because the specs are very strict and – even where they are more outcome-focused – accommodating TUPE obligations within a short term contract provides limited opportunity for better pricing. So the services that emerge from the process are probably very little changed from those that existed pre-tender and probably priced similarly.

So, along with the cost to the third sector of bidding, we can add the cost of the commissioning process (which in our sector appears to have grown exponentially in recent years) and the cost of statutory sector bids. The total cost to the economy must be immense.

And for that, we get the same old same old services. So there is no return on investment for the economy – social or financial – from this expenditure. How can this be good use of public funds ? Or of third sector resources that should be invested in the community?

In a climate of austerity, where public expenditure needs to be reduced and with demand for the third sector to deliver more through the Big Society, Swanswell believes that the current commissioning process is uneconomic and unsustainable.

A solution

The market needs to be re-appraised. The characteristics of our market, as set out above, don't lend themselves to single provider, high volume, high value contracts that require considerable pre-delivery investment.

On the supply side, it looks more like a retail market to me – lots of providers wanting to offer a varying range of styles of service which suit different customers (by which I mean service users).

So why not just stop commissioning contracts in this winner-takes–all manner and create a market where any provider can offer their services to the community and be paid if they achieve a desired outcome? That way, instead of spending £10,000 bidding for a contract, Swanswell could spend £10,000 delivering a service and, if it met the purchaser's objectives, be paid for it at an agreed unit price?

Of course, providers would have to meet minimum standards, so we would need a regulatory framework to ensure that vulnerable adults and children weren't put at risk. But this is a much more acceptable and value-adding 'barrier to entry' than the current, expensive and high risk bidding process. So it is likely to result in more, diverse, organisations participating in the market.

And we would need clear referral processes, so we know who is eligible for state-funded service, together with outcome-based payment models so that providers have clarity about what they have to achieve in order to be paid.

This retail - style market promotes high levels of variation in customer-focused choice and open, on-going competition with relatively low transaction costs. It also offers better certainty of sustainable income, so has the added value of enabling third sector organisations to invest for long-term efficiency gains – something that the current 'all-on or all-off' contracting process works against.

The good news is that we know how to do this. Many of the commissioning processes in the NHS are based on this sort of model, where commissioners purchase a number of procedures from provider hospital trusts.

And elsewhere in the Health and Social Care system, residential care homes provide services on a 'per resident' basis, funded or part-funded by local authorities and/or the health sector and/or the individual. So the model also offers the opportunity to blend state funded and privately purchased services through individual providers which, in turn, drives up quality through consumer choice and allows for cross subsidy within the sector.

This model would allow high quality, value for money providers, including those from the third sector, to flourish and to provide a climate for continuous innovation, collaboration and improvement within clear, outcome-based commissioning that doesn't require us all to spend a fortune on the bidding process.

Swanswell is pleased to provide this alternative as food for thought, and – we believe - an excellent springboard for the Big Society.

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