Children’s social care market study

Polaris response to the Interim Report

Polaris is pleased to submit this response to the CMA’s interim report on children’s social care. As set out in our previous submissions, Polaris supports the CMA’s review of children’s services. Children’s services have a profound impact on the lives of looked after children, and it is right that all providers of these services continuously strive to provide these children with the best possible life chances.

We share many of the views set out by the CMA in its interim report, and note that it reaffirms a number of similar findings that were made in the Narey review of foster care in England.[1]

Polaris especially welcomes the CMA’s interim findings that:

- there is no significant difference in the quality of children’s services provided by local authorities (LAs) and independent sector providers, including those owned by private-equity investors;
- the cost to LAs of services provided by independent fostering agencies has not increased for the entire 5 year period reviewed by the CMA;
- independent fostering agencies owned by private equity investors charge fees that are in line with, or less than, other large independent fostering agencies; and
- there is no evidence of any significant concentration of ownership in children’s social care services.

We agree with the CMA’s focus on improving the supply of placements for children and LAs’ commissioning of children’s services as areas for potential recommendations arising from its study. However, Polaris is less confident than the CMA that achieving a well-functioning market in children’s services will deliver sufficient appropriate placements for children, and believe that the CMA may need to consider a wider range of recommendations to achieve this outcome.

We further suggest that the CMA consider, in more detail than it has to date, LA processes for finding appropriate placements for children and the scope for improvements in these processes. The CMA’s interim report is largely silent on this issue, and we hope that this will be rectified in the final report.

The remainder of this submission provides more detailed comments on the analysis and findings contained in the interim report. These comments focus on the CMA’s expectations about what a well-functioning market in children’s services can deliver, and the CMA’s pricing and profitability analysis. Polaris’s comments in relation to regulation and commissioning will be set out in its response to the recently received questionnaire on these issues.

Ensuring appropriate placements for children

The interim report says that “the placements market overall is not providing sufficient appropriate places to ensure that children consistently receive placements that fully meet their needs, when and where they require them. This is resulting in some children being placed in accommodation

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[1] Narey M and Owers M, *Foster Care in England: A review for the Department for Education*, February 2018.

that, for example, is too far from their home base, does not provide the therapy or facilities they need, or separates them from their siblings".[2]

Polaris agrees with this finding, which is consistent with Polaris's own submissions to the CMA. However, we believe that the CMA could usefully give greater consideration of, and provide further insight as to its expectations of what a well-functioning market can be expected to realistically deliver in terms of providing sufficient appropriate placements, and how the challenge of matching children with the most appropriate placement can be best achieved.

1. Outcomes delivered by well-functioning markets

The interim report says that a well-functioning market for placements would support a supply of placements that was "sufficient so that places are available for children that need them, as they need them. These placements must be appropriate to the needs of the child and in the appropriate location".[3]

The CMA's benchmark for a well-functioning market in children's services is very high, and underplays the wide range of different placements that are needed for children and how services must regularly evolve and respond to changing requirements for looked after children (e.g. gangs, county lines, child sexual exploitation).

Polaris agrees that sufficient appropriate places should be available when and where needed, but for the children's services market to deliver this outcome it is likely that something close to perfect information and frictionless transactions would be needed. That is, the children's services market would need to be closer to the economists' ideal of a 'perfect' market, than a well-functioning market in the real world. There are probably very few, if any, real world markets that perfectly match supply and demand in the way suggested by the CMA's statement above.

Setting this unrealistic benchmark for the outcomes that can be achieved by a well-functioning market is likely to skew the CMA's thinking about the recommendations that are needed to better match supply and demand. By recognising that even a well-functioning market is likely to result in some children receiving sub-optimal placements, the CMA can give an appropriate level of attention to identifying the least desirable outcomes and the interventions needed to mitigate these outcomes.

The Department for Education's ban on placing under 16s in unregulated accommodation (as referenced in the interim report at para 3.8) is an example of the kind of intervention that can be used to directly address undesirable outcomes.[4] Recommendations to address specific sub-optimal outcomes can comfortably sit alongside other wider measures that will improve the functioning of the children's services market.[5]

Polaris also believes that a more detailed diagnosis by the CMA of the shortfall in appropriate placements would help the CMA develop the most effective set of recommendations. We appreciate that there are no readily available statistics and there are multiple indicators of

[2] CMA Interim Report, para 9.
[3] CMA Interim Report, para 3.2.
[4] Of course, attention needs to be paid to the possibility of unintended effects when considering potential interventions aimed at mitigating undesirable outcomes. The importance of this has been underlined by recent reports that the ban on unregulated accommodation may be increasing LAs' use of deprivation of liberty orders so that children can be placed outside regulated environments (see BBC News, *The court orders depriving vulnerable children of their 'liberty'*, 12 November 2021, https://www.bbc.co.uk/news/uk-59147367).
[5] An example of an intervention elsewhere aimed at avoiding the very worst outcomes is the energy market, where certain suppliers have a role in ensuring that they have a dedicated amount of additional extra capacity that is available to use when extenuating circumstances arise to ensure that power continues to be supplied. (For clarity, we are not suggesting that this intervention would read across to children's services, rather it provides an example of how interventions can be targeted at avoiding a specific sub-optimal outcome.)

appropriateness (as set out in the interim report at para 3.7). However, a more detailed understanding of the number, location and type of placements that might be needed compared to available capacity would help inform the CMA's assessment of the likely effectiveness and proportionality of different options for increasing the supply of places.

Further, the CMA could usefully seek to better understand the relationships between the demand and supply of placements in foster care, residential care and unregulated accommodation, and any resulting shortfalls. For example, if the number of inappropriate placements in residential care is being driven by a lack of foster care placements, then measures to increase the number of foster parents could be expected to generate better outcomes than measures to increase the supply of placements in residential care. Further analysis by the CMA would be helpful in shedding light on these relationships and ensuring high quality recommendations from the study.

2. Addressing the challenge of 'thin' markets

One of the CMA's key observations in the interim report is that each LA purchases "a relatively small number of placements each year. For the local authorities in our dataset, they purchased an average of 49 independent children's homes places per year and 126 fostering placements a year".[6] In other words, the market in each LA area is quite "thin".

Markets that attract a larger number of suppliers and customers will be more effective in matching demand with supply (i.e. in the context of children's services, placing more children in appropriate settings).[7] We recognise that the recommendations that the CMA is exploring in relation to collaborative procurement is one way of increasing the 'thickness' of the placements 'market'.

The interim report also refers to the proportion of placements made through framework agreements versus those that are spot purchased.[8] Polaris recognises that increasing the number of placements that are made through framework agreements is likely to increase market depth, and thus the proportion of appropriate placements. The interim report does not, however, highlight the much greater use of framework agreements in relation to foster care placements compared to residential care placements. The CMA could usefully explore the reasons why framework agreements are used more in fostering compared to residential care. This may be helpful in informing any CMA's recommendations on increasing the use of framework agreements in residential care.

The 'in-house first' policies that have been adopted by most LAs for placing children seem likely to be having an adverse effect on market depth and outcomes for children for at least two reasons. First, children are prioritised for placement with LA services on financial grounds even if a better placement is potentially available with independent sector providers. Second, the opportunity to find the best possible placement in the independent sector is compromised as a result of LAs compressing the time available to make these placements when only in-house placements are considered in the first instance.[9]

In 2018, the Narey Report said that LAs' in-house first policies are "entirely sensible" given the lower marginal cost of an in-house placement compared to an external placement.[10] However, this assumes that in-house placements, if not filled at the first possible opportunity, will remain

[6] CMA Interim Report, para 10.
[7] A market that works well will "attract a sufficient proportion of potential market participants to come together ready to transact with one another". This quote, taken from Roth AE, "What have we learned from market design?", National Bureau of Economic Research, Working Paper 13530, October 2007, is one example of the literature with which the CMA will be familiar.
[8] CMA Interim Report, para 2.11.
[9] As the CMA notes at para 5.7 of the interim report, "local authorities must find a placement for each child and do not have the ability to delay".
[10] Narey M and Owers M, *Foster Care in England: A review for the Department for Education*, February 2018, p.58.

vacant for an extended period. This further implies that either: (i) demand is insufficient to fill all of the places in LA services; and/or (ii) independent sector providers will always provide more appropriate placements if considered on equal terms to LA services. This seems both unlikely, given the demand for placements, and unnecessarily negative about the quality of LAs' in-house services.

We encourage the CMA to reflect on LAs' in-house first placement policies, their impact on providing the best possible placement for children, and the erroneous financial considerations, which prioritise financial considerations over outcomes for children, that seem to be driving these policies.

Profitability and pricing analysis

The CMA has requested feedback on its profitability and pricing analysis. We have set out below some suggestions for further developing the CMA's analysis so as to ensure a robust set of findings.

1. Operating costs in foster care

The CMA's interim report finds that in foster care "local authority operating costs have been approximately 37% lower, on average, between 2016 and 2020 than the equivalent for the large private providers".[11] The CMA notes the difficulties in making like-for-like comparisons given differences in, for example, the complexity of the needs of children fostered in the independent sector compared to LAs' in-house services.

The Narey report, which investigated this issue in some detail, concluded that "taking account of all the differences between the two sectors, and based on our sample, we believe that IFAs are more expensive, albeit by a relatively small amount. The cost difference is smaller than the variance in costs between and across local authorities and between and across IFAs".[12] The CMA's interim report, while referencing Narey's comparison of raw operating costs (i.e. a difference of 40%), does not mention the ultimate conclusion of Narey's analysis (set out above).

We think it would be helpful for the CMA to extend its analysis, similar to the Narey review, so that it can reach a firmer conclusion on the relative operating costs of foster care services at LAs and in the independent sector, which allows for differences in the services that are supplied. Without this additional analysis, the CMA risks producing a report that is less informative than earlier reviews of the sector when presumably the aim should be to advance on previous analyses.

2. Profit margin analysis for fostering agencies

Polaris believes that the CMA could usefully give greater attention to whether the conditions it identifies in Appendix A of the interim report as explaining high returns for suppliers in other markets are, in fact, present in foster care.

The CMA sets out three reasons why high profit margins might persist, namely: (i) IP, R&D or specialist technology; (ii) human capital or accumulated training; and (iii) risk.[13] The relevance of these issues to independent sector providers of foster care is rapidly dismissed by the CMA. However, we believe that further consideration should be given to two of these issues, namely human capital and risk.

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[11] CMA Interim Report, para 3.59.
[12] Narey M and Owers M, *Foster Care in England: A review for the Department for Education*, February 2018, p.62.
[13] CMA Interim Report, Appendix A, para 44.

Human capital

In relation to human capital, the interim report says that high profit margins can persist where "the value of a business comes from its people, who have a high level of training, accumulated experience and knowledge. Competitors or the incumbent can earn high margins in the short term by acquiring or developing those people respectively. However, the value that these people bring is broadly shared with them through high wages and compensation, such as in law firms or management consultancies".[14]

We would suggest that a "high level of training, accumulated experience and knowledge" is not sufficient on its own to create value for employing businesses, rather it is the scarcity of people with these characteristics that allows persistently high returns.

Bearing this in mind, independent sector foster care businesses are also characterised as employing people with scarce characteristics (i.e. foster carers), and the value that carers bring to fostering agencies is broadly shared with them if we look at the proportion of fostering agency revenues that are paid to foster carers.

In relation to scarcity, Polaris, and others, have shown the CMA how difficult it is to find people with the right characteristics to be a foster parent from the many thousands that express interest. The scarcity of foster carers comes about as a result of few people having the right set of skills that make them suitable for this role, which is clearly analogous to the skills that other people may be able to build up through education and training. Moreover, many foster carers will then undergo additional training to allow them to care for children with complex needs. (Polaris would also note that social workers and therapists are also critical to ensuring appropriate care for children in foster placements, and that these staff also bring high levels of human capital to their roles.)

In terms of value sharing with foster carers, Polaris looked for evidence of the amount paid to lawyers by law firms as a suitable benchmark. A study by Smith and Williamson, a financial and professional services firm, in 2018 identified the ten UK law firms which paid the most to their staff, as a proportion of revenues.[15] For these firms, staff costs ranged between 46% and 62% of revenues.

By way of comparison, Polaris in the most recent financial year paid out [✂]% of its revenues in staff costs, including to foster carers. That is, Polaris paid [✂] percentage points more in staffing costs, as a proportion of revenues, than the UK law firm that paid the most to its staff.[16] Further, if only foster carer costs are taken into account, and not other staffing costs, Polaris still paid out [✂]% of its foster care revenues to foster carers, which is similar to the amount paid by the ten UK law firms which pay the most to their staff.

In summary, independent sector providers of foster care appear to match the conditions related to human capital that explain why certain firms might earn high margins over a long period.

Risk

In relation to risk, the interim report says that businesses with certain risk profiles may be able to persistently earn high returns. The interim report says this "applies to high-risk businesses with

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[14] Ibid.
[15] See Stanley G, *Which law firms spend the most on staff?*, Law.com International, 13 June 2018 https://www.law.com/international-edition/2018/06/13/which-law-firms-spend-the-most-on-their-staff/?slreturn=20211002102004.
[16] The numbers highlighted and in square brackets are commercially confidential to Polaris and should not be published by the CMA.

volatile cash-flows (e.g. proprietary trading) where equity or debt investors might need to underwrite the business frequently to fund temporary liquidity shortfalls. The company will need capital to do so, for which investors will want a return."[17]

This example seems problematic in that it implies that proprietary trading businesses have to make frequent, and unanticipated, calls on debt funders and/or equity investors to ensure their ongoing liquidity. This characterisation seems highly doubtful. Why would equity and debt funders continue to offer funding to a business that could not manage without frequent calls for additional capital? We suggest that the CMA gives further thought to the characteristics of a business that carries a significant level of risk which allows it to earn higher returns. Having an appropriate benchmark will ensure appropriate comparisons with children's services businesses.

This issue also goes to the CMA's discussion of appropriate comparator firms for the planned profit margin analysis (see Appendix A, para 47). Polaris would suggest that the most appropriate comparator firms for independent sector providers of foster care are likely to be other businesses that also care for people, whether personal or clinical. Like foster care, these businesses face a common set of risks based on the possibility of care mishaps that can arise from human error or misjudgement. Of course, Polaris and other independent sector care providers work extremely hard to minimise these risks, and for the most part are very successful in doing so. However, this is an important risk that is intrinsic to these businesses and needs to be accounted for when making comparisons with other companies. None of the suggested comparators identified by the CMA, namely Capita, Serco Group and Mitie Group, have any significant care-based operations, and as a result, any comparison with these three firms is unlikely to be particularly insightful.

[17] CMA Interim Report, Appendix A, para 44.