

CONTRACTING FOR SOCIAL SERVICES

Introduction

The performance of the social services market and the challenges of social sector contracting are a recurrent issue at both an agency and ministerial level. There are a number of initiatives underway to improve social outcomes and the delivery of services. To provide advice on the effectiveness and efficiency of these initiatives and how we can improve performance we first needed to understand how the social services market works.

Much of the discussion in this paper focused on the Ministry of Social Development's (MSD) contracts and policy initiatives. This was largely down to the framing of the project where we initially chose to begin with a narrow scope, and we had pre-existing involvement with MSD-led initiatives.

However, MSD is not the only agency to contract for 'social services', and providers will commonly have contracts with multiple agencies including the Ministry of Health, the Ministry of Justice, Ministry of Education and Te Puni Kōkiri (which funds building provider capacity and capability through Whānau Ora). When we refer to social service providers in this paper, we are referring to NGO providers who are contracted to deliver social services regardless of which agency the contract sits with. We note that all of the NGOs we spoke to had at least one of their contracts with MSD. We also acknowledge that comments made by providers on their MSD contracts may not always generalise across all agency contracting, for example the Ministry and Health (MoH) and District Health Board (DHB) structure may create some points of difference which we have not covered in this paper.

However, within the scope of our analysis we have been able to draw out a number of issues with the social service market that clearly do extend beyond a focus on MSD. This paper presents our analysis of the issues and proposes further investment work which will develop more of a cross-agency viewpoint of contracting for outcomes with the goal of improving the performance of the social service market.

The paper is structured as follows:

1. **Context** – this section outlines the current social sector contracting environment, with a focus on MSD funding and a brief history of previous policy initiatives that attempted to shift towards contracting for outcomes.
2. **Methodology** – this section outlines how we went about engaging with NGO providers and developing our primary information source.
3. **Key themes** – this section outlines the key themes which have been taken directly from summaries of conversations with NGO providers.
4. **A market description** – this section analyses the contracting of social services from a 'market perspective'.
5. **Implications and Advice** – this section identifies the key areas of focus when considering how to improve social sector contracting with NGOs.
6. **Next Steps** – this section sets out what follow-up analysis we propose to undertake to address the issues identified through this paper.

Section 1: Context

Background

The spending environment:

In the 2011/12 financial year procurement accounted for approximately \$24 billion or 32% of total departmental and non-departmental operational expenditure across the state sector. Procurement covers all expenditure to third parties used for the acquisition and delivery of goods, services and construction. The social sector accounts for approximately \$12.4 billion or 52% of this procurement spend.

For example, in the 2011/12 year MSD spent \$574 million on social services through Work and Income, Family and Community Services, Ministry of Youth Development and Child Youth and Family. This funding was allocated through over 6000 contracts and grants to almost 3000 providers and almost 90% of the MSD contracted spend went to around 30% of the providers¹.

Procurement with the social sector is not only through contracts for the delivery of services. As the Office of Community and Voluntary Sector (within DIA) Code of Funding Practice² outlines, funding arrangements can take many forms along a continuum from conditional grants to highly specified contracts. Grants generally support activity and do not contain specific details on quality or quantity of a service to be delivered. They are distinct from contractual arrangements to purchase specified services. The structure of funding to the NGO sector has shifted over time. In their 2009 paper on the New Zealand not-for-profit sector, O'Brien, Sanders & Tennant³ describe this shift. In the 1980s government funding of NGOs was primarily in the form of grants to support NGOs' work. However, since the 1980s contracts for the delivery of specified services have increasingly replaced grants.

Governments contract out service delivery functions for a variety of reasons. It is not always possible or appropriate for government to deliver all social services directly, as often the delivery of some services will come into conflict with its enforcement role (for example children protection and law enforcement). Even where the state might deliver the service directly, NGOs are seen to have specific organisational capital which they can draw on to deliver services for communities in innovative, responsive and specialised ways. The relationship between NGO providers and government has strengthened over time as there has been a greater recognition by government agencies of the unique contribution made by NGOs as independent providers rather than just delivery arms of government (Sanders, O'Brien, Tennant, Sokolowski & Salamon, 2008)⁴.

The Policy History:

Given the size of social sector spending, and the importance of the outcomes being sought, it is not surprising that the efficiency and effectiveness of this expenditure in New Zealand is a focus area for Ministers and agencies. However, achieving substantial change in a sector of this size and significance is not easy. Over the last decade there have been many initiatives which have used the language of outcomes, including:

¹ Ministry of Social Development (2012). *Proposed Implementation of ISO Report to Hon Paula Bennett, Minister of Social Development*.

² <http://www.goodpracticefunding.govt.nz/>

³ O'Brien, Sanders & Tennant (2009) *The New Zealand Non-profit sector and government policy*, office of the Community and Voluntary Sector, Wellington.

⁴ Sanders, J, O'Brien, M, Tennant, M, Sokolowski, S & Salamon, L. *The New Zealand Non-Profit Sector in Comparative Perspective*. Office for the Community and Voluntary Sector, 2008.

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- **“Closing the Gaps”** (2000), now more commonly referred to as **“Reducing Inequalities”**, which aimed to promote equal opportunities to achieve a similar distribution of outcomes between groups. This required a cross-government focus on a set of defined outcomes.
- **Local Services Mapping** (2002), a budget bid for a process that enabled matching of service provision with local needs in a collaborative manner.
- **“Funding for Outcomes”** (2003), Cabinet agreed to progress with urgency the rolling out of integrated contracts with NGOs known as including establishing a team of **“brokers”** and associated funding to champion integrated contracting.
- **Pathways to Partnership** (2007), a budget initiative, which was a multi-year strategy aimed at strengthening community based family, child and youth focused services. Objectives of the policy included shifting to a focus on outcomes and moving away from inputs/outputs, enabling providers to build workforce capacity and capability and supporting organisations to work more closely together. The intention of the shift in focus was to give providers flexibility in their contracting arrangements and more freedom to be innovative.
- **Community Response Fund** (2009), a portion of the Pathway to Partnership funding was redirected towards this fund, while some funding was retained in departmental funding.
- **High trust contracts** (2010), an approach to contracting with providers which is intended to focuses more on outcomes and less on ticking boxes, paperwork and reporting for providers.
- Initiatives underway are trialling different approaches to designing, delivering or contracting for social services. These initiatives are still relatively new and the evaluations of results and impacts are still coming through or are yet to be determined. These include:
 - **Whānau Ora** (2010) and the application of integrated contracting with provider collectives.
 - **Social Sector Trials** (2011) giving responsibility for contracts and other resources to communities to deliver high level outcomes for young people.
 - **Welfare Reform and Youth Service contracts** (2012) trialling contracting out of case management and contracting for outcomes.

This collection of initiatives has played a part in shifting government towards talking about the importance of focusing on outcomes. However, it is very important to distinguish between ‘contracting for outcomes’ and ‘outcomes focused contracts’. When we refer to contracting for outcomes in this paper, we refer to funding that is linked to performance or results. Outcomes focused contracts, on the other hand, are still specified in terms of inputs or outputs, but there is an emphasis on how an activity improves higher level population or client outcomes. One example of advancement in outcomes focused contracting is through the introduction of the Results Based Accountability (RBA) framework by MSD. RBA provides a common language for assessing outcomes to drive greater accountability for the outcomes. The framework specifies population level and organisational performance results to demonstrate how services contribute to overall community results. The key value-add of RBA is that it enables providers to describe how their activities are intended to contribute to outcomes, but it should not be confused with contracting for outcomes. To date, it is contracting for outcomes that is a still a largely un-cracked issue.

Investing in Services for Outcomes (ISO):

One of the most recent projects in development in this area is MSD’s Investing in Services for Outcomes (ISO) programme of work. ISO is intended to refocus funding contracted by MSD more towards outcomes aligned with government’s priorities for vulnerable children and welfare reform. There are three broad objectives of the ISO workstreams:

- “determining what services will be purchased

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- improving how MSD works,
- and supporting the social service sector⁵.

Progress with ISO to date has included support for organisational capability building. A capability resource of \$31 million has been set aside to support providers to shift towards collaborative ways of working and achieving collective impact; an initial phase of funding has supported organisations to complete capability self-assessments and planning.

MSD is also focused on internal change to support improved contracting with the NGO market, through one contracting and one monitoring and reporting framework. A single approval process and point of contact with MSD will aim to remove compliance barriers to contracting.

Work is underway to determine how to increase the proportion of contracts that are linked to outcomes.⁵ Withheld under s9(2)(f)(iv)



Wider than ISO:

In the context of delivering Better Public Services, there has been an increasing focus on the contracting process itself with a view to further streamline and reduce bureaucracy. The Ministry of Business, Innovation and Employment (MBIE) is the functional lead for government procurement, and in the social sector the key project underway is the streamlining of contracting with NGOs. Last year MBIE lead a pilot to test whether government contracting with NGOs could be streamlined with much of the duplication and high compliance costs for NGOs removed. The pilot developed a suite of template contract, contract management and decision-making documents (collectively referred to as the contracting framework) that should create greater consistency within government to assess contracting risks, the form of contract and the approach to contract management for contracts between government agencies and NGOs. MBIE reported back to BPS Ministers on the pilot in December 2012 and in early 2013 Treasury prepared Cabinet papers to progress the pilot programme along with a number of other BPS initiatives.

The pilot was successful and now MBIE is leading a three year project with funding from the BPS Seed Fund to begin a phased roll out of the new NGO contracting framework across contracts where government purchases services from NGOs will now progress under MBIE leadership

In addition to the number of initiatives and trials discussed above, a pilot Children's Team will begin in Rotorua to be functional by July 2013. Children's Teams are part of the government's response to the White Paper on Vulnerable Children and Children's Action Plan released late 2012. Children's Teams aim to join up agencies and NGOs operating on the ground to take a holistic approach to identifying and responding to the needs of children and their families/whānau.

⁵ <http://www.msd.govt.nz/about-msd-and-our-work/work-programmes/investing-in-services-for-outcomes/index.html>

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The Implications:

There is a long history of initiatives in this area and a number of new projects underway which are all attempting to improve the performance of the social service market. Many talk about a focus on outcomes, but very few seem to be moving towards contracting for outcomes, or performance-linked funding. In order for Treasury to comment on how we can assist with improving the performance of the social service market and achieving a shift towards contracting for outcomes, it is important to understand how the market for social services operates. Answering this question is the focus of the next three sections of the paper.

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Section 2: Methodology

The evidence base for this paper and subsequent analysis is drawn from a series of discussions with NGO providers, complemented with comparisons to existing literature where appropriate.

The process of NGO engagement started with an informal discussion with two NGO providers in Wellington that was building on a series of discussions Treasury had been having with NGO providers over the previous 12 months. This provided a basis for understanding the social services market from a provider perspective, and enabled us to gauge what the general issues were. We used our initial discussions to form a question framework to structure discussions around key themes. This was then tested with a larger group of NGOs that differed in size, scope, practice model and geographic location.

Treasury has an established relationship with Social Service Providers Aotearoa (SSPA), and we used this pre-existing trusted source to arrange a series of visits to NGOs in Whangarei, Auckland and Christchurch. The only specification for a provider to be part of the project was that the provider had at least one current contract with MSD. This was to keep the scope of the project manageable. In reality however, as previously mentioned, many of the providers have multiple contracts with more than one government agency. Providers only needed to have a minimum of one government contract, it turned out that all of the providers received the majority of their funding from government. We also requested to our contact that providers would cover a range of sizes, service offerings and capability levels. This sampling methodology generally followed a snowball approach, with the idea that each provider would add some additional value to the overall sample.

Annex 1 lists the agencies that participated in the initial engagement stage of this project. It is the information received from these providers that informs the themes discussed in section 3. We undertook discussions with five separate providers in the Auckland region, a group of 10 providers in Whangarei and representatives from seven providers involved in the Right Service, Right Time initiative in Christchurch which equated to 22 NGO viewpoints represented.

We structured our discussions with these providers around a prepared question framework, although this was only a guiding structure. We were very conscious of generally listening to NGO's experiences on contracting with government. The structure of the discussion also differed depending on if it was an individual provider or a group setting such as Whangarei and Christchurch where a range of representatives from different social service NGO organisations were present. The discussions lasted between one and two hours. We also managed to achieve our aim of engagement with a group of providers who were notably different from each other in both the types of contracts and relationship with government, service offerings, size and observable capability differences.

Our approach to gathering a robust primary data source was to use a shortened method of grounded theory. We recorded the discussions and used the recordings to summarise the conversation and draw out key themes. Recordings were deleted after the summary documents were formed to maintain the confidentiality of the providers. Individual summaries were then reviewed by the relevant NGO providers to confirm their accuracy. This approach allowed the summaries to become our primary data source; we developed key themes from the NGOs own words in the summaries and then used these themes to ground our own commentary and theorising.

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Subsequent engagement:

We recognised that as with any selected sample method, we introduce the possibility of sample size and selection bias to our analysis. To address this we have shared the themes section of this paper with a wider group of agencies both within and outside of government. Through this approach we have been able to test our findings with a wider audience.

As we are aware our sample was drawn from organisations under SSPA, we have since shared the themes with NGO organisations that are represented under the ANGOA (Association of Non-Government Organisations of Aotearoa) network. There has been agreement to the issues we identified among the wider audiences we have discussed our findings with. We have also shared our findings across government agencies⁶. Through this subsequent testing approach, we are confident in the results and conclusions which can be drawn from our relatively small initial sample.

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⁶ MSD, MBIE, TPK, MoH, MoE, MoJ and OSVS within DIA.

Section 3: Key themes we heard from providers

Description of NGOs

NGO providers are not homogenous. There is a clear distinction between “corporate NGOs” and “small NGOs”. Corporate NGOs can put more resources into their tenders and operate more like a business, with clear understanding of their funding streams, expenditures and risks. Small NGOs rely more on individual passion and commitment, and being well connected to the local community. They can miss-out on contracts because they struggle with tender processes, contract management complexity and high compliance costs. These smaller NGOs are more likely to be unsustainable without government support. Providers also differ by practice models and there does not seem to be a way to compare the effectiveness and efficiency of these practice models. As an example, in more recent years there have been a number of Māori or Pacific providers entering the market. These providers often operate a service delivery model which differs in its grounding compared to other NGOs such as those with historical religious affiliations (the Church).

As end-consumers are the key focus, agencies were asked about their clients and noted:

- It is common to place the client’s needs at the centre of the engagement and for goals to be set by people on the programmes.
- Most NGOs ‘accessed’ their clients through referrals by other government agencies (e.g. Child Youth and Family or the courts) or from other NGOs.

Themes drawn from summaries

These themes were derived directly from what we were told by providers. These are providers’ words and not our own; our analysis of these themes is provided in subsequent sections of the paper. We are confident these summaries are an accurate reflection of what we heard from providers as the NGO representatives who participated had the opportunity to edit the summaries and all substantive changes suggested by the NGOs were accepted.

1. NGOs want funding linked to outcomes...

Despite a number of initiatives where there had been talk of contracting for outcomes, there was a clear message that NGOs’ current contracts are not specified in terms of outcomes; funding is linked to the achievement of inputs and outputs (with the exception of the new Youth Services contracts). However, there was strong support for funding to be based on outcomes so long as the expected outcomes were properly defined and realistic. No one expressed the belief that outcomes could not be measured, and a number of providers were very clear outcomes can be specified and measured (the current RBA framework was mentioned as moving towards this type of thinking). One NGO group suggested response times and client satisfaction were the main indicators of key outcomes.

The operational flexibility of outcome funding was seen as an important advantage that would lead to improved services. It was noted that local communities want to see a focus on outcomes and that this was a way of dealing with the issue of intergenerational transmission of violent behaviours. It was also suggested those NGOs who objected to contracting for outcomes are likely to have poorer delivery of outcomes.

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2. ...but there are important practical barriers to implementing outcome based funding...

This support for outcome funding had important practical caveats that were most succinctly expressed as cost, agency competence and attribution. A number of NGOs mentioned the cost and difficulty of research on outcomes as a barrier. Even the IT needed to analyse outcomes was often not available to NGOs and other forms of funded capacity building would be needed. Several agencies also mentioned they do not fully control the environment needed for success, and that would need to be taken into account.

This would particularly be a challenge for smaller NGOs, and it was not clear if mergers or other strong forms of collaboration would be possible, and if they were possible, what value would be lost from greater collaboration.

Ownership of the outcomes was also very important, with a strong preference for cross agency collaboration and accountability at a local level when deciding the outcomes to be measured.

3. ...and government creates barriers to achieving better outcomes.

For the delivery agencies, the way government operates is itself a barrier to achieving better outcomes. The strongest theme was the difficulty in finding out actual outcomes for clients because there is so little cross-government collaboration and information sharing. This was made worse by the fact government agencies were felt to be acting in a way that was slow, hierarchical and without input from NGOs.

Other problems were less about the interaction between NGOs and government, and more about government itself. The relatively high pay and better conditions that government offers creates churn in the NGO workforce because they do have the resources to offer equivalent salaries and benefits to their social workers. However, it was also suggested that the same type of workforce churn within government agencies made it difficult for NGOs to build up relationships.

Recent initiatives, such as Whānau Ora and ISO, were welcomed but NGOs were unclear about how much difference they would make in the long run.

4. NGO performance could be handled better...

A strong theme in the discussions was that contracts were based on delivery of 'units' and often felt like tick-box exercises. This had consequences for the way services were delivered, especially prescriptive contracts that made it difficult to innovate as there was no obligation to find the "best use" of resources. This has resulted in some providers focusing on easier clients to meet targets. Specifying contract volume in this way is sometimes an obstacle to delivering a good service and some people fall through the cracks in the system that this creates.

Despite the contracts being designed around making performance measurement easy, it was difficult to understand how good and bad performance was handled. Some contracts seemed to be revoked after an extended process. Conversely, those who did perform were not rewarded with new or extended contracts that recognised their past performance. It is difficult to understand where performance enters the decision to award contracts, and a question was raised by one NGO we talked to about whether contracting was based on who was known to people in the agencies. Another NGO did point out that contracts could be revoked with poor performance or not renewed.

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5. ...and there are many issues within the funding process.

Some of this absence of performance information may be due to flaws in the process of deciding who would be funded. The costs of applying for the funding was a recurrent theme, in particular, the cost of IT and partial funding that did not recognise full organisational costs. This can create barriers to the services offered, such as: siloing providers to particular geographical areas, making it harder to provide services to more difficult clients, and advantaging larger organisations.

Many NGOs we spoke to felt that processes were opaque. For example, those who did not get a contract had no information on why, while some contracts were rolled over with no tender process and no reason offered for this (possible these were 'relational contracts'). An NGO did note that there was a feedback loop in place when a contract was won; they were told why they had been awarded the contract. It was noted that there needed to be a closer link between outcomes and funding.

There was also a strong sense that processes were overly bureaucratic. This creates barriers to collaborating and slowed payment. A comment was made that high trust contracting had not reduced the amount of bureaucracy they faced. The Christchurch group commented an earthquake was needed for agencies to offer less bureaucratic/responsive funding.

It was suggested short term contracts were an important barrier to achieving better investment in outcomes. It was also noted that targeting funding to specialist kaupapa Māori providers meant that organisations that primarily work with Māori clients and were mostly staffed by Maori, could not receive the funding tagged for Māori.

6. Collaboration is the norm, but it is not easy...

One of the strongest themes was the ways in which NGOs work together; this idea was seen as an extension of a broader collaborative norm which can be observed in different ways. Working together at the tender process stage of the contract allows for a joint local community view on who should get the contract. One interview offered more detail, suggesting the costs of the contracting process encourage collaboration as a way of managing costs down and providing better outcomes. Sometimes this approach meant NGOs were able to influence the decision panel for the contract such as by changing what was contracted for, specifying that two NGOs would share the delivery of the contract or specifying a change in price that would be paid for the contract.

Collaboration of a different form was also encouraged through the Whānau Ora initiative, which encourages providers to work together as provider collectives and deliver integrated services.

While attempting to work collaboratively might be the norm, it is clear there is still competition between NGOs, as there is still limited funding to go around. Competition through the contracting process tends to be on the relevance of the organisation for the contract, rather than on price paid, with one organisation suggesting more money should be available so there was less unhelpful competition for funding and more collaboration.

Despite the fact working together was the norm, it was clear NGOs do struggle to work collaboratively at a more formal and integrated level. Outside of local geographic areas or similar service offerings, working together as NGOs was less common and most collaboration was based on personal relationships between senior members of the NGOs.

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The most successful example of working together, the “Right Service, Right Time” initiative in Christchurch, was also illustrative of the difficulties of collaboration. The local NGOs felt they needed a way to jointly manage the demand their services and initiated “Right Service, Right Time” to minimise waiting times by providing a single point of access for people needing family and children’s services. This initiative is based on local NGOs having a long history of working together and still took a couple of years to get off the ground. In addition, people within the local CYF office and the local DHB played an important constructive role. Those involved believe “Right Service, Right Time” may not be easily transferable to other areas given the investment in trust building needed.

Formal integration of providers such as mergers and joint-ventures do happen, but are far less common.

7. ...local community is key...

In all the discussions, the role of the local community was noted. Most expressed the view that NGOs needed to be rooted in local communities to find and support those needing their services.

There was also a strong feeling that contract decision making was too centralised and this had a detrimental effect on the services delivered. Views from Whangarei providers expressed this point particularly strongly, giving as an example how geographic distance and lack of transport in rural Northland was a barrier to access to services.

8. ...and NGOs do more than they are contracted for

Where outcome were specified in contracts, most NGOs mentioned that ensuring they delivered required them to do more than they were contracted for. This included providing extra support, follow-ups, and helping out-of-region clients with access to services. Demand also tends to far exceed contracted volumes, but this often doesn’t stop NGOs working with these clients, for example one provider noted “we can’t say no to families”.

9. Clients’ needs are varied

The clients vary in their needs and attitude to services and the approach to their involvement in the service will be based on this. Clients suffer barriers such as poverty, unemployment and poor information about what is available. This means interventions may not reach the people they are most intended to support. Where there are some costs which are borne by clients this can be an important barrier to delivery.

Those clients who know the system well enough to manipulate it need a mandated approach, but it seems greater client flexibility and choice is possible for others.

Section 4: A market description

The themes raised by providers are not new. These are difficult issues and have been discussed for some time (Sanders et al (2008)).⁷ Previous Treasury advice has grounded its analysis of the issues in a more generic “contracting theory”. The literature on contracting theory does include contracting with non-government organisations, for example the difficulties with managing incentives, information asymmetries and transaction costs. It also identifies risks such as difficulty in specifying KPIs and outcomes, provider segmentation of the market and clients, a lack of competition and the funders’ ability to sanction or terminate contracts.

Our discussion with NGO providers suggests many of the benefits of contracting-out cited in theory are not apparent in the unique environment of the social service market. For example, our discussions with NGOs suggest market structure is: a barrier to competition and contestability, makes it difficult to improve quality through increased accountability and transparency or better customer service, and it is unlikely enhanced accountability will improve responsiveness. In addition, even contracting theory literature recognises that incomplete contracting will more often than not lead to the undermining of conditions for pure competitive markets.

In this paper we apply a slightly different lens to thinking about contracting for social services. We focus on describing what the market for social services looks like and how this market differs from a standard service market.

When we refer to contracting with the market we are referring to contracting with non-government providers regardless of their shape or form, as noted earlier the providers we talked to were all differed in terms of size and practice models. We also focus on direct contracting between government agencies and NGOs rather than a devolved decision making model (such as indirect contracting between government and NGOs through DHBs or schools). The devolved model is a different case that requires specific analysis which we did not cover in this paper.

The Market for Social Service Provision

In economic theory, a perfectly competitive market has many buyers, services that are identical, perfect information and no barriers to entry or exit. Market price is determined by the interaction of supply and demand, and in that process the level of the service supplied balances the needs of those who want the service against other goods and services they want. Price generates valuable information about the costs of services and indirectly about their quality; price is also the mechanism by which resources are directed to those who value them the most. Competition therefore drives efficient markets, quality improvements, innovation and ultimately greater benefit to end service recipients.

The fact that government needs to purchase or supply the bulk of social services is evidence this market does not operate as a purely competitive market and there is no surprise that the theoretical model is a poor description of the social services market in New Zealand. The more interesting question is *to what extent* the market operates at all, and what are the consequences for government when it intervenes by supplying or purchasing services, or regulating the social sector?

⁷ Sanders, J, O'Brian, M, Tennant, M, Sokolowski, S & Salamon, L. *The New Zealand Non-Profit Sector in Comparative Perspective*. Office for the Community and Voluntary Sector, 2008.

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Most importantly, in this market the people who consume the service very rarely purchase it themselves, regardless of whether the service is supplied by government or NGOs. Instead of a fixed-service variable-price tender where the buyer is the consumer, it is a fixed-price variable-service tender where the buyer (the Government) is purchasing on behalf of a third party (consumers). These 'consumers' are typically vulnerable and ill-informed about the services that are being purchased. Some are indifferent to the service they are receiving, or even hostile to the outcomes that are being sought on their behalf.

From the provider perspective, the market operates more like a monopsony, with government the largest supplier and purchaser, and multiple sellers reflected by a relatively fixed number of NGO providers. This is a market that is highly 'managed' by government through the contracting process. The way in which government contracts with providers for social services effectively removes price signals from the market. Government decides on the level of funding it will provide for a given service, invites bidders for this funding and allocates the associated contracts to price-taking providers. It is common for funding to be allocated through a tender process, although once a contract is allocated, this funding tends to "roll-over" without going out to full tender, especially with MSD funding.

Although in theory sellers could compete on price by undercutting each other and driving down the original price set by the purchaser, the interviews we had suggest this does not happen, at least not with MSD administered funding. The providers of services compete through non-price differentiation for example demonstrating 'best fit' for a contract. In the main, 'best fit' is linked to the community the organisation supplies, or the skills it has built up supplying similar services. In economic literature, this can be referred to as organisational specific capital. The investments made are timely and costly and difficult to apply elsewhere, representing a form of sunk cost for providers entering this market. A market characterised by a monopsonist buying from firms with high organisation specific capital would be poorly described by a competitive model.

How are supply and demand married up?

As an external 'purchaser' of services on behalf of third-party consumers, government is attempting to match-up supply and demand, but as there is no price-competition, there are very limited economic signals on which to base its purchasing decisions. Feedback from consumers can also be weak, and knowledge about potential service provision, providers, and consumers' need can be variable. Consumers are often just grateful for the assistance they are receiving, and neither the consumer nor the purchasers, in many cases, are aware of what they could have got for the money spent (an unseen opportunity cost).

In this environment where price is not a mechanism to drive efficiency, the key question is how does government know that the services that are being purchased are the right programmes, in the right volume and from the right suppliers to get the result for the right end-client group who values (and benefits) from the purchase the most?

Performance information is likely to be the next best source of information to make judgements about what services to purchase from whom to get the best outcomes most efficiently. It is relatively easy to identify broadly what outcomes government wants to achieve, but it is not as clear to identify what intervention mix works best together and which providers will give this desired mix. Each provider can be differentiated based on the types of interventions they offer and the specific organisational capital they bring, for example Māori or Pacific providers can offer culturally-anchored services that are targeted towards meeting the needs of particular client groups. Robust

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performance information is the most obvious way for government to make purchase decisions based on the achievement of overall results. Robust performance information and transparency in a market allows funders to flexibly shift funding to where the intervention mix and service offered by providers are best meeting desired outcomes.

However, from the providers we spoke with it seems that past performance information is not commonly asked for by government when applying for a new tender. This included any input/output information from previous contracts delivered, and there is no information on outcomes requested. Providers also have little information on how best to participate in the market as they are often unclear why they have missed out on a contract. For small providers the resource cost of applying for funding is significant. In addition, as the purchaser is most commonly making decisions from Wellington for local communities they have little contact with, this may mean contracts are won based on the presentation skills of those producing tender documents, rather than who is the best fit to deliver for a particular community. The implications of such a process on the make-up of the providers in the market could be significant, resulting in large 'corporate NGOs' out-representing small not for profit community organisations.

What is purchased on behalf of third party consumers?

Although we commonly use the generic term contracting when discussing NGO service delivery on behalf of government, there are different approaches to making a 'purchase' from these providers. In reality, NGOs are providing public goods and government is giving them money to subsidise the production of these public goods. Government is in many cases when the term contracting is used in this market, not actually purely 'buying' anything. Rather, we are judging the provider and making a funding contribution to the provision of the public good through a grant; hence in many cases the funding does not actually match the true cost of production. As the consumers are third-parties, the most the government can expect in return for their funding is that more resource allows more of the desired public good to be produced which will hopefully lead to higher outcomes for the consumers.

Where a purchase (or contribution to a purchase) is made, the contract is largely programme- based. This involves providers delivering a specified service to a specified volume of clients in a given year. In most cases the client will not be fully aware of the service being purchased on their behalf as clients are commonly externally referred to a particular provider to be placed in a pre-purchased programme space.

Client referrals to providers often come from government agencies, for example a CYFs social worker will refer a client to a known provider who receives funding for a government programme relevant to the client's needs based on the CYFs social worker assessment. Referrals can also come from other NGOs identifying people in need of support that their organisation does not provide (or is too overloaded to provide) or sometimes self-referral depending on the service offered. The decisions on who to offer the programme to falls to the provider once the contract to deliver a programme is awarded. One notable exception is where the contract specifies to whom the programme can be delivered. For example, if the contract specifies clients must live in South Auckland then a client that receives the programme but lives in West Auckland cannot be counted against contractual volumes. A contract may also specify the minimum 'need level' of clients that the provider should be delivering the programme to.

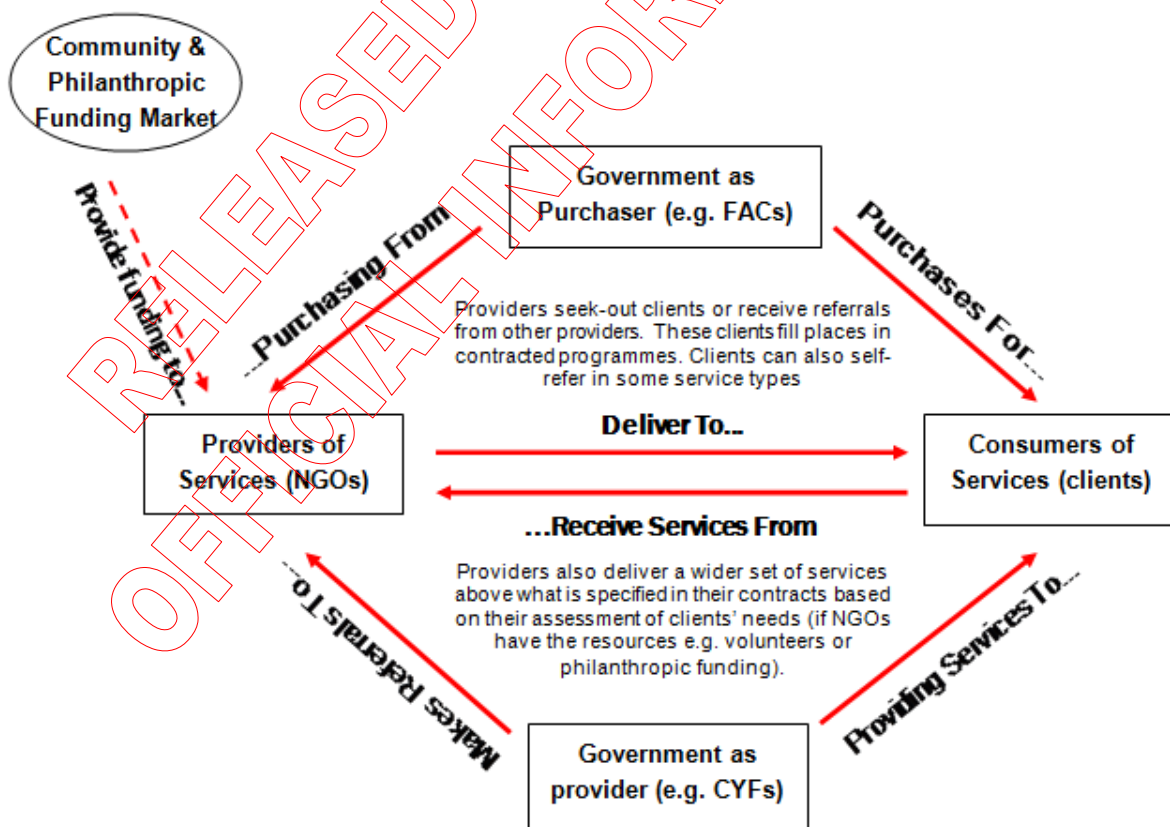
One example we discussed with an NGO was a contract to deliver a specific programme to 30 people annually. The contract specifies the clients will be aged between 10 and 18 and live within a given geographic area. It is then over to the provider to seek out and engage with people in the

community to fill the 30 places. The way the contract is specified allows the provider to determine who they deliver the programme to and this provider has determined results are more effective if they engage with people under 13 year olds. Even when this decision is entirely right as a strategy for efficiently and effectively delivering the service *as contracted*, it leads to a latent gap in provision according to what the purchaser believes they are buying and those clients who the purchaser thinks should be receiving a service are not. Volumes based contracts can also put pressure on providers to meet these volumes, which may disincentive working with 'hard-end' clients who need a lot more relationship management and time. Even if a client is referred to an NGO, unless participation is mandatory (such as from the Courts), clients can refuse to participate in the programmes.

Purchasing specific set programmes can also lead to rigidity in the system and slow the response to client needs. For example, if a programme that is purchased is expected to last 16 weeks but the client only needs 10 weeks and then requires some other form of service, the system does not allow for the flexibility to assess the needs of the client and move them onto a different programme earlier. The system may even punish the provider by counting early withdrawal as a "non-completion" that is therefore not funded.

Figure 1 provides a stylised overview of the market for social services.

Figure 1 – The Market for Social Services



A key feature of the market depicted in Figure 1 is the distinction between government as a provider and government as a purchaser. The existence of a government-funded NGO market for social service provision is built on the premise that government believes NGOs are better at producing some goods. The benefits need to outweigh the transaction and management costs to justify this

market structure. As previously discussed, target client groups may be suspicious of government and therefore NGOs may also have better access to target communities. NGOs can also raise additional revenue and in-kind resources which mean they can produce the outcomes government wants at a lower cost to the purchaser. In many cases this extra support is likely to cover the delivery of services which are only part-funded, or additional demand over and above contracted volumes. The motivations and values of people working for social service providers are an important feature of the market. The aspects of volunteerism and 'doing the work for the better good', are not easily measured or tangible, but offer an important element that is different from the corporate market.

Does the client drive demand?

A notable feature of the model is that, in the main, the model is not client-directed. Specific provider operating models place the client's needs and aspirations at the centre of their response, such as the Whānau Ora model which places the family unit at the centre, but funding generally does not follow the client in this way⁸. In client-centric models clients can choose where to receive their service and providers are compensated for the service they actually deliver (though client vouchers or post-service subsidies from the purchaser). This is most commonly cited in the disability sector, but not in the social services market. As indicated in section 3, we discussed the feasibility of more client-centric models with NGOs and noted that clients have differing needs and there was a spectrum along which such models would be appropriate. Some clients require more mandated service delivery (e.g. mental health and domestic violence) than others (e.g. budgeting advice services).

How is price represented?

There are different approaches to pricing within the Social Service Sector. The term contracting is used fairly generally. However, funding is transferred to NGO providers through different mechanisms. The contracting for service delivery, fee-for service and grant funding are different approaches to paying providers for their contributions to social service outcomes. Contracts for service delivery are not commonly based on a full-cost for service basis and providers we talked to strongly felt that the funding only partly compensates them the full costs they face to deliver the services government expects. Grants are usually more generally specified and do not carry the same accountability and reporting arrangements that a contract will have. Grant funding sends a signal regarding what government wants to achieve at an outcome level, although some are even more broadly specified, such as grants for supporting community-defined projects. NGOs will generally not be held accountable for whether outcomes have been achieved from grants. When considering levers to drive efficiency of the public service spend the funding lever is also crucial.

How is post-purchase value measured?

In a standard service market the provider would be accountable to the end client to deliver the value that the client desires. Providers not delivering value will not receive repeat business or find possible new consumers deterred by poor word of mouth.

In this market there is very little of this form of accountability to the client (unless providers impose accountability within their own business models). The purchaser tracks the value of the service through contract monitoring and performance measures of the provider. Important advancements such as the RBA measurement framework are assisting with information collection and reporting on

⁸ There may be specific cases we are not aware of where funding is client-centric but this is not the norm.

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client outcomes, but accountability from the purchaser to the provider for the contracts and funding is still primarily based on volumes, inputs and outputs. Highly specified contracts are an important form of risk management for government in industries where there is great uncertainty about the outcomes, such as supplying social services to clients who may not agree they have problems they need to address. It gives some ability to identify and manage poor performance by agencies where this is captured by the measures used. However, when the level of specification interferes with the delivery of the service, there may be a case to rethink if contracted delivery is the best way of supplying the service.

Even where external delivery is necessary, government may need to consider whether the level of risk management in additional specifications is too great. For example Family Start contracts were identified as having potentially over-specified KPIs, such as specifying a visit to the family home in the first three months regardless of whether other forms of contact might be more effective.

Greater risk aversion in managing contracts can incentivise behaviours which may not focus on the outcomes government is trying to achieve through contracting-out. The core accountability exists between the purchaser (government) to the provider (NGO) to meet the specifications of their contract such as volumes, inputs and outputs. In some cases the end-users of services can become accustomed to these accountabilities, especially if a particular programme is mandated (such as an alcohol addiction course). The clients may seek service providers who will offer them the 'tick box approach', as the provider is focused on the accountability to the purchaser. This approach will not lead to the client making an effort to change fundamental behaviours, but merely complete their requirements. This certainly does not occur for all providers despite the accountabilities set up by government. It should be noted that it is striking how committed providers were to their clients and to delivering quality outcomes. This idea is embedded in the theme around community connections discussed above; providers feel responsibility to their communities to deliver better outcomes. However, these outcomes will often not be directly reported back up to the purchaser, as it is not part of the contract.

Competition and collaboration in the market

Thus far we have described a market with multiple price-taking providers bidding for a set funding pool; this may seem to imply a market that would be highly competitive. There are three main areas where there is potential for competition in the market: contesting funding, the ability of clients to move between providers, and the ability to enter a new market.

Although there is more competition in some of these areas than others, the market is more noticeably collaborative than competitive, although there are clearly different levels of collaboration. The social service market is not unusual in needing collaboration between different providers. Most goods, from computers to houses, require collaboration between providers with many different skills. There are efficiency gains to be had by varying forms collaboration, from co-operating on standards through to mergers and joint service offerings. However, even in these industries there is intense competition for clients and this incentivises efficiency and innovation. Those performing poorly ultimately close down.

In the social sector, working closely together could lead to better outcomes through the provision of linked services, provision for the wider family and co-ordination of the interventions (such as is being sought with initiatives such as Whānau Ora). Indeed, given the emphasis on co-operation, it is surprising how rarely initiatives like "Right Service, Right Time" emerge. Most of the collaboration seems to be informal and based on personality of those within the organisations. The "Right Service,

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Right Time” initiative took two years to build up and the trust needed to go this far had been built up in previous collaborative activities over the last 10 years. The level of collaboration that is required for joint-ventures and mergers to be the norm is still not typically seen in the market.

Competition for funding: Providers do not want to spend substantial time and money competing for funding so they work together to “map out the market” and decide who will go for which contracts. This form of collaboration appears to be more like collusion. When providers choose to work together they can regain a degree of power over the monopolistic purchaser. This is not to say competition between providers for limited funding pools does not exist, this is a tight fiscal environment. However, the key feature of the market is that there is no price competition for MSD contracts. We have not explored the area in detail for other sectors, but we understand that there is competition on price for contracts in some areas such as the health sector, where there is also competition between not-for-profit and for-profit providers.

Competition for clients: Once funding is allocated there is virtually no competition to deliver to end-clients as the services have already been purchased on their behalf and most services are provided with as low a cost as possible falling on the client, or mandated by courts where there are a limited number of alternative providers. For most providers demand for their services far exceeds what they are contracted to deliver. This lack of competition for clients creates very little incentive to make performance information transparent for clients. The value of client-choice in a market is effectively removed. Even when clients do have some choice over which provider they go to, and are aware of this choice (something which we understand would be quite rare), as providers have demand greater than their contracted volumes and therefore do not seem to have issues meeting their contract obligations.

Ease of entry and exit: In a perfectly competitive market there are no barriers to entry or exit. In this market there are very few new entrants, which is a typical characteristic of an industry with high sunk costs. Sunk costs in this sector are predominately the high level of specific organisational capital required to be an established social service provider in a region. A key characteristic of these providers is the long adjustment period required to become established in the market. It takes time to build relationships and expertise. It is these characteristics which primarily determine providers’ ability to win contracts in the market as providers do not compete on a price or cost basis. It is very difficult for a new provider to win a tender in a new service area or geographic region unless these investments have been made. Existing providers are well rooted in their local communities and are well-established.

Further closing-off the market to new entrants occurs through contracting procedures. Contracts are often rolled-over to existing providers without being opened up to new entrants or competition, this may be partly down to the existence of contracts which are partly based on maintaining relationships (‘relational contracting’). Contracts are also specified in ways which create provider monopolies in geographic regions. For example a provider is awarded a contract to deliver a set of services to clients in West Auckland, providers stick to their regions and their clients and do not face the threat of competition unless they were to substantially and continuously under-deliver on their input/output based contracts (quite rare). Although competition can drive improved practices, there may be advantages to geographic monopolies such as increasing providers’ market share and ability to generate economies of scale.

Providers can lose their contracts with government; however, it would appear that this only occurs after extensive poor performance and a number of assessment processes. The performance appears to need to be significantly poor, and usually associated with some level of public transparency

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regarding this poor performance to be revoked. There has been some consolidation of the market in recent years but we still see a market characterised by a large number of very small providers.

Mergers and joint-ventures are increasing but quite uncommon. The level of collaboration required to operate in this formal manner is far greater than the co-ordination we can observe between NGOs in the market currently. Such collaboration is encouraged through the Whānau Ora collective model, but we have heard that even these models are difficult to operate in practice. Some of the providers we talked to were attempting to operate joint venture models but found it difficult to be funded as a collective without a lead contracting agency (which puts relationship dynamics at risk). Additionally, the way in which government relates to the market and purchases services has a significant impact on the way in which providers operate, in isolation or as collectives.

As in any market, the benefits of collaboration (and consolidation) need to be weighted up against the risks of a market with a lack of competition. While there is a push towards working together for greater outcomes, without any competition, there is a question of whether the theory of monopoly externalities will become a problem, such as limiting the drive for continued improvement. We do think there is a balance to be struck. There are likely to be efficiencies of economies of scale (through greater formal collaboration and shared service offerings focused on client outcomes). However, there are also benefits to specialisation, for example different practice models to suit different clients' needs.

What is the impact of capability and capacity building funding on the market?

In addition to funding provided for social services, this market is further complicated by funding associated with investment in providers as organisations. Capability and capacity building funding is the premise of the Whānau Ora funding provided by TPK. MSD's ISO work programme also includes a significant investment in capability resource for social service providers.

We do not disagree that in order to make significant improvements in outcomes from the social service market, the NGO providers need to be capable to respond to the expectations of government, for example have the ability to track activities to outcomes, measure and report on these outcomes. However, significant monetary flows of capability funding into the sector as the mechanism to achieve this lift in capability may raise questions about the production efficiency of the market, and call into question why government chooses to contract with external providers rather than deliver services directly. One explanation for capability and capacity funding is that government may be more efficient at producing services, so has to provide subsidies to NGOs to ensure that these providers can produce as well as government would themselves.

For the services which government cannot, or would prefer not, to deliver directly, it has been suggested that capability funding limits efficiency of the market by 'propping up' providers that would likely be forced out of a standard service market due to inefficiency. Funding of this kind also supports NGOs that would otherwise be incentivised to more vigorously look at how to efficiently manage their finances. We talked to a participant within the provider sector who expressed that capacity building funding may be reducing incentives for driving efficiency as such funding assumes that a lack of government money is the barrier to efficiency. Additionally, providers may not be considering how they use their equity efficiently (i.e. owning central real estate or continuing with practice models which promote individualistic approaches to operating rather than partnerships and joint service offering).

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We do recognise that given the importance of provider capability, there may be a role for funding to assist NGOs in areas such as workforce development, infrastructure, information technology systems and monitoring, and evaluation and reporting ability. These investments are aimed at improving the effective and efficient operation of the sector and lifting equity of access. This can be important to ensure diversity of service provision by region and by practice type, such as specialised Māori and Pacific providers.

What is important to consider are the levers to available to achieve greater long-term effectiveness of the provider market, and whether capability subsidies are the best approach. It may be that more funding alone does not create the right incentives to achieve a lift in sector capability.

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Section 5: Implications and advice

Thus far we have discussed a number of themes drawn directly from our engagement with providers and analysed the issues in the context of the social service environment as it operates as a market (or as it doesn't as the case has proven to be). In this section we draw out what this analysis implies for the way government contracts with NGOs in the market for social services if government is looking to focus on improving performance.

To help inform our analysis we looked for what guidance was available on contracting with NGOs and questioned whether this guidance takes account of factors such as the nature of the purchase and the market in which the government is purchasing. It does not.

In 2003⁹ Treasury published *Guidelines for Contracting with Non-Government Organisations for Services Sought by the Crown* to assist departments and Crown entities in managing contracting and funding with NGOs. The guidelines cover advice on all aspects of the contracting lifecycle from planning stages through to selecting providers, negotiating, managing and evaluating the contract¹⁰. This document is almost 10 years old but represents Treasury's most recent public advice on contracting with NGOs. Two other pieces of guidance exist: The Community and Voluntary Sector Department of DIA's *Code of Funding Practice* (voluntary guidelines)¹¹ and the Auditor-General's *Principles to underpin management by public entities of funding to NGOs*¹². We reference Treasury's previous advice throughout this section to highlight how a focus on the market for social services changes perspectives about what this may mean for contracting with NGOs.

As previously indicated, this is a complex area and there is no one clear answer. There are a number of interrelated issues relating to both contract management and performance management. This discussion is intended to highlight points of consideration and not recommend concrete solutions. Concrete solutions will differ depending on the way in which you apply the analysis.

Lack of Price signals on which to base purchasing decisions:

As previously identified, government is attempting to determine what the 'right services' are to purchase from the 'right providers' on behalf of the 'right clients'. NGOs are price-takers to the funding level set by government for these services externally to the market.

Treasury guidance on contracting is too simplistic in this regard as it assumes contracting processes will be based on negotiating price and payment. This is not entirely helpful when considering a market where price does not form part of the providers tender bids. One of the more fundamental issues in this market is whether the contracting mechanism effectively directs resources to where they are valued the most, or more appropriately expressed for this market, obtain the highest benefit.

It is not our view that government should introduce price competition into the social service market to solve the issue of efficiency and effectiveness. This is not a standard market and price

⁹ Minor amendment made to 2003 paper in 2009

¹⁰ See Annex 2 for link

¹¹ www.dia.govt.nz/cvs

¹² <http://www.oag.govt.nz/2006/funding-ngos/>

competition would not lead to the direction of resources towards the clients who would benefit the most. NGOs have already expressed that they are only partially funded for the cost of their services and therefore there would not be any desire to 'undercut' each other on a price basis in this collaborative environment. Price as a lever to incentivise efficiency within NGOs will be limited. Although not explicitly stated by providers, we have interpreted the supply of services provided by NGOs to be relatively inelastic to price. People are clearly motivated by outcomes for the people they work with, and as such there is more than funding that drives this sector. This is evident in the substantial volunteer time and philanthropic funding element, and the resilience of NGO providers rooted within communities. Many NGOs are driven to respond to community need rather than responding to prices.

Therefore, the question becomes what non-funding related options can be considered to improve efficiency and effectiveness of the social service market?

We have structured our priority areas of focus on the basis of our assessment of how NGOs weighted the issues that they faced regarding contracting with government.

A. *Improve the management of risk*

Contracting will inevitably involve risk sharing, a point that is recognised in Treasury's contracting guidance. However the guidance falls short of guiding agencies on how to approach this idea of 'risk sharing'. What this seems to result in is a large degree of risk transfer to the NGO sector without clear identification of the benefit of that risk transfer. Many of the issues identified through our analysis can be linked back to this question of risk. While we expect government to internally manage risk, we think that risk could be more effectively managed between both parties.

For example, providers raised many issues around funding efficiency and performance management, such as the commonality of 12 month contracts. From a market perspective 12 month contracts hinder providers and ultimately limit performance: uncertain funding streams result in a high churn of skilled staff, and limit the ability of providers to have a medium term strategy for investment in outcomes. As many of these contracts roll over after 12 months anyway, it is not clear what the shared benefit of 12 months contracts is other than risk control for the government agency. The question is whether this is an efficient and effective way of managing risk given the high costs it creates for those providing the service? To our knowledge no analysis of this has been attempted by any government agency.

Tightly specified input and volumes-based contracting is another example of government's management of risk. Monitoring and reporting against these types of contracts is unlikely to make either party uncomfortable. For providers, funding is almost certainly secure for the period of the contract so long as they meet their targets. For government, there is very little risk as there is low likelihood of providers not meeting contract obligations. However, determining whether a desired outcome has been achieved from buying those inputs requires someone to link the input to a desired population or client outcomes, and then demonstrate through analysis, that purchasing those inputs contributes to achieving the desired outcomes, thereby showing the effectiveness of that purchase. Normally this is easier said than done. In addition, this degree of risk aversion has high costs, including limiting provider innovation, creating inefficiency and stopping NGOs operating at their most effective.

Recognising regional differences (and funding accordingly) is a riskier funding strategy. These types of differences are currently not built into the system. Devolving decision making to communities

and away from central government is also a contracting approach which requires a level of tolerance for risk.

The idea that government should consider the way it manages contracting risk is not new. However, managing risk does not imply government's base position is to minimise risk, or transfer the risk to the sector. We think that greater emphasis needs to be placed on risk in the contracting and performance management process.

B. Improve information accessibility and transparency

Across all the discussions there is a reoccurring theme regarding information asymmetries in the market. Improved information coupled with improved transparency and accountability appears to be a key issue.

Transparent performance information is the only signal on which the purchaser in this market is able to robustly make efficient and effective purchase decisions without price signals. Without this transparency of purchasing strategy, NGOs do not understand the government's funding priorities and are unclear how to best participate in the market. Treasury's guidance to contracting states that a tender process must be based on a clear criteria and robust decision making process. However, in this sector there is no overarching investment strategy transparent to all parties to guide decision making.

Of course sitting behind improved transparency needs to be meaningful and robust performance information. Transparent information about how well a provider has met volumes and inputs is likely to be less valuable to the purchaser as they look to fund providers and interventions that will have the largest benefit to the outcomes of end-consumers. A focus on outcomes would also contribute to shifting the accountability in the market back towards the provider and end-client relationship rather than the provider to purchaser link.

The key challenge to improved information management is how to make quality, robust and consistent information collection more of a standard practice in the sector; in particular, shifting to a focus on collecting outcomes-based performance information. Affordability, access to tools, and capability appear to be the key barriers.

C. The choice between, and mechanism for, internal and external delivery

Given Treasury's role as government's lead advisor on economic and fiscal issues, we think it is important to consider the question of whether services are best delivered through NGOs or delivered directly by government agencies. We discussed in section 1 some of the reasons why government would contract out service delivery to NGO providers. Treasury guidance on contracting with NGOs discusses the consideration of in-house versus contracting. The elements to consider include: legal factors, policy constraints, codes of conduct, whether part of the service can be contracted without the whole and whether there is a potential supplier. It is a complex decision whether to 'make' or 'buy', but these questions dive into the technical aspects before considering the strategic framework underpinning the decision. We think at a high level there is a preliminary set of questions that need to be asked when this tradeoff is being considered: who has the best information, capacity and incentives to deliver what is required at greatest value for money? These questions should draw out the ability of the parties to manage risk and most importantly the how the nature of the market impacts on the decision. There is a question regarding what form the NGOs may take if some of their service delivery functions were brought in house to government. Is

government subsidising activities that NGO providers would undertake regardless of government support? Or, would we lose the delivery of the public good by bringing service delivery directly back into government?

Why is the 'make or buy' question so relevant to work through in such detail? A relevant example to current policy processes would be in thinking about the impact on providers of contracting-out for outcomes. It has been well recognised that capability and capacity funding is likely to be required to bring providers up to a standard government believes is necessary to allow the providers to manage contracts on an outcomes basis. However, the question is whether capability building funding is the most efficient approach to building up provider ability to participate in this market, or does capability funding reflect the fact that government could deliver the outcome at a much lower cost?

In addition, if the cost of NGO information collection on outcomes is too significant, or agreement on outcomes to contract for cannot be reached between parties, there is a question of whether government should revert back to funding inputs and outputs as per current practice, or should government deliver the service directly? As demonstrated through the market diagram in figure 1, government is also a provider of social services directly and government can take a focus on delivering outcomes just as the market providers could be contracted to deliver outcomes.

D. Identifying final outcomes jointly with NGOs

Once we have addressed the core issues of risk management, transparency of information and the decision to deliver in-house or contract out, we can shift the focus to the outcomes themselves.

Treasury guidance discusses the need to have a balance between specificity and flexibility in contracts, with the need for a value judgement on how much flexibility is built in to the contract. The problem with this approach is that this value-judgement on flexibility currently falls away from flexibility and more towards the 'tick-box' approach. As previously discussed specificity is a risk management approach built into government contracting. The challenge is to build flexibility into the system. The main approach government has taken in an attempt to achieve greater flexibility and performance in the sector is through attempting to contract for the outcomes. Given the sector is positive about outcomes contracting, we think the government should continue with this approach.

Treasury's guidance states that "contracting for outcomes is feasible if the NGO can reasonably be held accountable for the achievement of the outcomes, and the meaning of success cannot be manipulated". Literally applying this guidance when considering contracting for outcomes will rarely lead to the conclusion that a true outcomes contract is appropriate. Government needs to recognise and acknowledge that attribution to a single NGO would be near impossible. Outcomes do need to be able to be realistic for the NGO, and contribution to final outcomes does need to be measurable. Outcomes of this nature are not impossible to work through, despite attribution issues. However, the significance of this process shouldn't be understated. What the outcomes being sought are and what level of contribution can be expected from NGOs towards these outcomes, will both need to be determined.

The development of an outcomes framework will be an extensive process and will need to involve both government agencies and NGO providers. Government and NGOs will not always agree, and in these cases it will be about being transparent about areas where government and sector outcomes will differ. Contracts based on outcomes will not always be possible either, and in these circumstances a mixed model or contracts for inputs and outputs may be more appropriate. Mixed

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models with stepped funding for outputs on the path to outcomes can also be explored depending on the circumstances (including the risk model adopted).

When an outcomes contract is not feasible, it may also be appropriate to come back to the previous question of whether government should contract out for the delivery of the outcome or deliver directly.

E. Other considerations

There were a number of other issues raised which we have classified as other considerations. Although still important in the design of a contracting system, we think these are secondary to the five key areas raised above.

Capacity/Capability of the market

Government's contracting practice drives the construct of the social service market and therefore any shift in contracting approach should be driven from within government. However, the provider sector needs to be well placed to respond. For example a shift to contracting for outcomes will require providers to be well positioned to move from tracking inputs and outputs to being able to attribute their activity to outcomes and subsequently measuring and reporting on these outcomes.

TPK have noted that their experiences from Whānau Ora show that moving to service delivery efforts that are focused on outcomes requires significant investment from both the government agency and NGO parties: agreement on outcomes and investment in monitoring, evaluation, data collection, analysis and reporting (including new IT systems) are significant. However, as discussed earlier, the incentives of channelling funding into the sector as the lever to increase capability and capacity will likely require far greater consideration to ensure the greatest effectiveness and efficiency is being achieved from the investment.

Collaboration

Working together is a normal feature of the operation of the market for social services. Any model of contracting should recognise this feature and consider how to respond and build on it to realise the efficiencies of greater formal collaboration, while minimising the creation of provider monopolies which lead to negative market externalities.

Regional differences

There are clearly regional differences that affect the way the NGO sector operates. In Northland, for example, achieving outcomes with clients is challenged by geographic and demographic factors. In general, urban service delivery is different to provincial service delivery. One generic national contracting framework will not necessarily take these differences into account. A contracting system that either explicitly or implicitly recognises regional differences may be appropriate.

Build in client focus

To create a greater focus on outcomes there may be a need to strengthen the accountability driven from the end-client back up to the purchaser. Client needs are varied and simply introducing client-choice into the system will not necessarily be the answer. Some services may be more suited to client choice (such as budgeting services) than others (such as mandated domestic violence programmes). In any given approach, the recognition of the client as the key player in the market needs to be recognised; currently the strongest accountability line appears to be from the purchaser to the provider (with the exception of the Whānau Ora model).

Section 6: Next Steps

Given the full agenda of government initiatives underway, our work has focused on understanding and defining the problems in social service contracting so that we can share information and feed into this wider work programme. Our aim is to assist agencies in their combined efforts to improve the performance of the social service market. We think that our value-add will be in the cross-government perspective we have and our ability to share information and draw linkages across agencies.

Through our analysis of the market we have drawn out four key issues which should be taken into consideration when developing policies with impacts on contracting with NGOs for social services. In summary these four key considerations can be classified as:

- Managing contracting risks
- Information
 - The burden of collecting, researching and reporting on NGOs' performance
 - The transparency of government processes
- Determining the balance of what is delivered directly and what is contracted out, and
- Processes to agree outcomes and maximise NGO ownership of final outcomes

We acknowledge there is quite a shift to make to a market where contracting for outcomes is standard practice in government agencies contracting for social services, but this shift will be significant.

We propose an initial follow-up paper to further draw out the issues identified in this work. This paper will aim to analyse New Zealand's best examples of outcomes-linked funding, and a selection of international examples. These examples will extend beyond the social service sector. The paper will draw out the key features and characteristics of contracting for outcomes models. To link the two papers together, we will assess whether the key issues we identified in this paper have been addressed and how key barriers to outcome-linked funding have been overcome.

The purpose of this piece of work will be three-fold:

- To help clarify where we are now in regard to contracting for outcomes across government agencies and where we could get to if we continue to focus on contracting for outcomes.
- Using evidence to demonstrate that contracting for outcomes is a realistic goal and how the issues identified in our first paper have been addressed. Or, if they haven't been addressed, how this has impacted on the success of the initiative.
- Creating a resource for agencies to draw from when considering new initiatives where there is opportunity to contract for outcomes or include an element of performance-linked funding. We have identified that there are pockets across government where agencies are experimenting with these forms of contracting in a number of different areas. However, the experimentation seems to be done on a bespoke basis with no development framework to follow. The risks of this approach are that lessons from other areas are not being shared or built in a comprehensive way so the potential benefits from such approaches are not being fully realised.

Part of the MBIE's "Streamlined Contracting for NGOs" project will be looking to develop guidance for thinking about 'outcome focused' contracting at a practical level and where certain services might best fit in terms of contracting for inputs and outputs or linking these contracts to outcomes. This could incorporate some thinking about when pure contracting for outcomes is most

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appropriate. Treasury and MBIE, and other agencies where relevant, will continue to work together to help identify on-going examples of outcome focused contracting that come to MBIE's attention as they begin transitioning government agencies onto the new outcome focused contracting template.

Summary:

To enhance our understanding of the operation of the social service market we undertook a number of discussions with NGO providers. One of the key takeouts was that social service providers are currently not contracted to deliver outcomes, but they would like to be.

Governments across the years have attempted to implement contracting for outcomes to achieve greater flexibility and performance in the social service sector. We have made significant shifts in recognising the importance of linking to outcomes, but this is not the same as linking funding to outcomes. Given the sector is positive about contracting for outcomes we think that the government needs to continue to pursue the shift towards contracting for social services outcomes with NGO providers.

Lifting the performance of the social service market requires cross-agency effort and there are a number of social sector agencies focusing their work programmes on this goal. We are sharing our findings with these agencies and propose a follow-up piece of work to continue to draw out the issues identified in this paper. The next piece of work we propose is to examine examples of contracting for outcomes and performance-linked funding across the state sector in New Zealand and internationally. The aim of this paper will be to draw out the key features and characteristics of these case studies to enable agencies to apply lessons to the social service market.

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Annex 1: Providers interviewed

Summaries of conversations with providers have not been included to protect the confidentiality of providers' comments.

Auckland:

- Withheld under s9(2)(ba)(i)

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Whangarei:

- Withheld under s9(2)(ba)(i)

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Christchurch:

Withheld under s9(2)(ba)(i)

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Post-Report Engagement:

Within- Government:

We have shared our paper and met with officials from the following government organisations:

- Ministry of Social Development
- Ministry of Business, Innovation and Employment
- Ministry of Justice
- Te Puni Kōkiri
- State Services Commission

We met with the Accident Compensation Commission to learn from their experiences in changing their business model and the way ACC contracts with providers to deliver services.

Non-Government

Withheld under s9(2)(ba)(i)

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IN-CONFIDENCE

Annex 2: Treasury Guidance - Contracting with Non-Government Organisations for Services Sought by the Crown

<http://goodpracticefunding.govt.nz/open-communication/reviewing-the-funding-process.html>

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