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Soft block contracts in the commissioning of children's care services

A discussion paper

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Executive summary

A substantial majority of current practice in contracting of placements for children by local authorities with independent sector providers is a version of spot contracting. It makes for an inefficient and unmanaged sector economically.

The most influential factor on economic efficiency for providers is the occupancy rate of their services. Commissioners have the potential to directly influence occupancy through tools such as block contracting.

Traditional block contracts move the occupancy risk away from the provider and onto the purchaser. There are clear examples (including the Cross Regional Project referenced by recent reports on the sector by Sir Martin Narey) where that shift has resulted in better outcomes for children allied to lower prices for the purchaser and stability of income for the provider. A clear win-win-win situation.

Purchasers are understandably fearful of over-commitment to block contracts and the risk that the local authority may end up paying for voids. Soft block contracting mitigates against and manages that risk. Through thoughtful analysis of the elements of current contracting practice, it is possible to engineer a new form of block contract that gives all parties the opportunity to manage any anxieties they may have about the commitment they may be making.

What about individual children and needs?

The main fear of professionals is that commercial arrangements such as block contracting result in children being forced into inappropriate placements or out from placements for economic reasons.

It is our contention that this does not have to be the case and that intelligent design and application of soft block contracts can not only prevent those scenarios but also can enhance the information available to the professionals and enhance their decision making.

It is our view that commercial arrangements must always sit in a neutral fashion behind the scenes of professional decision making. We believe this is absolutely achievable.

How do soft block contracts manage the risk?

The tools available are numerous, and include:

- Intelligent use of historical demand and purchasing information.
- Aggregation of demand across regional or sub-regional groups to reduce the risk on individual purchasing bodies.
- Strategic selection of the anticipated demand level to be prudently targeted through soft blocks.
- Use of pilots and trials to gain experience and confidence.
- Adaptable blocks that can grow or shrink if they are not working for any of the parties.
- Blocks that target either one large supplier in a single-soft-block, or a consortium of smaller providers to increase sustainability of local supply.
- Flexible length of contracts and child-focused terms and conditions.
- Breaking down the mantra of a unit price per week of care. Creative redesign of financial arrangements to recognise the fixed cost nature of different service types.
- Fixed cost contributions and increments for actual placements.
- Use of local authority capital budgets alongside revenue expenditure.
- Joint Ventures and contractual partnerships.

Will it work?

There are already examples from pioneering Local Authorities that show what does and does not work in block contracting in reality in children's services. Some have demonstrated huge efficiencies. Learning is available.

There is undoubtedly more work involved in establishing and commissioning soft block relationships but the benefits for all parties are substantial and economically well in excess of the benefits of yet another framework that guarantees no business at all.

Providers currently have the upper hand; will they give much in exchange for soft blocks?

There are several counters to this fear:

- Many in the sector have been around long enough to know that patterns of supply and demand are cyclical. Providers in the sector for the long term will plan strategically for changes in the balance across coming years. Attitudes and opinions may differ between providers, but an increased predictability of demand and security of income is an attractive proposition to many.
- Many providers are in the sector with the primary goal to provide good quality services to children. Dealing with financial and commercial matters is not what they want to be doing. Putting arrangements onto a less volatile footing for the longer term allows a focus of energy on children, their needs, and quality of services.
- When ownership of providers changes, incoming investors look for stability and predictability of future performance. Spot purchasing erodes investor confidence, whereas more predictable income from soft blocks would enhance the value of providers and attract more investors and capital (and contestability) to the provider sectors.
- Commissioners have the opportunity to test the market to ascertain the appetite for soft block arrangements. This activity should be part of a more intelligent and strategic market influencing role. Timing of the actual procurement phase for soft blocks can be subject to market testing exercises.

Can providers play a role?

Although soft blocks may often need to be subject to normal procurement practices, that should not prevent provider organisations from being proactive in suggesting new partnership approaches in the sector. Only through demonstration of a positive intent to work more in harmony with one another is there potential to improve compared to the more dysfunctional approaches we see and experience currently. Providers should challenge commissioners to break out from mundane and ineffective procurement approaches that currently fail children.

Engagement with market testing exercises will be essential to signal if providers feel a proposed soft block approach is appropriate and has potential. Providers also have an acutely honed focus on the commercial and financial aspects of their business and contracts. There is undoubtedly much commercial and financial creativity that can be accessed from the provider base that would enhance design of soft blocks and other arrangements.

Background

The predominant form of contracting for placement by a LA of a child or young person with an IP of any type is spot purchasing. Here each placement generates a new contract that customarily exists for the length of the actual placement. The commercial arrangements for the contract will typically be a simple weekly fee rate to cover all of the service provided by or via the IP.

During the last 20 years, as the volume and value of placements with IPs increased, LAs have often come together as regional commissioning groups. One of the main features of their work has been to attempt to regularise the local contracting conditions, with tendered frameworks being a key tool. Such frameworks bring some commonality to the terms and conditions of placement contracts used by the participating LAs but the framework is often little more than an ordered spot purchase system, sometimes with a limited number of IPs. The commercial advantage of such frameworks has been perceived by LAs to be the control of pricing, including in some instances, the fixing or capping of prices for several years.

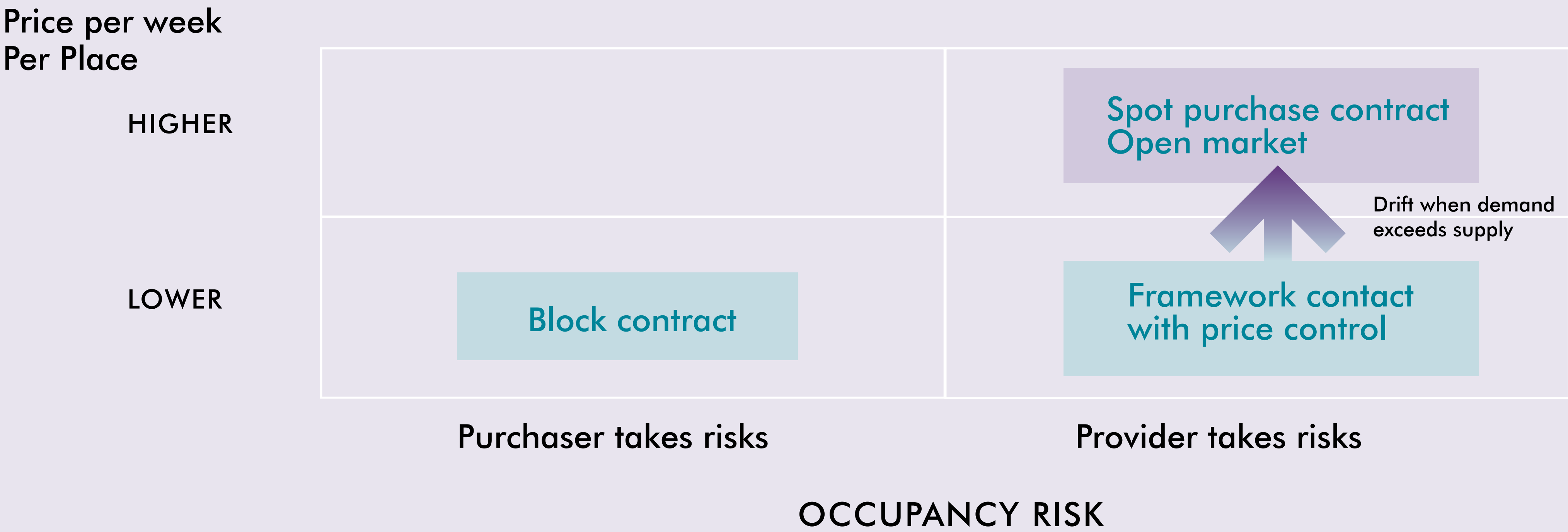
It is evident however, that, especially when demand grows, market economics operate as in most markets, and price constraints break down. This is either through overt action such as providers negotiating higher prices during a framework period, or providers opting out of the framework and selling via the open spot market once more.

In all variations of the spot market, providers essentially assume all of the investment, capital and occupancy risk. In the services with higher fixed costs and therefore higher break-even points (e.g. regulated residential services) this occupancy risk is ultimately the single most influential economic parameter that determines their financial results.

By contrast there has also been some limited exploration of fixed block contracting around the sector, although it is a small minority of all activity. In block contracts the LAs essentially agree to take on the risk that they will commit to paying for places “reserved” with a specific provider whether or not they are used and sometimes for a contract period of several years. Essentially the occupancy risk is moved to the purchaser and the expectation is that a much lower average weekly price per place is achieved.

The following diagram 1 illustrates the different current contracting options.

Diagram 1:
Current contracting for children's services

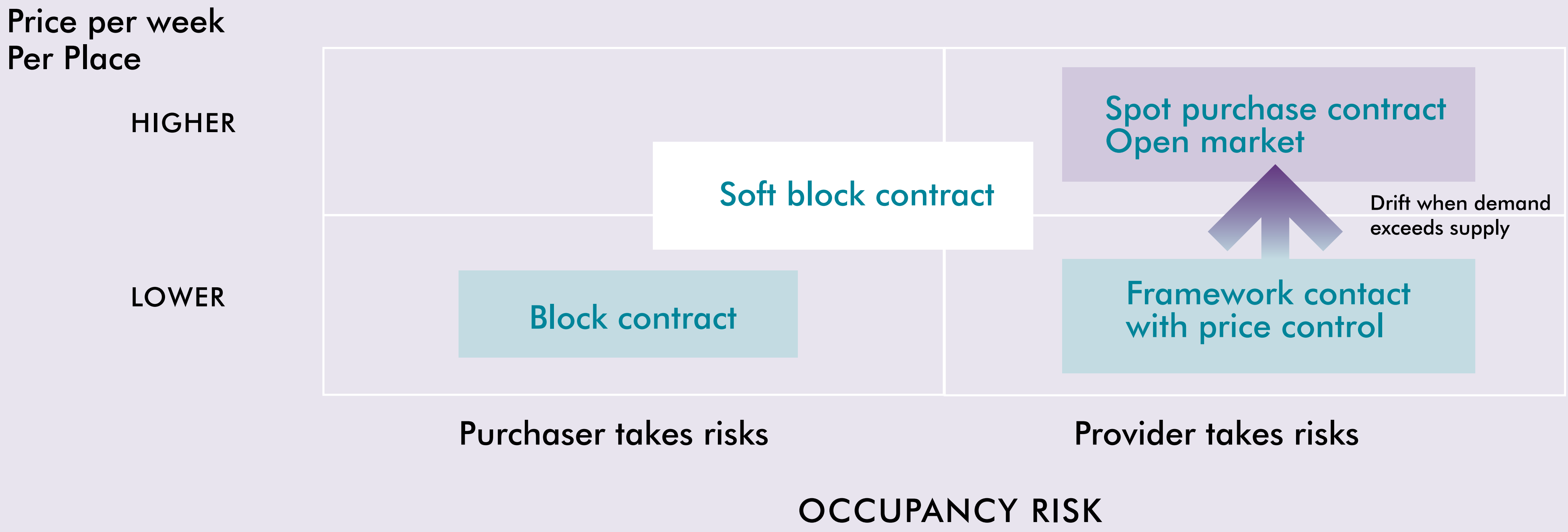


What are soft blocks?

A soft block contract seeks to find a middle ground between hard block contracts and open market spot purchasing.

The hypothesis is that, through a considered analysis of the key elements of existing commercial contract terms, it is possible to devise a new form of contract that shares occupancy risk between partners and achieves pricing and commercial arrangements that benefit both parties to the contract.

Diagram 2: Positioning of soft blocks



Key aspects of a soft block contract

There are four key aspects to soft blocks in the context of children's services, two of which are clearly indicated by diagram 2, two are more qualitative in nature:

- Children's needs and matching remain paramount.

  Soft blocks must be underpinned by an inherent and explicit contractual assumption that no child or young person will be forced into a placement or removed from a placement on commercial grounds. Assessed and emerging needs of individual children and young people must always take priority over commercial drivers. Matching of children, needs and the care setting (and other children placed there) are paramount.

- Occupancy risk would be shared between the parties.

  Often the main objection to block contracting is the transfer of occupancy and usage risk to the purchaser. There are ways that partnering organisations can share this risk rather than moving it entirely. Shared or managed occupancy risk is at the heart of soft block thinking.

- Pricing is optimised to reflect and to balance variable demand, most economically advantageous purchasing, and provider sustainably and market attractiveness.

  Pricing would naturally fall between open market spot pricing and hard block pricing, reflecting the occupancy risk sharing approach. There is also the potential to consider financial and commercial arrangements that break down the unit price approach altogether and to shape new, more suitable terms.

- Improving the relationships between purchasers and providers.

  Soft blocks, in their operation, their administration and monitoring bring much closer relationship working between the purchaser and provider. Whilst purchaser-provider relationships are still subject to proper use of commissioning rules via public sector contract regulations, the closer relationships required are also more conducive to shared corporate parenting of society's more vulnerable children and young people, much more so than in combative and competitive open spot markets.

Each of these key aspects is discussed in the following sections.

Children's needs and matching remain paramount

The decision to place or to move a child must always be based on appropriate, informed and considered professional judgement.

This judgement will typically be exercised by a professional for the LA, e.g. the social worker allocated to the child (operating within the structures and guidance of their employer LA and the statutory guidance for placement management under the Children Acts), and a responsible person on the provider side (e.g. the registered manager of a children's home for example).

Decisions and considerations around the appropriateness of a placement move in to or out of a care setting would ideally be arrived at by consensus between the parties, and that consideration should be completely isolated from any commercial pressure arising from the underlying contract terms. Resolving different opinions around such decisions should be viewed as an opportunity for close partnership working between the LA and provider, potentially leading to innovative and hybrid solutions on a case by case basis. Resolution of disagreement mechanisms can be built into contract terms to motivate the parties to reach agreement.

Concerns from purchasers about any form of block, hard or soft, will be that empty places could end up being paid for under the contract. The mechanics of how this might be managed to mitigate the risk during the life of the soft block arrangements are discussed in the following section about shared occupancy risk. The initial commission stage of a soft block also offers an opportunity to minimise the risk of non-use of purchased capacity.

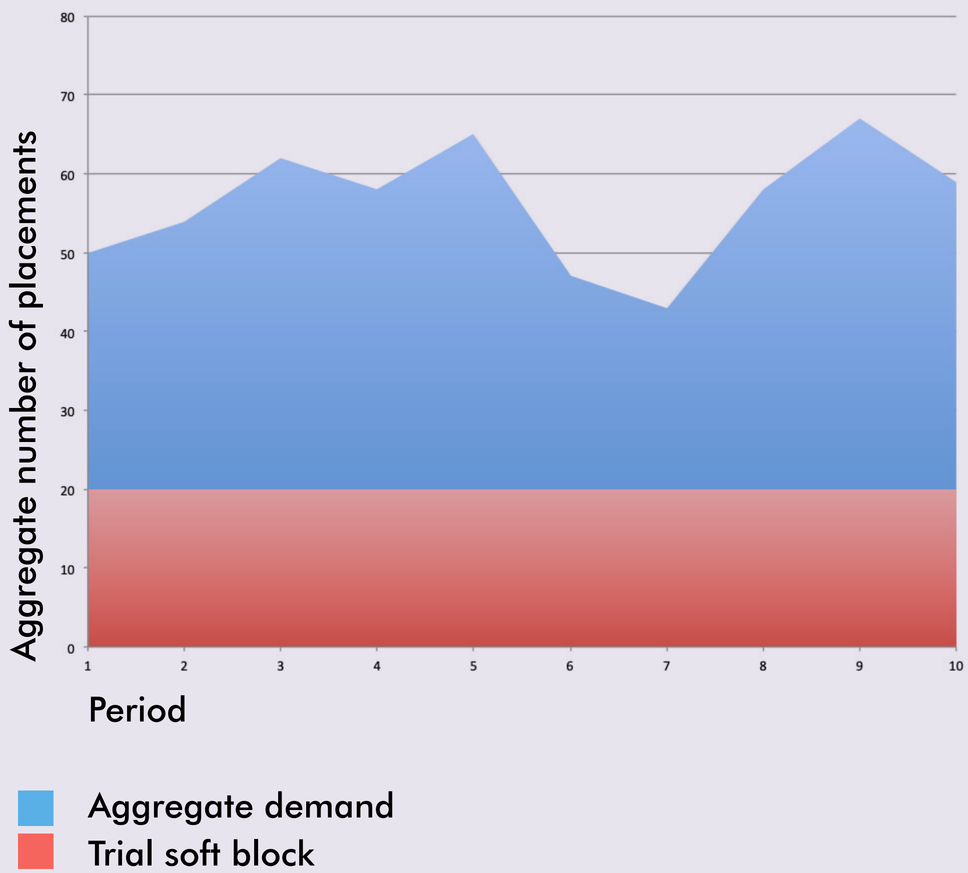
The key to commissioning a soft block contract with minimised risk of non-use lies in good use of demand data allied to a cautious approach to build confidence and experience.

A logical approach for LAs is to analyse demand patterns for the cohort of needs for which services are to be purchased, and to project the need level going forward, being sensitive to any other strategies being put in place that might influence forward demand. By pitching the maximum soft block places under contract at a level well below the minimum anticipated need level (in the illustration below, the soft block will operate at under 50% of the minimum demand level), the commissioning LA can be as assured as possible that demand relative to the commitment made should maximise the chances of 100% utilisation of the soft block commitment.

To mitigate risk further, the LA might consider partnering with other neighbouring LAs to aggregate demand across all of the LAs together, further reducing risk, and sharing it amongst LAs. This will require a partnership agreement between LAs, but there are versions of such multi-authority block arrangements already in existence, for example where each participating LA commits to a proportion of the block, and there is a trading mechanism between LAs to ensure that LAs with higher than anticipated demand can buy places on the block from LAs experiencing lower than anticipated demand.

Pilot soft blocks at levels below that illustrated below would also offer the potential to control risk and to build learning in how to operate such contracts and relationships. Contract terms can include the ability to increase the soft block if successful or terminate it if not.

Cautious approach to soft block



Clearly, a precisely defined cohort of children and young people's needs, and specification of the services required to meet those needs will facilitate a greater chance of designing and successfully operating a soft block. These would further de-risk the empty bed scenario.

As the work of the What Works Centre and other research in the looked after children field develops this may help LAs sub-divide the overall population of children in care who need different services and intensity of services. Existing frameworks often have only crude segmentation and lot structures, but even these could be starting point for soft block contracting. Indeed, a simple analysis of existing spending with each different current provider, aggregated across a number of LAs would be informative to identify potential segmentation. As an example, the Cross Regional Project (a block residential contract) targeted a broadly described higher need profile cohort of children and young people.

It is likely that, at least initially, LAs would look to prefer the use of a soft block contract (on economic grounds) in their placement finding protocol, and especially before going out to the open spot market. If the professional decision-making imperative set out at the start of this section is maintained, then there is a level of professional assuredness that an appropriate place has been found for the child or young person if the soft block is used in preference to a place elsewhere. However, it also risks putting a limitation on professional decision making ahead of whole market avaialability.

Many LAs today already seek placements in in-house services before looking externally, so the same approach to soft blocks alongside in-house would be an improvement on current practice. The ultimate goal may be that in-house services are also effectively commissioned as soft blocks, and where a sequential approach to placement finding is found to be unnecessary it is ultimately abandoned. Instead a parallel approach to placement finding would allow widest possible choice for a child or young person and their responsible professional.

Segmenting the demand and supply bases to target soft blocks at different cohorts also facilitates strategic approaches to market influencing. For example, commissioning LAs are able to consider whether they want to help to foster a number of smaller and medium sized providers, or whether they are prepared to risk placing a large block with just one provider. Soft blocks could be subdivided between a number of providers or limited to one or two.

Occupancy risk would be shared between the parties

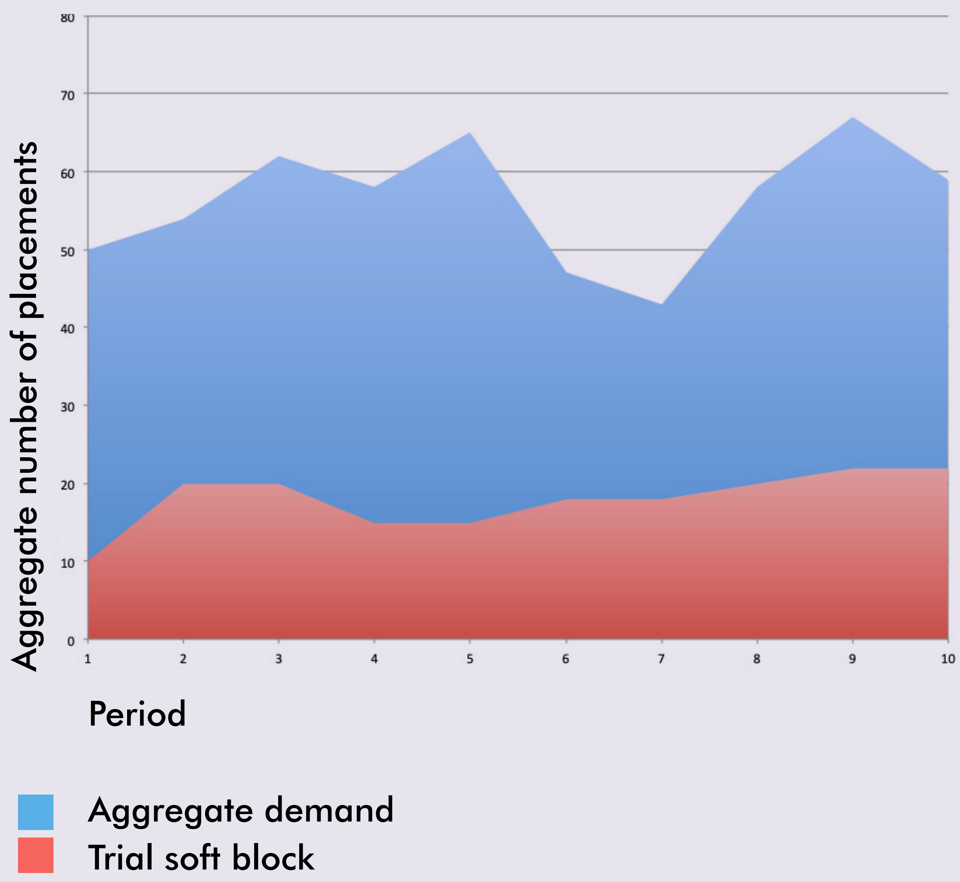
The essence of block contracting is the transfer of the risk of using the available capacity under the contract from the provider to the purchaser. A simplistic view in a hard block contract is that a number of places are guaranteed to be bought by the purchaser for a fixed period, often many years.

The tensions around the right to force a child into a vacancy, the right to refuse to allow an exclusion from a care setting and the concerns about paying for empty places are often enough to dissuade LAs from hard block arrangements. As set out in this paper, those tensions and concerns can be managed through a different set of approaches and relationships.

Soft block contract terms can also offer ways to manage and mitigate the risks and extend the benefits. Examples include:

- Mechanisms in the contract that allow the commitment to a block to be altered during the term of the contract in response to actual demand and operation patterns. If the experience were to be that too few placements are actually agreed by the professionals on both sides of the contract for a period, then the contract can be designed to allow for a step-down of the soft block. It can equally allow for a step back up if demand and matching increase again.

Flexible approach to soft block



- Early termination could be built into the contract if it is not working in practice.
- Perpetual contracts that have no set end date, but that can be subjected to market testing periodically could be considered.
- Long tail soft block contracts should contain terms that, should the contract come to an end, priority is given to the rights and treatment of any young person in placement at the time the contract ends.

Pricing is optimised to reflect and to balance variable demand, most economically advantageous purchasing, and provider sustainably and market attractiveness.

An understanding of the real economic drivers of the children's services markets also provides areas where soft block contracts have an opportunity to redesign the commercial interface.

Current spot purchasing with occupancy risk staying with the providers means that weekly pricing is an acute focal point for commercial negotiations. Many recent reports have highlighted pricing as the battleground where relationships between purchasers and providers are at their worst.

Purchasers must look for the lowest prices to buy the services they need at good quality levels, and providers price to try to maximise long term returns of investment.

For a provider this means assuming all of their fixed cost risk (often fixed cost is dominated by staffing costs) and running at a loss (that requires funding) when occupancy is below break-even levels. In addition, the provider may have already expended capital risk by acquisition of property and other assets.

Low occupancy periods are the critical threat to provider sustainability in spot markets.

When occupancy improves the provider then looks to make a surplus or profit to repay the risk taken during the low occupancy period (or periods), with spot purchasing break-even occupancy is never assured.

Hence providers target spot pricing that yields a clear surplus at higher occupancy levels. When demand is high providers who offer scarce services at their higher end prices, whilst effectively responding in a classical market economic fashion, are deeply unpopular with purchasers who have budgets restricted by years of austerity and demand increases for statutory services that are not matched by budget increases.

Block contracts and the transfer of occupancy risk allow providers to offer lower unit prices as the loss-making periods of low occupancy are eliminated or mitigated. The economic impact of secure occupancy should not be underestimated. Most current procurement frameworks fail to recognise this.

The security of demand is extremely valuable to the provider. It is also the case that, as provider organisations are also involved in selling and acquiring other provider organisations, then the value of a provider at that key transaction point is influenced by the nature of the contracts in place. Investors looking to acquire a provider may take significant comfort from the existence of long term guaranteed income into the target organisation.

This paper contends that, with purchasing and commissioning devolved to LA level, and with little evidence of a national strategy to manage supply and competitiveness, spot purchasing (the current dominant model) is sub-optimal. The last decade has also seen a period with an aversion to block contracting, and indeed further outsourcing of their own services by LAs. Soft block contracting, although more complex than spot purchasing, offers all parties a greater balance of risk and reward, and should encourage a more competitive and innovative supplier-side market.

The understanding of financial implications for providers at different occupancy levels also leads to the potential to redesign the commercial interface altogether. Ideas that might be applied include:

- Purchasers assuming the fixed costs (or staffing cost only) risk of low occupancy through a fixed contribution during low occupancy periods for a provider in exchange for lower than spot prices when the occupancy is above break-even. This discards the unit cost model and requires particular circumstances where the arrangements might work. However, during a low occupancy period the purchaser, rather than paying a full contracted unit price is actually covering only the critical core cost of the provider, a more partnership-based approach.

- Purchasers making a fixed cost contribution at all times to a provider and paying a small premium for each actual placement.

- Purchasers with capital assets such as property to bring to a contract. This contribution could be factored into a soft block contract.
- Purchasers with under-utilised capital budgets that could be brought into the soft block mix.
- Joint Ventures and alternative partnership forms with balanced risk and reward.

If the sector can break out of a "price per week of care" mindset and look instead at the economic realities of service provision there is clear potential to redesign commercial relationships to reflect partnership working that benefits the children and young people at the heart of the task, but also the purchaser and provider.

Improving the relationships between purchasers and providers

Evidence from existing hard block contracts is that they require a level of working between the purchaser and provider involved that is different and more intensive than those relationships formed in relation to spot contracts. This may simply take the form of closer contract monitoring, bespoke reporting of contract outcomes measurements, and regular face to face or virtual meetings between senior staff on both sides to review progress and performance, or to resolve issues arising.

In the discussion of other key aspects of soft block contracts in this paper it is clear that a soft block would potentially require an even closer relationship between the organisations.

This would begin at the procurement stage for the soft block, but would include all of the partnership structure and processes of a hard block, along with additional requirements for the soft block, for example including:

- Mechanisms related to decisions to increase and decrease a flexible soft block.
- Mechanisms related to the operation of commercial arrangements that may break the standard unit price models.
- Mechanisms related to the need for robust and practical dispute and issue resolution.
- Development of outcomes monitoring in a cooperative partnership-based environment where the children are the primary focus.

- Soft blocks also offer a unique research opportunity. Information collected before, during and after a soft block relationship may be uniquely able to analyse the impact of services on specific cohorts.

Although an innovative soft block contract arrangement is clearly going to require different and more informed management of the contractual relationship that very requirement has the potential to form stronger partnership bonds between purchasers and providers.

Both parties are highly likely to have vested interest in making the contract, and the partnership work. This will switch the mindset of each party to better and more open communication about the operation of the contract and also to a perspective of the need to consider the implications of decisions and results for their partner, as well as for themselves.

The most success partnerships will be those where both parties are looking for "win-win" outcomes.

This will be a far cry from the combative and distrusting relationships extant in the sector that are largely related to open market spot purchasing and unit pricing.

Reflections and implications

Circumstances demand that commissioning, procurement, purchasing and supply of children's services needs to move on from the current state. LAs are challenged by Central Government to show they are spending current budgets effectively before more funding will be made available.

A range of flexible soft block contracts offers LAs, acting alone, or via regional groups (or for very low incidence needs, even national level soft blocks may be appropriate) a new way to demonstrate effective stewardship of efficient supply markets.

Alongside the further segmentation of need and service types through appropriate assessment and matching to contracts, there is also potential to forge new, trusting relationships between purchasers and providers.

Against a background of closer working relationships other initiatives such as outcomes-based approaches can more readily be trialled and tested. Each soft block contract can be designed to fit the specific needs of the children and young people and the parties coming together in the contract to take on the shared corporate parenting of those children and young people. Each soft block can also respond to the specific situation, e.g. is the provider using existing capacity in a geographic area, or is it new build? e.g. Is the LA bringing property assets to the contract?

It is possible to foresee that widespread use of soft blocks would still then need the excess demand for services (often a volatile pattern) to access spot purchase markets. With relationships already improved through partnership working those spot markets should operate more smoothly and openly. It is also logical to advocate for one national spot market framework, an open dynamic purchasing system ("DPS") to meet procurement regulations for all LAs and thereby avoiding the duplication effects of individual and regional groups of LAs each essentially producing variations of the same thing.

With each LA able to utilise a portfolio of needs based soft block contracts there will come greater ability to influence the shape of markets. For example, the use of voluntary organisations, and the support of smaller, regionally based providers can be better controlled than via mass open spot methods. Use of soft blocking would allow the encouragement of greater competition in areas of scarce supply, with the ability to motivate new entrants and investors to bring innovation and service redesign. Similarly, soft block contracts might be able to take more control over whether contracts survive a change of ownership of the provider organisation.

Procurement regulations (whether or not they are EU based post Brexit) contain the flexibility to facilitate soft block approaches and should not hamper the development of soft blocks.

The role of the regulators, Ofsted and CQC could be enhanced in relation to both how they inspect soft block arrangements and also in potentially being instrumental in providing information to a national DPS of providers.

The in-house services owned and operated by LAs could also be considered as part of the soft block market and commissioned as such, creating supply sectors more akin to a level playing field.

To achieve a change to soft blocks needs resource, know-how and leadership. The refocusing of LA based commissioning resource to soft blocks and a national DPS and away from the wasteful duplication of multiple single LA and regional DPS structures will free some resource.

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The recently announced National Stability Forum, led by the DfE, and the Residential Care Leadership Board should have a pivotal role to play in leading a move to soft block innovation, and funding from the Children's Social Care Innovation programme should be directed to this task. The "What works" centre should also take on commissioning as a more important influence on placements and outcomes. Clearly the level of commercial acumen of commissioners will also need to be enhanced to execute balanced and strategic soft block contracts. Purchasers and providers alike may need enhanced financial modelling and partnership management skills and support in order to maximise benefits from soft blocks.

In a funding constrained environment, there also needs to be a longer-term focus on the sustainability and risks present in the supplier base. Soft block approaches can potentially de-risk in this area also.

None of this should represent an insurmountable barrier.

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