Key points

- **Contracting out** is the primary service model used for non-government social service provision in New Zealand (Chapter 6). Government agencies have several thousand service delivery contracts with many thousand not-for profit and for-profit providers.

- Submitters (predominantly service providers) reported many problems with contracting, and considered that tendering procedures, and contract design and administration need to be improved.

- Many of these problems may result from poor commissioning, including inappropriate selection of a contracting out service model. Such problems are unlikely to be ameliorated by improved contracting.

- Contracting out is well suited to some services and to some client types, particularly those in quadrants A and B. Contracting out is a poor match to situations requiring integrated responses and packages tailored to specific clients (ie, quadrants C and D) (Chapter 6). It is important that contracting out is done well, whether selected by a robust commissioning process or a legacy of past decisions.

- Current contracting regulations and guidance from the Ministry of Business, Innovation and Employment (MBIE), the Treasury and the Office of the Auditor-General (OAG) is difficult for agencies to follow and apply and this is a potential source of confusion.

- To improve clarity, the Government should publish separate Rules of Sourcing for Social Services. These rules should make it explicit that contracting out is just one of several models available for the purposes of commissioning social services. A single set of guidelines to support the rules should be developed and training provided.

- When contracting out, social services agencies should:
  - ensure that relevant information is provided to all participating suppliers in tender processes;
  - meet their own tendering timelines and report yearly on their compliance with timelines and deadlines set out in tendering documentation;
  - take account of providers’ past performance when assessing bids;
  - apply a standard duration of three years to social services contracts unless risk analysis indicates otherwise;
  - adopt a risk-based approach to monitoring contracts; and
  - expand the use of contracting for outcomes.

- Improving capability for contracting out should be developed alongside improved capability for commissioning (Chapter 6).

Chapter 6 introduced **commissioning** – the set of inter-related tasks that social services agencies need to take to turn policy objectives into effective social services. Choosing the service model best suited to a social service and its clients is one of the key commissioning tasks set out in Figure 6.1. **Contracting out** is one of

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114 See Chapter 2 for a description of the quadrants.
seven described service models. It is the primary service model used for non-government service provision in New Zealand. Contracts are also a feature of other service models, though they play a lesser role.

Contracting out is well suited to some services and to some client types, particularly those in quadrants A and B. Contracting out is a poor match to situations requiring integrated responses and packages tailored to specific clients (ie, quadrants C and D) (Chapter 6). It is important that contracting out is done well, whether selected by a robust commissioning process or a legacy of past decisions.

Submitters (predominantly service providers) reported many problems with contracting, and considered that tendering procedures, and contract design and administration need to be improved. Many of these problems may result from poor commissioning, including inappropriate selection of a contracting out service model. Such problems are unlikely to be ameliorated by improved contracting – these should be addressed closer to their root cause. However, the Commission observed significant evidence of poor contracting behaviour by government.

This chapter largely addresses the issue of contracting with not-for-profit providers (who provided most feedback about contracting practice) for the delivery of social services but should apply equally to for-profit providers.

Section 12.1 describes the extent of contracting out. Section 12.2 covers why contracting is both attractive and challenging for government agencies and why it has limitations. Section 12.3 describes the legislation, rules and guidelines surrounding contracting. The issues raised by inquiry participants are summarised in section 12.4 and opportunities for improvement are explored in section 12.5.

12.1 Contracting out in social services

Government agencies have several thousand contracts with many thousand not-for-profit (NFP) and for-profit (FP) organisations for delivering social services (Chapter 2). The New Zealand Treasury (2013) estimated that social services account for about $12.4 billion of procurement. It did not indicate how much was through contracts, but in 2011/12 the Ministry of Social Development (MSD) spent $574 million on social services through more than 6,000 contracts and grants to almost 3,000 providers, with almost 90% of contracted expenditure going to around 30% of the providers (New Zealand Treasury, 2013). Contracting therefore needs to be done well. However, performance too often falls well short of best practice.

Further, approaches to contracting are evolving and while many submitters see significant room for improvement, contracting out as a service model may not be the best option (Chapter 6). Nevertheless considerable effort is being applied within government to improve contracting and there is certainly room to adopt better practice where contracting out is the best model to be applied.

Box 12.1 Commissioning, contracting out and using contracts in other service models

“Contracting out” and the “use of contracts” are not synonymous in the context of this report.

Contracting out is one of seven service models that are part of commissioning (Chapter 6). Good commissioning is about judging which model will best match the characteristics of a defined population or client group to achieve a specified outcome. Contracting out is the primary service model used for outsourcing social services in New Zealand and is the subject of this chapter.

Clients with multiple, complex needs (in quadrants C and D) are not well served by the current approach to purchasing social services which is dominated by contracting out (Chapters 2 and 4). This report recommends different service models and approaches be adopted to meet the needs of these clients (Chapters 10 and 11).

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115 Information supplied by MartinJenkins and based on data covering four government agencies: the Ministry of Health, the Ministry of Social Development, the Ministry of Justice and Te Puni Kōkiri.

116 In 2014/15 MSD had around 3,700 social services contracts with some 2,155 providers financial year (Chapter 2).
12.2 The attractions and challenges of contracting out

A contract is a formal, legally enforceable agreement between two or more persons or entities, involving a commitment to do something in return for a payment. Contracts with external providers are almost always issued by an individual agency.

The attractions of contracting out

Purchasing social services through contracts typically holds attractions for governments, including:

- Providers, especially NFP providers, may have built up relationships and trust with their clients, which are difficult for government to emulate.

- Contracting can create an entirely new service culture. Governments have sometimes turned to external providers where a “fresh start” is required (Sturgess, 2012). This was one reason why the UK Government introduced prison contracting – to assist in driving what the Blair Government came to call its “decency agenda”.

- Contracting can enable government to pay for outcomes rather than funding inputs, and to step back from day-to-day management. It “demands that policy makers make a clear decision about their desired outcomes from a service, and then to step back to allow room for providers to deliver. … The contract has become a powerful tool in the devolution of management authority” (Sturgess, 2012, p. 51).

- Contracting can reduce costs. Private prisons in the United Kingdom are estimated to have achieved cost savings of between 11% and 30%, and the Acacia prison in Western Australia is about A$15 million a year cheaper to run than the least expensive public facility. However, such comparisons are complicated by differences between prisons (New South Wales Legislative Council, 2009).

- Governments have sometimes found that service contracting drives greater transparency in service delivery because of the need to specify requirements. On at least one occasion the international inspection and verification firm SGS was contracted by a government in the developing world to manage its customs service because of ongoing concerns about corruption.

The challenges – and limitations – of designing and administering contracts

Effective contracts impose clear obligations, and reward performance that is measured against these obligations. This section describes features of contracts that influence their design and administration. Appendix F provides more details.

The principal–agent relationship

The principal–agent relationship is a useful framework for analysing many contracts. In the social services sector, the principal is usually a government agency, while the agents are often, but not always, NFP organisations. The New Zealand Treasury (2013, p. 8) distinguishes between “corporate NGOs”, which operate more like a business, and “small NGOs”, which “rely more on individual passion and commitment, and being well connected to the local community”. So government contracts with NFPs need to be effective to take account of many different types of organisations, operating in a variety of client situations and services. A “one-size fits-all” approach is unlikely to succeed.

The principal in a contract engages an agent to undertake a task or perform a service to advance a desired objective. In general, the principal and agent have differing incentives and information.
To encourage the agent to act in the principal’s interests, the principal needs to:

- specify the required objective;
- design incentives that are mutually acceptable while aligning the agent’s interests with their own (usually by rewarding the agent for achieving the objective or by penalising failure); and
- monitor whether the objective is being achieved, based on observable information.

Ideally, payment is made in exchange for achieving a clearly specified and measurable outcome. However, this ideal is often difficult to achieve and contracts instead specify inputs or outputs, rather than outcomes (Box 12.2):

> It is very important to distinguish between ‘contracting for outcomes’ and ‘outcomes focused contracts’. When we refer to contracting for outcomes…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. (New Zealand Treasury, 2013, p. 2)

Outcome-focused contracts are predicated on an anticipated link between the inputs or outputs and outcomes. If this link is weak or absent, “providers are not rewarded according to how good their service is, but whether they enact certain processes” (Haldenby, Harries & Olliff-Cooper, 2014, p. 30).

Negotiating and administering contracts involves transaction costs, such as legal fees to draft and check the contract, the cost of setting up and running a disputes resolution procedure, and reporting requirements. These costs are incurred to improve contract operation.

Even when government is the principal, it is often not the direct recipient of the services. Rather, it purchases services that are then made available to, for example, an unemployed person or a person with a disability.

**Incomplete contracts**

Contracts are normally incomplete, because they do not specify remedies for all possible future contingencies. It is usually not feasible to identify all risks, even with the best drafting. Therefore, contracts may:

- leave the problem of how to deal with unanticipated situations that are not covered;
- distort behaviour, as the parties focus on contracted elements while ignoring others that may also affect the intended outcomes, but are more difficult to observe;
- focus on inputs, about which there is usually more complete information, rather than on outputs or outcomes (Box 12.2); and
- become outdated if circumstances change, but contracts are rolled over rather than amended (section 12.4 provides examples).
Specifying contracts for providing social services

Typically, contractual obligations are specified in one of several ways (Figure 12.1). Moving from left to right across the figure, obligations match more closely to desired objectives but are typically more difficult to measure.

**Figure 12.1 The continuum of contractual obligations**

- **Input-based** What resources are required?
- **Process-based** What process will deliver the services?
- **Output-based** How many services will be delivered?
- **Results-based** What impact will the service have on clients?
- **Outcome-based** What purpose will the service achieve?

More specifically:

- *input-based obligations* specify the resources a provider must expend in delivering the service (e.g., the number of trainers that must be present at a training course);
- *process-based obligations* specify the process or methods that a provider must use when supplying a service (e.g., the content and method of instructing a training course);
- *output-based obligations* specify the services that a provider must supply (e.g., the number of attendees that complete a training course);
- *results-based obligations* specify the impact that the purchaser expects the provider to have (e.g., the percentage of trainees that were able to find work); and
- *outcome-based obligations* specify the objectives the purchaser expects the provider to deliver (e.g., a reduction in youth unemployment).

Some problems caused by incomplete contracts will be less serious if there is alignment of mission, values and objectives between principals and agents, as is often the case with NFPs and may also occur with some FPs. The closer the alignment, the less is the risk that the agent will under-deliver on contract obligations that are difficult to observe. Alignment of mission orientation can substitute to some degree for the use of incentives (and tight specification) in contracts (Appendix F). Government agencies need to avoid over-specification of contracts, as this can undermine the intrinsic motivation of NFPs and their staff in working to improve outcomes for their client groups.

**Managing risk**

Efficient contracts clearly assign responsibility for various risks (e.g., cost overruns, unexpected changes in demand or provider under-performance) to those who are best placed to manage them. The challenge is to design contracts that anticipate risks without unnecessarily hindering beneficial risk-taking and innovation.

The aim should be to achieve an *optimum* – rather than a *maximum* – transfer of risk away from government. However, if ministers and government agencies expect to be held accountable for the failures of providers, they may seek to reduce their exposure by controlling what the provider does, through contracts that specify inputs, processes and outputs. Yet this is likely to reduce providers’:

- incentives and room for innovation;
• flexibility to respond to changes in clients' needs or in the environment; and
• scope to work together and to supply integrated bundles of services (Spiller, 2008).

Further, trying to transfer risk to providers can backfire on the Government, which may in any event bear the cost of inappropriately transferred risk through higher service charges or increased likelihood of default:

Ultimately, providers will not bear risks that they cannot control. They may agree to. They may attempt to. However, in the final analysis, if providers lack the levers to mitigate their risks, they will fail, and hand the risk back to the state. Therefore, it is in government’s interest to do all it can to ensure the level of risk it is asking providers to take on is appropriate and manageable. (Haldenby, Harries & Olliff-Cooper, 2014, p. 35)

There are ways to manage risks without introducing excessive prescription. These include tying payments to the delivery of services or to quality performance criteria; imposing obligations on suppliers to have adequate financial reserves or insurance cover; and tying contract renewal to contract performance.

Incentives for opportunism
Both parties usually incur costs if they leave a contract, particularly if they have invested in specific assets that have more value in a particular use or in a particular relationship. This creates incentives for opportunistic behaviour, because one party can “hold up” the other, to the value of that specific commitment. For example, the Commission heard of a case where a funder during a short-term pilot required a provider to develop intellectual property, which was shared with the funder, but then offered the longer-term contract to a different provider. To protect against opportunism, private contractors may seek contract specificity, commit to investing in fewer and smaller specific assets, and favour forms of rewards that are more difficult for the principal to appropriate. Opportunism can also happen on the other side of the contract. For example, a contractor could seek to exploit government’s aversion to public failure by bargaining for additional payments.

Relational contracts
Relational contracts rely on informal agreements and self-enforcement, based on the parties agreeing to contract variations without formal re-negotiation or litigation. They can be particularly useful where dimensions that are hard to measure are important.

Long-term relationships form the basis of many private sector contracts. These relationships can span multiple contract periods – creating an incentive for both parties to cooperate (as their actions can impact their likelihood of securing future contracts). The arrangements can take different forms. The “keiretsu” system used in Japanese industry (eg, by Toyota) is illustrative. Under this approach, procurers maintain relationships with a small set of suppliers, combining information sharing, close monitoring and limited competition (Aoki & Lennefors, 2013). There are also alliance relationships, which are based on a collaborative approach to project risk, project management and the adoption of mutual objectives and outcomes. They tend to be used in infrastructure projects.

Relational contracts reduce cost by enabling adjustments to service delivery, when unforeseen or unexpected circumstances arise, to occur without re-negotiation (Baker, Gibbons & Murphy, 2001; Spiller, 2008). The Blind Foundation argues that successful relational contracts can occur where contact between the two parties is consistent and personal, and relationship managers are empowered to modify and adjust the contract or how it works (sub. 16). National Services Purchasing suggested that:

Relational contracts are best when there are close, trusting, and highly communicative relationships between funder and provider at governance and operational levels, with stable personnel and organisational cultures. (sub. 111, p. 9)

The high trust contracts initiative, introduced by MSD in 2009, attempted to move towards relational contracts. It recognised that stable and established providers with a good track record pose less risk and that, as a result, inflexible contract terms could be removed. Some participants commented that the introduction of high trust contracts had been a real improvement. However, the Commission also heard examples of contract managers introducing conditions into high trust contracts that made them indistinguishable from highly specified contracts. And the Public Health Association noted that “gold
standard” commissioning has been compromised by, among other things, “suspicion of relational contract management” (sub. 122, p. 6). This suspicion may arise because relational contracts do not fit easily within the public sector accountability framework. To avoid the risk of cronyism and favouritism, administrative rules limit the discretion of contract managers to make ad hoc adjustments to service delivery, and yearly funding cycles reduce the certainty of future contracts (and therefore the incentive to cooperate).

**Competitive tendering**

Competitive tendering for contracts can improve the efficiency of service delivery.

- Specifying the objective, incentive arrangements and performance measurement can enhance accountability.

- Open tendering reveals the prices at which providers are willing to provide specified services.

- Allowing entry by new providers and encouraging poor performers to reform or exit can stimulate efficiency and innovation. This requires that tenders are not so frequent that providers cannot secure the gains from innovation, or so infrequent that they are insulated from competition.

- Opening itself up to competition from external providers can improve government service delivery.

However, the design and implementation of tenders is complex and competitive tendering is not always the right approach. This may be in a situation where there is only one viable provider or where there are multiple providers and the best results will come from forming an alliance between them, as in the shared goals model (Chapter 6). In the latter case competitive tendering could lead to fragmentation and lack of trust where integration and close relationships are critical to achieving the outcomes being sought.

**Impacts on quality**

Tenders based on lowest price are well-suited to procuring simple services whose characteristics are easily specified in advance and for which there is little risk of changing specifications post-tender. However, when quality is important and is difficult to measure, competitive tenders can result in lowered effort on non-measured aspects of service quality.

**Frequency**

If providers feel exposed to the risk of contract non-renewal they may make fewer or less-specific investments. Aligning the length of tendered contracts with the investment horizon of the providers would reduce such under-investment.

**Other features**

Appendix F discusses other features of the tendering process, such as the information structure; disclosure of project information; the capabilities of public sector tendering and enforcement institutions (eg, regulatory bodies); and the credibility of commitments by public bodies. It notes that stronger mission alignment in NFPs supports non-monetary incentives for quality provision, but that this advantage relative to FP firms must be weighed against the ability of the latter to pay more and so attract more able workers, who are more productive and so enable the FP to remain competitive in spite of their higher wages.

Section 12.3 demonstrates that many NFPs feel that tenders impose excessive costs, can reduce quality, and are too frequent. Section 12.4 puts forward proposals for addressing these concerns.

### 12.3 The framework for government contracting of social services

This section describes the legislative, regulatory and guidance framework within which government purchasers operate. Government agencies that fund non-government providers need to operate within the public accountability legislative framework that applies to all public expenditure (Box 12.3). The pressure for accountability that this framework creates encourages the use of contracts (OAG, 2006).
Government rules of sourcing

In 2013 MBIE issued the Government Rules of Sourcing. (The third edition was published in 2015.) The purpose of the Rules is to:

- modernise the Government’s approach to procurement to align with good international practice and provide better value;
- encourage agencies to use more strategic approaches and commercial expertise when procuring; and
- encourage agencies to engage early with the market to stimulate competition and innovation, and work with suppliers to develop better solutions, include procurement requirements in Cabinet directives, Whole of Government Directions and legislation (MBIE, 2015b).

Sixty-six procurement rules cover all aspects of contracting for and acquiring goods, services and works; from identifying the need to either the end of a service contract or the end of the useful life and disposal of an asset. For the most part the rules do not differentiate between social services or other services or assets. In addition to the rules there are five procurement principles. All government agencies must have policies that set out how they will comply with these principles:

- plan and manage for great results;
- be fair to all suppliers;
- get the right supplier;
- get the best deal for everyone; and
- play by the rules.
Rule 6 sets out that all public service departments, New Zealand Police, New Zealand Defence Force, and State Services agencies covered by the Whole of Government Direction, must apply the Rules. Agencies acquiring certain public health, education and welfare services, which include many social services covered by this inquiry, can opt out of applying 16 of the rules. However, Rule 13 (2) specifies that even if an agency opts out, it is still expected to conduct its procurement according to the procurement principles and other procurement good practice guidance (MBIE, 2015b). And Rule 13 (4 and 5) specifies that some of the rules apply to all opt-out procurements while others apply where relevant.

**Guidelines**

**Contracting**

Two core documents are the Treasury’s *Guidelines for Contracting with non-government organisations for services sought by the Crown* (New Zealand Treasury, 2009) and the Office of the Auditor-General (OAG)’s *Principles to underpin management by public entities of funding non-government organisations* (OAG, 2006). Both were published before the Government Rules of Sourcing and have not been reviewed since the rules were issued.

The Treasury Guidelines, first issued in 2001 and revised in 2009, are intended to encourage better contracting practices, consistent with the Treasury’s “responsibility to ensure that all government departments and Crown entities are aware of, and take into account, best practice principles in the management of public resources” (OAG, 2006, pp. 7–8). A recent review by the Treasury considered that its Guidelines have weaknesses (section 12.4).

Both the Treasury and OAG Guidelines set out principles that should guide contracts. Together with the Government Rules of Sourcing, agencies must have regard for three sets of principles. These sets overlap but are not identical.

Some other government agencies also set out guidance, policies or procedures. The OAG noted that this guidance “usually” aims to be consistent with the Treasury and OAG guidance, and that MSD and the Ministry of Health (MoH) adopt this approach (OAG, 2006).

The framework within which contracting for social services takes place consists of three important documents: the Government Rules of Sourcing and the Treasury and Office of the Auditor-General guidelines. These documents were developed at different times and are not consistent. This creates confusion for social services agencies.

**Funding**

The Department of Internal Affairs (DIA) has published a voluntary Code of Funding Practice (DIA, 2010), which aims to assist government and non-profit organisations when entering into government funding arrangements. The Code sets out seven code areas: respect; cultural context; transparency; open communication; flexibility and innovation; integrity; and accountability. It provides criteria for each code area and recommends performance indicators.

According to the DIA, the Code does not duplicate the advice provided by the Treasury or the Office of the Auditor-General, but rather embodies a common understanding of, and mutual commitment to, specified principles and minimum standards that may be used by both government and non-profit organisations. (DIA, 2010, p. 7)

However, the Code does seem similar to the other guidelines.

Compliance with the Code is not monitored or reported. Indeed, the Commission is not aware of formal reporting against any of the identified contracting guidelines.

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117 These agencies are listed at www.procurement.govt.nz.
118 The Code is primarily aimed at the funding relationships between government agencies and the not-for-profit sector, although its general principles “may apply to a wider range of funding arrangements” (DIA, 2010, p. 7).
The streamlined contracting project

In March 2013 Cabinet directed MBIE to lead the “Streamlined Contracting with NGOs” 3-year project (2013–2016). The project aims to reduce inconsistency in, and duplication of, contract management practices across government agencies, and to reduce compliance costs for non-government organisations (NGOs). The project includes six government agencies (MSD, Health, Justice, Education, Corrections and Te Puni Kōkiri).

The project, undertaken in partnership with non-government providers, with oversight from the cross-agency Social Services Procurement Committee, has created a suite of contract, contract management and decision-making tools, collectively referred to as the Contracting Framework (Box 12.4)

Box 12.4  The Contracting Framework

The Contracting Framework provides documents and tools to be used when contracting between government agencies and non-government providers: the Government Agency Agreement, Framework Terms and Conditions (FTC), Outcome Agreement (OA) and the Outcome Agreement Management Plan.

The OA and FTC together document all the legal obligations between a government agency (that purchases services) and a provider. Neither legal document can be used without the other. The OA details:

- specific services being purchased;
- community or population outcomes the services contribute to;
- desired client outcomes;
- how performance will be measured;
- price;
- monitoring and reporting arrangements;
- contract duration;
- conditions either party must comply with; and
- any other engagement-specific details necessary.

Source: MBIE, 2015c.

MBIE considered that this project has created an outcomes-focused contracting framework, supports collaborative provider/purchaser relationships, and achieves efficiencies in contract management. Expected benefits include:

- standard terms and conditions for contracts to enable providers to focus on service delivery;
- tools and templates to support more consistent management of contracting arrangements;
- enhanced ability for providers to work collaboratively with and across multiple government agencies;
- reduced training and up-skilling requirements for people moving between government agencies and/or non-government providers;
- reduced requirements for legal advice;
- more data and information, including identification of opportunities for more collaborative contracting;
- less duplication of contract management activity, such as audit and monitoring;
increased focus on identifying and measuring improvement in client outcomes through the use of Results Based Accountability (RBA); and

streamlined reporting through shared performance measures across programmes. (MBIE, 2014)

MBIE is building agency capability in contracting for outcomes, with more than 700 training places taken up by agency staff by May 2015 (MBIE, pers. comm., 7 April 2015).

Agencies will continue to transfer providers to the new outcome agreement template. Forecasts indicate that government agencies would enter into about 900 contracts using the Contracting Framework by 1 July 2015, with about 1 240 more contracts planned for transition in 2015/16. These contracts make up approximately 60% by number of government agency contracts with non-government providers. The intent is that all contracts with non-government providers will be migrated to the Contracting Framework when their current contracts expire, renew or are replaced with new services (MBIE, pers. comm., 7 April 2015).

The Social Services Procurement Committee has a wider programme of streamlined work, including harmonising audit, approval and accreditation standards and practices. MSD’s information technology system for approvals is being developed as the initial technology platform for coordinating audits across agencies, providers and programmes.

 Investing in Services for Outcomes

The project Investing in Services for Outcomes, led by MSD between 2012 and 2014, was intended to improve contracting practice and re-focus purchasing towards outcomes aligned with government priorities (New Zealand Treasury, 2013). The project included:

- developing a purchasing strategy (published as the Community Investment Strategy in June 2015);
- streamlining MSD’s contracting and monitoring processes;
- offering providers with multiple contracts a single MSD contract with a single MSD lead relationship manager; and
- developing a single MSD approvals framework for all service providers.

The project includes transferring MSD’s provider contracts onto the MBIE Streamlined Contract for NGOs framework as their contracts expire. MSD has transitioned 747 providers, with 570 more to be transitioned in 2015/16. Most remaining providers will be transitioned by the end of 2017/18. MSD is also leading the cross-agency contract accreditation process, to join up the processes for assessing providers’ capability and capacity to deliver social services. The objective is to work towards one way of accrediting a provider across government, against a common set of standards. As a first step, social sector agencies have jointly developed a number of shared standards (MSD, n.d.). MSD will continue to work with MBIE and other government agencies to achieve further gains in reducing duplication and compliance costs (MSD, sub. DR224, p. 20).

These initiatives indicate the considerable effort under way to make contracts more outcome-focused. The combined use of different measures – including outcomes – is a feature of MSD’s RBA framework (Box 12.5). In addition to the RBA framework, as part of its Community Investment Strategy, MSD is conducting trials with providers to develop an outcomes framework and performance measures. The trials cover some services in: social workers in schools; budget services; Family Start; functional family therapy; integrated health and social services for at-risk under five year olds and their families; and intensive wrap-around family social work (MSD, 2014c). The purpose is to develop standard methods and models for definitions and measurements, and methods of data collection and management.

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119 Formerly the Social Sector Purchasing Steering Group

120 When MSD merged the Child, Youth and Family and the Family and Community Services contracting teams and established the Community Investment group within MSD, the Investing in Services for Outcomes project was transitioning to the new group.
Implications

Government has significant initiatives to improve contracting, with Government Rules of Sourcing issued in 2013 and updated twice since, and MBIE and MSD leading projects intended to focus contracts on outcomes; to streamline contracting processes; and to encourage collaboration between providers.

The joint Treasury and State Services Commission submission on the draft report argued that the Streamlining Contracting project provides the basis for further improvements in contracting (sub. DR226).

The various regulation and guideline documents seem to have been left behind by these developments, and are likely to be confusing for social agencies negotiating contracts. They need updating and consolidating (section 12.5).

In 2013, the Treasury argued that many initiatives “talk about a focus on outcomes, but very few seem to be moving towards contracting for outcomes, or performance-linked funding” (New Zealand Treasury, 2013, p. 5). A likely reason for slow progress towards contracting for outcomes is that contracting out is a poor match to situations requiring integrated responses and packages tailored to specific clients (ie, quadrants C and D) (Chapter 6). This is discussed further in section 12.5.

12.4 Issues raised by participants

Submissions, most from NFP providers of social services, covered many aspects of contract design and management.

Some providers oppose contracting; for example, because they consider competition for contracts discourages trust and collaboration between NFPs, or undermines their independence and advocacy role. 121

However, most focused on four issues:

- the tendering process;
- contract design;
- contract administration, including the burden of reporting; and
- impacts of contracting.

Overwhelmingly, submitters see a need to improve contracting, implying that the initiatives described in section 12.3 have not (as yet) achieved the Government’s objectives.

The tendering process

Tendering can improve efficiency but needs to be carefully designed. Submitters focused on problems with the administration and frequency of tenders (and therefore the transaction costs visible to them).

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121 Submitters with one or both of these views include the Methodist Mission (sub. 4), Restorative Justice Aotearoa (sub. 28), Barnardos (sub. 12), Disability Support Network (sub. 47), Dunedin Community Law Centre (sub. 48), New Zealand Public Service Association (sub. 108), Relationships Aotearoa (sub. 56), Tauranga Budget Advisory Service (sub. 57) and Waves Trust and Community Waitakere (sub. 83).
Information and timeliness

Healthcare of New Zealand Holdings (HCNZH) considered that the quality, accessibility and usefulness of information provided by funders during contestable processes is variable, inadequately prepared and can increase the time and effort required to respond to a Request for Proposal (RFP). It has also observed a secretive approach to answering questions during the procurement process (sub. 51). The Salvation Army pointed to “baffling” tendering decisions, and indicated that it had very little confidence in a tendering process it was involved in (sub. 104). Whakaata Tohu Mirror Services noted:

Crown entities are very limited in their contracting skills, generally manage small budgets and don’t seem to have the infrastructure in place for contracting. Reporting processes are rushed and there is no auditing process in place. These contracts seem to be administered on a who-knows-who basis. (sub. 23, p. 3)

Some providers commented that agencies do not adhere to their own timetables in tender processes. So a provider might not know until after contract expiry whether the contract was to be renewed, making it difficult to keep on staff. Spectrum Care Trust Board criticised this and other aspects of a tender it was involved in, suggesting that “the timelines, rules, communication undertakings and RFP protocols are sometimes severely compromised…. with many providers believing the decision was ‘fait accompli’ from the beginning of the process”. (sub. 90, p. 2)

Other submissions acknowledged recent attempts to improve tendering processes, such as MBIE’s Contracting Framework. However, Te Rūnaka o Ōtākou observed that, in the health area,

Government’s recent streamlined contracting initiative and commitment to reduce the audit burden are welcome moves, but so far they have only impacted on a very small number of providers. As long as DHBs and other government agencies are not part of the streamlined approach, the burden of compliance will not reduce significantly for non-profit health providers. (sub. 110, p. 10)

Short-term contracts

A common view is that tenders are too frequent, and that short-term contract periods increase costs and reduce service integration, innovation, investment, and the ability of providers to retain staff and premises.

The Wise Group noted that

[M]ost contracts tendered are short-term, never greater than three years and for many now one year agreements; this despite their definition being for essential services. This is certainly the case in specialist mental health and addiction services where in one DHB area all of the group’s contracts are for one year. Longer term agreements, five years minimum, would reduce the cost of contestability.

A similar example is year on year contracts which are continuously re-issued. For example, in one DHB area we have had 12 one year contracts over 12 years! (sub. 41, p. 23)

The Wise Group considered that the cost to the Crown, to the Group and to other tenderers is difficult to justify, particularly given that contracts are often re-issued, and that contestable processes have been used to bring about changes to services that could have been given effect at lower cost through negotiation and contract variation.

The Southland Interagency Forum worries that frequent changes to tendering rules increase cost, pointing to

protracted and resource draining contract negotiations, onerous audit requirements for all (even if the contract value is less than $10 000), continual threat of either tendering contracts on the open market, or changing the rules and accepting of tenders that don’t meet original “Request for Proposal” criteria, all of which have come about in the last two years. (sub. 29, p. 1)

Other participants considered that as well as imposing excessive costs on bidders, frequent tenders discourage partnerships between providers, which take time to develop.

Supporting Families in Mental Illness (sub. 49) and Restorative Justice Aotearoa (sub. 28) noted that short-term contracts create uncertainty and stifle innovation. Care NZ pointed out that “year to year contracts make planning difficult” (sub. 99, p. 5), while the Auckland Council of Social Services considered that short-term contracts reduce the incentives for providers to share good practice, reward staff and advocate policy
or practice changes (sub. 55). Community Networks Aotearoa (CNA) observed that short-term contracts make it difficult to retain staff or premises (sub. 31). With many 3-year contracts tied to an electoral cycle, “after every election, new ideology can change everything that an organisation has been requested to do” (p. 8).

**Impact on providers of different sizes**

Some submitters argued that the tendering process discriminates against small providers (Box 12.6).

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**Box 12.6  The tendering process and small providers**

CNA argued that the system of tendering online for social services “is not a level playing field. Local NFPs cannot compete with large organisations who have resources to employ contract lawyers” (sub. 31, p. 8). The Community Care Trust considered that the process favours larger providers who can employ professionals to write tender documents (sub. 96).

Inclusive NZ argued:

Smaller community organisations … have less resource and capacity and are at a disadvantage when competing with larger and for-profit providers who have experience and funds to invest in tender bids. Tender processes that are awarded on the strength of a tender document and do not take into account an organisation’s relationship with its community also place these organisations at a disadvantage. (sub. 32, p. 8)

The New Zealand Red Cross noted:

All parties contesting a contract are generally required to complete all steps in the tendering process. This represents a significant duplication of effort particularly for smaller organisations. A simple staged process to shortlist contenders may enable interested parties to provide a high level expression of interest, and be selected to progress to detailed design on a needs basis only. (sub. 94, p. 4)

Presbyterian Support New Zealand observed that the “cost and complexity” of the tender process “will concentrate the sector and potentially exclude niche providers” (sub. 76, p. 14).

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**Should tenders be used to shape markets?**

Submitters had differing views about whether the Government should use tenders to shape the market within which providers operate; for example, by encouraging a shift towards larger or more specialised providers (Box 12.7).

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**Box 12.7  Should tenders be used to shape markets?**

Some submitters argued that the Government should use contracting to encourage larger or more specialised providers:

Attempting to introduce competition among service providers where there is not sufficient capacity or capability tends to damage the limited capacity or capability that is available, with a corresponding decrease and disruption to the quantity or quality of the services available. There are real examples where this has happened in the last few years. (Carers New Zealand, sub. 71, p. 7)

For target populations which have complex and hard to treat conditions the country should invest in a small number of providers which can scale up evidence-based interventions, implemented with high model fidelity, and with the capacity to build ongoing data collection and quality improvement systems. We recommend that government agencies make a strategic decision to take a targeted investment approach … [to] facilitate strong organisations delivering interventions which yield strong investment returns via reduced costs of crime and other social harms to the state and private sectors. (Youth Horizons, sub. 67, p. 14)
Contract design

Participants commented on the attractions and challenges of contracting for outcomes and on the disadvantages of overly prescriptive contracts.

Contracting for outcomes

Contracting for outcomes, involving payments to providers contingent on achieving specific outcomes, has supporters and critics.

MSD suggested that moving towards an outcome focus has both community and provider support:

The providers and communities that MSD works with have also advised that they want to see a stronger link between government priorities and the services we purchase. They want to see contracting of services move away from a focus on purchasing outputs. They want MSD to be clear on the outcomes sought and how their performance will be measured in meeting the outcomes. They see that this will give them the flexibility to respond in innovative ways about how they achieve those outcomes.

(sub. DR224, p. 13)

A number of participants argued that contracting for outcomes focuses activity on what matters, helps innovation, encourages flexibility, allows for culturally specific responses, and facilitates relational contracts:

Outcomes are more important than processes and inputs. Contracts need to be refocused on how people’s choices have improved their lives and the lives of those around them, and how the supports and services have contributed to these outcomes. (Manawanui, sub. 8, p. 2)

Outcomes are the only truly reliable measures that matter for clients, and in establishing return on investment, and value to the wider population. (Blind Foundation, sub. 16, p. 29)

The Wise Group considered that while defining outcomes is challenging, activity-based contracts focus attention on less important activities, by creating “unhealthy pressure to focus on the immediate service delivery via contact hours at the expense of workforce development, community development, quality improvement and a focus on outcomes which demonstrate a higher value than being busy” (sub. 41, p. 18).

Footsteps (sub. 42), the Methodist Mission (sub. 4) and HCNZH (sub. 51) suggested that measuring outcomes helps innovation and flexible service delivery. Max Solutions (sub. DR200, p. 30) considered that “contracting for outcomes provides a suitable risk-sharing environment”. Te Rūnaka o Ōtākou observed:

Contracts that co-design outcomes rather than specified outputs allow for a much more culturally specific response to human need. Narrowly defined outputs produce a silo that [captures] human experience inhumanely, as data and diminishes their status as citizens. A broad focus on outcomes, value added and strong communities requires contracts that reflect these complexities. I am struggling here to find an example of one. (sub. 110, p. 6)

Alzheimers New Zealand considered that measuring outcomes facilitates the development of relational contracts:

High trust contracts rely on a sense of mutual value in the relationship and high levels of professional judgement, supported by strong outcome measures and reporting. The current purchasing model for services for people living with dementia is based on low cost and easy to count/capture aspects.

A shift to relational contracting would require significant investment in the development of outcome measures to be used across service providers and in relation to different health or social matters, together with the professional capability required to develop and manage the necessary relationships.

(sub. 27, p. 4)

Anglican Advocacy accepted that contracts with larger organisations may sometimes improve efficiency, but argued that reducing the diversity of suppliers could reduce resilience and the value to a community beyond contracted outcomes, which might come through facilities being used at other times, volunteer hours, and greater flexibility for innovation (sub. DR180).
The Department of Corrections provided an example of a trial involving a contract in which part of the payment to providers is based on measured outcomes. The trial’s initial success has led to the programme being extended to more difficult cases (Box 12.8).

Other examples of contracts involving incentive payments include: MSD’s Youth Services (Chapter 3), its Mental Health Employment Service (MHES) and Sole Parent Employment Service (SPES) (sub. DR224), and Whānau Ora (Appendix C).

Supporting Families in Mental Illness pointed out that contracting for outcomes is new for many organisations (sub. 49, pp. 12–13). The Platform Charitable Trust suggested that moving to contracting for outcomes would require time and cultural change, as well as extra resources:

> [S]ome existing contract reporting requirements may no longer be necessary or useful in an outcomes based contract, in which case organisations will need to be given time to transition their staff and their IT systems to accommodate a new way of reporting.

> Such a significant shift in approach will also require a significant shift in mind-set. The establishment of an outcome-focused health and social sector will rely on major culture change at multiple levels in all parts of the sector. The government will need to be prepared to invest in a significant change management process that includes training and support for those community providers that have not had the benefit of being involved in the implementation of Results based Accountability (RBA) agreements funded by the Ministry of Social Development. (sub. 45, pp. 9-10)

Some participants, however, considered that contracting for outcomes is not practicable, for a number of reasons.
Auckland Council of Social Services (sub. 55), Presbyterian Support New Zealand (sub. 76) argued that only some services have measurable outcomes. According to the Salvation Army

> [T]he idea that social outcomes and social wellbeing can be measured by simple numbers is illusory. While simple numbers are good for rewarding commercially driven service providers and their investors, these numbers are easily manipulated and the social outcomes being sought through the provision of social services remain elusive. (sub. DR214, p. 8)

The Health and Disability Network noted the differences and challenges of defining outcomes in the health and social services sector (compared to say engineering or manufacturing), and that a “one-size-fits-all” approach should not be imposed on all providers (sub. 70, p. 4).

The Association of Salaried Medical Specialists argued that if outcomes are not measurable, linking them to funding “carries a high risk of unintended consequences where there is inadequate public accountability” (sub. DR155, p. 8).

Others (eg, Jane Lee, sub. 60; New Zealand Education Institute, sub. 40) considered that some outcomes are only observable in the long term, beyond the duration of normal contracts.

Often it is difficult for outcomes to be attributed to a particular service. The Auckland Council of Social Services observed that “[f]or building community resilience a great many services come together each with varying but unmeasurable effectiveness so the proportionate role of each input which led to the outcome usually can’t be determined” (sub. 55, p. 4). This can be particularly problematic when a number of agencies work together (Superu, sub. 82). The Blind Foundation saw several risks to their organisation, although it is not opposed to outcome contracting:

> [The Foundation] is able to work with outcome directed contracts. However the outcomes are not to the stage where the Blind Foundation would be prepared to take on financial risk. Outcomes have to be able to be reported within the time frame of the contract and to be properly attributable to the Blind Foundation’s interventions and not to external uncontrolled events. These are quite high barriers. (sub. DR209, p. 11)

Some participants (eg, Jane Lee, sub. 60; Sue Johnson, sub. 3; NZCTU, sub. 103; IHC, sub. DR218) suggested that contracting for outcomes can create opportunities for providers to divert resources from the most difficult (and costly) cases:

> We understand that other commercial private training establishments are ensuring their survival by only taking clients onto their programmes who are very likely to succeed. We submit that many of this type of client would succeed without government funded interventions. The Salvation Army will not leave clients behind and we will continue to take the neediest clients despite the pejorative impact these clients have on our outcomes/success statistics. (Salvation Army, sub. 104, pp. 5–6)

Carers New Zealand noted that contracting for outcomes can shift the risk for performance on to the service provider, when the result or outcome will probably be beyond their control. It is also inconsistent with the objective of NGOs and government agencies being in a partnership or collaborative relationship if the responsibility and risk associated with the desired outcomes is shifted on to the service provider. (sub. 71, p. 5)

Max Solutions considered that while outcome-based contracts can contain metrics that show whether outcomes are being achieved, they rarely look at the underpinning inhibitors of more successful delivery, some of which may relate to government policy levers (sub. DR200).

The South Waikato Social Services Group considered inadequate consultation had taken place (sub. DR185). Hui E! considered that other problems with tendering and contracting need to be resolved first (sub. DR213).

**The extent of prescription in contracts**

Submissions provided many examples of prescriptive contracts, and voiced concerns that they restrict the ability of providers to meet their clients’ needs and to innovate (Chapters 2 and 4).

**Reporting and auditing requirements**

The burden of reporting and auditing obligations, particularly against prescriptive contracting requirements, drew much comment from submitters.
The Wise Group submitted a report by PricewaterhouseCoopers (PwC) that evidences significant duplication [in reporting and audit requirements] that comes at an avoidable cost to the Crown and the group as a provider. Importantly the report also identifies the ease with which an integrated audit could be developed and adopted, creating significant savings in both time and money. (sub. 41, p. 35)

The Southland Interagency Forum referred to “punitive and overtly dictatorial reporting requirements” (sub. 29, p. 1), while the National Council of Women of New Zealand observed that too much time was wasted filling in forms while the real, often urgent work of a service had to wait. Some members reported instances of rushed or skewed reporting by agencies to secure the next round of funding. (sub. 20, p. 2)

One cause of complaint was the large number of reports required, sometimes to different parts of the same agency and sometimes to different agencies. Whakaata Tohu Tohu/Mirror Services report to MSD, [Southern District Health Board (SDHB)] & MOH which each have different timeframes and requirements. The MOH & SDHB contracts do not have templates for narrative reporting making it very difficult to provide the required information. Our organisation now uses many more resources than before to complete the required reporting. (sub. 23, p. 3)

Barnardos and the Laura Ferguson Trust had a similar concern:

A key problem at the moment is the wide variety of outcomes, results, goals and measures that are used by different agencies – both government and non-government. Identifying outcomes that are valid and meaningful, measuring them and learning from them is hugely resource intensive. (sub. 12, pp. 7–8)

Like many social service agencies we hold multiple service delivery contracts administered by a range of Crown-funded agencies. Inevitably there is a compliance burden associated with each contract. In practice this is far more onerous when the contract is in place as reporting expectations (even timeframes) and audit requirements do not align, even in cases where the service delivered is very similar and the need for multiple contracts is because of the demographic of the client receiving the service. (sub. 10, p. 1)

Hokianga Health Enterprise Trust holds over 80 Government contracts, each on the whole defining a narrow, mostly inflexible range of service outputs and often detailed but inconsistent, reporting requirements. The level of reporting across these contracts is varied and relatively arbitrary and [does] not appear to reflect the relative public sector performance risks. … Feedback on reports is also very arbitrary with some detailed and regular responses and concerns expressed by the funders for small contracts and in contrast, entirely absent feedback for larger and riskier contracts for over twenty years. …There is also an increasing trend to introduce more outcome based reporting within these contracts, but instead of reducing output reporting, they add another layer of expectation and compliance upon the provider.

The organisational cost of compliance of meeting the reporting and auditing requirements is proportionally extremely high for our relatively small organisation and unbalanced with the level of performance risk. It would be somewhat more efficient if the external reporting and quality compliances aligned with the Trust’s own internal need for management reporting and quality assurance, but unfortunately they are often entirely unaligned. (sub. 44, pp. 1–2)

Homebuilders Family Services considered that outcome measures need to be localised, and that care needs to be taken to avoid the burden from additional reporting:

Successful evaluation recognises differences between people, places and programmes. The requirement of differentiation raises doubts over the efficacy of a single common outcome framework such as RBA promoted by the current government. Outcome goals and measures should be developed and established where the delivery takes place. It should be based on effectiveness of service delivery or a determinant of programme shortcomings as the basis for improvements and not just as a reporting tool. Reporting with this framework can create considerable work for the provider without the benefit of activating any real learning and improvements in service delivery. (sub. 38, p. 2)
Impacts of contracts
Participants commented on the impacts of contracts on quality, innovation, and on rural and remote communities.

Impact on quality
Contestable processes can improve quality if this is valued by the tenderer and rewarded through contract payments. However, contracts can reduce quality if selecting providers on the basis of the cheapest bid encourages under-bidding (Southland Interagency Forum, sub. 29). However, Hui E! argued that “the problem for NGO providers is generally the reverse – that the procurer (being driven by a capped budget) cares less about quality than the provider, especially in terms of the longer-term outcomes for clients and communities” (sub. DR213, p. 12). The Disability Support Network had a similar view:

[T]he separation from the funder and provider that is a hallmark of the contemporary era of deinstitutionalisation has enabled government to distance itself from the adverse effects of its underfunding, including any concerns about quality standards, as well as the poor wages and conditions of workers. (sub. 47, p. 7)

Impact on innovation
Many participants considered that prescriptive contracts stifle innovation (Chapter 7). MSD recognised that “at risk clauses and tight service specifications can enhance accountability but there is a risk that they could stifle innovation by limiting the ability of providers to tailor services to clients” (sub. 72, p. 5). However, the Health and Disability Network (sub. 70) and HCNZH (sub. 51) argued that the Government does not consider the scope for innovation or value experimentation when drafting contracts. And Wesley Community Action commented that the Family Start programme is aimed to engage those whānau most at risk of poor outcomes, but does not allow flexibility in the manner or number of visits by a whānau worker. This leads to “a one size fits all approach which is risk adverse and thereby [restricts] innovative opportunities” (sub. 6, p. 2).

Impacts on rural and remote communities
The ACC (sub. 30) uses contracting to ensure that clients in smaller centres and rural areas have a choice of providers. Its vocational rehabilitation contract requires providers to deliver services throughout one or more defined geographical areas, defined so as to ensure that a choice of service provider is available to all New Zealanders. For example, Northland is included within the same area as Auckland, which means that providers who apply to deliver services in Auckland must also do so in Northland.

Yet some providers are less positive. The National Council of Women’s Organisations suggested that when a few larger organisations are contracted nationally they may “cherry-pick contracts”, leaving the remaining areas to subcontractors who are poorly resourced and reviewed (sub. 20, p. 3). Both they and Barnardos (sub. 12) called for additional funding to meet the higher costs of servicing smaller communities.

Implications
Providers were dissatisfied about the compliance burden of contracts. Some suggested that contracts impede desired outcomes. Submissions from government agencies offered a more favourable impression about how well contracting is working – but acknowledged there was scope for improvement.

12.5 Opportunities for improvement

Procurement: Government Rules of Sourcing
The Health and Disability Network considered that government purchasing processes would be “vastly improved if government agencies adhered to the three core funding guidance documents [that is, the Treasury and Office of Auditor-General and Government Rules of Sourcing] that already exist” (sub. 70,
Platform Charitable Trust suggested that the Government should develop one set of agreed rules for how all government and Crown agencies must engage with, contract with and fund NGOs, and that the three framework documents should become the rules, rather than guidelines, for engaging with the sector (sub. 45).

The Government Rules of Sourcing already provide a set of rules that apply to all government sourcing, with partial “opt-outs” for some social services (section 12.3). These opt-outs make the rules difficult to read. This problem would be addressed by developing separate rules of sourcing for social services that specify the rules that agencies have to comply with, rather than specifying a full set of rules from which they have to deduce the rules that do not apply. In the process of preparing this document, MBIE should consider whether the characteristics of NFPs or the social services within which they operate require that additional rules are needed or existing rules must be amended. The rest of this section sets out possible additional rules.

To improve clarity, the Government should publish separate Rules of Sourcing for Social Services. These rules should make it explicit that contracting out is just one of a number of models available for the purposes of commissioning social services, although contracts may be used with other models as well.

Guidelines

As the Treasury points out, guidelines are not a manual on how to write contracts and “do not diminish the need for Government agencies to exercise informed judgement about the arrangement that may be appropriate in their own circumstances” (New Zealand Treasury, 2009, p. 2). Even so, it is not helpful that the Treasury’s guidance material and that of the OAG were prepared independently of the Government Rules of Sourcing.

Further, a Treasury paper recently acknowledged that the Treasury guidelines are “simplistic” in some regards, do not provide advice on how to approach risk sharing and do not adequately address contracting for outcomes (New Zealand Treasury, 2013). Bringing this guidance up to date provides an opportunity to rationalise it with the other government guidance material, and with the Government Rules of Sourcing.

MBIE agreed that it would be helpful to “review the current requirements and guidance with a view to developing a simple coherent set which sets minimum and good practice expectations” (sub. DR153, p. 2). It pointed out that this could build on work that it and other organisations have already done.122 The Treasury and State Services Commission also agreed that updated guidelines are needed and pointed out that MBIE has “done much of this work” (sub. DR226, p. 24). The Public Service Association considered that new guidelines should be developed in consultation with NGOs, unions and providers (sub. DR221). The South Waikato Social Services Group submitted:

[T]he process for implementing guidelines needs to be robust, transparent, auditable, rigidly fair and equitable and universally applied. Without these assurances it is just more bureaucracy. (sub. DR185, p. 6)

Updated guidelines would support the Government Rules of Sourcing.

The Government should develop a single set of up-to-date guidelines to support the recommended Rules of Sourcing for Social Services and should provide training on these guidelines to social services agencies and providers.

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122 For example, MBIE has developed procurement guides, tools and templates. These are available at www.procurement.govt.nz. It is also proposing an introductory procurement course called Demystifying Procurement (sub. DR153, p. 3).
More effective social services

Improving the tendering process

Submitters highlighted several areas that need improvement, including: information provision during the tendering process; agency timeliness; taking account of past experience when selecting providers; standardisation; and excessive frequency of tenders (contracts are too short).

Information provision

Some providers complain that tendering agencies are unwilling to provide additional information after inviting a tender. However, those managing the tender have to manage the tension between not giving information to a single bidder that would give it an unfair advantage, and withholding advice that would improve the quality of the bids. Ways to manage this tension include:

- ensuring that RFPs are informative;
- holding briefing sessions for all bidders; and
- requiring bidders to commit questions about the tender in writing, with the answers circulated to all bidders.

The Rules of Sourcing address these issues in the following way.

- Rule 35.1 requires that Each Notice of Procurement must contain all of the information that suppliers need to prepare and submit meaningful responses, and sets out the information required.
- Rule 38 specifies that an agency may make additional information available to all participating suppliers, but must make additional information available to all participating suppliers at the same time.

However, these rules do not apply to opt out procurements (section 12.3), which include important social services procurements.

Agency timeliness

Agencies need to allow sufficient time for tenderers to develop adequate bids and for agencies to assess them. The time required is likely to vary between tenders. Rule 26 requires that agencies allow suppliers sufficient time to respond to a notice of procurement. Rule 37 requires agencies to respond promptly to questions, and suggests that agencies consider extending their deadlines if they are not able to answer questions promptly.

Good procurement practice means that agencies need to plan effectively and keep to their timetables, so as to maintain service delivery. Yet this does not always happen, as the Commission heard that agencies do not always comply with their own tendering timetables. This causes significant problems for providers (section 12.4). Clearly, the tendering process needs to start early enough for it to be concluded well before existing contracts expire. Options that would strengthen agencies incentives to run timely tender processes include:

- adding a rule that agencies must comply with their specified deadlines;
- imposing penalties on agencies that miss deadlines;
- transparent tracking and reporting of tender processes; and
- more frequent OAG audits of contracting processes.

Penalising agencies for not meeting timelines would require establishing a process and authority for determining that a penalty is payable, and perhaps an appeal process. Funding would need to be considered: if penalties could be paid out of the appropriation for the delayed programme, their burden.
would fall on service providers and their clients rather than on the agency. Further, agencies might simply set up longer initial timelines to avoid the risk of being penalised.

Better reporting could occur along a spectrum, from an annual report through to sophisticated real-time tracking and reporting systems. Any approach would need to take into account that providers may cause some delays.

The evidence does not so far indicate that the problem justifies the cost of installing a penalty system or sophisticated tracking systems.

**R12.4** Social services agencies should report annually on their compliance with the timelines and deadlines set out in tendering documentation.

### Failure to take account of past performance when selecting providers

Some providers told the Commission that tendering agencies do not take into account a provider’s past performance when assessing bids. For example, Community Network Aotearoa considered:

The system of tendering on-line for social services is deeply flawed. Although a representative of CNA was assured by MBIE staff that ‘blind’ committees (where the history and identifying features of the RFP writer are kept secret) are against best practice, it is widely known in the Sector that these committees exist. (sub. 31, p. 6)

[CNA] has a major problem with the contracting via GETS system. … NGOs we are aware of have been awarded contracts via a ‘blind’ system. For efficient services and good results, Government must take into account the added value that NGOs provide over and above for-profit services. NGOs often cannot compete with For Profits who have resources and abilities to hire contract lawyers. If the decision makers do not take into account the history, the community connectedness and the success of NGOs and look only at a value for money proposition, they risk making huge costly mistakes. (sub. DR236, p. 14)

While past performance is not necessarily a guide to future performance, it is difficult to understand why it would not be considered. Looking at past performance might also reveal a provider’s broader connections within the community (Home and Community Health Association, sub. DR192), which may influence its effectiveness. The Treasury considered that, after price,

performance information is the next best source of information to make judgements about what services to purchase from whom to get the best outcomes most efficiently. … 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. (New Zealand Treasury, 2013, p. 13)

Further, if providers know that their past performance will not be considered in future tender rounds, this removes a significant incentive to perform well.

One reason for not using past performance information could be to encourage new providers into the market. There may also be concerns that panel members may make biased decisions if they rely on their knowledge of a bidder’s past performance. These concerns could be reduced by measures – some already in use – such as requiring panel members to declare conflicts of interest; having a mixture of panel members with and without knowledge of the bidders; and publishing the reasons for decisions.

The Commission considers that each bidder’s past performance should be factored into tendering decisions, unless agencies have a good reason for not doing so. Agencies that decide not to take past performance into account should publish at the start of the tendering process why they are doing this, and why the advantages of this approach outweigh any disadvantages.

**R12.5** The recommended Rules of Sourcing for Social Services should incorporate a requirement for agencies to take account of the past performance of bidders when assessing bids. The requirement should enable agencies to ignore past performance only under exceptional circumstances and if they publish their reasons at the start of the tendering process.
Standardising tender requirements

Several participants suggested that standardising tender requirements would reduce tendering costs by standardising information requirements and reporting, and making more use of IT (Box 12.9).

Box 12.9  Standardised tender requirements

Barnardos suggested:

It would be very useful if all RFPs from government agencies use a standardised template (questions and lay-out) and submission process. Slight variations in the way questions are asked, the order of questions and the processes for submitting information lead to significant amounts of time and effort without any real benefit in the quality of information provided. (sub. 20, p. 12)

According to the Wise Group,

there is little or no adoption of technology that would streamline procurement processes”, and there should be “a standardised, secure, online proposal site that respondents populated. In the absence of this most government agencies operate paper based systems”. (sub. 41, p. 23)

The Blind Foundation, while acknowledging some improvements, noted that

different departments require different information creating redundancies and inefficiencies. Integrated contracting would be a big improvement on this. Ideally ACC, MSD and MoH would get together and create consistency of questions, quality measure and Outcome contracts based on RBA. (sub. 16, p. 30)

However, HCNZH considered that standardisation has disadvantages as well as advantages:

- [M]oving every NGO provider across all of government to a single set of “framework terms and conditions” risks paving over important differences in contracting arrangements and creating additional complexity.
- The streamlined contracting framework developed with MBIE has in our experience made it more difficult to have discussions with funders about mutually acceptable terms and conditions since funders now lack the discretion to make changes that are in our shared interest and that of our clients. (sub. 51, p. 4)

As described earlier, MBIE is two years into a 3-year project to streamline contract management. Standardising terms and conditions should also simplify tendering processes, although it will not necessarily address all of the concerns outlined above. There is also a Cross Government Accreditation Working Group, whose aims include reducing the compliance burden for providers by reducing the duplication of accreditation activity for agencies. It has recognised that the burden of compliance extends well beyond accreditation, with monitoring and reporting requiring “large amounts of provider resource” (sub. 132, p. 3). It suggests that these functions should be approached from the perspectives of providers rather than those of agencies.

The Commission agrees with MSD’s view that “more work is needed to streamline contracting across government” (sub. 72, p. 4). Yet standardisation should not be mandatory, as this would rule out negotiation of case-specific arrangements that meet the shared interests of the parties. It could also have unintended side effects, such as encouraging additional use of schedules to contracts, containing prescriptive terms and conditions that are not included in the standard contract forms and leading to more, rather than less, variation between contracts.

Less frequent tenders through longer-term contracts

In 2014/15, 46% of MSD’s contracts for social services had terms less than 2.5 years (Figure 2.9). Many providers considered that contracts are too short and tenders too frequent. The Tauranga Budget Advisory Service proposed that there be
longer term contracts (at least three years like high trust) subject to annual monitoring. Too many good staff are lost especially to the state sector due to insecurity of work tenure, career progression and poor pay. (sub. 57, p. 2)

The Commission learnt during its meetings with some providers that they were limited to 12-month contracts with their major funder, but these were typically rolled over. The Treasury also noted that many short-term contracts roll over after 12 months. However, it pointed out that 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. (New Zealand Treasury, 2013, p. 22)

The Wise Group considered that long-term relationships and contracts – with built-in flexibility to adapt to service environments that change over time – are a critical success factor for effective commissioning and contracting (sub. 41). Care NZ believes that longer-term contracts must be considered, especially if providers are performing well and can demonstrate effectiveness (sub. 99). The Care Trust Board welcomed that the MoH is contemplating moving away from standard three-year terms, to rolling three-year contracts. It considered that this would “provide some financial surety as a platform for strategy development and operational planning as well as investing in workforce development” (sub. DR182, pp. 1-2). Max Solutions (sub. DR200) pointed out that yearly reviews can identify poor performance without the need to re-bid a whole programme. Community Wellbeing North Canterbury Trust believed that multi-year contracts assist with service delivery and workforce continuity (sub. 112). The Treasury’s discussions with providers suggested that short-term contracts are an important barrier to achieving better investment in outcomes (New Zealand Treasury, 2013).

Yet longer-term contracts are not necessarily better. The appropriate length depends on factors such as:

• the service to be delivered;
• the views and track record of the provider;
• the lifecycle of the relevant policy;
• the contracting capability of the government agency;
• negotiation costs; and
• value for money (New Zealand Treasury, 2009).

The life of the capital equipment used to provide the service, the staff training required, and the extent to which capital and training are specific to the service, should be considered. It is also likely, as the Wise Group suggested, that longer-term contracts could be developed when there is “high trust” (sub. 41, p. 3).

The brevity of many contract durations does not prove they are all too short. However, as noted earlier, agencies may be attracted to short-term contracts to reduce their risk exposure. Further, the tendency to introduce new programmes creates a reluctance to use long-term contracts, because agencies do not know what will be coming next. And because agencies are usually the only purchasers, with several providers to choose from, they can impose some of the costs of short-term contracts (such as additional staff turnover and training costs) on service providers and their clients. Longer-term contracts might emerge if bargaining strength was more evenly balanced.

Mandating a default contract period of, say, three years, with an obligation on agencies to publish reasons for choosing shorter periods, would lengthen contract periods. However, pushing contracts towards an arbitrary standard may not be efficient, even if contracts are too short (on average) at the moment.

Some other practices can reduce the pressure for short contracts. For example, the Australian Productivity Commission (APC) has suggested that risk management frameworks help to build understanding of the risks involved in providing services, and lead to a discussion about who is in the best position to bear those risks (Box 12.10). They also clarify the appropriate tools for managing risks, only one of which is contract duration,
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and would lead agencies to identify the risks of short-term contracts. For instance, contracts that are not matched to the length of period required to achieve outcomes create a risk of non-delivery (APC, 2010). Because social agencies with more sophisticated risk management frameworks are likely to consider the range of ways in which they can manage risk, they should be less likely to default to short-term contracts as their main way to manage risk.

Contracting agencies that employ a risk-management framework can also adopt lighter-touch regulation for providers with good track records (Max Solutions, sub. DR200).

Box 12.10  **Features of a risk management framework**

A risk management framework should have:

- a clear process for identifying the risks involved in delivering the service;
- a common understanding of the nature and extent of those risks;
- clarity about who should bear those risks;
- agreed standards for assessing risk;
- clarity about requirements for providing information to the other party;
- clarity about the most appropriate tools for managing risks;
- agreed protocols for managing risks over the life of the contract; and
- clarity about what actions each party should take if a risk materialises.


Agencies with risk management frameworks and mechanisms for handling under-performance are less likely to rely on short-term contracts to manage risk. Agencies should also take into account factors such as those outlined by the Treasury, as well as the incentives of providers to invest in staff capabilities and capital equipment that are relevant to supplying the contracted services, when determining contract duration.

**Government agencies should apply a standard duration of three years to social services contracts unless their risk analysis indicates that a shorter or longer duration is better suited to the purpose of the contract. If the agency chooses a different duration they should publish their reasons.**

**Contract design**

This subsection considers the opportunities and challenges for improving contract design through contracting for outcomes; structuring payments to incentivise outcomes; reducing the burden of reporting; and managing contract transitions. It also considers when it is appropriate to use contracting for outcomes (as part of the contracting out model) and when an alternative might be a better path.

**Contracting for outcomes**

As recently as 2013, contracts in New Zealand tended not to be specified in terms of outcomes. Many were based on delivery of units and felt to the providers like “tick-box exercises” (New Zealand Treasury, 2013, pp. 8–9). And PwC recently observed that while service providers in New Zealand are motivated by what they are trying to achieve (their outcomes), this is not always formalised in their management systems:

> [M]ost service providers do not have intervention logics or defined outcomes, let alone the measurement tools and systems which will allow them to track progress against those outcomes. (PwC, 2014, p. 7)
Government agencies are starting to make more use of contracting for outcomes, albeit from a low base. Providers submitted that contracting for outcomes has important advantages, such as focusing activity on what matters, helping innovation, encouraging flexibility, and facilitating relational contracting.

The Ministry of Education pointed out:

When contracting for outcomes, recognition should be made of the role of Government to ensure social services are provided throughout the country and to all those most in need, especially in areas where provider capability is limited.

The feasibility of different approaches to achieve outcomes will depend on the area of the social sector, the type of services needed, and whether there are economies of scale. (sub. DR207, pp. 3-4)

The challenges of attribution

One of the main challenges in contracting for outcomes is that of attributing an outcome achieved to an intervention or a service by a provider for a client or family within a defined timeframe. This is especially difficult where the needs of that client or family are multiple and complex (quadrant D). The Treasury noted:

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. (New Zealand Treasury, 2013, p. 24)

One way to deal with this challenge is for the funder, working with the provider, to create an intervention logic or theory of change based on evidence of what works that establishes a series of steps that will lead to the desired change. The goal of a particular service may be an intermediate outcome that can lead to a high-level outcome. An example of an intermediate outcome might be “all family debt is repaid” that leads to the high level outcome of “sustained financial independence for the family”. Other factors are also likely to be involved in achieving sustained financial independence, like employment for one or more family members, an adequate income and the ability to budget well.

The attribution of an outcome to a particular intervention or single service is particularly challenging for clients with multiple, complex needs (quadrant D) because of the need to integrate services and work closely with the client in determining what is possible (Chapter 10). For example if the family also needed assistance with parenting and finding somewhere better to live, developing an outcomes contract would be harder and more unwieldy. It is also difficult to determine measures at a central point, like a government agency, which knows little about the circumstances of the family in question. A skilled person working at the local level needs the flexibility to identify goals with the family that will work for them.

Where there are multiple variables involved in achieving a desired outcome, the Commission recommends that decisions about how best to provide services are made much closer to clients by the range of providers who can best work alongside them. This calls for more flexibility than is usually possible in a tightly specified, top-down contract, even one oriented to outcomes.

A possible alternative to contracting for outcomes are alliance arrangements which might use a memorandum of understanding which still specifies outcomes to be achieved, but this is done by agreement between the parties. (See the description of the shared goals service model in Chapter 6).

If it is possible to develop one or more adequate outcome measures where the outcome sought is fairly universal, like completing education to a certain standard, then outcomes contracting can work. MSD’s Youth Services are an example of outcomes contracting for disengaged youth (Chapter 3; Appendix B). Many but not all of these clients are likely to be in quadrant D.

Developing outcome measures and building them into contracts requires new capabilities and setup costs (New Zealand Treasury, 2013). However, it will also generate considerable benefits, by leading to contracts that are more likely to facilitate experimentation, innovation, integration and a focus on clients. It will not always be easy to define outcomes. Agencies that seek to do so will find that they can best achieve this by
consulting closely with providers and their clients to find out what is important to them. This as an important part of an ongoing discovery process to find new and better ways to meet the needs of clients.

**Incentivising outcomes**

Incentives within contracts to encourage the achievement of outcomes could take several forms.

The structure of payments to providers influences how they focus their effort. Payments for delivering inputs encourage service availability, but the inputs do not necessarily lead to desired outcomes. Payments for outputs such as training courses encourage the provision of such courses, rather than securing an outcome such as placing people in jobs.

Payments for outcomes are more appropriate, but need to be well designed. For example, paying job search providers for placing people in “sustained work in a role the economy requires on a wage sufficient to provide for a family” is better than paying providers for the number of unemployed people placed in jobs for three months (Haldenby, Harries & Olliff-Cooper, 2014, p. 31). The short-term nature of the second indicator encourages providers to concentrate on easy-to-place people who might have found jobs without assistance, and to “park” those who have difficulty finding work without assistance, or to help them to find jobs that might last little longer than three months.

MSD described its outcome-based contracts with third-party providers for the delivery of the Mental Health Employment Service (MHES) and Sole Parent Employment Service (SPES). MHES is for clients with mild to moderate mental health conditions, and SPES is for clients with sole parent responsibilities who have part- or full-time work obligations. The provider delivers wrap-around, employment-related, case management; employment placement; and in-work support services to participants to support them into work. Providers receive fees on a per client basis upon enrolment, placement into employment and the achievement of continued employment at 6-month and 12-month milestones (MSD, sub. DR224).

Structuring payments to incentivise outcomes can be done in a range of different ways, reflecting factors such as the extent to which outcomes can be measured, and the appetite of government agency and provider to take on risk. For example, the Department of Corrections Out of Gate programme (Box 12.8) illustrated payments being made for both inputs and outcomes, which lessens the risks faced by providers while also providing them with an incentive to focus on outcomes.

Contracting agencies could also consider using non-financial incentives when negotiating contracts to deliver outcomes.

- Publishing the outcomes that providers achieve would keep agencies and providers focused on outcomes and promote knowledge sharing.
- Agencies could agree to less prescriptive contracts and to less oversight where providers have demonstrated that they can deliver outcomes. Given providers’ concerns about excessively prescriptive contracts, rewarding good performers with less prescription and oversight could be a powerful incentive.

Agencies will need to build their capability to manage contracting for outcomes, including how to structure payment for outcomes.

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**R12.7** Social services agencies and non-government providers should continue to expand the use of contracting for outcomes, including the use of incentive payments, where contracting out is the best service model.

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**Reducing the burden of reporting**

Many providers are concerned about the number and complexity of performance reports (Chapter 2). The provider in Figure 2.10 estimated that 20–25% of staff time was spent on contract management and reporting. The Wise Group proposed that “a project should be undertaken to review, standardise, simplify and reduce the volume of reporting for the NGO sector” (sub. 41, p. 3). Similarly, Barnardos supported a standardised approach:
This includes having common templates and processes for: invoicing – how it occurs and the information required; reporting and monitoring – standardised templates, standardised questions, common ways of collecting and reporting client data and information; [and] a common approach to outcome measurement (sub. 12, p. 22).

Reporting costs are borne by providers and their funders. Agencies specify more reporting than is justified by the risks they seek to mitigate. Barnardos advocated a risk-based approach to monitoring, and more emphasis on sharing the lessons across providers of similar services (sub. 12). The Commission agrees with Barnardos and with the Treasury’s view that agencies should structure their monitoring arrangements according to assessments of risks, and document the basis for their assessments (New Zealand Treasury, 2009).

The Treasury suggested that the level of monitoring should differ according to factors such as the nature of the service, the track record of the provider, the amount of money involved, and perceptions of risk (New Zealand Treasury, 2009).

**Managing contract transitions**

Contracts can be ended in many ways. When a contract ends, the purchaser needs to undertake a number of steps to complete the contract appropriately (including undertaking an evaluation of the overall performance of the contract) and to manage the transition to a new contract. The Australian National Audit Office’s *Better Practice Guide for Developing and Managing Contracts* has a chapter on ending contracts, including how to manage risks such as:

- failure to appropriately manage the transition-out by the contractor;
- not undertaking arrangements for a new procurement early enough in the procurement cycle;
- not managing the process of re-tendering in line with probity requirements, particularly where the existing contractor is re-tendering;
- disruption to the provision of goods and services;
- not addressing performance problems with an existing contractor who is re-engaged; and
- not reviewing value for money when contracts are extended (Australian National Audit Office, 2012).

This issue needs more attention as it is not addressed comprehensively in the Rules of Sourcing or in other guidance material.

**Improving capabilities**

Agencies that run tenders and design and manage contracts need many skills. These include cost-benefit analysis, risk management, needs analysis, development of performance management frameworks, contract design, running tendering processes, setting up and operating monitoring systems, and evaluation. Agencies also need financial and legal expertise.

Improving capability for contracting should be developed alongside improved capability for commissioning (Chapter 6).