

Public services

National report

November 2007



Healthy competition

How councils can use competition and contestability
to improve services

The Audit Commission is an independent body responsible for ensuring that public money is spent economically, efficiently and effectively, to achieve high-quality local services for the public. Our remit covers around 11,000 bodies in England, which between them spend more than £180 billion of public money each year. Our work covers local government, health, housing, community safety and fire and rescue services.

As an independent watchdog, we provide important information on the quality of public services. As a driving force for improvement in those services, we provide practical recommendations and spread best practice. As an independent auditor, we ensure that public services are good value for money and that public money is properly spent.

For further information about the Audit Commission, visit our website at www.audit-commission.gov.uk

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Summary

Councils can use market mechanisms like competition and contestability to generate benefits for taxpayers and service users.

- Over £50 billion, half of all council expenditure, per year is potentially subject to competitive pressure.
- When used appropriately, competition and contestability have reduced service costs and improved service quality.
- Councils are still using market mechanisms to improve efficiency. Up to £80 million of recent efficiency improvements in corporate services can be attributed to market mechanisms.
- There remains potential for further gains to be made in both cost and quality, but there is evidence that these may be increasingly hard to secure.

Competition and contestability can help councils deliver their place-shaping objectives.

- Councils are now expected to consider the role of markets and market mechanisms throughout the commissioning cycle.
- Councils are being challenged to use them alongside other mechanisms such as partnership working, citizen engagement and choice.

Successful councils are pragmatic in their use of competition and contestability.

- Councils that have used them well have:
 - done so as part of a broad set of improvement tools and not treated developing them as an end in itself;
 - created the right market conditions for them to have the greatest impact; and
 - used a mix of in-house and outsourced provision depending on where best value was to be found.
- Appropriate use of competition and contestability is associated with improved service outcomes and good performance.

But the pre-conditions for using competition and contestability most effectively are not widely in place.

- Competition and contestability are used most effectively where councils have a pragmatic mindset; understand markets, costs and performance well; and have the skills and capacity to procure effectively.
- However, members and officers do not always adopt a pragmatic approach to using market mechanisms.
- And councils generally lack:
 - sufficient people with the procurement, risk or contract management skills to make effective use of market mechanisms;
 - information about local public service markets that would enable them to use or develop those markets; and
 - information about delivery costs, management costs or service performance to determine the best service delivery option and the best way to secure that option.
- The Audit Commission will work with other agencies to develop tools to help councils use competition and contestability more effectively.

Recommendations

Local councils should:

- Establish the pre-conditions to make the best use of competition and contestability by:
 - identifying the current mindset and encouraging a pragmatic approach within the council;
 - identifying and filling any skills gaps in procurement and commissioning, either by building in-house capacity or seeking external expertise;
 - collecting and analysing market information before considering the use of competition and contestability in any particular service area; and
 - collecting and analysing performance information to ensure they adequately:
 - understand current performance;
 - assess the relative merits of the different options for service provision; and
 - monitor the performance of the chosen option.

Local government bodies and central government should:

- Establish a common language and approach to the role of competition and contestability in local public service improvement.
- Ensure that statutory and other guidance continues to set out the role of competition and contestability and enables councils to use them within the range of improvement tools at their disposal.

- Use the new National Improvement and Efficiency Strategy to enable councils to make the best use of competition and contestability, by:
 - providing training and development for senior officers and members;
 - establishing mechanisms to address skills gaps in procurement and commissioning;
 - providing better information on local public service markets;
 - supporting councils to establish the costs and benefits of competition and contestability; and
 - assessing the impact of these interventions.

The Audit Commission will:

- Disseminate good practice in using competition and contestability through its audit and inspection activity.
- Draw on the learning from this study to develop self-assessment and improvement tools that will enable councils to make more effective use of competition and contestability, in collaboration with local government and improvement agencies as appropriate.
- Work with central and local government to create a framework that encourages and enables councils to use competition and contestability effectively, through Comprehensive Area Assessment and use of resources assessments.

1

Introduction

- 1 Competition and contestability are important components of the public service reform agenda. Economic theory and experience tell us that competition in markets lowers prices, improves quality, leads to innovation and creates customer choice. Successive governments have sought to harness the power of competition to secure better public services at a lower price, especially when public service expenditure is tightly constrained.
- 2 The 2006 Local Government White Paper *Strong and Prosperous Communities* (**Ref. 1**) encourages councils to use competition and contestability more effectively as part of their commissioning role:

‘...by testing the competitiveness of services and, where services are under-performing, introducing fair and open competition where practical.’

‘This is not about a simplistic approach to outsourcing or a return to Compulsory Competitive Tendering. Rather, the focus now is on a more holistic approach to the ‘commissioning’ of services.’
- 3 The 2007 Pre-Budget report also presented councils with the challenge of achieving £4.9 billion cash-releasing efficiencies during the Comprehensive Spending Review 2007 period (**Ref. 2**). Much of this is to be met through enhanced competition and smarter procurement (**Ref. 3**).
- 4 Councils are now being asked to adopt a more sophisticated approach to markets to achieve their public service delivery objectives. Competition and contestability should no longer be considered simply when goods and services are purchased; they should be considered much earlier in the commissioning cycle, when decisions are made about what services to provide and how to provide them. These market mechanisms will have to be used when appropriate, alongside other mechanisms such as partnership working, citizen engagement and choice, to improve services and shape places.

- 5 This will not be easy. Competition does not always work well even in private sector markets, and there are additional complexities for public services. For example there are difficulties associated with:
 - the character of some services, which may be politically or bureaucratically sensitive, or hard to specify, measure and monitor adequately;
 - scarcity, or lack of diversity, in supply, caused by monopoly, high market concentration among suppliers or geographical remoteness; and
 - the need to consider the wider social and political objectives which councils may wish to pursue as part of their place-shaping role.
- 6 The Office of Fair Trading has highlighted the complex relationship between government procurement and public service markets. It has provided a framework for assessing how public sector procurement can affect competition (**Ref. 4**).
- 7 Dealing with this new agenda and overcoming the inherent difficulties of public service markets will require new skills in market management and commissioning. This report will help council officers and members consider the current challenges they face. It presents:
 - the potential for competition and contestability to generate cost savings and service improvements;
 - practical examples of councils successfully using competition and contestability; and
 - the pre-conditions that councils must have in place to make effective use of competition and contestability.

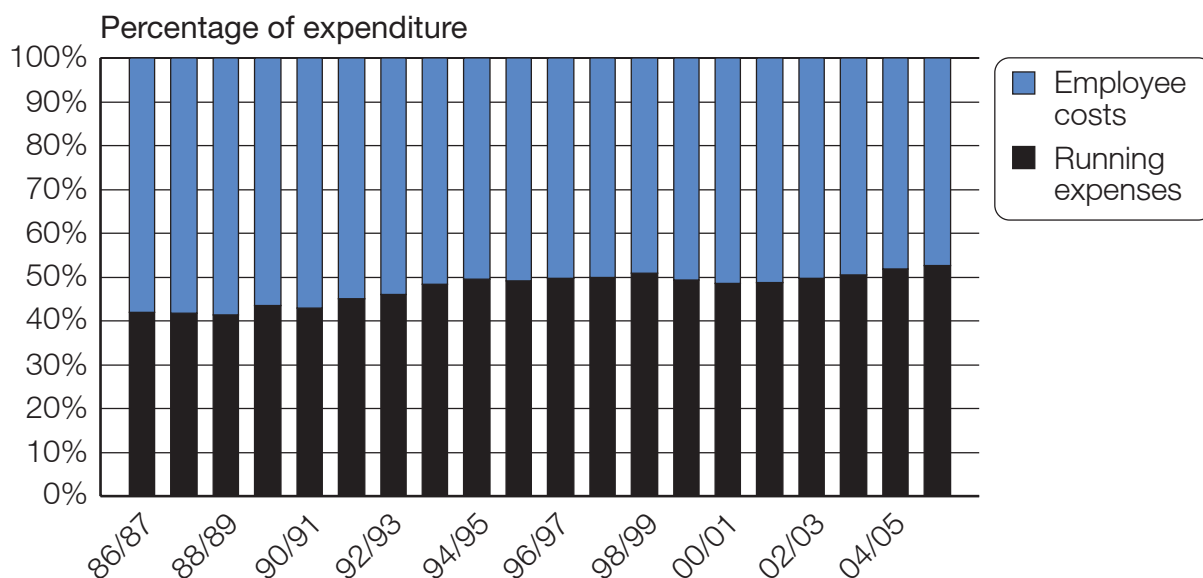
From compulsory competitive tendering to best value to contestability

- 8 Using market mechanisms is not new to local government. Compulsory competitive tendering (CCT) was first introduced in 1981 and gradually expanded until 1996. CCT was based on the assumption that competition between public and private sector providers would act to improve the efficiency of services that had previously been provided by councils themselves. However, CCT focused on the specific tool of tendering. This encouraged councils to prioritise short-term cost reductions over longer-term cost effectiveness. Empirical evidence indicates that it drove down the cost of service provision in some areas, but at least some of these savings were offset by the

costs associated with managing competitive processes (**Ref. 5**). Evidence on the impact of CCT on service quality is limited.

- 9 The Local Government Act 1999 introduced a duty of best value that was designed to address some of the concerns raised about CCT. The best value duty did not require councils to subject their services to competition, but accompanying statutory guidance stressed that subjecting the service to fair and open competition would normally be considered the best way to demonstrate that it was being provided competitively. Under best value, Compete is just one of four Cs for reviewing service performance, alongside Challenge, Compare and Consult.
- 10 The proportion of councils' expenditure on non-employee costs rose from 40 to 50 per cent of total expenditure between the mid 1980s and the mid 1990s. This fell slightly after the abolition of CCT in the late 1990s, but has slowly risen over the last five years back to the level seen at the end of CCT (**Figure 1**).
- 11 Of course, non-employee costs are only an indicator of the level of councils' outsourcing and the level of outsourcing itself is only an indicator of their use of competition. The fact that services are outsourced or provided in-house says little about whether the council has used market mechanisms effectively. However, at least half of councils' expenditure, over £50 billion per year, is potentially subject to competitive pressure.
- 12 It is important, therefore, that councils use competition effectively. Previous research by the Audit Commission (**Ref. 6**) and Communities and Local Government (**Ref. 7**) suggests that it has not been used as well as it might.
- 13 This study revisits and expands upon the Audit Commission's 2002 study on *Competitive Procurement* (**Ref. 6**). It drew upon councils' early experiences of best value and found that competition was used extremely patchily as an improvement tool. It identified a number of perceived barriers to its effective use, including:
 - risk aversion;
 - compliance with rules and regulations;
 - organisational culture;
 - lack of client-side capacity; and
 - supply-side weaknesses.

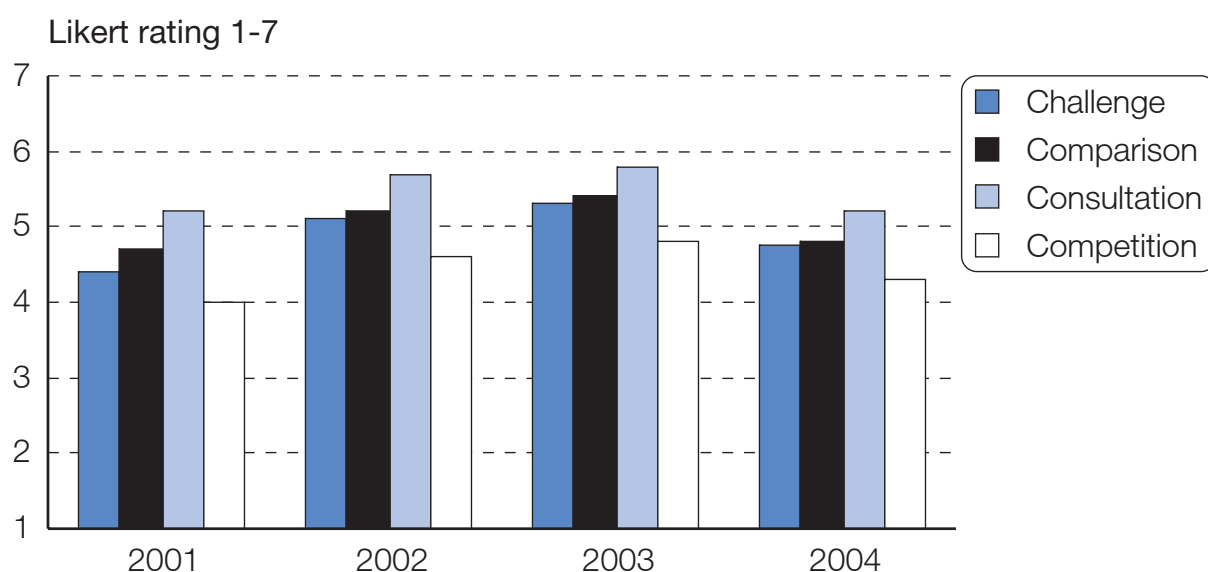
Figure 1
As a proportion of all spending, non-employee costs rose during CCT, fell at the start of best value, and have now risen back to the level seen at the end of CCT



Source: Communities and Local Government

- 14 The long-term evaluation of best value also found that competition has been the least, and least well, used of the four Cs within the best value framework (**Figure 2, overleaf**). Corporate officers consistently rated the test of the competitiveness of services as the weakest element of their councils' best value reviews.

Figure 2
Competition has been consistently the least applied of the four Cs in best value



Source: Martin et al (Ref. 7)

15 The evaluation found:

‘The importance attached to market testing declined over the period covered by the evaluation... ‘contracting out’ and ‘externalisation’ became less important features of authorities’ approaches to managing services and were rarely seen as significant drivers of improvement.’

(Ref. 7)

16 The concept of contestability has also been introduced to the public service reform agenda in recent years. The current government’s model of public service reform (Ref. 8) incorporates competition and contestability in a package that also includes better performance management; increased pressure from users; and improved capacity to deliver.

- 17 According to economic theory, a contestable market is one with low entry and exit barriers to potential new providers. This increases the opportunity for new providers to enter the market, thereby making the incumbent provider operate more efficiently **(Ref. 9)**. In a public service context, contestability involves using market pressures to improve the performance of the incumbent service provider, whether that provider is in-house or external. It does not necessarily involve a formal competitive exercise. Supporters of contestability theory argue that such an approach incurs fewer of the management costs associated with running competitive exercises and can be used for services and in situations where direct competition is difficult, for example where a monopoly supplier exists.
- 18 Chapter 2 looks at how competition and contestability are currently interpreted in councils; Chapter 3 considers their potential benefits; Chapter 4 draws on case study material to look at how councils currently use them to improve services; and Chapter 5 identifies the pre-conditions required to maximise their effectiveness.
- 19 This report has been prepared by the Audit Commission. Most of the findings are drawn from research carried out by the Centre for Local and Regional Government Research at Cardiff University in ten case study councils. Their detailed research findings are set out in a separate publication that accompanies this report **(Ref. 10)**. **Appendix 1** describes the study methodology adopted by the researchers.

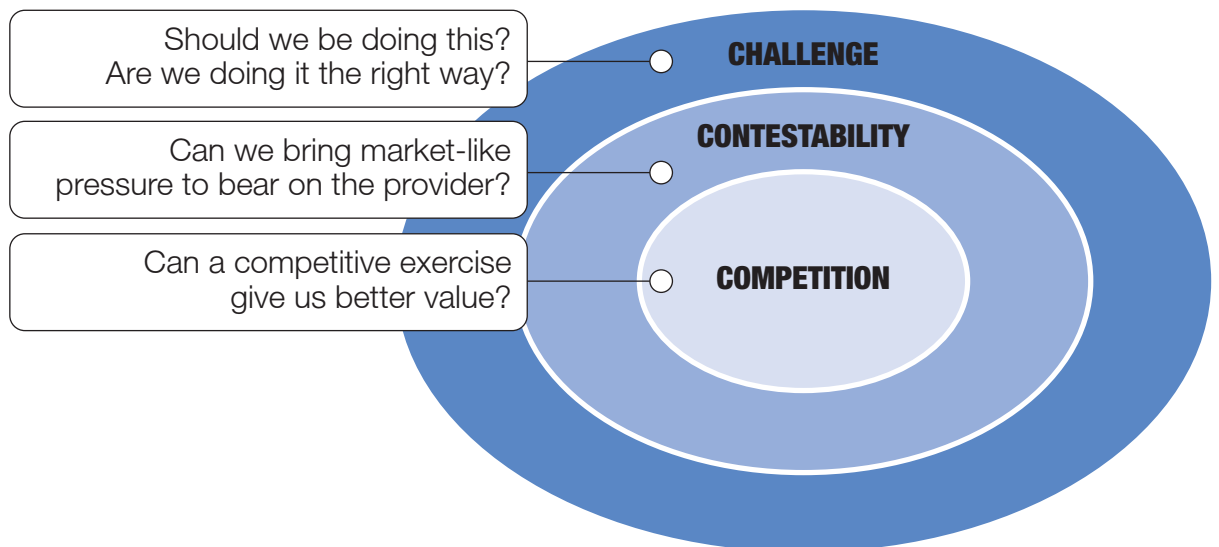
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Councils' understanding of competition and contestability

- 20 People in councils do not always understand or interpret the terms competition and contestability in the same way, but the principles behind them are generally understood. They are generally interpreted as specific forms of challenge (**Figure 3** and **Table 1**).

Figure 3

Councils understand contestability and competition as specific forms of challenge



Source: Centre for Local and Regional Government Research, Cardiff University / Audit Commission

Table 1**A practical interpretation of challenge, contestability and competition as improvement tools**

Concept	Definition	Example
Challenge	The process of examining each service or group of services critically to consider their purpose and effectiveness; the means by which they are delivered; and the options available to improve their effectiveness. One of the options which may emerge for individual services is contestability.	A best value review of a range of services for elderly citizens found a strong silo approach to the way they were organised. Transitions between the functional divisions were mechanistic and designed to suit organisational rather than client needs. The review led to a major reorganisation from function to area, the establishment of one stop shops linked to the health service, and a completely re-engineered IT system to support the new operation.
Contestability	The process of considering different supplier options. It differs from other forms of challenge options in that it poses the option of changing supplier rather than merely changing the management, method or processes of the existing supplier. If the option is pursued an element of competition may be part of the search for a new supplier, but is not inevitable.	A private sector supplier of revenue and benefits services had allowed service performance to deteriorate. The council developed its own option to challenge the supplier during negotiations to re-let the contract and achieved a much better offer from the supplier as a result. But the council eventually entered a consortium with two other councils to achieve economies of scale by providing a single service across all three of them.
Competition	The process of selecting a supplier, within procurement rules and regulations, by evaluating a range of competing options and selecting the one that appears to offer the best balance of quality, cost and scope.	One council decided that it wished to enter a long-term partnership agreement with suitable private sector providers to provide a wide range of services and facilities for cleaning, support, maintenance, repair and construction. It began by inviting expressions of interest on the open market and selecting possible partners through a competitive tender process. The partnership was then negotiated in detail with the providers presenting the two best tenders.

Source: Centre for Local and Regional Government Research, Cardiff University / Audit Commission

- 21 The concepts of competition and contestability are also closely related to the concept of choice. A previous Audit Commission study on choice (Ref. 11) drew the distinction between competition **for** the market, where the council commissions and manages a service on behalf of service users, and competition **in** the market, where different suppliers compete for business directly among service users. Building on these distinctions, there are four positions commissioners and users potentially face (Table 2).

Table 2
Competition and choice

Competition for the market only	Competition for and in the market
Commissioner has choice but user does not. Externally or internally contracted services with competition where users have to use the contractor chosen by the commissioner, eg, waste collection.	Both commissioner and user have choice. Multiple providers chosen through competition coupled with choice for user as to which provider to use, eg, direct payments in adult social care.
No competition	Competition in the market only
Neither commissioner nor user has choice. External or internal provider with a monopoly and where the user has to use that provider, eg, emergency services.	Commissioner has no choice but user does. Where the commissioner is required to use certain providers but users can select between the designated providers, eg, the relationship between primary care trusts, GPs, and patients.

Source: Centre for Local and Regional Government Research, Cardiff University / Audit Commission

- 22 This study focuses on councils' ability to use competition **for** the market to secure value for money.
- 23 Those councils using competition and contestability most effectively consider them as specific elements in a set of improvement tools. This set may also include: developing an improvement plan; internal restructuring; introducing or strengthening performance management; business process re-engineering; and systematic benchmarking.
- 24 Simply trying to establish the conditions for effective use of competition and contestability does not in itself necessarily produce benefits. This risks diverting councils' attention away from service improvement, which is the ultimate objective of the activity. But a council needs to have thought through what service improvement means and how

competition or contestability might contribute to it. South Oxfordshire District Council's statement of strategic intent is its primary driver for service improvement. And every improvement project and proposal to use competition and contestability is tested against this statement.

Case study

Driving service improvement through strategic objectives

South Oxfordshire's Statement of Strategic Intent

To work in partnership to maintain and improve the quality of life in South Oxfordshire

Strategic objective 1: EXCELLENCE

To be recognised as an excellent council

Key Aims

- Keep future increases in the Council's budget requirement at or below inflation (subject to any increases required to meet government legislation).
- Achieve external recognition of excellence.
- Improve customer satisfaction with the Council and its services.
- Continuously improve service standards in priority areas.
- Ensure equality of access for all to all of our services.

South Oxfordshire District Council's decision to enter into a partnership with a neighbouring district council (Vale of White Horse) to outsource its revenue and benefits service was underpinned by its first strategic objective: to be recognised as an excellent council.

The two councils entered the arrangement from very different positions: they had very different political histories and leadership styles; and one council was outsourcing this service for the first time while the other was relocating its already outsourced service to a new supplier. Various joint appointments were made to facilitate the process and keep the objectives of the two councils in balance.

As well as direct service improvement benefits, both councils have achieved several peripheral benefits from this partnership. They have learned a great deal about joint approaches and shared best practice more than previously, even though they have a long history of joint learning in the past.

The councils considered that the necessary conditions for success were trust, a willingness to share control, and a capacity to negotiate a mutually acceptable deal, all underpinned by a sharply focused objective.

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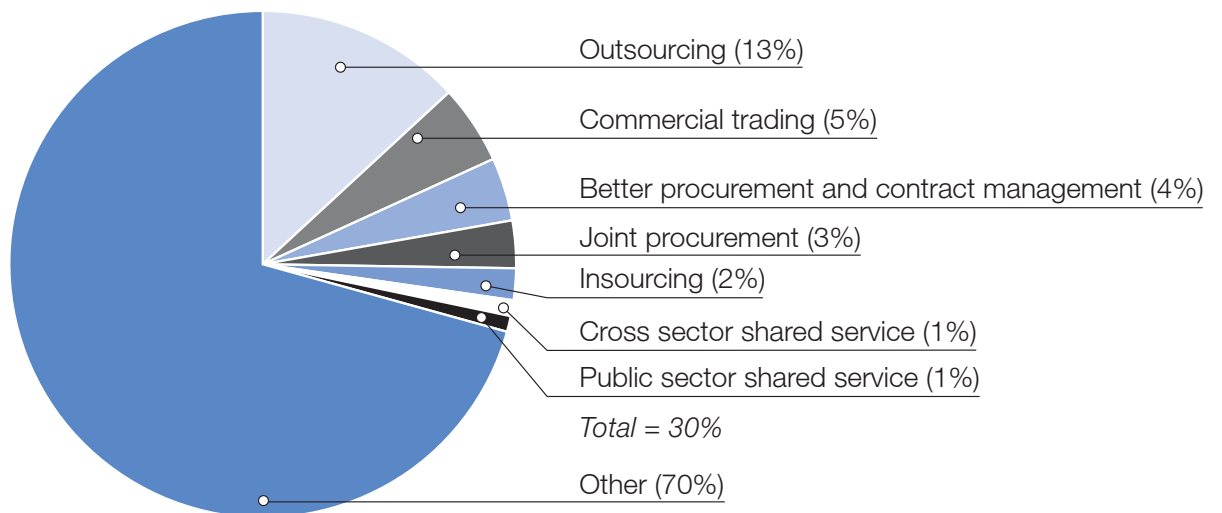
The potential of competition and contestability

Competition and contestability can be used to reduce costs and improve services

Service cost and quality

- 25 While economic theory suggests that competition improves outcomes for consumers, empirical evidence on public services is mixed.
- 26 The balance of evidence suggests that competition, as it has been used, has often led to cost savings. Two early studies found average cost savings of 7 per cent for those services subjected to the first round of CCT (**Refs 12 and 13**); a similar study of the second round found cost savings of 9 per cent (**Ref. 14**). A Confederation of British Industry (CBI) review of the impact of CCT found significant cost reductions in building and grounds maintenance (approximately 10 per cent); leisure management (5 to 25 per cent); and refuse collection (20 per cent) (**Ref. 15**).
- 27 An analysis of councils' annual efficiency statements suggests that councils are continuing to seek and achieve cost savings through market mechanisms. These mechanisms accounted for almost a third of the reported savings in corporate services (an estimated £80 million) over the two-year period 2004/05 to 2005/06 (**Figure 4**).
- 28 However, none of this analysis considers service quality, while the early CCT studies typically looked at blue-collar services only, such as grounds maintenance and refuse collection. The impact of competition on service quality, particularly in the more personalised services such as social care, is scarcer and more equivocal.

Figure 4
A third of recent efficiency savings in corporate services can be attributed to market mechanisms



Note: Figures rounded to nearest percentage point.

Source: Audit Commission analysis of annual efficiency statements 2004/05 to 2005/06

- 29 Recent studies in the education sector reflect the controversy about the role of competition in public service improvement. While the CBI has reported tangible improvements in the performance of privately run local education authorities (**Ref. 16**), one public sector union, Unison, has argued that competition in the school meals market has significantly reduced quality (**Ref. 17**). Yet neither study adequately tested the impact of competition itself on service quality. Instead they focused on the relative performance of the private sector. It is unclear whether similarly intensive interventions would have had a similar effect on those under-performing LEAs if they had remained publicly run, nor whether the apparent decline in the quality of school meals was a function of poor specification and contract management, rather than provider performance.

30 Most empirical evidence on the impact of competition on service quality is in the health field. Gaynor has reviewed empirical studies of the impact of competition for patients mainly in the US (**Ref. 18**). Most studies of Medicare patients (where the state regulates the price) suggest that competition has a positive impact on the quality of healthcare, while studies of privately insured patients (where providers are able to set the price) showed competition having both positive and negative effects. More research is required to determine which factors lead to increased or decreased quality when competition is introduced. This is particularly important as those are the factors that councils must consider when deciding whether and how to introduce competition for local public services.

Council performance

- 31 The relationship between councils' use of competition and contestability and their overall performance is equally complicated. The evidence suggests that they are correlated but does not reveal if there is a causal link.
- 32 The long-term evaluation of best value revealed a positive correlation between service improvement and the use of markets and competition. Although rated as the weakest element of best value reviews, the use of competition was associated with improved best value performance indicators (BVPIs) and self-reported improvements in the equity of services (**Figure 5**). More generally, a more positive approach to the market was associated with improved BVPIs and self-reported improvements in efficiency. Competition also played a significant role in driving service improvements in around a quarter of the 42 best value reviews tracked over time (**Ref. 7**).

Figure 5
Positive approaches to markets and competition are associated with improved performance on a number of measures

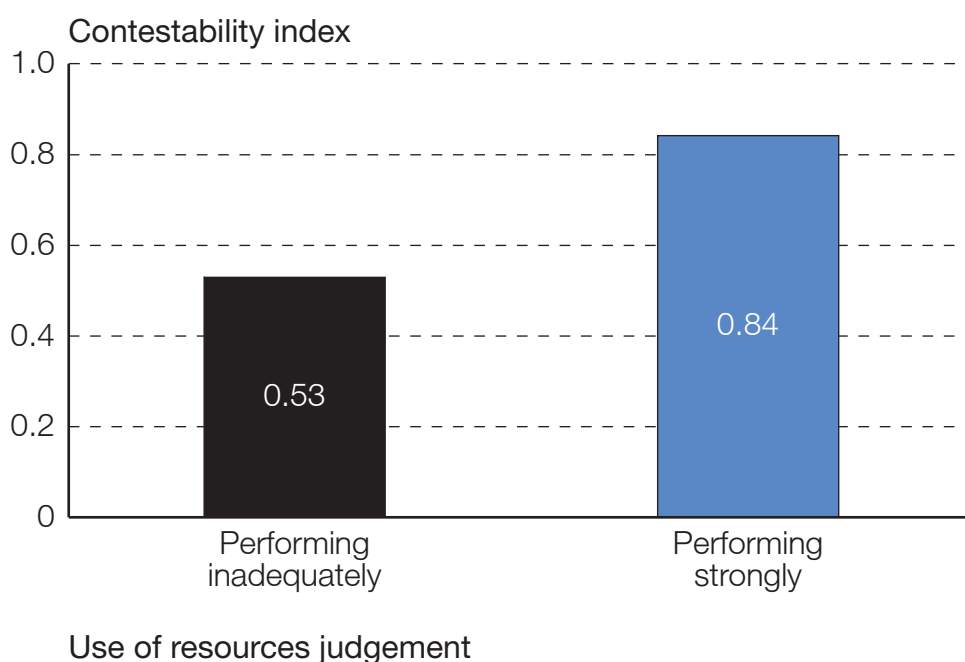
Summary impact of drivers of performance

Driver	Reported performance – efficiency	Reported performance – equity	CPA performance score 2004	User satisfaction BVPIs 2003	BVPIs	Total
Challenge (reviews)		-				1-
Compare (reviews)		+		+		2+
Consult users (reviews)		+				1+
Consult staff (reviews)		+				1+
Compete (reviews)		+			+	2+
Political leadership			-		+	1+ 1-
Managerial leadership		+	-	+		2+ 1-
Re-engineering and re-organisation	+			-		1+ 1-
Performance culture			+	+	+	3+
Targets and performance management		-		+	+	2+ 1-
Markets and competition	+				+	2+
Partnership working						0
Stakeholder and user engagement		+				1+
New information and communications technology	+	+	+			3+
Inspection						0
Central government policies				-	+	1+ 1-

Source: Martin et al (Ref. 7).

- 33 Officers' responses to survey¹ questions on their councils' approach to markets and the private sector have been combined to create a contestability index. Councils with a higher contestability index (i.e., those that were more likely to use, or had a more positive attitude towards, competition and contestability) achieved higher overall use of resources scores in 2006, but the difference was not statistically significant (**Figure 6**).

Figure 6
Councils judged to be performing strongly have a higher contestability index



Note: Difference not statistically significant

Source: Centre for Local and Regional Government Research, Cardiff University

- 34 The evidence suggests a positive correlation between use of competition and contestability and council performance. However, the size, strength and direction of the relationship are less clear. For example, does the poor use of competition and contestability affect overall council performance; or are their poor use and poor overall performance both underpinned by other factors?

¹ The 2004 survey was undertaken for the long-term best value evaluation; the 2006 survey was undertaken for the meta-evaluation of the Local Government Modernisation Agenda. Both studies were commissioned by Communities and Local Government.

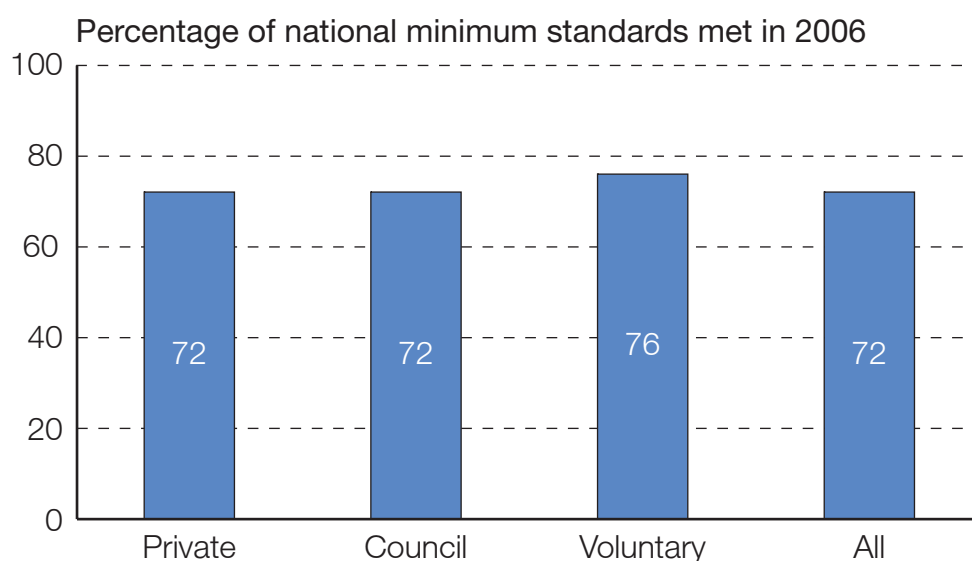
Further gains will require a more sophisticated approach to the market

- 35 Warner and colleagues suggest that a lack of competition in mature markets and relatively poor contractor performance means that outsourcing by local government has reached a 'natural limit' in the US (**Refs 19 and 20**). This has led to a significant rise in the use of mixed public/private provision. Expenditure data suggest that the level of outsourcing in England has also remained static over the last decade (**Figure 1**). Councils may have found it relatively easy to make initial savings by outsourcing services under CCT, but they will have to adopt a much more sophisticated approach to the market to generate further savings and improve services. Two service areas can be used to illustrate the challenges faced.

Social care

- 36 Home care service provision has changed rapidly in the last decade under the demographic pressure of an ageing population. The independent (private and voluntary) sector delivered just 2 per cent of the total hours of care in 1992; in 2005 it delivered more than 73 per cent (**Ref. 21**). This shift has been driven by rapidly expanding demand and the fact that the independent sector has been able to provide the same standards of care at lower cost.
- 37 Commission for Social Care Inspection (CSCI) data show that independent home care agencies are as likely as council providers to meet national minimum standards (**Figure 7, overleaf**).
- 38 The problems associated with comparing like for like services and variations in recording practice mean it is difficult to make completely accurate cost comparisons of social care provision between sectors. However, home care provided by the independent sector is consistently and significantly less expensive. In its recent *Time to Care?* report, CSCI states:
- 'The average price for a weekday, daytime hour of home care in the independent sector was £11.45 in 2004. Prices paid by local authorities to the agencies that took part in the UKHCA [United Kingdom Homecare Association] survey in the same year ranged from £5 to £14. The unit cost of councils' in-house provision has always been higher. For 2005-06 councils have reported their unit costs to be in the range of £13-£16.50, with an England average of £14.80.' (**Ref. 21**)

Figure 7
Independent sector home care providers are as likely to meet national minimum standards as public sector providers



Source: CSCI (Ref. 22)

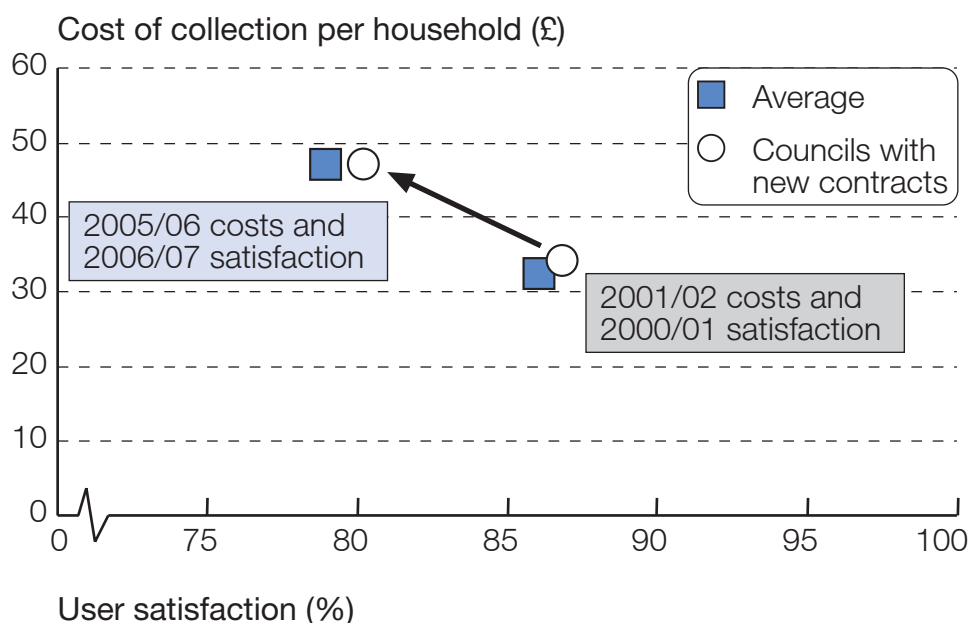
- 39 Part of this cost differential is likely to be because a disproportionate amount of the home care provided by councils involves more highly dependent users. However, the CSCI analysis suggests there remains some scope for councils to use competition and contestability to reduce costs without reducing service quality.
- 40 One council faced with these challenges has demonstrated that it can use the independent sector to provide a reliable and improving service at lower unit cost, while expanding the proportion of provision the sector provides.
- 41 Norfolk County Council turned to the independent sector in the mid 1990s to meet growing demand, while simultaneously trying to improve quality. Independent sector provision rose from under 5 per cent to 13 per cent of total provision in just one year. Following this initial rapid expansion, the Council gradually introduced block contracts for independent sector providers from 2001/02. This had a limited impact on service costs, but provided greater stability for providers. It also enabled the Council to reduce its administration costs and manage the market more effectively in response to changing demands.

- 42 A best value review in 2003 challenged the quality of the service and advocated a more professional and better trained workforce. The cost of the Council's own provision also continued to rise compared to the cost of the service provided by the independent sector. Consequently, in 2004/05 the Council decided that it would cease to provide standard home care in-house within three years. This was estimated to be 80 per cent of all home care. It is well on its way to meeting that target, with the independent sector now providing over 70 per cent of home care. At the same time it would re-engineer the in-house service to focus on the remaining 20 per cent of provision, comprising emergency and high dependency services.
- 43 It is too early to determine the full impact of this approach, but it does appear that the Council has been able to contain the costs of standard home care provision while maintaining the quality of care. More details on this case study can be found on our website: www.audit-commission.gov.uk.

Waste collection

- 44 Analysis of waste collection performance data and survey data collected for the Kelly review into the waste services market (**Ref. 23**) suggests that improvements have become harder to secure as the market has matured. Councils that let new waste collection contracts between 2002 and 2004 have not reduced costs or increased user satisfaction to a greater extent than other councils. Across all councils, costs of collection per household rose by 47 per cent between 2001/02 and 2005/06, while the figure for those councils that let new waste collection contracts was 46 per cent. User satisfaction data show a similar picture. User satisfaction levels fell by 7 per cent between 2000/01 and 2006/07 for councils that had let new contracts. The same percentage decrease in satisfaction occurred for all councils (**Figure 8, overleaf**).
- 45 The competitiveness of procurement exercises does not appear to impact on performance either. There were similar increases in costs and falls in user satisfaction for councils that received three or fewer bids in their procurement exercises and those that received more than three bids.

Figure 8
Councils that have let new contracts for waste collection have seen similar changes in costs and user satisfaction compared to the average



Source: Audit Commission / Kelly Enquiry

- 46 The fact that a council has awarded a new contract in recent years is unlikely to be the main factor influencing the cost of waste collection, or user satisfaction with the service. Much of the cost increase is likely to have been driven by external factors, such as the introduction of new performance targets. Nevertheless, councils do not appear to have been able to use the market to keep the cost of waste collection down, or increase satisfaction with the service, in recent years.

- 47 It is not clear whether this is a function of poor procurement practice, external market factors, or a combination of both. Nevertheless the Kelly review (**Ref. 23**) suggests the market for municipal waste services is not operating efficiently because:
- the public sector as a whole is not taking a sufficiently systematic approach to how it interacts with the market;
 - there is a lack of market intelligence;
 - there are too few suppliers bidding for there to be effective competition;
 - new entrants face significant difficulties; and
 - many councils lack the specialist skills and experience required to procure services in the waste market.

Conclusion

- 48 Introducing competition to local public services clearly yielded early and significant cost savings. However, a combination of external market forces and weak market management is making it harder for councils to generate further savings through market mechanisms. There also remains a question mark over the impact of competition and contestability on service quality. Councils will have to adopt a more sophisticated approach to the market to achieve further savings and improvements in services. The next chapter shows how some councils have used competition and contestability adeptly to lower the costs and improve the quality of services.

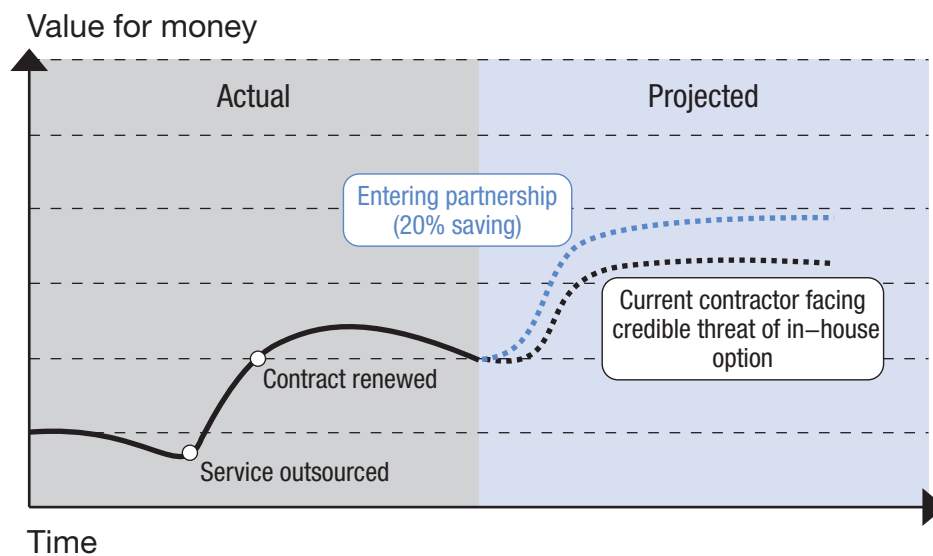
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Councils' use of competition and contestability

Improvement journeys

- 49 Councils that have adopted a mature and pragmatic approach have made best use of competition and contestability. Those councils have used them not only to reduce costs, but also to realise wider policy objectives, including service improvement.
- 50 Nor have they used competition and contestability solely as a means to outsource services. In surveys for the long-term evaluation of best value between 2001 and 2004, councils reported an increasing willingness to work in partnership with the private sector, but a fall in outsourcing (**Ref. 7**). This may not be as contradictory as it appears. Councils are using competition and contestability in increasingly sophisticated ways that do not necessarily lead to outsourcing.
- 51 Pragmatic councils have used market mechanisms during improvement journeys, moving between in-house provision, outsourcing and partnership working, depending on what is best in the circumstances. The case studies accompanying this report illustrate three such journeys. **Figure 9** below represents an example of how a variety of approaches to using market mechanisms, applied at different times, can deliver improvement.

Figure 9
Pragmatic councils have used market mechanisms during improvement journeys



Source: Centre for Local and Regional Government Research, Cardiff University / Audit Commission

Examples of effective use

- 52 Councils that have made best use of competition and contestability have taken an active approach to market management. This may include:
- aggregating demand in collaboration with other public authorities;
 - creating additional and/or alternative supply by stimulating competition or developing companies to trade in local and other markets; or
 - developing alternative approaches to contracting, including partnership working, that promotes flexibility, collaboration and innovation.

- 53 Aggregating demand with neighbouring councils or other authorities can create economies of scale and negotiating power that would not be available to a council acting alone. For example:
- East Cambridgeshire District Council recognised that its revenue and benefits service delivery contract was no longer attractive to external providers, compared to those of larger councils. It felt that a conventional re-tendering exercise was unlikely to yield a realistic challenge to the incumbent provider. It has entered into an innovative partnership arrangement with two neighbouring councils to exert greater influence in the market and capture economies of scale. This has generated a saving of 20 per cent on the original contract.
 - South Oxfordshire District Council faced similar circumstances with its revenue and benefits service. It joined forces with a neighbouring council to aggregate demand before seeking an outsourced solution.
- 54 Creating additional supply, whether by developing a credible in-house option or a publicly owned trading company, or by encouraging other external providers to enter the market, can impose competitive pressure on an incumbent provider. This can have desirable effects even where a council does not conduct a formal competitive exercise. For example:
- East Cambridgeshire District Council developed a credible in-house option to challenge its revenue and benefits service provider, even before it considered joining a partnership arrangement with its neighbouring councils. Ultimately, the Council did not use this in-house option, but was able to put pressure on the external provider simply by considering it.
 - In the face of declining standards and price rises of over 20 per cent, Norfolk County Council's trading company, Norfolk County Services (NCS), entered into direct competition with local passenger transport providers. This had the desired effect of reducing prices and improving the quality of services.
- 55 Developing alternative approaches to contracting can also yield benefits, particularly when the potential for direct competition for the market is limited. For example:
- Norfolk County Services Ltd and its sister company, Norfolk Property Consultants Ltd (NPS), have grown from in-house service providers established under CCT. The Council believed its own departments, given the freedom to do so, could compete in the market. Both departments bid successfully to continue to provide their services.

Since then NPS and NCS have continued to grow and now provide the Council with a substantial surplus. Their holding company reported pre-tax profits of over £2 million, budget savings of £500,000 and a dividend back to the Council of over £1 million.

- Croydon Council's housing department has used a highly innovative form of competition between the two providers of its housing management services. Both providers have contracts of equal size (approximately £5 million) for similar services. Less client-side management is needed to encourage good performance, as the two suppliers try to outperform each other under the expectation that they may gain a greater share of the service in the future. Performance on cost, quality and timeliness has been excellent, and customer satisfaction is at an all time high. Much of the improved performance has come in efficiency gains that the contractors have been encouraged to introduce themselves.

56 Further details on Norfolk's trading companies and East Cambridgeshire's revenue and benefits partnership arrangement can be found in case studies on our website: www.audit-commission.gov.uk.

Conclusion

57 As the cases above illustrate, when used well, competition and contestability can be used to generate significant benefits for service users and taxpayers. The final chapter considers the conditions under which they are likely to be used to best effect.

5

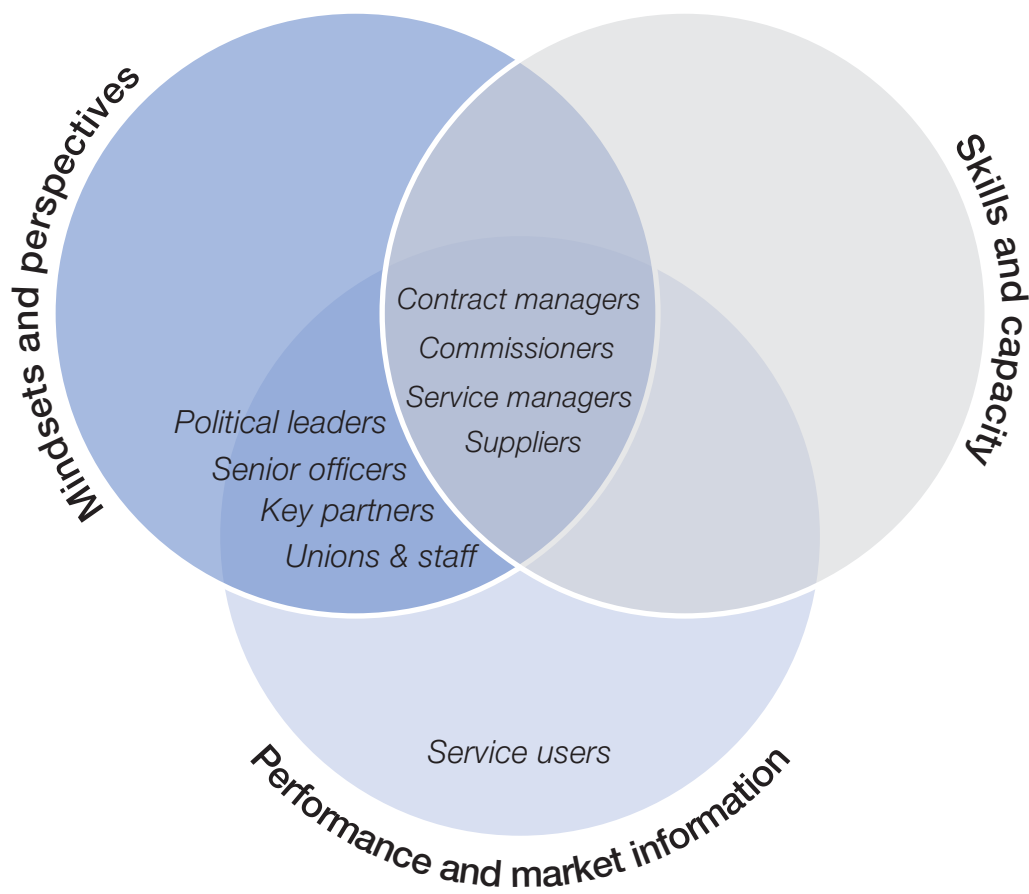
The right conditions for effective use of competition and contestability

- 58 Three pre-conditions are associated with effective use of competition and contestability. Councils need:
- the right mindset among members and council officers;
 - sound skills and capacity among those responsible for commissioning and procurement; and
 - accurate and timely information on markets and service performance.
- 59 In practice, different individuals or groups have different needs in different situations (**Figure 10**). No single council will ever be in a situation where all the right people have the perfect mindset, skills or information. But every council should consider the extent to which the right people have the right mindset, skills and information; and what they might do to improve them.

Mindset

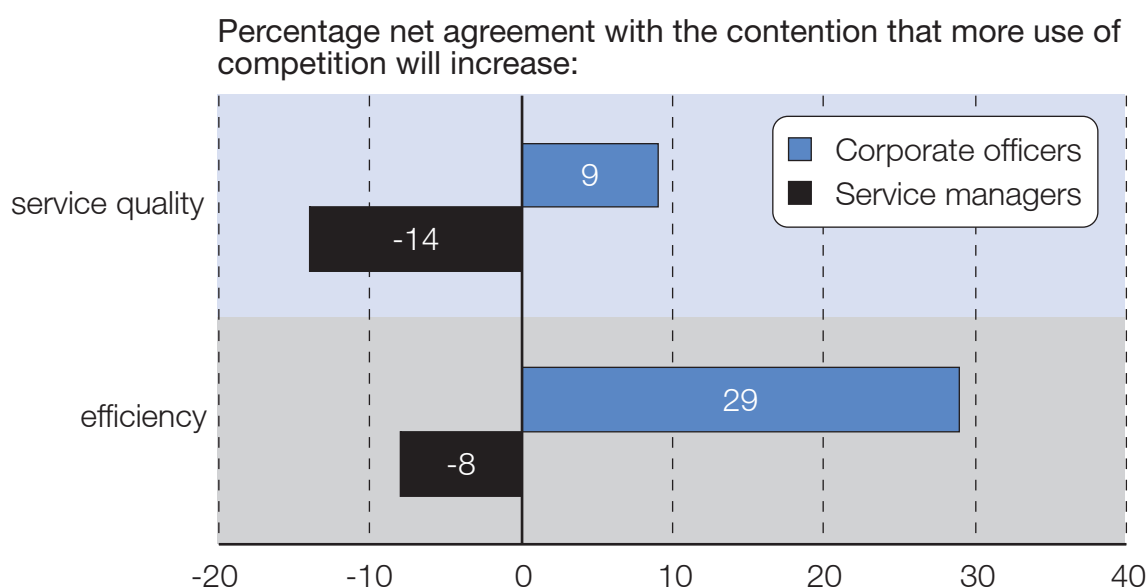
- 60 In the councils that made the best use of competition and contestability, members and officers saw competition and contestability as part of a set of improvement tools. They were open to competition or market mechanisms, but had no dogmatic preference for one form of service delivery.
- 61 They recognised that a firm ideological view about who provides a particular service may inhibit them from achieving value for money and delivering their social, policy and place shaping objectives. Instead, they used competition and contestability regardless of the identity of the incumbent service provider. Competition and contestability were frequently used to challenge external providers with the threat (or the reality) of the service being returned to public provision. This does not imply that the original outsourcing decision was incorrect; rather that those councils using competition and contestability most effectively are willing to reinstate in-house provision where market conditions warrant it.

Figure 10
Different individuals have different needs



Source: Audit Commission

- 62 However, this mindset is not widespread, nor is it always consistent within a council. There is a difference in attitude between corporate officers and service managers. While a majority of corporate officers believe that increased use of competition in their councils would lead to improvements in service quality and efficiency, the majority of service managers believe that it would not (**Figure 11, overleaf**).

Figure 11**Service managers do not believe increased use of competition would lead to improvements in service quality and efficiency**

Source: Survey of councils 2006, Centre for Local and Regional Government Research, Cardiff University

- 63 It is not clear whether this difference is driven by ideology or practical experience, but service managers are more likely to have experienced the negative consequences on services of the poor use of competition. Members and officers both expressed reservations about outsourcing in the light of previous experience. One chief officer noted:

‘The culture has been jaundiced by an IT outsourcing contract which went sour, so there are some current influences on the culture to resist the use of the market as well as the ingrained cultures of certain groups of officers and professionals.’

- 64 Many of the concerns that were raised echo those expressed in another recent study that identified five main reasons for a reluctance to outsource services:
- the desire to be a good and big employer;
 - protecting the public service ethos;

- difficulties in controlling external providers;
- perceived weaknesses in the supply market; and
- protecting core competence (Ref. 24).

- 65 Regardless of the underlying reasons, those councils that do, or do not, outsource in a dogmatic fashion are least likely to be using competition and contestability well.
- 66 The lack of empirical evidence of the impact of competition and contestability on services does not help to change prevailing mindsets, whether they are set by ideology or practice. The detailed case studies we have provided should help to illustrate the potential benefits available and help to change mindsets.

Skills and capacity

- 67 In the councils that made best use of competition and contestability, officers across the council had sound service definition, procurement and contract management skills.
- 68 Good service procurement requires accurate specification, and robust and clear negotiation, supported by sufficient technical knowledge to evaluate cost and quality. Service experts with deficient contract management skills may concentrate on technical aspects of the agreement to the detriment of the contractual relationship. Conversely, procurement experts without service expertise may have robust contract management arrangements in place but may not be able to evaluate technical arguments effectively.
- 69 One commercial director summed up the problem:
- ‘The biggest problem is to get people who understand the services really well but who are also interested in running the contracts. This is not a valued skill. Many professional cadres resist taking on commercial knowledge.’

70 Competitive exercises can go wrong as a result of poor specification and/or contract negotiation and management. In particular, councils experienced difficulties when they tried to outsource failing services without proper safeguards. For example, more than half the councils in this study had experienced a major IT breakdown at some stage and had sought to resolve the problem by outsourcing the service. In every case the problem was compounded by poor commissioning, not poor supply. The supplier was changed in the expectation that a new, expert supplier would know what the council needed and would act in its interests. All the councils discovered from this experience that they needed to be clear what they wanted before they could procure it, regardless of how the service was eventually to be delivered.

71 Another potential problem caused by outsourcing is the damage to the capacity of the corporate core and/or the critical mass at the centre of the council required to manage a service in the long term.

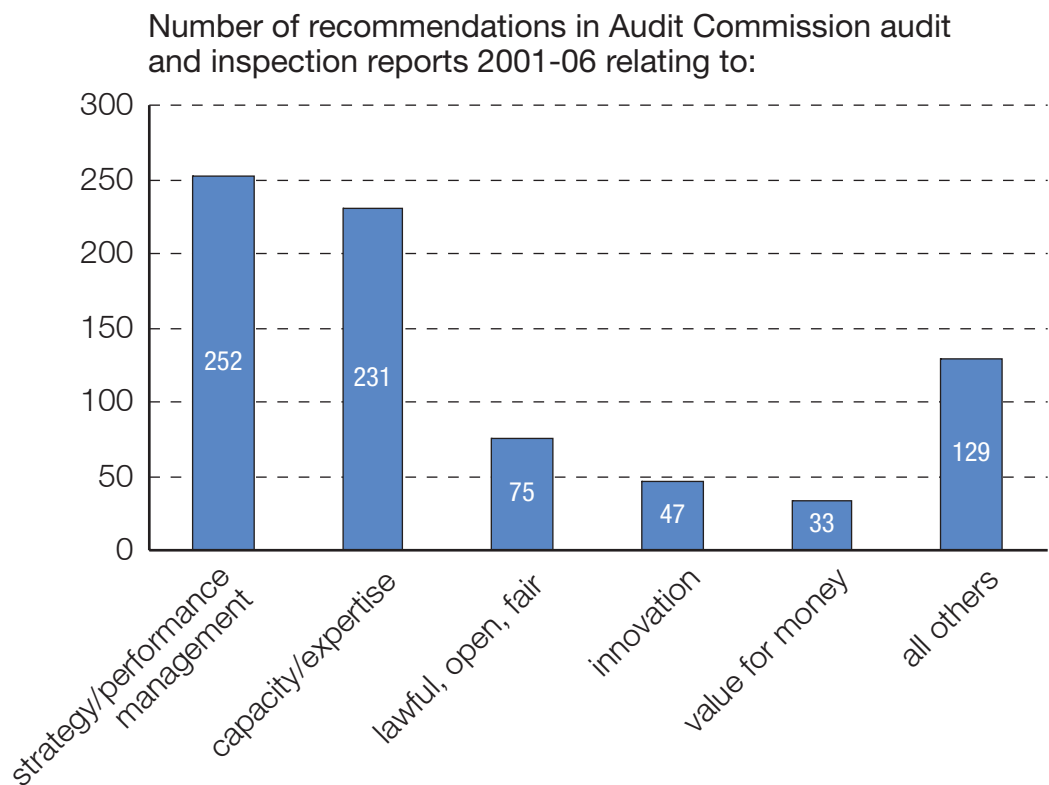
‘There is a danger in outsourcing that an organisation can lose its intellectual and cultural capital – that experience built up over years by experienced staff that may be lost when an in-house service becomes an out-sourced service. The new supplier may on paper be more efficient but where is that vital capital when you need it?’

Director of Education

72 Although critical for the effective use of competition and contestability, sound procurement skills are in short supply.

73 Audit and inspection reports highlight the gap in skills and capacity. Almost three-quarters of a sample of 95 audit and inspection reports on council procurement between 2001 and 2006 contain at least one recommendation relating to capacity and expertise. A third of all recommendations in those reports were on this theme (**Figure 12**).

Figure 12
Audit and inspection of councils' procurement activity have found that capacity and expertise are often lacking

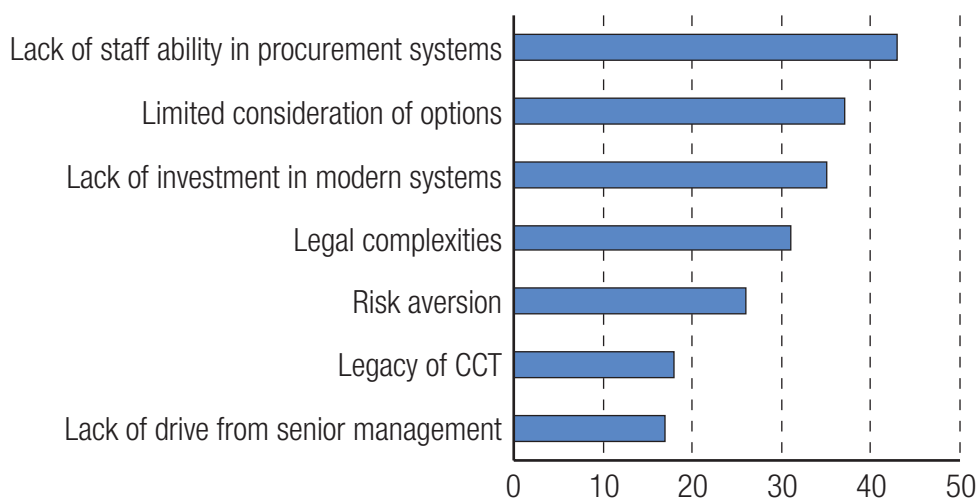


Source: Audit Commission (768 recommendations in 95 audit and inspection reports on council procurement)

- 74 The concentration of recommendations on capacity and expertise may partly reflect the focus of audit and inspection activity. However, based on the responses to a survey commissioned for the evaluation of the Local Government Procurement Agenda, councils themselves also consider a lack of skills to be the biggest barrier to improving procurement practice (**Figure 13**).

Figure 13 Councils see skills and capacity as the biggest barriers to improving procurement

Percentage of respondents reporting issue as a barrier to improving procurement



Source: ODPM (Ref. 25)

- 75 It is not clear whether this reflects a declining skills base or rising expectations of procurement staff. What is clear is that providing the right staff with the right skills is a major challenge. One council recently undertook an audit of procurement activity and found that almost 300 officers had some form of procurement function; yet very few had received any form of procurement training.

Case study

Assessing procurement skills within the Council

A recent survey of all Portsmouth City Council staff indicates that almost 300 members of staff undertake some form of procurement activity in their role, but currently there is no corporate requirement for training for officers involved in such activity.

The Council believes that the lack of experience is particularly acute in contract management, and there is a risk that required standards of service may not be delivered because contracts are not managed in a measurable, structured and professional manner.

The Council is planning to establish a system where a limited number of Licensed Procurement Practitioners (LPPs) are authorised and equipped with the range of skills and competencies to conduct procurement activity. Each service directorate will identify and complete a training needs analysis for those individuals who will become LPPs. Any skill gaps identified will be closed by training programmes currently under development. Details of the skills and competencies possessed and LPP status will be incorporated into the job descriptions and the person specifications of the officers concerned. The Council hopes to complete this process and have the required number of LPPs in place by March 2009.

- 76 Much work has gone into raising procurement skills and capacity in local government through the National Procurement Strategy. The two-year stock-take sets out a variety of activity by improvement agencies to raise the skills of local government procurement officers and other individuals within councils that have an impact on procurement activity (**Ref. 26**). The size and scope of this programme is to be welcomed, but much still needs to be done.

Information on markets and performance

- 77 Councils need to be able to determine whether competition and contestability are likely to be effective and, if used, whether they are having a positive effect. They need accurate and timely information on markets and service performance.

Markets

- 78 Councils need a good understanding of each service market to ensure competitive processes yield value. In particular, it is important to understand the number, size and strategies of providers in the market; how competitive the market currently is (and how this might change over time); and the extent to which the council has any power to influence or develop the market.
- 79 In its analysis of the local government services market, PricewaterhouseCoopers **(Ref. 27)** sets out three strands of market intelligence that must be developed further to improve market dialogue between commissioners and potential providers. Better intelligence on service expenditure and market structure; deals and opportunities; and market players and business models will enable suppliers to forecast and plan capacity more effectively, and commissioners to understand markets and select the most appropriate suppliers.
- 80 None of the ten councils visited in our fieldwork had all the information they needed about markets. As a result they were unable to judge how they might best use market mechanisms to deliver better services or better value for money.
- 81 It would be neither feasible nor efficient to expect individual councils to collect and maintain all the market information they require. But there is considerable scope to improve the amount, quality and timeliness of market data available in the sector. We welcome the plans set out in Communities and Local Government's response to CSR07 **(Ref. 3)** for the new Regional Improvement and Efficiency Partnerships to take this forward.

Performance

- 82 Councils need the right performance information at the right time throughout the commissioning cycle to:
- establish whether competition and contestability might be appropriate mechanisms for service improvement;
 - undertake a robust options appraisal and select the most appropriate form of service delivery and provider type;
 - evaluate the costs of the process undertaken to reach that solution; and
 - assess continually whether the current service configuration and provider are delivering the best value for money.

- 83 That requires an understanding of both current quality and costs and potential quality and costs under a variety of service delivery arrangements. It also requires an understanding of whether the arrangements following a competitive exercise deliver benefits, and whether they outweigh any additional costs of the competitive exercise itself.
- 84 The councils we visited often asserted that competition and contestability had reduced costs and improved performance. They occasionally had documentation to support this. But none had undertaken a comprehensive assessment of the impacts of competition and contestability on service cost, quality or equity.

‘You ask how I know the service has improved as a result of outsourcing. That’s a very good question because it assumes I knew how good they were before the change – and I didn’t, is the blunt truth.’

Council member

- 85 The management costs associated with running competitive exercises and managing external suppliers are frequently underestimated, especially in councils with the least experience of such activity. The position is very similar for in-house services; the cost of managing the in-house service is rarely articulated and transparent. As a result, these costs are seldom built into business cases or taken into account in procurement decisions.
- 86 Consequently, even those councils that appear to be using them well struggle to determine the impact of competition and contestability. Many costs were often underestimated, not considered or simply unknown, particularly the costs of:
- managing the transition from one position to another, including the procurement process;
 - subsequent contract management; and
 - loss of flexibility (when services are outsourced).

‘The headline costs of a major change are sometimes only the political or public face of it. The Council and the public always want to know, above all, how much it is going to cost us. The honest answer when we do something for the first time should often be, “we don’t really know”. But that answer will never do, so there is a headline figure.’

Chief Officer

- 87 The requirement for good performance information extends beyond the initial options appraisal and selection process. Good information also underpins good contract management, which in turn improves councils' ability to negotiate contract renewals, or appraise alternative options, in the future.

Addressing the gaps

- 88 Much guidance on commissioning, procurement and competition exists, and more is planned. However, councils have less access to practical tools that will help them use competition and contestability more effectively. Rather than provide further guidance, the Audit Commission will promote existing guidance and good practice, and collaborate with other agencies to develop and promote practical self-assessment and improvement tools that will allow councils to get the best out of competition and contestability.
- 89 The first two tools we have developed are a checklist for chief executives and senior officers and a mindset temperature gauge. The checklist sets out the issues that a council should consider. It can be found in **Appendix 3**. The temperature gauge can be used to help senior officers better understand whether relevant individuals in a council have the right mindset. It can be found in **Appendix 4**. If relevant individuals are deemed to be at either end of the scale, some of the case study material accompanying this report may help to change minds.

Appendix 1 – Methodology

- A1** Fieldwork and analysis for this study was conducted by the Centre for Local and Regional Government Research at Cardiff University. It comprised two distinct phases.
- A2** The first phase comprised:
- an analysis of key recent government policy statements;
 - a review of previous academic and policy research on competition and contestability in local public services;
 - a series of semi-structured interviews with officers, elected members and external partners in ten case study councils; and
 - a survey of a larger representative sample of more than 1,000 officers in 354 of the 388 English councils.
- A3** The second phase comprised:
- a review of theories and concepts through extensive consultation with external stakeholders and two workshops with experts; and
 - a more in-depth case study analysis in two of the councils visited in phase one, to look specifically at the relationship between competition and contestability and value for money.
- A4** Cardiff University’s research and analysis was supplemented by the Commission’s analysis of other inspection and performance data.
- A5** The case study councils should not be considered representative of English local government as a whole, but included a range of different types and sizes from different parts of the country operating under different kinds of political control. We also sought to include some councils that were considered to have made relatively little use of competition and contestability and some considered to be more pro-active.
- A6** Further details on the methodology can be found in Cardiff University’s report that accompanies this report. Although the findings presented here draw almost exclusively on the work carried out by Cardiff University, the views expressed here are those of the Audit Commission.
- A7** This report was written by Stuart Deaton. Simon Mahony was Head of Studies; John Kirkpatrick was the project director.

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Appendix 3 – Checklist for members, chief executives and senior officers

Does my council have the right mindset to use competition and contestability effectively?

- What do members and officers understand by the terms competition and contestability?
 - To what extent are officers and members open to using competition and contestability? What is shaping their views?
 - How do we know if there is a common understanding and approach between officers and members, and between officers at all levels in the council?
- What part do competition and contestability play in the council's approach to service improvement?
 - To what extent do we use competition and contestability as part of a set of improvement tools to ensure that existing services are effectively challenged?
 - Do we use competition and contestability for wider objectives than solely to achieve cost reductions?
 - How did we consider the options in our most recent commissioning exercises? Did we consider all options, including outsourcing, retaining or bringing back the service in-house, or going into partnership?
 - How do we ensure that market mechanisms are used appropriately through the whole of the commissioning cycle, from the stages before the actual procurement, through the procurement process itself, and into contract management or internal performance management? How did we do so in our last major commissioning exercise?
 - Do we make more or less use of market mechanisms than the councils we like to compare ourselves against?

Does my council have sufficient skills and capacity to use competition and contestability effectively?

- How many officers in service departments are commissioning or procuring services?
 - How many of these have received any training or have any procurement qualifications? What do our procurement experts think of their capabilities?
 - Do our procurement experts provide effective support? What do service managers think of this support?
- How much training and experience do those responsible for procuring and managing contracts have in contract negotiation, risk management or performance management?
- How do we decide on the level of service expertise we need to maintain within the council when services are outsourced?
 - What proportion of our key people transferred to contractors during recent outsourcing exercises?
 - How confident are we that we still have sufficient skills and expertise to manage the service effectively?
 - How do we assess the appropriate size and balance of skills for a client side management team? Do our current teams match that model?

What does my council do to shape local markets?

- How do we assess the level of competitiveness in markets we want to use?
- In which services do we think there is effectively a monopoly? If a monopoly does exist, how can we bring market pressure to bear on the provider?
- Have we assessed the scope for establishing trading companies or entering partnerships with other commissioners to stimulate the market?
- What do we do with partners to shape regional markets?

Does my council have sufficient understanding of relevant markets to use competition and contestability effectively?

- How do we ensure that relevant members of staff have enough knowledge of the market to understand the potential of competitive processes?

- What information was available during the most recent commissioning exercises about the number, size and strategies of providers in the market? How was it used to influence the commissioning decision?

Does my council have sufficient understanding of past, present and potential performance to use competition and contestability effectively?

- How well are current levels of performance and costs understood when commissioning services?
- How do we assess expected performance and costs under different delivery options?
- How are management costs accounted for when comparing different commissioning and service delivery options? What influence has this had on recent commissioning decisions?
- How do we assess whether competition and contestability has led to service improvements and / or cost reductions?

Appendix 4 – Mindset temperature gauge

The gauge can be used to:

- help senior officers better understand whether relevant individuals in the council have the right mindset; and
- test for any difference in views between different groups within the council.

Mindset	Too cold		Too hot
To what extent do we expose [failing] incumbent providers to competition?	We do not want to expose current providers to competition	We expose providers to competition where we feel competition can help deliver better services	We are exposing services to competition without regard for other improvement options
What would we do if the market became monopolised?	We would automatically bring the service in-house at the end of the contract	We would seek to develop alternative supply to ensure contestability, and commission the best option	We would be content with commissioning the monopolist to deliver the service
How do we see the role of the private sector in public service delivery?	We think that generally the public sector provides better value for money in all circumstances	We are happy to use private sector providers, so long as we are satisfied this is the best option	We think that generally the private sector provides better value for money in all circumstances
What do we see as the likely benefits of competition and contestability?	Competition and contestability can not be used to reduce costs or improve services	Competition and contestability can reduce costs and improve services when appropriate	Competition and contestability can always be used to reduce costs or improve services
What action do we take on market shaping?	We only ever use in-house services, therefore do not worry about the shape of the market	We understand the markets, and play a role in shaping these where necessary	The council should not be involved in shaping markets – we leave markets to themselves

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