National Audit Office

Report
by the Comptroller
and Auditor General

Principles Paper: Managing provider failure

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Summary

About this paper

1 Many organisations provide public services, and sometimes these organisations fail. The failure of a provider is not necessarily something that should be avoided at all costs. It can be the necessary price of innovation or come from effective competition, keenly priced contracts and robust contract management. However, the failure of a provider can have serious consequences and departments must manage failure effectively, in order to ensure continuity of services, and to protect the interests of people who use them. Our experience of auditing government over many years suggests that the way failure of providers is considered and managed leaves room for improvement. This paper draws together common findings from our work, to assist departments in meeting this challenge.

2 Managing the failure of a provider can be difficult. Departments may at times need to move quickly to respond to changing external pressures or new ministerial priorities. However, departments will be best placed to minimise negative impacts if they have planned how they would respond to a failure. Planning should start with deciding how a public service will be provided – by a public sector body, through a contract, via a market or by another approach, which should be informed by how much risk of failure a department is willing to tolerate.

3 It can be very difficult to decide how much risk to transfer to providers, and how such risk transfers will work in reality, given that the department retains ultimate responsibility for providing a service. We have seen many instances where departments believed that in contracting out services they had transferred the risks to the provider through financial penalties. But when a contract fails the provider can walk away, and government cannot. Departments have to recognise this position and refine their judgements on these and many other issues as they proceed.

4 There can also be a difference between a department's stated and revealed appetite for the failure of a provider. For example, market mechanisms and payment by results can seem significantly more politically attractive when they are introduced (and offer the potential for lower costs and improved outcomes through competition) than when they result in providers leaving the market. Failure regimes have often been established, but we have observed very few occasions when government allowed providers to actually fail. This change in risk appetite can be exacerbated by the 24 hour news cycle and the role of social media, which provide both an opportunity for departments to access unfiltered public feedback on a provider, and a challenge as failures unfold quickly and publicly, generating demands for instant action in complex situations.

5 In our experience, departments are very rarely able to specify at the beginning of a programme everything that they will require over its lifetime. There are practical steps departments can take to increase the flexibility they have to introduce changes, but these will come at a cost. In the past, we have seen departments jeopardise value for money by entering into long term but inflexible agreements, which need to be revisited part way through at significantly increased cost.

6 We have also observed that government has a poor record of learning from past failures. Departments face similar issues and often make similar mistakes in designing failure regimes. We have identified, over a number of reports, the need for government to take a more coordinated approach to learning about delivery models and this is especially true when thinking about this topic.

7 This principles paper draws on a review of our previous work, a wide ranging literature review and interviews with stakeholders across the private, public and third sectors. It sets out principles departments should consider when planning for and managing failure. We have included case studies to show how applying these principles can either assist departments in attaining ministerial objectives or, if they fail to apply them, lead to failing to achieve those objectives and reputational damage. Badly managed failure can discredit particular models of providing public services. It can also harm the users' interests, either because they experience a break in services or anxiety about losing their service. **Figure 1** overleaf sets out the structure of the rest of this paper.

Figure 1
Report structure

	Elements of the definition
Provider failure definition (Part One)	Providers Organisations that provide services to or on behalf of government departments. They can come from any sector. Failure Any situation requiring intervention above and beyond normal performance management.
Our principles	
Strategy and Planning (Part Two)	**Understand the appetite for failure**: departments should consider the potential impact of a provider failure and decide their appetite for it. They may wish to consider a range of factors including the impact of failure on users and the reliance of their delivery mechanism on individual providers. The appetite for failure may be high, for example where they are using market mechanisms where users choose providers and there are many alternative providers. It may be low, such as where the department co-produces with a provider and shares the financial or reputational risks. **Plan a delivery model which aligns to the appetite for failure**: departments should select a delivery model that aligns with their appetite for failure. **Plan for how to respond in the event of a provider failure**: departments should have a sufficiently detailed plan for how they would respond if a provider should fail.
Measurement and Implementation (Part Three)	**Put in place appropriate oversight to monitor providers, proportionate to risk appetite**: departments should establish and use appropriate arrangements to detect failure and early warnings of it. **Agree with providers and service users what constitutes failure and its consequences:** departments should establish a shared understanding with providers (and service users) about what constitutes failure, to make it easier to identify. Departments should also consider how far transparency about what will happen in the event of a failure will encourage positive behaviour, and how far it will enable providers to 'game' the system. **Balance the need to be consistent with the need to respond to individual circumstances**: when a provider fails, departments should weigh the risks of the 'moral hazard' arising from a rescue of a failing provider, against the risks that that failure involves. Departments should consider how far their risk appetite has changed since they planned for failure: for example as user vulnerability changes.
Evaluation and Feedback (Part Four)	**Assess the ways in which the response to a failure has affected the perception of the appetite for failure and therefore the incentives operating upon providers**. When a department acts it will reveal some of its appetite for failure. If the response has created moral hazard, then the department will need to take steps to ensure that it manages that risk in the future. **Reconsider the health of their providers**: after a failure departments should try to identify whether the failure of a provider is an individual instance or a pervasive issue. **Share lessons about failure within and outside the department**: government as a whole needs to learn from each major instance of provider failure.

Source: National Audit Office analysis