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Department of Health

The franchising of Hinchingbrooke Health Care NHS Trust

Key facts

£38m

was the size of the Trust's historic deficit as at 31 March 2012

£311m

is the saving Circle projects it will achieve over the ten-year life of the franchise

£31m

is Circle's projected franchise fee over the ten-year life of the franchise (excluding any performance payments or deductions)

£107 million	was the annual income of the Trust in 2011-12
£0	is the amount Circle will earn over the ten-year life of the franchise, unless the Trust achieves a surplus under its management
£5 million	is the amount of additional capital Circle has at risk if the Trust makes a deficit under its management
£9.9 million	is the current cost improvement plan target for the first year of the contract, which is greater than the £5 million savings anticipated in the bid
160,000	is the size of the local population served by the Trust
1,674	staff are employed by the Trust, as at 31 March 2012
£39.8 million	of working capital (cash) was given to the Trust by the Department in the form of public dividend capital between 2006 and 2008

Summary

1 Hinchingbrooke Health Care NHS Trust (the Trust) is a small district general hospital in Cambridgeshire with an annual income in 2011-12 of £107 million. The Trust has suffered financial difficulties and, between 2004-05 and 2007-08, developed a cumulative deficit of £39 million on an annual income of around £73 million.

2 Between 2006 and 2008, the Department of Health (the Department) gave the Trust around £40 million in working capital to support its cash position while it attempted to return to in-year financial balance. However, the Trust's financial recovery plans were unsuccessful and it required non-recurrent support from its main commissioner, NHS Cambridgeshire, and the NHS East of England Strategic Health Authority (the Authority) to achieve in-year financial balance and to prevent the deficit from increasing further.

3 In 2007, the Department gave the Authority approval to explore options to implement a new management structure at the Trust, to make it financially sustainable and repay its cumulative deficit. In July 2009, after a public consultation and review by the Department, the Authority obtained approval from the Department to seek a partner to run the Trust as an operating franchise. The Authority invited NHS organisations, private companies and the third sector to bid. In November 2011, the Authority awarded a ten-year operating franchise to Circle, a private company. The key events leading up to the award of the franchise are set out in **Figure 1** overleaf.

4 An operating franchise is an innovative approach to running an NHS hospital and Circle is the first private company to have the management functions of an NHS Trust transferred to it. This report assesses how the Authority designed, initiated and managed the project to franchise the Trust. The report is in three parts:

- **Deciding to franchise the Trust:** When undertaking a project, public sector organisations should understand a range of options and be satisfied that the option selected best meets its strategic objectives.
- **Selecting the franchisee:** Before committing to a project, organisations should undertake a range of tests and processes to ensure that the project is fit for purpose.
- **Managing the franchise agreement:** Good contract management enables organisations to address change and unexpected circumstances.

5 The Trust is the first NHS trust to be run as an operating franchise. The Department, however, is also considering whether to give approval for the franchising option to be pursued for the George Eliot Hospital in Nuneaton and other NHS trusts are working with their strategic health authorities to consider whether to seek approval to procure a franchise partner. This report highlights early lessons that can be learnt from the procurement process and creation of the franchise agreement with Circle.

Figure 1
Key events in franchising the Trust

2003-04 to 2007-08

The Trust's small cumulative deficit of £263,000 grows to £39 million within the space of four years due to a series of management errors including: payment by results submission inaccuracies; and miscalculating the demand for a new private finance initiative treatment centre.

Summer 2006

The Trust begins developing financial recovery plans, but these prove to be unsuccessful and do not deliver the savings expected.

February to June 2007

NHS Cambridgeshire holds a public consultation on options for reconfiguring the Trust's services with the aim of making them financially sustainable. The chosen option is to provide the same range of services, but at lower volumes and with a new management structure.

July 2007

The Department gives the Authority approval to start the process of finding a new partner to run the Trust's services.

April 2008

Following an appraisal of the available options, the Authority decides to seek a partner to run the Trust as an operating franchise.

April to May 2008

The Authority's board endorses the outline business case for an operating franchise and it is submitted to the Department for approval.

March 2009

The Trust returns to in-year financial balance.

July 2009

The Department approves the outline business case.

October to December 2009

Advert seeking a partner to run the Trust as an operating franchise is published. Bids are invited from NHS organisations, private companies and the third sector.

November 2010

The Authority identifies a private company, Circle, as preferred bidder following an open competition. A full business case is submitted to the Department for approval.

November 2011

The Department, following consultation with HM Treasury, approves the Authority's full business case for the operating franchise.

November 2011

The Authority awards the franchise to Circle.

February 2012

Circle takes full operational control of the Trust.

March 2012

The Trust breaks even in 2011-12 but only with support from the Authority and NHS Cambridgeshire. The Trust is estimated to have an underlying deficit of £3 million to £4 million.

Source: National Audit Office

Key findings

6 **The Authority's outline business case considered various options for implementing a new management structure at the Trust.** The Authority shortlisted six options, assessed them against clearly stated criteria and monetised all options; including a 'do nothing' baseline option. The Authority considered some innovative options. However, as some of these options had not been tried before in the NHS it meant that there were a number of uncertainties and the Authority had to use a range of assumptions that were not directly informed by previous experience to develop the business case. The Authority clearly identified these uncertainties, and made adjustments for risk, but the assumptions were not made subject to independent or external challenge, beyond the project team or project board. The project board included representatives from the Department, primary care trust, Trust and the Authority.

7 **The Authority assessed financial risk in a limited way, when evaluating bidders' proposals.** The Authority compared the two final bids, from Circle and Serco, against how much of any annual surplus the Trust would retain, to pay off its cumulative deficit. The Authority incentivised bidders to include guaranteed payments by double-weighting these in the financial assessment but made no other adjustments to bidders' projected savings to account for risk. This approach may have encouraged bidders to make overly optimistic savings projections, and was in contrast to the risk adjustment applied to the trust comparator.

8 **The Authority selected the bid that allowed the Trust to pay off the entire cumulative deficit, rather than the bid with a guaranteed payment.** The two bidders, Circle and Serco, proposed very different payment schemes. Serco guaranteed a payment of £11.5 million in the first year of the franchise but required the Trust to achieve greater surpluses before it shared any further profits. This reduced the chance of the cumulative deficit being repaid in full. Circle did not guarantee any repayments but proposed a scheme that could pay off the whole deficit if all of its savings proposals were realised. The Authority selected Circle as its preferred bidder.

9 **The franchise agreement transfers demand risk and up to £5 million of financial risk to Circle.** The franchise fully transfers demand risk to Circle as there are no guarantees over future activity levels. The franchise also transfers a good degree of financial risk as Circle is only paid if the Trust generates an in-year surplus. If the Trust generates a deficit, Circle must cover up to £5 million of the shortfall from its own resources. If the deficit exceeds £5 million either Circle or the Trust board, with the Authority's approval, can terminate the agreement. Alternatively, Circle can input more cash if all parties agree to continue. Circle also had to put £2 million into a security deposit account for the Authority to re-tender the franchise, in the event of termination. The Authority's total liability if it terminates the agreement for reasons other than franchisee default or full repayment of the cumulative deficit is capped at £10 million.

10 Circle's projected savings of £311 million over ten years are unprecedented as a percentage of annual turnover in the NHS. If delivered, Circle's proposal will make savings of over 5 per cent recurrently each year over the ten-year life of the contract. An essential element of the projected savings is an assumed annual 4.3 per cent efficiency saving from year four onwards. However, Circle's bid did not fully specify how it would achieve these savings. If Circle achieves the savings set out in its bid it will receive a franchise fee of around £31 million over ten years (excluding performance bonuses or deductions of up to 10 per cent a year). No fee is payable if a surplus isn't achieved. If successful, Circle will have achieved in-year surpluses at a far higher level than the Trust has been able to deliver over the last decade; the greatest of which was £0.6 million.

11 Twelve months passed between the Authority naming Circle as the preferred bidder and the signing of the franchise agreement. After the Authority announced its preferred bidder in November 2010, the Department and HM Treasury reviewed the project. The reviews focused on value for money for taxpayers, accountability and governance. The franchise agreement was signed in November 2011. The Department and HM Treasury have stated that the primary reason for the review process taking 12 months was the novel and potentially contentious nature of the proposal. The Trust has stated that the length of time taken to complete the review process hindered its ability to appoint permanent staff, which has had an impact on its financial position.

12 The governance, risk management and performance management arrangements for the franchise agreement are still being put into operation. The agreement refers to governance, risk management and performance management arrangements outside those stipulated in the NHS standard acute contract. As the contract progresses, the Trust board and Circle are seeking to clarify and strengthen these areas to better oversee the franchise. For example, the key performance indicators for the franchise focus only on patient satisfaction and annual workforce metrics, such as staff sickness absence rates. Over and above the requirement for all trusts to have in place a board assurance framework and corporate risk register, the Trust board agreed to develop a franchise management risk register to reflect the risks associated with the Trust board discharging its reserved powers even though the franchise agreement does not explicitly require the Trust board or Circle to have one. The franchise manager has now developed a risk register for the Trust board to use. The franchise manager is also working to agree a broader range of key performance indicators with Circle to enable the Trust board to review performance monthly.

13 The franchise aims are clearly stated in the franchise agreement, but stakeholders have contrasting views on what would constitute success and it is unclear how progress will be reported. The agreement states that Circle should aim to provide high quality clinical services and generate an annual surplus each year. If it generates an annual surplus as planned, the Trust will have achieved recurrent financial balance and the cumulative deficit will be paid by the end of the agreement. This goal is consistent with the aims stated by the Authority throughout the bidding process.

However, the Department, Circle, Trust board and HM Treasury, have different views on what would be a successful outcome and it is unclear how success will be measured. For example, some expressed a view that the cumulative deficit did not need to be repaid either fully, or partly, for the franchise to be considered a success. It is also unclear who will report progress, whether it will be reported publicly, and against which indicators.

14 **The Trust has improved in some areas of clinical performance but there are a number of immediate financial challenges to address.** The Trust's performance against accident and emergency, and cancer waiting times standards has improved since the franchise began in February 2012. By the end of September 2012, however, the Trust had generated an in-year deficit of £4.1 million, which was £2.2 million higher than Circle's financial plan to that point. Circle is expected to deliver £9.9 million savings in year one which is greater than the £5 million savings anticipated in its bid due to the Trust starting 2012-13 with an estimated underlying deficit of between £3 million and £4 million. This additional financial risk has been passed to Circle.

15 **Other NHS trusts are considering entering into franchise agreements before the outcomes of the project can be assessed.** Hinchingbrooke is the first NHS Trust to be run as an operating franchise. This approach is untested in the NHS and it is too early for the outcomes of the franchise agreement to be properly established and understood. However, other NHS trusts in the foundation trust pipeline are working with their strategic health authorities to consider the applicability of a franchise model.

Conclusion on value for money

16 In considering value for money, we should bear in mind that the Trust has been in financial difficulty for some time, and it was therefore reasonable to look to more radical options to turn things round. The Authority carried out a strategic evaluation of these options before opting for an operating franchise.

17 However, we have concerns about the winning bid for the franchise because most of the projected savings occur in the later years of the contract, and about how the risks associated with this were taken into account in the contract award decision.

18 If the contract goes well, it can deliver value for money, but it will need alert management by the Authority and the Trust board to monitor performance and intervene as necessary.

Recommendations

a **When assessing future savings schemes the procuring authority needs to apply consistent risk adjustments so that bidders are treated equally and that only realistic savings opportunities are considered.** The Authority let bidders risk adjust their own proposals, which means it cannot be sure it compared like with like when selecting its preferred bidder.

b **If further NHS franchises are to be let, the Department should establish which body is best placed to develop standard terms and conditions and ensure that they are developed to help minimise the length of time and costs of future procurements.** The Department and the Treasury took 12 months to approve the full business case for the franchise.

c **The Authority should ensure that the project's measures of success are clear to all stakeholders.** Our discussions with stakeholders highlighted various views of what would represent a successful outcome for the franchise. For example, there was a lack of agreement over whether it is necessary for the cumulative deficit to be repaid.

d **Public communication on the franchisee's performance should be balanced and based on a comprehensive set of indicators, covering clinical and financial performance, agreed between the Trust board and Circle.** Communication by the Trust board and Circle has focused on progress against measures of performance such as waiting times standards. However, it has not mentioned other important areas of performance such as financial progress.

e **The Authority should work with the Department to undertake a formal lessons learned process before agreeing any further franchise agreements.** The franchise for the Trust is the first of its kind in the NHS and it is important that future contracts are improved, based on lessons from the procurement process and early operational experience.