NSW Government Commissioning and Contestability Practice Guide

November 2016

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1 Purpose of the Practice Guide

The NSW Government Commissioning and Contestability Practice Guide (Practice Guide) has been developed to provide practitioners with a flexible guide to implementing the NSW Government Commissioning and Contestability Policy (Policy).

The Practice Guide provides the foundations for a consistent understanding of commissioning and contestability, and the key steps and considerations involved when commissioning and contesting services.

The Practice Guide is designed to support commissioning and contestability and not prescribe an exhaustive and fixed set of steps and processes. It will evolve as the needs of practitioners change and capability matures across the sector.

1.1 Guiding principles

The NSW Government has adopted the following principles to guide commissioning of services:

- commissioning of services should focus on improving outcomes and delivering quality services, regardless of organisational boundaries and constraints
- Government must act in the interest customers and the community by putting them at the centre, with greater attention to the integration of services and an improved end-user experience
- productivity, quality and efficiency benefits should be shared with the customer through service improvements as well as being reinvested in Government priorities
- effective commissioning will clearly define and prudently manage delivery and financial risk
- commissioning will encourage innovation and an openness to more diverse service delivery models in the public, private and not-for-profit sectors. These models should be flexible, reflect the needs of the customer and recognise the limitations of certain markets
- contestability allows Government to challenge existing providers to deliver service outcomes within agreed resources
- agencies should consider their role as policy-maker, commissioner, regulator and provider, and whether a separation of roles would benefit within the service design.

1.2 Applying the Commissioning and Contestability Policy

The NSW Government Commissioning and Contestability Policy (and Practice Guide) applies to all NSW Government agencies, and is to be used in the following situations:

- in developing new service delivery policies and proposals, or when service delivery policies undergo significant review
- when undertaking portfolio or service delivery reviews
- where commissioning and contesting services impact annual and mid-year budget submissions
- when undertaking strategic planning and whole-of-agency and/or cross-agency organisational redesign

- prior to executing major contracts that bind Government for long contract periods, to ensure they are as contestable as possible
- in determining service continuity arrangements prior to the end of major contracts, particularly when the contract and industry is affected by innovation e.g. technology.

Government agencies are expected to consider commissioning and contestability in the context of service delivery improvement, and provide Cabinet and the Expenditure Review Committee (ERC) with confidence that all service delivery policy and funding proposals have been developed in line with the NSW Government Commissioning and Contestability Policy.

The Policy is designed to be applied to commissioning and contesting services that fall within the remit of all NSW Government agencies. It is therefore to be applied to a wide range of Government services, recognising that there may be situations in which departure from the Policy is necessary with appropriate Treasurer, Treasury and/or Cabinet approval.

Other related policies and guidelines are contained at Appendix 1 of the Policy.

1.3 Commissioning and contestability business case governance

Where initiatives meet the threshold criteria for Business Case submissions (Treasury Circular 12/19), the Practice Guide must be adopted and applied in conjunction with the prescribed Business Case Guidelines and Investor Assurance Framework.

The following diagram sets out the relationship between operational funding, business case development and the NSW Government Commissoning and Contestability Policy.

Figure 1 - Relationship of existing guidelines and the Policy

2 Applying commissioning and contestability

This section sets out the practical definitions and uses of commissioning and contestability as they are intended for practitioners. This will help Government agencies and other partners focus on ways of using commissioning and contestability to improve service outcomes.

2.1 Commissioning and contestability hierarchy

Commissioning and contestability require government to reconsider its role in service delivery. This can be done at the highest level, where government looks at its overall service responsibility, or for individual service lines. Agencies need to consider the context of their commissioning and contestability initiatives applying the following hierarchy:

1. **(a) Strategic commissioning** – involves determining the services the community needs, whether there is a role for government in providing these services, and then designing the best service delivery system. It usually requires careful reconsideration of agency funding arrangements to deliver an integrated whole-of-government response.

   (b) Service commissioning - involves applying the design and governance principles of commissioning to a service, group of services or activities to create better service integration and community outcomes.

2. **Contestability** – used as part of commissioning when required, or standalone. Contestability can be applied in a number of situations, for example:

   - during the commissioning process where opportunities for improved outcomes through user choice and contestability have been identified
   - where deep markets that are proven to deliver more effective and efficient results already exist for services
   - when renewing a contract with a service provider.
   - when renewing a contract with a non-government service provider.

2.2 When to apply commissioning

The following scenarios may trigger a commissioning approach, but should not limit the opportunity to identify other scenarios where a commissioning approach could be applied:

- when a defined outcome and funding envelope is identified without a specific process, model, or owner e.g. an announced government outcome that requires a new approach
- when there is a deterioration in a key community outcome, and current service delivery models need to change to meet needs
- when there is a fundamental shift in funding models and approach, which changes the role of government and how to best operate within a new service delivery environment e.g. National Disability Insurance Scheme (NDIS)
- to bridge the gap between service policy and delivery in order to improve service design and provide confidence in successful policy implementation

- a government agency may reconsider its overall service model, objective and role at any time, and use a commissioning approach to help design how it will be structured, governed and operated in the future.

A commissioning approach must be considered even if the service remains an uncontested government supply, as it focuses on better outcomes for the customer.

2.3 Applying a commissioning approach to program management

Traditional program delivery has been aligned with government funding and contract cycles including:

- outcomes for the specific customers the program is targeted towards
- predetermined service models
- a centrally determined set of program guidelines
- reporting measures that focus on outputs
- short term contracts procured via competitive tender
- contract monitoring against agreed service levels
- provision of services to clients that meet eligibility criteria.

Under a commissioning approach, agencies would work with customers and stakeholders to determine appropriate outcomes for programs, in order to achieve service objectives first, before considering their response. The most effective outcome may not result in the purchasing of additional services, but may require legislative or systemic change. It is envisaged that most high level service outcomes will require a suite of activities that include both internal and external responses.

Adopting a commissioning approach to program management would therefore:

- focus on broad outcome areas
- consider common outcomes, frameworks and measures
- consider a range of service responses that could include policy change, in-house provision or system redesign
- consider a wide range of provider and procurement options
- focus on achievement of outcomes rather than the process
- recognise diversity and that one size does not always fit all.

3 Commissioning process

This section provides agencies and practitioners with a 'how to' reference guide for the commissioning process and sets out the objectives and considerations for each step. The application of the commissioning process should be considered within the context and nature of the service that is being looked at.

There are many models used to describe the process of commissioning, but all share fundamental activities including:

- a needs assessment
- defining objectives and desired outcomes
- research and analysis
- designing a response and testing it
- a plan for implementation and change
- measurement and evaluation.

The diagram below represents the commissioning and contestability process for NSW.

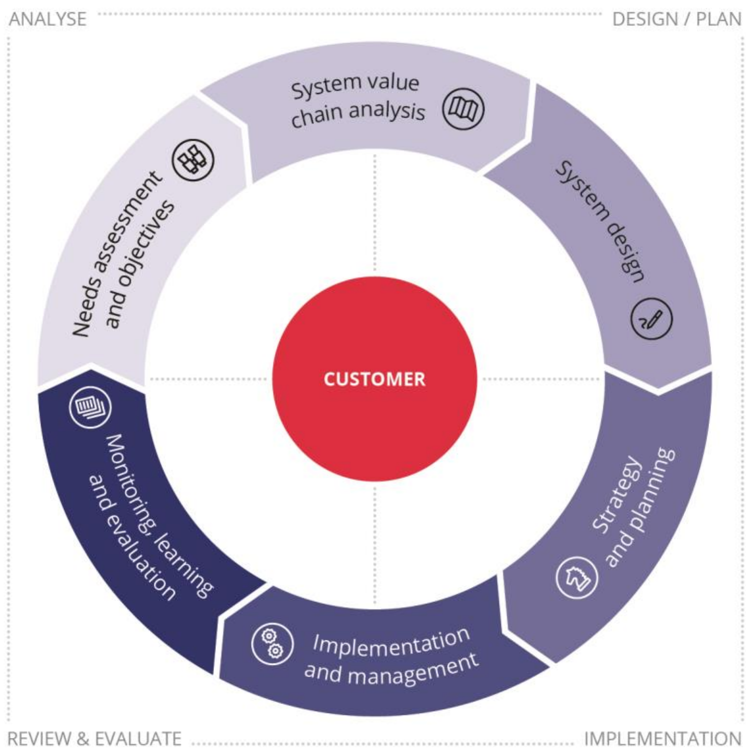

Figure 2- The Commissioning Process

Although the process is sequential in nature, practitioners must always reflect back to previous steps and make adjustments when new information changes the outcomes, benefit and/or design of the commissioning system. This is indicative of the iterative nature of commissioning, where more certainty is gained as the process progresses towards implementation, and a process of continuous improvement is applied to service delivery systems. The commissioning process incorporates contestability as an embedded practice.

The following table outlines key questions that need to be considered at each stage:

Table 1 - Commissioning stages and key questions

Stage	Key questions

Needs assessment and objectives	• What are the desired outcomes, individual and system wide?
	• What are the service needs, inputs and controls?
	• Would user-choice improve the likelihood of achieving the desired outcome? Consider the characteristics of service users, including:
	  o capacity and willingness of users to exercise choice
	  o customer access to information including price and quality
	  o customer access to expertise
	  o need for a specific customer protection framework.
	• What are the current and future population needs, behaviours and expectations?
	• Has a mandate been obtained to proceed with further analysis and investment?
	• Is a business case required?

System value chain analysis	• What goes into generating the outcome and what is it influenced by?
	• What are the characteristics of the value chain and the component services? With the customer in mind, ask:
	  o What are the most effective service models that improve outcomes? Consider:
	    - the target customer group
	    - the desired outcomes for this group
	    - what robust evidence is there for the services and other interventions that most effectively improve outcomes
	    - how these compare to existing service models and contracts.
	  o What are the supply characteristics? Consider:
	    - provider and market maturity, including market depth and breadth
	    - risks associated with service continuity
	    - whether there are capacity constraints
	    - barriers to service providers adapting to a different service model e.g. provider willingness to enter the service delivery system due to high entry costs or certainty of future demand
	    - location of supply e.g. rural and remote locations
	    - extent to which government specifications for service delivery are prescriptive.
	  o What are the transaction characteristics? Consider:
	    - the nature of relationships between the service providers and users
	    - whether they are repeat or one-off transactions

<table>
<tr><th>Stage</th><th>Key questions</th></tr>
<tr><td></td><td>
- whether services are currently bundled
- the complexity of the needs to be serviced and certainty of outcome
- costs of switching providers faced by service users.
</td></tr>
<tr><td>System design</td><td>
• What would a fresh market design that better achieves outcomes look like, knowing what we know?
• What are the service characteristics? Consider:
o Demand side perspective:
- What arrangements need to be in place to ensure that service users can exercise informed choice, wherever possible?
- What is the default option for users who do not have capacity to make informed choice?
o Service-wide perspective:
- Can a new service delivery model build on the existing community organisations and volunteers, and involve co-design?
- Can services be bundled to ensure a holistic response to user needs?
- Can making any of the services or bundles contestable make a difference to achieving the desired outcome?
- What rules and incentives are required to promote a more cost effective level and mix of services, and discourage ineffective services?
o Supply side perspective. Where user-choice is not possible, the following supply side considerations will be particularly pertinent:
- Is there an opportunity to introduce competition within the value chain to determine if services could be made contestable to deliver better outcomes?
- What customer protection arrangements will be necessary to ensure outcomes?
- Are there arrangements that are, or can be, put in place to deal with provider failure, apart from direct government provision?
• What measures, including contracting arrangements, are necessary to avoid monopoly providers developing?
• What mechanisms, including outcomes-based contracting, can be used to ensure the desired outcomes for service users?
• Is competitive neutrality a consideration? i.e. is there a level playing field between private and public providers?
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<tr><td>Strategy and planning</td><td>
• How does the new design need to be implemented to achieve the desired outcome?
• What short, medium and long term strategies are needed to implement the system design and develop the market?
• What policy arrangements need to be in place or changed?
• What regulatory arrangements are already in place that may need to be amended or adhered to?
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Stage	Key questions
Implementation and management	• How will performance be managed and the service system adjusted for the duration of the commission? • What arrangements are required to effectively manage the transition of client cohorts, workforce, assets and other infrastructure (if required)? • How will industrial relations matters be addressed? • What arrangements are in place for providers to report on performance based outcomes, rather than processes or inputs?
Monitoring, learning and evaluation	• Is the reform effective i.e. is the commissioning process delivering the intended outcomes and what should be done once the commission expires? • Does the case for reform still exist? • Are the investments appropriately targeted and are the benefits being realised? • Is the system functioning effectively? • What are the key lessons learned, and how will these be shared?

The following section covers each of the stages in the commissioning process, broken down by:

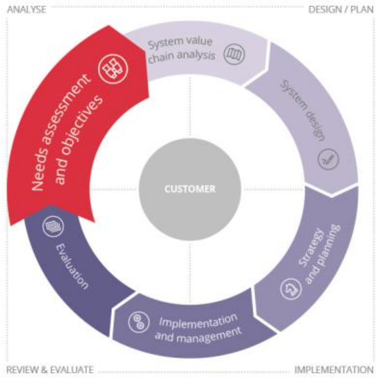
- purpose
- objectives
- considerations
- approvals, gates or decision points.

3.1 Needs assessment, objectives and outcomes

Needs assessment, objectives and outcomes

Purpose

To understand and define the problem you are trying to solve, the outcomes you want to achieve and who will be involved in solving it in order to establish a case for change and obtain a mandate to proceed.



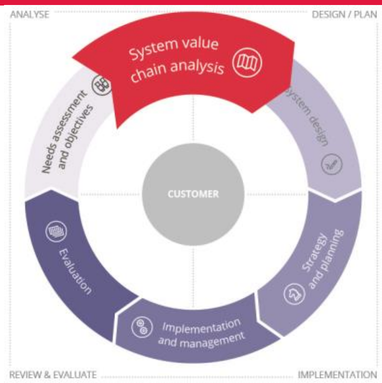
Objectives	Considerations
Understand the problem and the outcomes that need to be achieved	• Undertake a customer assessment with consideration for: - need (what, who, where, how) - target groups and cohort(s) - usage patterns - trends and growth. • Consider customer capacity, willingness or ability to exercise user-choice, and the impact of user-choice on achieving outcomes. • Consider how outcomes will be measured. • Methods may include root cause and problem analysis, statistical analysis including demographic and geographic analysis, surveys, user experience studies and direct community engagement.
Understand the customer and community's needs from the service, and drivers that will influence use	• Identify the need for information and how that will influence use of the service. • Consider how access to funding may impact on service use. • Consider customer needs and usage drivers from a behavioural economics perspective.
Understand alternative models of service delivery in other jurisdictions, or emerging models	• Research and identify alternative models of service delivery that exist or are emerging in other jurisdictions. • Analyse and compare viability of applying alternative models in the current context. • If needed, consider the engagement and contracting model opportunities within the commissioning environment that may influence the outcomes e.g. contracting for outcomes, general purchaser provider contracts.

Needs assessment, objectives and outcomes	
Understand the dependencies, linkages and key influences that may affect achieving the outcomes. This may influence other services	• Identify key stakeholders and their roles and objectives, including inter-agency interactions, responsibilities and their contribution to service outcomes. • Identify the role of government and other proponents in the commissioning system i.e. policy-setter, funder, regulator, provider.
Obtain approval to proceed	• Establish interim commissioning project governance. • Establish a case for change that demonstrates the high-level objectives, opportunities, benefits and risks associated with pursuing change. • Prepare a project charter/mandate seeking the approval and resources to investigate further.

Approvals/Gates/Decision points
• Executive approval to proceed

3.2 System value chain analysis

System value chain analysis



Purpose

To understand the component services within the value chain, performance characteristics and influencing factors in order to help build a 'straw-man' commissioning design. This is an opportunity to rethink the model of delivery by assessing "what is possible" unconstrained by historical practice, funding and policy.

Objectives	Considerations
Understand the customer journey and the elements that contribute to improved outcomes	• Understand the customer cohort and target population. • Map the customer journey and contact points with existing or planned services, not limited by agency boundaries. • Assess customer requirement by service type, volume, location and performance. • Undertake a risk and impact assessment on services/outcomes/ delivery options. • Consider diversity factors within the customer base, e.g. ability to make informed decisions, availability of local markets to support need and demographic attributes.
Understand the current delivery models	• Identify the components of the system value chain that directly contribute to the current service. • Conduct a detailed analysis of the current service delivery model. Methods may include cost benefit analysis, financial appraisal, service/business profiling and performance analysis. • Where assets are key to service delivery, consider accounting treatment and valuation processes as inputs to future value for money assessments. • Gather evidence of what works in the current model, with an emphasis on quality and cost effective interventions. • Define performance requirements, opportunities for improvement and new measures.

System value chain analysis

Understand in more detail contemporary service delivery model(s) and how they differ from the current model	• Conduct a detailed analysis of the proposed service model(s) from previous investigations. Methods may include cost benefit analysis and service profiling. • Benchmark the current services against services delivered under the alternate models(s). • Understand current and contemporary service channel options e.g. technology, front counter. • Understand diversity within the service model options including location, demography, accessibility, innovation. Consider overall customer, service and technology diversity, and if there is a potential need for a mixed approach.
Understand potential options for delivery of the commissioning system elements e.g. government, market, community/NGO opportunities	• Assess delivery options and staging options. Analysis should include existing service providers in an adjacent industry. • Benchmark the current services against alternate models and providers i.e. government, non-government, NGO. • Consider how options for delivery meet diversity needs.
Understand how the preferred service delivery model would perform	• Develop a 'strawman' model to test hypothesis and to sufficiently understand the opportunities for creating competition and contestability in the service chain. • Undertake a risk and impact assessment of the preferred delivery model(s) including assumptions and pre-conditions. • identify options and areas within the 'strawman' that need to be tested further. • Obtain points of view from customer, customer advocacy groups, industry and practice experts to validate feasibility. • Finalise risk assessment including impact of externalities. This will support future sensitivity analysis.

Approvals/Gates/Decision points

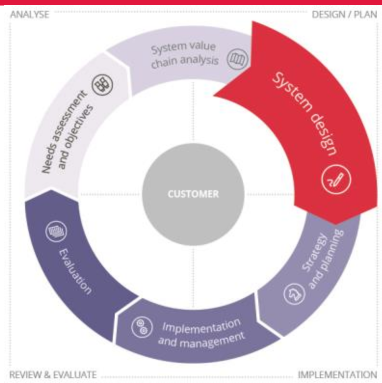
- Assessment against Treasury Circular 12/19 – Submission of Business Cases.

3.3 System design

System design

Purpose

Finalisation and validation of the commissioning design. At the end of this step, an agreed design that has been tested and validated is ready for broader consultation and approval. Assessment should include financial, operationalisation, customer preferences, risk and timing within an overarching value for money assessment. Impacts of market failure, non-compliance and regulation should be known to validate that the implementation is feasible. Contestability opportunities are identified and understood within the value chain to inform the market strategy to be implemented.



Objectives	Considerations
Design an integrated system to deliver the desired outcomes (commissioning design)	• Determine the component parts of the system design, its capacity and an appropriate funding approach. • Map the customer journey and contact points with existing or planned services. Don't limit scope by agency boundaries. • Understand each of the key elements in the system chain (upstream / downstream) and shape the system of supply, considering: - How relationships will be managed. - Who will have purchasing decision rights. - If funding should be open ended or capped. - How overall system performance and health will be monitored. - The management of system architecture and enabling environment. - Identify barriers to and opportunities for beneficial change. - Data collection and sharing in ways that enhance system performance and promote an effective learning system. - Innovation and technology impacting the commissioning system, including integrating technologies. - Any risks or opportunities presented by the geography of the service delivery area and any challenges presented by rural / remote locations or other diversity factors. (e.g. opportunities for cross-agency responses to create or develop markets in smaller geographic locations). • Identify information needs, considering: - How information will move within the system, including the use of technology to help inform providers, purchasers and customers on the performance of providers, the effectiveness of reforms, and the effectiveness of trials or

System design

	- pilot projects. - Embedding strong feedback loops to support learning by doing and driving ongoing process improvements. - Define customer support needs. • Define governance arrangements for the commissioning system. - Determine the role of government and other proponents in the commissioning system (i.e. policy-setter, funder, regulator, provider). - If government is a provider of service within the commissioning system, how to create segregation of responsibilities. - Define the government's and other parties' roles in the commissioning system and how to limit conflicts of interest. - Define the consumer protection framework (e.g. in the form of a regulator). - Assess regulatory impact on design and identify any uncertainties, including assessment of policy/legislative/competition risks/challenges/social consequences (intended or otherwise). - Articulate commissioning governance requirements and governance bodies relevant to controlling the commissioning system, including government appetite to provide system stewardship on an ongoing basis (regulate, monitor, operate). • Understand and manage potential impact on other government agencies (State, Commonwealth and Local) and any cost shifting impacts. • Define capability and capacity within organisational structures for managing the service delivery system including: organisational design, skills and capacity assessment, redesign.
Validate the service delivery options to provide reasonable certainty that the commissioning design is feasible	• Determine if the system value chain requires greater definition or redesign. • Investigate options for delivery within the detailed commissioning design e.g. government/non-government options and opportunities. • If opportunities are identified: - Identify options for contestability and alternate delivery models. - Undertake market testing and research, with consideration for testing market interest in assets (built or planned) that

System design	
	are related to the service. - Develop the contestability pathway for each elements within the commissioning design that will be made contestable. - Design service specification(s) including service description, performance and quality of service attributes, and hand over points. - Plan to help the public sector build the appropriate level of capabilities to support successful transition to any new service delivery models. • Adjust the commissioning design based on any variables identified in the contestability assessment.
Model the behaviour of the system to understand how it will react and the impact of achieving the intended outcomes	• Model system design performance, benchmarking against predicted and external comparators. • Complete sensitivity analysis i.e. if a parameter changes (volume, time, legislation etc.), assess how this would impact the behaviour of the model. • Determine if the inclusion of assets impacts financial modelling within the system design.
Prepare a recommended business model option, which demonstrates that the desired benefits and service outcomes can be achieved, a recommended pathway and, if relevant, a strategic procurement approach	• Define potential purchaser models and vehicles e.g. purchaser/provider, consumer driven (vouchers, bundling). • Undertake a value for money analysis, including assessment of the value proposition inherent in alternative models, with consideration for asset capital charges. • Undertake a business model options assessment e.g. retain and improve, franchise, commercialise, privatise, sell. • Undertake benefits mapping, including modelling to validate assumptions and demonstrate that benefits are achievable. • Prepare a strategic benefits map.

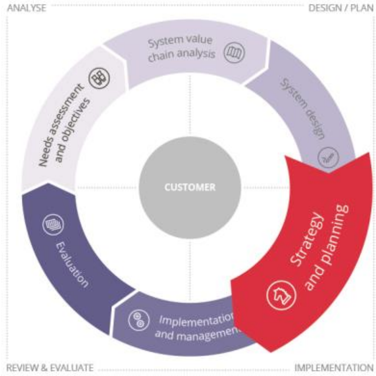
Approvals/Gates/Decision points

- Assessment against Treasury Circular 12/19 – Submission of Business Cases.
- ERC or Ministerial approval to authorise proposed recommendations, if needed.

3.4 Strategy and planning

Strategy and planning

Purpose
A commissioning strategy is developed articulating the services required, how the commissioner will shape supply, the timing of implementation, governance and overarching approach to commission and performance management with a clear articulation of outcomes and measures.



Objectives	Considerations
Develop an implementation strategy	• Determine the sequence of activities that need to be implemented, using tools like the benefits map. • Consider how diversity impacts the approach to implementation. • Determine the suitability of a progressive or 'big bang' approach to implementation. • Plan to decommission existing service elements that will become redundant. • Identify validation points that will track progress and success. • Determine the need for trial implementation(s) (note: multiple trials may need to be run if different models are adopted).
Establish a work breakdown structure for implementing the commissioning design	• Verify design components and market components and conduct further analysis (as needed). • Identify work packages and resources required for implementation including governance, organisational redesign, services, industrial relations, legislation and policy, etc. • Develop implementation sequence and timing for commissioning the design. • Manage deliverables and integration.
Establish a performance and benefits framework	• Using the model already developed for the design phase: - Develop a benefits realisation plan. - Establish a benefits and performance management framework, including performance indicators and the means of verification. • Develop a plan to implement the performance and benefits management framework.

Strategy and planning	
Build in contingency/risk mitigation to accommodate variations	• Conduct a risk assessment and validate the sensitivity analysis from the previous phase – for market and provider. • Adjust the model and expected benefits. • Establish risk mitigation requirements.
Plan to implement the contestability elements of the commissioning system, if required	• Define implementation strategies for contestability, taking into consideration timing, sequence and scope of all system components. This should include when/how services will be tested in the market, and how business model transition and the contestability process are aligned to this decision, if required. • Map out the implementation and change management approach and develop the project plan.
Plan to implement the policy, IR and regulatory change	• Determine the need for regulatory and policy change. • Commence drafting of regulatory and policy points that impact the commissioning system. • Assess whether additional regulatory requirements (e.g. procurement protection) are appropriate. • Ensure an industrial relations plan is in place, if required.
Undertake a commissioning system trial and validate the model, if part of the implementation strategy	• Test the commissioning system design through trial and evaluation. Adjust the design based on evaluation. • Reflect learnings back into design and review impact on benefits and outcomes.

Approvals/Gates/Decision points
• Assessment against Treasury Circular 12/19 – Submission of Business Cases. • For proposals that are predominately capital in nature: Gateway Policy including associated Infrastructure Investor Assurance Framework (IIAF). • For proposals that are predominately recurrent in nature: Gateway Policy and associated Investor Assurance for Major Recurrent (currently under development). • For proposals that are predominately ICT based in nature: Investor Assurance Framework (ICT IAF) (currently under development). • Seek procurement guidance, public private partnership (PPP) guidance. • Seek Cabinet /ERC approval to move to implementation, if required.

3.5 Implementation and management

Implementation and management

Purpose

Implementation covers the establishment of the commissioning system, management of its operation and adjustments to ensure that it operates and performs as intended. For contestability components of the system, this may simply be to retain and improve the business, through to market engagement, co-design, market creation, contracting and establishing an operating model.
It includes monitoring and reporting against KPIs defined for agreed outcomes, providers/suppliers issue resolution and improving system capability. Information collated will contribute to the evaluation process.

Objectives	Considerations
Establish commissioning system governance and manage overall implementation of commissioning system phases	• Manage specific project deliverables including the staged implementation of the commissioning system governance. • Identify and clarify interfaces and performance requirement. • Determine readiness for change using a risk management approach. • Establish a transition plan, including identifying resources required for service continuity. • Ensure there is sufficient availability of information in the system to inform customers, providers and the commissioner. This may require targeted communications plans to be implemented. • Manage industrial relations during implementation. • Implement legislative, regulatory and policy changes in alignment with governance changes. • Manage supply system integration. • Embed the changes as the new business-as-usual operating model. • Support system innovation to improve future capability. • Identify and share learning.
Implement contestability strategy, if required	• Implement contestability pathways for contestable components in the service design. • Execute market engagement and design. • Review results and confirm pathway - reflect back into commissioning design, outcomes, performance and benefits plans if there are any deviations. • Execute procurement and contracting as needed.

Implementation and management

Manage procurement, if required	• Procure specific components in the commissioning system. • If procurement is undertaken: - Work within the state procurement guidelines. - Consider probity requirements and controls. - Determine the method of approach to market and corresponding evaluation methodology (request for information / market sounding, request for tender, interactive bid, evaluation). - Determine contracting models and relationships, in particular where assets are involved in transaction. - Ensure a performance management framework is in place. • Plan and transition into operation and contract management and ensure that appropriate skills and capabilities are in place. • If an in-house bid is an option, ensure that sufficient probity measures are in place, and that sufficient resources are available to the in-house bid team so as to avoid negative impact on the quality of the bid. • Develop and execute communication and change management plans, including consideration of industrial relations requirements. • Ensure there is sufficient flexibility in any contract to allow for change. Consider including formal review points within the contract if a long term contract is being established. • Define the ongoing monitoring, measurement and management activities to track performance benefits; thereby reinforcing partnership with the market. • Define step-in mechanisms, i.e. what consequences are available to the contract manager (e.g. use of abatements).
Manage commissioning system	• Establish and monitor performance, including contracts. • Track outcomes and results. • Make adjustments to accommodate changes in conditions.

Approvals/Gates/Decision points

- Monitor and report within the commissioning system.

3.6 Monitoring, learning and evaluation

Monitoring, learning and evaluation

Purpose:
Continuous management of the service model including performance, regulation and realisation of benefits and outcomes. Make adjustment to performance agreements and services according to changes in service need. At expiry of term, consider if service requirements, market opportunity and customer needs have changed in order to decide on whether to renew, stop, recontest or recommission.

Objectives	Considerations
Evaluate and manage the outcomes and performance during operation	• Using the performance framework, measure outcomes and performance against performance criteria. • Make adjustments in the system as required. • Determine the impact of innovation on the operating commissioning system and contest components of the system as required. • Manage overall system integration to ensure end to end delivery and performance. • Manage relationships within the commissioning system • Manage regulatory compliance as required. • Prepare to execute mechanisms for step-in, in instances of failure or service threshold breach.
Adjust the system based on performance indicators	• Based on performance of contracts: - Adjust performance, design and specifications as needed. - Update benefits and performance framework. - Manage system of supply to management/contract agreements.
Determine what happens at the end of the commissioning terms (recontest/recommission/renew/cease at the end of the contract or service level agreement)	• Consider options before the operating period ends to allow time for evaluation and execution of alternative/renewal of current arrangement. • Before the end of contract and on the basis of performance, determine if: - The service objectives are still relevant. - The contract needs to be renewed as the target performance and service objectives have not

Monitoring, learning and evaluation	
	changed (market/opportunity remains consistent). - There is the possibility of improvements through competition and if value for money is questioned. - The commission strategy has materially changed and recommissioning is required. • Perform end of commission evaluation and assess the need for continuation, recommissioning or ceasing. • Evaluate the realisation of benefits and outcomes on an ongoing basis. This may be done at points beyond the commission or program delivery period.

Approvals/Gates/Decision points

- Assessment against Treasury Circular 12/19 – Submission of Business Cases.
- For proposals that are predominately capital in nature: Gateway Policy including associated Infrastructure Investor Assurance Framework (IIAF).
- For proposals that are predominately recurrent in nature: Gateway Policy and associated Investor Assurance for Major Recurrent (currently under development).
- For proposals that are predominately ICT based in nature: Investor Assurance Framework (ICT IAF) (currently under development).
- Assessment against NSW Government Program Evaluation Guidelines.

4 Commissioning and contestability considerations

The following section has been developed to provide support to practitioners in implementing the NSW Government Commissioning and Contestability Policy. It provides information about key concepts and considerations inherent to the commissioning and contestability process. The information provided is not exhaustive, and will be enhanced as agency requirements change. It has been developed with the input and at the request of agencies in support of the Policy and Practice Guide.

4.1 Understanding customer and user-choice

The concept of customer or user-choice plays an important role in commissioning and contestability processes[1]. Someone, whether the user, the commissioner or a third-party such as a regulator, must decide:

- which services a particular user can receive
- the price they will pay
- the subsidy they or the provider will receive from government.

There are many types of user-choice. Users can directly make decisions about the services they receive e.g. a person with a disability deciding which services best support their needs and which organisation is best to provide services to them e.g. choosing a residential aged care facility.

The user's choice may be assisted or facilitated through an agent or intermediary who is tasked with managing the user's preferences. In other cases, organisations or governments take the needs and preferences of the user into account when making decisions on the user's behalf.

To support informed user-choice, agencies as commissioners may need to facilitate the flow of information about services to the user and provide support to users to help them understand and act on that information. There are also circumstances when a user's capacity to exercise choice is explicitly removed (partially or fully), such as a court order to attend drug rehabilitation or while serving a custodial sentence in a correctional facility.

Agencies' commissioning approaches need to be tailored to incentivise competition in the market(s) and avoid reducing choice.

Informed choice can be enhanced or limited by a range of factors considered in the following table.

[1] Key source: Competition Policy Review Final Report (Harper Review) – March 2015

Table 2- Factors influencing informed choice

Factor	Consideration
User capacity to exercise choice	Some users will have less capacity to exercise choice, for example where they have complex or chronic needs or other vulnerabilities that impact their mental and emotional capacity to make decisions.
Availability of information	Users require sufficient information to make informed choices and there may be a role for government agencies to fill information gaps. In some cases there may be inherent information asymmetries or deficiencies that may be difficult or even impossible to fully overcome.
Geographic location	Lack of density in some locations may mean a more restricted market with less or no competition between services.
Matching markets / service types	The capacity of providers to meet the specific needs of potential customers, which may depend on the complexity of the service provided.
Service provider confidence to compete rather than withdraw in a contestable environment	Competition and contestability can provide incentives to deliver high-quality outcomes that respond to user demand. However, there can also be costs associated with increased competition and contestability if these are seen as a threat by existing providers, causing them to withdraw. The capacity of providers to remain in the market and compete may depend on provider capabilities (which government can help build), provider maturity, contractual arrangements (term of contract, performance, payment arrangements) and regulatory arrangements.
Market forces	The factors affecting the price of, demand for, and availability of a commodity or service.
Regulatory environment	Existing regulations can act as barriers for new entries into a market.
Switching costs	Users may face a number of barriers in switching between services after they have made an initial decision. In some cases these can be resolved through policy change (e.g. ensuring that switching does not lose a user's 'place in the queue'). In other cases there are inherent switching costs that may be more difficult to overcome (e.g. changing to a new aged care facility).
Government specifications on service delivery	Performance-based standards for service delivery provide more scope for innovation and product differentiation; however prescriptive standards limit the ability of providers to compete on price or quality.

4.2 Funding consideration for commissioning

Commissioning challenges how services are provided and outcomes are achieved. Government must reconsider how it funds and structures budgets to align with new service delivery models, and to leverage value from its investments.

Looking at alternative funding and payment models under a commissioning approach is fundamental because traditional bulk-funded services are, in some cases, not tailored to the specific service complexities and interdependencies. This can affect or limit outcomes that can be achieved. Key considerations when developing funding solutions within a commissioning system include:

- who in the commissioning system is best placed to hold and control funding, with the ability to make the most informed choice to generate the best outcome e.g. government (commissioner), provider, customer advocate or end user
- how could funding be better structured to encourage cross-agency collaboration e.g. through pooling of funds from multiple agencies
- how should funding be released to get the best performance and ensure desired outcomes are achieved e.g. performance bonus payments, payments by results, bulk payments, pre-payments, milestone payments or abatements
- whether there are alternative funding models available including private, federal, user-pays and inter-jurisdictional contributions e.g. social benefit bonds, Public Private Partnerships.

Two models of budgetary collaboration are predominantly described in the literature;

- aligned budgets
- pooled budgets.[2]

In aligned budgets, partners involved in funding a program agree to assign a part of their own budgets to support a common shared responsibility. In this way, each partner remains responsible and accountable for their funding contributions and control over their own budget.

Pooled funding is a type of budgetary collaboration where contributions from more than one source are spent in pursuit of a common objective, removing historical organisational funding barriers as a constraint. Pooled budgets can be governed in a number of different ways, including 'individualised budgets' allocated directly to clients.

[2] Integrated Public Service Budgets - Report of a Research Project; Raine, Watt, O'Donovan, Pritchard and Cattell.

Some of the factors affecting the preferred funding design are illustrated in the following diagram:

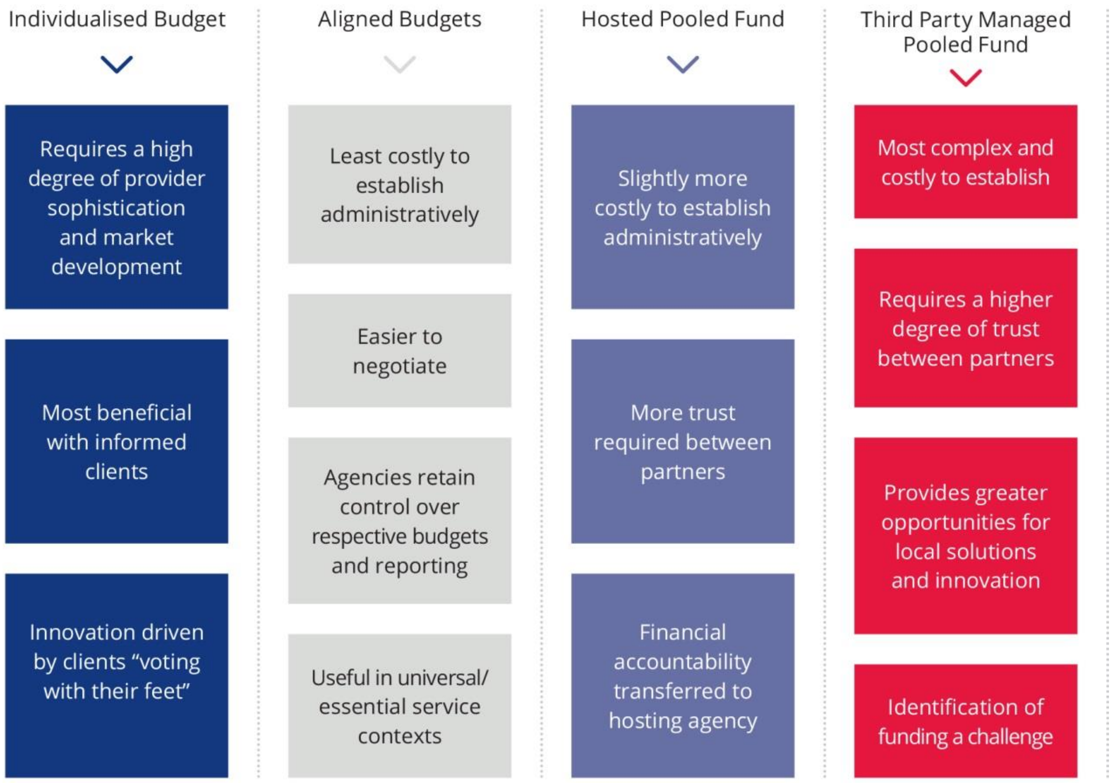


Figure 3 - Funding considerations

The benefits of pooled funding may include:

- achieving better outcomes for customers
- encouraging service innovations, through greater service model flexibility
- addressing problems that cannot be tackled by single organisations, through improved cooperation, coordination and integration
- achieving financial savings through better service prioritisation, integration efficiencies and reduced duplication
- empowering local ownership of solutions, with better acceptance and value from the community.

A pooled budget involves a greater degree of financial integration between partners. Pooling existing program funds is another approach, but will involve greater challenges in developing revised governance of the existing programs.

Decision-making on how to spend pooled budgets can be managed in a variety of ways, through:

- **individualised budgets -** where funds are allocated directly to customers, who become purchasers of whatever services they most need (controlled). This market-based approach is being used for the National Disability Insurance Scheme (NDIS)
- **hosting** approach - where one of the contributing partners takes lead responsibility for managing the pooled budget
- **third-party** approach - where an independent entity is made responsible for managing the pooled budget. This method is used for multi-donor trusts by the United Nations.

The precise design of pooled funding will depend on the specific needs and programs under consideration.

Case Study: Funding Considerations

Social Impact Investment

The NSW Social Impact Investment Policy (2015) is a whole-of-government policy jointly led by NSW Department of Premier and Cabinet and Treasury. Social Impact Investment (SII) offers an opportunity to bring together capital and expertise from the public, private and non-profit sectors to deliver better outcomes for the people of NSW. This includes sharing risks and returns between investors, service providers and government.

NSW Family and Community Services (FACS) in partnership with the private and community sectors, has developed two social benefit bonds (SBB) to deliver prevention and early intervention services.

The SII approach was favoured for its investment framework (shifting spend away from high cost acute services to prevention) and its focus on outcomes. It also differs from previous approaches as it involves the sharing of risks and benefits, sometimes, as for SBBs, through private investors providing up front funding for the prevention and early intervention programs.

Further reading: http://www.osii.nsw.gov.au/

(Source: Productivity Commission Inquiry into human services - NSW Government Submission July 2016)

4.3 Outcomes-based contracting

The following section describes the funding and contractual models applicable for outcomes-based contracting[3].

Funding and contractual models used for outcomes-based contracts vary across a number of dimensions, including:

- degree to which funding can be linked to inputs, output and outcomes or other measures
- prospective or retrospective funding
- length of contract
- scope of contract
- purchase model (e.g. broker, individualised entitlements)
- contractual governance model
- lead time for benefit or outcome to be measurable
- level of competition pursued.

These are described in more detail in the Table 3 following.

[3] Key source: Development of outcomes-based contracting for out of home care and other human services provision: health and human services summary report. NSW Government. Prepared by EY - October 2015

Table 3- Funding factors and considerations

Factor	Considerations
The degree to which funding is linked	Increments on historical funding; capitation-based funding linked to need-adjusted population serviced; funding for inputs used; funding for outputs delivered; funding for performance measures achieved; funding for intermediate outcomes achieved; funding for final outcomes achieved.
Prospective or retrospective funding	Prospective payment fixed; prospective payment varies on past performance retrospective adjustment to payment in advance for actual performance, retrospective payment in arrears.
Length of contract	Once-off fee for service; short-term; long-term.
Scope of contract	Contract for individual service; contract for pathway services; contract across a number of providers for a range of services (e.g. prime contractors or alliance contracts).
Purchaser of services	Agency on behalf of clients; broker assigned by agency on behalf of client; broker chosen by client or behalf of client; individual clients (using voucher, personal budget or entitlement).
Governance model	Transactional; relational contracting.
Lead-time for measurability	The timeframe from provision of service to realisation of benefit or measurability of outcome is key to establish a reasonable and workable contract for both parties.
Level of price competition	Price determined through bids in the market; maximum price set with provider able to make lower bids; fixed prices with bidding based on non-price factors.

There is no one model that should be used in all circumstances. As a result, the actual funding and contracting model needs to blend the various features appropriately, based on:

- the outcome sought
- the nature of the client and service
- maturity of the commissioners and provider market.

While there is no 'off the shelf' outcome-based contracting model, it will likely involve a degree of funding linked to the achievement of outcomes whether intermediate or final, and a degree of retrospective payment (or some other mechanism for sharing outcome risk).

The framework below provides a spectrum of funding and contracting models. The journey from left to right represents the transition from historic to outcome-based funding, and sets this on a continuum of market and commissioner maturity, defining the key features at each stage of transition. Mapped into this framework are a range of examples of contracting approaches drawn from case studies.

Table 4 - Funding and contracting approaches

	Block funding	Payment for inputs	Payment for outputs	Payment for performance	Payment for outcomes
Contract features	Payment lined to historic funding or needs based population serviced	Payment linked to resources (labour, material, facilities) used to deliver services	Payment linked to end products or services	Payment linked to intermediate outcomes i.e. short / medium outcomes that contribute to longer term benefits	Payments linked to intended impacts of service on customers and the community
	Prospective – to cover input costs	Prospective – to cover costs	Retrospective – payment contingent on achieving certain performance-based outputs	Retrospective – payment contingent on achieving certain performance-based outputs criteria	Retrospective – payment contingent on achieving outcomes
	Limited clawback KPIs included, but limited measurement requirements and limited mechanisms if not met		Price transparency. Some KPIs built into service specification		Price transparency
	Risk is with provider when payment does not vary with activity or demand	Risk allocated or shared on a demand basis but most likely to be with purchaser paying for varying volumes of input	Risk allocated or shared on a demand basis, e.g. purchaser risk if price varies with volume change	Providers might take more financial risk. Shared performance and reputational risk	Significant financial and performance risk transferred to providers. Shared reputational risk
	Loose to tight specification of service / activity	Tight specification of activity	Tight specification of results, flexibility to tailor solution	Tight specification of results, greater flexibility to tailor solution	Full flexibility in service provision (subject to minimum standards / regulations)

<table>
<tr><th></th><th colspan="4">Block funding</th><th colspan="4">Payment for inputs</th><th colspan="4">Payment for outputs</th><th colspan="4">Payment for performance</th><th colspan="4">Payment for outcomes</th></tr>
<tr><td rowspan="2">Provider requirements</td><td colspan="4">Mainly mission-driven NFPs</td><td colspan="4">Nix of NFPs and for profit</td><td colspan="4">Growing mix of providers</td><td colspan="4">Comprehensive mic of providers</td><td colspan="4">Mix of providers: NFPs, for profit, social ventures, partnerships</td></tr>
<tr><td colspan="4">Low requirements for commercial capital</td><td colspan="4">Efficiency-driven. Financial focus</td><td colspan="4">Performance-driven contracting. Greater commercial focus</td><td colspan="4">Performance-driven contracting.
Strong commercial focus</td><td colspan="4">Impact-driven</td></tr>
<tr><td rowspan="4">Commissioning / Regulatory feature</td><td colspan="4">Focus on activity / program / cost</td><td colspan="4">Focus on efficiency</td><td colspan="4">Focus on output performance measurement and efficiency</td><td colspan="4">Focus on performance measures leading to social outcomes</td><td colspan="4">Focus on outcomes and impact</td></tr>
<tr><td colspan="4">Low requirements for commercial capability (limited to policy)</td><td colspan="4">Investment in capacity and capability. Greater financial capability</td><td colspan="4">Commercial awareness. Greater use of payment for output performance to drive behaviour change</td><td colspan="4">High commercial awareness. Incentives are used to drive behaviour change</td><td colspan="4">High commercial awareness. Deep understanding of market responses and sensitivities. Sophisticated use of incentives</td></tr>
<tr><td colspan="5">Limited visibility of value for money. Limited visibility of impact</td><td colspan="5">Greater visibility of cost</td><td colspan="5">High visibility of cost and performance</td><td colspan="5">High visibility of cost, performance and impact</td></tr>
<tr><td colspan="5">Administrative management of payments</td><td colspan="5">Compliance-based contract management</td><td colspan="5">Collaborative contract management</td><td colspan="5">System stewardship</td></tr>
</table>

<table>
<tr><th></th><th colspan="2">Block funding</th><th colspan="2">Payment for inputs</th><th colspan="2">Payment for outputs</th><th colspan="2">Payment for performance</th><th colspan="2">Payment for outcomes</th></tr>
<tr><td rowspan="2">Market features</td><td colspan="2">Low requirements for competition</td><td colspan="2">Greater consolidation, evidence of supply chains. Some cost-based competition</td><td colspan="2">More complex supply chains. Potential for price-per-output based competition</td><td colspan="2">Complex and sophisticated supply chains. Potential for performance-based competition</td><td colspan="2">Mature, complex supply chains. Potential for outcome-based competition</td></tr>
<tr><td colspan="3">Independent financial review</td><td colspan="4">Independent review (performance and finance)</td><td colspan="3">Independent regulator and evaluation</td></tr>
<tr><td>Case studies</td><td colspan="2">Newquay Pathfinder (UK)</td><td colspan="2">OOHC in the UK
OOHC NSW (AUS)</td><td colspan="2">Whanau Ora (NZ)
Residential care in Illinois (US)</td><td colspan="2">Foster care in Illinois (US)

Work Programme (UK)
JSA (AUS)
Essex Social Impact Bond (UK)

OOHC in ACT (UK)</td><td colspan="2">London Homelessness Social Impact Bond (UK)

Workforce Investment Act (US)

Manchester Social Impact Bond (UK)

Benevolent society Social Benefit Bond (AUS)

Newpin Social Benefit Bond (AUS)</td></tr>
</table>

4.4 Market concepts

Understanding a market within a commissioning system[4]

The following diagram describes the main components of a market and commissioning system. It is important to understand the diagram in support of the material included in the following sections:

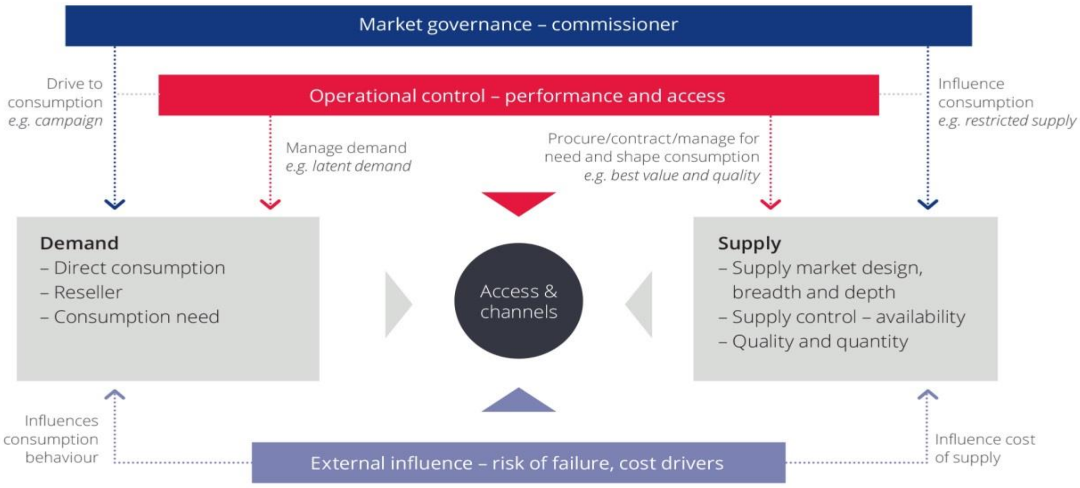


Figure 4 - Components of a market and commissioning system

Contestability requires the existence of, or the ability to create, open and contestable markets that are sustainable. Sustainability implies that the market displays certain attributes including:

- the existence of competition allowing the user or purchaser to have choice of provider
- limitations for monopolies to form
- existence of sufficient demand and ways for its management
- availability of funding supporting efficient cash-flow
- availability of information to support choice
- ability to protect the customer from service failure
- ability to make market adjustments.

4 Key Source: Deloitte - 2016

The following elements are important to understand in determining market maturity and whether further market development and design is needed or possible:

- market drivers – these are the forces that drive demand and trends that cause markets to develop and grow. Common examples include consumer demand, government policy and changes in technology
- future demand – demand forecasts would typically consider the historical growth in demand, a projection of growth under the existing delivery model, any changes in the delivery and the external market environment
- market capacity and capability – the ability of potential providers to meet the demand for different services in different locations
- barriers to entry – obstacles that prevent new competitors from easily entering a market e.g. asymmetric information, economies of scale, cost of entry, vertical integration, government regulation, uncertainty of demand
- market appetite – market capacity and capability are necessary but without sufficient incentives (financial, reputational, mission-driven) the market will not participate or will only do so at a high price
- barriers to exit – commissioners/customers need to be able to choose alternative providers and this means ensuring a way for existing providers to exit the market in an orderly way. Barriers to exit can include cost, large/non-transferable asset portfolios, disrupting long-standing provider/customer relationships
- effective regulation – there are two forms of regulation in any given market:
    i. regulation of providers to ensure compliance with standards
    ii. regulation of the market itself to ensure a level playing field, adherence to competition policy and law, and reduction in the risk of monopolistic behaviours.

Building and Influencing the market

Market building and influencing is about creating rules and structures through which commissioning and contestability participants operate in or interact. Market building and influencing should be considered when a decision is made to apply commissioning and contestability activities for delivery of specific services. It provides the agencies with options to influence the service provider landscape.

The desired outcome may differ depending on why these activities are being undertaken and the starting point could include:

- establishing a market with multiple providers
- creating the conditions for best practice to be adopted by providers in the market where appropriate
- enabling providers to run a viable service to meet customer needs
- encouraging national providers operating in adjacent markets to enter into a new market.

It will be important to consider the steps that need to be taken to ensure that the market has sufficient depth and diversity of providers over time. This may involve helping providers, especially smaller providers to build the necessary capabilities.

Barriers to entry can also be a potential sign of market failure. If it is identified that the market would be unable to respond to an opportunity for contestability over the medium term (i.e. could not respond to a government offer to contest for service delivery), market intervention may be required. A market intervention strategy and plan to address barriers to entry could be used to build the desired market. A number of interventions could be used and these can broadly be categorised as direct or indirect market participation. Examples are:

- regulatory changes
- subsidies
- funding arrangements
- provision of information
- direct participation in markets – this involves government acting as either a purchaser or supplier of goods in the market. This may involve the extension of an existing role, or the reconfiguration of government's role to support market development
- indirect participation in markets where government influences the behaviour of markets without acting as a specific market participant.

Intervention strategies can have unforeseen market consequences and will take time to come to fruition. It is critical that the impact of these strategies is monitored.

Keeping track of any unintended consequences of market interventions can minimise unnecessary economic costs. This should be looked at on an ongoing basis to track the market response to interventions. Potential outcomes might include:

- rectification of initial market failure
- unintended consequence and impact of interventions
- continued market failure.

Where there is continued market failure despite intervention, a review of the strategies employed and the terms of the service being offered for contestability should be undertaken with remedial action and removal of any distortions as needed.

Market Engagement

A critical aspect of the contestability lifecycle is market engagement. Some of the aims of market engagement are to:

- develop a long term strategic view of the market and whether greater competition could lead to service delivery improvement
- analyse and explore the current and potential service providers, and their capabilities/capacity to meet current and forecasted customer needs

- test options with the market including public, private and NGO sectors on how a market may be developed to deliver benefits
- identify and/or distinguish components of overall service value chains that have the potential to be market tested recognising interdependencies
- validate market interest and investigate whether the current scope of service and delivery models are attractive propositions or could be changed to improve service delivery outcomes and interest.

The possible methods of market engagement, both formal and informal are defined below. Blending and timing of these activities will be dependent on the specific service and opportunity, and can be applied flexibly across the steps of the lifecycle.

- informal market engagement activities include:
    - strategic working groups
    - market building and influencing
    - joint research and innovation
    - market input into solution design
    - market scan.
- structured market engagement activities include:
    - market sounding
    - market testing/assessment.
- formal market engagement activities include:
    - formal tender and selection
    - contract negotiations and management.

Latent Demand

Latent demand refers to a customer's expectation, desire or preference for a service, which currently goes unsatisfied because these services are not available or difficult to access. Latent demand is likely to exist for a wide range of government services for which service providers are directly or indirectly funded.

Latent demand can be activated when government reforms a service to make it more equitable or to introduce user-choice. The extent to which services reform has the potential to activate latent demand and the likely budget implications need to be clearly understood and managed.

Considerations for managing latent demand include:

- means testing or alternate restrictions to limit access, like gender or age
- co-payment, subsidy or pricing
- limitation of supply
- pre-qualification, like study accreditation
- physical access limitations
- capped funding with access based on need
- taxing or tolling
- managing available information.

Sensitivity Analysis

Sensitivity analysis can be performed to analyse the potential impacts of changes in future demand and to understand the implications for a delivery model under a range of different demand scenarios (e.g. activation of latent demand, pricing charges, etc.). Future demand is subject to a range of external and internal factors that the delivery model needs to consider. The outcomes from a sensitivity analysis are used to refine the commercial settings in the delivery model to ensure sustainability, affordability and that the specific target cohort will have access.

Sensitivity analysis could consider, but is not limited to, areas of risk, shift in regulatory frameworks, movements in the market impacting the supply chain, customer expectations, and funding changes.

Each element that is tested as part of the sensitivity analysis should be given a rating for likelihood of occurring to inform risk mitigation.

4.5 Service design and commercial concepts

Co-design of services

Co-design involves service stakeholders such as customers, front line service providers and system administrators in the service design process, with the aim of creating better services and subsequent outcomes. [5]

The processes used during co-design will depend on the nature of the service, the outcomes identified, the customers and the stakeholders involved. For services that are transactional or low-complexity, it may be adequate to engage stakeholders on the design of proposed services, rather than seeking their input into an extensive co-design process.

Challenges that come with implementing co-design processes can include:

- ensuring engagement with the right people
- increased timeframes
- managing expectations about the outcome of the process
- ensuring probity throughout the process.

There are, however, some key success criteria that can be used to drive a successful co-design process.

[5] Key source: Transforming FACS from provider of services to commissioner for outcomes. Final Report. Prepared by Strategic Reform and Policy Division FACS - June 2016

Table 5 - Co-design - key considerations

Key lessons	Considerations
Inclusivity	Ensuring a broad representation of participants through proactive engagement with non-traditional partners and providers. In many services where customer involvement is difficult such as people experiencing homelessness, the reliance on input from frontline staff becomes more important.
Timing	Ensuring there is enough time allocated to the design to allow for appropriate consultation and participation.
Probity and equality	Ensuring the scope, criteria, thresholds, decision points and access to information is communicated at the start of the co-design process so that participants are engaged on equal terms.
Measurement	New services need to be evaluated rigorously and adapted continuously in light of evidence.
Mutuality	Government shares and devolves some decision making power as part of the co-design process.
Transparency	Parameters, processes, requirements and decisions are communicated openly with all relevant stakeholders throughout the co-design process.
Flexibility	Government operates on an ethos that it is genuinely open to the opportunity to evolve solutions and co-develop new services.

Packaging of services

Packaging is a way of bundling services for commissioning. Key considerations for the development of contract packages are as follows:

- customer cohort characteristics, volumes and needs
- location of demand, influencing such thing as market depth and maturity
- models of care / care pathways
- budget and unit price
- timeframes – short and longer term
- number of contracts / extent of diversity and competition desired
- agency capacity to manage.

In particular consideration should be given to provider:

- location, scale and reach
- service scope, integration and performance
- client base and capability
- cost of service/unit cost
- value proposition – the commercial opportunity
- appetite for expansion/diversification.

There are three key dimensions that should be considered when packaging services: service type; location; cohort characteristics. All of these are underpinned by supply-side/market considerations. These are discussed below.

Table 6 - Packaging services - key considerations

Key dimension	Considerations
Service type	Services are characterised by the usual providers available for each of the particular service types. Another way to package is to bundle service types together to drive service integration. In this model a variety of services (such as drug and alcohol treatment programs, training and employment support and accommodation) could be contracted to a provider who is responsible for case managing and brokering access to services tailored to client needs. The benefit of this model is that it is possible to incentivise providers to target outcomes for cohorts of customers rather than the outputs associated with a single service as they managed the entire if not most of the supply chain.

Key dimension	Considerations
Location	Decisions must also be made about the geographical limits of the service. This is informed by the scale of demand and the depth of the market state-wide and in particular isolated areas e.g. it may not be possible for one provider to deliver a service across the whole state or there may be no or limited supply in isolated locations. Packaging by location will be informed by provider reach, unique characteristics of location that match with appropriate packaging by cohort characteristics such as the cultural make-up of the region and the ability to find the right commercial balance for provision of service in areas that may have a higher cost of delivery e.g. Incentivising provision in more complex than areas by contracting out volume.
Cohort characteristics	Determining if there are cohorts who may have specific service requirements (e.g. survivors of domestic violence, people of indigenous background or people experiencing homelessness), require higher cost services or different performance needs, will help inform how services can be packaging. Packaging a mixed cohort is an options for managing perverse behaviour from potential service providers in preventing such cherry picking.

Commercial principles

Commercial principles determine the overarching approach to contract design, and are informed by the commercial model chosen, having a clear understanding of the provider market and the behaviours and outcomes being sought through the contract. Some key commercial principles for consideration are as follows:

Table 7 - Commercial principles - key considerations

Key principles	Considerations
Contract duration and renewal terms	Contract duration sends signals to the market about the value of the opportunity. Renewal terms impact provider behaviour and performance, and need to be sufficiently results-focused to ensure providers perform through to the end of the contract. Long contract durations do not have to have fixed attributes and can allow for changing in technology, innovation, performance and price.
Volume guarantees	The extent to which volumes can be guaranteed in a contract impacts the price providers will bid; the more uncertainty, the higher the risk premium (and therefore price) is likely to be.
Service quality and minimum standards	Contracts can support the promotion of service quality and adherence to minimum standards (including statutory requirements) by specifying the service requirements and consequences for success or failure. The service requirements outlined in a contract need to be supported by a robust monitoring and assurance regime which uses both qualitative and quantitative data to assess quality and compliance.

Key principles	Considerations
Service continuity	Service continuity is a key challenge, particularly for services contracts, particularly for services types that require maintaining customer/provider relationships and in shallow markets. In the case of shallow markets, commissioners may want to invest in supporting providers to improve performance and sustainability rather than implementing any sanctions too early. This could be reflected in areas of pricing and performance.
Risk allocation	Risk allocation refers to the provisions in a service contract that determine who is responsible for assuming the risk of certain events occurring (or failing to occur). The level of risk assumed by a service provider can impact on the proposed price and/or performance of services and is a fundamental consideration. There are three main considerations in respect of risk allocation, which also impacts price. These are operational, financial and reputational.
Failure regime	The consequences of not meeting performance thresholds and other forms of service failure (e.g. failure to meet statutory or minimum standards) need to be clearly articulated in a service contract. These can be construed in terms of "one off" events (e.g. a major health and safety breach) or more gradual performance failures.

Contract Management

The commercial principles described above presuppose a performance management regime for providers, usually expressed in a contract. Key to contract management is establishing a performance management framework, which requires the following steps being completed:

- define outcomes
- determine lead indicators that support the outcomes
- Identity the means of verification
- establish baseline performance against lead and lag indicators
- set performance thresholds – minimum and stretch targets.

Performance indicators need to be linked to relative measures such as frequency of an event or progress from a baseline to avoid gaming and perverse incentives. Some further considerations for establishing lead indicators are described below:

- determine customer cohort segmentation and forecasting to determine cohort and provider-specific targets and performance thresholds
- developing a measurement and implementation methodology, including reporting frameworks, which takes account of the practical consideration for designing the performance reporting system including data collection, reliability, ethics, comparability and availability of resources, and cost benefit analysis
- test and consult with providers and other stakeholders
- development and inclusion of measures that will provide data on overall systems level performance, over and above individual provider effectiveness.

The role of the payment mechanism in contract management approach is to give financial effect to the risk allocation and contract outcome expectations. The way payments are structured influences the way that providers behave. There is no one model that should be used in all circumstances. As a result, the actual payment and contracting model may need to blend various features of these models, based on the outcomes being sought, the nature of the client and service, and the commercial maturity of both the contractor and the provider market.

There are a range of incentives and levers that can be used to drive the performance of providers. It is worth noting that payments for performance is just one incentive or lever that can be used in contracts with providers. Most successful approaches use a mixture of levers and incentives to drive performance outcomes and value for money, including:

- contractual volumes and revenue
- contract length
- reputation (e.g. awards, prizes)
- transparency and accountability (e.g. league tables, publication of performance data, client feedback)
- quality
- licensing and regulation
- direct political scrutiny.

In developing performance management regimes for providers, contract managers should consider applying a mixture of these levers and incentives, taking into account the perspectives of customers, providers and other stakeholders.

Performance contract terms should be structured so that they can be staged, enabling providers to adapt their business models and data collection methods appropriately.

It is critical to apply financial incentives or abatements to the right metrics or indicators, and to an appropriate degree, to create desirable responses from providers. Providers may be reluctant to accept payment risk against outcomes that cannot be measured for a number of years, but these are still key indicators of performance and value for money and should form part of a performance regime for service.

Outcome evaluation

As the outcomes defined will inform the commercial arrangements for providers, and ultimately the basis on which they are paid for services, any measures need to be robust and evidence based, to ensure they drive longer term results.

The critical success factors to consider when determining outcome measures are:

Table 8 - Outcome evaluation - key considerations

Key factors	Considerations
Establishing the counter factual	This refers to defining a benchmark or baseline against which outcomes can be measured. Approaches include: matched control groups (for pilots), use of historical baselines, national averages or matched to most similar areas aligned to particular cohorts (for large scale programs).
Dealing with attribution	It is essential to determine the extent to which it is acceptable to attribute full influence to providers (e.g. deliver of stable housing) and the associated risks/rewards.
Establishing appropriate measures	Aim for a small number of simple measures linked to the performance framework. Ensure that performance targets drive performance across the system. Link outcomes to proxy indicators if they take too long to realise.
Data and transparency	There is a need to ensure that data collection and publication requirements are optimally calibrated. If requirements are too stringent, data protection and the administrative burden can become an issue for service providers. If requirements are insufficient, the commissioner will be unable to adequately measure performance and release associated payments. Where possible, data collection should be automated and captured in real time, and gather from arrange of sources for the most holistic and accurate view of performance.
Independent assurance of data quality and performance	Investment in independent evaluation of outcomes, as well as mandated use of evidence based measurement tools provides assurance around the measurement quality.
Measuring different levels of the system	It is important to measure provider performance and market health (e.g. extent of competition) as well as client outcomes and overall system performance. The performance measurement systems need to be aligned and complementary to client outcome measurements to avoid providers focusing on their own rating at the expense of client outcomes.

4.6 Commissioning and contestability capability and capacity[6]

Commissioning and contestability requires a new way of redefining business models and implementing change. This will require a new and augmented set of capabilities and capacity across the sector. CCU will play a role in the assessment and development of capability across the sector.

Successful commissioning and contestability initiatives are generally delivered by multi-disciplinary teams covering business, commercial, legal, procurement, financial and customer advocacy to design and deliver the best service systems.

The following section outlines the key capabilities needed to commission services. These will form part of an overall baseline for capability assessment and development. The CCU will work in partnership with the Public Service Commission (PSC) to embed these key capabilities in the public sector capability framework. It is acknowledged that these skills and knowledge are not unique to commissioning and may already reside within government agencies as part of general operational and policy functions.

The following table outlines the capability requirement identified for commissioning and contestability. Each agency will be required to make a judgement on the use of in-house, consulting and contracting resources to balance capability and capacity building within their organisation.

[6] Key source: Transforming FACS from provider of services to commissioner for outcomes. Final Report. Prepared by Strategic Reform and Policy Division FACS - June 2016

Table 9 - Capability for commissioning and contestability

Leadership	Disciplines	Sectors
Vision and strategy System thinking and design Strategy execution and governance Change management Program and project management Knowledge management Communications	Data analytics and modelling (finance and performance) Client and community engagement Needs assessment Outcome setting and evaluation Behavioural economics Service definition and design Commercial management (strategy and execution) Market engagement and development Strategic and operational procurement Implementation and transaction management Contract and performance management Evaluation Relationship management	Policy, legislation, regulation Operational management and delivery Provider knowledge Local and regional recognition Research and contemporary practice Industry specific – health, justice, roads, transport

4.7 Value for money assessment

The development of a financial and economic appraisal is an important component in making a value for money decision. Treasury guidance is available as follows:

- Economic Appraisal Principles and Procedures Simplified (TPP07-6 Jul 2007)
- NSW Government Guidelines for Economic Appraisal (TPP07-5 Jul 2007)
- Guidelines for Financial Appraisal (TPP07-4 Jul 2007)

The appraisal is the first step in helping to determine value for money but is not the definitive step. Other important considerations include:

- service quality
- service continuity
- innovation
- efficiency
- market design and improvement in state productivity
- opportunity for future and ongoing contestability in the service provision.

Developing a Financial Model

The financial model is the base capital and operational cost of service to the purchaser. The financial model should include Competitive Neutrality adjustments, if required. The NSW Treasury Policy and Guidelines Paper for Pricing of User Charges (TPP 01-02), guides agencies on how to ensure their pricing is competitively neutral when they are selling goods and services into markets in competition with private sector, not for profit or other government suppliers.

The financial model should include:

- capital and operating costs associated with service delivery over the contract term (only direct costs)
- cash inflows and outflows not accrual items such as depreciation because the discounted cash flow method will account for this
- fixed assets, maintenance costs and management overheads associated with the service
- contingencies
- financing costs, if applicable
- all incentive or performance payments, and interest payable to investors if applicable
- forecasts that are based on “steady state” of current operation
- competitive neutrality adjustments if considered to be a material advantage to government delivery of services.

In most cases public sector operations have corporate overheads that need to be recognised as part of the market testing process. This should be done based on the most appropriate cost driver for the overhead category (e.g. payroll and administrative overheads could be allocated based on the number of staff, and management overheads could be based on the size of operations (e.g. budget) or management effort required.).

Public Sector Comparator

The Public Sector Comparator is a hypothetical, whole-of-life cost of a public sector project if delivered by a public sector agency. It is developed in accordance with service specifications, proposed risk allocation and based on the most efficient form of public sector delivery adjusted for the lifecycle risks of the project.

The purpose of the Public Sector Comparator is to provide an agency with a quantitative measure of the value for money it can expect from accepting a private sector proposal to deliver the service specification when compared to public sector delivery.

The Public Sector Comparator represents the most efficient form of public sector delivery and is comprised of the following four components:

- the non-risk adjusted cost of service
- Competitive Neutrality adjustments
- transferred risk adjustments
- retained risk adjustments.

4.8 Market approach

The NSW Government's Market Approaches Guide[7] assists agencies to identify the approach to market that best fits their procurement needs. It assumes that in all cases the agency is an informed buyer. The NSW Procurement Board's Industry Engagement Guide[8] explains how agencies can be informed buyers and how to gain an up-to-date understanding of the relevant markets. In deciding how best to approach the market, agencies should consider:

- value for money
- the impact on competition of different approaches (both short and long term)
- promoting and sustaining viable industry in NSW
- transparency and how to ensure probity throughout the procurement process
- agency capacity in managing the approach to market and related procurement activity
- government policies and the implications for other agencies in approaching the market in a particular manner.

The different methods to approach the market are outlined in the NSW Government's Market Approaches Guide, including:

- Request for Information (RFI)
- Expression of Interest (EOI)
- Request for Quote (RFQ)

[7] https://www.procurepoint.nsw.gov.au/system/files/documents/market_approaches_guide_ver_2_0-apr_2015_2.pdf

[8] https://www.procurepoint.nsw.gov.au/documents/industry-engagement-guide.docx

- Request for Tender (open, multi-stage or limited/selective) (RFT)
- complex market engagement methods including direct negotiation.

The market approach for selecting a service provider is influenced by a number of factors, including:

- market depth of prime and subcontract providers
- capital and investment requirements
- innovation, service design and improvement requirements
- governance structures such as pre-qualification or panel arrangements
- value of the services
- speed of procurement
- timing of service delivery.

Some general principles when considering a market approach are set out in the following table:

Table 10 - Market approach - key considerations

<table>
<tr><th></th><th>Market depth</th><th>Capital investment</th><th>Innovation</th><th>Value of services</th><th>Governance</th><th>Speed of procurement</th></tr>
<tr><td>RFI</td><td>High</td><td rowspan="6">Low to high</td><td>Low to high</td><td rowspan="6">Low to high</td><td>Open</td><td>Slow</td></tr>
<tr><td>EOI</td><td>High</td><td>Low to high</td><td>Open to panel</td><td>Slow</td></tr>
<tr><td>RFT</td><td>High</td><td>Low to high</td><td>Open to panel</td><td>Slow</td></tr>
<tr><td>Commissioning</td><td>Low to high</td><td>Low to high</td><td>Open to panel</td><td>Slow</td></tr>
<tr><td>RFQ</td><td>Low</td><td>Low</td><td>Panel / pre-qualification</td><td>Slow</td></tr>
<tr><td>Direct Negotiations</td><td>Low</td><td>Low</td><td>Panel / pre-qualification</td><td>Fast</td></tr>
</table>

Tendering – interactive versus traditional[9]

An interactive tender process provides an opportunity for active dialogue between the procuring agency and the service providers. This process should be conducted within probity guidelines of fairness and transparency. It is particularly useful in areas of technical specification and service innovation. An interactive tender should:

- clarify and expand an understanding of the service requirements
- help tenderers avoid significant or unnecessary costs due to a misunderstanding or misinterpretation of requirements
- improve outcomes and minimise need to re-tender services.

It is highly recommended that agencies adopt an interactive process when tendering for complex services.

A traditional approach may be appropriate where the services being sought are relatively commoditised or “off the shelf”. In those cases price is likely to be a key differentiator.

The NSW Government’s Market Approaches Guide provides further guidance on traditional and non-traditional approaches to market.

4.9 Selecting the right commercial model

Identifying the right commercial model plays an important role in the commissioning and contestability processes. To support selecting the right model, the following matrix is provided as a guide.

[9] Key source: NSW Government Market Approaches Guide.

Table 11 - Commercial models - key considerations

Service delivery method	Key feature	Pre-conditions
Commercialisation	Commercialisation aims to achieve value for money in the consumption and delivery of government services by applying commercial principles. The organisation designs itself in a commercial fashion allowing it to refocus on organisational activities (e.g. commercialised business units)	- on-going requirement for the service - opportunity for cost reduction by changes in governance and operation - appropriate regulatory controls - insufficient market depth of alternative providers
Corporatisation	Transformation of government assets or agencies into state-owned corporation. Generally, only the legal status of the employer will change (e.g. Sydney Water Corporation).	- on-going requirement for the service - opportunity for cost reduction by changes in governance and operation - availability of a suitable board - insufficient market depth of alternative providers
Privatisation	Transfer of ownership from the public sector to the private sector i.e. asset sale	- on-going requirement for the service - opportunity for cost reduction by changes in either governance, operations, structuring or synergies with investment portfolio - appropriate regulatory controls - market interest and appetite - additional income generating opportunities e.g. real estate - financial and balance sheet strength for future investment
Cessation of activity	The organisation chooses to stop providing a service or activity.	- no ongoing requirement for the service or small ongoing requirement that can be serviced by the alternative market
Outsourcing	Buying a good or service from a third party that operates at arm's length, i.e. the change from internal to external provision of the good or service.	- on-going requirement for the service - improved cost, efficiency or service quality from external provision - market appetite and interest for sufficient competition - ease of entry and exit for providers to ensure future contestability and avoid vendor capture - definable and measurable services

Service delivery method	Key feature	Pre-conditions
Franchise	An authorisation granted by a government or company to an individual or group enabling them to carry out specified commercial activities, for example acting as an agent for a company's products.	- on-going requirement for the service - improved cost, efficiency or service quality from external provision - market appetite and interest for sufficient competition - ease of entry and exit for providers to ensure future contestability and avoid vendor capture - definable and measurable services - management expertise - financial and balance sheet strength for future investment
Public Service Mutual (PSMs)	Organisations that have left the public sector but continue to deliver public services. Employee ownership usually plays a significant role in their operation There are three common models of PSMs: - employee owned corporations - community owned “social cooperatives” - multi-stakeholder owned cooperatives or mutuals. Employee-owned corporations are considered to be especially appropriate for: - community based, primary and preventative health services - social care	- on-going requirement for the service - opportunity for cost reduction by changes in governance and operation. - availability of a suitable board - insufficient market depth of alternative providers
Joint Venture	A joint venture is when two or more businesses combine resources, knowledge and skills to achieve a goal. Joint ventures share the associated risks and rewards of a project between businesses	- on-going requirement for the service - opportunity for cost reduction by changes in governance and operation - availability of a suitable board - strong and trusting relationship between business partners

4.10 Social impact investment[10]

Social impact investment often brings together capital and expertise from the public, private and not-for-profit sectors to achieve a social objective. Investments can be made by companies, organisations or funds, whether they be not-for-profit or for-profit.

Social impact investments come in different forms, including (but not limited to):

- Payment-by-results (PBR) contract – a service provider is paid on the results they achieve
- Social benefit bond – a financial instrument that pays a return based on achieving agreed social outcomes. This is a special type of PBR contract
- Layered investment – combines different types of capital in non-traditional ways
- Outcomes-focused grant – non-repayable grant funding provided on the basis of measuring outcomes. May also be used as a guarantee.

Typically, the commissioning agency would define the specific outcomes they are seeking within a funding envelope, rather than designing or specifying the service delivery model itself, e.g. the outcome specified might be improved educational outcomes or reduced recidivism for a defined cohort. Interested service providers then submit their proposals and one or more could be selected based on a pre-determined selection criteria. In implementing the social impact investment program, the amount of the commissioning agency's outcome payment to a service provider (and investors where appropriate) varies according to the service provider's performance in achieving the pre-agreed outcomes.

This is a significant change from the traditional grant funding approach, where input and output delivery is the focus. Using the social impact investment model, it is critical that outcomes are clear, measurable and robust.

In February 2015 the NSW Government published the Social Impact Investment Policy, which sets out the actions the government will take in order to:

- deliver more social impact investment transactions
- grow the market and remove barriers
- build the capacity of market participants.

[10] Key source: Principles for social impact investment proposals to the NSW Government. Office of Social Impact Investment – June 2015

The NSW Government's Principles for social impact investment proposals to the NSW Government, sets out five principles that Government expects social impact investment proposals to demonstrate:

- robust measurement
- value for money
- a service likely to achieve social outcomes
- appropriate sharing of risks and returns
- a focus on high priority social problems.

The *Principles* should be referenced when considering social impact investment as a potential commissioning approach. Support in implementing this approach can be obtained from the Office of Social Impact Investment.

4.11 Regulatory compliance

Regulatory bodies that may require consultation during commissioning and/or contestability include, but are not limited to:

- Independent Pricing and Regulatory Tribunal (IPART)
  http://www.ipart.nsw.gov.au/.
- Foreign Investment Review Board
  https://firb.gov.au/
- Australian Consumer and Competition Commission (ACCC)
  https://www.accc.gov.au/

Appendix 1 - Tables of terms and acronyms

Table 12 - Table of terms

Term	Description
Agency	NSW Government Departments, including the Executive Agencies, Services, Separate Agencies, Statutory Bodies and Entities within each Cluster.
Cohort	A group of people with shared characteristics.
Commissioning	An approach to considering the outcomes that need to be achieved, and designing, implementing and managing a system to deliver these outcomes in the most effective way. It leverages the strengths of the public sector and where appropriate, involves private and non-government organisations and individuals to transform outcomes for customers.
Commissioner	Provides the system governance and stewardship for the commissioning system. The Commissioner is responsible for maintaining the integrity and performance of the system and its integration.
Competitive Neutrality	A process to identify and mitigate the net competitive advantages that accrues to a government business by virtue of its public ownership.
Contestability	The process of evaluating and benchmarking services against credible alternatives and/or market testing in order to drive productivity, learning and improvement.
Customer	The beneficiary or recipient of a service.
Customer centric	A specific approach to doing business and delivering services that focuses on the customer. This ensures that customers are at the centre of service design and operation.
In-house bids	A proposal for the provision of services received from within the same government agency that is contesting the service.
Outcome	The higher order goal that is sought to be achieved for customers or NSW citizens. Sometimes described as a result, an outcome must have a measurable impact.
Program management	Involves managing groups of projects to achieve a desired outcome or benefit for an organisation. It is about the structuring and control of those projects so they deliver effectively as a group.
Service	The provision of activity to a customer or customers.

Term	Description
Service design	The process of designing services that provide the desired outcomes and address the service needs of the target population.
Service model	The assumptions, systems and structures on which the delivery and design of a service are based. This can involve services being delivered by government agencies, not-for-profit organisations, private businesses or a combination of these providers.
Service provider	Any person, group of people or organisations supplying a service (whether public, private or NGO sector). Also referred to as a Provider.
Strawman	A ‘strawman’ proposal is a simple draft proposal intended to generate discussion of its advantages and disadvantages, and to provoke the generation of new and better proposals.
System design	The activity of planning and organising people, infrastructure, communication and components of a system, in order to improve quality, the interaction between the service provider and customers, and the customer’s experience.
System value chain	The component parts and their relationship within a service delivery system. Each part creates and builds value contributing to the overall outcome and value of the system.
Whole-of-Government	Refers to public service agencies working across portfolio to achieve a shared goal and an integrated government response to particular issues. A whole-of-government approach can focus on policy development, program management and service delivery.

Table 13 - Table of acronyms

Acronym	Description
CCU	Commissioning and Contestability Unit
CPA	Competition Principles Agreement
EOI	Expression of Interest
FACS	Family and Community Services
IPART	Independent Pricing and Regulatory Tribunal
KPI	Key Performance Indicator
NCP	National Competition Policy
NDIS	National Disability Insurance Scheme
NGO	Non-Government Organisation
NSW	New South Wales
OSII	Office of Social Impact Investment
PBR	Payment-by-results
PPP	Public Private Partnership
PSC	Public Service Commission
PSMs	Public Service Mutual(s)
RFI	Request for Information
RFQ	Request for Quote
RFT	Response for Tender
SBBs	Social Benefit Bonds
SII	Social Impact Investment
TC	Treasury Circular
TPP	Treasury Policy Paper

Appendix 2 - Acknowledgements

The following NSW Government agencies, practitioners and advisors have been consulted throughout the development of the NSW Government Commissioning and Contestability Policy and Practice Guide:

- Department of Education
- Department of Family and Community Services
- Department of Finance, Services & Innovation
- Department of Justice
- Department of Premier and Cabinet
- Transport for NSW
- Department of Industry
- Department of Planning and Environment
- NSW Health
- NSW Treasury
- Dr Doug McTaggart
- Professor Gary Sturgess
- Associate Professor Helen Dickinson
- Deloitte
- EY
- KPMG
- McKinsey & Company
- PwC

The Policy and Practice Guide draw from the following papers and publications:

- Competition Policy Review Final Report (Harper Review) – March 2015
- Competition Policy Review – NSW Government Submission – June 2014
- Productivity Commission Inquiry into human services - NSW Government Submission – July 2016
- Development of outcomes-based contracting for out of home care and other human services provision: health and human services summary report. NSW Government. Prepared by Ernest & Young - October 2015
- Transforming FACS from provider of services to commissioner for outcomes. Final Report. Prepared by Strategic Reform and Policy Division FACS - June 2016
- Determining the Suitability of Developing an In-house Proposal for the Market Testing of Non-Clinical Support Services. Discussion Paper. NSW Health - February 2014
- Principles for social impact investment proposals to the NSW Government. Office of Social Impact Investment – June 2015

  NSW Treasury Use of Pooled Funding Mechanisms to Improve Service Delivery Outcomes Research & Information Paper - 2014

Further Information and Contacts

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