Collective purchasing as a means for social ends

Morten Hviid and Ruth Hancock
Centre for Competition Policy and ESRC Business and Local Government Data Research Centre

Some of the work reported here is also joint with Ferran Espuny Pujol and Marcello Morciano

Background on “good” buyer power

- **“Sir Philip Green has published his review into Government efficiency. The review found that the Government has consistently failed to make the most of its scale, buying power and credit rating.”**
  - **Summary from the Prime Minister’s Office of the October 2010 report**
- **“I think it’s a good report, it will save a lot of money and it’s important we do it.”**
  - **The then Prime Minister David Cameron welcoming the report**

Buyer power in action

- **In the UK Care Homes market the Local Authorities (LAs) negotiate on behalf of these with established care home needs combined with low income/asset base**
  - **LAs are typically successful in achieving fees below the average cost of a care home bed**
- **“We do not believe it is acceptable for self-funders to pay higher costs for the same care in order to subsidise the costs of local authority funded clients. ”**
  - **House of Commons Communities and Local Government Committee 2017**

Health care: buying for patients

Buying smarter could save NHS £1.2bn [Department of Health, 2012]

- **They are trying, but**
  - **In some cases there are other buyers**
  - **Patients may be reluctant to switch away from what they obtained at the hospital**
- **Example: Napp [OFT 1999-2001]**
  - **The OFT found that Napp had used heavy discounting when bidding for hospital contracts to supply SRM (Sustained Release Morphine)**
  - **The resulting switching costs enabled Napp to charge excessive prices in the larger community segment and retain a very significant share of the market**

Energy – collective solutions to non-engagement

- **In the UK energy market, collective switching has been trialled locally and nationally**
  - **With mixed results, mainly due to lack of consumer engagement**
  - **But also lack of enthusiasm for bidding among the established firms**
- **The market was subject to a CMA market inquiry which identified inadequate consumer engagement as a problem and the creation of a data base of these as a remedy**
  - **One potential use of the data base is as a tool for collective switching initiatives**
  - **Effects on three groups: the engaged, the newly engaged and the continually unengaged**

Big picture stuff

- **When does the purchasing of the government or an agent of a group of consumers cause negative externalities on some citizens?**
  - **Affects the recovery of fixed costs [e.g. care homes]**
  - **Affects the future demand of consumers through switching costs [e.g. Napp]**
  - **Affects the segmentation of markets [e.g. Energy]**

Focus in the care home market

- The spend on Local Authority assisted care home places is in the region £5 billion
- Funding social care in general is a big issue politically
  - Conservative Manifesto Pledge labelled a “dementia tax”
- Been subject to competition scrutiny in the past
  - OFT 2005 in response to a 2003 supercomplaint by the Consumer Association
  - OFT 2011 commissioned report on care homes
- Currently investigated by the CMA in a Market Study
- Key question: who should pay for the fixed cost of delivery?
  - A question with the root in justice and fairness, not efficiency

Care homes – key features providers

- **Very fragmented market with a some chains [35% of beds in 2016] but mainly made up of a large number of single-facility independent suppliers**
  - **2016: about 11,500 care homes in England**
  - **HHI is 0.078 for England**
    - **Local variation: only 0.007 for Norfolk**
- **Variable costs is mostly minimum wage workers with a time per bed more or less determined by regulation**
- **Large fixed costs, partly facility, partly management, partly staff training**
  - **These costs have to be met to avoid bankruptcy**

Care homes – key features consumers

- **Each at most want one**
- **The occupant may not be the decision maker**
- **It is typically a distress purchase**
- **Two types of occupants: privately funded and Local Authority assisted**
  - **One dominant buyer (locally), the rest fragmented**
- **Adverse effect on occupants from switching care home**

An equilibrium where LAs use their buyer power

- **The LA price will be below average total costs**
- **Care homes selling beds to LAs need to recover some of their costs from self-funders so stay solvent**
  - **The self-funder price will be above average total costs in those care homes**
- **"Free riding" by care homes who do not sell to LAs must be curbed**
  - **In particular, no free entry of care homes not selling to LAs**
- **Requires substantial control by LAs, both over price and capacity/ entry**

  - **And yet, this appears to be the most common outcome and has been for years [See old OFT study and current CMA study]**

The fleeced, the squeezed and the switched

- **There are three groups of potential users who are "affected":**
  - **Those who pay the LA price**
    - **They still hand over what they do have so are not directly affected**
  - **Those who pay the SF price**
    - **They pay more and where they rely on assets, they run down their assets quicker**
  - **Those who cannot afford the SF price but do not quality for the LA price**
    - **They are squeezed out of the market**

Exit is not an uncommon occurrence

- **Buyer power must be exercised with care because exit is more likely**
  - **A disproportionate turnover of self-funders has bigger effect in this case**
  - **Financial distress leads to user distress where exit occurs**
- **Exit/churn is not an uncommon occurrence**
  - **From April 2013-December 2016:**
    - **5233 transitions [to another use within sector, another owner or exit]**
    - **1700 cases of exist from market**
    - **1234 cases of entry to market**
- **LA has a role as a "market maker" in the care home market**

So do anyone benefit?

Using buyer power eases pressure on LA budgets

- LA spending is funded through mixture of central and local taxes
- Reduced budget pressure may
  - affect local taxes
  - affect local services
  - affect how "generously" the LA interpret rules about "applicability"
    - reduce the set of individuals excluded from the market

Fixed costs could be allocated in many ways

- **Intuitive answer may be Ramsey pricing**
  - **But unit demand, so how?**
- **Undistorted market outcome [no use of LA buyer power]**
  - **Not clear how market would allocate fixed costs**
  - **Simple solution: the LAs provided the necessary care places directly**
  - **Marginal burden on local tax payers**
- **Recovery from privately funded places [LA uses its buyer power]**
  - **Disproportionate recovery from privately funded places**
  - **Indirectly a progressive "dementia tax" - burden on those who need a care home place**
- **Recovery from (general) taxation [(national) insurance solution]**

So who should pay?

- **There are several options [including mixtures]:**
  - **Those in the local area with care home needs?**
  - **Those in the local area with care home needs and pensions or wealth above a threshold?**
  - **The local community through taxation?**
  - **The state through taxation?**
- **Two (unfair?) "lotteries"**
  - **If based on element of self-payment, we have a dementia lottery**
    - **Does progressivity make this more or less unfair?**
  - **If based on funding from the local area, we have a post-code lottery**

Conclusion

- **Where the public sector is purchasing on behalf of (a group of) consumers, surely consumer welfare is improved?**
  - **Indeed, competition law is typically not engaged in such cases**
- **The care home case provides an example of problems arising from collective purchasing**
  - **Without distorting marginal incentives, it has adverse effects on other groups**
  - **These groups may be better at lobbying**
- **Two ways to engage economics and potentially competition law:**
  - **Does the way in which fixed costs are recovered provide any incentives for fixed cost reduction?**
  - **What does the mode of recovery do for the incentives to innovate?**