

Buyer Power and Price Discrimination: The Case of the UK Care Homes Market

BACKGROUND

- In the UK, over 400,000 people aged 65 and over receive long-term care in a care home, and this is projected to more than double over the next 50 years.
- Local authorities purchase care home places on behalf of a large group of people based on a means test of their income and capital assets. People excluded by the means test are self-funding.
- The care home market is characterised by a large number of relatively small providers.
- The public sector, using its buyer power, may be able to procure assisted places at a price below the market rate.
- Concerns about the consequences for older people of local authorities using their buyer power are that:
 - excessively low prices paid to care homes may force care homes out of the market and lead to a shortfall in capacity; and
 - care homes may charge higher fees to self-funders in order to cross-subsidise publicly-funded residents i.e there may be an element of induced price discrimination in the care home market.

METHODOLOGY

- The authors provide a theoretical model of the care home market to establish the key effects of potential buyer power.
- The care home market is modelled as competitive, but where each firm faces capacity constraints.
- A microsimulation model is used to quantify key findings from the theoretical model. The simulations calculate what a representative sample of older people would have to pay towards their care home fees in the presence and absence of price discrimination.

KEY FINDINGS

- Under the theoretical model, if the local authority is able to negotiate a price which is below average costs then, to break even and cover costs, the care home has to charge all other users a higher price.
- The larger is the discount negotiated by the local authority, or the larger is the number of places procured by the local authority, the higher must be the private sector price in order for the care home to stay in business.
- The more price is increased for privately funded places, the more buyers will drop out of the private market and the fewer people will be available to pay the higher price. The candidates for paying the missing contribution to costs are those with high willingness to pay.
- A key conclusion is that, if a local authority does use its buyer power, some care homes will be forced out of the market and prices offered to self-funders will increase.
- Under these conditions, there are two groups of losers:
 - one group consists of those who are no longer willing or able to afford a care home place on the private market while remaining ineligible for local authority support; this is the 'squeezed middle' who can afford the market (no price discrimination) price but not the higher private rate that care homes charge when local authorities exercise their buyer power;

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- the other group of self-funders now have to pay an inflated price to keep the care homes financially viable.
- Simulation reveals that, under the first round (unchanged demand) effects of price discrimination, the number of local authority supported residents is just over 1% higher than in the absence of price discrimination, but local authority costs are about 8% lower. Costs met by local authority-funded residents are lower by 3% but self-funders pay 11% more in total. Total care home income is reduced by 0.06%. At these fee rates, the squeezed middle contains just under 200 residents, or 0.01% of the total. If the local authority includes them, the effect on care home income is small.
- The finding that the percentage of residents who are local authority supported is higher under price discrimination is because at the higher private fee rate, those who are initially self-funders deplete their capital faster and hence qualify for local authority support sooner.
- If local authorities push the price considerably further below the market rate, the consequences are greater. The size of the squeezed middle is larger but still a small proportion of the total.
- The scale of potential demand responses depends on the size of the squeezed middle since this is the group who would withdraw their demand. This group is small because of the operation of the capital test in the current means test. If the capital test were removed, the squeezed middle would be larger.

POLICY ISSUES

- One way to address concerns over those priced out of the market is for the local authority to include the squeezed middle by procuring places at the lower fee rate for all those who cannot afford the private fee rate. In this case, the immediate losers from the local authority using its buyer power are confined to those who remain self-funders.
- Including the squeezed middle does not cost local authorities anything directly because under the means test the squeezed middle are liable for the full fee rate negotiated by the local authority. But if the squeezed middle is large, such action may destabilise the market. To avoid that happening, local authorities would have to pay fee rates which are closer to the market rate than if they do not procure places for the squeezed middle.
- Various reforms to the means test continue to be a focus of UK debate. The authors' findings suggest the size of the squeezed middle is kept small by the current means test, assuming that willingness to pay for a care home is approximated by liability to pay under this means test. Under alternative forms of the means test where this assumption may be more plausible, the squeezed middle could be considerably larger. Reforms to the means test may therefore reduce local authorities' ability to exercise their buyer power. The public spending cost of such reforms could be larger than might be thought if local authorities have to pay fees which are closer to market rates as a consequence of the reforms.
- Exercising their buyer power enables local authorities to spend less on care home places (and so more on other things) or buy more care home places. The cost of this is borne by self-funding care home residents. Whether they are the right group to pay for this is debateable.

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FOR MORE INFORMATION

The full working paper (10-17) and more information about CCP and its research is available from our website: www.uea.ac.uk/ccp

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