THE UNIVERSITY OF MELBOURNE

Melbourne Disability Institute

Partnering for impact

Collaborative Commissioning & Formal Relational Contracting

What's the difference and what are the likely benefits?

Professor Mark Considine AM
Australian Welfare and Work Lab, University of Melbourne

Professor Bruce Bonyhady AM
Melbourne Disability Institute, University of Melbourne

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Acknowledgments

The Melbourne Disability Institute (MDI) and the University of Melbourne are situated on the land of the Woiwurrung (Wurundjeri) people of the Kulin nation and conducts their activities on Aboriginal land. This land has never been ceded and the impacts of colonisation are ongoing. MDI acknowledges Traditional Custodians' continual care for country, the importance of Indigenous sustainability practice and knowledge, and the Woiwurrung and Boon Wurrung's ongoing contributions to the life of this city and this region. MDI pays respects to Elders past, present and emerging.

Artwork

The art on the front and back cover of this report was created by Bruce Plant, an Australian artist with disability known for his colourful, narrative, and abstract primitive style paintings. Born in Melbourne in 1952, he studied at Melbourne University and began exhibiting his work in 1989. Plant's art is often described as joyful, playful, and providing hope and inspiration, with works appearing in public and private collections.

Credit: Plant, Bruce. *Revelation.* Displayed at the Melbourne Disability Institute, Melbourne. Acrylic on Canvas, 104x80cm, 2025.

Collaborative Commissioning & Formal Relational Contracting – What's the difference and what are the likely benefits?

Professors Mark Considine[1] & Bruce Bonyhady[2]

Recommendation 2.1 in the draft Productivity Commission report on *Delivering quality care more efficiently* states:

> Government should embed collaborative commissioning, with an initial focus on reducing fragmentation in healthcare to foster innovation, improve carer outcomes and generate savings[3]

However, while the potential benefits look significant, some caution should be attached to the suggestion that "even a modest (10%) reduction in potentially preventable hospitalisation could deliver savings of $600 million per year[4].

A similar estimation approach was taken to measuring potential economic benefits arising from the NDIS in the Productivity Commission Report on Disability Care and Support in 2011. Eleven years after the commencement of the NDIS, these economic benefits remain highly elusive.

In contrast, the benefits from Formal Relational Contracting (FRC) are real and have been measured (See attached paper: Formal Relational Contracts and the Commissioning of Complex Public Services).

Further, it would be very important to embed FRC within collaborative commissioning, which leads us to suggest that FRC, and building the necessary skills to implement this well, should be seen as an essential first step towards collaborative commissioning.

We therefore recommend that the Final Report on *Delivering quality care more efficiently* should include two additional recommendations:

1. Formal Relational Contracts should be trialled with a view to being adopted widely as the default position in the care economy where the services are complex and the outcomes are difficult to measure.
2. Collaborative Commissioning is most likely to deliver the expected benefits if these arrangements embrace Formal Relational Contracts and so Formal Relational Contracts should be a first step towards Collaborative Commissioning.

Our arguments in support of these conclusions are as follows:

1. Formal Relational Contacts (FRC) are specific legal agreements between a purchaser and a service provider where governance rules and processes promote cooperation between the parties and prioritise flexibility to achieve the best outcomes.

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[1] Professor Mark Considine is Co-Director of the Australian Welfare and Work Lab at the University of Melbourne

[2] Professor Bruce Bonyhady is Executive Chair and Director of the Melbourne Disability Institute at the University of Melbourne

[3] Productivity Commission (2025) Interim Report Delivering quality care more efficiently, p30

[4] *ibid*, p29

2. The FRC model is used in both public and private sectors and works via mechanisms to achieve alignment and transparency between the parties and a commitment to one another's legitimate interests.
3. With FRC there is an assumption that long term relationships with high performing providers will deliver the best outcomes for complex clients and for the purchaser.
4. Mechanisms also exist to promote the entry of new partners to meet expanding needs or new challenges.
5. Where the purchaser employs multiple service providers under a FRC there are options to include effective learning mechanisms which provide important feedback on the impact of policies and practices, promote rapid transfer of best practices or error reductions and grow capability[5].

On the other hand,

6. The term collaborative commissioning (C-com) is a recent addition to the public service lexicon in some OECD countries seeking better coordination of inter-departmental commitments to a common set of service users.
7. In the C-com framework a variety of possible methods can be used to coordinate groups of departments and their services, typically involving joint planning exercises, linked budgets and in some cases, enabling legislation to pool resources.
8. The C-Com idea also embraces the commitment to bring service users and other local interests into the planning process to better align the programs with different local conditions.

Can the two models work together?

9. The C-com idea is a significantly more complex ambition with fewer known methods and mechanisms, so it is more difficult to generalise about its possible trajectory.
10. There are some examples of FRC where the governance elements have included specific engagements with user communities to establish outcome ambitions they regard as optimal and to report regularly against those.
11. In the FRC model the focus is upon the purchaser-provider relationship, while in the C-com models the focus is upon coordinating several government agencies and engaging them with communities where those linked services are important.
12. However, by developing the skills to effectively manage FRC first and then embedding FRC in C-com, the full potential benefits from C-com are much more likely to be achieved, so FRC should be trialled and scaled first.

[5] See also Centre for Policy Development, Putting People First, https://cpd.org.au/wp-content/uploads/2024/11/Putting-People-First-FINAL-Web.pdf

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Formal Relational Contracts and the Commissioning of Complex Public Services

Position Paper

October 2024

Professor Mark Considine, School of Social and Political Sciences
Associate Professor Sue Olney, School of Social and Political Sciences
Professor Bruce Bonyhady AM, Melbourne Disability Institute
Professor Kirsten Deane OAM, Melbourne Disability Institute

University of Melbourne

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Nobel Prize winning economist Oliver Hart neatly summarised what is wrong with the transactional approach to contracts "where lawyers try to think of all the possible things that can go wrong in a relationship and include contractual provisions to deal with them" and he then concluded that this approach "is broken". Most people who have had anything to do with social service contracts would agree.

Current inadequacies in both DES and NDIS commissioning arrangements have been widely canvassed. For example, the recent NDIS Review identified several challenges in the current governance architecture which indicate low trust and poor communication between purchasers and suppliers (at Section 3.5.3, 3.5.4). The Parliamentary Select Committee Review of Workforce Australia made similar criticisms of the prevailing system of transactional contracts in that scheme.

What does the alternative, the formal relational contract, do instead? In simple terms it involves a clear agreement, combined with structured discussion of shared goals. There is also a set of guiding principles that all parties agree to use when an uncontracted event occurs. The contract includes a process for open communication and data sharing so that all parties are on the same page, all the time, including in relation to their costs and finances.

Typically these conditions are established in Part A of the formal relational contract, which create values and governance alignment. The Part A development stage also allows engagement with service users who wish to see their interests explicitly described. In Part B the contract parties agree 'the deal' in which outcomes are specified and prices detailed.

With over 70 years of successful implementation and detailed empirical research behind it, formal relational contacting stands as a compelling approach to commissioning in any field where exact outcomes are hard to predict, tools need continued refinement through practice and members of the supply chain can only contribute effectively to system-wide improvements if they can use shared insights and innovations in a trusted relationship. Formal relational contracting is not just the preserve of governments; it has been used very effectively by the private sector, when out-sourcing complex projects or functions.

Background

In the Australian public policy landscape the most accepted forms of commissioning include infrastructure contracts where the outcome is known and the measures of completion are well understood, through to tender-and-supply agreements for physical services where performance is also relatively easy to define, then to contracts in the human services field where many things are hard to specify in advance. It is this last category that concerns us in this position paper.

In many public service fields from childcare to vocational training, or from disability to employment services, we find publicly funded activities delivered by contracted providers. Typically, these contracts result from a request for tender (RFT) based upon a very detailed specification. In some cases the list of possible contestants is narrowed by use of a preferred provider licence or registration. What happens next is some form of confidential independent assessment and then follows a series of business offers to the contestants. Payments are then typically fixed to individual client services and perhaps to specified outcomes. Often the outcomes must be somewhat contrived to fit contract milestones or 'best estimates' of the client progress hoped for. As a result, what are aspirationally described as partnerships are, in fact, ever more detailed transactional relationships.

These arrangements frequently operate under the rubric of principal-agent choice as a key mechanism for driving efficiency. For the purchaser such choice involves turning over the suppliers on a regular basis, or threatening to do so, and this apparently keeps them attentive. The clients may also be required to exercise choice (and switching) of their service provider and this is thought to enhance service quality because their available exit option keeps suppliers focussed on their needs. In some fields the purchaser will also aggregate the performance data on suppliers and publish 'star ratings' to show everyone which firms are doing best.

Why might such a contracting system fail to perform as hoped?

Four typical problems weaken the mechanisms in these forms of service commissioning.

First, there is no abundance of qualified providers in many service sectors. Establishing high quality services involves time, investment and experience. Many generalist firms may bid in a request for tender but many will be there only to hunt quick returns. The subsequent tender deliberation process generally confines most of the adjudication to the examination of documents submitted, conducted behind locked doors and/or preference price as the most important selection criteria. The purchaser has to 'make do' with what is offered. The deeper values and motivations of bidders cannot be easily discerned from tender documents. Making judgments about those qualitative issues can also be deemed inappropriate in a formally 'objective' assessment conducted by independent experts such as lawyers.

Second, the exact outcomes being sought through the contract might not be easily specified. Complex human services are produced at the moment they are consumed. There is no way to check quality in the warehouse beforehand. This means we have to place greater trust in the delivery process. This increases the vulnerability of clients when faced with poorly performing service deliverers. It also significantly reduces oversight options for the purchaser. Implementation occurs inside a 'black box'. It is not surprising in these circumstances to find that opportunistic suppliers spend a good deal of effort finding ways to cut their costs and raise their profits, including at the expense of service quality or 'cherry-picking' easy to serve clients, leading to gaps in services for more complex clients.

Third, the public agency required to purchase these complex services under such conditions will have very limited means to drive the search for better system-wide quality. The terms of competitive allocation of the contracts will empower suppliers to treat their methods of delivery as a proprietary asset. Over time the purchaser will become more distant from the detail of service delivery and more concerned with performance milestones and payments. Heavy system regulation will inevitably follow outbreaks of bad behaviour and good providers will be handed higher costs.

Fourth, assessment of the public value of these forms of commissioning is still largely confined to the relative benefits and costs of different methods of service delivery, with limited consideration of flow-on effects, unintended consequences and possible cost-shifting. Transactional performance management systems are ubiquitous across outsourced public services, to report achievement of milestones and outputs, to trigger payments, and to serve both as policy evidence and a tool for making services more transparent and accountable to citizens.

There are risks in governments relying on transaction-based reporting as policy evidence, as particular groups of people can be invisible or misrepresented in these data and because satisfaction data may be biased. Factors that drive inequalities generally, such as age, gender, language and literacy, disability, mental and physical health, cultural and ethnic background, access to technology, socioeconomic status, geographic location and household structure, consistently emerge as fault lines in service systems built on aggregated measures of performance.

How is a relational contract different?

In the formal relational contract the attention shifts from a transactional deal designed to protect the purchaser against hold-ups or opportunism and moves to a focus upon structured, ongoing cooperation between the parties. The common ground is found in the commercial relationship and its value over time. The core idea is that the parties acknowledge that they are involved in a continuing set of engagements, not a once-off transaction. Both agree to respect and support each other's viability, subject to agreed principles.

With this "shadow of the future" in mind, it is rational for the parties to carefully consider each others' best interests. An opportunistic manoeuvre by the purchaser

might extract a lower price on Day One, but at the cost of losing a good supplier later on, or promoting opportunism and other risk-taking behaviour in response. Equally, opportunism by the supplier gives some immediate pay-offs but does so by risking the future supply of quality work.

Provided the work being done by the supplier is transparent to the purchaser and that problems are worked-through together according to pre-agreed principles, suppliers can expect reasonable profits and help from the purchaser to resolve problems along the way. On the other side, the purchaser can expect open dialogue and effort to raise service quality and manage costs.

An important element in the formal relational contract that sets it apart is the Part A of the agreement where the parties co-create a governance structure and agreed procedures which provide the means to continuously align their interests and the interests of users/citizens. Because all contracts are necessarily incomplete the benefit of the relational model is its explicit attention to the need for adjustment and alignment.

But what happens when interests do not align? The work done at the start to assure shared goals and open methods of implementation will reduce most conflicts. But the governance structure in a relational contract will also provide a means to identify and resolve issues that arise along the way. For example, it will use flexible pricing models to keep the system fair over time, while 'a robust governance structure' works to address the root causes underlying any problems.

Public Sector Options

Why might agencies in the public sector opt for a formal relational contract rather than a transactional contract with their service providers? The key issue here is the degree of service complexity, related in turn to the complex needs of clients across varied geographies. If that complexity includes greater vulnerability, transactional contracts will often fail to deliver continuous improvement of service quality. The parties will only negotiate their methods at the time of signing. Efforts to adjust, adapt and improve, including in response to user/citizen needs, will be difficult on both sides. And if there are multiple service providers all set in competition with each other, shared insight into service improvement will then be sacrificed in favour of competitive advantage. A relational approach allows better local alignment and feedback.

A second reason for using relational contracts is their greater capacity to include the voice of users/citizens and respond to changing circumstances. New economic conditions or altered expectations to deliver services to new cohorts or emerging evidence of best practice can easily upset the best laid plans in a transactional system. Amending those detailed agreements with multiple parties usually provides too great a barrier to adjustment.

The third compelling reason for using relational contracts in complex service systems is the capacity to experiment and innovate while the services are on foot. Goal alignment between the parties through the agreed governance structure (Part A) will provide a

means for the members of the supply chain to see what others are achieving and seek to enhance overall system performance.

The final element that relational contracts offer is a greater level of mutual engagement between the parties. This enables joint development of collective assets such as training, better and cheaper regulatory oversight through transparency, and assists flexibility through the ability to share capacity between different suppliers. When the economic achievements of the relationship between the parties extend over time there will be greater net benefit in any investment in service improvement, because a 'rising tide lifts all boats' understanding will be more likely.

Implementation Principles

While a relational contract can be created by any parties seeking to work together, research shows that often this approach will emerge after a period of transactional contacting through which the parties get to know one another and learn a great deal about each other's strengths and weaknesses. It is often the mature state of such relationships that leads to the 'flip' from transactional to formal relational contracts.

Regardless, the first step in implementation (Part A) involves creating a foundation process and document in which aspirations, outcomes, previous experiences and concerns are shared. This will include any doubts or previous experiences of conflict that have damaged trust. This is the place to express hopes for improvement. Parties may find a 360-degree relationship review process helpful.

This very first stage provides a means to assess just how much trust and alignment already exists and how much needs to be developed.

The next step involves creation of a statement of the shared goals in forming a service delivery relationship. From here the third step will involve the adoption of guiding principles for the work to be carried out, the transparency of decision making, reasonable expectations for cost and profit, plus agreed principles to use when uncontracted issues arise.

These first three elements form the platform for the practical commitments to be agreed next. With the foundations agreed, the next part of the contract involves 'the deal' in which responsibilities are defined, pricing frameworks and metrics are agreed, and expected outcomes are highlighted. The roles of each party will also be broadly defined and a governance structure for data sharing and regular review will be set.

Where the service involves multiple suppliers doing similar work in different places, or with defined sub-populations, the framework governance may also include transparency between suppliers and mutual support among them to enhance service quality. It will become one of the core principles of a relational contract in this case to support and reward joint efforts to improve services.

Implicit in this approach is that where the desired outcomes are difficult to measure or where effective measures of outcomes are still under development or where desired outcomes are likely to change over time, the most effective way to achieve best outcomes is through approaches which encourage sharing of experiences, such as communities of practice, to improve outcomes for all. This contrasts with standard practices in competitive markets which regard such activities as collusive and anti-competitive. In other words relational contracting is able to recognise the gains from collaboration between market participants.

In sectors which have a large number of suppliers the Part A conditions of the contract are developed as a unified process with common values and procedures for all participants. In the private market the equivalent cases involve cases such as farmers using a common framework in their contracts with processors. The Part B details may then describe different specific targets and prices for each participant.

Transition Issues

While the majority of documented examples of formal relational contacts involve parties with positive previous history, transition challenges nevertheless occur. Old habits die hard and early work will be required to enable the parties to form new habits, to be more trustful and to use the formal relational framework effectively.

In the Australian case for social services we have sectors with large numbers of service suppliers. Rather than attempt to shift all of them across in one cycle a recommended approach is to prove the model by shifting a volunteer group first, or nominating a region where the new approach will be modelled.

It is also likely that an investment stage will be needed to get the new Part A governance frame in place and to assure the parties that transparency will work for both the purchaser and the suppliers.

Skill development and cultural change among the staff previously tasked with contract monitoring will also be important. In a transactional system the regulatory steps are set in black-letter provisions and milestones are also firm. Deviations are difficult. But in a relational model the contract managers regulate with an approach that is based on the idea that suppliers will learn to improve if problem solving takes place locally and quickly. This means that the Part A framework needs to include principles to be used to adjust the rules for service implementation where such actions help clients and improve resource eficiency. This adjustment then becomes an object lesson for the governance group to share and to disseminate new practices that work.

Asking staff on both the purchaser and supplier side to work differently will mean some re-training, cultural change and new forms of professional development. If this also results in better working conditions and improved empowerment and results for clients one could hope this might pay for itself in better morale and lower turnover. But it may also mean some upfront investment costs in both training and support which the governance framework standing behind the Part A process will need to manage.

Results

The value expected under a formal relational contact approach is to replace heavy regulatory costs and incentives for opportunistic behaviour inherent in the transactional model and establish instead a transparent system of continuous mutual adjustment towards common, formally agreed goals.

The pay-offs include reduced monitoring costs, fewer time-consuming conflicts and wrong-turns, much lower tender costs, greater flexibility to have suppliers assist one another and to respond quickly to gaps or service surges in new domains and much greater opportunities to give users and citizens voice in improving both outcomes and the way the system operates.

Example: The opportunities and challenges for the NDIS – post the NDIS Review

As noted above, the NDIS Review made a number of recommendations in relation to the need for the utilisation of relational contracting by governments, when implementing the Review's recommendations.

To date the NDIA has implemented its Partners in the Community contracts using increasingly detailed purchaser-provider type contracts. These have prioritised inputs and outputs, over outcomes. They have not been successful with both the NDIA and the Partners reporting dissatisfaction with the current approach. Even more significantly, NDIS participants and their families have been very critical of the outcomes from these arrangements, because they prioritise outputs not outcomes and have an insufficient focus on quality of service.

Now, following the NDIS Review, the NDIS is an ideal test case for relational contracting. Potential areas in which relational contracting could be applied, post the NDIS Review, include, Foundational Supports, navigation and lead practitioners.

These specific areas of reform are also interesting from a wider public policy perspective, as all governments rely more and more on non-government agents from the community sector and for-profit companies to deliver government services where the outcome measures are a work-in-progress.

First, Foundational Supports, navigators and lead practitioners are all critical roles which are central to the successful implementation of the NDIS Review. At the same time, these are new structures and roles with nascent outcome measures that are in need of refinement. These roles therefore cannot be implemented based on "set and forget" approaches, which are implicit in transactional purchaser-provider relationships. There are therefore likely to be significant potential benefits that would accrue from using relational contracts to frame the development over time of optimal outcome measures. These outcomes must reflect what is most important to people with disability and their families and so require the type of deep engagement that is possible through relational contracting, and also drive system-wide improvements,

while guarding against perverse incentives. Using relational contracts shifts the focus of preparation from trying to pre-determine roles, rules, responsibilities and fixed outcomes, when there is insufficient evidence, to getting the commissioning framework in Part A and Part B right.

Second, the Review recommended that Foundational Support should be built out from existing local strengths and so should be strongly guided by the local knowledge of State and Territory Governments with the Commonwealth government providing oversight and ensuring that there are national standards. This means there is an excellent opportunity to undertake continuous processes of comparison and improvement or "natural experiments". Relational contracts can very effectively facilitate this process of continuous learning, across geographies and providers because the Part A structure allows the parties to experiment, review and adjust without need to write new contracts.

Third, Foundational Supports, navigators and lead practitioners all involve ongoing relationships with people with disability and their families. As noted earlier, in purchaser-provider relationships contract termination is the major mechanism used by the purchaser to achieve desired outcomes. In effect, the operating model says: don't perform or perform in the bottom quartile of providers, according to the measures that have been set, and you are out! However, when the service that is being delivered – such as through Foundational Supports, navigators and lead practitioners – involves building long term trusted relationships, any contract terminations are very problematic, as they disrupt all established relationships which have been carefully built over time. As a result, purchaser-provider relationships are better applied to transactional services, such as buying equipment. In contrast, relational contracting naturally supports ongoing relationships and creating shared objectives between the service providers and the customers/clients.

Fourth, the NDIS is unusual in the deep engagement it is generating across governments and within governments. National Cabinet, central agencies, including First Ministers Departments, social services/community/disability policy departments across the Commonwealth, State and Territory governments and the NDIA as the operating agency all have a role in the policy settings and implementation of the NDIS. Central agencies are most interested in costs and the ensuring that the target set by National Cabinet is met, while policy departments are focused on overall disability policy settings and the NDIA has to implement the scheme. For each of these areas of all governments to effectively undertake their roles, there must be an effective feedback loop from experiences on the ground from community partners, people with disability and their families all the way to central agencies, which then shapes fiscal and policy settings. Relational contracts are better from this perspective, as they build in formal feedback loops within the Part A structure and then permit continuous policy and practice improvements.

Finally, the reforms to the NDIS and the potential to implement key recommendations from the NDIS Review using relational contracts provides an opportunity to influence the approach to government contracting in other areas – across Commonwealth, State

and Territory governments. It is in fact an ideal test case, with much wider potential benefits in terms of how governments design and implement policies to provide the most effective support for vulnerable citizens where outcome measures need to be very sophisticated.

Partnering with community organisations and the disability community

MDI has identified a number of community organisations who are currently Partners in the Community, who are eager to work with all governments and the NDIA to implement an effective relational contracting approach as part of the successful delivery of Foundational Supports, navigators and lead practitioners.

MDI is also a founding member of the Australian Disability Dialogue, whose partners include Disability Advocacy Network Australia (DANA) and Inclusion Australia and will seek to ensure that the voices of people with disability are incorporated into this project through the Dialogue.

Melbourne Disability Institute

The MDI team members who will be engaged in this work are:

- Professor Mark Considine AM, is Co-Direrctor of the Australian Welfare and Work Lab. Professor Considine has expertise in the areas of government commissioning, welfare and work. He has both a national and international reputation, is very well-connected to leaders in commissioning globally and is the author of *The Careless State: Reforming Australia's Social Services*, which includes a chapter on the NDIS. (Prof Mark Considine : Find an Expert : The University of Melbourne (unimelb.edu.au)
- Associate Professor Sue Olney is the UOM – BSL Principal Research Fellow in the School of Social and Political Sciences. Her academic expertise includes commissioning of government services, support for people with disability outside the NDIS and improving employment outcomes for people with disability (A/Prof Sue Olney : Find an Expert : The University of Melbourne (unimelb.edu.au)
- Professor Bruce Bonyhady AM is Executive Chair and Director of the Melbourne Disability Institute. He is one of the key architects of the NDIS, was Chair of the National Disability Insurance Agency from 2013 to 2016 and was Co-Chair of the NDIS Review in 2022 in 2023. He is the father of three adult sons, two of whom have disabilities and was made a Member of the Order of Australia in 2010 for service to people with disability, their families and carers. (Prof Bruce Bonyhady : Find an Expert : The University of Melbourne (unimelb.edu.au)
- Professor Kirsten Deane OAM is Deputy Director of the Melbourne Disability Institute. She is a former Campaign Director of Every Australian Counts, former Deputy Chair of the National Disability and Carer Council, principal author of

the *Shut Out* report and was a Member of the Independent NDIS Review Panel in 2022 in 2023. Kirsten has a daughter with Down Syndrome and received an Order of Australia Medal in 2015.

Contact us

Melbourne Disability Institute

University of Melbourne
Ground Floor, Building 161
The University of Melbourne
161 Monash Rd, Parkville VIC 3010

email md-i@unimelb.edu.au
phone +61 3 9035 6416