Appendix G

A new way of delivering financial assistance

Just because the government says that cooperation is good does not mean that firms will take their word for it. Talk is cheap, and so may lack credibility. How can government signal that cooperation is really a worthwhile business strategy?

Governments do this sometimes by giving out grants in so-called demonstration programs. They foot the bill because the potential business user is not convinced of the benefits. Unfortunately, many demonstration programs do not induce much new activity but simply provide transfers to firms that were going to undertake the activity anyway. However, we think there is scope for a new economical and effective scheme that demonstrates the benefits of cooperation.

The new program would be a 'contingent reimbursement' scheme – it would provide insurance for firms wishing to develop a 'cooperation plan' or a 'best practice cooperative arrangement':

- The government would produce a list of certified, high quality private sector consultants. These could help firms with their cooperation plans or best practice arrangements.
- Any firm could use this consultant database to engage a consultant adviser.
- The consultant would be responsible for drawing up a detailed cooperation strategy in conjunction with the firms involved.
- The arrangement would not necessarily have to take the form of a formal contract, depending on the circumstances and nature of the business cooperation.
- Firms would pay the consultant's fees. However for a modest processing fee, firms would be able to request the government to underwrite failure of the resulting cooperation strategy. Thus, if after say 12 months the firm is unhappy with the results of its cooperation plan or best practice arrangement, it could claim a refund of all (or maybe part) of its facilitator fees from the government. That, in itself, is only a partial refund – the firm incurs other substantial costs in management time.

Such a program would have a number of built in safeguards. First, the government would only keep consultant advisers on the accredited list if they performed well – too many failures and you are off the list. This would discipline the consultants to carefully select firms suitable for cooperation and maximise the chances of the program's success.[1] Second, the government would drop the program itself if it had too many failures. This would provide a clear signal to firms participating in the program that if they lie this would be at the expense of other firms.

[1] A possible variant might allow consultants to have an initial meeting with the firm, and then choose to drop out, without any penalty points against their reputation. This would stop cooperation strategies going ahead which the consultants think are likely to fail.

The program would also have the advantage of alleviating the usual problems associated with inducement. Most programs provide assistance to activities that were going to happen anyway. But under this arrangement, firms that were going to enter one-to-one cooperative arrangements anyway would face little incentive to enter the program. Such firms clearly expect the arrangement to succeed (else they wouldn't undertake it autonomously). Unless they are willing to lie they therefore would not expect to claim reimbursement. They also face an up front fee for joining the program. The more likely you think cooperation will succeed, the less willing you will be to pay such a fee.

The only real risk of such a program would be if firms consistently misrepresented the benefits and costs of their cooperative arrangements – saying they had failed when they had really succeeded. In this case they hurt other prospective users of the program and the consultants(who will be trying their best to make things work and have firms tell the truth).

However, it is also possible that firms may resist the program if there are significant transaction costs under the scheme (such as legal and administrative costs) compared with the actual set up costs of the arrangements. Much will depend upon the complexity of the arrangement and its degree of formality.

These additional costs may be a particular disincentive for smaller firms. The new program could address this issue in two ways:

- The government could accept that many small firms will not be attracted to the program because of the relatively high transaction costs and target the program more towards the medium-sized firms.
- Alternatively, the program could try and reach smaller firms by funding a satellite private sector body which would act as the insurer. Such a private sector body could economise on the administrative and legal costs. Why is this possible? Governments tend to have 'gold plated' contracts which are costly for themselves and others. The private sector is able to choose better risk-management procedures, because the fallout from occasional errors is less. After all, contracts do not have to be complex to generally work well. A shop receipt, for example, is a form of contract. This would minimise the transactions' costs. And it would help to reduce the risks for both the participating firms and the government.

The program need not cost too much money to administer and could potentially be very beneficial. However, we realise that the idea is novel. The government may not find it practicable, or they may need to refine it to make it work. But it is worth trying to design programs which have high inducement rates, and are cheaper because the user pays in some circumstances.

The government could apply contingent reimbursement, and the principles underlying it, to other industry programs.[2]

[2] Note that if such schemes became more widely used, it might be worthwhile adding another variation. Recipients would be penalised for too many failures. So if a firm had tried many programs and declared them all failures (thus being reimbursed every time) then the government would cease to act as guarantor. The firm, like an accident prone motorist, would simply have become uninsurable.