

Payment by results

**What does it mean for voluntary organisations
working with offenders?**



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Introduction

This is the third in a series of Clinks discussion papers that aims to inform Clinks Members and to stimulate debate of the issues that are expected to feature heavily in the new coalition Government's rehabilitation Green Paper, due for publication in November 2010.

'Payment by results' has been presented as the dominant financial mechanism for delivering the Coalition's criminal justice reform package. So far, it is unclear at what level payment by results will operate, and how it will affect commissioning and procurement. For the Voluntary and Community Sector (VCS) working with offenders, payment by results poses both an opportunity and a risk.

This briefing starts by providing some definitions of payment by results and examples of past and present practice. In the second section, we raise some questions that will be particularly pertinent to small and medium sized VCS organisations.

The Coalition is currently consulting across sectors on how to operationalise this model. It is vital that organisations think about their ability to participate in a system of payment by results. Clinks would therefore like to invite you to participate in this debate. To help bring together our Members' perspectives, we would be grateful if you could consider and respond to the key questions posed at the end of this paper in Section 3.

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Section 1: Setting the scene

Payment by results

Payment by results aims to create a financial incentive for public, private and VCS providers that can prove a reduction in reoffending. In the words of David Cameron, payment by results is ‘rewarding people for work well done’¹. It is a system of outcome-based commissioning, which transfers the financial risk or reward to the service provider. Payment by results is framed as a shift away from ‘micro-managing processes and towards defining the desired outcomes to be achieved’².

In opposition, the Conservative Party laid out plans for applying payment by results to offender rehabilitation in its Green Paper Prisons with a Purpose³:

“all institutions in the system – prisons, the probation service, public, private and voluntary agencies – will have one clear incentive: to stop individuals re-offending once they have left prison. If they are successful, they will be able to earn more money. If they are not, they will still receive payments to cover their costs.”

A two tier payment tariff was proposed, with a basic tariff to be paid at regular intervals and a premium tariff to be paid only where the ex-offender does not reoffend within a fixed period following release. In this paper, it was suggested that higher payments would be made for offenders assessed as particularly likely to reoffend.

The Coalition Government and payment by results

Payment by results was featured in the Coalition Agreement and is firmly on the political agenda⁴:

“we will introduce a ‘rehabilitation revolution’ that will pay independent providers to reduce re-offending, paid for by the savings this new approach will generate within the criminal justice system.”

In his first keynote speech as the new Secretary of State for Justice, Ken Clarke reinforced this commitment⁵:

“Outside bodies would have clear financial incentives to keep offenders away from crime. And success would be measured perhaps by whether they find and keep a job, find housing and so on – whether they become functioning members of society – but above all by whether they are not reconvicted within the first few years of leaving prison.”

Ken Clarke’s list of desirable outcomes suggests that the VCS might be rewarded for a number of different steps in the journey to successful rehabilitation – employment, accommodation etc. But the question is begged, how does one go about measuring whether people have ‘become functioning members of society’?



The Ministry of Justice is currently consulting on payment by results, with a view to developing options for contracting out rehabilitation services to third parties⁶.

The concept of social investment bonds appears to be very much in vogue with policy makers; the Peterborough Pilot – funded by a ‘Social Impact Partnership’ – has been very prominent in speeches and reform plans so far. This paper provides a short explanation of the Peterborough Pilot, followed by other examples of payment by results in welfare provision.

What we do not know yet is how payment by results will be operationalised for the large volume of work that the Coalition envisages the VCS undertaking, given that most of the Sector lacks capacity to operate on a system of payment in arrears. If payment by results is to be accessible to the Sector, a financing vehicle will be needed to bridge the gap between upfront delivery and outcomes-based funding⁷.

The Peterborough Pilot

The Social Impact Partnership is one such vehicle; a financial mechanism that provides upfront funding for service providers from social impact investors. The investors have an agreement with a public sector body, which contracts to pay them a return on positive outcomes⁸. The service providers are thus shielded from financial risk, all of which is borne by the investors.

The Peterborough Prison pilot is being administered by Social Finance and will involve St. Giles Trust and other social (voluntary) sector organisations in delivery. The programme will provide support for 3,000 short

term prisoners over six years. If rates of reoffending drop by at least 7.5%, the bond investors will receive a return on their investment based on the savings made⁹. It is hoped that this method of financing will be an effective source of non- Governmental finance for innovative projects – particularly for those projects that struggle to attract public funding.

Social Finance has recently received £5 million from the Big Lottery Fund to develop three further pilots¹⁰. Pilots of this model undoubtedly provide an opportunity for VCS organisations to prove their social and financial worth and to develop their evidence base.

However, a great deal of working capital is required for such initiatives. The current Social Finance partnership is set to raise £4.9 million. Although the project is currently oversubscribed by funders¹¹, it can be anticipated that when social investment bonds are rolled out on a much larger scale, sourcing funders may become increasingly difficult.

Calculating the outcomes metric and satisfying the bond’s legal criteria are enormously time consuming and expensive processes. Given that the current pilot has a six year life span, concrete evaluative evidence of its progress will not be available for some time.

Payment by results in welfare provision

Payment by results is not a new concept. It has operated in areas of the NHS since 2000 and was introduced to the Department of Work and Pensions (DWP) and the Legal Services Commission in 2008. The Government now



intend to extend its application in its wide-ranging public service reform package¹².

Experience from past practice demonstrates that the devil is in the detail. When public service contracts are put out to tender, the format of the payment scheme is critical to an organisation's capacity to deliver.

VCS experience of payment by results in DWP welfare to work programmes is highly illuminative. The payment structures have included a service fee paid monthly, which remains consistent throughout the programme, and an outcome payment payable on achievement and evidencing of individual outcomes¹³.

Unlike the Peterborough Pilot, under this model providers have had to adapt to a system of part-funding in arrears, and have been required to demonstrate outcomes before receiving full payment. Under the Flexible New Deal, the service fee was 20% of the total fee but this was increased to 40% to assist with the economic downturn¹⁴.

DWP operates a prime contractor model, which means that most VCS organisations involved are engaged as subcontractors¹⁵. A recent survey of VCS experiences of subcontracting in the delivery of DWP/Job Centre Plus contracts suggests that there are many lessons to be learnt¹⁶.

Organisations have reported the expectation that the VCS would provide the 'free' half of service delivery. One organisation had to hand back two contracts because outcome-loaded payments made it impossible for them to deliver.

This summer, in a DWP online consultation on its payment by results model, concerns were voiced about large organisations 'parachuting in' for a short time and over-focusing on one outcome when many of the users had multiple needs¹⁷.

One organisation described being penalised when they had over-performed on a contract because the prime provider had failed to deliver and requested more rigorous subcontracting records to be held.

Complaints were raised that the evidence required was so rigorous that organisations struggled to receive payment, for example where a person was in work but could not provide the written form of evidence needed by DWP¹⁸.

These criticisms have been supported by the Work and Pensions Committee which described the system as 'bureaucratic and unpopular'¹⁹.

This observation from a 2010 research report published by DWP suggests that this model of outcome-based contracting has not successfully promoted flexibility and innovation from prime providers:

*"There was little evidence that prime providers were developing in-house provision to enhance the quality of customer services. Instead, partner agencies were increasingly used to address specialist service needs. Service innovation on the part of prime providers was largely focused on reducing operational costs and achieving performance efficiencies."*²⁰



Strengths of the VCS

Despite the pitfalls that might be encountered in the payment by results model, a focus on outcomes clearly provides opportunities for the VCS.

The Coalition has demonstrated a strong commitment to localism and VCS organisations are ideally placed to deliver within the community²¹. An outcomes-based approach aims to release the sector from bureaucratic processes and over regulation and to introduce a new framework for service delivery:

“In opposition, the Conservatives argued that the sector had been underused, undervalued and controlled like a ‘mini public sector’ and proposed to reduce burdens, interference, bureaucracy and wastefully complex initiatives, and to promote longer term contracts based on payment by results.”²²

The new outcomes-focused model could facilitate greater freedom and space for innovation and, in principle, may be a useful development for the Sector.

The Conservative Paper ‘Prisons with a Purpose’ certainly presents payment by results as an opportunity for VCS organisations to escape “unwieldy regional commissioning process(es)”. What is critical to the VCS is how this model will look on the ground.

Section 2: Questions for payment by results

Who will deliver the programme?

The Conservatives’ plans in its ‘Prisons with a Purpose’ Green Paper appeared to anticipate small organisations forming partnerships with private companies and large VCS organisations:

“As a result of our rehabilitation revolution, the larger voluntary organisations and private companies, who have access to capital, will have greater incentives to involve smaller charities, who have the experience, commitment and local community involvement to make the programmes work”²³

However, the model that the Coalition has in mind is far from fully formed. It seems that prime providers – private companies and large VCS organisations – will be expected to take on and bear the risk of large contracts. For small and medium sized organisations, subcontracting may be the only viable option for participating in the payment by results environment.

Subcontracting models pose risks to autonomy and accountability for the smaller VCS organisation. Operating beneath a prime contractor will mean a change in strategic direction for many organisations, particularly given the imperative to demonstrate outcomes in order to receive a financial return. A danger is that levels of competition will squeeze out VCS agencies, with prime contractors opting for partnerships with private sector providers.



One solution would be for Government departments to make payment by results contracts conditional upon the prime provider subcontracting with a minimum number of small VCS providers for delivery.

Who will bear the risk?

Fundamental to payment by results is the transfer of risk from Government bodies to independent providers. It is widely recognised that it will be untenable for smaller VCS organisations to take on this kind of risk. There seems to be a growing understanding that a 'payment by results' model cannot be implemented in the CJS in the same manner as in the DWP.

For large, scalable contracts (national and regional) the model now gaining acceptance within the CJS would be to attribute the success or failure of interventions to the prime contractor so that they, or their social investors, would bear the risks of deferred payment, and smaller sub-contractors would not be expected to wait to recover their costs. It seems likely that investors would have to carry most of the risk, leaving VCS providers to run on upfront payments, as in the Peterborough Pilot.

This scenario requires that VCS organisations of all sizes engender investor confidence in their programmes in order to secure funding. This is likely to intensify pressure on VCS organisations to provide a strong evidence base.

What will an acceptable evidence base look like?

With the emphasis on outcomes, organisations will need to prove that their activities effect reductions in reoffending. The rigours expected are likely to cause serious capacity problems for many groups, as shown by the recent Third Sector Research Centre evaluation of the sector:

“To be able to take part in the competitive market, [Third Sector Organisations] will need to be able to prove their effectiveness, yet many smaller organisations will not have the money, expertise or capacity to collect data demonstrating outcomes, particularly where longitudinal effects are required.”²⁴

It might be helpful if there was a universally accepted system of outcomes measurement for the Sector to adopt. An outcome measure that is cheap, easy to use and, most importantly, versatile will be essential to the VCS in demonstrating its results.

Beyond capacity, there are clearly empirical problems related to this Sector. How will it be possible to isolate the impact of one particular agency working with an offender? The burden of proof will be difficult to discharge where multiple organisations are working with an individual. These challenges suggest that it may be necessary for many VCS organisations to consider collaborating with one another and increasing capacity through partnerships.



How will payment by results be operationalised at local level?

The Government will need to consider how it is going to involve myriad smaller organisations working in the CJS at local level. It remains to be seen how payment by results will affect local micro-commissioning.

Small VCS organisations, operating under traditional charitable governance arrangements, have neither the capacity nor the reserves to wait for full recovery of their service delivery costs.

The ability of the Big Society Bank and sources of social finance such as Charity Bank to provide the levels of investment capital and loan finance that will be required to fund a wholesale transfer of public services to the VCS currently remains uncertain.

NCVO raise the possibility of trusts and foundations developing a 'joint working capital fund' to help with cash flow problems²⁵.

When will providers be paid?

For VCS organisations, many of which operate with little or no reserves, receiving full payment in arrears is not going to be viable. A more sophisticated model of payment by results will be required if the system is to be accessible to organisations of small or medium size.

The VCS need to consider payment plans that would be manageable, and individual organisations should think about what is feasible for them:

1. DWP has operated 'mixed' payment by results models. A mixed system might involve part-payment or a start-up fee followed by a series of staged payments and a system of bonuses.
2. The percentage of the total payment provided upfront is likely to determine ability to participate.
3. For many local organisations working with offenders, payment by results may not be a workable model. Organisations could look at subcontracting at a fixed rate from a prime provider.

Operating in this climate is going to place real pressure on the VCS, both financially and culturally. One strategy will be to advocate the continuing importance of The Compact, which commits public sector bodies to paying money in advance of expenditure where there is a clear need.

Which results?

The social investors in the Peterborough Pilot will be paid for just one outcome: reducing reoffending. Developing a metric for work with offenders is likely to be a problematic process. For much of the VCS, particularly the most localised, 'reducing reoffending' is not their single or necessarily even one of their core objectives. Much VCS work focuses on transforming the process of rehabilitation and addressing multiple needs.

Social Return for Investment approaches may prove useful here. Outcomes such as improved self esteem and relationships may be harder to measure but play a vitally important part in reducing reoffending. With a new focus on payment by results, there will be greater



pressure to prove soft outcomes. Policy makers will need to consider how these sorts of outcomes can be included in the metric, or risk marginalising very valuable work.

The agenda in this time of austerity is to reduce the number of people in prison by providing cheaper alternatives to custody. Organisations working with offenders need to build up a clear statement of how they can contribute to this picture.

How will the results be measured?

There are at least two aspects to this question.

Firstly, which offenders does an organisation have to include in their cohort? There are concerns about agencies cherry-picking their users. The Committee on Work and Pensions found evidence of ‘creaming and parking’ in Pathways to Work programmes; staff concentrating on participants who were closest to the labour market to optimise outcome payments²⁶. A number of solutions have been offered for this, mainly focused on some form of differential payment, with providers receiving a higher payment for offenders assessed as particularly likely to reoffend. Social Market Foundation suggests a ‘payment escalator’, with payments increasing with the proportion of the cohort not reconvicted.

Secondly, how large must the reduction in reoffending be to earn returns? And, even more fundamental, compared to which group? The latter question will be particularly important when considering how to pay agencies for preventative work and interventions that occur prior to entry to the CJS.

Over what time-frame?

Greater clarity will be needed about the length of time that an organisation will need to work with an offender before they can claim a successful result. For VCS organisations that have previously focused on immediate outcomes or short-term programmes, this will require strategic change and adaptation to a very different funding landscape, all of which will be organisationally challenging and potentially costly.

How will the Sector’s unique value be rewarded?

Payment by results should include recognition of interventions with softer outcomes that have developed organically within the VCS to address identified needs and gaps in statutory provision. It is critical that the VCS demonstrates to the government that there is unique value in the Sector that should be banked for future users.

Section 3: How to contribute to this debate

Clinks would be very interested to know how you think payment by results will affect your organisation, so that we can incorporate your views into our feedback to Government, to inform the rehabilitation Green Paper.

In particular, what would make payment by results a realistic source of finance for services delivered by your organisation?

To contribute to this debate, please email your views and ideas to clare.hayes@clinks.org

Author

Clare Hayes

Policy Researcher, Clinks

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Key questions to consider:

- What are your organisation's views on payment by results?
- What percentage of total payment would your organisation require upfront in order to deliver its programmes?
- Would you be willing to use your unrestricted reserves (if you have any) to provide the cash flow for this model?
- Does your organisation have previous experience of payment by results models?
- What are your previous experiences as prime or sub-contractors working in partnership to deliver larger scale contracts?
- What would help your organisation to adapt to the new funding models?

How ready is your organisation to measure and demonstrate its outcomes to funders?

Other Clinks papers in this series cover:

- **Localising Justice:** how can we increase VCS involvement in service design and delivery?
- **Big Society:** Constraints and Potentials
- **Innovative services for a rehabilitation revolution:** What could go to market?
- **A new focus on measuring outcomes:** Where do we start?

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