MAXIMUS United Kingdom

Commissioning Work Programme Plus:

Ensuring High Performance and Value for Money

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Executive Summary

Welfare to work programmes support individuals who are long term unemployed return to work. In the UK, these services are cost effective to the taxpayer as the government spend on programme delivery is offset by savings to the social security benefit bill.

The purpose of this paper is to provide recommendations to drive higher performance and better value for money in Work Programme Plus. We propose that the Department for Work and Pensions (DWP) implement the following changes to achieve this goal:

- Take Past Performance into Account
  - Past performance does not currently play a role when awarding new contracts. We highlight the risks of the approach and the significant impact providers' performance can have on the overall success of employment programmes.
- Move from Price Competition to Quality Competition through Fixed Price Contracts with Market Share Shift to drive better Return on Investment for DWP
  - Bidders for Work Programme contracts competed on price. We explore how the UK market has since matured and propose an alternative approach to pricing in light of this. We highlight the merits of fixing the prices in a Payment by Results (PbR) model when contracting for Work Programme Plus.
- Calibrate the Funding Model to Effectively Manage Risk and Reward
  - We assert that DWP can achieve better performance at a lower cost on Work Programme Plus by focusing on providing the right incentives for high performance and undertaking transparent and accurate modelling to ensure a comprehensive assessment of costs, revenue, risk and reward.

We explore each of these points in turn to demonstrate that Work Programme Plus can surpass predecessor programmes with better performance and better value for money.

Taking Past Performance into Account
Recommendations

- **DWP should take past performance into account when awarding future employment services contracts**
  - **How?** DWP can implement this recommendation by including an assessment of a bidders' past performance into the overall evaluation criteria; performance should comprise 30–40% of the overall score
  - DWP should award marks through a graded scale, where the highest marks are awarded to the highest performance rates. This is preferential to a binary pass/fail approach as it ensures full transparency of performance differentials.
  - DWP should assess performance within each Contract Package Area (CPA) as well as performance between CPAs. This will ensure a complete and transparent view of performance.

- **DWP should provide new entrants with the opportunity to demonstrate past performance in a comparable space, and incumbents should be judged on the hard data that DWP holds**
  - **How?** All bidders must provide a response to a question on past performance.
  - DWP can rely on the data that it holds about its contracted providers/bidders to score them against the performance criteria.
  - New entrants can respond by providing their performance data from similar services. They can mark their performance on alternative contracts where there is a direct transferability between the nature of the services. This could include services for the long-term unemployed or delivering large complex programmes through a supply chain of specialist providers.

Past Performance should be taken into Account when Commissioning Future Employment Programmes

To date welfare-to-work programmes have been commissioned based on quality and price. Bidders are awarded contracts subject to their pricing proposal and forward looking plans for service delivery. Previous performance has not been included in the evaluation criteria — a provider's track record is not considered. In this section we explore the reasons for and benefits of assessing past performance, and argue that past performance should be taken into account when commissioning employment services.

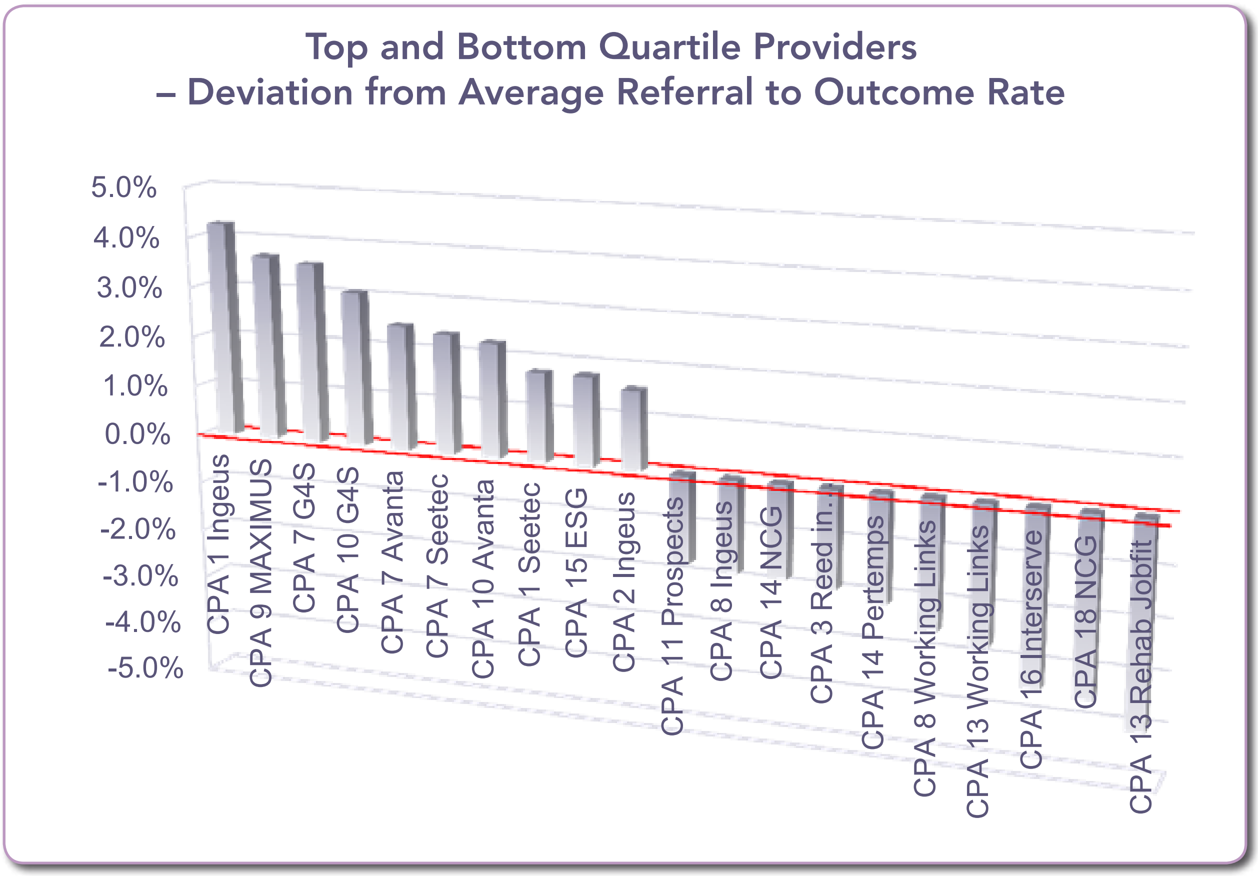
Why should Performance be taken into Account when Commissioning Employment Services?

Past performance is a reliable indicator of future performance. Though it is not a perfect guide, we can see across a range of public policy sectors that high performing providers deliver the best results consistently. For example, when evaluating DWP's previous programmes, we see that organisations that have performed well in the past at supporting jobseekers into sustained employment are likely to continue to perform well. Conversely, organisations that have consistently underperformed are likely to underperform in the future.

The success of any welfare to work programme is determined by the collective performance of all the providers. The impact of superior performance in welfare to work programmes cannot be understated both in terms of the impact for the tax payer, and ultimately on the number of people's lives that are changed for the better as a result of their inclusion in the labour market.

The current Work Programme demonstrates the differential that exists between high performing organisations and low performing organisations.

The graph below shows the gap in performance that exists across providers.

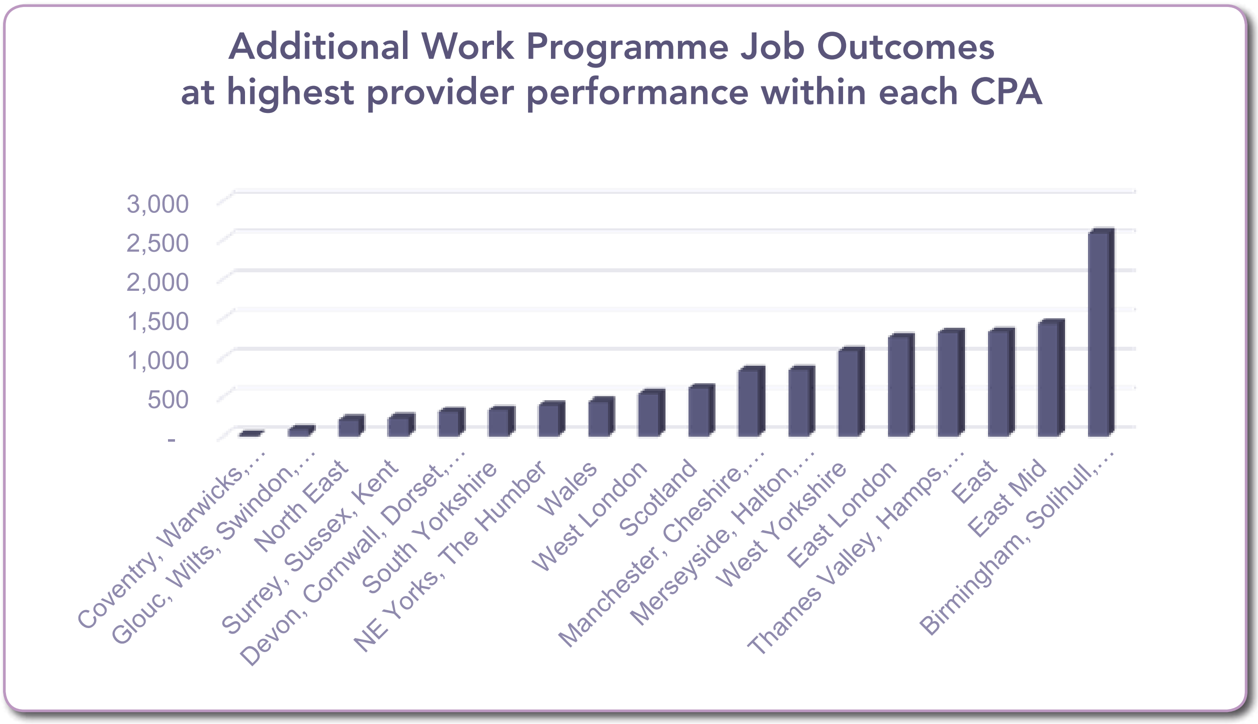


Source: Work Programme Statistical Summary: Data to 31 March 2015.

The average performance of the top quartile of performers is over 15% better than the average performance of the bottom quartile. 25,000 more people would have gone into sustained employment had the bottom quartile performed at the level of the top. This represents a saving to the taxpayer of £126m every year.[1,2]

[1] *Based on calculations from: Freud D, 'Reducing dependency, increasing opportunity: options for the future of welfare to work : An independent report to the Department for Work and Pensions', 2007, http://www.dwp.gov.uk/docs/welfarereview.pdf,*
[2] *No one written off: reforming welfare to reward responsibility' DWP Public consultation, 2008, http://www.dwp.gov.uk/docs/noonewrittenoff-complete.pdf*

However, the performance of the delivery organisation is not the only factor that affects the number of people securing sustainable employment — the local labour market and macro-economic factors also play a role. Fortunately, with the Work Programme, we can control for geographic and macro-economic factors by comparing providers within the same contract package areas (CPAs).

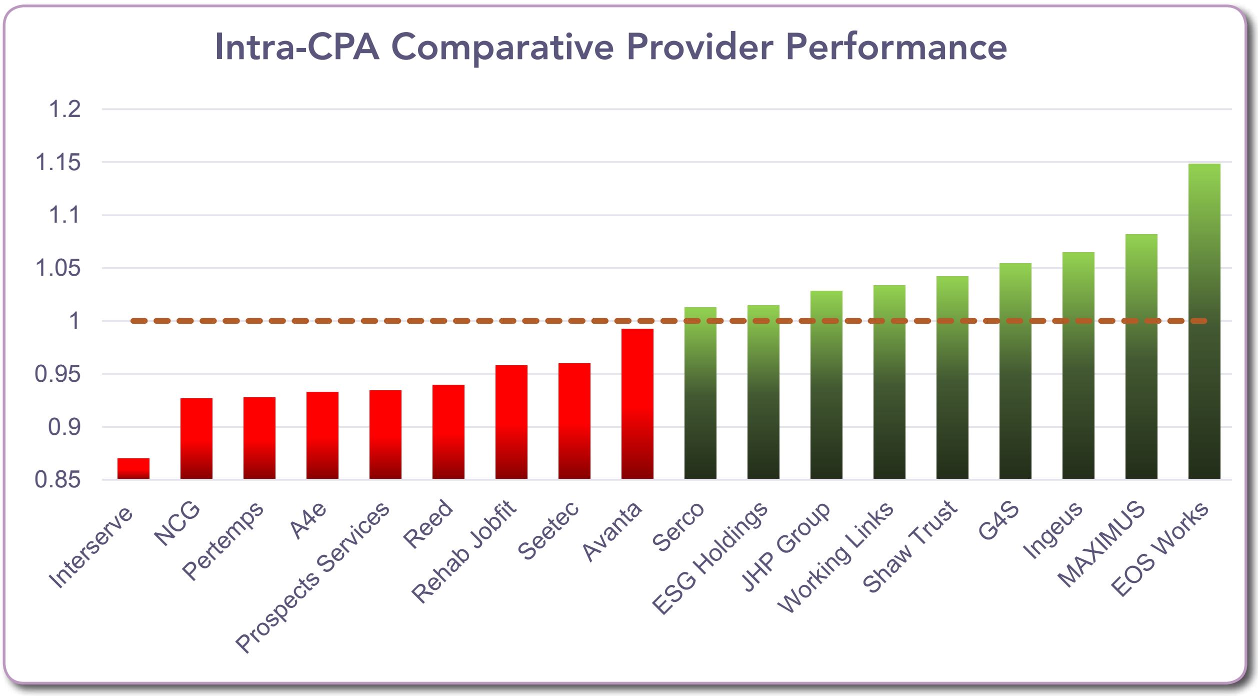


Source: DWP Work Programme cumulative figures, December 2014. Weighted for referrals, market share.

Had the bottom provider in each CPA performed as well as the top provider, then an additional 13,787 people would have found sustained employment through the Work Programme. This represents a saving to the taxpayer of £70 million every year.[3]

Work Programme data shows that there is a consistency between high performing contractors across CPAs. If an organisation is top performing in one CPA they are highly likely to be high performers in other CPAs in which they operate. Conversely, if an organisation is the worst performing in a CPA they are highly likely to be at the bottom in the other CPAs in which they operate.

[3] *Ibid*



Source: DWP Work Programme cumulative figures, December 2014. Weighted for referrals, market share. Job Outcomes as % of referrals.

Why has Past Performance not been included in the Procurement Process to Date?

There were two main reasons why past performance had not previously been included as a key decision criteria in the procurement of employment programmes in the UK to date.

First, previous European Union procurement regulations were interpreted in a way that assumed the prevention of past performance being taken into account when awarding contracts. Secondly, there is a view incorporating past performance into the evaluation process disadvantages new entrants. We explore each of these elements to illustrate that they do not act as barriers to introducing past performance part of the decision making process.

Changes to EU Procurement Regulations

The original rules were justified on the grounds of removing barriers to entry in public sector procurement and preventing anti-competitive or protectionist award practices (Public Contracts Regulations 2006, Utilities Regulations 2006). It was under this context the Work Programme was originally procured. Recent changes to regulations present an opportunity that was not available in previous procurement.

Following a shift in procurement policy at the EU level, these regulations have since been updated. DWP now have the authority under the new Public Contracts Regulations to incorporate objective past performance metrics into future contract reward criteria. It is now possible for bids to be excluded because of poor performance based on objectively 'proportionate' criteria.[3,4] For example, commissioners have to consider the organisation, qualification and experience of the staff assigned to performing the service.

[4] *'Commission Staff Working Paper Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council', 5.3.2. Impacts of STR.LEGI.FACILIT option, p. 60, http://ec.europa.eu/internal_market/publicprocurement/docs/modernising_rules/SEC2011_1585_en.pdf*

[5] *UK response to Commission's proposed new EU procurement Directive (Local Government), 2012, http://www.anthonycollins.com/briefings/uk-response-commission%E2%80%99s-proposed-new-eu-procurement-directive*

In addition, the new Cabinet Office Directive recognises the special characteristics of social, educational and health services that may make conventional procurement regulations inappropriate. This means commissioners need only adhere to the basic principles of transparency (for example publishing the OJEU notice and making clear the evaluation criteria) and equal treatment, but otherwise have wide discretion over the choice of supplier and the weight given to previous performance. These changes allow commissioners to account for past performance in contracting employment services.

Does using Past Performance to Award Future Contracts Disadvantage new Entrants?

As macro-economic theory and practice shows, high functioning markets require the possibility of new entrants. It is often argued that taking past performance into account, disadvantages new market entrants. Best practice approaches to procurement allow the procuring agency to both consider past performance and allow for new entrants. For example, the Australian Employment Services market demonstrates how taking past performance into account and allowing new market entrants can work simultaneously in procurement processes.

The latest round of contracting of employment services in Australia used past performance in the delivery of employment assistance or similar services to jobseekers and employers in the evaluation of prospective providers. Past performance accounted for 40% of the selection criteria. Incumbent providers were judged based on the data that the Australian government had on their performance. New entrants presented their past performance in similar areas. Specifically, the question was to:

> *"Demonstrate in quantitative terms your organisation's experience and performance in delivering Employment Services or similar services to Jobseekers and employers. Any qualitative information should be directly relevant to the assessment and understanding of the quantitative data provided as part of the response to this criterion.*
>
> *Your response should address, but is not limited to, your organisation's experience, expertise, and achievements in:*
>
> - *performing against measures of performance most relevant to Stream Services as described in the Request for Tender, including commencing eligible Jobseekers into Work for the Dole activities and monitoring their participation*
> - *moving a wide range of Jobseekers, including Indigenous Jobseekers and those with significant vocational or non-vocational issues into employment and sustaining those employment outcomes*
> - *achieving outcomes relevant to the Services being tendered, demonstrated performance against contractual Key Performance Indicators and verifiable evidence of performance against those Key Performance Indicators*
> - *ensuring adherence to all contractual requirements*

- *meeting the needs of employers and ensuring jobseekers have the skills that employers need, and how this has resulted in sustained employment*
- *identifying, establishing and managing Work for the Dole or similar activities, including ensuring the activities are conducted and maintained with a high regard for work health and safety*
- *establishing and building linkages (including partnerships and/or practical collaborations) with organisations, including other Employment Providers, which contributed in moving jobseekers into work and address how this performance demonstrates your capacity to deliver Stream Services in the Employment Regions for which you are tendering.*[6]

In the latest round of contracting, six new providers entered the employment service market in Australia demonstrating that taking into account past performance can sit alongside encouraging new market entrants.

The Consequences of not using Past Performance in Awarding Contracts

We have seen that the primary consequence of not using past performance in awarding contracts is that fewer jobseekers find sustainable employment and consequently that the benefits bill is higher than it would have otherwise been.

If providers' current performance not only affected their current revenue and league table position but also played a significant part in the future of their business, performance would receive an even greater degree of focus from them. By linking current performance and the long term future of the organisation, providers are incentivised to invest in performance throughout the life of the contract. This implies a better balance of investment between business development and operations.

In the absence of past performance as a consideration, there is no steer for commissioners to award contracts to the best performers per se. A greater share of work can be awarded to mid or low tier performers who propose the lowest cost and the most attractive service offer.

For example, in the awarding of Work Programme contracts:

- None of the four providers who were awarded the largest market share of Work Programme were in the top quartile of performers from the predecessor programmes. This meant that approximately 50% of the Work Programme market was awarded to contractors who were not top-quartile performers in the previous programme.
- Providers of the top three contracts in the predecessor programme were not awarded Work Programme contracts in the same area
- Only one of the providers who delivered a top five contract in the predecessor programme was successfully awarded the follow on contract in the same area

[6] *Australian Government, Department of Employment "Request For Tender For Employment Services, 2015–2020"*

Moving from Price Competition to Quality Competition

Recommendations

- **The employment services market in the UK is mature enough for DWP to move from price competition to quality competition through fixed-price commissioning**
  - **How?** DWP can fix the price per job outcome of each jobseeker group. All providers should be paid the same amount for achieving the same outcome.
  - DWP can award contracts based on measures of bidders' quality — past performance, service delivery — not on pricing discounts.

- **DWP should apply very robust market shift mechanisms alongside fixed price competition. This will result in better value for money and return on investment by diverting work flow to providers that deliver more for the available prices**
  - **How?** DWP should increase the frequency and magnitude of the current market share shift mechanisms.
  - The first market share shift should take place after 18 months of contract delivery — referrals should be reallocated from the bottom performing provider to the top performing provider
  - Market share shift mechanisms should then be applied every six months
  - This reallocation should occur within each CPA, for example at a JCP office or 'cluster of offices' level. This focuses market share shift down at the level where true performance differentials happen and mitigates against the risk that low performance at a site level is neutralised by good performance at a neighbouring site.

What is the Best Way of Paying for Employment Services in the UK market?

Welfare to work programmes in the UK are proving to be more effective than ever before. More and more jobseekers are being supported into employment each year and the cost per job outcome is decreasing with each procurement cycle[7]. This cost reduction is primarily a result of the move towards Payment by Results (PbR) contracting, where providers are paid for the achievement of job outcomes. Under PbR, risk is transferred to providers, and funding follows performance.

The increased efficiency and move towards progressive pricing mechanisms demonstrates how much the UK welfare to work market has matured over the last 15 years. As a consequence of the market's maturity, there is an increased level of public scrutiny — demands of the government's support systems are high, and there is a justified expectation to deliver value for money. Work Programme Plus is expected to deliver better value for money. Here we argue that the best way to drive cost effectiveness is through fixing the cost of the unit fee when commissioning Work Programme Plus and applying robust and regular market share shift mechanisms to direct referrals to those organisations that demonstrate the highest performance.

[7] *National Audit Office: The Work Programme Report HC 266 SESSION 2014-15, 2014, http://www.nao.org.uk/wp-content/uploads/2014/07/The-work-programme.pdf, pg. 4.*

Is Payment by Results combined with Price Competition Still the Best Method to Drive Performance in a Mature Market?

Contracts are awarded to bidders based on a combination of their pricing and quality offer. For the Work Programme, the scoring was out of 100. A maximum of 60 marks were awarded for the quality section, and a maximum of 40 marks for the pricing section. The differential between the scoring was narrow in the quality section, where the majority of bidders scored between 55 and 60 marks. However, in the pricing section, the scoring methodology meant bidders who offered the highest discount earned the maximum score. All other bidders were scored based on their relative ranking from the top. This resulted in the most aggressive discount receiving 40 points, and most other bidders received in the region of 0–15 points. Give the highest discount received a 20–30 point advantage, the differential between pricing scores was larger than the differential between quality scores.

As such, bidders' discount on pricing had a greater impact on the overall contract award decision. Bidders were driven to a "race to the bottom", offering the lowest price possible to obtain the maximum score.

While PbR is an effective way to ensure taxpayers only pay for proven outcomes, it is less clear that this approach should remain combined with price competition in a mature market. In the UK, efficiencies and economies of scale — used to drive down unit price — have already been identified over the course of 15 years of service delivery. Unless there are substantive changes such as vastly higher volumes or lower service requirements, price competition can lead to further cost cutting. This has detrimental effects on quality and performance.

The two main disadvantages of price competition in this context are:

- Winners curse — price competition almost inevitably guarantees successful bidders are those who have undercut the numbers. In a mature market, those who have undercut the numbers are not reflective of the true cost of delivery.
- Sacrifices quality for cost — lower quality means fewer job outcomes and so a reduction on potential benefit savings not realised. These can easily offset the benefits of a lower cost. As we have seen the savings are significant — £70 million could have been saved on the Work Programme if the bottom performing providers delivered as many outcomes as the top performers.

Price competition therefore does not guarantee the best value for money in a mature market. Although the cost of the programme will be cheaper as the commissioner is paying the minimum price per unit, it is possible that overall costs will be higher. This is because the programme may not get as many people into work as a fixed price competition therefore higher benefit bills will eclipse the lower programme cost. As such, we look to alternative ways to price employment service contracts while still using PbR.

Using Fixed Price Competition with Market Share Shift to Drive Value for Money

An alternative way to finance employment service contracts is to apply a fixed price. Fixed price competition dictates the unit price for an outcome is set by the commissioner of the service. The Commissioner does not need to second guess market rates in services such as this. As the market is mature, they know the value of a Job Outcome to the public purse and the current costs of delivery and can set prices accordingly. This, therefore, leads the market to focus on maximising outcomes and quality up to that price point.

The success of an employment programme is understood through two measures: number of job outcomes and the savings to the benefit bill as a result. It is, therefore, better to pay more for the service, generate better outcomes and save more. Using fixed price as opposed to price competition flips the purpose of the competition in order to capture the true cost.

Fixing the price does not eliminate the element of competition. Bidders must compete on other critical aspects such as quality and performance. PbR remains in force — providers are only paid on their achievement of outcomes that matter. The providers retain the majority of risk.

When coupled with the robust application of market share shift mechanisms, fixed price competition is a very effective way for commissioners to achieve value for money in a mature employment services market. As the price is fixed, the best return on the investment is the option that leads to the most sustained outcomes. Since commissioners use PbR to pay providers a uniform amount for each jobseeker group, the funding is best allocated to the providers who deliver more job outcomes for this amount. By shifting referrals to higher performers, market share shift allows commissioners to realise better value for money.

> *'Any move to payment by results creates new challenges for commissioners in setting and monitoring appropriate outcomes… performance needs to be monitored closely, so that no-one gets stuck over the long term receiving services from a failing provider, while commissioners wash their hands of the problem, unperturbed because they do not have to pay.'* [8]

If market share shift is absent and performance is not monitored closely, lower performing providers continue to receive an equal number of referrals as their neighbouring higher performer. Under fixed price contracting, this means less is achieved for the predetermined spend, reducing the return on investment. The government would receive lower value for money without implementing market share shift.

Why DWP should transition from Price Competition to Fixed Price

When applied to a mature employment services market such as that in the UK, DWP can recognise the following advantages:

- Better value for money when used in tandem with effective market share shift
    - Higher savings in benefit spend
    - Avoid the risks of price competition: the "race to the bottom", sacrificing quality for cost and winners curse
    - Decreasing likelihood of poor performers winning more contracts (as evidenced in the case study on page 13)

[8] IHM Government, *Open Public Services White Paper*, 2011, https://www.gov.uk/government/publications/open-public-services-white-paper, p. 34

Fixed Pricing in Practice: Case Study of the Australian market

We look to the Australian market to see how these benefits are applied — and realised — in practice. Commissioning employment services in Australia uses fixed price competition with market share shift, and takes past performance into account when awarding new contracts.

Rationale for Transitioning from Price Competition to Quality Competition

In 2002, Australia's Productivity Commission published its review on the market for labour market assistance arrangements.[9] The report clearly articulated the economic and market-based reasons for moving away from unfettered price competition. At present, the Australian system is extremely well regarded globally for both its contracting structure and performance outcomes. Analysis has consistently showed that the system was both cheaper and better performing than the preceding (state) provision.[10]

The report recommended that fixed administrative pricing was likely to be better across all Job Network services, with some new forms of optional incentives contracts, such as for providers who targeted outcomes at a price higher than the default. Its main arguments for abandoning price competition and adopting fixed price were:

- Bid discounting would result in a 'race to the bottom' on both quality and price. 'While price competition at the bidding stage can be an important feature of purchaser-provider arrangements, it cannot be given full reign' 11
- The Commission noted that an absence of, or reduced price competition does not mean no competition in other dimensions:
  - in an outcomes-based system, better performers (as defined by the rules of the quasi-market) receive higher payments, even at fixed prices — and will therefore tend to flourish and displace poorer performers; and
  - better performers will get higher performance ratings and increase their chance of repeated contracting (or in keeping a licence to operate)12

Commentators suggested the Commission's findings support the view that price competition and the lack of regulation encouraged providers to take up-front fees, work with the most job ready and 'park' the hardest to place jobseekers.

Application of Market Share Shift

Market share shift is applied at local level in Australia — referrals are reallocated on six-monthly basis at a local level. Each providers' office receives a Star Rating from one to five based on their performance relative to the average within that geography. Referrals are shifted away from lower performing sites (those with low star ratings) and reallocated to the higher performing sites (those with high star ratings) in the same region. The Government drives value for money through allocating funding to those who achieve the most job outcomes and therefore generate a higher saving on benefit spend in that region.

[9] *'Independent Review of the Job Network', Productivity Commission Report 21, 2002, http://www.pc.gov.au/inquiries/completed/job-network/report/jobnetwork.pdf*

[10] *Thomas, M., 'A review of developments in the Job Network', Research Paper No. 15, 2007, http://apo.org.au/research/review-developments-job-network*

[11] *Ibid., p. 3.18.*

[12] *Independent Review of the Job Network', Productivity Commission Report 21, 2002*

Evidence of Success

By transitioning from price competition to quality competition, the Australian market benefitted from the following programme improvements:

- Increase in performance
  - Evaluations of the service found an improvement in short-term job prospects of between 5 and 10%.[13]
  - A Departmental net impact study (cited by the Australian Productivity Commission, 2001)[14] showed the probability of leaving government benefits sooner (as at three months from programme entry) was 10% higher for the hardest to help seekers, and 3% higher for 'mainstream' jobseekers.
- Increase in cost effectiveness
  - The impact on the increase in cost effectiveness is significant — the average cost per job outcome reduced from a peak of Au$16,000 per job to Au$6000 within 3 years; a downward trend that has continued to the current level of Au$4,000.
- Increase jobseeker satisfaction
  - The Department found a high level of jobseeker satisfaction — 80% or higher for harder to help groups under the final version of the Job Network.[15]

From this case study, we can see that fixed price competition with robust market share shift has resulted in better value for money and performance improvements in the Australian employment services market.

[13] *Finn, D (2008) Lessons from contracting out welfare to work programmes in Australia and the Netherlands, Joseph Rowntree Foundation, 2008, p. 26.*

[14] *The evidence is summarized in the OECD 2012 report – see p. 218 and Table 5.2 on Net impact evaluations — 'The most recent net impact evaluation (DEEWR, 2010a) focuses on off/part-benefitoutcomes in March 2008 for jobseekers 12 months after programme commencement.'*

[15] *Finn, D (2008) 'Welfare markets': lessons from contracting out the delivery of welfare to work programmes in Australia and the Netherlands, Joseph Rowntree Foundation, 2008, http://www.jrf.org.uk/publications/lessons-contracting-out-welfare-work-programmes-australia-and-netherlands*

Calibrating the Funding Model and Leveraging Risk and Reward

Recommendations

- **DWP should explore means to share volume risk with providers. Variations to volume forecasting are detrimental to both performance and cost effectiveness**
  - **How?** DWP can use contractual mechanisms that allow flexibility within pricing models that will allow providers to effectively manage change.
- **DWP should focus on the average price received rather than total unit price when calculating how much money is available for interventions**
  - **How?** ADWP can calculate the average unit price by multiplying the unit prices against the expected referral volumes and performance levels.
  - The average unit price can show DWP how much money is available to spend on interventions and achieve a particular quality standard.
- **DWP should properly calibrate performance expectations alongside the expected average per person. This will enable the DWP to provide the right incentives to drive investment and exceptional performance on Work Programme Plus**
  - **How?** DWP can create a pricing model which ensures funding follows performance.
  - Average performance will only permit modest financial terms or cost recovery. Providers are driven to deliver above average performance and beyond. Providers who perform below average risk losing money.

DWP have stated that they want to achieve the following in the commissioning and delivery of Work Programme Plus:

- Maintain the performance improvements that have been made over the course of the Work Programme to establish a new baseline for performance on which to build further performance improvements.
- Improve the efficiency and cost effectiveness of delivery and to reduce the overall cost of Work Programme Plus.
- Ensure that significantly improved performance is achieved with the ‘hardest to help’ groups, in particular ESA jobseekers and those with disabilities. Improved performance with these groups will generate a greater level of benefit savings for the Government.

Taken together, this is a challenging set of demands. However, these can be realised if DWP correctly calibrates the funding model for Work Programme Plus. This can be achieved through focusing on two elements through the commissioning process:

1. **Transparent and accurate modelling to ensure a better assessment of costs, revenue, risk and reward including:**
   - Accurate forecasting of referral volumes and sharing volume risk
   - Clear and realistic performance benchmarks informed by a transparent and accurate assessment of historical and current performance levels: desired performance

improvements need to be within reach

- Understanding that it is the 'average unit price' that matters, not the 'maximum unit fee'

2. Providing the right incentives for high performance focused on:

- Suitably balancing risks and returns to attract bidders
- Mitigating the risk of the emergence of a low performance/low investment model

Accurate forecasting of referral volumes and sharing volume risk

Accurate and reliable forecasting of referral volumes is an essential part of achieving both a high performing programme and a cost effective one. On the Work Programme we have seen a negative impact from scenarios where referrals have been either significantly higher than forecast or significantly lower than forecast.

For example, over the first three months of the Work Programme, referral volumes were over 200% higher than forecasts and they continued at a much higher than forecast level for the whole of the first year. Providers had infrastructure and staffing capacity set up to deal with half the actual volume of referrals. This meant jobseekers referred over the early months of the programme had less interventions and a less intensive service, which in turn meant lower performance was achieved. It took between three to six months to stabilise the resources required to match referral volumes. For example, time was required to reach full staffing levels on account of recruitment, training and security clearing.

Undoubtedly this was a large contributing factor to the lower than expected performance in Year One of the Work Programme which led to criticisms. This negative image took a long time to neutralise.

At the opposite end of the spectrum, current referral volumes are one sixth of what they were in Year One of the contract and are less than 50% of what was originally forecast. This leads to poor cost-efficiency as money is currently being spent on fixed costs that are not required, such as premises and IT equipment. This inflates the cost of delivery and takes away investment from front line services that could further improve performance.

Recognising the importance of volume assumptions to both performance and cost effectiveness, DWP can support higher performance and a decreased cost of service by taking on some of the inherent volume risk. This can be achieved by committing to shifting referral trigger points when volumes are too low (or high) and/or reviewing unit prices in scenarios where volumes are outside a reasonable tolerance level.

Clear and realistic performance benchmarks informed by a transparent and accurate assessment of historical and current performance levels: desired performance improvements need to be within reach

When designing outcome funded models it is very important to accurately project the range of performance than can be achieved with a particular group — this should range from a base level of performance through to a good standard and a peak level. It is vital that performance benchmarks are informed by current performance levels and that there is transparency around levels of historical performance that have been achieved.

It is also important to accurately benchmark performance levels for groups based on levels of difficulty. There will be clear differentials in performance that can be achieved for different groups based on the difficulty of assisting them into work and the base level of performance that would be achieved if no service were offered.

For PbR models to work economically, providers need to be confident of being able to achieve targeted performance levels. Providers also need assurances that they can afford to pay the costs of delivery with a modest margin on top, with larger rewards available for peak levels of performance. If performance levels are set optimistically, then there will not be enough money available to cover the costs of delivery. This will ultimately lead to degradation of service and performance.

Insufficient performance data for providers to be able to assess whether the performance benchmarks are realistic can result in risk aversion and under investment. Providers will not have the confidence of receiving sufficient outcome payments to cover the cost of delivery.

Understanding that it is the 'average unit price' that matters, not the 'maximum unit fee'

In an entirely PbR model, the primary financial metric used by providers to financially model and create their business plan is the average price per claimant paid in each client group. This is calculated by multiplying the unit prices against the expected referral volumes and performance levels. It is this which dictates how much money is available to spend on interventions and what quality of service is achievable — determining the caseload sizes for advisers, level of training and specialist interventions. If the balance of risk and reward is set incorrectly because targets for certain groups are not achievable, this can result in an unintended and dramatic reduction in the average price available per claimant. This can greatly reduce the quality of services the business model makes it possible to offer, regardless of how high the theoretical maximum price per claimant is.

The illustrative example below demonstrates that it is the "average unit price" that matters, as opposed to the "maximum unit fee"

Average Price not Unit Price

Consider two separate Jobseeker Groups: Group A and Group B.
The characteristics of each group is described in the boxes below.

Payments made at three stages:
1) referral; 2) job placement, and 3) 3, 6, 9 and 12 months in work.

10% of the unit price is paid at referral, 10% paid at job entry, and 20% is paid for each of the 3, 6, 9 and 12 months stages in work.

This example illustrates the tracking of 1,000 jobseekers

Group A: 12 months unemployed

- Referred at 12 months
- Maximum unit price achievable: £4,000 per person.
- Target caseload size: 140
- Target into work: 60%

Group B: Hardest to help with multiple disadvantages

- Typically unemployed over 3 years
- Maximum unit price achievable: £8,000 per person

Having additional barriers,

- Target caseload size: 60
- Target into work: 20%

Consider the following performance levels are achieved for each Group:

GROUP A	Referral	Jobs	3 mths	6 mths	9 mths	12 mths	Total
Group A – Volumes	1000	600	450	360	306	275	-
Group A – Success Rates		60%	75%	80%	85%	90%	
Group A – Unit Price	£400	£400	£800	£800	£800	£800	£4,000
Group A Revenue	£400,000 (23%)	£240,000 (14%)	£360,000 (21%)	£288,000 (16%)	£244,800 (14%)	£220,320 (13%)	**£1,753,120**

GROUP B	Referral	Jobs	3 mths	6 mths	9 mths	12 mths	Total
Group B – Volumes	1000	200	140	105	89	80	-
Group B – Success Rates		20%	70%	75%	85%	90%	
Group B – Unit Price	£800	£800	£1,600	£1,600	£1,600	£1,600	£8,000
Group B Revenue	£800,000 (49%)	£160,000 (10%)	£224,000 (14%)	£168,000 (10%)	£142,800 (9%)	£128,520 (8%)	**£1,623,320**

As the Payment Schedule below shows, there is a risk of the service to the harder to help jobseekers in Group B by entering into a negative low investment, low performance model. This group is much harder to help than Group A and therefore the cost of assisting back to work should be higher and caseload sizes lower. Although the maximum unit price per person at £8,000 is double that available for Group A, this would on the surface suggest more intensive interventions can be afforded.

However in this case the peak level of performance into work is only 20% and when the model is run through we can see that despite a unit price that is twice as high, the lower rate of outcomes actually mean that the price per referral is £1,623 as the Payment Schedule shows. This is actually lower than the average price for Group A. This means that caseload sizes for Group B would actually have to be higher than for Group A, which in turn makes it highly unlikely that the modelled success rates could be achieved. This leads to a lower average price per referral which in turn would lead to less money being available to be spent on interventions.

The same amount spent on per referral Group B generates far fewer jobs and has a higher price per job.

Average Unit Price versus Price Per Job

Customer Group A

Max unit price per person	£4,000
Price per referral (Revenue/person)	£1,753
Price per job	£2,922

Customer Group B

Max unit price per person	£8,000
Price per referral (Revenue/person)	£1,623
Price per job	£8,117

To ensure that an outcome funded model works for both government, providers and jobseekers it is important to build a model in which the unit prices taken together with the target success rates possible with a group, lead to a price per referral that supports the level of intervention required to achieve the target success rates. This can get more challenging with hard to help groups where unit prices have to become very high to support the level of intervention required to make the programme work and which also provides (from a purely economic perspective) a lower return on investment for government.

If we apply this thinking to the Work Programme we can see that the model has worked well and has supported high performance for some groups but for others it has not worked as intended. The table below sets out each of the payment groups alongside the maximum unit price which can be earned and the average price per payment group we expect to receive based on our most up to date life of contract financial forecast.

	Maximum unit price	Average price per person
PG1 – JSA 18-24	£3,810	£1,428
PG2 – JSA 25+	£4,395	£1,467
PG3 – JSA Early Access	£6,600	£2,009
PG4 – JSA ex-IB	£6,600	£1,625
PG5 – ESA Volunteers	£3,700	£608
PG6 – ESA Flow	£6,500	£1,144
PG7 – ESA ex-IB	£13,720	£2,291
PG9 – ESA ex-IB	£5,600	£1,054

The funding model has worked well for the JSA groups in the main where high performance has been achieved, and the average price per person supports the required level of service to drive high performance. However, we can see that for some of the hardest to help groups (ESA and prison leavers) the average unit price is actually lower than the unit price for the JSA jobseekers. The consequence is that there is actually less money to invest in these harder to help groups and this will inevitably impact on the performance that can be achieved.

Suitably balancing risks and returns to attract bidders

Creating a platform that balances risk and reward is a sign of good market stewardship. With the right balance in place, providers can be appropriately rewarded for their performance in a risky environment. This means that exceptional performance is rewarded through the opportunity to reach high profit margins, and poor performance leads to the risk of financial losses.

Calibrating Risk and Reward

Performance	Poor	Average	Good	Exceptional
Financial Outcome	Breakeven → Loss making	Low Profit	Moderate Profit	High Profit

In this model, Work Programme Plus providers will be incentivised to invest in service delivery as they know it will lead to a greater financial reward. Average performance will only permit modest financial terms, so providers drive to deliver above average performance and beyond. Providers who perform below average risk losing money.

If the financial structure is set such that profit is capped and incremental increases in performance do not result in an increase in profit, investment will be lower, therefore so will the return. There is an expectation in government contracting that providers can expect a margin of between 6–10%. However, in light of the risk and potential for low return from low investment, Work Programme Plus has the option to push providers towards the best performed achieved on employment services through increasing this percentage bracket. This is pertinent in PbR models which load the majority of risk to providers. For example, if providers know there is an option to earn double digit profit for strong performance, they will invest in delivery to achieve exceptional performance. This will help more jobseekers into work and reduce spend on benefits. Quality will suffer if the margin is set too low, as providers will not risk investing in delivery without the potential for return.

Mitigating the risk of the emergence of a low performance/low investment model

As we have seen in the Work Programme Pricing Table above, the average price received on the Work Programme for an ESA (PG6) jobseeker is £1,144, compared to £2,009 for an early access JSA jobseeker (PG3). While both are hard to help groups, ESA jobseekers are relatively more difficult to help and require more time and resources to be supported into work. The lower amount of money means there is no option to invest in more costly health focused interventions and the there is a disincentive to invest and take risks in trialling new approaches because of the uncertainty of receiving that money back in outcome payments. This scenario can be mitigated against if the recommendations above are followed to ensure contracts and properly calibrated. However is there is no clear or reliable historical performance track record (as was the case at the beginning of the Work Programme with ESA jobseekers) the risk of under-investment can be mitigated by increasing the proportion of guaranteed funding, and building in review points as the contract progresses to ensure that the unit prices are properly calibrated to achieve the desired average spend per jobseeker — this could result in unit prices increasing or reducing over time.

Recommendations

Here is a summary of the recommendations listed through the paper:

Taking Past Performance into Account

- **DWP should take past performance into account when awarding future employment services contracts**
  - **How?** DWP can implement this recommendation by including an assessment of a bidders' past performance into the overall evaluation criteria; performance should comprise 30–40% of the overall score
  - DWP should award marks through a graded scale, where the highest marks are awarded to the highest performance rates. This is preferential to a binary pass/fail approach as it ensures full transparency of performance differentials
  - DWP should assess performance within each Contract Package Area (CPA) as well as performance between CPAs. This will ensure a complete and transparent view of performance.
- **DWP should provide new entrants with the opportunity to demonstrate past performance in a comparable space, and incumbents should be judged on the hard data that DWP holds**
  - **How?** All bidders must provide a response to a question on past performance.
  - DWP can rely on the data that it holds about its contracted providers/bidders to score them against the performance criteria.
  - New entrants can respond by providing their performance data from similar services. They can mark their performance on alternative contracts where there is a direct transferability between the nature of the services. This could include with long-term unemployed or delivering large complex programmes through a supply chain of specialist providers.

Moving from Price Competition to Quality Competition

- **The employment services market in the UK is mature enough for DWP to move from price competition to quality competition through fixed-price commissioning**
  - **How?** DWP can fix the price per job outcome of each jobseeker group. All providers should be paid the same amount for achieving the same outcome.
  - DWP can award contracts based on measures of bidders' quality — past performance, service delivery — not on pricing discounts.
- DWP should apply very robust market shift mechanisms alongside fixed price competition. This will result in better value for money and return on investment by diverting work flow to providers that deliver more for the available prices

- **How?** DWP should increase the frequency and magnitude of the current market share shift mechanisms.
- The first market share shift should take place after 18 months of contract delivery — referrals should be reallocated from the bottom performing provider to the top performing provider
- Market share shift mechanisms should then be applied every six months
- This reallocation should occur within each CPA, for example at a JCP office or 'cluster of offices' level. This focuses market share shift down at the level where true performance differentials happen and mitigates against the risk that low performance at a site level is neutralised by good performance at a neighbouring site.

Calibrating the funding model and leveraging risk and reward

➢ **DWP should explore means to share volume risk with providers. Variations to volume forecasting are detrimental to both performance and cost effectiveness**

- **How?** DWP can use contractual mechanisms that allow flexibility within pricing models that will allow providers to effectively manage change.

➢ **DWP should focus on the average price received rather than total unit price when calculating how much money is available for interventions**

- **How?** DWP can calculate the average unit price by multiplying the unit prices against the expected referral volumes and performance levels.
- The average unit price can show DWP how much money is available to spend on interventions and achieve a particular quality standard

➢ D**WP should properly calibrate performance expectations alongside the expected average per person. This will enable the DWP to provide the right incentives to drive investment and exceptional performance on Work Programme Plus**

- **How?** DWP can create a pricing model which ensures funding follows performance.
- Average performance will only permit modest financial terms or cost recovery. Providers are driven to deliver above average performance and beyond. Providers who perform below average risk losing money.

About the Authors

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