

## Summary

The Work Programme is a bold and innovative policy designed to help unemployed people back to work. Contractors will be paid according to their success in getting the unemployed into work and then sustaining them in employment. The National Audit Office (NAO) recently published a report looking at the design and implementation of the Work Programme to date. The report highlighted concerns about the level of performance in getting the unemployed back to work which had been assumed by DWP. This has led some to call for a rethink of the programme.

In this research note we examine certain aspects of the design of the Work Programme where we believe a different approach would have been beneficial. We conclude that:

- as a result of the relatively poor information available to bidders on claimants and performance that a rather different approach should have been used by adopting a 'discovery phase' in the early part of the contract.
- if a more rigorous analytical approach to risk transfer had been used in designing the programme then this may have led to a better value for money approach being adopted
- for future programmes an approach to bid evaluation which places somewhat less of a weighting on competition on price and rather more on quality should be examined.

Notwithstanding these comments, there are many very good, innovative aspects in the design of the Work Programme which other programmes would do well to mirror – in particular the mechanism which is in place to deal with contractor failure.

Whilst the underlying economic context is very challenging for the success of Work Programme contractors in getting the unemployed back to work, we do not consider that currently there is any need to alter the programme. To do so at

## The Work Programme:

keep calm and carry on

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this time would be a major error and would undermine both future DWP and wider government contracting for services and repeat the mistakes of the past by compensating contractors for their poor decisions when bidding for contracts.

Furthermore, whilst we understand why the third sector would be disappointed with the early outcome of the Work Programme, to have adopted a different approach would have fundamentally undermined some of the key aspects of the programme.

Whilst there are some lessons to be learnt for future programmes our key message in relation to the Work Programme is - keep calm and carry on.

## Introduction

The Work Programme introduced in 2011 is an integrated programme designed to help unemployed people get back to work using primarily private sector contractors. Contractors are paid according to their success in getting people into work - a so called payment by results regime. Since then it has aroused considerable debate and controversy. Criticisms have included that too much risk has been transferred to contractors, that performance expectations placed upon providers are overambitious and that the third sector is being unfairly treated by private prime contractors and are being squeezed out.

Most recently the NAO published a report on January 24<sup>th</sup> which reviewed the Work Programme to date, made a number of recommendations about its implementation, and suggested how future programmes could be implemented.<sup>1</sup> In particular the Report raised concerns about the performance assumptions made by DWP as well as the treatment of sub-contractors by prime contractors. This led one commentator to say that “the Government needs to have an urgent rethink on the Work Programme”<sup>2</sup>, and for the Chair of the Public Accounts Committee to state: “This report highlights real risks with the Work Programme, both in achieving its objective of getting more people into work and in ensuring value for money for the taxpayer. It is shocking that the business case and essential justification for the Work Programme were devised after the key decisions had already been made, and that no alternatives were considered.”<sup>3</sup>

This research note reviews certain aspects of how the Work Programme was designed which were absent from the NAO report and then considers whether there is a case for a change in how the Work Programme is being implemented. In our view it is important that lessons are learnt from the design and implementation of the Work Programme for two reasons. First, because the Work Programme handles 3.3 million claimants and between three and five billion pounds of public expenditure over 5 years and is a vital part of government economic and social policy. And second, it is to date the most significant ‘Payment by Results’

programme - an approach to paying for public services which the government is considering for other areas, such as reducing re-offending and providing for looked-after children.

As well as drawing on previous CentreForum research,<sup>4</sup> this research note draws on the author’s experience over 20 years of advising on public sector contracting and payment mechanisms. In particular he advised DWP on the contracting of Flexible New Deal Phase One – the predecessor programme to the Work Programme.

Initially we analyse key aspects of the design of the Work Programme, and then consider, given this critique, whether the government should amend the Work Programme. Appendix 1 sets out in outline the Design of the Work Programme.

## Analysis of the design of the Work Programme

### Poor information

One of the issues which has bedevilled government contracting over many years has been the relatively poor information available on the outcomes of government policies and the success of particular interventions. Indeed one of the significant side-benefits of private sector involvement in the provision of public services (including the use of the Private Finance Initiative) has been that it has led to much better information being collected and a more rigorous approach being adopted to the management of risk.

The first problem has been that there is relatively poor information available on the success of past interventions in getting the unemployed back to work. This has been compounded by the introduction of new categories of claimants (those on Employment Support Allowance) in addition to those on Jobseekers Allowance. These two factors together have caused the difficulties commented on by both the NAO and Social Market Foundation of the potentially unrealistic performance expectations of contractors. As the NAO correctly notes, if bidders have assumed performance which is lower than they attain then they could make super profits. If however they have assumed performance which is higher than they achieve then their viability could be at risk. The NAO argues that

1 NAO, ‘The introduction of the Work Programme’, 24 January 2012.

2 Ian Mulheirn, ‘The Work Programme: why we should be worried by the DWP’s overoptimism’, SMF, 24 January 2012;

3 Rt Hon Margaret Hodge, Chair of the Committee of Public Accounts, ‘Statement from PAC Chair on NAO Report on the Work Programme’, 23 January 2012.

4 Chris Nicholson, ‘Rehabilitation Works: ensuring Payment by Results cuts reoffending’, CentreForum, 2011, and Chris Nicholson, ‘Your choice: how to get better public services’, CentreForum, 2011.

this is of concern if it then leads contractors to seek to cut costs by ‘creaming’ (focusing on those who are easiest to help back into work) and ‘parking’ (giving less attention to the hardest to help).

Where there are problems with poor information there are three broad approaches which can be adopted. The first – that adopted by government – is to seek the best possible design upfront and then to pass the risk for achievement to the contractors. This has a number of significant risks as outlined above. The second is to use pilot projects either to ensure better information is available or to try out different approaches to the programme. Whilst this approach has many attractions it has the very significant disadvantage that it takes a considerable amount of time before the impact of pilot projects can be evaluated. As the NAO report notes: “Fast tracking the Programme brings forward any potential benefits but in order to achieve value for money the potential risks will have to be managed well.”<sup>5</sup> The third approach would be to have an initial “discovery phase” for say the first 18-24 months of the five year contract. During this period less risk would be transferred to the contractor and data on performance would be collected enabling the payment mechanism to be altered as appropriate after two years. This is similar to the approach which we advocated in our report ‘Rehabilitation works: ensuring Payment by Results cuts reoffending’. The main disadvantage would be that competitive tension and risk transfer would be less than under the approach that the Department has used.

Ultimately the main driver of value for money for government as a whole is not minimising the direct costs of the Programme but success in getting people back to work – the Department estimates that for every £1 spent on the Programme £1.95 will be saved. For this reason our judgement is that the Department would have been better to have adopted a discovery phase approach within the initial contracts rather than the approach it adopted.

It is also important to recognise that, with competitive letting of contracts, the full benefits are unlikely to be achieved in the initial round of contracts. Inclusion report that in Australia it was the second round of letting welfare to work programmes which

led to significant cost savings.<sup>6</sup>

### Risk transfer

The government, in both the Work Programme and in other Payment by Results regimes has sought to transfer outcome risk to contractors. However, we argued in ‘Your choice: how to get better public services’ that the government is not adopting a sufficiently rigorous approach to analysis of which risks it makes sense to transfer when adopting Payment by Results. For example it may not be good value for money to seek to transfer demand risks such as those caused by changing economic conditions which will affect the prospects of getting people back into work. We advocated that an analytical approach similar to that used for Private Finance Initiative schemes should have been adopted for the Work Programme and for other public service contracting regimes. This involves clarifying risks as:

- design risk (e.g. designing the policy interventions to get people back to work)
- performance risk (e.g. whether a welfare to work programme gets someone back into work)
- demand risk (e.g. the number of unemployed people who the contractor is trying to get into work)
- operating cost risk (e.g. the cost of interventions)
- financing risk (e.g. being able to finance the working capital for a PbR regime)
- termination (failure) risk (e.g. the risk of going out of business as a result of mispricing the contract).

A rigorous analysis of these risks should then be carried out to determine whether the risks should be borne by the private contractor, government or shared between the two. We think that use of such an approach would have benefited the Work Programme. In particular we think better value for money may have been achieved by a different approach to risk transfer eg in relation to demand and perhaps also financing risks.

### Bid evaluation

It is apparent that a significant factor as to which Work Programme contractors were successful was the level of discount offered

<sup>5</sup> NAO, ‘The introduction of the Work Programme’, 24 January 2012, p. 8.

<sup>6</sup> Dave Simmonds, ‘Work Programme results: perform or bust’, Work Programme Working Brief, CESI, May 2011, p. 9

in relation to the price for “job outcome.”<sup>7</sup> The most successful contractor Ingeus Deloitte reportedly offered discounts of up to 60 per cent in some areas compared to the average of 6 per cent reported by the NAO. Experience of other government contracting has found that accepting the lowest price bid without sufficient understanding of how the bidder has been able to offer such a materially lower bid often leads to difficulties (eg Connecting for Health, Benefits Agency/Post Office Counters Ltd automation, Libra Courts Service IT contract). This is particularly an issue given the “black box” nature of the contracting (ie government is only concerned with the outcomes rather than the way in which the outcomes are delivered) as there will not be the potential to examine in detail the underlying approach adopted by contractors which justifies the difference in pricing.

Whilst this is a concern, the contractor which offered significant discounts is of such a scale and presence in the government-contracting market that the government can reasonably assume an honouring of contractual obligations. For, even if the contractor were making substantial losses, the potential collateral impact on its other government business would deter it from walking away from the contract.

## Criticisms of the Work Programme

### Unrealistic performance assumptions

One concern raised by the NAO and other commentators has been around over-optimistic estimates of performance in getting people back to work. There are several reasons why these concerns should not be overstressed.

The particular design of the programme means that past programmes’ performance are likely to be a poor guide to the performance of the Work Programme. For example, the Flexible New Deal Phase One programme had barely started before it was cancelled; the period of the Work Programme contracts are longer and so will provide a greater period for contractors to work with those referred to them; and the Work Programme has a pure “black box” approach giving greater flexibility in delivering the programme.

As Inclusion concluded in February 2011: “Our overall view at this stage is that the

performance requirements for the Work Programme are, nationally, challenging but achievable”<sup>8</sup> Similarly the NAO reports that “Providers we spoke to told us that performance and cost targets were challenging but achievable.” This echoes what we have been told by those providers we have spoken to, although clearly deterioration in economic conditions makes the position even more challenging. This is borne out by the fact that DWP has recently revised upwards by 700,000 its estimate of referrals to the Work Programme. Whilst this will lead to an increase in revenue through the attachment fee element of the payment mechanism it also indicates how the underlying labour market conditions have worsened.

Even if performance expectations do not match those which DWP expected, this matters only as far as it affects DWP expenditure estimates. The risk of not attaining these targets is the contractors – this is an integral feature of Payment by Results. Indeed in pricing their bids contractors will have made their own assessments of what it is feasible for them to achieve. Hence failure to achieve DWP performance forecasts is not in itself a major cause for concern for contractors.

Some have argued that contractors will be more likely to cut costs, “cream” and ‘park’ claimants, and provide a lower level of service as a result. The NAO in particular expresses concern that providers will be tempted to ‘game’ the contract by focusing on claimant groups which are easier to help.

This theoretical risk exists irrespective of DWP’s performance expectations. In reality, contractors would have to have very good information about likelihood of placing particular categories of clients into work before they were able to game the system in this way. However as we have previously noted there has generally been pretty poor information on which to base decisions so we consider this unlikely to be the case, particularly early in the contract. Secondly even if this were the case, in a situation of constrained resources this is not necessarily an undesirable approach – to use finite resources to reduce unemployment by the maximum amount possible.

The only way to avoid such “creaming” and “parking”, if it were felt to be desirable, would be to have a more sophisticated

<sup>7</sup> Dave Simmonds, ‘Work Programme results: perform or bust’, Work Programme Working Brief, CESI, May 2011.

<sup>8</sup> Paul Bivand, ‘Can the Work Programme succeed’, Work Programme Working Brief, CESI, Feb. 2011.

payment mechanism. However as already noted there is not currently the granularity in data about the client base to enable this to be done. Experience of public sector contracting also indicates that the more complex a payment mechanism the less likely it is to be properly applied. Our view therefore is that the current Work Programme payment regime has about the right balance between simplicity and detail, given currently available information about the claimant groups.

The Programme has also been designed in such a way as to insulate the Department as far as is ever possible from the risk of contractor failure/underperformance. Previous DWP Welfare to Work Programmes have frequently led to the Department feeling that it needs to “bail out” contractors to ensure that they continue to deliver the service which they were contracted to provide. For example in its 2010 report on the Pathways programme the NAO noted that in renegotiating contracts DWP had made unilateral concessions because of contractor underperformance and cash flow problems.<sup>9</sup>

Indeed due to the Department’s past performance in this regard there was a material risk in the bidding for Work Programme contracts that contractors would be insufficiently risk averse on the assumption that if they got their bids wrong, that the Department would ‘bail them out’. The Employment Minister Chris Grayling has been adamant that this would not happen and has stated that there is an expectation that some contractors will have their contracts terminated. On Radio 4’s *The Report* programme in September 2011, Grayling said: “There is no question of saying, ‘Well, you know, if it all gets a bit difficult we will look after you.’ We won’t ... These are firms, big credible organisations ... And if they have got it wrong then we’ll look for someone else who can do the job better.”<sup>10</sup>

For any Work Programme contract area there are two or three contractors. If one contractor fails there is at least one other to whom the unemployed could be referenced. In addition there is a national framework of other contractors who could ‘step in’ in the event of a contractor failing or having its contract terminated for poor performance.

As a result there is far less risk of DWP coming under pressure to rescue failing contractors in the way that they have been forced to do in the past. Indeed the contract requires a defaulting contractor to pick up any additional cost caused to the DWP by having to award the contract to another supplier. Hence DWP has, in our view, done as much as it reasonably could do to insulate itself against a contractor’s poor performance resulting in additional cost for the Department. The only circumstances in which we think this position would not hold is if economic conditions worsen to such an extent that all contractors become unprofitable. In such circumstances “change control” procedures could legitimately be invoked as the external economic assumptions underlying the bid will have changed.

### Unfair treatment of the third sector

A further area of criticism of the design of the Work Programme has been that third sector providers have been “squeezed out”:

For example, the London Voluntary Service Council reported in October 2011 that: ‘most tier 1 providers report that prime contractors have simply passed the Work Programme’s high risk outcome based pricing structure on to groups in their supply chains, regardless of size or financial capacity of subcontractors’; the ‘vast majority of specialist ‘tier 2’ providers have had no Work Programme customers referred to them at all’; and ‘there is a grave risk that the expertise of those specialist groups will be lost unless they are given greater certainty regarding the number of customers they can expect to work with’.<sup>11</sup>

When the Work Programme was originally being planned there was probably an overemphasis on the potential which this would have for third sector involvement at a time when parts of the third sector were suffering from cuts in grants from the public sector. Whilst the DWP set out a guideline of 30 per cent of contract value which should go to the third sector (representing the approximate proportion of previous programmes which had been taken by the third sector) this was not a factor in the evaluation. To have included it as a factor would have conflicted with the “black box” approach to contracting.

Initial evaluation of contract awards has shown that three of the 40 prime contracts

<sup>9</sup> NAO, ‘Summary: Support to incapacity benefits claimants through Pathways to Work’, 28 May 2010, p. 9.

<sup>10</sup> Kiran Stacey, ‘Grayling warns back-to-work providers’, *Financial Times*, 14 Sept 2011, [www.ft.com/cms/s/0/dc555878-deeb-11e0-9130-00144feabd0.html#axzz1I9JCJ9w8](http://www.ft.com/cms/s/0/dc555878-deeb-11e0-9130-00144feabd0.html#axzz1I9JCJ9w8).

<sup>11</sup> LVSC. ‘Fair chance to work: initial voluntary and community sector experiences of the Work Programme in London, October 2011.

were awarded to third sector providers and only 11 of the 40 prime contracts had 30 per cent or more of contract value going to third sector subcontractors. Since this initial analysis there have been *ad hoc* reports of some third sector sub-contractors being unable to agree contracts with prime contractors because of the amount of risk that the prime contractor was seeking to place upon the third sector provider.<sup>12</sup> Furthermore as reported by the NAO and by the third sector there have been instances where the flow of referrals has not matched up to expectation. As a result third sector providers have not received the amounts expected. Sir Stuart Etherington, Chief Executive of the National Council for Voluntary Organizations, said recently: “The prime contractor model is supposed to safeguard small providers from financial risk, but these findings suggest it is currently falling far short of expectations.”<sup>13</sup>

This has particularly been the case with respect to Employment Support Allowance (ESA) referrals. The Employment Related Services Association (ERSA) estimates that between 20-25 per cent of referrals to the Work Programme were initially predicted to be of customers in receipt of Employment Support Allowance. However, reports from Work Programme providers to ERSA indicate that only 3-5 per cent of referrals are from that group.<sup>14</sup> As the NAO notes there have been two reasons for this – more people are being assessed as fit for work than assumed (and therefore become JSA claimants) and secondly it is taking longer to complete assessments and consider appeals. This latter factor will have led to a temporary lull in referrals which will clearly have caused cashflow problems for third sector providers. The combined effect of these two factors has meant that DWP has revised its projections for referrals of ESA claimants for 2011-12 downwards by 60 per cent.

The Work Programme has undoubtedly posed significant challenges for the third sector providers, particularly as the quantum of financial risk being transferred to them is not of easy for charities in particular, to bear. The DWP has sought to ensure that the arrangements between prime

and subcontractors adhere to “the Merlin Standard” and the Department will need to ensure that this happens. Prime contractors have reported to us that the performance of third sector providers has been very varied. Some have been superb but some have delivered poor performance. One of the consequences of the Work Programme may well be a consolidation of third sector providers (which is not necessarily a bad thing), and much better data on the relative performance of these providers.

It is understandable that third sector providers should feel resentment, given some of the statements made early on about the opportunities presented by the Work Programme. However unless there were to be positive discrimination in favour of the sector with quotas for third sector providers we think that the current approach is appropriate.

### Where next for the Work Programme and future Payment by Results programmes?

The NAO make a number of specific recommendations which we would generally support in relation both to implementing the Work Programme and implementing future programmes. As outlined in this report in a number of areas in relation to future programmes we would go further and recommend the following:

- In circumstances such as those faced by the Work Programme, where information is poor and it is not considered appropriate to pilot the programme, that consideration should be given to a “discovery phase” of the contract to enable better information to be collected.
- A more rigorous analytical approach be adopted to which risks should be transferred than that used by the Work Programme. For more details of this see Section 5 of ‘Your Choice: how to get better public services’.
- Alternative evaluation approaches be explored which put less weight on price discounting in decisions concerning award of contract. This is particularly important in programmes where the public expenditure savings from price discounting might be dwarfed by expenditure savings foregone elsewhere

12 Christopher Damm, ‘The third sector delivering employment services: research project and evidence review’, TSRC, January 2012.

13 NCVO, ‘Work Programme is leaving charity sub-contractors vulnerable to financial risk’, 17 January 2012, [www.ncvo-vol.org.uk/news/public-services/work-programme-leaving-charity-sub-contractors-vulnerable-financial-risk](http://www.ncvo-vol.org.uk/news/public-services/work-programme-leaving-charity-sub-contractors-vulnerable-financial-risk).

14 [www.twi.nuk.com/News/Article/government-work-programme-referral-numbers-unacceptable-1000000166](http://www.twi.nuk.com/News/Article/government-work-programme-referral-numbers-unacceptable-1000000166)

through poorer performance eg in getting people back to work.

However despite these suggestions it is clear that in designing the Work Programme there has been a serious attempt to learn the lessons from previous Welfare to Work Programmes. Even where we would have advocated taking different decisions about design of the programme we think it would be wrong to reverse or change some of the decisions now the contract is underway.

In particular we do not share the view that there should be an “urgent rethink of the Work Programme”. To do so would be to repeat the errors of previous Welfare to Work Programmes where changes were made mid way through the contracts. This had the effect of ensuring that contractors were rescued from the consequences of the poor bid decisions which they made. It would be very poor commercial contracting practice, which would have adverse consequences for other programmes

throughout government. Furthermore, the DWP has designed the programme in such a way as have step in arrangements in place in the event of contractor failure. Only in the event of widespread contractor failure would this be necessary and there are not currently indications that this is likely to occur. Whilst economic circumstances have undoubtedly worsened since the contracts were let, there are mechanisms within change control within the contract to adjust for this.

Our conclusion is that the Work Programme is undoubtedly a bold and challenging programme but there is not currently evidence which should lead to a change in how it operates – indeed to do so would be counter-productive. There are however some lessons which can be learnt for the design of future payment by results programmes, both in terms of good practice from the Work Programme, but also areas where we would recommend consideration of a somewhat different approach.

## Appendix 1: The design of the Work Programme<sup>15</sup>

The Programme's main objectives are to get people off benefits and into sustainable employment, and to narrow the gap in speed between disadvantaged groups and other groups when securing work. These aims will primarily be met, at a faster rate than previously, through 'longer and larger' contracts with well-capitalized providers: 'prime contractors'. These contractors manage one or more subcontractors, and are rewarded for their success.

Claimants, are classified into one of nine groups depending on age and barriers to entering employment, and are then referred to a prime contractor through Jobcentre Plus. The claimant may then be referred to a subcontractor, who will likely allocate them a personal adviser to examine barriers to their employment. The provider's approach and the individual's circumstances will determine the mode of support.

Prime contractors are paid through a Payment by Results mechanism. The mechanism maximizes payments for securing jobs that would have been otherwise unachievable (known as the non-intervention rate). The merit of the system lies in encouraging providers to secure suitable job outcomes for all claimants, using financial reward as the incentive.

There are four elements to the payment mechanism. These are:

- An attachment payment. For taking a claimant on to the Programme. The attachment fee reduces to nil by the start of the fourth year.
- A job outcome payment. When a claimant has been in work for either a continuous or cumulative period of employment, as defined by the Department. Job outcome payments for some claimant groups will be reduced in the later years of the contract. As part of the bidding process bidders were invited to offer discounts to the job outcome payment
- A sustainment outcome payment. A further payment every four weeks for keeping a claimant in employment.
- An incentive payment. For jobs delivered beyond a given performance level – defined by the Department as 30 per cent above non-intervention – the number of claimants who would have found employment without a programme.<sup>16</sup>

<sup>15</sup> 'Developing the Work Programme', from NAO, 'The introduction of the Work Programme', 2012, pp.12-15.

<sup>16</sup> NAO, 'The introduction of the Work Programme', 2012, p 13.

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