



Payment by Results – An Introductory Guide

September 2011

Why this document?



- The purpose of this paper is to:
 - ~ provide an introduction to and overview of the concept of payment by results (PBR) as an approach to the commissioning and funding of public services in the UK; and
 - ~ explain the relationship between PBR and the use of external investment in services, and especially in interventions which prevent or reduce later expenditure (sometimes known as “invest to save”).
- Please note that the contents of this paper should be treated with caution because the development of PBR is fast moving and this document is no more than a snapshot of policy and market developments at the time of writing. For an absolutely up to date picture of PBR, please use the contacts at the back of this document.

Structure and contents



In this document we cover the following:

- what is PBR? – definitions, main principles, common terms.
- issues and challenges faced by government and others in applying PBR.
- current developments – areas in which the use of PBR is being considered or piloted.
- common misconceptions and misunderstandings.
- A4e involvement in the development of PBR and associated areas (notably the use of private investment to fund PBR projects).

What is “payment by results”?



- Like other terms used by government, PBR means different things to different people and there is no “government approved” definition. It has also been used to refer to different policies at different times.
- For example the term PBR has been used in the NHS for some years to refer to the process by which a fixed tariff is “earned” by hospitals for each procedure or operation they carry out.
- However its main current usage (and the one which is the focus of this paper) refers to the general principle by which government and the wider public sector commissions services on the basis that all, or a substantial part, of the payment for those services is withheld unless and until specific outcomes have been achieved.
- This principle is not new and examples of payment being linked to outcomes can be found which go back many years.
- However PBR is now being developed and used more widely; is an established part of current Coalition government policy; and is a key element in proposals for public service reform as set out in the White Paper “Open Public Services”.



Why is PBR being used?

- In its purest form, payment by results is a way of driving improved provider performance through the pricing mechanism rather than by contract management alone. The Open Public Services White Paper (published in July 2011) says:

“it makes sense to build in an element of payment by results to provide a constant and tough financial incentive for providers to deliver good services throughout the term of the contract”

- If PBR is used purely as a performance mechanism, there are no major barriers to its application provided the public body which is devising and letting the contract can frame the “results” it wants in appropriate terms. In most cases this means specifying outcomes, rather than inputs or outputs, but in some cases specification of outputs may also be appropriate.
- As with PBR itself, there is no official definition of these terms but set out below are some suggested definitions of input, output and outcome, together with examples from A4e's core welfare to work services.

	Inputs	Outputs	Outcomes
Definition	The resources used to provide the service or activity	The direct and tangible products of the service or activity, including service levels where appropriate	What happens to individuals, communities or other specific groups as a result of the inputs and outputs
Examples	No of staff deployed Size and location of premises used Staff training provided Existence and quality of processes used to provide service	Number of clients in programme Number of meetings with advisors Number of employers engaged Interviews arranged Number of clients starting work	Number still in work after X elapsed time Average salary of jobs matched to clients Extent to which clients have benefited from programme

The relationship with “invest to save”

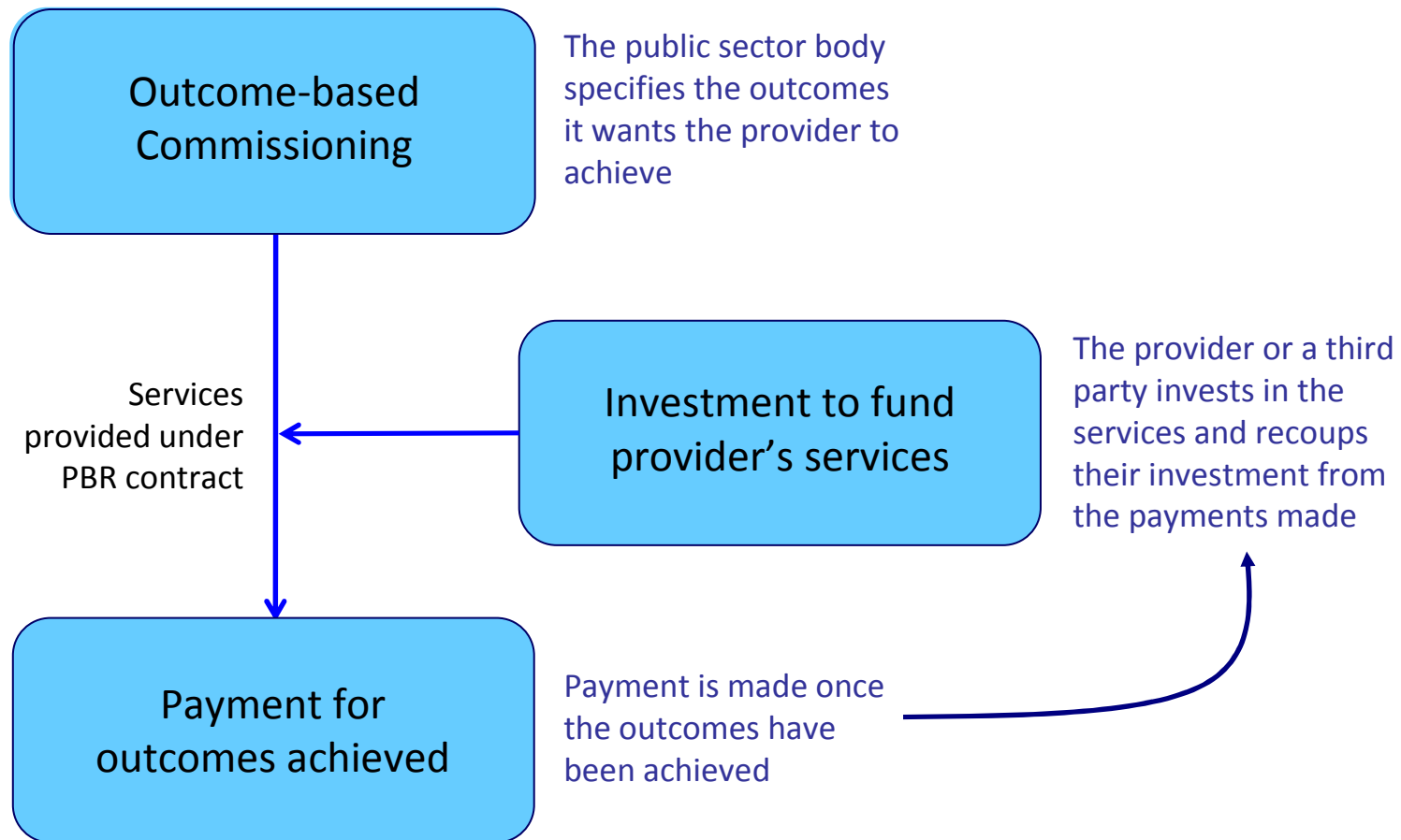


- The reason PBR is often much more complex to commission and implement is that it is frequently linked to “invest to save” i.e. the principle of external investment being used to fund the services provided.
- There are a number of reasons why this is happening:
 - ~ if providers do not get paid until they have achieved results they will need significant cash (technically called working capital) to fund the services in the meantime. Most providers need external investment to do this because they do not have enough cash to fund the services themselves (or do not want to use their cash for that purpose);
 - ~ the government is explicitly linking PBR to invest to save in some areas – arguing that money spent now will be more than recovered from future savings. This applies especially in social policy areas, where intervening to prevent or solve problems has often been shown to be much cheaper than the cost of the problem; and
 - ~ where there is a desire to invest now to save money later, the tight financial climate means that the public sector cannot afford the initial investment from the public purse – so there is a strong incentive to seek additional investment from other sources.
- Most importantly, the principles of PBR and invest to save have been successfully combined in the development and implementation of the Work Programme. The government wants to extend this approach to other policy areas – and there are obvious attractions to the government (and other public bodies) in being able to fund improved public services and better outcomes using other peoples’ money.

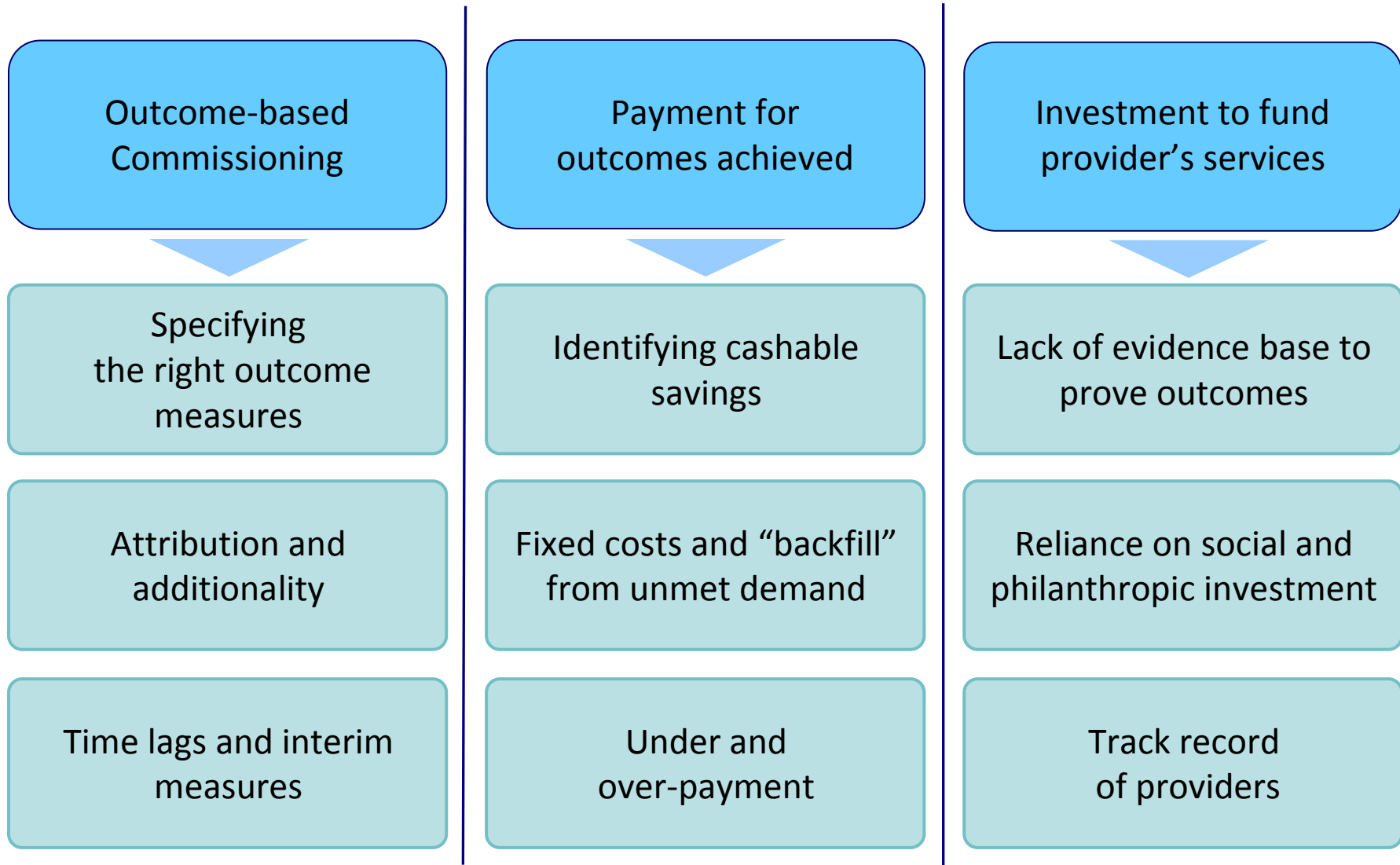
The combined PBR and invest to save model



This paper focuses on the combined PBR and invest to save model which in its simplest form has three key components



There are major challenges in each of these three areas





Outcome-based Commissioning

The biggest challenge in commissioning for PBR is setting the right outcomes which enable performance to be measured and drive the right provider behaviours

Specifying the right outcome measures

- Outcomes must be measurable and capable of being evidenced.
- Measures must reward appropriate behaviour and avoid “gaming” by providers to maximise payments without achieving the desired impact.
- Identifying the right outcomes in these circumstances can be difficult.

Attribution and additionality

- Outcomes should be wholly or mainly attributable to the provider's services and their impact (so-called additionality).
- Where outcomes may in part be achieved without provider intervention (so-called dead weight) commissioning needs to allow for this e.g. by setting a minimum threshold of performance below which payments will not be made.

Time lags and interim measures

- In some services outcomes may not occur until many years after intervention.
- This makes it more difficult to prove attribution (because external factors will have more impact), and increases provider and investor risk (because of the time lag between investment in interventions and payment for outcomes).
- In such cases interim and proxy measures may be needed (both to measure attribution and create an earlier income stream for providers and investors).



Payment for outcomes achieved

The biggest challenge in paying for services by results (if on an invest to save basis) is generating bottom line “cashable” savings from which payments can be made

Identifying cashable savings

- A key principle of many PBR projects is that the cost of intervention pays for itself, because the cost of intervening is lower than the cost of not doing so.
- However this works only if the money saved can be turned into real cash and used to make payment to providers and investors – if not there will be no money to fund payments.
- Identifying cashable savings is difficult for two reasons: fixed costs and so – called “backfill”.

Fixed costs and “backfill” from unmet demand

- Incremental reductions in demand (e.g. successful intervention means an ex-prisoner stops offending) will have minimal impact on fixed costs (e.g. a prison) unless and until they reach critical mass and the fixed costs can be reduced (e.g. by closing all or part of the prison)
- In many services, demand exceeds supply and is effectively rationed. Any reductions in demand will therefore be offset (or wiped out entirely) by unmet demand – a process sometimes known as “backfill” – for example the courts send other people to prison

Under and over-payment

- In new areas of policy where there is limited evidence on the costs and effectiveness of interventions, there is a significant risk that provider payments may:
 - be insufficient to meet the cost of service delivery; or
 - be too generous, leading to excessive payments.
- To mitigate the latter risk, some PBR schemes cap payments at a maximum figure

Major challenges – attracting and securing investment



Investment to fund provider's services

The biggest challenge in generating investment is that most PBR programmes are experimental and there is no history of “what works” on which investors can base decisions

Lack of evidence base to prove outcomes

- Investors are heavily influenced by evidence of past performance
- Data to prove such performance is limited in many areas where PBR is being considered, because outcome-based approaches have not been attempted at scale
- This makes it difficult for investors to judge risk in such programmes

Track record of providers

- Many investors prefer to invest in a specific company and its management team, rather than indirectly in a programme or project
- However many providers and their management teams are themselves unable to demonstrate a track record of success which will reassure potential investors
- Some smaller providers are also reluctant to take investment even if available

Reliance on social and philanthropic investment

- Due to the above factors there has been limited investment in PBR by mainstream finance (banks, private equity etc) except for the Work Programme (see overleaf)
- Most investment (e.g. in the Peterborough Social Impact Bond- see page 13) has been by social or philanthropic investors who will accept a lower return or even the risk of losing their money entirely

The Work Programme exemplar for PBR



- These challenges have been largely (but not entirely) overcome in the commissioning of the Work Programme as set out below. This reflects the experience of both providers and commissioners gained in FND and Pathways
- However there are major challenges in applying PBR to other areas as discussed in the pages which follow.

Work Programme Commissioning

- Outcomes (sustainable employment) are relatively easy to define and measure
- Division of Work Programme into specific cohorts and delay in referring cohorts to providers ensures high levels of additionality
- Relatively long history of employability programmes provides data on which to calibrate specification and performance assumptions
- The same data makes it relatively easy to structure the Programme to minimise risk of “gaming” by providers
- “Black Box” approach used to maximise provider flexibility and ability to innovate to meet outcomes
- Outcomes are relatively close to interventions – no long time lag and interim outcomes (in work) are available as well as long term outcomes (time in work)

Work Programme Payment

- Providers are relatively experienced and understand the performance risks they are accepting
- There is a known and certain saving when the outcomes are achieved – reduced benefit payments
- The majority of payment (90%) can be linked to outcomes including interim outcomes (in work) as well as the sustainability of employment (time in work)
- Payments can be matched to different cohorts with different costs and benefits
- History and data available enables appropriate calibration of dead weight
- Performance risks and working capital requirements still onerous especially for small contractors – mitigated in part by prime contract structure

Work Programme Investment

- Prime contract structure (with emphasis on balance sheet strength) means some providers can bear the funding risk themselves
- Previous history of employability programmes means that provider with a demonstrable track record (Including A4e) can raise conventional finance for working capital requirements
- No need to rely on social/philanthropic investment
- Early payback to investors (less than two years) possible
- Smaller providers/subcontractors may still need investment (or generous payment terms from primes)

Other PBR/Invest to Save programmes

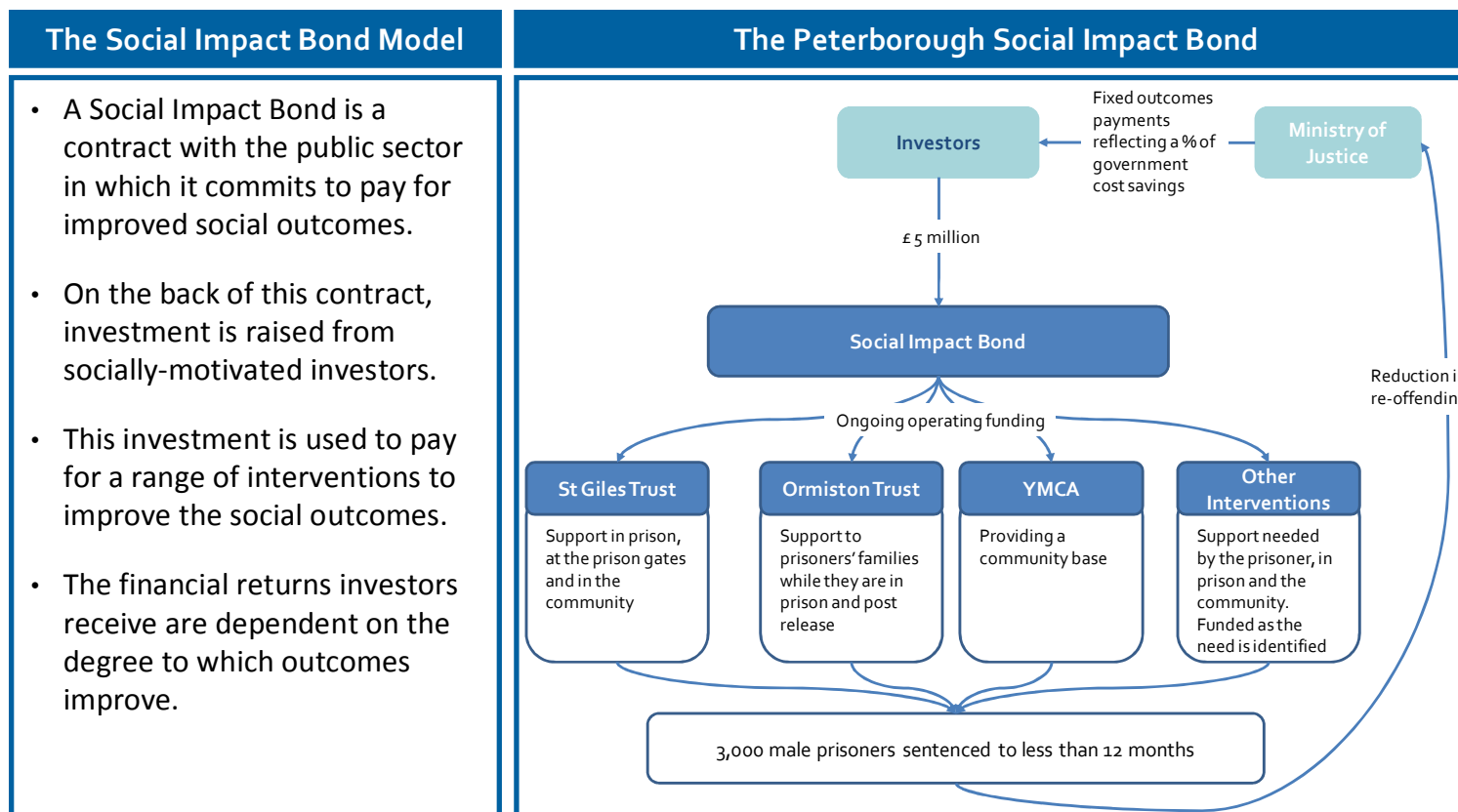


- In addition to the Work Programme the government announced in the Open Public Services White Paper that it is considering or actively exploring PBR in the following areas:
 - ~ offender rehabilitation – the Ministry of Justice has announced that it will commission at least six new projects to reduce reoffending delivered on a payment by results basis;
 - ~ drug and alcohol recovery – eight payment by results drug recovery pilot areas (some of which also include alcohol) have been working with independent experts and the Government since April to co-design local payment by result models to be implemented from October of this year;
 - ~ children’s centres – the joint DfE/DH Foundation Years Policy Statements set out plans to trial arrangements to pay Sure Start children’s centres in part for the results they achieve;
 - ~ vulnerable people – between late 2011 and 2013 ten local authorities will be testing out a range of innovative payment by results models with their providers in relation to Supporting People services.
- The principle of invest to save and use of external investment to fund interventions is also being considered or promoted in the following areas:
 - ~ Early intervention – the Allen Review (by Graham Allen MP) strongly advocates the use of external investment to fund early intervention in children and families, recovered from future savings. However his report is short on detail of how this will be achieved;
 - ~ Family Intervention Pilots – the Cabinet Office is exploring the use of PBR funded by external finance for four family intervention projects in pilot local authorities. A4e Insight has been awarded the contract to provide technical support to this; and
 - ~ DWP Innovation Fund – bids have been invited to share a £30m fund which will reward participants for outcomes achieved through innovative approaches to NEETs, funded through external investment

Social Impact Bonds



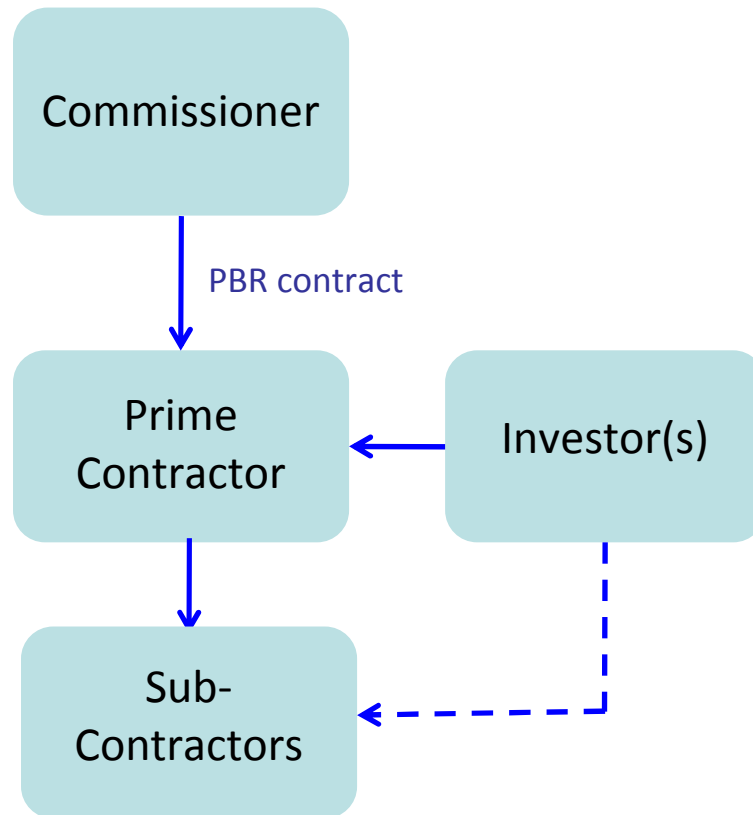
- In the development of PBR and invest to save much attention has focused on the Social Impact Bond (SIB), a specific investment model which was developed by Social Finance, an independent investment organisation, and is being trialled as a way of reducing re-offending among prisoners on short sentences in Peterborough
- Note that the Ministry of Justice have agreed to make payments if offending is reduced, but is not certain that it will be able to make cashable savings equivalent to those payments



Different contractual models are emerging

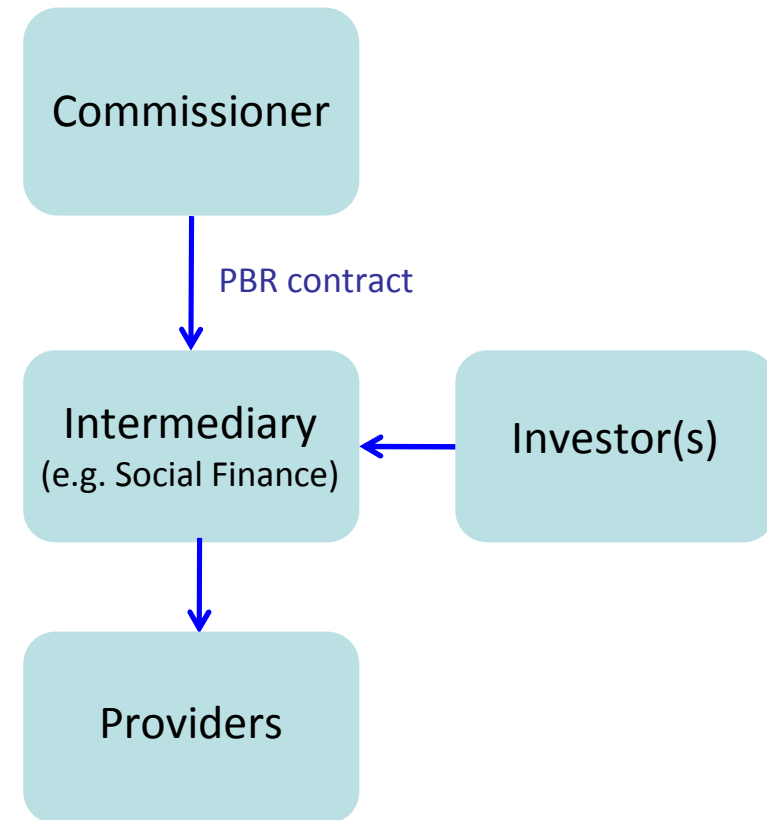


Conventional PBR (e.g. Work Programme)



- The contract lies with a prime provider who bears the risk of outcome delivery and payment
- Sub-contractors may also bear risk and therefore need their own working capital and investment

Social Impact Bond



- The contract and payment risk lies with the intermediary and ultimately with investors
- Providers are paid in the normal way for delivery and do not bear performance risk

Common misconceptions



PBR works in employability, so it can easily be extended to other programmes

- There are a number of features which are unique to the Work Programme, including the track record of providers and of previous programmes; the relatively straightforward outcome measures, the extent of attribution of outcomes to provider intervention, and the direct savings achieved by finding people work
- Other programmes are much less straightforward, and require much more innovative thinking

Avoided cost is the same as a cashable saving

- There is a body of evidence that many interventions reduce or eliminate future costs – for example working with multi-disadvantaged families can reduce the number/cost of children being taken into care.
- However an avoided cost is not the same as a cost saving; a saving is only achieved if the actual cost of children being care is lower than before – not simply lower than it would otherwise have been

Social Impact Bonds are the only way to achieve invest to save

- Civil servants and others appear to be starting to use Social Impact Bond(s) as a generic term for invest to save approaches of all kinds,
- However as explained on the previous page the SIB is a specific financial instrument which has been developed by one investment intermediary and which has only been successfully used to date in a single pilot area/programme. - many other potential models of investment are available

Social investment is the only external investment available

- There is a view in some quarters that social programmes can only be funded by social investment – i.e. investment where low or nil returns are expected, and the desire to achieve social impact and “make a difference” is a key driver for investors
- However as has been proved in the Work Programme, conventional investors can be attracted to social investment opportunities if the risks and returns are properly explained to them.

A4e involvement to date in PBR and its development



- A4e pioneered the use of payment by results in welfare to work in Israel.
- We delivered Pathways to Work and Flexible New Deal on a payment by results basis.
- We are the biggest single provider of the Work Programme, the most extensive PBR programme so far attempted.
- As a key part of the transition to the Work Programme, we proved our ability to raise conventional investment to support our working capital requirements.
- A4e Insight is providing consultancy support to the Cabinet Office which is working with four local authorities to develop payment by results agreements for family-based intervention.
- We deliver PBR-based work and skills programmes in Australia.
- We are designing a pilot programme in Hammersmith and Fulham to explore whether payment by results and invest to save can be applied to a programme working with ex-offenders who are also drug misusers and face other multiple disadvantage.
- We are working with the Ministry of Defence to develop a PBR/invest to save approach to the resettlement and re-employment of early service leavers.
- A4e Insight is building close ties with potential investors and exploring how they might invest in PBR across a range of programmes – one option is for A4e to set up its own investment arm to raise funds and invest in PBR.

Further information



- If you want further or more detailed advice on PBR or invest to save, please contact one of the A4e Insight team:
 - ~ Edward Hickman – Edward@i-A4e.com
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 - ~ Eileen Robinson – Eileen@i-A4e.com