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# The Work and Health Programme: levelling the playing field

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July 2016

#reformcommissioning



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## Acknowledgements

The authors would like to thank Big Society Capital for their kind support, without which this project would not have happened. We are extremely grateful to the 20 individuals who participated in semi-structured interviews for the paper, and Alan Cave, Christine Chang, Max Tse and others for helpful comments on an earlier draft of this paper. The arguments and any errors that remain are the authors' and the authors' alone.

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## Forewords

### **Rt Hon Frank Field MP**

A key priority for any government must be to help as many people as possible to find, and keep, a job. Work, it is now well evidenced, is good for people's health and wellbeing – it helps tackle social exclusion, provide self-worth and build confidence.

Remarkably, despite the 2008 financial crash and subsequent economic downturn, unemployment remained relatively low over the last Parliament. But behind the so-called 'jobs miracle' lies a group of people who have repeatedly been failed – those with a disability or health condition. Despite successive welfare-to-work programmes aimed at helping this group, millions have been left parked on benefits in a system that conflates disability with inability to work.

The replacement of the Work Programme offers an opportunity to change this – to ensure that welfare-to-work services are much more tailored to the often complex needs of those with a health condition or disability. This means making sure that specialist organisations – with deep local knowledge and expertise in different conditions – are involved in delivering those services. The new Work and Health Programme must be commissioned with this in mind. As *Reform's* report argues, it must be designed to enable a wide variety of innovative providers to compete, in particular those smaller, localised, specialist organisations from the voluntary sector.

At the end of last year, the Work and Pensions Committee, which I chair, published a report on welfare-to-work services calling on the Government to better support people facing serious, multiple barriers to work. *Reform's* report shares some of the recommendations we made, including the need to reintroduce upfront fees within a payment-by-results model and to share data on what works.

The Government should now take seriously the call for a levelling of the playing field in employment services, so it can begin making strides towards its goal of reaching full employment in our country.

**Rt Hon Frank Field MP, Chair, Work and Pensions Committee**

## Cliff Prior

Big Society Capital commissioned this research because we believe that government-commissioned services for particularly vulnerable people need to be high-quality and effective, as well as efficient and value for money. In the area of work and health, many previous models have not achieved the success we all want to see. So this is a programme where it is especially important to ensure innovative new models and diversity of providers.

Charities and social enterprises have considerable skills in this area and should be able to participate in the work and health field, often using social investment as one of the tools that can enable them to do so. Yet they face considerable barriers when it comes to bidding for, and winning, contracts – only one out of 21 contracts in the Government's ground-breaking Transforming Rehabilitation programme is currently being delivered by a social-sector-led consortium.

Public services are undergoing a system-wide reform with increasing demand for services juxtaposed against a Government that can only pay for less. So, we need new ideas and different ways of delivering services that can meet the needs of some of the most vulnerable people in the UK.

This is about effectiveness and value, not ideology. Public-service procurement needs to be competitive if it is to deliver the best outcomes for those in need and achieve value for money. As this report highlights, at the moment there is not a level playing field, and not enough diversity, in both the way public-service commissioning is designed and run. Government and local commissioners need to create conditions in which new providers including charities and social enterprises are better able to bid for and secure contracts.

As the Government prepares to launch the Work and Health Programme to provide support for those with health conditions and disabilities, we would urge them to consider the key findings from this new research by *Reform*.

Big Society Capital believes the following straightforward changes would have the greatest impact on increasing competition, participation and value.

- > Guarantee minimum-referral volumes. This will allow a broader range of providers to bid, with confidence that the scope is realistic and sustainable.
- > Set lower thresholds for parent-company guarantees at no more than 10 per cent of annual contract value, and allow bidders to use social-investor commitments or risk-sharing pools. This would reduce barriers to market entry and allow smaller and specialist organisations to bid.
- > Place a heavier emphasis on quality of bids. This would help prevent a race to the bottom on cost, where only those large providers able to offer discounts on price without improving quality are able to secure contracts. It would also allow smaller, specialist organisations to bid. To achieve this we need to: weight quality at least twice as high as price; set maximum, and more importantly minimum, price tariffs for suppliers to bid against; and invite organisations to submit bids within a range of 60 – 90 per cent of contract payable by results.

By learning from previous experience and making key changes to the procurement process before it begins, the Department for Work and Pensions can ensure that the expertise and innovation of charities and social enterprise are not frozen out of the bidding process. It is crucial that we recognise the specialist knowledge and experience that social-sector organisations bring and work hard to ensure they are given a fair chance to bid for, and secure, public-service contracts. As we move ever closer to devolution, there has never been a more important time for government and local commissioners to ensure there is a level playing field and better quality in the commissioning of public services.

**Cliff Prior, Chief Executive Officer, Big Society Capital**

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## Executive summary

Government's approach to outsourcing services has risen up the policy agenda in recent years. The Coalition Government saw high-quality competition between external suppliers as a key lever to deliver value for money for taxpayers and service users alike. In theory, dynamic public-service markets are well-placed to achieve this: at least half the productivity gains of private markets over 10 years can be attributed to the replacement of less-productive firms with more-productive ones.<sup>1</sup>

For these gains to materialise, government must ensure a level playing field for bidders. The removal of barriers to market entry was a key aim of the Coalition Government's flagship welfare-to-work programmes, the Work Programme and Work Choice. As then Minister for Employment Chris Grayling explained, the Government was agnostic about what type of organisation delivered the contracts, so long as the tendering process gave all types of providers an equal shot at delivering government aims.<sup>2</sup>

With the Conservative Government beginning the procurement of the successor to these programmes, now is an opportune time to assess whether past competitions achieved government aims. To do so, this paper draws on the insights of government officials, industry representatives and third-party experts.

The paper identifies a range of barriers to market entry in previous competitions. Poor contract design – including onerous financial-health requirements – erected barriers for smaller organisations hoping to bid for 'prime' contracts in the Work Programme. The same programme's heavy emphasis on payments by results also created cash-flow issues for smaller providers, which – if replicated in the Work and Health Programme – threatens to discourage bidders entering the market. A heavy focus on the price, rather than quality, of bids may have favoured large organisations capable of leveraging economies of scale to undercut competitors. Such a focus is indicative of a short-term approach to market creation by government, which encourages immediate gains over creating a healthy market, with a wide base of providers, to ensure value for money in subsequent programmes.

Solutions to these barriers to competition were also identified. A dynamic approach to risk management is needed to ensure that providers are not barred from entering the market through unnecessarily austere financial-health requirements. Commissioners should focus more on quality when assessing bids, including assessing past experience and local strategies. This does not mean that price should be ignored – it is an important factor in the value-for-money equation – but commissioners should take this into account by setting a range within which organisations can bid.

A critical facilitator of high-quality, open competition is a continuous dialogue between commissioners and bidders throughout the procurement. Commissioners should provide data and information in a timely fashion to enable bidders to prepare for market entry. Only then can government hope to create a long-term supplier base to maximise competition for this and future procurements of welfare-to-work services.

Local commissioners will also have a much greater role in the commissioning of the Work and Health Programme. Local authorities, and even health commissioning bodies, could help the Department for Work and Pensions (DWP) design services by providing forecasts on local labour market conditions, alongside advising central commissioners on outcomes assumptions. Co-commissioning regions, such as Manchester and London, could be involved in assessing the quality of bids in their areas.

All in all, these changes represent a strong evolution in government policy, with best practice from past approaches refined and built on. The design and procurement of

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<sup>1</sup> Office of Fair Trading, *Choice and Competition in Public Services: A Guide for Policy Makers*, 2010, 57.  
<sup>2</sup> Chris Grayling, 'The Work Programme a Year on: A Revolution Is under Way', 30 May 2012.



services are key determinants of their later success. If DWP gets these right, it can provide a model for the rest of central and local government on how to improve competition in complex-service markets. More importantly, it will provide a big step towards helping some of the most vulnerable members of society into work.

## Summary of recommendations

### Engaging providers

#### Recommendation 1

- > The Department for Work and Pensions should share the calculations underpinning Work and Health Programme referral assumptions and targets, and provide different forecasts that take regional variation into account.
- > Commissioners should also be clear from the offset on non-negotiable contractual requirements.
- > The Department for Work and Pensions should engage with suppliers throughout the procurement process, while ensuring that all parties have the time and information to refine contracts as a result of this dialogue.

### Designing contracts

#### Recommendation 2

- > If the Department for Work and Pensions opts for a programme in which participation is voluntary then minimum-referral guarantees should be introduced.
- > If the programme is mandatory, then the Department should insert a variation mechanism to review contracts if performance is affected by uncontrollable external factors. Commissioners should negotiate the precise variation with suppliers, but contracts should not allow unilateral change to be made by one party to the detriment of another.

#### Recommendation 3

- > Contracts should be small enough – in monetary terms – to incentivise medium-sized providers to bid for prime contracts. Commissioners should consult with bidders on the precise value, but £10 million per annum could be a reasonable upper limit.

#### Recommendation 4

- > Where they are appropriate, the Department for Work and Pensions should ensure that parent-company guarantees do not erect unnecessary barriers to market entry.
- > Government should accept a wide range of insurance from providers to reduce any further barriers. Commissioners should ensure that organisations have the time and information needed to organise these investments.

### Bid assessment and funding models

#### Recommendation 5

- > Commissioners should place a heavier emphasis on the quality of bids. A quality weighting of around 70 per cent could focus minds on the outcomes segment of the contract, opening up a wider base of competition and delivering better value for money for taxpayers.
- > Commissioners should take past experience and local strategies into account.

#### Recommendation 6

- > The Department for Work and Pensions should provide a bid range of around 10 per cent within which all bidders can submit offers.

### **Recommendation 7**

- > Contracts should include a heavy payment-by-results weighting. To ensure maximum competition, the Department for Work and Pensions should invite suppliers to submit outcomes weightings within a defined 'bid area' of between 60 and 90 per cent.
- > Suppliers should also be invited to submit bids that move to a heavier outcomes weighting as the contract progresses.

### **Creating a long-term market**

#### **Recommendation 8**

- > To create long-term markets, commissioners should create a data lab to understand and share information on successful interventions.
- > The Department for Work and Pensions should cap market share held by individual providers.
- > Government should learn from local commissioning approaches to understand how best to run future complex procurements in collaboration with local commissioners.

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# 1. Introduction

Across public services, government commissions programmes aimed at improving people's life chances. Whether focused on offenders, disadvantaged families, or vulnerable people, these services seek to address often complex, multiple needs. Success – lives transformed through, for example, a sustained job, stable housing, improved mental health – requires specialist knowledge and expertise, and can take a long time. Indeed, success is not always guaranteed.

There are, therefore, very good reasons why successive governments have outsourced the delivery of these services: it allows for greater diversity of specialist skills, shifting of delivery and financial risk and greater scope for flexible provision.

The way government buys these services is crucial, not just to the success of the initial contract, but the long-term health of that market. A competitive market is key to ensuring that government can procure the best services – and therefore deliver the best outcomes – at the best price. It is the optimal relationship between outcomes and cost that government seeks (value for money). To put it another way, public-service commissioners need competitive public-service markets to drive down costs for taxpayers and deliver high-quality services for users.

Welfare-to-work programmes have pioneered this delivery model. Since the introduction of the New Deal programmes in 1998, successive governments have relied on private and third-sector providers to support benefit claimants to make the transition from welfare into work.<sup>3</sup> The most recent of these are the Coalition Government's Work Programme and Work Choice. The Department for Work and Pensions (DWP) is now in the process of commissioning the new Work and Health Programme. The Government's aim is to help people with a disability or health condition, or who are long-term unemployed, to experience the well-evidenced benefits of employment.<sup>4</sup> To facilitate this, DWP's "commissioning strategy is to create and maintain a competitive and sustainable market."<sup>5</sup>

As the National Audit Office (NAO) has highlighted, government must avoid "over-reliance on a small number of providers" and too much "consolidation of markets".<sup>6</sup> The "sustainable market" that DWP seeks therefore requires a diverse provider base, and that means creating a 'level playing field' for providers to compete on. Any barriers to this must be identified and dismantled.

That is the focus of this paper: how can DWP ensure that the design and commissioning model for the Health and Work Programme ensures a vibrant, long-term provider market whilst balancing the competing demands of cost, quality and risk shift? Drawing on interviews with 20 expert stakeholders from across government, the private sector and charities (see Appendix A) this paper presents practical recommendations for how the Department can better achieve that balance and deliver value for money.

The recommendations are, of course, applicable beyond DWP and its Health and Work Programme. The paper learns lessons from previous government programmes, including welfare-to-work services and the Coalition Government's Transforming Rehabilitation. These lessons are no less relevant for local commissioners who, within the context of increasing devolution, will face the same challenges and opportunities in outsourcing complex, human services. Likewise for other central government departments in their future procurements.

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3 Employment Related Services Association, 'A Brief History of Welfare to Work in the UK', n.d., accessed 13 June 2016.

4 Gordon Waddell and A Kim Burton, *Is Work Good for Your Health and Wellbeing?*, 2006.

5 Department for Work and Pensions, 'Work and Health Programme', 26 May 2016.

6 National Audit Office, *Government Commercial and Contracting: An Overview of the NAO's Work*, 2016, 16.

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# 2

## Government commissioning: an overview

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## 2.1 Commissioning: what is government trying to achieve?

The way government designs and delivers public services is crucial to users and taxpayers alike. In many instances, services are delivered by the public sector, but, recognising the need to get the best quality services for the lowest price, government has increasingly turned to external suppliers. To achieve this, commissioners have aimed to cultivate competitive public-sector markets to drive down price and stoke innovation. In total, government spends somewhere around £225 billion procuring goods and services each year – of which central government accounts for approximately £44 billion.<sup>7</sup>

### 2.1.1 Value for money

Government has long aimed to deliver value for money when commissioning services.<sup>8</sup> Value for money is defined by the Treasury as “[s]ecuring the best mix of quality and effectiveness for the least outlay over the period of use of the goods or services bought.”<sup>9</sup>

This is a necessarily vague definition. When procuring goods and services, government reserves space to give prominence to one side of the equation over the other. For example, when buying commoditised items, such as office equipment or fuel, government will look to minimise cost by buying standardised products and leveraging economies of scale. Contracting with a small number of suppliers is less of an issue in this instance because quality will not be hugely variable.<sup>10</sup> When procuring complex or highly bespoke services, however, government aims to pay greater consideration to quality.<sup>11</sup> Focusing excessively on up-front cost can create a race to the bottom in service quality, resulting in higher long-term costs if outcomes, such as someone moving into work, are not then achieved – thereby undermining the Treasury’s aim to focus on the ‘whole life cost’ of the service procured.<sup>12</sup> If government is the only buyer, then ensuring a competitive market exists over the *long term* is also key to ensuring value for money. Otherwise, as the NAO has pointed out, government becomes over-reliant on a small number of providers.<sup>13</sup>

### 2.1.2 Competitive markets

Government aims to create competitive public-sector markets to deliver value for money. The Coalition Government’s *Open Public Services* set the tone: “Opening public services to competition and providing more freedom to innovate will improve the choices available to service users, as well as delivering better value for money for the taxpayer.”<sup>14</sup>

Evidence bears this out. At least half the increase in productivity of private markets over a 10-year period can be attributed to the exit of less-productive firms, and the entry of more-productive ones.<sup>15</sup> The NAO has explained that new providers can offer innovations in service delivery, which incentivise existing providers to maximise the quality of their own services or risk losing market share.<sup>16</sup>

There are, however, differences between private and public-sector markets – necessitating careful management by government to encourage competition. Public services must avoid “discriminating against certain users”, for example by prioritising higher-value customers.<sup>17</sup> The focus on quality alongside price may also require government to remove any barriers preventing organisations bidding. The Coalition Government was alive to the importance of ‘competitive neutrality’ to ensure the most diverse supplier base competing for contracts. *Open Public Services* explained that this

7 Ibid., 3–4.

8 HM Treasury, *Managing Public Money*, 2015, 27.

9 Ibid.

10 Alexander Hitchcock and William Mosseri-Marlio, *Cloud 9: The Future of Public Procurement* (Reform, 2016), 7.

11 Crown Commercial Service, *The Public Contracts Regulations 2015*, 2015, 9.

12 HM Treasury, *Managing Public Money*, 2015, 102.

13 National Audit Office, *Government Commercial and Contracting: An Overview of the NAO’s Work*, 3.

14 HM Government, *Open Public Services White Paper*, 2011, 41.

15 Office of Fair Trading, *Choice and Competition in Public Services: A Guide for Policy Makers*, 57.

16 National Audit Office, *Delivering Public Services through Markets: Principles for Achieving Value for Money*, 2012, 22.

17 Ibid., 10.

“means breaking down barriers, whether regulatory or financial, so that a diverse range of providers can deliver the public services people want, ensuring a truly level playing field between the public, private and voluntary sectors.”<sup>18</sup>

A level playing field in welfare-to-work services has a number of key characteristics. Information would be equally accessible to all competitors – incumbents and new entrants alike. This information would be accurate and timely to ensure that all have an equal opportunity to act on it. Administrative requirements would not place unnecessary barriers to bidders otherwise capable of delivering contracts. Similarly, contracts would be the appropriate size for the market, achieving a balance between securing the best price and fostering a healthy market. The cost of delivering services would be reflected in the price paid by the purchaser, including an appropriate reward for shouldering the greater financial risk inherent in an outcomes-focused payment model.

## 2.2 Employment services

### 2.2.1 Current policy

Welfare-to-work services have been at the forefront of the outsourcing agendas of recent governments. The Work Programme and Work Choice aimed to deliver value for money by helping jobseekers into sustainable jobs – at the lowest cost to government.<sup>19</sup> DWP has explained that the commercial strategy for the Work and Health Programme is to “create and maintain a competitive and sustainable market.”<sup>20</sup>

When designing programmes, commissioners must make trade-offs (see Figure 1).<sup>21</sup> Finding the right balance between these trade-offs – for example between cost and quality, scale and diversity, innovation and reliability – will enable commissioners to create a highly competitive market, capable of delivering value for money.

**Figure 1: Key characteristics of current welfare-to-work services**

Approach	Aim	Trade-off
Payment-by-results (PbR) <i>Outcomes payments for providers who hit specific targets</i>	Only pay providers for outcomes achieved.	Payments for outcomes can achieve value for money, but too heavy an emphasis can create cash-flow issues, thereby reducing the supplier base in the long term.
Differential pricing <i>Different payments for users, dependent on need</i>	Incentivise providers to help all users – and not ‘park’ harder-to-help claimants.	Government looks to get good price for services, but cutting margins too much may reduce number of suppliers capable of taking on substantial levels of financial risk.
Prime-contract model <i>Contracts offered to ‘prime’ contractors to deliver services in defined areas</i>	Providers assume risk of delivering PbR model on large scale, and take on the responsibility for managing a supply chain of subcontractors, where it exists.	Government aims to achieve economies of scale from large providers, but looks to design contracts able to incentivise a diverse range of bidders.

<sup>18</sup> HM Government, *Open Public Services White Paper*, 9.

<sup>19</sup> House of Commons Work and Pensions Committee, *Work Programme: Providers and Contracting Arrangements, Fourth Report of Session 2010–12*, 139–41.

<sup>20</sup> Department for Work and Pensions, ‘Work and Health Programme’.

<sup>21</sup> Department for Work and Pensions, *Evaluation of the Work Choice Specialist Disability Employment Programme: Findings from the 2011 Early Implementation and 2012 Steady State Waves of the Research*, 2013, 27.

Approach	Aim	Trade-off
Black box <i>Freedom for suppliers to design and implement their own approaches to delivering against defined outcomes, without sharing information on processes</i>	Allow providers freedom to deliver innovative approaches to helping individuals – thereby improving outcomes for users.	Freedom to innovate may incentivise suppliers to bid, but information asymmetries in the market may create incumbency advantages, by, for example, hampering learning about what works.
Larger, longer contracts <i>Larger geographical areas; contract duration of up to seven years</i>	Produce market stability and encourage providers to invest in provision; give providers sufficient time to help those furthest from labour market.	Government aims to encourage investment in user services, but large, lengthy contracts reduce competition by decreasing opportunities for market entry.

Sources: Department for Work and Pensions, *Commissioning Strategy*, 2008; House of Commons Work and Pensions Committee, *Work Programme: Providers and Contracting Arrangements. Fourth Report of Session 2010-12*, 2011; National Audit Office, *The Introduction of the Work Programme*, 2012; House of Commons Library, *Work Programme: Background and Statistics*, 2016.

These characteristics, the Coalition Government argued, signalled a more business-like approach to commissioning public services. As Chris Grayling, then Minister for Employment, noted in 2011, the aim of the Work Programme commissioning process was to “capture the creativity and innovation that drives successful corporations”.<sup>22</sup> The Coalition Government also emphasised the need to cultivate a mature market. In 2012, Grayling explained:

*Competition is an important part of the Work Programme. I am not sentimental about who does what – my single goal is to help unemployed people back into work. This scheme never was and never will be about providing an income stream for charities or the private sector. And competition means that if you’re not coming up with the results, someone else will, and they’ll get the work.*<sup>23</sup>

## 2.2.2 The Work and Health Programme

Referrals for the Work Programme and Work Choice are due to cease in April 2017.<sup>24</sup> In October 2017, the Government will introduce the Work and Health Programme.<sup>25</sup> This will focus on helping those unemployed for over two years and those with disabilities and health conditions back into work.<sup>26</sup> It is part of the Government’s wider aim to halve the present disability-employment-rate gap.<sup>27</sup>

<sup>22</sup> Chris Grayling, ‘Powerful Ideas’, 3 February 2011.

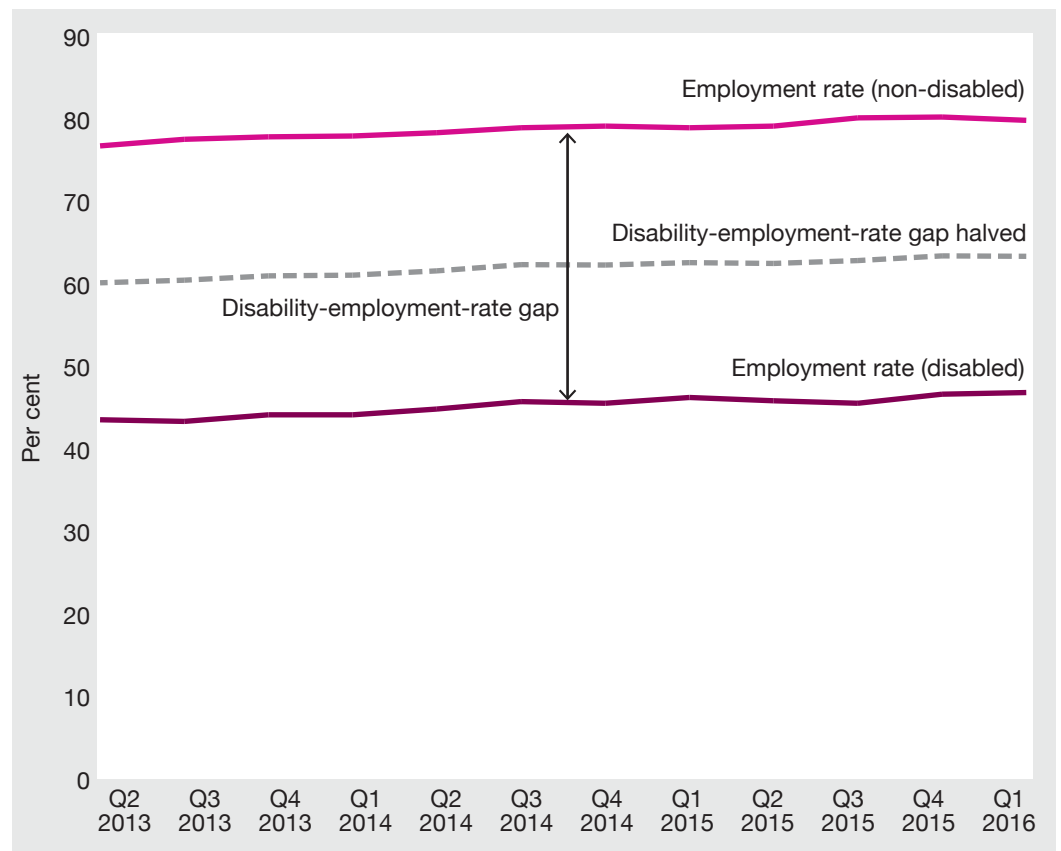
<sup>23</sup> Grayling, ‘The Work Programme a Year on’.

<sup>24</sup> House of Commons Work and Pensions Committee, *Welfare-to-Work, Second Report of Session 2015–16*, 2015, 5.

<sup>25</sup> Department for Work and Pensions and HM Treasury, ‘Department for Work and Pensions’ Settlement at the Spending Review’, 25 November 2015.

<sup>26</sup> Department for Work and Pensions, ‘Prior Information Notice’, 28 April 2016.

<sup>27</sup> Conservative Party, *The Conservative Party Manifesto 2015*, 2015, 19.

**Figure 2: Disability-employment-rate gap**

Source: UK Labour Force Survey.

The Work and Health Programme will be significantly smaller than previous programmes. The Government has pledged between £400 million and £500 million over no more than five years.<sup>28</sup> This is less than the total spend on the Work Programme in 2013-14 alone.<sup>29</sup> The contract is likely to be divided into around 10 regions – called ‘contract package areas’ (CPAs).<sup>30</sup> This is a reduction of CPAs compared to Work Choice’s 28 and the Work Programme’s 18.<sup>31</sup> The Government has committed to working with 10 Devolution Deal Areas (DDAs) in the design and commissioning of the programme, which allows greater flexibility within a national model. The Department is also working with non-DDAs to help the design of the programme.<sup>32</sup>

### 2.2.3 The commissioning process

As the retention of CPAs suggests, the commissioning process for the Work and Health Programme will build on some aspects of the tendering of the Work Programme and Work Choice. The timeframe of the Work and Health Programme tendering is expected to be closer to the year it took to procure the Work Programme – rather than the year and a half it took to procure Work Choice (see Figure 3).

<sup>28</sup> Department for Work and Pensions, ‘Prior Information Notice’. Timeframe based on overall value being estimated at between £400 million – £500 million, with the yearly estimated cost set at £120 million. Interviewees expected the Programme to pay out less for the first two years, as outcomes will not be achieved during this period. All figures exclude VAT.

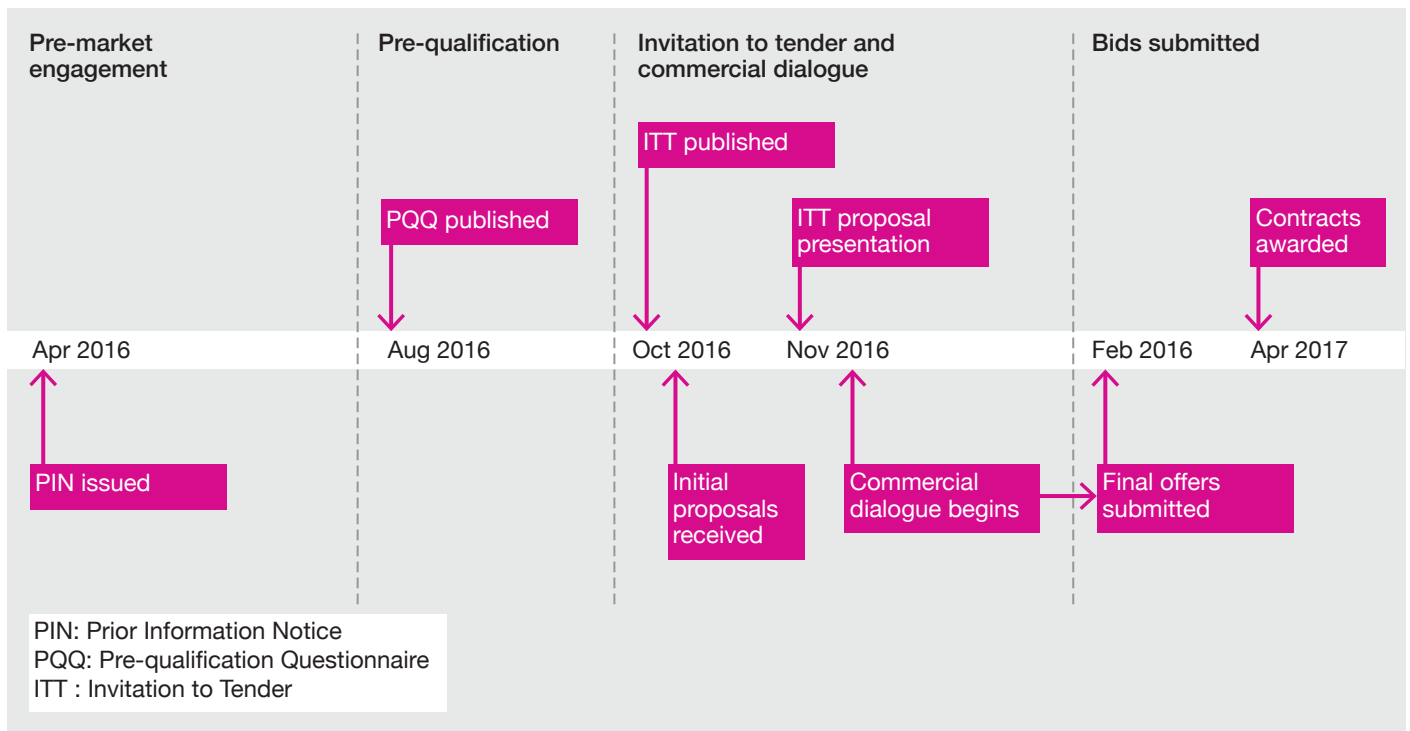
<sup>29</sup> Department for Work and Pensions, ‘Work Programme - Programme Costs to 31st March 2014’, July 2014, 3.

<sup>30</sup> Department for Work and Pensions, ‘Prior Information Notice’.

<sup>31</sup> National Audit Office, *The Introduction of the Work Programme*, 2012, 29; Department for Work and Pensions, *Evaluation of the Work Choice Specialist Disability Employment Programme: Findings from the 2011 Early Implementation and 2012 Steady State Waves of the Research*.

<sup>32</sup> National Audit Office, *English Devolution Deals*, 2016.



**Figure 3: Work and Health Programme procurement route**

Source: Department for Work and Pensions, 'Work and Health Programme', 26 May 2016.

There will, however, be crucial differences. DWP has signalled that it intends to reduce bureaucracy during the procurement process. The Department is using a Supplier Accreditation and Passporting (SAaP) process, which allows bidders for multiple lots to submit their details once.<sup>33</sup> It has committed to using a 'light-touch' process, which allows commissioners to follow fewer procedural rules during the procurement process – thereby affording them wider flexibility when assessing bids.<sup>34</sup> Fewer administrative burdens can reduce costs for procurement officials and bidders – potentially reducing financial barriers.<sup>35</sup> DWP has also announced its intention to run a 'competitive dialogue' between the shortlisted bidders following the Invitation to Tender (ITT),<sup>36</sup> which further allows procurement officials to actively engage with bidders for a defined period in the lead up to final offers being submitted (see Figure 3).

<sup>33</sup> Ibid.

<sup>34</sup> For more information on 'light-touch' regulations, see: Crown Commercial Service, *The Public Contracts Regulations 2015*.

<sup>35</sup> Crown Commercial Service, *A Brief Guide to the EU Public Contracts Directive (2014)*, 2015, 3; Philip Heath, 'Light Touch Procurement', *Harrison Clark Rickerbys*, 10 November 2015.

<sup>36</sup> For an outline of procurement processes set out under European Union regulations, see: Hitchcock and Mosseri-Marlio, *Cloud 9: The Future of Public Procurement*, 8.

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# 3

## Barriers to competition

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Despite attempts to encourage competition in public-service markets, a range of barriers to entry remain. Constructing and stewarding quasi-markets is an iterative process, however: identifying issues across a range of policy areas can provide lessons for governments designing future programmes.

## 3.1 Poor government engagement

### 3.1.1 Poor dialogue with providers

Engagement with prospective suppliers was identified by the Coalition Government as a means to ensure that contracts stimulated competition from a wide range of suppliers.<sup>37</sup> Government has committed to commence a procurement process only when “thorough engagement with suppliers has taken place” via in-person meetings and ‘boot camps’.<sup>38</sup>

Whilst some interviewees for this paper maintained that pre-market engagement was adequate during tendering for the Work Programme and Work Choice, this was not the general view. It has been argued that, across central government, “contracts are being designed without consultation.”<sup>39</sup> DWP is no exception. One interviewee characterised the Department’s approach to engaging with suppliers as “adversarial” and “defensive”, producing rigid, legacy contracts that reflect services delivered by incumbents.

Another barrier to market entry has been the timeframes within which government has operated. The Work Programme was introduced four times faster than previous similar schemes, following direction from ministers.<sup>40</sup> This “truncated” the contract-design process, according to one interviewee, limiting the Department’s ability to react to feedback from providers.<sup>41</sup> With prospective suppliers looking to government’s signals as to who it hopes to engage with, such an approach risks erecting barriers for those outside the market.

Interviewees were divided as to whether the Work and Health Programme builds in enough time for suppliers to prepare their bids (see Figure 3). Some expected pre-market engagement to provide time for government to consider feedback from all suppliers. Others believed that DWP should have provided clear messages to the market regarding contract design by May 2016. Reflecting on the lack of clarity over extra funding streams, one interviewee asked: “How can [providers] start working on the design when you don’t know what the budget is, let alone which areas you need to cover and what jobseekers you are targeting?” As late as June 2016, one prospective supplier raised concerns about the “uncertainty” of the programme design: uncertainty of referral numbers, uncertainty of contract size and uncertainty of contract geographies – all of which erect barriers to new entrants who require foresight to prepare bids for delivering new services. Another complained: “With the market engagement event end of May, and the SAaP coming out in June, realistically how much market engagement is there really going to be? You have to wonder if they’ve already shaped the market”. A prospective supplier lamented “the least level of clarity I have ever seen at this stage in the process”.

### 3.1.2 Poor use of data

Another barrier to competition has been government’s use of data. Data collected from past contracts, comparable services and engagement with suppliers should be used to design contracts that challenge providers to deliver high-quality services at a low cost.<sup>42</sup>

37 Crown Commercial Service, ‘The LEAN Sourcing Approach: Briefing & Self-Starter Pack for Procurement Staff’, April 2012.

38 Ibid.

39 David Hunter and Ruth Breidenbach-Roe, *Payment by Results Contracts: A Legal Analysis of Terms and Process*, 2013, 3.

40 National Audit Office, *The Introduction of the Work Programme*, 7.

41 Ruth Suleiman, *Stepping Stones: The Role of the Voluntary Sector in Future Welfare to Work Schemes*, 2014, 8.

42 The Government has begun to recognise this. The Cabinet Office has collaborated with the University of Oxford to collect data on PbR schemes: Cabinet Office, ‘New Partnership with Oxford University to Revolutionise Delivery of Public Services’, 23 May 2016.

If significant information gaps exist, government may fail to price contracts competitively: aggressive pricing may shut out those who offer high-quality services but do not have the balance sheet to bear significant financial risk, whereas too-generous pricing will erode value for money for the taxpayer.

Poor use of data within previous programme designs has affected market creation. Failure by the Ministry of Justice to provide suppliers with accurate and timely information led to forecasts of demand for rehabilitation programmes that were between 6 and 36 per cent above actual case volumes.<sup>43</sup> Poor forecasting assumptions during the Work Programme, including the unwillingness to share calculations underpinning these, has eroded supplier confidence in referral volumes.<sup>44</sup> Going into the Work and Health Programme, interviewees explained suppliers would not be confident that forecasts of volumes would be accurate. Two even argued that suppliers would assume volumes would be 50 per cent lower than government predictions. As the NAO has recognised, “high uncertainty over future business can reduce competition during procurement” by reducing the number of providers willing to enter the market.<sup>45</sup> Incumbents, with data collected from past programmes, will be at an advantage where this is not shared.

Interviewees argued that incumbency advantage may also be engendered by government’s reticence to gather data on best practice.<sup>46</sup> Without knowledge of successful approaches in the past, providers outside the market are at a disadvantage. The quality of competition, and the likelihood of innovative approaches being developed, may therefore be reduced. The Cabinet Office has recognised that the “challenges of working with current published data are a barrier to suppliers and businesses in deciding whether to bid for public sector business”.<sup>47</sup> This echoes Sir Ian Magee’s 2015 warning that: “The current opacity of contracting arrangements...makes it difficult for potential suppliers to spot opportunities to step in and offer a better service at lower cost to taxpayers.”<sup>48</sup> Clearly, within this, the need to protect the intellectual property of providers must be balanced against information reducing barriers to market entry (see Section 4.4).

### 3.1.3 Lack of market clarity

A competitive, diverse marketplace was the centrepiece of the Coalition Government’s aim of delivering better value for money in public services. Despite contracts being geared towards providers capable of delivering services across large areas, procurement for the Work Programme, Work Choice and Transforming Rehabilitation held competition at their heart.

Yet interviewees – including potential Work and Health Programme suppliers – explained that there remains a lack of clarity from the Government about what it desires the welfare-to-work market to look like. One stated that “the crux of the problem” for potential suppliers is a gap between government rhetoric of engaging a wide supplier base for prime contracts and the existence of a closed market only truly accessible to very large, established providers. Another stated that government wants to “have its cake and eat it”: it desires diverse competition at the prime level, but wants the security of large, private organisations, with a track record of providing services. A number of interviewees agreed with the latter point, with one asserting that DWP is “only really interested in big private-sector providers” holding prime contracts.

Though a vibrant market can mean one type of provider dominating, interviewee feedback – alongside wider reactions to government intentions<sup>49</sup> – suggests that barriers experienced by smaller providers may have reduced the provider base.

43 National Audit Office, *Transforming Rehabilitation*, 2016, 20.

44 Tom Gash et al., *Making Public Service Markets Work* (Institute for Government, 2013), 50–51.

45 National Audit Office, *Transforming Rehabilitation*, 10.

46 Gash et al., *Making Public Service Markets Work*, 54.

47 Cabinet Office, *UK Open Government National Action Plan 2016–18*, 2016, 17.

48 Chris Wajzer, Tom Gash, and Ian Magee, *Enhancing Transparency in Public Service Contracts*, 2015, Foreword.

49 New Philanthropy Capital, *The Transforming Rehabilitation Tier 1 Tendering Process: The Voluntary Sector Perspective*, 2015, 2.

Similarly, providers interviewed for this paper argued that the Government has not clearly outlined its aims for local commissioning within the Work and Health Programme. Providers explained that a lack of information – such as the involvement of local commissioners and requirements for tailoring bids to local labour markets – means there is uncertainty about how to prepare bids.

## 3.2 Contract design

### 3.2.1 Contract size

When designing contracts, government must ensure that providers are able to deliver contractual obligations, while incentivising the widest possible pool of organisations to bid. To this end, prime providers for the Work Programme were required “to have the financial capacity to deliver large scale contracts which require a significant amount of cash-flow due to outcome funding”, including an annual turnover of £20 million or more.<sup>50</sup>

Contract size materially affects the ability of providers to bid for public services. Across the European Union, size is one of the biggest barriers to small and medium-sized enterprises (SMEs) competing for contracts.<sup>51</sup>

Large contracts prohibited a variety of interested suppliers from bidding for the Work Programme. Barnardo's, Community Links and the Scottish Association for Mental Health explained that contract size effectively eliminated voluntary-sector organisations such as themselves from bidding for prime contracts.<sup>52</sup> At least one organisation intending to bid as a prime provider for Work Choice dropped out because of financial-liability guarantees.<sup>53</sup> A 2013 survey revealed that 73 per cent of voluntary-sector respondents argued that the financial risks and capital limits of PbR contracts significantly limit their ability to compete for contracts (see Figure 4).<sup>54</sup> Big Society Capital has identified a “large size bias” in Transforming Rehabilitation contracts, which undermined attempts to create a diverse supplier base.<sup>55</sup> The House of Commons Library explains that the capital required to cover upfront costs across large areas “lends itself to having large private companies as the prime providers”.<sup>56</sup>

50 House of Commons Work and Pensions Committee, *Work Programme: Providers and Contracting Arrangements, Fourth Report of Session 2010–12*, 14.

51 DG Enterprise and Industry, *Evaluation of SMEs' Access to Public Procurement Markets in the EU: Final Report*, 2010, 32.

52 House of Commons Work and Pensions Committee, *Work Programme: Providers and Contracting Arrangements, Fourth Report of Session 2010–12*, 14–15.

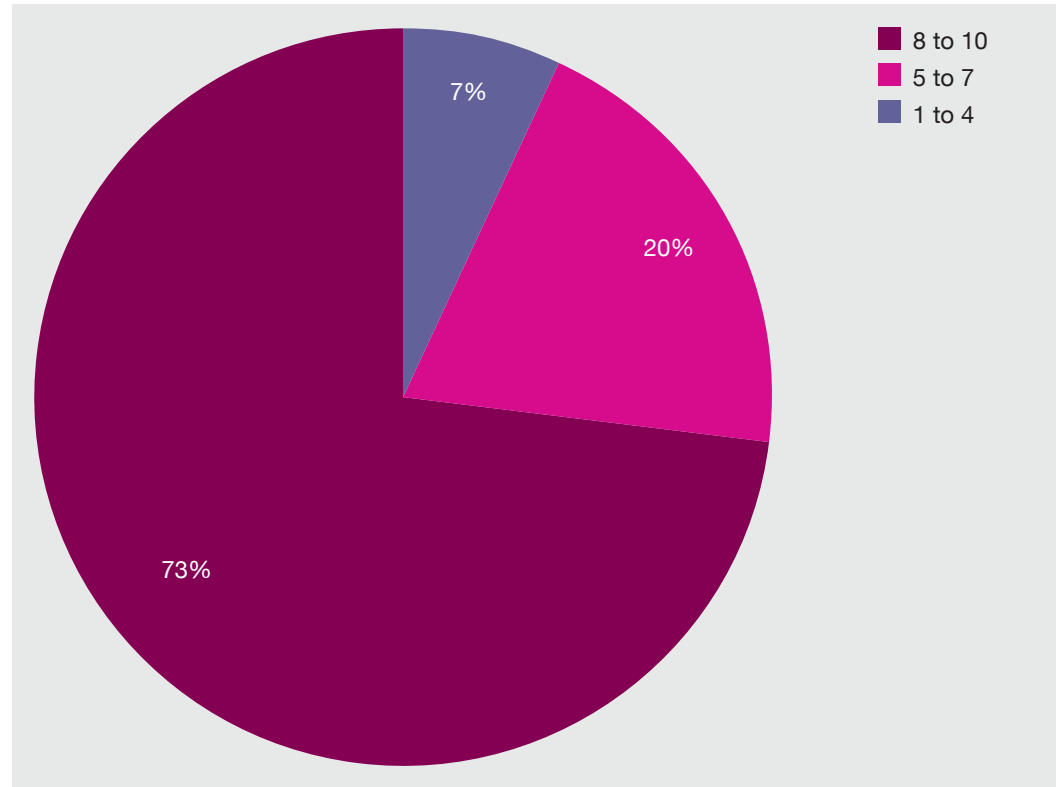
53 Department for Work and Pensions, *Evaluation of the Work Choice Specialist Disability Employment Programme: Findings from the 2011 Early Implementation and 2012 Steady State Waves of the Research*, 68.

54 Compact Voice, *Local Compact Survey Results 2013: Payment by Results*, 2013, 3.

55 Christine Chang, ‘Probation Services: What Next for the Social Sector in Big Public Service Outsourcing Contracts?’, *Big Society Capital*, 6 November 2014.

56 Aliyah Dar, *Work Programme: Background and Statistics* (House of Commons Library, 2016), 19.

**Figure 4: Degree to which respondents agreed that “the capital requirements of PbR, and the financial risks involved, limit VCS capacity to compete for contracts” (1 being “not at all” and 10 being “completely”)**



Source: Compact Voice, *Local Compact Survey Results 2013: Payment by Results, 2013*.

### 3.2.2 Parent-company guarantees

When outsourcing services, government must seek to protect taxpayer money, without erecting onerous administrative barriers to market entry. To this end, the Work and Health Programme requires a parent-company guarantee, which necessitates a parent or other group company of the contractor providing a guarantee for a defined proportion of contract value.<sup>57</sup> Parent-company guarantees were required in Transforming Rehabilitation contracts, covering one year of contract value against failure – totalling between £12 million and £72 million.<sup>58</sup>

Interviewees argued that previous use of parent-company guarantees has been disproportionate to the threat of supplier collapse. One interviewee labelled their use as “extreme risk aversion at the heart of government” – pointing to politicians’ propensity to make doomsday forecasts, which have not materialised.<sup>59</sup> Another interviewee stated that they have been “out of proportion to the scale of potential loss”, while one considered them “a waste of time” and “a barrier to entry”. Indeed, interviewees, including cross-government officials, could not name an instance in which a parent-company guarantee has been triggered.

Such risk aversion raises barriers to market entry. Depending on contract size, guarantees that cover a year’s worth of annual contract value threaten to restrict the number of

<sup>57</sup> Department for Work and Pensions, ‘Prior Information Notice’.

<sup>58</sup> National Audit Office, *Transforming Rehabilitation*, 45; Big Society Capital, ‘Written Evidence WTW0014 to the House of Commons Work and Pensions Committee Welfare-to-Work Inquiry’, August 2015.

<sup>59</sup> The example provided was the Public Account Committee’s 2014 warning that the Work Programme to be “dominated by a small number of contractors, [meaning] the government is exposed to huge delivery and financial risks should one of these suppliers fail.” House of Commons Committee of Public Accounts, *Contracting out Public Services to the Private Sector, Forty-Seventh Report of Session 2013–14*, 2014, 8.

suppliers able to cover the risk. National Council for Voluntary Organisations (NCVO) sample data shows that 0.012 per cent of non-profit companies have assets of £10 million or more, for example.<sup>60</sup>

Parent-company guarantees also disproportionately affect voluntary-sector organisations which, unlike private-sector organisations, are less likely to have huge reserves. This necessitates organising a guarantee from a third party which, according to one commentator, “is almost impossible”.<sup>61</sup> Where a market for third-party guarantees exists, insurance comes at a price. One interviewee explained that Transforming Rehabilitation guarantees were costed at 2 – 4.5 per cent of contract value per annum. One commercial organisation offered a 3 – 4.5 per cent annum plus a requirement for cash collateral to cover 10 per cent of per-annum value, which fell far short of the Ministry of Justice’s request for 100 per cent to be insured. The use of third-party organisations is also more onerous than using a parent company because of the relative lack of information built into these relationships.<sup>62</sup> One interviewee explained that charities will reconsider bids that require third-party guarantees – and that social-finance backers may be put off investing.

In practice, third-party guarantees have therefore reduced competition. Two voluntary-sector bids for Transforming Rehabilitation contracts were deemed non-compliant because of their third-party guarantees, before the quality of their bids were assessed.<sup>63</sup> In this case, the suppliers argued that it was not made clear by procurement officials that the proposal would not be considered.<sup>64</sup> One interviewee close to the process explained this left the organisations “completely despondent” and undermined market creation and value for money. One bid, it was explained, was priced lower than some winning bids – and the market may have been starved of new approaches. One organisation stated: “They should have been clear right at the beginning. We will never get involved in something like this again.”<sup>65</sup>

### 3.3 Funding model

#### 3.3.1 Payment-by-results problems

Outcomes payments are increasingly being used to pay for the delivery of public services.<sup>66</sup> *Open Public Services* explains that PbR “will build yet more accountability into the system – creating a direct financial incentive to focus on what works, but also encouraging providers to find better ways of delivering services.”<sup>67</sup>

Whilst the premise of paying for outcomes rather than inputs is right, the NAO has noted that “PbR contracts are hard to get right”.<sup>68</sup> The Work Programme’s PbR model has been identified as causing barriers to entry for some providers. For the first three years, contracts were designed so that a maximum of 89 to 98 per cent of Work Programme funding (depending on payment group, see Figure 5) was weighted towards outcomes payments – moving to 100 per cent for the remainder of the programme.<sup>69</sup> Interviewees explained that this level of outcomes weighting can cause cash-flow issues for providers: “you go to 100 per cent PbR and the only companies that can compete are big ones that can use their cash [reserves]”.

Market contraction due to overly aggressive PbR should be a concern for commissioners.

60 *Reform* calculations based on National Council for Voluntary Organisations, ‘Account Data’, n.d., accessed 20 June 2016.

61 *Ibid.*

62 Employment Related Services Association, *Improving Employment Outcomes: Empowering the Social Sector Through Social Investment*, 2015, 6.

63 New Philanthropy Capital, *The Transforming Rehabilitation Tier 1 Tendering Process: The Voluntary Sector Perspective*, 3.

64 *Ibid.*

65 *Ibid.*

66 National Audit Office, *Outcome-Based Payment Schemes: Government’s Use of Payment by Results*, 2015, 5.

67 HM Government, *Open Public Services White Paper*, 34.

68 National Audit Office, *Outcome-Based Payment Schemes: Government’s Use of Payment by Results*, 8.

69 Department for Work and Pensions, *The Work Programme: Invitation to Tender*, n.d., 12.



When government comes to retender for contracts, or contract for a new programme within that market, less competition may lead to poor value for money. Dependence on a small number of providers may also lead to those providers becoming “too important to fail”, even if their performance is not up to scratch<sup>70</sup> – as was seen in the electronic-monitoring market.<sup>71</sup>

### 3.3.2 Tariff model fails to reflect costs

Barriers to market entry are compounded by payment levels which fail to allow sufficient investment in service provision for users over the course of the contract. The Work Programme tried to address this through a differential-pricing system to reflect the varying costs associated with helping people with different needs into employment (see Figure 5).

**Figure 5: Work Programme payment model**

Payment group	Maximum attachment (£)	Maximum year 1 job-outcome fee (£)	Maximum sustainment fee (£)	Total (£)
JSA aged 18-24	400	1,200	2,210	3,810
JSA aged 25+	400	1,200	2,795	4,395
JSA Early Access	400	1,200	5,000	6,600
JSA ex-IB	400	1,200	5,000	6,600
ESA volunteers	400	1,000	2,300	3,700
New ESA claimants	600	1,200	4,700	6,500
ESA ex-IB	600	3,500	9,620	13,720
IB/IS	400	1,000	2,300	3,700
JSA prison leavers	300	1,200	4,000	5,500

Source: Department for Work and Pensions, *The Work Programme: Invitation to Tender, 2010*.

The pricing model used has not incentivised suppliers to focus attention on all user groups. Suppliers have found it difficult to make working with all claimants financially viable – meaning ‘creaming and parking’ has been an issue.<sup>72</sup> This has been a perennial problem in the Work Programme, with DWP recognising in 2013 that “there was little evidence that prime contractors have used different pricing in live delivery to target different types of support to different payment groups.”<sup>73</sup> Performance amongst ESA claimants has been lower than that for JSA claimants despite the different pricing (see Figure 6).

<sup>70</sup> National Audit Office, *Government Commercial and Contracting: An Overview of the NAO’s Work*, 16.

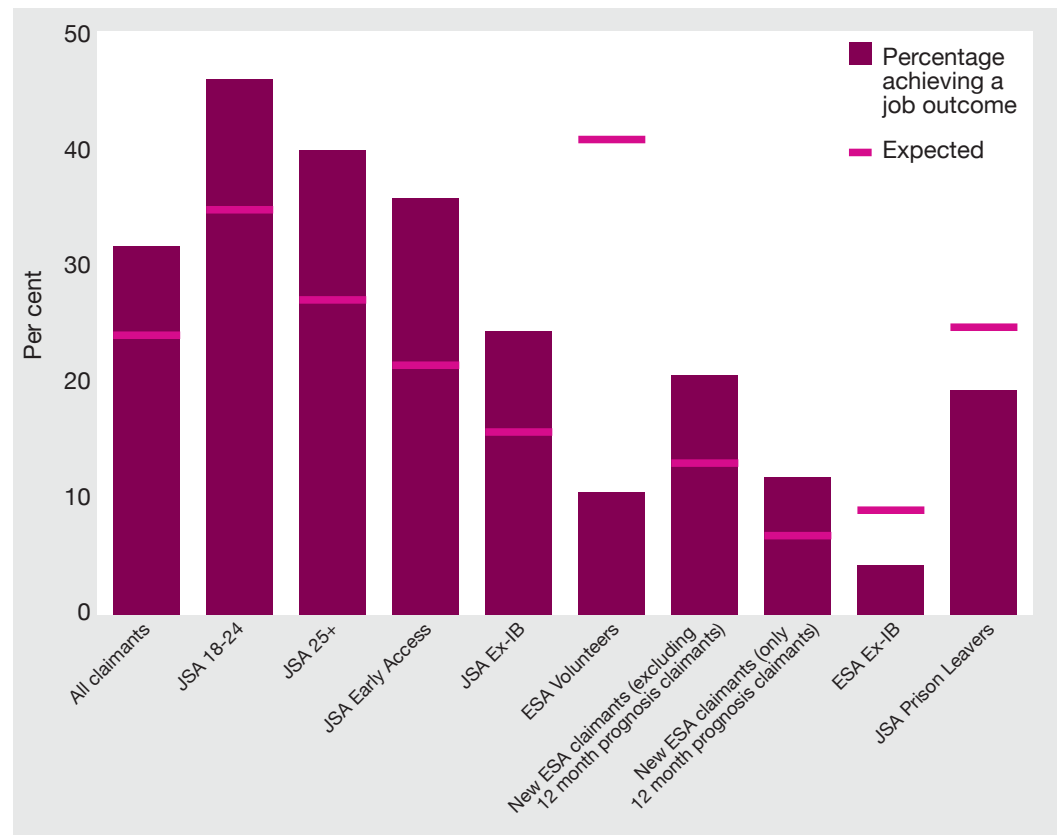
<sup>71</sup> Elizabeth Crowhurst, Gavin Lockhart-Mirams, and Charlotte Pickles, *Cutting Crime: The Role of Tagging in Offender Management* (Reform, 2015), 46.

<sup>72</sup> House of Commons Work and Pensions Committee, *Work Programme: Providers and Contracting Arrangements, Fourth Report of Session 2010–12*, 8.

<sup>73</sup> Pippa Lane, Rowan Foster, Laura Gardiner, Lorraine Lanceley and Ann Purvis, *Work Programme Evaluation: Procurement, Supply Chains and Implementation of the Commissioning Model* (Department for Work and Pensions, 2013), 4.



**Figure 6: Work Programme performance against expected performance over two years (September 2013 cohort)**



Source: Reform calculations. Department for Work and Pensions, *Work Programme Statistical Summary: Data to December 2015, 2016*.

The concern from a market-creation perspective is that poor pricing will fail to incentivise providers to bid for contracts. In some areas, providers have been subsidising Work Programme work with their own funds as payments have failed to cover the cost of provision.<sup>74</sup> This disproportionately affects smaller organisations, who are less able to bear the financial pressures of such an approach. Providers interviewed for this paper explained that small margins would make it difficult to persuade their boards of the financial case for investing in the Work and Health Programme. As the NCVO notes, any financial losses sustained will reduce the capacity for these organisations to be involved with future programmes.<sup>75</sup> This is applicable at both a prime and subcontractor level. DWP should be aware of the consequences of poor pricing on long-term markets: elsewhere, the House of Commons Committee of Public Accounts highlighted uncertainty over whether contractors providing health and disability assessments will rebid for contracts following aggressive pricing.<sup>76</sup>

Other interviewees raised concerns that large providers had used their scale to offer loss-leading bids to undercut rivals. Several argued that some organisations offered 50 per cent discounts on price. Such 'kamikaze' discounting may actually reduce value for money by rewarding discounts, not outcomes, and running the risk of a provider not being able to effectively deliver the services after winning bids.<sup>77</sup>

<sup>74</sup> Kate Youde, 'Most Charity Subcontractors Say Work Programme Contracts Are "at Risk of Failure"', *Third Sector*, 4 October 2012.

<sup>75</sup> Ramzi Suleiman, 'Stepping Stones: The Role of the Voluntary Sector in Future Welfare to Work Schemes', *NCVO*, 29 July 2014.

<sup>76</sup> House of Commons Committee of Public Accounts, *Contracted out Health and Disability Assessments. Thirty-Third Report of Session 2015-16*, 2016, 72015-16.

<sup>77</sup> Andrew Haldenby, Richard Harries, and Jonty Olliff-Cooper, *Markets for Good: The Next Generation of Public Service Reform* (Reform, 2014), 35.

### 3.3.3 Excessive emphasis on price

As discussed, achieving value for money within competitive markets requires commissioners to focus on both quality and price when considering bids. The Work Programme ITT explained that bids would be assessed on a score of 120 points – with 60 awarded for quality and 60 for price.<sup>78</sup> For programmes which stand to deliver long-term savings by getting people into work, quality is critical. Low-cost provision could result in higher long-term costs if people remain on benefits – a false economy for taxpayers.

In practice, however, price trumped quality.<sup>79</sup> This is a common complaint across procurement: price is seen as easier to measure for those assessing bids – and procurement officials can find it harder to justify not opting for the lowest-cost bid.<sup>80</sup> Some have argued that “bidding for government contracts requires 100% focus on technical merit and zero on artistic interpretation” with quality “dominated by evidence of previous results and levels of assurance rather than creative new ways of addressing old problems.”<sup>81</sup>

This emphasis on price was identified by a number of interviewees as creating a barrier to market entry for new providers. One explained that experienced providers “clocked” that DWP was leaning on price and constructed their bids accordingly. Large companies have also been identified as best placed to provide heavy price discounts, which again narrows the market for new entrants. Despite equal weight in bid scoring being given to price and quality, Big Society Capital has argued that a greater emphasis on price during Transforming Rehabilitation procurement contributed to only 3 per cent of programme value being won by a socially led consortium.<sup>82</sup>

When quality was taken into account, interviewees argued that the procurement process itself inhibited smaller, less-experienced providers, since the paper-based review of quality lent itself to organisations able to write the “prettiest bids”, as one private provider put it. Another explained that experienced bid writers rotated between a small number of providers, which entrenched their market dominance. A third relayed a conversation with a bid writer before the Work and Health Programme PIN had been released, who explained that, with virtually no information, they would already be able to write a successful bid. Similar problems with paper-based procurements have been raised in Australia, with a Senate committee noting that a lack of active discussion tilted “the playing field...in favour of those with a strong submission, as distinct from a strong performance in the field.”<sup>83</sup>

## 3.4 Short-term markets

Such reactions reveal another issue: government’s ability to create long-term markets for providing services. DWP considers itself to have adequately created sustainable markets, noting for Work Choice that incumbent suppliers intend to continue providing welfare-to-work services.<sup>84</sup> A number of interviewees agreed that government had been successful in this respect.

Others, however, were worried that government has simply created a rigid supplier base, which will not expand. Interviewees argued that reticence to bid for a number of future programmes signalled that government does not have an eye for long-term market

<sup>78</sup> Department for Work and Pensions, *The Work Programme: Invitation to Tender*.

<sup>79</sup> Gash et al., *Making Public Service Markets Work*, 51.

<sup>80</sup> House of Commons Public Administration Select Committee, *Government Procurement, Sixth Report of Session 2013–14 Volume II: Written Evidence*, 22.

<sup>81</sup> Graham Duxbury and Eoin Heffernan, *What’s a Working Life Worth? Engaging the Social Sector Better to Deliver Better Social Outcomes*, 2015, 13.

<sup>82</sup> Big Society Capital, *Transforming Rehabilitation and the Social Sector - Our Lessons Learnt from Engagement in the Procurement Process*, 2015, 2.

<sup>83</sup> Education, Employment and Workplace Relations References Committee, *DEEWR Tender Process to Award Employment Services Contracts*, 2009, 15.

<sup>84</sup> Department for Work and Pensions, *Evaluation of the Work Choice Specialist Disability Employment Programme: Findings from the 2011 Early Implementation and 2012 Steady State Waves of the Research*, 80.

creation and is instead focused on short-term wins – particularly cutting costs. One interviewee who agreed that government had created a market explained that DWP is now focusing on how to “feed it” with less money for the Work and Health Programme: the “primary focus” for government, it was argued, is how to “get the 20 or 30 we’ve currently got down to 10.” This, it was claimed, renders the Government’s aim for the entry of new providers as nothing more than “lip service”.

As the Work Programme has advanced, the market has concentrated.<sup>85</sup> The problem of exposure to a small number of suppliers has been identified by the Public Accounts Committee and the NAO.<sup>86</sup> A shrinking marketplace will aggravate the concerns about barriers to new entrants and may force government to focus on a diminishing base of established providers. This has the potential to undermine the quality of services for users and erode value for money for taxpayers.

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85 Rebecca Cooney, ‘Takeover Agreed for A4e to Create “biggest” Work Programme Contractor’, n.d., accessed 8 June 2016.

86 House of Commons Committee of Public Accounts, *Contracting out Public Services to the Private Sector, Forty-Seventh Report of Session 2013–14*, 8; National Audit Office, *Government Commercial and Contracting: An Overview of the NAO’s Work*, 16.

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# 4

## Levelling the playing field

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For the Work and Health Programme, DWP has explained that its “overall commercial strategy is to create and maintain a competitive and sustainable market.”<sup>87</sup> International best practice and the lessons of other UK-based procurements show how commissioners can take meaningful steps towards this.

DWP has also signalled a larger role than before for local commissioners to design and commission services. The precise roles of local commissioners is beyond the scope of this paper. To ensure that barriers to entry are removed to as great an extent as possible, recommendations here apply to commissioners at all levels.

## 4.1 Engaging providers

Recent governments have attempted to engage proactively with prospective suppliers to deliver, in the words of Francis Maude, a “level playing field” amongst all bidders.<sup>88</sup> Across government, modest progress has been made, including better advertising of opportunities through Contracts Finder, and bridging the gap between suppliers and government through the creation of Crown Representatives.<sup>89</sup> Yet, much more can be done to improve contract design and prepare the market for procurement of services.<sup>90</sup>

During the pre-market stage of procurement, government could do the following:

**Share calculations underpinning programme forecasts and assumptions** to help suppliers confidently bid for contracts.<sup>91</sup> This information should be made available on DWP’s Virtual Data Room – an online portal designed to provide guidance and documentation for providers.<sup>92</sup> Commissioners should also work with providers and local authorities to produce forecasts for different regions, to avoid bids in some areas being more attractive than others.<sup>93</sup>

**Provide clarity on major contractual requirements for prime contractors**, including financial-health requirements to avoid government wasting time and resource assessing ineligible bids, and give confidence to prospective bidders that they will not be wasting their time.

**Show willingness to amend contracts to reduce barriers identified by suppliers.**

The Ministry of Justice’s increase of contract package areas from 16 to 21, following early supplier feedback, was identified as “significant in ensuring that as wide a range of providers as possible could participate in the competition.”<sup>94</sup>

The involvement of local commissioners in the process was identified by interviewees as having the potential to disrupt the procurement if mismanaged. An elongation of the process due to unclear responsibilities could provide an extra burden for bidders. Local commissioners must buy in to the approach at the earliest possible stage. This was the lesson of the Department of Health’s National Programme for IT: failure to get buy-in from trusts and clinicians – who were not involved in the development of services – was a key barrier to delivering the programme.<sup>95</sup> A strong leadership structure is critical here. The Troubled Families programme employed a strategic coordinator to align actions across local authorities.<sup>96</sup> Local commissioners involved in the Work and Health Programme

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87 Department for Work and Pensions, ‘Work and Health Programme’.

88 Lord Maude, ‘Speech to SME Procurement Event’, 9 March 2012.

89 Hitchcock and Mosseri-Marlio, *Cloud 9: The Future of Public Procurement*, 15–16.

90 House of Commons Committee of Public Accounts, *Government Spending with Small and Medium-Sized Enterprises. Forty-Second Report of Session 2015–16*, 2016, 15–16.

91 National Audit Office, *The Disposal of Remploy Businesses*, 2014, 2.

92 Department for Work and Pensions, ‘Work and Health Programme’.

93 National Audit Office, *The Introduction of the Work Programme*, 7. Government could follow the approach favoured during the procurement of the Troubled Families programme, where the Department for Communities and Local Government liaised with local authorities through conferences and meetings to design elements of the programme. National Audit Office, *Programmes to Help Families Facing Multiple Challenges*, 2013, 25.

94 Commissioning Academy and Ministry of Justice, *Commissioning Case Study. Transforming Rehabilitation: Diversifying the Market*, n.d., 5.

95 House of Commons Committee of Public Accounts, *The National Programme for IT in the NHS: An Update on the Delivery of Detailed Care Records Systems*, 2011.

96 National Audit Office, *Programmes to Help Families Facing Multiple Challenges*, 24.

could establish a small number of representatives, in the form of a commissioning board, if necessary, to liaise with DWP and help commission services between local authorities, NHS England, clinical commissioning groups (CCGs) and any other organisations.

Following this, interviewees were supportive of DWP running a competitive-dialogue procedure.<sup>97</sup> One described it as the “best solution to being blinded by bid writers.” The iterative nature of the Transforming Rehabilitation procurement was seen by interviewees as an attractive model to prospective bidders. The high number of meetings (4,300),<sup>98</sup> however, was deemed onerous by some providers interviewed. DWP should also be careful not to ‘oversell’ the programme which, in the case of Transforming Rehabilitation, eroded the trust of some suppliers and put pressure on “stretched” commissioners.<sup>99</sup>

As the Treasury has warned, competitive dialogue “is only a positive addition to the procurement spectrum when it is conducted appropriately.”<sup>100</sup> For welfare-to-work services, this requires commissioners to concentrate on a number of key areas:

**Expertise:** commissioners must have a very detailed knowledge of the sector to ensure that quality can be clearly identified. Interviewees believed that Work Programme and Work Choice procurements were handled by relatively junior officials with little experience running these services. Another worried that high staff turnover reduced the knowledge of officials – a concern that has been raised by the NAO across government.<sup>101</sup>

**Continuity:** aims should be consistent between the policy and strategy officials who design services and the procurement officials who run the tendering process. Only then can providers receive consistent information and be sure that strategies – such as the sharing of information and removal of barriers to entry – remain consistent throughout the process.

**Focus:** such a resource-intensive approach should also target a small number of strategically important areas, such as how organisations will deliver outcomes, rather than generic descriptions or due-diligence issues that have beset past dialogues.<sup>102</sup>

**Time:** commissioners should set appropriate timeframes for the process. Too long, and bidders will be put off by the costs; too short, and government risks giving the message that it has no time to consider bids. One prospective Work and Health Programme supplier argued that the planned three-month dialogue process suggests government is erring towards the latter – “going into it with very fixed ideas”, not giving providers the time to come back with different solutions.

**Preparation:** Commissioners could help prepare smaller potential prime contractors for competitive dialogue by publishing a detailed plan for the procurement.<sup>103</sup> This will allow government and suppliers to understand costs and develop a strategic approach to incentivising providers to enter the market.

Competitive dialogue can only be effective if it is used fully. One interviewee explained that DWP commissioners plan to eliminate all but three bids per contract following the pre-qualification questionnaire (PQQ) stage of procurement. This raises concerns. First PQQ assessments are relatively high level and so do not benefit from the specificity of competitive dialogue. Second, the originally proposed timeframe between the PQQ being published and submitted in one month renders it possible that organisations would submit bids without really knowing their potential to deliver the contracts, to “stay in the game”. This could result in drop outs when a full cost-benefit analysis is undertaken following the PQQ stage. This would reduce an already small number of bids per contract

97 This included smaller organisations, previously identified as not having the resource to enter competitive dialogue. HM Treasury, *HM Treasury Review of Competitive Dialogue*, 2010, 8.

98 National Audit Office, *Transforming Rehabilitation*, 20.

99 *Ibid.*, 18, 20.

100 HM Treasury, *HM Treasury Review of Competitive Dialogue*, 6.

101 National Audit Office, *Outcome-Based Payment Schemes: Government's Use of Payment by Results*, 8.

102 HM Treasury, *HM Treasury Review of Competitive Dialogue*, 9.

103 *Ibid.*, 10.

during the competitive-dialogue stage. It would only take one bid to be deemed inappropriate for competition within a CPA to be eliminated altogether.

Clear information and timely procurements can also enable small and medium-sized organisations to form consortia – through joint ventures and special-purpose vehicles – to enable them compete at a prime level.<sup>104</sup> This was the lesson of the Transforming Rehabilitation procurement, which resulted in 20 of 21 prime contracts being awarded to joint ventures. Commissioners must be aware that administrative burdens, such as due diligence, take a significant time to undertake.<sup>105</sup> Networking and ‘speed-dating’ events, such as those run during the pre-market stage of Work and Health Programme procurement can help suppliers.

### Recommendation 1

The Department for Work and Pensions should share the calculations underpinning Work and Health Programme referral assumptions and targets, and provide different forecasts that take regional variation into account. Commissioners should also be clear from the offset on non-negotiable contractual requirements. The Department for Work and Pensions should engage with suppliers throughout the procurement process, while ensuring that all parties have the time and information to refine contracts as a result of this dialogue.

## 4.2 Designing contracts

### 4.2.1 Minimum-referral guarantees and contract alterations

Commissioners could also address concerns regarding referral volumes to make contracts more attractive. Providers interviewed for this paper explained that indeterminate demand created uncertainty over the financial viability of contracts – raising questions over the ability to bid and complicating the ease of obtaining external investment, where necessary. A variety of interviewees called for minimum-referral guarantees to ease these concerns.

Precise labour-market forecasts are notoriously difficult across the economic cycle.<sup>106</sup> There are therefore challenges in setting such guarantees – too-high guaranteed levels may undermine value for money in services. In addition, providers working with government must bear some risk of service provision to justify their income. This would also incentivise suppliers to rigorously assess government assumptions at the pre-market stage. Nonetheless, if the Government chooses to opt for a model in which participation is voluntary – and therefore the commercial risks associated with forecasts are even higher – minimum guarantees should be introduced.

If they do not opt for a voluntary programme, a better approach would be to build an alteration mechanism into contracts. Recognising that assumptions are imperfect, commissioners could insert a commitment to review contract structure, such as expected performance, if exogenous factors affect activity volume.<sup>107</sup> This should permit discussion between both parties, rather than allowing commissioners to change terms unilaterally.<sup>108</sup> Interviewees were supportive of Transforming Rehabilitation’s contractual obligation to act “reasonably or proportionately” when considering providers’ demonstrations of uncontrollable factors affecting contract performance.<sup>109</sup> DWP has previously used

<sup>104</sup> HM Treasury, *Joint Ventures: A Guidance Note for Public Sector Bodies Forming Joint Ventures with the Private Sector*, 2010, 21.

<sup>105</sup> Kate Hodge, ‘Best Bits: Charity Mergers and Collaborations’, *The Guardian*, 12 August 2011.

<sup>106</sup> National Audit Office, *The Introduction of the Work Programme*, 7.

<sup>107</sup> Hunter and Breidenbach-Roe, *Payment by Results Contracts: A Legal Analysis of Terms and Process*, 16.

<sup>108</sup> *Ibid.*, 12.

<sup>109</sup> National Audit Office, *Transforming Rehabilitation*, 43.



'allowable assumptions' clauses to amend the accuracy of contractual assumptions.<sup>110</sup> In the case of health and disability assessment contracts, amendments must be made within ten days of the start of the service.<sup>111</sup> Clearly the accuracy of labour-market forecasts will take longer to become clear, and so DWP should reflect this in the timeframes within which contract alterations can be made for the Work and Health Programme. The Department should also work with providers to calculate the precise variation needed to trigger renegotiations. These would provide security for providers and for any external investors.

### Recommendation 2

If the Department for Work and Pensions opts for a programme in which participation is voluntary then minimum-referral guarantees should be introduced. If the programme is mandatory, then the Department should insert a variation mechanism to review contracts if performance is affected by uncontrollable external factors. Commissioners should negotiate the precise variation with suppliers, but contracts should not allow unilateral change to be made by one party to the detriment of another.

## 4.2.2 Contract size

Contract size is a critical determinant of competition. Too large, and only a small number of suppliers will have the resources to deliver; too small, and the return on investment may not be attractive to providers.<sup>112</sup> Equally, the existence of lots of small contracts places a much bigger contract management burden on government, whereas a suitably sized prime-contractor model passes supply chain management responsibilities to those primes.

For outcomes-based welfare-to-work services, contract size is fluid: it depends on the volume of business (including whether outcomes are achieved) and length. Contract length of five to seven years was deemed sufficient to encourage regular competition for previous welfare-to-work programmes, while allowing time for providers to invest in services. Regarding monetary value, Big Society Capital estimates that organisations "can best manage growth where new annual contract value is no more than [circa] 50% of existing turnover."<sup>113</sup> It calculates that to involve medium-sized charities contracts should be limited to around £10 million per annum.<sup>114</sup> One provider interviewed also suggested £10 million as an appropriate size for contracts. The 50 per cent calculation is also pertinent: the Work and Health Programme SAaP holds 50 per cent annual turnover as the baseline for suggested contract size for those deemed to have "medium" risk following financial-health calculations.<sup>115</sup>

Commissioners can create contracts of a competitive size by focusing on two variables: the number of CPAs and the number of contracts available within each CPA. If DWP desires one provider per CPA, CPAs should be smaller. More competition – between two, three or more providers, within each CPA – would allow DWP to create larger CPAs. Commissioners must note, however, that a contraction of CPA numbers could provide barriers to entry for providers who do not have the infrastructure or profit margins to deliver services over larger geographical areas.<sup>116</sup> On the other hand, commissioners should take note from Australia, where excessively small contracts reduced the financial viability of some providers.<sup>117</sup>

110 National Audit Office, *Contracted-out Health and Disability Assessments*, 2016, 39.

111 Ibid.

112 National Audit Office, *Outcome-Based Payment Schemes: Government's Use of Payment by Results*, 24.

113 Big Society Capital, 'Written Evidence WTW0014 to the House of Commons Work and Pensions Committee Welfare-to-Work Inquiry'.

114 Ibid.

115 Department for Work and Pensions, *Supplier Accreditation and Passporting: Instructions to Potential Suppliers*, 2016, 20.

116 Stephanie Johnson, Patrick Murray, and Sam Windett, *Roundtable Write-up: Shaping the New Work and Health Programme*, 2016, 4.

117 Dan Finn, *Job Services Australia: Design and Implementation Lessons for the British Context*, 2011, 9.



Though the Work and Health Programme PIN identifies an average annual value of around £120 million a year, the total funding is unknown as other departments or local authorities may invest. DWP should make clear to bidders, at the earliest possible opportunity, how much funding will be available for contracts. It should then use this information to consult with prospective suppliers and local commissioning bodies across the country on the optimum size of CPAs. Following the example of Transforming Rehabilitation, government should be willing to amend the number of CPAs if this is able to yield a wider pool of competition.

Another lever to stoke competition may be to cap the number of contracts providers can win – with respect to percentage of total contract value or number of contracts. During Transforming Rehabilitation procurement, the Ministry of Justice found that smaller organisations faced financial barriers to bidding for more than two contracts simultaneously. There, the Ministry of Justice prevented any one provider controlling more than 25 per cent of the market by selecting second-placed bidders in four geographical lots.<sup>118</sup> Mirroring this approach in the Work and Health Programme could help to mitigate the advantages conferred by economies of scale, whereby larger private providers are able to mobilise greater resources simultaneously, and encourage providers to focus bids on those geographical areas which they are best equipped to serve. Whilst realising economies of scale may be attractive in the short term, over the longer-term reliance on a small number of suppliers may damage the health of a market.

### Recommendation 3

Contracts should be small enough – in monetary terms – to incentivise medium-sized providers to bid for prime contracts. Commissioners should consult with bidders on the precise value, but £10 million per annum could be a reasonable upper limit.

#### 4.2.3 Risk management

When imposing risk-management criteria, government gets the markets it deserves. Onerous requirements will mitigate risk for government, but will exclude all bidders except those with the most robust finances. Smaller levels of insurance will increase competition, but may disrupt future markets and value for money if providers fail.

In welfare-to-work services, government should take comfort from the lack of precedent of invoking third-party guarantees. With this in mind, and with smaller contract values, third-party experts interviewed for the paper explained that now is an opportune moment to lower financial-health requirements. Precisely what proportion of contract value parent-company guarantees should cover is dependent on what level of risk government is willing to bear in return for removing barriers to market entry. Low levels would allow smaller organisations, with smaller asset bases, to bid, but exposes higher levels of taxpayer money to the risk of failure; high levels would reduce the supplier base, but better protect taxpayer money. DWP commissioners should work with prospective suppliers to understand the level of guarantee that would incentivise a wide pool of providers, while ensuring taxpayer money is protected.

Simultaneously, government should accept a wider range of insurance. For bidders willing and able to easily organise third-party guarantees, government could continue to ask for these. For those for whom third-party guarantees pose a barrier, government could permit a number of other options.

**Social finance:** social investors provide funding for schemes, either taking on the financial risks of the contract through a Social Impact Bond (SIB) or providing investment directly to a charity's balance sheet. The investment commitment can act as financial cover for the contract. DWP has previously accepted – at pilot level – the use of investor

<sup>118</sup> National Audit Office, *Transforming Rehabilitation*, 20.

commitment in a SIB in lieu of third-party guarantees.<sup>119</sup> The SIB market is also growing and the Government announced an £80-million SIB fund in 2015.<sup>120</sup>

**Mutual risk-sharing pools:** a consortia of providers combine resources to pay into a shared fund which is used as a bond in the event of failure. This requires each provider to account for only a share of the cost of failure, lowers the financial barrier to participation while maintaining protection of the public purse.<sup>121</sup>

To facilitate these risk-sharing agreements, government must ensure voluntary-sector organisations have enough time to organise investment.<sup>122</sup> Where appropriate, commissioners could also facilitate meetings between voluntary-sector organisations and investors in order to encourage negotiations.<sup>123</sup>

As bidders, voluntary-sector organisations should also be more proactive about attracting investment – organising meetings with government officials, social investors and private investors. One interviewee was clear that charities “must do more to demonstrate our competency, come up with solutions and share some risk – and not think that because we exist we have the right to win everything”. Where multiple organisations are involved, third parties, such as Big Society Capital and New Philanthropy Capital, could organise early stakeholder buy-in:<sup>124</sup> this would take the demands off charities with little experience of organising social investment.<sup>125</sup> In the longer term, social investors and charities should build the evidence base to show the effectiveness of social investment to attract private investment.<sup>126</sup>

#### Recommendation 4

Where they are appropriate, the Department for Work and Pensions should ensure that parent-company guarantees do not erect unnecessary barriers to market entry. Government should accept a wide range of insurance from providers to reduce any further barriers. Commissioners should ensure that organisations have the time and information needed to organise these investments.

## 4.3 Bid assessment and funding models

### 4.3.1 Focus on quality

DWP has committed to shifting “the balance in our tender evaluation process toward quality from price.”<sup>127</sup> Successful interventions in welfare-to-work services provides value for money by saving the taxpayer cash: in 2007, David Freud estimated that the annual saving of moving an Incapacity Benefit claimant into work was £9,000.<sup>128</sup> Continuous engagement allows government to better assess the quality of the bid.<sup>129</sup>

Greater emphasis on quality could also open up prime-contractor competition to smaller organisations without the resources to compete largely on price. Remove the primacy of price and new entrants, offering different services, are able to distinguish bids for

119 Employment Related Services Association, *Improving Employment Outcomes: Empowering the Social Sector Through Social Investment*, 6.

120 Hillier, Andy, ‘Additional £80m to Be Invested in Social Impact Bonds’, Third Sector, 25 November 2015. DWP also has a £20 million SIB within the Innovation Portfolio of the Work and Health Unit.

121 National Audit Office, *Delivering Public Services through Markets: Principles for Achieving Value for Money*, 28.

122 National Council for Voluntary Organisations, *The Work Programme - Initial Concerns from Civil Society Organisations*, 2011, 4.

123 Daria Kunznetsova and Jenna Palumbo, *Social Investment Insights Series* (Big Society Capital, 2014), 3.

124 *Ibid.*, 7.

125 Abigail Rotheroe, *Lessons and Opportunities: Perspectives from Providers of Social Impact Bonds*, 2014.

126 *Ibid.*, 3.

127 Department for Work and Pensions, *Commissioning Strategy*, 2014, 27.

128 David Freud, *Reducing Dependency, Increasing Opportunity: Options for the Future of Welfare to Work* (Department for Work and Pensions, 2007), 7.

129 National Audit Office, *Procurement Manual: Guidance for Procurement Professionals*, 2010, 16.

commissioners.<sup>130</sup> Some organisations have called for bids to be assessed exclusively on quality, but this would fail to reflect reasonable price reductions that providers could offer (see Section 4.3.2.1). One interviewee argued that scoring should be weighted two-thirds towards quality to create a wider pool of bidders. This would mirror the Transforming Rehabilitation split, which saw bidders beyond those offering the lowest price win contracts (see Figure 7). Providers interviewed for this paper argued that such an approach sends a message to future markets that commissioners are willing to look beyond lowest cost. Similarly, the Employment Related Services Association (ERSA) has recommended a 70-30 quality-price split for future welfare-to-work programmes.<sup>131</sup>

DWP could also use a wider range of quality indicators. The Work Programme took a number of measures into account, including:

- > how a provider planned to assess claimants;
- > a provider's approach to supply chain management;
- > the resources committed; and
- > a provider's implementation plan.<sup>132</sup>

The NAO highlighted that Work Programme commissioners did not take into account past performance or performance levels offered.<sup>133</sup> During the commissioning of Job Service Australia, which focused solely on quality, commissioners took the following factors into account (with weighting shown in parentheses):

- > understanding and general strategies (20 per cent);
- > management and governance (10 per cent);
- > past performance (30 per cent); and
- > local strategies (40 per cent).<sup>134</sup>

Past performance can provide a clear indicator of quality, but is precluded from being taken into account by the Public Contract Regulations.<sup>135</sup> Instead commissioners could look to bidders' previous experience with similar client groups, or their experience delivering services in particular areas of the country to ensure high-quality competition.

Bids weighted to account for local needs could engender competition. Indeed, the Public Services (Social Value) Act 2012 requires commissioners to assess the added value to that area of the services procured.<sup>136</sup> Providers with expertise in specific areas, or with strong local connections could feel more confident bidding for services if this was part of the assessment of quality.

One DWP official explained that taking a regional view of quality would incentivise bidders with bespoke local knowledge to enter the market. Local government, local enterprise partnerships (LEPs) and even CCGs are better placed to understand the value of bids to local areas and so could play a part in assessing bids. This could include the applicability of the proposed approach to local labour-market conditions.<sup>137</sup> Government could also follow Australia in asking providers to explain how they will work with local organisations, as well as to demonstrate links to local communities. There, local management cultures were seen as a distinctive feature of high-performing providers.<sup>138</sup>

<sup>130</sup> Duxbury and Heffernan, *What's a Working Life Worth? Engaging the Social Sector Better to Deliver Better Social Outcomes*, 16.

<sup>131</sup> Employment Related Services Association, *Evolution Not Revolution: Recommendations for the Future Provision of Employment Support for the Long Term Unemployed*, 2013, 9.

<sup>132</sup> National Audit Office, *The Introduction of the Work Programme*, 31.

<sup>133</sup> Ibid.

<sup>134</sup> Education, Employment and Workplace Relations References Committee, *DEEWR Tender Process to Award Employment Services Contracts*, 18.

<sup>135</sup> Crown Commercial Service, *Procurement Policy Note – Taking Account of Suppliers' Past Performance*, 2015, 2.

<sup>136</sup> HM Government, *Public Services (Social Value) Act 2012*, Chapter 3.

<sup>137</sup> Local Government Association, *Realising Talent: Supporting People with Multiple Needs into Work*, 2015, 11.

<sup>138</sup> Finn, *Job Services Australia: Design and Implementation Lessons for the British Context*, 11.

**Recommendation 5**

Commissioners should place a heavier emphasis on the quality of bids. A quality weighting of around 70 per cent could focus minds on the outcomes segment of the contract, opening up a wider base of competition and delivering better value for money for taxpayers. Commissioners should take past experience and local strategies into account.

**4.3.2 Market-based pricing**

When designing contracts capable of incentivising a large pool of suppliers to compete to provide services for claimants facing significant barriers to employment, government must make a trade-off. It needs to ensure that funding is constructed to reflect the costs of helping users into work, while not eroding value for money by paying too generously.

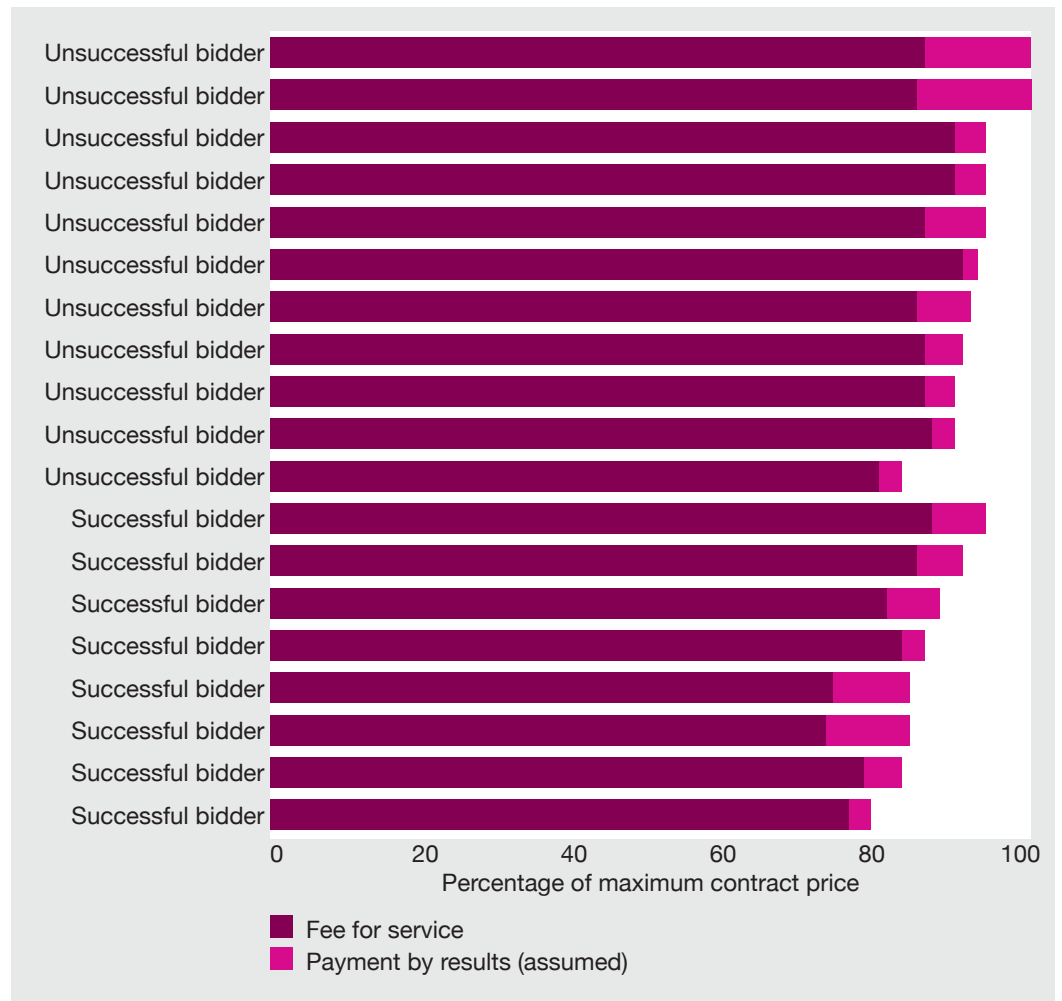
**4.3.2.1 Overall price**

Managing this trade-off requires government to interact with suppliers to determine appropriate pricing levels. The total value of payments (that is, all payments, including outcomes payments and any up-front fees) should be put to the market. Such an approach will allow government to better understand providers' assessments of costs for harder-to-help claimants. One reason for the 'parking' of ESA claimants, according to Professor Roy Sainsbury, is the lack of financial resources devoted to those with significant barriers to work; market-driven pricing may go some way to addressing this.<sup>139</sup>

This was the path favoured by the Work Programme and Transforming Rehabilitation: for the latter, the Ministry of Justice set maximum price limits to suppliers to bid on or below (including the outcomes element of the contract) (see Figure 7).

<sup>139</sup> House of Commons Work and Pensions Committee: *Can the Work Programme Work for All User Groups?*, 2013, 32.

**Figure 7: Composition of bids submitted for Transforming Rehabilitation**



National Audit Office, *Transforming Rehabilitation*, 2016.

The Work and Health Programme – targeted at a smaller group of service users than the Work Programme – could follow this approach. Interviewees argued that previous welfare-to-work services have demonstrated that government, in the words of one, “does not understand” the investment needed to deliver services. While government should be mindful of quality, this approach would allow commissioners some room to assess bids based on price, which remains an important part of any value for money assessment.

To avoid problems of bidders offering loss-leading discounts on some areas of the contract or not focusing on harder-to-help claimants, commissioners could set a range within which providers can bid. Transforming Rehabilitation shows that bidders may reduce prices by over 20 per cent. The precise total for the Work and Health Programme would depend on the maximum price, but commissioners would do well to set a narrow range within which providers can offer a price discount to ensure that the key focus of competition is quality. The average discount for the Work Programme was 6 per cent, which would suggest that 10 per cent would be an appropriate boundary to account for price variation while reducing the likelihood of loss-leading bids.<sup>140</sup> This could ensure competition based on quality, but also alive to price.

<sup>140</sup> National Audit Office, *The Introduction of the Work Programme*, 7.

**Recommendation 6**

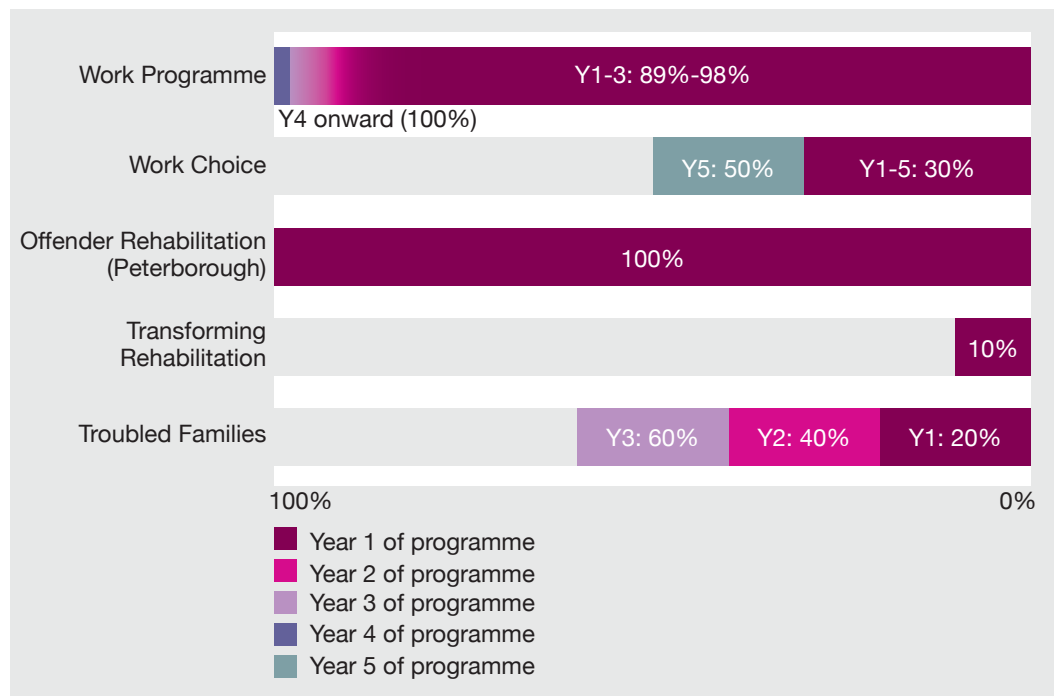
The Department for Work and Pensions should provide a bid range of around 10 per cent within which all bidders can submit offers.

**4.3.2.2 A better payment-by-results model**

There is a strong case for using PbR for the Work and Health Programme. As the Work and Pensions Select Committee, the NAO, ERSA and others have noted, PbR can encourage innovation in delivery by specifying outcomes, not processes, and delivers cost-effectiveness through paying for successful interventions.<sup>141</sup> Interviewees also agreed with the principle of rewarding providers for demonstrable results. Outcomes payments have reduced costs for the taxpayer. DWP’s modelling suggests it stands to spend £41 million – or 2 per cent – less on the Work Programme between 2011 and 2020 than it would have done for comparable performance on previous welfare-to-work schemes.<sup>142</sup>

As Chapter 3 outlines, however, a more nuanced approach is required to incentivise the widest-possible pool of providers to bid for services. Most notably, the proportion of outcome payment should be amended. Government as a whole has approached the outcomes-weighting of PbR contracts in a number of ways, from which it can draw lessons (see Figure 8).

**Figure 8: Outcomes-payments weighting across different services**



Source: National Audit Office, *Outcome-Based Payment Schemes: Government’s Use of Payment by Results*, 2015.

Providers of welfare-to-work programmes interviewed for this paper indicate that the key cause of cash-flow issues, and therefore a critical barrier to entry, is a lack of attachment fees. One put it simply: “you will get a bigger pool of providers where there is an upfront fee”. On the other end of the spectrum, the NAO has argued that Transforming

<sup>141</sup> National Audit Office, *Outcome-Based Payment Schemes: Government’s Use of Payment by Results*, 19; ACEVO/Shaw Trust Work Programme Review Group, *Refinement or Reinvention? The Future of the Work Programme and the Role of the Voluntary Sector*, 2013, 18–19; House of Commons Work and Pensions Committee, *Work Programme: Providers and Contracting Arrangements, Fourth Report of Session 2010–12*, 26.  
<sup>142</sup> National Audit Office, *The Work Programme*, 2014, 37.

Rehabilitation's 10-per-cent outcome weighting "limits the incentive on providers to innovate and focus on 'what works' to reduce offending".<sup>143</sup> Work Choice achieved 20 per cent sustained unsupported job outcomes in 2013-14.<sup>144</sup> Yet it is unclear how much each outcome cost per user and so the value for money is hard to ascertain.<sup>145</sup>

This provides guidance as to what hampers competition and value for money. Government could use a 'bid area' of between 60 and 90 per cent of contract value for outcomes payments as a basis from which to negotiate. Interviewees were positive about this approach: one labelled it the "most effective levelling of the playing field" since it allowed providers to bid based on their capacity, rather than fitting a box government had created. Game theory suggests that, if other bids are unknown, suppliers will offer competitive submissions – which would return more heavily weighted outcomes payments.<sup>146</sup> Using a market-based approach in Transforming Rehabilitation, one government official explained, resulted in suppliers offering a higher level of outcomes payments than the Ministry of Justice otherwise anticipated. Suppliers interviewed for this paper suggested that they would be willing to offer a PbR weighting of 70 – 80 per cent of contract value for the Work and Health Programme.

Government could also consider asking providers to bid on outcome payments in each year of the contract. This would allow providers to take on more risk as the contract matures – after providing an up-front investment in restructuring services, reducing cash-flow issues and other financial risk in early years.<sup>147</sup> For these reasons, a government official interviewed for this paper described it as a "lever for opening up competition." Two Work and Health Programme bidders interviewed for this paper stated they would be happy to offer outcomes weightings of 65 per cent rising to 75 per cent. DWP should model the likely effects of an outcomes-weighting shift on market entry. Assuming a significant outcome weighting, somewhere in the region of a 10-percentage-point shift is likely to be appropriate.

#### Recommendation 7

Contracts should include a heavy payment-by-results weighting. To ensure maximum competition, the Department for Work and Pensions should invite suppliers to submit outcomes weightings within a defined 'bid area' of between 60 and 90 per cent. Suppliers should also be invited to submit bids that move to a heavier outcomes weighting as the contract progresses.

## 4.4 Creating a long-term market

To create a sustainable market, commissioners must understand the long-term implications of current decisions. Large savings may be beneficial in the short term, but without incentivising a healthy variety of providers to bid for subsequent programmes, competition will diminish and service quality may stagnate. In quasi-markets, government can use a number of policy levers to craft a long-term pool of bidders.

Government can use its position as market maker to understand and share information on successful interventions. The NAO has identified "incumbency advantages enjoyed by existing firms, such as access to information" as a barrier to a level playing field.<sup>148</sup> The black box, whilst empowering providers to deliver the services they think will best help

<sup>143</sup> National Audit Office, *Transforming Rehabilitation*, 21.

<sup>144</sup> These are the most up-to-date figures provided by the Government. Department for Work and Pensions, *Work Choice: Official Statistics*, 2016.

<sup>145</sup> A *Reform* FOI request on the cost of the programme was rejected. The DWP estimated that, in 2011-12, "Work Choice had an average unit cost of just under £30,000 per paid outcome". Department for Work and Pensions, *Residential Training Provision - Independent Advisory Panel Report*, 2013, 15.

<sup>146</sup> Roger A. McCain, *Game Theory and Public Policy* (Edward Elgar Publishing, 2015), 53.

<sup>147</sup> Department for Communities and Local Government, *The Troubled Families Programme: Financial Framework for the Troubled Families Programme's Payment-by-Results Scheme for Local Authorities*, 2012, 7.

<sup>148</sup> National Audit Office, *Outcome-Based Payment Schemes: Government's Use of Payment by Results*, 21.



their participants, reinforces this. A number of interviewees backed the sharing of best practice between providers to reduce this advantage. The NAO has highlighted the value of sharing best practice in the Work Programme.<sup>149</sup>

Identifying a causal link between specific interventions and outcomes is difficult. Yet this should not dissuade commissioners and providers from working together to identify lessons learnt. One way to do so would be through an employment data lab. This service, pioneered by the Ministry of Justice, attempts to understand the causality of interventions by comparing outcomes for people who receive interventions with similar people who did not. A report is published after organisations request information from the Ministry.<sup>150</sup> Eighty-three per cent of users found data-lab analysis useful for understanding the effects of their interventions.<sup>151</sup>

DWP has previously committed to piloting a data lab for employment services.<sup>152</sup> As then Secretary of State for Work and Pensions Iain Duncan Smith explained: “By opening up much more of the Government’s data to providers, charities and social ventures, all of us can better understand the outcomes of what we do on the frontline – proving its effectiveness.”<sup>153</sup> This would sit well with the Government’s wider aims for greater transparency when procuring goods and services.<sup>154</sup> It could also act as a ratchet for the quality of competition: with knowledge of what works, providers could improve services during each iteration of welfare-to-work programmes. It would also – as the Cabinet Office has noted – help bidders assess whether they are in a position to outbid rivals on quality,<sup>155</sup> as well as provide better information for commissioners to assess the quality of bids.<sup>156</sup>

Government must also avoid concentrating the market into the hands of fewer and fewer providers across the longer term.<sup>157</sup> Commissioners can guard against this by setting a cap on the value of market share – with respect to percentage of total contract value or number of contracts – individual providers can control. Ensuring a wide pool of providers is likely to ensure competition for subsequent programmes. The Transforming Rehabilitation and Work Programme models were supported by a number of interviewees, so DWP should consider setting similar caps for the Work and Health Programme.

Going forward the Government should learn from the commissioning process for the Work and Health Programme and other local models. This is pertinent for local commissioning routes. With different approaches pursued across the country, commissioners have a semi-controlled trial, capable of revealing lessons about different methods. The relationship between central and local government, the level of responsibility and involvement of local commissioners in the design and procurement of the process, and the ability of local commissioners to manage markets can all be scrutinised to improve the process in the future. This would be a significant win for government: the NAO has argued that government does not have a good evidence base for identifying integration opportunities for commissioners or assessing the costs and benefits of integrated commissioning.<sup>158</sup> Understanding this would equip future local and central government commissioners for running similarly complex procurements across public services.

149 National Audit Office, *The Work Programme*, 28.

150 In the two years to April 2015, 156 requests returned 124 reports. Ministry of Justice, *Justice Data Lab: Pilot Summary*, 2015, 4.

151 Ministry of Justice, *Justice Data Lab: What Has the Pilot Told Us? User Feedback Summary*, 2015, 5.

152 New Philanthropy Capital, ‘DWP & NPC Unveil Pilot “data Lab” to Fight Unemployment’, 19 March 2015.

153 Iain Duncan Smith, ‘Social Investment for Better Public Services’, 19 March 2015.

154 Cabinet Office, UK Open Government National Action Plan 2016-18. Work and Health Programme contracts also provide a valuable opportunity for the Government to use the new transparency clause recently placed in its Model Services Contract. Government Legal Service, Model Services Contract, 2016, 42–44.

155 Matt Foster, ‘Cabinet Office Vows Greater Transparency over Outsourcing Deals with New Contracting Standard’, *Civil Service World*, 17 May 2016.

156 Duxbury and Heffernan, *What’s a Working Life Worth? Engaging the Social Sector Better to Deliver Better Social Outcomes*, 2015, 13.

157 Gash et al., *Making Public Service Markets Work*, 38.

158 National Audit Office, *Integration across Government*, 2013, 6.



**Recommendation 8**

To create long-term markets, commissioners should create a data lab to understand and share information on successful interventions. The Department for Work and Pensions should also cap market share held by individual providers. Government should learn from local-commissioning approaches to understand how best to run future complex procurements in collaboration with local commissioners.

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## Conclusion

The Government has set out its ambition to deliver a competitive and sustainable welfare-to-work market. To do so, commissioners at all levels must act decisively. Most immediately, the programme design and information must be made available to suppliers. Commissioners should treat contract design as a positive-sum game and work with bidders to ensure that key aspects, such as referral forecasts and the size and shape of contracts, incentivise a wide range of providers to bid. Commissioners should be sure that as this dialogue continues through the process, they are strategic in approaching the most important areas for stoking competition. Putting contract price and the outcomes weighting of the payment-by-results model to the market can further enhance competition; an emphasis on quality through the competitive dialogue and local strategies will ensure that this competition results in delivering high-quality services at the best cost.

This is not a revolution. Taken together, these steps build on successes in previous programmes and use best practice to refine an established approach. Opening up the market to a wide pool of competitors, offering a range of solutions, is critical for delivering value for money for taxpayers. More importantly, it is a fundamental step to offering the services needed to help some of the most vulnerable members of society into employment.

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## Appendix A: list of interviewees

The research for this paper was informed by 20 semi-structured interviews, lasting approximately one hour each. The interviews were conducted under the Chatham House Rule. The interviewees included representatives from the following organisations:

Association for Project Management

Bates Braithwaite Wells

Big Society Capital

Catch-22

Department for Work and Pensions

Employment Related Services Association

Groundwork UK

House of Lords Select Committee on Charities

Independent employment services provider

Ingeus

London School of Economics and Political Science

National Audit Office

National Council for Voluntary Organisations

National Offender Management Service

New Philanthropy Capital

Pluss

We would like to extend our thanks to all those involved in the above interviews.

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ISBN 978-1-909505-92-6