



# BREAKING BAD HABITS

Reforming rehabilitation services

Nigel Keohane and Arthur Downing

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Any errors or omissions remain those of the authors.



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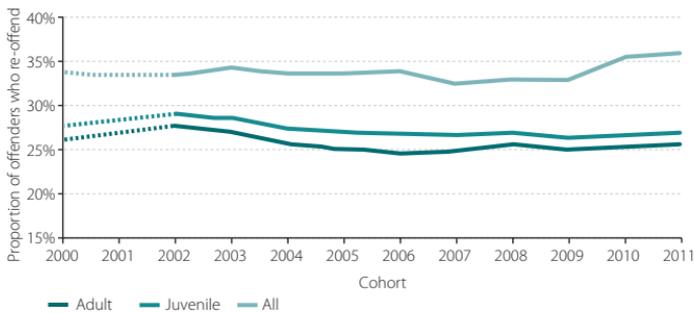
## INTRODUCTION AND SUMMARY

### THE PROBLEM OF REOFFENDING

Despite reductions in levels of recorded crimes in recent years, the Government spends more than £3bn a year on prisons and £1bn a year on delivering sentences in the community, including £800m on probation services.<sup>1</sup>

Many of the crimes recorded each year are perpetrated by people who have already committed crimes and been subject to punishment from the courts. The figures are startling – approximately 600,000 offences were committed in 2012 by people who had previously committed a crime – equating to about one in six of all recorded crimes.<sup>2</sup> About half of those finishing their prison sentence will go on to reoffend.<sup>3</sup> As Figure 1 shows, these reoffending rates have been stubbornly high for a decade or more.

**Figure 1: Proportion of adult and juvenile offenders in England and Wales who commit a proven re-offence, 2000, 2002 to 2011<sup>4</sup>**



1 John Bardens and Gabrielle Garton Grimwood, *Introducing "Payment by Results" in Offender Rehabilitation and other reforms* (London: House of Commons, 2013).

2 ONS, *Crime in England and Wales, year ending September 2012* (London: ONS, 2013).

3 Ministry of Justice, *Transforming Rehabilitation: A Strategy for Reform* (London: HMSO, 2013).

4 Ministry of Justice, *Proven Re-offending Statistics: Quarterly Bulletin January to December 2011, England and Wales* (London: HMSO, 2013).

The costs to government are enormous. In 2003, the Social Exclusion Unit calculated the total cost of reoffending as up to £65,000 for a reconviction and followed up by up to £37,500 per year in prison.<sup>5</sup> Re-offending produces very high costs to society but also directly to the criminal justice system.

Preventing just a small proportion of these offences from being committed would have immense benefits: to the individual who desists, to the Ministry of Justice as it seeks to manage a budget cut of about a third imposed from 2010, to those who would otherwise be victims of a crime and to society and the economy more generally. The large social payoff from reducing reoffending warrants a radical approach to the problem. There is little evidence to suggest that the problem of reoffending is likely to be resolved without changes to the way offenders are supported post release. In this context the ambitions behind the Government's reforms are to be lauded.

## THE TRANSFORMING REHABILITATION REFORMS

The Ministry of Justice's *Transforming Rehabilitation: A strategy for reform* set out in May 2013 how a redesigned probation service will respond to the problem of reoffending. The reforms comprise changes to who will receive support, how the service will be delivered and who will deliver it.

- The scheme will cover adults but not young offenders below the age of 18. An estimated 50,000 prisoners released from short-sentences (12 months or less), who have not been subject to supervision since 1996, will be included in the scheme in addition to those released from a custodial sentence of 12 months or more, and those sentenced to a community order or a suspended sentence order.

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5 Social Exclusion Unit, *Reducing re-offending by ex-prisoners* (London: HMSO, 2003).

Those released from short sentences have a higher one-year reoffending rate than matched offenders receiving a community order, a suspended sentence, a court order or a prison sentence of between one and four years.<sup>6</sup>

- The prison estate will be reorganised with the establishment of resettlement prisons so that offenders can be supported ‘through the prison gate’. These will allow more joined-up resettlement help for offenders as they move from custody to the community.
- The majority of probation services are to be put out to the market to be delivered by private, voluntary and community sector providers. These providers will manage low and medium risk offenders, numbering some 236,000.<sup>7</sup> The UK is being divided into 21 Contract Package Areas (CPAs). Most of the current probation staff will be transferred over to the winners of these contracts.
- The remaining functions of the existing Probation Trusts will be reformed into a new National Probation Service. This new entity will retain responsibilities for risk assessment and supervision of high risk offenders.
- The payments that providers will receive will comprise two parts: first, a ‘fee for service’ component for providers to deliver interventions mandated by the courts; second an incentive payment to innovate and take risks to reduce reoffending.

## PAYMENT BY RESULTS FOR REOFFENDING

As noted above, a crucial element of the probation reforms is the intention to pay providers by results according to the extent to which they reduce reoffending. Payment by results (PbR) has already been introduced in employment support services (the

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6 Ministry of Justice, *2013 Compendium of re-offending statistics and analysis* (London: HMSO, 2013).

7 Ministry of Justice, *Transforming Rehabilitation: A Strategy for Reform* (London: HMSO, 2013).

Work Programme), in family support services (the Troubled Families initiative) and is being piloted in two prisons. It aims to exploit the superior knowledge that private and voluntary, social and community enterprises (VCSE) agencies have of their clients and their circumstances, to help achieve socially-desirable outcomes, in this case desistance from crime. At the same time as devolving autonomy for delivery it also seeks to hand down accountability for achieving these outcomes. In putting the risk of failure (i.e. the failure to prevent reoffending) on to the provider, the commissioner seeks to make the provider worry about the same issue that the state is worried about (namely the fiscal and social costs of crime). At least in theory, attaching prices to outcomes offers a powerful mechanism to achieve both the devolution of operational autonomy and financial risk.

In a service area such as offender rehabilitation, PbR has particular attractions given the complex behaviours and needs of offenders and the complicated path to desistance. Although the evidence is incomplete, two existing pilots – in Peterborough Prison and Doncaster Prison – indicate that there may be gains from incentivising providers on the ground to develop tailored support to rehabilitate offenders.<sup>8</sup>

However, turning this neat theory into effective practice relies on getting four fundamental pillars in place:

- **Designing the incentive payment correctly.** If the payment incentive is not strong enough or the expectations made of providers unclear, then providers may not invest in rehabilitation services. If the payment incentive is excessive then the Government may not get value for money because it is paying providers more than necessary to achieve the outcomes.

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<sup>8</sup> Ministry of Justice, "Annex A Interim re-conviction figures for Peterborough and Doncaster Payment by Results pilots", [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/225168/annex-a-interim-reconviction.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/225168/annex-a-interim-reconviction.pdf) Accessed 5 March 2014.

- **Putting a price on an outcome and investing sufficient state money into rehabilitation.** Under the current reforms, providers will receive a fee for service element to carry out specific prescribed activities determined by the court and only a smaller incentive payment linked to reoffending rates. If more offenders are to be rehabilitated, over time the Government needs to incentivise providers to invest more into rehabilitation services by providing stronger reward incentives, especially as the potential savings to the state are significant if reoffending can be reduced. The Government also needs to consider what price to pay for outcomes, especially whether to pay more for certain types of offenders or preventing offences that are costly to the state and society.
- **Ensuring that the provider is in control of the factors that affect rehabilitation.** If many factors affecting the likelihood of an offender reoffending are outside of the control of the provider then the latter is likely to disinvest in the service and refuse to innovate. Some factors are impossible to put within the control of the provider, such as local policing priorities and sentencing policy. However, a range of other services commissioned or provided by central government have an effect on the re-offending rate. Under these circumstances, rehabilitation providers are accountable for something that they do not control fully.
- **Developing a competitive, diverse and sustainable market of providers,** including meaningful roles for the charitable and social enterprise sector. Given that VCSE providers possess much of the expertise in working with offenders and ex-offenders, they must be allowed to act as providers. What is more, the Ministry of Justice needs to ensure that the market is competitive and sustainable by guarding against market concentration and ensuring that the risks faced by providers are controllable.

The Social Market Foundation (SMF) has already published a paper setting out how the Ministry of Justice should design its

payment mechanism to ensure that providers have an incentive to invest in rehabilitation services. *Paying for results? Rethinking probation reform* argued that the Ministry of Justice should simplify its proposed payment mechanism so as to pay (or penalise) on a per-person basis for any observed reduction (or increase) in re-offending rates below the baseline level.<sup>9</sup>

Drawing on new statistical analysis as well as roundtable events held in spring and summer 2013, this paper, therefore, addresses the three latter aspects. It makes recommendations for immediate revisions, to the design of the scheme along with proposed future steps that the Government should take as it develops its policy post-2015.

## THE REPORT, ITS FINDINGS AND RECOMMENDATIONS

Chapter 1 sets out the case for the Government to incentivise providers to invest significant sums of money into rehabilitating offenders. The research calculates the cost of re-offences against the person committed within a one-year period during 2011 (the most recent figures available): a conservative estimate puts the costs at £2.4bn. While many of these costs were borne by victims and society, the direct costs to the criminal justice system added up to approximately £335m. The scale of the potential savings that could come from stemming the tide of reoffending indicates that the Ministry of Justice should expand significantly the incentive on providers in the future. This argument is borne out further when set against what is going on in the Peterborough prison pilot, where interim results indicate that re-offences have been reduced significantly (set against a rise nationally).<sup>10</sup> The report recommends that:

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9 Ian Mulheim, *Paying for results? Rethinking probation reform* (London: SMF, 2013).

10 It should be noted that these are interim rather than final findings, cover only half of the cohort and have not yet been measured against the control group.

- The Government should dramatically lift the cap that it is imposing on the level of reward that a provider can receive for reducing reoffending.

Chapter 2 demonstrates the problems that occur when the provider does not have control of the factors that affect reoffending outcomes because of the fragmented way in which public services are commissioned. Under these circumstances, providers are accountable for something that they do not control, which increases the risks to which they are exposed and weakens their incentive to invest in innovative interventions. It also means that the Government may end up paying twice for the same outcome. The research identifies two specific areas where commissioning services separately will lead to accountability problems: prison services and the Work Programme. In light of this, the report argues that the Government should:

- Provide a performance reward for prison governors to promote rehabilitation.
- Hand responsibility for employment support for ex-prisoners – currently provided through the Work Programme – to rehabilitation providers as part of the reform and re-commissioning of the Work Programme in 2015.
- In the longer-term, work towards putting the resettlement prisons into the supply chain of the provider. In the immediate future, prison governors and prison staff should be encouraged to create, lead or take roles with social enterprises that are bidding for the rehabilitation contracts.

A principal rationale for the reforms is that expertise from charities and social enterprises can be brought in to help turn around the lives of offenders. However, Chapter 3 explains that the current proposals risk causing real harm to the prospects of small charities and community organisations that participate in the programme as well as undermining the incentives of the programme. Using new



statistical modelling, the research shows that smaller providers will be playing a dangerous game of roulette if they are paid by results on the reoffending rate. The analysis identifies a sampling problem which means that the observed change in the reoffending rate for an organisation with a small number of clients cannot be trusted as a means of measuring the performance of the organisation. It argues that:

- If the Government is serious about involving expert charities and promoting a diverse market of providers, then it must be ready to proscribe that prime contractors cannot pay small sub-contractors by results.
- The Government should proactively seek diversity of providers at the prime contractor level where the statistical significance problem is much less acute.
- In order to help the mutual sector achieve scale, the Government should consider under-writing a mutual provider by offering a government guarantee on the finance they need to grow.

## CHAPTER 1: REHABILITATION: PUTTING A PRICE ON IT

The success of payment by results in reoffending is predicated on reducing the social costs of crime, whilst cutting demand for state activities expended in anticipation and in response to a crime. An effective payment by results rehabilitation programme will target future savings to the criminal justice system and to society, thus enabling significant investment in rehabilitation activities.

### THE COSTS OF CRIME

To get a better understanding of the potential savings that come from preventing a re-offence we should look at the costs of crime. The economic and social costs of crime fall into three broad categories:

- Costs incurred in anticipation: such as insurance and private and public security
- Costs incurred by the victim as a consequence of the crime: property, lost output, ill health, damage to well-being and loss of productivity
- Costs incurred in responding to the crime: such as police time, court time and prison.

Costs to the criminal justice system also vary depending on whether or not the crime is detected or not. For instance, detected crimes (which register through convictions) incur direct costs to police time, the prison service and to the courts. Undetected crimes incur costs to the victim and to the police but do not bring costs associated with court time or incarceration. In 2003, the Social Exclusion Unit calculated the total cost of reoffending as up to £65,000 for a reconviction and followed up by up to £37,500 per year in prison.<sup>11</sup> In 2010, the NAO estimated that reoffending by all

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<sup>11</sup> Social Exclusion Unit, *Reducing re-offending by ex-prisoners* (London: HMSO, 2003).

ex-prisoners cost the economy between £9.5 billion and £13 billion a year – although a significant proportion of these costs were incurred by youth offenders.<sup>12</sup>

The analysis below seeks to paint a picture of the potential cost savings that could come from effective action. It sets out the costs associated with indictable offences committed against the person by adult offenders within the first 12 months of release from prison in the period January and December 2011. Over this period, 137,462 adult offenders committed 400,629 detected re-offences, of which 205,257 were crimes committed against the person alongside an estimated further 195,372 so-called ‘victimless crimes’.

As a very conservative estimate, re-offences committed against the person in this 12-month period by this subset of offenders incurred a cost of £2.4bn to society and the economy. It is important to note that this is a very conservative estimate as not only are victimless crimes excluded, but a whole host of additional incalculable costs are often triggered by a re-offence. For instance, imprisonment is likely to increase demand for state-supported childcare or even taking a child into care; and, families left behind may become reliant on state benefits.

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<sup>12</sup> National Audit Office, “Managing offenders on short custodial sentences”, 2010 National Audit Office, Managing offenders on short custodial sentences (London: HMSO, 2010). [www.nao.org.uk/wp-content/uploads/2010/03/0910431.pdf](http://www.nao.org.uk/wp-content/uploads/2010/03/0910431.pdf). Accessed 5 March 2014.

### Box 1.1. Estimating the cost of re-offences committed

There have been a number of efforts to estimate the costs of crime to society and the state.<sup>13</sup> To give an illustration of the costs faced by society as well as to the state, this calculation limits its scope to crimes against the person. These include crimes such as murder, burglary, theft and violent crime, but not driving offences or drugs-related crimes (for a full list see Appendix 1). It is much harder to estimate the costs of victimless crimes.

The analysis relates to a cohort of adult offenders who were released from custody, received a non-custodial conviction at court, received a caution, reprimand or warning, or tested positive for opiates or cocaine between January and December 2011. The Ministry of Justice defines a proven re-offence 'as any offence committed in a one year follow-up period that leads to a court conviction, caution, reprimand or warning in the one year follow-up or within a further six month waiting period to allow the offence to be proven in court.'<sup>14</sup>

To estimate the costs, the following data and assumptions were used:

- Data on the volume of re-offences was taken from 'Proven re-offences committed in the one-year follow-up period, by re-offence group, 2000, 2002 to 2011. Figures for January 2011 to December 2011, Table 10a'. Ministry of Justice, Proven Re-offending Tables, January to December 2011.<sup>15</sup>
- Unit costs for each crime were derived from the Home Office's 2005 study. Prices were up-rated using a GDP deflator.<sup>16</sup>
- Where offence categories were different, offences were matched (see below). The 2005 report used a slightly different categorisation scheme to the one used in the in the Ministry

13 National Audit Office, *Managing offenders on short custodial sentences* (London: HMSO, 2010).

14 Ministry of Justice, *Proven Re-offending Statistics Quarterly Bulletin: January to December 2011, England and Wales* (London: HMSO, 2013).

15 Ministry of Justice, *Proven Re-offending Statistics: Quarterly Bulletin January to December 2011, England and Wales* (London: HMSO, 2013).

16 Home Office, *The economic and social costs of crime against individuals and households 2003/04* (London: HMSO, Report 30/05, 2005). It should be noted that there are more recent figures developed by the Home Office, but crime categories did not match onto the reoffending data published by the Ministry of Justice.

of Justice's 2011 report on reoffending. Therefore we matched these categories in the following way:

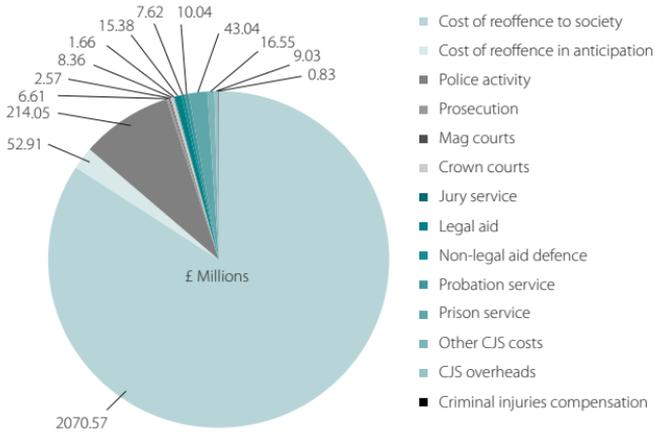
Category in 2005 report	Category in 2011 reoffending report
Violence against the person	Violence, Serious
Sexual Offences	Sexual, and sexual child
Common Assault	Violence (non-serious)
Robbery	Robbery
Burglary in a dwelling	Domestic Burglary
Theft	Theft
Criminal damages	Criminal or Malicious damage

To calculate the total cost of re-offences we combined the cost of recorded offences and the cost of unrecorded offences – the so called 'dark figure' of all crime statistics. The 2005 study by the Home Office used a variety of survey techniques to establish how many unrecorded crimes take place per recorded offence and published a table of offence specific 'multipliers' to move from convicted offence to all offences.

The total cost of recorded re-offences was calculated by multiplying the number of convicted re-offences by the cost per crime, in this case defined as the cost to the victim and society, and the cost to the criminal justice system. The calculation is slightly different for non-recorded offences because, by definition, there is a limited cost to the criminal justice system; obviously you don't have to pay for putting a criminal in prison if you don't catch them. The total cost of undetected offences was calculated by multiplying the number of undetected re-offences by the cost per offence to the victim and the police costs, but excluding any of the other criminal justice system costs.

The breakdown of these costs to the criminal justice system and to wider society is set out below in Figure 2. As can be seen, in aggregate, by far the largest cost is borne by society rather than the criminal justice system. However, approximately, £335m of costs were borne directly by the Ministry of Justice.

**Figure 2: Breakdown of costs of Proven re-offences committed in the one-year follow-up period, January to December 2011**

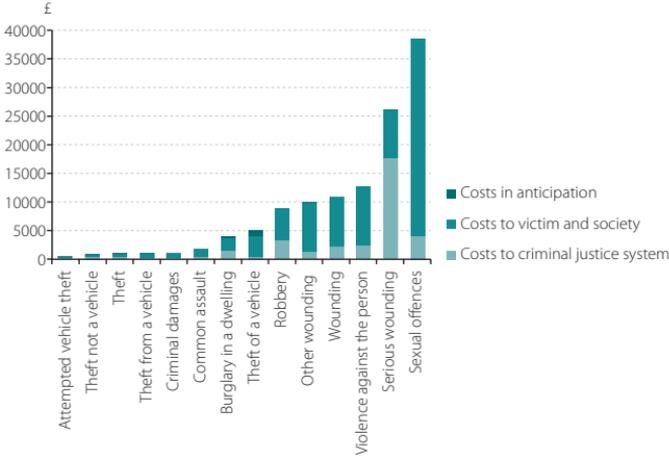


Source: See Box 1.1 for description of sources

### The distribution of the costs of crime by re-offence

While Figure 2 shows the scale of the costs of crime committed by this offender group in 2011, Figure 3 illustrates how these costs vary across offences. For example, the average cost of a serious wounding is approximately £25,000, comprising about £14,000 direct costs to the state and a further £11,000 costs to society.

Figure 3: Average cost per crime to the criminal justice system and society (note homicide is excluded because of its distorting effect)



Source: see Box 1.1 for description of sources

Theoretically, there is a case to encourage providers to invest in rehabilitation services to a point only marginally lower than the entire saving for each offence. However, decisions to invest are also affected by other factors.

### FACTORS AFFECTING THE SAVINGS THAT ACCRUE FROM REHABILITATION

A number of factors affect the confidence that the Government will have in eliminating associated costs and capturing any savings. These relate to:

- **How confident the government is in predicting or attributing any savings that will result from the intervention.** For example, a fall in the costs incurred in anticipation would only occur at the aggregate level and only if there was sufficient difference made to offending generally to reduce the need for security and insurance. Insurance companies

could be expected to reflect these lower costs in lower premiums. However, there is little evidence that reductions in crime rates have a definable effect on concern about crime. Quite the opposite might be true: we have never been more concerned about violent crime in spite of the fact that levels are low compared to historical standards.<sup>17</sup> This may mean that expected reductions in security costs may not materialise because fear of crime may encourage individuals and firms to spend the same or more on private security.

- **Which party recoups the saving.**

Savings can accrue to government or to society at large. For instance, where the savings accrue to a party other than government then there is less fiscal incentive to pursue the saving. However, this does not mean necessarily that the government should not seek to reduce the costs. After all, in other areas, the rationale for government intervention is typically to achieve social goals (such as a safer community). In fact, if designed efficiently, a payment by results scheme may offer a better way to achieve social objectives than more traditional public services.

There may be a trade-off between focusing on re-offences and re-offenders with high costs to the victim and to society versus preventing crimes with high direct costs to the Exchequer. For instance, the costs to the criminal justice system of a 'robbery' are far larger than the costs of 'wounding', but the costs to society are far higher for the latter than the former.

The fiscal consolidation and repeated cuts to the budget of the Ministry of Justice is likely to determine how this trade-off is made in the short term. The 2010 Spending Review allocated a budget cut of 27.8% for the Ministry of Justice to be applied between 2010–11 and 2014–15; the summer 2013 spending

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17 Steven Pinker, *The better angels of our nature* (London: Penguin, 2012).

round announced a further cut of 8.7% to be implemented in 2015–16.<sup>18</sup> Given these budget constraints, commissioners are likely to prioritise managing demand for justice services.

In addition, government may be concerned about the danger of backfill – although interventions may prevent offenders from re-offending, the police may find other people to arrest and prosecute. Therefore, while the costs to society would reduce, the costs to the state may not reduce to the same extent. Specifically, the policy itself may produce more work for the courts, the police and other parts of the criminal justice system. The Government has estimated additional costs of £25m per year associated with breach of licence and supervision conditions for short sentenced offenders.<sup>19</sup>

- **How easily the theoretical saving can be translated into an actual saving.**

It may be difficult to recoup all the theoretical costs associated with preventing a crime. In the instance of a re-offence being prevented, the courts would have to process one less crime thus saving money. However, in other areas of the criminal justice system, the money may be harder to net and the savings to the Department will not necessarily be linear. For example, were an intervention to lead to one fewer prisoner needing to go to prison and a prison having to cater for 999 rather than 1,000 prisoners then the government would be unlikely to save one thousandth of the cost of the prison. In fact, the marginal saving would be much smaller. This is because, although the prison may make marginal savings (such as on food and heating) by not providing accommodation for the individual, removing one prisoner from a prison is unlikely to reduce necessary prison staffing

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18 Institute of Fiscal Studies, "We shall squeeze... until the pips squeak", 2013, [www.ifs.org.uk/budgets/sr2013/gemma\\_tetlow.pdf](http://www.ifs.org.uk/budgets/sr2013/gemma_tetlow.pdf). Accessed 5 March 2014.

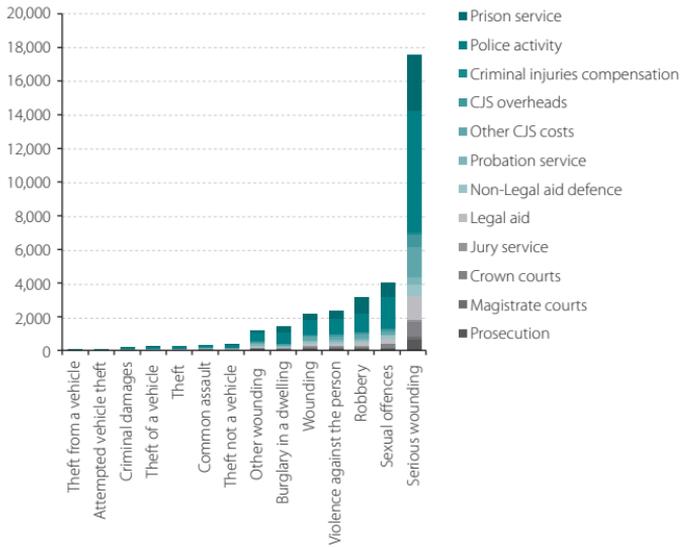
19 Ministry of Justice, *Offender Rehabilitation Bill Impact Assessment* (London: HMSO, 2013).

levels nor allow the governor to shut part of the prison. If, however, a more significant number of incarcerations were to be prevented and a wing of the prison could be closed then this would achieve very significant savings.

Risk aversion or indeed lack of control of the institutions (such as prisons) may encourage commissioners to be cautious about the savings that can be captured, thus limiting the level of investment that can be made in rehabilitation services.

As Figure 4 demonstrates, the costs of a crime to the criminal justice system surface in different parts of the system. Notwithstanding this constraint, an ambitious scheme would seek to incentivise providers to invest close to the total limit of departmental savings.

**Figure 4: Costs of an individual crime to the CJS by offence category (note homicide is excluded because of its distorting effect)**



Source: SMF calculations based on 2003 Home Office data on the cost of crime

## DESIGNING THE PRICES

A number of important conclusions flow from the analysis above. First, there are huge potential savings to be unlocked by preventing reoffending. It would be optimal to focus on aligning payments to the total cost to society. However, given current budgetary pressures, the Government may prefer to align payments to the direct costs to the Exchequer. In the current fiscal environment, the Ministry of Justice is likely to seek to target savings in its own budget rather than savings that accrue more widely to society. In doing so the Government should be alert to the fact that, as Figure 2 shows, there is a potential tension between prioritising the prevention of crimes that cost the most to society versus prioritising the prevention of crimes that cost most to the Exchequer.

Nevertheless, even when only considering savings that accrue directly to the criminal justice system (CJS), it appears the Government could go much further in incentivising rehabilitation. Just for the specific group of offenders illustrated here, the (extremely conservative) estimates above indicate that the Government could incentivise providers to invest up to £335m (the savings to the criminal justice system) into rehabilitation activities. The scale of these potential savings indicates that once the scheme is established, the Government could ramp up significantly the reward incentives on providers so as to maximise the opportunity of reducing reoffending.<sup>20</sup>

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20 The Government has estimated that collectively the 21 CPAs will have a contracted value of as low as £406m. This will cover all statutory supervisory functions as well as the rehabilitation reward payments. Ministry of Justice, *Target Operating Model: Rehabilitation Programme* (London: HMSO, 2013). It is expected that the vast majority of this contracted value will be dedicated to statutory supervisory functions though no exact figure has been published by the Ministry of Justice.

### Recommendation

In line with this, the Ministry of Justice should lift the upper cap that it proposes to apply to the reward payments. Under its current proposal, the bonus payment is 'capped at an absolute, affordable figure.'<sup>21</sup> The lowest figure the cap should be set at is the savings that accrue to the CJS, which would amount to some £16m per Contract Package Area (CPA). By raising the cap, it would enable providers to make significant investments to reduce reoffending.

Second, given the distribution of costs to the CJS across different categories of offences and the distribution of offences committed by re-offenders, there is a strong case to design the payment so that providers are incentivised to invest in preventing not only the crimes that are easiest to prevent but also those crimes with high costs, as well as helping repeat offenders to desist.

#### Box 1.2. The link between incarceration costs and payments to the provider: Rikers Island Prison

The linkage between costs to the prison estate of each prisoner and the reward that providers can receive for preventing a crime is made in Rikers Island Prison, New York. This scheme operates under a social impact bond model of payment by results, with the provider receiving a graduated payment that rises in steps. These payments are made according to the extent that the provider meets re-incarceration reduction targets, and therefore the payments reflect the savings to the City's budget that come from fewer incarcerations.<sup>22</sup>

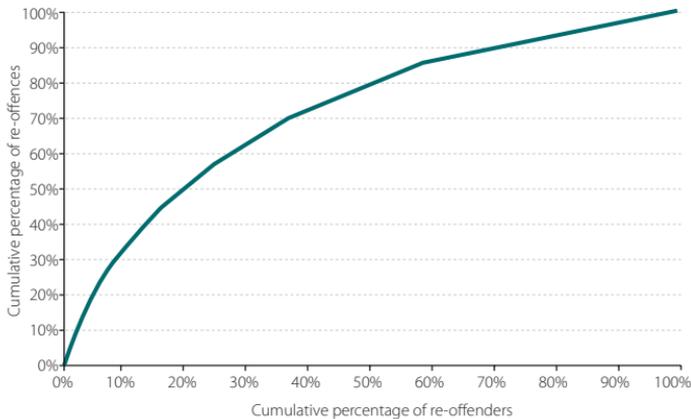
In an ideal world, the distribution of costs across offence categories indicates that the Government should consider the severity of the offence that is averted by the provider as well as

21 Ministry of Justice, *Payment Mechanism – Straw Man* (London: HMSO, May 2013).

22 The City of New York, "Bringing social impact bonds to New York City", [www.nyc.gov/html/om/pdf/2012/sib\\_media\\_presentation\\_080212.pdf](http://www.nyc.gov/html/om/pdf/2012/sib_media_presentation_080212.pdf). Accessed 5 March 2014.

simply the volume of offences when it prices these outcomes. The costs stemming from reoffending are also distributed very unevenly across re-offenders. As the Government admitted in its, *Breaking the Cycle* Green Paper, 'a relatively small number of highly prolific offenders are responsible for a disproportionate amount of crime'.<sup>23</sup> The report identified around 16,000 active offenders at any one time, who each have over 75 previous convictions and have been to prison 14 times on average.<sup>24</sup> This distribution of offences is illustrated in Figure 5.

**Figure 5: Distribution of proven re-offending across re-offenders; 2009 cohort<sup>25</sup>**



Source: Ministry of Justice, *2012 Compendium of re-offending statistics and analysis*

Creating this link between savings to the CJS and payment reward to the provider is difficult. During the consultation phase there was significant discussion over the relative merits of paying providers simply to reduce the number of clients in the cohort who re-offend (the 'binary' measure) versus reducing the number of offences that are committed by the cohort (the 'frequency' measure). Under its current

23 Ministry of Justice, *Breaking the Cycle: Effective Punishment, Rehabilitation and Sentencing of Offenders* (London: HMSO, 2010).

24 Ministry of Justice, *Breaking the Cycle: Effective Punishment, Rehabilitation and Sentencing of Offenders* (London: HMSO, 2010).

25 Ministry of Justice, *2012 Compendium of re-offending statistics and analysis* (London: HMSO, 2012).

plans, the Ministry of Justice is right to target not only reducing the number of offenders who re-offend (the binary measure), but also the frequency of offences. It is the volume and severity of offences overall that drives costs to both society and the state. However, the proposal to impose a binary hurdle so that a provider can only receive a performance reward if the binary metric improves (i.e. if the proportion of the client group going onto to re-offend does go down) serves to undermine this principle.<sup>26</sup>

So, how can the government put a higher price on the prevention of certain types of offences or desistance from specific categories of offenders? One suggested way of achieving this is to pay a premium for offenders who are more likely to offend. Under this proposal, the payment incentive would be stronger for those with a higher propensity to reoffend – through the Offender Group Reconviction Scale (OGRS) score.<sup>27</sup> This is an interesting idea, although it might end up favouring CPAs with more difficult clients as the OGRS already features in the baseline weighting (in other words the OGRS score would be double counted). Instead, the Ministry of Justice, in revising its approach beyond 2015, should seek to pay larger incentive payments to those providers that reduce the incidents of crimes that are costly to the CSJ and to society.

### **Recommendation**

As the Government develops its policy beyond 2015, it should seek to design the scheme so that the price schedule recognises the prevention of serious and costly offences and costly reoffenders. This could be executed by designing a bonus payment that gives providers a percentage of the savings that are made to the predicted incarceration costs of the offender cohort. This could be calculated from reconviction data.

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26 Ministry of Justice, *Transforming Rehabilitation Programme – Payment Mechanism: Market Feedback and Development Considerations* (London: HMSO, 2013).

27 Max Chambers, *Expanding Payment-by-Results: Strategic choices and recommendations* (London: Policy Exchange, 2013).

## CHAPTER 2: ACCOUNTABILITY AND CO-COMMISSIONING

As Chapter 1 showed, the costs to society of re-offending are much wider than simply the costs associated with preventing a court conviction. To make serious inroads into reoffending, providers must be given a clear incentive to invest. A related problem also exists: other services commissioned by government have an effect on the re-offending rate.

Perhaps understandably given the time constraints, the Government has largely focused thus far on commissioning out probation and rehabilitation services rather than seeking to commission these services alongside other departments or authorities. However, many other government-funded interventions affect the reoffending rate and should be linked coherently with rehabilitation services. If they are not, they will cause providers to hold back investment in rehabilitation services and undermine the very premise of paying by results.

### THE COMPLEXITY OF OFFENDERS' LIVES, REHABILITATION AND OTHER SERVICES

Offenders' lives are very complex and often require support in a wide range of areas of their lives. Research by the Ministry of Justice, the Home Office, the Social Exclusion Unit and others has shown that:

- 15% of prisoners were homeless prior to custody, and 37% of prisoners reported needing help with finding a place to live on leaving custody.<sup>28</sup> Offenders with accommodation difficulties have been found to be more likely to reoffend.<sup>29</sup>

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28 Ministry of Justice, *Green Paper Evidence Report – Breaking the Cycle: Effective Punishment, Rehabilitation and Sentencing of Offenders* (London: HMSO, 2010).

29 Ministry of Justice, *Transforming Rehabilitation: a summary of evidence on reducing reoffending* (London: HMSO, 2013).

- Only 51% of prisoners had been in employment in the year before custody; 13% reported that they had never been in paid employment.
- 70% of offenders suffer from at least two mental health problems.<sup>30</sup> Adults with mental health problems are over-represented in populations of offenders.<sup>31</sup>

Linked to this, a wide range of related factors have been shown to affect the likelihood of reoffending. Factors which influence reoffending consist of static factors (such as age, gender and criminal history) and dynamic factors such as education, employment and drug misuse.<sup>32</sup> While government cannot affect static factors, it may be able to have an effect on dynamic factors through the support and opportunities it provides to individuals. Dynamic factors that are associated with an increase in the likelihood of reoffending include being homeless or in temporary accommodation and use of Class A drugs. Factors that are directly associated with a reduction in the likelihood of reoffending include employment in the 12 months before custody. Meanwhile, research suggests that a number of intermediate outcomes are good proxies for the likelihood of eventual desistance from offending, such as improved family relations, access to accommodation, and improved employability.<sup>33</sup>

However, despite being closely related to the chances of reoffending, many services connected with reoffending are currently separate from the payment by results scheme being designed under *Transforming Rehabilitation*.

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30 Social Exclusion Unit, *Reducing Reoffending by ex-prisoners* (London: HMSO, 2002).

31 Ministry of Justice, *Access to Justice: a review of the existing evidence of the experiences of adults with mental health problems* (London: HMSO, 2009).

32 Ministry of Justice, *Transforming Rehabilitation: A Strategy for Reform* (London: HMSO, 2013).

33 Clinks, "Clinks response to Ministry of Justice consultation: 'Transforming Rehabilitation: A revolution in the way we manage offenders'", 2013 [www.clinks.org/sites/default/files/FINAL%20Clinks%20response%20to%20Transforming%20Rehabilitation%20consultation%20%281%29.pdf](http://www.clinks.org/sites/default/files/FINAL%20Clinks%20response%20to%20Transforming%20Rehabilitation%20consultation%20%281%29.pdf). Accessed 5 March 2014.

The Ministry of Justice accepts that this agenda is important, noting that ‘our system will support co-commissioning and we will also explore opportunities to pool some of the funding allocated to work with offenders so that it can be used more efficiently.’ In some areas, the Ministry of Justice is piloting innovative activities: for example the Ministry of Justice and the Department of Health are partnering on a ‘through the gate’ drug treatment programme for offenders.<sup>34</sup> However, in many areas, such alignment does not exist.

## THE PROBLEM OF COMMISSIONING REHABILITATION IN ISOLATION

When considering reoffending it is important to acknowledge ‘network’ effects and complex system dynamics – where the actions of one agency have an influence on the performance of another agency. Commissioning programmes in isolation present a number of fundamental problems. First, there is a problem of **inefficiency**. Evidence from the PbR pilots in Doncaster and Peterborough indicates that significant benefits come from better coordination.<sup>35</sup> Meanwhile, ‘multi-modal interventions’ which address a range of problems are seen as an effective way of reducing reoffending.<sup>36</sup>

The sequencing of interventions is also important in preventing reoffending: clients may need support to overcome addiction or find accommodation *before* they are placed onto a behavioural treatment programme or put into a training course. In fact, blockages in single aspects of this may impede recovery – for instance, offenders often need to be given settled accommodation so that they can get a bank account and subsequently a job. As recent evidence from the Ministry of Justice concluded, ‘integrated

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34 Ministry of Justice, *Target Operating Model: rehabilitation programme* (London: HMSO, 2013).

35 Ministry of Justice, *Lessons learned from the planning and early implementation of the Social Impact Bond at HMP Peterborough* (London: HMSO, 2011).

36 Ministry of Justice, *Transforming Rehabilitation: a summary of evidence on reducing reoffending* (London: HMSO, 2013).

case management and multi-agency working can play an important part in addressing the complex needs of offenders and reducing reoffending.<sup>37</sup>

However, where the alignment is weak or where other priorities appear more important than collective action, providers may pay insufficient attention to collaboration. In the worst cases, this may lead to competition across different programmes. Recent research by the Institute for Government found that 'employment service providers would complain that ex-offender probation appointments could clash with job interviews and further education colleges did not have the incentives to deliver skills that employers value.'<sup>38</sup>

Second, even where alignment of interest is strong, there may be an **accountability problem**. For providers paid on reoffending outcomes, the actions of others may ultimately determine results achieved. Therefore, providers are accountable for something that they do not control. This increases the risks to which the provider is exposed, thus lowering the risk adjusted rate of return and pushing up the costs of capital. In February, the National Audit Office noted that in the Ministry of Justice's pilot programme, providers considered that the risks were unacceptable to their boards and that 'risks included not having the level of control to match the amount of risk which the Ministry proposed transferring'.<sup>39</sup>

This blurred accountability also means that once the service is underway there is a clear danger of free riding, namely that a provider of one programme may disinvest in the hope that the

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37 Ministry of Justice, *Transforming Rehabilitation: a summary of evidence on reducing reoffending* (London: HMSO, 2013).

38 Tom Gash, Nehal Panchamia, Sam Sims and Louisa Hotson, *Making public service markets work: Professionalising government's approach to commissioning and market stewardship* (London: Institute for Government, 2013).

39 National Audit Office, *Response to the Ministry of Justice consultation on its proposals outlined in Transforming Rehabilitation* (London: HMSO, 2013).

outcome on which they will be paid will be influenced positively by the actions of a provider on a different programme. For instance, the provider being paid to reduce reoffending may disinvest because it believes that the drugs and alcohol treatment given to a client under a Department of Health commissioned programme will obviate the need for them to invest in the client. In such circumstances, the risk is that the government ends up paying two providers when only one has made a positive intervention (in some circumstances it could end up paying the same provider twice for one result).

These problems are more severe the more interdependent the outcomes are. In response, commissioners can take three approaches. Currently, the Ministry of Justice is pursuing a mixture of the three models.

1. **Expect the market to integrate.** Under this approach, the commissioner assumes that it will probably be in the interests of the providers of different services to collaborate and thus expects them to cooperate to deliver an efficient service. As the Ministry of Justice has argued: 'it will be in providers' interests to work with other partners to achieve the best results and our payment mechanism, which will reward reductions in reoffending, will incentivise them to do so.'<sup>40</sup> For instance, it may theoretically be in the interests of the providers of employment support, housing, rehabilitation and drug and alcohol services to work together, even to pay for a coordinating function. There is some evidence that joint working can emerge – partly encouraged or systematised by delivery approaches such as co-location between different staff which can break down organisational and cultural boundaries and infuse a collective focus on the client. However, the incentive for providers to integrate is often weak and vulnerable to being overwhelmed by more pressing commercial concerns.

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40 Ministry of Justice, *Transforming Rehabilitation: A Strategy for Reform* (London: HMSO, 2013).

2. **Align commissioning.** In addition to (1), commissioners may seek to minimise contradiction between separately commissioned programmes and align the incentives of different programmes.
3. **Co-commission the service.** Beyond (2), commissioners can pool money and commission a broader outcome or a range of outcomes from a single fund. This resolves both the alignment problem and the accountability problem because the provider controls the various factors that can affect the outcome. For instance, the Ministry of Justice and the Department of Health are partnering on a 'through the gate' drug treatment programme for offenders.<sup>41</sup> Lessons should be learnt from the rapidly-evolving policy agenda in integrated health and social care.

The evidence suggests that as the Government seeks to increase the payment by result element of the programme that it will have to act to integrate commissioning in order to promote efficiency and accountability.

## RECOGNISING THE COMPLEXITY OF DESISTANCE IN COMMISSIONING

In assessing which public services the Government should consider aligning or integrating with rehabilitation services, two factors are particularly important:

1. **The desirability of co-commissioning a service.** This should be determined by the extent to which the outcomes are causally related rather than simply co-occurring. Co-occurring outcomes are those that are frequently correlated but where it is unclear which factor causes the other, whether they are coincidental or both caused by a third common factor. As an example: offenders

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41 Ministry of Justice, *Transforming Rehabilitation: A Strategy for Reform* (London: HMSO, 2013).

are more likely to smoke than the general population, but this does not mean that smoking causes crime. It is likely, rather, that both smoking and criminal behaviour share a common cause.<sup>42</sup> In contrast, causally-related outcomes are those where one can be statistically confident that an outcome has an effect on the likelihood of a second outcome occurring.

2. **The feasibility of co-commissioning the service.** Successive governments have made repeated attempts to join up commissioning. However, there are often major barriers including cultural differences across services, budgets being held by different accountable bodies (such as local government versus central government) and departmental isolationism. Strong central direction is needed to achieve it.

Given these twin considerations, the Ministry of Justice should differentiate between tactical adjustments to its commissioning and major changes that could result in much clearer and more effective incentives being applied through payment by results. Below we set out what steps the Government should take to promote efficiency and accountability.

## IN-PRISON SERVICES

In order to site offenders as close as possible to the area that they will be resettled on leaving prison, the Government has established a category of resettlement prison. Seventy such prisons are being established, with each CPA having at least one.<sup>43</sup> This will mean that about 80% of male offenders will be able to be released from a resettlement prison to their 'home' CPA.<sup>44</sup>

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42 Ian Albery, "Drug use and criminal behavior : indirect, direct or no causal relationship?", <http://media.routledgeweb.com/pdf/9781843924142/chapter%208.pdf>. Accessed 5 March 2014.

43 Ministry of Justice, "List of Prisons by CPA", 2013, [www.justice.gov.uk/downloads/rehab-prog/resettlement-prison-list.pdf](http://www.justice.gov.uk/downloads/rehab-prog/resettlement-prison-list.pdf). Accessed 5 March 2014.

44 Clinks, "Clinks briefing on the competition stage of the transforming rehabilitation reforms, 2013 [www.clinks.org/sites/default/files/basic/files-downloads/Members%20Briefing%20-%20Competition%20stage%20of%20the%20TR%20reforms%20FINAL.pdf](http://www.clinks.org/sites/default/files/basic/files-downloads/Members%20Briefing%20-%20Competition%20stage%20of%20the%20TR%20reforms%20FINAL.pdf). Accessed 5 March 2014.

This policy draws on a SMF proposal from 2009 and enables a much more integrated service whereby a provider can work with a prisoner ahead of release (so-called ‘through the gate’ services) and prepare them for life in the community.<sup>46</sup> It also prevents prisoners churning around different prisons immediately prior to their release. Furthermore, as the MoJ has noted, ‘the creation of resettlement prisons will present opportunities to create better continuity of service for offenders, in relation to wider mainstream and co-commissioned services.’<sup>47</sup> However, despite these efforts a number of external forces are likely to continue to undermine the accountability of the provider for reoffending outcomes.

First, there are significant budgets spent on rehabilitation within the prison that are not part of the PbR policy. The Offenders’ Learning and Skills Service (OLASS) is commissioned by the Department for Business, Innovation and Skills and the Ministry of Justice, and it costs approximately £130m per year. The 2011 *Review of Offender Learning* concluded that employers had insufficient influence on the skills that offenders were being taught; providers and prisons should be incentivised to achieve beneficial outcomes. Under the OLASS Phase 4 programme launched in August 2012, the reforms seek to boost partnership working and give governors a greater say in the skills that are delivered in their prison.<sup>48</sup> However, given that the primary purpose of OLASS is to increase the employability of the inmate and to reduce reoffending, the case for it to be rolled into the PbR scheme is compelling.

Second, existing evidence suggests that the wider prison environment, security policy and prison culture also affect reoffending

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45 See Max Chambers, *Expanding Payment-by-Results: Strategic choices and recommendations* (London: Policy Exchange, 2013).

46 Ian Mulheirn, Barney Gough and Verena Menne, *Prison Break: Tackling recidivism, reducing costs* (London: SMF, 2010).

47 Ministry of Justice, *Transforming Rehabilitation: A Strategy for Reform* (London: HMSO, 2013).

48 BIS, *Review of Offender Learning* (London: HMSO, 2011).

rates. Pressures from overcrowding, political expectations and the prevalence of drug abuse and mental health problems make it difficult for prison staff to promote rehabilitation.<sup>49</sup> Official inspection reports have previously criticised the prison sector for very variable performance in relation to rehabilitation. A report by HM Inspectorate of Probation argued that, as well as serving to punish offenders and to prevent and deter crime, prisons existed also to reform offenders and to ‘work with individual prisoners needs to address effectively their attitudes, behaviour and lifestyle. We were disappointed to find that, with some notable exceptions, this is not happening to any meaningful extent.’<sup>50</sup> This lesson has been repeated recently by HM Inspectorate of Prisons, which argued that ‘in a greater number [of prisons] relations between prisoners and staff were friendly enough but officers were not sufficiently proactive in challenging poor behaviour or supporting rehabilitation work.’<sup>51</sup> Changing this culture so that prison governors prioritise rehabilitation alongside security will require significant reform.

### Recommendation

The Government should reform the relationship between prisons and rehabilitation services.

From 2015, the Government should work towards

- Providing a performance reward for prison governors to promote rehabilitation. This could be attached to the outcome performance in the CPA. Although this would be imperfect (because the reward would be predicated in part on the performance of the provider and potentially other prison governors), it would act as a spur for prison governors to work proactively with providers. Beyond this, there may be scope for enabling prison governors

49 Centre for Social Justice, *Locked Up Potential: A strategy for reforming prisons and rehabilitating prisoners* (London: Centre for Social Justice, 2009).

50 HM Inspectorate of Probation and HM Inspectorate of Prisons, *Second Aggregate Report on Offender Management in Prisons* (London: HMSO, 2012); HM Chief Inspector of Probation, *Transforming Rehabilitation response* (London: HMSO, 2013).

51 HM Chief Inspector of Prisons for England and Wales, *Annual Report 2012–13* (London: HMSO, 2013).

and prison staff to create, lead or take roles with (such as non-executive directorships) social enterprises that are bidding for the rehabilitation contracts.

- Giving mechanisms of redress to rehabilitation providers who believe that prison governors are obstructing efforts to boost the education of prisoners.
- Instituting a working group or rehabilitation board that oversees rehabilitation activities in each prison with representation reserved for the provider as well as the local Police and Crime Commissioner.
- Allocating those elements of in-prison expenditure directed at rehabilitation to the provider (e.g. OLASS money).<sup>45</sup>

From 2020, work towards

- Putting the resettlement prisons into the supply chain of the provider. By establishing Resettlement Prisons, the Government has opened up the possibility of putting these prisons under the control and responsibility of a single provider. This would resolve the accountability problems, as the SMF has previously argued in its *Prison Break* report and facilitate a much clearer focus on rehabilitation. Given the scale of change this would necessitate, this should be a long-term goal and one which could be implemented incrementally where the existing provider has the capability and inclination to take on the responsibility for running a prison.

## SERVICES IN THE COMMUNITY

As suggested earlier, there are a whole host of services that have a relationship to reoffending. Some of these are under the control of other democratic authorities, namely Police and Crime Commissioners and local authorities. For instance, housing allocation policy is overseen by local authorities and this can delay or bring forward housing opportunities for offenders.

In these instances, central government has limited tools at its disposal beyond maintaining co-terminosity with PCC and Local

Authority boundaries to facilitate co-commissioning opportunities. In other areas, more direct action needs to be taken.

### Work Programme and employment support

The evidence shows that the connections between employment and rehabilitation are closely entwined. A recent report by the Ministry of Justice tracked two matched groups of offenders post-release and assessed the extent to which attaining employment had an effect on the likelihood of reoffending. The research found that the one-year proven reoffending rate was significantly lower for those who found P45 employment than for the matched group who did not attain employment.<sup>52</sup> The study concluded that 'the magnitude of the estimates of the reduction in re-offending and their statistical significance, alongside the results of the sensitivity analysis we have conducted, means we are confident that P45 employment has a positive impact on reducing re-offending.'<sup>53</sup>

These conclusions provide compelling evidence that employment outcomes affect reoffending and thus that employment services for offenders should be co-commissioned with rehabilitation services. From March 2012, offenders leaving custody have had to engage with a Work Programme provider who will be paid for getting them into work. Under this policy, offenders are attached to the Work Programme from day one of their release.<sup>54</sup> Work Programme providers get a premium of approximately £1,000 (or 25%) for finding work for ex-offenders

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52 The effect was: 9.4% lower for those with custodial sentences of less than one year and 5.6% lower for those with sentences lasting more than one year.

53 Ministry of Justice, *Analysis of the impact of employment on re-offending following release from custody, using Propensity Score Matching* (London: HMSO, 2013).

54 DWP, *Access to the Work Programme for Prison Leavers from "Day One" Equality Impact Assessment* (London: HMSO, 2011).

compared to other job seekers.<sup>55</sup> In addition, the Government has been piloting in Wales and the West Midlands an integrated service which has incorporated a re-offending outcome into the Work Programme.

Given the strength of the statistical evidence, there is a strong case to pursue integration immediately. However, as the boundaries of the Work Programme contract package areas do not map onto those of the rehabilitation services it makes it impossible to put one provider in charge of all employment and all rehabilitation services (and this might be undesirable for other reasons). Instead, rehabilitation providers should be allocated the budget that currently goes to the Work Programme provider for each offender. This would make the provider responsible for achieving two outcomes: employment and desistance. It would be down to the provider to identify the best sequence of steps to achieve these outcomes. The provider may, of course, sub-contract the local Work Programme provider to support their client into work, but the rehabilitation provider will be fully accountable and have a strong incentive to innovate. With the Work Programme being re-designed from 2015, this would be a natural stage at which to remove offenders from the Work Programme cohorts. If possible, this payment should also include funding for skills training.

The evidence for co-commissioning other services is more varied. Although the evidence from the USA is stronger than that in the UK, the importance of drug treatment – both in-prison and in the community – is widely acknowledged as having an important influence on reoffending. The 'Payment by results for drugs recovery' programme includes outcomes related to desistance

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55 Work Programme providers can get a maximum of £4,050 for a JSA client under the Work Programme. House of Commons Work and Pensions Committee, *Work Programme: providers and contracting arrangements* (London: House of Commons, 2011) Under the scheme for offenders, providers will get a maximum of £5,600. BBC, 'Companies promised fee for giving ex-prisoners work', 2012 [www.bbc.co.uk/news/uk-politics-17266825](http://www.bbc.co.uk/news/uk-politics-17266825). Accessed 5 March 2014.

from reoffending.<sup>56</sup> These pilots focus on 'sustained recovery' hence the inclusion of wider outcomes such as employment and desistance from offending.<sup>57</sup> As noted earlier, the Government is seeking to pilot a co-commissioned service supporting those with drug addiction. There is also much crossover with the Troubled Families initiative, under which local authorities and other agencies work with families where a member is involved in youth crime and antisocial behaviour; has children of school age not in school; and has an adult on out-of-work benefits.<sup>58</sup>

### **Recommendation**

The aim should be to establish the rehabilitation provider as the key agent who decides on the best sequencing of interventions to work towards the desistance from crime, including employment services and addiction support. From 2015, the Government should seek to put accountability for employment outcomes onto the rehabilitation provider as employment is a key determinant of desistance from crime. It should do this by diverting the Work Programme outcome payment for each offender to the rehabilitation provider.

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56 HMG, *Piloting payment by results for drugs recovery* (London: HMSO, 2013).

57 Department of Health, "Drug and alcohol recovery pilots", 2013 [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/97806/pbr-lessons-learnt.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/97806/pbr-lessons-learnt.pdf). Accessed 5 March 2014.

58 National Audit Office, *Programmes to help families facing multiple challenges* (London: HMSO, 2013).

## CHAPTER 3: DIVERSITY, COMPETITION AND SUSTAINABILITY

*'There is no question of us paying only lip-service to the voluntary and community sector as we transform rehabilitation. I am determined to ensure these organisations are right at the heart of our approach.'*

Chris Grayling MP, Secretary of State for Justice

However perfectly the payment mechanism and commissioning strategies are designed, the success of the reforms relies on the participation of the right delivery organisations on the ground. This chapter explores why and how the Ministry of Justice should pursue the involvement of the voluntary and community sector in supporting offenders and ensure a diverse, competitive market. Drawing on new analysis, this chapter considers the following questions:

1. How important is a plural and diverse market in rehabilitation services?
2. What are the principal factors that commissioners should consider in developing a diverse, competitive and sustainable market?
3. How can commissioners overcome the barriers to a diverse and competitive market?
4. How should the Government seek to prepare the market?

### THE CASE FOR DIVERSITY AND COMPETITION IN REHABILITATION

Contestability in provision and diversity in the supplier market have featured as central tenets of the Coalition Government's public service reform agenda.<sup>59</sup> The Cabinet Office has led a drive to increase the number of public service mutuals alongside efforts to

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<sup>59</sup> Cabinet Office, *Open Public Services White Paper* (London: HMSO, 2011).

reduce the barriers to entry that prevent small businesses, social enterprises and not-for-profit organisations from competing for services.<sup>60</sup>

This intention has been reiterated by the Ministry of Justice in its *Transforming Rehabilitation* programme. The White Paper argued for 'opening up the market to a diverse range of new rehabilitation providers, so that we get the best out of the public, voluntary and private sectors, at the local as well as national level'.<sup>61</sup> Its *Principles of Competition* document added: 'The Authority believes that the primary objective of the Transforming Rehabilitation Programme – reducing reoffending rates – will be best supported by harnessing the wide range of expertise which exists across different sectors and by facilitating the introduction of locally sensitive, flexible and innovative ways of working.'<sup>62</sup>

Despite the popular debate about the merits of public, private or charitable providers, there is little evidence to substantiate the point that not-for-profit organisations deliver better outcomes than commercial companies. Instead, research has tended to indicate variation within sectors rather than between.<sup>63</sup> In part this is because different sectors have different attributes which may cancel each other out: for example, charities may be more mission driven, less liable to commercial gaming and able to subsidise their activities with voluntary donations of time and money, but for-profit organisations are better-able to make capital investments in innovative practice.

Notwithstanding this fact, a plural and diverse market of potential delivery organisations capable of winning and delivering

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60 Cabinet Office, *Public Service Mutuals: Next steps* (London: HMSO, 2012).

61 Ministry of Justice, *Transforming Rehabilitation: A Strategy for Reform* (London: HMSO, 2013).

62 Ministry of Justice, *Principles of Competition – Transforming Rehabilitation Programme* (London: HMSO, 2013).

63 Dr DeAnne Julius, *Public Services Industry Review: Understanding the Public Services Industry: How big, how good, where next?* (London: BIS, 2008).

contracts is essential if the provider marketplace is to be sufficiently competitive to stimulate innovation and hence productivity improvements.

For a number of reasons, diversity is of particular importance in a service area such as reoffending.

First, many efforts to rehabilitate offenders have thus far been delivered by not-for-profit organisations. This is partly because much previous activity has been funded by philanthropy, but also because individuals require very tailored and expert support. Some social sector organisations are well-placed to provide this support given their connections to local communities and their networks with other community groups and agencies who are needed to help solve the problem. Different offenders often require very distinctive treatments or support. Desistance theory suggests that the path to total desistance may be zig-zag in nature and that a very wide range of factors affect whether an offender will re-offend, including employment, housing, sobriety and recovery from addiction, hope and motivation, having a place within a social group, and not having a criminal identity.<sup>64</sup> As a review of the evidence concluded, 'holistic interventions that address multiple criminogenic needs are more likely to be effective in reducing reoffending'.<sup>65</sup>

In many respects, the best VCSEs have an unrivaled expertise to provide assistance which can boost reintegration as they develop relationships and networks outside prison, including; relational support and connections into the community; mentoring (including from ex offenders); and, education and training programmes.

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64 NOMS and Shadd Maruna, *Understanding Desistance from Crime* (London: HMSO, 2010); Carol Hedderman, 'Payment by results: hopes, fears and evidence', *British Journal of Community Justice*, Vol 11 (2–3), 2013: 43–58.

65 Dr. Maria Sapouna, Catherine Bisset and Anne-Marie Conlong, *What Works to Reduce Reoffending: A Summary of the Evidence* (Edinburgh: Scottish Government, 2011).

Second, there is significant scope for innovation and for encouraging the adoption of best practice in rehabilitation services. While the 'what works' literature has evolved, there still remain multiple options for addressing offending behaviour. In fact, there remains a major difference in approach between advocates of the 'what works' method – which includes activities such as Cognitive Behavioural Therapy – and desistance theorists. Therefore, the greater the diversity of the supplier base, the wider the range of methods for reducing reoffending that can be tested by providers. Successful interventions can then be replicated by other providers. Indeed, this scope for innovation and testing new approaches is a founding rationale for commissioning using payments by results.

Third, commissioners should be particularly alert to the dangers of consolidation of the market in rehabilitation. There are only a small number of large private companies who currently operate in the justice sphere.<sup>66</sup> Under the contracting terms, companies can win only a maximum of 25% of the total value of all contracts (an estimated £100m).<sup>67</sup> This effort to control the concentration of the market is sensible but limited given that four providers could potentially share the market between them. This problem is compounded by the fact that the Serious Fraud Office is carrying out a formal investigation into potential fraudulent activities in criminal justice contracts awarded to two of the largest providers of justice services, Serco and G4S.<sup>68</sup> Neither of these contractors is on the shortlist of thirty providers for the rehabilitation contracts. A final consideration is that the prime contracts will reportedly be let for 7 – 10 years with the possibility of extension of up to 3 years.<sup>69</sup> This reduces opportunities for new competitors to enter the

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66 For a list see, Chris Nicholson, *Rehabilitation Works: ensuring Payments by Results cuts reoffending* (London: Centre Forum, 2011).

67 Acevo, "Frequently asked questions from the transforming rehabilitation information workshops", [www.acevo.org.uk/document.doc?id=2618](http://www.acevo.org.uk/document.doc?id=2618). Accessed 5 March 2014.

68 BBC, "Probe of G4S and Serco tagging contract begins", 2013 [www.bbc.co.uk/news/uk-24805255](http://www.bbc.co.uk/news/uk-24805255). Accessed 5 March 2014.

69 Acevo, "Frequently asked questions from the transforming rehabilitation information workshops".

market, diminishes the threat of competition from new entrants and increases barriers to entry.

## POTENTIAL CHALLENGES IN ACHIEVING A DIVERSE SECTOR

Despite the advantages, achieving a diverse provider base when paying by results for rehabilitation is extremely problematic and considerable care needs to be taken in designing the policy.

A number of decisions have already been taken that affect the potential diversity of the market. Providers will potentially be able to fulfil a number of roles in the delivery of rehabilitation services. In each CPA, the Government will commission out the service to a Tier I Provider. Thirty bidders have been shortlisted to win the right to deliver services in one or more of the 21 CPAs. These 'prime providers' will then be able to sub-contract services to Tier II and Tier III sub-contractors. 800 organisations have expressed an interest in playing a role as a sub-contractor, including more than 550 voluntary sector organisations.<sup>70</sup> The Department has also increased the number of CPAs from 16 (the number originally proposed)<sup>71</sup> to 21 and reduced the geographic scope of the CPAs and the size of the contracts. Although this is bad for economies of scale and for incentivising rehabilitation (see previous SMF paper, *Paying for results*), it is good for market diversity.

Other efforts have been aimed more squarely at the not-for-profit sector:

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70 Ministry of Justice, Press Notice: 'Transforming Rehabilitation – Thirty bidders shortlisted for contracts', 19 December 2013.

71 Ministry of Justice, *Transforming Rehabilitation: A revolution in the way we manage offenders* (London: HMSO, 2013).

- The MoJ has set up a registration process for Tier II and Tier III providers to help the matching process between partners
- The Cabinet Office has funded Partnership Finder
- The scheme will be procured within the rules of the Compact Commitment
- Assistance is being provided to VCSE organisations through workshops, financial modelling tool and legal services
- Drawing on research by New Philanthropy Capital showing how important access to good quality data on what works to reduce reoffending,<sup>72</sup> the Justice Data Lab service was launched in April 2013 to provide better evidence on interventions that work. This can help the VCSE evidence the effectiveness of the services they provide<sup>73</sup>
- There is financial assistance for probation trusts to transform into mutuals.

These are important and helpful policies. However, as will be discussed below, diversity in the market may be affected by other inherent difficulties.

## PAYMENT BY RESULTS AND EFFICIENT ALLOCATION OF RISK IN THE SUPPLY CHAIN

The aim of Payment by Results (PbR) should be to transfer risk on to providers to the extent that they can understand and control this risk by reducing re-offending. If risk is inefficiently allocated (i.e. if more is put onto entities than it is within their power to control) then the cost will come back to the taxpayer: either organisations will go bust or they will stop investing in rehabilitation and will cut services, leading to a rise in reoffending and higher costs.

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72 Benedict Rickey and David Pritchard, *Unlocking offending data: How access to offending data could help charities improve outcomes for offenders* (London: New Philanthropy Capital, 2012).

73 Rebecca Marples, 'Transforming rehabilitation – the risks for the voluntary, community and social enterprise sector in engaging in commercial contracts with Tier 1 providers', *British Journal of Community Justice*, Vol 11 (2–3), 2013: 21–32.

Paying providers – at least in part – according to the degree by which they reduce reoffending against a baseline has several very important commercial effects for potential providers. First, assuming that payment is made on achievement of the rehabilitation, the provider will have to incur costs in delivering the service and only expect to receive payment later once the result has been observed. This causes a delay in cash flow for the organisation. Second, given that the organisation will only be paid if the reoffending rate reduces, there is a risk that the provider will underachieve and recoup only part – or potentially none – of the costs already incurred.

In both these instances, smaller providers and especially the not-for-profit sector are typically poorly-placed to manage the challenge. Much of this comes down to the size and balance sheet of a provider. Those providers with large balance sheets and access to the capital markets are better placed to cope with cash flow problems and to manage outcome risks. It was for this reason that, under the Work Programme, a minimum requirement of £20m turnover was put on prime contractors. These characteristics are usually associated with the private sector although alternatives may exist: a very large not-for-profit organisation with a large balance sheet, a consortium of providers or a significant chunk of social finance could offer viable alternatives.

In all this, therefore, it is important to note that the interest of the Ministry of Justice extends not only to its contractual relationship with the ‘Tier 1 Provider’ (the prime contractor) and the balance of risks divided between government and this provider but also to the distribution of risk in the supply chain. Below we set out three specific problems that the not-for-profit sector and smaller organisations face in participating in PbR:

- a. Whether a provider gets paid: Outcome risk, statistical significance and diversity

- b. When a provider gets paid: cash flow
- c. Predicting how much work will come in: Referrals and volumes

The chapter concludes with recommendations for how diversity can be achieved and how the market can be prepared.

## WHETHER A PROVIDER GETS PAID: OUTCOME RISK, STATISTICAL SIGNIFICANCE AND DIVERSITY

SMF's paper *Paying for results? Rethinking probation reform* published in August 2013 illustrated the implication of statistical risk for the financial incentives that will apply to prime contractors. It demonstrated that if reoffending rates remain at their historical level in a given CPA (the 'baseline'), providers will receive no additional payments above the fees for service. If reoffending outcomes are marginally better than the baseline, providers will not receive any success payments since improvements could be the result of random variation (or 'statistical noise'), rather than superior underlying performance. The same is true if performance dips somewhat below past levels: no change in payment. The reason is that fluctuation in the baseline historically means that the commissioner cannot be confident that the change in reoffending rates is the outcome of the interventions of the provider rather than an outcome that would have occurred anyway.

Since then, the Ministry of Justice has proposed reducing this flat payment zone by expecting achievement against it at only the 80% confidence (rather than 95%).<sup>74</sup> The Government has also proposed encouraging investment in reoffending by raising the bar over which providers have to achieve in order to avoid the risk of contract termination.<sup>75</sup> These are sensible decisions. However, below we discuss how statistical significance injects major

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<sup>74</sup> Ministry of Justice, *Transforming rehabilitation programme: payment mechanism* (London: HMSO, 2014).

<sup>75</sup> Ministry of Justice, *Transforming Rehabilitation Programme – Payment Mechanism: Market Feedback and Development Considerations* (London: HMSO, 2013).

problems for commissioners as they seek to achieve a diverse market in which providers are paid by results.

### Random variation in the reoffending rate

Thus far, the primes have been advised that ‘all contractual and other risk should be appropriately managed’ and that ‘this should extend to not passing risk down supply chains disproportionately’.<sup>76</sup> This implies that prime contractors will be able to pay their sub-contractors by results and pass outcome risk down the supply chain as long as it is ‘proportionate’. Indeed, the Secretary of State advised the Justice Select Committee that he anticipated that some financial risk could be passed down as long as there is transparency.<sup>77</sup> However, the statistical significance problem that applies at the level of a CPA also applies at a more local level for smaller organisations providing services to smaller cohorts of clients.

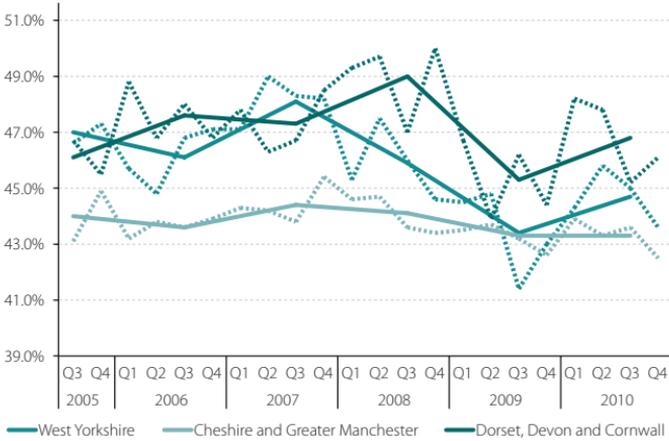
Figure 6 below illustrates the proportion of offenders that reoffended in three Contract Package Areas in each year of a six year period. These examples illustrate areas with significant variation year-on-year and quarter-on-quarter (West Yorkshire; and Dorset, Devon and Cornwall) compared with a CPA where the baseline has been comparatively constant (Cheshire and Greater Manchester). The graph shows that historically there has been significant variation in reoffending rates. This variation occurs even after the Ministry of Justice has used information it has on offenders to control for the propensity of each group of offenders to re-offend (through OGRS).

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76 Ministry of Justice, *Principles of Competition – Transforming Rehabilitation Programme* (London: HMSO, 2013); Ministry of Justice, *Schedule 23: Market Stewardship Principles* (London: HMSO, 2014).

77 House of Commons, Justice Select Committee, *Crime reduction policies: a co-ordinated approach?* (London: House of Commons, 2014).

Figure 6: Percentage of offenders that reoffended by area, adjusted for propensity of the client group to reoffend



Source: Data from MoJ table: Modelled management information on offender cohorts and re-offending in the 21 planned Transforming Rehabilitation Programme Contract Package Areas. Dotted lines refer to quarterly figures. Solid lines refer to annual figures.

It is unclear what factors cause this variation: it is possible that it is caused by significant and regular policy changes being taken in different localities (such as courts' decisions on sentencing); alternatively, the variation may stem from unobservable characteristics of the offender group. Changing economic circumstances, such as better employment prospects, may also have a significant impact on re-offence rates. None of these potential factors will be within the control of the provider.

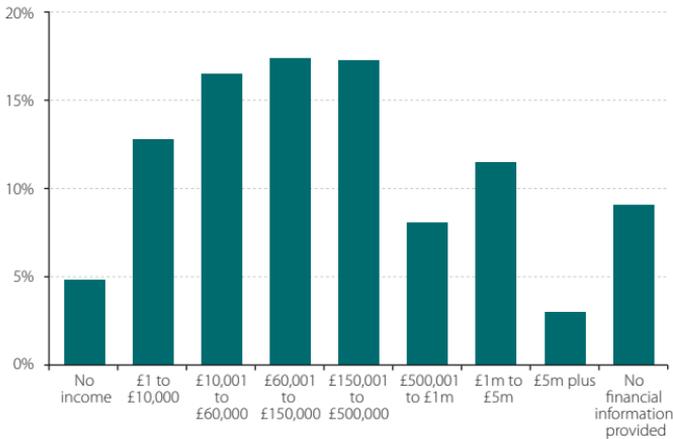
As the Ministry of Justice has recognised, this variation is problematic when a provider is being given responsibility for thousands of clients.<sup>78</sup> The Department has established a band (a margin of error) either side of the baseline to account for random variation in the data. The banded target acknowledges that some variation is unpredictable and random and that it is unfair

<sup>78</sup> Ministry of Justice, *Payment Mechanism – Straw Man* (May 2013); Ministry of Justice, *Transforming Rehabilitation Programme – Payment Mechanism: Market Feedback and Development Considerations* (London: HMSO, 2013).

to penalise or reward providers for variation that is essentially statistical noise and not attributable to the quality of the service they provide. Since the true re-offence rate is unknown, we are only 80% confident that it lies within a certain range around the point estimate derived. Under the proposals, the Ministry of Justice also controls for the characteristics of the client group by giving a weighting for each offender (OGRS), based on the historical observations that reveal that certain types of offenders are more likely to reoffend than others.

However, the Department’s proposed targets apply at a prime contractor level and ignore a second statistical problem of ‘sub-sampling’, which results from the fact that the re-offence rates observed for smaller providers are based on a much smaller client base, or sample, than the re-offence rates observed in each CPA. Therefore, the level of uncertainty is magnified for smaller providers.

**Figure 7: Annual income or turnover of voluntary organisations working with offenders, ex-offenders and their families in England (2010)<sup>79</sup>**



Source: 2010 National Survey of Charities and Social Enterprises, cited in CJS.

79 Centre for Social Justice, *The new probation landscape Why the voluntary sector matters if we are going to reduce reoffending* (London: Centre for Social Justice, 2013).

## Description of the provider sector

The size of providers in the not-for-profit sector varies hugely. Some charities such as Nacro, the Shaw Trust, Catch 22 and Home Group have very large turnovers. However, the vast majority of providers in this sector are very small, and many sub-contractors are likely to be small organisations. There are an estimated 1,475 VCS organisations whose main clients are offenders, ex-offenders or their families in England.<sup>80</sup> As Figure 7 shows, many of these charities are small: roughly two thirds have a turnover of less than £500,000 per year; half have a turnover of less than £150,000.

## The sampling problem

Where the number of clients is small the statistical uncertainty surrounding the observed re-offence rates is very high. Even if we observe a specific re-offence rate at the sub-contractor level that suggests that the provider has performed above or below the regional benchmark, this may simply be due to luck and not actually attributable to the provider and, in a statistical sense, no different from the baseline figure. If we assume that the payment structure is the same for these organisations as for the prime providers then there is a 'sampling problem'.

Imagine a bag of 1,000 marbles (the population) split evenly between green and red (the distribution of attributes in the population). If you draw 500 marbles (a sample) there is a very good chance you will have a 50/50 red-green split. However, imagine you selected four (a very small sample). It is plausible that you would have three red and one green, or vice versa. The point is that the smaller the sub sample, the greater the chance that the distribution of attributes in the sample is different to the distribution of attributes in the population as a whole.

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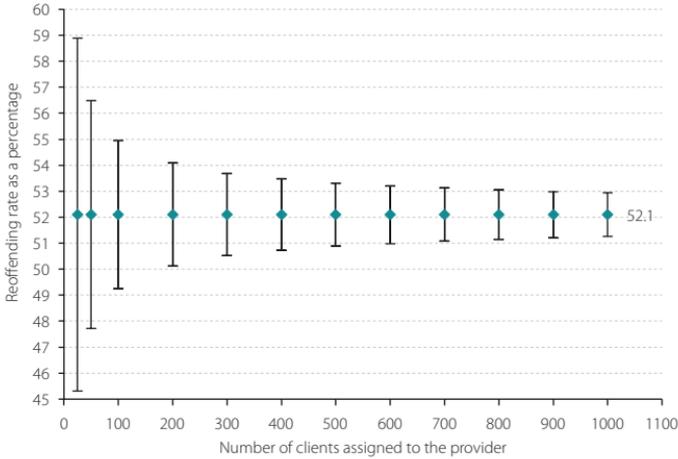
80 Centre for Social Justice, *The new probation landscape Why the voluntary sector matters if we are going to reduce reoffending* (London: Centre for Social Justice, 2013).

Returning to reoffending rates, take the Northumbria CPA as an example, which contains some 5,860 offenders. The point estimate of the reoffending rate is 52.1%. This controls for the observable characteristics of the client group (through OGRS). But, unobservable characteristics remain as do other factors that may affect the reoffending rate. Therefore the sample may include some who are more likely to reoffend than their OGRS score would suggest and some who are less likely to reoffend than their OGRS score would suggest, together with other external factors that may increase or reduce the reoffending rate.

Just by sampling we run the risk that the average probability of reoffending of the individuals assigned to the smaller organisation is different to the average for the entire population of offenders in the county. In Figure 8 we have used the percentage re-offence rate for Northumbria of 52.1% and shown the 80% confidence intervals for smaller sub samples. The 80% confidence interval means that we can be 80% certain that the mean of the sample is somewhere in between the bars. As the sample gets larger we can have a 80% certainty in a narrower range of figures.

As Figure 8 demonstrates, as the number of clients allocated to the sub-contractor decreases in size, the problem of statistical inference becomes more acute. The prime contractor in Northumbria will get rewarded or penalised by the Government for any change 1% above or below the baseline (at the 80% confidence level). However, in order to be confident that an observed increase or decrease in the reoffending rate is attributable to the actions of the provider (rather than a different factor), the reoffending rate for a sub-contractor with a smaller client group would have to move above or below the baseline by a much larger percentage. At the 80% confidence level, the change for a client group of 100 would have to be about three times larger than that observed for the prime contractors.

Figure 8: Confidence intervals around re-offence rates by sample size for the sub samples of Northumbria population (80% confidence)



Source: See Appendix 2

So, if outcome risk is passed down to these smaller (predominantly charitable) providers, it is essentially a game of roulette for them. While the prime provider can spread the risk of overpaying sub-contractors across its thousands of clients, the sub-contractor cannot manage this risk except by taking on more clients.

This transfer of risk is systemically inefficient: if the sub-contractor foresees this risk it will be reluctant to participate in the service thus undermining diversity; if it does participate it will be bearing risks that it cannot control. In such circumstances, the small organisation will be vulnerable to going bust, to being absorbed by a large provider (in which case innovation suffers) or having to disinvest in the service.

In a perfectly-functioning market, where the prime contractor and the sub-contractor had equal bargaining power and information, it might be in the commercial interests of the prime contractor to retain some of the outcome risk. This would be the

case if sub-contractors were fully informed, understood the small sample problem and had sufficient bargaining power to turn down the headline terms. This is not the case in this market.

Smaller charities typically find it difficult to assess commercial risks. As the NCVO has argued, previous PbR experiences provide 'lessons for the sector in terms of ensuring they know exactly what they are taking on, and the importance of declining to do so where the risks are disproportionate.'<sup>81</sup> In addition, given the dominance of the *Transforming Rehabilitation* policy, many providers may feel that they have to participate. Finally, evidence from past and current programmes suggests that policymakers cannot rely on prime providers necessarily acting benignly. In its analysis of past experiences of PbR, the NCVO has spoken of numerous examples of primes 'passing down the terms of the head contracts in full to their supply chain with no mediation of the risks involved.'<sup>82</sup> The experience of the Work Programme suggests the same (see Box 3.1. below).

This suggests that the market cannot be left to itself without harmful consequences for small charities and for the prospects of innovation and rehabilitation outcomes as a whole.

### Selection problems

This problem of randomness is potentially exacerbated in instances where the prime provider can select the clients with which it and its sub-contractors work. It may be desirable for the prime contractor to allocate specific clients to specific sub-contractors where a provider has a distinctive competence to help particular groups. However, this can create a selection problem if the prime contractor hoards the easier cases itself and hands out the harder

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81 David Hunter and Ruth Breidenbach-Roe, *Payment by Results contracts: a legal analysis of terms and processes* (London: NCVO and Bates Wells and Braithwaite, 2013).

82 David Hunter and Ruth Breidenbach-Roe, *Payment by Results contracts: a legal analysis of terms and processes* (London: NCVO and Bates Wells and Braithwaite, 2013).

cases to its sub-contractors. As described in Box 3.1, evidence suggests that this occurs in the Work Programme leaving some sub-contractors with the hardest cases. This problem only occurs where sub-contractors are paid by results. But, where they are, it is hard for the commissioner to prevent as the provider has more detailed and privileged information about the clients than does the commissioner.

Given that it is likely that many VCS organisations will be working with the hardest to help clients, this is likely to be a particular issue in relation to the 'binary' measure (i.e. whether a client does or does not offend) compared to the frequency measures (the number of offences committed).

### **Recommendation**

There is a clear danger that small providers may be affected by random bad or good luck which would override any efforts they make to affect reoffending. If prime providers pay solely on the basis of results then this will lead to an inefficient transfer of risk.

Therefore:

- There would be significant merit in seeking to achieve diversity at the prime level (where this statistical risk is less of a problem)
- Commissioners will need to regulate the supply chain robustly to ensure that risk is transferred efficiently
- Consideration should be given to the selection problem
- The Government should continue its efforts to boost the analytical capability of small providers and the VCSE so as to better educate sub-primes about managing risk

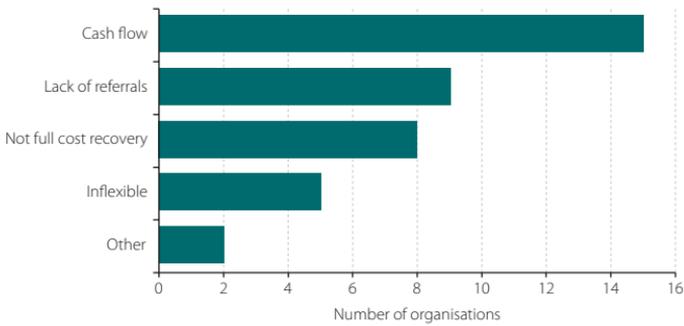
## **WHEN A PROVIDER GETS PAID: CASH FLOW**

Cash flow represents the second large constraint that PbR models introduce. This stems from the fact that the provider only gets paid after the outcome (desistance from crime) has been observed.

Given their small balance sheets, VCS organisations are less able to hold out for payment.

Research by the NCVO shows that cash flow is the most frequently-cited problem facing charities under PbR schemes. VCS providers have had to cross-subsidise their PbR work and limit the volume of PbR work they undertake.<sup>83</sup> Cash flow problems therefore inject inefficiency as the organisation reduces investment in the service.

**Figure 9: Responses to NCVO survey question – Have you had problems with [the payment by results] approach? (NCVO)**



Source: Clarks, *Economic downturn State of the Sector* (February 2013)

The cash flow problem can also accentuate the negative effect of the sampling problem, because the consequences of being dealt a bad hand may mean having to wait even longer for payment, resulting in organisations pulling investment in services and potentially going bust.

There is an implicit trade-off between the constraints imposed by the rigours of statistical significance (as described above) and

83 David Hunter and Ruth Breidenbach-Roe, *Payment by Results contracts: a legal analysis of terms and processes* (London: NCVO and Bates Wells and Braithwaite, 2013).

cash flow considerations. Shorter cohort periods lessen the cash flow constraint but mean smaller cohorts of offenders and a larger zone of statistical uncertainty. In contrast, longer cohort periods result in a smaller zone of statistical uncertainty zone, but exacerbate cash flow problems.

The SMF suggested in the last paper, *Paying for results* that the department should offer to pay providers for observed reductions in reoffending beyond the baseline, on a cumulative rather than a cohort basis. Initially this would mean making payments to providers where reoffending appeared to be below expectations and clawing back money where reoffending appeared to be above the expected level, regardless of the degree of statistical certainty. As more offenders flow through the scheme, the number of outcomes would grow, and payments could be adjusted accordingly. There is no reason why this policy should not be adopted by prime contractors so that smaller and VCSE sub-contractors are able to manage cash flow.

### **Recommendation**

Paying by results poses cash flow problems for organisations with smaller balance sheets. The MoJ should adopt the SMF's proposal for a cumulative payment schedule. This principle should also be adopted by prime providers so that sub-contractors do not experience a more significant cash flow problem than the prime provider.

## PREDICTING HOW MUCH WORK WILL COME IN: REFERRALS AND VOLUMES

As Box 3.1. shows, under the Work Programme, uncertainty and variation in the volume of referrals for providers has caused significant commercial difficulties for small not-for-profit organisations. Providers expecting a certain number of clients have not seen them come through the door. It is likely that referrals at the CPA level for rehabilitation services will be more stable than under the Work Programme where external policy and economic factors have

### Box 3.1. What can we learn from the Work Programme?

The performance of the Work Programme has thus far been underwhelming, although providers achieved better results in 2013 than previously. Sub-contractors have faced particular problems even though the DWP included supply chain management in its quality criteria when assessing contract bids.<sup>84</sup> The scheme can offer lessons for how rehabilitation services can be commissioned.

- The evidence suggests that some who entered as specialist providers have come under significant financial strain. Anecdotal reportage suggests that some are even leaving the market voluntarily.<sup>85</sup>
- Providers went in at ambitious costs and were very reliant on the predicted volumes of referrals coming through. When volumes varied significantly, this placed them in difficult positions. Survey evidence suggests that many VCS organisations have struggled with low levels of referrals. A high number of those organisations that believed their contracts were at financial risk said that the volume of referrals had been

84 Tom Gash, Nehal Panchamia, Sam Sims and Louisa Hotson, *Making public service markets work: Professionalising government's approach to commissioning and market stewardship* (London: Institute for Government, 2013).

85 Third Sector, "Volunteer centre withdraws from work programme because of restrictions on service delivery, 2013 [www.thirdsector.co.uk/Policy\\_and\\_Politics/article/1185819/](http://www.thirdsector.co.uk/Policy_and_Politics/article/1185819/). Accessed 5 March 2014.

lower than expected. In part, this may stem from the fact that the volume of referrals of Employment Support Allowance (ESA) claimants (with whom many specialist providers work) has been much lower than envisaged.<sup>86</sup> Volumes of clients forecast by the DWP did not come through as expected. Instead there were large peaks and troughs. This was particularly the case with ESA claimants where the VCS were most likely to be providing the service.

- There has also been criticism that prime contractors are doing too little to protect sub-contractors from financial risk. For instance, when asked in a 2011 survey 'to what extent do you feel your prime has used its financial scale to shield your organisation from financial risk?', 58% of VCS respondents replied 'not at all'. This evidence was corroborated by more recent survey analysis.<sup>87</sup>
- Evidence from the Work Programme suggests that some prime providers have 'creamed' off the easiest clients on to their own books, leaving sub-contractors with the harder cases.<sup>88</sup>

led to significant variation away from the forecasts.<sup>89</sup> The numbers of offenders in each cohort has varied in the last six years, but not severely. Of greater concern, is the fact that many third sector providers will have limited geographic boundaries and therefore will

86 NCVO, *The Work programme: perceptions and experience of the voluntary sector* (London: NCVO, 2012).

87 James Rees, Rebecca Taylor and Chris Damm, *Does sector matter? Understanding the experiences of providers in the Work Programme* (London: TSRC, 2013).

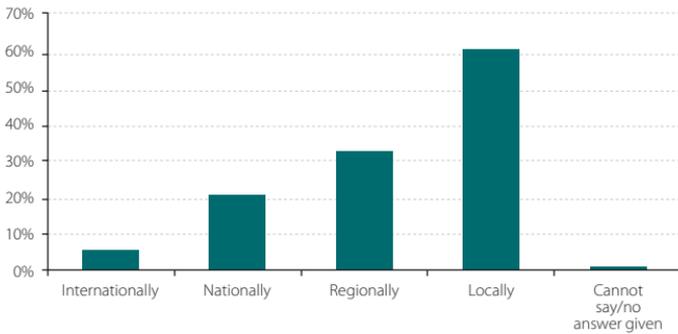
88 Pippa Lane, Rowan Foster, Laura Gardiner, Lorraine Lanceley and Ann Purvis, *Work Programme Evaluation: Procurement, supply chains and implementation of the commissioning model* (London: DWP, 2013); Centre for economic and social inclusion, "The work programme and the voluntary sector", 2013 [www.cesi.org.uk/blog/2012/oct/work-programme-and-voluntary-sector](http://www.cesi.org.uk/blog/2012/oct/work-programme-and-voluntary-sector). Accessed 5 March 2014.

89 Department for Work and Pensions, "Work Programme official statistics to June 2013", 2013, [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/245184/work-programme-statistical-release-sep13.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/245184/work-programme-statistical-release-sep13.pdf), Centre for Economic and Social Inclusion, "Work programme referrals and attachments: Inclusion and analysis, 2014 [www.cesi.org.uk/social-inclusion-news/2012/feb/work-programme-referrals-and-attachments-inclusion-analysis](http://www.cesi.org.uk/social-inclusion-news/2012/feb/work-programme-referrals-and-attachments-inclusion-analysis). Accessed 5 March 2014.

be vulnerable to more marked fluctuations in referrals at the localised level. This problem is likely to be particularly acute in rural areas where the number of clients per square mile is likely to be the lowest.

As noted above, most charities in the criminal justice sphere are small. Many are also local, with six in ten of those primarily working with offenders, ex-offenders and their families doing so at a local level.<sup>90</sup>

**Figure 10: The main geographic area in which English voluntary organisations working with offenders, ex-offenders and their families carry out their activities (2010)**



Source: Centre for Social Justice, *The new probation landscape Why the voluntary sector matters if we are going to reduce reoffending* (2013)

### Recommendations

The MoJ has given significant thought to volume risk for prime providers but attention should also be given to how this may affect small geographically-bound sub-contractors.

<sup>90</sup> Centre for Social Justice, *The new probation landscape Why the voluntary sector matters if we are going to reduce reoffending* (London: Centre for Social Justice, 2013).

## ACHIEVING DIVERSITY

### Boosting diversity at the prime level

As suggested above, it is highly desirable that diversity of the supply base is achieved at the prime contractor level, as well as at Tier II and Tier III. Here, at the Tier I level, the problem of statistical uncertainty is less severe. In addition, left untended, there is a significant danger of market concentration at the Tier I level notwithstanding the rule that one provider should receive more than 25% of the market.

There are several options for seeking to boost diversity at the prime level. First, the Government must be ready to pay extra for a more sustainable and competitive market. Large private sector providers are likely to be at a competitive advantage due to economies of scale – but it is not in the interests of the taxpayer for the market to be concentrated. Second, there may be not-for-profit organisations that combine a balance sheet large enough to take on the risk alongside a community focus. These are likely to include the largest VCSE providers and housing associations. Third, the Government has been keen to encourage consortia to bid for CPAs.<sup>91</sup> Some of the 30 lead bidders include staff-led probation mutuals – although it is likely that these will also participate in the supply chain.<sup>92</sup>

Third, there may be opportunities for social investment to finance the activities in a CPA. The Peterborough One Service – a project to provide rehabilitation services to prisoners coming out of Peterborough Prison – is currently using social finance to pay for interventions. However, the comparatively large size of the CPAs together with the rapid timetable mean there is probably

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91 Civil Society, "Charity consortium formed to bid for rehabilitation contracts", 2013 [www.civilsociety.co.uk/finance/news/content/15131/charity\\_consortium\\_formed\\_to\\_bid\\_for\\_rehabilitation\\_contracts](http://www.civilsociety.co.uk/finance/news/content/15131/charity_consortium_formed_to_bid_for_rehabilitation_contracts). Accessed 5 March 2014.

92 The Observer, "Probation privatisation plans will put 'public at higher risk'", 2013 [www.theguardian.com/society/2013/dec/15/probation-reforms-put-public-at-higher-risk](http://www.theguardian.com/society/2013/dec/15/probation-reforms-put-public-at-higher-risk). Accessed 5 March 2014.

little prospect of a social financed prime provider. For instance, the cohort in Peterborough has a size of 1,000 compared to an average of 10,000 in each CPA. Raising sufficient investment to finance the interventions in a CPA is likely to be a big ask given that the market in social investment is immature.<sup>93</sup> Therefore, it is unclear whether sufficient capital could be secured at a sufficiently good rate to make this viable.

### Regulation of the supply chain

The MoJ has – quite rightly – advocated maximum **transparency**, recommending that it:

*‘envisages that all parties have visibility of participation within the supply chain. This should include payment terms against contractual targets, the volume of business handled by supply chain partners, transparency for refresh and retendering of services, fair apportionment of referrals with regard to easier cases, and how the supply chain adjusts to changing volumes or demographics within each Contract Package Area (CPA).’<sup>94</sup>*

As a first principle, transparency is indisputable. However, it is only a very partial solution to the problems set out above: it does not resolve the selection problem, the sampling problem or the information asymmetry. As Dan Corry, Chief Executive of New Philanthropy Capital has argued, ‘Just because there is transparency about the transfer of risk to subcontractors does not mean that the burden of risk is going to be reasonable or manageable – we need to be sure that subcontractors are able to cope with this risk.’<sup>95</sup>

The MoJ has stated that, as long as there is transparency, ‘providers will not be prohibited from signing sub-contracts with

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93 Nigel Keohane, Ian Mulheirn and Ryan Shorthouse, *Risky Business: Social Impact Bonds and public services* (London: SMF, 2012).

94 Ministry of Justice, *Principles of Competition – Transforming Rehabilitation Programme* (London: HMSO, 2013).

95 Sarah Neville, ‘Ministers seek to revive Big Society project’, *Financial Times*, 30 May 2013.

partners which transfer financial risk'.<sup>96</sup> According to the Principles of Competition document:

*'all contractual and other risk should be appropriately managed. This should extend to not passing risk down supply chains disproportionately, the management of volume fluctuations and other events and the management of intellectual property rights'.<sup>97</sup>*

But, the real question is *how* the risks should be managed, including how any revised Merlin Standard and the Market Stewardship Principles should operate.

Lessons from previously commissioned PBR contracts provide clear warnings for how the supply chain is regulated. In the Work Programme, the Government opted for a 'black box' approach to supply chain management limiting its scope to intervene. The Merlin Standard was developed to offer regulation of the supply chain – but few believe it has had much effect.<sup>98</sup> The regulator cannot intervene in commercial arrangements; and it directs sub-contractors to channel complaints to their primes, but the former are often hamstrung by 'gagging clauses'.<sup>99</sup> As the House of Commons DWP Select Committee has noted, all eighteen prime contractors have achieved the Merlin Standard despite significant problems around referrals and risk distribution. The Committee recommended that the Merlin Standard be given 'more teeth'.<sup>100</sup>

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96 Ministry of Justice, *Transforming Rehabilitation Programme – Payment Mechanism: Market Feedback and Development Considerations* (London: HMSO, 2013); Ministry of Justice, *Transforming Rehabilitation: A Strategy for Reform* (London: HMSO, 2013).

97 Ministry of Justice, *Principles of Competition – Transforming Rehabilitation Programme* (London: HMSO, 2013).

98 See responses to Ministry of Justice strategy document.

99 Tom Gash, Nehal Panchamia, Sam Sims and Louisa Hotson, *Making public service markets work: Professionalising government's approach to commissioning and market stewardship* (London: Institute for Government, 2013), 53.

100 House of Commons, DWP Select Committee, *Can the Work Programme work for all user groups?* (London: House of Commons, 2013).

## PREPARING THE MARKET

The first phase of reform – due to take place by spring 2014 – is the conversion of the current probation trusts into the Community Rehabilitation Companies (CRCs) and the National Probation Service (NPS). The Government has indicated that it will test the model with shadow state-run companies before the services are outsourced, using the same buildings and IT equipment.<sup>101</sup> This period could be an important intelligence-gathering opportunity for potential providers and the Government should consider how it can use this shadow period as a means of preparing new providers for undertaking their contracts and widening the knowledge of new entrants to the market. This could also present an opportunity for staff of probation trusts to help co-design the future service in collaboration with short-listed providers.

The pace of change is rapid. However, the desire to see the reforms take effect quickly should not blind policymakers to the evolution process that the market will have to undertake. In reality, the early phase reforms will consist of a significant transfer of responsibilities over from the current probation trusts to new providers, together with associated costs. These costs will include existing fixed contracts as well as staff. At the same time, providers will be innovating in a sphere where much evidence remains inconclusive. Expectations on providers for Year 1 should not therefore be the same as expectations in Year 3. The Ministry of Justice has accepted that there should be a learning curve discount to reflect the fact that providers should not be expected to make significant inroads into reoffending on contract commencement.<sup>102</sup>

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101 House of Commons, Justice Select Committee, *Crime reduction policies: a co-ordinated approach?* (London: House of Commons, 2014).

102 Ministry of Justice, *Transforming Rehabilitation Programme – Payment Mechanism: Market Feedback and Development Considerations* (London: HMSO, 2013).

## Recommendations

Evidence from existing programmes together with the difficulties highlighted in this analysis, suggest that a much more exacting regulatory standard must be established which sets clear expectations for behaviours from Tier 1 providers as well as mechanisms of recourse where providers act inappropriately.

- If the Government is serious about involving expert charities and promoting a diverse market of providers, then it must be ready to proscribe that prime contractors cannot pay small sub-contractors by results. As demonstrated above, due to the small sample size, it is incoherent to reward or penalise small charities and social enterprises on such a crude measure. Prime contractors would, therefore, be encouraged to make a much wider assessment of the performance of sub-contractors.
- In addition to transparency, a new complaints and appeals procedure should be established that enables sub-contractors to bring evidence against their prime providers where regulations have been broken.
- There should be clear expectations in terms of how prime providers should make payments to sub-contractors. Paying by results poses cash flow problems for organisations with smaller balance sheets. The SMF previously advocated that prime providers should be paid on a cumulative basis. This principle should also be adopted by prime providers so that sub-contractors do not experience a more significant cash flow problem than the prime provider.
- In order to help the mutual sector achieve scale, the Government should consider under-writing a mutual provider by offering a government guarantee on the finance they need to grow.

## CONCLUSIONS

The Ministry of Justice has made significant efforts to develop a market of providers in rehabilitation services. This research suggests just what a challenge it is. The recommendations above indicate further market making activities that are needed.

Problems in the market cannot be allowed to resolve themselves; proactive regulation is needed to ensure that smaller providers and the charitable sector are encouraged to participate and participate on the right terms.



## APPENDIX 1: MODELLING THE COSTS OF REOFFENDING

Crimes against the person included in the calculations:

- Violence (serious)
- Violence (non serious)
- Robbery
- Sexual
- Sexual (child)
- Domestic burglary
- Theft
- Theft from vehicles
- Criminal or malicious damage

'Victimless crimes' that were not included in the calculations included:

- Public order or riot
- Soliciting or prostitution
- Other burglary
- Handling
- Fraud and forgery
- Absconding or bail offences
- Taking and driving away and related offences
- Other motoring offences
- Drink driving
- Drugs import/export/production/supply
- Drugs possession/small scale supply
- Other

## APPENDIX 2: SIMULATION OF CONFIDENCE INTERVALS FOR SUB-SAMPLE

Error bars are used to calculate uncertainty in graphs. In this case there is uncertainty that the mean of the sample will be the same as for the population. To calculate error bars we used the average for Northumbria (52.1%). We used the following formula:

$$P \pm z_{critical} \sqrt{\frac{P(1-P)}{n}}$$

Where P is the proportion reoffending and n is the sample size. Z critical is the z-score (derived from a z score calculator) appropriate for a specific level of confidence – 80% here.<sup>103</sup> It is important to stress that this is a simulation exercise designed to demonstrate that as the sample size gets smaller we can be far less certain that the mean and the distribution will be the same as in the population. This procedure could under or overestimate the problem given that we do not know anything about the variability of the propensity to reoffend in the population or in the sample. The Ministry of Justice have used historical variation in the mean over time to calculate their confidence intervals. This is very different to variation within a population at any one point in time (which we simulate).

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103 T.H. Wonnacott and R.J. Wonnacott *Introductory Statistics For Business and Economics* (4th Edition, 1990), pp.273–4.

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Some 600,000 offences were committed in 2012 by people who had previously committed a crime. Reducing this rate of reoffending is central to the Government's Transforming Rehabilitation proposals.

This report analyses the Government's reforms and makes three principal points. First, it calculates the costs of reoffending to the public purse and to society and it argues that the Government should seek to be much more ambitious in the level of investment. Second, it recommends that other government schemes – such as the Work Programme and prison services – should be rolled into the rehabilitation reforms. Finally, the report provides new analysis showing that a principal rationale for the reforms – that expertise from charities and social enterprises can be brought in to help turn around the lives of offenders – is in danger of misfiring if additional safeguards are not put in place.

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