

## CASE STUDY OF A CLINKS MEMBER - ECO-ACTIF CIC

### THE IMPACT OF PAYMENT BY RESULTS CONTRACTS

August 2013



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### The impact of payment by results contracts

Eco-Actif Services CIC was incorporated as a Community Interest Company in February 2006. The company was set up by two founding directors who had previously worked in the public sector and who had been responsible for delivering Welfare to Work support. Eco-Actif focused on programmes to create opportunities for some of the most marginalised and vulnerable people in South London and Surrey.

This case study sets out the impact of payment by results on a third sector organisation and covers issues of relevance to many Clinks Members, and will be of interest to public sector commissioners too. These issues include:

- Payment by results contracts
- Lessons from the Work Programme
- Managing cash flow

It was carried out in June 2013 and published as part of the Clinks Sustainable Work with Offenders Project.

### Payment by results

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The drive towards more and more public sector contracts which incorporate payment by results (PbR) elements is having a significant impact on many delivery organisations. In essence payment by results is about public sector commissioning bodies paying (in part or whole) on the basis of a particular outcome being achieved, rather than the service provided.

An example would be where the contract is based around successfully placing an unemployed person into a job and for them to still be employed six months later. A more traditional service contract would be focussed largely around the delivery of assessment, advice, training and other support. These more traditional contracts can include an outcome related element, although these usually only contain 10-20%, are often more loosely defined and include 'distance travelled', in contrast to the binary measure favoured in PbR to date, such as used in the Work Programme.

The shift towards PbR based contracts has significant implications on the delivery organisation, particularly around cashflow and the risk that it may never get paid enough to cover its costs. Many organisations have struggled with these implications. In some cases, this has led to insolvency, whilst many others have decided not to take on such contracts and either ceased these activities or found other sources of funding.

Whilst the delivery organisation can have a significant impact on the achievement of a successful outcome, no service or provider has control over the outcome. For example, an individual may have deteriorating mental health triggered by bereavement and therefore leave a support service after four months, even though they have been given very high quality and effective support.

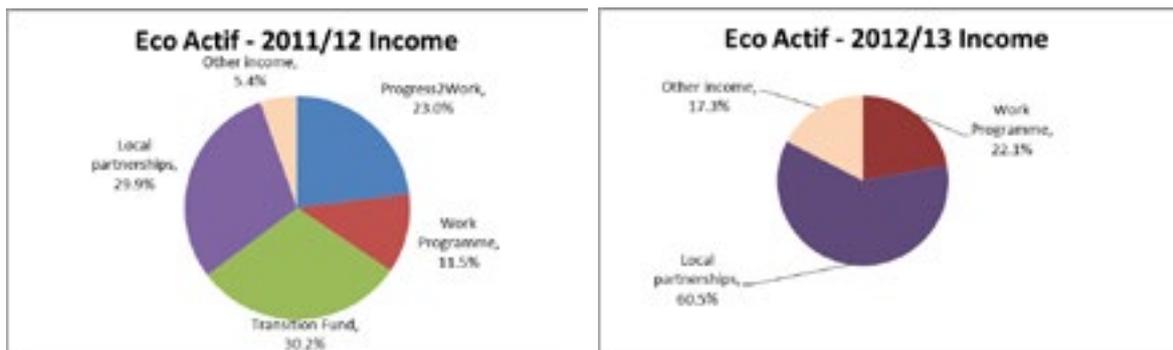
### Eco-Actif Services CIC

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To illustrate the impact in a real context, this case study sets out an example of a third sector organisation based in Surrey.

In 2011 Eco-Actif helped over 800 people to improve their lives through the provision of a holistic package of support to ex-offenders, recovering addicts, vulnerable young people and many other people who had experienced the consequences of social exclusion. Through the Progress2Work programme, it helped over 500 of these people in 2011, but the programme discontinued as the Government's Work Programme had been introduced. Eco-Actif had been successful in winning funding from the Transition Fund in 2011/12 to cover this change, and it had begun delivering two PbR contracts. The larger of these was the Work Programme - getting people into employment. The other was Problem Families, which was a more holistic and targeted programme, which better fitted Eco-Actif's approach.

The charts below show the significant change, both in the breakdown of income and in overall size from 2011/2 to 2012/3. The loss of the Progress2Work contract coupled with the Transition Fund made a significant impact with income falling from around £500k to £380k.



## The Work Programme

In six years of trading, Eco-Actif had built a very successful track record and a good reputation for helping disadvantaged people into sustainable jobs, as well as providing and sourcing training and support to help people move towards self-sufficiency.

The major changes to the continued funding for these programmes and the replacement in a large part by the Work Programme, clearly presented significant challenges to the company. The directors were focussed on continuing to support Eco-Actif's established client group and looked at ways they could make the Work Programme and smaller Problem Families contract work for them as best as possible. With its successful track record on outcomes, the feeling was that Eco-Actif could make the new contractual arrangements work.

Unlike previous programmes where Eco-Actif could contract directly with the Jobcentre Plus, under the Work Programme they needed to work with prime contractors who in turn had large contracts with Department for Work and Pensions. This added extra layers and complexity and gave sub-contractors such as Eco-Actif little room for negotiation over terms.

The new arrangements for the Work Programme were based on an attachment fee (i.e. when taking on a case), a weekly payment once in a job (first 12 months) and an outcome payment after two years. The amounts for each depended upon the prime contractor and the complexity of the situation of the individual, but to give an indication, the attachment fee would be in the region of £210 per person, the weekly payment for the first year in employment about £20 per week whilst the outcome payment at the end of two years could be as high as £5,600 for the most complex cases. This could mean up to £6,800 per case, although in practice getting to this point would be rare. Something like £210 to £1,000 was more likely.

Whilst the purpose of giving high outcome payments, especially for complex cases, was intended to encourage more support, in fact the cost and risk actually encourages providers to focus on the simpler cases and go for volume. There was a strong incentive to neglect complex cases, such as many ex-offenders, to make the cashflow and business model work.

In addition Eco-Actif experienced many administrative difficulties with prime contractors including:

- Incompatible and poorly set up IT systems at the prime contractor including use of Windows XP as recently as 2012/3.
- IT security requirements in the contract seemed excessive for what was required and hence a significant cost to comply with.
- Data sets were poorly managed by the prime contractor, leading to complex and bureaucratic reporting requirements.
- A lack of understanding of the operation of the Work Programme by partnership managers at some prime contractors leading to a difficult relationship.

## Cash-flow

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Payment by results (contracts, such as with the Work and the Problem Families programmes, place considerable cash-flow risk onto the provider. In this case, Eco-Actif had no option but to take on this risk in order to deliver both these contracts.

As with many VCS organisations of their size their financial systems were basic. They included a basic cash-flow, but this did not provide a sufficiently accurate picture of the cash-flow situation or forecast.

When the cash-flow issue became apparent, the directors of Eco-Actif proactively sought out potential funding and financing options including discussions with local stakeholders, their bank and social lenders. They had little real success with local stakeholders and even social sector lenders felt that the risk associated with PbR contracts, especially with Eco-Actif's contract with the Work Programme, was too high, even though they had been performing relatively well at that stage.

In addition, without accurate up to date cash-flow forecasts it was more difficult to secure additional finance. Eventually their bank did promise to lend them enough to address their cash-flow. But when it came to the time to draw it down, the bank backtracked and reduced the amount it was prepared to lend by more than 60%, which was not sufficient. By this stage, it was impossible to try and find alternative financing as time had virtually run out. Eco-Actif felt very let down by the bank.

Eco-Actif negotiated a reduced rent with its landlord and made other cost savings. However despite this, cash-flow continued to be a challenge. On 13<sup>th</sup> July 2013, following advice from their solicitor and an external accountant, the board made a decision to cease trading and close the company immediately.

This was a major blow for the directors and its client group but the situation had got to a point where continuing to trade would only worsen the position and potentially have led to trading whilst insolvent.

## A happy ending?

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The insolvency of Eco-Actif was a significant blow. However, determined to continue their good work, some of Eco Actif's staff created a new social enterprise called 'Drop the Tag training and consultancy partnership'. The aim was to form a small, but agile, partnership to continue the good work by offering training to individuals and organisations, as well as consultancy to social enterprises and charities working with disadvantaged people.

The new business model is focussed around a partnership with their local college and the delivery of training and consultancy services for a range of organisations including Work Programme sub-contractors. This approach keeps the PbR element relatively small and manageable, although this may change in the future as PbR is rolled out into the Criminal Justice System.

Drop the Tag has grown quickly but cautiously, and has developed three new courses already this year as well as establishing an exciting new partnership with their local drugs and alcohol service providers.

There is still a challenge around financial expertise, although they have been offered some voluntary help with business planning from a Finance Director.

## Learning points

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The purpose of this case study is to highlight some learning points for others. The main ones are:

- PbR contracts place considerable risk and cash-flow implications on an organisation. It is important that these are understood and calculated at the outset.
- The importance of cash-flow management and financial control must not be underestimated - as the case study illustrates. Senior staff and Trustees need to understand, and when necessary challenge management accounts and projections to ensure they are robust.
- Understanding and exploring different business models and opportunities is really important. The business model for "Drop the Tag" is around training delivery rather than the PbR focus of the Work programme.
- Existing stakeholders and funders are likely to be more supportive than new ones when things become difficult, although an unworkable business model finally led to the collapse of Eco-Actif.
- Whilst the bank was originally supportive and offered the finance needed, it significantly reduced its offer at the last minute. It is important to be mindful that this can happen. Seek written confirmation of any agreement and clarify conditions.
- When things become difficult it is important to seek advice as early as possible and consider potential options, such as reducing costs through negotiation. Eco-Actif did this with its landlord.
- Even at the point where things are collapsing, there are often new opportunities arising, so keeping a positive frame of mind is important.

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