URBAN INSTITUTE

Incentivizing Results
Contracting for Outcomes in Social Service Delivery

Rayanne Hawkins, Brian Bieretz, and Madeline Brown
June 2019

Most government contracts with social service organizations focus on those organizations' activities, outputs, and costs, not the goals or outcomes of interest that necessitated the service. Rarely do contracts link payment to achievement of desired outcomes or require organizations to demonstrate that their services caused changes in outcomes. This creates a disconnect between what stakeholders are interested in and what gets measured and accounted for in social service contracts. Outcomes-based contracts (OBCs) are a potential solution to align what the government, service providers, and the public care about with what a contract incentivizes.

In this brief, we aim to provide government officials with a better understanding of how OBCs are used for social services contracting. We first discuss critical components of OBCs and how they differ from other forms of performance-based contracts (PBCs), then proceed to discussing the benefits, risks, and challenges associated with them, and finally we outline considerations for effective OBC implementation. In developing this brief, we consulted literature on performance-based contracting; located government examples; and interviewed researchers, government managers, and procurement practitioners.

Overview of Outcome-Based Contracts

In recent decades, governments have increasingly signaled a desire to include performance measures in their contracts with service providers (Hatry 2006; Lu 2016). That is, governments hope to monitor

outputs and outcomes associated with the program being funded to gain a better understanding of its effectiveness. This shift has been encouraged in federal, state, and local contracts and manifests as a range of performance management approaches, including PBCs, OBCs, and pay for success (PFS).[1] A 2013 national survey revealed 9 percent of small nonprofit organizations (with annual expenses up to $250,000) had at least one PBC, and 22 percent of larger nonprofit organizations (with annual expenses greater than $1 million) had PBCs as a funding source (Pettijohn et al. 2013). Including performance measurement in procurement can allow governments to track contractor performance and spending, but many PBCs focus on activities and outputs without including the intended results or outcomes of the services provided.

Outcome-Based Contracts, Performance-Based Contracts, and Pay for Success

OBCs are any contract structure in which payment is wholly or partially based on the achievement of predefined outcomes.[2] For example, a government may be interested in paying service providers to run a program that helps unemployed people find new work. Under a non-OBC arrangement, payment would likely be tied to the number of training classes delivered or number of people enrolled (i.e., a fee-for-service contract). An OBC, however, would tie payment to the achievement of outcome metrics, such as the number of clients who obtained jobs, the quality of the jobs obtained (e.g., full-time jobs that pay a living wage with benefits), or the number of people still employed after one year. The service provider's payment is based on the achievement of these metrics, with payment amounts varying based on levels of success. Although OBCs can be structured in different ways, the key element is that the contractor is paid, at least in part, on achievement of specified outcomes.

Under this definition, OBC can be seen as a subset or type of PBC, although a more rigorous one. The Institute for Public Procurement defines PBC as

> "a results-oriented contracting method that focuses on the outputs, quality, or outcomes that may tie at least a portion of a contractor's payment, contract extensions, or contract renewals to the achievement of specific, measurable performance standards and requirements. These contracts may include both monetary and nonmonetary incentives and disincentives."[3]

This definition highlights the importance of outputs, quality, and outcomes, and notes that under PBCs, the nature and size of the performance incentive can vary. For instance, PBCs could include nonmonetary incentives such as special recognition, preferred contractor status, or monetary incentives up to and including full payment of the contract. Although similar, this paper will focus on OBCs, which we distinguish from other types of PBCs in two main ways:

- **OBCs are focused primarily on outcomes rather than inputs or outputs.** An outcome is a result or accomplishment of a program, such as job stability, housing stability, or an extended period of time out of foster care. An outcome is a more robust performance specification than an output, which is often measured in units of service or the number of people served. See box 1 for a more in-depth discussion of inputs, outputs, and outcomes.

- **An OBC must tie at least some portion of payment to achievement of outcomes; contract renewal is not a sufficient level of accountability.** Unlike broader PBCs, in which contract renewal or progress reporting is used as the accountability mechanism, some portion of actual payment (whether by fee schedule, bonuses, or milestone achievement) must be linked to improved outcomes.

BOX 1

Inputs, Outputs, and Outcomes

Inputs, outputs, and outcomes are measures that refer to different levels of accountability in contracting. An input is a component of design specifications and includes things like staff hours, curricula, and strategic planning. Outputs and outcomes are both components of performance specifications. Outputs include things like the number of trainings offered, the number of course completions, and the number of clients served. An outcome is a result of the output and measures things like an increase in advanced math placements, reduced days in jail over time, or increased housing stability over time. Table 1 lists a few examples of inputs, outputs, and outcomes across five different social service delivery fields. It is not meant to be a comprehensive list; rather, it is a sample of what potential inputs and outcomes could be.

TABLE 1

Examples of Inputs, Outputs, and Outcomes by Service Field

Social service field	Input examples	Output examples	Outcome examples
Workforce development	- Staff hours - Curriculum	- Number of people served in a training - Number of training sessions offered	- Job placement and stability - Quality of jobs obtained as measured by wages and benefits - Rate of wage increase across a group
Child welfare	- Staff hours - Residential care facilities - Programming for family	- Number of families referred for child welfare services - Number of cases managed - Number of families completing child abuse prevention programs	- Reduction in foster care reentry - Housing stability over time - Reduction in per capita child abuse rate
Criminal justice	- Staff hours	- Number of persons served by a reentry program	- Reduced jail bed days over time - Reduced arrests over time
Housing and homelessness	- Staff hours	- Number of persons referred for housing assistance	- Housing stability (6- or 12-month period)
Education	- Staff hours	- Number of persons enrolled in a course	- Increased test scores over time - Increased advanced class placement

Source: Authors' review of field.

PFS is an innovative contracting method that uses investor capital to scale social service programs. Government payment is based on successful achievement of outcomes, usually determined by an impact evaluation. We include PFS projects within our definition of OBCs because they focus on outcomes achieved and tie government repayment to those outcomes. PFS projects can be significantly more complex and include additional elements, such as investors and impact evaluations, but the core social service contracting components are the same as with an OBC. But unlike OBCs, where payment to providers is tied to outcomes, PFS contracts pay providers up front and may or may not include performance-based incentives for the provider when the government repays the investor.

Outcomes-Based Contracts Today

The federal government started focusing on outcomes and performance in the 1980s, and federal contracting standards often set precedent for public procurement. Given that, we expected that OBCs would be well developed at the local level. During our scan of the OBC landscape, however, we were only able to identify a handful of state and local examples, most of which concerned child welfare or workforce development, including projects at the state level in Tennessee and Wisconsin and the county level in San Francisco, and a few homelessness- or housing-focused projects, including one in Seattle. Including PFS contracts as a type of OBCs, as we have done, only yields 24 additional projects, most of which are in the early stages of implementation.

The scarcity of OBCs may be tied to (1) the challenge of switching from contracts that pay for milestones or activities to contracts that pay for outcomes, (2) the costs associated with incentives, (3) the difficulty in tracking or proving outcomes, (4) the challenge of creating a level playing field among providers, and (5) the lack of accompanying physical and human infrastructure and capacity necessary to carry OBCs out. For example, one interviewee noted that staff turnover is frequent within many government procurement offices, which means institutional knowledge is repeatedly lost and staff need to constantly be trained on OBCs. Public-sector innovations, such as a shift to OBCs, also typically require strong government champions. Although OBCs could be a critical tool for improving government effectiveness and advancing evidence-based decisionmaking, they are just one of many competing priorities for government officials. PFS has attracted significant public attention and may help galvanize this high-level support and contribute to the environment needed to facilitate systemic change.

Benefits, Challenges, and Risks

OBCs bring with them new benefits, challenges, and risks that governments must consider. Simply moving to OBCs without a full appreciation of these changes is unlikely to yield the results governments seek. OBCs are not appropriate in every situation, and even in situations where they may be, governments must still balance the contracts' potential benefits against their risks and challenges as well as the additional time and effort required to administer them. We next describe the most common benefits, risk, and challenges of OBCs.

Benefits

As noted, OBCs help governments address the disconnect between the end goal of a project and how the contract structures payment to incentivize achieving that goal. Although each project is unique, governments may see many benefits to using an OBC as part of an effort to monitor service provider performance and make payments based on results. Those benefits can include the following:

- **Creating a clear and transparent link between services and their objectives.** Paying for the outcomes of social services rather than their activities creates clear goals for the desired results of the services and their effects on the people receiving them. This has the added benefit of tying stated objectives to actual priorities (i.e., what the government wants to see as a result of the service).

- **Shifting nonperformance risk.** When outcomes are priced correctly, governments get the results that are possible for the amount they are willing to pay or for the amount proposed by the most qualified service providers. The government must review the outcome targets to make sure they are achievable and equitable across all providers and communities. When properly designed, if a program is unsuccessful or less successful than desired, the cost of that program to the government should be less than the anticipated total contract value. This allows governments to reward successful programs with new contracts and shift resources away from unsuccessful ones.

- **Understanding the true costs of social service success.** In theory, OBCs could help governments and service providers estimate the actual costs associated with reaching their goals. If service providers can accurately estimate their costs of delivering high-quality social services to everyone and allocate them through an outcomes-based payment structure, over time the government can add or subtract incentives and determine the actual cost of success. This is only possible if governments allow for contract adjustments that account for lower-than-anticipated success rates caused by factors outside the control of the provider or government.

- **Collecting data for better resource allocation.** OBCs require better data collection to track outcomes, which allows governments to collect a wealth of information on service provider performance and intervention effectiveness. This information can be useful to future procurement discussions as well as to strategic planning conversations on what programs to adopt or scale.

- **Incentivizing improved performance.** Studies have found that tying compensation to performance changes the contractors' behavior to focus more on performance (Martin 2005). A study of the Wisconsin Works workforce development program found that overall, the shift to PBCs changed service providers' behavior to be more outcomes oriented, though the government's challenges with contract management led to some performance issues and setbacks (Heinrich and Choi 2007).

- **Enabling continuous improvement.** When contract inputs and activities aren't the basis of payment and data on outcomes are used to actively manage contracts, officials can work with

service providers to improve performance during the contract's period of service delivery. For this to be effective, contract periods need to encompass the period when an outcome will be achieved, or contract payments need to be phased to account for the fact that services delivered toward the end of the contract period may not lead to measurable changes in participant outcomes until after the contract period has ended.

Challenges

Tying payment to outcomes can present challenges for both governments and service providers. Although some of these challenges are present with any project, they can be heightened in OBCs. This is because payment is tied to the achievement of outcomes, which adds time and resources to review results and manage the contract after services are delivered. These challenges include the following:

- **Measuring outcomes takes time and may be difficult for governments and service providers.** Improvements in outcomes need sufficient time to be realized and ready to measure, so projects may select interim outcomes for measurement and payment. Research or best practice information is not always available to guide the selection of interim outcomes, so the outcomes being measured and incentivized may not align with the goals of the project.

- **Tracking and verifying outcomes changes requires robust data systems both on the part of the government and service providers and time to review the results after services are delivered.** Without adequate data systems, reported results can be unreliable, and using these results as the basis for payments is inadvisable. OBCs also require more contract management after service delivery to review the outcomes and make payment decisions. Ideally, the outcomes tracking would be done by the government or an independent third party that would validate the outcomes before payment. Further, if the government funded an impact evaluation of the services being delivered, it could determine whether the change in outcomes was caused by the program.

- **Funding contracts that include financial incentives for good performance may be politically difficult if budgets are restricted or government resources are tight.** The use of bonus payments as incentives for the achievement of good outcomes poses less financial risk to the service provider. This is because the cost of providing services is covered regardless of the project's success, and incentives can motivate providers to focus on improving performance. However, many local governments are already underresourced, and finding additional money to use for incentive payments may be unrealistic even when the public wants the outcome to change.

- **Implementing OBCs effectively may require additional training for staff**. Both government and service provider staff may need training on topics such as effective service delivery, outcome measurement, and how to review and interpret changes in outcomes. Allowing adequate time for training can help mitigate this challenge. We discuss this in greater detail in the Considerations for Implementing Outcomes-Based Contracting section.

- **Retaining employees with OBC experience can be difficult.** With limited resources, governments and service providers may have difficulty offering competitive salaries and salary increases for staff. Consequently, once people are trained by one organization, their skills are highly marketable and they may switch employers. Without adequate planning around staffing transitions, these changes can disrupt the implementation of OBCs.

- **Changing political administrations or management could shift priorities away from OBCs**. Some outcomes take a long time to be achieved and rely on long periods of tracking and evaluation. For example, most impact evaluations take three to seven years. In a constantly changing political environment, maintaining focus on the implementation of OBCs can be difficult as priorities fluctuate with changes in leadership. (Also, because most government entities' budgets cover only one year at a time, money for "bonuses" may not be available in future years.)

- **Changing processes and culture can be met with resistance.** Generally, governments see contracting and procurement as a necessary part of their work but not as an opportunity to drive better outcomes and improve government effectiveness. Similarly, members of the public often don't see government procurement as being directly linked to the quality of public services. Some states, such as Wisconsin, have even had to abandon PBC efforts in the face of public opinion and provider issues (Heinrich and Choi 2007).

Risks

Although OBCs present potential benefits for governments, service providers, and the communities involved, they also present risks that all parties should be aware of in order to manage or mitigate them. Although some of these risks can be closely connected to specific challenges, stakeholders should understand how OBCs may negatively affect government or service providers, because those effects are not always evenly distributed. Many of these risks can be easily managed; we offer a starting point in the Considerations section, which outlines considerations for OBC implementation.

RISKS TO GOVERNMENT

From the government's perspective, a few key risks could negatively affect a project or their community.

- **Pricing risk.** Even when the correct outcomes are selected, the government may set success thresholds and repayment triggers too high or too low. Incorrect outcome targets and prices often occur because governments have insufficient data to accurately price the outcomes and estimate the project's likelihood of success. Governments need to walk a tight line when pricing an outcome: set it too high, and the government is overpaying for the result; set it too low, and the service provider may be unable to cover its costs. Robust data and prior research are critical to accurate pricing because they help governments determine the likelihood (or difficulty) of achieving an outcome. Further, governments need to allow for future adjustments to

repayment schedules that account for external factors that affect providers' ability to achieve outcomes.

- » **Overpayment risk.** If the outcome payments are too easily achieved, the government overpays for results and has fewer resources to spend on other outcomes and services of interest. This risk to governments is financial. An example of this might be a home visiting program in which the government decides that an outcome of interest is a reduction in child visits to the emergency room. If the government sets the success threshold at a 50 percent reduction, but the program leads to a 70 percent reduction, the government has underestimated the likelihood of the program affecting that outcome. The government might thus have overpaid service providers for delivering on that outcome, and now fewer resources might be available for other outcomes of interest, such as reduced preterm births.
  - » **Underpayment risk.** If the government either makes achieving outcomes too difficult for providers or pays too little, the service provider market could shrink. If service providers are not paid adequately because the threshold for achieving outcome payments is too high, or providers are paid too little for outcomes that are achieved, some providers may shut down. This could reduce competition in the market, particularly in smaller jurisdictions that have only a few service providers for a given social service.

- ▪ **Outcomes selection risk.** If the wrong outcome measures are chosen or if the contract fails to include provisions that address quality, people receiving services may not benefit. For example, a workforce development contract that focuses solely on job placement might place a lot of people in new jobs, but governments should pay attention to the quality of the jobs obtained to help increase the financial well-being of people participating in the workforce program.

- ▪ **Perverse incentives risk.** Service providers may be incentivized to "cherry pick." This occurs when providers focus on people who are easiest to serve to maximize their successful outcome payments. Consequently, harder-to-help people, who likely have a greater need for services, may go unserved. In an Illinois Department of Children and Families child welfare program, providers were able to increase child permanency placements. However, they succeeded by focusing on the easiest-to-place children. Guidelines had to be put into place so that providers couldn't ignore children with more complex case histories (Garstka et al. 2012).

RISKS TO SERVICE PROVIDERS

A shift to OBCs can present additional burdens, and governments should fully understand and account for the risks from a service provider perspective. Some key risks to service providers include the following:

- ▪ **Programmatic risk.** The program may not work as expected in the local context. Holding providers to strict outcomes payments is complicated because so many complex factors affect human service delivery contracts. And some governments are hesitant to hold service providers accountable for bad outcomes if they think the outcome wasn't influenced by the intervention. Rigorous impact evaluations are often too costly and cumbersome for most OBCs,

making it difficult to confidently estimate whether the program or provider caused the change in outcomes.

- **Performance risk.** Service providers may have insufficient staff resources to serve the population and to input data accurately and timely. Many service providers operate with lean staffing models, and when time is tight, they choose to focus on delivering services. This may leave little time to enter data or review the results of their services. Consequently, service providers might miss payments because of scarce staff time for data entry, not because of their success at achieving outcomes. Before entering into an OBC, service providers should consider the impact of data entry and reporting on their staff.

- **Market risk.** The government may be the sole purchaser of the services provided and have more control over pricing than the service provider. A government's relationship with service providers can typically be classified as a monopsony, where one actor (the government) is the sole buyer in a market and can thus effectively dictate prices and contract terms. Although some providers have revenue from philanthropies and other nongovernment sources, a single state government agency often provides a large portion of a service provider's revenue. In the context of OBCs, this means that providers may have limited leverage or power to ensure that outcomes and pricing reflect their costs, programmatic expertise, and understanding of the local population.

- **Financial risk.** Service providers may not recover all their costs if a contract doesn't go as expected. When payments are tied to outcomes rather than service delivery costs, the risk increases that the provider may not recoup the full cost of delivering the service. This may cause some providers, which already operate within tight margins, to go out of business. In Kansas, an evaluation of an early experiment with PBCs in human services found that contractors (service providers) experienced financial problems because they lacked the necessary cost accounting systems and were subsequently unable to adequately project costs (State of Kansas 2005). In smaller jurisdictions with fewer providers, the loss of a single provider may be particularly difficult for the community to bear.

Many of these risks and pitfalls can be addressed by developing and implementing a plan to shift toward OBCs over time. The next section includes recommendations for implementing OBCs.

Considerations for Implementing Outcomes-Based Contracting

In this section, we walk through the primary decision points that stakeholders and officials will confront and offer guidance and some key questions to consider, drawing from emerging best practices from a few existing examples. Although each OBC will be unique, when negotiating the contract, all parties must be open to the concept of an outcomes-oriented contract and to outcomes monitoring, aware of the risks involved, and reasonably accommodating of the challenges and constraints each party faces.

Base Decisions on the Evidence and Data

Evidence and data should be at the heart of OBC decisionmaking. Ideally, prior research and evidence should demonstrate a link between the proposed intervention, the population being served, and the desired outcomes. Data are needed to inform how many people might benefit from the program and to determine which outcomes are measurable and could be used for outcomes-based payments. To select an evidence-based intervention, governments should do the following:

Review the evidence base for the intervention. Do studies exist of similar programs for similar populations, or were evaluations already performed on similar programs in your community? If so, did the studies find that the intervention had a beneficial impact on the outcome of interest? Does the study provide specific data that indicate the costs or outcomes of the program that would provide guidance for your OBC request for proposals or contract?

Use relevant local data to identify the service needs and the number of people to be served by the intervention or program. An important question for any program is who will it serve. Limiting a program's services to the people that need them the most can help ensure that the intervention is well suited to the local context and the outcomes are appropriate. Understanding the demographics and needs of the local population will also help inform payment strategies to mitigate cherry picking (discussed previously in the Risks section).

Select outcomes that can be measured and tied to payment. Once a target population and intervention are identified, evidence-based outcomes should be selected. Governments can use data on past service utilization and learn from other examples of the same intervention to articulate the right outcomes. For instance, if a jurisdiction wants to pay for reduced recidivism, knowing past recidivism rates for different subsets of the population is necessary for setting realistic outcome targets. In selecting outcomes, governments should also consider whether past evaluations of the intervention can provide a baseline for those outcomes. Other confounding factors can sometimes make comparison between the evaluation context and the OBC context difficult (e.g., a youth population in a study versus an adult population in an OBC).

A critical concern with OBCs is selecting outcome targets that aren't too difficult or too easy to achieve. In the former case, a well-intentioned government could penalize service providers if they can't meet the outcome targets and be fully paid. In the latter case, the program may lead to cherry picking and not really serve the people who need it the most.

Governments should consider asking a few key questions about an intervention's evidence base:

- What outcomes are under the control of the service providers and logically impacted by the intervention?

- Which of those outcomes could be measured in data, and when are they measurable?

- If rigorous research about the outcomes of interest does not exist, can it be developed?[4]

Ensure Data Systems Are Ready and Able

Data systems are important not only early in a project's development but also throughout the life of the program to track the outcomes. If a project is paying to improve housing stability, adequate and reliable systems must be in place to monitor the number of days a person is housed and report it to the appropriate agency. In Seattle, for example, the Human Services Department shifted to OBCs for homeless services by first focusing on getting service providers to improve their data collection and tying payment to improved data quality.

When assessing existing data systems, considering several elements of data quality is helpful:

- **Accuracy.** Metrics can sometimes mean different things to different people. It is important to ensure that metrics are well-defined and the system is measuring what partners think it should be measuring.

- **Completeness.** The data collection should have no major gaps, such as some information not being collected on particular groups of people.

- **Consistency.** Data should be collected in the same manner each time, for each person. In particular, staff members need to be trained to ask questions in a consistent manner for intake forms and other data collection tools.

- **Timeliness.** Data need to be collected within the time frame necessary for the project. If payments are made quarterly, data need to be collected at least that frequently. Further, if information is collected long after an event, it is less likely to be correct.

Governments will also need to consider data security issues and ensure that the correct agreements and protections are in place, such as data-sharing agreements and secure transfer procedures.

Governments should consider asking a few key questions about relevant data systems:

- Where are data stored, and are they managed by the government?

- Does the government or service provider enter the data?

- Can the existing data system track outcomes, or will it need to be adapted?

- Can the existing system handle increased usage by service providers and contract managers?

- What quality are the data stored in the system?

- What kind of training might be necessary on data entry and tracking or sharing?

- Are any additional client privacy provisions needed for data collection on specific outcomes?

Work to Enhance Government Staff Capacity

OBCs can place new and unique demands on the procurement officials who oversee them. Procurement staff could benefit from training on how to write requests for proposals and contracts for OBCs,

execute those contracts, work with data systems to monitor and verify results, and meet with service providers to discuss their performance and strategies for improvement. One of the challenges with OBCs is ensuring that procurement staff are well prepared to oversee the contracts and offer real-time technical assistance to service providers. Failure to augment staff capacity to meet these challenges can harm the overall success of the contract. For example, Wisconsin's workforce development OBC, the Wisconsin Works project, was found to have mixed results because of contract management challenges experienced by the government (Heinrich and Choi 2007). Governments should not expect to transition overnight to OBCs; they should sufficiently prepare staff and gradually make the shift. Many governments have used the help of technical assistance providers to help with internal staff capacity (including experts and organizations such as Harvard University's Government Performance Lab and the Urban Institute).

Governments should consider asking a few key questions about their staff capacity:

- What is the current staff capacity to implement an OBC (including monitoring data, reviewing evidence, and other steps), and where are the major gaps?

- Is the government likely able to fund the staff capacity needed to administer the contract in future fiscal years?

- What experience do procurement and contracting staff have with discussing performance measures with service providers or with training service providers in using performance measures? How can that experience be augmented?

- What experience do staff members have with using dashboards and other systems to track, monitor, and assess performance?

- Are sufficient information technology staff members available to ensure that data systems are operating the way they should?

- Does the government need assistance from an outside entity to make this shift?

Train and Engage Service Providers to Build Strong Programs

Governments should look to service providers as essential partners in developing OBCs. Providers often have extensive experience working with specific groups, knowledge of the challenges associated with their programs, and a strong desire to have a positive effect on their community. One common strategy to solicit feedback from providers is to issue requests for information.[5] Requests for information are a low-stakes tool to survey the field and get information on what outcomes providers think are possible and how to align payments with those outcomes. This information gathering can also be done in person through informal conversations about the opportunities, benefits, and challenges OBCs might present for service providers. Requests for information tend to be most effective when tied to a funding source, which motivates community members to engage in the process.

If governments are not using a request for information or a period for public comments, they should still be open during the negotiation phase of a contract to the concerns that providers raise about their

ability to achieve and price outcomes. This flexibility can include a "hold harmless" period in the contract, discussed further in a later section. This helps prevent the government from selecting outcomes targets that could unintentionally reduce payments to providers.

To improve provider readiness, governments should consider providing or helping procure technical assistance. Technical assistance could be offered at different points during the procurement and contracting process and cover a range of areas such as improving provider ability to help price outcomes, improving staff data capacity, improving data and technology systems, and building education around an outcomes orientation. Governments should solicit input from service providers to understand what training and support those providers need.

Once a contract is launched, governments should continue to meet with service providers to discuss the program, review metrics and outcome data, and consider opportunities for improvement. Active contract management[6] is a strategy to improve contract accountability that may require additional staff time on the part of the government and service provider to be implemented effectively. Governments should also anticipate the need to modify contracts over time and can use the information gathered by contract management conversations and performance reports to inform those adjustments.

Governments should consider asking a few key questions about service providers:

- Do service providers understand the financial implications of being paid for outcomes achieved, and can their accounting systems accurately predict their costs and revenue for the contract?

- What are the outcomes the service providers think they can impact and are willing to use for reimbursement?

- What data do service providers collect on those payment outcomes?

- What kind of training might be necessary for service providers?

- How can governments constructively engage service providers and other stakeholders in identifying outcomes, targets, appropriate pricing, and other elements of OBCs?

Determine the Most Appropriate Repayment Strategy

OBCs allow for several different payment strategies governments can use to incentivize achievement of outcomes. Governments can create a payment schedule that uses a different strategy for each outcome. Using different strategies and paying for different outcomes can reflect the fact that these projects typically have multiple goals, such as reducing recidivism and improving housing stability. Based on our review of existing projects, we have identified five main strategies:

1. Unit of outcome achieved. Potentially the simplest form of OBC is to have governments pay on a per person, per outcome basis. Governments will identify an outcome and assign a value for achieving that unit of outcome. Governments then agree to pay the service provider an agreed-upon amount for every client for whom the specified outcome was achieved. To determine the price, governments can work with providers to determine the costs associated with delivering the service and the value to the

government of achieving the outcome.[7] In the Denver Social Impact Bond, for example, the city is using a PFS contract to implement permanent supportive housing. The project is paying on two outcomes, one of which is housing stability (defined as the number of days a person remains housed within the service provider's unit). The contract pays $15.12 per person, per day, with days removed for time spent in jail.

2. Weighted incentives. Governments can encourage providers to serve harder-to-serve clients by adding weighted incentives or performance standard adjustments to compensate providers for the potential difficulty in serving these clients. San Francisco launched a workforce development program to encourage providers to focus on traditionally hard-to-serve communities, including clients with a criminal record, people with disabilities, and people with limited English proficiency. To do this, the city introduced a payment approach where a small portion of payment (2 percent) is linked to placing high-need clients into jobs that pay more than a minimum wage; another 2 percent is linked to placing any client into a job. The remaining 96 percent of contract payment is allocated based on the number of clients served.

3. Percent changes in outcomes. Governments can also pay on percent increases or decreases in an outcome, which can be structured in one of two ways. First, percent change can be measured against a historical baseline (either a benchmark set by the government or the provider's past success). One reason a historical baseline is advantageous is that it encourages providers to improve while giving some flexibility to lower-performing providers. The other option is to measure percent change against a comparison or control group. For example, the government may track returns to jail for a group of people over a period of time and compare that rate to a similar group of people not receiving services. Payment would then be based on the percent difference between the two groups. Although much more complex than the former structure, this has the benefit of showing that the provider caused or is the reason for the change.[8] In the Denver Social Impact Bond, the second payment outcome is related to the number of days a person spends in jail. For this outcome, success is being measured against a control group as part of a randomized controlled trial. Evaluators are tracking the number of days on average that the group receiving services and the control group spend in jail. At the end of the evaluation, a success payment will be made based on the percent difference between these two groups.

4. Tiered payment schedules. The government assesses provider performance and then assigns providers to different payment bands, with higher-performing providers being placed in higher performance bands. This has the advantage of giving lower-performing providers an incentive to improve in situations where they may otherwise be unable to compete with the highest-performing providers. The Tennessee Department of Children's Services child welfare program assessed service providers on days in care, permanency, and reentry, and separated them into three payment bands based on their success. Under this model, service providers are first judged on their performance on the three outcomes against their past results. Then they are placed into one of the three payment bands based on their previous standing. Higher-performing bands have higher blended daily rates and incentives (box 2).

5. Bonus payments. A bonus payment contract includes the total cost for basic service delivery as the baseline payment and then awards bonuses, in the form of additional payment, to service providers

that meet certain outcome targets. Bonus payments can be difficult to finance when a government is facing a fiscal crisis or is already trying to reduce the amount of services for which it contracts. However, this structure addresses the concern that OBCs could penalize providers for negative outcomes outside of their control. Governments frequently use cost-plus-award-fee contracts to incentivize performance; an OBC example of this would tie the award bonus to a social service outcome rather than an outcome related to contract performance (i.e., on-time delivery).

BOX 2

Tennessee Department of Children's Services

The Tennessee Department of Children's Services (DCS) began exploring using performance measures in its contracting in 2005 in an effort to reduce its reliance on out-of-home care and congregate care.[a] After working with service providers and a technical assistance provider,[b] DCS began a year-long hold harmless period with five pilot service providers. The contract is grounded in a longitudinal database that was developed and is maintained by the Center for State Child Welfare Data, and it contains the foster care trajectories of all children placed in out-of-home care. In Tennessee, agencies were initially tested against their past performance rather than the performance of others.

When the contract was developed, a "baseline-target-actual" method was used to measure change in agency performance over time. Baseline-target-actual methods are agency specific and create provider-specific, risk-adjusted (i.e., they account for the needs of the agency's specific target population) baselines for exits to permanency, care days used, and rate of reentry to care. Beginning in 2014, the state adopted baselines for each of the state's regions that applied to every service provider in that region (Lester 2016). In 2016, the model was further developed to include "performance banding," in which social service agencies are ranked and placed into either a high-performance, mid-performance, or low-performance band.

The payment structure is divided into two parts: a blended daily rate[c] and either a performance bonus or penalty. When providers exceed their baseline performance rate, DCS returns a portion of the savings generated back to the provider. The performance bonuses and penalties now differ based on performance band[d] and providers are evaluated every three years. In the first three years, the five pilot providers achieved an 8 percent reduction in care days and a 6 percent increase in permanent exits. Additional providers were included in the PBC until 2009, when all of DCS' contracted agencies were working under the PBC protocol.

Notes:

[a] "Performance-Based Contracting," Tennessee Department of Children's Services, accessed June 12, 2019, https://www.tn.gov/dcs/for-providers/performance-based-contracting.html.

[b] "Performance-Based Contracting in Tennessee's Foster Care System," Center for State Child Welfare Data, Chapin Hall at the University of Chicago, accessed June 12, 2019, https://fcda.chapinhall.org/wp-content/uploads/2018/02/Performance-Based-Contracting-in-Tennessee_2.2018.pdf.

[c] "Current Contracted Rates," Tennessee Department of Children's Services, accessed June 12, 2019, https://www.tn.gov/content/dam/tn/dcs/documents/for-providers/TN_DCS_Contracts_Rates.pdf.

[d] "Basic Principles of the Tennessee Department of Children's Services Performance-Based Contracting (PBC) Initiative," TN.gov, accessed June 19, 2019, https://www.tn.gov/content/dam/tn/dcs/documents/for-providers/PBC_Basic_Principles.pdf.

Governments should also consider the following:

Issues related to cherry picking. Regardless of the repayment strategy, governments must ensure that adequate provisions guard against perverse incentives, such as a service provider prioritizing easy-to-serve individuals. For example, a workforce development program may be designed to get unemployed people jobs, but a person with a college degree is likely easier to serve than a person without a high school diploma. Governments can guard against cherry picking by carefully defining the target population, monitoring provider performance to see if they are serving everyone and, when necessary, developing more robust outcome payment thresholds or performance standards adjustments.

The quality of the outcome achieved. Governments need to ensure that results that technically fulfill the outcome requirement match what the government intended. For example, a government wants to increase the number (or share) of low-income families receiving child care. However, an additional important service characteristic is the quality of that care. The government wants to assure that both outcomes are satisfied. The contract might cover each outcome measure separately or combine them into one measure (e.g., the number of child care placements for low-income families into programs that met specified quality levels measured in part by child safety and adult-to-children ratios).

Timing of payments to the contractor. This is an important issue for contracts that cover multiple years and have outcomes that take time to achieve. Most multiyear OBCs will need provisions for interim payments. These payments could be made on the basis of one or more of the previously listed payment methods. For example, an OBC could use a tiered payment schedule for regular service delivery and have a bonus for exceeding targets on an outcome that is more difficult to achieve.

Governments should consider asking some key questions when determining an appropriate payment structure:

- What payment structure makes the most sense for the program? In answering this, governments would benefit from considering the timing and likelihood of achieving the selected outcomes. That will depend on any existing evidence or past service delivery, procurement policies, and budgetary considerations (i.e., the availability of appropriations in the short or long term).

- What are the outcomes service providers think they can change and are willing to use for reimbursement? Governments should consult directly with service providers to answer this question. Technical assistance providers and consultants can also bring a helpful neutral perspective to these negotiations.

- What terms can be included in the contract to renegotiate if service delivery outcomes targets used in the original contract are found to be too high or too low?

Create a Phased Plan to Transition to Paying for Outcomes

Governments should work to ensure a smooth transition to OBCs by building in appropriate transition strategies. Developing and adopting OBCs should be an iterative process where the government and service provider work together to determine fair and equitable outcome targets the government can use for payment.

Develop a hold harmless period, during which service providers will be assessed based on their success, but payments will not yet be tied to those outcomes. This provides an opportunity to test the likelihood of achieving various outcomes and ensure service providers are familiar and comfortable with the OBC's outcome targets and planned payment structures. Hold harmless periods can vary in length based on the providers' existing capacity, the timeline to upgrade data services, and the need to expand or train new staff. Such a period can also be used to identify needed capacity improvements among providers and governments to ensure OBC implementation runs smoothly with minimal surprises, which will increase the government's ability to genuinely incentivize and reward outcomes.

Once the government is confident that the payment structure will not unfairly penalize service providers or create perverse incentives, it can move toward a full OBC. This can include gradually stepping up how much payment is linked to outcomes. For example, during the first year, only 20 percent of the payment may be based on outcomes, but that could increase in subsequent years. Regardless, writing contracts with some flexibility is helpful. Even after full implementation, governments might notice factors affecting outcomes that are outside of all parties' control and need to make contract modifications or adjustments for them. Further, payment thresholds may need to be adjusted annually to account for natural case load fluctuation and inflation.

After perhaps two or three years of full OBC implementation, the government can sponsor a review of the OBC process, preferably carried out by a third party. This review should not take the place of regular communication about results between the government and service provider. It could examine data on the current needs of the target population and use it to revise outcome improvement targets, recommend process changes to make the OBC management easier on government and service providers, and, if possible, compare data on outcome improvements against other similar communities.

Governments should consider asking some key questions of project partners while rolling out an OBC:

- Are service providers prepared for OBC implementation, or do they need additional training? Will a hold harmless period help them transition to OBCs?

- Are service providers hitting the expected success measures? Are they underperforming or overperforming? Are they encountering any unforeseen challenges, and are those challenges outside of their control?

- How are service providers changing their delivery approaches to achieve the desired outcomes?

- Do stakeholders have a high level of confidence in the data being collected, or do the data have quality or resource constraints?
- Are the chosen outcomes improving the lives of service provider's clients?

Conclusion

OBCs are one tool used by governments to get better results. OBCs can incentivize service providers to focus their efforts on delivering positive outcomes for people and their communities. This switch to OBCs offers benefits such as transparent contract goals and paying for results but also comes with challenges and risks.

Governments can mitigate some of those challenges by being deliberate at key decision points in the implementation of an OBC. This brief outlines six primary considerations, including a review of previous research on the program, the capacity of the data systems that can measure outcomes, and the service provider's ability to adapt to a new payment schedule. Governments should develop a plan to adopt OBCs that allows adequate time to train both service providers and their contract staff. The plan should also include time to review the OBC and its outcomes once it is being implemented to determine if the payment terms need any adjustments.

Adopting OBCs should be a collaboration between service providers and the government. It is ideal to engage the service provider community early, learn from their experiences, develop their data and outcomes reporting capacity, and help them learn how to use that information to adjust service delivery. Although OBCs are not appropriate for every situation, they have the potential to manage service provision using a continuous improvement feedback loop and better align the objectives of government and its contractors.

Notes

[1] For example, the current regulation that governs federal contracting, the Federal Acquisition Regulation, requires the use of performance-based contracting when contracting for services to the "maximum extent practicable." See Subpart 37.102 of US General Services Administration, US Department of Defense, and National Aeronautics and Space Administration (2019). See also our short brief on performance-based strategies (Brown, Eldridge, and Bieretz 2019).

[2] Governments can and do use OBCs for infrastructure and IT contracts, but for this paper, we focus on social service contracts.

[3] "Performance Based Contracting," Institute for Public Procurement, Principles and Practices of Public Procurement, accessed June 19, 2019, http://engage.nigp.org/acton/attachment/24793/f-01ce/1/-/-/-/-/Performance%20based%20contracting.pdf.

[4] If the services are new or lack previous research, jurisdictions can consider funding an evaluation and a pilot to build evidence before tying payment to outcomes.

[5] For more information see Hawkins and Bieretz (2017).

[6] According to the Harvard Government Performance Lab, active contract management is "a set of strategies... that apply high-frequency use of data and purposeful management of agency service provider interactions to improve outcomes from contracted services." See "Active Contract Management: How Governments Can Collaborate More Effectively with Social Service Providers to Achieve Better Results," Harvard Kennedy School Government Performance Lab, accessed June 19, 2019, https://govlab.hks.harvard.edu/files/govlabs/files/active_contract_management_brief.pdf.

[7] For more information, see Hatry et al. (2017).

[8] Comparison or control groups are used in the context of an impact evaluation, which is much more common in pay for success projects and which contributes to the complexity of those projects.

References

Brown, Madeline, Matt Eldridge, and Brian Bieretz. 2019. "Performance-Based Strategies: Defining Terms and Comparing Common Strategies." Washington, DC: Urban Institute.

Garstka, Teri A., Crystal Collins-Camargo, Jennifer G. Hall, Melissa Neal, and Karl Ensign. 2012. "Implementing Performance-Based Contracts and Quality Assurance Systems in Child Welfare Services: Results from a National Cross-Site Evaluation." *Journal of Public Child Welfare* 6 (1): 12–41.

Hawkins, Rayanne, and Brian Bieretz. 2017. "Procuring for Success." Washington, DC: Urban Institute.

Hatry, Harry P. 2006. "Performance Measurement: Getting Results." Washington, DC: Urban Institute.

Hatry, Harry P., Matthew Eldridge, Arden Kreeger, and Reed Jordan. 2017. "Making Sound Cost Decisions in Pay for Success Projects." Washington, DC: Urban Institute.

Heinrich, Carolyn J., and Youseok Choi. 2007. "Performance-Based Contracting in Social Welfare Programs." *American Review of Public Administration* 37 (4): 409–35.

Lester, Patrick. 2016. Building Performance Systems in Child Welfare: Lessons from Performance-based Contracting, Performance Management, and the Emergence of Social Impact Bonds. Social Innovation Research Center.

Lu, Jiahuan. 2016. "The Performance of Performance-Based Contracting in Human Services: A Quasi-experiment." *Journal of Public Administration Research and Theory* 26 (2): 277–93.

Martin, Lawrence L. 2005. "Performance-Based Contracting for Human Services: Does It Work?" *Administration in Social Work* 29 (1): 63–77.

Pettijohn, Sarah L., Elizabeth T. Boris, Carol J. De Vita, and Saunji D. Fyffe. 2013. *Nonprofit-Government Contracts and Grants: Findings from the 2013 National Survey*. Washington, DC: Urban Institute.

State of Kansas. 2005. "Minutes of the Joint Meeting with the SRS Oversight Committee & Children's Issues Committee of the Kansas State Legislature, September 26, 2000." In *The Challenge of Public-Private Partnerships*, edited by Graeme A. Hodge and Carsten Grove, 157. Cheltenham, UK: Edward Elgar Publishing.

US General Services Administration, US Department of Defense, and National Aeronautics and Space Administration. 2019. *Federal Acquisition Regulation*. Washington, DC: Office of Management and Budget.

About the Authors

Rayanne Hawkins is a policy program associate for the Pay for Success Initiative in the Research to Action Lab at the Urban Institute. Her research focuses on the intersection of PFS with procurement and criminal justice. She manages the Ask an Expert web tool for PFS and provides training and

technical assistance to PFS sites. Hawkins received her MBA from Georgetown University's McDonough School of Business, where she studied alternative financing for social programs.

Brian Bieretz is a policy associate with the Policy Advisory Group at the Urban Institute. He provides training and technical assistance to local governments interested in PFS. Previously, he worked for Sage Computing, where he wrote about housing and community development issues, and for the Maryland Department of Planning. Bieretz received his BA from American University and his MA in urban planning from University of Maryland.

Madeline Brown is a policy assistant in the Research to Action Lab at the Urban Institute, where she works on a range of projects, including PFS. Before joining Urban, she worked at FairVote, a nonprofit focused on US electoral reform, providing research and analytical support. Brown received her BA in political science and Spanish from Emory University.

Acknowledgments

URBAN
INSTITUTE

2100 M Street NW
Washington, DC 20037

www.urban.org

ABOUT THE URBAN INSTITUTE

The nonprofit Urban Institute is a leading research organization dedicated to developing evidence-based insights that improve people's lives and strengthen communities. For 50 years, Urban has been the trusted source for rigorous analysis of complex social and economic issues; strategic advice to policymakers, philanthropists, and practitioners; and new, promising ideas that expand opportunities for all. Our work inspires effective decisions that advance fairness and enhance the well-being of people and places.