Pay for Success

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Questions and Answers

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1. What is "pay for success"?

Under a "pay for success" or "outcome-based" contract, a government pays a service provider for achieving pre-defined outcomes for the population served. This contrasts with a more traditional model, where providers are paid a set amount for delivering a certain level of services. For example, a traditional contract for job training might specify the number of individuals to be served, the number of hours per week of class, and the curriculum to be used. As long as these criteria were met, the service provider would be paid. Under a pure pay for success contract, the provider would only be paid if the participants got jobs. Depending on the contract, the means to this end – the number of hours and the curriculum – might be specified, or left up to the provider's discretion.

2. Is "pay for success" new?

While the use of the term "pay for success" has increased in recent years, the concept has been around for decades. There is a long history of performance-based contracts in a range of policy areas, especially in job training, welfare-to-work, and child welfare programs. Under such models, service providers are typically paid a set amount when participants achieve certain milestones, such as entering employment, or avoiding foster care for a certain period. Contracts can be either entirely performance-based, or combine base payments for services with additional incentives for performance.

3. What is the difference between "outcomes" and "impacts"?

In the evaluation literature, there is an important distinction between "outcomes" – how participants in a program fare – and "impacts" – what *difference the program made*. Impacts measure whether participants are better off or worse off than they would have been in the absence of the program. The gold standard for measuring program impacts is a random assignment evaluation, where the outcomes of program participants are compared to the outcomes of people who are otherwise identical, but who did not receive the services. Because programs are only one factor in determining outcomes, there is not necessarily a correlation between the programs with the best outcomes and the programs with the largest impacts. For example, a program serving a disadvantaged population may have greater *impact* --measured by how frequently the program participants get jobs compared to others like them who don't have access to the program -- than one serving a more advantaged population, but it is likely to achieve lower *outcomes*, measured by the number of participants who get jobs..

This matters a lot for performance measurement. In the example above, if providers are paid based on outcomes, the one serving the more disadvantaged population will be penalized. Even worse, providers will have an incentive to "cream," or only serve the people who are more likely to have positive outcomes – even if they would have had these outcomes whether or not they received services. Moreover, external factors such as a recession can have a dramatic effect on whether programs achieve the desired outcomes.

4. What are the benefits of "pay for success"?

Under a traditional contract, governments pay for services whether they are effective or not. In this era of tight budgets, the idea that the government could pay only for proven results has a broad appeal. In addition, many traditional contracts specify the services that must be provided in great detail. Pay for success contracts open up the possibility of providing service providers with more flexibility to experiment with new models of services, or to package services in more effective ways.

5. What are the challenges of "pay for success"?

Pay for success contracts can be very challenging. First, there must be agreement about what are the desired results, and how to measure them in ways that reflect the value added by services. While this is an important conversation, it can often bring to the surface disagreements between stakeholders that have previously been hidden. It is also critical to have agreement about whether there are expectations about a minimum level of services that all eligible participants will receive. Creaming is often a significant concern for performance-based contracts, as there is little incentive for programs to serve the most disadvantaged individuals, who may well require help that costs more than the agreed-upon payment. High-stakes performance measures can also result in skewing services to focus on the selected outcomes of interest at the expense of other aspects of a program ("tunnel vision") or a focus on the measured indicators but not the actual outcomes of interest ("teaching to the test").

Small service providers often find the need to provide services up-front (and pay staff and vendors) while waiting for payment particularly challenging. Thus, a shift to performance-based contracts may advantage larger organizations and for-profit entities over small neighborhood-based providers, regardless of the quality of the services they offer.

6. What is a "social impact bond"?

A social impact bond (or SIB) is one type of pay for success mechanism, under which the contract for achieving the outcome is not directly with the service providers, but with a private investor (which could be a for-profit investor or a foundation) who puts up the initial funding, and receives a profit if the specified outcomes are met. The investor then contracts with service providers (either directly or through an intermediary) to actually deliver the services needed to achieve these ends. This therefore shifts the burden of providing the initial funding and the risk of non-performance from the service providers to the investors. Moreover, because the time frame for repayment can be longer, a SIB can be evaluated based on impacts, not just outcomes.

7. Do SIBs save money?

SIBs are often promoted as a way to save money by increasing investment in prevention-focused services that will result in enough savings to pay for themselves. However, because of the need to pay for the evaluation and the intermediaries, as well as the profit for the investors, a successful SIB always more expensive than simply paying for the same services with direct government funding. In addition, at this early stage in their history, SIBs involve significant up-front investments of time, attention and money in order to identify the partners and negotiate a contract.

For more information, see: http://www.clasp.org/SIB