

AN EXAMINATION OF PERFORMANCE BASED CONTRACTS TO PURCHASE SOCIAL SERVICES FROM NON-PROFIT SERVICE PROVIDERS

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EXECUTIVE SUMMARY

The purpose of this report is to explore the use of Performance Based Contracts (PBCs) to purchase social services from non-profit service (NPO) providers. The Housing Policy Branch (HPB) commissioned this report because BC Housing, a crown corporation they work very closely with, has indicated a desire to implement PBCs to purchase support services for homeless people. The intent of the report is to provide HPB with valuable information regarding the use of PBCs in the social sector and high-level recommendations for implementing PBCs.

The report is based on a review of academic literature related to PBCs and a scan of four America jurisdictions, Oklahoma, New York City, Illinois and Kansas, which have implemented them to purchase social services from non-profit service providers.

The report found that PBCs should not be implemented with procedural agencies. According to Wilson, procedural agencies are defined as agencies in which the outputs or their work are observable, but the outcomes are not. The outcomes are often not observable because their achievement requires the interaction of multiple factors outside the control of any one agency. By basing at least a portion of payment on the achievement of outcomes, PBCs unfairly hold procedural agencies accountable for outcomes that are beyond their control. This places a great deal of risk on procedural agencies and threatens their financial security. Since procedural agencies only have direct control over inputs and outputs, their contracts can only be based on these elements

All four jurisdictions studied implemented PBCs with procedural agencies. While outcomes improved in Oklahoma and Illinois after PBCs were implemented, it cannot be concluded that PBCs resulted in the improvements. Once again, outcomes in procedural agencies involve the interaction of numerous different factors; none of these jurisdictions conducted a program evaluation that took into account the multiple factors involved. Therefore, the improvements in outcomes may be the result of factors other than PBCs.

Another key theme that arose from the academic literature and the jurisdiction scan is that there are multiple, practical barriers associated with implementing PBCs. These barriers include challenges in selecting goals, performance measures and targets, creating distortions that deteriorate the quality of services, and overburdening service providers. Oklahoma, NYC and Illinois were able to address many of these practical barriers. However, Kansas was not able to successfully address these barriers. As a result, the implementation of PBCs in Kansas caused service providers to experience severe financial problems. This demonstrates that if the practical barriers are not addressed, the implementation of PBCs will result in immediate financial problems for service providers.

Ultimately, PBCs can only be implemented with agencies that have control over outcomes. With these agencies, the problems related to unfair risk are avoided. Therefore, it is reasonable to hold them accountable for outcomes. However, it is essential to note that even when implementing PBCs with agencies that control

outcomes, there are numerous, practical challenges that must be addressed. If these practical issues are not addressed, it will result in significant problems for service providers and governments alike.

Based on the experience of the above jurisdictions and the academic literature associated with PBCs the following recommendations are made for implementing PBCs in the social services sector:

- 1) **Use PBCs selectively** - PBCs can only be implemented with agencies that have control over outcomes. If service providers do not have control over outcomes, which is often the case in the social services sector, it is impossible to base a portion of payment on them; there is no way to verify if outcomes are the result of the service providers' actions.
- 2) **Performance measures should include inputs and outputs** - This will help ensure that the contracts encourage service providers to focus on the full spectrum of service delivery and not too narrowly on a few outcomes. Moreover, it will reduce the risk placed on service providers as it results in them being reimbursed for inputs and outputs and not just outcomes, increasing the chance that they will at least be paid for a portion of the contract.
- 3) **Engage service providers** - From the very initial stages it is essential that governments engage service providers in the development of PBCs. PBCs represent a fundamental change in the nature of government contracts. Service providers may be resistant to making any changes and oppose the implementation of PBCs. Working collaboratively and engaging them will significantly help to overcome this resistance.
- 4) **Select appropriate performance measures and targets** - Selecting appropriate performance measures and targets is essential to the success of PBCs. To do this government should develop a clear understanding of the goals that they want a particular program to achieve. Second, government should work closely with service providers in developing the performance measures and targets. Finally, the targets, if possible, should be based on baseline data.
- 5) **Structure payment schemes to avoid creaming** - Government can go a long way to avoiding creaming by simply offering a higher payment for individuals who are more difficult to serve. In collaboration with service providers, criteria could easily be developed to define which types of clients would be deemed "difficult to serve" and, thus, warrant a higher payment.
- 6) **Build the capacity of service providers** - Government must be willing to invest the resources required to develop the capacity of service providers to operate under PBCs. For example, government should be willing to purchase computer and software packages to enable service providers to store data; they must provide training to help service providers develop the skills needed to operate under the system; and they should offer on going support to help service providers address any technical problems they may experience with PBCs.

- 7) **Continually review and adjust PBCs** - Once PBCs are implemented it is important to consistently review and, if required, revise the system. This will entail closely monitoring the performance of service providers, working closely with them to identify any issues, and having the flexibility to make changes to improve the system.
- 8) **Acknowledge the limitations of PBCs** - PBCs cannot inform decision makers why outcomes were or were not achieved. Therefore, they cannot be used to make targeted interventions to improve services or provide information regarding the allocation of resources.
- 9) **Involve an evaluation team in the design of PBCs** - This team will have the knowledge and the experience to help determine if the service providers have control over the outcomes, thus, helping government to avoid implementing PBCs with inappropriate agencies. In addition, they will be able to help select appropriate performance measures and targets.

Ultimately, implementing PBCs is not an easy task. To implement them and avoid causing hardships for service providers requires a significant investment of time, energy and money. If governments are not willing to make this effort, they should not implement PBCs.

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INTRODUCTION

Performance based contracts represent a fundamental shift in the nature of contracts between government and non-profit service providers. Under PBCs, government contracts shift from their historical focus on input and output measures, to outcome measures.

For the purpose of this report, De Lancer Julnes' (2006, p. 222) definition of inputs, outputs and outcomes are used.

- inputs are defined as the resources used to produce outputs. These may include dollar costs, staff and staff time, materials and other resources;
- outputs are defined as the final product or service delivered that ultimately, it is hoped, will lead to a desired outcome;
- outcomes are the consequences of outputs; they are the end result that is sought from the service.

Under PBCs, at least a portion of the service provider's reimbursement rate is based the achievement of outcomes.

The use of PBCs to purchase services from non-profit service providers is highly contentious. Proponents argue that by focusing on outcomes, they provide service providers with an incentive to deliver outcomes, afford them the flexibility to focus less on government design specifications and more on meeting their clients' needs and to experiment with new forms of service delivery. As a result of these factors, it is argued that PBCs will improve the efficiency and effectiveness of contracted service providers. Since they monitor the outcomes that service providers deliver, they afford these benefits without compromising governments' accountability requirements.

On the other hand, opponents argue that the use of PBCs to purchase social services from non-profit service providers is unfeasible and unrealistic. They base this on several factors; first, they argue that due the complexity of social services, it is extremely difficult, if not impossible to directly attribute outcomes to any single service provider; second, they argue that NPOs do not have the capacity to operate under PBCs; third, they feel that PBCs place too much risk on NPOs. As a result of these factors, they conclude that PBCs will have a detrimental impact on NPOs and erode the quality of services that they deliver.

The Housing Policy Branch (HPB), a branch of the Office of Housing and Construction Standards, commissioned this report to examine the use of PBCs to purchase social services from NPOs in the social service sector. They have requested that the report explore the following issues:

- potential benefits to implementing PBCs;
- potential risk with implementing PBCs;
- strategies to overcome/mitigate the risks;
- other jurisdictions' experience with PBCs; and
- recommendations for implementing PBCs.

To satisfy the requirements established by HPB this report is divided into seven sections. The first section, the background, provides contextual information regarding the client and explains their interest in PBCs. The second section discusses the methodology used in preparing this report. The third section reviews the literature related to PBCs. The literature review will define PBCs, briefly explain how they work and explore the potential benefits and risks to using them. The fourth section provides a cross jurisdictional scan of four regions' experience with PBCs. The cross jurisdictional scan will analyze how these jurisdictions have structured PBCs, the process they used to implement them and analyze what happened after PBCs were implemented. The fifth section will synthesize the literature review and the jurisdictional scan. It will pay particular attention to the barriers that jurisdictions faced in implementing PBCs and the steps they took to address them. The sixth section will provide a series of high-level recommendations for implementing PBCs. The final section will provide a summary of the information presented throughout the report.

BACKGROUND

The client for this report is the Housing Policy Branch (HPB), a branch of the Office of Housing and Construction Standards, Province of British Columbia. According to its service plan:

HPB is responsible for developing provincial housing policy, strategies and programs and for providing policy advice on specific issues such as housing markets, social housing, homelessness, and housing for persons with special needs. The branch also publishes research and guides on housing issues (Government of BC, OHCS Service Plan, 2007, p.25).

As this description indicates, HPB is a policy shop and is not responsible for delivering services directly to the public. The vast majority of housing related services are delivered by BC Housing, a crown corporation. HPB and BC Housing work collaboratively as BC Housing implements the policies developed by HPB.

A key goal for both BC Housing and HPB is to reduce the number of homeless people in BC by providing them with support service and access to stable, supportive housing (Housing Matters BC, 2006). To this end, BC Housing delivers such services as homeless shelters, outreach services for the homeless and supportive housing for homeless people.

Homeless shelters are an important component of the support services provided to homeless people in British Columbia. The current budget for the Emergency Shelter Program is \$57 million and there are approximately 1,300 government funded shelter units in BC. According to BC Housing, shelters fulfill to following functions:

As the primary function, emergency shelters provide temporary accommodation and essential services designed to meet the essential, immediate needs of the homeless for shelter, food and security. Shelters provide short-term responses to the challenge of homelessness. Their function...is to [also] act as a gateway to stable housing and support services. To fulfil this gateway role, emergency shelter providers will need to provide access to on-site support services within the shelter or drop-in facility; external linkages to key services such as health care, addictions treatment, or employment programs will need to be in place. Combined, the essential and gateway services comprise the core service functions of emergency shelters (BC Housing Shelter Program Framework, p. 1, 2008).

Based on this description, shelters are responsible for providing emergency services and connecting people to supports that will help them transition off the streets; they are not responsible for providing individuals with stable, permanent housing, or for outcomes related to the services they referred their clients to.

The Homeless Outreach Program (HOP) is another important service offered to help homeless people transition from life in the streets to permanent housing.

HOP provides outreach services in approximately 40 communities across BC and has a budget of \$4 million. The following is BC Housing's description of the program:

BC Housing staff work in conjunction with community providers to engage individuals who are homeless or at risk of homelessness and link them to the appropriate services and housing. Outreach workers undertake a wide range of support activities. [For example they] address [clients need for] immediate physical and safety needs, such as food, warm clothing and a place to stay; connect people with housing and income support, including making and accompanying them to appointments; provide links to other support services, such as life skills training, personal health, household and financial management, and crisis intervention; and act as a landlord liaison (BC Housing, 2008)

In many respects HOP is similar to the shelter program as it focuses on connecting individuals to services that meet their unique needs.

Permanent supportive housing is a third service the BC Housing provides to help homeless people transition from life in the streets to stable housing. The Province has committed to develop 4,000 units of supportive housing; currently there are approximately 2,400 supportive housing units for homeless people in BC. These units provide homeless people with long-term housing, integrated with supports. The support services include employment training, life skills training and addictions support. The types of support services provided depend on the target population. Clients are permitted to live in these units for a number of years. Unlike homeless shelters and outreach programs, providers of supportive housing have direct control over keeping formerly homeless people permanently housed; the operators of these units control the housing units and are responsible for providing the supports that will help the client to remain housed.

A key priority for HPB and BC Housing has been to enhance the services provided to homeless people. The majority of BC Housing services for the homeless are contracted out to NPOs. PBCs have been identified as a potential means to enhance the quality of service provided by NPOs without requiring an increase in the funding they receive. However, there are also some reservations regarding PBCs. Currently, they are not being used by BC Housing to purchase services for homeless people. Implementing PBCs would therefore fundamentally alter the contracting regime. HPB is concerned that PBCs could have a detrimental impact and erode the quality of service they provide. This concern is based on several factors:

- There are significant transaction costs associated with PBCs. They require significant investment to develop, implement and monitor.
- PBCs may place too much risk on service providers and as a result cause them financial problems.

The implementation of PBCs to purchase social services from NPOs is a contentious matter. Currently, HPB does not have enough information to advise

BC Housing on how to best use them. This report will address this lack of information.

METHODOLOGY

The methodology for this report consisted of reviewing the literature related to the use of PBCs to purchase social services from NPOs and of conducting a jurisdictional scan of the experiences with PBCs in four jurisdictions. The literature was gathered from multiple sources, including academic journals, books, government reports, and reports published by think tanks. The literature review is primarily based on the academic sources, while the jurisdiction scan is primarily based on government and think tank reports.

The jurisdiction scan analyzes the experience Oklahoma, New York City, Illinois, and Kansas with using PBCs to purchase social services from NPOs. Oklahoma was chosen as it is identified as a leader in the field of PBCs (Vinson 1999, Frumkin 2001, Boyle, 2002, and Martin 2002). New York City was included because they have implemented PBCs with NPOs that deliver services to the homeless, which is particularly relevant as HPB/BC Housing are responsible for providing these services. Illinois was included as it is identified as a leader in the field (Vinson 1999, Martin 2002). Finally, Kansas was included as it provides an example of the detrimental impacts that implementing PBCs can have.

Three of the four regions included structure their PBCs differently. This variety was planned to illustrate the flexibility in the structuring of PBCs.

There are several limitations to this report. First of all, it is an exploratory analysis. At the request of the client, it introduces the concept of PBCs, analyzes their benefits and risks, provides an analysis of how they work and provides recommendations for how develop them. It is not an implementation strategy. It does not include a detailed description how PBCs should be structured, which performance measure should be used and how they should be implemented. While these are important considerations, they are beyond the scope of this report.

Another limitation is that the report only includes jurisdictions from the state and local level in the United States of America. The primary reason for this is that the vast majority of literature pertaining to the use of PBCs to purchase social services from NPOs, studies jurisdictions in the United States.

The social context in the United States is different from that in British Columbia. Therefore, the examples and lessons learned may not be completely applicable to British Columbia. While there are some differences in context, they are not likely large enough to discount the lessons from these regions. Ultimately, the report will provide information on the fundamental concepts and principles of PBCs that would be generically relevant.

LITERATURE REVIEW

This section of the report analyzes the literature related to the use of PBCs in the social service sector. It will begin by briefly discussing the government contracting regimen. This part will explore why governments contract with NPOs, how traditional government contracts have been structured and the problems that arise as result of traditional contracts. The next part will define PBCs and establish why governments have implemented them. The final section will explore the benefits and problems/risks associated with PBCs.

The government contracting regimen

Governments across Canada rely on non-profit organizations (NPOs) for the delivery of social services. Governments primarily secure the services of NPOs through the process commonly referred to as 'contracting out'. Through this process governments and NPOs enter into a legally binding agreement (a contract) in which government agrees to pay an NPO in exchange for the specific services rendered (Perrins, 2006).

Governments have contracted out the delivery of social services to NPOs because it is believed that they can offer better quality, more cost effective services (Smith and Lipsky, 1993). NPOs are self-governing, non-profit distributing, and community-based organizations. Thus, they occupy a social position in which they are free from the pressures of broad-based public opinion and the demands of shareholders (Frumkin, 2001). It is argued that these characteristics enable them to focus specifically on their clients, be sensitive to their needs, and be flexible and innovative in the delivery of services (Smith & Lipsky 1993; Frumkin, 2001). Consequently, these factors enable them to deliver high quality, cost effective services.

The contracting out of social services presents an accountability dilemma as organizations that are not under the direct control of democratically elected officials are awarded public money. Since contracted out services are financed by public money, governments have the responsibility to monitor and evaluate the performance of service providers (Mulgan, 1997). If the government does not develop a mechanism to monitor contracted service providers, the public will have no way of knowing how its money is being spent and if they are receiving a quality product for their money.

Monitoring and evaluation requirements are established in the contracts between governments and service providers. Compliance with contract requirements largely determines if service providers will be paid. Thus, the structure of the monitoring and evaluation requirements has a fundamental impact on the design and, in turn, quality of the services provided (Peat & Costley, 2000).

Traditional government contracts have been structured in two ways, cost reimbursement or unit cost (Else, Mirr & Whelllock 1992; Martin, 2003). Under cost reimbursement, contractors are reimbursed for the expense of producing and delivering a service. This type of contract focuses on the inputs that go into

the service and how the service is delivered. The monitoring techniques under cost reimbursement focus on the “structure and processes of the service delivery, such as fiscal auditing, license requirements, and personnel qualifications (Peat & Costley, 2000, p.23). In these contracts, governments monitor, evaluate and, in turn, reward, service providers according their ability to meet program design specifications.

Fixed fee for service contracts focus on the outputs, or units of service, that a contractor provides. With fixed fee for service contracts, service providers are paid a fixed amount per unit of service that they provide. The total amount they are paid is dependent on the volume of service that they provide (Else, Mirr & Whellock 1992; Martin, 2003). For example, a group home provider would be paid based on the number of children they care for, within a given time frame. Monitoring techniques generally entailed contractors collecting and reporting data on the amount of outputs, or units of service, they provide in a given time frame (Martin 2003).

Numerous authors argue that the traditional types of government contracts have a detrimental impact on the quality of services delivered by NPOs (Behn and Kant, Martin, and Frumkin). They draw this conclusion based on several points. First, they argue that by focusing on inputs and outputs, governments exert too much control over the services being delivered and, thus erode the autonomy of NPOs. Second, they argue that basing payment on inputs and outputs creates a distorted incentive structure as it encourages service providers to maximizing the volume of service being delivered and not on achieving outcomes.

On the other hand it is argued that contracts that focus on inputs and outputs are the most appropriate for purchasing services in the social sector (Perrin, 1998 and Schlesinger and Dorwart, 1989). It is felt that they are the most appropriate because service providers only really have direct control over inputs and outputs; therefore it is only fair to hold them accountable for these elements. Second, inputs and outputs are often the only elements that can be accurately measured in the social services. As a result, government can only assess service providers based on these factors.

The sections on the benefits and problems/risk will more thoroughly explore the debate regarding PBCs versus traditional, input/output based contracts.

Defining performance based contracts

Martin (2000) defines PBCs as contracts “that focus on the outputs, quality and outcomes of service provision and may tie at least a portion of contractor’s payment, as well as contract extension or renewal to their achievement” (p.32). PBCs represent a fundamental shift from traditional government contracts as they hold service providers accountable for inputs, outputs and outcomes, while traditionally they were only held accountable for just inputs and outputs.

Two essential points flow from Martin’s definition. First, it demonstrates that in many cases, PBCs define performance as a multidimensional concept consisting of inputs, outputs, and outcomes (Martin, 2002). Thus, PBCs often reward

contractors for multiple components along the service delivery continuum, including inputs and outputs, but stressing outcomes.

Second, this definition implies there is no one, universal way to structure PBCs. In fact, jurisdictions that have implemented PBCs, have structured them in numerous different ways. The Quality Improvement Centre on the Privatization of Child Welfare Services (2006) reviewed jurisdictions that implemented PBCs and found that their structure differed in the following ways:

- **Timing of payments** – Some contracts reimburse service providers retrospectively, that is they only pay service providers once they demonstrate that they have met the performance requirements. Others pay providers prospectively, meaning that they pay a portion upfront, to enable providers to cover administration costs.
- **What information they collect** – PBCs vary according to the information that they require service providers to report. Some require information on inputs, outputs and outcomes, while others only require information on outputs and outcomes.
- **Payment structure** – In certain cases contracts only include outcome based performance measures and, thus, only reward service providers when these outcomes are achieved. Conversely, some contracts include input, output, and outcome performance measures, rewarding service providers for each component of the services they provide.

There is a great deal of flexibility in how PBCs are structured. The unifying feature of PBCs is that, in varying degrees, they shift the focus of contracts from inputs and outputs to outcomes.

What do performance based contracts entail?

PBCs are able to shift the focus of government contracts by incorporating performance measures, which include measures based on outcomes, and make payment contingent on meeting them. The contracts do not include design specifications for how the service provider should achieve the performance measures; they afford service providers the autonomy to determine for themselves how to best meet them. Thus, the focus of the contract is on meeting the performance measures.

PBCs have evolved from the performance measurement systems implemented in both the private and public sector (Heinrich, 1999; Blasi, 2002; and Propper & Wilson, 2003). The Government Accounting Office defines performance measurement as:

The ongoing monitoring and reporting of program accomplishments, particularly progress towards pre-established goals...performance measures may address the type or level of program activities conducted (process), the direct products and services delivered by a program (outputs), or the results of those products and services [outcomes] (GAO, quoted in Gagné, 2007, p.2).

PBCs represent the practice of incorporating performance measurement principles into government contracts. PBCs are simply an application of performance measurement.

A vital component of PBCs is articulating the goal/goals for a program. Goals establish what the program should ultimately achieve. All of the work undertaken by the service provider should lead to the identified goal/goals. At the highest level, the goals of most social services are to improve the quality of life outcomes for the clients being served. For example, a goal for a supportive housing service provider could be to provide a homeless individual with the supports they need to maintain a stable, safe and permanent home.

The second key step in PBCs is to develop the performance measures that are to be included in the contract. These are important as they will be used to determine if the goal is being achieved. The United States Office of Management and Budget (USOMB) define performance measures as, “the indicators or metrics that are used to gauge program performance. Performance measures can either be output or outcome measures” (2003, p. 2). In many cases, in the social sector, the exact goal cannot be quantified by a single measure, thus, the measures that are developed are often proxies that are used to represent the goal and determine if it is being achieved.

A third component of PBCs is establishing the targets to be included in the contract. Targets can be defined as the “quantifiable or otherwise measurable characteristics that tell how well a program must accomplish a performance measure” (USOMB, 2003, p. 2). They establish the level of performance that the government contracting agency expects the service provider to achieve. Under PBCs, at least a portion of the service providers’ payment is based on their ability to meet the established targets.

PBCs require service providers to develop a new set of skills. Under traditional contracts service providers only had to concern themselves with inputs and outputs. The requirements under PBCs are different as they must focus on outcomes, as well as inputs and outputs. This means that they must be able to work with governments to select goals, performance measures and targets based on outcomes. Furthermore, the data requirements will be different as they will have to track information on outcomes and not just inputs and outputs. If service providers are not able to develop the skills to deal with these new requirements, they will not be able to operate under the system.

Potential benefits of performance based contracts

PBCs have been implemented with NPO service providers because it is believed that they will enhance governments’ ability to hold service providers accountable, improve performance, and outcomes. It is argued that they are able to do this because they afford NPOs a greater degree of flexibility in designing their services, lead government and service providers to focus on outcomes and enable government to allocate resources to programs that deliver positive

outcomes (Behn & Kant 1999; Frumkin 2001; Martin 2000, 2002, 2003, 2005; Boyle, 2002).

Proponents of PBCs argue that a major benefit of these contracts is that they afford NPOs a higher level of autonomy compared to conventional government contracts (Frumkin 2001; Martin 2005). Under this system, the contracts state the performance levels that service providers must achieve, but they do not state how the service has to be designed and delivered; the service provider is afforded the freedom to design the program as they see fit. Therefore, NPOs do not have to focus their attention on meeting government design specifications. As result, NPOs have a greater degree of control over the design and delivery of social services. This enables them to focus their attention on meeting the needs of clients, instead of government contract requirements. It is argued that this results in more effective, client centred services.

It is also argued that PBCs afford NPOs' autonomy without compromising government's accountability demands (Frumkin, 2001; Boyle 2002). By focusing on outcomes, PBCs enable government to determine if the money they are spending is having a positive impact. In turn, this enables government to demonstrate to the public that they are spending public funds wisely. They can do all this without dictating to NPOs how they should deliver services. Therefore, this leads supporters of PBCs to conclude that they strike an effective balance between accountability and autonomy.

Another potential benefit that arises from not prescribing how services will be delivered is that it provides NPOs with the opportunity to experiment with new methods of service delivery. In turn, this affords them the opportunity to develop new and innovative programs that may result in better outcomes.

Under PBCs, at least a portion of service providers' payment is contingent upon delivering specified outcomes. This provides service providers with a financial incentive to achieve the specified outcomes. It is argued that the payment structure of PBCs will lead to better quality services because they reward, and thus, encourage service providers to focus their efforts on achieving outcomes and not on maximizing the volume of service, as is the case with traditional government contracts (Behn and Kant, 1999).

PBCs clearly articulate what government expect NPOs to deliver. This helps to clarify the purpose of the contract and, in turn, helps NPOs to focus their efforts on common goals and purposes. In fact, a study by the United Way of America found that 88 percent of service providers felt that PBCs helped them to clarify the purpose of their program and 88 percent found that they helped them to focus on common goals. According to the respondents of the survey, PBCs help them to set priorities and direct the investment of resources accordingly (2000).

Another benefit identified in the literature is that PBCs result in less, but more meaningful contract monitoring. With PBCs monitoring is "primarily concerned with determining and validating the extent to which the desired performance is achieved" (QICPCWS, 2006, p.16). Therefore, NPOs do not have to provide detailed information on the inputs that are required to deliver a service or

describe how the service was delivered; rather they only need to report if the performance standards were achieved. “In short, PBCs can reduce time dedicated to contract monitoring when contracts specify a limited number of outputs and outcomes that are monitored over time” (QICPCWS, 2006, p.16). In theory, this enables service providers to devote more resources to meeting the needs of their clients; resulting in improvements in the quality of services delivered.

It is argued that by tracking performance PBCs enable government to analyze the effectiveness of NPOs (Kettner and Martin, 1995). This will help to improve the quality of services as it will demonstrate to government and NPOs if results are being achieved or not. If they are not, corrective measures can be taken to improve the quality of the service. Moreover, if they continue to fail to meet performance standards, government can cease to contract with them and direct resources to those NPOs that do deliver results (Heinrich, 1999). Ultimately, this enables government to spend money more effectively, as it will enable them to contract with NPOs that consistently produce the desired outcomes and avoid spending on those that do not.

Finally, according to Behn and Kant, PBCs encourage NPOs and government to work collaboratively in an effort to deliver the best possible results for clients. Under PBCs government and service providers enter into an agreement that is focused on achieving outcomes. Both parties will be judged according to their ability to do so. Thus, both have a vested interest in working together to ensure that the best possible results are achieved.

Concerns/Problems with performance based contracts

Numerous authors (Kravchuk & Schack, 1996; Perrin, 1998; Heinrich, 1999; Feller, 2002; Blasi, 2002; Propper & Wilson, 2003; Carrilio, Parckard & Clapp, 2003; Gagné, 2007) have raised concerns with performance measurement or the implementation of PBCs in the social service sector. At a fundamental level, critics argue that PBCs cannot be implemented in the social services sector because achieving an outcome is incredibly complex and involves the interaction of numerous different macro and micro factors beyond the control of any single service provider. Since the factors that influence the achievement of outcomes are outside the control of service providers it is unfair to hold them accountable for outcomes. In addition, critics have pointed to numerous practical challenges associated with implementing PBCs. These criticisms tend to focus on the difficulty of selecting goals/performance measures in the social sector and NPOs lack of capacity to operate under PBCs.

This section is divided into two parts: the first part of this will discuss the fundamental problem of accounting for outcomes in the social service sector, while the second part will discuss the practical challenges related to implementing PBCs.

Accounting for outcomes in the social services sector

Using Wilson's (1989) typology of agencies, Dixit (2002) and Gagné (2007) identify difficulties with implementing PM and by extension PBCs with social service agencies. According to Wilson, from a managerial perspective, there are two defining features of any agency: First, can the activities of their operations (outputs) be observed? Second, can the results (outcomes) of those activities be observed? (Wilson, quoted in Dixit, 2002, p. 438) Based on these two factors, Wilson determines that there are four types of agencies:

- Production agencies – where both the outputs and outcomes of an agencies work can be observed;
- Procedural agencies - where outputs are observable, but outcomes are not;
- Craft agencies – where outputs are not observable, but outcomes are;
- Coping agencies – where neither outputs nor outcomes are observable.

Several authors argue (Gagné 2007; Dixit 2002, and Feller, 2002) that the ability to evaluate performance and, in turn, implement PBCs is largely determined by the type of agency that is being evaluated. It is relatively easy to measure performance in production agencies as the outputs and outcomes are observable; the performance of procedural agencies can be evaluated based on outputs, but not outcomes; the performance of craft agencies can be based on outcomes; while it is extremely difficult to measure the performance of coping agencies because outputs and outcomes cannot be observed.

NPOs contracted to deliver social services frequently fall into the procedural category because the outputs of their services can easily be observed, but the outcomes cannot be easily observed (Gagné 2007; Dixit 2002, and Feller, 2002). The outputs of social service agencies can be observed by counting such components as the number of clients served over a specific period of time and the types of services that clients received. However, due to the complexity of social services, it is extremely difficult to observe the outcomes. As a result, it is argued that it is extremely difficult, if not impossible, to implement PBCs for procedural agencies; if the outcomes of a service cannot be observed payment cannot be based on them (Gagné 2007; Dixit 2002, and Feller, 2002).¹

The literature related to performance measurement identifies numerous examples of why the outcomes for procedural agencies are so difficult to observe (Perrin, 1998; Heinrich, 2002; De Lancer Julnes, 2006). The issues that procedural agencies address are very complex; achieving an outcome may involve numerous different individual and social factors, many of which are beyond the control of any single service provider (Perrin, 1998; Heinrich, 2002; De Lancer Julnes, 2006; Gagné, 2007). PBCs struggle to take these complexities

¹ Although this and much of the literature focuses on performance measurement rather than PBC, authors conclusions regarding performance measurement, here and elsewhere in the paper, are extended to PBC, as PBC is simply an application of performance measurement.

into account because they hold individual service providers accountable for achieving specific outcomes that may involve multiple factors; this is commonly referred to as the attribution problem (Gagné, 2007).

Perrin elaborates on the attribution problem with PBCs:

[PBCs] ignore the inherent complexities of social phenomena, which involve many interacting factors that cannot meaningfully be reduced to one or a finite number of quantitative indicators. Attempting to reduce a complex program or social intervention....to a small number of quantitative indicators can disguise and mislead rather than inform what is really happening (1998, p. 372).

Employment training programs provide a good example of how an outcome (in this case securing employment) cannot be attributed to a single factor. To secure a job, an individual in an employment training program must learn marketable skills, but there must also be jobs available for him/her in the market place. If there is a downturn in the economy, resulting in shrinkage of available jobs, it is unfair to hold a service provider accountable if a client does not find a job – there are numerous factors, outside the control of a service provider, which result in the individual not being able to secure a job. Under PBCs, NPOs that fall into the procedural category will be held accountable for outcomes that they have little control over. As a result, they unfairly place a great deal of risk on service providers.

The attribution issue raises an important limitation of PBCs – while it may be possible to demonstrate if outcomes have been achieved or not, PBCs are not be capable of explaining why an outcome was or was not achieved. Newcomer elaborates, “performance measurement typically captures quantitative indicators that tell what is occurring with regard to program outputs and... outcomes but, in itself, will not address the how and why questions” (quoted in Perrin, 1998, p. 374). This limits their effectiveness, as it means that they cannot provide decision makers with the information needed to make targeted interventions to improve a service or identify where resources should be allocated.

For example, it is argued that PBCs are of little use in facilitating corrective actions because they are not capable of demonstrating which elements of the service are ineffective. Moreover, PBCs are of limited use in terms of resource allocation, as they cannot determine if positive or negative outcomes are the result of service provider’s actions. Therefore, PBCs do not provide decision makers with enough information to fairly determine if a service provider should or should not be paid. Ultimately, due to the attribution problem numerous authors concluded that PBCs should not be implemented with procedural agencies (Perrin, 1998; Heinrich, 2002; De Lancer Julnes, 2006, Gagné, 2007).²

² To provide government agencies with the information needed to make resource allocation decisions requires a program evaluation system. Implementing a program evaluation system that takes into account attribution issues is extremely complex. In order to conduct useful research in what works and does not work, evaluations should be conducted that measure client outcomes and service quality elements. This requires having specialized staff trained in quantitative research methods, comparable data on multiple services providers and their clients over long-time horizons, information on the policy environment and sophisticated computer software programs. Non-profit service providers do not possess the

Another key criticism levelled against PBCs is that they unfairly shift the responsibility for outcomes from governments to service providers. As the discussion on attribution demonstrates, achieving an outcome in the social sector often depends on the interaction of numerous different factors, including the quality of service being delivered, but also policy choices and resource allocation decisions made by government (Heinrich, 2002; De Lancer Julnes, 2006).

Governments have a great deal of authority and control a significant amount of resources. The decisions they make have a fundamental impact on any given policy area. In many ways, the options available to NPOs are determined by the policy decisions made by governments; therefore, governments have a significant influence in determining if outcomes will or will not be achieved. NPOs, on the other hand, have limited authority and control over resources; as a result, their ability to influence the achievement of outcomes is much less than that of governments'. Ultimately, NPOs can only really control the quality of services they provide and not broader social policy issues (Heinrich, 2002; De Lancer Julnes, 2006).

Implementing PBCs with homeless shelters provides a good example of unfairly downloading responsibility to service providers. Culhane and Metraux (2008) argue that the essential outcome for a homeless person is to secure a safe and stable home. Achieving this outcome is largely dependent on the stock of affordable housing; if there are no units available, a homeless person cannot be placed into housing. The availability of affordable housing units is beyond the control of the shelter provider. The shelter provider, therefore, cannot be held responsible for the outcome of individuals being placed into housing units. The shelter provider only has control and, thus, can only be held responsible for the quality of the services they provide. Ultimately, the service provider only has control over outputs, not outcomes.

Practical issues with implementing performance based contracts

Even in situations where attribution can be accounted for, there are numerous other practical challenges to implementing PBCs. A challenge that is frequently identified in the literature is selecting appropriate program goals/performance measures. The difficulty in selecting goals/performance measures results in numerous potential problems for PBCs. For example, the performance measures included in a contract are supposed to be proxies used to indicate if a program is achieving its goals. However, there is a risk that the performance measures selected may not be related and/or relevant measures of the goals of the program (Perrin, 1998).

Further compounding matter is the fact that there are multiple principals involved in the contracting of social services. When a government agency contracts with an NPO there are multiple entities whose needs these organizations must meet

skills and resources necessary to conduct such an evaluation. Moreover, the responsibility of these organizations is to deliver services, not to evaluate them. It is the responsibility of the government-funding agency to conduct such evaluations.

(the principals), including service users, politicians at different levels of government, taxpayers, and professional organizations (Propper and Wilson, 2003). Each of these principals may have different expectations and goals for the program, which could possibly be contradictory to each other. This presents a challenge for implementing PBCs, as it leads to a situation where it is unclear which goals should be selected to guide and shape the contract and, in turn, the services delivered.

If inappropriate or irrelevant measures are included, it will result in distortions in the NPO's behaviour that will erode the quality of services. Under PBCs, NPOs are paid according to their ability to meet performance measures identified in their contracts. Since payment is tied to achieving these, the performance measures will fundamentally influence the service provider's actions. As Behn and Kant (1999) observe, if the "measures of performance used in the contracts are not [relevant]... the contract's incentives will direct the service provider's efforts away from this true public purpose" (p.478). If inappropriate performance measures are included in the contract it gives NPOs a strong incentive to work towards inappropriate ends, diminishing the positive impact they have on clients and, in turn, society.

Since it is difficult to measure many important outcomes in the social sector, there is a risk that agencies will only measure what is easily quantifiable (Carrillio, et al, 2003; Blasi, 2002; Propper & Wilson, 2003). This has the potential to have a detrimental impact on the quality of services as it may result in service providers working towards ends that are easily quantifiable, as opposed to what is truly important. Schelesinger and Dorwart (1989) use education as an example of the risk of measuring the easy as opposed to the important. They argue that an important outcome for education is to provide citizens with the skills necessary to be active participants in a democratic society. However, this outcome is very difficult to quantify and evaluate; as a result, PBCs would not take this outcome into account. This demonstrates that selecting easy to measure outcomes may cause service providers to focus on minor issues, at the expense of the more important, yet difficult to measure ones.

Propper & Wilson (2003) and Blasi (2002) found that PBCs often focus on short term outcomes at the expense of long term ones. Propper and Wilson discuss this point in the context of an employment training program:

The use of these short-term outcomes creates the possibility that [PBC] misdirect activity by focusing training centre attention on criteria that may be perversely related to long-term net benefits... This is especially likely in human capital programme, as one benefit of such programme is that it encourages further education and training. Such additional investment depresses short-term earnings but increases them in the long run (2003, p.256)

Most government contracts are renewed on an annual basis, thus, outcomes that are achieved over many years of service will not be rewarded. In addition, if the outcome of a service cannot be accurately measured in the short term, contracts

cannot reward service providers based on them. This may lead government to only fund programs that deliver easy to measure, short term outcomes and avoid funding programs that are more complex in nature (Perrins, 2006, p. 9). In turn, this may cause NPOs to focus strictly on short-term outcomes, at the expense of long term ones.

Another distortion that PBCs may create is, by tying payment to outcomes, they may provide NPOs with an incentive to only work with clients who are most likely to achieve outcomes. This is phenomenon referred to as creaming (Perrin 1998, Frumkin 2001 and Barnow 2000). Through creaming, service providers only accept the highest functioning clients, significantly increasing their likelihood of achieving outcomes and getting paid. The fundamental problem with creaming is that it results in the most marginalized and in need clients not receiving services.

PBCs are also criticized for overburdening service providers. Implementing PBCs requires services providers to develop a new set of skills, including participatory planning with government to establish targets and measures, quantitative and qualitative metrics, valid and reliable data collection techniques to record outcomes and a system to report the outcomes to government (Frumkin, 2001, p.7). NPOs have traditionally not required these skills; they may not be able to develop them without additional, outside assistance (Herman and Heimovics, 1994; Osborne & Tricker, 1995, Morely, Vinson, & Harty, 2001, and Carrillio, et al, 2003). If they are not able to develop these skills they will not be able to demonstrate their performance and, in turn, lose their funding.

A 2000 study by the United Way of America found that NPOs identified capacity challenges as a major barrier to implementing PBCs. For example, 55 percent of respondents stated that PBCs overloaded their record keeping capacity; and 46 percent stated that implementing PBCs caused them to divert resources away from existing activities (p. 6).

Given the pressure to develop new skills, PBCs may cause NPOs to divert resources away from programs, towards administration costs. Diverting resources away from programming towards administration will erode the quality of services. This is primarily due the fact that NPOs will spend more time, energy and money on meeting the requirements of the contract, instead of meeting the needs of the clients. If this happens, it will defeat the intended purpose of PBCs as it will result in NPOs focusing on administrative issues and not achieving outcomes.

PBCs are a riskier endeavour for service providers compared to conventional contracts. The level of risk that PBCs place on NPOs is largely depended on how the contracts are structured. For example, if contracts pay service providers retrospectively they will receive no funding for start up or input costs. As a result, they will not have the resources to invest in developing the inputs that are required to deliver their services. Moreover, some PBCs tie 100 per cent of payment to service providers achieving outcomes. If service providers are not able to deliver these outcomes, they will not receive any money. This may result in service providers not having enough money to continue to operate.

Finally, NPOs may strongly resist the implementation of PBCs. They may see PBCs as being too risky, demanding them to develop skills beyond their capacity and holding them accountable for outcomes that they are not responsible for. Furthermore, they may be concerned that the outcomes will be imposed on them and will not be in line with their original mission or purpose. This will cause them to change the nature of the services they provide and, in turn, lose control of the programs they deliver. These concerns could lead to a breakdown in the relationship between service providers and government.

Conclusion

PBCs have been implemented because it is believed that they will enhance the efficiency and effectiveness of NPOs, without compromising government's accountability requirements. It is argued that they are able to improve efficiency and effectiveness because they offer a financial reward for achieving outcomes, in turn, providing an incentive for NPOs to focus on delivering outcomes. Moreover, they free NPOs from the confinements of government design specifications, affording them the flexibility to focus specifically on their clients' needs and the freedom to experiment with new and innovative service delivery techniques. They do this without compromising accountability, because they track and record the performance of service providers and, thus, enable government to determine if they are providing a beneficial service.

On the other hand, critics argue that the use of PBCs in the social service sector is inappropriate. It is argued that PBCs are inappropriate because they do not take into account the complexities of social services and hold service providers accountable for outcomes that they have limited control over. By doing so, PBCs unfairly place a great deal of responsibility and risk on service providers. In addition, critics point out that the implementation of PBCs is fraught with practical and design challenges, which have the potential to create serious distortions in quality of services. As a result of these factors, critics argue that PBCs will have a detrimental impact on NPOs and erode the quality of services they deliver. Ultimately, they conclude that service providers only have control over inputs and outputs and, therefore, contracts can only be based on these elements.

JURISDICTION SCAN

The following section provides an overview of four jurisdictions that implemented PBCs with NPO service providers in the social service sector. It will explore how each jurisdiction has structured their contracts, the steps they took to implement them and the outcomes that occurred after they were implemented.

Oklahoma State - Department of Rehabilitation Services

Structure

The Oklahoma Department of Rehabilitation Services (DRS) is seen as an international leader in PBCs (Vinson, 1999; Frumkin 2001). Since 1992 they have used PBCs to purchase employment training and placement services for people with physical and intellectual disabilities. The majority of their contracts are with NPO service providers.

Prior to implementing PBCs, DRS purchased services using cost reimbursement contracts. They felt that these contracts created a distorted incentive structure that encouraged service providers to maximize the volume of service they provided. As a result, they felt that cost reimbursement contracts had a negative impact on the efficiency and effectiveness of service providers. DRS felt that implementing PBCs would address this distortion and improve the efficiency and effectiveness of their employment assessment and training program (Frumkin 2001).

DRS implemented a type of PBCs called 'milestone contracting'. NPOs earn a percentage of the total fee when a client successfully accomplishes one of the key steps (a milestone) in achieving a job. They do not receive the full fee until the client completes each of the milestones and secures stable employment. The milestones include inputs, outputs and outcomes. Table 1 summarizes the contracting system.

Table 1: Oklahoma Milestone Contracting

Milestone	Type of Measure	Percent of Payment
Determination of need	Input	10%
Vocational Preparation	Input	10%
Job Placement	Output	10%
Job Training	Input	10%
Job Retention	Outcome	15%
Job Stabilization (10 to 17 week of employment)	Outcome	20%
Case Closure Stabilization plus 90 days)	Outcome	25%

Source: Martin, 2002.

The total reimbursement rates were based on state-wide averages. They used the average because it encouraged the more expensive NPOs to find inefficiencies in their system and deliver the outcome at a lower cost. In order to encourage the appropriate placement of clients, NPOs are only paid once for each milestone (Frumkin, 2001).

Implementation

DRS began the transition to PBCs by holding a series of engagement sessions with NPOs. According to Rebecca Cook, one of the founders of milestone contracting, DRS “tried very hard from the very beginning of [milestones] to bring vendors in as partners into the process of what we were trying to do” (Quoted in Frumkin, 2001, p. 19). They used these sessions to educate NPOs about the system, enable them to have input into the design of NPOs and highlight that PBCs will reduce paperwork and increase programmatic freedom (Frumkin, 2001).

Another key step they took in implementing PBCs was developing appropriate performance measures. There were two key actions that DRS took in developing the performance measures. First, they engaged NPOs and got a sense of what they thought were the vital and achievable measures. Second, they committed to include only a few meaningful and easy to track performance measures.

DRS made a concerted effort to ensure that NPOs had the capacity needed to implement PBCs. DRS developed technical assistance teams to aid in this process. These teams enhanced the capacity of the NPOs by hosting a series of training sessions. At these sessions they focused on developing their skills in information technology and performance measurement. The technical assistance teams remain intact and offer ongoing support and assistance to NPOs (Frumkin, 2001).

Finally, there was a concern that implementing PBCs would create an incentive for NPOs to only work with higher functioning clients, who are easiest to place and avoid working with the lowest functioning clients, who would be the most difficult. To avoid this they have developed a two-tiered payment system that pays service providers a higher fee for serving “highly challenged” clients (Frumkin, 2001). This has mitigated ‘creaming’ as it provides an incentive to accept difficult to serve clients.

What happened after implementation

Since PBCs have been implemented there have been improvements in the efficiency and effectiveness of employment training and placement services in Oklahoma. A review of the milestones found that:

- The amount of paper work required by service providers decreased by 33 percent;
- Data entry requirements were reduced by 98 percent;
- The average time clients spent on wait lists decreased by 53 percent from 8.14 months to 3.85 (Vinson, 1999, p. 2);

- The average number of weeks clients spent in assessment declined 18 percent, from 12.1 to 9.9;
- The number of clients who have never found a job fell by 25 per cent (Vinson, 1999);
- The average cost per case closure fell from \$22,000 in 1991 to \$10,740 in 1997 (Frumkin, 2001, p. 21).

The above data demonstrates that since the implementation of PBCs, NPOs have fewer reporting and monitoring requirements and are delivering enhanced outcomes at a lower cost.

A 2000 satisfaction survey found that 80 percent of NPOs preferred milestones to traditional government contracts. There were multiple reasons why they preferred milestones. First, “most non-profits seem to agree that the new, less onerous reporting requirements...have freed [staff] to spend more time...with clients” (Frumkin, 2001) Second, they felt that milestones clarified the goals of the program, making it easier for them to focus their resources and do their job. Finally, they felt that milestone afforded them a greater degree of flexibility (Frumkin, 2001).

DHS felt that the fundamental problem with their system of PBCs is that it does not reward and may, in fact, punish NPOs that place their clients too quickly. Under the current system, NPOs that place all their clients must either cease accepting new clients or provide services to new clients for free while they wait for new contracts. As result, “high-performing nonprofits that place their clients too quickly into employment under one contract have no avenue for going back to Milestones if they run out of money” (Frumkin, p.29). This discourages NPOs from exceeding the identified performance measures.³

It is important to note that DHS has not conducted a thorough program evaluation that takes into account attribution issues. Therefore, it cannot be concluded that the improvements in efficiency and effectiveness are the result of PBCs. For example, other factors, such as improvements in the economy, may be responsible for the higher rates of job placement and stabilization.

New York City - Department of Homeless Services

Structure

The New York City Department of Homeless Services (DHS) implemented modified version of PBCs to purchase homeless shelter and outreach services. They were the first jurisdiction in the United States to use PBCs to purchase services for the homeless. DHS implemented PBCs because they thought it would enable them to:

³ An evaluation of the effectiveness of a job training program is more complex than what occurs in Oklahoma under milestone contracting. The key problems are that milestones cannot conclude if individuals became employed because of the program and it cannot draw conclusions regarding the cost and benefits of the program. A discussion of the complexities of evaluation job training programs is beyond the scope of this paper. For a thorough discussion of these issues please see Heckman and Smith, 2004; Heinrich, 1999; and Heckman, Ichimura & Todd, 1997.

Clarify and communicate the mission and priorities throughout a large and complex organization; and second, [they] gave the Department a mechanism by which it would be able to reward the [NPOs] that are effective without mandating how the results are to be achieved (Campbell and McCarthy, 2000, p. 339).

The PBC system implemented by DHS monitors and rewards NPOs based on their ability to meet input, output and outcome requirements. The input and output requirements include such measures as hours of service provided and number of programs offered. The outcomes that are included vary according to the type of service that is offered (e.g. outreach services and homeless shelters). However, they all “focus on the placement of clients into long term housing or rehab settings and on low rates of recidivism back into the shelter system once placed” (Campbell and McCarthy, 2000, p. 345).

The majority of the reimbursement rate is based on input and output requirements; so in many ways the contracts used by DHS are essentially the same as traditional government contracts. The contracts differ slightly from traditional contracts and are considered performance based because NPOs receive a small bonus of up to 3 percent of the total dollar amount of the contract based on their ability to meet the performance measures. Furthermore, contract renewal is based on the NPO’s ability to achieve the measures.

The following are the performance measures that are included in the DHS contracts for adult transitional shelters⁴:

- clients placed in to permanent housing;
- clients placed in permanent housing remain there for 6 months;
- and overall service provider performance⁵ (Campbell and McCarthy, 1999).

The measures that are included in transitional shelter provider contracts are a mix of output and outcomes measures. For example, clients placed into permanent housing and the numbers of clients that remain there for 6 months are outcomes; while the overall quality is based on outputs.

The following are the performance measures that are included in the contracts with outreach service providers:

- client shall complete a drug or alcohol detox program and/or be referred to a drop in center and be an active member for a minimum of 28 consecutive days;
- client shall be referred to an assessment shelter and remain in the shelter for a minimum of 15 consecutive days;

⁴ What DHS refers to as transitional shelters, would be referred to as emergency shelters in British Columbia.

⁵ This is based on qualitative evaluation of the quality of the service that the contractor provides. It takes into account such factors as recreation and programming for clients.

- client shall be referred to a drug/alcohol rehab program and remain in the program for a minimum of 28 consecutive days, and/or be placed in permanent housing (Campbell and McCarthy, 1999).

The performance measure for outreach services all focus on the service providers' ability to connect clients to other support services. Therefore, all of the performance measures for outreach services measure outputs.

DHS has developed a series of formulas to determine eligibility for the performance bonuses. The formulas are designed so that certain outcomes, depending on the type of service delivered, are more heavily weighted than others. For example, contracts with adult shelter providers place the most weight on long-term placements in housing or rehabilitation services and low recidivism rates.

It is important to note that DHS did not implement PBCs for homeless drop-in centres. DHS felt that drop-in centres do not have enough direct control to influence short-term outcomes for their clients. As result, they still use process based on contracts to purchase these services (Campbell and McCarthy, 1999).

Implementation

The first step DHS took in implementing PBCs was engaging NPOs. At the early stages of developing PBCs, executive staff members held focus groups with NPO service providers. At these meetings they communicated the benefits of PBCs and elicited feedback from service providers. They have continued to involve them by holding meetings with them every six months. These meetings ensure that NPOs are continuously able to provide feedback and shape the system.

There was a concern that NPOs lacked the capacity needed to operate under PBCs. DHS initially addressed this by providing each contracted facility with computer equipment and training to allow for more efficient communication and reporting. They have provided ongoing support through the semi-annual meetings, where they provide training and technical support to NPOs (Campbell and McCarthy, 2000).

DHS has put a great deal of effort into including appropriate performance measures in the contracts. For DHS, ideal performance measure should "benefit the client, reflect the mission of the [government] agency, and provide a realistic challenge to service providers" (Campbell and McCarthy, 2000, p. 348). They have taken the following steps to implement such measures:

- ensured that the performance measures were consistent with their strategic plan;
- focused on including clearly defined outcome measurements;
- involved service providers in the selection of performance measures and negotiated with them the measures that were actually included;

- frequently met with service providers to review data related to the performance measures. When measures were deemed to be unachievable, DHS adjusted them;
- established a policy to adjust performance measures based on feedback from service providers, data analysis, and shifts in management priorities (Campbell and McCarthy, 2000).

What happened after implementation

DHS did not collect outcome data from NPOs prior to implementing PBCs. Therefore, they have not been able to conduct a before/after comparison of PBCs versus traditional contracts.

The preliminary study of the PBCs implemented by DHS found that 40 percent of NPOs would earn at least portion of the bonus payments (Campbell and McCarthy, 2000). In addition, DHS executives felt that the system effectively enabled them to convey their mission and goals across the homeless support system. Finally, the majority of NPOs indicated that the contracts did not interfere with their mission.

DHS has identified several major concerns with their PBCs system. The first problem identified is that they have no baseline data to help determine the performance measures. This has made it very difficult to select appropriate measures. Moreover, it has made it next to impossible to evaluate PBCs and determine if they resulted in improvements to the system (Campbell and McCarthy, 2000).

A third concern they have is that PBCs cannot inform them why a particular outcome has been achieved. PBCs do not enable government or service providers to determine, with a high degree of certainty if:

outcomes are the direct result of the program rather than chance, [and therefore, cannot] assist organizations in duplicating part of successful programs, identify which factors are responsible for the success and identify problems if there is no success if the outcomes that are achieved are the direct result (Campbell and McCarthy, 2000, p. 346).

DHS has acknowledged that if they are to do this, they will need to implement an analytical program evaluation system.

Finally, DHS has found that, despite their efforts, there is still some resistance from NPOs to PBCs. Some service providers have indicated that they require additional training and better technology to collect data and report on performance (Campbell and McCarthy, 2000).

Illinois - Department of Children & Family Services

Structure

In the early 1990s the Illinois Department of Children & Family Services (DCFS) had one of the highest levels of children in care in the United States. In 1997 they

undertook a series of reforms to increase the number of children being placed in permanent settings (permanency rates) and, in turn, improve the outcomes for children and families (Shaver, 2006). PBCs were one of the key reforms they implemented to achieve this goal.

DCFS felt that one of the reasons permanency rates were so low was because the financial structure of the contracts encouraged NPOs to keep children in care. The original contracts were fee for service contracts, which paid them according to the number of children and the number of days of service those children received (McEwen, 2006). Thus, as long as a child was in care, they would continue to be paid. This provided them with an incentive to keep children in care longer and, thus, discouraged them to permanently place the child.

DCFS implemented PBCs so they could provide a financial incentive to encourage NPOs to place a greater number of children in permanent settings. The type of PBCs they implemented provides this incentive by manipulating contractors' caseloads. DCFS increased the number of children on each caseworker's load from 25 to 33. However, they continue to reimburse caseworkers for 25 children per year; they are not paid for the eight additional children that are placed on their caseloads.

Caseworkers are expected to permanently place eight children annually. If they do not, they will have 33 children on their caseload, but will only be compensated for working with 25. On the other hand, "If caseloads fall below 25 per worker, the [NPO] continues to receive payments for the full 25 cases' (Vinson, 1999, p. 3).

Mike Shaver, who helped design the contracts, discusses the financial incentive they provide:

[The contracts] leverage a set of self-enforcing financial and market-driven incentives among private providers to ensure a targeted level of performance improvement. Simply put, when providers meet or exceed specific performance expectations, they benefit financially. When providers fail to meet specific performance expectations, they lose financially (Shaver, 2006, p. 1).

By rewarding those that exceed the target number of placements and punishing those that do not meet the target, the contracts provide a strong incentive to permanently place children.

The following table summarizes how the system works:

Table 2: Illinois PBC payment structure

	Beginning caseload per worker (basis for payment)	Guaranteed caseload per worker at Intake	Cases in which permanency was achieved	Ending Caseload	Cases for which agency is paid per worker	Net Gain/Loss in income
1. Permanency Positive	25	33	13	20	25	+ 20%
2. Permanency Neutral	25	33	8	25	25	0%
3. Permanency Negative	25	33	3	30	25	- 20%

Adapted from McEwen, 2006, p. 1

Implementation

The first step that DCFS took in implementing PBCs was developing a strategic plan. The plan established the larger system wide goals for the child welfare system. This guided the development of the PBCs, as it helped to ensure that PBCs were consistent with the other initiatives they were implementing and that they focused on the larger goal of improving the child welfare system by increasing the permanency rate. Shaver discusses this point:

The first step in designing a performance framework that works is using performance expectations to reinforce broader system objectives...Whatever the area of interest; the performance contract should be designed with an eye toward addressing some system wide inefficiency, not an arbitrary sense that performance needs to be improved across the board (2006, p.3).

DCFS worked closely with NPOs in developing PBC. They focused their initial meetings with them on demonstrating that the current system was under performing. They relied heavily on data they had gathered on the permanency rates to support this position. Shaver describes how the use of data aided the DCFS in convincing service providers that the system was not working:

The data brought to the table detailed the performance of the system as a whole. The data was not used to single out any particular provider, but instead was used to ask a fundamental questions: Is it reasonable to expect a child placed with a relative or in foster care to wait seven years to achieve permanency?...the answer [from service providers] was a resounding no” (2006, p. 6).

They also used the engagement meetings to demonstrate how the traditional fee for service contracts were one of the major barriers to improving the system. They explained the distorted incentives they created and how this was related to poor performance. They introduced the concept of PBCs, explaining the theory behind PBCs and the benefits that they would bring. They also stressed that NPOs would have to change the way they operated and become more focused on outcomes, instead of on process.

The second step they took was engaging NPOs in structuring the contracts. This entailed working with them to select the performance measures, determining the size of the case loads and the reimbursement levels.

Through these session NPOs expressed that they would require additional resources to improve permanency rates. This resulted in DCFS increasing the amount of money available for reunification services⁶ from \$600 per child to \$8,000 per child (Vinson, 1999).

The DCFS established Agency Performance Teams to manage the contracts. These teams are responsible for monitoring and reviewing contractor performance. This entails monitoring the performance measures to ensure they are appropriate, developing a methodology for measuring performance, and for evaluating the performance of NPOs (McEwen, 2006).

What happened after implementation

Since the implementation of PBCs permanency rate have substantially improved in Illinois. In 1997, the year before PBCs were implemented, there were 50,000 children in care. By 2005, there were 17,800 children in care (Shaver, 2006). Erwin McEwen, a deputy director at the DCFS, stated that “performance based contracting is largely responsible for moving over 30,000 children out of state care and into permanent placements” (McEwen 2006, p.2).

It is important to note that DCFS simultaneously implemented other reforms that could have resulted in the improvements in the permanency rate. For example, increasing the funding for reunification services from \$600 to \$8000 per child most likely contributed to the improved performance (Vinson, 1999). PBCs were part of a larger reform package and, thus, cannot be considered solely responsible for the improvements. Since DCFS has did not conduct a through program evaluation, it cannot be concluded that PBCs are responsible for the improvements.

The Federal Children and Family Service review conducted an evaluation of PBCs in Illinois. They found that the contracts had several glaring weaknesses. First, the contracts did not include any measures to monitor the quality of the service being delivered. Second, they did not include any measures regarding the children’s’ quality of life. DCFS has acknowledged these shortcomings and is

⁶ Remedial efforts by social worker and other professionals that are designed to help get children that are in foster care, and their biological parents, into a position where they can live together again as a family unit (<http://glossary.adoption.com/reunification-services.html>).

working on adjusting their PBCs to include provisions to track these variables (McEwen, 2006).

Kansas - Department of Social and Rehabilitation Services

Structure

In 1997 the Kansas Department of Social and Rehabilitation Services (SRS) completely privatized their adoption, foster care and family preservation services. Simultaneously, to privatizing the child welfare system, they also implemented PBCs.

Prior to the complete privatization, SRS had used contractors to deliver a portion of these services. They used a fee for service system that paid NPOs for every day that a child was in care. SRS felt that the fee for service contracts had a detrimental impact on quality of services because they provided contractors with an incentive to keep children in care. SRS implemented PBCs in an effort to address this distorted incentive structure and encourage the permanent placement of children. Ultimately, they felt that PBCs would improve the efficiency and effectiveness of the child welfare system (Petr and Johnson, 1999).

Under the PBCs SRS implemented, child welfare service providers were paid a one time, fixed fee per child. The rate they were paid remained the same, regardless of how long the child was in care. For example, foster care providers were reimbursed the following way:

- Providers were paid \$12,860 per child. This was based on the average cost of providing services for 8 months (Unruh and Hodgkin, 2004).
- To guard against creaming, a no-rejection clause was included in the contracts requiring service providers to accept all clients referred to them by the state.

If the child was placed before 8 months, the NPO would be financially rewarded; however, if they were not placed after 8 months they would begin to lose money. It was felt that this would provide a strong incentive to place children as quickly as possible. In turn, this would reduce the cost of running the child welfare system and improve the permanency rate.

The contracts all included a series of performance measures related to the goal of improving permanency. The specific measures differed slightly according to the particular service. The following are examples of performance measures DRS used to monitor permanency:

- Adoption providers must place 70 percent of children into permanent adoptive settings within 180 days of the referral and 90 per cent within a year (Eggers, 1997).
- Foster care providers must permanently place sixty-five per cent of children within 12 months of referral (Unruh and Hodgkin, 2004).

Payment was not directly tied to achieving these targets; however, not meeting them was grounds for terminating a contract. SRS included them to establish the level at which service providers were expected to perform (Eggers, 1997).

In addition, all of the contracts included performance measures that emphasised children's safety. The SRS was concerned that the reimbursement system created an incentive for NPOs to place children as quickly as possible, with little regard for their safety. In an effort "to guard against this, SRS officials carefully designed the outcome measures in a way that compels contractors to value the children's safety at all times" (Eggers, 1997, p. 4). For example, adoption contracts included the following measure:

- 98 percent of children in each provider's care never suffer abuse or neglect as measured by confirmed reports (Eggers, 1997);
- 80 percent of children returning home from foster care should not experience abuse or neglect within 12 months (Kansas Action for Children, 2001).

Failure to meet the safety performance standards would result in the termination of a contract. There was no explicit financial reward for successfully meeting the safety requirements.

The contracts were reviewed annually and re-bid on every four years. DRS staff was responsible for rewarding the contracts and monitoring the performance. NPOs had to provide annual performance reports. Allegations of abuse were investigated on a case by case basis (Unruh and Hodgkin, 2004).

Implementation

DRS implemented PBCs in approximately 4 months. They implemented PBCs with all NPO service providers; they did not run any pilots before hand. In addition, DRS did not undertake an engagement process prior to implementation. Gurwitt discusses:

[SRS] sent out notices of informational meetings on the state's plans to those outside the social service department...who would be affected by the change. But couched in dry, bureaucratic language, the state's heads-up gave no inkling how profound a change was in the work. And as result, nobody showed up (2000, p.1).

Since there was no engagement process, SRS did not educate NPOs about the system, enable them to have input into selecting the performance measures or help them develop the capacity needed to administer it. The primary reason they did not engage service providers is because state contracting laws forbid service providers from bidding if they gave any advice on the structure of a contract (Gurwitt, 2000).

The reimbursements rates were set by service providers during the bid process. Awarding the contracts was largely based on which provider could deliver the service at the lowest cost. This encouraged service providers to suggest low rates. Moreover, the service providers have stated they provided, at best, rough

estimates, as they did have access to baseline data or the skills needed to project costs accurately (Unruh & Hodgkin, 2004).

What happened after implementation

The Kansas Action for Children (KAC), a non-partisan, non-profit organization dedicated to shaping health, education and economic policy, conducted a study of the impact of PBC. One of their major findings was that permanency rates did not increase after PBC were implemented. For example, prior to implementing PBC, 26 percent of children were returned home or achieved another permanent placement, while after implementation 27 percent achieved permanency (2001).

The same study found that under PBC, the safety of children was ensured. For example, in both 1998 and 1999 only 1 percent of children experienced abuse or neglect while in foster care. In addition, 97 percent of children returned home from foster care were not abused within 12 months.

The implementation of PBCs resulted in financial problems for the vast majority NPOs. It was reported that the actual cost of providing services to children was much higher than the reimbursement rates set in the contracts. In an effort to help contractors deal with the financial hardship, SRS provided additional funds on top of the 10 percent risk rate they included in the original contracts. For example, in the initial four years of PBC the state provided:

- foster care contractors with an additional \$8.4 million outside the original contracts;
- the adoption contractor with an additional \$6.97 million outside the original contracts (KAC, 2001).

Despite the financial support from the state, the adoption provider “reported serious financial problems and only avoided bankruptcy after subcontractors agreed to absorb some of its losses and accept 74 cents on the dollar for services already provided” (Unruh and Hodgkin, 2004, p. 779).

Due to the financial problems caused by the initial fixed fee PBC system, the Kansas SRS switched to a Milestone system of contracting in 2001. The system they implemented was based on the one developed in Oklahoma (Martin, 2005).

Conclusion

The following provides a brief summary of the four jurisdictions experience with PBCs:

- After implementing PBCs in Oklahoma, outcomes were improved and costs were reduced.
- After implementing PBCs in Illinois, permanency rates improved. However, they also increased funding to NPOs; therefore, the implementation of PBCs was not related to any short term cost savings.
- Based on the literature available it is too early to determine if outcomes improved in NYC after implementing PBCs. This is because they did not have data on outcomes prior to implementation, so it cannot be

determined if outcomes improved after they were implemented. Moreover, there is no information available on the impact they have had in terms of cost. The literature demonstrates that PBCs have not caused any major problems for NPOs or resulted in the disruption of services.

- Kansas clearly had the worst experience with PBCs. Client outcomes did not improve after PBCs were implemented and their implementation resulted in NPOs experiencing severe financial hardships.

The experience of jurisdictions that have implemented PBCs has been mixed. After PBCs were implemented in Oklahoma and Illinois there were improvements in effectiveness and efficiency, there is not enough evidence to determine if there were improvements in NYC, and they had a detrimental impact in Kansas.

While there were improvements in outcomes in Oklahoma and NYC, it cannot be concluded that PBCs were responsible for the improvements as these jurisdictions did not conduct program evaluations that took into account attribution. Therefore, the improvements may be the result of other factors. For example, the outcomes in Oklahoma may be the result of improvements in the economy and those in Illinois may be the result of increased funding. In order to determine why outcomes improved a program evaluation, which takes into account attribution, must be conducted.

The experience of Kansas demonstrates that if the practical problems associated with implementing PBCs are not addressed, they can cause immediate serious problems for service providers and governments. Based on the experience of Kansas, it can be concluded that the dangers associated with PBCs are very real and they do have the potential to have an immediate detrimental impact.

DISCUSSION

The discussion section is divided into three parts. The first part uses Wilson's typology of agencies to examine the types of agencies where PBCs can be implemented. This section will pay particular attention to the implications of using PBCs to purchase services from procedural organisations. The second section explores why Oklahoma, Illinois and NYC were able to avoid many of the practical pitfalls associated with implementing PBCs. The third part analyzes why Kansas was not successful in its attempt to implement PBCs and immediately experienced problems as a result of implementing PBCs. Particular attention will be given to identifying the barriers that they did not address.

Wilson's typology of agencies and the implementation of PBCs

Oklahoma, NYC, Illinois, and Kansas all implemented PBCs to purchase services from procedural agencies. In all four cases the outputs are easily observed, but the outcomes are not. The outputs are observable as service providers can easily record service volume levels. For example, they can track factors as how many clients received services, what types of services did they receive, and how many services did the client receive. Service providers can record these and report them to the government contracting agency.

The outcomes for the service providers in all four jurisdictions are not observable. In the Wilson context, outcomes are not observable if attribution cannot be accounted for. Essentially, if the outcomes cannot be attributed directly to the service providers' work, they cannot be considered observable. In all four jurisdictions the service providers did not have direct control over the outcomes included in their contracts:

- Oklahoma, the outcome of securing employment is dependent on multiple factors, including the state of the economy, which service providers do not control;
- In NYC, the outcome of placing clients into stable housing and into support services depends on the stock of affordable housing and the availability of support services. The service provider does not have control over these areas;
- In Illinois and Kansas, the ability to place children into permanent homes is dependent on the availability of permanent homes, which the service provider does not control.

Therefore, in all four jurisdictions PBCs were implemented with procedural agencies, where outputs are observable, but outcomes are not.

There are several key issues that arise as a result of implementing PBCs with procedural agencies. First of all, since the outcomes for these agencies involve numerous different factors, it is very difficult to know why outcomes were achieved or not. The only way to do this would be to conduct a program evaluation that takes into account attribution. None of the jurisdictions did this, so

it is impossible to conclude that the improvements in performance were the result of implementing PBCs; there are numerous other factors that may be responsible for the improvements. This demonstrates that PBCs do not provide decision makers with the information they need to make targeted interventions to improve services and that they are of limited use in aiding resource allocation as they cannot identify the elements of a program that have a positive or negative impact.

Another important consequence of implementing PBCs with procedural agencies is that it results in agencies being held accountable for an outcome that they have limited control over. This places a great deal of risk on service providers as a portion of their payment will be based on a component of service delivery that they do not completely control.

The amount of risk that PBCs place on procedural agencies varies according to how the contracts are structured. The Milestone system that Oklahoma developed bases 40 percent of payment on input and output measures and 60 percent on outcomes related to securing a job. The ability of service providers to place clients into jobs is dependent upon the health of the economy. Oklahoma's contracts do not account for this and end up holding service providers accountable for an outcome that they do not have complete control over. If there was a downturn in the economy it would have severe negative repercussions for employment training service providers as their ability to receive 60 percent of their payment would be compromised by a factor outside of their control.

Illinois and Kansas both implemented PBCs that make payment contingent on achieving the outcome of placing a child into a permanent home. Achieving this outcome is largely dependent on the availability of permanent child care placements, which is beyond the control of the service provider. Therefore, these contracts place a great deal of risk on service providers because they will experience cost overruns if they are not able to place a child into a home. This risk is unfairly placed on them as they have no control over the availability of permanent placements.

The contracts implemented by NYC place the least amount of risk on service providers. The payments are based on inputs and outputs provided by the NPOs. NPOs receive a bonus of up to three percent of the total contract if the outcomes related to placement of clients into housing and support services are achieved. While structuring the contracts in such a way minimizes the chance that NPOs will experience financial hardships due to the contracting system, it is still unfair as the service providers receive a bonus based on an outcome that they have limited control over.

Based on the above factors, it can be concluded that PBCs should not be implemented with procedural agencies. PBCs unfairly place a great deal of risk on procedural agencies as they hold them accountable and make a portion of their payment dependent on outcomes that they have limited control over. If a factor outside the control of the service provider changes and has a detrimental impact on the ability to achieve the outcome, the service provider will be

punished. This is unfair as service providers will be punished for elements that they cannot influence. Moreover, as service providers would lose a significant portion of their funding, it would compromise their ability to deliver quality services.

Based on the evidence gathered in this report it appears as though PBCs can only be implemented with production and craft agencies. As these types of agencies have control over outcomes, the attribution and lack of control over outcomes issues are addressed. Therefore, PBCs do not hold them accountable for outcomes that are beyond their control and place an unfair amount of risk on them. However, even with these types of agencies, there are practical problems with implementing PBCs. The next section will discuss strategies for overcoming these challenges.

Oklahoma, Illinois and New York City: Avoiding the practical pitfalls of PBCs

While Oklahoma, Illinois and NYC all implemented PBCs with agencies that they should not have, they were able to avoid causing any major short term problems for service providers. They were able to do this by successfully addressing many of the key practical barriers identified in the literature. Kansas, on the hand, did not successfully address these barriers and it resulted in the implementing a system that caused immediate short term problems. This part of the paper will explore why Oklahoma, Illinois and NYC were able to avoid many of the practical barriers associated with implementing PBCs. This will provide valuable information for implementing PBCs with agencies where the outcomes are observable.

A key barrier to implementing PBCs identified in the literature is selecting appropriate performance measures. Selecting appropriate performance measures is challenging for several reasons. First, care must be taken to ensure that relevant measures are selected; second, governments must be careful not too include too many measures as this may overwhelm service providers; finally, government must be careful not to exclude any key measures.

The selection of appropriate performance measures was a challenge that all of the jurisdictions experienced. The approach they took to address this barrier was remarkably consistent.

For example, all three of them worked closely with service providers in developing the measures. This enables government and service providers to engage in a discussion about the nature of the service and reach some consensus regarding what they should be trying to achieve. This also helps to promote a common understanding regarding what is expected of the service provider under the contract. Finally, it helps to ensure that the measures are relevant as all parties have an opportunity to shape and influence the measures that are included.

They also linked the performance measures to larger, department wide goals. They all had a clear direction of the outcomes they wanted the system to achieve

and selected measures that indicated if service providers were helping them to achieve them. Linking the performance measures to government department goals helps “to clarify and communicate the mission and priorities through a large and complex system” (Campbell and McCarthy, 2000, p. 339). This leads to consistency across the system, demonstrates that NPOs have a vital role to play in helping government achieve its goals, and helps to ensure that the measures are meaningful as they are consistent with goals identified by democratically elected government.

These three jurisdictions only included a few, easy to measure and understand performance measures in their contracts. Frumkin explains the benefits this results in:

When [performance measures] become too numerous, the administrative oversight and reporting requirements become acute. By keeping the number of [measure] small and by placing special emphasis on the final outcome sought, public managers can create room for nonprofits to innovate by freeing them from heavy reporting requirements (2001, p.33).

It requires a significant amount of resources to track performance measures; as the number and complexity of the measures increases so does the cost. Including a few, essential, yet easy to evaluate performance measures helps to ensure that PBCs do not overwhelm NPOs.

However, it is important to note that by only selecting a few measures these jurisdictions ran the risk of excluding key goals of the programs (Perrin, 1999). To guard against this NYC and Oklahoma both developed systems that tracked multiple indicators, including input, output and outcome measures. This helps to ensure that they struck an effective balance between implementing manageable contracts and taking into account the complexity of social programs.

These jurisdictions also made the effort to ensure that the measures remained accurate over time. As Perrin notes, “few measures will be perfect the first time around...measures that remain static are most susceptible to goal displacement” (1998. p. 376). They avoided this by working with NPOs to review the system and adjust measures if they were not working.

It is interesting to note that despite all the above efforts, two of the jurisdictions indicated that they still experienced issues with selecting measures. For example, Illinois felt that the measures they selected were too narrowly focussed and neglected other key outcomes and NYC could not implement outcome measures for drop-in centre services. This demonstrates how difficult it is to select measures and that government must continually work to ensure that the measures that have been included are appropriate.

An issue raised in the literature is that NPOs may lack the capacity to operate under PBCs. Consistent with this, NPOs in NYC and Oklahoma did initially lack the capacity to operate under PBCs. Both were able to address this barrier and successfully help NPOs to develop the required capacity.

The approach NYC and Oklahoma took to help NPOs develop the required capacity was similar. For example, both of these jurisdictions held workshops to train NPOs on how to collect and manage data. In addition, they both developed technical assistance teams to provide NPOs with support once the new contracts were actually implemented.

New York faced a particular challenge in the capacity area as many of the NPOs they were dealing with did not have the information technology infrastructure needed to operate under PBCs. They addressed this shortcoming by providing the service providers with information technology systems that enabled them to track and record data.

It is interesting to note, that despite making only minimal changes to the contracting system, NYC had to invest the resources to engage with NPOs and build their capacity. This indicates that even making minor changes towards PBCs requires working closely with NPOs and investing in their capacity to operate under the system.

By investing staff time and money, these jurisdictions were able to enhance the capacity of NPOs to record data, operate information technology systems and report on performance. Building this capacity is vital as it helped to ensure that the service providers were able to operate under the system and focus their resources on serving their clients, instead of on developing the capacity needed to meet government contracting requirements. Moreover, it helped to build support for the system as it demonstrated to service providers that Government was willing to provide them with support to overcome key challenges they faced in implementing the system.

A key barrier to implementing PBCs identified in the literature is resistance from service providers. Consistent with the literature, each of the jurisdictions that implemented PBCs did face resistance from service providers. Given the numerous risk and challenges associate with implementing PBCs, this resistance is well founded. Oklahoma, NYC and Illinois were able to minimize this resistance by engaging NPOs in the design and implementation of PBCs.

These three jurisdictions all began the engagement process at the initial stages of implementing PBCs. They used these initial meetings to put PBCs into context and explain the larger system wide goals that they were trying to achieve by implementing them. Specifically, this entailed highlighting the problems with the current system, how PBCs would address them, the benefits that PBCs incur on government and service providers and how the system will enhance outcomes.

Engagement sessions also enabled NPOs to have input into the system. NPOs are responsible for interacting with clients and actually delivering the service. They have an intimate knowledge of the program area; therefore, they will have numerous valuable insights into how PBCs will impact their work. Involving service providers will strength the system as they will be able to identify potential problems and offer solutions that will help PBCs to everyone's advantage.

Engagement is essential because it provides government with the opportunity to educate service providers about the system and, in the process, quell some of the fears they may have had. Moreover, engagement allows NPOs the opportunity to have input into the system, this benefits the system as they have a significant level of expertise and can offer ideas on how to improve the contracts. Finally, involving NPOs will generate a sense of ownership among service providers and, in turn, building support among them for the new system.

Why did Kansas fail?

Kansas' initial experiment with PBCs was not a success. They did not achieve the intended outcomes related to increasing permanency rates and they caused financial hardships for NPO service providers. The financial problems caused by PBCs were so severe that the state had to spend millions of dollars to ensure that NPOs could deliver services.

There were two fundamental flaws with the PBCs that Kansas implemented: first, they selected inappropriate performance targets; second, they set reimbursement rates too low. Thus, they set targets that were very difficult to achieve, but did not provide service providers with the resources required to meet them. This resulted in service providers experiencing significant cost overruns as they could not place children in the time they were allotted under the contracts.

The key problem with the targets and reimbursement rates is that they were too ambitious. The targets and reimbursement rates were far beyond what the baseline data indicated was feasible. For example, the following information from the foster care contracts demonstrates how much the reimbursement rate and a performance measures differed from baseline data:

- Foster care providers were paid \$12,860 per child under PBC, but prior to PBC, services for one child typically cost \$17,000 to \$25,000 a year.
- The performance measure was that 65 per cent of children should be permanently placed within 12 months of referral to foster care contractor, but previously, a child in Kansas would stay in foster on average more than two years (Eggers, 1997).

According to the baseline data, on average, it took two years and costs \$42,000 to place a child. Under PBCs, Kansas paid service providers \$12,860 a child and expected the majority of them to be placed in a year. Service providers were expected to place the majority of children in half the time and provide 70 percent fewer funds to do so. This resulted in substantial cost overruns, which put the entire child welfare system at risk.

The fact that Kansas did not engage service providers in the development of the targets is one of the reasons such inappropriate ones were included. By not talking to service providers, the government had little sense of what they were capable of achieving and at what cost. If government would have met with service providers, they could have indicated to them the targets were not achievable and that including them would cause serious financial problems.

Not engaging with service providers also helps to explain why the reimbursement rates were set too low. This was a new contracting system and they did not fully understand how the system worked and what was expected of them. As a result, in an effort to win the contracts, they underestimated how much it would cost them to meet the performance measures (KAC, 2001).

The experience of Kansas demonstrates the dangers associated with PBCs. If the practical pitfalls of implementing PBCs are not addressed, it will cause immediate, serious hardships for the government contracting agency and the service provider. If governments want to implement PBCs, they must be willing to invest the time and resources needed to address the challenges.

RECOMMENDATIONS

1. Use PBCs selectively

PBCs work best when the outcomes of a service are measurable and they can be attributed to the service provider. Therefore, PBCs should only be implemented with agencies that fall into the production and craft categories.

In agencies where outcomes cannot be observed, which is often the case in the social services sector, it is impossible to base a portion of the payment on them because it cannot be determined if the outcome is the direct result of the service provider's actions. Further, if outcomes cannot be attributed to the service provider it is not fair to hold them to account for achieving an outcome they have little to no control over. Based on these factors, PBCs should not be implemented with coping and procedural agencies. Instead, contracts should focus on outputs.

Supportive housing is an example of a service where it is appropriate to use PBCs. For example, a key outcome of supportive housing is to provide individuals with stable, long term housing. This outcome is measurable, as service providers can easily verify if individuals remain housed in their supportive units. Moreover, the service providers are responsible for the units and providing supportive services that will help the person stay housed. As they are responsible for these elements, it is fair to hold them accountable and basing a portion of their payment on providing individuals with long term, stable housing.

Homeless shelters and outreach services are both services where the use of PBCs is not appropriate. Neither of these services have direct control over housing homeless people. Their fundamental role is to connect clients to services. Since they have limited control over outcomes, it is not fair to hold them accountable for achieving them. Contracts with these agencies should only be based on inputs and outputs.

2. Performance Measures should include inputs and outputs

PBCs should be structured in such a way as to reward service providers based on inputs, outputs and outcomes. This will help ensure that the contracts encourage service providers to focus on the full spectrum of service delivery and not too narrowly on a few outcomes. Moreover, it will reduce the risk on service providers as it results in them being reimbursed for inputs and outputs and not just outcomes, increasing the chance that they will at least be paid for a portion of the contract.

In the case of supportive housing it is particularly important to reward service providers based on outputs. Outputs, especially the support services, are essential in achieving the goal of keeping formerly homeless people stably housed. Since the outputs play such a vital role in achieving the key, service providers should be encouraged and rewarded for providing them.

3. Engage service providers

From the very initial stages it is essential that governments engage service providers in the development of PBCs. PBCs represent a fundamental change in the nature of government contracts. Service providers may be resistant to making any changes and oppose the implementation of PBCs. Working collaboratively and engaging them will significantly help to overcome this resistance.

The engagement process should be used to achieve the following:

- Explain to service providers the benefits of PBCs and why they are being implemented;
- Educate service providers about PBCs and the skills they will need to operate under them;
- Give service providers an opportunity to shape and influence the design of PBCs.

The engagement process will help to generate buy in at the service provider level, helping to promote good relations between government and service providers. It will also prevent government from imposing an unworkable system on service providers and, ultimately, improve the quality of the contracts that are implemented.

4. Select appropriate performance measures and targets

Selecting appropriate performance measures and targets is essential to the success of PBCs. If inappropriate measures are selected, it will result in distortions in the service and may lead to service providers to work towards the wrong ends. If inappropriate targets are selected in can either make it too difficult for service providers to achieve them, adversely impacting their level of payment or make it too easy for them and provide them with an incentive to scale back their operations.

There are several key steps that government can take to enhance the likelihood of selecting appropriate performance measures and targets. First, government should develop a clear understanding of the goals that they want a particular program area to achieve. This will help to ensure that measures that are included in a contract are consistent with government's vision.

Second, government should work closely with service providers in developing the performance measures and targets. This enables service providers to have input into the process and, in turn, will help to create buy in for the system at their level. In addition, it will help to develop meaningful measures as service providers can identify measures that they think are inappropriate. Finally, it will develop some consensus between government and service providers as to what the system should be trying to achieve.

Finally, when selecting targets, if possible, the targets should be based on baseline data. This demonstrates the current status of the program and should

shed some light on targets that service providers can be reasonably expected to achieve. If baseline data is not available, government and service providers must work collaboratively to select targets and be willing to adjust them over time.

5. Structure payment scheme to avoid creaming

There is a risk that PBCs may lead to creaming. Oklahoma demonstrated that the payment scheme of PBCs can be adjusted to mitigate the risk of this occurring. Government can go a long way to avoiding creaming by simply offering a higher payment for individuals who are more difficult to serve. In collaboration with service providers, criteria could easily be developed to define which types of clients would be deemed “difficult to serve”.

6. Build the capacity of service providers

PBCs represent a fundamental change in the contracting regimen. To effectively operate under them, service providers must have the skill and IT capacity to track, record and report on outcomes. Government must be willing to invest the resources required to develop this capacity. For example:

- a. government should be willing to purchase computer and software packages to enable service providers to store data;
- b. they must provide training to help service providers develop the skills needed to operate under the system;
- c. and they should offer on going support to help service providers address any technical problems they may experience with PBCs.

Helping service providers to develop this capacity will ease the burden of transitioning to PBCs and help to ensure service providers can focus their resources on meeting their clients’ needs. It will also have the added benefit of reducing service provider resistance to PBCs.

7. Continually review and adjust PBCs

Once PBCs are implemented it is important to consistently review and, if required, revise the system. This will entail closely monitoring the performance of service providers, working closely with them to identify any issues, and having the flexibility to make changes to improve the system.

It is particularly important to review the performance measures and targets. As Perrin observes:

Few measures will be perfect the first time around. Even if they are, they are almost certain to become out of date due to changed needs, circumstances, opportunities and priorities. Measures that remain static are most susceptible to goal displacement (1998, p. 376).

By reviewing the measures and targets, government can help to ensure that they remain relevant and at an appropriate level.

8. Acknowledge the limitations of PBCs

It is important that government understand the limitations of PBCs. PBCs cannot inform them why outcomes were or were not achieved. Therefore, they cannot be used to make targeted interventions to improve services. To acquire this information, government must complete a thorough and scientific program evaluation. It is essential that governments realize the PBCs are not a substitute for program evaluations.

9. Involve an evaluation team in the design of PBCs

Members of an evaluation team should include individuals who are experts in program evaluation and performance measurement. This team will have the knowledge and the experience to help determine if the service providers have control over the outcomes, thus, helping government to avoid implementing PBCs with inappropriate agencies. In addition, they will be able to help select appropriate performance measures and targets. Ultimately, this team will play a key role in helping to avoid many of the pitfalls of PBCs.

Implementing PBCs is not an easy task. To implement them and avoid causing hardships for service providers requires a significant investment of time, energy and money. If governments are not willing to make this effort, they should not implement PBCs. Ultimately, PBCs may reduce overall costs, through a reduction of production costs, but they require a significant initial and ongoing investment in governance. If expected reductions in production costs compensate for increases in governance costs, then PBCs are appropriate.

CONCLUSION

This report examines the use of PBCs to purchase social services from non-profit service providers. It provides the Housing Policy Branch with the following:

- An overview of theoretical reasons for why PBCs should be implemented;
- The potential problems with implementing PBCs in the social services sector;
- The experience of four American jurisdictions with PBCs. This section highlights how they structured their contracts, the steps they took to implement them and what happened in these jurisdictions implemented them;
- Finally, the report includes recommendations for implementing PBCs with non-profit service providers in the social services sector.

This report has found that PBCs can only be implemented with agencies where the outcomes of their work are observable. In these situations, PBCs have the potential to effectively hold service providers accountable, promote innovation and improve the performance of service providers.

In service delivery areas where outputs are observable, but outcomes are not PBCs cannot be implemented. They hold service providers accountable for outcomes that they have limited control over and in the process place an unfair amount of risk on them.

A key theme of the report is that implementing PBCs, even with agencies that have control over outcomes, is not an easy task. There are numerous barriers, including resistance from service providers, difficulty selecting and measuring outcomes and placing an undue amount of risk on service providers, which must be overcome before implementing PBCs. This report has found that government can take the following steps to overcome these barriers:

- Selectively implement PBCs – payment should only be linked to outcomes when they are measurable and service providers have control over achieving them;
- Engage service providers through the entire process of developing, implementing, monitoring and revising the contracts;
- Invest the required resources to select appropriate measures and targets – including developing a clear vision of the goals government wants to achieve; working closely with service providers to select measures and targets; and basing targets on existing baseline data;
- Structure payment schemes to avoid creaming;
- Invest in building the capacity of service providers to monitor and track outcomes;
- Continually review and revise the PBC system
- Acknowledge the limitations of PBCs.
- Involve an evaluation team in the design of PBCs

These steps will maximize the benefit of PBCs and mitigate the risk of them having a detrimental impact.

This report has several important applications for the Housing Policy Branch. First, it provides them with the information they need to make recommendations to how best develop PBCs. It will also be beneficial in the future as it can act as a resource guide that can assist them in evaluating the PBCs that BC Housing implements.

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