

Chapter 2

Performance Over Promises

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Abstract Globally, stories of environmental health efforts are filled with good intentions and broken promises. Linking payments directly to long term social and environmental change can in some cases provide a solution. Pay for performance is now being used in a wide range of interventions and programs, but the potential of this approach is only beginning to be understood in the social sector. We explore theories that underlie pay for performance and lay the groundwork for understanding why and how this approach works. We then describe our Intent-to-Impact cycle—a four-stage model of Intent, Interventions, Evidence, and Pay for Performance that closes the loop between good intentions and impacts delivered. The challenge now is to use knowledge from this cycle to identify, explore, and learn from funding approaches that have and have not worked in important fields within the sector.

Keywords Pay for performance • Intent • Impact • Environmental health • Management theory • Global development

2.1 Pay for Performance

The common goal of nonprofits and social enterprises is to create positive social and environmental change. Yet the effectiveness of organizations in creating these changes varies greatly and the positive contributions of some organizations is debatable. In the absence of positive impact, some organizations are cost-ineffective in use of valuable resources that could be put to better use in making positive change.

When organizations fail to deliver promised impacts, donors can become skeptical and redirect their donations, taxpayers may push to reduce their governments' support of change efforts, and socially-oriented financiers may withdraw financial

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support or further emphasize financial returns. Such changes can greatly restrict the resources available to tackle devastating and persistent social problems.

2.1.1 Focus on Performance

One widely-promoted solution to this problem is increased accountability and transparency. Many funders are increasing their requirements for project monitoring and reporting and have encouraged more systematic evaluation and communication of activities and performance. These funders want evidence that their investees are doing the promised work and delivering the agreed upon outputs. But meeting these demands for accountability doesn't guarantee that the desired social changes have been achieved.

To ensure that these investments are having an impact, there has been an ongoing push toward providing hard evidence. The "gold standard" for reliable evidence comes from randomized control trials (RCTs). In this approach, measurements are taken before any action is taken, and groups are randomly assigned either to receive or not receive a funded intervention. At the end of the intervention, the organization or some external auditor measures whether the group that received the intervention is better off than the group that did not.

Although trials can be valuable, they are only useful for a fraction of investments, because they require very careful control of the intervention and they don't allow for any course corrections during the delivery of the program. This isn't possible in turbulent environments. And evidence about one intervention can rarely be generalized to another, because local conditions and populations vary so widely. This has left the sector with insufficient guidance on how to more efficiently and effectively address the needs of beneficiaries and to create the desired impacts.

Nonprofits and social enterprises in many fields are acutely aware of this challenge. As funds remain tight and problems remain massive in number and scope, the sector is looking for new ways to improve resource allocation and efficiency so that providers can do more with less. Pay for performance has begun to emerge in various forms in the social sector as organizations and their funders begin to recognize the potential for this paradigm.

At its core, pay for performance is the payment of money or other resources contingent on achievement of a performance goal. The increased recent interest in this approach results from the belief that funding can be designed to increase an organization's social performance through impacts such as improved quality of services, higher number of beneficiaries positively affected, or increased efficiency of service provision.

Donors have always cared about performance, and it has been common practice to link performance in one time period to funding in the next. However, like most ongoing funding, this performance-based funding has typically linked funding to inputs and activities rather than outcomes (Klingebiel 2012). This status quo is simplified in the following image.

Funders pay for successful performance in the delivery of services, such as the installation of solar panels or latrines. But whether these services have the intended



Fig. 2.1 The status-quo in many environmental health interventions includes linear flow of funding that does not result in continuous or reliable feedback on impact for beneficiary communities

impact on the populations they're intended to serve remains unknown. So funders and service providers alike are left with little feedback for improving their operations or for more effectively directing resources (Fig. 2.1).

2.1.2 Elements of Pay for Performance

Pay for performance provides an approach and incentives to help ensure that the question of impact will be answered and the answer will be that positive performance outcomes have been achieved. Three key elements are important when designing and managing performance-based contracts:

Performance: The agreements made between partners will include process for measuring and evaluating performance. Outcome and/or impact goals are specified and related performance indicators are identified. This forces parties to be clear about both the end conditions they seek to achieve and the path through which these conditions flow from activities and outcomes.

Incentives: In performance-based contracts, at least part of the payment is linked to performance outcomes. Financial and non-financial incentives are developed to align the risks and objectives of the parties so that when an implementer produces the desired impacts, both the funder and implementer will benefit.

Risk: Linking rewards to performance creates increased risk for implementing partners. In traditional contracts, funders select implementers based on their past and expected future performance. The only recourse funders have for poor performance is the drastic measure of terminating the contract. In pay for performance, parties have incentive to refocus and innovate to continually improve performance outcomes.

These foundational dimensions of pay for performance arrangements affect and guide the intervention process, because the compensation received is directly linked to the impacts achieved. Contracts are carefully designed and executed to maximize their benefits.

2.1.3 *Current Approaches*

Pay for performance approaches can be characterized based on three broad categories: performance based aid, performance based incentives, and performance based contracting. Performance based aid refers to programs that link foreign assistance to program outcomes. For example, one program funded by the World Bank's Global Partnership on Output-Based Aid reserved final payments for water service until it was shown that the service was functioning six months after it had been installed (Klingebiel 2012).

Performance based incentives are programs that incentivize behaviors. In this approach, the funder has specific behavioral expectations for the beneficiary and/or service providers that are closely linked to desired outcomes. Typically these are individual behaviors, such as patient completion of health treatments.

Performance based contracting can be defined as a contractual agreement between a funder or purchaser of goods and services and the supplier of those services. A contract ties at least part of the payment to performance. Performance based contracting has become a standard feature of management in for-profit corporations. It includes a clear set of objectives and indicators, processes for gathering and evaluating performance data, and rewards or sanctions based on performance to which the contracting parties agree.

Pay for performance is used in a wide range of interventions and programs and the potential of this approach is only beginning to be understood in the social sector. The challenge now is to identify and explore funding approaches that have and have not worked in important fields within the sector. We begin by exploring the theories that underlie pay for performance to lay the groundwork for understanding why and how this approach works.

2.2 Theoretical Foundations

Linking pay to performance has a foundation in decades of research and experience with pay for performance, both within and between organizations. Early principal-agent economic models focused on the relationships between owners (principals) and workers (agents) under circumstances in which the two groups had different goals and the worker's efforts weren't always visible to the owners. Paying workers for their output, such as for the number of items they produced, was a way of aligning the incentives of the workers and owners and overcoming problems of unequal information and the potential for shirking.

In recent years, pay for performance models have increasingly been used to understand and manage the relationships between organizations and they have been widely studied in business-to-business and business-to-government settings. Performance based contracting (PBC) is used to align the interests of partners across the entire supply chain.

Pay for performance is perhaps especially important for social sector work because it stresses beneficiary (customer) value. By using financial tools to align interests, it ensures that all supply chain partners benefit when social impact goals are achieved. Contracting partners and beneficiaries have the incentive to work together to produce results, and as a result, have the incentive to share knowledge and work together to improve processes and pursue other innovations that can improve impact.

Principal-agent models use contracts to govern relationships. The contracts are usually designed to guarantee benefits for the principals or investors when outcomes are uncertain and they lack information. These contracts can specify what agents are supposed to do, or as we propose here, they can specify what agents are expected to achieve.

Management control theory, in part, combines both of these outcomes and focuses on coordination of activities across contracting partners. Processes are monitored throughout the project which enables greater control over the outcomes produced. Process monitoring requires a clear understanding of how inputs and activities result in outputs and desired outcomes. This approach requires the investor to have a better understanding of the value chain and greater participation in monitoring throughout an intervention.

Transaction cost economic theory can also shed light on the value of pay for performance contracts. This theory considers the contracting costs and the efficiency of maintaining partnerships across contracting periods. When financial rewards are linked to outcomes, implementers may be more willing to invest in assets and processes specific to one funder or intervention, because the mechanisms through which those investments will be recouped are more clearly specified.

Experience in for-profit businesses demonstrates that pay for performance contracts can not only provide greater benefits to investors, by generating the desired performance outcomes, but they can provide a host of other benefits as well. Shared goals and greater cooperation across the supply chain can lead to knowledge sharing, collaborative innovation, and greater performance returns on investments. These benefits can also be realized in participatory development initiatives if the interests of beneficiaries are embedded into contracts.

2.3 Aligning Intent with Impact

Achieving sustained social and environmental impact requires much more than good intentions. Parties working to create the change must develop a closed-loop system that ensures that the investments they make are monitored and managed

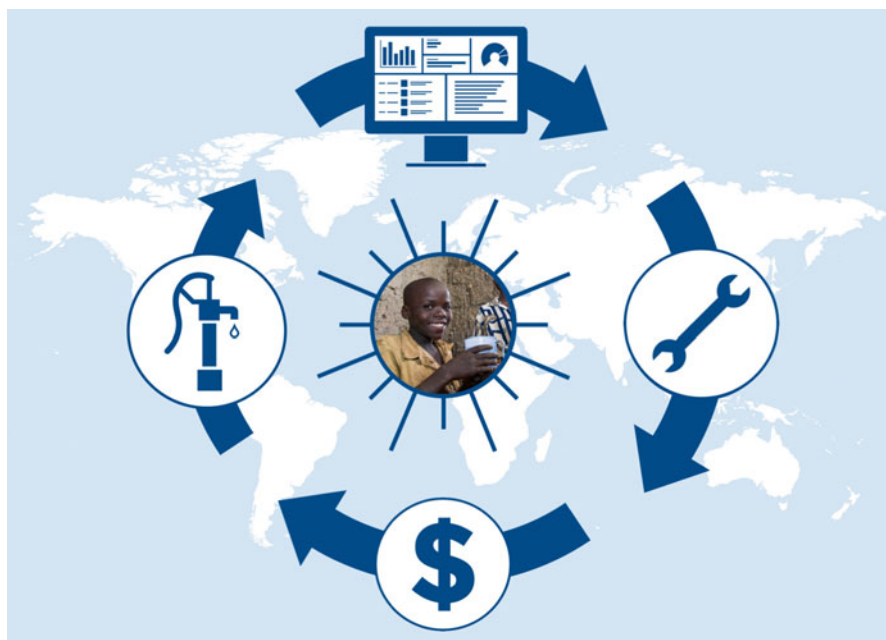


Fig. 2.2 A closed-loop pay-for-performance model aligns direct impact with funding. In this figure depicting a water pump installation project, water point functionality is monitored, maintenance activities provided, and payments generated through evidence of service delivery

such that progress toward impact is visible, course corrections can be made, and achievement of impacts is rewarded. Here, we develop a model of how pay for performance can be used to turn good intentions into lasting social and environmental change. The model presented here includes four elements, as seen in the diagram below: intent, interventions, impact evidence, and pay for performance. The cycle then loops back to intent as the cooperating partners re-define and re-imagine their intentions and interventions to create greater impact in the next round (Fig. 2.2).

The intent-to-impact cycle has four elements:

- Intent—the desired social and environmental impact goals are identified and agreed upon.
- Interventions—the implementing partners plan and execute interventions to achieve performance goals.
- Impact Evidence—measurements of performance are gathered and analyzed.
- Payment for Performance—payments are made based on evidence of impact delivered.

This cycle provides a way for funders and implementers to close the loop by linking pay to the performance of those activities that provide the social and environmental benefits both parties seek. Linking pay to impacts has many advantages over traditional approaches in which implementers are paid based on their activities

or on the delivery of products and services. Looking beyond these outputs to real, long-term impacts encourages partners to allocate resources to high-impact projects, to continuously innovate ways to achieve impacts more effectively and efficiently, and to make beneficiaries full partners in the co-production of impacts. This alignment is illustrated in the following figure.

2.3.1 Objectives of P4P

Pay for performance arrangements of all types are typically designed to achieve a similar set of objectives. First, they facilitate coordination between funders and providers to achieve end results for beneficiaries by designing incentives to ensure that goals among all three of these parties are aligned.

Second, by heightening the importance of performance outcomes and better defining the steps necessary for achieving them, pay for performance can help promote goal-oriented organizational systems. They can help create and support organizational systems in which achievement of goals isn't something attended to after completion of a project. Rather, it becomes embedded in the policies, processes, and even the culture of the organization. Third, pay-for-performance approaches promote external legitimacy. These arrangements signal that resources are being effectively managed, which can impact individuals from the parties involved but also potential future contracting partners. Because they demand accountability and transparency, at least to funders, these methods require systematization and discipline that can have numerous other organizational advantages.

Funders will typically seek to maximize the impact of any intervention and may have lofty or aspirational goals. Knowing that at least part of their payment will be determined by achievement of these goals, implementers will have the incentive to make sure that these goals are realistic, measurable and achievable.

2.3.2 Element 1: Intent

The first element, and the key to the pay-for-performance model is intent—the intended social and environmental changes that define and drive the model. In the first step in the intent-to-impact cycle, the collaborating partners establish the intent of their partnership. Before an intervention is planned, the partners need to agree on a clear set of output and impact goals. This is not the same as agreeing on expenditures, activities, or even goods or services to be delivered. For example, rather than agreeing that a certain number of water filters or malaria vaccines will be delivered, the parties will agree on the impact goals, such as disease reduction, that they want and expect to achieve. Each party must clearly define what a successful intervention would look like to them and eventually identify the kind of evidence that would convince them that long term success had been achieved.

This can lead to very different conversations than those focused on behavioral expectations. And the process can be quite enlightening, as it can reveal differences in intentions and perspectives among parties and even among members of one of the parties. For example, microfinance investors have very different intentions even as they agree on the means for achieving desired outcomes. If the focus is on short term operational goals, like granting a certain number of microloans or achieving a targeted portfolio value, the true intent of the loans may not be clear. But when intent is made visible, different perspectives will become apparent. Some investors seek to provide financial services in underserved markets. Others go further and seek poverty alleviation. Still others seek other outcomes such as women's empowerment, community cohesion, or improvements in environmental health. Clarifying the intent of an intervention can therefore help funders and operators to be more transparent about their objectives and formulate partnerships based on a better understanding of individual and mutual expectations and goals.

Voices of beneficiaries and other stakeholders affected by the proposed changes are also important in this process. The fact that interests and utility don't translate well across cultures has been well documented, and it is important to develop an understanding of whether the impact goals of funding and operating partners are consistent with the interests of their would-be beneficiaries. In one study, for example, it was shown that hungry people didn't maximize caloric intake when they had additional money to spend on food. Instead they spent part of the money on high quality food items they couldn't normally afford (Banerjee and Duflo 2012). In other studies, the poor have been shown to spend money on culturally important activities like weddings or funerals, despite having insufficient money to meet basic needs.

The advantage of using pay-for-performance approaches in such circumstances is that even if these preferences are not anticipated up front, these and other unintended consequences will quickly be identified as a result of performance monitoring, and if contracts are effectively designed, interventions can be re-designed to better achieve beneficial outcomes.

2.3.3 Element 2: Intervention

Intervention refers to the processes that will be enacted to achieve the intended long-term impacts. In traditional linear models of aid and development, the intervention comes first and impacts come second. The focus of many improved water initiatives, for example, is on how many water pumps will be installed and where they will be installed. If instead, impacts are prioritized, the focus might be on how many people will have improved health outcomes and how many cases of illness can be avoided.

Prioritizing impacts requires that each step in the intervention be designed with the goal of maximizing impacts. So a pump installation with a greater potential impact on health would be prioritized over one that reaches a greater number of people. When impact is the principal concern, related organizational structures,



Fig. 2.3 Logic model depicting the logical sequence leading up to intended impacts

systems, and processes can be designed to maximize potential for achieving intended goals. This emphasis should result in a logic model that tightly couples each element with ultimate impacts. Figure 2.3 shows a standard logic model.

A clear and well-designed logic model is essential for achieving desired impacts. Inputs include the monetary and human resources that will be devoted to achieving the desired impacts. Processes are the behaviors and actions that are to be performed. Outputs are the goods and services to be delivered by the implementers, such as immunizations delivered or cookstoves installed. Impacts are the social and environmental changes created by the interventions. They include core issues such as health, poverty, security, environmental health and resource depletion. Impacts are sometimes divided into intermediate outcomes such as changes in the behavior or attitudes of beneficiaries and longer term progress toward ultimate social goals.

Historically, the focus for the vast majority of funders and implementers has been on outputs. Under an output-oriented approach, funders specify deliverables in terms of outputs, and implementers carefully monitor and manage their achievements in delivering these outputs. Implementers are held accountable for outputs, and outputs are central to accountability and reporting activities. Far less effort is focused on the long-term impacts of these outputs and how these outputs will produce lasting social and environmental changes.

The intent-to-impact cycle requires organizations to clarify the linkages between outputs and impacts. Participants must understand why their investments and actions are expected to lead to change and how they expect this change to materialize. They must also estimate how much impact can be projected to result from the outputs to be delivered. Making this clear up front is critical because the sequence of steps in the logic model will be used to identify milestones toward achieving impacts. These milestones will be monitored and may be linked to intermediate payments in the pay-for-performance model.

2.3.4 Element 3: Impact Evidence

Gathering evidence through effective metrics and monitoring programs is the third essential element for ensuring that intended impacts are realized. When pay is linked to performance, effective systems are needed for gathering evidence regarding execution and outcomes for each step in the logic model leading to impact. And the impacts themselves must be very clearly defined and measured. This evidence is

the only way to know whether an investment is making a social impact and to know the scale of that impact.

Developing effective measurement processes requires a systematic approach to measurement. Epstein and Yuthas (2014) describe the process in detail. After the intent and interventions have been established, partners must first agree on how the results of the measurement system will be used. Some of the metrics will be used as a basis for financial rewards, but measurements should also be used to control activities, to advance learning, and to drive actions to continuously improve expected impacts.

Epstein and Yuthas (2014) further argue that while a broad range of metrics may be gathered, a small number of metrics most closely linked to performance milestones should be actively monitored and analyzed. These metrics form the basis for communicating with funders and other stakeholders. They will ultimately be used as a means for managing performance and improving impacts.

Typical measurement systems, even in well-established social sector organizations, tend to focus on monitoring the quantity and quality of goods and services delivered to beneficiaries. Pay for performance agreements require development of measurement systems that are capable of either directly or indirectly measuring the social impacts achieved.

In the most advanced measurement systems, intermediate and final impact metrics are integral to the day-to-day management of the organization and are well understood by managers and key stakeholders. Further, they are used to drive resource allocations and to inform strategic decision making to ensure continuous improvement in the achievement of social impacts.

2.3.5 Element 4: Pay for Performance

The final element is linking payments and other rewards to desired social performance. Carefully designed financial incentives help to ensure that funders and implementers are in alignment on the impacts they seek to create. As a result of this goal alignment, the parties are more likely to share information and work together to execute plans. In addition, all parties are incentivized to innovate when conditions change or milestones are not met. Because incentives are linked to ultimate outcomes, implementers have the freedom to make course corrections as problems are identified or as new performance-enhancing opportunities arise.

Incentives are used to motivate providers to provide high quality goods and services and to ensure that these outputs are resulting in the expected social and environmental outcomes. Incentives can be monetary or non-monetary and they take the form of rewards or sanctions. In addition to cash and other monetary resources, non-monetary incentives such as a strengthened relationship with the funder or recognition by funder and peer communities for success are also strong incentives.

Typically, incentives take the form of monetary rewards linked to specific performance targets. Evidence of achievement of these targets is typically gathered using one or more metrics that seek to effectively represent the desired long-term outcomes. By their nature, metrics can never fully represent the broader phenomena

they purport to measure, and they can be subject to misinterpretation or manipulation under the wrong circumstances. In addition, funders seeking to demonstrate rapid results may preferentially fund projects that are quickly and easily measured. Thus pay for performance methods work best when the real goals of the parties are aligned and not aligned because one party seeks a payoff.

Incentives must be carefully constructed to avoid focusing too much attention on only the outcomes specified. Other positive or negative activities or outcomes should also be anticipated and monitored. Funders will typically seek to maximize the impact of any intervention and may have lofty or aspirational goals. Knowing that at least part of their payment will be determined by achievement of these goals, implementers will have the incentive to make sure that these goals are realistic, measurable and achievable.

When effective pay-for-performance arrangements are designed, participants will be in alignment on desired impacts, the processes necessary for achieving them, and the role of the implementer in achieving these outcomes. When implementers achieve performance goals, they benefit in two ways: they gain financially as a result of well-designed investment arrangements, and they more effectively meet their social performance objectives—their *raison d'être*. Funders also benefit. Pay-for-performance arrangements ensure that each individual investment is logically linked to the desired goals and that investment performance is more transparent and incremental progress is visible. The wealth of information and insights provided as a result helps funders allocate resource investments in a manner that aligns with their own impact goals, and helps to ensure that each individual investment will maximize expected social returns.

2.4 Moving Toward Pay for Performance

Many organizations and funders aren't interested in outcome-based incentives because they believe they aren't needed or even that they are counterproductive. Implementers who are living day-to-day with programs and seeing positive outcomes first hand believe that they are already making optimal decisions regarding allocation of resources and execution of programs, and that they need no further incentives to ensure that their work is successful. For them, spending money on any type of monitoring or evaluation of outcomes is viewed as a diversion of funds away from programs and benefits for recipients, and will result in reduced rather than improved impacts.

While it is true that these organizations may be functioning optimally, evidence suggests that there are opportunities for improving outcomes in virtually any endeavor and better information about outcomes can inform and facilitate those improvements. Beyond this, clear evidence about what works can inform others working in the sector and the good works of one organization can be leveraged to improve others and greatly expand impact. A large number of organizations do recognize these benefits and are very interested in obtaining clear performance information, but are prevented from doing so by financial and other barriers.

2.4.1 *Overcoming Hurdles*

One of the biggest hurdles faced by organizations seeking information about their impacts is the difficulty of measuring outcomes. Although some organizations have such faith in the value of their work they find measurement to be a waste of resources, many believe that there would be value in measuring performance but it is simply too ill-defined or unstructured to be measured. Substantial work is in progress in many fields to overcome such problems. In microfinance, for example, the social performance task force (SPTF) has established a body of metrics for measuring many facets of impact in the sector. There is still much work to be done, but progress in the area is rapid.

Cost is another considerable barrier for many organizations that want reliable evidence about the effectiveness of their work. As we've discussed earlier, there are many reasons organizations are unable to invest in systems that would help gather this evidence and provide the feedback necessary to guide and improve their performance. Top among them is preference among funders for investing in the programs themselves, rather than in the infrastructure needed to measure and manage information. In addition, even within program investments, many funders seek to fund new projects and innovations and are less interested in supporting the ongoing administration and management of investments that are already in place.

While these hurdles are significant, means of overcoming them are on the horizon. One significant development that has the potential to both improve the effectiveness of measurements and reduce cost barriers is the introduction of information and communication technology (ICT). As technologies become less expensive to develop, install, and maintain, the amount of information that can be made available to program operators increases dramatically. For example, distributed and remote sensing technologies, such as micro-weather stations that gather and relay information about weather conditions have been effectively implemented in a variety of regions. This information can be used to inform agricultural inputs or determine when insurance payments should be made for low crop yields. ICT-A refers to the use of ICT for accountability, and there are many recent examples of using ICT to improve transparency, and ultimately governance of both public and private services.

One important benefit of using these technologies is to provide greater access to information for contracting parties that are remote from the intervention or otherwise lack information about activities and performance. For example, recipients of health services in Karnataka India were provided with smart cards that could be updated when services were delivered by health workers (Bhatnagar 2014). Reports were generated automatically from the smart card data, which eliminated the time required and potential inaccuracies associated with records kept by health workers. Those in charge of managing health care were able to receive more timely, accurate, and complete information regarding successes and failures.

2.4.2 Pay for Performance in Practice

Moving from intent to impact by implementing pay-for-performance methods is a distant prospect for many organizations working in the social sector. They believe it is too costly, too time consuming, or too difficult and is beyond their grasp. But increasingly, there are success stories of organizations that have moved from promises to performance by linking pay to desired long-term impacts.

This book is full of detailed examples of organizations that have achieved success in closing the loop. They follow the principles of the intent-to-impact model laid out here and they are achieving impacts. Also included in this book are stories of failure to achieve impacts and discussions of how those failures could be prevented or remedied by effectively linking social and financial goals.

The massive resources devoted in development to achieving social goals, although well-intentioned, often fail to deliver on the promised impacts. Addressing this problem by linking rewards to impacts could be seen as a common sense approach to improving social performance or could be seen as a moral imperative for making faster inroads into addressing the devastating circumstances faced by half of the people on the planet. Either way, valuing performance over promises by creating financial links between intent and impacts can dramatically change the way investments are made and the world's most intractable problems are addressed.

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