quiet revolution is taking hold across the United States. Faced
with diminishing budgets and a rising demand for social services,
governments at every level are adopting innovative funding
models to protect against waste and ineffective programs while
improving outcomes for the people they serve.

In the wake of a child welfare crisis in 2006, Tennessee adopted a new
model to reduce the amount of time it takes to place children in perma-
nent homes. Research indicated that reducing the time a child spends
in a temporary home would not only lead to better outcomes for the
child but also decrease costs in services and their administration later on.
With this in mind, Tennessee implemented a new contract that sought to
transform its child welfare system. The terms were relatively straightfor-
ward: Providers that improved on baseline performance received a share
of the state’s savings, and those that performed worse than the baseline
reimbursed the state for cost overages. Once fully implemented in 2010,
Tennessee’s new model nearly cut in half the average time a child spends
in temporary care, from more than 22 months to 14.

Tennessee is part of a wave of governments and other funders looking for
new and better ways to have an impact with increasingly scarce resources.
By re-engineering the way it traditionally delivered services, the state
was able to improve the lives of some of its most vulnerable populations
while saving taxpayer dollars. The state employed just one of a growing
number of outcomes-based funding models that hold immense promise
for transforming the way governments deliver services and improve the
lives of their citizens.

This chapter outlines the challenges of traditional funding models and
how results-based funding improves on them. It also covers different types
of results-based funding mechanisms and considerations for selecting
and designing these mechanisms. It reviews the benefits, weaknesses, and
challenges to using results-based funding models as well as the potential
for widespread adoption of these innovations.

MISDIRECTED INCENTIVES OF TRADITIONAL FUNDING MODELS
In traditional funding models, governments and the social sector primarily
focus on providing a prescribed set of services or activities. For different
reasons, these efforts often fall short of delivering on the outcomes that
funders want, and they do not always help the beneficiaries. One potential
reason for this is that traditional funding models do not lend themselves
to knowing which programs work and which do not. Instead, the model
focuses on compliance and performing prescribed activities. Bureaucratic
inertia can compound the problem. Organizational or legislative resis-
tance to change leads to programs getting funded the same way year after
year, regardless of impact.

The second hurdle centers on rigid and misaligned funding streams, or
what some call the “wrong pockets” problem. Sometimes, the entity that
fronts the cost of implementing a program does not receive commensurate
benefit. For example, one government entity may know of a cost-efficient,
evidence-based intervention or program that produces better outcomes.
However, the majority of the resulting savings may accrue to different
government entities. Therefore, the first government entity would bear the
cost of implementation and have little incentive to pursue the program.
This challenge dissuades that entity from carrying out a program that
would improve lives and save money.

However, change is coming. With a growing emphasis on evidence-based
practices, data-driven decision-making, and fiscal accountability, govern-
ments and the social sector are redoubling efforts to identify and support
programs that work. Funders, too, are devising new and creative ways to
get around the wrong pocket problem. For example, the U.S. Department
of Education, as part of its Performance Partnerships Pilots, has launched

1 Beeck Center for Social Impact & Innovation, “Funding for Results: A Review of Government
Outcomes-Based Agreements,” Georgetown University (November 2014).

2 John Roman, “Solving the Wrong Pockets Problem: How Pay for Success Promotes Investment in
Evidence-Based Best Practices,” Urban Institute (September 2015).
 initiatives to “braid” (strategically coordinate separate programs and funding streams) and “blend” (consolidate funding streams from separate programs) funding to increase the success of disconnected youth in achieving educational, employment, wellbeing, and other key outcomes.

IDENTIFYING, MEASURING, AND PAYING FOR RESULTS

No longer interested in paying for compliance, governments and other funders are shifting the focus to identifying, measuring, and evaluating success. Funders also now have many distinct tools to deploy based on the unique circumstances of the challenge or social policy to be addressed. We focus on three of the most promising models: 1) incentive prizes and challenges, 2) outcomes-based grants and contracts, and 3) Pay for Success. (See Figure 1 for a summary of the models.)

Incentive Prizes and Challenges

Incentive prizes and challenges are competitions among individuals, groups, or other entities designed to achieve clear, defined goals in a defined time frame. In a challenge, the funding organization identifies a problem, creates and publicizes a prize-based challenge for solving that problem, signs up diverse participants, and offers a reward to the winner. The funding organization awards the prize funds to the solver(s) with the best solution that achieves the desired outcome.

Outcomes-Based Grant or Contract

Outcomes-based grants or contracts are bilateral agreements between a payer and service provider(s). Under the arrangement, service providers receive some funding from the payer to operate the program, and they receive additional performance payments if they achieve agreed-on outcomes. (The proportion of total funding that additional payments make up can vary significantly.)

Pay for Success

Pay for Success projects, also known as social impact bonds, are contracts that enable a funder, typically government, to pay only when the program achieves desired outcomes. An external organization assumes responsibility for delivering outcomes. If (and only if) the outcomes are achieved, the funder releases an agreed upon amount of money to the external organization. Often, external organizations raise money from investors to fund service providers who work to achieve the outcome.

CHOOSING A RESULTS-BASED FUNDING OPTION

Not all results-based funding mechanisms are suited for all social policy objectives. When considering which innovation to use, governments and funders should closely examine the challenge they wish to address and consider several factors before selecting a specific instrument. We recommend considering four factors: 1) the nature of the problem, 2) the track record of solutions or potential solutions, 3) the time frame for achieving outcomes and making payments, and 4) the typical level of outside resources and partner organizations involved. Each of these considerations is important to identifying the most effective tool.
Time Frame for Achieving Outcomes and Making Payments

Another consideration is the timeline. On one end of the spectrum is incentive prizes and challenges, which can take as little as a few months to structure, implement, and pay out (although they can take years to complete). Loan incentives, investment tax credits, and performance-based contracting also tend to be quicker to structure and lead to change on shorter timelines.

Outcomes-based grants or contracts typically last between one and three years. Because they are often modifications to existing government grants that provide base funding and incentives based on performance, the timeline of outcomes-based grants and contracts tends to mirror that of traditional funding models and government contracts.

Meanwhile, Pay for Success arrangements typically last between three and eight years, although there are exceptions, such as the Chicago early childhood education project, which is slated to run 17 years. The typical three-to-eight-year timeline is driven largely by financial considerations; Pay for Success must balance the time needed to prove or disprove the efficacy of an intervention (and achieve results) and the time that investors and funders are willing to tie up money before receiving payment.

Outside Resources and Partnerships

Another important distinction between the various types of results-based funding is the degree to which external partners are engaged in the process. For funders, it is critical to determine to what extent outside resources are needed and desired to solve the problem. Although collaboration across levels of government and sectors is almost always necessary, the degree to which external partners contribute resources and are involved in program implementation will vary. Given the significant investment required for creating and managing partnerships, funders must weigh the benefits, limitations, and appropriateness of engaging external resources to meet their objectives. In addition, the specific ways that funders (particularly government agencies) can leverage external resources may vary by state on the basis of legislation and other regulations.

On one end of the spectrum are Pay for Success projects, which require a high degree of resources from external stakeholders. The most obvious resource requirement is the external financial resources typically used to...
pay the implementation partner conducting the intervention. In the United States, private investors, philanthropies, and even nonprofit organizations have all contributed financial resources to Pay for Success deals. For many funders, one or more partners are required to fill knowledge gaps related to innovative finance, monitoring and evaluation, stakeholder management, or other issues.

Perhaps even more important than the financial commitment is the investment of time required from all stakeholders. Pay for Success is still a fairly new concept, and each deal requires a highly tailored agreement that aligns the objectives of each group. The deals can take from several months to more than a year to craft, and they require a high level of commitment and coordination from all stakeholders.

As mentioned earlier, the very nature of the problems that incentive prizes and challenges are best at tackling lends itself to involving multiple stakeholders. The problem solvers in particular must invest significant time and potentially money in developing solutions. In addition, funders may work with other organizations to identify potential solvers and promote participation. They may also seek out partner organizations to provide financial and advisory resources for the planning and design phase of a challenge as well as contributions to the award.

The external resources required for outcomes-based grants or contracts are comparatively low. As discussed above, the social issues addressed by this type of results-based funding are more clearly defined. As such, funders may only need to engage an implementation partner who will be paid on the basis of his or her success.

**SHARED CHARACTERISTICS OF FUNDING MODELS**

**Delivering Greater Impact**

Although the considerations in determining the most suitable tool for a given challenge vary, the benefits of these tools are similar. The most important is, of course, the impact on a given population or issue area. One of the principal benefits of outcomes-based funding is that it allows government and other funders to differentiate between programs that are providing value to beneficiaries and those that are not. By requiring programs to meet established outcomes for a target population and then rigorously testing programs’ abilities to achieve those goals, funders have the data to make decisions about where to channel resources for the highest impact.

**Sharing and Shifting Risk**

The structure of many results-based funding mechanisms offers funders the opportunity to share or even shift financial risk. In the case of outcomes-based contracts, government or foundations are able to share the risk of success or failure with the service provider. If a provider does not successfully meet the objectives of the contract, the provider may forfeit a bonus or may not receive a portion of the agreed upon contract value. In the case of Pay for Success projects, the government does not incur any costs should a program not meet the outlined objectives and targets. For incentive prizes, government shifts the costs of developing innovative solutions to the problem solvers (although there may be some sunk program management costs). When choosing between mechanisms, funders should consider their appetite for taking on financial risk.

The “failure” of the first Pay for Success initiative in the United States, New York City’s Adolescent Behavioral Learning Experience (ABLE) intervention, demonstrates the success of outcomes-based funding. The ABLE project did not meet the targets established by the city of New York and agreed on by the investors, philanthropic partners, and the service provider. As a result, government paid nothing for the intervention. This left the city with the ability to channel resources to more proven interventions or to experiment with another innovative solution.

**ISSUE AREAS IN OUTCOMES-BASED FUNDING**

Outcomes-based funding mechanisms have already covered a range of issues, including but not limited to:

- Early childhood education
- Recidivism
- Public health
- Healthcare
- Job skills and employment
- Green energy infrastructure
- Homelessness
- International development
- Scientific innovation
Greater Financial Stewardship of Scarce Dollars
A focus on results also means that government and philanthropic resources are spent in a more responsible and meaningful way. In an era of tighter budgets, results-based contracts and other “pay for results” tools allow funders to ensure greater social value for every dollar spent. In the case of services that prevent a more costly intervention, paying for outcomes may actually mean paying less in the long run.

Reduced Administrative Burdens
A results approach also lowers administrative costs. As discussed, the current model of grant or contract management focuses heavily on monitoring who does what and how, rather than on what they achieve. This focus requires funders to spend a great deal of time monitoring various activities and arbitrary indicators of compliance, placing a significant administrative burden on agencies.

Challenges to Transforming the Status Quo Funding Model
To make this transition possible, funders must invest significantly in developing the capacity to monitor and evaluate the programs. This will require not only training, the creation of new tools, and the development of new business processes, but also a fundamental shift in the way administrators think about funding. For government, this would require both steps taken at the executive level and the alignment of other powerful actors, including the legislature and government administrators. Despite the significant investment in resources and time, a shift from an administrative to an outcomes focus would pay significant dividends for both funders and beneficiaries.

Additionally, as with any system that awards funding, there is the potential for manipulation of programs or data to give the appearance of meeting outcomes. It is possible that some programs may seek to channel services only to those most likely to succeed, leaving out those who are most at-risk and often have the most need. This would be a perverse incentive that lowers the social value of funding. In addition, without the ability to substantively monitor and evaluate programs, it is possible that results could be manipulated to demonstrate outcomes that have not been achieved.

Scaling Results-Based Funding
Despite the challenges, outcomes-based funding is once again the focus of governments and philanthropic funders across the country. Several Pay for Success initiatives have been launched. (See Figure 2 for a map of Pay for Success activity in the United States.) Large philanthropic funders like the Annie E. Casey, Laura and John Arnold, and Bill & Melinda Gates foundations (to name only a few) have also changed how they think about grant making, with a renewed focus on demonstrated outcomes for continued funding.

Most important, the infrastructure required to scale up outcomes-based funding is improving. The body of evidenced-based interventions is growing. Organizations such as the Washington State Institute for Public Policy (WSIPP) have created databases of evidence-based interventions, which funders can use to determine which issue areas might be ripe for scaling their outcomes-based funding portfolios.

An important step to leveraging this growing body of evidence will be to develop a common language for describing outcomes and measuring performance. In the impact investing field, initiatives such as IRIS and the Sustainable Accounting Standards Board are attempting to codify...
what impact means for investors. Similar initiatives would offer funders the opportunity to speak with one voice and reduce the monitoring and evaluation burden for all parties.

---

**Daniel Barker** is a senior consultant at Monitor Deloitte where he focuses on social finance, public sector innovation, and sustainable development. Prior to Monitor Deloitte, Barker was a program coordinator at Columbia University’s Earth Institute where he managed a number of the organization’s global health partnerships. Barker also served as a research associate within the Global Health Program at the Council on Foreign Relations. He holds an MA in international finance and economic policy from Columbia University and a BA in international relations from New York University.

**John Cassidy** is a senior manager in Monitor Deloitte’s public sector strategy practice based in Washington, DC. His work focuses on helping governments and public sector foundations use innovative finance and market-based solutions to improve program design and outcomes. Cassidy has an MPP from Harvard University.

**Winny Chen** is a manager in Monitor Deloitte’s federal practice where she consults to government agencies and commercial entities on strategy, innovation, communications, and performance management. Prior to Monitor Deloitte, Chen was a senior associate at Human Rights First, where she developed and advocated U.S. policies on prevention of and intervention in genocide and other mass atrocities. Before that, she was manager of China studies and a policy analyst on the Center for American Progress’ national security team. Chen holds an MA and a BA from Georgetown University.