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SETTING, PRICING, AND ADMINISTERING PERFORMANCE METRICS IN PAY-FOR-RESULTS PROGRAMMING

Step-by-Step Guide

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EXECUTIVE SUMMARY

The U.S. Agency for International Development (USAID) is undertaking a major cultural and operational transformation to expand its engagement with the private sector to achieve outcomes of shared interest and shared value. USAID's Private-Sector Engagement Policy signals an intentional shift to pursue market-based approaches and investment as means to accelerate countries' progress on the Journey to Self-Reliance.

As USAID and the broader development community seeks to increase accountability and evidence-based development, foster innovation, and maximize development dollars, new approaches are emerging to demonstrate measurable results from U.S. assistance programs and initiatives.

The Pay-for-Results (PFR) is an approach to development in which USAID makes payments when implementers achieve milestones or development results. By bringing together all stakeholders together from the beginning of the development activity to set performance metrics, this innovative approach seeks to ensure that funds allocated for U.S. development and humanitarian efforts achieve measurable results as cost effectively as possible.

HOW TO USE THIS GUIDE

The *Setting, Pricing, and Administering Performance Metrics in Pay-for-Results Programming Step-by-Step Guide* is designed to give development implementers simple and actionable steps on how to apply the Pay-for-Results in U.S. assistance programs that address some of the world's most complex development challenges. This Guide aims to serve as an essential tool to strengthen the capacity of implementing partners in aligning program outcomes to performance payments to incentivize measurable and sustained development impact in the countries where USAID serves.

DISCLAIMER: THE AUTHORS' VIEWS EXPRESSED IN THIS PUBLICATION DO NOT NECESSARILY REFLECT THOSE OF THE UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT OR THE UNITED STATES GOVERNMENT.

Introduction

Contracts and grants¹ in development are frequently awarded on a cost-reimbursement basis, where those undertaking the work (implementers) are paid for their *efforts* to achieve the desired outcomes. Pay-for-Results (PFR) shifts this model to one in which donors, governments, or other funding entities (funders) pay for *results*, in whole or in part, only when they are realized by an implementer. As such, establishing the right set of performance metrics (i.e., *how success is determined*) and pricing those metrics (i.e., *how much to pay for success*) are critical and quite challenging.

Implementers are understandably concerned with covering their costs, and not surprisingly, prefer to tie payments to shorter-term measures, usually inputs, milestones, and outputs, which are easier to assess and within their direct control. Funders, however, are more interested in producing measurable outcomes (which may take longer to materialize) and accomplishing those outcomes as cost effectively as possible.

For PFR to work, the implementer and the funder need to agree on metrics, which both parties feel are challenging but achievable and are priced fairly. Intended to support PFR-designers in developing, pricing, and administering appropriate metrics, this concept note is structured around six steps, as shown below:



In addition to building off of existing USAID guidance and authorities, each step highlights key considerations when determining the design of PFR programming. A generalized example on a clean water project is included to illustrate how each step may be executed in practice.²

¹ In USAID parlance, acquisition and assistance instruments.

² Within USAID, a critical first step in applying PFR is engaging early on within relevant offices (e.g., *Technical, Program, General Counsel, Office of Acquisition and Assistance, and Financial Management*) to ensure that the design and execution of PFR can be supported by all parties.

STEP ONE: ALIGNING ON SHARED GOALS AND DEFINING SUCCESS

“Our plans miscarry because they have no aim. When a man does not know what harbor he is making for; no wind is the right wind.”

Seneca



Arguably the most important component of PFR is aligning on shared goals. This should not be done in a vacuum, but rather through bringing together the key stakeholders (i.e., funders, implementers, and beneficiaries) to achieve consensus on what constitutes success. Optimally through a collaborative and iterative process, stakeholders will determine: (i) the problem to be addressed and the magnitude of that problem, (ii) their short- and long-term priorities (milestone indicators), and (iii) success or intended outcomes (the desired end state).

Aligning on Shared Goals

The most important component of PFR is bringing together key stakeholders to achieve consensus around a shared set of goals to be accountable to.

By aligning on shared challenges and goals for development objectives and requiring greater accountability for measurable progress on those goals, stakeholders increase the potential of maximizing the benefit that is created by the PFR programming.

In some programs (particularly those focused on social challenges), there may be multiple beneficiary groups, each with specific challenges requiring unique programming and unique metrics. As such, stakeholders will have to determine which approaches may work best in different contexts.³

WATER EXAMPLE:

Your office has been asked to consider an activity to increase access to clean water, and you have been tasked to convene a group of stakeholders to align on shared challenges and goals by asking the following questions:

- What is the problem communities face with regard to clean water access?
- What will success look like 3-5 years out?
- What is/are the best solution(s) to achieve success?
- How will we know if progress towards that success is being achieved?

The stakeholder meetings include your office, existing and potential implementers, beneficiaries impacted by the challenge, and relevant government representatives.

Coming out of this meeting, stakeholders agree that the challenge is water-borne disease as a result of limited access to clean water, and success is a significant, measurable reduction in water-borne diseases. The best solution is creating Clean Water Provision (CWP) sites (physical infrastructure that enables clean water access), which can be utilized by targeted communities. Progress will be measured by the construction of and access to CWP sites, along with reduction in water-borne diseases in impacted areas.

³ By disaggregating population-level metrics within existing datasets, there is an opportunity to differentiate the needs and characteristics of beneficiary groups (i.e., *create unique client profiles*) and identify programming best suited to support each group. Moreover, data analysis allows stakeholders to examine the full landscape of programming.

STEP TWO: DETERMINING WHICH METRICS TO USE



Chabuma's Corlette project: This 39-unit project consists of three types of residential units ranging from 75 to 140 square meters (807 to 1,507 square feet). 14 out of 15 residential homes have been completed and sold. Chabuma has recently completed the second and final phase of this project which consists of multi-family units. These units are set to be sold under the condominium law framework. Thus far, Chabuma has invested USD 4 million in private funds, in exchange for USD 336,363 in incentives from HOME. This means that every public dollar spent by HOME has leveraged 12 dollars in private capital, proving to the HOME team that a little can go a long way. However, beyond the incentives, HOME has worked tirelessly with Chabuma to provide assistance in project design, project financing, product marketing, coordination with banks, business plan development and green building construction/certification (EDGE).

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“What you count is what you get.”

Clifford Geertz



Building off of the shared goals articulated by the key stakeholders, the next step is to translate those goals into metrics that can be used to both track progress towards success (i.e., a set of positive outcomes from the project) during the course of the award period and evaluate the program at the end of the award period to determine possible performance payments.

USAID's ADS 201.3.5 (Monitoring, Evaluation and Learning) provides guidance on performance monitoring and evaluation. ADS 201.3.5.7 (Monitoring Indicators) addresses types of indicators and the selection thereof, noting the balance between the quality and quantity of indicator data, and the management and financial resources required to collect and analyze those indicators.

- *Quantitative Indicators* – can be counted on absolute terms (e.g., number of inoculations); whereas,
- *Qualitative Indicators* – can be measured either on a relative basis or against some other index (e.g., an improvement in the World Bank Doing Business indicators); whereas,
- *Milestone Indicators* – can be used to determine progress against metrics.

ADS 201.3.5.8 (Monitoring Data Quality) stipulates that indicators should meet the following standards of data quality:

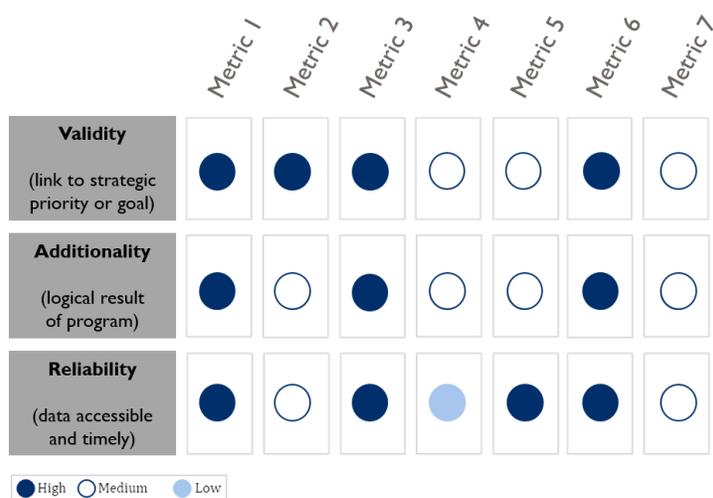
- *Validity* – data should clearly, adequately, and directly track and measure the intended result.
 - *Integrity* – data collected should have safeguards to minimize the risk of transcription error or data manipulation.
 - *Precision* – data should have a sufficient level of detail to permit management decision-making.
- *Reliability* – data should reflect stable and consistent data collection processes and analysis methods over time.
 - *Timeliness* – data should be available at a useful frequency, should be current, and should be timely enough to influence management decision-making.

Other criteria may be useful in building context around the performance indicators. For example, other criteria may verify that the results are additive and/or do not create unintended consequences. Such criteria include:

- *Additionality* – ensures the output or outcome would not have happened without this activity.
- *Time to Impact* – in cases of urgency, measures how rapidly results are met.
- *Sustainable Impact* – assesses whether the accomplishment of the desired outcome can be sustained once the activity ceases.
- *Minimizing Distortion* – certifies that the activity avoids significant market distortion.
- *Value for Money* – highlights cost-effectiveness of the activity in accomplishing the outcome (and in initiatives with outside financing, how much leverage was accomplished).

Taking the criteria listed above as a starting point, it is important to create a prioritization framework tailored to the shared goals of the PFR programming. Note: In all cases, trade-offs will have to be made because it will either be impractical or impossible to track metrics that touch upon all of the criteria. One suggested approach would be to start with the following criteria: *validity*, *additionality*, and *reliability* when brainstorming the initial list of metrics and then add on additional criterion to the prioritization framework as the metrics are whittled down to the ones that are most relevant to the shared goals of the programming.

FIGURE 1 | WATER EXAMPLE PRIORITIZATION FRAMEWORK



The benefit of creating consensus around the shared goals is that these trade-offs are acknowledged upfront and incorporated in the design of the PFR. For instance, if there are difficulties in identifying metrics within existing data sources that are both direct and practical, there is the option of tracking a mix of short-term process measures and long-term program outcomes. Process measures build capacity for data collection while also increasing attention on activities that drive success through continuous

program monitoring and adaptation. Examples of process measures could include inputs such as “number of CWP’s established” and “number of households trained”.

On the other hand, program outcomes tied to performance payments explicitly incentivize measurable and sustained improvements in the lives of beneficiaries (e.g., *reduction in hospitalizations, increase in mental health functioning, and increased utilization of preventative services*) or accomplishment of broader development goals (e.g., *increases in household earnings or households with increased food security*). Ultimately, the process measures and program outcomes should be complementary and mutually reinforcing. Therefore, a blend of quantitative and qualitative indicators may provide a more nuanced ‘balanced scorecard’ means of looking at performance.

Using a prioritization framework to apply qualitative rankings to each of the selected criteria will help narrow in on a short list of metrics that may be good candidates to tie to performance payments. In the illustrative example above (Figure 1), metrics 1, 3, and 6 are promising based on the criteria of *validity, additionality, and reliability*. “High” indicates that a metric is assumed to be high priority and/or there is severe need to be addressed within the target beneficiaries or development goals;

| Determining Which Metrics to Use |
|---|
| Metrics track progress towards a set of positive outcomes for the target beneficiaries and are a measure of final impact. |



Developed by Panamera, Les Residences Vesta will offer affordable homes within a secured community in the Croix-des-Bouquets area near Port-au-Prince. HOME has structured a pay-for-performance mechanism under this phase under which the developer will receive a payment at every step successfully implemented. The activity is spread over 5 phases and milestones under Phase 1 have been completed. To date, PANAMERA has invested over USD 1.7 million in its pursuit to complete this activity while HOME has disbursed USD 206,430 in incentives.

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There is strong evidence to support the programming’s influence on the metric; and data can be accessed and evaluated in a timely fashion.

On the other end of the spectrum, “low” demonstrates that a metric is of little priority and/or there is inadequate need identified within the target beneficiaries or development goals; there is no demonstrated impact of the programming; and there is no access to quality data and reliable indicators. Once a short list of metrics is determined from the prioritization framework, the stakeholders should go back to their shared goals to determine how they would want to weigh or determine a relative order of importance for each of the metrics. Considerations include the timing of when the metric will be measurable, strength of relationship between the goals and the metric, and the economic value of the metric (i.e., *would this metric generate cost savings that is salient to the funder*). The final selection of metrics requires stakeholders to balance these factors with the needs of the target beneficiaries or development goals.

WATER EXAMPLE:

Your initial report was favorably received and you have been requested to develop a set of metrics – a range which span across outputs, short-term outcomes, and long-term outcomes. Although each metric can be directly tied to one of the criteria associated with good performance indicators (listed below), you have been asked to address how to prioritize the metrics and ways to select those that are most relevant.

IMPACT

- Number and percentage of households with access to a Clean Water Provision (CWP) site in targeted area
- Percentage of CWP sites in which water quality is rated “Good” or higher
- Percentage decrease in water-borne illnesses in targeted area
- Number of reduced work and school days lost from water-borne illnesses in targeted area

COST AND MANAGEMENT

- Cost per household of providing access to CWP site
- Period of time required to provide households with access to CWP site

SUSTAINABILITY

- Percentage of CWP sites in which water fees cover O&M costs

You decide to walk your boss through a simplified prioritization framework (Figure 1) before deciding which additional criterion to use in your determination. You ask her to think about the following questions while going through the exercise:

- *Validity:* Does this metric clearly track and measure the intended result?
- *Additionality:* Is it reasonable to expect that this program will have a direct effect on this metric?
- *Reliability:* Does the data have stable and reliable collection processes over time?

STEP THREE: ESTABLISH BASELINE AND TARGETS

“Call it what you will, incentives get people to work harder.”

Nikita Khrushchev



Once you know what you are going to measure, step three is to set preliminary targets. Reaching final agreement on targets and possible pricing structure will ultimately result from negotiations between the funder and the implementer. But as in all negotiations, it is better for the parties to come to the table with a clear sense of a reasonable outcome. Metric baselines and targets are interrelated, but it is important to think through how they are independently defined and approached. Baselines answer the question of “*what would happen in the absence of the program*” and are sometimes called the counterfactual case, while targets determine “*what the stakeholders want the program to achieve*”. Impact, then, is the difference between the two (i.e., *how does the program itself move the needle on a given output or outcome compared to status quo*). Per ADS 203.3.4.5 (Setting Performance Baselines and Targets), targets should be ones which “*can optimistically but realistically be achieved within the stated timeframe and with the available resources*”. Targets need to be set against baselines and should ensure, to the extent possible, accomplishment of the targets are a result of the activity being undertaken by the implementer.

Establishing Baselines and Targets

Baselines answer “what would happen in the absence of the program”. Targets determine “what the stakeholders want the program to achieve”. Impact is the difference between the two.

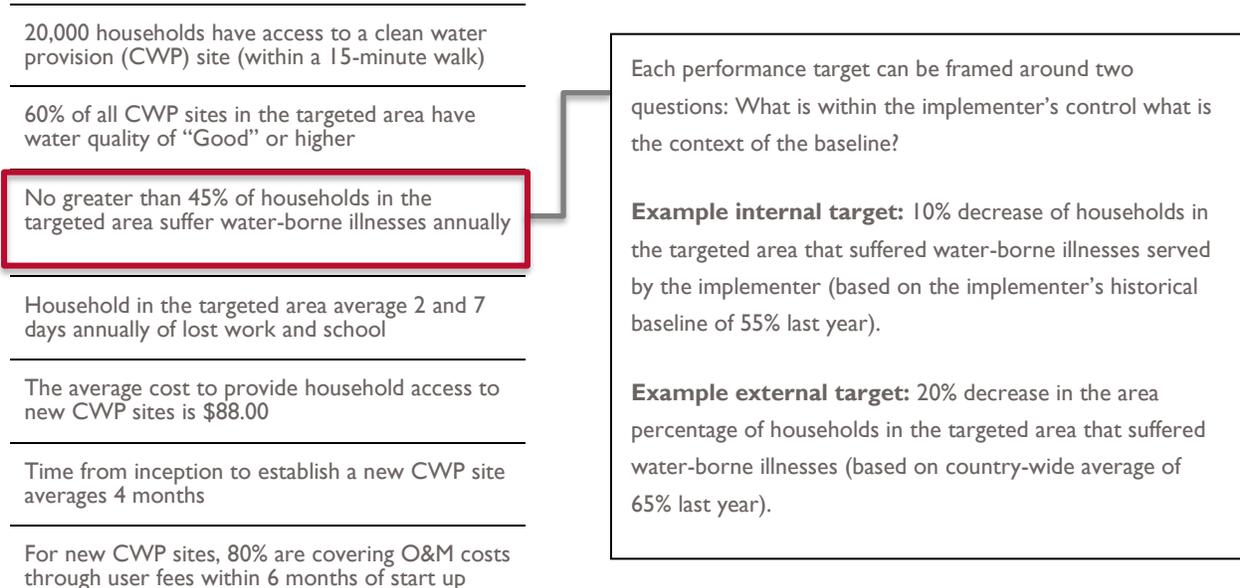
FIGURE 2 | WATER EXAMPLE BASELINES

| BASELINES AND TARGETS | | |
|---|----------|--------|
| METRIC | BASELINE | TARGET |
| 10,000 households have access to a clean water provision (CWP) site (within a 15-minute walk) | ✓ | |
| Of existing CWP sites 30% have water quality of “Good” or higher | | ✓ |
| 60% of households in the targeted area suffer water-borne illnesses annually | | ✓ |
| Household in the targeted area average 4 and 12 days annually of lost work and school | ✓ | |
| The current cost to provide household access to CWP sites averages \$198.00 | ✓ | |
| Previous initiatives have taken on average 9 months to establish a CWP site | ✓ | |
| Of existing CWP sites, 10% are covering O&M costs through user fees | | ✓ |

Baselines can range in rigor and complexity and are the basis for comparison of program performance. The most rigorous and complex is a dynamic baseline, which uses timely data to continuously update the baseline. This type of baseline is not set in stone before the project is launched, but instead will change as outcomes are observed. A static baseline does not change over the course of the project, and instead is determined before the program begins. To do so, stakeholders develop an expected baseline for what would happen in the absence of the program, for example by analyzing historical data. Program outcomes are then compared to this baseline. Targets must balance a push for improved outcomes with the need to meet the implementers where they are.

There are a number of different approaches in setting targets. An internal target is based on an implementer’s historical performance. This can be focused on improving and building on performance over time. On the other hand, an external target is calibrated to the performance of local peer organizations or implementers with comparable populations served and program models implemented. In some cases where data is either unavailable or not easily accessible, targets may be established around international standards that are widely accepted, such as the World Bank DataBank, Doing Business indicators, etc., especially if reporting is already required. Setting targets is realistically more of an art than a science because the chosen approach will depend on the specific context of the PFR programming.

FIGURE 3 | WATER EXAMPLE PERFORMANCE TARGETS



PERFORMANCE TARGETS

| METRIC | BASELINE | TARGET |
|--|----------|----------|
| Households with CWP access within 15-minute walk | 10,000 | 20,000 |
| CWP site with water quality of “Good” or higher | 30% | 60% |
| Households in the area suffering from water-borne illnesses annually | 60% | 45% |
| Lost work days and school days | 4 and 12 | 2 and 7 |
| Average household cost to access CWP | \$198 | \$88 |
| Average time to establish a CWP site | 9 months | 4 months |
| Sustainability (O&M costs covered) | 10% | 80% |

WATER EXAMPLE:

As your team begins to develop an economic model to illustrate how the project size, impact, and economics change with varied assumptions and inputs, you work to weigh different options of risk sharing between the funder and implementer. After conducting individual interviews and facilitating stakeholder discussions, you learn that implementers are uncomfortable with their performance, and therefore payments, being tied to external targets that are not directly within their control. After reporting your findings to your boss, you collectively decide to implement internal targets that leverage both static and dynamic baselines to create risk sharing between the funder and implementer.



The Desal Prize was managed by USAID as part of the Securing Water for Food Grand Challenge for Development in partnership with the U.S. Bureau of Reclamation. This prize incentivized the development of small-scale technology for brackish water (i.e., salt and fresh water mixed together). MIT and Jain Irrigation Systems (a university - industry partnership) designed a photovoltaic-powered electrodialysis reversal (EDR) system that desalinates water and was awarded \$240,000 for first place.

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AgResults is a \$118 million collaborative initiative between DFID, the Department of Foreign Affairs and Trade (DFAT) of Australia, Global Affairs Canada, USAID, and the Gates Foundation, to use pay for results to incentivize the scaling of high impact agricultural innovations. AgResults uses prizes to incentivize the private sector to enter markets they would usually deem unattractive, by reducing the barriers to entry. One AgResults pilot is the Zambia Biofortified Maize prize, which aims to build a market for pro-Vitamin A (PVA) maize meal.

TANAGER INTERNATIONAL

STEP FOUR: SELECTING AN EVALUATION APPROACH

“Everything that can be counted does not necessarily count; everything that counts cannot necessarily be counted.”

Albert Einstein



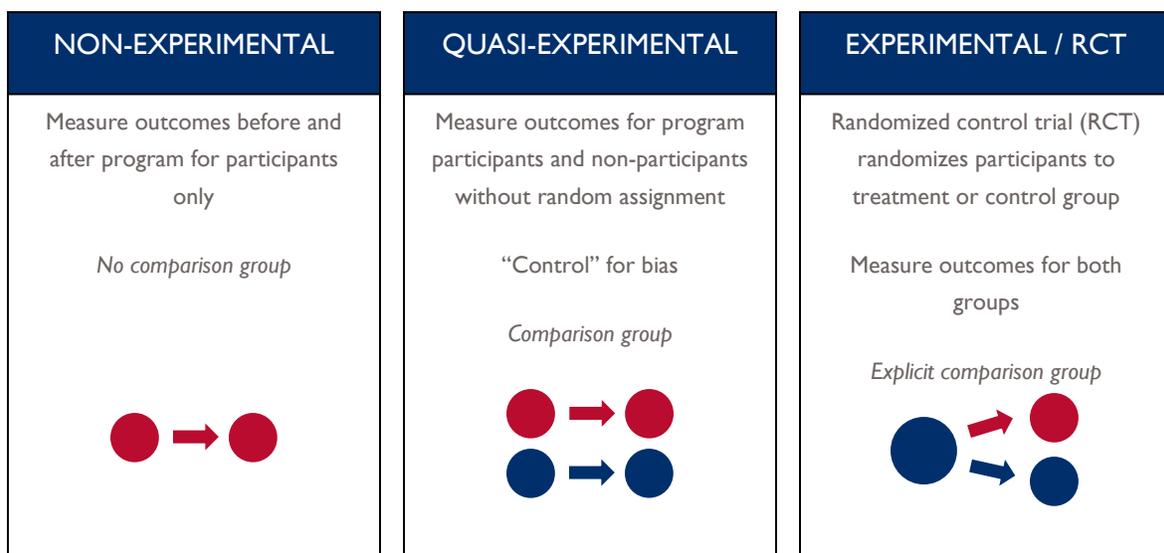
In PFR, the timing and design of the data collection and evaluation is often determined by the funder. In theory, the more rigorous the evaluation, the less risk the funder is exposed to since the implementer will need more evidence to demonstrate the results of their programming to trigger performance payments. However, the funder may agree to a less rigorous evaluation as long as this trade-off is reflected in the pricing of the performance payments.

A range of evaluation approaches can be used in PFR. Randomized control trials (RCTs) can isolate the impact of a program with a high degree of confidence, but also require significant resources to ensure that the program design can accommodate randomization and the randomization is implemented with fidelity. Moreover, RCTs necessitate individual-level randomization, which may not be practical or even feasible. On the other end of the spectrum, non-experimental designs are substantially less resource intensive but do not provide evidence of a program’s impact in isolation. These designs have relatively low evaluation costs, and under these methodologies, outcomes might be compared to a historical baseline for the subpopulations and geographies in question. Performance payments under non-experimental designs are

then made on a “rate card” basis, that is, outcomes are paid for if they are achieved, and are not compared to a counterfactual scenario. A quasi-experimental design measures the outcomes for program participants and non-participants without random assignment. Such a design can isolate the impact of the program, as long as other variables can be controlled for and sufficient data are available to evaluators.

Once the evaluation approach is selected, the funder and implementer will have to determine the weights and pricing of the performance targets based on the anticipated impacts of the programming. Regardless of the evaluation approach selected, timing of performance monitoring and conditions for performance payments are established in advance and become a part of the award document.

FIGURE 4 | SPECTRUM OF EVALUATION OPTIONS



WATER EXAMPLE:

Although it would be feasible to identify similar sites to serve as a quasi-experimental control group, given the vast majority of water projects are funded by other development projects, it seemed unnecessarily complex to try to control for all of the confounding factors. Instead, you decide to propose a non-experimental evaluation approach that uses pre-project metrics as baselines. (Note: In this situation, you could have chosen one of a number of evaluation methodologies. The important thing is that the method aligns with the level of rigor deemed necessary to trigger payments.)

The evaluation design reaffirms that this project is positioned as a learning opportunity for both the funder and implementers, with the hopes of scaling after the project collects enough evidence to determine the impact levels of the programming on the selected metrics. For the purpose of the initial rollout, you decide to focus on the following metrics: (i) households with CWP within 15-minute walk, (ii) household in the area suffering from water-borne illnesses annually, and (iii) average time to establish a CWP site. These metrics were selected based on estimated effect size of the programming based on historical data.

STEP FIVE: SETTING PRICING FOR METRICS

“Pricing is actually pretty simple... customers will not pay literally a penny more than the true value of the product.”

Ron Johnson



Price = Cost + Profit (i.e., fee), meaning that when consumers pay for a service/product, the price represents the costs (i.e., *direct and indirect*) of producing the service/product and the markup or premium, which is determined by balancing the producer’s valuation of utility and the consumer’s willingness to pay. How do you know if a service/product is accurately priced? When most of us go shopping, we do not simply pick up the first item we see; we look at substitutes, features and functionality, and price points, while also taking personal preferences into account, prior to point of purchase. The manner in which we determine if a price is fair and reasonable is through market research. Within an open marketplace, competition amongst producers will typically drive down prices to become more attractive to consumers. These general principles are also applicable for PFR.

Under PFR, once we have the targets and evaluation approach, there are a number of ways to derive pricing (i.e., *how much should we pay for accomplishing the targets*), including: (i) conducting cost- benefit analysis, (ii) imputing the cost from other projects, and (iii) establishing a competitive procurement process to seek different approaches and establish ‘fair and reasonable’ pricing from potential implementers. Some combination of these three may be the most useful.

- *Cost-benefit* – A cost-benefit analysis may quantify the economic benefits to be realized from the achievement of metrics against the financial cost of the initiative. At a minimum, some form of imputed economic benefits should be established (e.g., *for every additional water treatment plant built, benefits for each person in the area it serves will be \$98 annually as a result of lower healthcare costs and lost work days due to water-borne illness*). In those cases where the associated costs are too high to justify the expenditure, other opportunities where funds may be leveraged more effectively should be evaluated.
- *Comparable costs* – If comparable projects are available, the costs associated with those projects could serve as a proxy, providing a pricing benchmark. For example, a Department for International Development (DFID) water project in Tanzania provided 100,000 people with access to clean water at a total project cost of \$17 million or \$170 per person (i.e., *household cost of \$850 assuming average household size of 5*). However, it is important to calibrate the costs with the local context when building off of comparable costs from past projects. This ties back to the importance of maintaining alignment with the shared goals of the PFR programming.
- *Competitive procurements* – A formal process of creating a solicitation is implemented, which seeks and fosters competition among implementers wanting a financial gain for providing goods and services. The process will help determine the ‘market price’ for the desired outcome. Further, it will ensure multiple technical approaches to the same outcomes can be evaluated.

Even after the pricing level for the metrics is determined, the next challenge lies with how to structure the performance payments. Unlike traditional cost reimbursement mechanisms, the use of PFR shifts much of the implementation risk away from the funder and onto the implementer. However, few implementers are willing or able to accept all of the performance risk. The design challenge is finding a way to strike a balance for structuring performance payments. The structure should provide enough risk

protection for the implementer so that failure to meet the maximum targets is not catastrophic to them, while simultaneously providing sufficient financial benefit to keep them funded and motivated.

One method to balance these demands is to have a range of payment metrics that have different levels of control and impact. Shorter-term metrics tied to outputs and immediate outcomes are likely both more in the implementer’s control and necessary steps consistent with their theory of change toward the ultimate outcomes. Partial payment tied to implementing the program model reduces the total risk while keeping upside available by making the longer-term outcomes goals. Using the water example as a guide, the program would first reach the interim performance target of access to clean water with a “good” rating prior to reaching the longer-term performance target related to reduced illness and missed school and/or work-days.

| Setting Pricing for Metrics |
|--|
| The design challenge is to find a balance between downside protection to the implementer (ensuring that the failure to meet metrics will not be catastrophic) and sufficient upside to keep them highly motivated. |

In general, when implementers are faced with carrying the financial and programmatic risk of not having their costs fully covered in the event that targets are not met, they will need to be compensated for that risk in the form of a premium-type payment if targets are achieved. The potential financial loss associated with missing targets must be balanced with potential financial gain, so that the traditional cost reimbursement approach is not perceived as a universally better option. The diversification and distribution of performance risk is critical in PFR. Neither the funder nor implementer must be put in a situation where unrealistic targets and financial consequences (positive or negative) are in place. If such a situation arises, both sides will lose, which will ultimately mean the end beneficiary is no better than when the intervention started.

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| <p>WATER EXAMPLE:</p> <p>In order to price the metrics in your economic model, you conduct a literature review of past programming in the issue area and comparable countries. From the empirical evidence, you are able to establish key assumptions and inputs to determine the projected impact levels of your programming on the metrics, as well as estimate the costs associated with hospitalizations and lost productivity (e.g., wages) related to water-borne illnesses. As with any economic model, there are key levers that ultimately drive the project economics. In your model, there is a strong interplay between the impact levels and the performance payments since the causal link between the programming and the three selected metrics can easily be drawn. You decide to divide the total cost savings equally across the metrics and set the price of each on the rate of success you expect to see over the course of the project.</p> <p>You create a rate card (see below) that attaches a performance payment for each defined metric. (Note: The rate card builds in flexibility for implementors to receive payments throughout the life of the contract since payments are designed around the achievement of metrics on a “per household” basis.)</p> |
|---|

A few methods to institute and execute PFR are:

- *Impact Bonds* – Impact bonds are a way in which performance risk can be shared not only between the funder and the implementer, but also with a third-party investor. In this case, the investor, sometimes also called a funder, accepts the risk and reward from the implementer. Often it is an incomplete risk transfer so that the implementer retains some upside potential and downside risk as ‘skin-in-the-game’. Performance payments in impact bonds are often linked to reduction in longer-term remedial costs and increase in social benefits. Traditionally, rigorous evaluation

and/or pre-existing evidence base was critical to establishing the effect size of the program on the contracted outcomes. Recently incentives have expanded to include both financial and nonfinancial ones that balance the risk held by the funder and implementer with the benefit that is created by the expanded impact of the program. Thus, value creation encompasses more than just the costs associated with avoiding a negative outcome (e.g., *reduction in lost work days*) but also the trickle-down effects associated with societal good generated from the program (e.g., *increased cross-sector communication through the implementation of clean water initiatives*). In addition to performance payments that are triggered upon the achievement of outcomes, implementers have opportunities to reap benefits related to reduction in compliance requirements, increased flexibility in use of funding, and augmented data sharing and dynamic feedback loops.

- **Performance-Based Acquisition** – For services, Performance-Based Acquisition methods are described in FAR Subpart 37.6. Contract types that can be utilized to create incentives and performance payments are covered in the FAR Subpart 16.4. It is important to note that incentive contracts and can be used in both fixed-price and the cost reimbursement arenas, where performance payments can be tied directly to fee schedules or time extensions. This method shifts the risk from the funder onto the implementer. In doing so, the implementer is incentivized to achieve cost savings while meeting the desired outcomes.
- **Milestone-Based Assistance** – Assistance mechanisms can also lend themselves to PFR; whereby, a program can tie performance payments directly to outcomes. Therefore, if an implementer does not meet the milestone or outcome their payments are suspended until they do. It is important to remember that profit (i.e., fee) is not allowed under assistance.



Haitian mobile operator Digicel, flanked by banking, Gates Foundation and USAID and other representatives, claims a \$2.5 million award from the Haiti Mobile Money Initiative (HMMI) on Jan. 10, 2011, in Port-au-Prince. Digicel was recognized for being the first to launch a mobile money service in Haiti which meets the HMMI competition's criteria. HMMI is funded by the Bill & Melinda Gates Foundation and USAID.

KENDRA HELMER FOR USAID

STEP SIX: MONITORING PERFORMANCE AND PAYING FOR SUCCESS



In the FinGAP project in Ghana, USAID and its implementing partner Palladium, developed an innovative pay-for-results approach to facilitating financing for agriculture. The output sought was an increase in loans for targeted agriculture related investments. The performance metrics agreed were clear - evidence of disbursement of those loans. And in collaboration with Ghanaian banks, pricing arrangements were negotiated for accomplishment of those metrics. The net result was over \$150 million of targeted loans disbursed with incentive payments made of less than \$4 million...a leverage of 40:1.

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engage in process evaluations to assess efficacy of program delivery, identify real-time program adaptations, and track interim progress on metrics over the course of the award period. These process evaluations are effective mechanisms for continuous improvement and adaptive management, especially when coupled with a strong governance structure. Governance structures embed explicit roles and responsibilities for each stakeholder, establish clear expectations of how data will be collected and reviewed, and enforce ongoing oversight to allow for timely decision-making based on data insights.

“Price is what you pay. Value is what you get.”
Warren Buffet

Structures and processes to monitor performance over the course of the PFR programming are critical to not only tracking and paying on outcomes achievement but also informing continuous improvement. For the purposes of this guide, continuous improvement is described as leveraging data to measure the impact of day-to-day efforts and supporting informed, collaborative, and transparent decision-making to better align resources, services, and efforts to advance outcomes. The insights gleaned from the data analysis are then utilized to assess the efficacy of services, identify program delivery adaptations, and performance payments if and when agreed upon targets are met.

Once all parties have formally agreed and an award is executed, efforts shift toward active award management and continuous improvement strategies. The terms and conditions of the award outline the process for performance monitoring and timing of success payments. Both the funder and implementer have a responsibility to monitor progress and effectively communicate any areas that may impact the outcomes or delay a performance payment.

Monitoring Performance and Paying for Success

Insights from data analysis are utilized to assess the efficacy of services, identify program delivery adaptations, and trigger performance payments if and when agreed upon targets are met.

The impact evaluation, which measures outcomes against counterfactual achieved against the agreed upon targets, may be conducted periodically during the life of, or at the end of, the agreement to validate the outcomes (and thus determine performance payments). In addition to the impact evaluation, funders may also

WATER EXAMPLE:

It has been three years since your office issued the first PforR award to improve clean water access across the country through the development of Clean Water Provision (CWP) sites. Although implementers initially expressed concerns about their ability to cover costs due to the payment terms, your office was able to mitigate some of their risk by instituting partial performance payments tied to process measures. For instance, as a proxy indicator to the outcome of “households in the area suffering from waterborne illness annually”, you agreed to make smaller payments for the distribution of water tablets that increased the community’s water quality to “good” or higher.

Throughout the course of the project you sought to create clear channels of communication between the relevant stakeholders and established an advisory committee of key decision makers to oversee the implementation and governance of the project. To date:

- 50,000 households are within 15 minutes of a CWP;
- The rate of households in the area suffering from water-borne illnesses has dropped to below 30% annually; and
- The overall cost-savings generated as a result of lower health care costs and lost work days due to water-borne illnesses amount to \$14.7 million.

Based on this successful performance, payments can be made to continue to incentivize performance.

CONCLUSION

PFR programming when approached with intentionality and rigor has the potential to considerably augment a program’s impact on the community, while also positioning the program for scale. By bringing together key stakeholders at the beginning of the engagement you ensure that shared goals rise to the top, trade-offs and obstacles are acknowledged upfront, and decisions are made through consensus building. Stakeholder input coupled with timely access to data create the foundation necessary to articulate meaningful metrics and design incentives that will hold funders and implementers accountable to providing programs that measurably improve the lives of the beneficiaries served. The value of PFR stems from the fact that its components can easily be adapted to fit the requirements of different issue areas and local communities.

For example, Third Sector and Dalberg are supporting the USAID’s Center for Innovation and Impact (CII), within the Global Health Bureau, and the UN Special Envoy for Haiti to evaluate innovative financing approaches in hopes of accelerating the elimination of cholera transmission in Haiti. The initiative identified PFR as a promising funding vehicle to (i) attract new sources of public or private capital, (ii) increase transparency and accountability for results by introducing incentives for performance, (iii) allow greater flexibility and efficiency in approach, and (iv) build the capacity of the local government and implementers by investing in more robust data collection and reporting structures. Project parties are working with implementers, funders, and other local stakeholders to define priority outcome metrics, document a theory of change for eliminating cholera transmission in Haiti, and construct an economic model and finance terms that reflect the goals of all parties.

As you find opportunities to deploy PFR in your own work, we urge you to share your learnings and serve as catalysts for continued exploration with USAID.

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About U.S. Agency for International Development

The United States Agency for International Development (USAID) is the world's premier international development agency and a catalytic actor driving development results. USAID's work advances U.S. national security and economic prosperity, demonstrates American generosity, and promotes a path to recipient self-reliance and resilience.

About Third Sector Capital Partner

Third Sector Capital Partners provides advisory services for government, service providers, investors and project intermediaries pursuing Pay for Success and Social Impact Bond initiatives as well as growth capital advising to nonprofits and other service providers.

For more information on USAID's programming on Pay-for-Results, please contact Lawrence Camp, USAID, Office of Private Capital and Microenterprise, at lcamp@usaid.gov.