

5.2 PERFORMANCE-BASED CONTRACT

Brief Description

A Performance-Based Contract (PBC) is a pay-for-results funding model between public or philanthropic donor(s) and one or more service provider(s)/ implementer(s). With the objective to enhance the targeting and effectiveness of interventions, payments are (partly) linked to the achievement of pre-defined and independently verified targets – historically mostly outputs (e.g. medical treatments performed), but increasingly also outcomes (e.g. treatment results). A shift from outputs to outcomes is in particular valuable to ensure that funding is used effectively, and service providers are incentivised to create the desired effects for the end beneficiaries.

While a "pure" PBC is possible, e.g. in cases when implementers have enough own funds to pre-finance the programme (figure 9.3), most PBCs feature a hybrid structure (figure 9.4), with part of the funding paid upfront (e.g. on an input/activities-basis) and the rest based on results. Providing implementers – often NGOs with a limited budget – with an upfront payment allows them to increase their resources and have greater flexibility on how to reach the pre-defined targets. The proportion of upfront and performance-based payments is variable.

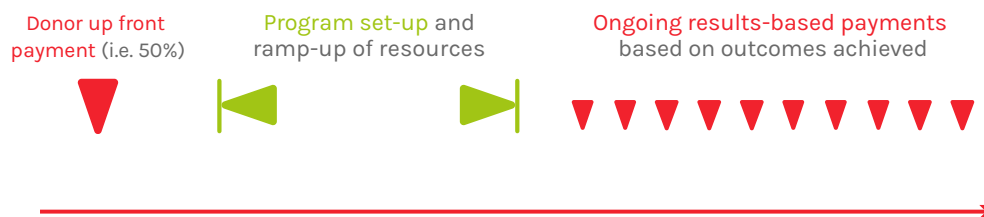


Figure 5.3 - "Pure PBC", source: Roots of Impact.

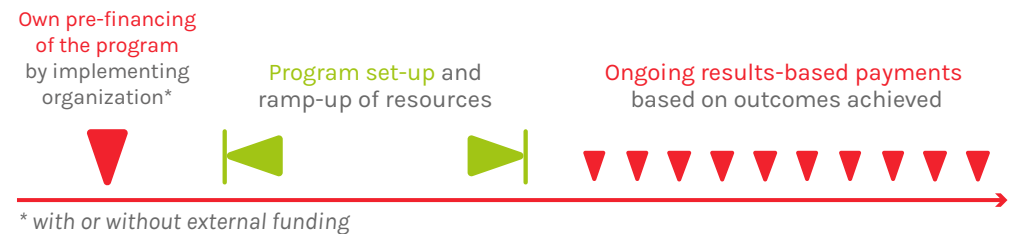


Figure 5.4 - "Hybrid PBC", source: Roots of Impact.

The underlying aim for PBCs is to empower innovative service provision and trigger higher performance. Strong probability of success (e.g. proven track record, credible data, clear and common objectives, solid monitoring system etc.) are needed to provide the necessary confidence for all stakeholders to implement a Performance-Based Contract. Especially when outcome-focused, PBCs represent a valid alternative to social/development impact bonds (see page 53). Given no private investment is involved, PBCs do not require a special purpose vehicle (SPV), thus decreasing the costliness and complexity of transactions. A PBC can also be used by the service provider to raise external, repayable finance in order to pre-finance the activities. By doing this, the structure becomes quite similar to an impact bond with the exception that the risk of underperformance lies with the service provider.

Purpose/Fit	Enable and incentivise social service providers (typically non-profit organisations) to implement effective solutions and outperform on impact, thus ensuring successful deployment of donors' funds
Can replace	Social/Development Impact Bonds, grants, public contracts
Risk/Return Profile	n/a (typically no investor involved)
Enterprise Lifecycle	All stages (typically non-profit organisations)
Maturity	Linked to the length of the intervention

Defining Criteria

- **Output or outcome-based:** Ongoing results-based payments tied to the achievement of results (outputs or outcomes).
- **Direct incentivisation:** Incentivisation of the value creator/outperformance trigger.
- **Flexibility:** Pre-defined metrics and verification methods, but flexibility on approach.
- **Optional upfront funding:** Potential upfront funding to service providers so as to increase their resources and flexibility.
- **Risk transfer to implementer:** Transfer of risk to implementing organisation (depending on proportion of upfront and performance-based payments).
- **Output or outcome verification:** Outputs or outcomes are independently verified.

Interesting Variants and Options

- **Output-Based Aid (OBA):** This is a PBC between donors and public/private providers, with the latter being provided with subsidies dependent on the achievement of certain pre-agreed results. OBAs complement or replace users' contributions. They are used to improve access to and delivery of basic infrastructure and social services (e.g. water and sanitation services) to the poor.
- **Performance-Based Financing (PBF):** This is a PBC typically used to fund health providers on a fee-for-service basis, with payments being conditional on the achievement of pre-defined targets that assure the quality of the service.
- **Prize-Based Challenge:** This is a form of PBC where an open-bid competition rewards (financially) those providing the best (i.e. most cost-effective and innovative) solution to a specific issue.

- **Conditional Cash Transfers (CCTS):** Upon achievement of pre-agreed results (e.g. regular health care checks, increased school attendance) payments are made to disadvantaged households to stimulate investment in human capital.

Example of Impact Bond structures

- Trickle UP Foundation and three NGOs (Association Monde Rural, Alliance Internationale pour le Développement et la Solidarité en Afrique, Aid Aux Enfants) signed a PBC in 2015, which focused on implementing coaching services to support poor families in Burkina Faso to secure paths out of poverty. Payments were made contingent upon families living under USD 1.25 a day reaching specific economic stability targets. Outcome targets included levels of savings and confidence.

Examples of relevant terms (as formulated in a contract):	
Funding structure	<ul style="list-style-type: none"> ○ Payments are made in proportion to achievements, and results are reported and verified (annually). ○ Baseline for the disbursement linked indicators is in both cases (zero).
People provided with access to an improved water source under the programme:	<ul style="list-style-type: none"> ○ A total of up to (USD 9,000,000) is allocated to this indicator, of which (USD 2,000,000) are available as an upfront payment. ○ <u>Example for output indicator:</u> For each person served by an improved water source built under the programme, a payment of (USD 77.70) is provided. ○ <u>Example for outcome indicator:</u> For each percentage of reduced diarrhoea morbidity in the defined communities a payment of (USD 350,000) is provided.

Number of new sanitation cabins equipped with handwashing facilities in schools built under the programme:

- A total of up to (USD 2,500,000) is allocated to this indicator, of which (USD 500,000) are available as an upfront payment.
- Example for output indicator: For each new sanitation cabin equipped with handwashing facility in rural schools built under the programme, a payment of (USD 1,689) is provided.
- In the event the number of sanitation cabins that are verified to be operational and properly maintained reaches at least (70%) of the number of sanitation cabins built in the previous year, an additional payment of (USD 150,000) will be provided.
- Example for outcome indicator: For each percentage of reduced student absence in the defined communities a payment of (USD 50,000) is provided.

- Implementers need to have the capacity to absorb some of the (financial) risks.
- PBCs can have unintended effects such as market distortion and cherry-picking/creaming.



Case studies and additional resources about Performance-Based Contract can be found [here](#).

Main Advantages

- Contract is between two parties only, and thus not overly complex or costly.
- No investor needed and no financial returns to be paid.
- Encourages outcomes-focused innovation and performance management in development.
- Pre-defined outcomes align expectations.
- Greater flexibility for implementers.
- Potential introduction of regular outcomes-based commissioning for governments.

Main Challenges

- Appropriate measurement framework and payment metrics are critical for success, but require time and resources.