Performance-Based Contracting for Human Services: Does It Work?
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ABSTRACT. Performance-based contracting is receiving increased attention today as a method of improving the efficiency, quality and effectiveness of human service delivery. This article looks at the performance-based contracting activities of selected state human service agencies, the approaches being used and the results being achieved. The article concludes that performance-based contracting for human services does appear to be accomplishing its objective: changing the behavior of contractors to focus more on performance.

KEYWORDS. Contracting, performance-based, outcome, outputs, quality
INTRODUCTION

State human service agencies have been making significant use of service contracting since the late 1960s (Wedel, 1974). Today, more publicly funded human services are provided via contractual arrangements than are provided directly by public employees (Martin, 2001). By some estimates, upwards of 80% of all human services funding may involve contracting by the year 2010 (Martin, 2001; Lauffer, 1997). Because contracting and human service delivery are so closely aligned, any major change in how governments contract has significant implications for the human services. A major change does appear to be occurring. Governments today are increasing their use of performance-based contracting.

At the federal level, the Office of Management and Budget has established a goal of making 20% of all service contracts over $25,000 performance based by the end of fiscal year 2002. More ambitiously, the federal Procurement Executive Council has established a goal of making 50% of all service contracts performance based by fiscal year 2005 (OMB, 2001:1; GAO, 2001a:8-9). State and local governments are also expanding their use of performance-based contracting for both human services and non-human services (Martin, 2002a; Gordon, 2001). At least ten state human service agencies (Arizona, Florida, Illinois, Kansas, Maine, Massachusetts, Minnesota, North Carolina, Oklahoma, Pennsylvania) are experimenting with performance-based contracting. In two instances, the Florida Department of Children and Families and the Maine Department of Human Services, the state legislatures have mandated that all human service contracts be performance based (Martin, 2002a; 2000b; 2002c). Given the current level of interest, most public and private human service agencies can expect to have a close encounter with performance-based contracting sometime in the near future.

WHAT IS PERFORMANCE-BASED CONTRACTING?

Performance-based contracting represents one of those interesting phenomena that arise from time to time where practice has outpaced theory. For example, no commonly accepted definition of performance-based contracting exists. To fill the void, several working definitions have been proposed. The Office of Federal Procurement Policy (OFPP) defines performance-based contracting as an approach where the statement of work is based on “objective, measurable performance standards outputs” (OFPP, 1998:5). In a related policy memorandum, the OFPP further states that a performance-based contract contains “performance standards (i.e., quality, quantity, timeliness)” (OFPP,
The National Association of State Purchasing Officials (NASPO) suggests that performance-based contracting is characterized by “specification of the outcome expectations of the contract and the requirement that any renewals or extensions be based on the achievement of the identified outcomes” (NASPO, 1997:120). Finally, the Federal Acquisition Regulation Part 37.601 states that “performance-based contracting methods are intended to ensure that required performance quality levels are achieved and that total payment is related to the degree that services performed meet contract standards.” (Emphasis added in all quotations.)

The various working definitions of performance-based contracting may appear at odds with one another, particularly given their various emphases on outputs, quality, quantity, timeliness, and outcomes. In reality, a great deal of commonality exists. Rather than saying different things, one can argue that these various definitions are merely saying the same thing differently. Performance-based contracting (Figure 1) is an attempt to move human service contracting away from its historical reliance on input and process design specifications (telling contractors how to perform the work) in favor of output, quality and outcome performance specifications (telling contractors what is expected) and leaving the how-to up to them. By building upon the various working definitions presented above, a consensus definition of performance-based contracting can be derived. A performance-based contract can be defined as one that “focuses on the outputs, quality and outcomes of service provision and may tie at least a portion of a contractor’s payment as well as any contract extension or renewal to their achievement” (Martin, 1999).

STATE HUMAN SERVICE AGENCY USE OF PERFORMANCE-BASED CONTRACTING

In this section, the performance-based contracting experiences of several state human service agencies are presented and discussed. Some of the state initiatives are broad based and involve several different human services (e.g., child welfare, mental health, refugee resettlement, job training, etc.). Other initiatives are more experimental in nature and tend to be targeted at one or a small number of human services. The state human service agencies selected for discussion here were identified using a variety of methods: previous work on performance-based contracting conducted by the author (Kettner and Martin, 1995, 1993; Martin, 2000), online journal searches, the Internet, and personal contacts. Additionally, the author attended a series of national conferences on performance-based contracting conducted in the United States and in Canada where the experiences of several state human services agencies were featured.
All of the state human service agencies reviewed here are generally recognized as leaders and innovators in the use of performance-based contracting for human services (Martin, 2002b, 2002c). Two of the states (Illinois and Oklahoma) have won national innovation awards; two other states (Maine and Florida) have both extensive and broad-based histories with performance-based contracting. Data on the use of performance-based contracting by state human service agencies are difficult to obtain, and data for comparable time periods are virtually impossible to obtain. For the most part, the data presented here were collected by others and cover various time periods.

Because the state human service agencies included in this study represent a purposeful sample and not a random sample, the findings and conclusions cannot be generalized to all states. Rather, the findings and conclusions should be considered as impressionistic and preliminary. Nevertheless, the experiences of these state human service agencies do shed some interesting light on the use of performance-based contracting.

**Maine Department of Human Services (Maine DHS)**

By mandate of the state legislature, all contracts issued by the Maine Department of Human Services (Maine DHS) must contain performance (e.g., output, quality and outcome) standards (Maine DHS, 1997). The Maine DHS has not attempted to directly tie contractor payments to performance, but does link contract renewals and extensions to the accomplishment of performance standards. The Maine DHS approach to contractor compensation is cost reimbursement. The Maine DHS refers to its approach as a "partnership" model of performance-based contracting (Clary, Ebersten & Harlor, 2000).
Commons, McGuire and Riordan (1997) conducted an evaluation of the Maine DHS’s use of performance-based contracting for substance abuse services. Their study reported two major findings: (a) the achievement of outputs and outcomes increased when tied to contract renewal, and (b) the greater the proportion of a contractor’s operating budget that came from a performance-based contract, the greater the performance. While the findings are not startling, they do confirm the basic premise of performance-based contracting: that contractor behavior can be influenced by the design of the contract (Shetterly, 2000). More importantly, the study suggests that contractor behavior can be changed to focus more on performance even without directly tying contractor compensation to performance.

Minnesota Department of Human Services

For several years now, the Minnesota Department of Human Services (Minnesota DHS) has been experimenting with performance-based contracting for job placement services (Dam, 2001; Vinson, 1999). Each contractor has quarterly job placement (outcome) and other performance goals that the Minnesota DHS closely monitors. If a contractor’s actual quarterly performance is less than the contractor’s quarterly performance goals, a corrective action plan must be developed by the contractor describing how it intends to improve performance. The Minnesota DHS approach to contractor compensation is cost reimbursement based on the number of clients contractors propose to serve and the cost per placement (Minnesota DHS, 2000).

As Table 1 illustrates, the Minnesota DHS’s approach to performance-based contracting has achieved some impressive results. In 1995, total job placements (outcomes) achieved by contractors numbered 591. By 1998, under performance-based contracting, job placements had increased to 1,136 and further increased to 1,423 in 1999 (Minnesota DHS, 2000; Vinson, 1999:5). The 1999 figure represents an increase of some 240% over the 1995 base year.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>1995</th>
<th>1998</th>
<th>1999</th>
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<tr>
<td>No of Job Placements (Outcomes)</td>
<td>591</td>
<td>1,136</td>
<td>1,423</td>
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Source: Adapted from Minnesota DHS (2000) and Vinson (1999:5).
Florida Department of Children and Families

The Florida Department of Children and Families (Florida DCF) is under a legislative mandate to contract out all department services by fiscal year 2003 (Sachs, 2002; Snell, 2001). As part of its strategy for achieving this objective, the Florida DCF is using performance-based contracting. Florida DCF spent several years working with its contractors to develop mutually acceptable performance standards to be used in its performance-based contracts. Thus, there is general acceptance, if not universal agreement, between Florida DCF and its contractors on how human service performance should be assessed.

To date, the Florida DCF has not attempted to directly tie contractor compensation to performance, but it does tie the award of new contracts to performance. Contractors that meet or exceed the standards (output, quality and outcome) in their performance-based contracts receive new contracts; those contractors that fail to meet their performance standards have their current contracts extended and are provided technical assistance to help them improve. Contractors that repeatedly fail to meet their performance standards may have their contacts terminated.

Table 2 presents a summary assessment of the results achieved by contractors under the performance-based contracts awarded by the Florida DCF for substance and mental health services during fiscal year 2000. Florida DCF staff compiled the data by comparing contract performance (output, quality and outcome) standards with contractor quarterly reports. The proportion of contractors meeting all of their client-specific performance standards was 80%. Among other issues, the Florida DCF case example raises the intriguing possibility that contractor involvement in the establishment of performance standards may lead to greater acceptance of the performance standards and perhaps ultimately to greater contractor performance.

Table 2. Florida Department of Children and Families Performance-Based Contracting for Substance Abuse and Mental Health Services

<table>
<thead>
<tr>
<th>Assessment of 516 Performance-Based Contracts:</th>
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<tr>
<td>• The proportion of contractors meeting all client specific performance (output, quality and outcome) standards = 80%</td>
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<td>• The proportion of contracts requiring corrective action = 44%</td>
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<td>(1) the number of contracts with payment reductions = 61</td>
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<td>(2) the number of contracts extended for six months = 18</td>
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<td>(3) the number of contracts terminated = 3</td>
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Source: Adapted from Florida DCF (2000):15.
Illinois Department of Children and Families

The Illinois Department of Children and Families (Illinois DCF) is using performance-based contracting for child permanency placement (reunification, adoption and subsidized guardianship) services (Martin, 2002b; Illinois DCF, 2000, n.d.). The premise of the Illinois DCF approach is one of attempting to increase desired outcome performance (child permanency placements) by managing contractor caseloads.

Contractors are compensated, using cost reimbursement type contracts, at a level of 25 cases per caseworker. Caseworkers are expected to find permanent placements for at least five children each fiscal quarter. At the beginning of each new fiscal quarter, every contractor caseworker is assigned five additional cases by the Illinois DCF. No additional compensation is provided to either the contractors or the caseworkers. If a contractor caseworker places five children during the preceding fiscal quarter, his/her caseload remains constant at 25. If fewer children are placed, the caseworker’s caseload goes up; and if more than five children are placed, the caseworker’s caseload goes down (Martin, 2002b; Karp, 1999).

As Table 3 indicates, the Illinois DCF approach has significantly increased child permanency placements. Based on Illinois DCF data, child permanency placements increased from 2,220 in fiscal year 1997 to over 7,000 in fiscal year 1999. The Illinois DCF reports that more child permanency placements were achieved during fiscal year 1999 than were achieved during a seven-year period between fiscal year 1987 and 1994 (Illinois DCF, 2000). The Illinois DCF approach has not been without its critics who raise questions about the appropriateness of some of the child permanency placements (Karp, 1999).

Oklahoma Department of Rehabilitation Services

The Oklahoma Department of Rehabilitation Services (Oklahoma DRS) has been experimenting for some time now with performance-based contracting for employment services. The Oklahoma DRS calls its approach “milestone” contracting because each client served under the contract is treated as an individual project (Frumkin, 2001; Novak, Mank, Revel & O’Brien, n. d.). The Oklahoma DRS’s approach is perhaps best explained by an illustration (Table 4).

As Table 4 demonstrates, each client served by a contractor is treated as an individual project with a definable start point (determination of need), a definable end point (case closure) and major milestones along the way (e.g., job placement). The payment mechanism used by the Oklahoma DRS equates to a fixed fee with progress payments. A fixed-fee per client is established in
the contract and the contractor earns a portion of that fee every time a client achieves one of the milestones. An evaluation of 13 performance-based contracts awarded by the Oklahoma DRS between fiscal years 1992 and 1997 found that the time clients spent waiting to receive services declined 53%, case closures (outcomes) increased 100% and contractor costs decreased 35% (Oklahoma DRS, n.d.).

Two features of the Oklahoma DRS approach to performance-based contracting warrant special mention. First, the idea of treating each person served under the contract as an individual project is simply a derivation of classic project management. Second, the idea of tying portions of a contractor’s compensation to performance specifications (outputs, quality and outcomes) and other portions to design specifications (process and perhaps even inputs) demonstrates

| TABLE 3. Illinois Department of Children and Families Performance-Based Contracting for Child Permanency Placements |
|---|---|---|
| Fiscal Year | 1997 | 1998 | 1999 |
| No of Child Permanency Placements (Outcomes) | 2,229 | 4,293 | 7,315 |
| Source: Adapted from Illinois DCF (2000). |

| TABLE 4. Oklahoma Department of Rehabilitation Services Performance-Based “Milestone” Contracting for Employment Services |
|---|---|---|
| Milestone | Type of Milestone | % of Fee |
| 1. Determination of Need | Process | 10 |
| 2. Vocational Preparation | Process | 10 |
| 3. Job Placement | Output | 10 |
| 4. Job Training | Process | 10 |
| 5. Job Retention | Process | 15 |
| 6. Job Stabilization | Quality/Outcome | 20 |
| 7. Case Closed | Outcome | 25 |
| Sources: Adapted from Frumkin (2001):12; Oklahoma DRS (n.d.):1-2; Novak, Mank, Revell & O’Brien (n.d.):29. |
that performance-based contracting does not have to be conceptualized as an “all or nothing” proposition where contractors are only paid for performance with no other factors being taken into consideration.

**Pennsylvania Department of Welfare**

The Pennsylvania Department of Welfare (Pennsylvania DW) has been experimenting with performance-based contracting to implement an experimental job training program called “community solutions.” The Pennsylvania DW approach is another variation of milestone contracting similar to yet different from the Oklahoma DRS approach. Again, an example is perhaps the best way to explain the Pennsylvania DW approach (Table 5). Unlike the Oklahoma DRS approach, the Pennsylvania DW does not compensate contractors for the accomplishment of any process milestones; contractors are compensated only for performance (output, quality and outcome). The Pennsylvania DW approach also differs in that a fixed fee is paid to contractors for accomplishing any or all of the four performance milestones. Contractors earn a payment of $1,000 when a client assessment is completed and another $1,000 when the client is placed in unsubsidized employment. If the job includes medical benefits, contractors earn an additional payment of $400. And if the client remains employed for a period of 12 months, contractors earn a final payment of $1,600 (Pausell & Wood, 1999:7).

An external evaluation of the Pennsylvania DW approach to performance-based contracting was conducted in 1999 (Paulsell & Wood, 1999). The evaluators reviewed some 70 performance-based contracts awarded by the Pennsylvania DW up to that time. As part of the evaluation, the researchers conducted in-depth interviews with contractors. According to the evaluators, and in keeping with other study findings cited above, contractor staff reported focusing more on performance after the change to performance-based contracting than they did before the change. A finding not previously reported, however, was that some contractors gave money to clients to stay in the program, presumably to continue their employment long enough for the contractor to receive the final $1,600 payment. This finding suggests that while performance-based contracting may resolve some contract service delivery problems, it can also create new ones. Fortunately, in this instance the newly created problem can easily be rectified by simply including contract language that prohibits this practice.

**Kansas Department of Social and Rehabilitative Services**

The Kansas Department of Social and Rehabilitative Services (Kansas SRS) has been using performance-based contracting for child welfare services
including family preservation, foster care and adoption (Scott, 2001; Gurwett, 2000, Martin, 2000). Kansas SRS’s original approach to performance-based contracting was arguably the boldest such experiment ever undertaken by a state human service agency (Scott, 2001; Petr & Johnson, 1999; Eggers, 1997). The original Kansas SRS approach can be thought of as contracting for outcome performance within a managed care environment.

Under the original Kansas SRS approach, contractors were paid a one-time up-front fee per child. Contractors were then required to provide all services the child might need until he/she exited service and the case was closed (an outcome). For example, contractors providing adoption services were paid a one-time up-front fee of $18,000. Since contractors received no additional compensation, a strong incentive existed for the contractors to place children for adoption as quickly as possible (Eggers, 1997). In order to insure that contractors did not attempt to cut corners, numerous quality standards were included in the contracts. If contractors quickly placed children for adoption, then at least theoretically they could earn a profit on the contract. However, the contractors were legally obligated to continue to care for children until they were placed for adoption regardless of the length of time required.

The Kansas SRS experiment with performance-based contracting can be considered both a success and a failure. On the success side of the equation, an evaluation conducted by the General Accounting Office (GAO, 2000) found that the outcomes achieved by the contractors equaled or exceeded the contract requirements. On the failure side of the equation, the Kansas state legislature (State of Kansas, 2000) found that the funding arrangements created severe financial problems for contractors pushing some to the brink of bank-

<table>
<thead>
<tr>
<th>Milestone</th>
<th>Type of Milestone</th>
<th>Fee</th>
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<tbody>
<tr>
<td>1. Participation (client assess completed)</td>
<td>Output</td>
<td>$1,000</td>
</tr>
<tr>
<td>2. Placement (client placed in unsubsidized employment)</td>
<td>Output</td>
<td>$1,000</td>
</tr>
<tr>
<td>3. Medical Benefits (job includes medical benefits)</td>
<td>Quality</td>
<td>$400</td>
</tr>
<tr>
<td>4. Job Retention (client remains employed for 12 months)</td>
<td>Outcome</td>
<td>$1,600</td>
</tr>
</tbody>
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Source: Adapted from Paulsell & Wood (1999):7.
ruptcy. The problem with the Kansas SRS’s approach to performance-based contracting can be described as going beyond the capacity of its contractors. Unfortunately, many of the human service contractors in Kansas apparently lacked the cost accounting systems necessary to identify the full cost, or total cost, of service provision (Scott, 2002). As a result, contractors tended to under-estimate their true costs of service provision. The Kansas SRS subsequently changed to a milestone approach to performance-based contracting.

The Kansas SRS case example underscores an important point, before government human service agencies begin tying contractor compensation to performance they should consider the extent to which their contractors have the capacity to operate under this type of contractual arrangement.

WHAT ABOUT CREAMING?

Although the subject of “creaming” was not envisioned as part of this inquiry, two interesting studies were discovered that are worth noting because so little research has been done on this subject. One of the criticisms leveled against performance-based contracting is that it inevitably leads to contractor creaming. The argument is made that once you begin requiring contractors to focus on performance they will seek out those clients that are the easiest to serve and will avoid those clients that are the hardest to serve. While this criticism has been around for a long time, little research bearing on the issue exists. Recently, however, two studies have been done that do shed some light on this issue. What makes the two studies interesting is not only their findings, but the fact that they were both conducted by Canadian research organizations looking at performance-based contracting for human services in the United States.

The first study, conducted by three researchers at the University of Calgary, looked at performance-based contracting for substance abuse services in the State of Maine (Lu, Ma & Yuan, 2001). The study examined the records of 18,972 clients served by contractors between 1989 and 1995 focusing on referrals between contractors. If creaming was taking place, the researchers expected to find that harder to serve clients would be referred between contractors more often than easier to serve clients. What the researchers found was that referrals between contractors did increase over the study years, but that clients with more severe substance abuse problems were referred and treated in the most intensive programs, while clients with less severe substance abuse problems were referred and treated in less intensive programs. Rather than creaming, the researchers concluded that contractors were specializing in the types of clients served.

The second study was funded by the Social Science and Humanities Research Council of Canada and involved a meta-analysis of other studies of
performance-based contracting under the U. S. federal *Job Training Partnership Act* (JTPA) (Heckman, Heinrich & Smith, 1999). The JTPA program has the longest history of performance-based contracting of any human service. The researchers found little evidence of creaming. In summarizing their findings, the researchers stated that “the literature has devoted too much attention to cream-skimming given the weak evidence of its existence” (Heckman, Heinrich & Smith, 1999: 50).

**SUMMARY AND CONCLUSION**

This article has looked at the performance-based contracting experiences of a purposeful sample of state human service agencies. What do these experiences suggest?

*First,* performance-based contracting appears to be accomplishing its primary objective: changing the behavior of contractors to focus more on performance. All of the case examples examined demonstrate increased contractor interest and concern with performance; some of the results noted are quite remarkable.

*Second,* performance-based contracting can involve outputs, quality, outcomes or any combination. Several of the case examples clearly demonstrate that outputs, quality and outcomes can be successfully mixed and matched in performance-based contracts.

*Third,* performance-based contracting does not necessarily require that all contractor compensation be tied to performance. The case examples demonstrate the successful application of performance-based contracting when contractor compensation is only partially tied to performance and even when little or no contractor compensation is tied to performance.

*Fourth,* the two Canadian studies suggest that performance-based contracting does not lead inexorably to contractor creaming.

Some cautions are also in order. Performance-based contracting for job training services and child permanency placements have both undoubtedly benefited from a combination of changes in federal law and an expanding economy. The old Job Training Partnership Act (JTPA) required the use of performance-based contracting, and the Adoption and Safe Family Act has placed increased emphasis on client outcomes. Additionally, performance-based contracting for these two services has most certainly benefitted from an expanding economy. What happens and how well performance-based contracting performs during an economic downturn will have to await future research.
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