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The Evolving Promise of Pay for Success

by Sindhu Lakshmanan, Roger Low & Caroline Whistler, October 23, 2019

Despite growing pains, the pay for success funding model is finding renewed success in communities across the United States and is primed to evolve into an ever-more-powerful tool for social change.

Today, 40 million people, including 15 million children, live in poverty in America—the wealthiest nation in history. In the half-century since President Lyndon Johnson launched the War on Poverty, policy makers have tried many approaches to reduce economic hardship in the United States. Yet poverty, as measured by earned income, has barely budged.

Addressing social problems like poverty is one major rationale for the public policy approach called pay for success (PFS). The big idea behind PFS is simple: Results should drive public-sector decisions and dollars. In other words, we should determine the success of a social service not by the number of people enrolled in it or by the degree to which it complies with a checklist of programmatic requirements, but by whether it actually improves lives.

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In our direct work with PFS initiatives over the past decade, we've seen the field mature and believe the approach has massive potential to address intergenerational poverty and other social issues over the next 50 years. However, as with any new approach, there have been setbacks. For instance, some of the first projects aren't on track to achieve their original target outcomes. In other cases, critics have raised questions about the methodology of project evaluations. This isn't surprising—achieving durable systems-change is hard. But instead of throwing in the towel, governments, nonprofits, and funders should "fail forward" and improve.

At its core, PFS includes a number of fundamentally strong elements, including data-informed decision-making, adaptive governance structures, and active performance management. It clarifies desired outcomes, and links funding to outcomes and progress toward those outcomes along the way. PFS also powerfully incentivizes stronger cross-sector collaboration and coordination between governments, funders, evaluators, and nonprofits. We believe more and more communities across America can adopt and scale these elements to fit their needs and make measurable social progress in the coming years.

Getting Our Terms Straight

Much of the recent commentary and critique on this topic conflates PFS and PFS financing—two related but distinct ideas. PFS is an overarching policy approach that ties public sector payments to better outcomes. By contrast, PFS financing is a process through which private investors provide upfront funding for services that a government entity later repays if—and only if—those services achieve targeted outcomes. (PFS financing is synonymous with social impact bonds.)

Critics often focus on the investor component of PFS financing, objecting to the idea of governments paying any returns to investors through social programs, while ignoring the broader elements of the model, such as outcomes-based funding and data-driven performance management. In fact, many PFS projects feature no PFS financing and no external investors. In recent years, Congress has authorized PFS for several federal education and workforce funding streams, without ever requiring PFS financing. The goal of PFS is to achieve better outcomes, in partnership with external funders only when it is both necessary and practical.

Centering Public Policy on Outcomes

Others have argued that the first wave of US-based PFS projects has focused too much on single interventions and over-emphasized cost-savings. With this, we fully agree. PFS projects are often more effective when they combine multiple approaches, and their primary goal should be better results for people in need, not cashable savings. Yet we take issue with those who attack the very idea of putting outcomes at the center of public policy. Failing to confront, disrupt, and improve the current, unacceptable outcomes that abound in our society perpetuates a status quo of poverty, inequity, and injustice.

PFS financing can empower communities to confront that status quo. As one example, numerous studies show that chronically homeless Americans cycle frequently through emergency rooms and jails, while the underlying problem of housing instability remains unaddressed. Evaluations show that permanent supportive housing can reduce the time in jail for this population by more than 38 percent and decrease avoidable hospital visits by up to 70 percent. Communities in Massachusetts, California, Colorado, Ohio, and Utah have successfully leveraged PFS financing to move thousands of chronically homeless Americans off the streets and into stable housing, supported by additional services.

Of course, in some cases, governments can and should fund services that improve outcomes directly, without the complexity of PFS financing. But policy makers face many barriers to doing so. Public dollars for prevention are limited, and costs often diffuse across many systems. Local leaders encounter fierce opposition to redirecting funding streams that reliably flow to incumbent providers—even if those providers have failed to improve outcomes. And as stewards of taxpayer money, government officials can be wary of directly funding approaches, however promising, that service providers haven't yet proven at scale.

In the face of such challenges, policy makers can use PFS financing as part of a sequential strategy to achieve reform. Starting projects with PFS financing, then scaling services that work with direct government funding (as the city of Denver, Colorado, recently did by expanding its permanent supportive housing PFS project) allows policy makers to embrace reform while mitigating the risks of innovation.

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Expanding Beyond External Investors

Given the misconception that PFS depends on leveraging investor capital, it's worth emphasizing that, increasingly, PFS often doesn't involve external financing. In Santa Clara County, California, for example, the Telecare Corporation provides behavioral health supports and additional services to residents experiencing serious mental illnesses. Through a PFS contract, the county agrees to make conditional outcome payments to this provider if an independent evaluator finds that the people Telecare Corporation serves are healthier, lead more stable and happy lives, and require fewer trips to emergency rooms, inpatient psychiatric facilities, or jail over a six-year time period.

On a larger scale, Washington's Department of Children, Youth, and Families initiated an agency-wide shift to base its more than 1,000 contracts for child and family services on outcomes and improved quality standards. The agency is emphasizing performance improvement, recognizing that outcomes-oriented contracting is not merely an accountability mechanism, but also an opportunity to fundamentally change how public resources contribute to better client, contractor, and ultimately community outcomes. Separately, Connecticut's Office of Early Childhood pays bonus payments to home-visiting providers that serve families who subsequently benefit from improved birth, health, child safety, and economic security outcomes. None of these recently launched PFS efforts has external investors. In each case, the provider has skin in the game and good incentives, with some financial upside if the families they serve are safer and healthier. And in each case, by linking public dollars to better results—whether improved mental health or birth outcomes—the PFS approach is disrupting an unacceptable status quo and bettering lives.

Evolving Pay for Success for Systems Change

We believe PFS will continue to evolve far beyond the discrete, one-off projects that have defined it for the past decade. While both PFS financing and rigorous evaluations should continue, running seven-year evaluations is a painfully slow recipe for change, especially in a political system built on two- and four-year cycles. The following actions can help achieve more rapid progress toward the goal of systems change.

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First, we envision PFS taking a page from the lean startup community and adopting a build-measure-learn feedback loop to transform the model so that it's responsive enough to keep up with politics. PFS projects need to move beyond the same pilot-evaluate-replicate trajectory social innovation has followed for many years, where philanthropy funds pilot programs, researchers evaluate the results, and, if all goes well, governments replicate what works. In this sense, the first generation of PFS projects were not an anomaly. Emulating a lean startup approach can enable the type of collaborative, social sector R&D needed to test and develop better solutions.

By embracing data and technology, for example, government could make anonymized administrative data available to the social sector, with strong privacy safeguards. Governments could then work with service providers to actively manage their performance and adapt as needed. Both service providers and policy makers could track outcomes and measure them at the population level, enabling data-informed policy and program decisions, and ultimately ensuring that results—rather than inputs or outputs—determine how agencies and communities allocate public dollars.

To make this a reality, philanthropies should partner with government and nonprofits, and fund their capacity to do this work. In addition, the federal government should give state and local governments the flexibility to blend and braid together tightly controlled federal funding streams, encouraging investment in better data systems, good evaluations, and the staff and technical assistance necessary to fundamentally improve the way governments and service providers execute their work. Creating new state and local "outcomes funds" to make payments based on results could catalyze healthy debates in city councils and state legislatures across America about where communities most want to see measurable progress.

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Second, and more broadly, the PFS sector needs to work toward greater equity. PFS can achieve the systems change necessary to improve all lives equitably only if the field designs initiatives that acknowledge racism exists in every structure and system in America and works to identify and correct for biases to ensure that efforts don't perpetuate current inequities. If a PFS initiative achieves its explicit target of reducing recidivism by 30 percent, for example, but does so only by reducing incarceration for white participants and not for people of color, it has actually increased racial disparities. Governments, researchers, and nonprofits must work alongside communities and ensure that a diversity of voices weighs in on what constitutes success. In the end, PFS is only valuable insofar as it empowers communities to make progress on the outcomes most important to them.

StriveTogether, a national network of nearly 70 communities across the country closing disparity gaps and improving outcomes for youth, brings this vision to life. In Cincinnati, for instance, the StrivePartnership convened hundreds of elected officials, businesses, activists, and community partners around the shared goal of increasing kindergarten readiness, resulting in a successful, $15 million preschool ballot initiative in 2016.

To fuel community involvement and create more success stories, philanthropic funders could provide stipends to help make it financially feasible for community members to take part in the development of PFS efforts. They can also support the diversification of talent through fellowships and provide unrestricted grants to community-based nonprofits that enable them to recruit and hire people from their communities.

Policy makers and anyone else pursuing PFS projects can also incorporate tools like Race Forward's Racial Equity Impact Assessment into decision-making to minimize adverse impacts. Nonprofits, funders, and researchers should practice equitable evaluation, and ensure that their data is demographically disaggregated to facilitate discussions around which services are most effective for whom, and why. Finally, more PFS projects should specifically link success payments to measures of equity.

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PFS is much more than a financing model; it's a set of linked approaches that uses data to drive decisions, establishes governance structures that transcend traditional power dynamics, disrupts the inertia of procurement with active performance management, builds evidence, and ties some payments to measurable outcomes. If we can make this approach dynamic enough to keep up with politics, adaptive enough to empower communities rather than dictate to them, and equitable enough to challenge deep and systemic inequities, PFS can become both widespread and potent enough to move the dial on even the most entrenched social challenges.

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