# Designing and Delivering Payment by Results Programmes: A DFID Smart Guide

This document gives a brief overview of guidance to people considering, designing and implementing Payment by Results (PbR) interventions. It is based on international and domestic lessons learnt. This Smart Guide is a short version of longer technical guidance that is available from DFID staff on request.

PbR is a form of financing that makes payments contingent on the verified achievement of pre-agreed results. DFID is currently testing a range of PbR approaches, to learn the circumstances under which it works most effectively. DFID set out a strategy in June 2014. As an incentive tool, PbR can and should be tailored to particular contexts. This short guide does not set out rules, but rather provides options and advice. As evidence and learning evolves, we will update these guidelines further.

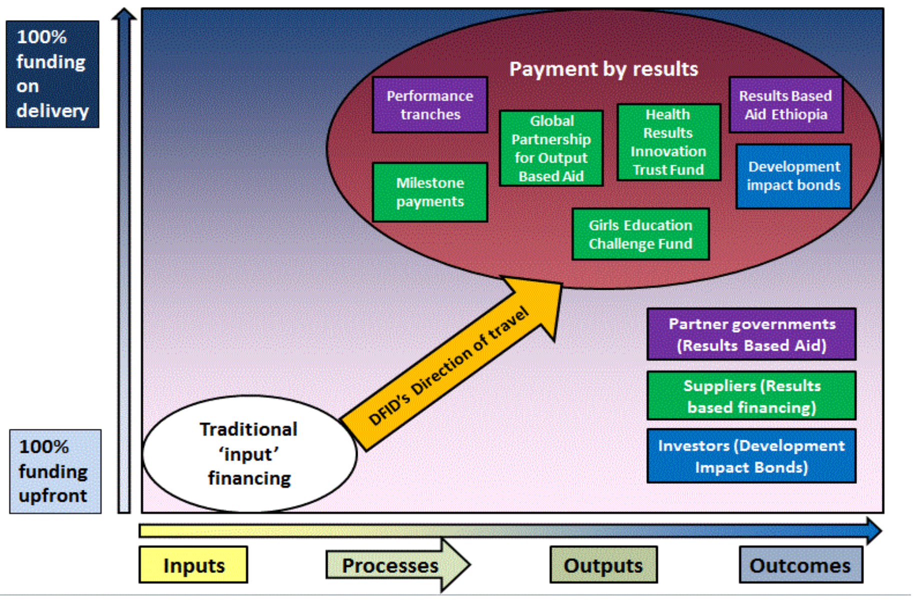
**What is PbR?**
There no internationally agreed definition, but for DFID, PbR involves disbursements tied to the delivery of pre-agreed results**.** Within this broad definition there are many forms of PbR, which differ around three main dimensions:

- The level of payments on delivery (upfront/ ex-post)
- The level of result the payment is linked to (outcomes, outputs or processes)
- The type of organisation DFID contracts with.

The type of organisation we pay for results is a main distinguishing factor in terms of "types" of PbR:

- Results based aid (RBA) is when we pay partner governments for results
- Results based financing (RBF) is when we pay service providers
- Development impact bonds (DIBs) are a new type of PbR whereby investors put money upfront into a programme and are repaid upon results.

Payments made on the basis of outcomes, i.e. change in people's lives such as finishing school, are a particularly important and innovative form of PbR; one that DFID is keen to do more of.



**Why PbR?**
According to theory, PbR works through incentive effects. If designed and delivered well, potential benefits of PbR include:

- Improved efficiency and effectiveness of delivery from the sharpened incentives in a PbR contract (paying once results are delivered rather than upfront)
- Increased potential for innovation and flexibility in delivery through not specifying how to achieve results
- Increased transparency and accountability for results
- Strong focus on performance.

However, PbR has its limitations, including:

- An undeveloped evidence base and market for design and delivery, meaning that early programmes may incur greater transaction costs.
- Poorly designed PbR could increase costs if risk and other payment considerations are designed or managed poorly; or risk perverse incentives (e.g. focus on short-term results) if results are poorly chosen.
- Due to these risks PbR requires high analytical, financial and procurement capacities for design, management and negotiation, in both funders and recipients/ implementers.

**Evidence**
Evidence about how PbR can be most effective is still at an early stage. Where evidence is available, the following themes are repeatedly highlighted:

- The lack of evidence on the circumstances under which PbR works best
- The fact that PbR needs complementary measures such as technical support or upfront financing to work
- High context sensitivity.

**When to choose PBR?**
It is recommended that you assess the suitability of PbR as part of the DFID Business Case appraisal process. This should normally take place in the commercial case, as recommended by the DFID Smart Rules, with an assessment of the costs and benefits of using elements of PbR, relative to other instruments. Quantified costs and benefits can then be fed back into the economic appraisal, to see how this affects the overall value for money of the programme. Some of the factors affecting benefits and costs follow in the table below (based on Clist and Vershoor, 2014). Note that factors may affect costs or benefits positively or negatively (e.g. a good indicator may increase benefits realised, but an indicator that is easy to game risks decreasing benefits).

| | **Factors affecting benefits** | **Factors affecting costs** |
|---|---|---|
| **Indicator** | • Is there a good measure? A good indicator (e.g. children sitting exams) will be strongly correlated with the result of interest (completion of education) even after it is used as a performance measure.<br>• Are other things we care about likely to be negatively/ positively affected (e.g. broader incentives/ results)?<br>• How easy is it to 'game'? | |
| **Agent (organisation being paid on results)** | • Does the agent have a lot of control over the intended outcome?<br>• Will the agent respond positively to PbR?<br>• Can the agent manage risk? (e.g. funds to invest upfront, able to spread risk across | • Is the agent risk averse? (if so, a higher tariff will be needed)<br>• Does the agent have a long time horizon? |

| | Factors affecting benefits | Factors affecting costs |
|---|---|---|
| | portfolio). | |
| **Level of result** | Is the indicator a process, output or outcome? | |
| | Higher (e.g. outcome):<br>• Is the indicator an outcome, implying greater innovation, but … | • … higher risk. |
| | Lower (e.g. process)<br>• Is the indicator a process, implying greater agent control but … | • … limited potential for efficiency improvements. |
| **Tariff** | • Is there a sensible tariff level? If the tariff is too high there may be negative distortion in incentives, but if it is too low nothing may be done (opportunity cost of non-performance). | |
| **Verification** | • Is the verification needed/useful to improve data? | • How costly and feasible is the verification? |
| **Principal (funder)** | • Can the donor withhold funds in the case of non-performance?<br>• Can the donor commit over a long-enough time horizon? | |

**Designing and delivering PbR interventions**

As PbR is a relatively new approach, and getting it right is tricky, it is recommended that you create a PbR agreement that is open to adaptation (e.g. building design reviews into monitoring and evaluation), while taking care not to negatively affect the incentive in operation. Analytical skills and sector expertise are particularly important to work with forecasting results trends, establishing value for money and setting out robust payment structures for the PbR intervention.

Many of the considerations for PbR are similar across different types (RBA, RBF, DIBs) and so are dealt with uniformly across the different sections, unless evidence has proved the need for a distinct approach.

- **Objective:** Early identification of a clear objective for the PbR programme (if different from the programme as a whole) will help you keep in mind what you are trying to accomplish. This can be based on benefits identified above (e.g. is the primary purpose great efficiency of delivery or better transparency of results).

- **Agreeing results and indicators**: Agreeing results to be targeted and choosing appropriate indicators is fundamental to PbR, as what gets measured (and rewarded) gets done. It may be that an appropriate measure does not exist, in which case PbR will not be feasible. In particular, the potential for perverse incentives (e.g. short-termism or misrepresentation of results) and the complexity of the underlying theory of change needs to be considered and, if possible, mitigated. Key considerations include the level of the indicator (outcome, output or process), the number of indicators, and availability and quality of indicator data.

- **Payment structure and value for money**: Agreeing the payment structure is one of the most technically complex parts of PbR design. It’s important to consider three main factors:

    - Structure of reward: A PbR agreement can have a range of payment structures, from all payments being contingent on results (ex-post), to most money upfront with only a small degree of ex-post payment. Perception is critical and the payment should be understood by all as being made for progress on results.

- Agreeing a price for payment: The key for agreeing a price/ reward is balancing sufficient incentive for progress with value for money. A basic principle to ensure value for money is that the total price paid (and other associated costs) should not exceed the benefits created. Informed negotiation between parties has proved to be key. With private providers competition can also be used to drive up value for money. Principles to consider include the level of risk (as higher risk generally means a higher price), existing incentives and expected return. Affordability constraints (the total amount of finance available) have also proved to be important in practice.

- Thresholds for payment: In principle PbR acts as an incentive for additional results and thus payments should be made over and above existing results achieved (i.e. the level of the result the recipient would have achieved in the absence of PbR) – a threshold. Different thresholds will be appropriate in different contexts, e.g. in some contexts it may be appropriate to use a forecasted trend as the threshold, and in others a benchmark counterfactual may be more appropriate.

- **Finance**: You may wish to consult with DFID staff over management of finance in PbR programmes. There are two main issues here:

  - Managing unpredictable payouts: Paying upon results always involves an element of unpredictability of finance. Unlimited liability can be avoided, for example by using payment "caps". It's recommended that caps should be multiyear to the extent possible and unutilized funds "recycled" in later years. Forecasts can be based on realistic estimates of what will be achieved, bearing in mind optimism bias.

  - Delivery channel and fiduciary risk: Allowing recipients greater discretion over how results are achieved will change the profile of risks programmes face. It is essential that these are properly assessed and understood. Due diligence of financial management systems should be carefully performed according to DFID standards. The PbR incentive should be carefully designed and managed to minimize misuse of funds, gaming or perverse incentives which would cause reputational risk.

- **Verification**: Verification is an audit of both the existing results (the threshold) and results achieved above that once the intervention commences. Without robust and preferably independent verification there is a much higher risk of dispute over payments, doubt over what has been achieved, and gaming to give the impression that more results have been achieved than is actually the case. In order to capture the baseline threshold (over and above which payments are made), verification needs to be in place at an early stage.
- **Governance and contracting**: All relevant parties need to agree respective roles and relationships, and key terms and conditions. These should be set out clearly in the PbR agreement. It is recommended that the agreement be made publically available in order to enhance transparency and accountability for results. Novel or contentious terms and conditions can be discussed in advance with DFID staff.
- **Transparency, accountability and citizen engagement:** Transparency and accountability can help strengthen verification and improve the quality of results. Public reporting can be used to incentivise better performance, and has been shown to strengthen incentives. In line with DFID's transparency commitments it is recommended that all key PbR project documentation should be published.

- **Monitoring and Evaluation**: As PbR is based on results, it lends itself to outcome-orientated log frames. Try to set realistic results targets to avoid setting the programme up for failure. Due to the innovative nature of this instrument, we strongly recommend that you put in place independent evaluations, especially for the most innovative programmes. Where possible, these should seek to draw out process lessons, in addition to impact. Recommended evaluation questions include identifying the mechanisms and sets of circumstances under which PbR approaches can make a positive difference. DFID's Evaluation Department can assist with the design and delivery of PbR evaluations. It is recommended that they be contacted early in the design stage of the programme.

**Further information about PbR**

Contact the Development Effectiveness team in DFID for more information on PbR.

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| DFID | (2012) | *Evaluation of Payment by Results: Current Approach; Future Needs* |
| DFID | (2014) | *Sharpening incentives to perform: DFID's strategy on Payment by Results* |
| DFID | (2014) | *Designing and Delivering Payment by Results programmes: Technical Guidance* |
| Clist, P and Verschoor, A | (2014) | *The Conceptual Basis of Payment by Results* |
| Clist, P and Dercon, S | (2014) | *12 Principles for Payment by Results* |