PAYMENT BY RESULTS
WHAT IT MEANS FOR UK NGOS
Payment by Results (PbR) is a relatively new funding mechanism in international development. Discussion of PbR in international development often focuses on government-to-government agreements (‘Results-Based Aid’), and there is relatively little literature on PbR contracts involving NGOs and other suppliers (‘Results-Based Financing’). This guidance provides an overview of what PbR is; what it aims to achieve; what the evidence base says; what NGOs need to think about when considering engaging with PbR contracts; and what are the system-wide issues that PbR could raise.

Payment-by-Results (PBR) is an aid mechanism whereby payment is given only on the verified achievement of agreed results. PBR requires suppliers such as NGOs to pre-finance activities; it should allow flexibility in how suppliers implement their activities; and should involve donors only paying suppliers in arrears upon achievement of agreed verified results. ‘Results’ in this context are usually taken to mean changes in the lives of people the intervention aims to support, i.e. outcome-level results. In the UK, DFID also sometimes defines PbR results at output level.

When PbR contracts have those characteristics, the objective is for the aid to be more effective and provide greater value-for-money through the focus on higher level results and the ability to rapidly adapt interventions to learning. Flexibility is claimed to promote more innovation.

The evidence base in support of PbR in international development is still very limited, and it remains to be proven whether and when PbR may provide better value for money than other aid mechanisms. In practice donors may retain restrictions on flexibility in PbR contracts, define ‘results’ at lower levels (e.g. outputs), and emphasise the transferring of risk onto suppliers as a key objective, all of which undermine the potential for PbR contracts to improve aid effectiveness.

There are also alternative ways for donors to achieve these objectives, including by:

- Allowing more flexibility for implementers in existing funding mechanisms;
- Rewarding learning, and not just results, particularly when addressing complex issues;
- Requiring greater transparency and downward accountability.

Within the UK domestic sector, there has been greater usage of PbR contracts by government. Some of the results of PbR contracts (which Bond members with emerging experience of PbR aid contracts also observe) are:

- PbR can stifle innovation as the benefit of flexibility is offset by the threat of financial loss;
- PbR contracts that don’t have an intentional equity focus can lead suppliers to avoid supporting marginalised groups or complex cases as the added cost is not rewarded;
- Engaging effectively with PbR requires a more sophisticated skill-set among organisations in relation to contracting, financial risk management and M&E than is required for working with other forms of contracts and grants;
- In international development work, some efforts to include PbR in contracts in complex environments have had to be abandoned.

EXECUTIVE SUMMARY
PbR is not inherently positive or negative. The ability to consult and negotiate on elements of the design and terms of PbR contracts mean that its appropriateness to addressing different development problems needs to be determined on a case-by-case basis. Nonetheless, some key factors affecting suitability of interventions to PbR are:

- Are relevant outcome-level results measurable?
- Is there a strong evidence base about ‘what works’ to draw on?
- Do providers have or can they generate baseline data before committing to achieve specific results?
- Is the achievement of results largely within the control of providers?
- Are there reasonable expectations and scope for monitoring, learning, adapting and improving within the project timeframe?
- Do you wish to target particularly marginalised groups, and is that incentivised?

The contracting process is key in determining whether PbR contracts will be effective. In a competitive bidding process, there may be limited scope to negotiate with the commissioner, and your organisation will need to consider how competitors may bid in response to the terms of the tender (e.g. if reaching marginalised groups is not incentivised, other bidders may appear more cost effective by targeting less marginalised groups).

Wider concerns about the effects of PbR have been raised, which include:

- Reducing the diversity of actors who can bid for contracts
- Skewing aid priorities further towards measurable and short-term results
- Inhibiting open relationships and learning among aid partners
- Undermining the intrinsic motivation to act by replacing it with extrinsic/mone tary incentives

Payment by Results is a mechanism in aid that is still relatively untested but growing in use. By focusing attention on higher-level results (rather than inputs and activities) and only paying for activities delivered if pre-agreed and externally verified results are achieved, it aims to increase aid effectiveness. In the international development context, discussions of PbR often focus on government-to-government ‘Results-Based Aid’, rather than the sort of ‘Results-Based Financing’ that involves donors and service providers. Yet the mechanisms, relationships and implications differ significantly. This paper focuses solely on PbR as it may affect non-governmental organisations.

Increasing effectiveness is clearly an objective of PbR that NGOs would support. The theory and the limited available empirical evidence however suggests that there are a number of risks associated with PbR. Engaging with PbR contracts is more complex and risky for NGOs than dealing with the sort of grants and non-PbR contracts that they are used to. This means that PbR contracts may be more or less likely to achieve the desired objectives depending on different circumstances.

This guidance is divided into two parts. • Part 1 helps NGOs understand when PbR may be appropriate for them. It may also be of interest to donors or commissioners of PbR contracts. Our focus is on two sets of issues that need to be considered in parallel. First, what does your organisation need to have in place to engage effectively with PbR? Second, which development problems are more or less suited to being addressed through funding with a PbR component?

• Part 2 considers some system-wide issues that organisations interested in PbR debates should also be aware of and consider, and will be of interest to donors, NGOs and other stakeholders.

There is a lack of evidence around when PbR may or may not be appropriate, making PbR a contentious issue in which ideology and hypotheses play a large role. While there is still a need for more evidence, we also present some hypotheses of our own. These are based on experience of PbR in service delivery in the UK, and in related areas of international development experience. Overall, we recognise that PbR has a place in the portfolio of funding mechanisms available to tackle development problems. But we think there is a need to be collaborative and cautious in relation to PbR while the evidence base is developed further.
What is Payment by Results?

PbR is a mechanism for aid whereby payment is given only on the verified achievement of agreed results. Within this broad definition, the two main types of PbR arrangements are: Results Based Aid (RBA), usually government-to-government funding; and Results Based Financing (RBF), usually government-to-service providers. This paper focuses on RBF, considering NGOs in the role of service providers.

PbR is often contrasted with ‘traditional’ forms of aid where donors make payments upfront for activities, and the implementing organisations are held to account for spending according to budgets agreed at the outset. Usually recipients are paid for delivering agreed inputs and possibly for achieving outputs. PbR contracts however typically transfer risk from donors to recipients.

Key characteristics of PbR are:

• The implementing organisation pays upfront for the costs of inputs and activities (although sometimes some level of pre-financing can be negotiated);
• The donor pays an agreed price for results achieved, and aid is disbursed only upon verified achievement of specified results;
• The implementing organisation should have discretion over how to achieve results (activities, approaches, budget allocation, etc.). They should be enabled and incentivised to be flexible in their implementation and to change plans in response to what they see works and doesn’t work, to have the greatest chance of achieving the results.

Payment triggers can vary in PbR contracts. Typical models include:

• Binary: payment is ‘all or nothing’ based on achievement or not of an agreed target;
• Frequency: payment is made for each ‘beneficiary’ or service user who achieves a specified result (e.g. for each child passing an exam).

Some PbR funding specifies payment triggers for results that are not at outcome levels, but instead are based on outputs or other milestones. On the positive side, these may be easier to measure and more within organisations’ control, and thus it is a more appropriate level to hold organisations directly accountable for. However if an intervention’s contribution to higher-level outcomes is not monitored, its effectiveness will not be well understood, reducing opportunities to learn and adapt. At worst, a focus on outputs can lead to so-called perverse incentives such as gaming or distortion. For example, if changes in household income were considered too difficult to measure in a microfinance programme, and the results for PbR purposes were defined instead in terms of loan repayment rates, it may encourage a focus on forcing loan recipients to repay irrespective of their capacity, or lead the service provider to only lend to the most credit-worthy individuals, who may not be most in need of support.
2.2 Why Use Payment by Results?

The overall purpose of using PbR is to increase the effectiveness and efficiency of aid through incentive effects. Donors and supporters of PbR have suggested a variety of routes by which PbR can achieve this, some of which are agreed and some of which are not. Widely agreed routes are:

- Sharpening the focus on results by incentivising and increasing the focus of actors on meaningful changes in the lives of those the aid is intended to support rather than on just doing activities.
- Increasing the flexibility given to those delivering aid so that they can learn and adapt (and potentially innovate) within the contract lifetime in order to improve results, rather than being required to adhere rigidly to budgets and logframes developed before the intervention started.

PbR mechanisms must be designed and tailored in each project context if they are to achieve those purposes. Poorly designed PbR can increase costs and reduce value for money relative to other mechanisms if risk and other payment considerations are designed or managed poorly. In some cases it will not be an appropriate mechanism at all.

Flexibility and innovation are not inevitable in PbR. For example, if funders combine a PbR mechanism with detailed reporting requirements on budgets and inputs, this can undermine the ability to be flexible. Furthermore, while flexibility can encourage innovation, the risk of financial loss if you fail to achieve results - a risk inherent in innovation - often leads organisations to ‘play it safe’ with tried and tested interventions.

Some donors are attracted by the idea of using PbR to transfer risk from aid donors to those who deliver aid. DFID, for example, cites the transfer of risk from them to partners as a way of increasing the value for money of aid to citizens of the UK and developing countries. Others state that risk transfer should not be used as a rationale for PbR, as donors are typically better able to bear risk across a diverse portfolio of work. Furthermore there are certain types of risk that it is not beneficial to pass on to implementing agents (e.g. risks of failure due to external factors such as conflict).

2.3 Where is PbR Used?

In the UK, it is government policy to increase the use of Payment-by-Results in the delivery of public services. Most experience of PbR to date in the UK has been on domestic issues, such as criminal justice, housing and welfare-to-work.

DFID’s July 2014 strategy on Payment by Results commits them to considering the use of PbR in all circumstances. Their ‘Smart Guide’ to designing and delivering PbR programmes provides guidance to DFID staff on how to make that decision, taking into account various factors that may affect the costs and benefits of a PbR approach. To date, PbR has been used in a variety of instruments that NGOs have accessed such as the Girls Education Challenge and the WASH Challenge Fund. However, initial plans to incorporate a PbR component in the final year of the 2011-14 round of Programme Partnership Arrangements was withdrawn, as were plans to use it in the BRACED programme on resilience.
Experience of PbR contracts in the context of international development is relatively limited. Claims made for PbR are often assertions based on untested hypotheses rather than evidence. However, as PbR has been a preferred policy mechanism of the UK government in the delivery of a variety of domestic services in recent years, there is a growing body of experience and evidence from the domestic charity sector which is transferable to international development.

Highlights of the evidence from the UK sector and from initial experience informally reported by Bond members in relation to PbR suggest that:

- In practice, innovation is often stifled under PbR contracts due to payment in arrears and fear of financial loss;
- Some of the most competent service providers lack the specific technical capacity and financial resources required to manage and bid for PbR contracts. In the UK, evidence to date suggests that mission-driven organisations who are otherwise competent to manage contracts despite this lack of capacity as they felt they had no alternative. Therefore the supply of bidders did not initially decline. However concerns have been raised that over time, otherwise competent organisations may be squeezed out of the market due to the financial and contractual demands of PbR, reducing the diversity of suppliers of services and potentially reducing the quality of services delivered;
- Service providers with PbR contracts are incentivised to “cherry-pick” the cheapest/easiest-to-reach clients where the PbR contract specifies equal payment for each client reached;
- Where different people require different combinations of services or tailored support to achieve specific outcomes, PbR can drive more ‘one size fits all’ approaches from implementers; and
- PbR contracts have some additional costs that are specific to that mechanism, such as the cost of independent verification of results (which is additional to the service provider’s own monitoring and evaluation costs), and the increased unit costs charged by suppliers to account for the risk of failure. Whether PbR achieves better value-for-money overall relative to other mechanisms depends on a case-by-case basis on the extent to which additional costs are balanced out by increased achievement of results.

- Complexity in operating environments and in measuring development outcomes has led to the abandonment of a number of attempts to include PbR in aid contracts because of impracticality and/or the inability to agree terms for triggering payments.
- PbR may specify results that are at odds with the priorities of clients or ‘beneficiaries’. This is by no means a risk that is exclusive to PbR, but because PbR requires precise measurability, this limits the range of results that can be investigated and thus makes the risk of divergence from clients’ priorities (which may be for less measurable results) greater.

In conclusion, it is not yet proven whether PbR provides better value-for-money than other aid mechanisms.

### 3 IS YOUR ORGANISATION PREPARED FOR PbR?

#### 3.1 Cash Flow

- Do you have access to finance to pay for bid preparation? Due to the technical complexity of PbR contracts (see section 3.2 below) bid costs are typically higher than for other grants and contracts of a similar value.
- Do you have up-front funding to pre-finance activities once a bid is secured? As payment by donors is in arrears, organisations need significant upfront funds to pay for work until payments are triggered.
3.2 Capacity and Skills

In addition to whatever capacity is needed to deliver the activities being funded by a contract, PbR contracts require specific additional skills in preparing bids, negotiating terms and implementing PbR contracts. Specifically:

- As with any funding, fully and accurately pricing the cost of delivering activities is essential if the implementing organisation is not to make a loss from the contract. PbR contracts add the complexity of pricing for a contract with a 10% PbR component; you could price your activities at 110% of the actual cost. Thus if you failed to achieve the targeted results you would still receive the full cost of activities (no downside risk), and if you succeeded you would get 10% more than you spent (upside risk).

- Strong M&E capacity is essential for PbR. Designing the monitoring and evaluation of a PbR contract is a very high stakes business, given that results determine payment. Choosing appropriate indicators, predicting what you can achieve and setting realistic targets for results are difficult but vital. It is also essential that the implementing agency has the means and capacity to monitor outcomes and progress throughout the project lifetime to track progress and adjust course if necessary. The cost of M&E is typically higher in PbR contracts as a result, and this must be budgeted for appropriately.

- There will usually be a process of negotiation over the terms of PbR contracts. There may be more or less scope for negotiation based on whether the PbR contract is awarded on a ‘preferred supplier’ basis, or through a competitive tender. Either way, NGOs need to consider the capacity – and confidence – to negotiate fair and realistic contract terms with an often much more powerful donor. When results are not fully within your control, careful contracting on issues such as breach of contract and force majeure, and when and how to share risk with sub-contractors/ partners is likely to require access to legal and financial risk management advice.

- Capacity and M&E exercises by the implementing organisation and independent verifier. Finally, there can be disputes in interpreting results which need to be negotiated with care given that it can determine whether you get paid or not.

VERIFICATION OF RESULTS IN PbR

The external verification of results in PbR contracts is different to what NGOs are used to, including external evaluations. Donors or fund managers may insist on particular evaluation designs or methods to unearth the contribution of your project to results. There can also be practical and ethical challenges to overcome with communities when there are parallel M&E exercises by the implementing organisation and independent verifier. Ultimately, senior staff and governors in an organisation need to make a judgement about the level of risk to which they are willing to expose their organisation by undertaking a PbR contract. Making a good assessment of the risk involved in a PbR contract will often be technically challenging in itself, but even assuming a good understanding of risk, an organisation needs to consider the implications for its financial position – and viability – should it fail to achieve the level of results necessary to trigger payments from donors.

PRICING RISK

A commercial practice that NGOs are not always familiar with is pricing risk. NGOs operate on a not-for-profit basis overall, and often apply that principle to individual projects too. Thus most NGOs are used to budgeting for activities at cost (and indeed NGOs often fail to recover full costs), and this is required by many types of donor funding mechanism.

Those familiar with commercial contracts are used to pricing for profit and/or to account for risk. In PbR, for example, in bidding for a contract with a 10% PbR component, you could price your activities at 110% of the actual cost. Thus if you failed to achieve the targeted results you would still receive the full cost of activities (no downside risk), and if you succeeded you would get 10% more than you spent (upside risk). At higher percentages of PbR however, the need to be competitive in tendering makes it less likely that a winning bid could price in all risk, and thus the ability of an organisation to absorb potential losses becomes even more important.

- As with other forms of competitive funding, bidding NGOs will typically need to be able to name proposed senior staff who would be involved in delivering the contract if it is won. Few organisations are able to reassign staff at short notice, and thus need the HR capacity to pre-contract staff on a conditional basis.

- Putting all of this together typically requires excellent project managers and systems.

3.3 Risk appetite:

Ultimately, senior staff and governors in an organisation need to make a judgement about the level of risk to which they are willing to expose their organisation by undertaking a PbR contract. Making a good assessment of the risk involved in a PbR contract will often be technically challenging in itself, but even assuming a good understanding of risk, an organisation needs to consider the implications for its financial position – and viability – should it fail to achieve the level of results necessary to trigger payments from donors.

There is typically an imbalance between attitudes to upside risks and to downside risks in NGOs that is relevant to considering PbR. Unlike private sector actors, who can use profits generated elsewhere to absorb a certain level of loss on PbR contracts, NGOs typically have low levels of reserves available for these purposes. The holding of significant reserves by charities is discouraged and can expose them to reputational risks, while opportunities for profit-making in other parts of the organisation may be limited. Therefore the downside risk to an NGO’s overall financial security from making a loss on a PbR contract can have very serious consequences. This is likely to outweigh the benefits from upside risks such gains from over-achieving targets or from having priced in risk. Therefore, as the percentage of a contract value that is dependent on the achievement results increases, the risk to an NGO’s financial security increases disproportionately.

Because the sequence for most PbR contracts involves competitive tendering before at least some negotiation with the donor on PbR terms and contractual conditions, there is an additional risk with PbR that an NGO could find the terms unacceptable after investing in winning a bid. The sunk costs of bidding and negotiation may tempt an NGO to agree to terms they are not happy with, but this could prove costly in the long run.

NGOs must be prepared to walk away if necessary. Walking away, however, can be a challenge for mission-driven organisations if PbR becomes the only financial route to continuing to support your clients or ‘beneficiaries’.
In addition to considering your own organisational readiness, it is necessary to consider whether PbR is an appropriate route to addressing the particular development problem at hand. This section considers a number of key questions to determine whether a PbR mechanism is likely to achieve the purpose of increasing effectiveness, efficiency and flexibility, without imposing an unreasonable financial risk on your organisation. If the answer to each question is ‘yes’, then PbR is likely to be an appropriate mechanism. Where it is ‘no’, the risks are outlined for each question, and the determination of whether to go ahead should be made based on your ability to mitigate those risks and your risk appetite. Alternatively, you may decide to go ahead and to heavily price risk into your bid for a PbR contract. Often the answer to the questions below will not be clear cut, making discussion and negotiation among relevant stakeholders important.

**Is there a strong evidence base about “what works” in addressing this problem?**

If not, you may lack a sound basis for predicting and thus committing to achieving specific results, and thus take on excessive risk.

**Do you have or can you generate adequate baseline data before committing to achieving specified results?**

If not, your results targets are likely be unrealistic. This can be mitigated by having an inception phase to gather baseline information before finalising targets, if this can be negotiated with the donor.

**Is the achievement of outcome-level results largely within your control?**

Outcome-level results may be influenced by or dependent on other interventions or factors (weather, conflict, etc.) outside your control. This may be the case especially in fragile, conflict-affected or other high-risk contexts. In such circumstances, a PbR contract may be extremely risky to your organisation. This can be mitigated by (a) negotiating down the proportion of the contract value paid through PbR, thus sharing more of the risk with the donor; or (b) agreeing more intermediate outcomes or outputs that are more within your control as the basis for triggering payments (although – as previously mentioned – this risks taking attention away from higher-level outcomes and/or creating perverse incentives.)

**How long is the contract relative to the time taken to achieve measurable changes in results?**

(Or, how many cycles of feedback loops will it comprise?) A fundamental benefit of PbR is supposed to be that you can monitor, learn and adapt within the project lifetime, i.e. you can change course and improve quickly if it looks like things are not working out as planned. The shorter the contract period, the fewer chances you will have to test and iterate, and thus the more confident that you need to be that your intervention will be successful. The effect of interventions on some outcomes can be seen quickly (e.g. treatment of acute malnutrition), but in other cases can take years (e.g. changing levels of women’s empowerment).

**Do you wish to target particular marginalised groups with your intervention?**

The simplest PbR mechanisms may pay a flat amount for each client/beneficiary supported to achieve a result, which incentivises focusing on the easiest or cheapest to reach. This can go against equity considerations, particularly if there are different sets of interventions required or challenges to be overcome to achieve desired results among particular marginalised groups (e.g. the disabled, or the ultra-poor). PbR contract terms can be negotiated to mitigate this risk through a combination of specifying groups to be reached, and/or offering different payment rates or premiums for results achieved with different population groups.
The PbR contracting process itself can have a significant bearing on the likelihood of an NGO being able to compete and negotiate on terms that strike an appropriate balance between incentivising good development practice and managing financial risks.

PbR funding may either be awarded through an open, competitive process or through a negotiated process with a preferred bidder. The key difference is the extent to which the donor fixes the scope and terms of the tender in advance and simply seeks bids on those terms, or whether there is a more collaborative process to set the terms.

In an open competitive process, it is important that you have as much upfront information as possible on likely contract terms from the donor to enable you to make an informed decision on whether to bid or not. This will help you both to consider your own value-added and competitive position relative to others who may be expected to bid for the contract, and to consider how likely competitors may behave in response to the terms of the tender.

Estimating your likelihood of success is particularly important given the costs involved in preparing a PbR bid.

Key issues on which to negotiate to mitigate risks are:

- Definition of results, targets and triggers;
- Responsibility for failure to achieve results (including a get out clause in the case of external factors outside your control);
- The percentage of the contract to be paid by PbR;
- Flexibility to easily change budgets and planned activities in response to learning;
- Whether and how risks are passed on to sub-contractors.

It will take time to prepare bids and negotiate terms, but also potentially to carry out baseline data collection to inform planning and target-setting for PbR contracts. While these timeframes are often set by donors, it is in everyone’s interest to take the necessary time to prepare well, and bidders/Prospective implementing agencies should seek to secure reasonable timeframes for preparation before beginning implementation.
In addition to the points above that organisations need to consider individually in relation to their engagement with PbR, there are a number of potential issues of wider relevance to the sector arising from PbR which are discussed in this section.

6.1 Effects on the Diversity of Implementing Agencies

The sorts of organisational prerequisites outlined in Section 3 will narrow the potential range of suppliers who are able to bid for such contracts and in doing so this may rule out some highly competent organisations. If PbR is used extensively and replaces other forms of grants and contracts, this may put smaller organisations out of business even if they are very competent. For individual contracts, the ability to communicate openly and work collaboratively to address complex problems is being narrowed22. Furthermore, M&E information can become commercial and of proprietary interest, undermining efforts towards transparency and learning.

6.2 Skewing Aid Priorities

A hypothetical risk is that increased popularity of PbR could skew donor priorities away from complex and risky problems, and towards simpler problems and contexts, and shorter-term solutions. In other words, the focus could be ‘what problem can we find to use this instrument on?’ rather than ‘what instrument is best for the most pressing problems?’ As PbR has not been used extensively to date, this is far less of a concern currently than whether PbR is being applied appropriately to complex problems. But with increasing interest in PbR among some donors, this risk needs to be monitored.

6.3 Inhibiting Open Relationships and Learning among Aid Partners

A more fundamental concern about the wider ‘results agenda’ is that the focus on contractual relationships and strong emphasis on results over learning is leading to less open and equal relationships between donors, suppliers and beneficiaries. In a world of large suppliers - NGOs or private sector - winning contracts, an often contrasted with can be addressed by means other than the use of PbR. We believe there are three key ways that such shortcomings could be addressed.

6.4 Undermining Intrinsic Motivations

NGOs are typically motivated by missions that align closely with the achievement of results. There is evidence that introducing financial incentives to reward behaviour that a person is already motivated to do because of their values can irreversibly undermine such intrinsic motivation, leading them to do less of that activity once the payment is withdrawn23. It is not clear how introducing PbR may affect NGO behaviour and values in that respect, but it is certainly a concern to be monitored. For example, one UK NGO reported having internal discussions on whether to include disabled children in the target group for an intervention funded through PbR when their contract would not have paid them the additional cost required to achieve the specified results with them. They decided to go ahead based on their organisational values, but could such behaviour change over time?

This guidance focuses on whether and when PbR may be appropriate to use, and how its appropriateness could be improved through dialogue and negotiation. It is important to also consider whether the shortcomings in ‘traditional’ aid mechanisms that PbR is often contrasted with can be addressed by means other than the use of PbR. We believe there are three key ways that such shortcomings could be addressed.

7. ALTERNATIVE WAYS OF ACHIEVING THE OBJECTIVES OF PAYMENT BY RESULTS

• Allowing Flexibility: Giving responsible implementing organisations flexibility to adapt and innovate is widely recognised as helpful, particularly in addressing complex and long-term development problems. This could include at the design/bidding stage, if bidders were allowed and encouraged to suggest changes to the theory of change that a donor may have developed. During a project lifetime, giving organisations more power to alter budgets and activities, and focusing less on outputs and inputs in reporting formats and in feedback to implementing organisations can help in this respect.

• Rewarding Learning: Where development problems are complex and evidence bases are lacking, it is vital that donors incentivise and reward learning rather than just results (while still holding implementing organisations to account for implementation failures). Where organisations have managed interventions well, made good use of existing evidence and made appropriate effort to learn and adapt throughout a project lifetime – and to document and share that learning - it is in everyone’s collective interest that those organisations should be paid for those efforts.

• Transparency and Accountability Requirements: Requiring greater transparency from implementing organisations – particularly towards clients or ‘beneficiaries’ – and requiring and facilitating organisations to be more responsive and accountable, is another way that donors can encourage a focus on the results that matter most.
WHAT ARE THE KEY RECOMMENDATIONS FOR IMPLEMENTING PBR?

Given the specific capacities and skills required of organisations, and how PbR may be more or less appropriate as a mechanism for addressing different development problems, we recommend the following:

For NGOs

1. Be proactive in considering how amenable your (geographical and sectoral) areas of work are to PbR mechanisms. This will help you to engage in any consultations with donors considering PbR, and allow you to make more considered decisions about whether to pursue PbR contracts.

2. Invest in building your capacity in financial risk management, preparing tenders and in monitoring and evaluation if you decide to pursue PbR contracts.

3. Engage in peer learning around experiences of PbR contracting to understand emerging evidence and good practices.

For Donors

While this guidance has focused on the implications of PbR for NGOs, it is typically donors who initiate PbR contracts. Their strategies and approaches therefore have a great influence on the situation that NGOs are presented with, and on the system-wide issues discussed in section 6. Some key recommendations for donors therefore are:

1. Design results collaboratively. Measures should be designed carefully and in collaboration with service users and providers, to minimise potential for distortion.

2. Use PbR at below 20%. Balanced risk speaks to Principal Agent literature and encourages more innovation than higher levels.

3. In safe, controllable situations with well-proven interventions, high percentage PbR contracts may be suitable. But in risky, fragile or complex environments, if PbR is to be used at all, it should be at very low levels (5-10%), it should allow high levels of flexibility to implementers; and it should have clauses protecting implementers for failures outside their control.

4. Ensure incentives to reach the marginalised are in place so that PbR supports a focus on helping hard-to-reach and the most excluded communities and population groups, and doesn’t further entrench marginalisation.

5. Enshrine flexibility. Reducing oversight and reporting burdens and allowing suppliers to make adjustments in response to learning is key to enabling PbR contracts to increase efficiency and effectiveness relative to other funding mechanisms. Flexibility is also essential if the objective of increasing innovation is to be achieved.

6. Allow regular drawdowns. It is important to ensure a level of cash flow that doesn’t disadvantage smaller agencies or non-profits, who don’t have access to large reserves or credit markets.

7. Build capacity to engage with PbR. This needs to be done both internally within donors and also among potential suppliers, as the relative lack of NGO capacity around pricing risk and design of PbR metrics will limit the competitiveness of markets for PbR contracts.

8. Build the evidence base behind PbR. At this early stage in the use of PbR in international development, a cautious approach combined with a strong emphasis on gathering and sharing evidence and learning from experiences is essential if PbR is to increase the value-for-money and effectiveness of aid.
In practice, however, donors may impose conditions and reporting requirements that undermine that flexibility. 6

**Note:** This paper has been written by Michael O’Donnell and Rosie Longhurst from Bond, with additional inputs from Michael Ash, the authors benefited from feedback on PbR experience received by Bond members, from an unpublished report from Tim Boys-Watson, Mango on “How the Increasing use by DFID of Contracts and Payment by Results may affect NGOs and Value-for-Money. Comments were received on drafts of the report from Rita Paraskev (Centre for Global Development), Paul Clis (University of East Anglia), Tim Boys-Watson (Mango), Ramzi Suleiman (NCVO), Ben Heaven-Taylor (Oxfam), Tim Wainwright (ADD International) and Faye Ruck-Nightingale (Opportunity International).

**1** In this context, service providers may include, for example, NGOs, multilateral agencies, for-profit companies or social enterprises.

**2** NGOs may also be interested in PbR in the context of policy engagement on broader aid effectiveness issues, but that is not discussed in this guidance.

**3** This is not to say that donors lack mechanisms to promote achievement of outcome-level results in existing types of funding, however. Feedback on interim progress reports, the potential to terminate agreements early, and the risk of not receiving follow-up reports, all serve that purpose.

**4** In practice, however, donors may impose conditions and reporting requirements that undermine that flexibility.


**6** Clist and Decon, 2014: 12 Principles for PbR. http://principles-payment-results-pbr-real-world-0.pdf


**9** Ten submissions received from Bond members with experience of PbR in DFID contracts in July 2014.


**12** For example The Department for Work and Pensions’ evaluation of the first phase of The Work Programme in the UK, a welfare-to-work programme aimed to help people get and stay in employment. The evaluation found that individuals facing the most complex – and expensive – barriers to getting work (e.g. those with health issues or care responsibilities) were under-served - or “parked” - by service providers who received a flat payment rate per person supported back into work. (DWP, 2012; https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/190323/rrep821.pdf)

**13** See UK Cabinet Office guidance for an explanation: https://www.gov.uk/local-entrepreneurs-established-snake-farms-to-reap-large-bounties!


**15** Clearly it is essential that the donors you are dealing with have these capacities also.

**16** Some organisations involved in the DRD Girls Education Challenge experienced protracted contract negotiations over clauses that were felt to lead disproportionate costs on them in case of fraud or misuse of funds in their projects. Examples of these challenges are contained in a 2014 Fund Managers’ Survey by Bond. http://my.bond.org.uk/resources/survey-dfid-fund-managed-grantees-final-report-dec-2014.pdf

**17** For example, if you know that a contract has a 10% PbR component, you may inflate the costs in your bid by 11% to account for that risk. Hence, if you won the bid and failed to achieve the results, you would still not lose out financially. This may be a less familiar practice to NGOs than to private sector suppliers. Clearly the extent to which you price in risk in that sense increases the possibility of your bid being considered less value for money by the commissioner.

**18** Clist and Dercon give the example of an initiative in India which intended to reduce the number of snakes in Delhi by paying a bounty for dead snakes. But instead of reducing the snake population, local entrepreneurs established snake farms to reap large bounties. See: http://www.cgdev.org/blog/12-principles-for-pbr-in-the-real-world/


**20** During project implementation, this results in “missing” where service providers target the cheapest beneficiaries to reach to maximise their own profts/returns from PbR contracts.

**21** For example, behaviour cited in response to a PbR bid by a number of NGOs related to choosing what countries to propose to work in for the 2013 DFID-USAID Challenge Funds. Bidders could select from a large number of countries to propose to work in, and a number of NGOs reported ruling out work in more expensive and complex environments (such as South Sudan) where needs were greatest as they felt this might increase the cost and/or risk of their bid relative to others and reduce their chances of winning the bid.

**22** Robert Chambers also argues that as the sector skills-up in some new areas (contracting, formal evaluation), it is de-skilling in some key areas that are essential to effectiveness such as community engagement. Those are risks that are unanticipated by PbR. (See: http://participationpower.wordpress.com/2014/09/03/treasures-payment-by-results-frogs-in-a-pot-and-straitjackets-for-obstacle-courses/ )
