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# Using Performance-Based Funding to Incentivize Change

Steven G. Klein

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#### About the Author

**Steven G. Klein**, PhD, directs the Center for Career & Adult Education and Workforce Development at RTI International.

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RTI International  
3040 East Cornwallis Road  
PO Box 12194  
Research Triangle Park, NC  
27709-2194 USA

Tel: +1.919.541.6000  
Fax: +1.919.541.5985  
E-mail: [rtipress@rti.org](mailto:rtipress@rti.org)  
Website: [www.rti.org](http://www.rti.org)

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# Using Performance-Based Funding to Incentivize Change

Steven G. Klein

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## Abstract

Performance-based funding is a resource distribution strategy used in education to reward service providers for the outcomes they achieve. Institutions that produce above-average results earn additional financing, while those that fall short may face funding reductions and may be targeted for technical assistance to address their performance shortcomings. Efforts to introduce performance-based funding in education frequently encounter resistance from program administrators and their staff, who, among other objections, fear the application of competitive funding may unfairly penalize programs serving low-performing students. This paper describes how performance-based funding systems can be incorporated into state education resource distribution formulas to incentivize improvements in educational services, and presents a seven-step process that RTI has developed to build stakeholder support for system adoption. It draws on RTI's years of experience working with state education administrators to create funding formulas that allocate federal and state funds—equitably and objectively—to the most effective service providers.

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## Incentivizing Change

Performance-based funding is a resource-distribution strategy used in education to reward service providers for the outcomes they achieve. School districts or postsecondary institutions that produce above-average results earn additional financing, while those that fall short may face funding reductions and be targeted for technical assistance to address their performance deficits. Many states currently use performance-based funding to allocate funds to public higher education and adult education providers, and the use of competitive funding is drawing increasing attention—from both federal and state policy makers—as a tool for improving program accountability and effectiveness at all education levels.

Efforts to integrate performance-based funding into state education funding formulas often encounter resistance from local program administrators and their staff, some of whom object to applying marketplace principles in the public sector. Opposition frequently stems from issues related to educational equity, as students have diverse educational experiences, personal abilities, economic resources, and family supports, all of which may be associated with academic achievement. Because student populations are not uniformly distributed across sites, concerns are raised that some service providers may be unfairly advantaged.

While there are clear differences in how private sector firms and public educational institutions operate, ultimately both rely on people and financing to produce results in the most efficient manner. And while public schools are not intended to be profit-maximizing entities, the business of schools is to graduate students who possess the academic knowledge, career training, and life skills necessary to succeed in the workplace and society. Well-designed performance-based funding formulas motivate educational institutions to produce results, while safeguarding those serving at-risk populations.

This paper describes how performance-based funding systems can be incorporated into state education resource distribution formulas to allocate funding

among local providers.<sup>1</sup> It does so by profiling a seven-step process that RTI International has developed to build stakeholder support for system adoption. It draws on RTI's years of experience working with state adult education administrators and local program staff to create formulas to allocate federal and state funds equitably and objectively. Lessons learned from this work suggest that the formula development process may be replicated in other educational contexts to introduce and sustain performance-based funding.

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## Changing Performance Expectations

How does one get the best out of people? Private sector employers motivate people by offering salary increases and bonuses; in contrast, our educational and workforce training systems use threats and penalties to induce better performance. For example, adult education providers that fail to meet their local performance accountability measures established under the federal [Workforce Innovation and Opportunity Act \(WIOA\)](#) face a progressive series of sanctions, which may begin with the drafting of a performance program improvement plan and escalate to institutional reorganization. Meanwhile, those that succeed may go unnoticed.

A fundamental premise of performance-based funding is that people respond better when their efforts are recognized and rewarded. This premise holds whether compensation is directed into staff salaries or used for other purposes, such as purchasing new instructional equipment and supplies, lengthening program hours, providing release time for professional development, or hiring additional instructors to expand student offerings.

This is not to suggest that performance-based funding is without its downside. In the absence of additional investment, performance-based funding creates winners and losers as it redistributes limited federal or state resources across service providers. While the potential loss of backing can raise staff anxiety in sites performing below the state average, well-designed performance-based funding systems can drive

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<sup>1</sup> RTI has developed a set of online tutorials documenting the formula development process. Access the tutorials at [http://www.rti.org/page.cfm/Policy\\_-\\_Analysis\\_-\\_and\\_Funding](http://www.rti.org/page.cfm/Policy_-_Analysis_-_and_Funding).

### Performance-based funding systems offer a variety of benefits, which may include improvements in ...

- **Data quality**—Connecting program allocations to performance creates a high-stakes environment that gives local program directors a financial incentive to enhance the accuracy and completeness of their data.
- **Program delivery**—Compensating educators for the results they achieve directs attention to curriculum and pedagogy, which can induce program administrators to undertake reforms to boost resource eligibility.
- **Political support**—Allocating funding based on performance positions educators to ask for increased resources because they can produce data to show that taxpayer dollars are being used effectively.
- **Teacher professionalism**—Linking funding to performance holds school leaders and their staff accountable for learner outcomes, which can spur changes in classroom curricula, instructional practice, and professional development.

systemic improvement while protecting institutions serving students with significant economic or personal challenges. This is accomplished by incorporating formula adjustments that compensate providers for the relatively higher cost of serving certain high-need populations. In an environment of declining public financing and rising educational needs, performance-based funding ensures that resources are directed to the most effective and efficient service providers and, in so doing, helps maximize the return on taxpayer investment.

## The Evolution of Performance Funding

Performance-based funding has been applied in higher education for nearly two decades to reward institutions for producing superior results. Early approaches, dating back to the mid-1990s, awarded cash bonuses to postsecondary institutions achieving state-established outcomes, using funds specifically

authorized for competitive allocation. This infusion of additional resources positioned performance-based funding as a perk, since all institutions continued to receive their basic state aid or institutional base funding.<sup>2</sup> Studies of performance-based funding's application in higher education indicate that these funding systems suffered from a high degree of instability, with some states abandoning performance-based funding during economic downturns. This was due, in part, to how funds were budgeted: Faced with declining tax revenue, policy makers responded by cutting nonessential, extra-formula programs to protect institutional bases (Dougherty, Natow, & Vega, 2012).

The origins of some funding formulas also placed systems at risk. Many early performance-based funding systems were legislatively imposed without input or support from postsecondary leaders. It has been suggested that policy makers' failure to gain buy-in from institutional administrators contributed to system instability, with the least stable systems shaped by legislators, governors, business, and community leaders (Burke & Associates, 2002). Other factors attributed to formula volatility included the use of indicators perceived as lacking institutional purpose, concerns over the loss of campus autonomy, and high implementation costs associated with the collection of data (Burke & Associates, 2002; Burke & Modarresi, 2000).

Over time, performance-based funding systems have evolved to become an essential element of state investment in higher education. Dubbed "performance-based funding 2.0" in the literature, these newer compensation models integrate provider performance into state resource distribution formulas used to dispense annual operating funds (McLendon & Hearn, 2013; Community College Research Center, 2014). This approach has contributed to formula persistence because performance-based funding is treated as an integral part of the state funding system rather than as a separate pot of money. Formulas also are more tightly connected with states' educational

<sup>2</sup> Institutional base funding encompasses resources that are distributed to educational service providers on an entitlement basis, often conditioned on enrollment. Other formula allocation criteria may include institutional size and location, student characteristics, and program type.

goals, which increase their perceived value and utility (Albright, 2009). For example, output-based formulas that reward institutions for increasing the number of students who complete degree programs contribute to institutional effectiveness while simultaneously expanding the state's population of educated workers.

While logic suggests that performance-based funding should work, to date, there is limited evidence on its impact. Analyses of early performance-based funding systems have produced few statistically significant findings, and rigorous studies on the effect of performance-based funding 2.0 systems have yet to be conducted. The information that does exist suggests that performance funding can help to spur changes in staff awareness of state priorities and of their own performance, as well as promote status competition among colleges (Dougherty & Hong, 2005). Changes to academic programming were most often noted within developmental education and in course articulation and transfer between two-year and four-year colleges, though actual formula effects have been difficult to gauge because the shift to competitive funding was one of several concurrent initiatives (Dougherty et al., 2014). Potential unintended consequences associated with the use of performance funding may include restrictions in college admission and a weakening of academic standards by colleges seeking to game formulas in order to qualify for increased revenues (Lahr et al., 2014).

Although methodologically rigorous evidence has yet to be produced in higher education or other areas in which performance-based funding has been applied, recent federal legislative proposals have called for its expansion to promote transparency and accountability in the public sector (Harnisch, 2011). Underlying this approach is the belief that when funding is contingent on performance, legislators and the public are better able to identify state and institutional priorities and calculate the return on investment of taxpayer funds. Most recently, pay-for-performance has been incorporated as a strategy within WIOA to incentivize youth workforce investment, adult and dislocated worker employment and training, and adult education and literacy programs. Competitive funding also is under consideration as part of the reauthorization of several landmark pieces of federal legislation, including the

Higher Education Act and the Carl D. Perkins Career and Technical Education Act of 2006.<sup>3</sup>

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## Developing Formulas for Performance-Based Funding

The successful implementation of performance-based funding depends in large part on how allocation formulas are designed. Our firsthand experience working with state performance-based funding task forces has taught us the importance of engaging key stakeholders in the formula development process. This not only lessens the likelihood of future opposition, but also can help to ensure that formula components are practical and address the actual needs of the field. States often use the performance-based funding development process to reexamine the operation of all state formula components, which may include strategies for allocating both institutional base funding (a.k.a. foundational funding) and performance-based funding. This can be an effective approach, since competitive allocations should complement states' distribution of other resources.

Our highly participatory formula design process hinges on the convening of a performance-based funding task force, led by an experienced RTI facilitator, to drive system development. The development process proceeds in the following manner.

### Step 1. Establish State Commitment

Formula development begins well before provider allocations are calculated. A key first step is securing the political support of state governance and education leaders, who agree to publicly advocate for performance-based funding adoption. This may entail enlisting superintendents of public instruction, higher education system presidents, program directors, or other respected, high-level administrators. Ideally, these individuals will confer authority to the task force members by, for example, making the opening remarks at planning meetings or providing statements

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<sup>3</sup> See *Fact sheet on the President's plan to make college more affordable: A better bargain for the middle class* (The White House, Office of the Press Secretary, 2013) and *Investing in America's future: A blueprint for transforming career and technical education* (US Department of Education, 2012).

to the press in support of project objectives. Having the backing of recognized state authorities sends the message that formula adoption is impending, important, and nonnegotiable.

## Step 2. Convene a State Task Force on Performance-Based Funding

Recruiting credible task force members is critical to formula success. Ideally, participants will be experienced professionals, knowledgeable of program administration and financing and representative of the diverse providers and students across the state. Often this entails engaging institutional leaders who oversee local programs and have decision-making authority. Members also should be respected by their peers for their integrity and judgment; capable of making objective and rational decisions; and willing to collaborate, listen, and share new ideas.

*Performance-based funding systems are not imposed on educators by outside forces; rather, they are something that educators choose for themselves ... because improving results is in the best long-term interest of students, institutions, and the state.*

Task force members need not initially embrace performance-based funding. Having competing opinions helps strengthen formula design discussions and can bring to the surface issues that might otherwise derail formula adoption. Ultimately, statewide acceptance of performance-based funding requires building alliances, first among task force members and subsequently with the larger field. Having the visible support of task force members, including those who initially doubted the effort, can send a compelling message to those who might be resistant to change. Finally, members must be counseled on the importance of maintaining confidentiality. Since numerous models will be tested and discarded, team members must refrain from sharing too much information early in the process to avoid panicking those lacking context.

## Step 3. Specify State Funding Priorities

Initial task force discussions focus on identifying priorities to drive formula development. These may range from increasing the number of students making

educational skill gains or completing programs, to expanding the efficiency of program operations. Priorities should be derived from the state's existing system goals and strategic plans or initiatives. These goals become the touchstones for the formula development process; team members will return to them repeatedly to ensure that their work reinforces identified needs.

### Good resource distribution formulas are:

- **Equitable**—Providers must be able to compete for resources on a level playing field and not be penalized for factors outside their control.
- **Simple**—Formulas must not be overly complicated: staff must understand how their actions affect funding.
- **Precise**—Allocation data must provide valid and timely measures of program and student performance.
- **Auditable**—Allocation data must be accurate.
- **Transparent**—Allocation procedures must be clear and reproducible.

At meetings, conversations about priorities begin with a brainstorming exercise in which members reflect on state purposes in funding educational services, as well as their own programmatic mission and personal beliefs. Once the members record preliminary goals, they vote for their top priorities to select which outcomes to include in the funding formula. Next, team members consider how the existing state formula allocates resources, and whether (and if so, to what extent) it aligns with the goals and priorities identified by the group.

To illustrate how the current state formula operates absent performance-based funding, the task force facilitator shares a table summarizing allocations and outcomes within the education or training system selected for adoption of performance-based funding. Metrics commonly used include the percentage of state funding each provider receives, as well as program expenditures per enrollee and per outcome achieved. For example, when working with adult education providers, RTI draws on data contained

within the National Reporting System,<sup>4</sup> which all states use to report on the performance of adult populations.

Comparisons of provider results typically reveal considerable variation in resource allocations and program cost structures. Table 1 illustrates how adult education outcomes and costs vary in a hypothetical state with seven service providers. Here, Provider B accounts for roughly 14 percent of the state's total adult education funding and enrolls 18 percent of statewide learners, yet achieves well over 21 percent of the performance outcomes recorded within the state. In comparison, Provider F receives a much larger percentage of state funding (31 percent) and enrolls a greater number of students (26 percent), yet achieves an equivalent number of outcomes. As a consequence, the two programs' costs differ substantially when expressed on a per-learner and per-outcome basis, with Provider F spending more than twice as much as Provider B for each outcome achieved (i.e., \$206 per outcomes versus \$94).

This information generally sparks a spirited discussion relating to the fairness of resource allocations and the size of cost differentials across institutions. While different providers might logically be expected to spend different amounts to achieve a

given outcome, programs with substantially higher costs per outcome might be perceived as operating less efficiently. Task force members are encouraged to offer possible explanations for the observed variation, which may include differences in provider type and size, the ways in which services are administered and delivered, geographical considerations, and the characteristics of the student populations served.

The dialogue often helps convince team members with reservations about performance-based funding of the need to reevaluate the operation of their state education resource distribution formula. This is particularly the case when a significant percentage of funds is allocated based on student enrollment. Since institutional task force members generally know the composition of their own student populations and that of other service providers, large unexplained variations in performance outcomes, when expressed on a per-student basis, can raise questions about the fairness and efficiency of state investments. This provides an opening for a discussion about how performance-based funding can be used both to target resources to address agreed-upon educational priorities and motivate service providers to undertake changes to reduce their operating costs.

#### Step 4. Define Measures for Allocating Resources

Using the funding priorities identified in the preceding step as a guide, task force members select measures for awarding base and/or performance funding. To avoid complicating the formula,

<sup>4</sup> The National Reporting System for adult education includes indicators of educational gain, rates of entered employment, retained employment, the award of a secondary school diploma or general education development (GED) certificate, and placement in postsecondary education or training.

**Table 1. Example metrics for comparing program performance, from the National Reporting System**

Program	State Funding Dispersed		Enrollment			Completions on the NRS Core Measures		
	Funding	Percent of total funding	Number enrolled	Percent of state total	\$ per enrollee	Number of completions	Percent of state total	\$ per outcome
Provider A	\$85,096	9.8%	978	13.3%	\$87	945	15.6%	\$90
Provider B	\$122,753	14.1%	1,339	18.2%	\$92	1,299	21.5%	\$94
Provider C	\$54,987	6.3%	439	6.0%	\$125	320	5.3%	\$172
Provider D	\$49,542	5.7%	385	5.2%	\$129	335	5.5%	\$148
Provider E	\$186,731	21.4%	1,527	20.8%	\$122	1,320	21.8%	\$141
Provider F	\$268,159	30.7%	1,882	25.6%	\$142	1,300	21.5%	\$206
Provider G	\$104,933	12.0%	802	10.9%	\$131	535	8.8%	\$196
<b>State totals</b>	<b>\$872,201</b>	<b>100.0%</b>	<b>7,352</b>	<b>100.0%</b>	<b>\$119</b>	<b>6,054</b>	<b>100.0%</b>	<b>\$144</b>

NOTE: Shading indicates amounts that are greater than the state average.

members may initially focus on a subset of measures identified during their brainstorming session, or may focus on high-stakes metrics, such as those contained in federal education legislation. For example, when developing a performance-based funding formula to allocate career and technical education resources, task force members might select those that address student placement into postsecondary education or employment (or both), which are key performance indicators in the Perkins Act.

Once they have selected criteria, team members choose a mechanism for distributing funds. This entails consideration of the following points:

- **Amount earmarked for competitive funding**—Our experience suggests that states need not invest large sums for performance-based distribution to motivate providers. Reserving a modest amount—between 5 and 15 percent of grant resources—is often enough to gain people’s attention.
- **Importance of outcomes**—Not all results are equally valued. Based on their ranking of state priorities, team members may choose to differentially allocate funds across performance-based funding measures, with weightings usually expressed as a percentage of funding. For example, a state seeking to emphasize educational progress and credential attainment for its adult learners in WIOA-funded programs might structure its performance contracts to award funding based on the percentage of program participants, with funds distributed in the following proportions:

Obtained unsubsidized employment (2nd quarter)	15 percent
Obtained unsubsidized employment (4th quarter)	10 percent
Had median earnings above the state average	5 percent
Obtained a secondary diploma or postsecondary credential	40 percent
Earned measureable skill gains	30 percent
Effectiveness in serving employers	0 percent

Under this approach, the state would reserve a majority of the funds for competitive distribution—a total of 70 percent—for allocations directed toward individuals’ attainment of a secondary diploma or postsecondary credential, or measured skill gain. Lesser amounts might be reserved for other metrics that while important, are less aligned with state training goals. Moreover, not all metrics need be addressed through the funding formula in order to remain as important state goals. In this example, no funding would be targeted toward provider effectiveness in serving employers, either because the outcome is not as highly valued by the state or because insufficient data exist to accurately measure employer satisfaction.

- **How outcomes are measured**—States may choose from among several different approaches for rewarding providers. One option is to assess the number of student, program, or process outcomes that a provider has achieved. Another is to allocate funds based on the number of performance targets a provider has met or exceeded. A third is to compensate programs using process or program quality indicators that account for the manner in which programs operate. Different criteria offer different advantages (Table 2). Irrespective of the approach, funds are usually distributed on a pro rata basis. For example, a program accounting for 5 percent of statewide outcomes on a given measure would qualify for 5 percent of the funds earmarked for the area.

**Table 2. Approaches and considerations for rewarding providers**

Criteria	Example	Considerations
<b>Number of outcomes</b>	<ul style="list-style-type: none"> <li>• Program completers</li> <li>• Retained students</li> </ul>	<ul style="list-style-type: none"> <li>• May favor larger providers</li> </ul>
<b>Performance targets</b>	<ul style="list-style-type: none"> <li>• Exceeding negotiated performance rates</li> </ul>	<ul style="list-style-type: none"> <li>• Small and large providers have equal opportunities to earn resources</li> <li>• Different rates may be set to account for program or learner characteristics</li> </ul>
<b>Process indicators</b>	<ul style="list-style-type: none"> <li>• Meeting program quality indicators</li> <li>• Performing well on desk audits</li> <li>• Making continuous improvement</li> </ul>	<ul style="list-style-type: none"> <li>• Accounts for program structures</li> <li>• Must be based on proven criteria</li> </ul>

- **How equity is addressed**—Not all students or programs achieve results at similar rates. Individuals with learning disabilities or facing other personal challenges may take longer to record a positive outcome. Likewise, programs enrolling large numbers of low-skill students may have a harder time achieving results. Accordingly, formulas should be built to lessen the risk of perverse incentives, such as shifting services away from those with the greatest need. This can be accomplished by earmarking funding for categories of students, establishing performance targets that emphasize growth over time, or increasing the weight attached to certain outcomes. Individuals with learning disabilities, for example, may be weighted at twice the level of those without such challenges to account for their slower progress. Whenever possible, formula weights should be based on quantifiable data so that compensation rates reflect actual conditions. In some instances, this will require improving data quality or collecting new information.
- **Other programmatic considerations**—While no formula can account for all situations, task force members should attempt to address critical factors affecting performance. For example, formula adjustments may be needed for rural providers who face higher operating costs or for those serving small or relatively more diverse student populations.

### Step 5. Identify Data Sources

Not all outcomes can be readily measured. To ensure formulas are fair and effective, task force members must determine whether data already exist or might be collected to assess provider performance. For example, if postsecondary credential attainment is selected for formula inclusion, task force members will need to agree upon the types of awards included in the measure, the methods used to collect data, and whether all programs already have the capacity to collect accurate and reliable data. Procedures for ensuring the accuracy of data also must be put in place—for example, by conducting desk and on-site audits of data and holding program directors legally responsible for reporting accurate information. Ultimately, all providers must be able to compete on

a level playing field if the formula is to be seen as fair and unbiased.

Members will also need to consider how well existing data are tied to current practice. While some lags between when data are collected and released are unavoidable, care must be taken that information is not outdated before it can be entered into allocation formulas. Ideally, data from the preceding program year are used to award funding so that program staff can see a direct link between their actions and results.

### Step 6. Model Formula Allocations

Once agreement is reached on a formula framework, task forces can begin modeling formula allocations. It may be helpful to explore various funding scenarios—predicated on the performance criteria and other decisions that have been agreed upon—so that members can evaluate the effects of different approaches. For simplicity, formula allocations are modeled using spreadsheets containing worksheets with the raw data used to establish allocations. This helps ensure that task force members can participate in the modeling process without the need for specialized training. An example of an allocation model is provided in Table 3.

This example illustrates how state adult education funding might be allocated among seven adult education service providers distributed across five regions within a state. Here, 80 percent of total funds (or \$800,000) are distributed as an institutional base (column C), in which all providers receive an allocation regardless of the outcomes they achieve. The remaining 20 percent of funds are allocated using performance-based funding (columns D and E), in which providers are funded according to their relative performance. The actual criteria used to allocate funds may differ from those identified here, and may include additional or fewer elements. Performance components profiled here include:

- **Completions**—The number of outcomes achieved by students within each provider. In this example, the criteria are based on students who achieve a positive outcome on one or more of the core measures identified in the federal adult education legislation. Each provider receives a pro rata share of the funds earmarked for distribution, based on the state's total recorded outcomes.

**Table 3. Sample allocation model for performance-based funding**

Column A	Column B	Column C	Column D	Column E	Column F	Column G	Column H
Region and provider	Prior year allocation	Base funding <sup>a</sup>	Performance-Based Funding Components		Total PBF (D+E)	Coming year total allocation (C+F)	Change in allocation from prior year (G - B)
			Completions on NRS core measures	State target points achieved			
<b>Region 1</b>							
Provider A	\$97,565	\$116,981	\$23,414	\$5,556	\$28,970	\$145,951	\$48,387
Provider B	\$140,739	\$160,176	\$32,185	\$6,790	\$38,975	\$199,152	\$58,412
<b>Region 2</b>							
Provider C	\$63,044	\$56,473	\$7,929	\$8,642	\$16,571	\$73,044	\$10,000
Provider D	\$56,801	\$49,483	\$8,300	\$8,025	\$16,325	\$65,808	\$9,007
<b>Region 3</b>							
Provider E	\$214,092	\$137,681	\$32,706	\$6,173	\$38,878	\$176,559	(\$37,532)
<b>Region 4</b>							
Provider F	\$307,451	\$201,978	\$32,210	\$5,556	\$37,766	\$239,743	(\$67,708)
<b>Region 5</b>							
Provider G	\$120,308	\$77,227	\$13,256	\$9,259	\$22,515	\$99,742	(\$20,566)
<b>TOTAL</b>	<b>\$1,000,000</b>	<b>\$800,000</b>	<b>\$150,000</b>	<b>\$50,000</b>	<b>\$200,000</b>	<b>\$1,000,000</b>	<b>\$0</b>

<sup>a</sup> Base funding may include multiple allocation criteria, which for purposes of illustration are represented as a single allocation.

- **Target Points**—The number of points achieved by providers for meeting or exceeding their negotiated state performance rate on a measure. Each provider receives a pro rata share of the funding earmarked for distribution, based on the state’s total points awarded.

Base and performance funds earned by each provider for the coming program year are summed (column G) and compared with the amount the provider earned in the preceding year (column H). Since the total amount of funds allocated to providers remains constant across the two years, the total net change in resources allocated among providers shows as a zero balance.

The resource distribution formula can be designed to run using a “control panel,” which allows task force members to modify their allocation assumptions and immediately see updated results. For example, to see the effects of increasing the amount of funding allocated using performance-based funding, members may reduce the percentage of base funding from 80 percent of \$1,000,000 (Option 1) to 60 percent (Option 2), while keeping the relative amounts and funds constant (Table 4). Dollar amounts and

funds displayed in the control panel automatically readjust to keep allocations equivalent to available resources. In this instance, the amount of funding allocated as base funding would fall to \$600,000 and the amount of performance-based funding would correspondingly increase. Amounts allocated within performance categories are automatically adjusted (based on the identified percentages) to keep the total amount of funding constant.

**Table 4. Control panel illustrating allocation criteria and dollar amounts, two options**

Funding criteria	% of total	Dollar amount
<b>Control Panel: Option 1</b>		
Total funding		\$1,000,000
Base funding	80%	\$800,000
Performance-based funding	20%	\$200,000
# Completions	15.0%	\$150,000
% State target points	5.0%	\$50,000
<b>Control Panel: Option 2</b>		
Total funding		\$1,000,000
Base funding	60%	\$600,000
Performance-based funding	40%	\$400,000
# Completions	30.0%	\$300,000
% State target points	10.0%	\$100,000

Alternatively, task force members may choose to change the relative weight attached to differing allocation criteria—for example, by lowering the weight attached to completions in Option 1 from 15 to 5 percent. Again, the resource distribution formula will automatically adjust to the new assumptions, instantly reallocating funding across all providers in the state to align with new values in the control panel. Additional distribution categories may be added as rows to the control panel. This allows task force members to test multiple assumptions to determine how different allocation approaches may affect resource allocations.

### Step 7. Design an Implementation Plan

New resource distribution formulas typically are introduced at the start of a state's program year, which may cause substantial shifts in provider funding eligibilities that may limit a provider's ability to maintain similar services from year to year. This is particularly the case if previous formulas allocated resources based on subjective criteria or drew on historical data that are now out of date. One means of avoiding windfall gains or crippling losses to providers is to phase in formula adoption, such as by instituting harm limits that bound the amount that a provider may gain or lose on an annual basis. For example, in the first year of formula implementation, funding changes may be capped at 5 percent, meaning that regardless of their projected eligibility, providers may not earn less than 95 percent or more than 105 percent of their prior year grant. Providers falling between these bounds would be awarded their formula-determined allocation. Restrictions may be relaxed over time to allow the educational system to gradually move to a new, more equitable funding equilibrium. A possible timeline is shown in Table 5.

Despite the task force members' efforts to ensure that formula operations are transparent, not all staff within providers will understand how the funding system operates or the steps they can take to increase their funding. Ensuring that formulas achieve their desired effect often entails reaching out to program staff, though workshops or individualized training, to explain how formula components function. Effective performance-based funding systems lead program staff to reflect on their program organization,

**Table 5. Sample timeline for phasing in funding formula(s)**

Implementation year	Harm limit <sup>a</sup>	Maximum provider change from prior year
Year 1	5 percent	Gain: 105% Loss: 95%
Year 2	10 percent	Gain: 110% Loss: 90%
Year 3	20 percent	Gain: 120% Loss: 80%
Year 4	None	Formula allocation

<sup>a</sup> Harm limits bound the amount that a provider may gain or lose annually.

pedagogy, and outcomes, but they must first understand how their actions affect the funding they receive. For these reasons, some states may choose to delay formula introduction until after a year devoted to educating the field and other stakeholders about how the formula operates.

The performance-based funding formula development process never really ends. Educational systems are dynamic: state priorities change over time, as do population demographics and educational needs. To ensure that performance-based funding continues to address state needs, formula components and funding assumptions should be periodically evaluated and, where necessary, refined to reflect changing state conditions. Formula adjustments should not be too rapid, however, lest providers be unable to connect cause to effect or benefit from instituting programmatic reforms. A 3- to 5-year review cycle, which may entail reconvening the task force, may be appropriate in most cases.

Inertia is perhaps the greatest obstacle to performance-based funding adoption. Educators typically inherit formulas that are historically rooted and behaviorally ingrained. Finance systems replicate the status quo, in part because deviating from established norms can threaten jobs and programs. Yet form often follows financing. And as such, performance-based funding can help jump-start systemic change by motivating people to take chances in order to increase their resource eligibility, and rewarding those who succeed.

## In Sum

Performance-based funding systems hold institutional administrators and staff accountable for program and student outcomes. Although state performance-based funding formulas vary somewhat in their procedures for distributing resources, each one links state fiscal allocations to provider performance, and each is designed to motivate providers to improve their performance outcomes to qualify for additional resources. Change need not be instantaneous. Harm limits can be introduced to protect providers from catastrophic losses (or staggering gains), buying time for program staff to pursue technical assistance and modify their instructional programs to adapt to the new funding environment.

In directing resources to the most successful institutions and agencies, performance-based

funding systems focus the attention of program administrators and other key stakeholders—including state legislators, educational administrators, and taxpayers—on program and learner outcomes. This increased awareness of performance and its financial implications can generate cost efficiencies, contributing to improved instruction, gains in statewide and local student performance, enhanced accountability, increased use of performance data to drive state and local improvement initiatives, and expanded political support for educational programs.

RTI's experience working with states to design performance-based funding systems has taught us the importance of engaging key stakeholders in the formula design process. Working together, it is possible to design education resource distribution formulas that can incentivize change, while ensuring that funds are distributed—equitably and objectively—to the most effective service providers.

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