



National Center for Higher Education Management Systems

Performance Funding: From Idea to Action

Prepared for Complete College America

December 2011

Performance Funding: From Idea to Action

Performance funding – the linking of allocation of resources to accomplishment of certain desired outcomes – is an idea that is once again finding favor with policymakers. It has intuitive appeal; what’s not to like about paying for results? While it is a notion that makes common sense to most decisionmakers, it is an idea with a very checkered past – it has been tried, found wanting, and with few exceptions abandoned. A review of past experiments suggests that it’s not the idea that failed, but the design and implementation of the strategies that derived from the idea. This brief paper presents a set of first principles for putting in place an approach to performance funding that will help policymakers avoid many of the pitfalls that plagued prior efforts in this arena. The principles presented fall into two categories – those dealing with design of the system, and a separate set dealing with implementation.

Design Principles

1. Recognize that all funding models are performance based; this is not a new idea. Institutions have consistently received appropriations from the state for achieving certain objectives. Most often the objective has been providing greater access and growing enrollments. In other cases, the incentives have been for maintaining the status quo. In the current incarnation, it’s not the idea that’s new – it’s the objectives for which incentives are being provided that are new. Access is no longer the dominant goal. It has been replaced by an emphasis on completion of academic programs. Numbers of students enrolled is becoming less the coin of the realm; production of degrees and high value certificates is becoming the new currency. Over the years decisionmakers and analysts have become very good at devising ways to appropriately reward improvements in student access. The task now is to become equally adept at rewarding a different set of goals.
2. Get agreement on goals before putting performance funding in place. Resource allocation models are means to an end, not ends unto themselves. If there is not a clear statement of goals that has broad bipartisan acceptance, there is almost no chance of creating a performance funding model that can last. It is well worth the time and effort to get broad consensus around a “public agenda” for the state before embarking on design of a performance based funding model. The public agenda should state a limited set of goals that:
 - Are tailored to the needs of the state, not borrowed from elsewhere
 - Focus on the needs of the state and its citizens, not the institutions of higher education

Absence of such a public agenda undercut the efficacy of many prior efforts to build performance funding systems. Goals need to be the driving force for performance funding, not a rhetorical afterthought.

Texas provides a good illustration. Their goal of “Closing the Gaps” preceded by several years their initiation of a performance funding component to their allocation model that rewards institutions for increasing the numbers of degrees awarded. Indiana and Ohio also illustrate this principle.

3. Don’t construct performance metrics too narrowly. The current focus nationally is on education attainment of the population and the associated encouragement for institutions to increase the numbers of degrees and employer-recognized certificates produced. In most

states this is a necessary and important goal, but is likely not the only one of importance to the state. Others frequently found include:

- Innovations that expand and broaden the state’s economy
- Production of graduate and professional degrees in selected fields such as STEM or health care
- Development of a workforce for high need occupations

It is important that all institutions have an opportunity (not a guarantee) to benefit by excelling at their different missions. It is important to reinforce the point that institutions should be able to “win” by contributing to state goals, not doing well at their own. Failure to abide by this principle can easily lead to:

- Encouragement of unwanted behavior by institutions – mission creep by some institutions, and research institutions enrolling more students than deemed desirable by policymakers and increasing competition for students even more in the process.
- Legislative opposition from supporters of institutions that can’t benefit from staying within their mission and doing that mission well.

Illinois is a good example of a state whose public agenda is both well-focused on the needs of the state while simultaneously calling on the different capacities of different kinds of institutions to achieve that agenda. (See http://www.ibhe.state.il.us/masterPlanning/materials/070109_PublicAgenda.pdf)

4. Design the funding model to promote mission differentiation, not mission creep. This can be accomplished in at least two distinct ways:
 - Use different metrics/drivers for different kinds of institutions. Tennessee’s model is particularly good on this dimension, rewarding
 - The research universities for producing doctoral and professional degrees and successfully competing for more research funding
 - The comprehensive institutions for producing masters and baccalaureate degrees
 - The community college for producing associate degrees and certificates, transferring students and reaching specified “momentum points” (remedial success, dual enrollment, and job placement, for example.)
 - Create different pools of resources for different kinds of institutions – and make sure that each institution can compete for resources in only one pool. Ohio uses this strategy and makes distinctions among
 - Main campuses
 - Regional campuses
 - Community colleges

The fundamental principle is to reward institutions for fulfilling their missions and not encourage/allow them to benefit by altering their mission. The largest bone of contention

almost always arises when teaching institutions are discouraged from benefitting from engaging in research.

5. Include provisions that reward success with underserved populations. One of the major concerns voiced about performance-based funding, especially when the goal is to produce more graduates, is that institutions will seek to enroll only those students most likely to succeed and ignore students who are at risk academically, economically, or otherwise. To counter this possibility most states that have instituted performance funding give extra weight for graduating students from at-risk populations. The weights vary from 40% (in Tennessee) to 100% (in Texas). The definitions of “at-risk” differ considerably from state to state. Examples include:
 - Low income – usually measured as Pell or state grant eligible (Tennessee, Ohio, Texas)
 - Adult (Tennessee, West Virginia, Texas)
 - Academically at-risk – below national average on ACT/SAT and those with GED (Texas)

The beauty of the formulation that gives added weight to graduates with specified characteristics is its flexibility; flexible in the weights attached and in the characteristics of students identified as priorities for extra attention.

6. Include provisions that reward progress as well as ultimate success (degree completion). This is especially important in the early implementation stages of performance funding. Degree production is difficult to increase in a single year; a mechanism that rewards improvement in the shorter term is a useful and appropriate tool. It helps institutions, but more importantly it helps students succeed by rewarding institutions who help students make step-by-step progress.

States that have implemented performance funding have pointed the way to different approaches to accomplishing this objective. They include:

- Providing rewards to institutions on the basis of number of students who complete 24 credits, 48 credits, 72 credits (Tennessee).
- Valuing completed credits at the upper-division level at a higher rate than at the lower division level (Ohio).
- Rewarding institutions for students achieving certain momentum points – completing developmental education and succeeding in the first college-level courses, completing 15 credits, 30 credits, etc (Washington community colleges).

It is possible to make this an inclusive provision, but it is also possible to confine this provision to at-risk students.

7. Limit the categories of outcomes to be rewarded. A frequent urge is to create an ever-expanding list of variables that can serve as drivers of the performance funding model; all institutions will press for inclusion of a factor that will benefit them. It must be remembered that performance funding should reward contributions to attainment of state, not institutional, goals, and state policymakers are counseled to keep the variables attached to each type of institutions to no more than four or five. One of the primary purposes of

outcomes-based funding is to focus institutional attention on key state priorities. If state policymakers can't limit the number of priorities, they are providing insufficient leadership and the message sent to institutions will be garbled at best. Success will be achieved only if the message is clear.

8. Use metrics that are unambiguous and difficult to game. Numbers of graduates is an unambiguous measure; students either graduated or they didn't. Graduation rates on the other hand are fraught with ambiguities. There are all kinds of definitional problems associated with determining rates. Furthermore, institutions can "game" improvements in graduation rates; rates can be improved by graduating fewer, better-prepared students. This doesn't serve the overall goal – raising education attainment by graduating more students.

Regardless of the goal being pursued, it is always useful to test the metrics that will serve as drivers of the calculation by asking two questions:

- If an institution sought to maximize their benefit on each metric what would they do? What is the easiest way to "win"?
- Is the behavior elicited the intended behavior?

If the answer to the second question is "no", go back to the drawing board; the chosen metrics are constructed incorrectly.

9. Reward continuous improvement, not attainment of a fixed goal. Creating conditions under which institutions can be rewarded only if they reach a predetermined level of performance is generally a bad idea. Either the goal will be set too low in effort to ensure success by at least a few institutions, or the goal will be viewed as unattainable and institutions will give up before they make a concerted effort to succeed. Better each institution's current performance be established as the baseline and funds allocated on the basis of year over year improvements from that baseline.
10. Make the performance funding pool large enough to command attention. Controversy almost always surrounds the determination of the proportion of the state appropriation to be allocated on the basis of performance. Institutions typically argue for a small percentage; there is comfort in business as usual. Policymakers take the opposite position; more is better. There is no proven right answer and different states have reached different conclusions in this regard. Tennessee for years allocated 5.4% of the state appropriation on the basis of performance. Under the new model, nearly all of the allocation is outcome based. Legislation in both Colorado and Louisiana sets the amount at 25%. Indiana now has one of the lower amounts at 6.5%. A minimum of 10% is probably a reasonable target.
11. Ensure that the incentives in all parts of the funding model align with state goals. In most states the performance funding component of the allocation model is constructed on top of a base funding component that can be characterized as either enrollment driven or base-plus. The former rewards access rather than success. The second is a recipe for maintaining the status quo. The orientation to enrollment increases as the primary driver is reinforced by the growing importance of tuition as a revenue source. Regardless of state goals, institutions have an ever-growing incentive to increase enrollments. Both approaches to base funding work at cross-purposes to the intentions of performance funding.

Faced with these realities, it is important that steps be taken to ensure that the performance funding component doesn't get negated by the (often countervailing) incentives inherent in the base allocation. Some suggestions:

- In enrollment-driven base models, base the calculations on completed credits, not enrolled credits. This based on the fact that programs won't be completed if courses that constitute those programs aren't completed.
- In base-plus arrangements, freeze the base at current levels and devote all new funds to the performance pool.
- Make the performance pool an increasingly large part of the state allocation. In states where tuition makes up half of institutional revenues, allocation of half the state appropriation to performance equates to 25% of institutional revenues – a level still overshadowed by enrollment-driven considerations.

The process by which the model is designed is critically important to long-term success. It's not just adherence to sound principles; but the environment in which they're deployed that matters. Institutions are understandably interested in the means by which state funds are distributed. For both technical and political reasons it is important to have institutional representatives at the table every step. Most have knowledge and experience that will improve the final product. Equally important, their involvement improves the chances of achieving a model that has broad support.

Implementation Principles

Even a well designed performance funding scheme will likely come up short if not thoughtfully implemented. Some basic implementation principles are:

- Don't wait for new money. Given the economic outlook for most states, funding the performance component of the allocation model only with new resources is a recipe for indefinite postponement. Because pursuit of state goals is such an imperative, delay in attaching performance requirements to some part of the allocation sends entirely the wrong message.
- Include a phase-in provision. Don't try to do it all at once. If the ultimate size of the performance fund is intended to be 25%, consider phasing it in at the rate of 5% over five years – 5% in year one, 10% at year two, etc. The objective should be to get to the target level as fast as possible without making the changes so large that institutions can't adjust.
- Employ stop-loss, not hold-harmless, provisions. Institutions should not be held harmless from cuts to their allocations if they are not contributing to state goals. At the same time, cuts should not be so large as to jeopardize the stability of the institution. One way to accomplish this objective is through a "stop-loss" provision that establishes a maximum cut that can be imposed in any one year – e.g., 2% the first year, another 2% the second, etc. At some point – four or five years from the point of implementation – the stop-loss provision should be sun-setted and the performance funding model should function without artificial constraint.
- Continue performance funding in both good times and bad. If pay for performance is intended to reward institutions for addressing the most critical issues facing the state, it is hard to see how postponing its implementation could be a good idea. Funds that address the issues identified as being most important should be the last dollars cut, not the first. If the overall state appropriation is reduced, the strategy should be to allocate performance dollars

first and then make cuts. The net effect will be to cut the high performers less than those making a lesser contribution to state goals.

The Road Blocks

Those not fully sold on performance funding will raise predictable counter arguments. Among them:

- Performance funding has been tried before with limited, if any, success. Why should this incarnation of an old idea be any more successful than previous cycles. There are several critical differences this time around. First, if done right it is now being driven by a public agenda; it is seen as a tool to achieve key goals not as a device for talking the legislature into providing marginal new dollars. Second, it derives its power from a consensus about priorities, not from promotion by a single persuasive leader or a group of self-interested proponents. Third, data systems are now much improved; it is possible to calculate metrics for important outcomes directly without relying on proxy measures. Finally, legislatures are raising the stakes; it's no longer 2-5%, but 25%. It is much harder to ignore such programs than it was in times past.
- Quality will suffer – institutions can easily graduate more students if their standards are lowered. There are several potential responses to this concern.
 - Faculty are the guardians of institutional quality; we have every faith that they will continue to be diligent in fulfilling this responsibility.
 - We will put in place a rigorous (outcomes-based) approach to assessing quality and will monitor results on an on-going basis to ensure that quality is not slipping.
- What is the evidence that it has made a difference? It's too early to judge in several cases, but there are some states in which implementation has resulted in higher performance.
 - In Texas, institutions increased degree production by 9.3% over baseline levels. The number of “at-risk” students graduated increased by 17.6%.
 - Similarly, Washington Community Colleges increased the number of momentum points achieved by 12% after initiation of a modest performance funding program.
- You have to restore base before setting aside funds for performance. This is perhaps the most common argument put forward by opponents of performance funding. The reality is that institutions are producing their current (baseline) level of outcomes with whatever resources they currently have at their disposal. It should be expected that any new resources lead to higher levels of performance, not the same level of performance at higher cost.

Concluding Comments

Performance funding is moving into the mainstream of state-level higher education financing policy. Several states have thoughtfully fashioned approaches to allocation of resources in ways that link funding to achievement of state goals. As a result, here is a growing body of information about good practices regarding design and implementation of such financing models. This brief paper is an attempt to succinctly describe those practices. The field has advanced to the point that the knowledge base regarding “how” to develop such systems is now in place. The issue now is one of political will, not technical know-how.