

## PERFORMANCE-BASED CONTRACTING FOR SERVICES: A SURVEY OF NIGP MEMBERS

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**ABSTRACT.** Performance-based contracting (PBC) for services has been a “hot topic” in the public procurement literature for some time now. Thus, it is surprising that little baseline data actually exists as to the nature and extent of PBC for services. This paper presents the results of a survey of the members of the National Institute of Governmental Purchasing (NIGP) on their governments’ use of PBC for services. The survey results confirm some popular notions about the use of PBC for services, but challenge others.

### INTRODUCTION

Performance-based contracting (PBC) for services continues to be one of the hottest topics in public procurement (e.g., Walters, 2009; Burman, 2008; Newell, 2008). The *Federal Acquisition Regulation*, the policies and procedures that govern procurement and contracting by the United States (US) federal government, states that PBC is the “preferred method” of acquiring services (*FAR*, Part 37.102-Policy). The Office of Federal Procurement Policy (OFPP) of the White House Office of Management & Budget reports that some 45 percent of federal service contracts are now performance-based (Newell, 2008:1)

The interest in PBC for services cuts across all levels of government (federal, state and local) and involves a variety of services including: consulting, prisoner reentry, housing, maintenance, public health, janitorial, job training, lottery operations, marketing, child welfare,

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elevator maintenance and others (Martin & Desenberg, 2009; Perrins, 2008; McEwen & Phillips, 2007; O'Brien & Revell; 2005; Chapin and Fetter; 2002; Martin, 2002; Gordon, 2001).

### **WHAT IS PERFORMANCE BASED CONTRACTING (PBC) FOR SERVICES?**

While general agreement on the purpose of PBC for services exists (focusing on the results of service provision and leaving the “how to” to contractors), there is no generally accepted definition of PBC for services. For example:

- the *Federal Acquisition Regulation (FAR Part 37.102 Policy)* prefers the term “performance based service acquisition” and does not specifically define the term “performance based contracting.” However, the FAR (Part 37.6 Performance Based-Acquisition) does state that “performance-based contracts for services” must satisfy specific criteria.
- the National Association of State Procurement Officials suggests that performance-based contracting (PBC) is characterized by “specification of the outcome expectations of the contract and the requirements that any renewals or extensions be based on the achievement of the identified outcomes” (NASPO, 1997:120).
- Various state governments (e. g., Florida, Maine, Washington) have their own definitions, which are similar but different (Martin, n.d.)

Because of its definitional ambiguity, PBC for services is perhaps best understood as an “umbrella term” that means different things to different people depending upon the level of government (federal, state or local), geographical region and the nature of the service being contracted (Martin & Miller, 2006.)

### **ADVANTAGES OF PERFORMANCE-BASED CONTRACTING (PBC) FOR SERVICES**

State and local governments (including municipalities, counties, school districts and special districts) procure the vast majority of their services through traditional methods including the use of: invitations to bid (ITBs), requests for proposals (RFPs), and invitations to negotiate (ITNs). These methods typically include work statements or scopes of

work that contain detailed *design specifications* that prescribe, sometimes in great detail, how the services are to be provided.

In performance-based contracting (PBC) the same traditional methods are employed, however, the use of design specifications in work statements and scopes of work are replaced by *performance specifications*. The use of PBC for services has many potential benefits for both contractors and governments including:

- contractors can utilize alternative and innovative service delivery approaches,
- contractors can achieve higher levels of performance because the focus is on the *results* of service delivery and not the *process* of service delivery,
- contractors can earn additional compensation and/or new contracts or contract extensions for the achievement of superior performance,
- governments can decrease the time and effort expended on contract monitoring, and
- governments can reduce service delivery costs because they pay only for the performance achieved (Martin & Miller, 2006; Mangum, 2002; Rogin, n.d., USGAO, 2002; Behn & Jant, 1999).

Despite the interest in, as well as the advantages of PBC, it remains an under-researched area of public procurement. Most of the existing research on PBC can be classified as case studies (e.g., Martin, 2002; O'Brien & Revel, 2005). Consequently, little baseline data exists that can be used to inform policy discussions about PBC for services. In an attempt to address this gap in the literature, the authors undertook a survey of the membership of the National Institute of Governmental Purchasing (NIGP). The NIGP is a professional organization dedicated to supporting and promoting public procurement through: education, research, technical services and advocacy. The NIGP has some 2,600 member agencies representing over 16,000 public procurement professionals in the US, Canada and other countries outside of North America.

### **THE STUDY**

An on-line survey, utilizing SurveyMonkey, was conducted in early 2009. All members of the National Institute of Governmental Purchasing (NIGP) as of December 31, 2008 were contacted by email, invited to

participate and directed to the survey website. The study was conducted under the auspices of the NIGP and the Public Procurement Research Center at Florida Atlantic University. The survey questionnaire, that forms the basis of the study, was developed by the authors with review and comments provided by a small group selected from the NIGP membership.

Because of the definitional ambiguity that surrounds the concept, survey respondents were asked to identify which of five approaches to PBC for services their governments' utilized. The five approaches were derived from the literature on PBC and from actual practices (Table 1). As part of the study, respondents were provided with detailed background information on each of the five approaches. As Table 1 shows, one of the five approaches was labeled a "different approach" to insure that the response categories were exhaustive.

Some 614 NIGP members from the US and Canada completed the survey. Because the survey does not represent a random sample and because of the low response rate, the study is best classified as exploratory in nature and the study findings should be regarded as tentative. Nevertheless, the study findings do provide the first systematic look at who's doing what in the area of PBC for services. Study data also provide additional support for many of the anecdotal observations noted in the case study literature.

## **STUDY DATA**

Table 2 identifies the survey respondents' type of government. The vast majority (88.1%) of respondents represented US state and local governments. A small proportion of respondents were from Canadian governments (4.7%), US colleges and universities (4.7%) and the US federal government (2.5%). It should be noted that although the study includes some 614 respondents, not all chose to answer all questions. Consequently, the number (n) of cases reported in the following tables and graphs vary.

**TABLE 1**  
**Approaches to Performance Based Contracting (PBC) for Services**

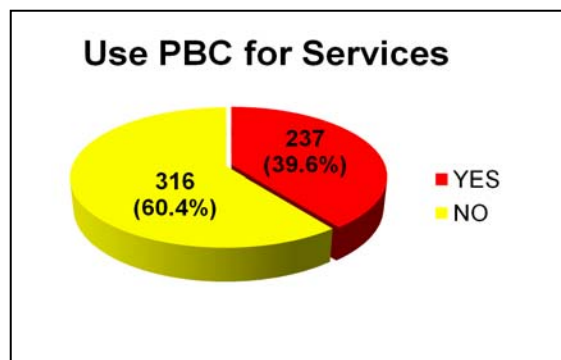
<b>Approach</b>	<b>Description</b>
US Federal Government Approach	An approach that is the same or similar to the US federal government approach as detailed in the <i>Federal Acquisition Regulation</i>
GASB SEA Approach	An approach that is the same or similar to the Governmental Accounting Standards Board (GASB) service efforts and accomplishments (SEA) reporting framework which identifies performance as having three dimensions: <i>output</i> , <i>quality</i> and <i>outcome</i> .
Composite Approach	An approach that combine the US federal government approach and the GASB SEA reporting approach utilizing the following definition: “A performance-based contract is one that focuses on the outputs, quality and outcomes of service provision and may tie at last a portion or a contractor’s payment as well any contract extensions to their accomplishment” (Martin, 1997: 1 & 8).
Mixed Approach	An approach that combines aspects of two or more of the approaches noted above.
Different Approach	An approach that is different from any of the approaches noted above.

**TABLE 2**  
**Study Respondents by Type of Government**

Type of Government	# ( %)
US Federal Government	10 (2.5)
US State Government	125 (31.0)
US Municipal Government	109 (27.1)
US County Government	84 (20.8)
Other US Local Government	37 (9.2)
US College/University	19 (4.7)
Canadian Government	19 (4.7)
Number of cases (n =)	403 (100)

When asked if their governments utilize PBC for services, some 60 percent of respondents replied in the negative (Figure 1). This finding suggests that despite being a “hot topic” in public procurement, PBC has not exactly caught on as a working concept among many governments.

**FIGURE 1**  
**Use of Performance-Based Contracting (PBC) for Services**



When the data in Figure 1 are disaggregated by region, the use or non-use of PBC for services is quite consistent (Table 3).<sup>1</sup> For purposes of regional analyses, the four standard US regions as established by the U. S. Bureau of the Census are employed.<sup>1</sup> Given the small number of responses, Canada is treated as a single region. In all 4 U. S. regions as well as in Canada, *non-use* is the modal response category with the range being from 57.5% in the Northeast region to 76% in Canada.

**TABLE 3**  
**The Use of PBC for Services by U. S. Regions & Canada**

<b>Region</b>	<b>Yes</b>		<b>No</b>	
	<b>#</b>	<b>(%)</b>	<b>#</b>	<b>(%)</b>
Northeast	15	(42.9)	20	(57.1)
Midwest	22	(30.1)	51	(70.0)
South	77	(36.2)	136	(63.8)
West	40	(35.4)	73	(64.6)
Canada	6	(24.0)	19	(76.0)
Number of cases (n = )	160	(34.9)	299	(65.1)

The types of approaches to PBC for services being utilized is, of course, a topic of considerable interest to both researchers and practitioners alike. Table 4 presents the responses to the question: Which approach to PBC for services is utilized by your government? Respondents could only select one approach.

It was anticipated that a large number of respondents would indicate their approach was the same or similar to the US federal government approach. Nearly 30 percent (28.6%) of respondents selected this response category. Somewhat surprising was the finding that only 5.1 percent of respondents indicated their approach was the same or similar to the Governmental Accounting Standards Board (GASB) service

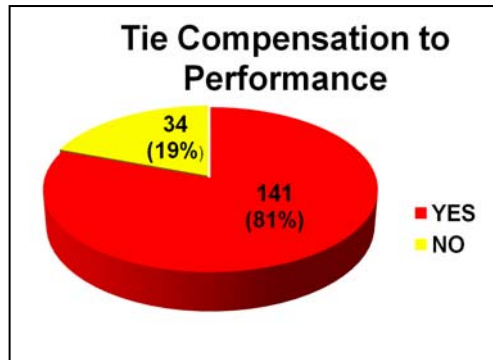
**TABLE 4**  
**Approaches to PBC for Services**

<b>Approach</b>	<b># ( %)</b>
US Federal Government Approach	50 (28.6)
GASB SEA Approach	9 (5.1)
Composite Approach	42 (23.9)
Mixed Approach	63 (35.8)
Different Approach	12 (6.8)
Number of cases (n = )	176 (100)

efforts and accomplishments (SEA) reporting initiative. GASB has invested considerable time and energy since 1993 attempting to convince state and local governments that performance has three dimensions (output, quality and outcome). GASB's guidance, while informing state and local government performance measurement systems, apparently does not inform state and local government PBC for services. In keeping with the observation that PBC for services means different things to different people, the major approaches identified by respondents are the mixed approach (35.8%) and the composite approach (23.9%), while a small percentage (6.8%) maintained that their approaches were different than the other four response categories.

One of the theoretical underpinnings of PBC for services is the proposition that compensation should be tied to performance (Martin, 2004). When asked (Figure 2), respondents overwhelming (81%) said that they do in fact tie compensation (either partially or totally) to performance. However, when asked what proportion (%) of their contracts (the number of contracts, not the dollars involved) actually tied compensation to performance, the average of the responses was only 46.2% with a range between 1% and 100%.

**FIGURE 2**  
**Tie Compensation to Performance**



A variety of methods exist to tie compensation to performance in PBC for services. Based upon categories derived from the literature, respondents were asked to identify the methods they use (Table 5). Because respondents were asked to identify all the methods utilized, the reported percentages do not total to 100 percent.

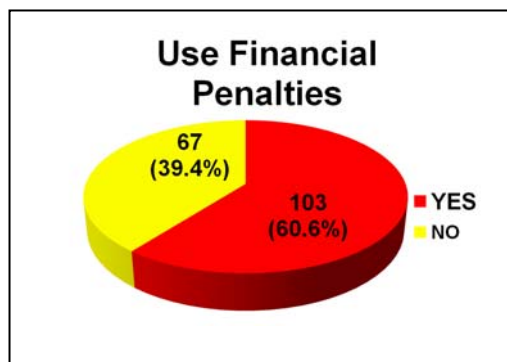
The most common method used to tie compensation to performance, as reported by some 69% of respondents, is the use of *milestone* contracting. This method involves tying compensation to the accomplishment of specific milestones similar to progress payments in construction contracts. The second most frequently mentioned (65%) method of tying compensation to performance is the use of *fixed-price* contracts where contractors are compensated at a fixed price upon completion of the contract, followed closely by *fixed-fee* contracts (61.0%). Cost reimbursement contracts, with some sort of bonus payment tied to performance, was reported by nearly a quarter (21.3%) of respondents. Award fee, (17%), revenue enhancement (12.1%) and share-in-savings (10.6%) methods were also mentioned.

A somewhat controversial issue is the use of financial penalties or other “negative financial incentives” in PBC for services. Anecdotal evidence, principally in the form of feedback during NIGP training programs is that financial penalties are not permissible in many state and local government contracts. Somewhat surprisingly, over 60 percent of respondents (Figure 3) indicated they do in fact use financial penalties or other negative financial incentives in their PBC for services.

**TABLE 5**  
**Methods Used to Tie Compensation to Performance**

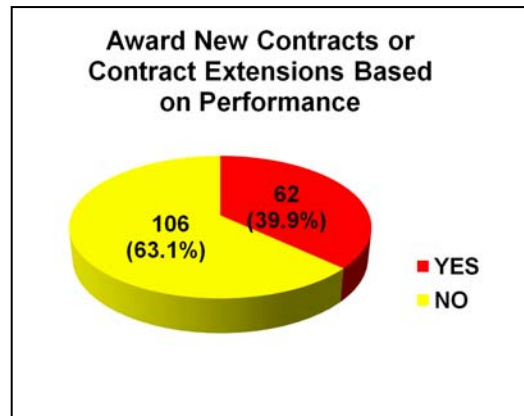
<b>Method</b>	<b># (%)</b>
<i>Award Fee</i> (fixed payment or percentage above and beyond contract price paid for superior performance at end of contract term)	24 (17.0)
<i>Fixed Price</i> (upon completion of contract)	92 (65.3)
<i>Fixed-Fee</i> (per unit of output, quality or outcome provided or achieved)	86 (61.0)
<i>Cost Reimbursement</i> (with some sort of financial bonus <i>or</i> other financial incentive for performance)	30 (21.3)
<i>Milestone</i> (payment only for the accomplishment of specific milestones during the term of the contract similar to progress payments in construction contracts)	98 (69.0)
<i>Share-in-Savings</i> (where a contractor's compensation, partially or totally, is dependent upon the cost savings achieved)	15 (10.6)
<i>Revenue Enhancement</i> (where a contractor's compensation, totally or partially, is dependent upon generating increased revenues)	17 (12.1)
<i>Other Approaches</i>	22 (15.6)
Number of cases (n = 141)	

**FIGURE 3**  
**Use of Financial Penalties or Other Negative Financial Incentives**



The use of “award term” contracting is also sometimes mentioned as a form of PBC. An award term contract is one that offers a contractor an extension of an existing contract or a new or additional contract without benefit of competition as a reward for superior performance. Contract extensions, while arguably a form of PBC for services, have been a standard practice in public procurement for some time. Offering a contractor a new contract as a reward for performance is a more recent concept and is in keeping with the emphasis placed today on “past performance.” When specifically asked about awarding a new contract or a contract extension as a reward for superior performance (Figure 4), only 40 percent of respondents indicated they do so.

**FIGURE 4**  
**Award of New Contract Based on Performance**



Respondents were also asked their views on the major impediments, if any, to the use or the increased use of PBC for services (Table 6). The major response (38.5%) category was the lack of professional procurement staff trained in PBC for services. Other identified impediments to the increased use of PBC for services were: a lack of understanding of PBC on the part of top government managers (27.8%) and a similar lack of understanding about PBC on the part of contractors (25.4%). A larger number of respondents (n = 598), representing governments that both use and do not use PBC for services answered this question.

**TABLE 6**  
**Impediments to Increased Use of PBC for Services**

<b>Impediments</b>	<b># (%)</b>
Lack of legal authority	71 (11.9)
Lack of regulatory authority	69 (11.5)
Lack of professional procurement staff trained in PBC for services	230 (38.5)
Lack of understanding on the part of our contractors	152 (25.4)
Lack of understanding of PBC for services on the part of our top administrators	166 (27.8)
Lack of understanding of PBC for services on the part of our elected officials	103 (17.2)
Lack of contracted services for which PBC is appropriate	108 (18.1)
No impediments	62 (10.4)
Number of cases ( n = 598)	

Looking down the road (Table 7), respondents were asked if in the future they thought their governments would make more use of PBC for services, less use or about the same level of use. Respondents were about evenly split between those who thought the use of PBC would increase (48.4%) and those that believe the use of PBC for services will stay about the same (47.3%). Only a very small proportion (4.3%) expressed the opinion that the use of PBC will decrease in the future.

**TABLE 7**  
**Future Use of PBC**

Response	# (%)
Make more use of PBC for services	215 (48.4)
Make less use of PBC for services	19 (4.5)
Make about the same use of PBC for services	210 (47.3)
Number of cases ( n = )	444 (100)

### SUMMARY & CONCLUSION

As the data presented in this paper indicate, PBC for services is alive and well and is being practiced in all regions of the US as well as in Canada. A multiplicity of different approaches to PBC for services exists. This finding provides support to the contention that PBC for services is actually an umbrella term. The study found that a large proportion of respondents indicated that their governments tie compensation to performance, while a significantly smaller proportion utilize financial penalties and award term contracting. The study suggests that PBC for services is here to stay. The overwhelming majority of respondents believe that in the future the use of PBC for services will either increase or stay the same. A very small proportion of respondents believe that PBC for services will decline in the future.

Perhaps the most interesting finding from this study is the apparent underutilization of PBC for services compared to its perceived popularity. The major reason for this underutilization is a general lack of understanding about what actually constitutes PBC for services on the parts of: procurement professionals, elected officials, top administrators and contractors. The lack of clarity surrounding PBC for services by its very nature points to the need for increased training. This training need is something the NIGP should consider addressing. The training should include when, how and under what circumstances this procurement technique can be best utilized. When government officials, administrators and procurement specialists as well as the contractor community better understand PBC for services, its utilization should increase.

Obviously, the research reported on in this paper is only a first step. Clearly, more baseline data on PBC for services are needed. In particular, more research is needed to help determine the particular strengths and weaknesses of PBC for services. It may well be that PBC works better for some services and less well for others. Investigating this issue should be a priority.

## NOTES

1. The regional groupings for the 50 states utilized in this study follow the categories of the U. S. Bureau of the Census: *Northeast* (Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut, New York, Pennsylvania, New Jersey); *North Central* (Wisconsin, Michigan, Illinois, Indiana, Ohio, North Dakota, South Dakota, Nebraska, Kansas, Minnesota, Iowa, Missouri); *South* (Delaware, Maryland, Virginia, West Virginia, North Carolina, South Carolina, Georgia, Florida, Kentucky, Tennessee, Mississippi, Alabama, Oklahoma, Texas, Arkansas, Louisiana). *West* (Idaho, Montana, Wyoming, Nevada, Utah, Colorado, Arizona, New Mexico, Alaska, Washington, Oregon, California, Hawaii).

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