Common Themes from Research on Performance-Based Funding
February 2015

Performance-based funding is a resource-distribution strategy used in education to reward service providers for the outcomes they achieve (Klein, 2015, p. 2)

Background Information

Most of the documents NCC uncovered pertained to research on performance-based funding as it has been implemented in primarily in community colleges since 1979 or in adult education programs. In postsecondary institutions it has been put into practice in two waves referred to as “performance-based funding 1.0” and “performance-based funding 2.0”. The literature is replete with recommendations – many a result of learning from the implementation of performance-based funding 1.0 and now incorporated in the refined performance-based funding 2.0 systems. Although some recommendations are specific to higher education, many pertain to the development and implementation of performance-based funding in K-12.

Several reasons were offered for the failure of 1.0 models. Among them are:

- Lack of support by higher education institutions for the continuation of performance funding;
- A sharp drop in higher education funding;
- Loss of key supporters of performance funding;
- Lack of support by the business community; and
- Establishment of performance funding through a budget proviso rather than a statute (Dougherty, et al., 2011, pp. 131-132).

Research on 1.0 funding systems revealed that their impact on student outcomes is limited as they are only one of several external influences that seek to improve higher education institutional outcomes by changing practices and programs (Natow et al., 2014, p. 55; Dougherty, 2014b, p. 40; and Lahr et al., 2014, pp. 58-59). Rutherford & Rabovsky found that policies in 1.0 models may in fact contribute to lower performance over a longer period of time. However, more recent policies (2.0 systems) linked to institutional base funding may produce some likelihood of long-term improvement and require further research to determine their effectiveness (Rutherford & Rabovsky, 2014, p. 185).

The most common unintended impacts of performance 1.0 models have been restrictions in admissions to college of less-prepared and less-advantaged students and a weakening of academic standards (Dougherty et al., 2014b, pp. 41-42). The most commonly made campus-level student services changes following performance funding adoption have been the altering of advising and counseling services (e.g., early warning systems, degree maps and audits, involvement of more faculty in advising, and tutoring and supplemental instruction) (Lahr et al., 2014, p. 56).

The newer models, being implemented in Indiana, Ohio, Tennessee, and Washington use performance-based funding "as a policy lever to shine a light on their policy priorities, drive institutions to adopt best processes and practices to help more students succeed, and promote significant changes in institutional behavior and resource allocation without intrusive, inflexible mandates" (Alstadt, Fingerhut, & Kazis, 2012, p. 18). Miao (2012) identified three models of performance-based funding used by states: output-based funding (portion of the annual base appropriations); performance set-asides (percentage of state funding set-aside to be awarded to high-performing institutions); or performance contracts (funding awarded if college meets the agreed upon performance goals set forth in the contract).

There are various types of performance indicators:

- General outcome indicators (number of credentials awarded);
- Progress outcome indicators (dual enrollment credit completion);
- Subgroup outcome indicators (low-income status); and
- High-need subject outcome indicators/state economic and workforce needs (e.g., STEM fields) (Friedel, 2013, p. 4)

Common Findings/Best Practices

A review of the research (see appended reference list) revealed the following best practices:

- **Stakeholder involvement:** It is critical to engage credible stakeholders—policymakers, higher education leaders, and faculty members—to ensure the successful implementation of postsecondary performance-based funding models (National Conference of State Legislatures, 2014; Blankenberger & Phillips, 2014, p. 14; Friedel, 2013, pp. 9-10; Alstadt, Fingerhut, & Kazis, 2012, p. 17; Miao, 2012, p. 1; and Harnisch, 2011). For K-12, this might translate into policymakers and experienced professionals in the field, "who are knowledgeable of program administration and financing and representative of the diverse providers and students across the state" (Klein, 2015, p. 5). For career technical education, engagement of business and industry leaders, who have knowledge of the state's economic and workforce needs, would be helpful in the process and offer support in the system's implementation.

> *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 (Klein, 2015, p. 5).*

- **Clearly defined goals:** The first step in the development of a performance-based system is to identify the goals and behaviors the state and stakeholder groups want to encourage (Klein, 2015, p. 5; Friedel, 2013, p. 10; Alstadt, Fingerhut, & Kazis, 2012, p. 16; and Cavanaugh & Garland, 2012, p. 7). To be effective, missions, measures, and incentives must be more tightly and efficiently linked in performance funding systems (McLendon & Hearn, 2013, p. 2), and goals and behaviors aligned with one or more of the performance indicators identified above by Friedel (2013).

- **Clear expectations/funding formulas:** Keep the funding formula simple, with unambiguous metrics, so expectations are clear to everyone (Klein, 2015, p. 5; National Conference of State Legislatures, 2014; Friedel, 2013, p. 10; Cavanaugh & Garland, 2012, p. 7; and Crellin, Aaron, Mabe, & Wilk, 2011, p. 13). 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. As measures are developed, stakeholders need to ask themselves can all programs achieve these measures? Do we need to make any adjustments [weighting] or stipulations [completion vs. progress] based on provider characteristics, e.g., location, demographics?[1]
    - *Simple*—Formulas must not be overly complicated: staff must understand how their actions affect funding.[2]
    - *Precise*—Allocation data must provide valid and timely measures of program and student performance.
    - *Auditable*—Allocation data must be accurate, reliable, and collected consistently across the state.
    - *Transparent*—Allocation procedures must be clear and reproducible (Klein, 2015, p.5; Klein & Foster, 2013, notes from their conference call with RIDE staff).
- **Effective incentives:** States need to provide enough funding to create an incentive for institutions/programs to change behavior and improve results. Most states have set aside 5-25 percent of their funding for performance funding (National Conference of States Legislatures, 2014; Friedel, 2013, pp. 9-10; Miao, 2012, p. 1; and Alstadt, Fingerhut, & Kazis, 2012, p. 17). In its 2.0 system, Tennessee set aside 80 percent. Postsecondary models that allocate performance funding from the state's base budget as opposed to creating supplemental funding are more likely to result in stronger incentives (Miao, 2012, p. 9; Cavanaugh & Garland, 2012, p. 4; and Harnisch, 2011).
- **Phase in system:** In implementing 2.0 models, states have used several practices to phase in the new system to make the transition easier and more predictable (National Conference of State Legislatures, 2014; Alstadt, Fingerhut, & Kazis, 2012, pp. 6, 12, and 17; and Miao, 2012, p. 2). Some of the practices employed include:
    - Implementing a learning year—Ohio is phasing in its new system over five years. The first year was a learning year in which state spending did not change, but the Board of Regents reported out to all two-year colleges what the impact would be if the full 20 percent performance funding allocation had been in place that year (Alstadt, Fingerhut, & Kazis, 2012, p. 22);
    - Incorporating stop-loss provisions that prevent institutions/programs from losing more than a certain level of funding each year (Miao, 2012, p. 2);

[1] This criterion was also noted by the following: the National Conference of State Legislatures, 2014; Blankenberger & Phillips, 2014, p. 19; Alstadt, Fingerhut, & Kazis, 2012, p. 16 and 20; Friedel, 2013, pp. 10-11; McLendon & Hearn, 2013, p. 2; and Miao, 2012, p. 2.

[2] This criterion was also cited by the National Conference of State Legislatures, 2014; Friedel, 2013, p. 10; and Crellin, Aaron, Mabe, & Wilk, 2011, p. 13.

- Building rewards into base funding in lieu of bonuses that can fluctuate in lean years;
- Basing performance incentives on a multiyear rolling average (Friedel, 2013, p. 11; Alstadt, Fingerhut, & Kazis, 2012, p. 17; and Miao, 2012, p. 2).

- **Build understanding and ensure effectiveness:** Several strategies, as presented below, are identified in research.
    - *Communication*—Policies can only be effective to the extent that they are properly publicized and understood by those responsible for ground-level execution (Reddy et al., 2014, p. 72).
    - *Training*—States should offer targeted and ongoing training to help local providers understand how the funding system operates and how they can improve their performance and increase their eligibility for resources by:
        - Building local providers' capacity to identify and analyze barriers to student success through data gathered and to develop meaningful solutions (CCRC Policy Brief, 2015, p. 1; Reddy et al., 2014, pp. 68-69 and 73; and MPR Associates, 2010).
        - Supporting learning about strategies that can improve student outcomes, e.g., sponsoring discussions of organizational changes in which institutions further along can share their experiences, sharing research, creating communities of practice (CCRC Policy Brief, 2015, p. 2; and Alstadt, Fingerhut, & Kazis, 2012, p. 17).
- **Modification/revision of formulas/systems:** Performance-based funding systems operate in a changing world and both base and performance components should be reviewed periodically to ensure that they continue to address a state's goals. Data and experience can point the way to improvements (Blankenberger & Phillips, 2014, p. 27; Friedel, 2013, p. 11; Alstadt, Fingerhut, & Kazis, 2012, p. 14; Cavanaugh & Garland, 2012, p. 7; Miao, 2012, p. 2; and MPR Associates, 2010).

There were three other suggestions that were not mentioned frequently, but might merit consideration:

- Provide some degree of flexibility to institutions on how to reach the state's goals (Crellin, Aaron, Mabe, & Wilk, 2011, p. 13).
- Introduce performance-based funding in the context of a strategy to improve the performance and efficiency of higher education (Alstadt, Fingerhut, & Kazis, 2012, p. 17).
- Design the system to enable colleges to compete against their own baseline of performance (Alstadt, Fingerhut, & Kazis, 2012, p. 16).

Recommendations

The consensus of most researchers is that more studies are needed to:

- Determine whether performance-based funding practices are effective and/or efficient, e.g., do they achieve desired student outcomes (Natow et al., 2014, p. 55), what features and processes produce changes in student outcomes (Dougherty et al., 2014b, p. 41)?
- Gather evidence on how different amounts or proportions of performance-based funding will affect institutional decisions and student outcomes (Alstadt, Fingerhut, & Kazis, 2012, pp. 21-22).

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