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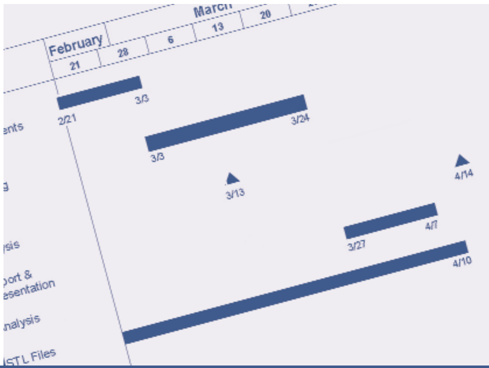
Managing for Outcomes:
Milestone Contracting in Oklahoma



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The PricewaterhouseCoopers Endowment for
The Business of Government

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Founded in 1998 by PricewaterhouseCoopers, The Endowment is one of the ways that PricewaterhouseCoopers seeks to advance knowledge on how to improve public sector effectiveness. The PricewaterhouseCoopers Endowment focuses on the future of the operation and management of the public sector.

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Foreword

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On behalf of The PricewaterhouseCoopers Endowment for The Business of Government, we are pleased to present this report by Peter Frumkin, "Managing for Outcomes: Milestone Contracting in Oklahoma."

Over the last 30 years, government has increasingly contracted with nonprofit organizations to perform services. Throughout the past decade, the movement to reinvent government has placed greater emphasis on results-oriented and performance-based management. This report shows how public executives can manage for outcomes and results. There is much to be learned from the experience of Oklahoma in its move to milestone contracting with nonprofit human service providers.

In 1991, the Oklahoma Department of Rehabilitation Services (DRS) altered its fee-for-service reimbursement structure for nonprofits assisting developmentally disabled individuals to prepare for and obtain jobs. DRS established a new system, called Milestones, to reimburse nonprofits when clients reach a series of steps — the "milestones" — along the way to getting a job. Professor Frumkin describes the implementation and success of this approach in Oklahoma, and offers six lessons learned based on the Oklahoma experience.

Milestone contracting not only enables public managers to build the desired accountability for outcomes into the contracting vehicle, it also allows nonprofits to retain the autonomy they need to define and pursue their missions. Oklahoma's milestone contracting specifies a series of distinct and critical achievements that must be met prior to payment. The achievements are set collaboratively by both the government and the nonprofit service provider. Professor Frumkin asserts that this approach represents one of the most promising ways to achieve increased accountability and autonomy simultaneously.

It is our hope that this report will help public and nonprofit executives to design mutually beneficial contracting relationships and systems that generate desired outcomes, preserve public accountability, and safeguard nonprofit autonomy.

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Executive Summary*

Over the past three decades, the nonprofit sector has undergone a major transformation in the way it finances its operations. Few nonprofits today can survive on charitable contributions alone. Instead, most successful agencies, particularly in the health and social services fields, depend in large measure on government contracts to supplement the fees they charge clients and the gifts they receive from donors. The effects of this financial transformation of the nonprofit sector over time have been considerable. The sector has grown rapidly in size, measured both in terms of the number of nonprofit organizations and the amount of resources devoted to nonprofit activity as a percent of gross national product (Boris, 1999). Amidst the spectacular success of the nonprofit sector, nagging questions have emerged about the costs and implications of the growing importance of government funding to the overall financial health of the sector. As the embrace between government and the nonprofit sector has grown stronger, no two issues are more critical than those of nonprofit autonomy and public accountability.

When the issues of accountability and autonomy come together they generate a simple but pointed question: How can government and nonprofit organizations work together to deliver quality services in a way that respects nonprofits' need for freedom in defining and pursuing their missions while at the same time responding to the public sector's need for accountability? As public sector agencies and nonprofit organizations around the country search for answers to this classic problem in contracting, a recent innovation in the way a public agency in Oklahoma manages its contracts with nonprofit human service providers represents a potentially powerful solution to this dilemma.

Different from both hourly "fee-for-service" systems that require heavy auditing and traditional outcome funding that can distort the complexity of programs, Oklahoma's milestone contracting specifies a series of distinct and critical achievements and confers payment for a set of collaboratively defined programmatic results. This approach represents one of the most promising ways to achieve accountability and autonomy simultaneously.

* *The author gratefully acknowledges the financial support of The PricewaterhouseCoopers Endowment for The Business of Government, the fieldwork of Susan Rosegrant, and the research assistance of John W. Barry and Jennifer Johnson in the preparation of this report.*

Background and Problem Statement

On the surface, nonprofit autonomy and public accountability seem to be in tension with one another. Nonprofit organizations want and need autonomy to design innovative programs that meet community needs. The independence that nonprofit organizations enjoy separates them from government and business organizations. Free from both the pressures of public opinion and the demands of shareholders, nonprofits are positioned, in principle at least, to act as vehicles for social experimentation and innovation. The autonomy that nonprofits enjoy can be an important tool for delivering new and innovative solutions to long-standing public problems. Many times, nonprofits working in fields as diverse as early childhood education and welfare-to-work transitions have made important breakthroughs that have influenced entire fields. Innovation is not the only justification for nonprofit independence. The autonomy of the sector is protected in order to create a realm where private visions of the common good can be pursued and where the values and commitments of individuals can find expression. The freedom that is granted to nonprofits by exempting them from taxation is thus designed to recognize their sovereignty and independence, while also giving them a subsidy to carry out their important work (Brody, 1998).

The very independence that lies at the heart of the nonprofit sector's privileged tax position can, however, be a major stumbling block when nonprofit organizations depend on direct financial support from government. In almost every case in which public funds pass from federal, state, or local authorities to nonprofit organizations, the public sector establishes and communicates expectations about both program design and performance. These expectations arise out of government's need for accountability and transparency. Public funds carry with them a special burden that neither private gifts nor fees for service need shoulder. Often anchored in a core commitment to equity and access, government grants must affirm and be applied to purposes that are in keeping with the public sector's broad public agenda, one that is far wider than that of most private contributors or paying clients. Accountability is a critical value in public sector organizations because it constitutes the foundation for both the legitimacy and support that government needs to carry out its work.

At one level, therefore, the values of autonomy and accountability seem at odds with one another. While nonprofit organizations might want to maximize the freedom they enjoy to experiment with new programs and service models, this impulse can and does come into conflict at some point with the public sector's need for a certain level of uniformity and consistency in the programs it funds (DeHoog, 1984; Smith and Lipsky, 1993). At the same time, while government might want to achieve very high levels of accountability in all the projects it funds, this impulse often comes into conflict with the desires of nonprofits to pursue their missions as they see fit (Gooden, 1998; Kearns, 1996). This tension between sectors can be depicted along a tradeoff line stretching from a combination of a high level of nonprofit autonomy and a low level of government accountability to a combination of a high level of government accountability and a low level of nonprofit autonomy. Government has traditionally staked out a position somewhere near point A on the tradeoff line, while nonprofits have gravitated more in the direction of point B (see Figure1).

In most circumstances, this classic contracting tension is resolved in one of three ways: (1) The government adheres to a given decision making process and refuses compromise, fearing a loss of accountability, uniformity, and fairness; (2) The nonprofit organization refuses to give in to the demands of the government and either forgoes public funding or takes the funding but does not comply with mandates; or (3) Government and nonprofits reach an accommodation of sorts that produces less accountability and less autonomy.

This third solution results in both sides moving to point C in Figure 1. Often, this third option represents a sub-optimal, political compromise that satisfies neither side. A central challenge for both public and nonprofit management comes down to finding a fourth alternative to this classic dilemma, an alternative that allows government and nonprofits to simultaneously maximize both the accountability and autonomy dimensions (point D in Figure 1). Such a solution involves moving the production possibility frontier outward to reflect a new range of tradeoffs, a frontier on which a point can be located that improves on both the accountability and autonomy agendas of the public and nonprofit sectors.

What might this fourth option entail? How can government meet its need for control, uniformity, and accountability while giving nonprofits the freedom they need to design and implement innovative programs? One answer lies in the move away from process measures inherent in traditional fee-for-service arrangements and toward a system geared to outcomes (Behn and Kant, 1999; Volkmann, 1999). In their contractual relations with nonprofit organizations, government agencies have traditionally focused on outputs, not client outcomes or actual results (Cline, 2000; Cohen and Eimicke, 1998; Osborne and Gaebler, 1992).

Figure 1: Accountability and Autonomy in Public-Nonprofit Contracting

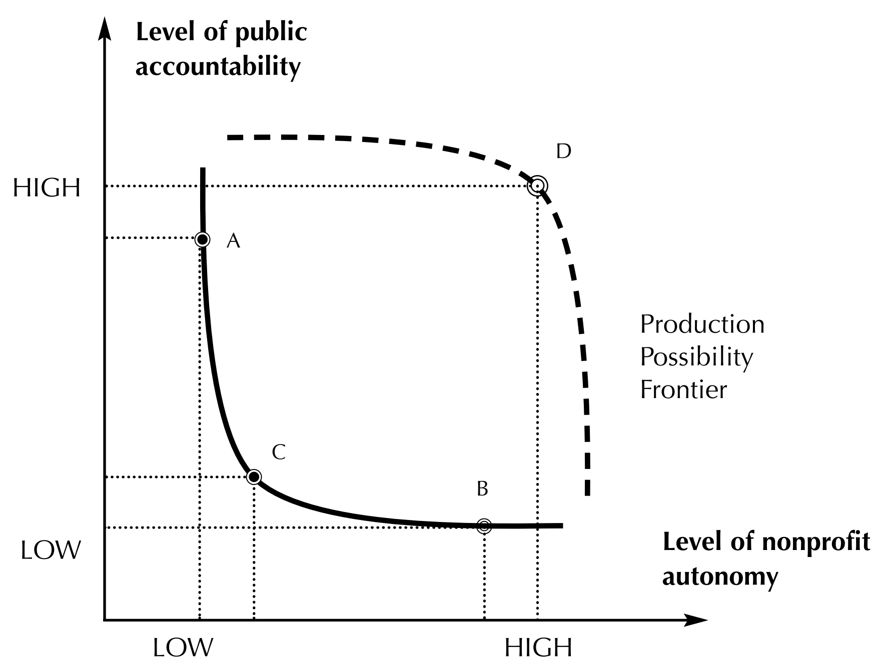
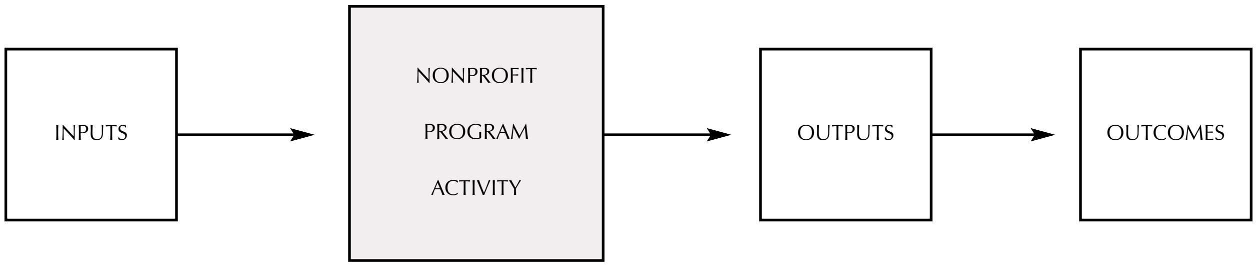


Figure 2: Outcomes and Nonprofit Program Autonomy



Inputs, outputs, and outcomes in the nonprofit sector (United Way of America 1995:3) can be defined as follows:

- **Inputs** are resources dedicated to a particular program (e.g., money, staff, facilities, volunteers, equipment and supplies, regulations, and funders' requirements).
- **Outputs** are the direct products of program activities (e.g., literature distributed, participants serviced, classes taught, counseling sessions, and hours of service delivered).
- **Outcomes** are the benefits for participants of program activities (e.g., new knowledge, increased skills, changed attitudes, improved conditions, modified behavior, altered status).

Under the standard fee-for-service method of contracting, nonprofit organizations often are rewarded regardless of the outcomes of their efforts. Government simply pays out money to nonprofits based on contracts keyed to the delivery of units of service. Thus, if a social service agency provides 1,000 hours of counseling services at $35 an hour, a state funder would write a check for $35,000 upon presentation of an invoice. Under fee-for-service arrangements, ultimate client results or outcomes are rarely tracked, because they are not the basis on which the performance is measured or rewarded. The consequences of this system reveal that there are rarely positive results when outcomes are not measured (Osborne and Gaebler, 1992).

As pressure for greater efficiency in the public sector has mounted over time, interest in changing the terms of government contracting rose. A new system was needed, one that tracked the use of inputs, measured the outputs produced, and — most importantly — tracked the final outcomes (see Figure 2). By the early 1990s, the shift to performance-based contracting (PBC) began. The driving rationale behind PBC was the simple idea that public agencies need a way to ensure that they get impact for every public dollar spent and thereby ensure public support for government action (Zak Figura, 1999). Also driving the move to PBC was the sense that government could and should learn about management from businesses. The private sector has traditionally used a system of rewards to encourage certain actions and activities. When organizations are funded according to outcomes, however, they focus on performance and devote themselves to improving it (Osborne and Gaebler, 1992). The Government Performance and Results Act of 1993 (GPRA, 1993) standardized this new and different approach. It required organizations that received federal money to create specific goals and then post their advancement towards these ends (Buckmaster, 1999).

While much of the impetus to measure outcomes came from accountability concerns, the shift has had ripple effects on public management (Buckmaster, 1999). This new mind-set created the need to rethink the structure of performance measurement. When the focus is placed on performance and on paying nonprofits only upon demonstration of results and client outcomes, accurate assessment and performance measurement become critical (Herman and Heimovics, 1994; Murray and Tassie, 1994; Osborne, 1994; and Osborne and Tricker, 1995). Outcome measurement requires new skills, including participative planning, negotiated rules, quantitative and qualitative yardsticks, valid and reliable data collection, and a system for feeding information back into strategic planning systems. An entire field can be enhanced when outcome contracting is performed correctly and when best practices are shared (Buckmaster, 1999).

While outcome measurement procedures have been advocated as a means of eliciting better accountability and more effective program evaluation of nonprofit organizations, doubts about the efficacy of this approach persist. Five broad problems and concerns have surfaced in the literature. First, many managers resist the measurement of outcomes because they have previously seen it fail (Osborne and Gaebler, 1992). One well-known example of how an outcomes-based system can go awry is the Job Training Partnership Act of 1982. Providers were encouraged to target and train individuals who were most likely to succeed in a job, because their rewards were based upon the number of individuals that had secured job placements (Barnow, 2000). Sadly, the incentives of this program encouraged providers to select and assist people who were likely to succeed but who may not have been most in need of the services (Osborne and Gaebler, 1992). This phenomenon, often referred to as "creaming," occurs when organizations receive payments even when they follow the path of least resistance and avoid clients who are most in need of assistance.

A second concern with keying program payment to outcomes is related to the possible gaming of such systems (Gibbons, 1998; Lu, 1999). Defined as taking actions that increase payouts from incentive contracts without actually improving performance (Baker, 1992:600), gaming is a serious problem because it effectively negates the performance basis on which outcome funding rests. When nonprofits and their activities are not being tracked closely, it is easy for organizations to engage in activities that may call for payment, but that may not represent the fulfillment of the contract's real intentions. By taking advantage of the letter of a contract, nonprofits can undermine the spirit of a program (Brooks, 2000; Lawler, 1971, 1990; Hamner, 1975; Beer et al., 1984).

Third, some worry that a shift from traditional fee-for-service contracting to performance-based contracting will create conflicts within many mission-driven nonprofit organizations. These conflicts can challenge an organization's culture and identity. For some organizations, moving from fee-for-service to outcome funding raises deep questions of control and internal priorities (Williams, Webb, and Phillips, 1991). All aspects of nonprofit operation have the potential to be affected, from the location at which services are offered to the number of clients that are served (Smith and Lipsky, 1993). Some nonprofits find the shift to outcomes stressful because it brings with it a commitment not just to results, but also to programmatic scale and expansion. If outcome funding specifies both a rate of payment for a given set of outcomes and a minimum number of outcomes, nonprofits can be left scrambling to build the capacity to deliver services.

To make these adaptations harder, many nonprofits have organizational cultures that are grounded in the belief that performance targets are not appropriate for many of the human services (Light, 2000). Frequently, nonprofits have missions that are rooted in values and beliefs, and aim toward such broad outcomes as empowerment, improved quality of life, and community well-being. The fulfillment of these missions is often very difficult to measure (Brower, Abolafia, and Carr, 2000; Kanter, 1979; Drucker, 1992; Thompson and McEwan, 1958; Milofsky, 1988; DiMaggio, 1988; Drucker, 1990; Salipante, 1995; Buckmaster, 1999). Resistance to keying programs to outcomes may be strong if the chosen performance measures are seen as being detached from the broad social objectives of an organization (Stone and Gershenfield, 1996).

Fourth, there is some worry associated with outcome funding that nonprofits will not be able to focus on the quality of their services, but instead become engrossed with the number of outcomes produced. If reward systems are keyed to the achievement of results, there is the possibility that nonprofits will be forced to abandon their traditional systems of delivering services in favor of lower cost and lower quality methods. The threat to quality is particularly acute in markets where multiple nonprofits are competing for contracts and where programs appear comparable. In such cases, cost — not quality — may become the deciding factor by which organizations receive contracts for the provision of services.

Fifth, outcome funding can place personnel and human resource demands on nonprofits. As nonprofits grow and change to meet new accountability standards, employees need to acquire the knowledge and skills that will enable them to successfully meet the challenges of their newly defined roles. Program and technical staff may need special training to adapt to the new systems. Also, as these organizations continue to expand and develop, there is a concern that there will not be enough money available to attract and hire much needed, well-trained staff (Blacksell and Phillips, 1994). In organizations that traditionally depend on volunteers, the push to organize and professionalize may lead these nonprofits to bring in paid staff (Billis, 1989). The human resource challenge is rendered more acute when nonprofits are forced to compete with business firms for outcome contracts. In the field of welfare-to-work services (Pavetti et al., 1997; Jennings, 2000), where major corporations such as Lockheed and EDS actively pursue outcome-based contracts with states, nonprofits are struggling to attract and retain the best people in their organizations, especially when business can and will pay higher salaries (Frumkin and Andre-Clark, 2000).

While the debate over the strengths and weaknesses of outcome funding rages on, public managers need to define for themselves *in practice* how they can best structure their relationship with nonprofit service providers. As they develop contracting relations with nonprofit service providers, public managers will need to seek answers to the following question: How can the need for accountability be balanced with the need to give nonprofits freedom in program design and implementation? Instead of ignoring this question and the emerging tensions created by contracting, a new perspective on public-nonprofit relations is needed — one that preserves some of the boundaries between sectors, that gives nonprofits as much freedom as possible, and that makes broad, multi-dimensional appraisals of their performance easier. Rather than see the nonprofit sector as the servant of the public sector that obediently executes programs, public managers must begin to take more seriously the unique visions, values, and commitments that animate the nonprofit sector itself and that lead to programmatic innovations. Moving public management to a point where the values of public accountability and nonprofit autonomy can coexist will require the development of new strategies for managing public-nonprofit relations. An experiment in Oklahoma provides a glimpse of what a well-functioning, outcome-based system might look like (Rosegrant, 1998).

The Oklahoma Milestone Payment System

Preparing people with mental and developmental disabilities to live and work independently in society has long been a dilemma for public policy. Over the last several decades, many of the old solutions, including institutionalization as well as a variety of physical therapies, have been abandoned in favor of more humane measures that aim to assimilate the disabled into the broader community. Beginning in the 1970s, the federal government mandated that the public schools educate disabled children in regular classrooms alongside other children and prepare them to go to work after graduation. These changes did much to improve the prospects for many mentally and physically disabled young adults. However, for those such as the profoundly disabled, who needed more help, there was no place to go after graduation from high school. For a long time, putting the profoundly disabled to work was not thought to be feasible, and it thus took some time for the adult social service system to catch up with the education system. Finally, in 1986, in response to pressure from a variety of advocacy groups, the federal government passed legislation that authorized the delivery of vocational services (referred to as "Supported Employment") to people with "the most severe disabilities."

After the legislation was passed, 10 states began receiving funding to start programs to train the severely disabled. However, many other states were hesitant because they had not worked with the severely disabled before and thus required further impetus before they would respond. In 1987, in response to a lawsuit brought by the parents of children who had been residents of Oklahoma's largest institution for the developmentally disabled, Oklahoma began planning a program to train disabled adults to work in integrated jobs in their communities. In 1988, the Oklahoma Department of Rehabilitation Services (DRS) began providing employment assessment and training services for adults through community-based nonprofits (and a few selected government agencies).

Eligible individuals — primarily people with mental retardation or mental illness, though people with many other disabilities were also eligible — are those for whom direct placement in a job in their community is the desired outcome. Typically, they would be paired with a job coach in order to assist them in locating and getting a job. Since they were providing a new service and did not really have any idea what it would cost, the state decided to structure the program as a traditional fee-for-service model that would reimburse the nonprofits at an hourly rate for all services provided.

Planning Change and Moving to Outcomes

By 1991, the program had expanded significantly, working with 20 nonprofits and serving nearly 500 clients. But Daniel O'Brien and Rebecca Cook, two administrators in the Community Rehabilitation Services Unit of the Department of Rehabilitation Services (referred to herein as "the agency"), concluded that the program was too expensive and that it was not doing a very good job of achieving its stated objective of training disabled people for integrated employment in their communities. For example, in 1991, it cost the agency more than $22,000 and took an average of 438 days to bring a single case to closure.

They concluded that the major cause of these problems was the agency's fee-for-service reimbursement structure, which created a distortion in the way the goal was pursued, putting too much emphasis on the process of providing the services — on ability and skills assessments, job training, and constant supervision once on the job (all of which would be billed on an hourly basis to the state) — at the expense of moving the clients as quickly as possible into stable jobs. They concluded that the system had created two competing goals: an implicit one, to maximize the number of hours spent on a particular client; and an explicit one, to get clients into employment. More often than not, the implicit goal took precedence. According to Cook, "the emphasis was not on the individual that they were serving…. It was on billing hours…. We've got everything askew here. We have a system in place, but it costs too much money and it's not doing what it ought to do."

Cook and O'Brien aimed to devise a new way of paying for services that would, in the fairest and most efficient and cost-effective manner possible, put the emphasis back on the outcome. Their goal, according to O'Brien, was to create "an incentive for [the nonprofits] to find the inefficiencies in their system and to eliminate them. Within the hourly system, we created inefficiencies … by the way we paid. There was no incentive for them to find the inefficiencies and we couldn't find them because we're external to their organization." The goal was thus to construct a system that would force everyone to compete with the most efficient and effective nonprofits.

What is a Milestone?

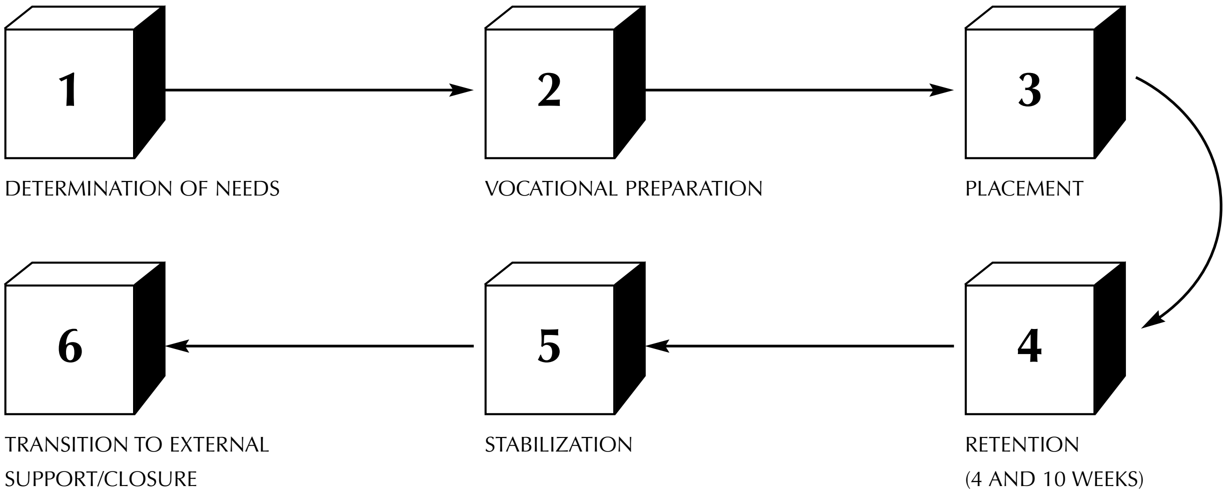
The Community Rehabilitation Services Unit of the Oklahoma Department of Rehabilitation Services created the Milestone Payment System, a reimbursement method based on incentive payments for service outcomes. DRS defines each milestone as a predefined checkpoint on the way to a desired outcome.

After much deliberation, O'Brien and Cook designed a system, which they called the Milestone Payment System (MPS), that would reimburse nonprofits when clients reached each of a series of steps — the "milestones" — along the way to getting a job. (To qualify as a "job," federal guidelines require that the client work at least 20 hours a week and must earn at least minimum wage.) The milestones, designed to be easily observable, would involve looking at indicators such as job retention, wages, and employer and client satisfaction. The largest payment would be the final milestone, full employment for 17 weeks plus 90 days (known as "26 closure").[1] MPS would reimburse the nonprofit for the "average" cost of providing the outcome of the service rather than for the cost of staff time (as in fee-for-service). The structure of the milestones would differ slightly depending on whether the clients had mental or developmental disabilities, but looked roughly like this (see Figure 3):

- determination of need 10%
- vocational preparation 10%
- placement 10%
- four-week job training 10%
- 10-week job retention 15%
- stabilization 20%
- 26 closure 25%

[1] *Sheltered workshop environments do not count toward the final payment. Group placements count for partial payment. To receive the full payment, they must place the person in an integrated, competitive job in the community.*

Figure 3: Six Milestones



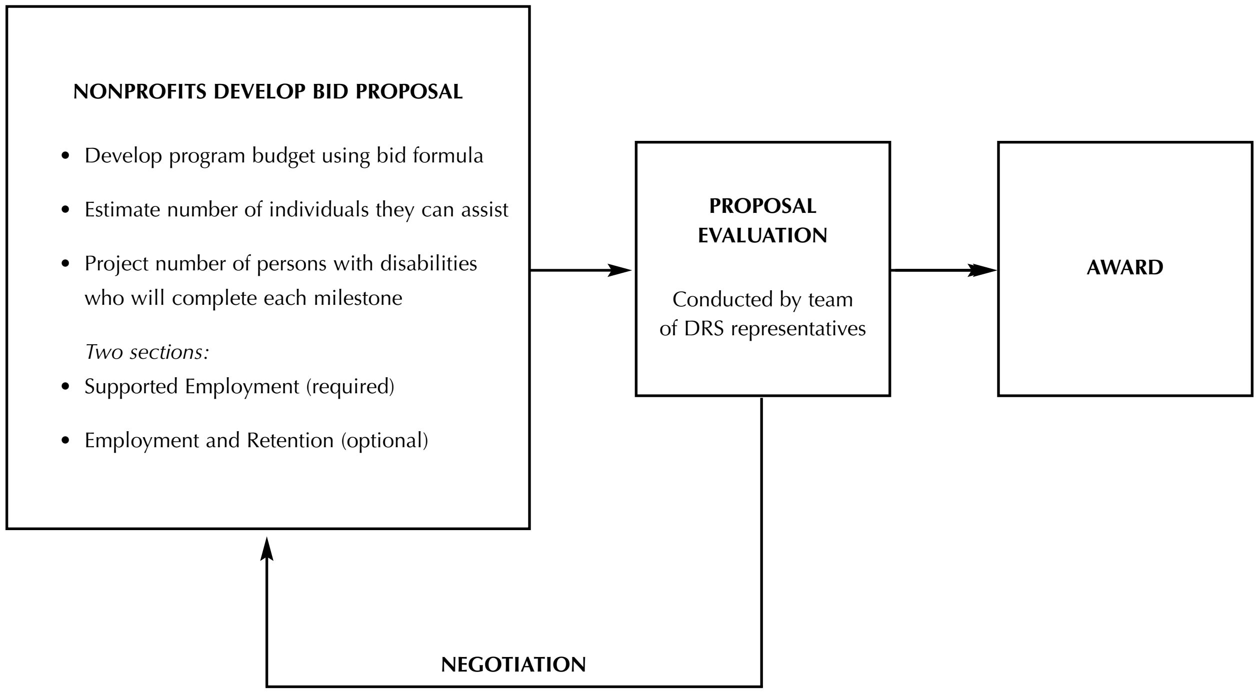
In order to encourage the nonprofits to make good matches, the organization would be paid only once for each milestone. According to Cook, "It's very motivating to the vendor to make a good job match to begin with." In order to aid nonprofits in taking on more difficult clients, MPS also created a two-tiered system of payments through which service providers would be paid higher fees for serving people designated as "highly challenged." Cook notes, "We try to define who are the people who cost more money for the vendor to serve so that we can build a rate into the system that will help them say, 'It's OK to take a chance on this person because they are going to pay us more for him.'"

The agency solicits bids from primarily community-based nonprofits to care for a specified number of clients in the following year. To put together a bid, the nonprofit first must develop a budget that includes estimates for the number of clients they will serve and the number of staff they will need. Then they develop a bid based upon the average cost per closure from the previous year multiplied by the estimated number of closures for the contract year. Comparing the estimated number of clients to the estimated number of closures allows them to account, to some extent, for "dropouts," people who for whatever reason will not reach closure (and thus will deprive the nonprofit of the final, biggest payment). According to O'Brien, the bidding process forces all the service providers "to compete against the average, bringing down the high, the very inefficient providers, pressuring them to move towards the average."[2] Once the bids are received, DRS evaluates them — by looking in particular at the per-customer bid price and the average cost per closure, as well as past history and the geographical area served — and then negotiates with the nonprofit organizations to arrive at a reasonable bid. Required documentation at each stage ensures progress and triggers payment (see Figure 4).

Though the specific arrangements may differ some from one service organization to another, the process involves three key figures. First, counselors (something of a misnomer, since they do not actually "counsel" or work with clients), who are employed by the agency, authorize services to approved nonprofits. They oversee a number of different service providers and supervise the technical assistants. Second, technical assistants, who are also employed by the agency, train and oversee the job coaches. Third, job coaches, who are employed by the nonprofit, work directly with the client. They may work with anywhere from five to 12 (or sometimes more) clients at any one time. The job coaches try to find jobs in environments that will support the client. If a client has very restricted skills — most have at least three functional limita-

[2] The term "competition" overstates the practice somewhat, because, in some parts of the state, especially rural areas, there may be only one nonprofit to choose from, and thus there isn't any real competition. Those nonprofits' bids are evaluated using averages and qualitative factors.

Figure 4: The Milestone Bidding Process



tions — they will look for a job that requires only one or two of those skills, which usually means entry level positions at low wages. By all accounts, being a job coach is an enormously difficult and low-paying job. According to one estimate, regardless of training, it takes a job coach two years to become proficient.

Implementation and Expansion

The earliest Milestone's pilots — two nonprofits that served mentally ill individuals — were funded in October of 1992. Several other pilots followed over the next several years. In order to prepare the nonprofits to make the transition from fee-for-service to MPS with minimum confusion, the technical assistants from the agency held numerous training sessions and retreats with managers and job coaches so that they would understand how the bidding procedures worked and what would be expected of them in terms of outcomes once they received contracts. According to Cook, "We tried very hard from the very beginning of supported employment to bring vendors in as partners into the process of what we were trying to do … they were accustomed to us calling them and saying, 'What do you think about this?'"

Still, in 1997, when the remaining programs from across the state that work with the agency were converted to MPS, they faced much trepidation on the part of the nonprofits. Many were concerned that they would be forced to spend less quality time with their clients, and others were worried that the nonprofits would be forced to select clients most likely to reach closure. The executive director of one MPS nonprofit, worrying that the quality of services would suffer, commented, "Will we really still be able to perform services in a similar manner to what we do now if it is purely outcome based?"

The changeover proved fairly painless for organizations that had been highly effective under fee-for-service. However, for many others, there were considerable growing pains. Looking back on the shift, 36 percent of nonprofits involved with the program said the overall transition to MPS was challenging. Despite all the preparation, getting used to the new bidding system simply took some time and adjustment. Many of the nonprofits had their bids rejected two or even three times before the agency determined that they were eligible for funding. For some, it was a struggle to shift the focus of their organization from "process" to outcomes.

It also became clear that many managers were not immediately up to the job of running effective outcome-focused organizations and that many job coaches simply did not have the skills and experience to work with profoundly disabled people. According to one technical assistant who spent a lot of time working with nonprofits during the transition, many of them "didn't have the skills for the job." A few nonprofits dropped out because they did not believe philosophically that employment should be the only outcome available to people in the program.

Finally, the clients with mental illness raised a host of additional complications. While the founders of MPS were convinced that integrated work in the community was just as important for the mentally ill as for the developmentally disabled, the directors of many of the nonprofits serving the mentally ill did not necessarily see employment in the community as an appropriate goal for their clients. According to Cook, "We had great difficulty getting mental health centers to see beyond [the view that] the person comes in for therapy, the person takes medication, the person sits and smokes and watches television all day, and getting them to see that work is part of the recovery process." Thus, it took a while for some organizations to come around, while many still have not and do not work with MPS.

Under a system like MPS, which trades some control for improved outcomes and programmatic freedom, how is success measured? Most obviously, the key measure is increased achievement of the core outcome, the placement of disabled people into stable jobs in their communities. The agency also looked at success in two other ways: the satisfaction of the consumers (meaning mainly the clients and the employers, but also the counselors and job coaches) and a reduction in the need for regulation and oversight. By these three measures, for the vast majority of those involved, MPS has been a dramatic success. The clients are receiving the kind of support that they need and are being placed in jobs in greater numbers and with far more success and satisfaction than before. The employers are getting well-trained employees who are often more dedicated to their jobs, and thus longer lasting, than non-disabled workers, which saves the employers additional funds in training costs.[3] The agency is getting greater impact because the system links funding with outcomes, which builds public support for the agency's mission. And the nonprofits are doing a much better job of achieving their explicit goal —and they are being rewarded for it.

According to a 1997 survey, 13 of 16 nonprofits that had converted had shown improvement in all areas. Time on waiting lists was reduced by half; time before job placement was reduced by 18 percent; the cost of assessments was reduced by 9 percent; paperwork decreased by 33 percent; data entry items were reduced by 98 percent; and the cost per closure dropped by 25 percent. To give a specific example, Goodwill of Tulsa has become twice as productive under MPS as it was under fee-for-service: They have been able to treat twice as many clients under Milestone with the same budget they had under fee-for-service. (See "Goodwill of Tulsa" on page 17.)

When asked what difference MPS has made, most nonprofits seem to agree that the new, less-onerous reporting requirements under MPS have freed the job coaches to spend more time with clients — not less, as had been feared by many nonprofits — and have freed the managers to spend more time supporting their job coaches and making sure their organizations are being run efficiently. One MPS participant says that his organization saves three months a year in employee time because of the reduction in paperwork. One nonprofit manager echoed these thoughts when she said, "Fee-for-service is a headache because there is so much paperwork involved." That alone — the more

[3] Client and employer satisfaction are verified using formal surveys that must be filled out before the final milestone is paid.

hours per week that they have to work with clients — may go a long way toward explaining why MPS has been so much more successful in achieving outcomes than the old fee-for-service system.

Most of those with experience under MPS seem to agree that its transparency — the idea that everyone understands their role in pursuing MPS's main goal — makes it much easier for them to do their jobs. The clients know, from the beginning, that they will have to follow a number of steps over a period of time and, at the end, they will have a job. The nonprofits know that they have to scout for jobs more aggressively, and are encouraged to spend more time marketing — themselves and their clients — which hadn't been a priority under fee-for-service. When a job coach focuses on making sure that a placement is suitable from the beginning of the process of working with a client, it often means that the first placement fits well, meaning that both the client and the employer are happy and that the placement is a success (see Figure 5).

In order to investigate this level of satisfaction further, a group of 20 nonprofits that participated in MPS was randomly selected and surveyed in the fall of 2000. Three quarters of the group had been

Figure 5

MILESTONE	DOCUMENTATION NEEDED
Determination of Needs	• Computerized Progress Report • Situational Assessment Reports and/or Vocational Assessment Forms • Summary Vocational Assessment Report or Vocational Profile Form
Vocational Preparation Services	• Dates and hours of attendance (attendance sheets submitted) • Consumer has completed program • Consumer has achieved 75% of predefined competencies
Job Placement	• Computerized Progress Report • Employment Verification Form signed by employer • Task Analysis Form • Job Analysis Form
Job Retention (four and 10 weeks)	• Employment Verification Form (verification of continued employment and hours worked per week will be required for payment) • Computerized Progress Report
Stabilization	Verification of the following: • The individual has been employed for a total of at least 17 weeks • A written Employer Evaluation has been submitted which indicates acceptable job performance during the most recent month • A current Client Job Satisfaction Questionnaire has been submitted which indicates client/family satisfaction • The individual has received support services defined in the IRP, including a minimum of two individual contacts and one employer contact per month • The individual has worked at least two entire shifts without job coach support in one week, as verified in the employer evaluation (This may be waived by the DRS Counselor if the consumer meets criteria for Highly Challenged) • The individual has met the weekly work goal in the IRP
Closure	• Current employer Evaluation Form • Current Computerized Progress Report • Current Client Job Satisfaction Questionnaire

Goodwill of Tulsa

When MPS first came on the horizon in the early 1990s, Goodwill was worried that it would alter their ability to provide high-quality services to the clients they had traditionally served. David Oliver, Goodwill's executive director, remembers wondering, "Will we really still be able to perform service in a similar manner… if it is purely outcome based?" Cindy Donathan, who directs Goodwill's Career Development Center, comments, "There was a lot of concern in our group about how we can continue to serve the people that we're supposed to be serving and also meet these Milestones' requirements." While they had considerable input with the agency while MPS was in the design process, they were nevertheless on pins and needles, wondering which of their suggestions would be taken and which would be ignored. In particular, they were worried that the additional money that was promised for working with "highly challenged" clients would not end up being enough to make it worth the risk.

In January of 1997, they finally switched over to MPS, and the results were surprising. In the first year under MPS, while the size of their contract remained the same, they found that they were able to place twice as many people as they had in any previous year. This meant, financially speaking, that they did much better — not worse, as had been feared — than they had ever before. Oliver says, "The most surprising thing to me about MPS was that we started out … billing more per month than we had under the old contract. And that amount stayed relatively stable." The keys to success were that (1) they reorganized their management structure to clarify everyone's roles and to be more responsive to the employers, and (2) they spent a considerable amount of time retraining their job coaches to be more client-and outcome-focused.

Speaking to the ways that their management style changed, Oliver suggests, "It caused us to operate more like a business.… If we didn't sharpen our thinking, then we weren't going to have any revenue with which to pay our job coaches." Cheryl Slaton, who manages Goodwill's Supported Employment program, explains what this entailed: "I went through a lot of stuff in terms of just building organizational skills, reprogramming the way we were going to think, and reorganizing how caseloads ran, how billings ran, getting things set up…. We found additional people that would fit into place." One crucial decision they made regarding the management structure was taking marketing — identifying potential jobs in the community — out of the hands of the job coaches and putting it in the hands of a marketing specialist — in Goodwill's case, the program manager. Most of he job coaches had social work backgrounds and thus were, for the most part, inept at marketing. This made life easier for the employers — their customers — who prefer not to hear from multiple contacts at the same agency.

Most importantly, these changes helped the job coaches clarify their role so that they could focus on what is important for them — being a good job coach. In the process of retraining the job coaches, they found that some of them weren't up to the task and replaced them with job coaches with more experience. Asked about how MPS has changed the way job coaches work, Slaton comments, "I don't know if I'd call it pressure. But there's definitely encouragement to make those placements work and to really focus on the right job match. We think about the individual, what are their needs, what is their way to get to and from work, what are their limitations on the job. And then we market specifically for that person."

Sharon Brice, a job coach, feels there was much more pressure under fee-for-service: "If you're focusing on showing output every minute of your day, it binds you up." In contrast, she found that she had much more freedom under MPS. Slaton concurs. When asked what she likes best about MPS, she says, "If I had to label something, it would probably be the freedom that the job coaches have, because it enables them to really make their own decisions as to what's best for the client rather than what's best to get the billings up…. They like it much better."

It has been alleged by some nonprofits that Goodwill has been so successful because it doesn't accept the most difficult clients. Slaton herself comments, "If we don't believe that this [client] is somebody that we can help to be successful, and help to be independent — and we don't want to set anybody up to fail — if we don't believe we can get them to be independent, we can't take them in the first place." But she denies that creaming is going on. "The only people I wouldn't take are the people that … wouldn't meet the qualifications of the program. If they can't be independent on the job, then they need to be in a different program…."

The bottom line seems to be that Goodwill has excelled under MPS. The administrative details are important, but the crucial difference is that they spend more time working with and getting to know clients. Slaton observes that MPS has allowed them "to help people overcome barriers to employment, to give them a chance, and not only to be successful, but to give them a chance to fail. Why should they be in the workshop all of their life if they can do other things? They need to have a chance to decide if they like working in the outside world, and if they can do it."

with MPS for at least three years. The group was asked a variety of different questions. When nonprofits were asked about switching from their previous method of payment, 57 percent of the group said their transition to the MPS Payment System was easy. In response to follow-up questions about the design of MPS, 45 percent of the group said that the system afforded them a great deal of flexibility and 55 percent said they felt they had a lot of input in fine-tuning their contract with DRS.

The system also was perceived as being built on sound benchmarks: Almost half of the nonprofits polled said that Milestone was extremely accurate in measuring client progress. When the question of "creaming" was raised with nonprofits by asking if Milestone encouraged them to select clients who were more likely to succeed, 65 percent of the group answered no. When asked if the Milestone system increased their accountability to the state, 83 percent responded yes. When the nonprofit organizations were asked to choose the method of payment they preferred, 80 percent chose Milestone over fee-for-service.

At the end of the survey, 75 percent of the organizations rated their overall experience with Milestone as good or excellent. As one nonprofit manager said, "Milestone gives us a sense of accomplishment because the outcome is more clear." These responses are particularly impressive given the fact that in 2000 it cost the state $10,740 on average to bring a single case to closure, a substantial savings compared to an average cost in 1991 of $22,000. Milestone has thus created real savings for the taxpayers without alienating the nonprofit service providers.

Challenges and Concerns

Though reaction to MPS has been largely positive, the system does have its critics, and while most of them are managers with nonprofits that have performed poorly under MPS, some of their concerns are worth considering. From the outset, the two principal objections have been that the enhanced emphasis of the program on outcomes may potentially force the nonprofits to provide a lesser quality service and that outcomes will lead nonprofits to screen their clients more carefully for those who are most likely to succeed. The concerns voiced by nonprofits in Oklahoma correspond fairly closely to the first and third reservations about outcome funding that we outlined in our summary of the public management and contracting literature bearing on outcome funding.

In the transition from fee-for-service to MPS, many providers worried that they would have less time to spend with clients and thus the quality of service would suffer. A technical assistant commented, in discussions with nonprofits before the transition, "Quality of services kept coming up time and time again." But MPS was designed explicitly to address this concern. One of the big problems of fee-for-service that MPS aimed to correct was that once providers got on the list of approved providers, they were almost never removed, no matter how ineffective they were at providing services. O'Brien and Cook felt that nonprofits who were not able to deliver effective services ought to lose their contracts. Given the nature of the clients seeking to achieve milestones, proper training and sensible placements are essential. MPS made nonprofit organizations, not the agency, responsible for outcomes, thus demanding of nonprofits that they provide quality services and penalizing them if they did not. Beyond putting the onus for quality services on nonprofits, MPS introduced careful monitoring of the end result of the service delivery system: The counselors under MPS have been vigilant about not approving placements unless the clients were sincerely happy on the job. This gives the service provider considerable incentive to focus on quality and to make sure the job is a good fit from the beginning.

The second concern, the selection problem of "creaming," is more serious. O'Brien has commented that creaming is the "Achilles' heel" of outcome-based payment systems. He notes, "It is something we have to be constantly vigilant about." One key measure to combat creaming was MPS's two-tiered structure of reimbursements that gives nonprofits a monetary incentive not to discriminate against harder-to-serve clients.[4] Clients are designated as either regular (though all of these clients had substantial problems) or as "highly

[4] *O'Brien and Cook discussed adding more levels — an Australian program that is modeled after Milestones has more levels of payments — but felt that the only thing they would really gain was more complexity.*

challenged," and the nonprofits receive a larger payment — typically about $1,000 to $2,000 more than the regular payment — for taking on highly challenged clients. Despite these measures, as well as the fact that their budgets are supposed to include estimates of dropout costs, some agencies appear to be hesitant to work with difficult clients because of the perceived risk involved in failing to achieve closure. After all, the largest payment is the final one. And it has been suggested by some that the larger payment may not be large enough to make it worth assuming the risk of working with the most challenged clients.

What looks to some observers as creaming may in fact be a byproduct of some remaining confusion about the purpose of MPS, however. If MPS accomplished nothing else, it was able to alter the incentive structure in support of a very clear and enforceable goal. The concept of closure at the heart of this goal — integrated work for an extended period and a reasonable wage at a business in the community — reflects the conviction of its designers that everyone who is capable and wants to work should be able to do so, and that just about everyone can work if they get the right kind of assistance and support. O'Brien notes, "Work is part of what makes you feel part of the larger community. And staff people who think work is too difficult or demanding can increase the stress clients feel and contribute to low self-esteem, low expectations, and an inability to function fully in society." In addition, he comments, "We don't believe in sheltered employment…. We don't believe that it's good for people. It is institutionalizing…. The ideal is to put them in a normal environment, and what they start doing is acting like everyone else."

Further, O'Brien and Cook would suggest that the fact that no one got screened out in the old system was a flaw in *that* system. The reimbursement process under the old fee-for-service system encouraged nonprofit inefficiency by rewarding organizations for accepting people who could not work and then extending the service delivery process so their budgets could get padded. O'Brien comments, "It would take two or three years really to get to the point of saying, 'OK, you're not going to make it.'" The reason for this, O'Brien contends, is that the agency had all the risks. "There was absolutely no risk in taking somebody who would never get a job." Those people who will not be able to make it to closure or who may be excluded because of their inability to work are not without recourse. Other programs — at the state as well as federal level (e.g., programs such as Social Security, Title 16) — are available to help them with their needs. But Milestone is designed to encourage work and it ought to admit people who are capable of work.

Managing for Outcomes

Milestone contracting was designed to weed out ineffective or inefficient nonprofits and to give providers the opportunity to devise new interventions. Thus, it should not be surprising that not every program that made the transition to MPS has survived. But for those who have stayed and been successful, the key seems to involve two related factors — namely, strong management and effective job coaches. Organizations with strong managers made the transition to MPS with a fair amount of ease. And organizations with good job coaches have been able to make good assessments and to place their clients into suitable employment the first time out.

One of the biggest obstacles to the success of MPS was getting the nonprofits to change the way they approached their jobs, from a process-oriented mind-set to an outcome-oriented one. During the pilot phase, the agency spent a great deal of time working with the nonprofits in order to ensure that they knew what would be expected of them under MPS. And it seems to have worked. It is interesting to note that nonprofits commonly say that Milestone forced them to act in a more business-like fashion. Analogies like this often break down rather quickly if one looks too closely, but what it seems to mean in this case is that the nonprofits have been forced to treat potential employers as if they are customers. Nonprofits have had to learn to market themselves to those customers with a fair amount of sophistication. In order to ensure that the employer and the client are happy, they need to pay close attention to the needs of both so that they will make a good match.

But how they do so — e.g., whether they will need more or fewer staff members or what kind of training they will use — is completely up to them. According to Cook, "All we care about is: are you meeting the parameters of our contract in terms of outcomes? You figure out how you're going to do it." The additional risk they assume under MPS is balanced by the autonomy they have over how they will operate. As long as the nonprofits meet the conditions of their contract — that is, they make (or surpass) the amount of placements they promised — they have complete freedom in determining the best way to do it. MPS clearly affirms a fair amount of nonprofit autonomy by turning the service delivery process into an opaque, if not black, box from which outcomes are generated.

In such a situation, an organization without strong management may soon be out of business, because the freedom given to nonprofits can be used to innovate or it can be an excuse to flounder. Effective managers under MPS have to be well organized in order to deal with the many start-up issues that come up and, because of the nature of the contracting system, they must be particularly adept at managing money. Also, they have to know their "business" inside out so that they are able to recognize a good job coach from a bad one.

The job coach is really the linchpin of the whole process. One nonprofit manager noted, "The most important part in a client reaching closure is who the clients have as a job coach and how much that job coach is willing to help the client. Most people quit if there hasn't been substantial contact with the job coach."

It may be worth noting that the job coaches seemed to have a better understanding of what would be expected from them under the new system than the managers did. The amount of documentation and the rule-boundedness of the old system tended to frustrate job coaches. They were also frustrated by the eternally open-ended process, with nonprofits having little incentive to "fade" the job coach to allow the client to function independently. Under MPS, roles and goals were clarified and risk was distributed so that everyone had a stake in achieving better outcomes. One job coach observed, "We went from being caretakers to being coaches." They found it liberating. As another job coach noted, "I know if I have done my job well enough that this person is going to make it and we'll get our payments."

MPS still has a few wrinkles that need to be ironed out. High-performing nonprofits that place their clients too quickly into employment under one contract have no avenue for going back to MPS if they run out of money. According to O'Brien, "If you set up a system that has incentives for being productive, some people are going to go in and do that, and they're going to do it better than anybody else…. And if you don't have a way that they can grow their contract or grow their program, then, in effect, you're going to punish them for doing good." Under the current program design, they must either stop accepting new clients or operate for free until the new contract begins, neither of which is an attractive prospect. In several cases, the agency has been able to renew nonprofits' contracts early. This is hardly a permanent solution, however.[5] One possible solution that has been proposed is to institute open-ended contracts. The constant evaluation that MPS necessitates would seem to offer enough accountability to make such an arrangement possible. Others have suggested that MPS might be effective as a voucher system, allowing the clients (or their surrogates) to make their own decisions about the quality of services.

Whatever the value of these and other suggested improvements, it remains true that Milestone has been a remarkably successful innovation in public management. Fee-for-service has long been *the* chosen method for governments to pay for contracted services under the modern welfare state. But MPS has shown that there is a plausible alternative to fee-for-service, an alternative that exchanges the worst incentives of the old system — inefficiency, over-regulation, and poor performance — for the shared risk, greater accountability, heightened autonomy, and high performance of MPS.

A few key elements are worth some emphasis. The complexity of the change under Milestone necessitated extensive consultation on the part of the agency with the managers and job coaches or, it seems clear, it would have been a disaster. To combat creaming, the two-tiered reimbursement process gave the nonprofits incentives to take on difficult cases. The decision to set reimbursements

[5] It's worth noting that this is a problem not just of Milestones but also of all contract-based programs.

at the average cost of a service was also crucial, giving the nonprofits incentives to root out inefficiencies within their organizations. The decision to offer a final payment only once per case gave the nonprofit an incentive to make sure that the initial placement would be the right one. Finally, by making the final payment the largest one and by making it apply only to real work in the community, MPS encouraged the nonprofits to not waste time on training and assessment and to place the clients in jobs they were suited for.

Perhaps the biggest obstacle to the success of MPS was changing the mind-set of the nonprofits. It was to be expected that the providers who were comfortable under fee-for-service would offer some resistance in the face of change. Managing the process under fee-for-service had been easy. Nonprofits simply needed to keep track and bill the agency for every minute of the workday, maximize enrollment, extend client assessment and training time, and stay on the job site with the client as long as possible. In the end, the dominance of this way of thinking distorted the process, causing inefficiency and poor performance. In sharp contrast, MPS offered the nonprofits an interesting bargain: If the nonprofits do a better job of putting their clients to work, the state will leave it to the nonprofits to figure out the best way to achieve this goal. Not all nonprofits were prepared to take the public sector up on this kind of bargain, but those who did have thrived. These nonprofits have risen to the challenge and their clients are far better off for it.

A Conversation with Dan O'Brien, Program Field Representative, Oklahoma Department of Rehabilitation Services

Given your experience, what do you think is the ideal number of milestones?

I firmly believe that the number of milestones needs to be kept to less than 10. If you have too many milestones, at some point you have diminishing returns because the system becomes too complex without yielding significant benefits. Having said that, some states use three milestones, and I think three is too few. A small number of milestones means that the state agency is not accepting enough risk. The number and weighting of the milestones determines the amount of risk each party is willing to accept. It represents the risk sharing agreement between the funder and the service provider. Part of the value of this system is the acceptance of risk by the nonprofit as well as the state. Traditionally, the state has carried all the risk; some outcome-based systems reverse this and shortsightedly ask the vendor to carry all the risk. Either risk-dumping approach is a mistake, creating perverse incentives leading to unintended consequences. It is our belief that an equitable method of risk sharing is the right balance. This acceptance of risk makes the vendor, usually a nonprofit, more accountable, reducing the need for oversight and micromanagement by the funder. The service providers become more serious about creating the outcomes sought by the customers that are represented in the milestones. Usually, six to seven milestones represents an equitable risk sharing arrangement, a win-win situation.

Have any other agencies adopted the Milestone Payment System?

About 15 to 20 other states including Massachusetts, Texas, and New York are using the Milestone Payment System. The Human Resources administration in New York City uses this system with their welfare-to-work recipients. They are very successful, especially given that they are working on a much larger scale. They work with about 30,000 people every year whereas we work with about 1,000.

Have you tracked the progress of any nonprofits that have dropped out of the system?

So far, only a couple of nonprofits have dropped out. Generally speaking, the nonprofits that drop out are the organizations that do not want to do what we want them to do. For example, one nonprofit we used to work with ran a sheltered workshop. Their main goal was to keep clients in their workshop and not to encourage individuals to seek outside employment. It was only the rare occasion where this organization would place someone in a work situation outside of their workshop. This same nonprofit previously received $68,000 for one person who went to work for six months. With MPS, the most amount of money a nonprofit would receive for this person was $6,500. Using MPS was not a lucrative thing for them, so they left. This particular organization had distinct philosophical differences with our system.

Did you find that your concerns about creaming were ill founded?

When we created the Milestone Payment System, we built in two measures that effectively negated any tendency towards creaming. One of the countermeasures we incorporated was the increased rate of payment we gave vendors for taking on more difficult cases. We paid nonprofits 30 percent more for taking on clients that met the severe-needs criteria. The second measure we used was the bidding process, a process that used a stochastic probability model. This model is used to calculate the likely risk picture a nonprofit will face for the next three years. With this model, we built in payment for the amount of risk nonprofits figured they expected to face. We tried to make the risk more manageable so that nonprofits were not forced to cream.

Has any nonprofit you've worked with made outstanding progress?

The best success story belongs to Goodwill of Tulsa. When this organization switched from the traditional fee-for-service system to the MPS system, they made an incredible amount of progress. Goodwill related to me that before MPS, progress was measured by simply putting people in jobs until clients did not fail. More money was made this way. When Goodwill made the switch to MPS, they started asking clients what they actually wanted to be doing, what they wanted to get up and do every morning. This shift made a big difference in the quality of work experience for the customer.

Have you had any major disappointments?

Presenting MPS as a collaborative approach has been challenging. It is difficult to get across to individuals that work within the state government that MPS needs to be approached with a collaborative mind-set. I try to get people's attention by saying they have a choice between using the Soviet model of "command and control" or by using a business approach. In general, these individuals are used to dictating based on their concept of what was needed and not by what was needed by the market.

If you could make any changes to Milestone, what would they be?

Currently, we are in the process of creating a more fulsome array of incentives for quality results for customers. The incentives we are creating demonstrate how we are moving to a place where we are improving and adding to the definition of our product, the customer.

One of the incentives we are creating is providing incentive payments for service providers, mainly nonprofits that find career jobs with benefits for customers. Unfortunately, not all of the jobs nonprofits find include medical insurance or other benefits. By "incentivizing" better jobs, we are encouraging nonprofits to become more invested in the long-term progress of their customers.

Another incentive we aim to create is a voucher for customers. This voucher would go to customers and allow them to select a service agency of their own accord. We envision this voucher becoming a tool of empowerment for customers. The voucher will encourage customers to take a more proactive role in their overall experience. This selection process will force them to think harder about the type of employment opportunity they want. Along with the voucher, we are developing a report card. The report card would be developed by an independent evaluation contractor and given to the customer so that the customers can decide which service provider to spend their voucher with. We believe that empowering the customer with the choice will create competitive forces that will improve service quality.

Lessons Learned

As nonprofit organizations consider the quality and impact of their relations with government, two fundamental concerns emerge that together constitute a strategic dilemma of significant proportions. On the one hand, nonprofits must be open and accountable to the public agencies that fund them. This usually entails complying with regulations and guidelines for the provision of contracted services, as well as completing evaluations and reports on the use of public funds. On the other hand, nonprofits must jealously guard their autonomy and independence. This often comes down to protecting their distinctive missions and values in the face of pressures from outside. For public managers, the stakes involved in working with nonprofits to strike the right balance could not be higher. As devolution and privatization push more and more government functions "down" to lower levels of government, and as privatization continues to push government function "out" to contractors, the task of working effectively with nonprofit service providers is becoming ever more pressing.

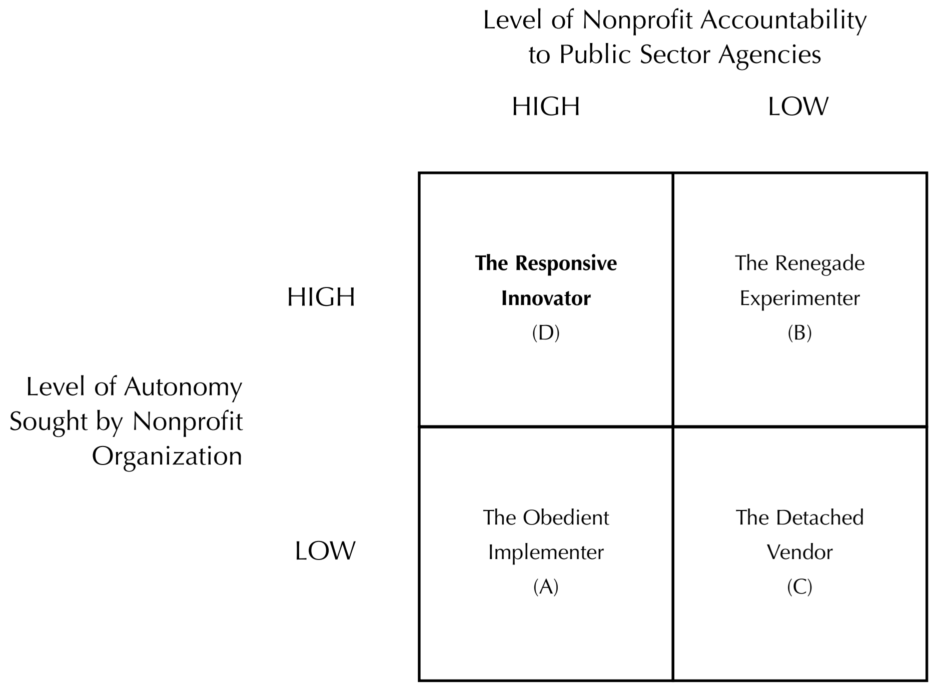
We identified at the outset the difficult tradeoff that nonprofit and public managers must strike between accountability and autonomy (see Figure 1). Finding ways to satisfy both nonprofit and public agencies is clearly a challenging task. Often, contracting relations prioritize accountability at the cost of nonprofit autonomy and end up supporting obedient, if uninspired, service providers who simply implement programs as instructed (point A in Figure 1 and cell A in Figure 6). Other times, contracting systems privilege the autonomy demands of nonprofits at the cost of sound oversight and create room for nonprofit renegades to take advantage (point B in Figure 1 and cell B in Figure 6). In some cases, neither value is optimized, and nonprofits simply perform poorly as unaccountable and unproductive vendors (point C in Figure 1 and cell C in Figure 6). The core challenge in public management is to promote both the values of accountability and autonomy at the same time and to allow nonprofits to act as responsive innovators (point D in Figure 1 and cell D in Figure 6). This appears to be happening in Oklahoma through the MPS system.

The MPS model is significant because it represents a clear attempt to move contracting to an optimal mix of accountability and autonomy. From the experience in Oklahoma, it is possible to draw some simple lessons for public managers on how to go about designing and implementing milestone contracts:

Design Stage

1. **Collaborate with nonprofits in the initial design of milestones.** Public managers should bring nonprofits into the process of designing milestones. One lesson that emerges from the Oklahoma experiment is that good communication between public and nonprofit managers early in the contracting design process is essential. Many nonprofit organizations are likely to be apprehensive of a major shift in the way public contracts are administered. Collaboration will

Figure 6: The Four Identities of Nonprofit Organizations



go a long way toward both assuring nonprofit support for change and the selection of meaningful and appropriate measures of progress. Public managers need to work to ensure that nonprofits buy into outcomes that are chosen, and this means giving them a voice in the development of the contracting system.

2. **Use a small number of milestones and use simple reporting forms.** The Oklahoma experiment demonstrates that the number of milestones should be kept modest if the system is to work efficiently. When milestones become too numerous, the administrative oversight and reporting requirements become acute. By keeping the number of outcomes small and by placing special emphasis on the final outcome sought, public managers can create room for nonprofits to innovate by freeing them from heavy reporting requirements. While the number of appropriate milestones will vary considerably depending on the kind of service being delivered, public managers should err on the side of too few rather than too many milestones.

3. **Shape incentives to avoid creaming.** Worries about client creaming were present in Oklahoma. Rather than dismiss these concerns out of hand, it is useful to confront them directly and to reassure nonprofits that incentives will be established to encourage organizations to continue to tackle the most difficult cases. By paying more money for hard-to-serve cases and by allowing nonprofits to get paid based on the risks they assume, public managers can go a long way toward removing the incentives that some agencies might have to become selective in the clients they serve under a milestone payment system.

Implementation Stage

4. **Help nonprofits make the shift from fee-for-service systems to outcomes.** Shifting away from fee-for-service clearly creates stress for nonprofit organizations. It removes a long-held safety blanket from these organizations and introduces contingencies into their funding. This can be a source of cultural conflict within nonprofits, as long-standing priorities and practices must be

revisited in light of changes in the funding environment. To the extent possible, public managers need to be sensitive to these stresses that changes in payment systems can create and to work directly with nonprofit organizations to explain milestone systems and the rationale for moving away from fee-for-service systems. Demonstrating that milestones have the potential to both reduce paperwork and increase programmatic freedom may go a long way to ease nonprofits' concerns.

5. **Be flexible and revisit milestones once a system is in operation.** Flexibility is a virtue in outcome funding. Although milestones allow the state to treat all nonprofits fairly, there is room to accommodate some variation in the system. Public managers need to be ready to accommodate special cases, especially when nonprofits work with special populations or when the system is first being implemented. Once a milestone system is in place, it is important to revisit the selection of milestones to ensure that the right outcomes have been selected. This can be done in consultation with nonprofit organizations after they have had some experience with milestone funding.

6. **Study effective programs and disseminate best practices for achieving outcomes.** Outcome funding is still in its infancy in nonprofit human services. A critical task for public managers is building knowledge about effective performance-based contracting systems. A critical step in this process is documenting and disseminating best practices so that others can learn and the field can continue to develop. Public managers should also be open to the possibility that outcomes may work better in some fields of social service activity than in others. Understanding exactly when, where, and why outcome funding is likely to be most helpful in improving performance needs to be illuminated through experimentation and analysis in the years ahead. Public managers should take a lead role in this work.

By breaking down some traditional boundaries and by challenging long-standing operating principles, public and nonprofit managers can work together to deliver effective programs. The Milestone system in Oklahoma represents a potent tool for advancing the shared interests of public and nonprofit sectors. By holding nonprofits accountable for producing results and by giving nonprofits substantial freedom in the design and implementation of interventions, Oklahoma has gone a long way toward defining a model that others can apply and develop even further.

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Appendix

List of Interviewees

Vera Cheek
Project Director, Francis Tuttle Vo-Tech Center, Oklahoma City, Oklahoma

Rebecca Cook
Program Field Representative, Department of Rehabilitation Services, Oklahoma

Teri Egner
Technical Assistant, Department of Rehabilitation Services, Oklahoma

Mary Howell
Technical Assistant, Department of Rehabilitation Services, Oklahoma

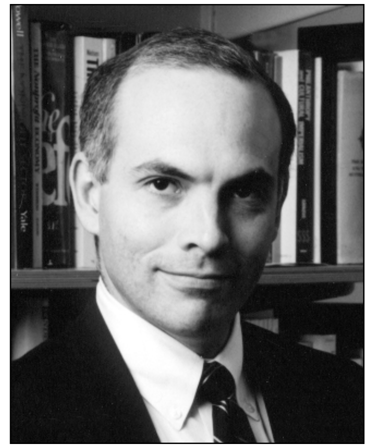
Dan O'Brien
Program Field Representative, Department of Rehabilitation Services, Oklahoma

Linda Shipley
Project Director, Community Development Support Association, Enid, Oklahoma

Vionette Torres-Miles
Director of Employment Services, Northcare Mental Health Center, Oklahoma City, Oklahoma

Brian Wadell
Chief Executive Officer, Employment Resources, Inc., Tulsa, Oklahoma

Lydia Zachary
Jim Taliaferro Community Mental Health Center, Lawton, Oklahoma



About the Author

Peter Frumkin is Assistant Professor of Public Policy at Harvard University's John F. Kennedy School of Government, where he is affiliated with the Hauser Center for Nonprofit Organizations. At the Kennedy School, he teaches courses on public and nonprofit management.

His recent research has examined compensation policies in nonprofit organizations, the impact of fundraising strategies on nonprofit revenue generation, the professionalization of private foundations, and the impact of public funding on nonprofit mission definition. He has published articles in the *American Review of Public Administration*, *Public Administration Review*, *Nonprofit and Voluntary Sector Quarterly*, *Nonprofit Management and Leadership Society*, and numerous other journals.

Frumkin's current research focuses on public policies shaping the nonprofit sector, the management of non-profit organizations, and the performance of private philanthropic foundations.

Frumkin has been awarded both the Best Dissertation Prize and a Best Paper Prize from the Academy of Management's Public and Nonprofit Division.

Prior to coming to the Kennedy School, Frumkin worked as a foundation program officer and as a program evaluator in nonprofit and public agencies.

He is a graduate of Oberlin College (1984) and holds an M.P.P. (1989) from Georgetown University. He received his Ph.D. in sociology from the University of Chicago in 1997.

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