

Public Disclosure Authorized

Public Disclosure Authorized

AN INTRODUCTION TO OUTCOME-BASED FINANCING

GPRBA's Outcomes Fund MDTF



The US\$2.5 trillion annual financing gap for achieving the United Nations Sustainable Development Goals necessitates that existing resources are used more effectively and that additional resources are mobilized. Innovative funding approaches such as results-based financing (RBF) can contribute to narrowing the funding gap by increasing the cost-effectiveness of existing funding and unlocking financing from the private sector.

The Global Partnership for Results-Based Approaches (GPRBA) recently launched a new Multi-Donor Trust Fund (MDTF), known as the Outcomes Fund. The objective of the Outcomes Fund is to drive improved social, infrastructure, and environmental outcomes for poor and vulnerable populations using innovative outcome-based financing approaches.

The World Bank is a market leader in RBF, having disbursed over US\$22 billion globally through various results-based mechanisms. Although there are notable exceptions, the majority of RBF to date is provided to incentivize government performance, not service providers, and is tied to intermediate results, not outcomes. GPRBA's Outcomes Fund provides an opportunity for the World Bank to maximize finance for development through the scaling of outcome-based financing.

The objective of this note is to introduce GPRBA's approach to outcome-based financing.



Focusing on Outcomes

All RBF approaches tie the disbursement of financing or funding to the achievement of independently verified results. However, the term *outcome-based financing* delineates RBF mechanisms that tie funding to metrics more closely related to the ultimate development objective – outcomes – as opposed to intermediary results – system actions, inputs, activities, and outputs. Table 1 provides an exemplary classification of results into the four intermediary and one ultimate results category.

In contrast to traditional contracting or budgeting approaches, outcome-based financing excels at driving innovation that leads to greater impact for beneficiaries and lower costs for funders. By tying funding to outcomes, outcome-based financing (i) creates strong incentives for service providers to achieve results, and (ii) grants service providers the autonomy to adjust implementation in a quest for greater development impact. The following boxes provide examples of different outcome-based models. In box 1 (next page), the Employment Fund in Nepal provides an example of how RBF can foster innovation and improvements in cost-effectiveness by creating a market for social outcomes.

Table 1: Moving from intermediary results to outcomes: examples

| | SYSTEM ACTIONS | INPUT | ACTIVITIES | OUTPUTS | OUTCOMES | IMPACT |
|---------------------------------|---|--|---|---|---|--|
| Vocational skills training | Passing conducive laws, regulations, policies | Instructor payroll; training center; training supplies | Training delivery; labor market demand assessment | Training received | Skills improvement; job placement; job retention; income generation | Increased life-time earnings; social inclusion; happiness |
| Affordable housing ¹ | Passing conducive laws, regulations, policies | Permitting; construction materials; financing | Build affordable housing units | Housing units developed; low-income families housed in affordable units | Improvements in quality of life; connectivity to economic opportunities; increased safety (reduction in crime); increased investment in community | Improved quality of life (economic opportunities, health, happiness) |

BOX 1. THE EMPLOYMENT FUND IN NEPAL²

The program was a success, with 75% of the 100,000 trainees gainfully employed within 6 months of the program; 80% of these beneficiaries are considered disadvantaged.



In 2008, almost 90% of the youth entering the Nepalese labor market each year were unskilled, and 46% of youth were either unemployed or underemployed. The Government of Nepal, World Bank, DFID, and SDC established the Employment Fund. This outcomes fund issued performance-based contracts

for 57 service providers to provide skills trainings to approximately 100,000 beneficiaries. 60% of RBF funding was tied to job retention after 3-6 months, and 40% to assessments measuring improvements in marketable skills. To incentivize service providers to focus their efforts on harder-to-place populations, they received a greater reward for women and disadvantaged individuals who gained employment. The program was a success, with 75% of the 100,000 trainees gainfully employed within 6 months of the program; 80% of these beneficiaries are considered disadvantaged. Similar RBF programs are now being scaled by governments and development partners in Morocco, Ethiopia, and Colombia.

Under any RBF scheme, service providers require upfront working capital to implement their intervention. This working capital can come from three sources: (i) the service provider's own-source capital, (ii) an outcome funder's advance, or (iii) a private financier. Private financiers can include entities such as commercial banks, investors, philanthropists, or microfinance institutions. Outcome-based financing can contribute to unlocking financing from the private sector and incentivizing the impact of such financing. As outcomes can be more susceptible to factors outside of the service provider's control, it is important to carefully consider the appropriate combination of outcome and output indicators to which payments are tied to help mitigate this risk.

One private financing option - often used when working with non-state providers - is to underpin outcome-based contracts with an instrument known as an *impact bond*. With an impact bond, investors finance the intervention and are repaid upon the achievement of pre-agreed results, typically at a premium. Impact bonds can be leveraged by governments who wish to fund innovation with reduced risk. With funding tied to results, service providers (i) are incentivized to achieve critical outcomes, and (ii) have greater autonomy to respond to the project needs and course correct where necessary. This is in contrast to traditional fee-for-service government contracts, where service providers are held accountable for delivering pre-defined services, but not necessarily on innovating to find more effective ways to achieve outcomes for their beneficiaries. Box 2 provides an example of an impact bond.



BOX 2. THE EDUCATE GIRLS DEVELOPMENT IMPACT BOND³

In Rajasthan, 40% of girls drop out before reaching fifth grade and only 15% of children in primary schools can read a simple story in Hindi. In response to these challenges, Educate Girls' Development Impact Bond designed a program targeting girls' enrollment and providing an after-school program in public schools. The outcome payer pledged to repay an investor for the working capital, conditional on the improvement of the targeted outcomes. Motivated by falling short of the ambitious literacy and numeracy outcome targets in the first two years, Educate Girls iteratively experimented with programmatic adjustments, leveraging the operational and financial flexibility granted by the DIB. In the third and final year of the DIB, these adjustments paid off. Learning outcomes grew 79% more in Educate

Girls' treatment schools than in control schools – almost the difference of an entire additional year of instruction. Overall, Educate Girls exceeded targets for both enrollment and learning, achieving 116% and 160% of targets, respectively. The CEO of Educate Girls credits the outcomes-focused pressure that the impact bond generated for transforming her NGO into a more impact-driven organization; Educate Girls now uses performance management to quickly identify and resolve challenges in program implementation, as well as new technologies to lower program costs. For example, Educate Girls routinely uses remote sensing and data science target aid by predicting which villages are likely to have the highest percentage of out-of-school girls.

Overall, Educate Girls exceeded targets for both enrollment and learning, achieving 116% and 160% of targets

Outcome-based financing can also be used to incentivize institutional reform. Box 3 describes an ongoing RBF program implemented with three public utility companies and their regulator in Sierra Leone. This type of program can be highly impactful, as access to services as well as technical and commercial losses are measurable; however, turning around a low-performing utility company is a complex challenge.

BOX 3. INSTITUTIONAL REFORM IN SIERRA LEONE⁴

The program's intermediate results from 2019 and 2020 are encouraging, with some institutions significantly exceeding their ambitious performance targets.

Freetown's one million inhabitants and businesses suffer from unreliable access to clean water and electricity. The Millennium Challenge Corporation's 4-year, \$44 million program aims to improve the performance of the responsible utilities and regulator by implementing policy reforms, building institutional capacity, and facilitating an RBF program. The \$4 million RBF is distributed across three utilities and the regulatory body. The RBF was co-designed with the government and incentivizes utilities to increase revenue, lower technical loss, and fight corruption.

The metrics of higher capacity institutions were set at the outcome and output levels to grant them the flexibility to discover new solutions to complex problems. The metrics of lower capacity institutions were set at the output and activity levels, as a more prescriptive approach focused on implementation was required. The program's intermediate results from 2019 and 2020 are encouraging, with some institutions significantly exceeding their ambitious performance targets.



Focusing on Service Providers

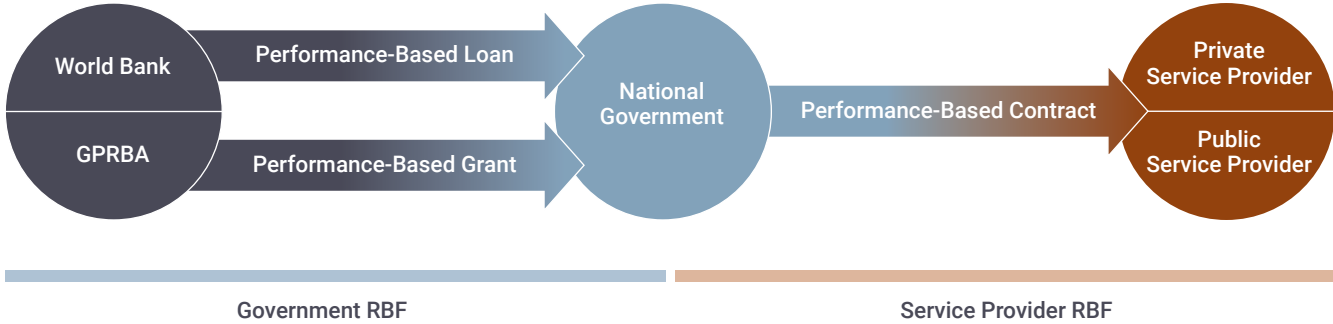
With a variety of RBF instruments and terminology in existence, it is important to understand how outcome-based financing fits into this domain. RBF instruments differ chiefly by which stakeholders they seek to incentivize. Whereas the World Bank's Program-for-Results (PforR) provides incentive to national governments to enhance their capacity to deliver services, for example, Conditional Cash Transfers incentivize behavior change among households and individuals. Table 2 below depicts this by providing a typology for RBF instruments by incentivized agent. Several variations of outcome-oriented mechanisms exist and are used by different organizations, such as impact bonds, social success notes, pay-for-success contracts, and social impact incentives. The GPRBA Outcomes Fund and this document focus specifically on outcome-based financing mechanisms which incentivize service providers and/or social investors (rows 3-4 in Table 2).

At the World Bank, outcome-based mechanisms can be integrated into performance-based loans (*PforR* or *IPF with Performance-Based Conditions*), or performance-based grants. Figure 1 below provides an example of how a service-provider RBF program can be combined with a government-level RBF scheme.

Table 2. Typology of RBF Instruments⁵

| | INCENTIVIZED AGENT | RBF INSTRUMENT CATEGORIES |
|---|---------------------------------|--|
| 1 | National Government | Performance-Based Loans (PBL), e.g. Program-for-Results (PforR) Performance-Based Grants (PBG), e.g. Cash-on-Delivery (COD) |
| 2 | Local Government | Performance-Based Transfers (PBT) |
| 3 | Service Providers | Performance-Based Contracts (PBC), e.g. Performance-Based Financing, Output-Based Aid |
| 4 | Financier and Service Providers | Impact Bonds, e.g. Development Impact Bond (DIB), Social Impact Bond (SIB) |
| 5 | Beneficiaries | Conditional Cash Transfers (CCT) |

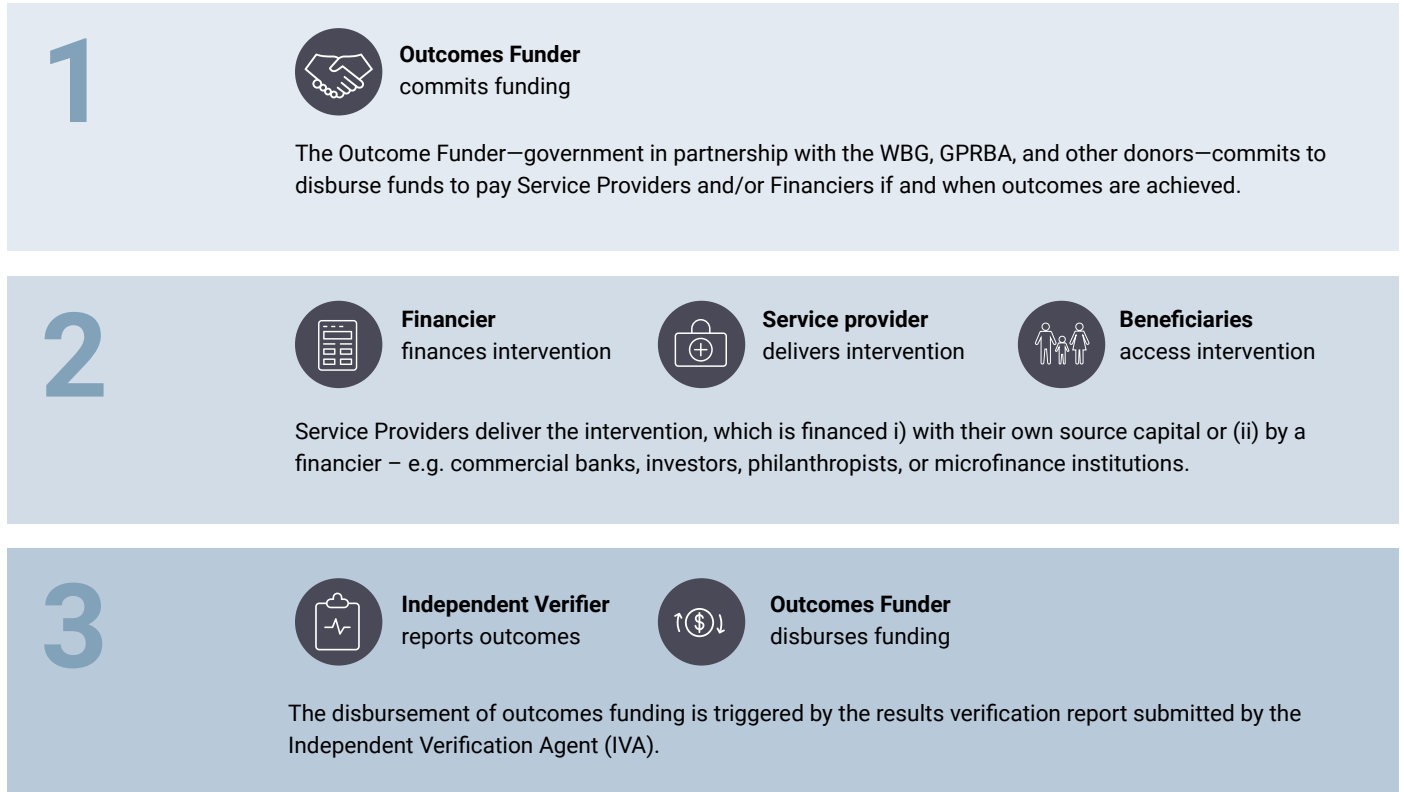
Figure 1. Stacking RBF instruments



GPRBA Outcomes Fund

The GPRBA Outcomes Fund will pool donor funding and work with government partners to design and co-fund outcome-based financing programs. Figure 2 provides an overview of the outcomes funding process.

Figure 2. Outcomes funding process



For more information, please reach out to GPRBA at rbfinfo@gprba.org.

ENDNOTES

- ¹ Adapted from: Urban Institute (2015). Candidate Outcome Indicators: Affordable Housing Program. https://www.urban.org/sites/default/files/2015/04/10/affordable_housing.pdf
- ² Instiglio (2019). Results-Based Financing to Enhance the Effectiveness of Active Labor Market Programs. <https://www.instiglio.org/wp-content/uploads/IDRC-Final-Report.pdf>
- ³ IDinsight (2018). Educate Girls Impact Bond (Final Evaluation Report). <https://www.idinsight.org/reports-2/2018/8/22/evaluating-the-educate-girls-development-impact-bond>
The Brookings Institution (2018) What can we learn from the results of the world's first Development Impact Bond in education? https://www.brookings.edu/wp-content/uploads/2018/07/global_20180713_impact_bonds_transcript.pdf
- ⁴ Millennium Challenge Coordinating Unit and Instiglio (2018) Final Results-Based Financing Design Report.
- ⁵ Adapted from: Instiglio; Lopez, Jessica Anne (2018). A Guide for Effective Results-Based Financing Strategies. World Bank Group.

IMAGE CREDITS

Page 5: Educate Girls, Other Images: World Bank Group