

## OUTCOMES FUNDS

### Overview: improving aid outcomes at scale

In 2016, over \$150 billion in Official Development Assistance (ODA) was distributed by OECD members to developing countries worldwide.<sup>1</sup> Given the size of these flows, and the ongoing tight fiscal position faced by most donors, improved accountability for aid expenditures remains a high priority.

The increasing interest in outcomes-based funding instruments, such as development impact bonds (DIBs), arguably reflects a growing concern with the efficiency and efficacy of aid. These instruments aim to provide rigorous frameworks that ensure that public money is only spent if pre-agreed outcomes are achieved.

As of November 2017, five DIBs have been contracted, and a further 24 Impact Bonds in low- and middle-income countries are under development.<sup>2</sup> But most of these projects are designed as a single investment for a single intervention in a specific geography. In the context of the search for scalability to accelerate the progress towards the SDGs, a project-by-project approach to outcomes-based funding has significant limitations.

The evolution of the impact bond market in the UK provides useful lessons on how to increase the size and speed-to-market for outcomes-based funding interventions. In the UK, central Government funding was pooled into flexible, thematic ‘Outcomes Funds’ from which a series of programs could then be financed. Six years later, lessons are emerging that could help inform the evolution of DIBs.

This paper summarises Social Finance’s views on how a shift to Outcomes Funds could retain the fundamental rationale of impact bonds in improving accountability for aid outcomes, while doing so at scale.

### A shift to outcomes-based and programmatic funding

Effective and efficient distribution of development assistance remains a priority for donors. Two approaches have emerged:

- The first is a move away from a short-term ‘project-by-project’ approach to a longer-term, **programmatic approach**, where interventions are part of an ongoing commitment by donors to a series of investments, often with a sector or thematic focus<sup>3</sup>. This shift to strategic programming steps away from start-stop financing where low visibility of future funding limits scale-up and deters co-investment.
- The second is a **commitment by donors to focus on - and pay for - outcomes** (or, at least, outputs and results that are a sufficiently robust proxy for outcomes), reflecting a move away from the traditional log-frame approach where payments are made for inputs regardless of final impact. The focus on outcomes has been driven not least by the need to demonstrate value-for-money in the use of taxpayer resources.

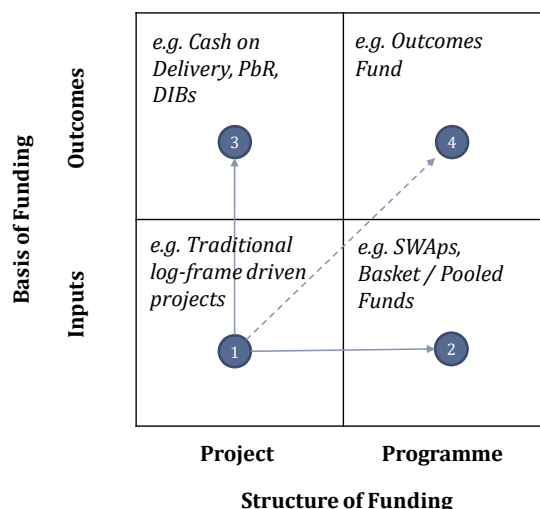
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<sup>1</sup> OECD data. Available at: <https://data.oecd.org/oda/net-oda.htm>

<sup>2</sup> Peru Sustainable Cocoa and Coffee Production (2015), India Educate Girls DIB (2016), Rajasthan ‘Utkrisht’ Maternal and Newborn Health DIB (2017), Village Enterprise ‘Graduation’ DIB (2017), and the ICRC Programme for Humanitarian Impact Investment (2017).

<sup>3</sup> For example, ‘Sector Wide Approaches’ (SWAs) were an early example of donors attempting to commit to a single policy and expenditure program as a group and under government leadership, adopting common approaches across the sector. Multi-agency ‘pooled funding’ or ‘basket funding’ is frequently adopted to support developing country authorities across a sector. And agencies such as the World Bank rely on programmatic instruments such as a ‘Series of Projects’ (formerly ‘Adaptable Program Loans’)

These approaches are illustrated below. Moving from point 1 to point 2 represents a move to a programmatic approach; moving from point 1 to point 3 represents a move to funding on the basis of outputs or outcomes.



### The next step: combining both approaches via an Outcomes Fund

To date, there have been few efforts in the international development field to combine the benefits of both approaches into a more strategic, longer-term “**Outcomes Funds**” approach (i.e. moving from point 1 to point 4 in the diagram above). However, the UK government is already using this approach to drive a longer-term and more strategic approach to commissioning, and to grow the overall market for social investment, as set out in the box below.

**Outcomes Funds in the UK**

Several outcomes funds have been deployed in the UK, beginning with the £30m **Innovation Fund** launched by the Department for Work & Pensions (DWP) in 2012 to pay for outcomes on a series of programs designed to bring 14-18 year olds closer to the workplace. This thematic fund was followed a further iteration by DWP to incentivize local authorities to participate as joint outcome funders, as well as by another thematic fund - the £10m **Fair Chance Fund** - launched by the Department for Communities & Local Government in 2014 to stimulate programs to support displaced youth. In each case, the outcome fund published a schedule of tariffs which would guide market participants when developing their intervention models and pricing their bids. The use of recurrent deadlines stimulated the market by aggregating demand and creating competitive tension: itself a measure of value for money.

A more recent initiative in the UK has been the National Lottery’s £40m **Commissioning Better Outcomes Fund**, which provided local authorities with resources and incentives to explore different applications of outcomes commissioning. Again, the use of deadlines was very effective in driving activity, although the absence of a thematic focus may be responsible for the relatively low conversion of interest into firm transactions. The most recent initiative - the £80m **Life Chances Fund** - has, by contrast, adopted a strongly thematic approach.

In our view, in the current environment of budget constraints and a renewed emphasis on results and value-for-money, there is a clear opportunity to replicate this strategy in the international development sector, learning from the UK’s experience.

### Characteristics of an Outcomes Fund

At its simplest, an Outcomes Fund pools development finance from one or more funders in support of a set of pre-defined outcomes. Payments from the fund only occur if specific criteria agreed ex-ante by the funders are met. Although there are many different ways Outcomes Funds can be structured – depending on specific contexts and what funders are seeking to achieve – learnings from our UK work suggest that a successful Outcomes Fund would likely have the following characteristics:

- **Open Ended & Open Access:** Multiple transactions by multiple actors<sup>4</sup> supported by the fund on an ongoing basis over multiple years, potentially with multiple funders.
- **Contestable:** Multiple recipients could bid into the fund with some level of competition to maximize the efficient allocation of resources, particularly for a fund that seeks to drive improved outcomes in a particular theme. (See below for more on ‘thematic’ vs. ‘innovation’ funds). This could be achieved via recurring deadlines or funding sub-windows as part of the fund’s governance.
- **Open Data:** A thematically- or geographically focussed fund could begin to build a centralised repository of key lessons, helping to inform future scaling of interventions or coordination of complementary services.
- **Adaptive:** The fund would target ‘complex problems’ where adaptive management during implementation is likely to raise the odds of success – i.e. there is room to test and measure different interventions and to change course as a result.<sup>5</sup>

### Benefits of an Outcomes Fund

Such an approach offers several benefits in comparison to either a pure programmatic approach or a pure outcomes-based approach. These include:

- **Learning & Market Development:** Many of the theoretical benefits of outcomes-based contracting remain unrealised to date, due to a project-by-project approach and limited knowledge sharing across these projects (for example, on how to price outcomes effectively). An Outcomes Fund would provide a formal, institutional structure to capture and scale this knowledge beyond one-off projects and individual actors. This would rapidly create a new body of sector learning: a “data commons” open to all.
- **Price Discovery:** The multi-actor, multi-transaction structure would also foster price discovery. A track record of transactions supported by the fund over time would establish benchmarks for pricing outcomes, which in turn would create a more transparent market with faster turnaround times and lower transaction costs for future transactions.
- **Adjustable Pricing:** Where there is inadequate data to establish a robust picture of the true cost to deliver an outcome, an Outcomes Fund could propose dynamic or adjustable pricing. Outcomes prices could be adjusted upward or downward in subsequent transactions depending on the actual cost to deliver. This would balance the imperative of cost effectiveness with the level of effort required to deliver a particular outcome.
- **Preparation Funding & Technical Assistance:** An Outcomes Fund could also incorporate a stream of grant funding to build the broader marketplace of providers, as well as to prepare a pipeline of projects, reducing the upfront and unrecoverable resources needed to bring projects to market. For example, the fund could make capacity-building resources available to providers to enhance their data collection and analysis capabilities.
- **Greater Contracting Expertise:** Project-by-project approaches inhibit the development of the contracting expertise that a shift to outcomes-based funding requires from funders. Contracts based on an ongoing Outcomes Fund structure, by contrast, would allow funders to build their experience in managing potential outcomes risks – e.g. perverse incentives, cherry picking, appropriate performance management frameworks and systems etc.<sup>6</sup>

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<sup>4</sup> Ideally, an Outcomes Fund would be agnostic as to the nature of these program implementers: they could include NGOs, social enterprises, project developers and other service providers

<sup>5</sup> A useful resource on ‘strategic’ adaptive management is “Adaptive Management – What it Means for CSOs”, Bond, 2016 ([https://www.bond.org.uk/sites/default/files/resource-documents/adaptive\\_management\\_-\\_what\\_it\\_means\\_for\\_csos\\_0.pdf](https://www.bond.org.uk/sites/default/files/resource-documents/adaptive_management_-_what_it_means_for_csos_0.pdf))

<sup>6</sup> By contrast, traditional input-based programming by its nature is simpler to manage, given that the funder retains full control of program implementation – but also retains all the disadvantages associated with input-based aid.

- **Long-term Institutional Strengthening at Sector Level:** Multiple participants, on both the funder and program implementer sides, would enable an Outcomes Fund to play a ‘standard setting’ role over time, as it would be of sufficient scale to identify and synthesise best practice to a wide group of actors within a sector. In the medium-term, this could form part of an evolving institutional framework for a given sector – for example, around quality standards in the context of primary healthcare interventions. In this way, the convening power of a well-structured Outcomes Fund could play an informal quasi-regulatory function.<sup>7</sup>

### Designing an Outcomes Fund

There is no unique, standardised model for an Outcomes Fund and there are multiple ways they can be structured, depending on the context and objectives of the donor or funder. The optimal structure will depend on a number of factors including:

- **Market maturity:** the number of strong service delivery organisations with sufficient capacity to bid into the fund and the level of prior knowledge about the cost of delivery and outcomes pricing;
- **Types of interventions that are funded and the outcomes sought:** the design of the fund will reflect whether the fund is seeking to (i) to build up an evidence base for interventions by funding in parallel different solutions to the same challenge, (ii) to accelerate the scaling of evidence-based interventions in new operational contexts (e.g. covering new geographies or target populations), or (iii) test innovative and more complex delivery solutions through pilot projects;
- **Level of flexibility:** the level of specificity around the geographic focus and issue area being addressed by the fund, and how much flexibility is considered to be valuable.

That said, drawing on the UK’s experience to date designing and managing Outcome Funds, a useful distinction can be made between two broad categories of Outcomes Funds: ‘**Thematic**’ funds and ‘**Innovation**’ funds.

- **Thematic Outcomes Funds** commission multiple interventions in parallel, by multiple providers, against an identical set of outcomes sought. The results are compared in order to build an understanding of what the most effective interventions are, and to determine the real cost of delivery and price per outcome achieved. This approach is good for price discovery, as it injects a measure of contestability between providers. It also builds up an evidence base, as different providers test different interventions to find the most *efficient* way of achieving the outcome.<sup>8</sup>
- **Innovation Outcomes Funds** commission solutions which involve an element of co-creation between the funder and providers. This is more likely to entail bespoke delivery and ‘one-off’ pricing. This approach offers greater scope for more complex innovation and learning, and is well-suited to complex issues requiring tailored approaches. This type of Outcomes Fund commissions innovative solutions to complex issues and tests them in order to learn about the *effectiveness* of an intervention.

Needless to say, this is not a hard and fast typology. It is, rather, a useful way to think about the objectives behind an Outcomes Fund, reflecting their versatility as a funding instrument. In practice, an Outcomes Fund will be tailored to a specific context and will sit somewhere on a spectrum between a pure Thematic Fund and a pure Innovation Fund. The table below compares the two broad categories, assessing the circumstances that each is best suited to.

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<sup>7</sup> In addition, institutional strengthening over the longer-term could mean a greater likelihood of a “DIB to SIB” transition (that is, the Government supplanting donors as the primary funder) or the adoption of new Public-Private Partnerships.

<sup>8</sup> A variant of this “what works?” approach would be to help scale well-evidenced interventions in different geographies or different target populations: a “where does it work?” approach.

## Thematic or Innovative? A simple categorisation

	Thematic Outcomes Fund	Innovation Outcomes Fund
<b>Function</b>	Commissioning multiple interventions in parallel against the same outcomes (and potentially in different geographies/ target populations) to identify the most <b>efficient</b> way of delivering the outcome sought	Commissioning solutions which involve elements of co-creation (e.g. bespoke delivery/outcomes metrics/pricing) to learn about their <b>effectiveness</b>
<b>Definition and key characteristics</b>	This type of Outcomes Fund can act as an accelerator by allowing knowledge capture beyond one-off projects: a shift from a 'project-by-project' transactional approach.	This type of Outcomes Fund allows for greater innovation and learning about new interventions to address complex issues. Both individual or multiple deals can be commissioned through Innovation Outcomes Funds.
<b>When is this type of Outcomes Fund more appropriate?</b>	<ul style="list-style-type: none"> <li>• <b>Deepening the evidence base:</b> tests different solutions in parallel, same/similar problems or target groups</li> <li>• When <b>price discovery</b> is one of the commissioner's main objectives</li> </ul>	<ul style="list-style-type: none"> <li>• When more complex issues requiring a <b>bespoke approach</b> are being addressed</li> <li>• When <b>testing new delivery solutions</b> is an objective</li> <li>• For pilot projects where there is no or only a <b>low evidence base</b></li> <li>• In contexts where <b>outcomes measurement</b> is more <b>complex</b></li> <li>• When there is relative <b>flexibility</b> in the definition of the geographic focus and issue areas to be addressed</li> </ul>
<b>When is this type of Outcomes Fund less appropriate?</b>	<ul style="list-style-type: none"> <li>• For interventions where there are <b>few or no service delivery organisations</b></li> <li>• When there is <b>limited data</b> that can be used to <b>price</b> outcomes</li> </ul>	<ul style="list-style-type: none"> <li>• In contexts with more certainty / lower risk about the effectiveness of a given intervention</li> </ul>
<b>What is required for this type of Outcomes Fund to be successful?</b>	Sufficient maturity and understanding of both the issue and the delivery environment to enable pricing and choice of providers.	Dedicated funding to support service providers as they prepare to bid into the fund.
<b>Examples of this type of Outcomes Fund in the UK</b>	<ul style="list-style-type: none"> <li>• DWP Innovation Fund and Youth Engagement Fund</li> <li>• Life Chances Fund</li> <li>• DCLG Fair Chance Fund</li> </ul>	<ul style="list-style-type: none"> <li>• Commissioning Better Outcomes Fund</li> </ul>

### Conclusion

The development challenge is changing. The new set of global goals – the SDGs – are more complex and multi-faceted than their predecessors, the Millennium Development Goals. Their funding requirements significantly exceed the means of the public sector, and we will not go 'from billions to trillions' via an input-based, project-by-project, business-as-usual approach<sup>9</sup>

Scaling impact requires a rigorous focus on outcomes, not inputs. A shift to financing outcomes will create space for front-line innovation, learning, and adaptation. It moves implementation and delivery

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<sup>9</sup> Even if aid is maintained at currently historically high levels (such as the recent record IDA-18 replenishment, and the ongoing commitment of a few bilaterals to the 0.7% of GNI target); in reality, there is a risk of significant retrenchment in aid commitments, particularly by the US.

risk to those seeking to take it. And, perhaps most importantly in the SDG era, it facilitates the integration of new sources of private capital.

The early DIB transactions are important test cases in demonstrating the concept of outcomes-based financing in aid delivery, not least to build stakeholders' capacity to adopt the new approaches to commissioning that it requires. But going to scale will require pooling donor resources in a longer-term vehicle that can fund results from multiple interventions over time in a specific thematic area or geography, all within a common outcomes framework. Our view is that the time is right to apply the lessons learned from the UK's experience with Outcomes Funds to the international level.

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