RESULTS BASED FINANCING (RBF) IN EDUCATION

QUICK-AND-DIRTY OPERATIONAL NOTES

CAN IMPACT BONDS DELIVER BETTER RESULTS, FASTER AND CHEAPER?

Panel Discussion on Social and Development Impact Bonds as a Results Based Financing (RBF) Approach in Education.

KEY QUESTIONS & ANSWERS

This series consists of summarized conclusions and key discussion points from operational clinics and other events organized by the REACH Trust Fund*.

These events bring together experts working on RBF to share their experiences and operational "trade secrets".

Note 5, October 2017

*The Results in Education for All Children (REACH) program in the World Bank's Education Global Practice supports efforts in RBF. It is currently funded by the Governments of Norway, the United States of America and Germany. See more at www.worldbank.org/en/programs/reach

Introduction

The Education, Trade and Competitiveness and Finance and Market Global Practices at the World Bank collaborated to bring together the leading experts and practitioners on Impact Bonds to discuss what has happened since the launch of the first development impact bond (DIB) in education (Educate Girls in India); what it means for other sectors; and how this up-and-coming financing model affects our work in international development.

The management of the World Bank's Education Global Practice: **Jaime Saavedra,** Senior Director, Education Global Practice; **Omar Arias**, The Program Manager of GEAK (chair); and **Samer Al-Samarrai,** Program Manager of REACH (moderator) posed questions to the panel of experts, who included:

- **Emily Gustafsson-Wright**, Fellow, Center for Universal Education, Brookings Institution
- **Avnish Gungadurdoss,** Managing Partner and Cofounder, Instiglio
- **Diane Mak,** Director, Social Finance U.K., and
- **Simon Bell,** Global Lead, Finance and Markets GP, World Bank

This note lists the key questions asked about Impact Bonds in the event and summarizes the answers provided by the panelists.

Omar Arias as the chair opened the discussion by emphasizing the cross-sectoral nature of the topic and the development taking place across the World Bank on such innovative financing approaches. From the education perspective, some of the key questions are:

- Incentives for providers and the constellations of financiers and stakeholders that are behind the financing?
- The role of government?
- What kind of interventions are more appropriate for the use of this tool: teacher training, infrastructure, things that are directly linked to learning outcomes?
- The learning outcomes are not easily measured which brings some complexities that are different from other interventions. How does the tool work in such cases?

The Development and Social Impact Bonds that were presented in the event are briefly described in Box 1. Their structures are further illustrated in Annexes 1-5.

Box 1. Development and Social Impact Bonds in Low- and Middle-income countries

Educate Girls DIB, India
Target: Improved enrollment of girls and learning outcomes of 15,000 children in 166 schools in Rajasthan. After two years: 579 out-of-school girls enrolled out of 835 targeted (87.7%), and 50.3% of the 3-year learning target achieved. The investor remains on track to recoup its initial funding of US$ 267,000.

Workforce Development SIB, Colombia
Target: 514 vulnerable individuals formally and sustainably employed. First social impact bond in a developing country. Total investment approximately US$756,000.

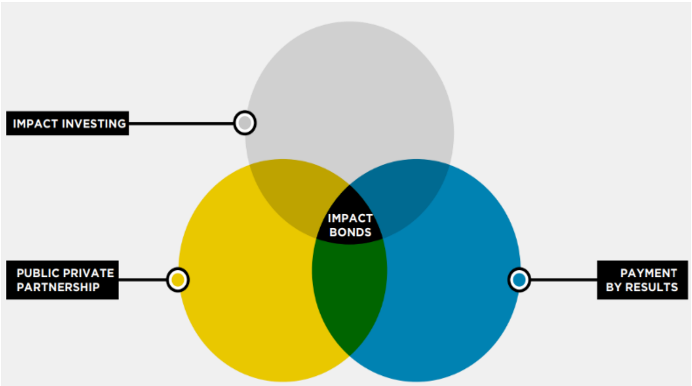
Village Enterprise DIB, sub-Saharan Africa
Target: Income of over 13,000 households in sub-Saharan Africa improved; and first replicable and cost-effective DIB for poverty graduation created. US$4.3 million in outcomes funding. Setting up an outcomes fund that will serve more donors and service providers in the future

Kangaroo Mother Care, DIB, Cameroon
Target: 10,000 low birth weight (LBW) infants enrolled in Kangaroo Mother Care (a proven intervention for neonatal survival) over 3-4 years across 10-12 hospitals in five regions of Cameroon, with US$3.5 million in outcome funding

Key Questions & Answers (ctrl+click to follow the links)

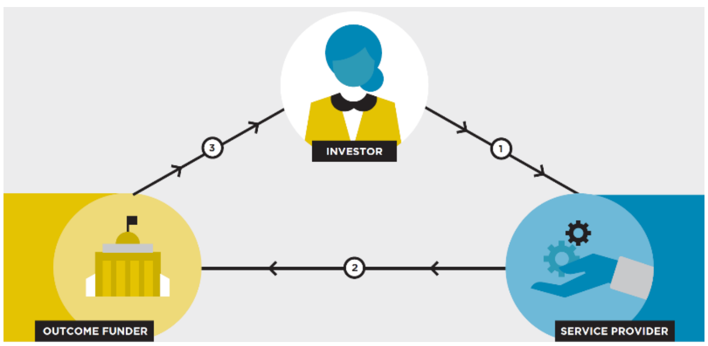
I DEFINITIONS

1. What are Impact Bonds?



Impact Bonds are results-based financing tools used to link socially conscious private investors with enterprises that aim to deliver social outcomes. They can be thought of as a tool which draws on elements of impact investing, public private partnerships and payment by results financing. They are not bonds.

The three key actors in an impact bond are *investor*, *outcome funder* and a *service provider*. In the typical structure of an impact bond, an investor provides upfront capital to a service provider, who then delivers services to a population in need. Upon the achievement of pre-agreed impact metrics, the outcome funder will repay the investor their initial capital, plus a return. If the impact metrics are not met, the investor is not repaid: meaning that an outcome funder only pays in the case that desired results are delivered.



Other key players include *evaluator*, who verifies if the outcomes have been achieved; and *intermediary*. Intermediaries such as Instiglio and Social Finance UK work with the outcome funders to structure and design the bonds, raise capital and arrange negotiations. Depending on the capacity of the service provider, they may also manage the programs. There may be other actors providing *technical assistance*, and usually *lawyers* who are knowledgeable in this form of contracting.

2. What's the difference between Social Impact Bond (SIB) and Development Impact Bond (DIB)?

In a social impact bond, the outcome funder is the government, while in a development impact bond, it is a third-party, such as a donor or foundation.

3. How does an Impact Bond differ from traditional Payment by Results (PbR)?

In Impact Bonds:

- external investors provide upfront risk capital
- There are intermediaries that work with the service providers around performance management
- Investors may engage the service providers & bring in their private sector mentality.

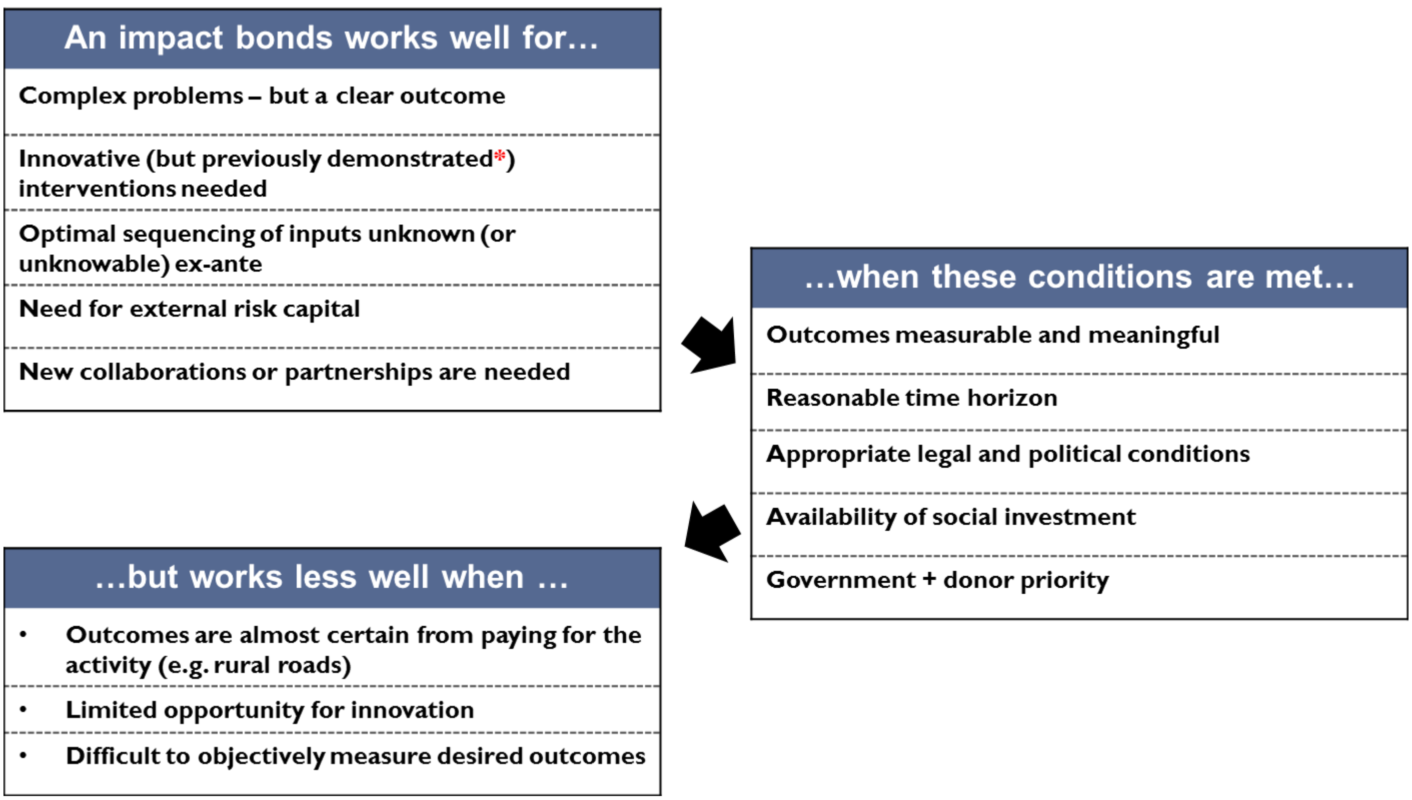
II MECHANICS

4. When to use Impact Bonds?

Whether to use impact Bonds or not, depends on what problem you are trying to solve and whether it can be solved by paying for outcomes.

Impact bonds are useful when needing external risk capital. The model brings external investors into the mix. Private sector investors are also argued to bring a different drive to achieving outcomes.
Impact Bonds can also be a suitable tool when trying to solve a complex problem where the results chain is not clear beforehand. The bonds allow for learning and changing the program along the way. However, innovation needs to be balanced by having some idea of the model being able to work, e.g. introducing interventions that have worked somewhere else in the world. Otherwise, the risk factor is too high for the investors to get on board

The chart below outlines the conditions in which Impact Bonds can work well/less well.



The basic conditions necessary for the effective use of Impact Bonds include:

1. Outcomes are clear and objectively measurable. E.g. mental health outcomes are too difficult to objectively measure.
2. Outcomes can be achieved in a reasonable time horizon. If the program can be expected to demonstrate intermediate or final results in a maximum of 5-6 years, it may be a good candidate for an impact bond.

3. Government support and legal structures are in place to support and enforce the programs.
4. Investors are interested in funding the space. Some social spaces are more attractive to investors than others.
5. The sought after outcomes are a government and donor priority, for them to be willing to invest.

5. How has the design of Impact Bonds evolved?

Annexes 1-3 describe the three impact bonds discussed here, that were launched in Low- or Middle-income countries: India DIB, Colombia SIB and Kenya and Uganda DIB.

The design of the bonds has evolved with each new bond. The second bond was launched in Colombia in March 2017 and it was the first Social Impact Bond (SIB). This was the main difference between the India (first launched bond) and Colombia bonds: the government providing part of the funding as an outcome payer. With IDB as the other outcome payer, this it also the first time bilateral and multilateral agencies got together to pay for outcomes

The Colombia Bond also involved many different providers who were able to offer integrated packages of services together to address multiple needs of the target population. The verification in India was done through randomized control trials, whereas in Colombia the existing systems enable the use simple administrative data verification.

The most recent bond, launched in October 2017 in Kenya and Uganda by USAID AND DfiD is different from the other two in its contracting arrangement. Rather than being a pure impact bond, it is an *outcomes contract*. There is a trustee, GDI, that holds the funds of the donors in a separate fund and signs the agreement with the service provider instead of the investors like in the other bonds. This is done to relax the financing constraints in the investor side. The service provider is tasked with the job of finding capital and there are no contains on how to do that. At 4.5 million and 4 years, the bond is also significantly bigger and has a longer implementation period than the others.

6. Who are the service providers and what incentives do they have to implement impact bonds?

Service providers are typically local non-governmental organizations (NGOs).

Impact bonds provide them with:

- upfront capital that they might not have and that reduces their own risk
- added flexibility (no dictated inputs or prescribed activities, just outcomes to reach as they see fit)

- with service providers who have evidence of their approach, opportunity to shine light on their ability to deliver results and impress the investors by being held accountable to results, not activities.
- Where there is no evidence, opportunity to have the approach be evaluated to demonstrate the provider's ability to achieve outcomes
- private sector mentality
- capacity building support where needed around data collection and monitoring from intermediaries/investors/technical assistance providers.

7. Are there service providers who are state actors rather than NGOs?

Not in the DIBs launched so far, but this is an interesting idea and there is no reason why they could not be. For the Kangaroo Mother Care (KMC) DIB in Cameroon, training will be provided to health staff in selected government-funded hospitals to create "Centres of Excellence". Public health staff will be the ones delivering the KMC intervention to mothers and low-birth weight infants, and also training up health staff in other hospitals to deliver KMC. The aim of this "train-the-trainer" arrangement is to institutionalize high-quality KMC delivery in the public health system, such that quality delivery would be sustained beyond the life of the DIB.

8. Who bears the risk of non-performance?

External investors. They regain their investment from the outcome funders, potentially with interest, only if the outcomes are reached by the service providers.

9. What are the transaction costs of such an Impact Bond?

Transaction costs vary depending on the size and complexity of the deal. There are several issues to consider:

(i) **Supervision costs.** Most of the supervision costs for a DIB are explicitly included in total project costs, rather than being recorded separately as donor administrative expense.

(ii) **Service provider inputs.** By their nature DIBs require less micro-design of service provider inputs which can save time at the project design stage. The early Impact Bonds have taken a long time to structure, but this is considered to be due to lack of stakeholder knowledge of the instrument, and is expected to reduce as stakeholders become familiar with DIBs.

(iii) **Project outcomes.** When assessing unit costs, the actual results of the projects should be considered. For unsuccessful DIB projects, outcomes funders are not paying out and investors take on the costs of failure.

(iv) **Return to investors**. This is often cited as an additional cost when comparing Impact Bonds with traditional RBF approaches, but in even in these approaches the cost of risk capital is usually factored into the price of service providers' bids.

10. Who pays for the intermediaries and external evaluators? Are the transaction costs included into the rate of return calculation?

Intermediary and external evaluator costs are typically paid for by outcomes funders, separate to the outcomes funding pot allocated to the DIB.

11. What is the range of rate of return for the investment? What do the investors anticipate?

The range of returns varies depending on the level of risk transfer (both actual and perceived). Some DIBs include a guarantee on the principle investment, which reduces the required rate of return to investors. Others include a mixture of outputs and outcomes payments, which also helps to reduce the level of risk and hence, the level of returns required.

12. Are the payment schemes pro-rated?

The question of non-binary vs. continuous outcomes is a very important design question when it comes to perverse incentives. All cases presented at the event have non-binary outcomes.

The outcomes are prorated. Every unit has an outcome payment and every percentage of improvement contributes to a higher payment.

13. Do we really want to shift risk away from service providers (at the same time encouraging them to take risks on the provision of the program)?

Service providers, who work closely with the target community, are often small and don't have the revenue to take risks connected to new innovations. Therefore, some of the interventions might not happen without the external financing.

Moreover, there is still a reputational risk involved for the service providers. More attention is paid to their project, so if it does not go well, they may lose investors in the future.

14. Shouldn't we calculate the cost savings generated and pay for each outcome based on what it's worth?

The valuation of outcomes is important, and difficult. To pin down a precise number while working and learning throughout the process is complicated. Also, the costing would include calculating the cost of delivering an outcome and cost of inaction.

The trend in the UK and U.S. is on how much the government can save by preventing something from happening (such as child going into the foster system).

In the international development space there is one added layer of complexity in terms of valuing outcomes since the focus is even more on social benefits and social value added, and sometimes cost savings are even harder to come by in those scenarios. Creating demand for social services may in fact increase the costs when more people are made aware of the services.

15. Why does it take such a long time (years) to put together an Impact Bond?

When such high stakes are put on results, it generates new levels of diligence on all parties. When paying for specific results, a lot of time ends up being spend on thinking about the incentives and what is realistic. More focus is paid to potential perverse incentives and how to avoid or mitigate for them. Significant time is also spent on developing the monitoring systems and rigorous ways of measuring outcomes.

In addition, engaging with country governments and operating in the public sector adds another level of complexity. When this is the case more time is needed for the setting up.

These are good reasons to take some additional time when developing the bonds and often lead to significant benefits by improving the organizations and their decision-making processes.

However, sometimes long preparation times are related to trying to force-fit impact bonds where they don't fit. Where other financial instruments have been shown to work and outcomes are clear (such as in building infrastructure) one should not waste time in trying to find a role for an impact bond.

In the past, it has also taken a long time to bring an investor at the table. From the perspective of a program manager such as Instiglio the implementation of impact bonds requires a lot of micromanaging and thus takes a long time. It was suggested that there may be a need to take more open design/free market approach, in which the funder and service providers sign an **outcomes contract**, and the provider is then free to raise the funds and implement the outcomes as they see fit. The donor focuses on identifying the outcomes and setting realistic conditions and payment rates. Doing this, reduced the design time to 6 months in the case of the East Africa bond. This is also the direction taken in the UK.

Also, impact bonds typically offer a funding solution for projects that are complex, unclear on exact solutions and require an a-typical design. Often, they could take a form of rapid prototyping, initiating the intervention fast, allowing for many flaws, collecting feedback, iterating etc. This would take three cycles or more and takes time.

16. All IBs look different. What processes can be streamlined and standardized to reduce costs and time of setting up the program?

There are a lot of materials and learning that can be shared across DIBs, for example key questions to answer during the scoping/feasibility process, considerations around DIB structuring (financial, legal, governance), contracting templates including key terms for the various DIB contracts, data and performance management systems/frameworks etc. At the same time, there will inherently be differences in terms of the target population, intervention approach, political and cultural context etc.

17. Can impact bonds be scaled up?

All parties involved agree on a need to expand from the relatively small-scale bonds in order for the model to have a future. Ways to do rapid scaling up are being tested in the UK. Many rapid impact bonds were tested in spaces where outcome funds already existed and every round of iterations has brought lessons.

III PRACTICE

18. How many Impact Bonds are there and where?

As of September 1, 2017, there are 93 impact bonds contracted globally; 90 SIBs and 3 DIBs. UK has the most with 36, followed by USA with 16 bonds.

There are 28 impact bonds in the Low- and Middle-income countries, most in design stage; 27 DIBs, 1 SIB (in Colombia). South Africa has the most bonds. Other countries have 1-3 each.

First impact bond in a developing country was launched in 2015 in India. Since then, there have been 3 more Impact Bonds launched in Low- or Middle-income countries. Annexes 1-4 describe these impact bonds and demonstrate their structures.

The Sectors with most IBs are: 1. Health, 2. Agriculture, 3. Employment, 4. Education and 5. Social welfare with two bonds.

19. What are the benefits of doing Impact Bonds?

The Brookings Institution collected common claims about the benefits of impact bonds made in the literature and by the practitioners. Six claims are supported by some demonstrated evidence.

- **Focus on Outcomes**: Outcome funders supporting the model see the impact bonds as a way to draw attention to certain results by placing greater incentives to reaching them. The focus on results which emerges from the financing mechanism encourages service provides to course adjust in light of feedback, ensuring that interventions are focused on the achievement of the pre-agreed outcomes.
- **Drive Performance Management**: Impact bonds have the capacity to improve existing performance management systems and encourage the set up of new systems (in order to meet the need for the focus on outcomes and adaptation)
- **Incentivize Collaboration**: Collaboration is encouraged not just across the public and private sectors, but also across government both vertically and horizontally. There is also the potential to increase collaboration across service providers serving the same populations.

  E.g in Ohio in the U.S. multiple service providers working together to get children back with their homeless families, different service providers address the different reasons for the homelessness and other related problems together

- **Build a Culture of Monitoring and Evaluation**: Monitoring and evaluation is driven by the need to demonstrate the achievement of results. End up improving their systems
- **Invest in Prevention**: Investing in preventive services should allow outcome funders to save over the long-term, which is why it is no surprise that in HICs interventions have focused on increasing employability (particularly among young people & vulnerable groups), and why health plays such a predominant role in developing countries
- **Reduce risk for Government**: It is still early on, so the only clear case of impact bonds reducing risk for government is in Rikers Island, where the results were not achieved, and the government did not pay for the results. Without rigorous evaluation evidence that compares the same intervention with and without an impact bond, it cannot be said definitely that SIBs reduce risk for government. Don't need to pay if there are no results. I.e. the question is, how much risk is actually there in the first place if the investors are willing to make the investment?

Four of the common claims about of impact bonds don't have enough evidence to support them at this point, but are mentioned by the literature or practitioners as benefits:

- **Crowd in Private Funding**: At the end of the day the outcome funders pay for the outcomes achieved in a particular impact bond, so this does not indicate that more money is flowing into social services. However, it may be the case that these types of investments are more appealing to the private sector because there is the possibility of some return. Moreover, private funding does help with the issue of liquidity and may be directing funding to sectors that usually don't receive it.
- **Achieve Scale**: So far impact bonds have not been used to achieve scale. The evidence suggests that impact bonds are more suited to middle-phase, or transition financing
- **Support Experimental Interventions**: Similarly, impact bonds have not been used to support truly experimental interventions, in the sense of interventions that thus far have no evidence behind them. Although that is not to say that impact bonds do not encourage innovation – we do see more combinations of services provided, services provided to new groups of beneficiaries and service provider innovation
- **Sustain impact**: Finally, in terms of sustained impact, it is too soon to say whether impact bonds have led to long term improvements in outcomes, despite evidence of systemic change. We look to future evaluative evidence to judge whether this financing mechanism has the ability to drive sustainable improvements.

20. What are the results so far?

There are results available from the developed countries and some intermediary results from the India Education Girls Impact Bond, at the 2-year mark of implementation.

1. **'One Service Peterborough', UK:** The project reduced reoffending of short-sentenced offenders by 9% compared to a national control group and against the target of 7.5%. The

investors were repaid in full. The project was an example of adaptive performance management in action. The target population historically received little or no support on release from prison. The impact bond enabled the provision of a range of services that was continuously adapted to address the needs of the client group. The hypothesis was that using the impact bond model would drive improvements in outcomes, which was proven right by this case study.

2. **Educate Girls, India:** By year two the enrollment (out-of-school girls enrolled) progress is 88% of the target, with a year remaining of the intervention. Progress towards the learning target is at 50% of the overall target, this clearly being a more challenging metric to reach.

   Although overall outcomes will not be calculated until 2018, from these results UBS Optimus Foundation, the investor, will have recouped 72% of the initial investment and 54% of the expected outcome payment (initial investment plus internal rate of return).

3. **High Quality Preschool, Utah:** Out of 595 low income 3 and 4 year old children in 2013-14 school year (Cohort 1), 110 children were identified as at-risk. After the intervention, only one needed special education services in kindergarten. This was calculated to contribute to total savings of $281,550 (based on special educational add-on of $2607 per child). Investors received amount equivalent to 95% of savings.

   http://www.goldmansachs.com/what-we-do/investing-and-lending/impact-investing/case-studies/sib-slc-fact-sheet.pdf

   https://ssir.org/articles/entry/pay_for_success_is_working_in_Utah

4. **Uniting Newpin Social Benefit Bond:** The intervention has shown four years of positive results and had a 63% rate of restoration, having returned 203 children to their families over those years. This resulted into coupon payment of 16.44% of the amount invested.

   http://www.socialventures.com.au/assets/Newpin-SBB-Investor-Report-2017-web.pdf

   https://probonoaustralia.com.au/news/2017/09/australias-first-social-impact-bond-growing-stronger-year/

21. Why should the World Bank use Impact Bonds?

From the perspective of the finance sector, the World Bank has been very traditional in its financing approaches. It has had one instrument to finance SMEs for the past 70 years: line of credit through commercial banks. The expectation by the countries is that this helps generate jobs. However, most SMEs don't create job. If any do, they are usually the young ones that are not funded by commercial banks.

The SIBs and DIBs are therefore of interest and have many of the elements appreciated by the institution. They crowd in private money, bring in private sector providers (PPPs) and are outcome based. It is not a solution to all problems, but worth looking into more carefully as a more creative approach that can incubate innovative ideas, incentivize players and enable adaptive learning.

There are a lot of questions that remain to be answered, but there is a need to experiment more and take more risks to come up with more suitable models. It was suggested that the biggest breakthrough in developing financing models within the World Bank is collaboration between Global Practices such as Market and Finance, Human Development sectors, Infrastructure etc.

22. What's the Bank's experience on Impact Bonds?

The World Bank is currently involved with two impact bonds, both of which are developed by Social Finance UK. Both bonds are in final design stages, raising capital, with plans to launch next year. The structures of the bonds are outlined in Annexes 4 and 5.

1. The USD 3.6 million **Cameroon Kangaroo Mother Care (KMC)** Development Impact Bond is targeted at improving outcomes for preterm and low birth weight babies. It aims to scale up quality Kangaroo Mother Care in five regions in Cameroon and achieve better health outcomes for the babies.

Impact bond was seen as a good fit for the program because:

1. The ministry was very supportive and engaged, prioritizing Kangaroo Mother Care in their national health plan.
2. The expansion of Kangaroo Mother Care requires quality training and upgrades in infrastructure and equipment, and impact bond was able to bring together the different components that are needed.
3. KMC requires continuous monitoring and supervision even after the initial training, to maintain quality delivery, which the IB can provide by embedding KMC knowledge within the public health sector over a multi-year program.
4. Government had funding through the Global Financing Facility (GFF) managed by the World Bank, and was able to use this money to fund the impact bond. As an outcome funder, they gained a seat on the table, which further incentivized the engagement.
5. Because of GFF's involvement in the country, the government and the hospitals \were familiar with the PbF model and the potential benefits of a results-based approach, which made it easier to gain understanding and buy-in for the DIB model
6. It gave a chance to test the proof of concept and see what results it brings without a big risk to the government
7. If the results are achieved, it provides foundation to scale up across the country.

2. The USD 5 million **Development Impact Bond (DIB) in West Bank and Gaza** aims to decrease youth unemployment. It offers training, job placement & in-job training to link youth to employment opportunities.

The key difference between this approach and those currently available in the area is that it has a stronger focus on demand from the employers and attempt to identify linkages in services. The goal is to put together consortia of providers (including potential employers / the private sector) who can offer the full chain of services and linkages needed to help the youth build the sought after skills sets and transition into employment.

23. Why are all the investors so far foundations and not the private sector?

Foundations have been the first-movers in investing in DIBs, as they tend to be "social-first" investors, and are able to take on more innovative, higher risk investments. Investors with a stronger focus on financial returns would only likely come into transactions when there is a more substantive track record of DIBs achieving financial results and when deals are of larger scale. At the moment, investors in the private sector find it challenging to evaluate the performance risks of social programs, which can be significant.

24. Could impact bonds help address the issue of incentives between central and local government?

Possibly. In the UK, the Life Chances Fund was set up by the central government, though local government could bid to get impact bond development grants and top-up outcomes funding, to launch impact bonds in a select set of priority issue areas (e.g. children's services, drug and alcohol dependency etc.). In this way, central government money is being used to encourage social innovation and potentially to generate public sector cashable savings.

25. What are "fund of funds" structures to scale up performance-based financing globally on particular issues?

These are structures that enable financing across multiple performance-based financing projects. For example, UK and Portugal have both launched outcomes funds targeted at financing outcomes in particular issue areas (e.g. children's services, early years, youth unemployment etc.). These "platform" structures reduce the time and transaction costs required to raise outcomes funding for each individual transaction. They also enable learning across different performance-based financing projects, such that a wider evidence base can be built around target population needs, drivers of behavior, what interventions work for which populations, implementation challenges and ways to improve impact.

26. What has been done to attract more interest from potential investors considering that they bear most of the risk?

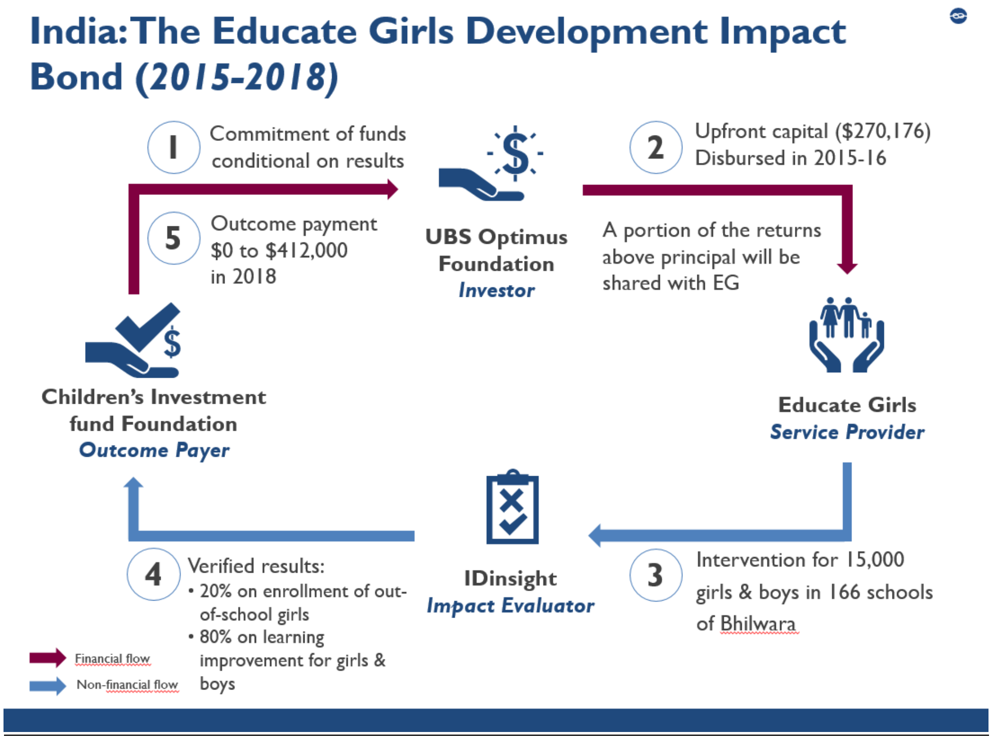
There have been many investment fora featuring DIBs, and there is an increasing level of awareness amongst "social-first" investors about the instrument. Nevertheless, for the vast majority of investors, DIBs are a very new concept. Continued sharing of data and lessons learnt from existing DIBs will be important to raise awareness and confidence among potential new investors.

ADDITIONAL RESOURCES

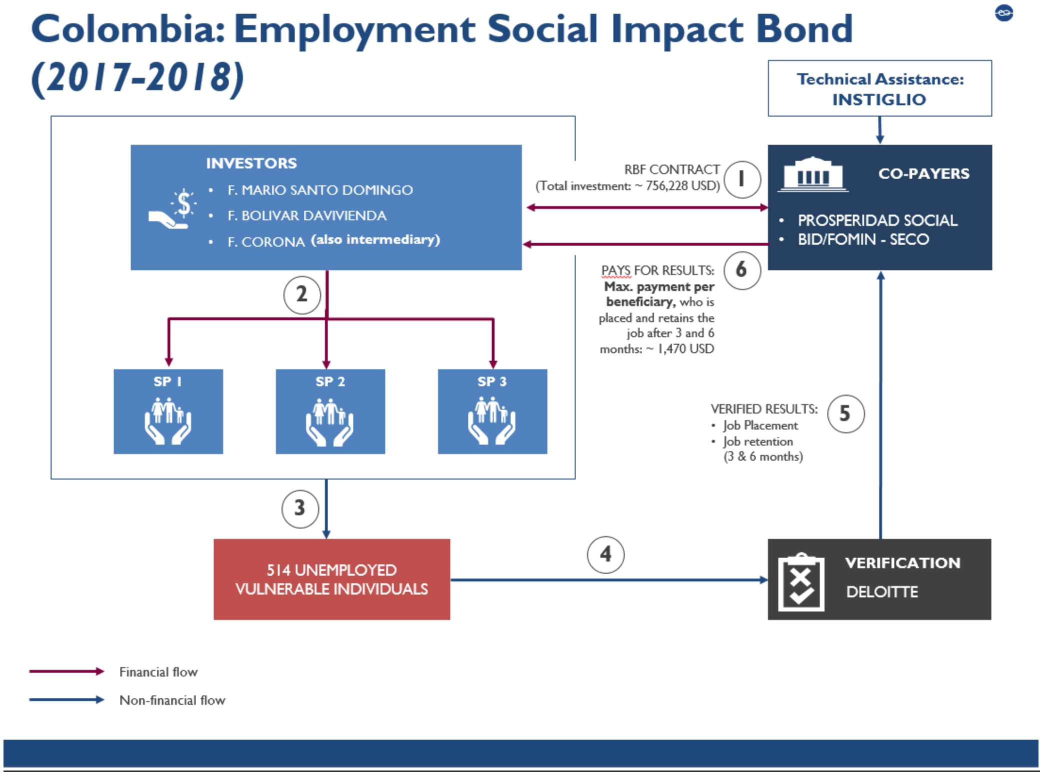
- Joint PowerPoint presentation by the panelists: http://pubdocs.worldbank.org/en/205301507728450436/Impact-Bond-Presentation-WB-Oct-2017.pdf
- Brookings impact bonds research: https://www.brookings.edu/series/impact-bonds/
- Instiglio: www.instiglio.com
- Social Finance U.K.: www.socialfinance.org.uk

ANNEXES

Annex 1



Annex 2



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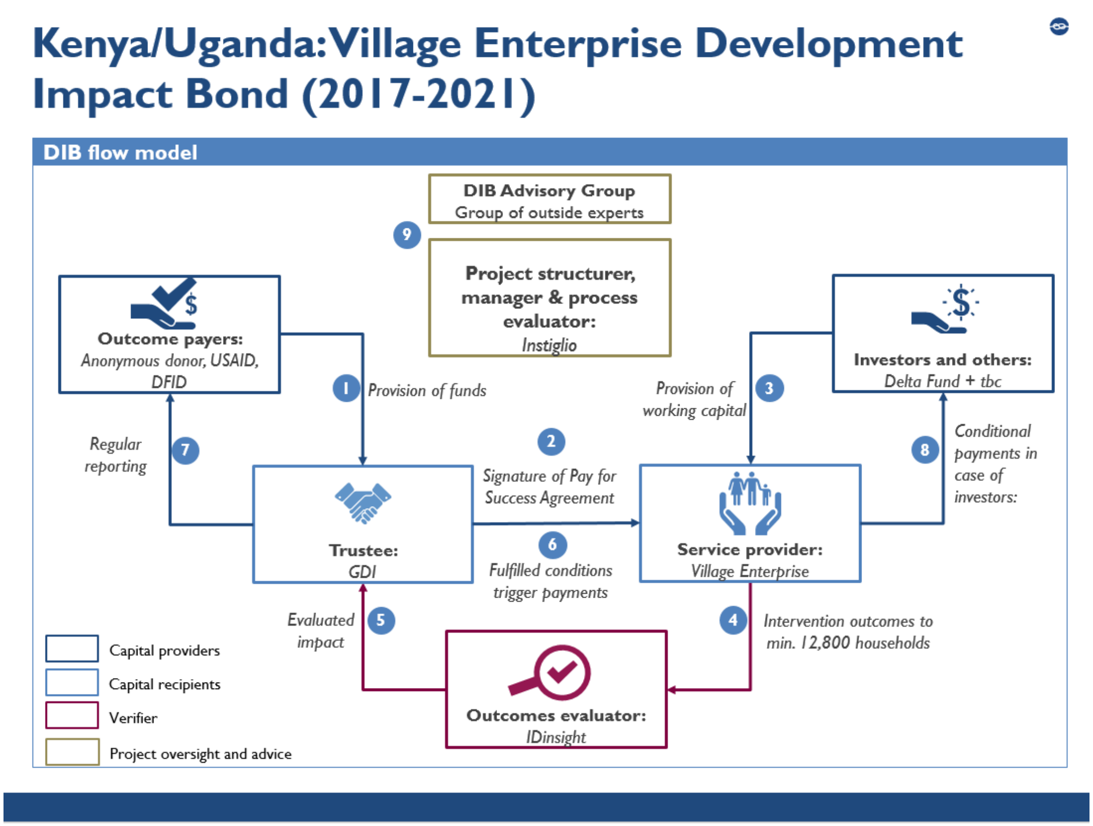
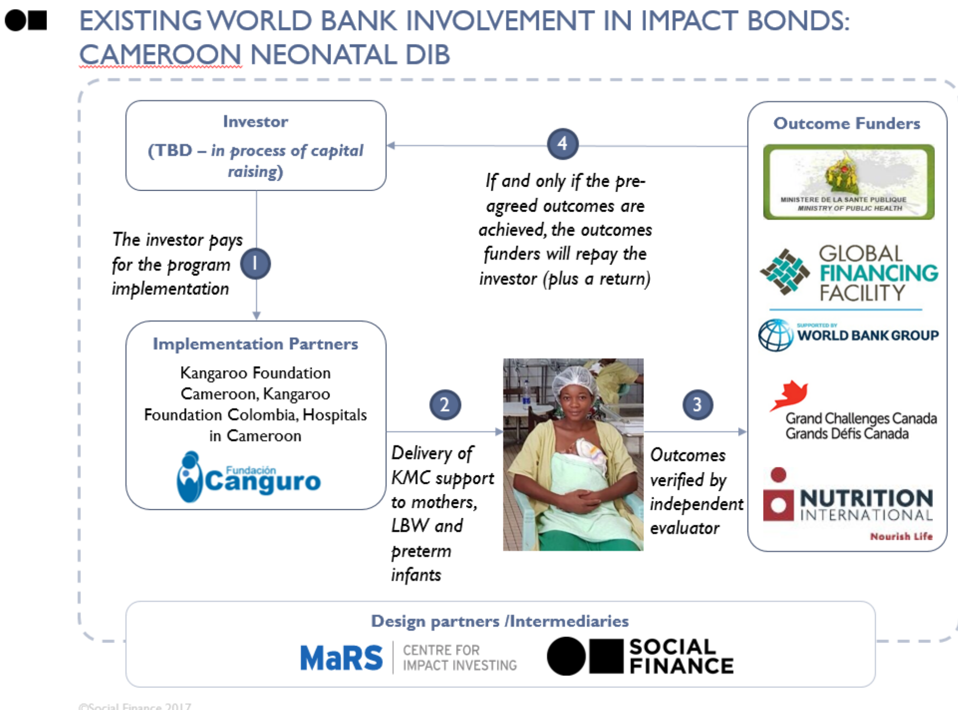


Annex 4



Annex 5