

Pay for Results in Development

A Primer for Practitioners



USAID
FROM THE AMERICAN PEOPLE





Pay for results (PfR) has shown great promise as a tool for accomplishing health and other social outcomes. Interest is growing in how it can be applied more broadly in international development. Of particular interest to USAID's Office of Private Capital and Microenterprise (PCM) and Palladium, which co-wrote and co-sponsored this document, is the ability of PfR to encourage private sector financing for investment that advances development objectives.

This primer draws on numerous sources, including the Dalberg Global Development Advisors report for USAID, entitled *Mainstreaming Results-Based Finance: Actionable Recommendations for USA*, and the recently published paper from Brookings Institution and Convergence, *Impact Bonds in Developing Countries: Early Learnings from the Field*.

Principal drafters of this report are Lawrence Camp of USAID/PCM and Amanda Fernandez of Palladium. We appreciate the insights and contributions we received from the many reviewers and contributors to this primer, including Dr. Amit Bhanot, Amanda Grevey, and Peter Vanderwal of Palladium; Tom Flahive of Crossboundary; Kanini Mutooni and Robin Young of DAI; Paula Feeney of Cardno; and Joe Wilson and Grace Hoerner of USAID.

—Lawrence Camp, USAID, Office of Private Capital and Microenterprise, lcamp@usaid.gov

—Amanda Fernandez, Palladium International LLC, amanda.fernandez@thepalladiumgroup.com

Contents

I. Executive Summary	2
II. What Is Pay for Results?	3
III. The Suite of Pay-for-Results Applications.....	5
Performance-Based Contracts.....	5
Prizes.....	12
Development Impact Bonds/ Social Impact Bonds.....	20
Advance Market Commitments	27
Conditional Cash Transfers.....	33
IV. Pay for Results Pros and Cons.....	39
V. Using Pay for Results to Catalyze Investment	41
VI. Scaling Up Pay for Results – An Agenda for Action	47
VII. Conclusions	48

I. Executive Summary

Interest in using pay-for-results (PfR) strategies in development has risen sharply in recent years, in line with growing attention to aid effectiveness and the need to use scarce funding resources more efficiently. PfR is seen as a disruptor, providing an alternative to the traditional cost reimbursement service procurement model. Per a recent study commissioned by USAID, PfR development initiatives are already substantial, with total investment estimated at \$3.3 billion in 2016, and strong growth projections of 15–20% per year, reaching \$6–7 billion by 2020¹.

Supporters of PfR programs believe that PfR:

- Encourages innovation in development
- Attracts new funding sources (including from the private sector)
- Facilitates alignment of interests among funders and implementers—toward achieving development outcomes rather than inputs
- Fosters evidence-based development

But PfR is not without its challenges, and (for most of its applications) is not a fully proven development model. There are only a few studies on the effectiveness of PfR in achieving better development outcomes, and the quality of those studies is mixed.

Critics of PfR express concern about:

- Unintended consequences such as gaming, distortion, and “teaching to the test”
- High upfront project design effort and ongoing monitoring and verification costs
- Increased performance risk along with upfront cash needs that may limit the appetite of service providers for PfR projects and potentially limit innovation by crowding out smaller actors
- Challenges in setting proper performance metrics and pricing appropriately for them
- Disincentives for service providers to share learning with other providers

This primer is intended to provide development practitioners (donors, development finance institutions, and service providers) with a basic understanding of what PfR is and its most common applications, along with the positives and negatives of the approach. It introduces the ways PfR is being used to mobilize financing, and suggests key issues and challenges that must be addressed to bring use of PfR in development up to scale.

¹ Mainstreaming Results-Based Finance: Actionable Recommendations for USAID, May 2016, Dalberg Consulting USA

II. What Is Pay for Results?

“Pay for results” (or performance/success/outcomes) is an umbrella term for initiatives that pay upon accomplishment of results rather than efforts to accomplish those results. In PforR, the principal or funder sets financial or other incentives for an entity (or individual in the case of cash transfers) to deliver predefined outcomes, and rewards achievement of the results upon verification. While PforR is not a new idea (and is commonly used in the private sector), there is growing interest in applying it to accomplish development outcomes. Donors must provide evidence that funds expended on development achieve results and are encouraged to “do more with less.” In the developing world, governments increasingly must justify allocation of their funds to development and social programs. PforR has gained importance over the last decade in the context of aid effectiveness agendas emerging from the Paris Declaration on Aid Effectiveness in 2005, the Accra Agenda for Action in 2008, and later forums on aid effectiveness (e.g., Busan in 2011).

Those efforts have contributed to the U.K. Department for International Development’s (DFID) recent incorporation of payment-by-results (PbR) extensively across its programming. SIDA (Swedish International Development Agency) is currently exploring results-based financing (RBF). USAID has been steadily increasing its use of PforR in its contracts in recent years, requiring implementers to invoice larger percentages of their costs and fees against outcomes rather than efforts. The World Bank has been using PforR in its health and transportation improvement programs for decades, and has been steadily scaling up use of related tools (e.g., the Program for Results (PforR) financing instrument released in 2012), investing an estimated \$13 billion in PforR programs by 2015.

There are many different iterations of PforR, motivating both the supply and demand sides of given markets, but most fall into five categories:

- **PERFORMANCE-BASED CONTRACTS (PBCS):** Contracts or grant agreements where payments are disbursed upon accomplishment of predetermined results. These arrangements are principally between funders and implementers/service providers; however, they can also be between funders and recipient governments, which then subcontract service provision (e.g., the Millennium Challenge Corporation’s approach, the World Bank’s PforR approach, and Center for Global Development’s proposed Cash on Delivery Aid² approach).
- **PRIZES:** An arrangement where prizes (financial rewards) are awarded, usually through an open and competitive process, to one or more competitors that are successful at accomplishing a pre-specified desired result (which could be a fresh approach to a development challenge).
- **SOCIAL IMPACT BONDS (SIBS) / DEVELOPMENT IMPACT BONDS (DIBS):** Arrangements where private investors provide upfront capital for social services, and then are repaid with a success premium if successful by an outcome funder upon achievement of results by the implementer/service provider. A SIB involves a government entity as the outcome funder; a DIB is the application in a developing country context with a third party paying for the outcomes.

² An Introduction to Cash on Delivery Aid for Funders, February 2014, Center for Global Development

- **ADVANCE MARKET COMMITMENTS (AMCS):** Agreements to guarantee a price or market for a product upon its successful development, as a way to mitigate uncertainty in building products/markets (initially used to encourage vaccine production).
- **CONDITIONAL CASH TRANSFERS (CCTS) / SOCIAL PAYMENTS:** Arrangements whereby cash payments are made directly to needy households to stimulate investment in human capital upon meeting pre-determined conditions (e.g., ensuring periodic health checks or school attendance).

In some of the above approaches (such as most prizes), payment is only made to entities when performance metrics are achieved, placing 100% of the performance risk on the implementer. More commonly, funders and implementers share project cost and performance risk, with the performance payment more akin to an incentive payment (for USAID, a performance award fee).

III. The Suite of Pay-for-Results Applications



Performance-Based Contracts

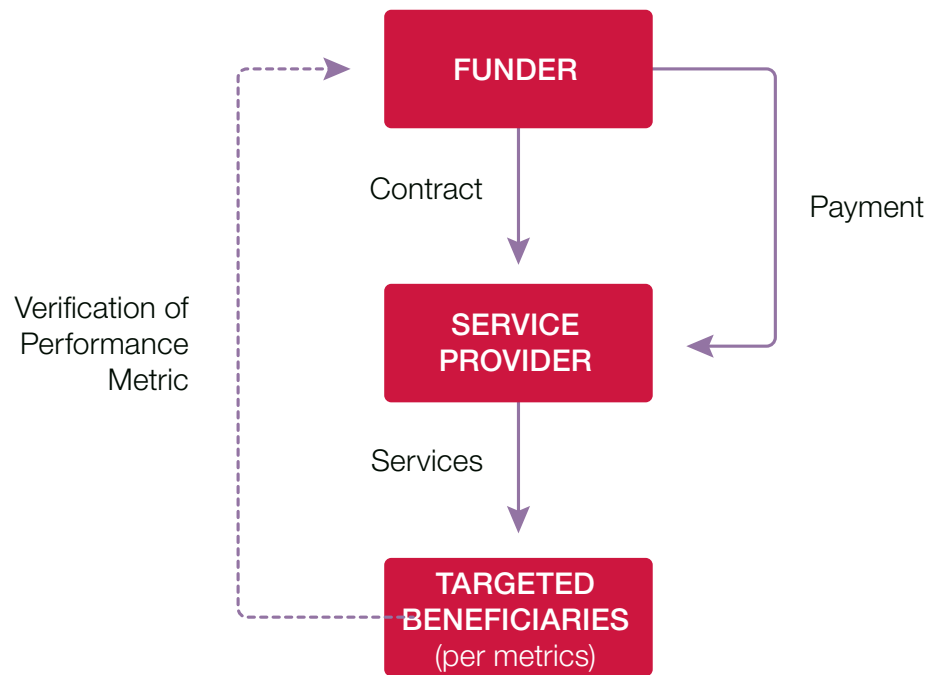
- Performance-based agreements/contracts can be structured as either with both grants and/or contracts; both fall under the umbrella term of PBCs.
- Most commonly used form of PFR, with funding payments explicitly linked to a service provider / implementer achieving outcomes or outputs, rather than for inputs or “best efforts” in achieving the outcomes.
- Few PBC contracts or grants are “pure,” meaning 100% of a contract is structured as a PBC. Most are hybrids where implementers are paid part of their contracts on a unit or input basis, while the remainder of payments are linked to successful performance relative to target outcomes.
- Funders and implementers agree on pre-determined outcome metrics and verification methods, with the implementer given latitude on how it will accomplish the metrics (which could include the implementer making PBC sub-awards).

Coaching services to reduce extreme poverty in Burkina Faso

To address extreme poverty in Burkina Faso (families living on less than \$1.25/day), in 2015 the Trickle Up Foundation created a coaching program. To administer the program on a results-based basis, Trickle Up entered into PBCs with three NGOs (l'Association Monde Rural (AMR), L'Alliance Internationale pour le Développement et la Solidarité en Afrique (AIDAS), and Aid Aux Enfants (ADEFAD). These actors implemented coaching services to help target families find secure paths out of poverty. The PBCs used were structured by Instiglio, and payments were made upon successful performance against economic stability outcomes among families, including levels of savings and confidence.

PBC Structure and Implementation Steps

Example 1: Traditional PCB



Step 1

Design program. Define outcomes and timelines, and set performance pricing.

Step 2

Compete award. Select service provider(s) and finalize contract(s) and payment conditions.

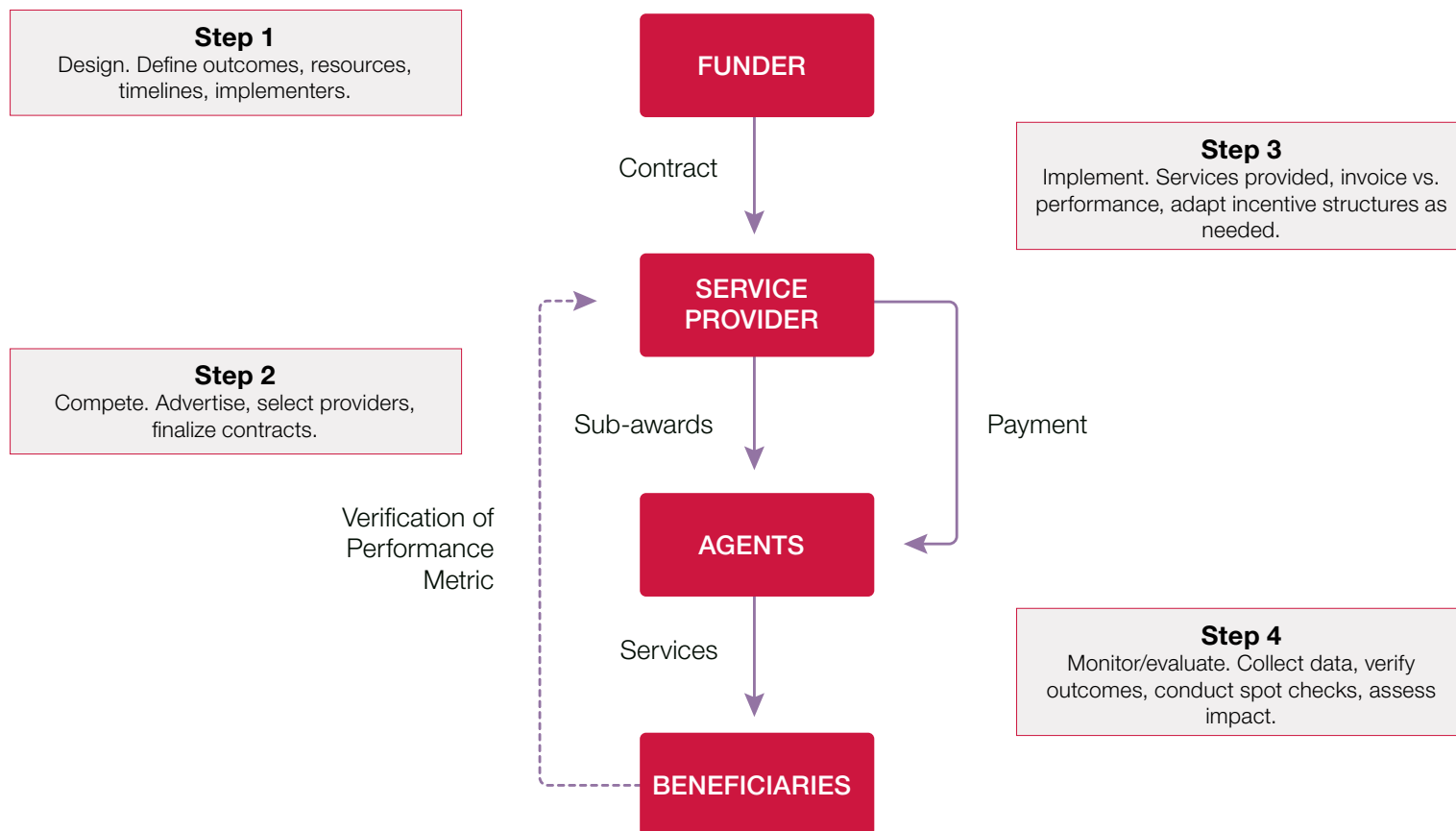
Step 3

Implement. Services provided, invoice vs. performance, adapt services as needed.

Step 4

Monitor/evaluate. Collect data, verify outcomes, assess impact.

Example 2: Hybrid PBC Structure



History

Pioneered in the private sector, PBCs have been used for decades by development finance institutions, governments, donors, and foundations across a diverse set of countries and social and economic sectors. PBCs have improved road maintenance, health services, and job creation, among other things. The World Bank was an early pioneer in use of this methodology, USAID has been increasing its use in recent years, and the Millennium Challenge Corporation based its business model on the concept. A growing research base exists on the application of PBCs in the health sector to improve cost savings, results, and efficiency gains³.

“Switching from traditional funding modalities to results-based approaches only makes sense if [these] are more efficient than other aid modalities.”

— Amanda Melina Grittner, Policy Analyst, McGill University

When Are PBCs Appropriate?

PBCs are most appropriate when:

- Targeted outputs and outcomes are well defined, measurable, and plausible to accomplish
- Service providers have experience delivering desired outcomes and have interest in finding new efficiencies
- Data sources and monitoring systems exist to track and validate outcomes
- Donors/funders are comfortable giving service providers room to innovate to achieve outcomes
- Cost of achieving outcomes can be fairly priced

³ See Soeters, Musando and Meesen's 2005 study for the World Bank, Rwanda Ministry of Health and the Global Partnership on Output-Based Aid (CPOBA), Comparison of two output based schemes in Butare and Cyangugu provinces with two control provinces in Rwanda; and Grittner's 2013 study, Results-based financing: evidence from performance-based financing in the health sector, for the German Development Institute.

Challenges

- Defining performance specifications and agreeing on verification methods
- Designing the incentive payment amount and structure to avoid overpayment or perverse incentives (e.g., reduced service quality, fraud, ignoring unrewarded activities, encouraging demand for unnecessary services, undermining sustainability)
- Getting all parties to embrace outcome-based service delivery
- Proving the effectiveness of PBCs without using counterfactuals

Additional Resources

Grittner, Amanda Melina, *Results-based financing: evidence from performance-based financing in the health sector*. German Development Institute, 2013.

Soeters R., L. Musango, B. Meessen (2005): *Comparison of two output-based schemes in Butare and Cyangugu provinces with two control provinces in Kigali, Rwanda*. Global Partnership on Output-Based Aid (GPOBA), World Bank, Ministry of Health of Rwanda.

Introduction to performance-based contracting. World Bank, 2006.

Improved Family Planning and Reproductive Services Project (UJJWAL)

Challenge/solution

In response to two Indian states' high, unmet needs for family planning, DFID designed UJJWAL and awarded it to Futures Group Europe (now Palladium), which it managed with consortium partners Hindustan Latex Family Planning Promotion Trust, Public Health Foundation of India, Johns Hopkins University (JHU CCP) and impact evaluation partner Oxford Policy Management in Bihar and Odisha states. UJJWAL was a 3-year (January 2013 – March 2016), £16 million project, the first 100% PforR program that Palladium implemented.

How does it work?

Seventy payment milestones were structured over a 36-month period to encourage health-related outcomes, including:

- Setting up a network of 280 social franchisee clinics for quality, clinical family planning and reproductive health (FP/RH) services in rural and underserved areas
- Increasing access to family planning products through 18,000 social marketing outlets, with a focus on rural and underserved areas
- Building capacities of private sector health providers, including training and mentoring support
- Generating demand, overcoming barriers to family planning uptake, and addressing gender norms through communication and community outreach
- Monitoring and evaluation for better implementation

Invoicing for each milestone payment required Palladium to develop a technical report to prove the outcomes achieved using verifiable data, and then submitting this to DFID and a third-party assessor (Sambodhi) that reported periodically to the client on deliverable satisfaction through sample surveys and interviews on the ground.

Results

- Generated 3.58 million years of protection for couples (Couple Years Protection (CYPs))
- Reached more than 1.5 million additional family planning users (twice the 2016 target of 780,000)
- Supported spacing methods contributing to 47% of CYPs
- 306 UJJWAL franchisee clinics were created; 100 are accredited
- UJJWAL clinics offered paid and free services, expanded services (including maternity, newborn, and child health services), and differentiated prices
- Business plans developed to attract new capital to improve service quality
- Initiated design of a DIB to make social franchising sustainable; Palladium's DIB structuring effort for improving maternal and newborn health in Rajasthan is, in effect, a follow-on effort for this project

LEARN MORE:

Dr. Amit Bhanot, Senior Regional Advisor, Palladium
amit.bhanot@thepalladiumgroup.com

Guyana Agricultural Diversification Program (GADP)

Challenge/solution

CARANA (now Palladium) managed the USAID Guyana Trade and Investment Support project (GTIS) for USAID from 2005–2012, which provided “proof of concept” that groups of producers could rapidly scale up production and increase investment to achieve commercial scale in agricultural development. USAID announced its cessation of activities in Guyana following completion of this project. However, DFID Guyana and DFID Regional staff (with British High Commission support), agreed to fund a follow-on agriculture diversification program in Guyana, building on GTIS’s success.

The £1.3 million GADP began in February 2013 with the overall goal of increasing economic growth and rural incomes, and reducing poverty. The program was designed to increase export of non-traditional agriculture to markets in the Caribbean, Europe, and the United States, while facilitating

commercial sustainability of Guyana’s agriculture sector.

How does it work?

GADP was structured as a rapid start-up PBC with payments made against specific deliverables over the life of the contract, mainly related to CARANA’s progress on achieving acres under production using modern agricultural or aquacultural techniques and complying with Global Gap Standards. The PBC required a cumulative total of 300 acres under production by 2015.

The donor and implementer discussed at length which metrics would be used to measure acres under production. Ultimately, DFID used “acres cleared” as the indicator, and asked CARANA to hire a third-party actor to verify progress against this.

Of the 15 milestone payments, 11 were linked to increasing acres under production, 3 were related to improving the export environment (e.g.,

regulatory changes, reduction in paperwork and time to export) and 1 was related to completing start-up activities (e.g., establishing an office, setting up an investment platform, developing a work plan).

Results

CARANA completed all the deliverables set forth in the deliverable and payment schedule, made possible by the positive response from farmers who were eager to join the program. Unfortunately, GADP was terminated early (May 2014) for external reasons. CARANA transitioned project activities to a Guyana-based company with multiple shareholders called CARANA Agriculture Development Partnerships, which continues to operate two commercially viable export businesses, a pepper farm and a fish farm.

LEARN MORE:

Eduardo Tugendhat, Director, Thought Leadership,
Palladium
Eduardo.tugendhat@thepalladiumgroup.com



Prizes

- Contests designed to incentivize fresh approaches or other needed action in response to development challenges
- A way to raise awareness of difficult development challenges, while engaging a larger universe of problem solvers and market actors (including non-traditional partners) around a given problem
- Prize competitions mobilize a range of participants to try to achieve a desired result and select winners based on assessment of evidence of their achievements, rather than pre-selecting a single implementer
- An effective way to complement traditional grant programs by addressing some of their limitations
- Designing successful prizes is complicated

Prizes Structure and Implementation Steps

The funder (usually a donor or foundation) highlights a development challenge and announces an award for solving

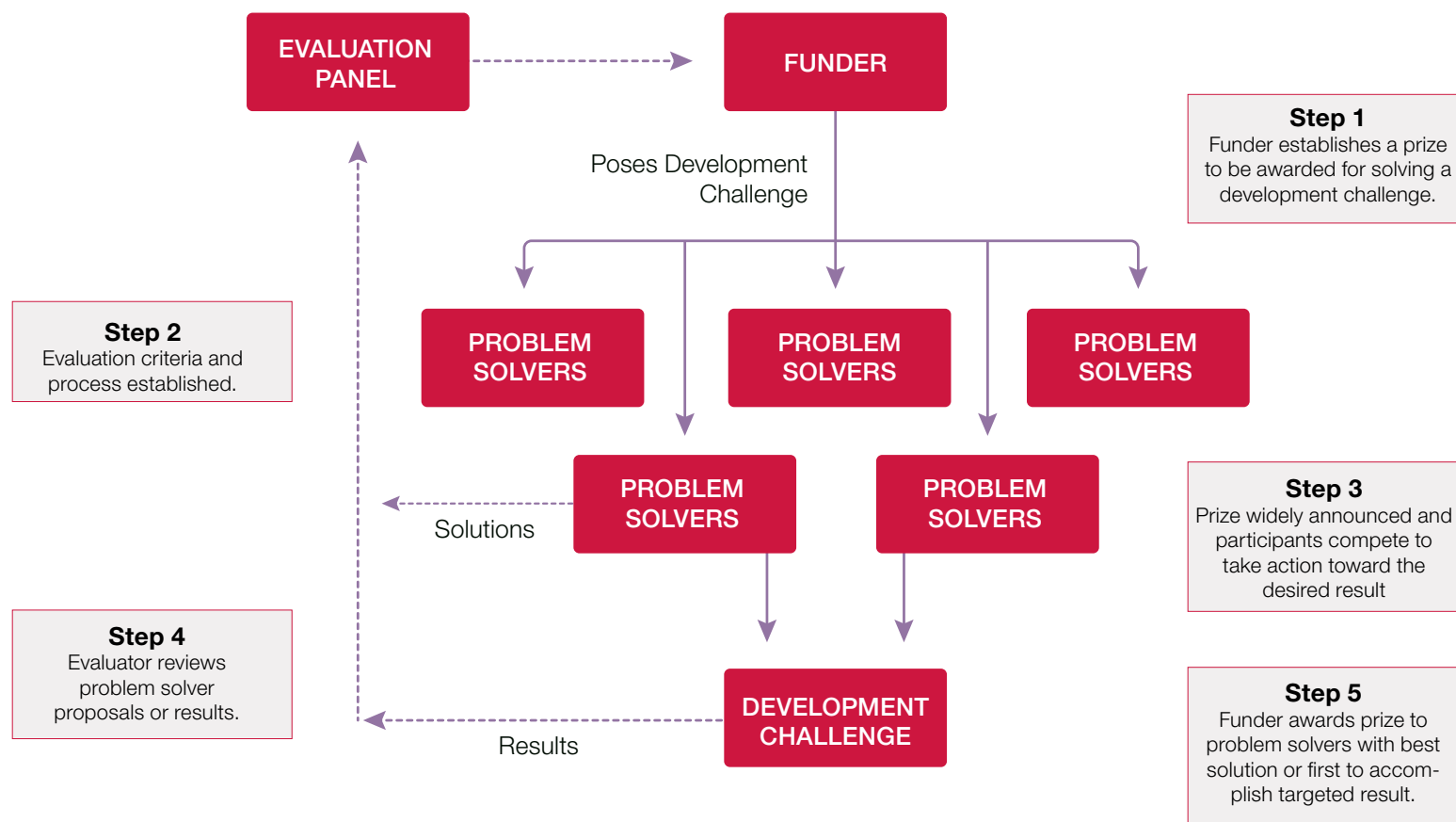
Haiti Mobile Money Initiative (HMMI)

Following the 2010 earthquake in Haiti, the financial infrastructure was decimated and the country needed a new financial services provision model. USAID and the Bill and Melinda Gates Foundation saw in this crisis an opportunity to stimulate a shift in the delivery model via digital financial services. Accordingly, they jointly raised funds and launched HMMI, which offered a \$10 million prize fund rewarding:

- The first two companies to offer a viable mobile money service
- All companies helping to scale up utilization of mobile money

By October 2011, two prizes totaling \$4 million were awarded to two telecom providers that had launched mobile money applications and reached the milestone of 100,000 transactions via this platform. One year later, a mobile money provider received another prize for achieving the milestone of 5 million transactions.

Example 3: Prizes Structure



it or achieving a certain result. The funder establishes evaluation criteria and the award process, and launches the prize competition. An array of problem solvers compete to develop promising solutions and/or attempt to achieve the desired result, and evaluators track progress. The award is made based on an assessment of which participant best or first achieved the pre-specified result.

History

The U.S. National Aeronautics and Space Administration (NASA) has been successfully crowdsourcing solutions and offering prize purses to innovators for decades. The use of prizes across the U.S. federal government increased rapidly following the passage of the America COMPETES Reauthorization Act of 2010, which greatly expanded the authority of government agencies to conduct prize competitions. More recently, USAID was granted new, innovation incentive award authority, enabling the agency make prize awards to non-US citizens on a limited basis.

When Are Prizes Appropriate?

Prize competitions are appropriate and can be most successful in the international development context when:

- They are designed to address specific problems that have no single, widely accepted solution
- The pool of existing solvers is too small, and designers want to expand the number of minds tackling a problem (as well as to bring out-of-discipline perspectives to bear).
- Clear and measurable outcomes against which to make awards can be defined in advance, and can be shared and compared across participants.
- Prize funds are significant enough to attract capable problem solvers.
- Market forces are insufficient to incentivize needed action in the absence of a prize competition.
- There are no disadvantages to mobilizing multiple courses of action and attempts to solve a problem simultaneously.
- They are structured not as endpoints but rather as an element within a broader program focused on solving the challenge and scaling the solution
- There is a clear plan for how to sustain results after the prize or connect efforts to a broader program.

Challenges

- On the designer side:
 - Only a few winners with the time and resources to take the needed action to achieve results ultimately receive funding; other problem solvers with great ideas (but without deep pockets to fund their participation in the competition) may be excluded
 - Defining the proper metrics for measuring success upon which prizes are awarded, and ensuring fairness in the evaluation process
 - Finding capable participants that can rise to the challenge and communicating the opportunity to them (often need non-traditional channels)
 - Determining cost-effective testing or assessment procedures to determine winner/s and finding qualified judges in the subject area
- On the applicant side:
 - Funding rewards are often small, and often out of proportion with the risk of participating
 - Chances of winning are low and difficult to calculate, so cost/benefit of applying is unknown
 - Feedback on losing applications can be minimal, so often not a learning opportunity
 - Attendant publicity of winning often does not lead to “bigger things.”



Additional Resources

How Foundations and NonProfits Are Using Prize Challenges to Achieve Their Missions: www.innocentive.com/files/node/casestudy/whitepaper-how-foundations-and-non-profits-are-using-prize-challenges-achieve-their-missions.pdf

McKinsey & Company, *And the Winner Is...Capturing the Promise of Philanthropic Prizes*, 2009.

Knight Foundation, *Why Contests Improve Philanthropy*, 2016.

Nesta, *Challenge Prizes: A Practice Guide*, 2014.

USAID Desal Prize

The Desal Prize was managed by USAID as part of the Securing Water for Food Grand Challenge for Development in partnership with the U.S. Bureau of Reclamation. This prize incentivized the development of small-scale d technology for brackish water (i.e., salt and fresh water mixed together). The \$1.5 million program set specific performance benchmarks as part of the competition, such as the ability to produce a certain quantity of water at a specific quality level within 24 hours, running solely on renewable energy.

Five semi-finalist teams competed in field tests in the desert of Alamogordo, New Mexico. Two teams, each with drastically different approaches, met the required performance outcomes and were awarded prizes of \$240,000 for first place and \$140,000 for second place. Both teams then engaged in follow-up piloting of their technologies in developing countries.

MIT and Jain Irrigation Systems (a university - industry partnership) designed a photovoltaic-powered electrodialysis reversal (EDR) system that desalinates

water. This system uses electricity to pull charged particles out of the water and further disinfect it by using ultraviolet rays. The system was designed for low energy consumption, limiting costs especially in off-grid areas. The runner-up team was from the University of Texas at El Paso. This team designed a zero discharge desalination (ZDD) technology that reduces water waste in the desalination process.

LEARN MORE:

www.youtube.com/watch?v=LrBFRFszSJ4

AgResults Zambia Biofortified Maize Prize

AgResults is a \$118 million collaborative initiative between DFID, the Department of Foreign Affairs and Trade (DFAT) of Australia, Global Affairs Canada, USAID, and the Gates Foundation, to use pay for results to incentivize the scaling of high impact agricultural innovations. AgResults uses prizes to incentivize the private sector to enter markets they would usually deem unattractive, by reducing the barriers to entry.

One AgResults pilot is the Zambia Biofortified Maize prize, which aims to build a market for pro-Vitamin A (PVA) maize meal. In Zambia, vitamin A deficiency rates can be as high as 31% in children and 21% in women, and can cause blindness, disease, and death. The objective of this prize was to enable widespread consumption of biofortified PVA maize by incentivizing millers to produce PVA maize meal. A \$2.2 million prize purse was offered to millers who met sales thresholds for

maize meal. Millers can be conservative in new product design, as consumer demand is often unclear. Competing for this prize helped de-risk Millers' entry into a new market segment, and encouraged them to start milling PVA maize, while validating consumer demand.

LEARN MORE:

[http://agresults.org/en/307/
ZambiaBiofortifiedMaizePilot](http://agresults.org/en/307/ZambiaBiofortifiedMaizePilot)

NASA's Power Beaming Centennial Challenge

NASA has been crowdsourcing solutions via challenges and prizes for decades to expand the number of minds tackling the many challenges inherent in space travel. In the early 2000s, NASA sought new ideas to beam power via wireless transmission. To find advanced technology

and new solutions to this challenge, NASA established the Technology Development and Demonstration Prize with \$2 million in potential prize money. The competition was open for 4 years (2005–2009) and 12 teams competed. The outcome sought was to speed up the time at which wireless

energy climbed. The winner, LaserMotive, accomplished this at 3.9 meters per second, and won \$900,000. LaserMotive continues to advance this technology

LEARN MORE:
www.nasa.gov/solve

Scientists Without Borders Prize to Encourage Folic Acid Use in Staple Foods

Challenge/solution

Infant and maternal mortality is a persistent problem in the developing world, and undernutrition causes many needless deaths every year. While thousands of actors are managing donor-funded grants to address this problem, in 2010 Scientists Without Borders sought a new breakthrough in solutions and designed a competition to reduce infant mortality by fortifying staple foods with folic acid.

How does it work?

The group marketed the prize via its web-based platform and international network of partners, and joined with InnoCentive (a leader in open innovation) to administer the award.

Results

64 applications were submitted from 21 countries in response to the competition,

and 3 winners from the U.S., India, and New Zealand shared the \$10,000 prize money (sponsored by PepsiCo) and published their winning ideas to inspire other implementers to scale their ideas.

LEARN MORE:
www.nyas.org/press-releases/scientists-without-borders-challenge-offers-10-000-for-solutions-to-combat-a-critical-consequence-of-malnutrition/
www.nyas.org/programs/scientists-without-borders/



Development Impact Bonds/ Social Impact Bonds

- Leverage private sector investors to provide upfront financing, shifting the risk in implementation to achieve social development outcomes
- Involve four key actors: investor, outcome sponsor, project implementers, independent verifiers
- Upfront financing of development implementation is replaced by implementers usually on PfR contracts backed by private capital
- Desired outcomes to be achieved are jointly agreed by the parties involved and verified by external agents, triggering success payments to implementers and repayment of principal to investors via outcome sponsors, sometimes with interest
- Complicated to structure, particularly in agreement of payment metrics and timing—cost/benefit still in question

Educate Girls DIB

Educate Girls, an Indian NGO, was instrumental in designing a DIB with the goal to improve education for 18,000 children (including 9,000 girls) in 166 schools in 140 villages in Rajasthan. The investor is the UBS Optimus Foundation, which invested in Educate Girls (service provider) to increase enrollment, literacy, and numeracy among the target population. The Children's Investment Fund Foundation (CIFF) (outcome funder) will repay the investor its principal plus 15% interest upon achievement of agreed outcomes by Educate Girls. Instiglio plays a performance monitor role for the DIB, and IDinsight is the independent verification agency. The DIB will run 3 years (2015–2018). According to Instiglio, the DIB is on track in terms of results: By the end of its second year, Educate Girls had achieved 87.7% of its 3-year enrollment targets and 50.3% of its learning targets.

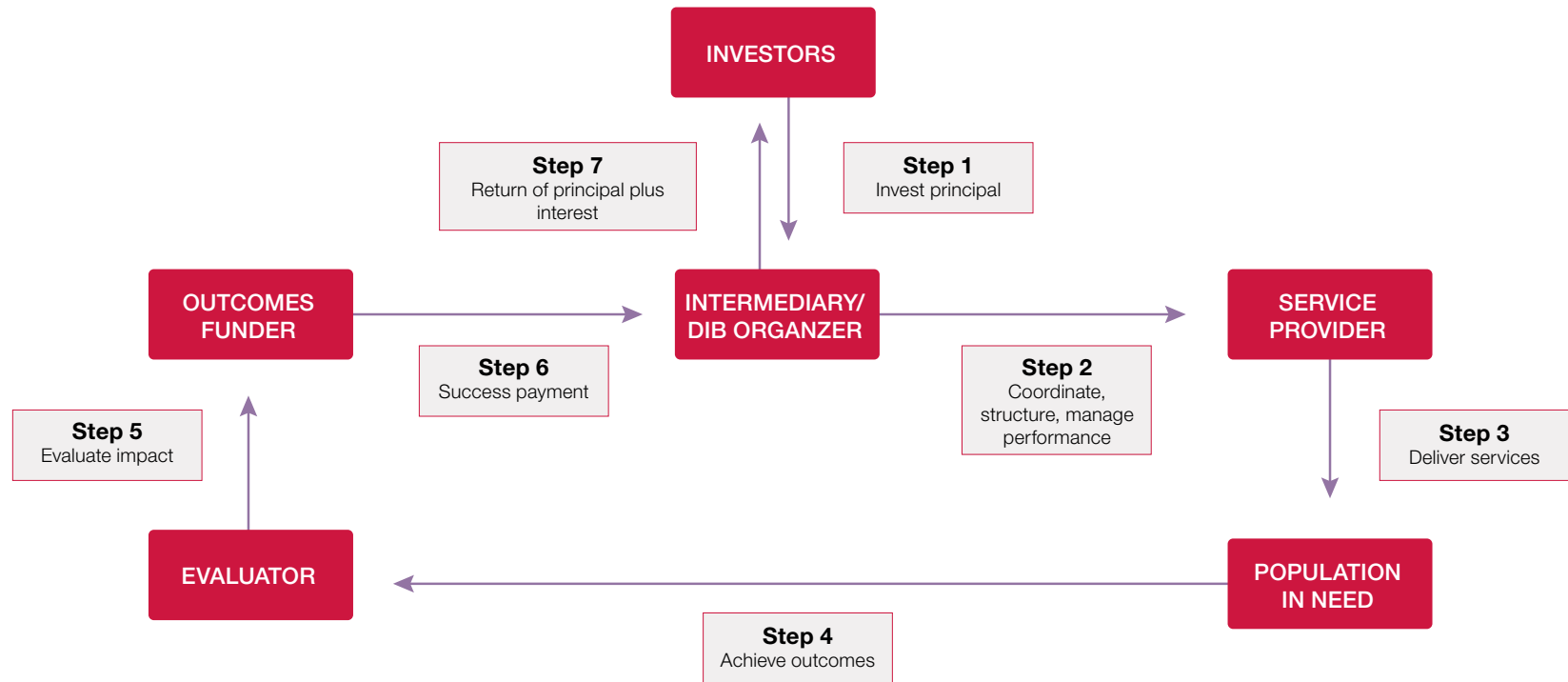
DIB Structure and Implementation Steps

A development challenge is identified and the value of addressing the issue is agreed. While there are several approaches to building the coalition of actors, often a public sector or foundation outcomes funder engages with investors with the desire to invest principal in a solution through an intermediary that also has the knowledge and relationship with high-quality service providers with demonstrated capacity in tackling the development challenge. Together these actors structure the DIB. The DIB organizer, usually the intermediary, engages appropriate providers to deliver the services needed to meet the challenge. An agency validates the results of the services and reports them to the outcomes funder, which makes success payments to the DIB organizer. The investor is then compensated based on that performance, with the potential to generate a real return on the investment.

“ The DIB has brought about a shift in our organization’s DNA and had a positive ripple effect across our entire organization. The razor-sharp focus on outcomes and the flexibility in program delivery that comes with a payment -for-results contract has enabled us to deliver improved outcomes.”

— Safeena Husain, Executive Director, Educate Girls

Example 4: DIB Structure



History

In the finance world, governments or corporations can issue debt (bonds) that is repaid over a set period at specified interest rates (also called the “coupon” rate), and that can be traded. SIBs/DIBs are not bonds in this traditional sense (there is no trading of this debt), but they are a variation, and have the potential to generate real returns to investors based on project performance. SIBs are used in developed economies when outcome funders are typically government entities. DIBs operate in low and middle-income countries, where donors or foundations are likely involved as outcome funders.

DIBs, sometimes known as pay-for-success or payment-by-results financing, are a relatively new concept. The first SIB was implemented in the United Kingdom in 2010 to reduce prison recidivism. As of August 2017, there are 88 DIBs in the world, only 3 of which are in the developing world. Given the challenges inherent in DIB design, including pulling together private sector investors, governments, and the implementation community under one concept; agreeing on a set of outcomes; and most importantly agreeing on a unified contractual structure, most DIBs remain in the design stage. Only three DIBs have been fully contracted, including Educate Girls in India and a DIB to encourage improved cocoa and coffee production among indigenous communities in Peru. Twenty-eight other DIBs are in the design stages in developing countries.⁴

Despite the challenges, DIBs have already generated significant interest among investors and donors, leveraging over \$200 million in upfront private capital for social services worldwide since the inception of the model. The growth prospects for DIBs are high—by 2020 the DIB market is expected to triple.

⁴ Impact Bonds in Developing Countries: Early Learnings from the Field. Brookings Institution and Convergence, September 2017.

“ A huge amount has been achieved by a relatively small group of pioneers taking the initiative to build the start of an evidence base of what works and what doesn’t. Now, in order to fully realize the transformative potential of these [DIB] structures, governments and donor agencies need to commit to working through both the philosophical objection to the involvement of profit within the social sectors, as well as the bureaucratic and procedural barriers, particularly with regards to procurement and contracting of outcomes.”

— Peter Vanderwal, Head of Innovative Impact Financing, Palladium

When Are DIBs Appropriate?

- Results-based financing will improve efficiency and effectiveness of service delivery, and when other PFR interventions are unlikely to achieve the desired outcomes
- Evidence exists of appropriate interventions that will achieve the desired outcomes
- Service providers exist that are capable of delivering the outcomes
- Procurement and payment mechanisms exist to support a DIB
- Data are available to appropriately measure outcomes achieved
- Time is not a consideration; DIBs take time to structure

Challenges

- Complex, challenging, and expensive to structure; most DIBs initiated years ago are still in the feasibility or structuring stage
- Emerging enabling environment; actors are structuring DIBs as donors and outcome funders are simultaneously building the architecture to support the operations and contracting of them; work-around solutions in the interim can complicate DIB design
- Finding service providers that are not just performance-oriented, but with capacity to implement the desired activities
- Limited capacity in designing, implementing, and evaluating DIBs
- Require funders and providers to embrace a new way of doing business (e.g., more hands-off, more performance-oriented)

Additional Resources

Brookings Institution and Convergence, *Impact Bonds in Developing Countries: Early Learnings from the Field*. September 2017.

Center for Global Development, *Investing in Social Outcomes: Development Impact Bonds*, 2013.

Instiglio, *A Legal Road Map for Social Impact Bonds in Developing Countries*, November 2014.

Improving Maternal and Newborn Health Outcomes (India)

Challenge/solution

Rajasthan, a large state in northern India, has some of the world's most persistent maternal health problems. Health service infrastructure has improved markedly over the past few decades in India, and availability of maternal health services in rural areas has increased with high levels of facilities-based births. Despite this, maternal and newborn mortality rates remain very high.

The Rajasthan Maternal and Newborn Health Impact Bond is designed to address this challenge by working with private facilities to improve the quality of maternity services throughout the state.

How does it work?

The design of this DIB has evolved over 2 years, and the latest outcomes sought are focused on reducing the incidence of maternal mortality and infant deaths. The major investors in this 3-year, \$9 million opportunity will be the clients of the largest wealth manager in the world, Swiss bank UBS, through the UBS Optimus Foundation. Service providers are Population Services International (PSI) and the Hindustan Latex Family Planning Promotion Trust (HLFPPT). Initial outcome funders—the function of which will later be transferred to the Government of Rajasthan in a strategic decision to institutionalize this new mechanism within the Indian Government—are USAID and U.S. pharmaceutical giant Merck, through the 10-year, \$500 million commitment to saving mothers lives, Merck for Mothers.

Palladium designed the DIB and serves as the implementation manager. U.S. firm Mathematica serves as the DIB verification agency. An interesting twist to this DIB is that investor principal and interest will not be repaid to UBS's clients; rather, the UBS Optimus Foundation will establish a fund that will continue funding maternal health activities over the long term. To completely align both positive and negative incentives, all of the implementation team (Palladium, PSI, and HLPPT) are also co-investors, together contributing 20% of the risk capital. After 2 years of development, the DIB is finalizing the deal structuring stage and will be ready for implementation in early 2018.

LEARN MORE:

Peter Vanderwal, Head of Innovative Impact Financing, Palladium
Peter.vanderwal@thepalladiumgroup.com

Asháninka Cocoa and Coffee Impact Bond (Peru)

Challenge/solution

Despite being the birthplace of cocoa, Latin America lags behind other parts of the world in terms of cocoa yields and production. To address this and the poverty most Peruvian cocoa farmers live in, four actors (the Common Fund for Commodities (CFC), Schmidt Family Foundation (SFF), Rainforest Foundation UK (RFUK), and Royal Tropical Institute (KIT)) joined forces in 2014 to design a small DIB (\$110,000) to help the indigenous Asháninka people of Peru and their cooperative (the Kemito Ene Association) set up improved production and marketing systems for coffee and cocoa.

How does it work?

The DIB was built based on the previous experience of RFUK managing a project in the Peruvian Amazon. RFUK served as the service provider performing all activities of the DIB in collaboration with partner organizations in Peru. CFC served as the

outcome funder, committed to repay the investor (SFF) the capital put forward to achieve the results. KIT served as the evaluator to verify accomplishment of the jointly agreed goals.

Outcomes included improvements in the volume of cocoa supplied by farmers to the cooperative (increases of 20%), increases in cocoa yields per hectare (to 600kg/ha), marketing of 35 tons of cocoa at the end of the project, and expansion of newly established coffee plots with rust-resistant varieties. Success ranges were set for each outcome (quantification of 100% success, 75% success, 50% success, etc.). When one performance indicator was 100% achieved, CFC would reimburse SFF the full amount for that specific outcome, but if it was 75% achieved, CFC reimbursed the foundation 75% of the value of the outcome.

Results

At the end of the project, the verification report developed by KIT concluded that some impact indicators were met either fully or partially (such as volume of supply, marketing and expansion of coffee plots), while others were not met (yields). KIT concluded that the service provider (RFUK) did not fully understand its responsibilities in terms of data collection, the consequences in terms of implementing an outcome-focused intervention, and the freedom the DIB allowed it to achieve the outcomes. However, the experience led to a fundamental shift in how RFUK viewed implementation of development projects, and powerful lessons learned for new actors in this space.

LEARN MORE:

Belt, Kuleshov & Minneboo, Development impact bonds: learning from the Asháninka cocoa and coffee case in Peru, Enterprise Development and Microfinance Vol. 28 20s. 1-2.

See a link to this report at: www.developmentbookshelf.com/doi/abs/10.3362/1755-1986.16-00029



Advance Market Commitments

- Agreements to purchase a certain quantity of a product in the future at a certain price, mitigating downside risk for the product developer
- Useful when there is a clear benefit from developing the product; however, there is uncertainty in market demand for the product
- While largely associated with the Global Alliance for Vaccines and Immunizations (GAVI), Advance Market Commitments (AMCs) can be used in any sector where uncertain market demand deters investment in products that might have strong development benefits

Advance Market Commitment Structure and Implementation Steps

Under this mechanism, a funder (usually donors and/or foundations) identifies a product that is critical to accomplishing a development outcome, and agrees with a product developer (or set of them) to produce a set quantity

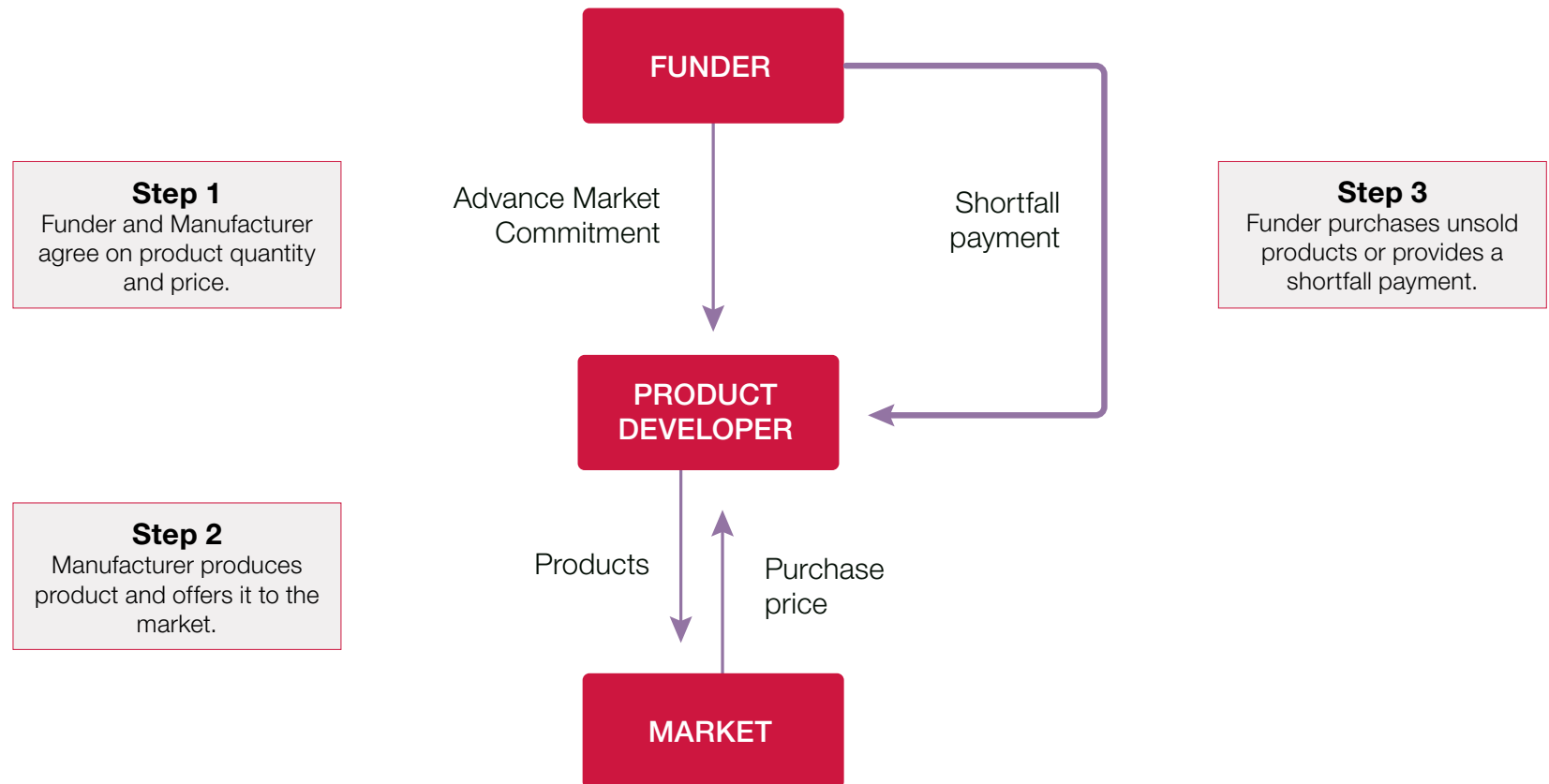
USAID Haiti HOME Project

USAID/Haiti is pursuing a market-based solution to affordable housing in Haiti by encouraging housing developers to experiment with lower cost housing units with innovative construction technologies. The idea is for Haitian banks and microfinance institutions (MFIs) to offer construction loans and longer term mortgage loans for these units.

Developers are reluctant to build lower cost housing units because of the financial risk that they might not sell. An AMC could be utilized to guarantee a forward sales price.

The USAID/Haiti HOME project has a financing facility that is being used to cost-share innovative affordable housing units, but which could be used to provide an AMC to guarantee a developer a certain floor price for construction of innovative housing units for which demand is likely but not assured.

Example 5: Advance Market Commitment Structure



of the required product to be available at a set price. The product is produced and offered to the market. If demand is insufficient to recoup the full product development and production price, the funder commits to purchase all or some of the unsold product and/or to cover the difference between the actual product sales price and the agreed floor price (shortfall payment).

History

Academic research and a 2005 report by the Center for Global Development argued that AMCs could increase investment in R&D to develop vital new vaccines for the developing world, given that only 10% of health R&D was targeting diseases that affect 90% of the global population. These writings catalyzed donors, development professionals, and pharmaceutical actors to create new mechanisms to make vaccines more accessible and affordable in developing countries. In 2007 the Bill and Melinda Gates Foundation and a group of donors joined forces to create the first AMC facility, worth \$1.5 billion, to accelerate production of a pneumococcal vaccine.

When Are AMCs Appropriate?

- Development solution is absolutely clear, but commercial viability is not, because both supply and demand are uncertain due to the high costs to produce and procure the solution.
- Manufacturers (and in some cases service providers) exist, and can be encouraged to bear the high cost of developing products and services with development impact and potential commercial viability.
- Sufficient donors exist to share the financial risk in product development and marketing by offering a “floor price” to manufacturer(s).
- Potential market size is significant enough to stimulate more R&D into future products for developing country populations.
- The AMC is designed to meet the needs of all stakeholders involved, from donors, to industry actors, and mostly the people in developing countries.
- They are seen as one of many tools in the broader context of market development.

Challenges

- From the perspective of designers:
 - Setting the purchase price. Setting the price too high creates the potential for a windfall benefit for the manufacturer/service provider at the expense of the funder(s). Setting the price too low may not sufficiently mitigate the risk in product development and marketing, and the product may therefore not be developed.
 - Avoiding a “winner take all” situation and creating a true market for products that can be commercially available and marketed in developing countries.
 - Payment upon full development of a product inadvertently discourages smaller firms from participating, as upfront investment costs are extremely high.
- From the perspective of manufacturers/service providers:
 - Funding is only provided when new products are fully developed
 - Ensuring AMCs are legally binding and enforceable in courts
 - Ensuring copy-cat products will not take up the guaranteed market
- From the perspective of developing countries:
 - Contributing to some of the development costs
 - Ensuring long-term affordable prices on developed products.

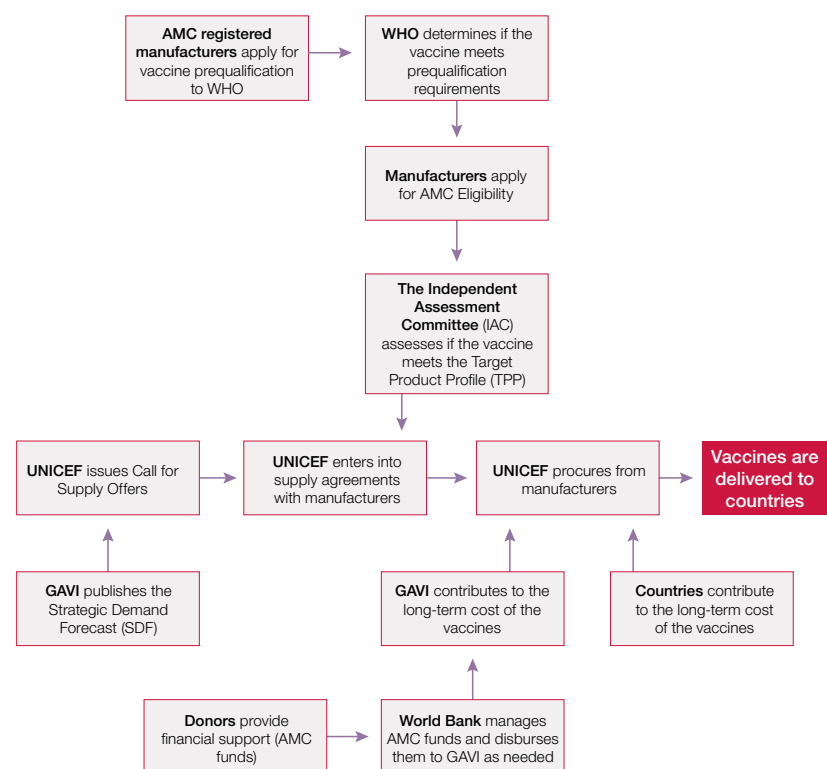
Additional Resources:

Levine, Kremer, Albright, *Making Markets for Vaccines: Ideas to Action*. Report of the Center for Global Development Advance Market Commitment Working Group, 2005.

Light, Hai Europe and Medico International, *Advance Market Commitments: Current Realities and Alternate Approaches*, 2009.

GAVI: Pneumococcal Advance Market Commitment Vaccine Alliance

Below is a graphic representation of how the pneumococcal AMC model works, reproduced from the GAVI website (www.gavi.org):



Challenge/solution

Vaccinations are a critical public health intervention, with potential to save millions of lives annually. However, because of the high cost of designing and developing vaccines along with long repayment periods, the incentives to invest in new vaccines, in particular those geared toward developing country populations, are limited. In 2007 the Bill and Melinda Gates Foundation, in conjunction with five countries, launched the first AMC to accelerate the development and availability of a new vaccine for pneumococcal disease, expected to save the lives of 7 million children by 2030.

How does it work?

A group of donors (Italy, the UK, Canada, the Russian Federation, Norway, and the Bill and Melinda Gates Foundation) committed more than \$1 billion to guarantee prices of vaccines once developed. These funds

are managed by the World Bank. Donor commitments provide manufacturers with the incentive to invest in vaccine R&D, and to build capacity for the vaccine. UNICEF plays a supply organizing role, managing supply offers. The World Health Organization (WHO) prequalifies manufacturers, and the Independent Assessment Committee determines whether the products developed meet the specifications. Manufacturing companies sign contracts with UNICEF for 10-year periods that bind them to provide vaccines at an affordable price to developing countries. In return, manufacturers receive a share of the committed funds in proportion to their supply commitment. By 2016 more than 100 million children were immunized with the vaccine.⁵

LEARN MORE:

www.gavi.org/funding/pneumococcal-amc/how-the-pneumococcal-amc-works

⁵ Case Studies for Global Health Building relationships. Sharing knowledge. www.casestudiesforglobalhealth.org Alliance for Case Studies for Global Health

DFID Support for Renewable Energy

Challenge/solution

Because of upfront capital costs, high risk, and uncertain regulatory environments, clean energy developers and installers were unable and unwilling to invest in renewable energy in Rwanda. A \$10 million, 5-year pilot AMC was designed by DFID to jump-start low-carbon development and catalyze private sector investment in renewable energy projects, including biogas and off-grid solutions.

How does it work?

The project encouraged development of owner-operator models by providing short-term cash incentives to renewable energy system developers (guaranteeing the revenue source). The AMC was structured into one funding pot targeting biogas and hydro developers. Local financial institutions (FIs) would disburse funding from this pot to renewable energy developers following a competitive tender, and successful project development, on a PfR basis. The idea

was that DFID incentives were phased out to operators over time to encourage “first movers.”

Initial findings presented to DFID’s Sub-Committee in 2010 pointed to challenges among service providers to access sufficient capital from FIs to pay upfront costs, and difficulties achieving scale in the model.

LEARN MORE:

www.climateinvestmentfunds.org/sites/default/files/meeting-documents/uk_presentation_amc_0.pdf



Conditional Cash Transfers

- Programs that seek to resolve social challenges through cash payments to poor beneficiaries, contingent on the beneficiaries meeting certain human capital investment requirements (e.g., health checkups for children/mothers, child school attendance, perinatal care for mothers)
- Good evidence these improve the lives of poor people through better access to health and education services, reducing poverty and inequality. Impact on health and education outcomes is mixed, however, so CCTs should not be seen as a replacement for a comprehensive social protection system.

Conditional Cash Transfer Structure and Implementation Steps

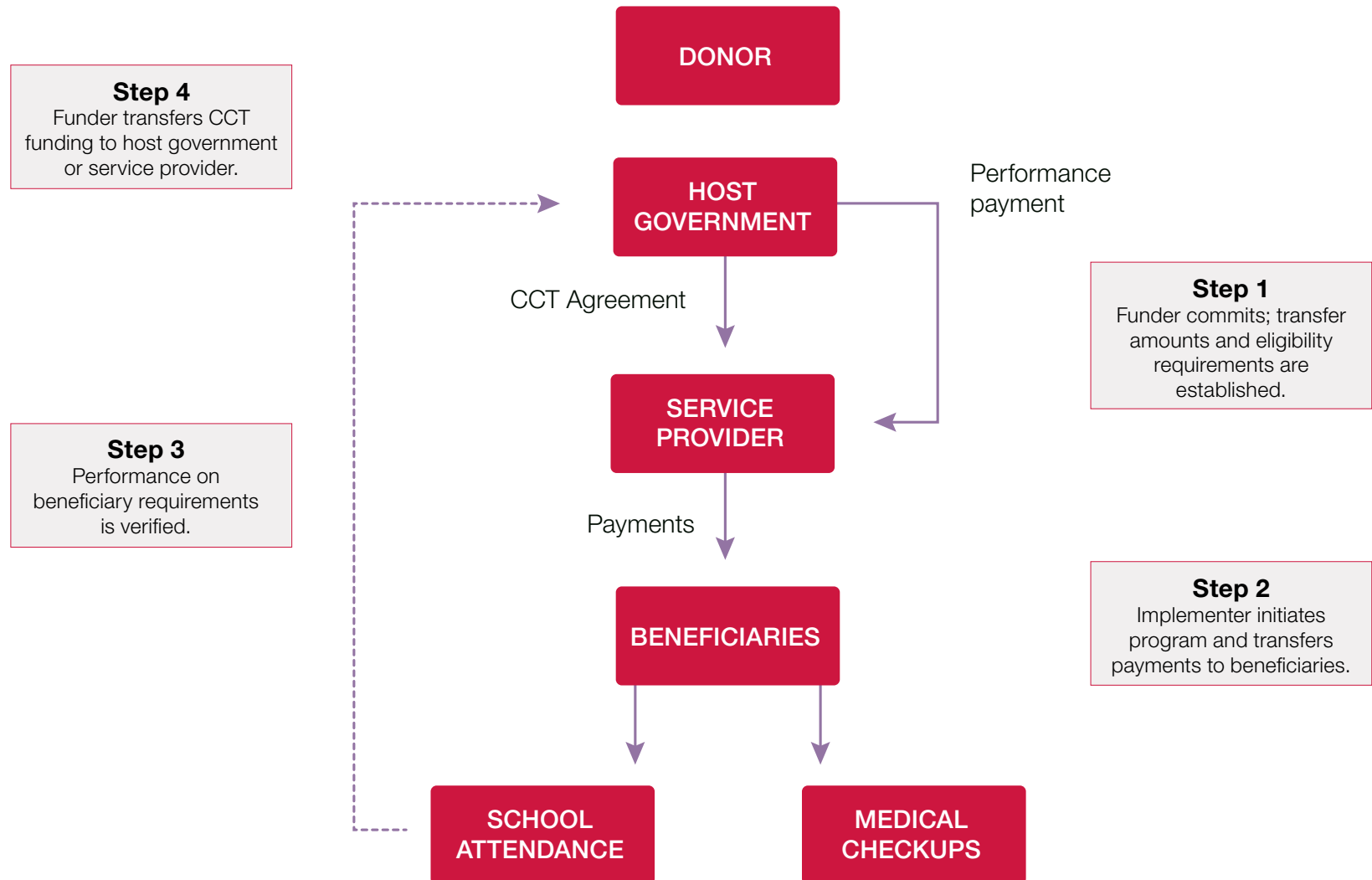
Under a CCT, a funder (donor, host government, or philanthropy) provides funding for a program, then stipulates eligibility, payment amounts, and beneficiary performance requirements. A service provider (or set of them) (usually

Bolsa Familia Conditional Cash Transfer Program

The Bolsa Familia program of Brazil began in the early 1990s to support school attendance in two regions (Brasilia and the Campinas municipality) and was later replicated by local governments, its scope expanded, and then turned into a federal program.

Today, Bolsa Familia provides financial assistance to poor Brazilian families contingent on their attending school and receiving vaccinations. The goal is to fight short-term poverty through cash transfers, and to counter persistent poverty by upgrading human capital. Bolsa Familia currently serves 11 million households (an estimated 50 million people), and costs about 0.5% of Brazil's GDP. The average benefit per household is only \$54, yet for the poorest families, the impact on stabilizing household income and reducing child labor is significant.

Example 6: Conditional Cash Transfer Structure



a sub-sovereign entity) implements the CCT program and payments are made to beneficiaries. Performance is verified and reported to the funder. Payments are made to the service provider or implementing entity.

History

CCT programs date back to the 1990s, when governments began programs in Mexico, Pakistan, and Brazil to use state resources to directly encourage school attendance. CCT programs expanded in scope and number, and countries have been adopting CCTs at prodigious rates. There are hundreds of CCT programs throughout Latin America, Asia, Africa, the U.S., and Europe. In 2011 in Latin America alone, there were an estimated 18 CCT programs covering 117 million people⁶. Perhaps the best known CCT programs are Mexico's PROGRESA (started in 1997, renamed Oportunidades in 2001, and Prospera more recently), and Brazil's Bolsa Familia. Mexico's focus on robust evaluation as part of its CCT contributed to a healthy evidence base that (in addition to support from international financial organizations) contributed to the expansion of CCT programs throughout the region and globally. Significant empirical evidence exists that CCT programs serve the poorest populations, are administratively efficient, and reduce inequality. However, the research base on the extent to which CCT programs reduce poverty in the short and long terms, effectively accumulate human capital, and can break intergenerational transmission of poverty, is more mixed.

⁶ Institute for the Study of Labor, IZA Policy Paper No. 49, The Growth of Conditional Cash Transfers in Latin America and the Caribbean: Did They Go Too Far?, November 2012.

When Are CCTs Appropriate?

- Private investment in human capital is thought to be too low
- Redistribution of resources is politically feasible when conditioned on good behavior
- In economies with high inequality but where poor communities have access to critical social services, such as healthcare and education (potential stepping stones to exit poverty)
- The behavior change sought and metrics to measure it are clear, and data exists to verify compliance
- Governments are interested in strong evaluation and sharing results transparently
- They are cost-effective, relatively easy to implement, and have demonstrated impressive results in improved health and education outcomes

Challenges

- Balancing expanded supply of services vs. improved quality of services
- Whether to design CCTs with more focus on outcomes / root poverty causes rather than on increased service use
- Targeting: When in the lifecycle to apply CCTs? Younger children or youth? Pregnant women? Poor? Nearly poor?
- Setting the appropriate transfer amount and rules for entry/exit from the program
- Potential for shifting political winds influencing government expenditures, affecting scale and impact
- Potential to create dependency among beneficiaries
- Leaking benefits to populations outside of the target group

Additional Resources

Fizbein, Schady, Ferreira, Kelleher, Olinto, Skoufias. *Conditional Cash Transfers: Reducing Present and Future Poverty*. World Bank, 2009. http://siteresources.worldbank.org/INTCCT/Resources/5757608-1234228266004/PRR-CCT_web_noembargo.pdf

Enrique Valencia Lomeli, *Conditional Cash Transfers as Social Policy: Contributions, Limitations, and Illusions*. Annual Review of Sociology, 2008.

PROGRESA/Oportunidades/Prospera (Mexico)

Challenge/solution

Following a severe financial crisis and deep recession, poverty levels spiked in rural areas of Mexico. In 1997, the government of Mexico, with leadership from its President, designed a CCT called the Program for Education, Health and Nutrition (PROGRESA) to address poverty in a more direct way by providing cash payments to families in exchange for regular school attendance, health clinic visits, and nutrition support. Mexico created a new government entity to administer this program, a move that initially caused friction with other government entities.

How does it work?

Eligibility for the program was determined via results gathered through the government's Socio-Economic and Demographic Characteristics of Households survey. Families accepted into the program had to comply with health and education-related "co-responsibilities" they shared with the government entities providing services. Families' compliance was reviewed every 2 months by the Secretaries of Public Education and Health. Once a compliance determination was made, payments were wired to families via payment points.

Results

Prospera has been proven to improve rates of monetary poverty, school enrollment, and nutrition levels among children throughout Mexico. The newest version of Prospera is designed to build on its basic components of nutrition, health, and education to expand into early childhood development and favor social and productive inclusion, such as facilitating access to financial services, and improving beneficiaries' access to higher education and formal employment.

LEARN MORE:

<https://publications.iadb.org/bitstream/handle/11319/7569/How-does-prospera-work.PDF?sequence=4&isAllowed=y>

Chile Solidario

Challenge/solution

Chile Solidario was a CCT program created in 2002 by the Government of Chile as a strategy to eradicate extreme poverty among 225,000 indigenous households.

How does it work?

Families were targeted to participate in the program via national socioeconomic survey data. Once they joined, they were provided access to a “household support worker” and an income transfer. The support worker served as a counselor and held a series of sessions with all household members to identify human investment deficits across seven indicators of well-being: education, employment, health, household dynamics, housing, income, and registration. Discussions were held on ways these deficits could be addressed, and strategies for how families could meet

minimum thresholds for each category (e.g., registering land/home title, children being up to date with immunizations, or attending school regularly). Based on those discussions, a set of commitments were drawn up between the families and the support worker. The support worker’s role was to link family members to critical services and programs that addressed identified deficits. The family had to meet their end of the bargain (take children for health check-ups, work through registration/titling for land/house, etc.) to receive cash transfer payments related to their broader uptake of public services.

Results

This original CCT program was designed to “graduate” participants from subsidy; an evaluation in 2005 demonstrated that 86% of eligible households were contacted,

and 51,000 had exited the program as planned because they met the minimum development thresholds previously established.

Since this first CCT, Chile Solidario has developed into a set of psycho-social programs that provide social worker accompaniment to target populations (such as families in extreme poverty, adults and vulnerable senior citizens who live alone, homeless populations, and families with an incarcerated member) so they can achieve social integration goals. Different programs are managed by different ministries at the federal and regional levels.

LEARN MORE:

www.ips.gob.cl/servlet/internet/content/1421810829144/chile-solidario (Spanish); UNESCO’s Anti-Poverty Policies and Citizenry: the “Chile Solidario” experience <http://unesdoc.unesco.org/images/0014/001402/140240e.pdf>

IV. Pay for Results Pros and Cons

Properly implemented, PfR projects can offer a number of benefits:

- **AID EFFECTIVENESS:** In a time when concern about the effectiveness of foreign assistance is increasingly important, PfR strategies shift the dialogue from spending on foreign assistance to paying for tangible development outcomes.
- **SPREADS RISK:** Traditional development awards compensate actors for completing a set of pre-determined activities rather than accomplishment of results, leaving the donor principally responsible for both performance and financial risk. PfR spreads the financial risk by paying implementers upon achievement of results, and spreads the performance risk by mandating outcomes rather than inputs/activities.
- **ALIGNS EXPECTATIONS:** Because payment is based on accomplishment of metrics that are agreed upon upfront, expectations for outcomes between the funder and implementer should be more aligned.
- **GREATER FLEXIBILITY AND POTENTIAL FOR INNOVATION:** PfR arrangements should be designed to provide the implementer greater flexibility to innovate and accomplish the desired outcomes.
- **STREAMLINES THE PROCUREMENT PROCESS:** Because the procurement focuses more on what is to be achieved instead of how it should be accomplished, the process should be accelerated (although more time may be required negotiating the award to clarify and agree on metrics and performance award payments and procedures).

- **IMPROVED MONITORING AND EVALUATION:** PfR projects demand more precise performance indicators and measurement, so the quality of these and their relationship to implementation reality are improved.

But PfR is not without challenges:

- **UNINTENDED CONSEQUENCES:** PfR instruments encourage implementers to accomplish development outcomes quickly and cheaply, which has led on occasion to implementers “gaming” when inadequate risk management systems are in place. When proper monitoring systems are not in place, PfR can also create the temptation for implementers to lower quality standards, or to “cherry pick” less challenging-to-serve target populations.
- **HIGHER COST AND EFFORT FOR DESIGN AND MONITORING:** Defining, negotiating, and monitoring the award structure (the metrics, policies, and procedures upon which performance payments are made) is challenging when both donor and implementer must agree. Many donors are accustomed to unilaterally setting metrics and validating performance, but when performance and financial risk is shared, determination of metrics and performance upfront must also be shared. The need for qualified third parties to verify performance also means there may be a higher cost associated with tracking and validating implementation performance.
- **POTENTIALLY LESS ATTRACTIVE TO IMPLEMENTERS:** Because financial and performance risk is shifted to other parties in PfR arrangements (usually to the implementer), and costs are recovered

only when performance targets are met, some implementers will find PfR arrangements less attractive.

- **EVIDENCE BASE IS THIN:** Even though many studies are underway, overall there are few studies on the longer term impact of PfR programs. More longitudinal and intensive research is needed.



V. Using Pay for Results to Catalyze Investment

PfR strategies have proven to be useful in helping practitioners (1) identify new solutions to development challenges, (2) optimize accomplishment of development outcomes, and (3) change behavior of development beneficiaries.

The application of PfR has been a disruptor to more traditional development programming, and is especially promising in terms of obtaining results related to a pressing development challenge: mobilizing private capital at commercial terms to generate investment driving economic development.

Supplying the trillions of dollars in investment needed to accomplish the Sustainable Development Goals will require abundant amounts of private capital. Fortunately, this capital exists (with a significant proportion available in the developing world), and its owners/managers are actively seeking investment opportunities. However, for various reasons, available capital is not being intermediated at sufficient rates into the types of investments that will quickly accelerate development outcomes. PfR holds promise to remedy this market failure—rapidly, cost-effectively, and if done right, sustainably.

Investment opportunities in developing countries can often yield impressive economic returns from a development perspective, but be just short on generating the financial returns required by providers of finance, primarily because of the higher cost of capital requirements (attributable to higher risk and transaction costs) that prevail in the

developing world. PfR is being used to support both the supply side (providers of finance) and demand side (actors seeking financing) to lower transaction costs, incentivize entry into new sectors, and/or directly offset the higher cost of capital. In some projects, it is even being used as a form of blended capital to adjust the risk-return balance for finance providers.

Below, we include projects that have or will utilize PfR to catalyze financing.

USAID Financing Ghanaian Agriculture Project (USAID FinGAP)

Challenge

With production expected to increase sharply as a result of Ghana's Feed the Future (FtF) initiatives, staple food value chains (VCs) required expansion and modernization, including investment in input stores, grain warehouses, and processing facilities. However, capital providers (banks and investors) were reluctant to extend financing to the agriculture sector because of the perceived risks and high transaction costs associated with agricultural lending and investment. USAID and FtF's FinGAP project was designed to assist the range of beneficiaries supported by USAID's agricultural interventions to obtain the finance and investment necessary to increase staple food VC competitiveness and food security.

Solution

USAID awarded CARANA (now Palladium) this \$22 million project, including a \$5 million fund designed to stimulate financial sector expansion into agricultural lending and incentivize new, blended finance solutions for small, medium, and large enterprises. After identifying the types of investments critical to upgrade Ghana's staple food VCs, Palladium designed a two-pronged (supply and demand side) PfR approach. On the demand side, the project assembled a group of Ghanaian business advisory services (BAS) providers, and placed them on PBCs to identify, package, and present investment opportunities to prospective investors. BAS providers were paid upon meeting targets for project identification, structuring, and reaching financial closure. Palladium also designed a parallel PfR incentive program for Financial Institutions (FIs) to encourage expanded lending. Once procured, the two PfR incentives worked quickly to accelerate financing to staple food SMEs; by year 4 of

“Agriculture financing, particularly lending to smallholder farmers, is perceived as very risky. Using the USAID FinGAP (PBC) financing approach helps to mitigate that risk.”

- Victoria Antwi, Managing Director, Success for People (Microfinance Entity)

the 5-year program, over 1,700 Ghanaian small, medium, and large businesses had received more than \$200 million in financing/investment from partner FIs. There are strong indications that USAID FinGAP's PfR approach has sustainably changed Ghana's market for agricultural finance. Barclays Bank of Ghana's agricultural loan portfolio, for instance, went from roughly \$680,000 to \$54 million in just 3 years.

USAID Financing Ghanaian Agriculture Project (USAID FinGAP) *continued*

How does it work?

Palladium established loan selection criteria to maximize the development impact of incentivized lending. It surveyed the BAS market to identify potential partners, and carefully structured performance fees to pay the lowest amount needed to close transactions and avoid market distortions. Through a competitive process, Ghanaian BAS providers and local FIs were awarded performance-based contracts/grant agreements. The BAS providers competed with each other to address the financing

challenge on the demand side (identifying/ packaging loans), and the local banks competed with each other to scale up lending on the supply side (financing/ investing in deals). Providers invoiced Palladium upon achieving outcome targets, motivating a focus on results and ensuring efficient use of project funds —risk capital is not spent if results are not achieved. USAID FinGAP modifies BAS and FI incentives as needed and to ensure sustainable, long-term engagement in agricultural lending. The project conducts rigorous data collection

(tracking the progress of every loan) and performance monitoring to understand the impact of its PforR approach and ensure high loan repayment. A performance assessment proved the connection between expanded financing to small and medium enterprises (SMEs) via USAID FinGAP, and impact on sales, employment, profitability, land ownership, and livelihoods of both SMEs and smallholder farmers.

LEARN MORE:

www.agrifinanceghana.org

Water Services Trust Fund of Kenya (WSTF)

Challenge

Access by the poor to clean water and sanitation services in Kenya is limited, but investing in rehabilitation and expansion of water and sanitation systems is prohibitive given the capital costs relative to the low-income households these systems are meant to serve.

Solution

WSTF is a Kenyan State Corporation that was created in 2004 to finance water and sanitation for poor and underserved communities; it became operational in 2005. Donor partners instrumental in creating and expanding this fund include KfW, the World Bank, European Union, USAID, Bill and Melinda Gates Foundation, IFAD, UNICEF, UN Habitat, and the governments of Sweden (SIDA), Finland, and Denmark (DANIDA).

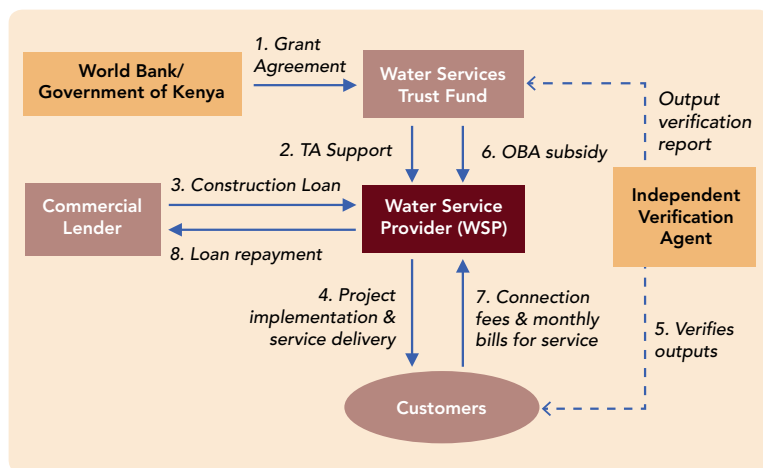
How does it work?

Qualifying WSPs were eligible to obtain financial incentives in conjunction with investments they made to build new water and sewer connections, water kiosks, public water supply points, and public toilets. To qualify for these incentives, WSPs needed to secure commercial loans for the investments (ensuring an effective appraisal process on the viability of the proposed investment). The incentive grants covered up to 60% of the project cost covered by the lenders (subject to a cap of \$115 per beneficiary) and were disbursed following project completion and upon verification of results.

As of June 2016, the program had facilitated financing of five projects worth 338 million KES (roughly \$3.2 million) from two banks, with another 17 projects in the pipeline. USAID provides risk mitigation to the banks via a 50% guarantee from its Development Credit Authority (DCA).

Below is a depiction of the structure and flow of funds of the WSTF, taken from its website:

FLOW OF FUNDS



WSTF, in conjunction with the World Bank, USAID, KfW, and SIDA, established an output-based aid, or Results-Based Financing (RBF), project in 2014 to channel financial incentives (through grants) to Water Services Providers (WSPs) so they can receive financing from private sources to invest in rehabilitation and expansion of water and sanitation infrastructure in critically underserved areas. The project will run through 2018, and its goal is to provide 150,000 people with access to water connections.

LEARN MORE:
www.waterfund.go.ke

East Africa Trade and Investment Hub

Challenge

Larger SMEs in East Africa were having difficulty obtaining the financing they needed to expand.

Solution

The USAID East Africa Trade and Investment Hub (EATIH), implemented by DAI, subcontracted with U.S. small business CrossBoundary on a PfR basis to help achieve aggressive targets for catalyzing new investment. CrossBoundary, with the direct collaboration of EATIH, developed a pipeline of transactions and assisted with opportunity validation, due diligence, financial modelling, fund raising, transaction structuring, neutral intermediation, and investment implementation strategy. During the first 2 years, \$51.1 million in transactions was closed for eight firms in Ethiopia, Kenya, and Uganda, and in the agribusiness, financial services, and logistics sectors, with an additional \$75 million pending close and \$133 million in the pipeline. Support for deal

closure acceleration—from initial investor enquiry to full transaction close—was shortened from the regional average of 18–24 months to an average of 6–10 months, reducing transaction costs and leading to follow-on deals with other investors.

“ The pay-for-performance mechanism within the private capital sphere incentivizes the exact results we are looking for. It empowers both us and our partners to focus on measurable impacts and outputs, and helps us leverage programming resources. Our results in the attraction and allocation of capital speak for themselves: We don’t believe we would have achieved these results without a pay-for-results mechanism in place.”

Kanini Mutooni, Director for Investment for EATIH

How does it work?

DAI’s award with CrossBoundary is a hybrid PfR contract within a fixed-price subcontract structure. Under the

agreement, some success payments are made against traditional deliverables (e.g., reports, workplans), others are structured against progress toward building an investment pipeline (firms identified, pipeline generated), and others are paid in the form of a success fee upon deal closure.

As DAI has adapted this model for other markets, it has learned that costs and incentive structures vary depending on several factors, including the advisors’ market experience and local presence, limitations placed on the target market, and project objectives. In the case of EATIH, the engagements have typically focused on complex private equity structures. This has meant engagement on each transaction has been time-intensive, but completed deals serve as landmark transactions in their respective regions and sectors, breaking a path for other institutional investors to follow.

LEARN MORE:
www.eatradehub.org

Bosnia Reconstruction Finance Facility

Challenge

By the end of the Balkan conflict in 1995, the Bosnian economy had plunged into crisis. Bosnian businesses no longer had secure markets, unemployment was rampant, and private investment was limited. A market-based stimulus was urgently needed to assist with economic recovery.

Solution

In 1995, USAID launched the Bosnia Business Development Program (BDP) as the U.S. Government's flagship economic reconstruction and recovery program for the country. The key element of the program was the Bosnia Reconstruction Finance Facility, a quick-disbursing on-lending program designed to provide credit through Bosnian banks to the productive sector, while reviving the Bosnian banking sector. The initiative extended \$150 million in loans to Bosnian companies, creating 20,000 new jobs.

How does it work?

PBCs were structured with participating banks in which they were paid incentive fees for originating and managing loans. Quality control was maintained through a second-tier loan approval process, as well as a "claw back" provision for the banks in case of loan defaults. A performance award fee was also structured with the service provider (then the Emerging Markets Group, now Deloitte) in which USAID reimbursed most of Deloitte's implementation costs to identify businesses and build bank capacity. A portion of the award fee was structured to be reimbursed on a semi-annual basis based on performance against specific, pre-determined metrics (e.g., value of loans issued, success in loan repayment).

LEARN MORE:
www.deloitte.com

VI. An Agenda for Action to Scale Up Pay for Results

Increasing use of PfR in development will depend on several factors. The following is a list of (often overlapping) activities that could be useful to more rapidly bring PfR up to scale.

BUILDING THE EVIDENCE BASE: Creating evidence on the effectiveness of PfR will require developing a comprehensive monitoring and evaluation framework through which donor PfR projects can be tested and measured.

KNOWLEDGE SHARING AND BEST PRACTICES: There is limited understanding of how PfR can be deployed, both within the donor community as well by service providers. A central point should be established for collecting and disseminating PfR best practices and examples.

BUILDING DESIGN AND IMPLEMENTATION CAPACITY: In line with the above, there is limited understanding of how to structure PfR contracts and awards. Many USAID officers are not aware of their ability to propose performance award fees in acquisition instruments, nor how performance-based incentives can be structured in awards and contracts. Training resources to address this knowledge gap can be developed and disseminated.

POLICIES AND GUIDANCE: Utilizing PfR, particularly when public funds are used to incentivize private entities, raises legal, procurement, and other issues. Guidance is needed on these issues, as well as on ensuring that PfR initiatives accomplish core requirements, such as maximizing leverage, ensuring additionality, and avoiding

market distortion. New contracting innovations such as Broad Agency Announcements, Statements of Objectives (SOOs) rather than Statements of Work (SOW), Progressive Design and Perform, and Adaptive Management may complement use of PfR, but guidance or “best practices” is lacking on how they should be integrated and aligned to achieve development outcomes.

SETTING AND VERIFYING PERFORMANCE TARGETS:

The heart of a successful PfR is setting the proper performance targets, and correctly monitoring and measuring achievement of them. But as noted, this can be challenging, costly, and time consuming for “first movers.” Actors interested in implementing PfR require technical assistance in setting appropriate performance targets and designing cost-effective verification methods in line with broader monitoring and evaluation frameworks.

DEDICATED EXPERTISE/TIGER TEAM TO SUPPORT

PFR: While DFID has established a unit focused on PfR, USAID has no central unit with PfR responsibility. A “tiger team” could be formed, tasked with moving the PfR agenda forward while providing guidance on use of PfR to Missions, Bureaus, and Offices.

PFR INNOVATION FUND: Development of an innovation fund to test and scale up PfR approaches would provide an incubator for learning and building future, successful PfR models.

VII. Conclusions

The goal to improve international development aid efficiency and effectiveness is not new; donors, countries, and implementers have been actively addressing this challenge for decades, inspired by a multitude of global declarations and recognition that progress against the millennium development goals (MDGs) was not progressing quickly enough. What is new is the emergence of new applications that have demonstrated great promise in using monetary incentives more effectively to stimulate new business model, and share implementation risk across multiple actors to achieve development outcomes more quickly and at greater scale.

While PfR in the international development context is best known for its application in health, it has been used in developed and developing countries in a wide range of sectors, such as improving energy access, agricultural yields, and educational access and outcomes, and for a variety of social purposes (e.g., improving juvenile justice systems, reducing rates of homelessness).

While the cases in this report highlight the success of PfR programs, especially those that have been designed to mobilize development finance for underserved populations, more qualitative and quantitative research is needed to determine whether improvements in outcomes are due to the results orientation of these programs or other contextual factors, and the extent to which these mechanisms are proven more effective than traditional aid schemes.

Development practitioners relish innovation, and are always on the search for “magic bullets” to solve the great development challenges of our time. Yet none of the PfR applications in this paper should be seen as magic bullets, nor should their use be mandated across the board. They should be carefully curated and applied as appropriate, when circumstances merit.





The U.S. Agency for International Development (USAID) is the lead U.S. Government Agency that works to end extreme global poverty and enable resilient, democratic societies to realize their full potential.

USAID's Office of Private Capital and Microenterprise (PCM) is focused on new ways to collaborate with the private sector in development, and to engage private sector capital in mutually beneficial investment.

www.usaid.gov



Palladium is a global leader in the design, development, and delivery of Positive Impact, the intentional creation of enduring social and economic value. We work with corporations, governments, foundations, investors, communities, and civil society to formulate strategies and implement solutions that generate lasting social, environmental, and financial benefits.

For the past 50 years, we have been making Positive Impact possible. With a team of more than 2,500 employees operating in over 90 countries and a global network of over 35,000 technical experts, Palladium has improved businesses, economies, societies, and—most importantly—people's lives.

www.thepalladiumgroup.com