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Foreign, Commonwealth & Development Office

Findings from the third wave of the Independent Evaluation of the FCDO Development Impact Bonds Pilot Programme

Summary report

December 2022

> “It was the most inspiring project I’ve ever worked on in my entire career. I saw the unification around the achievement of the outcomes amongst all players – staff all across the organisation, funders – in a way I’ve never seen before.”
>
> **Village Enterprise**

Introduction

The Foreign, Commonwealth & Development Office's (FCDO's) Development Impact Bonds (DIBs) pilot programme ran from June 2017 to March 2023 and funded three DIBs:

- **International Committee of the Red Cross (ICRC): Humanitarian Impact Bond (HIB)** for Physical Rehabilitation, which funded the building and operationalising of three new physical rehabilitation centres in Mali, Nigeria, and Democratic Republic of Congo (DRC);
- **Village Enterprise: Micro-Enterprise Poverty Graduation Impact Bond**, which aimed to raise the income levels of the extreme poor through Village Enterprise's microenterprise development programme; and
- Support to the **British Asian Trust** to design impact bonds for education and other outcomes in South Asia, including the **Quality Education India (QEI) DIB**, which aimed to improve education outcomes for primary school-aged children in India.

Ecorys was commissioned to evaluate the programme, aiming to generate learning to inform FCDO's future policy around DIBs. This is the third and final report from this assignment. It summarises and captures final learnings and conclusions from the implementation stage.

What is a DIB?

Impact bonds are outcome-based contracts (OBC) that incorporate the use of private funding from investors to cover the upfront capital required for a provider to set up and deliver a service. The service is set out to achieve measurable outcomes established by the commissioning authority (or outcome payer) and the investor is repaid only if these outcomes are achieved. Impact bonds encompass both social impact bonds (SIBs) and development impact bonds (DIBs).

The programme aims to: (a) understand the process of agreeing and managing DIBs and implications for FCDO's processes; (b) build an understanding of whether DIBs enable efficient delivery of programmes; and (c) build an understanding of the conditions for DIBs to be an appropriate commissioning tool and the costs and benefits of using them.

The objective of the evaluation is to generate learnings and recommendations on the use of DIBs as an instrument for aid delivery, by using the experience of the FCDO DIBs pilot programme to generate learning to inform FCDO's future policy aiming to make the most effective use of DIBs. This evaluation also draws on learning from the wider literature, including the Cameroon Cataract Bond (2018-2025).[1]

The two evaluation questions are:

1. How does the DIB model affect the design, delivery, performance and effectiveness of development interventions?
2. What improvements can be made to the process of designing and agreeing DIBs to increase the model's benefits and reduce the associated transaction costs?

The evaluation focuses on the use of the DIB funding mechanism and understanding the 'DIB effect', that is, the effect of using a DIB instead of a grant or other PbR mechanism. The evaluation team developed a DIB Theory of Change (ToC) that outlined anticipated DIB effects (summarised in the table opposite), based on wider literature and consultations with stakeholders in these three DIBs. The evaluation seeks to test this ToC.

A key challenge is trying to isolate the effect of the DIB from other factors on the different stakeholders and phases, and from the PbR effect. The evaluation team used a combination of process tracing and comparative analysis to achieve this. The evaluation draws on interviews and programme data, including design documents, cost data, monitoring data, and other evaluation and reviews. The evaluation identified 'comparator sites' delivering similar interventions but funded through grants in order to examine how delivery compares between a DIB and a grant. The evaluation team also interviewed stakeholders working on other DIBs and reviewed the broader literature on DIBs, social impact bonds (SIBs), and PbR.

This report presents the evaluation's initial findings against the evaluation questions, building on two previous waves of data collection undertaken in 2019 and 2020. This Research Wave 3 (RW3) report focuses on understanding how the DIB mechanism has impacted the delivery, performance, costs, and results of the DIBs. It provides an assessment of the 'DIB effect' within the pilot DIBs (including potential negative DIB effects) and considers how the DIB affected the sustainability of the interventions.

Findings

EQ1: How does the DIB model affect the design, delivery, performance, and effectiveness of development interventions?

The table overleaf summarises the extent to which the different DIB effects were present across the three DIB pilots. Each effect is 'RAG' rated[2] on the extent to which it was identified across all projects, followed by individual ratings for each DIB. It should be noted that the rating identifies the extent to which the effect is present, not whether it had a positive effect (i.e., both positive and negative effects would be marked green if present). It is also important to bear in mind that stakeholders decided to use the DIBs for different reasons, and not all DIB effects were anticipated.

1 Findings from the Cameroon Cataract Bond were integrated into the reports for Research Wave 1 (RW1) and Research Wave 2 (RW2). However, due to pandemic-related delays, the Cameroon Cataract Bond implementation period was extended past the end of the three FCDO-funded DIBs included in this pilot. Given the focus of Research Wave 3 (RW3) on the end of implementation and legacy of the FCDO-funded pilots, the Cameroon Cataract Bond was excluded from this final research wave. However, findings from the Cameroon Cataract Bond collected during RW1 and RW2 have been integrated into this report as relevant.

2 Green = effect is present in all three DIBs; amber = mixed evidence over presence of DIB effect; red = effect is not present in at least three DIBs. Green/amber and amber/red ratings designate ratings between green and amber or amber and red, respectively.

DIB effect summary

Design DIB effects	Summary	ICRC	QEI	VE
Transfer of risk				
Transfer of financial risk from outcome funder to investor	🟢🟠	🟠	🟢	🟢
Increased reputational risks resulting from the use of the DIB	🟢	🟢	🟢	🟢
Partnerships				
More service providers entering into PbR contracts due to pre-financing and transfer of risk	🟢	🟢	🟢	🟢
Financing and funding				
Funding projects which would not have been funded otherwise, or not in the same guise	🟢	🟢	🟢	🟢
Additional financing to the development sector	🟠	🟢	🔴	🔴
Longer term funding	🟠	🟢	🟠	🔴
Design				
Enables innovation	🟠	🟠	🟠	🟠
More careful and rigorous design of interventions	🟠	🟠	🟠	🟠
Complex to design and expensive to set up	🟢	🟢	🟢	🟢
Delivery DIB effects	**Summary**	**ICRC**	**QEI**	**VE**
Positive DIB effects				
Shift focus to outcomes and greater accountability	🟢🟠	🟠	🟢🟠	🟢🟠
Drives performance management	🟢🟠	🟢🟠	🟢🟠	🟢
Providers deliver adaptive management and course correction, supporting innovation	🟢🟠	🟠	🟢🟠	🟢
Greater collaboration between stakeholders	🟠🔴	🟠🔴	🟠	🟠🔴
Negative DIB effect				
Cherry picking of participants from target population	🔴	🔴	🔴	🔴
Quality of support reduced	🔴	🔴	🔴	🔴
Tunnel vision	🔴	🔴	🟢🟠	🔴
Lowers staff morale	🟠🔴	🟠🔴	🟠🔴	🟠🔴
Greater outcomes				
Increased efficiency and effectiveness, leading to more outcomes	🟢🟠	🟠	🟢🟠	🟢🟠
Spillover effects	**Summary**	**ICRC**	**QEI**	**VE**
Organisation level				
Rolling out of processes and learning	🟢🟠	🟢🟠	🟢🟠	🟢
Increased visibility	🟢🟠	🟢	🟢🟠	🟢🟠
Diverting of attention	🟠🔴	🟠	🔴	🟠
Ecosystem level				
Capacity strengthening to deliver DIBs	🟢	🟢	🟢	🟢
Increased stakeholder interest in DIBs	🟠	🟠	🟢🟠	🟠
Contributions to the evidence base	🟢	🟢	🟢	🟢

Key: 🟢 Hypothesised DIB effect observed and attributable to the DIB; 🟠 Hypothesised DIB effect observed and/or somewhat attributable to the DIB; 🔴 Hypothesised DIB effect not observed and/or not attributable to the DIB. Green/amber and amber/red ratings designate ratings between green and amber or amber and red, respectively.

Please Note: this report focusses on the 'Delivery DIB Effects' and 'Spillover Effects'. In-depth analysis of the 'Design DIB Effects' can be found in the RW1 report.

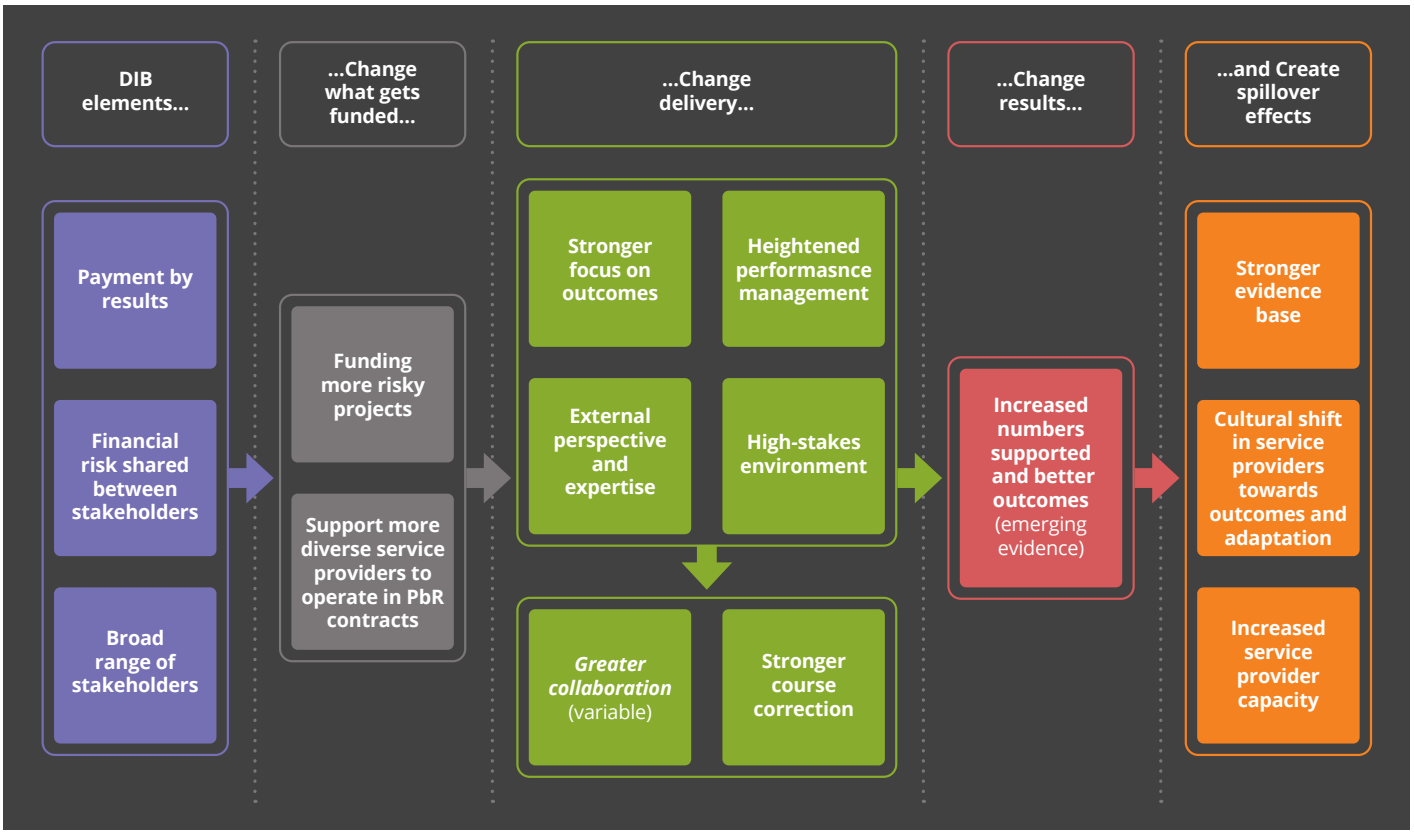
The pilots were broadly successful in achieving their aims. The core effects of funding these pilots through DIBs were that the sharing of risk and pooling of funding made donors more comfortable in funding riskier projects due to the PbR aspect. The financial risk sharing with investors enabled more service providers to operate in PbR contracts. The combined elements of PbR, financial risk sharing, and bringing in a broader range of stakeholders (such as performance managers) led to a stronger focus on outcomes across all organisations, heightened performance management over delivery, and introduced a high-stakes environment. This led to organisations introducing new adaptive management systems and adapting more quickly when issues arose. There are signs to suggest that these changes led to improved outcomes. Although the literature indicates that the high-stakes environment created by DIBs can lead to negative effects, all three DIBs broadly avoided these. Furthermore, all three DIBs met their targets against the set outcome metric(s).[3]

There was also evidence of organisation-level spillover effects; across all three DIBs, systems and lessons learned from the DIB were being transferred to non-DIB programmes. Looking at the potential ecosystem-level spillover effects, the DIBs provided capacity strengthening to deliver DIBs to a range of stakeholders while also contributing to the evidence base about impact bonds and innovative finance. The DIBs also sustained stakeholder interest in innovative finance mechanisms more broadly, but many stakeholders were interested in outcomes-based contracting mechanisms more generally rather than impact bonds per se.

It is important to note that the DIB effects seen were not exclusively DIB effects, and many of the successes of these DIBs were attributable – at least in part – to various non-DIB factors in addition to the DIB model. These non-DIB factors included the quality, capabilities, and commitment of service providers as well as longer-term funding arrangements. The implication of this is that a DIB is not always necessary. Some of the desired effects could also be achieved through a well-designed grant or PbR, and it is possible to design these to include many of the features of a DIB. However, the DIB appeared to be the catalyst for change that set things in motion and accelerated changes.

The figure below summarises the DIB effect observed across the three pilots, building on the existing evidence in the literature and the previous research waves. The most critical elements that drove the DIB effect are highlighted through pink outlines around the boxes.

The DIB effect summarised



3 Modifications were made to the outcome targets for both VE and QEI to account for the effects of the COVID-19 pandemic. Both VE and QEI met these modified targets. QEI also met the original pre-COVID targets as well.

EQ2: What improvements can be made to the process of designing and agreeing DIBs to increase the model's benefits and reduce the associated transaction costs?

Relevance of the DIB model

Our research suggests that DIBs may be most appropriate where:

- Performance could be enhanced through a stronger focus on outcomes buttressed by performance management;
- The system/culture needs an external 'disruption' to bring about change;
- Service providers would not be able to tolerate high levels of financial risk within a PbR contract; and
- Where providers would benefit from external expertise and support.

Many of the DIB effects identified in this evaluation were also identified in previous evaluations of PbR contracts. One therefore needs to consider the added value of a DIB over-and-above a PbR contract, and in what situations a DIB should be considered rather than PbR. The experience of these three pilots suggests that a DIB is likely to be more appropriate than a PbR contract when the context requires smaller organisations to deliver services who may lack the resources or capacity to operate in a PbR contract. They are also more appropriate when the specific intervention is less certain, and so more experimentation is necessary.

Our research into impact bonds in Latin America identified five 'DREAM' factors that affect the ability to successfully launch and deliver impact bonds.[4] This evaluation supports the importance of these factors. These are:

- **Demand from outcome payers:** There needs to be an interest from all relevant organisations (service providers, investors, outcome payers and intermediaries); however, the limiting factor often appears to be outcome payers.
- **Regulatory framework:** It is easier to launch and deliver an impact bond when there is a regulatory framework that supports payments being made on outcomes and returns to investors.
- **Economic and political context:** It is easier to design and launch impact bonds when there is relative economic and political stability.
- **Availability of data:** Impact bonds work best in sectors with existing practice around measurement, including clear and measurable outcomes. This evaluation showed that education and poverty elimination are good examples where suitable outcome metrics can be developed.
- **Market capacity:** It is essential to have investor interest, sufficient service provider interest, service providers with the right capabilities to operate within an outcomes-focused structure, and an interest in testing new approaches. in all three DIBs stakeholders carefully selected service providers that already had a strong focus on outcomes and could work in an adaptive management way, so we do not know how effective DIBs would be with service providers with lower capacity.

Increasing the DIB model's benefits

Our analysis identified some key opportunities identified for potentially increasing the DIB model's benefits, including:

- **Role of the intermediary:** The intermediary played an important role in coordinating the DIBs. At the same time, intermediary costs can be high. For the DIB market to grow, the intermediary role needs to be clearly defined and costed effectively. The precise role of the intermediary should be tailored to the specific DIBs, including the mix of stakeholders and skillsets brought by the other stakeholders.
- **Role of evaluation:** The use of validated administrative data versus experimental approaches should be guided by the policy objectives of the DIB and the geographical/sector context. A more pragmatic approach that values simpler indicators as measures of attribution could bring down evaluation costs (both in terms of time and resources) and support scalability of future DIBs but will diminish the quality of the evidence produced and may diminish some of the DIB effects.
- **Performance management systems:** The three DIBs involved strengthened performance management systems, which led to improvements in the efficiency and effectiveness of delivery. Additional investment in performance management was a valuable component of the DIB model and should be integrated into future DIBs where necessary to increase the model's benefit.
- **Role of collaboration and governance:** The consortia managing each DIB were large, and not all stakeholder roles or decision-making processes were clear. It is important to clearly identify the specific added value of expertise and experience from different DIB stakeholders, and clarify roles, responsibilities, and decision-making authority within the project.
- **Designing outcome metrics:** Some stakeholders felt that the selected outcome metrics did not capture the true impact of services provided through the DIBs. There can be challenges in capturing all components of delivery into only one or a few key outcome metrics that accurately reflect a project's full impact. Although there is a drive to simplify impact bonds and only focus on a smaller number of metrics, this must be balanced with the need to accurately capture the outcomes from the project.

4 Agusti Strid, A. and Ronicle, J., 2021. Social Impact Bonds in Latin America: IDB Lab's Pioneering Work in the Region: Lessons Learnt. IDB Lab.

COVID-19 affected all three of the DIBs. It created challenges in delivering the interventions, with VE and QEI delivery shifting to virtual delivery; this was less possible in ICRC, and instead COVID-19 led to delays in constructing the centres. COVID-19 also created large challenges for verifying the outcomes – something that was not anticipated during the launch of the DIBs. In response, the agreed outcome measures were changed in VE and QEI – though QEI still performed against the original targets. There were mixed opinions on how the DIBs responded to COVID-19 – all projects successfully worked through the issues and none of the projects were halted, however some stakeholders were unhappy about the way the negotiations were handled and the final agreements.

In relation to the DIB model, COVID-19 has highlighted that the strong relationships that form due to the intense nature of launching and running a DIB can help stakeholders work through crises. However, COVID-19 has also highlighted how it can be challenging to adapt a DIB to major crises, due to the DIBs' complex partnerships and structures.

Costs of designing and delivering DIBs

Calculating the additional DIB costs was challenging and relied on a large degree of interpretation on the part of both the stakeholders and evaluators. They should therefore be treated as indicative.

Operating the projects through a DIB required additional costs compared to funding them through grants. From set-up to end, the additional DIB cost ranged between $1.8m-$2.3m. This ranged from 9% to 42% of the total programme budget. Across the DIBs, the highest costs were in the areas of investor return, verification, and performance management. Generally, stakeholders perceived the additional costs to be value for money.

To assess whether the DIB costs were justified, we considered whether there was a close relationship between the DIB costs and benefits. Overall, we found that the additional DIB costs were in areas where there are strong DIB benefits, suggesting that the additional DIB costs are focused in the right areas. Furthermore, there was a good association between the magnitude of the DIB costs and the magnitude of the DIB benefits. However, there was general consensus from stakeholders that, whilst they thought the additional costs were value for money, the costs could be reduced to improve the DIBs' cost effectiveness. Our research suggests it could be possible to reduce additional DIB costs in future programmes:

- Set up costs could be reduced as projects are able to replicate these pilots, and build on the lessons learnt.
- Costs could be reduced through running larger DIBs and/or outcomes funds.
- Costs will likely reduce as the market matures.
- Costs will likely reduce if inefficiencies around co-ordination are removed.
- Costs could be reduced if the risk premium was decreased.

Key lessons learned

EQ1: Assess how the DIB model affects the design, delivery, performance, and effectiveness of development interventions.

1. **The DIB effect varies across DIBs depending on the stakeholders involved, their motivations for using the DIB, and the structure of the DIB.** It is useful to carefully consider the objectives of using a DIB and ensure that the DIB is structured to support this.
2. **A DIB can be an effective organisation-level change management tool.** In these pilot DIBs, the funding mechanism was a catalyst and driver for change and the better use of data to inform delivery. Changes introduced in a DIB can sustain and be rolled out across organisations.

EQ2: What improvements can be made to the process of designing and agreeing on DIBs to increase the model's benefits and reduce the associated transaction costs?

1. **Additional stakeholders do result in greater coordination and communication costs.** These costs can be managed by having clarity on what added value different stakeholders are bringing and clarifying roles, responsibilities, level of input and decision-making processes.
2. **The role of the intermediary should be carefully considered, to ensure costs and benefits are proportionate.** There is a balance between bringing in external expertise and building the capacity of providers and funders to take on some of these tasks.
3. **There may be potential to further explore the extent to which verification and performance activities can be synergised, to reduce costs and maximise the benefits of these activities.** Verification techniques sometimes had the dual benefit of calculating payments and supporting data-driven adaptive management, whilst in other projects these two functions were separate.
4. **Additional investment in performance management was a valuable component of the DIB model and should be integrated into future DIBs where necessary to increase the model's benefit.** However, performance management systems can be expensive; future DIBs could explore 'lean data' models or platforms that could bring down these costs.

5 **Measuring cost-effectiveness is extremely challenging.** Full costs, including in-kind contributions, were not captured by these projects. This makes it difficult to assess value for money. We would encourage donors to stipulate financial reporting requirements within funding agreements.

6 **Ensure appropriate capacity-building is embedded into the DIB:** Service provider capacity is a particular concern when thinking of implementing or scaling impact bonds, therefore a capacity building element may need to be considered in DIB design. Peer-learning may be an effective and cost-efficient way of supporting this.

7 **It is important to balance the 'black box' commissioning approach of an impact bond with ensuring minimum quality standards are in place.** Outcome payers learnt that they cannot solely focus on paying for outcomes and not oversee delivery. They learnt that they need to ensure that minimum standards – such as adequate safeguarding policies – are in place.

8 **Account for emergency situations within contracting:** COVID-19 created challenges for the projects, and the contracts or agreements did not always provide clarity on how to respond (such as who has the ultimate say, and how projects should respond when outcome verification is not possible). One way to address this would be to undertake more scenario-testing upfront during the design and set-up phase to plan for and accommodate potential risks.

9 **Striking a balance between complexity and usability for outcome payment formulas:** Complex metrics and outcome payment formulas can make it difficult for service providers to understand and onboard colleagues onto the DIB. This could also create challenges with scalability and replicability for organisations with lower capacity.

10 **A large amount of the 'additional costs' of a DIB are incurred during the design phase.** This is a good sign, as replication may reduce these costs if DIBs continue to be designed and delivered. Though this is only correct if tailoring requirements are relatively low.

11 **Additional DIB costs do not increase in relation to the scale of the DIB.** This suggests there are economies of scale in running larger DIBs.

Possible next steps for the DIBs model

This pilot has provided a lot of important lessons learned about the successes and challenges of the impact bond model in humanitarian aid and development contexts. Drawing on the evidence from this evaluation, there are a few pathways that could offer opportunities regarding the 'next steps' for the DIBs model:

- There is scope to design **dedicated outcomes funds** in particular policy areas to support their implementation and improve efficiency.
- **One option moving forward may be to take a 'model agnostic' approach to outcomes-based contracting.** In this scenario, the donor could establish a desired outcome, set a price they are willing to pay for those outcomes, and let service providers and/or the market determine what outcomes-based contracting mechanism they think is best-suited.
- **Another option for scaling is to prioritise organisation-level scaling rather than sector-level scaling.** DIBs can be cumbersome and time-consuming to set up, but this evaluation has found that they have the potential to create long-term process and cultural shifts within service provider organisations. If effects are maintained at the organisational level after the end of the project, then it may be more efficient to use an impact bond to fund multiple service providers, and then scale the interventions with the most effective organisations afterwards, through a more conventional funding mechanism.

- One option could be to try to **simplify the model** to reduce some of its complexity and costs. Options for this could include:
  - Our analysis shows the added value of the DIB comes mainly from the stronger focus on outcomes and high stakes environment; it does not seem to come – at least not in a substantial way – from intermediaries and/or external expertise. Could you design a model that retains the focus on clear outcomes and a high-stakes environment but reduces the reliance on intermediaries and/or external expertise?
  - Would a **25% PbR** model be able to create a focus on clear outcomes and a high-stakes environment but reduce financial risk down to a range that service providers could tolerate? This would then reduce the need to access external investment (possibly almost entirely), would simplify the model, and would possibly simplify contract negotiations.
- Another alternative could be where a philanthropic organisation provides the upfront working capital as a grant, on the proviso that a government or bilateral donor either 'tops up' or expands the model if pre-agreed outcomes are achieved. This again might create all the benefits seen in the DIB model (risk sharing between different entities, the bringing together of interested parties around the same goal, focus on outcomes and high-stakes environment) with less complexity. **Social Impact Guarantees** are similar, in which an external organisation agrees to refund the donor if pre-agreed outcomes do not occur, in the hope that it encourages donors to take greater risks with untested solutions and maintains a sharp focus on outcomes.[5]

These ideas would require further testing and research.

Recommendations

Recommendations to FCDO

- **FCDO can support the wider sector in collecting more robust cost data.** This evaluation has supported the progress of this endeavour by working with the DIBs to create a standardised cost reporting approach. We would encourage FCDO to collaborate with other donors and outcomes funders to roll out the cost template.
- **FCDO should consider designing thematic outcomes funds, using a 'model agnostic' approach to the particular outcomes-based contract.** This evaluation has demonstrated the ability to use impact bonds in education, poverty graduation and humanitarian-development settings. FCDO could explore supporting the launch of outcomes funds in these areas, as well as experimenting with their use in other policy landscapes[6].
- **Continue to experiment with alternative outcomes-based contracting models:** This evaluation has highlighted that the DIB model can be effective, but that there is scope to improve and streamline the model. If future outcomes funds were launched, we would encourage experiments to be included within their designs, to enable robust testing of different OBC approaches.

Recommendations to the wider DIB sector

- **Clarify roles and responsibilities upfront.** The pilots included in this evaluation highlighted that the 'right' mix of stakeholders can offer significant value-added with regard to capacity-building for the service provider(s). To ensure stakeholders are adding value to delivery, roles and responsibilities should be clearly defined and linked to the specific experience and expertise stakeholders are bringing.
- **Build flexibilities into the contract to respond to changing situations without having to substantially change contracts.** It will likely be impossible to incorporate all eventualities into a contract; therefore, building in flexibilities and agreed steps for approving changes will help the DIB mechanism remain relevant in crisis situations. The more that DIB contracts and learnings captured can be made public may help accelerate learnings in this area.
- **Create opportunities for peer learning within impact bond programmes:** Across multiple evaluations service providers have fed back to us that it can be challenging to deliver outcomes-based contracts when the organisation is inexperienced with them. We would encourage future programmes to build in peer learning opportunities for both service providers and donors.
- **Be transparent and share lessons learned and key successes and challenges to support the strengthening of the sector.** There is a very high level of scrutiny and focus on these early DIBs. It can be difficult to openly share 'failures'. A broader understanding of what 'success' looks like, especially during this pilot phase, will be important for building the wider sector.

5 Tan, K. et al, 2021. Social Impact Guarantees: **The Next Evolution in Outcomes-Based Funding.** Stanford Social Innovation Review.

6 FCDO has already supported the launch of an outcomes fund in education; the **Education Outcomes Fund (EOF)**.

> Stakeholders are all different and motivated by their own internal goals, but at the same time connected by a common interest in the overall benefit of the DIB.
>
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