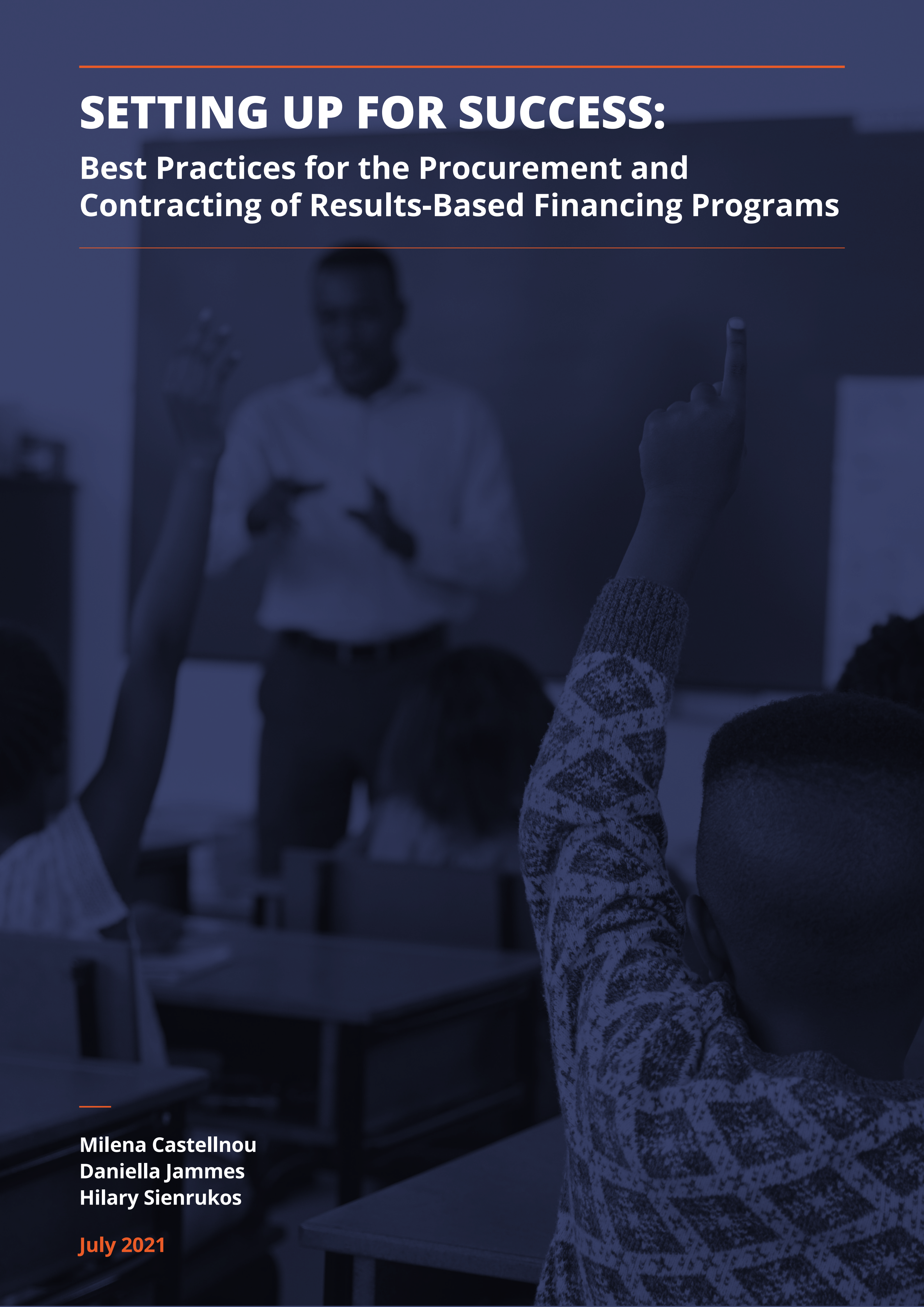

SETTING UP FOR SUCCESS:

Best Practices for the Procurement and Contracting of Results-Based Financing Programs

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CONTENTS

EXECUTIVE SUMMARY

Contracting and procurement are critical components to successful Results-Based Financing programs. However, too often they are ignored, leading to significant delays and sub-optimal results.

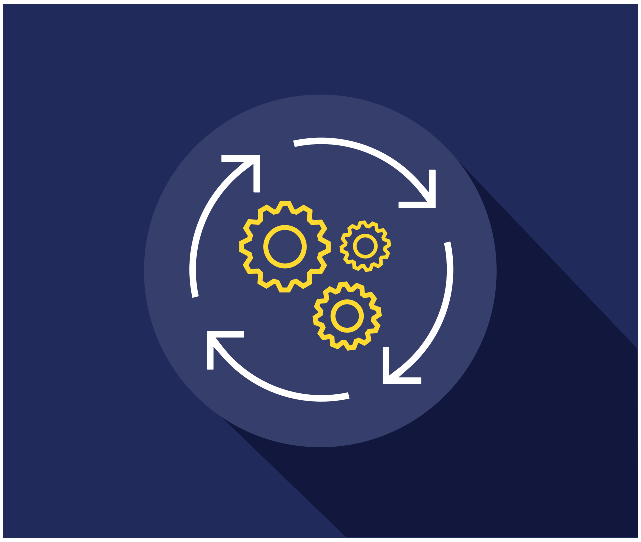
Results-Based Financing (RBF) is attracting interest as an innovative way to fund social programs in order to improve the effectiveness of spending, enable innovation in service delivery, and promote partnerships between the public sector, non-profit, and private entities. However, lengthy design processes and high transaction costs are often mentioned to explain the reluctance of organizations to adopt this financing mechanism. Little attention has been paid to the procurement and legal challenges faced when structuring RBF programs. Technical teams too often neglect these considerations until the last minute, assuming that lawyers and procurement officials will be able to rely on existing processes and templates which are often not adapted to RBF programs.

Procurement for RBF programs should follow a different logic than for traditional grants or service contracts.

Procurement teams will be faced with many strategic decisions, including whether a grant or contract is more appropriate for a specific RBF program and whether to use a competitive process to select implementers or not. This paper proposes considerations to guide their decisions as well as best practices for the evaluation of proposals in a competitive process. In an RBF program, assessing the technical and organizational capacity of implementers takes a different meaning and more emphasis should be placed on their capacity to achieve results (and adjust their interventions when needed) than on conformance criteria with a detailed list of activities. Similarly, cost-effectiveness should be assessed on a 'price per outcome' basis and attention should be paid to limiting the risks of winner's curse as implementers may overestimate their ability to achieve the outcomes.

Existing grant or service contract templates are not well-suited for RBF programs and require significant redesign.

As RBF programs require a strong focus on outcomes, flexibility on inputs and implementation delivery is a key condition of their success and needs to be recognized in the contract. RBF programs also establish a transfer of risk as implementers or investors pre-finance at least a portion of the delivery costs whilst some or all of the payments will only be disbursed by the outcome funders when results have been achieved. This risk transfer has implications for the obligations assumed by each party and the contract termination clauses. Lawyers should also consider RBF programs as a new form of partnership which calls for a strong governance and processes, allowing all parties to seek mutually agreeable solutions to unforeseen circumstances that may arise during the implementation period.



The lack of familiarity of procurement and legal teams with RBF and the absence of well-suited templates result in high-transaction costs and delays but these are not intrinsic to the financing mechanism.

This paper offers recommendations for practitioners engaging in RBF programs for the first time, emphasizing that it should be approached as a change management process. As teams gain experience with the mechanism and specific templates are created, there is no reason why selecting or contracting implementers for RBF programs should take longer than for any other contract or grant.

INTRODUCTION

Results-Based Financing (RBF) instruments,[1] which share the characteristic of tying at least a portion of the funding of programs to the achievement of pre-determined outcomes, are attracting growing interest.

The argument for using RBF as a financing mechanism is compelling for governments and donors as the approach can improve the effectiveness of spending, enable innovation in service delivery, and promote partnerships between the public sector and other stakeholders. However, despite an upward trend in adoption, RBF programs are still considered 'innovative' and the amount of funding disbursed through this mechanism remains marginal when compared with public spending overall. High transaction costs and lengthy design processes are regularly mentioned among the most common criticisms of RBF. Discussions about these challenges often focus on the need to find the right technical expertise and share best practices on technical aspects of the design process, the choice of outcomes metrics, or data on prices per outcome. In the specific case of impact bonds, observers point to the additional challenges involved with establishing partnerships with different types of actors not used to working together.

Although these factors are critical, much less attention has been paid to procurement and contracting challenges. Stakeholders engaging with RBF for the first time too often neglect these considerations until the technical design has been finalised, assuming that they will be able to rely on well-established processes and templates. This commonly leads to significant delays in program launch as months of work are then required to on-board and align the procurement and legal teams and iterate the draft documents. The contracting process for a Social Impact bond in Massachusetts is a good example of the type of challenges practitioners often face: it required 27 drafts of contracts and more than 1,100 legal hours were billed.[2]

In addition to timeline risks and high transaction costs, inadequate procurement and contracting processes and templates can significantly affect the implementation of the program and the results achieved. As disbursement will be conditioned upon the achievement of outcomes, the procurement strategy needs to ensure the selection of implementers most capable of achieving the targets set. Similarly, balanced contract terms are essential to encourage implementers, and when applicable, investors to participate in RBF programs. As implementers and investors assume a greater share of financial and reputational risk when results are not achieved, unbalanced terms proposed by commissioners are also likely to lead to protracted negotiations. Finally, specific choices in procurement and contracting can limit the level of flexibility provided to implementers and investors and the ability to amend the contract to adapt to changing circumstances. Finding ways to overcome these challenges and streamline the procurement and legal processes is therefore critical to promote the adoption of RBF approaches.

Provided that legislation does not establish specific constraints,[3] selecting implementers and drafting contracts for RBF programs is not by nature more complicated than in the case of more typical service contracts or grants. We argue that two reasons explain the challenges mentioned above: the absence of well-suited templates for RBF programs and the lack of familiarity of the procurement and legal teams with RBF. With the exception of countries with greater experience with RBF such as the United Kingdom, procurement and legal teams only have at their disposal templates which are often not adequate for RBF programs. Adapting them can be time-consuming as any departure from existing processes often needs to be justified, and depending on the nature of the original contract, multiple layers of approvals may be required.

As summarized by the Brookings Institution,

'it is important to note that development and transaction costs are certainly not zero in any other social service provision. Responsible public procurement requires significant due diligence, including legal and compliance costs, as well as a thoroughly structured contract. However, because other forms of financing have been around longer and are more common, governments and service implementers using these other forms of financing have more standardized processes and procedures, which decreases some of the costs involved'.[4]

This adaptation process is further complicated by the lack of familiarity of procurement and legal teams with RBF approaches. Although lack of awareness can easily be overcome as legal and procurement officers get introduced to the functioning of the financing mechanism and its implications, adapting existing practices also requires a willingness to engage in creative problem-solving. Risk averseness[5] within governments' and donors' procurement and legal teams makes the process particularly challenging:

'the point is that while many procurement and legal professionals excel at innovation and the art of procurement and lawyering, others are more comfortable (or are forced to operate) in an environment of compliance that is highly regulated'.[6]

Throughout the procurement and legal process, it is critical to remember that engaging for the first time with RBF approaches is a change management process. However, as the teams gain familiarity and become more comfortable with RBF and once RBF-specific templates have been established, there is no reason why selecting or contracting implementers for RBF programs should take longer than for any other contract or grant.[7] The United Kingdom provides a good example: the use of template outcomes contracts and the fact that many local authorities have launched more than one Social Impact Bond has greatly increased efficiency.

This paper provides practical guidance to practitioners, procurement and legal officers on the key differences between RBF programs and typical service contracts or grants, for which adaptations of existing practices might be required. We will examine in turn implications for the selection of implementers and the content of contracts. We will then conclude with a few recommendations for practitioners as they approach the procurement and contracting processes for RBF programs for the first time.

PROCUREMENT FOR RBF PROGRAMS[8]

When approaching an RBF program, the first step is to choose the right procurement strategy for selecting implementers (and if relevant, investors). A key component of the strategy is whether a contract or a grant would be the best instrument for the RBF intervention.

1. The choice of instrument: grant or contract?

Each organization or government entity will have their own rules regarding the use of grants and it is important for commissioners to understand these rules before selecting a grant mechanism. However, there are generally accepted differences between the two instruments.

	PURPOSE	TYPE OF RELATIONSHIP	LEGAL IMPLICATIONS
GRANTS	A grant is a form of financial assistance that provides support or stimulation to organizations to accomplish a public purpose. Grants must also have an intent to benefit the Grantee's mission or purpose. In most cases, grants are awarded to non-profit and community-based organizations, but private sector entities may also be eligible to receive grants.	The relationship between the grantee and the funder is collaborative rather than directive.	Grants require "best efforts". The funding assistance is given to hopefully achieve some result but there is no legally binding requirement to achieve the result.
CONTRACTS	The purpose of a contract is to purchase services or goods for the use of the buyer.	Contracts are more appropriate when there is a buyer/seller relationship and the buyer expects control over the deliverables and a high level of direction.	A contract is a legally binding agreement to deliver goods and/or services in exchange for compensation (usually money).

Grants and contracts share some common requirements. For instance, an estimated amount of award must be determined up front and an agreed budget will be part of the agreement or contract. However, the choice of using a grant or a contract will have implications on the procurement templates, selection methods, and content of the legal agreement further down the line.

This paper does not provide a recommendation on whether grants or contracts are better suited for RBF programs as this will depend on the specific regulation of the funding organization and the objectives of the program - however it is critical that practitioners consider these implications carefully.[9]

2. Direct award or competitive selection process

Procurement professionals working on RBF programs may consider direct award or an open and competitive process for the selection of RBF projects when several implementers could be eligible.[10] An open and competitive process which determines the price to be paid, driven by outcome funders rather than implementers or investors, is considered as the best way for commissioners to ensure that they receive value for money when there are multiple implementers that could deliver the program. An open competition provides other benefits such as transparency and the possibility to find new/unknown implementers and solutions. However, for some specialized services and when targeting high-capacity organizations in some contexts, competition can be limited. In these cases, even when going through a competitive process, it may be difficult to determine value for money.[11]

A direct award (or a sole source) is appropriate when it is determined that there is only one implementer that can do the work and/or the implementer has unique skills or services. For example, there may be only one organization working in a certain region of a country with the skills and capacity to carry out an RBF program or they may be the only organization legally registered with the Government to work in a certain region. Direct contracting does not provide the benefits of competition and therefore a direct award should be fully justified with sound reasons as to why an open competition is not in the best interest of the RBF program or commissioner.

Within the universe of RBF instruments, Impact Bonds have often relied on direct award. Many Social and Development Impact Bonds were designed for a single implementer, with the investor or implementer sometimes even leading the initial design work. Although this approach may be adequate when using this instrument for the first time in a new context, ideally the selection processes would evolve over time towards a greater use of competitive bidding. In addition, moving from single-provider transactions to the competitive selection of several implementers is essential to achieve impact at scale through RBF. It will allow commissioners to reach more beneficiaries, lower transaction costs (the design and set-up costs are not expected to be significantly higher when selecting more than one implementer), test different intervention approaches to learn about what works and what does not, and collect data to refine estimates of prices per outcome over time. The model of the Education Outcomes Fund, a hosted fund at UNICEF, was designed precisely around these principles.

3. Best practices for the evaluation of proposals for RBF Programs

Assessing technical and organizational capacity

It is critical that technical teams designing RBF programs communicate clearly to procurement officers the required level of technical and organizational capacity for implementers. These criteria are translated into the evaluation criteria and are one of the most important things to get right when contracting implementers. For RBF, performance-based specifications that describe the outcomes or outputs required in terms of business or functional performance requirements should be used to evaluate proposals rather than conformance criteria which describe in detail the technical criteria needed for delivery or design of the program. Similarly, key personnel, specific details of the proposed intervention, and workplan are less critical since flexibility needs to be provided and inputs might be adapted during implementation.

Performance-based criteria are less prescriptive and allow for greater innovation[12] and flexibility but can be more time-consuming to prepare for procurement teams. Procurement staff may need training on how to prepare performance-based criteria. Evaluating bids using performance-based criteria is also more complex and panel members should be qualified to do this type of evaluation and briefed in advance on how to assess performance-based procurements. It is worth noting that a less prescriptive performance-based approach might also facilitate future contract revisions if these are needed during implementation, as any edit would have to be justified as remaining within the original scope of the contract.

This recommendation reflects the conclusions of The Government Outcomes Lab (GO Lab):

'In your communications to the market, be as flexible as possible regarding the inputs and activities required to achieve the outcomes, allowing the implementer to propose how they will achieve them. There are benefits to this flexibility. During market engagement and procurement, you may receive more interest and more alternative solutions or innovation. If you are too detailed about the inputs and activities in your notices and invitation to tender documents, then making changes may require a contract cancellation and re-procurement'. [13]

To identify high-capacity implementers of RBF programs, several considerations are particularly critical, taking into account the fact that implementers (or the investors backing them in Impact Bonds) are assuming the risk in case of low performance:

CONSIDERATION	IMPORTANCE	FEATURES
PAST PERFORMANCE	Evidence of past performance is a key predictor of the capacity to achieve results and is a critical factor in RBF programs. The case of A4e in the United Kingdom's Work Programme is an interesting case study: this implementer facing significant struggles to achieve targets had been awarded the contract despite its previous poor track record in other Government programs.[14]	Past performance evaluation should take into account the results previously achieved as well as the rigor of the methodology used to measure them.
PERFORMANCE MANAGEMENT SYSTEMS AND CULTURE	It is key to assessing the capacity of organizations to adjust their intervention during implementation in response to challenges and successes encountered. The flexibility granted to implementers and possibility to adapt the interventions is one of the key drivers of impact of RBF.	Elements to look out for include existing data collection systems, use of data for decision-making, feedback loops to communicate challenges faced on the ground to management teams, and a performance-oriented culture which rewards achievement of results rather than adhesion to processes.[15]
CAPACITY TO MANAGE FINANCIAL RISK	This aspect of capacity is critical for implementers when they are pre-financing the intervention or investors in the case of Impact Bonds.	In addition to ensuring that the required amount of capital is available, the procurement process should ensure that organizations have a good understanding of the level of risk assumed as well as internal financial management processes to anticipate and manage these risks (for instance if performance is lower than expected and additional pre-financing is required).

Additional due diligence can be conducted as part of the overall evaluation. For grants, this is commonly done to determine grantee's capability and grantees that are considered high risk, for example, those that do not have a robust financial management system, may have special conditions put on their award to strengthen their ability to carry out the work or they may not be awarded the grant. For contracts, organizational and technical capacity is usually assessed through past performance, references, financial statements and organizational management structure. Commissioners should, however, consider whether additional due diligence is appropriate considering the risk level of potential implementers and investors. Members of the evaluation panel should be qualified to assess these varying criteria and, if necessary, independent consultants could be hired to perform financial capacity assessments or other specific areas of expertise needed to evaluate organizations for awards.

Assessing cost-effectiveness

In a traditional grant selection process, cost-effectiveness is assessed through a detailed analysis of budgets – to assess whether each budget line is needed to achieve the objectives of the program as well as whether each unit price is reasonable. When accepted, budgets are expected to be adhered to during implementation (with some flexibility between line items) regardless of whether the specific activities or line items are achieving the desired impact. In the case of service contracts, price reasonableness is determined through competition or through a benchmark comparison with similar services.

For RBF programs however, what matters is the price of each outcome, which will trigger disbursements irrespective of the budget spent. A fixed-price contract based on performance can provide the right mechanism and if the choice was made to use a grant, fixed-amount milestone-based awards that are based on performance are recommended. In this way, the grantee is not held to spending within line items of a budget but is paid based on the milestone achieved. A fixed price contract based on performance follows a similar process.

In an ideal procurement process, the focus of the cost-effectiveness analysis should therefore be on comparing prices per outcome. The specific budget distribution should matter less: two organizations might propose very different interventions with different budget lines or budget distribution but the most competitive one would be the one offering the lowest cost to achieve a set unit of outcome. Unfortunately it is more difficult to price outcomes than traditional services or goods as commissioners, implementers, and investors are not used to budgeting in 'price per outcome' and are more familiar with the cost of teacher training than the cost required to achieve learning gains for students.[16]

Commissioners who have access to sufficient data to determine the value of the price per outcome, as is often the case in high-income countries, may choose to define a pre-determined rate card and the competition becomes focused on the quality of services only.[17] RBF programs in the United Kingdom (Department for Work and Pensions' Innovation Fund) and Australia (JobActive) have for instance used these mechanisms.[18] Alternatively, an open competitive process can determine the price to be paid. Commissioners using this approach might nevertheless use benchmarks to determine price reasonableness in the RBF award processes.

This is even more challenging in low- and middle-income countries where governments and donors operate in low data environments, at least for the first iteration of an RBF program. Commissioners can determine an estimate of the price per outcome for the RBF activity using data from past RBF programs in similar environments, or past programs in the country that shared the same objective and discussions with implementers through market research.[19] Beyond imperfect benchmarks, the cost of interventions is often all we have to assess cost-effectiveness in nascent RBF ecosystems. Applicants should therefore submit detailed budgets for the activities they propose to undertake and this overall budget, in conjunction with the targets proposed, forms a price per outcome which can be compared across proposals. It is important to recognize that this budget can include a premium or return on investment to compensate the risk assumed by the implementer or investor or the opportunity cost of mobilising capital to pre-finance the intervention.

Although common in procurement, awarding to the lowest priced bidder is often problematic in an RBF context. Many forward-looking procurement professionals are moving beyond the 'lowest cost compliant method', however, many public procurement professionals are still constrained by lowest cost evaluation methodology. As RBF often operates with a high degree of uncertainty over the cost of achieving outcomes, there is a specific risk associated to the weight put on cost-effectiveness: the winner's curse.

Winner's curse consists of applicants overestimating their ability to achieve the outcomes and/or underestimating the costs to be incurred. Particularly when implementers are assuming the financial risk (in the absence of investor pre-financing), it can lead to serious financial difficulties if they are awarded the contract. From the authors' experience, implementers often tend to underestimate the cost of achieving results when it is their first time engaging in an RBF program. This is a particularly important risk for those with less rigorous performance management practices as they lack good data on the results they have achieved in the past and base their proposals on unverified assumptions. It can mean that some of the implementers with the strongest capacity to achieve results offer higher prices than the weakest ones.

To address this risk, procurements should be structured so that less weight is put on price and more on technical quality. This allows implementers with high quality interventions to compete fairly and win contracts. Strict qualification criteria should be part of the evaluation criteria at the proposal stage to ensure that only implementers with the systems and capacity to do the work are selected. Procurement and technical teams need to work closely to make the evaluation criteria as relevant and strong as possible. During the evaluation, selection officials can rigorously scrutinize budgets submitted to ensure that all potential cost items have been included as well as the targets proposed (when applicable) to ensure that they are in line with results previously achieved. Alternatively, 'Quality based' selection methods do not emphasize price and can mitigate the risk of low bid interventions that fail to deliver.

Although cost-effectiveness analysis might require activity-based budgeting during the selection process, selected organizations should have the flexibility to depart from their submitted budgets during implementation (as long as deviations remain within the scope of the initial grant or contract) in order to adjust their interventions if required to achieve results, as flexibility is one of the key benefits and drivers of impact of RBF.[20] The budgets ultimately executed by implementers and investors will be an important source of learning for policy makers about what should be considered the 'right price to pay' in the future.

Over time, RBF programs can be expected to facilitate the selection and scale up of the highest performing interventions and organizations. In addition to data on the cost of achieving outcomes, the first completed iterations of RBF programs will provide more visibility on the impact achieved, making it easier to separate highest from lower performers. It can lead to a self-regulating system in which the highest performers are awarded new contracts at a greater scale, therefore maximizing the impact achieved. The JobActive program in Australia provides a good example: a 'star rating' system is used in addition to the financial incentives to award a larger share of the market to high-performing implementers.[21]

CONTRACTING FOR RBF PROGRAMS

When contracting for outcomes there are a number of crucial differences to making a traditional grant or a fee-for-service contract. This section aims to provide guidance to technical and legal teams as they approach the contracting process.

1. Focus on outcomes

The first and most obvious difference between an outcomes contract[22] and a traditional grant or service contract, is that the emphasis will be on outcomes rather than activities or inputs. An outcomes contract needs to clearly describe the desired outcome(s) that will be paid for, but also consider:

- how that outcome will be measured or evidenced;
- if an evaluation or third-party verification is required to evidence or verify an outcome, the process for such evaluation or verification; who will pay for it and what will happen if it is not carried out as expected;
- if the evaluation of the outcomes is based on a randomised controlled trial (RCT) or similar methodology, what protections are in place to ensure that the control group remains in place;
- if an implementer is reliant on the commissioner to provide data to evidence the achievement of outcomes, what rights does the implementer have to be given that information under the contract and what happens if it is not provided;
- how the payment decision process will work.

While a strong focus on and tight definition of the outcomes is essential, flexibility on inputs is seen to be one of the key benefits of an outcomes contract. Allowing flexibility in the implementation is crucial for implementers and investors: as implementers and/or investors only receive payments when the results are achieved, they need to be able to design and adapt the intervention as they see fit. Of course, a general framework can be defined to make sure that implementers and investors respect certain pre-established conditions (for instance related to ethical conduct or a minimum standard of delivery). However, within this framework implementers should have the flexibility to choose and adapt their activities and use their budget as needed. For the same reason, approval processes should be kept to a minimum and if they are needed, for instance regarding changes of delivery partners, they should be established in advance to ensure a smooth coordination.

The inflexibility within the first Social Impact Bond (SIB) in the US, the Rikers Island SIB, has been cited as one of the factors having contributed to its failure to achieve sufficient outcomes to make it a financial success.[23] Conversely, in the Educate Girls Development Impact Bond (DIB) the flexibility inherent in the program allowed delivery to be substantially adapted after the first year of relatively disappointing results in achievement of learning gains outcomes; following such changes achievement of outcomes rapidly increased and surpassed the targets set.[24]

As noted by Instiglio and GPRBA:

'Program rigidities introduced by complex legal or practical constraints limit the potential of the agent to adjust its program in the pursuit of results and therefore weaken the role of flexibility as one of RBF's drivers of impact. This can mean that the agent is held accountable for results while also not being able to flexibly adjust its approach to achieve these results. This is particularly problematic in low and medium stages of maturity because it can deprive agents of the capacity to experiment and adjust their program in the search of better solutions. In practice, funders' capacity to develop sufficiently flexible contracts can be affected by certain institutional, legal, and political conditions.' [25]

Outcomes contracts have been stress tested during the COVID-19 pandemic and, while it is difficult to speak for all RBF programs (partly because the levels of flexibility within them vary), many have been seen to have performed well.[26] The ability to react to changes in circumstances and refocus services to meet evolving requirements is not only part of the contract but part of the mindset of the actors. This flexibility, coupled with the strong governance structures discussed below and use of data that are characteristic of RBF programs, may account for the strong performance.

2. Risk transfer from commissioner to implementer and/or investor

By paying only or partly for outcomes, commissioners transfer the performance risk to the implementer and/or investor. However, implementers and investors will not want to take on additional risks that are beyond their control. The parties to an outcomes contract should consider carefully what variables could affect the ability of the implementer to achieve outcomes and ensure that those risks are appropriately allocated. In the case of unexpected events outside of the control of either party, passing on the risk to the implementer and/or investor may lead to commissioners paying a premium, comparable to buying an insurance for natural disasters or other such unexpected events.

There will also likely be factors which are within the control of the commissioner. In particular certain minimum operating conditions which will enable an implementer to achieve or evidence the achievement of outcomes are likely to be, at least to some extent, within the control of the commissioner. In a service contract or traditional grant-based program, the implementer would generally expect to be paid for its activities even if conditions are not in place for these to translate into outcomes and funding would be disbursed without having the desired impact. Where the implementer is reliant on achieving outcomes to be paid, it will expect obligations on the commissioner under the contract to ensure that those conditions will exist. This may include specific obligations on the commissioner such as to provide minimum levels of referrals; to provide certain data or timely evaluation or verification of outcomes as well as a more generic obligation not to do anything that makes it materially more difficult to achieve the outcomes.

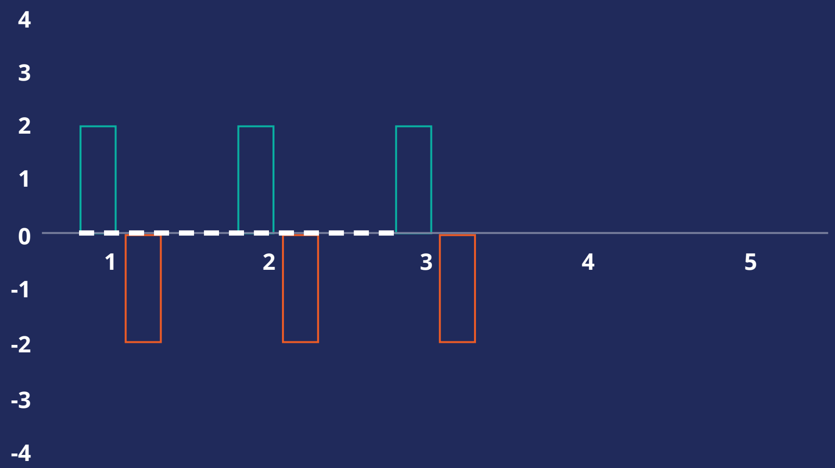
Another key consequence of paying for outcomes is the cashflow of a program. In an RBF program, investors and/or implementers pre-finance at least part of the intervention and generally payments are only disbursed after outcomes have been achieved.[27]

Looking at the three types of funding in turn assuming annual payments:

Revenue Expenses Cumulative net cashflow

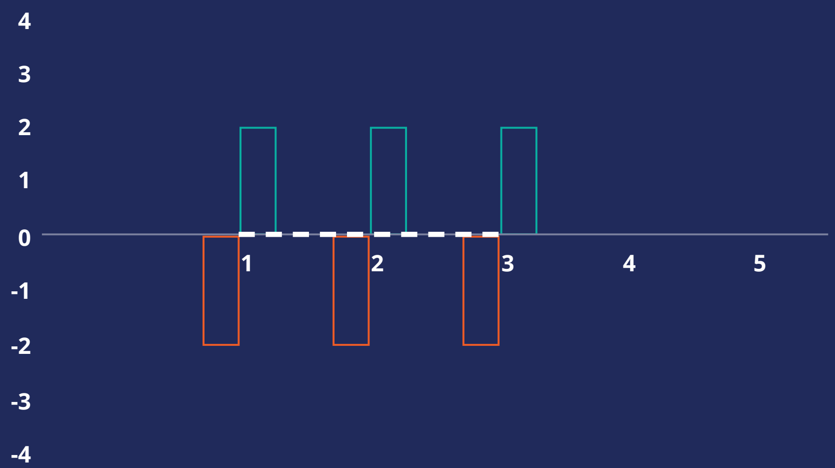
Cashflow of typical grant

Under a typical grant, a grantee will usually be paid in advance and use those funds to fund activities for the next year



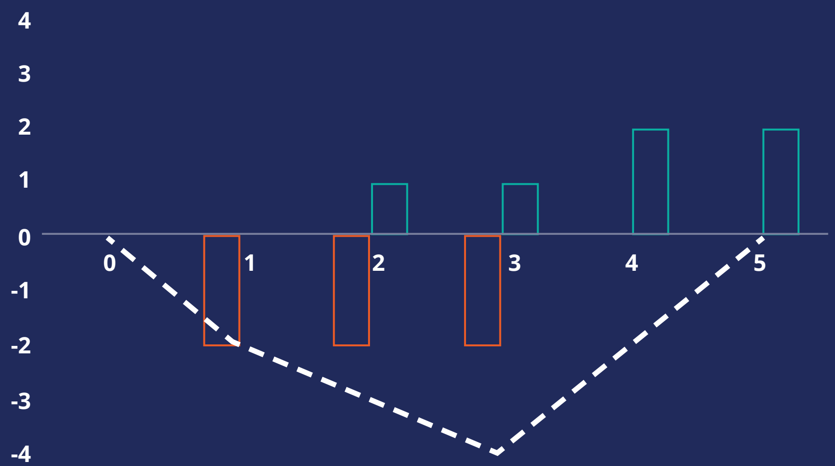
Cashflow of a service contract

Under a service contract the contractor will usually be paid on a regular basis in arrears for the expenditure it has incurred for that period



Cashflow of a Results-Based Financing program

Under an outcomes contract, models will clearly differ but it is likely that a significant amount of funding is incurred in the first years but that payments are structured such that the implementer or investor only breaks even towards the end of the contract



This difference has a large impact on the risk appetite of implementers or their investors. Under a typical grant or service contract if the contract terminates early, a portion of the grant funding may need to be returned, or the contractor may not receive all of the payments it expected. However, given the periodic payments, they would not usually expect to make a loss. In contrast, from the above it can be seen that, were the contract to terminate part-way through the implementation period, implementers or investors in an outcomes contract (in which all or a portion of the funding is at risk) would make a loss. They will therefore generally require to be compensated for costs already incurred or for the amount that they could have expected to receive had the contract run to completion in the event that the contract is terminated early for reasons outside of their control (for example a voluntary termination or breach of contract by the commissioner).[28] Implementers and investors will similarly be concerned about any events giving rise to a right to terminate by the commissioner which are outside of their control (including a force majeure event), or so called 'hair trigger' termination events which give rise to a right to terminate for non-material breaches.

3. The importance of governance in outcomes contracts

Good governance procedures are important to build partnerships which can benefit an RBF program in two ways. Partnerships between stakeholders from different sectors have been cited as one of the key advantages of RBF programs for a number of reasons.[29] Strong partnerships also increase the ability of the parties to work together to overcome challenges.

When challenges arise, as they inevitably do on a fairly long-term complex program, the goal is to ensure that all parties have an incentive to find a resolution to move forward, rather than walk away. An RBF program will usually have mutual incentives for the program to succeed built in: the commissioner will continue to want to achieve the outcomes and, from an implementer or investor's perspective, early termination may well result in it making a loss as described above. These mutual incentives are supported by good design, in particular, through the definition and measurement of outcomes to avoid perverse incentives or cherry picking.[30] However, throughout the COVID-19 pandemic we have found that the relationships built during the development and operation of programs have been particularly important to the success of a program in times of disruption. Building in contract governance procedures can be a useful tool to ensure constant dialogue and that issues are raised early. This may involve a dual level of contract governance with an operational committee overseeing delivery and an executive committee with greater decision-making abilities, as well as the mandate to make improvements to the implementation of the program or the contract that the parties agree would be in the interests of all involved.[31]

4. Remaining flexible

However perfect the contract may be, circumstances can arise in which changes should be made. Given the length of time for which an RBF program may run and the number of assumptions upon which a model is based, it is possible, and in some cases even likely, that, over the lifetime of a contract some of those assumptions or the operating conditions may change. A number of reasons may lead to the decision to amend the design of the program during the term of the contract; for instance if the outcomes themselves are found not to reflect the needs of the community being served or potentially give rise to a perverse incentive. The example of the Fair Chance Fund in the United Kingdom illustrates this challenge as its design encouraged implementers to achieve training outcomes which were not aligned with the priorities of the beneficiaries.[32]

There may also be changes in operating conditions due to a force majeure type event or for other reasons including events within the commissioners' control. In these circumstances we suggest that, rather than either continuing with a contract that is no longer fit for purpose or simply terminating the contract, parties should be encouraged to agree on amendments. This would involve a process of renegotiation where both sides are incentivized to achieve a solution. While this should be a separate process to the governance structures outlined above, we expect that the strength of the partnership and mutual understanding built by these structures will be important in delivering an outcome acceptable to all parties.[33]

It must however be noted that public procurement often restricts the flexibility to change course once a contract is signed. Completely revising a contract after a competitive process risks undermining the public procurement principles of competition and transparency. Changes to a contract must therefore stay within the original scope of the contract and different organizations will have different levels of tolerance with regards to the amount of change that can be done without having to resort to running a new procurement process. It is therefore important for practitioners to understand these restrictions at the time of contract-drafting to anticipate any potential challenges.

RECOMMENDATIONS FOR PRACTITIONERS ENGAGING IN RBF PROGRAMS FOR THE FIRST TIME

Considering the key differences between RBF programs and more typical service contracts or grants outlined in the previous sections, we suggest four best practices for practitioners, legal and procurement officials approaching RBF programs.

1

Engage the procurement and legal team from the very beginning.[34]

Too often this work only starts when the technical design has been finalized. Advancing in parallel will reduce the risk of delays whilst also ensuring that the procurement and legal strategy adopted is best suited for the program.

Procurement personnel need to understand the unique aspects of RBF and best practices in procurement for RBF programs. Early discussions with the procurement and legal teams are critical to understand the contracting mechanisms available in their organizations, determining upfront whether a grant or contract would be the most appropriate instrument and whether or not the organization has experience and templates for performance-based contracting.

2

Remember that although RBF programs are often born out of the interest of champions within technical teams, procurement and legal professionals might need additional onboarding and convincing.

This engagement should be approached as a change management process and our experience has demonstrated that it is critical to make sure that the relevant stakeholders understand well the characteristics of RBF mechanisms before focusing on specific clauses and practices.

At its core, RBF can be a more direct way to achieve some of their key objectives: to ensure that the program has the desired impact and is cost-effective. Whilst commissioners have greater oversight of the activities in traditional grant funding, this does not guarantee that impact will be achieved. Although RBF requires funders to relinquish control over the specific activities implemented, it establishes a more direct link between the funds disbursed and the ultimate objectives of the program. Similarly, cost-effectiveness calculations in grants and service contracts rely on the assumptions that the funds spent will translate into impact and that a lower cost per beneficiary will lead to impact for more beneficiaries. RBF strengthens these assumptions as it establishes a direct link between funds spent and outcomes achieved. It allows funders to redirect funding towards the most effective interventions and over time, as high-performing interventions are scaled up, to achieve greater impact.

Discussing the rationale for RBF with internal stakeholders and its alignment with the core principles they uphold can play an important role in sparking their interest in engaging in collaborative problem-solving.[35]

3

Create specific templates for RBF programs rather than attempting to use existing ones which were initially intended for grants or service contracts.

Making adaptations to numerous provisions to account for the key differences previously detailed can be more time-consuming and risks resulting in suboptimal solutions. In addition, the creation of a new template rather than one-off exceptions will lead to greater efficiencies if the same institution engages in another RBF contract.[36]

4

Consider pooling funding and leveraging existing efforts and vehicles to minimize the efforts required for creating templates and establishing new policies and practices for each donor and government.

One idea would be to set up a 'community of practice' for procurement and contracting professionals to share templates and best practices for RBF so that governments and donors are not always reinventing the wheel.

In addition, some initiatives such as the Education Outcomes Fund have developed the fiduciary structure to pool outcomes funding and templates for selecting and contracting implementers and investors specifically designed for RBF programs. The time invested in establishing this type of financial and legal infrastructure should facilitate and accelerate the launch of RBF programs.

REFERENCES AND NOTES

1. This paper aims to provide guidance for the legal structuring of RBF programs generally. Some sections will be more relevant for practitioners working on specific instruments (for instance the discussion on the selection process is more relevant for Impact Bonds and Performance-Based Contracts than it is for Performance-Based Aid or Performance-Based Transfers), however the shift from paying for activities to paying for outcomes has legal implications relevant to all instruments, such as the importance of allowing for flexibility in the implementation for instance, and the authors' recommendations regarding legal templates seek to encompass all RBF programs. For a review of RBF instruments, see the following reports: GSG and EOF. (2021). Tying Funding to Results. A primer in results-based finance to support a just covid recovery and foster impact driven economies. GPOBA and Instiglio. (2018). A Guide for Effective Results-Based Financing Strategies. Washington, DC: GPOBA.
2. A survey from the Brookings Institution on challenges faced in developing impact bonds identified amongst the key ones the lack of favorable legal conditions. The survey quotes the legal counsel to the intermediary in the Massachusetts recidivism SIB, who reported that "27 contracts were written and more than 1,100 legal hours were billed" to develop the bond. Gustafsson-Wright, E., Gardiner, S., & Putcha, V. (2015). The potential and limitations of impact bonds: lessons from the first five years of experience worldwide. (Global Economy and Development Program at Brookings). Washington, DC: The Brookings Institution.
3. In some countries, there can be legal barriers limiting governments' ability to sign contracts with investors, or their capacity to commit resources to be disbursed in future financial years. For more details on the required legal framework for impact bonds see: Instiglio. (2014). A Legal Road Map for Social Impact Bonds in Developing Countries. Bogota, Colombia: Instiglio.
4. Gustafsson-Wright, E. & Osborne S. (2020). Do the benefits outweigh the costs of impact bonds? (Measuring the Success of Impact Bonds). Washington, DC: The Brookings Institution.
5. As mentioned by a study in the United Kingdom on impact bonds: 'Issues relating to procurement often stem from a risk averseness among commissioners, and the framing of SIBs as 'innovative' perpetuates the notion that they are more difficult than other types of complex commissioning.' Wooldridge, R., Stanworth, N., & Ronicle, J. (2019). A study into the challenges and benefits of commissioning Social Impact Bonds in the UK, and the potential for replication and scaling: final report. Birmingham, UK: Ecorys.
6. GO Lab. (n.d). Awarding outcomes-based contracts. Available at: https://golab.bsg.ox.ac.uk/toolkit/technical-guidance/awarding-outcomes-based-contracts/
7. It is worth noting that practitioners have noticed that RBF may take more effort up front to design and launch, but does reduce contract management including oversight and audit functions later on.
8. The term 'procurement' is used throughout this paper as general term designating the selection process, applicable both to service contracts and grants.
9. Other RBF instruments, such as prize-based challenges, cash on delivery or conditional cash transfers might require other options than grants or contracts, however these are out of the scope of this paper.
10. This is most often the case when implementers are non-state actors but might not be applicable in the case of RBF programs incentivizing governmental or quasi-public entities.
11. For instance in the case of The Worcestershire Reconnections program in the United Kingdom, 'the commissioners chose to run an open procurement exercise that took 10 months, to give themselves some power to negotiate terms. Unfortunately, the only respondent were the team that had developed the concept – Age UK and Social Finance, supported by Nesta and Big Society Capital. So there was no competitive pressure in practice.' GO Lab. (n.d.) Procurement guide – a guide to procurement for social impact bonds. Available at: https://golab.bsg.ox.ac.uk/toolkit/technical-guidance/awarding-public-contract-social-impact-bond/procurement-guide/

12. This was confirmed by a study in the United Kingdom: 'Taking a 'black box' approach, where commissioners specify parameters and then encourage providers to design services, has been credited by some commissioners as supporting the development of higher quality and more innovative approaches to delivery.' Wooldridge, R., Stanworth, N., & Ronicle, J. (2019). A study into the challenges and benefits of commissioning Social Impact Bonds in the UK, and the potential for replication and scaling: final report. Birmingham, UK: Ecorys.
13. GO Lab. (n.d). Awarding outcomes-based contracts. Available at: https://golab.bsg.ox.ac.uk/toolkit/technical-guidance/awarding-outcomes-based-contracts/
14. 'The record of welfare-to-work company A4e has come under scrutiny from MPs, as they questioned why a company with an "abysmal" record of delivering government programmes had been awarded new contracts to provide the coalition's Work Programme when it launched last summer.' The Guardian (2012). A4e got welfare-to-work contract despite 'abysmal' record, MPs say. 09 February. Available at https://www.theguardian.com/politics/2012/feb/09/a4e-welfare-to-work-contract The Guardian 09.02.12
15. This element is mentioned in Gustafsson-Wright, E. (2020). What is the size and scope of the impact bonds market? (Measuring the Success of Impact Bonds). Washington, DC: The Brookings Institution. 'A pool of service implementers ready to contract on outcomes is crucial to building a market for impact bonds. Outcome-based financing typically demands high levels of data capacity and rigorous performance management from delivery organizations.'
16. The challenge is even greater when outcomes are evaluated through an RCT.
17. As mentioned by The Government Outcomes Lab (GO Lab): 'This approach is most useful when commissioners are confident that they can define the value of payments for improved outcomes, because the costs of the alternative are easy to define e.g. the cost of keeping children in residential care.' GO Lab. (n.d.) Procurement guide – a guide to procurement for social impact bonds. Available at: https://golab.bsg.ox.ac.uk/toolkit/technical-guidance/awarding-public-contract-social-impact-bond/procurement-guide/
18. In the case of the Innovation Fund for instance, 'the list of payable outcomes, and amount per outcome, was published in the specifications for each round. Bidders then proposed the payments they expected for each outcome, often offering a discount on the published price. Bidders were allowed to 'pick and mix' from the list of outcomes and work toward outcomes appropriate for each young person up to the maximum cap.' GO Lab. (n.d.) Procurement guide – a guide to procurement for social impact bonds. Available at: https://golab.bsg.ox.ac.uk/toolkit/technical-guidance/awarding-public-contract-social-impact-bond/procurement-guide/
19. Confirming assumptions with implementers is an important step of the process especially when Government data is reported in the absence of a rigorous evaluation. This can be the case in employment programs where data on placement and retention outcomes achieved is rarely verified which can lead commissioners to underestimate the cost of achieving these outcomes.
20. Although it is preferable to provide complete flexibility to implementers and investors on the execution of budget during implementation, Governments might be subject to specific constraints and wish to establish a minimum or maximum spending level.
21. For more information on the JobActive star rating system, see JobActive. JobActive Star Ratings and Perfomance. Available at https://www.dese.gov.au/jobactive/jobactive-star-ratings-and-performance.
22. In this paper, 'outcomes contract' is used as a generic term to cover grants or contracts as the concepts apply to both forms of agreement.
23. Galloway, I. (2015) Perspectives on Impact Bonds: Scaling the social sector through innovation and

impact bonds. The Brookings Institution. Available at https://www.brookings.edu/blog/education-plus-development/2015/09/09/perspectives-on-impact-bonds-scaling-the-social-sector-through-innovation-and-impact-bonds/

24. IDinsight. (2018). Educate Girls Development Impact Bond: final evaluation report. IDinsight.
25. GPOBA and Instiglio. (2018). A Guide for Effective Results-Based Financing Strategies. Washington, DC: GPOBA.
26. Gustafsson-Wright, E. (2020). What happens in an outcome-based financing model when a major crisis hits? The Brookings Institution. Available at: https://www.brookings.edu/research/what-happens-in-an-outcome-based-financing-model-when-a-major-crisis-hits/
27. This is not applicable to RBF programs in which the portion of funding tied to the achievement of outcomes is structured as a bonus and the totality of implementation costs are covered under a traditional grant modality.
28. The Government Outcomes Lab (GO Lab) also mentioned this specificity in its technical guidance: 'In order to develop its financial model, the contractor (implementer, investor, and/or intermediary) needs to understand what will be paid if the payer makes a voluntary termination or defaults. This is because the contractor may not have had the chance to achieve enough outcomes at the point of termination to cover their costs up to that point and the termination will deny them the chance to achieve more outcomes in the future and recoup their upfront costs'. GO Lab. (n.d). Awarding outcomes-based contracts. Available at: https://golab.bsg.ox.ac.uk/toolkit/technical-guidance/awarding-outcomes-based-contracts/
29. For example 'Some of the commentary focuses on the potential to foster cooperation across different types of players in the public and private spheres, while others highlight the possibility for impact bonds to break down silos and bring together players across different government agencies. Another type of collaboration is across partisan lines where agreement on policy would otherwise be difficult or impossible. When collaboration takes place across agencies or stakeholders and alignment of interests to attain certain outcomes, there is an exchange of information and know-how that leads to increased efficiency and creative solutions.' Gustafsson-Wright, E., Gardiner, S., & Putcha, V. (2015). The potential and limitations of impact bonds: lessons from the first five years of experience worldwide. (Global Economy and Development Program at Brookings). Washington, DC: The Brookings Institution.
30. Gustafsson-Wright, E., & Osborne, S. (2020). Are Impact Bonds reaching the intended populations? (Brookings, Measuring the Success of Impact Bonds). Washington, DC: The Brookings Institution.
31. Note that we believe that these governance processes are important even where the contract contains the flexibility for the implementer to unilaterally make the required changes since they support the development of the partnership.
32. The Fair Chance Fund in the United Kingdom focussed on individuals that were not in education, training or employment (NEETs) and agreed to pay for a variety of outcomes including achievement of certain levels of qualification and obtention and retention in jobs. Implementers working with the young people found that many more were interested in securing employment rather than engaging in further training, particularly in a formal setting. However, the Fair Chance Fund had put in place limits for each type of outcome rather than for the outcomes overall. This meant that if an implementer had already hit the limit for claiming outcomes payments in respect of employment outcomes it would be left with a choice between doing what was right for the individual participant and what would allow them to claim outcomes. In this case, retaining the flexibility to respond to challenges or new information by amending the design would have been valuable. Ministry of Housing, Communities & Local Government. (2019). Evaluation of the Fair chance Fund: final report. London: Ministry of Housing, Communities, and Loval Government.

33. Our advice in this and the previous paragraph is influenced by the arguments set out in: Burand, D. (2020). New development: the application of incomplete contract theory to documenting Social Impact Bonds. Public Money & Management, 40(3), 247-249.
34. This recommendation was also highlighted by The Government Outcomes Lab (GO Lab): 'Involve your lawyers and procurement professionals early in the process.' The Government Outcomes Lab (GO Lab). (n.d). Awarding outcomes-based contracts. Available at: https://golab.bsg.ox.ac.uk/toolkit/technical-guidance/awarding-outcomes-based-contracts/
35. This is consistent with the conclusion of a study from the UK Government: 'Alongside getting political and senior executive buy-in, the case study research emphasised the importance of getting buy-in from key staff in different teams within the commissioning organisation. These included individuals from the finance department, legal team, and procurement team, as well as service leads.' Wooldridge, R., Stanworth, N., & Ronicle, J. (2019). A study into the challenges and benefits of commissioning Social Impact Bonds in the UK, and the potential for replication and scaling: final report. Birmingham, UK: Ecorys.
36. This remains rare as mentioned by the Brookings Institution: 'At the moment, outcome payers do not have established contracting and procurement mechanisms, meaning that negotiations are often extended and expensive, and each contract process follows its own logic, with little opportunity to learn from the experience of other deals'. Gustafsson-Wright, E., Bogglid, Jones, I., Segell, D., & Durland, J. (2017). Impact Bonds in developing countries: early learnings from the field. (Centre for Universal Education at Brookings). Washington, DC: The Brookings Institution.

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