Development Impact Bond

Introduction:

A Development Impact Bond or DIB is a results-oriented funding mechanism that coordinates public, philanthropic, and private-sector resources to leverage upfront financing for service delivery (Roxanne Oroxon et. al 2018). Investors provide upfront funding for the development program through impact bonds such as DIB. The amounts are remunerated by the host country/state government or donors and earn returns upon successful achievement of pre-agreed development outcomes (Design Grant case study, 2018). DIB involves four main players: **investors** who provide upfront funding and bear financial risk, **a service provider** who supports the implementation of the program, and **an outcome funder/payer** who agrees to pay the principal amount with a pre-agreed rate of return once the development outcomes are achieved, **third-party independent outcome evaluator** agency which verifies the results in order to help outcome funder in repairing the amount to invest (Roxanne Oroxon et al, 2018).

DIBs are required to fill the investment gap in the development sector. It is important to pool money from the private sector which requires an exciting financial mechanism. The investment in health, education, water, and sanitation requires $3.9 trillion each year to achieve developing countries toward the Sustainable Development Goals (SDGs) by 2030. The current investment gap (as of 2019) is at $2.5 trillion with a per-year investment of $1.4 trillion in development (The World Bank, 2019). Thus, DIBs perfectly works out in filling the investment gap and successfully engaging public-private partnership (PPP).

But DIBs are different from Social Impact Bonds (SIBs). In DIB, the outcome funder is a third-party organization whereas in SIB it is the government.
DIBs provided a platform for the private sector to complement the public sector in financing and delivery of social services. It looks for double bottom line (social and financial) return which ultimately led to growth in impact investing. (Emily Wright et al, 2015).

Sunk Cost and Upfront Funding:

(The uptake is the sustainability of intervention beyond the Utkrisht contract period.)
The upfront funding is provided by investors and bears the risk in the DIB program. It is important to look at the sunk cost[1]. The higher the sunk cost, the higher will be the risk

[1] **sunk cost**, in economics and finance, a cost that has already been incurred and that cannot be recovered.

associated with it. Since it cannot be recovered. Higher investment at an initial stage can comply with higher future investment. Thus, while designing the program. There has to be the proportion of investment that should be capped for the sunk cost (For ex. Maximum of 10% of initial investment out of which 5% of the total is sunk cost. This is important in DIBs because of incentivized structure).

Effectiveness and Efficiency:

Effectiveness means the ability of the program to achieve the intended outcomes and impact. Efficiency is the time spent, effort expended, and cost incurred to implement a program (CMS, 2021).

The evaluation is required for assessing the effectiveness and efficiency of Result based financing. It is very complex to evaluate the performance of RBF. The externalities associated with the implementation of RBF can have uneven effects and assessing its interrelated mechanism is a difficult task. RCT may not be the proper way to evaluate RBF. Although it is used in previous DIBs.

PBF is more concerned about outputs than health outcomes. The results are measured in a quantified way rather than qualitative. This is because of the monetary incentives attached to the program. The program needs a great deal of attention on the qualitative aspect as the objective of monetary incentives is to improve the quality outcome of the program. There is some evidence that suggests PBF may be more cost-effective (synonymously used with efficiency) than other funding programs. It is difficult to do a comparative analysis and evaluation of two programs due to a lack of financial information The result-based financing is a newly implemented program. Its long-term effects are yet to be tested. It takes time and experience to analyze its long-term effects (Glassman, 2013).
Thus, it is important to build a good monitoring and evaluation system in order to improve the existing and forthcoming programs.

Innovation and effectiveness at scale:

The Cameroon Kangaroo Mother Care (KMC) Development Impact Bond was launched in 2018. It aims to reduce morbidity and mortality among low weight and premature infants in five regions of Cameroon. It supports delivery in 10 hospitals across Cameroon.

KMC DIB in Cameroon is successful in improving maternal and newborn health in the country. It has demonstrated with confidence that future KMC DIB will be effective at scale and in regions with diverse socio-cultural contexts. As these DIBs are flexible in nature compared to traditional grand-based funding. There is scope for innovation and adoption in DIBs to deliver better outcomes in diverse regions. (Louise Savell and Chloe Eddleston, 2021). Although, the modification and improvisation required for DIB when performing in other regions, it is important to consider the innovation factor which plays a crucial role. In grant-based aid, there is no incentive for innovation.

For the investor (Grand Challenges Canada), DIBs are an exciting innovative financial mechanism. It incentives and open the opportunity for innovators to address global challenges.

Few learnings come forward from KMC DIB. These are as follows:

1. An active role of government is vital in DIBs. Government active engagement facilitates the program and helps in better coordination.
2. In the local context, an adaptive service mechanism is important. The cultural sensitivity and practices, and norms have to be taken into consideration.

The learning from outcome-based approaches to health is as follows:

1. At initial, the frequent outcome verification felt like strain. But eventually, the quarterly payment metric evaluation process became a rich source of data. This has further helped in improving the program delivery.
2. The KMC DIB is a flexible and data-driven approach that is well suited for changing contexts and ensures quality program delivery. For example, the change in context can be Covid -19. ((Louise Savell and Chloe Eddleston, 2021).

Most of the evaluations focused on the effect of impact bonds rather than the efficacy or efficiency added by a particular SIB strategy. It is important to analyze the functioning of impact bonds in terms of their outcome and how the strategy played out. Simply, looking at the outcome is not helpful in the assessment of impact bonds. The comparison between results-based financing and result-based aid has to be taken into consideration. This will provide a brief idea of the certain factors such as **innovation, monetary incentive**, and **collaboration that have** helped in achieving efficiency or efficacy or not. Impact evaluation is necessary to see the difference in the outcomes beyond what would have happened using other methods (Eleanor Carter, et al 2018).

<u>Risk Mitigation:</u>

DIBs are interesting compared with grant-based funding for donors as they transfer the risk to an investor who provides upfront funding for the service provider. The outcome funders payout the principal amount plus the pre-agreed rate of return only “if” and “when” predefined targets are achieved (Roselle Care, 2021). The continuous verification and check-on process enabled the service provider to adopt a new strategy and go for innovation in order to lower the cost and maximize the profit. And investors are engaged in this process because of their financial investment and the risk associated with it.

External investors bear the risk of non-performance. They get benefits from the outcome funder only if the service provides archives the targe (REACH Trust Fund, 2017).

According to Emily Wright et al (Jan 2016) report, impact bonds are best suited to mezzanine financing[2] rather than pilot or nationwide programming. Further adds, DIB is necessary when there is a complete lack of ability to pay or political will for the outcome. It should be used to pilot programs in order to attract public investment.

Scale and sustainability:

Result-based financing motivates to complete short-term targets, and neglect the long-term goals. Service providers are bound to meet short-term goals due to financial incentives and risks associated with it. Long-term goals are not rewarded for service providers in a short span of time. It is difficult to measure and evaluate long-term goals. They are obliged to achieve short-term targets in order to gain financial benefits. This may harm long-term sustainable impacts and capacity development (Glassman, 2013).

Sr. No	Parameters	**Result Based Finance (RBF)**	**Grant-based Funding**	**Comments (DIB or anything).**
1.	Efficiency	Comparatively some evidence shows efficiency. As the incentives work out here.	Not having strict guidelines to be followed makes it less efficient	Requires proper data collection and structured evaluation methods for accurate assessment.
2.	Scope for Innovation	Incentivized payment structure and non-financial risk such as fame-defame promote innovation	No motivation/ incentive to look for innovation	DIBs are structured for high innovations. A lot of scope for it.

[2] Mezzanine financing is a kind of financing that has both features of debt and equity financing that provides lenders the right to convert their loan into equity in case of a default (only after other senior debts are paid off)

3.	Risk - operation, fiduciary	Risk is involved due to outcome-based finance and incentivized structure	Risk-averse. Fixed investment and no incentivized rate of return.	Risk can be properly mitigated by stakeholders. There is scope for improvement.
4.	Scale and Sustainability	Yes but depends on the design and demography to a an extent.	Not necessarily or very limited.	DIBs are scalable and sustainable with the proper design of the program
5.	Effectiveness	More focus on the outcome rather than the intended impact (quantified measures are heavily considered)	the Structure of the program doesn't consider to effectiveness a large extent.	DIBs requires a checklist or parameters which pay attention to impact.
6.	Replicability	Yes possible with modification. Innovation plays a crucial role. Requires changes in design and framework.	It is replicable within a certain specific area or some form of similarity.	DIBs are in the initial stage but they are replicable with design modification. It is yet to be tested fully.
7.	Accessibility[3]	Yes it is accessible to outcome funder, investor, and service provider	Not applicable. If applicable then stakeholders are not actively engaged due to a lack of incentives.	DIBs are accessible but require proper stakeholder mechanism in terms of functioning.

[3] The ability for a range of stakeholders to participate in the programme as outcome funder, investors and service providers.

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Links for Rushikesh:

1. https://www.mathematica.org/publications/maternal-health-care-quality-and-outcomes-under-the-utkrisht-impact-bond-midline-findings
2. https://www.mathematica.org/publications/maternal-health-care-quality-improvement-in-rajasthan-india
3. https://www.oecd.org/dac/peer-reviews/Results-based-financing.pdf

- **Work in progress:**

Development Assistance aid has been provided to poor countries from rich countries. The government in developed countries collects taxes from rich citizens. Some of these are utilized for development assistance to poor countries. This is the traditional framework that operates in development assistance aid. The international system of measuring results for development is in evolving stage and requires improvement. The broader assessment of the impact of development assistance aid programs still remains unaddressed. Development assistance aid program faces challenges in scaling up as they might achieve narrowly defined objectives. And it doesn't contribute to broader development outcomes. Also, the changes in the political situation either political transition or resistance affects the scale-up (Kharas 2017).

The introduction of result-based financing in development aid was part of international efforts to make aid more effective than other aid and funding source (Amanda, 2013).