CONCEPTUALIZING FIDUCIARY STRUCTURES THAT CREATE DEMAND FOR DEVELOPMENT OUTCOMES

Position Paper, 25 July 2019.

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To realize the promise of outcomes funding in international development, fiduciary structures must be put in place that pool funds, create demand for outcomes, and manage associated risks. We discuss which features such structures should have and which they should avoid, and list criteria to help assess alternative institutional options.

Keywords: results-based financing, outcomes funding, aid effectiveness, pull mechanisms

BACKGROUND

Outcomes funding involves binding pledges to fund implementing institutions *ex post*, based on the outcomes that have ultimately been achieved. This stands in contrast to grants that provide funding *ex ante*, based on inputs that will be used. Outcomes funding calls for a different set of tools and procedures. As an analogy, angling does not involve pushing a spear but pulling a string.

One tool that is needed to enable outcomes funding at scale is a structure that creates demand for outcomes by writing binding commitments to make future payments as a function of yet-unknown results. As this function will typically hold funds in trust, we label it “fiduciary”. There are open questions about how to design this function for the development space, or how to select among existing institutional options. We discuss the long-term vision for the ecosystem and conceptually illustrate how its emergence is impeded by the absence of appropriate fiduciary structures. We then lay out specific criteria by which alternative fiduciary options might be evaluated.

THE LONG-TERM VISION: A MARKET FOR OUTCOMES

The rationale for outcomes funding goes beyond the idea of “performance pay” to incentivize implementers to exert more effort. Done right, outcomes funding may overcome difficulties that traditional, input-based funding approaches face in resolving some social problems. These weaknesses are less likely to be gaps in implementer motivation than gaps in collective knowledge about how to solve complex social challenges.¹ While input-based funding presumes that complex social problems can be grasped and addressed through the execution of well-designed plans, outcomes funding embraces the principles of flexibility and iteration.²

Outcomes funding may be especially suitable where critical success factors are not easily defined and monitored, and where implementers are involved in an iterative process of trial-and-error.³ This can be the case both in the process of innovation and the process of service delivery.

Where outcomes funding is applied, the roles and responsibilities of funders and implementers are fundamentally altered. Funders consult available evidence not to determine which approach will work, but to establish the opportunity cost of capital and “price” social impacts. They can then leave it to implementers to figure out how to achieve those as cost-effectively as possible. Implementers are not forced to align themselves with the theories of others but can break with conventional wisdom and popular fads. They can be creative and are free to mutate if they find new and less resource-intensive ways of achieving the same outcomes.

Over time, outcomes funding may provide more financial tailwind where better outcomes materialize, thereby selecting for approaches and implementers that prove cost-effective.⁴ Rates of return on different outcomes may crystallize, making the opportunity cost of capital more visible to funders and allowing them to refine what outcomes in what contexts they choose to route funding to. Pricing could be adjusted over time, increasing the relative competitiveness of the most cost-effective approaches.⁵

ECOSYSTEM FUNCTIONS

In principle, funders can fund outcomes directly: they could agree with implementers on a price per outcome and pay if and once the implementers deliver.

Figure 1: Simple outcomes contract

In practice, a number of complications call for intermediation functions.

Figure 2: Intermediation functions

- **Financing function.** Implementers may lack the working capital to start implementing in the first place. In so-called impact bonds, investors step up to bridge this financing gap. But the availability of working capital may not be the first-order impediment to functional outcomes funding arrangements in pilot settings. It has been demonstrated that once demand for outcomes is created, it is possible for implementers and their capital providers to coordinate de-centrally.¹ Substantial demand for impact investing opportunities already exists.⁶ For the foreseeable future, it appears sensible to

assign the responsibility to raise and pool working capital to the implementers themselves.

- **Evaluation function.** It is sensible to outsource the verification of outcomes to evaluators that are independent and have specialist knowledge in measurement and in the definition of counterfactuals. The practice of applied impact evaluation is already commonplace and numerous capable outfits exist.
- **Managerial & technical function.** Outcomes funding calls for a new set of frameworks, processes, and capabilities on the funding side. Building these can be expensive and the design and transaction costs of individual projects can be high. A number of initiatives have emerged to originate entire clusters of projects in different thematic and geographic development domains. In line with models pioneered in the UK,^{5,7} these are labeled “outcomes funds” (e.g., the *Education Outcomes Fund for Africa and the Middle East* and the *Poverty Alleviation Outcomes Fund*).
- **Fiduciary function.** Many funders are currently not well set up to pay for outcomes directly. Outcomes payments introduce uncertainty about budget outflows and many bilateral and philanthropic donors can be legally mandated to operate on minimum or fixed annual spending budgets. Other donors have institutionalized policies (e.g., due diligence standards) that are tailored to assuring the “proper” use of “eligible” expenditures, which can be inconsistent with the principle letting the supply of outcomes self-organize. The “outcomes funds” in the international development space are also not currently capable of channeling funds for outcomes at any significant scale; none is even a legal entity. For the foreseeable future, a solution is needed to receive grant funds and re-grant them in an outcomes-based manner.

Figure 3: The current state of the ecosystem

Intermediation Functions	
Financing Invest working capital	Market solutions exist
Evaluation Propose measurement frameworks Collect and publish outcome data Analyze and report project impacts	Market solutions exist
Technical & managerial Onboard partners (incl. funders) Share oversight (with funders) Design and execute strategies Design payment functions Originate projects Communicate sectoral advances	Domain of emerging "outcomes funds"
Fiduciary Contract with all parties Manage funding flows Prevent / resolve disputes	Only prototypes exist

Figure 3 summarizes the central functions of an outcomes funding ecosystem and the solutions that are currently available in the market.

ON THE FIDUCIARY FUNCTION

The spread of outcomes funding is currently impeded by the absence of a function that routinely receives grant funds and uses these to create demand for outcomes. There are a number of important design considerations.

- Though the concept of results-based financing is already well established in the development space, few efforts have gone far down the results chain until recently.⁸ The technical frameworks and the institutional mechanisms to routinely pay implementers on the ultimate outcomes of development programs have not yet been found.^{9,10} This calls for an experimental mindset and iterative approach as opposed to a centralized command-and-control structure.
- Though much foundational experimentation and learning remains to be done, it is sensible to engage with local government structures early. Most development outcomes of potential relevance are already under the purview, and institutional solutions that ignore their strategies, procurement processes, and governance structures are not likely to scale and persist.
- The legal risks associated with the fiduciary function may be substantial. In outcomes based funding arrangements, both implementers and their capital providers have high stakes in the evaluation findings. These can routinely yield results that are contrary to expectations. Given that they can also be sensitive to inputs and assumptions, disputes may be commonplace; and as the central contractual counterparty, the fiduciary is in the line of fire. It should have the capability to grasp the range of possible evaluation outcomes and prevent disputes (or where necessary, resolve them).
- The so-called “outcomes funds” that currently operate in the development space are quintessentially social entrepreneurial initiatives that have taken on a broad range of non-routine activities, including the mobilization of resources. This leadership is naturally synergetic with the overall managerial responsibility to advance outcomes funding in specific domains. The fiduciary function should accommodate this.
- Customized fiduciaries have been piloted in the development space, but only prototypes exist to date. In the very long run, it is conceivable that funders alter rules and procedures that currently impede outcomes funding and expand their capability to handle outcome based payments in-house (effectively absorbing the fiduciary function). But in the foreseeable future, other forms of integration appear more likely. In a form of vertical integration, the thematic outcomes funds might expand their own fiduciary capacities over time and effectively become one-stop-shops;¹¹ alternatively, the fiduciary function might horizontally integrate into a specialized

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service provider, leading to a what has been labeled a “clearinghouse” for outcomes funds.¹²

Figure 4: Possible integration paths

CONCLUSION

As outcomes funds and their funders appraise alternative options for fiduciary vehicles, they need to consider important trade-offs. For example: it will obviously be important to account for the robustness and experience of candidate institutions and their ability to accommodate the standards and procedures of interested funders. But it is simultaneously important that the fiduciary is able and encouraged to innovate in its procedures, as the appropriate institutional frameworks to create demand for development outcomes at scale have not yet been found. Structures that operate on the principles of input-based funding can be inconsistent with the concept of creating a pull mechanism and liable to “pushing the strings”.

To assist outcomes funds, funders, and other development partners with the assessment of such trade-offs in the selection of fiduciary options, the appendix proposes a set of evaluation criteria.

APPENDIX: EVALUATION CRITERIA

An intermediary entity serving as the fiduciary for an outcomes fund carries a pivotal role. Alternative institutional options might be scored using the following criteria:

Capability:

To become operational promptly, with limited requirements in terms of financial investment and time.

To manage assets and liabilities by transacting in-and outflows, handling multiple currencies and funding sources, reconciling fund availability with payout commitments, and managing funds.

To engage in contractual design to ensure that agreements are well articulated and understood.

To mitigate and manage legal risks, especially ones associated with inevitable disputes about evaluation outcomes.

To realize efficiencies, e.g., by specializing on comparative advantages in the collaboration with multiple partners, or by realizing synergies by providing access to valuable relationships to the outcomes funding function.

Alignment:

With the vision of a market for outcomes. It should be willing, able, and motivated to enable a true pull mechanism. It should operate on principles of outcome-based, not input-based, accountability. It should be inclusive and accessible to a wide range of funders and implementers. It should not act as a gatekeeper nor discourage its own replication.

With the efforts of outcomes funds. These have the drive and managerial responsibility to advance the field. The fiduciary should provide them with the autonomy and ownership they need to arrange opportunities, select and vet implementers, negotiate delivery and pricing terms, mobilize resources, communicate with the field, and broadly exercise their managerial roles. It should not curtail their expertise, initiative, visibility, or identity.

With needs of the implementing sector. It will need to serve as a credible counterparty whose contracted commitments to pay for outcomes are seen as fair, trustworthy, straightforward and low-risk.

With the needs of local governments. The fiduciary structure should account for local government structures and align with locally owned development strategies. It should be capable of co-funding from local governments or synergetic with existing government procurement systems.

With needs of donor-funders, providing them with a robust framework that secures their funding commitments and mitigates their reputational risk. It will in turn need funder respect for its policies, procedures and control systems, allowing it to match its responsibilities with the authority to undertake them.

With development values such as transparency, objectivity, fairness, and inclusivity. It should also embrace local expertise and build local capacity.

Flexibility:

In light of possible funder needs. Donors may have different preferences about contribution modalities, e.g., the desire to make only pledges, or to use the fiduciary to buffer their budgets.

In light of possible investor needs. While the pooling of investor funds has not been a binding constraint in pilot settings, it could become a constraint with greater scale. An ideal fiduciary would be capable of expanding its functions in the future to handle not only outcomes funds but also investor funds.

In light of possible integration needs with the outcomes funds. Over time, efficiency considerations will likely lead the fiduciary functions to either vertically integrate with the

managerial functions overseen by the so-called outcomes funds (leading to a set of separate thematic 1-stop-shop outcomes funds) or integrate horizontally as a dedicated service used by multiple outcomes funds. The ideal fiduciary solution should be capable of accommodating either of these scenarios.

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