

# EXECUTIVE SUMMARY

## EVOLUTION OF

### COLOMBIA'S PAYMENT- BY-RESULTS ECOSYSTEM:

#### CASE STUDY



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This publication is the result of the Agreement No. 004 signed between the Colombian Presidential Agency of International Cooperation, APC-Colombia<sup>1</sup>, and Fundación Corona, as executing agency of the Social Impact Bonds Program in Colombia (SIBs.CO). This agreement was implemented during September 2020 and March 2021, and made it possible to join technical, administrative, and financial efforts between APC-Colombia and Fundación Corona, with resources from the Innovation Laboratory of the Inter-American Development Bank (IDB Lab) and the Swiss State Secretariat for Economic Affairs (SECO). This agreement had the objective to generate market opportunities for public and private actors and strengthen the ecosystem of results-based financing in Colombia.

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<sup>1</sup> In accordance with Decree 4152 of 2011, the Colombian Presidential Agency of International Cooperation, APC-Colombia, is a decentralized entity of the Executive Branch at the national order, with legal personality, administrative and financial autonomy, and its own assets, attached to the Administrative Department of the Presidency of the Republic. APC-Colombia's objective is to manage, guide and technically coordinate public, private, technical, and financial non-reimbursable international cooperation received and granted by the country, as well as to execute, administer and support the channelling and execution of international cooperation resources, programs, and projects in accordance with foreign policy objectives and the National Development Plan.

# EVOLUTION OF COLOMBIA'S PAYMENT-BY-RESULTS ECOSYSTEM: A CASE STUDY

## EXECUTIVE SUMMARY

### Key takeaways

As the first middle-income country to launch a Social Impact Bond (SIB) and the first Latin American country to develop an Outcomes Fund (OF), Colombia is a leading example of the rapid development of a payment-by-results (PbR) ecosystem internationally.

These achievements have been promoted by a holistic, integrated Program – SIBs.CO – that seeks to develop PbR projects, implement market-building strategies and disseminate knowledge, and which has provided the technical and financial resources needed by the market in its early stages. SIBs.CO has created a set of conditions that have contributed to the development of the ecosystem:

- Close collaboration across multiple sectors, and alignment around first principles.
- The participation of international cooperation agencies as outcome payors alongside the government.
- A test-and-learn approach, where each project is considered a minimum viable product, which has been essential to identify barriers early on, make quick adjustments and evolve flexibly and continuously.
- The deliberate and meaningful investment in learning and market-building strategies.
- The provision of extensive specialist assistance by national and international experts.
- Continuous support to the stakeholders in the ecosystem – especially the government – to promote and sustain progress.

The early stages in the development of the PbR ecosystem in Colombia were marked by the participation of a group of stakeholders, mostly stable, in two consecutive SIBs. These pioneering actors were aligned around the need for innovation and put great emphasis on learning, taking the lead in testing a novel mechanism and deliberately opening spaces to improve it over time.

The efforts of SIBs.CO and these early adopters have borne fruit in the broader ecosystem, as more and more public and private entities have become interested in promoting the use of PbR tools. Simultaneously, SIBs.CO has evolved to co-create an OF with the government, which aims to facilitate a more rapid adoption of these mechanisms by public entities and to foster the uptake of PbR instruments by the wider market.

The future consolidation and expansion of the ecosystem will depend, to some extent, on overcoming the obstacles currently faced by each of the stakeholders involved. SIBs.CO and its allies have already demonstrated leadership in addressing some of the most important limitations identified to date. To continue expanding the ecosystem, it's important to consolidate the legacy of this Program and sustain its work and impact in the future; these aspects are already being led by SIBs.CO partners.

As the first middle-income country to launch a Social Impact Bond (SIB) and the first Latin American country to develop an Outcomes Fund (OF), Colombia is a leading example of the rapid development of a payment-by-results (PbR) ecosystem internationally. This achievement has been possible thanks to the efforts of the Social Impact Bond Program in Colombia

(SIBs.CO)<sup>2</sup>, which has launched three different SIBs and promoted the creation of an OF within government in the last six years. All this was carried out under the leadership of the SIBs.CO partners - the Swiss State Secretariat for Economic Affairs (SECO), the Innovation Laboratory of the Inter-American Development Bank Group (IDB Lab) and Fundación Corona, with the support of the national government's Department for Social Prosperity (Prosperidad Social, as per its name in Spanish) and other public and private actors that joined the initiative.

The SIBs and the OF have been developed following a test-and-learn approach, as each one of them has been designed as a minimum viable product that generates valuable lessons to improve the instruments themselves. Rather than examining each of the SIBs and the OF independently, this case study offers a comprehensive look at the evolution of the PbR ecosystem to address two key objectives: firstly, to understand the main factors that facilitated or hindered its early development and, secondly, to identify strategies that might promote its consolidation and expansion. Although this study focuses mainly on SIBs, it collects relevant information for the use of other PbR mechanisms more broadly, such as performance-based contracts or development impact bonds. The evolution of the ecosystem is broken up in three different stages, spanning from the beginning of the SIBs.CO program to the present moment (March 2021):

- **The origins.** How did SIBs.CO and SIBs in Colombia start?
- **In search of mainstream adoption.** How are PbR mechanism being adopted and what progress has been made?
- **Looking towards the future.** What strategies are important to further consolidate and expand the market?

This case study uses a series of terms that refer to the PbR models and vehicles used by the stakeholders in the ecosystem. A brief explanation of the terminology used is provided here:

- PbR mechanisms are contracts where the remuneration received by the provider is tied to the achievement of results, and not to the delivery of a service (the terms payment-by-results tools, mechanisms or contracts will be used to refer to these instruments).
- SIBs are a type of payment-by-results contracts which involve an investor, who assumes the financial risk of the project by providing the working capital for its operations until such time when results are (or are not) achieved.
- The OF is a financial vehicle managed by the national government's Department for Social Prosperity, designed to facilitate the procurement of multiple PbR contracts and to operate as a learning platform and knowledge repository.
- The terms PbR ecosystem or PbR market both refer, indistinctly, to the set of actors that use or might use PbR tools to advance their respective agendas, social or otherwise.

### **The origins. How did SIBs.CO and SIBs start?**

The starting point to analyze the evolution of the ecosystem in this case study requires examining the first two SIBs: *Empleando Futuro* (first SIB) and *Cali Progresá con Empleo* (second SIB). Both SIBs were designed and implemented under SIBs.CO and were supported by the Program's market-building and knowledge dissemination strategies.

### **Characteristics and evolution of the stakeholders involved in the first two SIBs**

The first two SIBs were developed with public entities at different levels of government, in response to the desire of SIBs.CO and its allies to learn how the instrument would work with a national and a local public entity as outcome payors. Both public entities showed some

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<sup>2</sup> SIBs.CO is a holistic program that seeks to develop a Social Impact Bonds (SIB) model to achieve better employment outcomes for vulnerable populations and victims of the internal conflict. It also seeks to improve the knowledge and competencies of different stakeholders about payment-by-results (PbR), SIBs and impact investment.

differences in terms of their participation in the SIBs, especially around areas such as the desired objectives, the sources of public funding to pay for outcomes, and the impact in the project's development due to changes in the technical teams. Although these findings cannot be extrapolated to all national and local entities in the country, SIBs.CO and other market players could use these insights to continue learning about the differences of engaging governments from different levels. In both cases, the political will of the public entities involved and the support of SIBs.CO, which facilitated the transfer of knowledge across SIBs and financed the legal and technical advisory required for their design, were crucial for the projects to launch.

Investors have played an important role in the development of the ecosystem. The number of investors involved in the second SIB doubled compared to the first one, as three new organizations joined the three anchor investors who had financed the first SIB. They were all impact-first investors, who prioritized social impact in their investment decisions, and they used resources from both their annual grant budgets and their endowments, in some cases. All of them were non-profit entities aiming to generate positive social changes. As the first SIB developed and demonstrated that social and financial returns could be achieved at the same time, financial returns increased in importance for these organizations. In addition, the involvement of new investors in the second SIB contributed to the professionalization of SIBs as an impact investing instrument.

The first two SIBs – *Empleando Futuro* and *Cali Progresa con Empleo* – involved five different service providers, both for-profit and not-for-profit, which suggests that the model is appealing and workable for both types of organizations. Service providers have been able to leverage the increased innovation space granted by the contracting mechanism and have demonstrated that better results are generally achieved by those with extensive issue-area expertise and the ability to adapt their intervention to improve their performance. These stakeholders, for whom the decision to participate in a second SIB was more complex than that to join the first one - as they were more aware of the instrument's benefits and risks -, highlight that their involvement has triggered positive transformations within their organizations, particularly in terms of better result-measurement practices and/or the use of operational data to monitor performance.

In addition, the first two SIBs in Colombia included an intermediary as the main contractor to the outcome payors. This type of actor has been crucial in responding to government's demand by playing a variety of roles, including: assuming the legal responsibility for coordinating the full operation towards achieving outcomes, managing investors' resources and monitoring the performance of service providers. All public and private stakeholders involved in the SIBs - including outcome payors, investors and service providers - recognize that the intermediaries were critical to achieving positive results.

Finally, the technical and legal advisors who helped design the first two SIBs, bringing with them relevant experience at the national and international levels, were also key actors in the development of the PbR ecosystem, as they contributed to building the capacity of the rest of the participating stakeholders.

### **Key factors that encouraged stakeholders to participate in the SIBs**

Both public entities were motivated to implement the SIB mechanism for reasons that ranged from making a more effective use of their public resources, to securing additional funds from international cooperation, achieving higher social outcomes through innovation and fostering public-private partnership schemes. Procuring this type of PbR mechanism is not an easy task for governments, as they face multiple barriers in the process; having the project developed under SIBs.CO and the close collaboration with the partners was instrumental in enabling the public entities to overcome those. The reputational boost and institutional support provided by the highly respected alliance partners, the access to technical and legal support via SIBs.CO, and

the flexibility introduced by the multilateral organization into the procurement process were key factors that facilitated the launch of the SIBs.

The investors' interest in joining the projects was driven by their desire to learn about SIBs as an innovative investment instrument, by the opportunity to achieve greater social impacts and financial returns simultaneously, and by the desire to influence other stakeholders to promote the use of these tools. Their participation was possible thanks to the fact that the SIBs themselves were aligned to the investors' own organizational priorities – e.g. several of them were looking for innovative ways to invest - and because the SIB appeared to be a solid investment opportunity due to factors such as the project's short timeframe and expected social impact, among others. As for the service providers, the alliance partners' solid reputation, their own confidence in their ability to achieve the required results, their familiarity with the PbR concept, and their capacity to take financial risk facilitated their engagement in the different projects.

### **Main barriers faced by each stakeholder**

The experience of the public entities that participated in the first contracts helped surface a series of obstacles to the widespread adoption of the SIB instrument within government. Structural factors such as the difficulty to secure multi-annual budgets and to transfer resources from one fiscal period to the next; the absence of a relevant legal framework to provide confidence among public sector officials to procure innovative PbR mechanisms; the limited available data; and the scarcity of public resources to finance the design process and the evaluation of outcomes (for projects not funded by SIBs.CO) were some of the limitations faced by the public sector. In addition, due to the low level of market maturity, most government actors involved lacked sufficient knowledge and information about the mechanism. Finally, the implementation of the first two SIBs was also affected by circumstantial factors associated with public sector staff turnover and government transitions.

The difficulties faced by the private sector actors involved in the first two SIBs were less severe than those experienced by the public sector. In engaging with the SIB opportunity, investors felt that they were not able to adequately assess the quality of the investment proposition - due to the novelty of the instrument itself and to the difficulty of appraising certain risks -, and they didn't have full confidence in the commitments made by outcome payors at the local level. Service providers, for their part, faced certain problems during implementation that stemmed to a great degree from their relative lack of engagement during the definition of the technical parameters of the contracts. This resulted in operational difficulties related to disparities between the agreed goals and the timing available for achieving them; an excessively prescriptive design that limited opportunities for adaptation; and high administrative burdens.

Based on the lessons learned of the design and implementation of the first two SIBs, SIBs.CO and its allies sought for international best practices to overcome the barriers faced by the government. This led to a significant change in the Program and the ecosystem: the creation of an OF, managed by a government body. At the time of its conception, the Fund sought to find solutions to issues such as: the limited knowledge and experience of SIBs among the public entities that had participated as outcome payors; the constraints imposed by the government's annual budgetary cycle; the high transaction costs of each individual SIB; and the lack of widely available information to inform future design processes.

### **In search of mainstream adoption. How are PbR mechanism being adopted and what progress has been made?**

Efforts made in recent years by SIBs.CO and its partners have borne fruit in the market, as more and more stakeholders have become interested in promoting the use PbR tools. On one hand, the OF created by government represents a turning point both for SIBs.CO and for the

ecosystem, as it can facilitate a more rapid adoption of these mechanisms by public entities and increase their use. The Fund, managed by the national government's Department for Social Prosperity, is an example of the progress that has been made towards greater institutionalization of PbR mechanisms inside government. On the other hand, SIBs.CO's efforts around market development and knowledge dissemination have also had a strong influence in the ecosystem, as more and more public and private sector actors appear interested in exploring PbR schemes to advance their own initiatives, not only around employment but also in other issue areas such as education or early childhood development.

All these changes have been underpinned by the 2018-2022 National Development Plan (NDP), one of the most important public policy documents for the country, which incorporated PbR instruments as innovation tools and provided a framework to facilitate the creation of the OF based on the lessons learnt from the two original SIBs. SIBs.CO previous work, among other factors, contributed to the government's decision to incorporate PbR in the NDP.

In this context, progress towards a more generalized adoption of PbR instruments in Colombia is happening through two separate, but concurrent, routes: first, through the OF managed by the government, where SIBs.CO and its allies co-lead one of the initiatives; second, through different efforts emanating from other sectors and led by new actors in the market.

### **Route 1: Outcomes Fund led by the government**

The OF is a financial vehicle with the purpose of funding, designing and implementing PbR mechanisms within the government. The creation of this fund was possible thanks to the support that SIBs.CO and its partners offered to the government: the Program allowed the transfer to the OF of important knowledge from the first two SIBs and funded the technical and legal advisory services of national and international experts needed for its design. The public entity itself funded all costs related to the Fund's team, and the verification and evaluations processes. After the first year of operation, the OF had shown positive and important results.

The OF originally launched a first challenge (*Reto Empleo*) with the aim of selecting different organizations to implement several SIBs, the first of which was the *Emergency Innovation Bond*, as it emerged in response to the COVID-19 crisis. This first SIB, which had the government and the international cooperation agencies as outcome payors – since it is the third one procured under SIBs.CO – was structured in approximately five months, from the selection of the intermediary to the beginning of the project, which represented a significant improvement over previous SIBs. The SIB also brought along new types of stakeholders able to contribute important learnings to the Program and to the ecosystem.

The OF also achieved two positive effects during its launch year that had not been anticipated. On one hand, the vehicle was used by government to launch a second challenge (*Reto Empléate*), in order to procure services through non-SIB PbR mechanisms, which reflects a change of mindset in the government entity and a move to adopt these new contracting mechanisms more generally, which is one of the key goals of the SIBs in Colombia. During the first year the OF also worked to raise additional funding from international donors and other government entities, seeking the financial space to develop a broader portfolio of projects and expand its work to new social issues.

When the OF was created, it was with the aim of overcoming some of the barriers that public entities face when procuring PbR mechanisms. After the first year of operation, however, some of these barriers are still to be successfully addressed, while new opportunities for improvement have been identified. In this sense, key stakeholders agree that the OF should continue working on finding solutions to the government's budgetary constraints, on creating a national set of guidelines for procuring through PbR mechanisms, on establishing a governance

structure for the Fund that is appealing to entities outside DPS, and on ensuring that all projects launched within it utilize proven PbR practices and principles.

However, the first priority for the OF in the short term is to ensure its continuity beyond the current administration, so it can contract PbR mechanisms with longer-term outcome metrics. Its designation as a strategic priority of the national government is key to achieving that purpose, in such a way that it possible to commit public resources for the OF operation, its task force and the projects beyond the current presidential term.

## **Route 2: Initiatives led by the wider market**

Progress towards a more mainstream adoption of PbR mechanisms in the country is also taking place outside the OF managed by the Department of Social Prosperity, with several actors from the public, private and international cooperation sectors starting to promote fresh PbR initiatives.

Within the public sector, forays into new issue areas are happening mostly at national level, where entities outside of DPS have been encouraged by the experience of SIBs.CO and the endorsement of PbR by the NDP 2018-2022 to explore their own SIBs and innovate in their areas of responsibility; local entities, meanwhile, are showing limited interest in working on issues other than employment, due to the fact that employment is a priority matter, particularly in the context of a pandemic. Likewise, the leadership of the international cooperation has been a fundamental factor for the government to explore the use of these schemes: in several cases, these agencies have financed feasibility studies or lead the implementation of the projects, hoping to generate enough evidence to be adopted by the competent public entities. Despite this budding interest, new public entities wishing to launch their own SIBs face a lack of sufficient resources to finance the legal and technical design of the contracts, which for the SIBs.CO SIBs and OF have been provided by international cooperation agencies.

Nevertheless, for the PbR ecosystem to develop further, government demand is not sufficient: the private sector, both investors and service providers, need to be willing and able to respond to this growing public interest. With regard to investors, non-profit entities, family offices, and development financial institutions are likely to continue playing the main part, given their focus on the social impact of their investments; it appears premature to engage institutional investors or impact investment funds at this point, given the level of risk-return they seek. As for providers, new operators wishing to enter the market will again face the challenge of not having enough knowledge and understanding about PbR mechanisms, which they need to assess the risks and implications of participation and to perform successfully under this new type of contracts.

## **Looking towards the future. What strategies are important to further consolidate and expand the market?**

The future consolidation and expansion of the market will depend, to some extent, on overcoming the barriers faced by the different types of stakeholders involved. SIBs.CO and its allies have already demonstrated leadership in the development of strategies to address issues identified to date; the alliance has, for instance, created a working group to develop public procurement guidelines, funded the technical and legal design processes of new contracts, and developed training for participant organizations, among other initiatives. Looking ahead, there are several other opportunities to continue pushing down existing barriers, as reflected in the below strategies. The following strategies should be considered as a set of options to develop the PbR ecosystem rather than as a magic formula to achieve this goal, since their effectiveness will depend on the specifics of each context and stakeholders.

The first set of strategies aim to overcome the barriers faced by government entities and focus on four key points:

- Generate legal guidelines to encourage the procurement of PbR mechanisms and to instill greater confidence in public sector officials wishing to contract in this way.
- Provide PbR training and capacity building to public sector staff, focusing on practical issues to facilitate the development of specific pilots.
- Secure finance for the design of particular PbR contracts, in order to seize the momentum with highly committed public entities.
- Identify suitable champions in government who can drive the institutional processes that will facilitate the adoption of PbR mechanisms.

Considering the central role of the OF in the development of the ecosystem, a couple of actions would help enhance its ability to achieve results:

- Clearly embed the OF within a strategic priority of the national government to guarantee its continuity beyond the current administration.
- Modify the current procedures and governance of the OF to optimize its operations and demonstrate its potential to contract new PbR projects in new areas or with different counterparts.
- Guarantee the availability of sufficient financial and human resources to enable the Fund to meet its strategic objectives.

On the private side, a couple of strategies are suggested to eliminate key barriers faced by investors and service providers today:

- Develop practical tools and essential information around PbR for investors and service providers to grow their capacity and expertise.
- Devise strategies to mitigate the risk, perceived by investors, of potential non-payment by the public entity.
- Promote the use of processes (for the design, procurement and implementation of PbR contracts) which involve an open and collaborative dialogue with the market.

Beyond the elimination of existing barriers, developing the ecosystem could benefit from exploring a handful of critical questions. From the government's perspective, one ought to evaluate, over the next couple of years, whether a more drastic change in legislation (beyond the guidelines mentioned above) is required to generate a more robust operating framework for public entities. Likewise, the role of the existing OF in mainstreaming the adoption of PbR by the public sector should be assessed: if it is deemed to be central, additional flexibility to improve its performance and respond to the demands of different public entities will be required; if this is not possible, a proliferation of smaller OF focused on different thematic areas and housed across government entities might need to be considered.

Within the private sector, the strengthening of intermediaries, who have played various key roles in the SIBs launched to date, should be viewed as an efficient way to develop the broader ecosystem. This may be the most expeditious way to overcome the fragmentation of the service provider and investor markets, and to create a critical mass of stakeholders capable of responding quickly and expertly to growing government demand.

Finally, it would be desirable to promote the development of an independent entity that can inspire confidence in these instruments by providing impartial information, practical, well-evidenced tools, technical assistance and tailored advice to both public and private actors. Ensuring the continuity of SIBs.CO could contribute to the consolidation of these issues and therefore, to strengthen the Colombian PbR market.

## Conclusions

The evolution of the PbR ecosystem in Colombia has been exceptionally fast compared to other middle-income countries. In a very short time, two SIBs have been implemented and an OF, managed by the government, has been structured and become operational, allowing the procurement of an additional SIB – third SIB developed under SIBs.CO – and opening the opportunity for several more in the future. This progress has been promoted by SIBs.CO, a Program that enabled the existence of technical and financial resources for the development of this market during its initial phases; the participation of international cooperation agencies as outcome payors alongside the government for all SIBs under SIBs.CO; the provision of extensive specialist assistance by national and international experts; and the drive and collaborative approach of the private sector actors (intermediaries, investors and service providers) who decided to invest on these mechanisms early on. All the stakeholders have been aligned around the need for innovation and have put great emphasis on learning, taking the lead in testing a novel mechanism and opening spaces to improve how it operates.

To continue developing this market in coming years, it will be key to address the specific barriers that still constrain the use of PbR mechanisms by government, investors and service providers. The consolidation of the ecosystem is a long path that requires important shifts around particular structural obstacles and a transformation of the mindsets of public and private actors. The leadership of the public sector, as the key promoter and user of these type of mechanisms, will be essential to drive greater adoption of the tool to improve social outcomes, while the capacity of the private sector to respond to this growing demand it will be essential to expand the market. The role of the international cooperation and the social sector will also be key to facilitate the continuity of these efforts despite shifts in public administrations.