Unlocking the potential of Pay for Success

Outcomes-based partnerships can help governments tackle our biggest social challenges at scale - but this may require us to design products that are a better fit with funders' existing systems

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N.B. This essay is an edited version of the transcript of Kevin's 20/30 Visions interview, which you can watch at www.bridgesfundmanagement/2030Visions.

Over the last 50 years or so, East Asia has been one of the most astonishing development stories globally, with hundreds of millions of people led out of poverty by very competent government systems.

But as we look to the next 50 years, the social problems we face are becoming so complex that no government, no matter how far-sighted, can possibly solve them alone. So the question is: how do you involve the rest of society in solving these issues?

Tri-Sector was set up to create these new ways of the different sectors working together, so we can solve these emerging challenges.

Finding that one in ten

When a U.S. group called the Coalition for Evidence-based Policy looked across medicine, business and social sector, they discovered that the things we think might work usually don't.

For example, of all the drug programmes that start a clinical trial process, only one in ten actually gets approved. Similarly in the business space, despite the push towards A/B testing, companies like Microsoft and Google have found that 7-9 times out of 10, their guesses about which marketing campaign will work are wrong. And it's same in the social sector: many intuitively sound ideas just don't work in practice.

So if most of our guesses are going to be wrong, the question is: how do we set up systems that pick out the right ones? And who should do what in such a system?

We focus on 'Pay for Success' (PFS; or social outcomes contracts as they're called in the UK) because we thought it was a nice microcosm of what everyone's role should be. The Government sets the bar for what's right, and serves as the long-term funder of successful programmes. But philanthropy and the private sector play the 'guessing and optimising' role, to make sure we find the one idea in ten that is going to be successful.

In an Asian context particularly, it's quite difficult for government to say that it failed; because the social contract is such that government is supposed to be infallible, the best and the brightest. So this way, we're essentially letting Government fail, by having the private sector and social sector take the innovation risk.

Increasing take-up

One big challenge from governments in Asia is: if PFS is just about raising money, why should we do it? Because either they have the funding already, or there are easier ways to raise it than through this fairly complicated structure. So to increase take-up, we've modified the value proposition of PFS in two ways.

The first is what we call the social impact guarantee. A traditional social impact bond or pay for success project is a combination of an insurance plan and a lay-away plan, sold as one. And in Asia, people were telling us that they liked the insurance plan, but they didn't need the lay-away plan.

With the social impact guarantee, we say to government: "OK, why don't you fund things as you normally would? But if it doesn't work, we'll give you the money back to try again". The incentives are all the same. But mechanically, it be-

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In Singapore, Tri-Sector has partnered with the YMCA and two foundations to launch a project aiming to reintegrate at-risk youths though education or employment; it is the first project of its type backed by a 'social impact guarantee'

(Photo by Tobi on Unsplash)

comes easier for governments to fund, because they don't need to do anything special. At the same time, the investors' money is not locked up as it is in an impact bond structure. So the same dollar could guarantee multiple projects, like insurance companies do – or they could grow their dollar at the back end, so if the guarantee ever gets called, it might now be worth $2.

If you look at the catastrophe bond market, which is a form of insurance-linked security to do with underwriting climate risk – that's a $50 billion market globally. The total value of every social outcomes contract combined is something like half a billion dollars globally. Is there a way for us to crowd in insurance companies and insurance-linked securities to this space, and thereby increase its scale by 100 times?

The second modification is what we call the outcomes amplifier.

If you ask the investors in a traditional social impact bond whether they're doing it to make money, almost all of them would say no. If you then ask: "Would you rather get your money back, or have the government fund the programme forever?" – they would probably choose the latter. Similarly, if you ask governments whether they'd rather pay back private investors or scale up successful programmes, they normally prefer the latter, because that's what they're used to doing.

In most countries, if you draw a bar chart of government spending versus philanthropic spending (even if you include impact investing), the ratio is usually around 20:1, from our estimates.

So we've got to find a way to free up our innovation capital, which is philanthropy and impact investment capital, and exit to government.

One analogy I use is the COVAX initiative for developing Covid vaccines. Governments around the world created what's called an Advanced Market Commitment to say: if you can develop a Covid vaccine that will deliver certain outcomes, I'd be willing to pay for it in the future. And that incentivised all the private companies to develop the vaccine.

So that's what the outcomes modifier model is trying to do. We're trying to create a marketplace of ideas for innovation, to allow the best ideas to get taken up – and to incentivise that.

Meeting Governments where they are

Governments are certainly open to these new ways of working; particularly post-Covid, there's a move towards doing more with less (or more with the same).

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Today, the conversation has moved from the 'why', to the 'how'. So a lot of our work is trying to show this 'how' is better than other traditional 'how's – like public consultations, or focus groups.

One key challenge from government, especially in Asia (which I think is actually a good challenge) is: what's the value proposition for the private sector, if we're paying them a premium? That's pushing us to up our game in terms of capacity-building (something that Bridges does very well in the UK).

It would be a mistake to see this as purely an education issue: that we've got the right product, and government just needs to be taught more about why it's great. We need to go back to the drawing board – just as many start-ups do – and ask ourselves: what is it that we're trying to achieve?

Fundamentally, if we are going to take this to scale, we can't rely on lobbying government to carve out a small part of its spending to do this kind of work.

We've got to find a way to say: how do we meet you where you are in your existing areas, and improve them? It's about really trying to understand, in each case: what exactly is the procurement issue? And how do we design a product round that?

In some respects, Pay for Success has been very successful; because it has shown government what could be done.

But if the goal was capital mobilisation from the private sector, then it clearly hasn't scaled as some hoped. And that's just a product/ market fit problem.

So it's all about trying to meet the end outcomes payers where they are – which is what we've tried to do with the different models we've adopted.

The trends are converging

This is an area with huge potential, because there are so many variations using the core principles of PFS that could be scaled. For example, we could take the idea of carbon credits – which is now being extended to biodiversity credits – into social impact credits; that feels like a natural move.

The world is clearly moving towards the core principle of outcomes models, which is trying to price in externalities. Fast-forward five years, and it's easy to imagine a world where we have a whole marketplace of these outcomes credits (with various related investment products).

So I'm very optimistic about this space. The trends are converging: Government is open to new ways of working; the investment community is moving more and more towards deep impact instruments (which these are); non-profits are adopting more and more of a business lens. The fundamentals are all there – and we can certainly solve the mechanical issues, as long as we're open-minded and keep innovating with our product.

Kevin Tan founded Tri-Sector Associates in 2017, to help develop new ways for the public, private, and people sectors to work together in improving governance throughout the Asia-Pacific.

He previously served in the Boston office of Third Sector Capital Partners, where he led PFS engagements in the areas of early childhood, workforce, public health, homelessness, and criminal justice.

He holds an MPP (Business and Government) from the Harvard Kennedy School, and a BA (First Class Hons) in Philosophy, Politics and Economics from the University of Oxford. In 2019, he was listed by Forbes Asia as one of its 30 under 30 social entrepreneurs.

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