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Development in brief

Results-based financing – a driver for innovation

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Principles for result-based aproaches

Result-based financing links payments to the verified achievement of concrete results that are contractually defined in advance between a donor ("result funder") and a project partner ("service provider"). Unlike traditional investment finance, cooperation is based on results rather than inputs and processes. Costs are not reimbursed, but, instead, payments are linked to results achieved. The project partner is responsible for achieving the results and therefore also for selecting adequate input measures. The project partner can apply its own processes and procedures.

Basic structure of result-based financing approaches

Source: own illustration

Project partners are providing advance services for the implementation of the required measures and bear the risk of success. If results are not or only partially met, there will be no or reduced remuneration. This arrangement creates a clear incentive for the project partner to not only achieve results in full but also to do so in the most cost-effective way, as the partner has to pay for any partial achievement and all additional costs. Financial incentives are therefore aligning interests of donors, project partners and the benefitting target groups.

Types of result-based approaches

Result-based approaches can be distinguished primarily in terms of the level of impact logic where disbursement-linked indicators can be found. "Output-based aid" approaches, like coupon systems for vaccinations performed or births asisted, sit at the lower end. At the upper end are "development impact bonds", where only longer-term developmental effects that have occurred are rewarded, e.g. lower infant and maternal mortality rates. Between these extremes, there is a broad spectrum of mixed approaches.

Opportunities and challenges

Result-based approaches encourage flexibility and creativity in service provision by loosening control over activities and by incentivising service providers to try new methods to achieve objectives. This promotes innovation and efficiency. Furthermore, the use of partner systems reduces transaction costs.

However, one risk of this approach is that incentives may be set for fragmented individual objectives, at the cost of holistic and systemic progress.

In addition, result-based approaches are not suitable in all sectors to the same extent. Social sectors such as education and health, as well as sectors with well-measurable infrastructure services, offer comparatively good conditions for payment by results. In other areas, such as good governance, results are sometimes more difficult to measure or a consensus with the partner is unlikely to be reached.

Requirements for result-based approaches

The main requirement for the use of result-based financing is measurable results that are linked to the desired developmental impacts and whose achievement is suitable as a trigger for payment. To be able to independently verify the achievement of the results, data of sufficient quality must be available at reasonable costs and at regular intervals.

Another prerequisite is that the project partner has the necessary capacities to deliver the planned results. This includes technical implementation capabilities as well as means to pre-finance the required expenses as well as to manage the associated risks.

An ex ante appraisal of the systems and processes for achieving results is important for risk management. This includes assessing systems for financial management, procurement, and environmental and social standards.

Summary: An effective approach to fostering innovation by leveraging partner capacities

Result-based financing can be used flexibly across different sectors and country contexts, provided that the above-mentioned necessary prerequisites are met. Result-based financing approaches leverage local competences through financial incentives. They promote a focus on results, innovation and efficiency in the provision of services, and strengthen ownership on the part of partners. ■

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