Guest Blog

Pay for Success: How "Impact Investing" Can Make Government Services Better

A new funding concept proves you can combine societal impact with financial returns

By Sarah Guminski on October 6, 2016

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In 2011, Antony Bugg-Levine and Jed Emerson published a book called Impact Investing to explain a new way to think about capital. Traditionally, profit-making and charity have been held in opposing camps backed by the belief that for-profit organizations should seek financial return, while non-profit organizations should fund societal impact.

However, impact investing has broken that barrier to deliberately combine impact with financial returns, particularly in the area of social service provision. Enter Pay for Success programs, also known as Social Impact Bonds.

In this approach to financing interventions like early childhood education and homelessness prevention, private investors or philanthropies provide the initial funding to test or scale up social programs, and an outcome payer, typically a local government, pays back the investment with interest if the program meets agreed upon goals.

Pay for Success represents a departure from the status quo because often in government contracting, programs continue irrespective of whether or not they're effective. These contracts contain detailed outcome goals and often include language that allows investors to exit if certain goals are not met.

Although most Pay for Success programs have not produced definitive results yet, psychological research tells us that even introducing outcome measurement in government contracting can positively influence the behavior of social service providers.

Brian P. Gill, Jennifer S. Lerner, and Paul Meosky address this very idea in their upcoming Behavioral Science & Policy publication, *Reimagining Accountability in K-12 Education: A Behavioral Science Perspective*. In their study of school performance, they find that "transparency alone can create accountability, even in the absence of explicit rewards and sanctions." The researchers determine that this transparency aids in accountability through the mechanism of feedback.

Take, for example, a Pay for Success program called Educate Girls in Rajasthan, India. In a recent webinar hosted by the Brookings Institution on year one results from the world's first Development Impact Bond, Safeena Husain talked about her experience using real time data collection to evaluate progress in Indian schools.

By continuously monitoring students, Husain noticed that one out of the 166 participating schools was significantly underperforming in math. After going to that school to address the problem, it turns out that there was a simple solution. Husain was able to provide immediate feedback to the teacher that one particular class had not grasped the lesson on decimal points.

As a result, Husain saw significant improvement in math scores by re-teaching the topic and the organization learned the value of feedback for performance management. Instead of waiting until the students were evaluated at the end of the year, the transparency of real time data increased accountability of the teacher and the overall performance of the program.

With the ability and desire to track complex information on social service performance, Pay for Success programs are just the start of how impact investing can be incorporated into government service provision. However, Pay for Success is not a panacea. Because impact investing does not typically offer high, or even market rate returns, a barrier to expansion is finding the right kids of investors to grow the field. However, for investors who want to shift from traditional valuation to a triple bottom line (social, environmental, and financial) approach, Pay For Success is full of potential.

The critical piece that makes Pay for Success work is that funding for the service is contingent upon meeting well defined goals, which in the case of education, means tracking more than standardized test scores. In contrast to traditional service delivery that measures how many people are served, contracting on outcomes pushes the focus to how well people are served.

The views expressed are those of the author(s) and are not necessarily those of Scientific American.

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