

Social Impact Bonds Roundtable

Introduction

Grant Thornton UK LLP recently hosted a roundtable discussion on the topic of Social Impact Bonds (SIBs) as part of our ongoing research into the coalition's broader public sector reform agenda, commonly referred to as the Big Society. Attendees were drawn from groups representing potential commissioners, service providers and investors in SIBs. This paper summarises the key points raised in the discussions and the differing perspectives of the various interested groups.

What are Social Impact Bonds?

Social Impact Bonds are a new type of contractual arrangement that link financial returns to the delivery of improved health and social outcomes.

The term 'bond' may be slightly misleading in the purely technical sense, but the term Social Impact Bond refers to a new way of structuring and raising finance from either social or commercial investors in order to provide an upfront investment which encourages innovation and best value in public service delivery.

Contractual payments are triggered by the service provider delivering agreed outcomes and payment is split between the service provider and the investors. Typically, enhanced performance outcomes trigger further payments, which may be funded by budgetary savings flowing from these service outcomes.

More helpful terminology may be Social Impact Payments (SIPs) or perhaps Social Impact Contracts, although, as with the contractual structure, the vocabulary needs to be flexed to suit each individual set of circumstances.

Determining suitable services

It was agreed that there is a range of public services that could potentially be suited to the application of SIBs/SIPs. The roundtable discussed their key characteristics in the context of the current Ministry of Justice pilot study with Social Finance and St Giles' Trust, working with offenders leaving Peterborough Prison, to reduce re-offending rates.

The discussion revealed a tension between services and populations where outcomes are easiest to deliver and those where the public impact (both social and financial) is greatest. For prisoner rehabilitation, preventing the cycle of re-offending was considered easiest for first time entrants and low-level offenders who are least entrenched in the criminal justice system. Changing the behaviour of long-term and high risk offenders was recognised to be more difficult to achieve. However, as these cohorts involve higher levels of spend, they offer the highest potential savings, and so are potentially more attractive to both investors and commissioners. Service providers' appetite to deal with such challenging cohorts would depend critically upon both their focus and the commercial arrangements.

Other public service areas that were identified as being suitable include:

- education, particularly Not in Education, Employment or Training (NEETs)
- looked after children / foster care

- youth justice
- health and wellbeing, including social care (end of life care), drugs and alcohol rehabilitation.

The opportunities

Roundtable participants expressed a view that the introduction of SIBs/SIPs provides an opportunity to fundamentally restructure and improve delivery mechanisms and drive wider change in the delivery of public services. SIBs/SIPs could encourage better collaboration on service provision to achieve targets more effectively, delivering more innovative and holistic approaches to service provision. This could stimulate and encourage truly 'joined up' funding streams and the use of locally pooled budgets, from which to draw payment to service providers and investors.

The presence and vested interest of an external third party investor providing the initial funding to establish the service delivery, which is core to the implementation of a SIB/SIP is expected to focus and align the efforts and objectives of the parties involved, adopting the commercial and financial disciplines of a private sector investor.

Commissioners

Commissioners recognised that SIBs/SIPs are potentially a good method for managing financial risks in the long-term, delivering services and achieving outcomes while being driven by a need to ensure a return on the upfront investment.

The incentives for the successful delivery of performance targets provided through a structured payment mechanism has the potential to drive forward measures which will increase the likelihood of achieving the outcomes in addition to providing scope for savings to the taxpayer.

Providers

Providers suggested that, by focussing on rewarding outcomes rather than controlling outputs or indeed costs, there is the potential to enhance autonomy for providers, thereby allowing them greater control over how they intend to deliver the outputs and to take on the risks of service delivery.

Investors

Social investors were clear that if the opportunity exists for savings to be made through early interventions and innovate approaches, then these could be used to create appropriate returns for investors, although this crucially must be matched by an authentic appetite within the public sector for the necessary innovation and change involved.

The challenges

The roundtable highlighted a number of challenges to be addressed if SIBs/SIPs are to be applied more widely.

It was discussed that while SIPs/SIBs conceptually provide a foundation upon which innovation can flourish and be enhanced, the focus on securing returns for investors could also stifle change. For example, if failure to achieve outcomes would mean loss of the contract or payment for the service

delivered, putting both the forecast returns and the initial investment at risk, providers and investors would become more cautious.

The roundtable recognised that the scale of success will be important. Substantial savings, and hence returns on investments, may only be achieved where early interventions and rehabilitative service provision are sufficiently effective for the government to then reduce reactive and crisis intervention spending in that area, for example, by permanently closing a prison wing due to a reduction in re-offending.

Commentators expressed concern at the level of transaction costs potentially needed to establish each contract. There was a significant amount of pro bono legal input required for the current pilot scheme. It was recognised that the standardisation of contracts would help bring down transaction costs, although the challenge would be to avoid stifling innovation.

In line with the view that the delivery of public services is already overly complex, there is a concern that overlaying a sophisticated commercial and contractual arrangement may exacerbate existing problems by adding further complexities to the system.

Commissioners

The roundtable noted that commissioners face the challenge of deciding how to identify, capture and measure the range of benefits and outcomes that are desired. If the payment mechanism is driven by outcomes which lead to measurable public sector savings, decisions will need to be made about where these savings fall, or where they do not, and whether sufficient benefits have been created.

Using the example of criminal justice savings, it was argued that offenders being rehabilitated back into society and not repeat offending will not necessarily directly correlate to a prison place being no longer required - there can be a 'successful' outcome (rehabilitation) without the intended by-product (a reduction in spend on prison places).

The roundtable also noted that SIBs/SIPs will also face the particular challenge of engaging investors in this relatively adolescent investment market where the bond does not guarantee a return on investment. A related issue will be how to capture long-term outcomes with a payment mechanism that withholds reward until outcomes reach fruition. Solutions to this may include enabling the 'shares' in these investments to be bought and sold to ensure that returns are made across the life cycle of a project.

Providers

Discussions focused on how providers could manage the delivery of outcomes which may be heavily reliant on the existence of other factors and variants within the wider public realm, over which, as the provider of a single service, they may have little or no control. This creates the opportunity to increase joined-up working between public service providers as well as a prominent role for joint commissioning. Success will depend on the effectiveness of collaboration achieved between all of the relevant partners.

Investors

Commentators suggested that a key success factor for investors will be a full understanding by all parties of the range of risks involved. The intelligent management of these risks and the manner with which they are passed along the delivery chain will be essential here. Example risks include:

- measurement - can successful outcomes be objectively measured within a suitable timeframe, can a baseline be established and can the outcomes be audited?
- oversight - what governance arrangements are required?
- management - are service providers equipped to take on the risks involved, are new skills or resources needed?

The need to align service providers' and investors' incentives was emphasised. It may be that there are useful lessons to be drawn from the private equity market, where share options and other incentive mechanisms are used to both reward long-term performance and align incentives between operational management and investors.

Given the immaturity of the social investment market, some investors suggested that tax and other fiscal incentives may prove useful enablers to help stimulate interest.

The roundtable also recognised a need to avoid confusion over the language adopted in this developing area, for example the term 'social impact bonds' had been adopted for arrangements where no bond issue was involved.

Conclusion

This initial examination of the issues was encouraging with an underlying desire on all sides for innovation and change in service delivery, which is exactly the intention social impact bond/payment arrangements aim to foster.

The adoption of outcome commissioning was itself considered to be a powerful delivery tool if implemented appropriately. Where done well, such arrangements could inspire change across the wider service provision supply chain and there are examples of this beginning to emerge elsewhere in public service delivery.

The selection of appropriate services and the adoption of agreed, transparent and workable measures were seen as key factors to successful implementation.

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