

Social Impact Bonds

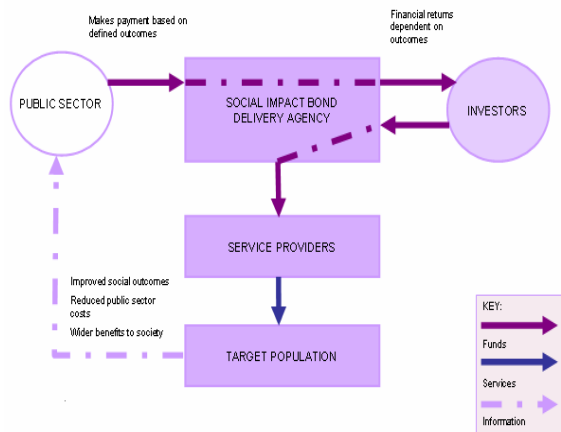
"The Social Impact Bond aligns the interests of government, charities, social enterprises and socially motivated investors around a common goal. We are delighted to be launching the first such structure in the world here at Peterborough."

David Hutchinson
Chief Executive, Social Finance

The Ministry of Justice launched the world's first Social Impact Bond in September 2010; a financial tool harnessing private investment to social ends. This six year pilot is run by social investment organisation, Social Finance, and seeks to reduce re-offending rates among 3,000 short-term prisoners at Peterborough Prison. If re-offending rates drop by 7.5% or more during the period then investors receive a return, capped at £8m.

What is a Social Impact Bond?

Social Impact Bonds (SIBs) are a new contracting and financing mechanism which aim to generate non-government investment into early intervention and prevention measures to deliver improved societal outcomes. Returns for investors are generated from the savings made as a result of the related reduction in spending needed on acute and crisis interventions.



How does it work?

SIBs transfer the financial risks associated with achieving outcomes from early and preventative interventions to those delivering and financing them. Government pays only once when an agreed outcome(s) has been achieved and validated, and then shares an element of the savings produced by the reduction in spend on acute and crisis interventions as a result of the improved outcomes achieved.

The government perspective

Not every policy area is suitable for the SIB approach from a government or commissioner perspective. The following key characteristics show which types of public sector service delivery may benefit from a SIB approach:

- outcomes that can be robustly measured, priced and validated. This is key to the success of a SIB and a payment by results regime
- high cost to the public purse – areas where there are potentially great savings to be made from successful early intervention reducing the need to crisis or reactive interventions
- short-term services focusing on subjects/client who are first-time entrants, therefore allowing social impact to be more quickly and easily achieved.

The key obstacle from a government perspective is how to capture and measure the social benefit, in short, the outcomes expected from the intervention funded by the SIB:

- Can the outcomes be easily measured? If not, how can success be defined?
- Do the benefits accrue to one or many government departments? If the latter, then which department would commission the service and bear the costs?
- Is there a common language an understanding of outcomes, and a move away from measuring inputs and outputs? Outcome commissioning and management can be powerful when done well, but disastrous if done badly.

In addition to issues above, there are also the following considerations:

- What mechanisms are in place to share learning and best practice in more competitive and mixed economy of providers?
- The complexity of setting up SIBs implies high transaction costs, especially in the early days of the model where no precedents are available.
- Scale is important - the big savings and returns on investment will occur when early intervention are so effective that the government can scale back its involvement in the area.

These problems are not unsolvable and a number of initiatives may encourage the take-off of the SIB model:

- joined up funding streams and pooled budgets
- development of an outcome targets and performance management framework
- tax and other fiscal incentives to help stimulate interest from investors
- standardisation of contracts to help reduce transaction costs. The challenge would be achieving a balance between standardisation and the flexibility to allow innovation.

The service provider perspective

SIBs present a number of opportunities from a service provider perspective. From a financial point of view, SIBs could provide a significant investment which gives financial security over a period of time, to allow the provider to focus on delivering their services and achieving the social objectives. Secondly, the SIB allows them to address these social objectives in innovative ways (compared with traditional government contracting which may be too prescriptive in terms of how to address issues).

SIBs provide a number of opportunities to providers:

- the chance to fundamentally restructure and improve delivery mechanisms. The SIB model allows flexibility in terms of service provision and could increase the effectiveness of interventions and promote joint working
- the opportunity to increase collaboration and cooperation between service providers in order to achieve the targets and required outcomes. There is a related risk that innovation may be stifled through fear that outcomes will be mitigated and therefore payment not be achieved
- greater autonomy for the provider and greater control over how they intend to deliver the outcomes with the incentives for efficiency and success provided through the payment mechanism.

The SIB model, however, risks adding another layer of complexity to the already complex and multi-dimensional arena of public service delivery and social goods.

The risks around outcomes need to be properly managed; risks being forced onto one provider with no control over key issues may not result in an optimum outcome. Therefore, it makes sense that providers share the risks with others. A model can be envisaged whereby consortiums signing up to a SIB use a range of providers to deliver the required outcomes. Indeed, this flexibility could be viewed as a benefit of the model.

The investor perspective

The role of the investor is critical in the Social Impact Bond structure. The model hangs on financial returns being realised through the achievement of social goals. To this end, a SIB will need to demonstrate the following characteristics so as to present a viable investment:

- clear boundaries – the population subject to the SIB (on which the outcomes are based) must be clearly defined
- clear outcomes – the targeted outcomes must be clear and unambiguous
- transparency and auditable data – the quality of data around the achievement of outcomes must be strong so as to avoid any risk of challenge
- independent monitoring – outcomes and the reporting thereof must be independently monitored. This keeps the investor side and the commissioner side happy, knowing that the results of activities are recorded fairly.

Moving from the SIB model generally to the investor's consideration of specific projects, the following factors will be important:

- sponsoring organisations who can:
 1. undertake contract negotiation
 2. raise finance

3. manage programmes – the role of managing a SIB is a varied one and requires a range of skills.

- partners with a track record – the service delivery body(ies) will need to demonstrate to investors their value within the consortium and their track record in improving outcomes
- confidence that consortia can adapt and have the remit to do so if circumstances change.

Investors will require regular updates on progress against the SIB's objectives. This puts the onus on the provider to demonstrate progress against the required outcomes in order to secure their position. Investors will undoubtedly seek the ability to remove underperforming service providers in this instance in order to secure their investment.

For the SIB model to take off it will need to demonstrate its appeal to investors with a range of motivations:

- philanthropic – those motivated by social outcomes rather than financial return
- commercial – those primarily motivated by a financial return
- hybrid – those seeking to 'do more' with their money, that is, they may not require a financial return other than initial investment if investment is being used towards social gains.

Acknowledging this situation means that the various sources of capital can be maximised so as to support as large a range of projects as possible.

Government intervention may be required to stimulate the market; favourable tax treatment and lighter touch regulation could grease the wheels of the SIB model in its early days. These actions would provide further incentive to motivate more commercially minded investors and bring them into the market.

Conclusion

The Social Impact Bond is in its infancy as a practical means of achieving social benefits. In order for the SIB to grow into a thriving market Grant Thornton's five key characteristics for success:

1. the SIB needs to be targeted at avoiding a major downstream cost to the government
2. data needs to be readily available and measurable in a transparent manner
3. where benefits accrue to a range of government bodies, one lead sponsor should be identified
4. the different types of investors and their associated motivations should be acknowledged
5. favourable development in the tax regime (assisting lending for social benefit) would be a significant boost to the model.

Who should I contact for more information?

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