

**Thinking about  
Social Impact Bonds  
in the South African context  
(lessons from the United Kingdom)**

by

**Michael Mulvaney and Laurel Kriegler**

---

**June 2014**

**A research report commissioned by  
Cornerstone Economic Research**

---

## Acknowledgements

Thanks to all the people who made time to be interviewed for this project (see list at the end of the paper). Also thanks to those that provided documents or other inputs.

Thanks also to the team at Cornerstone Economic Research who commissioned the research and provided suggestions and comments on previous drafts of the paper.

As the authors of this paper, we are responsible for its contents and all opinions expressed in the paper are our own and cannot be attributed to Cornerstone Economic Research.

**Michael Mulvaney**

E-mail: [m.mulvaneyuk@yahoo.co.uk](mailto:m.mulvaneyuk@yahoo.co.uk)

**Laurel Kriegler**

E-mail: [laurel.kriegler@gmail.com](mailto:laurel.kriegler@gmail.com)

**Michael Mulvaney** is an independent consultant based in the United Kingdom. He has seven years experience working as a senior policy analyst responsible for providing financial and spending policy advice to central government departments within the United Kingdom. He is a graduate in Economics from Oxford and has an MA in Political Economy from the University of Sheffield.

**Laurel Kriegler** is an independent consultant based in the United Kingdom. She holds a BComm (Hons) degree in Economics from Rhodes University, Grahamstown, South Africa.

### Citation suggestion –

Mulvaney, M. and Kriegler, L., 2014 'Thinking about Social Impact Bonds in the South African context'. Research paper commissioned by Cornerstone Economic Research, Pretoria, South Africa

---

**For more information regarding Cornerstone Economic Research contact:**

**Jonathan Carter**

Senior Researcher with  
Cornerstone Economic Research

Email: [jonathan.carter@cornerstonesa.net](mailto:jonathan.carter@cornerstonesa.net)

Website: [www.cornerstonesa.net](http://www.cornerstonesa.net)

## Table of Contents

|   |           |
|---|-----------|
| EXECUTIVE SUMMARY.....  | I         |
| <b>1 INTRODUCTION .....</b>   | <b>1</b>  |
| <b>2 SOCIAL IMPACT BONDS AS A TYPE OF PAYMENT BY RESULTS MODEL.....</b>           | <b>2</b>  |
| 2.1 PAYMENT BY RESULTS .....  | 2         |
| 2.1.1 <i>Public Finance – state delivered</i> .....                               | 2         |
| 2.1.2 <i>Public Finance – non-state delivered</i> .....                           | 3         |
| 2.1.3 <i>Private Finance – non-state delivered</i> .....                          | 3         |
| 2.2 SOCIAL IMPACT BONDS.....  | 3         |
| 2.2.1 <i>Stages in the life of a SIB</i> .....                                    | 4         |
| 2.2.2 <i>Stakeholders in a SIB</i> .....  | 5         |
| 2.2.3 <i>What can SIBs be used for?</i> .....                                     | 6         |
| 2.2.4 <i>Why are governments turning to SIBs?</i> .....                           | 7         |
| <b>3 ADVANTAGES, CHALLENGES AND DETERMINANTS OF SUCCESS .....</b>                 | <b>7</b>  |
| 3.1 ADVANTAGES OF SIBS .....  | 7         |
| 3.2 CHALLENGES WITH SIBS.....   | 8         |
| 3.3 DETERMINANTS OF SUCCESSFUL SIBS.....  | 9         |
| <b>4 CASE STUDIES.....</b>  | <b>10</b> |
| <b>5 DISCUSSION OF METRICS AND FUNDING .....</b>                                  | <b>11</b> |
| 5.1 METRICS USED IN SIBS .....  | 12        |
| 5.2 DEVELOPMENT OF THE SIB MARKET .....   | 13        |
| 5.3 FUNDING MIX.....  | 13        |
| 5.4 THE ROLE OF FINANCIAL INTERMEDIARIES.....                                     | 14        |
| <b>6 LESSONS RELEVANT TO SOUTH AFRICA .....</b>                                   | <b>14</b> |
| <br>  |           |
| PEOPLE INTERVIEWED FOR PROJECT .....  | 17        |
| REFERENCES .....  | 17        |
| <br>  |           |
| ANNEXURE 1: SIBS IN OPERATION IN THE UK.....                                      | 19        |
| ANNEXURE 2: CASE STUDY ONE: THE ESSEX SIB .....                                   | 20        |
| ANNEXURE 3: CASE STUDY TWO: THE GLA HOMELESSNESS SIB .....                        | 24        |
| ANNEXURE 4: CASE STUDY THREE: THE DWP INNOVATION FUND.....                        | 28        |
| ANNEXURE 5: CASE STUDY FOUR: THE SOCIAL ENTERPRISE MODEL: TOGETHER PROJECTS ..... | 32        |
| ANNEXURE 6: DWP INNOVATION FUND ROUND ONE AND TWO OUTCOMES .....                  | 34        |

## Executive Summary

### General findings

1. Different SIB models are starting to emerge. Regardless of the model used, the balance of risk is weighted heavily in favour of commissioners. Whilst this “money back guarantee” approach is attractive to governments, it is constraining the growth of the market. For the market to expand, governments need to share the risk with investors. Moreover, as the model evolves, it remains to be seen what percentage of intermediary fees will be performance-based.
2. Metrics and their relationship with investors depend on: i) who the investors are, and ii) what their motivations for investing in SIBs are.
3. Following the first SIB launched in the UK in 2010, SIBs have been implemented and explored in countries around the world, including Australia, Canada, Columbia, India, Ireland and Israel. Currently there are fifteen active SIBs in the UK, four in the US, two in Australia and one in the Netherlands. Of all the active SIBs, only four have any portion backed by financial guarantee. Two of these are based in the US, and the other two are in Australia:
4. In the UK and Canadian SIB markets, the funding pool is characterised by a relatively large investor base. Their motivations for investing in SIBs are generally aligned with those of service providers with regards to achieving outcomes. In contrast, the US and Australian SIB markets are characterised by large financial investors seeking financial returns.
5. Cultural and regional differences have been observed in SIBs in both Canada and Scotland, and these influence the way contracts are designed and managed – and therefore also the choice of metrics used to measure impact.
6. In two of the case studies, namely the Essex and Innovation Fund second round SIBs, it is clear that as data collection systems improved, investors’ understanding of risks and financial returns improved.
7. The reassessment of the financial rates of return in the case of the Essex SIB led to payments being made for lower thresholds of impact. With respect to the Innovation Fund SIB, commissioners agreed to pay higher rates in order to incentivise investors to work with niche groups, including gangs.
8. In contrast with the GLA Homelessness SIB and the Innovation Fund round one SIB, commissioners unilaterally decided what the metrics would be and investors and intermediaries had minimal input. In the case of the Essex SIB there was extensive co-development of the metrics between the commissioners and Social Finance at the time it was designed.
9. No official statistics on the fifteen SIBs in the UK have been released. However, interim results for the Peterborough SIB released by the Ministry of Justice show positive results. That said, it is reported that all the SIBs covered in this paper are performing relatively well to date.
  - Performance with respect to the Essex SIB has been fairly successful. However, the project is still in its infancy and there remain challenges around embedding the programme into local authority structures and building up volumes of young people covered by the SIB services.
  - The Innovation Fund SIB is performing in line with profiling, and both of the GLA Homelessness SIBs are performing equally well.
10. There is no mix of government and non-government funding of SIBs in the UK to date. This reflects the heavy concentration of funding emanating from public sector-financed organisations. In 2011-

12, the three largest SIFIs accounted for 80 per cent of total investment. The fifteen smallest SIFIs grew by 25 per cent since 2010-11, but still only accounted for 3 per cent of total social investment.

## Lessons relevant to South Africa

There are a number of things that anyone proposing to set up a SIB in South Africa should take into account – both relating to the nature of SIBs and the economic environment prevailing in South Africa.

### Getting going

11. SIBs are a complicated source of funding. Investors in SIBs have to spend a lot of time and money working out whether they will get their money back. However the key benefit is that they encourage and reward innovation.
12. Social investment, social enterprises and SIBs are part of a funding mix that includes loans and traditional grants. SIBs cannot be seen as a replacement for these other sources of funding, but is part of the basket of tools that can be used.
13. SIBs are a worthwhile funding mechanism to consider if addressing the social issue leads to cost savings for government. However, they are not necessarily the best mechanism to consider even in such circumstances.
14. The experience so far with SIBs in the UK demonstrates that much learning happens as individual SIBs mature. Commissioners need to show they are willing to adapt the SIBs and respond to lessons learnt.
15. The role of specialised intermediaries such as Social Finance has been seen as critical in consolidating the market in the UK. The UK market is concentrated with a few investors and the risk profile of SIBs has tended to be skewed in favour of commissioners and large service providers. Markets in other countries do not necessarily have to follow the same pathway of development.
16. The best way to demonstrate the potential of SIBs is to tackle discrete social issues where success is likely.

### Metrics

17. Because cash payments are tied to performance targets, SIBs demand rigorous evaluation, which is costly. To this end, investors need to be included in the development of metrics used in the SIBs they finance. It is critical that they understand what level of performance will be rewarded and how.
18. The cost of collecting and evaluating data for the purpose of constructing metrics must be understood by all involved. Ideally, data should be drawn from existing official government databases, as this does not involve additional costs for the SIB role players and is typically objective data. Metrics must be underpinned by comprehensive databases and all stakeholders of the SIB must understand the need for complete and accurate data.
19. The costs of current service provision must be clearly understood, as well as the costs of the intervention the SIB will support. The SIB must lead to savings for the commissioner and the cost of administering the SIB must be worthwhile for the investors.
20. Existing barriers to data sharing need to be taken into account when designing metrics.

21. The scope of the SIB needs to be targeted. However it must also ensure that there is a large enough target population so that potential monetary rewards from the SIBs are large enough to attract investors.
22. Tariffs must, for a traditional SIB, be tied to outcomes and incentivise the service providers and the investors to buy in to the success of the SIB. They must be structured so that they encourage the use of the intervention rather than a short-cut to receiving a payout (perverse incentives).

### Capacity and learning

23. Even though South Africa has comparatively good data sets, government databases and data collection capacity will need to be greatly enhanced to meet the data intensive requirements of SIBs.
24. The South African government must approach SIBs with a willingness to learn and share knowledge gained with the emerging global SIB market. Canada – with large regional and cultural differences as well as large wealth disparities offers good potential for information sharing with social investors and social entrepreneurs in both markets. Canada also has a similar provincial governance structure to South Africa where intermediaries, service providers and investors need to engage with different levels of government, unlike the UK's central government.
25. For the South African social investment market to develop, engaged commissioners and social intermediaries will be required. They need to have or develop the technical capacity to allay investor concerns and negotiate between government and investors.
26. The South African National Treasury has expressed an interest in SIBs, which shows intent. There is also a range of private investors and trusts who are interested in this financing model. Time will tell if the two parties are able to agree to terms that will result in the implementation of SIBs<sup>2</sup>.
27. Even though South Africa has one of the most sophisticated and transparent budget processes in the world, it is likely that some changes to existing procurement legislation are required to enable the effective implementation of a SIB. Exemptions from certain requirements will be necessary to allow for the contracting processes associated with SIBS to be used. Specifically, the requirement that contracts should be limited to a period of three-years will need to be relaxed.
28. A ring-fenced SIBS innovation fund that is administered by the National Treasury should be considered. Consideration should also be given to establishing specific capacity within the National Treasury to provide technical assistance to role-players exploring SIBS (similar to the PPP-unit, but less cumbersome).
29. Departments in both national and provincial spheres of government, as well as municipalities should be allowed to apply for the funding, but only on a matching funding basis. Matching funding ensures that the relevant department or municipality shares the risks of the SIBs with National Treasury.

---

<sup>2</sup> Cornerstone Economic Research was not aware that the report of the Bertha Coalition (2014) had been commissioned at the time this study was commissioned. Nevertheless, in our view this study adds to the debate around the use of SIBS within the South African context. Cornerstone commissioned the research as part of its investigations into the development of a software solution for tracking performance in the social welfare sector, hence the particular focus of the paper on the SIBS metrics.

## 1 Introduction

For the past fifty years the social sector in the United Kingdom (UK) has been almost entirely dependent on financial support from central government. Many social programmes could not have been undertaken without government funding. Until recently, most private corporations' involvement with the social sector was limited to corporate social responsibility (CSR) programmes. CSR is generally defined as "a company's sense of responsibility towards the community and environment"<sup>3</sup>. The most common approach to CSR was through the awarding of grants and donations.

The current socio-economic climate has opened the door for a new developmental paradigm: investing in products and services that aid socio-economic development, with the express aim of making a profit. The emergence of these 'for-profit' organisations take a variety of forms, including social banks, non-bank social investors (such as CAF Venturesome) and support providers who offer business support services to government or the non-profit sector. These organisations, which serve a social purpose while making a profit, fill a gap in the market: namely, to connect investors with charities and social enterprises which struggle to access capital. While their primary goal is social impact, their for-profit structure means a double bottom line dual social and financial aim driving their investments.

The emergence of the for-profit social enterprises has occurred at a time of growing pressure on public sector funding in the UK, reflected by the March 2012 budget announcement suggesting a further £33 billion reduction target in departmental budgets by 2018. In addition, public services productivity in the UK has stagnated by an average of 0.3 per cent per annum, adding further pressure on central government to deliver better value for money at a time of great austerity<sup>4</sup>. Additionally, government is seeking to promote innovation within public services by encouraging the autonomy of frontline services, the theory being that those on the ground know what works better than those in central government. Enabling such autonomy traditionally reduces the financial accountability of the service providers, and the problem for central government is to ensure that the service providers remain financially accountable for the risks they may take. The main question for government is whether or not SIBs in particular would enable this goal to be achieved.<sup>5</sup>

To gather and analyse the evidence, two methodologies were used. Firstly, semi-structured interviews were conducted with private sector investors, non-profit intermediaries and government officials. The interviews focused on answering specific questions required for the report, with additional research and discussion around the future of SIBs in the UK and across the world. Secondly, desktop research was conducted following participation at the Social Investment Conference held in London during October 2013.

One limitation of this report is the small pool of investors who were prepared to discuss commercially-sensitive information. For example, some financial investors were reluctant to share information regarding the metrics and how they were set up. A mitigating factor is that Dr Bublely, a leading consultant with over 14 years' experience structuring deals worth £20 billion, provided invaluable insights into the relationships between the metrics and investors which would otherwise not have been available. Dr Bublely represents investors on a number of panels, including the special purpose vehicles set up to manage the GLA Homelessness SIB, one of the case studies of this report.

The case studies for this report were selected in order to demonstrate the differing relationships between the metrics and the investors.

---

<sup>3</sup> <http://www.businessdictionary.com/definition/corporate-social-responsibility.html>. Accessed 12 March 2014.

<sup>4</sup> Keohane, Mulheirn and Shorthouse. 2013. 10 see [http://www.smf.co.uk/files/7713/7518/4818/Risky\\_Business\\_final.pdf](http://www.smf.co.uk/files/7713/7518/4818/Risky_Business_final.pdf). Accessed 12 March 2014.

<sup>5</sup> Keohane, Mulheirne and Shorthouse. 2013.



## 2 Social Impact Bonds as a type of payment by results model

In the face of severe fiscal and productivity challenges, the UK's Coalition Government is pursuing a reform agenda to promote and actively support the public service sector. One solution to budget constraints currently being promoted by the Coalition Government is the Payment by Results (PBR) model. The PBR model has its roots in the 1950s and makes providers compete to deliver services to improve overall quality of performance and deliver value for public funds. In previous PBR arrangements, the service providers were paid by results – they received finances mostly or entirely ex post. However, there have long been concerns that some smaller providers (who may be well-placed to deliver services that respond to community needs) are unable to provide services before receiving financing under the traditional PBR model.<sup>6</sup>

### 2.1 Payment by Results

There are three PBR models currently in operation, as set out in Table 1 below: First is the Public Finance; State Delivered model, characterised by projects financed and delivered by the public sector. Second is the Public Finance; Non-State Delivered model, which has been adopted by the Doncaster prison, where services are privately delivered but publicly financed. Finally we see the Private Finance; Non-State Delivered option, of which the Work Programme is an example.

**Table 1: The different Payment by Results models**

|  | Source of funds<br>(capital and operational)                                       | Service Provider  | Level of Risk  |
|--|--|---|--|
| <b>Public finance - state delivered</b>      | Taxpayer-funded capital expenditure as well as operational costs.                  | Government agencies including non-departmental public bodies and local authorities. | No risk transfer – the state as funder and service provider retains maximum risk.              |
| <b>Public finance - non-state delivered</b>  | Taxpayer funded capital and operational expenditure in the form of loan financing. | Non-governmental organisations (NGOs), charities and service providers.             | Limited risk transfers from the state to service providers, dependent on recuperation of funds |
| <b>Private finance - non-state delivered</b> | Private sector leverage finances both capital and operational expenditure.         | Large service providers such as G4S and Serco.                                      | Maximum risk transferred to providers encourages higher incentives to improve services.        |

It is worthwhile noting that the features of the “private finance - non-state-delivered” model set out in Table 1 also covers SIBs, as they are a variant of this particular type of PBR. In the first two PBR models, the service provider is only paid in full after specified outcomes have been achieved. Some providers may receive a portion in advance of the core payout, which is contingent upon them meeting pre-agreed outcomes (the “reward payment”), although most receive no early portion.

#### 2.1.1 Public Finance – state delivered

In this model, public money sponsors the projects delivered by state agencies. While creativity may be encouraged by offering extra incentives to improve quality, the financial risk remains within the public sector. An example of creativity being encouraged in this way can be found in UK Department of Health's plan to give Local Authorities incentive payments on improvement of various public health indicators<sup>7</sup>. Since the financial risk is retained by the public sector, the scope for offering incentives is

<sup>6</sup> Disley, E. et al, 2011:1

<sup>7</sup> Department for Health, Health lives, healthy people: improving outcomes and supporting transparency (London: HMsO, 2012)



limited. Moreover, the risk of failure is unlikely to act as a substantial spur to service improvement, given that the state cannot be allowed to fail.

Where a state monopoly, such as the Local Authorities in the previous example, provides the services, competition is absent. As a result change in the public service generally happens slowly. Public services that perform poorly continue to receive allocated budgets until comprehensive service delivery reviews are performed. It can take years for these reviews to happen and in the meantime a poorly provided service continues to receive budget allocations. Budget processes in government typically support certainty, transparency and stability with respect to budget allocations. The certainty is important to planning service delivery. Income from incentives on the other hand is generally uncertain and unpredictable. This involves a different approach to planning which does not necessarily gel well with orthodox public sector planning processes. Therefore the marginal additional funds that could be provided in incentives may not be perceived as being worth the extra effort. It therefore remains unclear how much more effective financial incentives are likely to be as opposed to using targets.<sup>8</sup>

### **2.1.2 Public Finance – non-state delivered**

Under this approach, payments are made to non-state providers for services delivered, but some of the finance will be placed 'at risk'. For example, the provider may be required to repay some of the money if specific outcomes are not met. If the providers deliver the services within budget, they will not need to use their own funds, which means the service is financed by the taxpayer. This approach introduces a wider pool of possible service providers, resulting in healthier competition and, hopefully, better quality. However, the state still carries the ultimate risk since it may not be able to recover funds from failing providers. This approach represents a limited transfer of risk with accompanying incentives for innovation.<sup>9</sup>

### **2.1.3 Private Finance – non-state delivered**

There is a greater degree of risk transfer under this model, given that providers must finance their own projects and the state pays out if pre-agreed results are completely met (e.g. Social Finance). The greater degree of risk transfer offers the greatest incentives to service quality improvement, and frees the need for the commissioner, or guarantor to dictate processes. However, there is a chance that:

- a) subsequent payments will not cover the costs of intervention, especially where outcomes are unknown,
- b) government would need to ensure that the likely pay-off is substantial enough to attract private investors, and that returns cover the higher cost of sourcing funding for the scheme from the private sector, and
- c) in conditions that require large capital injections, smaller, more specialised providers – which might be the ones with innovative ideas for improving value for money – are unable to take on the risk.

This restricts the pool of potential providers and inhibits competition. Consequently, in large PBR programmes, the main contractors are likely to be large private sector providers such as G4S and Serco, who can draw on their own resources or borrow capital, deliver the project and reap the rewards.<sup>10</sup>

## **2.2 Social Impact Bonds**

SIBs, which are a form of PBR, differ from earlier approaches to the financing of service providers in the way their financing is structured. They are financed by initial investments undertaken exclusively by

<sup>8</sup> Keohane, N., Mulheirn, I. and Shorthouse, R. 2013. 14, 15.

<sup>9</sup> Keohane, N., Mulheirn, I. and Shorthouse, R. 2013. 16, 17.

<sup>10</sup> Keohane, N., Mulheirn, I. and Shorthouse, R. 2013. 17, 18.

private or philanthropic investors, and government only pays investors if and once the results are achieved. Financial rewards for SIBs are coupled with social outcomes (the results) such as improved health, sustainable employment or reduced reoffending rates. The distinction of SIBs is that they are intended to transfer financial risk away from the public sector to the private sector, and at the same time give the investors and the service providers greater freedom in the design and delivery of services. In this way, government hopes to improve both accountability and quality in the provision of public services<sup>11</sup>. SIBs also differ from PBRs in that funds (the initial investments) are usually disbursed upfront.

There are relatively few SIBs in the world. The first SIB, the Peterborough SIB, was launched in the UK in 2010. There are now a total of fourteen projects in the UK that have been financed by SIBs, having a combined worth of £26 million<sup>12</sup>. The UK SIBs operate across a variety of policy areas, including youth unemployment, homelessness, children in care, reoffending and adoption. They build on the innovative work done by a wide range of civil servants from the Department for Work and Pensions (DWP), the Department for Communities and Local Government (DCLG) and the Ministry of Justice, as well as public servants from Local Authorities. There is growing interest in SIBs around the world, with SIBs being launched recently in both the US and Australia, and being explored in Canada, Israel, Germany, South Korea and South Africa.

### **2.2.1 Stages in the life of a SIB**

There are five distinct stages in the life of a SIB – once the SIB contract is in place:

1. An intermediary issues the SIB and raises the capital from private investors.
2. The proceeds are transferred to service providers who draw down the funds to implement programmes.
3. As service providers improve social outcomes, they reduce demand for more costly services.
4. An independent evaluator measures performance against agreed outcomes set out in the SIB contract. If the outcomes are met, government pays the intermediary a percentage of returns and retains the rest. If the outcomes have not been met, government owes nothing.
5. If outcomes are achieved, investors are repaid their principal plus a rate of return, which can be structured on a sliding scale basis: the better the outcomes the higher the return.

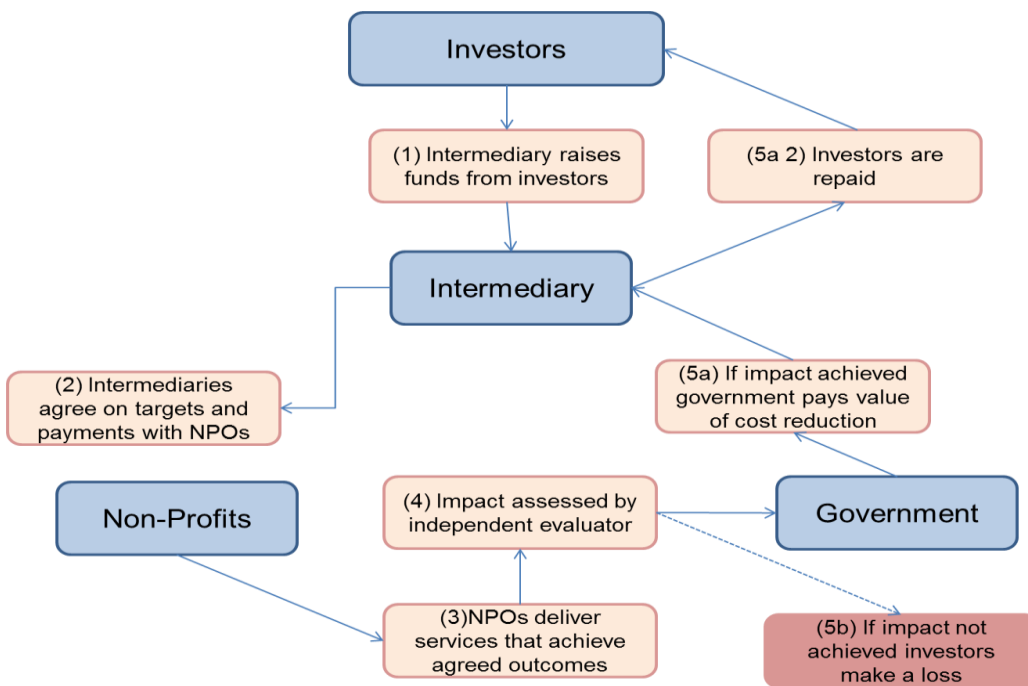
Figure 1 below shows how the various stages relate to one another in practise once a SIB contract has been signed.

---

<sup>11</sup> Keohane, Mulheirne and Shorthouse, 2013. 6

<sup>12</sup> <http://clarmondial.com/social-impact-bonds-an-overview/>. Accessed 12 March 2014.

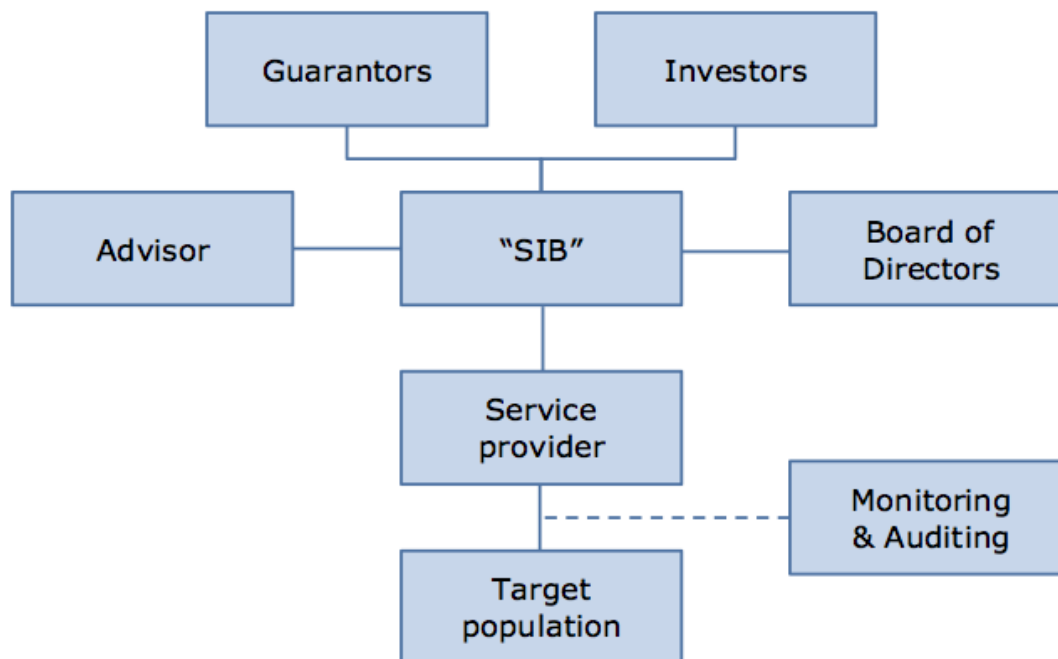
**Figure 1: Stages in the Life of a SIB**



**2.2.2 Stakeholders in a SIB**

The relationships between a SIB and its stakeholders are illustrated in Figure 2 below, and the roles of each of the stakeholders are detailed in Table 2.

**Figure 2: The stakeholders in a SIB**



Source: F. Werneck and T. Havemann (2013)

**Table 2: Roles of stakeholders in a SIB<sup>13</sup>**

| Stakeholder                          | Roles  |
|--------------------------------------|--|
| Investor                             | <ul style="list-style-type: none"> <li>• Provides upfront capital to fund the project</li> <li>• May be involved in execution</li> <li>• Receives regular performance reports</li> <li>• Receives financial &amp; non-financial returns, subject to project performance</li> </ul> |
| Guarantors<br>(e.g. Government body) | <ul style="list-style-type: none"> <li>• Guarantees the return to investors, subject to project performance</li> <li>• Benefits from project implementation</li> <li>• Typically drives the process</li> </ul>   |
| "SIB"                                | <ul style="list-style-type: none"> <li>• Special purpose vehicle (e.g. trust) established to manage and finance the intervention</li> </ul>  |
| Advisor                              | <ul style="list-style-type: none"> <li>• Structures the SIB</li> <li>• Liaises with investors and guarantors</li> </ul>  |
| Board of Directors                   | <ul style="list-style-type: none"> <li>• Monitors SIB's management and operations</li> </ul>   |
| Service Provider                     | <ul style="list-style-type: none"> <li>• Executes the intervention</li> </ul>  |
| Monitoring and Auditing              | <ul style="list-style-type: none"> <li>• Independently assesses project status and outcome, based on pre-defined standards</li> </ul>  |
| Target Population                    | <ul style="list-style-type: none"> <li>• Beneficiaries</li> <li>• Consulted in the design and implementation phases and monitoring</li> <li>• Can be split into control group and experimental groups</li> </ul>   |

### 2.2.3 What can SIBs be used for?

SIBs can be used to finance projects that have quantifiable social outcomes in the near future. Since repayment is subject to success, a critical aspect is the definition of success. Therefore, the project must have a well-defined scope and clear goals. The goals must be measurable and quantifiable, whether based on incidence or prevalence. The performance must also be audited by third parties. This characteristic adds transparency to the public services under analysis.

That said, it is usually difficult to attract investors willing to commit for a period longer than five years. Additionally, it may become more difficult to control the influence of other variables in a longer term project, so most SIBs are linked to a 1 to 5-year project. In certain instances, however, SIBs may finance programmes that don't necessarily ensure near term savings. For example, preschool programmes for low income children have proven to be highly effective, even though their outcomes are manifest years later in the form of improved health outcomes and lower crime rates in adulthood.

This raises the question: what projects have been funded by SIBs to date in the UK? SIBs have thus far been used to support proven programmes that government is currently either not funding at all or not funding at scale, whether due to budget constraints or an unwillingness to assume the financial risk if intervention fails. To expand programmes already in place that ensure near term savings, SIBs should supplement existing funds, transferring the financial risk of programme expansion to investors prepared to accept that risk.

The Peterborough SIB provides a practical example of how a SIB is applied. Social Finance raised £5 million from private capital markets (mostly trusts and foundations) to reduce the rate of recidivism amongst 1 000 prisoners at Peterborough Prison England, all of whom were serving one year periods or less and classified as low risk. Using the money raised, they hired an NGO called St Giles Trust in September 2010 to manage the programme to reduce recidivism. Reoffending must decrease by at

<sup>13</sup> F. Werneck and T. Havemann (2013)

least 7.5 per cent to trigger the dividend payments in each of the six years of the bond's lifespan. An independent third-party will determine the outcome. If successful, a maximum of £8 million can be refunded to investors, which is comparable to an annual return of 7.5 per cent in a conventional bond market investment. If the predefined outcomes are not achieved, no money will be refunded to investors.

#### **2.2.4 Why are governments turning to SIBs?**

SIBs “[e]nable governments to execute projects without increasing short-term public expenditure and taking on new debt.”<sup>14</sup> They should result in financial savings to the public sector, allow governments and service providers to secure upfront financing for specific initiatives while spreading risk, shift government expenditure from the short term to the longer term, thus improving expenditure profiles, and shift risk of non-performance to the service provider, keeping the government as administrator.

### **3 Advantages, challenges and determinants of success**

#### **3.1 Advantages of SIBs**

The main advantage of SIBs is that they create a financing mechanism for implementing and testing innovative approaches to social service delivery. Generally SIBs focus on preventative social services that are needed. If these approaches are successful they improve social outcomes while also saving taxpayers money.

They increase the social impact of non-profit innovations, and are able to reach more people than traditional state contracts can by tapping into new sources of capital, including trusts and private investors. Dale Hutchinson, founder of Social Finance – a major intermediary in the UK – believes that “[T]he simple power of the Social Impact Bond model is that...funding is flexible and can be directed on a case by case basis to meet the needs of the service users on the ground.” He continues to say that, in contrast to many existing services (as of 2011, that is), SIBs are not financed to provide services irrespective of need.<sup>15</sup>

The SIB model allows the providers to focus on achieving objectives in a way that is transparent to taxpayers. Moreover, programmes that fail to achieve results do not continue to receive funding. The SIB model could also lead to accelerated adoption of new solutions: government agencies will have an incentive to invest in promising new approaches because the risk of wasting taxpayer money if these models fail is transferred to the private sector.

By allowing smaller more specialist organisations to get involved in delivery, SIBs may bring greater expertise compared to markets in which only a handful of large firms can operate.

Social Finance discusses the role SIBs could play in preventative healthcare. They argue that using SIBs to fund interventions relating to long-term health conditions can lead to better quality healthcare and to a more efficient use of funds.<sup>16</sup>

Professor Paul Corrigan (who served as senior health policy advisor to Tony Blair in 2005) believes that SIBs can play a critical role in preventative healthcare. Corrigan reported that people with long-term conditions are disproportionately high users of health services, because they comprise 50% of General Practitioner appointments, 68% of outpatient and Accident and Emergency attendees and

---

<sup>14</sup> Werneck, F. and Havemann, T. 2013

<sup>15</sup> Social Finance, 2011:2

<sup>16</sup> Social Finance 2011a

70% of inpatient bed days in the UK.<sup>17</sup> According to Corrigan, a SIB that worked on funding long-term preventative healthcare goals such as reducing obesity in children, will not only result in better economics, but better healthcare. However Corrigan also highlights that measurability, especially in terms of attributing a reduction in healthcare to the preventative measures undertaken decades previously could be very difficult.<sup>18</sup>

To summarise, SIBs can perform a much-needed function in the preventative healthcare services market, in that SIBs can be focussed on successful programmes and provide hard data on the effect of such programmes.

### 3.2 Challenges with SIBs

SIBs exhibit a number of weaknesses that can benefit from further development. These include:

- bureaucratic and time-consuming procurement processes;
- tension between service provision and profits (that may result in perverse incentives);
- performance measurement;
- attributing impact to the programme financed by the SIB; and
- undue risk to government.

To expedite the procurement process, Social Finance suggests “[s]tructuring a procurement process and contract in a way that is attractive to social investors”, designing new methods by which to judge fair deals in new markets by juggling between preventing large profits and service failures, and integrating the new SIB service with existing services.<sup>19</sup>

With regards to the Peterborough SIB, a question raised by an investor (a trustee of a charity) concerned whether or not the duty of a trustee of a charity is to maximise financial return at a cost of the service provided.<sup>20</sup> Currently, if Social Finance reduces reconviction rates by 10 per cent, investors get an annual return of 7.5 per cent, and the maximum return is capped at 13.5 per cent. But if the returns have a ceiling, then they should perhaps also have a floor, i.e. a certain minimum amount that is guaranteed to investors if the bonds achieve a slight reduction in the rate of conviction. One of the main problems of the current model is the lack of guarantees provided to private investors, who carry all the financial risk. It is argued that this level of risk will definitely impede investors’ future involvement with SIBs.

One possible solution to this is to set up a pay-by-percentage model whereby the government will pay for a given percentage of social impact created by the bond, even if the bond fails to meet the overall target. Until the risk of the bond is reduced, the only organisations that will get involved are socially-focussed funds and non-profits such as Barrow Cadbury Trust; because the prospect of losing all money invested (even the principal) if the bond misses the targets by even one per cent is too risky.

Another major challenge is performance measurement. In the Peterborough SIB, although outcome measurement relies upon a control group that relates to the whole prison population, it is noted that although perverse incentives may be minimised within the particular prison, there may be an incentive

---

<sup>17</sup> Corrigan, 2011,18

<sup>18</sup> Corrigan, 2011,9

<sup>19</sup> Social Finance, 2011c:7

<sup>20</sup> Disley, E. et al, 2011:28



to cherry-pick an area or prisons (choose the best inmates to achieve good returns) if the SIB were to be rolled out nationally.<sup>21</sup>

Moreover, measurement of outcomes also depends on the money available for measurement. Even if more sophisticated and accurate methods are available, they may not fit the budget. Additionally, the third party evaluator needs to be perceived to be trustworthy and independent; otherwise they could be influenced by investors or government officials to modify their evaluation to the benefit of either party.

Finally, statistical significance and attributing changes to the SIB-funded intervention are crucial elements of negotiation. In future SIBs where there is more than one service provider, problems will arise regarding who is to be credited for any resultant changes in social outcomes. For example, if one organisation is helping ex-convicts complete job training and another is helping to reduce their drug dependency, who claims the credit for a convict's reintegration into society? One way to overcome this is to design a SIB that focusses on the impact, i.e. reintegration into society – and the provider would then be incentivised to provide both job training and drug rehabilitation services in order to achieve that impact.

In certain circumstances, a SIB is not appropriate and traditional funding streams will be better suited to the nature of the project. For example, a commissioner securing a printing or IT back office support service may seek to introduce a PBR approach. There is a wide spectrum of well-capitalised commercial providers capable of providing the service and covering the risk using their own capital reserves. It therefore won't be necessary, or make sense, to consider attracting investors, particularly social investors, in procuring the service.

Another example where a SIB is not an appropriate instrument is where the service provider is providing a service where it has an effective monopoly. For instance the installation of a Combined Online Information Network (COIN) to capture public spending data across the whole of central government. In this instance, given the service provider's monopoly, their strong negotiating position meant they were able to charge exorbitant fees for servicing the contract at different central government sites across England for the period of the contract.

Another instance where a SIB would not be appropriate is mentioned by Social Finance: SIBs should not be used for public health interventions for the general population. The reason given is that over the long-term (e.g. 20 years) it becomes difficult to draw a causative link between the intervention and the money saved.<sup>22</sup>

In terms of increased risk to the government providing financial guarantees, experience with the Private Finance Initiative (PFI) regarding infrastructure investment should act as a cautionary lesson regarding adopting new financing methods such as SIBs. Under early PFI initiatives in the UK, the government was widely considered to have borne too much risk.

### **3.3 Determinants of successful SIBs**

Given the nature of SIBs in place already, it can be said that a successful SIB will result in improved social outcomes that cause cost savings for government. In the process, service providers are able to achieve the cost savings for government through programmes that are less costly than the average cost saving. Thus SIBs involve a win-win relationship between investors, intermediaries, beneficiaries and government. A key input into making this relationship function effectively are an agreed set of objective and precise definitions of the metrics that will be used to quantify the cost savings to

---

<sup>21</sup> Disley, E. et al, 2011:33

<sup>22</sup> Social Finance, 2011a: 19



government. Metrics that are linked to cashable savings are required. It is critical that the metrics balance the tension between being too focused and not focused enough.

If the metrics are not sufficiently focused it becomes difficult to measure the social impact achieved amongst the beneficiaries of the target population. This is mainly because the target population becomes difficult to identify. However, if the metrics are too focused the target population may not be sufficiently large to require a dedicated service. It is important that the value of resources raised in a SIB can justify and cover the administrative costs associated with the SIB. Therefore the target population needs to be sufficiently large.

A final aspect of metrics is their ease of measurement. Measuring performance is very often a costly process. The more difficult and/or time consuming it is to capture data on the metrics the more costly it is to collect them. As the cost of measurement needs to be factored into the overall return generated from a SIB it is important that the cost of measuring metrics be kept as low as possible. If existing government processes collect the relevant data or can be tweaked to collect the relevant data then the cost can be significantly reduced. However, if appropriate data is not collected routinely by government then data collection could be a major constraint on setting up a SIB

## 4 Case Studies

The table below summarises the main features of the four case studies included in this paper.

**Table 3: Summary of the Four Case Studies**

|                                       | <b>Case Study One<br/><i>The Essex SIB</i></b>                                     | <b>Case Study Two<br/><i>The GLA Homelessness SIB</i></b>  | <b>Case Study Three<br/><i>The DWP Innovation Fund</i></b>   | <b>Case Study Four<br/><i>The Social Enterprise Model: Together Projects</i></b>                          |
|---------------------------------------|--|--|--|---|
|                                       | <b>Appendix 2</b>  | <b>Appendix 3</b>  | <b>Appendix 4</b>  | <b>Appendix 5</b>   |
| <b>Contracting parties</b>            | Commissioned by the Essex County Council Service provision by Action for Children. | Funded by DCLG. Commissioned by the GLA. Contracts operated by St Mungo's and Thames Reach.  | Over thirty investors, including dedicated social funds, social philanthropists and the DWP.   | Triodos Bank and a range of social investors  |
| <b>Source of funds</b>                | DWP budget   | DCLG   | DWP budget   | Private funding from institutional investors of Triodos Bank.   |
| <b>Objective of the SIB</b>           | Reduce anti-social behaviour and prevent out-of-home placement – care or custody.  | Reduction in numbers seen sleeping rough in each quarter compared to a baseline; sustained moves to settled accommodation outside the hostel system; reconnection of foreign nationals; increased employment; reduction in accident and emergency visits compared to baseline. | Support young people who are disadvantaged or at risk of disadvantage to get into education and training.<br><br>Extend the SIB to generate benefit savings and other wider social benefits.<br><br>Support the development of the social investment market. | To provide paid employment to ex-offenders and offer a wide package of construction training and support. |
| <b>Payment triggers and frequency</b> | Payments begin nine months after services start.<br><br>Payment is trigger based.  | Quarterly payments.  | Invoices may be submitted on a monthly basis.  | Quarterly payments.   |
| <b>Data sources used</b>              | LEA data system supplemented by a new  | Rough sleeping- the CHAIN database.  | Local Authority recording systems and the DWP  | N/A   |

|                             | <b>Case Study One<br/>The Essex SIB</b>   | <b>Case Study Two<br/>The GLA Homelessness<br/>SIB</b>  | <b>Case Study Three<br/>The DWP Innovation<br/>Fund</b>   | <b>Case Study Four<br/>The Social Enterprise<br/>Model: Together Projects</b>   |
|-----------------------------|---|---|---|---|
|                             | <b>Appendix 2</b>   | <b>Appendix 3</b>   | <b>Appendix 4</b>   | <b>Appendix 5</b>   |
|                             | recording system provided by Social Finance.  | The health outcomes are calculated from hospital statistics.<br>Employment and housing outcomes – providers tell DCLG what has been achieved, backed up by hard evidence – P60s, payslips, etc. underpinned by robust monitoring undertaken by GLA. | Central Government database.  |   |
| <b>Examples of metrics</b>  | Days spent out of care.<br><br>Reduced entry into care or number of care weeks.   | Reduction in numbers sleeping rough in each quarter compared to a baseline; sustained moves to settled accommodation.   | Young person has to demonstrate improved behaviour for a period of thirteen continuous weeks, eg. through improved attendance at school, achievement of level 1 or level 2 qualification, or entry into employment.   | N/A   |
| <b>Eligibility criteria</b> | Adolescents aged 11-16 displaying anti-social or offending behaviour.<br><br>At risk of out of home placement.  | Rough sleepers seen out two nights in a row   | Targeting 14 and 15-year-olds is a preventative measure to reduce the number of young people who go on to become NEET <sup>23</sup> from age 16.  |   |
| <b>How it works</b>         | Combines parenting support with practical assistance and a therapeutic approach to rebuilding relationships between the young person, the family and the networks around them.<br><br>Delivered by a team of family therapists, each of whom work with around ten families per year in the home or community, providing 24/7 support. | Active intervention to help cohort members to address long-standing drug, alcohol and mental health issues.   | DWP did not specify precise interventions, and leaves it to service providers to develop delivery models.<br><br>On the Think Forward project, which works with 950 vulnerable 14 to 17-year-olds, coaches are deployed in schools for three years, providing intensive one to one support. | The Together Project buys empty properties (in partnership with social enterprises) to refurbish and then sell for a profit. The surplus is reinvested back into the business to expand the property portfolio. |

## 5 Discussion of metrics and funding

The purpose of this paper is to understand the metrics used in SIBs, and the ways in which SIBs can be funded. The first SIB in the world was inaugurated in 2010, so this is a relatively young investment market.

<sup>23</sup> Not in Education, Employment or Training.

## 5.1 Metrics used in SIBs

It is apparent from the case studies that metrics need to be based on sound data. Toby Eccles of Social Finance noted that accurate metrics are the basis of a SIB contract.

The Essex and GLA Homelessness SIBs are good examples of this. Much time and effort was spent determining the data required for the desired metrics, as well as ensuring that the data required for the metrics is present in the database and ensuring that the service providers understood the need for the data to be input into the database. That said, the role of Social Finance in developing the metrics for the Essex SIB has been seen as crucial by the investors. The metrics of the GLA Homelessness SIB was entirely developed by government. The need to revise the metrics became apparent once the investors became involved.

The Innovation Fund SIBs further demonstrate how issues can arise when care is not taken to ensure that the data required for the metrics does not breach data-sharing protocols. If these issues are not sorted out the data is not present when it comes to determining the results of interventions.

To ensure accurate data it is crucial to engage with a range of stakeholders early on. In the earliest years of SIBs, investors were not interested in the development of the metrics. This is evidenced in the Peterborough and Essex SIBs: excited about the new investment market, they asked for a deal to be put on the table and invested with minimal input into the design of the metrics. Having had the experience of these earlier SIBs, however, by the time it came to the GLA Homelessness SIB and the DWP Innovation Fund, the investors knew what they were looking for and insisted on understanding and providing input to the development of the metrics. This resulted in the change in metrics between rounds 1 and 2 of the Innovation Fund in particular.

If sophisticated investors raising £10 million or more approach SIBs with typical commercial attitudes to risk begin to get involved in funding SIBs, the metrics and the investors need to be managed effectively within the constraints of rigid procurement rules. In this respect, the role of the commissioner will be critical to determining success.

The best example of this is found in the case of the Innovation Fund, as it reflects one of the major structural weaknesses of the SIB market in the UK. One of the problems with the UK Government's tendering process is that commissioners don't engage with investors in metric design. There is a fairly linear process whereby commissioners attempt to design a metric and put out an invitation to tender before any investors get involved in the process. Another issue is that government-designed metrics (in the UK, that is) tend to be designed to favour incumbents and large service providers.

The fact that metrics need to be tweaked once a SIB is up and running reflects their complexity and that they sometimes don't measure what they are intended to measure. An example of this is the GLA employment metric not capturing the self-employed category.

Regarding the complexity of metrics a difference between the Essex and GLA Homelessness SIBs is worth considering. Both of these SIBs make use of existing databases that have been enhanced for the purposes of the SIBs. The Essex SIB delivers more obvious cashable savings to the taxpayer. In this SIB savings can be attributed to a single metric – care days saved. In contrast, the GLA Homelessness SIB uses a basket of metrics, each of which has different degrees of success. In the case of the GLA SIB it is more difficult to gauge precise savings.

The decision to increase the tariffs in the Essex SIB demonstrates that investors were able to influence the design of the metric after the contract had been ratified. In the GLA Homelessness SIB, the introduction of the Competitive Dialogue Procurement allowed investors a short window of opportunity to discuss the design of metrics. However, owing to time pressures, they had minimal influence on the actual design or tariff structures. Gray (2013) conceded that the DCLG amended the tariffs during

contracting once they became acquainted with delivery costs relative to outcomes. This last point is common with both the Essex and GLA Homelessness SIBs in that delivery costs relative to tariffs are not well understood at the contracting stage, but comprehension improves during monitoring and as the SIB matures. This is a key issue as under estimating the actual cost of achieving the desired outcomes will reduce the real returns to investors. .

A final point regarding the metrics is that they need to be sufficiently prescriptive to eliminate subjectivity and, within reason, opportunities for perverse incentives. On the other hand, overly prescriptive metrics can stifle the innovation in service provision that is one of the hallmarks of the SIB concept. For instance, the risk assessments used in the GLA Homelessness SIB involve a degree of subjectivity in determining whether a rough sleeper is high or low risk following intervention. This provides some flexibility in the interpretation of the metrics, which encourages innovation.

In the case of the Together projects, the SIBs that fund these projects only carry limited risk compared to the other three case studies. They have no metrics and no outcomes that are tied to metrics. Clearly, making use of SIBs in this manner would be attractive to investors in terms of risk, although the return on investment may not be as high as could be achieved through the riskier SIB applications.

## 5.2 Development of the SIB market

Many commentators promote SIBs as the solution to many social ills in society. In actual fact, SIBs make up a very small proportion of the social investment market and need to be seen as part of a funding mix that includes the social enterprise model. Bublely (2013) estimates that the value of the global SIB market is around \$50 million. Some experts believe that the market will grow for a few years and then stagnate. Other more optimistic commentators see much potential, but qualify this optimism with the need to make SIBs less risky for investors.

The key question for the SIB market is: what happens when a SIB reaches the recommission stage? If the intervention was successful, the commissioner will have saved money and can make further pay outs to service providers and investors. If the intervention did not fulfil its purpose, the commissioner won't have the political capital to reinvest again.

In terms of investors, it is important to consider how the SIB market is being taken forward internationally. In the UK the SIB market has been dominated by high net worth individuals and grant-making foundations. However, newly emerged wholesale banks such as Big Society Capital will probably dominate the market for the foreseeable future. In contrast, in Australia and the US a different investor profile has emerged, where the risk and return is different. For example, Goldman Sachs has negotiated a 75 per cent guarantee of capital in the Rikers Island SIB.

A positive development in the UK has been the introduction of standardised contracts<sup>24</sup>, which provide very useful pointers and guidance to local authorities looking to contract with a SIB SPV. While it is an open debate as to how standardised the sector will become, many investors felt that if a standard contract is the starting point of negotiations, the design of metrics will be much easier and the final document would reflect what parties actually agree on.

## 5.3 Funding mix

There is no mix of government and non-government funding of SIBs in the UK to date. This reflects the heavy concentration of funding emanating from public sector-financed organisations. In 2011-12, the three largest SIFs accounted for 80 per cent of total investment. The fifteen smallest SIFs grew by 25 per cent since 2010-11, but still only accounted for 3 per cent of total social investment.

---

<sup>24</sup> See [http://data.gov.uk/sib\\_knowledge\\_box/contact](http://data.gov.uk/sib_knowledge_box/contact)

## 5.4 The role of financial intermediaries

The role of financial intermediaries is much like that of a stock exchange in the bond market. They must ensure fair payment and returns on investments as per the agreed terms and in accordance with the performance of service providers. Their role does not involve lobbying on behalf of the investors or shaping metrics and tariffs that unfairly benefit investors. They must ensure the investors and the commissioning department meet at a point that is fair to both parties and importantly realises real benefits to the tax payer.

Financial intermediaries thus must have the expertise that will enable them to do the following:

- Accurately quantify, in monetary terms, the cost savings that the government department is hoping to achieve from the SIB.
- Identify and/or develop metrics that can be used to attribute the cost savings.
- Assess the costs of administering a SIB.
- Draw down metrics from agreed databases and/or evaluate independent assessments of performance of service providers.

To perform the above tasks properly involves an appropriate combination of the hard technical skills required to define precisely what the terms of the SIB should be and the softer skills required to negotiate the different interests of a variety of stakeholders.

## 6 Lessons relevant to South Africa

There are a number of things that anyone proposing to set up a SIB in South Africa should take into account – both relating to the nature of SIBs and the economic environment prevailing in South Africa.

### Getting going

1. SIBs are a complicated source of funding. Investors in SIBs have to spend a lot of time and money working out whether they will get their money back. However the key benefit is that they encourage and reward innovation.
2. Social investment, social enterprises and SIBs are part of a funding mix that includes loans and traditional grants. SIBs cannot be seen as a replacement for these other sources of funding, but is part of the basket of tools that can be used.
3. SIBs are a worthwhile funding mechanism to consider if addressing the social issue leads to cost savings for government. However, they are not necessarily the best mechanism to consider even in such circumstances.
4. The experience so far with SIBs in the UK demonstrates that much learning happens as individual SIBs mature. Commissioners need to show they are willing to adapt the SIBs and respond to lessons learnt.
5. The role of specialised intermediaries such as Social Finance has been seen as critical in consolidating the market in the UK. The UK market is concentrated with a few investors and the risk profile of SIBs has tended to be skewed in favour of commissioners and large service providers. Markets in other countries do not necessarily have to follow the same pathway of development.

6. The best way to demonstrate the potential of SIBs is to tackle discrete social issues where success is likely. As demand for social services outstrips existing supply, SIBs are likely to result in improved service delivery quality and effectiveness but not reductions in total expenditure.

### Metrics

7. Investors need to be included in the development of metrics used in the SIBs they finance. It is critical that they understand what level of performance will be rewarded and how.
8. The cost of collecting data for the purposes of constructing metrics must be understood by all involved. Ideally data should be drawn from existing official government databases as this does not involve additional costs for the SIB role players and is typically objective data. Metrics must be underpinned by comprehensive databases and all stakeholders of the SIB must understand the need for complete and accurate data.
9. The costs of current service provision must be clearly understood, as well as the costs of the intervention the SIB will support. The SIB must lead to savings for the commissioner and the cost of administering the SIB must be worthwhile for the investors.
10. Existing barriers to data sharing need to be taken into account when designing metrics.
11. The scope of the SIB needs to be targeted. However it must also ensure that there is a large enough target population so that potential monetary rewards from the SIBs are large enough to attract investors.
12. Tariffs must, for a traditional SIB, be tied to outcomes and incentivise the service providers and the investors to buy in to the success of the SIB. They must be structured so that they encourage the use of the intervention rather than a short-cut to receiving a payout (perverse incentives).

### Capacity and learning

13. Even though South Africa has comparatively good data sets, government databases and data collection capacity will need to be greatly enhanced to meet the data intensive requirements of SIBs.
14. The South African government must approach SIBs with a willingness to learn and share knowledge gained with the emerging global SIB market. Canada – with large regional and cultural differences as well as large wealth disparities offers good potential for information sharing with social investors and social entrepreneurs in both markets. Canada also has a similar provincial governance structure to South Africa where intermediaries, service providers and investors need to engage with different levels of government, unlike the UK's central government.
15. For the South African social investment market to develop, engaged commissioners and social intermediaries will be required. They need to have or develop the technical capacity to allay investor concerns and negotiate between government and investors.
16. The South African National Treasury has expressed an interest in SIBs which shows intent. There are also a range of private investors and trusts who are interested in this space. Time will tell if the two parties are able to agree to terms that will result in the implementation of SIBs<sup>25</sup>.
17. Even though South Africa has one of the most sophisticated and transparent budget processes in the world, it is likely that some changes to existing procurement legislation are required to enable the effective implementation of a SIB. Exemptions from certain requirements will be necessary to

---

<sup>25</sup> See The Bertha Coalition (2004).



allow for the contracting processes associated with SIBS to be used. Specifically, the requirement that contracts should be limited to a period of three-years will need to be relaxed.

18. A ring-fenced SIBS innovation fund that is administered by the National Treasury should be considered. Consideration should also be given to establishing specific capacity within the National Treasury to provide technical assistance to role-players exploring SIBS (similar to the PPP-unit, but less cumbersome).
19. Departments in both national and provincial spheres of government, as well as municipalities should be allowed to apply for the funding, but only on a matching funding basis. Matching funding ensures that the relevant department or municipality shares the risks of the SIBs with National Treasury.



## People interviewed for project

Bennet, S. Croydon Council. Interviewed by Michael Mulvaney. 18 December 2013.

Brown, V. DWP. Interviewed by Michael Mulvaney. 16 December 2013.

Bublely, R. iForExchange. Interviewed by Michael Mulvaney. 17 December 2013.

Gray, T. DCLG. Interviewed by Michael Mulvaney. 20 December 2013.

Newman, J. Social Finance. Interviewed by Michael Mulvaney. 23 December 2013.

O'Kelly, M. Barrow Cadbury Trust. Interviewed by Michael Mulvaney. 2 December 2013.

Ross, A. Bridges Ventures. Interviewed by Michael Mulvaney. 30 December 2013.

Steward, A. Finance for Good. Interviewed by Michael Mulvaney. 8 January 2014.

## References

Bertha Centre, 2004. Final Policy Paper: Exploration of Social Impact Bonds for SME Development. Paper prepared by a coalition of The Bertha Centre (at the University of Cape Town's Graduate School of Business), Genesis Analytics and Social Finance. Funded by the National Treasury and FICA.

Bristol Together. Online at <http://www.bristoltogether.co.uk>. Accessed 04 April 2014.

businessdictionary.com Online at: <http://www.businessdictionary.com/definition/corporate-social-responsibility.html>. Accessed 12 March 2014.

Centre for Social Impact Bonds. 2013. Essex County Council: Children at risk of going into care. Online at: [http://data.gov.uk/sib\\_knowledge\\_box/essex-county-council-children-risk-going-care](http://data.gov.uk/sib_knowledge_box/essex-county-council-children-risk-going-care). Accessed 27 March 2014.

Centre for Social Impact Bonds. 2013. Greater London Authority: Homeless people. Online at: [http://data.gov.uk/sib\\_knowledge\\_box/greater-london-authority-homeless-people](http://data.gov.uk/sib_knowledge_box/greater-london-authority-homeless-people). Accessed 31 March 2014.

Corry, D. and Atterbury, M. (Tuesday 11 June 2013) The Only Way is Essex. *Guardian Professional*. Online at: <http://www.theguardian.com/social-enterprise-network/2013/jun/11/council-lay-foundations-for-sibs>. Accessed 28 March 2014.

Disley, E., Rubin, J., Scraggs, E., Burrowes, N. and Culley, D.M.. 2011. Lessons learned from the planning and early implementation of the Social Impact Bond at HMP Peterborough. Online at: [http://www.rand.org/content/dam/rand/pubs/technical\\_reports/2011/RAND\\_TR1166.pdf](http://www.rand.org/content/dam/rand/pubs/technical_reports/2011/RAND_TR1166.pdf). Accessed 13 March 2014

Keohane, N., Mulheim, I. And Shorthouse, R. 2013. Risky Business: Social Impact Bonds and public services. Online at: [http://www.smf.co.uk/files/7713/7518/4818/Risky\\_Business\\_final.pdf](http://www.smf.co.uk/files/7713/7518/4818/Risky_Business_final.pdf). Accessed 12 March 2014.

Midlands Together. Online at: <http://midlandstogether.co.uk>. Accessed 04 April 2014.

Social Finance. Social Impact Bonds. Online at: <http://www.socialfinance.org.uk/work/sibs>. Accessed 25 March 2014.

Social Finance. 2011a. Prevention is not only better healthcare but better economics. Can Social Impact Bonds fund a shift to prevention? Online at [http://www.socialfinance.org.uk/sites/default/files/a\\_new\\_way\\_to\\_invest\\_in\\_better\\_healthcare.pdf](http://www.socialfinance.org.uk/sites/default/files/a_new_way_to_invest_in_better_healthcare.pdf). Accessed 25 March 2014.

Social Finance. 2011b. Reducing Reoffending Among Short Sentenced Male Offenders From Peterborough Prison. Online at [http://www.socialfinance.org.uk/sites/default/files/sf\\_peterborough\\_one\\_year\\_on.pdf](http://www.socialfinance.org.uk/sites/default/files/sf_peterborough_one_year_on.pdf). Accessed 25 March 2014.

Social Finance. 2011c. A Technical Guide to Developing Social Impact Bonds. Online at [http://www.socialfinance.org.uk/sites/default/files/technical\\_guide\\_to\\_commissioning\\_social\\_impact\\_bonds.pdf](http://www.socialfinance.org.uk/sites/default/files/technical_guide_to_commissioning_social_impact_bonds.pdf). Accessed 27 March 2014.

Social Finance. 2013. A Technical Guide to Developing Social Impact Bonds. Online at: [http://www.socialfinance.org.uk/sites/default/files/technical\\_guide\\_to\\_developing\\_social\\_impact\\_bonds.pdf](http://www.socialfinance.org.uk/sites/default/files/technical_guide_to_developing_social_impact_bonds.pdf). Accessed 27 March 2014

Social Venture Fund. Investment Example Essex Social Impact Bond. Online at: [http://www.socialventurefund.com/eng/social\\_enterprises\\_portfolio/investment\\_example\\_essex\\_social\\_impact\\_bond/](http://www.socialventurefund.com/eng/social_enterprises_portfolio/investment_example_essex_social_impact_bond/). Accessed 27 March 2014.

Werneck, F. and Havemann, T. 2013. Social Impact Bonds: An Overview. Online at: <http://clarmondial.com/social-impact-bonds-an-overview/>. Accessed 12 March 2014.

## Annexure 1: SIBs in operation in the UK

There is little doubt that the SIB market is developing rapidly in the UK. People count SIBs slightly differently depending on whether they insist on there being multiple or non-state investors, but it is fair to say that about fifteen have either been launched or are looking for investors. Many others are being developed. The following is a list of the SIBs currently operating in the UK.

1. Peterborough SIB – Peterborough Prison – £5 million raised from multiple funders; £8 million maximum contract payment. Reducing recidivism in short-term offenders.
2. DWP Innovation Fund Round 1 – six awards – maximum contract payment £16.4 million. To support disadvantaged young people and those at risk of disadvantage aged 14 years and over. It will focus on the most disadvantaged young people rather than those who spend a short time NEET while in transition between other activities.
  - APM UK Ltd – Birmingham – £3.3 million
  - Stratford Development Partnership – East London – £1.3 million
  - YMCA – Perthshire and Kinross – £1.2 million (multiple funders)
  - Nottingham City Council – £2.9 million
  - Tomorrow’s People – Shoreditch, London – £3.2 million (BSC and one other)
  - Greater Merseyside Connexions Partnership – £4.5 million (multiple funders)
3. DWP Innovation Fund Round 2 – four awards – maximum contract payment £12 million. Three are SIBs. To support disadvantaged young people and those at risk of disadvantage aged 14 and 15 years to reduce prospects of them being or becoming long term NEET.
  - Adviza – Thames Valley – £3.7 million (multiple funders)
  - Teens & Toddlers – North West – £3.3 million (multiple funders)
  - Dyslexia Action and CfBT Education Trust (3SC Capitalise) – £2.0 million (multiple funders)
  - Prevista £3.0 million (PBR)
4. Greater London Authority – London Homelessness – two SIBs – maximum contract payment: £4.8 million.
  - St Mungo’s (North & West London) – £2.4 million (multiple funders)
  - ThamesReach (South & East London) – £2.4 million
5. Essex – Children on the edge of care (Essex) – total investment £3.1 million (multiple funders)
6. CVAA “It’s all about me” (National) – Scalable, target investment around £6.5 million (multiple funders), announced investment £2 million. To facilitate and support around 300 extra adoptions a year in the UK. These are likely to be focussed on children from black and minority ethnic backgrounds, children with medical or clinical conditions, children over four years old, or children in sibling groups.
7. Manchester City Council – multi-systemic treatment foster care project.

## **Annexure 2: Case Study One: The Essex SIB**

In 2010, the Children's Services department at the Essex County Council faced a problem common to many local governments: the cost of their service was unsustainable in the financial climate. There was scope for outcomes to be improved but not the budget to pay for the services. The budget constraints felt across local government were accentuated by the fact that Essex had higher numbers of young people than both the national average and statistically-comparable local authorities, as well as a predominance of older adolescents. Care costs are high, ranging from £20,000 to £180,000 per annum per individual. (Centre for Social Impact Bonds. 2013) Within this context, the Essex County Council became the first local authority to launch a SIB in the UK. The SIB was launched in April 2013 providing support for 380 young people between the 11 to 16 years who are at the edge of care or custody segregated into twenty mini-cohorts over the five years. The aim is to help these young people remain at home with their families, with the aim of substantial improvements in their long term outcomes.

The defining feature of the Essex SIB is that payments are threshold-based, whereas with the DWP Innovation Fund (Case Study Three) payment is on a per child basis. Put simply, payment is based on the assumption that if you have a cohort of 100 individuals and 70 per cent are expected to go into care as determined by the control figure, then payments are based on keeping the number of children in care below 70 per cent. If the interventions deliver successful outcomes based on a reduction in the number of days spent in care by the target group, commonly known as the frequency metric, the investors might expect returns in the range of 8.2–12.3 per cent per annum. "The investment is entirely at risk; should the intervention fail to reduce days spent in care (against a defined benchmark), the local authority does not pay." (Social Venture Fund)

### **1. Value of the SIB**

Social Finance raised £3.1 million from eight social investors, including Big Society Capital (£825,000, or 27 per cent) and Bridges Ventures (also £825,000, or 27 per cent), plus additional investments from high-net-worth individuals.

### **2. Impact the SIB set out to achieve**

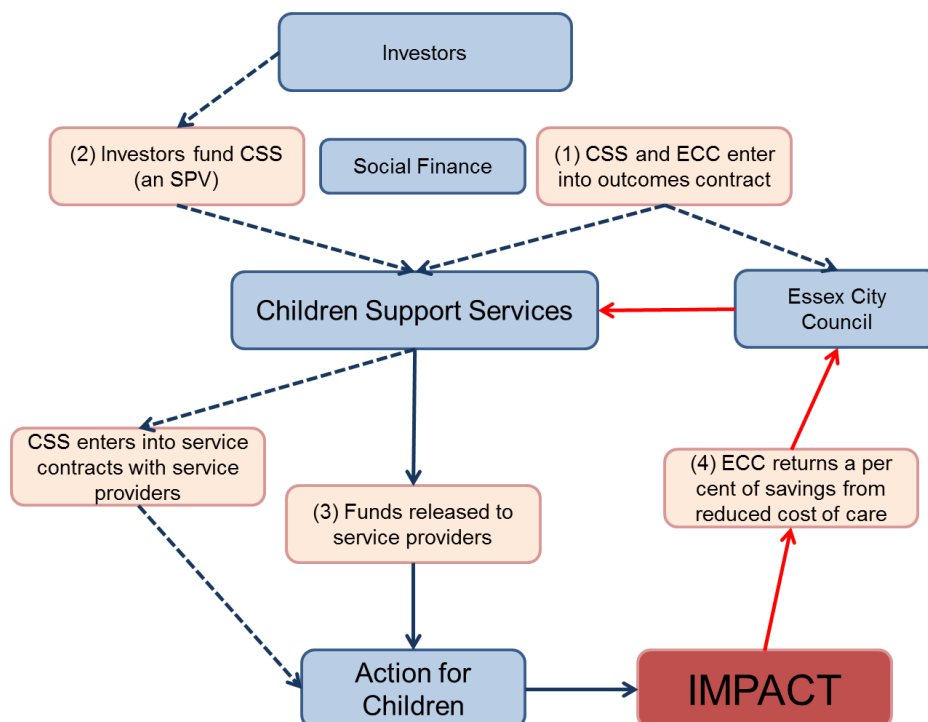
The SIB forms part of the Essex County Council's broader preventative strategy, which sets an ambitious target for the reduction of young people in "out of family" placements, whether care or custody. Moreover, while the SIB won't solve the problem on its own, it has nevertheless enabled the Essex County Council to implement targeted investment into an issue that was causing problems financially. The SIB has also provided the Council with a ready-made performance management wrapper that would drive it towards achieving outcomes. It moved risk away from the Council, so that if there was no improvement, they didn't pay. This approach is in stark contrast to the prior arrangement where the Council was budgeting £2 million annually without seeing any results.

### **3. Contracting parties**

The SIB establishes a tripartite set of arrangements whereby a special purpose vehicle (SPV) manages the commissioning of the provider, the delivery of outcomes, the flow of investor funding, and the relationship between the various parties and the local authority. Outcomes payments are made according to the delivery of positive outcomes, through a predefined and agreed payment mechanism directly from the budget where the savings will be achieved. The Essex County Council awarded the contract in November 2012 to Children's Support Services Ltd (the SPV), with Social Finance as their agents. A second contract was signed between the SPV and the service provider, Action for Children.

The contractual process was comprised of two stages. The first stage involved intense negotiations between Social Finance and the Essex County Council around identifying the metrics, completing data work and proposing payments for each outcome. Social investors were not involved during this stage. During the second stage, once the metrics had been agreed and designed, the package was presented to investors. Anthony Ross (2013) of Bridges Ventures related that, from the outset, the investors approached by Social Finance and the Essex County Council felt that the profile payment did not reflect a reasonable balance of returns for investors. In essence, investors felt the balance was heavily weighted in favour of the commissioner because, while there was no pay out at 65 per cent of children going into care, some payment at 60 per cent and more at 50 per cent, the commissioner was saving millions even when 65 per cent of the cohort was in care. The investors (including Bridges Ventures) felt the balance of risk was weighted against them and they, therefore, renegotiated the terms of payment.

The structure of the SIB is presented below:



#### 4. Funding arrangements

Outcomes funding was committed by the Essex County Council. Additional finance is coming from three government departments: the DWP; the Department for Education (DfE) and the Department of Health (DoH). This funding covers some setup costs as well as the evaluation of the effectiveness of the approach in Essex, with a view to this SIB being a prototype for other local authorities.

In terms of the financial agreements negotiated, Newman (2013) commented that the terms reflected a standard SIB governed by an SPV structure, where outcome payments will be generated and will fund the later part of the SIB. Given that case workers start to measure the outcomes once individuals have ceased to be part of the programme, there is a point in time where the programme is rolled over. At this point, case workers track the data on a quarterly basis, and cash flows immediately afterwards. Obtaining information from investors on the specific payments made on care days saved is commercially sensitive information that requires board approval to release. This information is currently not in the public domain. Both sets of investor representatives interviewed did reveal that their organisations advance funds as and when needed, rather than from day one.

## 5. Data management

To collect the data and establish baselines, the Essex County Council made use of their existing recording system, which held information on children already registered. Using a historical profile of data to identify the prevalence of children going into care as a baseline measure proved more attractive to investors such as Bridges Ventures and Barrow Cadbury Trust. For investors, the advantage of using historical data is that they then know exactly how much they will be paid and when, as payments are based on a clearly defined baseline. This is, according to Ross (2013), much harder to do with live data, where the control group would not receive any treatment over the nine month tracking period. In addition, twice as many referrals would have been needed and, as there were fixed costs attached to this, investors did not want to incur further charges generating a sufficient amount of referrals.

To ensure the independence of data once the intervention commenced, a new recording system was developed as part of the SPV package. This system enables Action for Children to provide better quality data against the baseline data. Case workers are asked to input data into data streams on a live basis, which Social Finance then analyses. Social Finance reports to the board on a monthly basis as to whether the outcomes that should be measured are in fact being measured. The monthly auditing of the data by Social Finance, apart from being a contractual commitment, is also an attempt to introduce a step change in data and case management whereby they are working with social workers who cannot be compelled to use the new system, but must want to.

In addition to the independent verification of data undertaken by Social Finance, investors, including Bridges Ventures, have imposed strict reporting requirements on Action for Children. Ross (2013) noted that the introduction of a clear project management team, comprised of both service provider representatives as well as individual investors, looking at monthly data reflected this extra burden imposed on the service provider, which is accountable to the project team. Ross explained further that financial interests, as well as the need for social investors to understand the data before results are achieved, means a more sophisticated reporting system was put in place as part of the SPV package.

## 6. Process for agreeing to metrics and the metrics used

The SIB will have twenty cohorts over its five-year lifespan, and the measurement of outcomes for each cohort begins at the start of the month following referral of the first cohort member to Multi Systemic Therapy. In terms of the metrics used, Social Finance and the Essex County Council agreed that while the primary outcome metric is average number of care days saved compared to a control review figure, they will measure success along a range of metrics. These include both objective and subjective metrics, school performance, offending rate and emotional well-being.

The primary metric that will determine success will be to prevent 101 individuals, or 30 per cent of the cohort, from going into care. This key metric can be defined as a frequency metric, in that it measures a reduction in the number of days spent in care by the target group as benchmarked against an historical group. This approach encourages service providers to work with the entire target population. It is harder to measure, however, since it is relative to a benchmark (what is the expected number of care days in the absence of the intervention?), and that benchmark had to be established first. Any reduction in number of days spent in care over a thirty-day period, compared to what would have happened without the intervention, is recorded as a positive outcome.

To ensure successful outcomes are not being perversely affected by artificially keeping children out of care, Action for Children can only work with children who are likely to go into care as chosen by the Essex County Council's Children's Services department. Secondly, at the end of the intervention it's up to the Essex County Council's Social Services to determine whether a child goes into care or not. Finally, the alignment of motivations between commissioner, investors and service providers implies there is less opportunity for creating a perverse incentive, since the prime motivation for everyone is to reduce the number of children going into care. Some grant-making foundations suggested that if



commissioners work with commercial investors whose primary objective was profit, there would be a greater risk of perverse incentives distorting outcomes. These opinions represent a jaundiced view of commercial investors that are investing in this space. If the incentives are properly aligned the interests of commercial investors will be served while also achieving the social outcomes that government seeks.

Another defining feature of the Essex SIB is that although payment is based on a single metric, “number of care days saved”, broader metrics are also being measured. Newman (2013) of Social Finance explained that it was always apparent this programme would have a broader social impact. By tying success to other indicators of the individual’s well-being (e.g. education outcomes) while having a single payment metric, there were two benefits. Firstly, a basket of metrics would help Action for Children reduce unnecessary use of the residential care system. Secondly, if there were payment triggers for each metric, then the service provider would need to understand how the datasets relate to each other, which would require an expensive measurement programme, which had not been costed.

The concerns raised by investors – that the commissioner was primarily motivated by cashable savings – first surfaced during the Essex SIB contractual process, albeit from different perspectives. For example, the inclusion of these broader metrics, motivated by Barrow Cadbury’s Trust, helped allay their concerns that the commissioner’s focus was solely around cashable savings. In contrast Bridges Ventures were more concerned that when SIBs are implemented purely to drive cash savings, then they could be applied in contexts where they are not appropriate.

## **7. Payment triggers**

Payment triggers are threshold-based, in that the service providers must record that the number of care days saved over a 30-day period exceeds the 30 per cent threshold set by Social Finance and the Essex County Council before payment is made. If the number of care days saved equals 30 per cent, then no payment is forthcoming.

## **8. Strengths and weaknesses of the SIB**

A major benefit of the SIB is that, if successful (currently all investors interviewed feel it is successful), the Essex County Council will be able to pay the costs of family-based therapies with the savings made by keeping young people out of care. Roger Bullen, head of partnership for Essex Schools, Children and Families, states that the funds will come from where money is being saved, which means the impact will be seen very quickly.<sup>26</sup>

A significant weakness of the Essex SIB relates to the robustness of the existing data collection systems managed by Action for Children. These required extensive enhancements given that they were not capturing the measures Social Finance wanted them to capture. This view was reinforced by Ross (2013), who indicated that the biggest challenges from a metrics perspective came from data quality, data availability, data access, and a lack of understanding as to why accurate data is required. Moreover, Action for Children showed little appetite for feeding back to investors what they were seeing on the ground. This lack of operational preparedness on the part of Action for Children reflects the wider difficulties service providers experience in developing a culture of accountability where investors impose extra reporting requirements on them. Newman (2013) remarked that, while social investors require a change in culture from all service providers, it is not true to say that the smaller they (the service providers) are the more receptive they are to change, but that with larger organisations investors need to engage with the correct people at the right level to ensure appropriate systems are put in place.

---

<sup>26</sup> Corry and Atterbury (2013)



### **Annexure 3: Case Study Two: The GLA Homelessness SIB**

Taking inspiration from the Peterborough Prison SIB, Department for Communities and Local Government (DCLG) and the Greater London Authority (GLA) have developed a Social Impact Bond to try to improve outcomes for a group of 831 persistent rough sleepers in London. London is unique in the UK, and possibly the world, in having a comprehensive database (CHAIN) which records when individuals are seen sleeping rough on the streets, when they enter and leave hostel accommodation, along with data on support needs, nationality, age, etc. Evidence from CHAIN shows that about 1/6th of rough sleepers account for almost half of all recorded rough sleeping and suggests that despite a range of existing services for London rough sleepers, provided by the London boroughs, the GLA, and the voluntary sector, outcomes for this group of vulnerable individuals have remained consistently poor over a number of years. The intention of the SIB is to focus on these individuals over a three year period to try to improve their outcomes and tackle the fundamental issues which often prevent them benefiting from existing service provision. The SIB does not replace existing services and effective cooperation with them is likely to be crucial to success.<sup>27</sup>

Highlighting how the SIB can add value in practical terms, Tim Gray (2013) alluded to the wide array of services provided by local authorities, who have a legal duty to house the homeless categorised as Priority Need. These services, which include the Outreach programme, are not picking up a group of 831 rough sleepers who account for 47 per cent of all bedded down contacts across London. Moreover, this group is not classified as Priority Need by local authorities across London. The SIB is aimed specifically at this group who fall outside the local authorities' legal obligations.

#### **1. Value of the SIB**

Social Finance calculated the average cost per rough sleeper to be £37,000 net present value over five years. This gives a total cost in excess of £30 million over a 5 year period. In contrast, the cost of the SIB is £5 million over a three-year period (starting 1 November 2012) – with a further year for some longer-term outcomes to be achieved, measured and paid for – provided optimum outcomes are achieved.

#### **2. Impact the SIB set out to achieve**

The intended impact of the SIB is to encourage people to get off the streets as early as possible over a three year period, with incentives to help them move into settled accommodation, and employment where possible, as well as to reduce chaotic use of the NHS. The SIB does not replace existing services, and effective co-operation with them is likely to be crucial for success.

#### **3. Contracting parties**

The group of rough sleepers was split geographically into two cohorts of 415 individuals. Holding a Dragon's Den-style event to bring investors and service providers together, the DCLG awarded SIB contracts to St Mungo's (a service provider) and Thames Reach (using an SPV and drawing funding from providers and investors), each working with one of the cohorts. Gray (2013) noted crucial differences in the structure of the two SIBs. The GLA Homelessness SIB, the one we are focusing on in this case study, is structured around an SPV model, while the latter is a direct contract with the service provider. However, the cohorts are as equal as possible in terms of previous frequency of rough sleeping, nationality and support needs.

<sup>27</sup> Centre for Social Impact Bonds. 2013. Greater London Authority: Homeless people. Online at: [http://data.gov.uk/sib\\_knowledge\\_box/greater-london-authority-homeless-people](http://data.gov.uk/sib_knowledge_box/greater-london-authority-homeless-people). Accessed 31 March 2014.

#### 4. Funding arrangements

Development of the GLA Homelessness SIB was supported by the government's ministerial working group on homelessness. The DCLG is providing the funding, but there is potential for other government departments to realise savings if the SIB intervention is successful, particularly resulting from reductions in crime, chaotic use of health services, movement to settled accommodation from the hostel system, and decreased benefit claims.

Private sector investment in the SIB comes from a combination investors and service providers, so the risk is shared and both stand to make financial gains if the project is successful. Outcomes are paid quarterly, and payments can be reinvested so that only a proportion of the service costs need to be funded by investment if expected outcomes are achieved. The service providers may choose to subcontract at their discretion.

#### 5. Data management

To collect data, the GLA uses a comprehensive database called CHAIN, which required enhancements to capture the data relating to all five metrics used by the SIB. For example, the DCLG paid for an extra module on CHAIN to allow case workers to log in and scan documentary evidence, such as P45s and tenancy agreements, onto the system.

Data for rough sleeping and numbers of accident and emergency visits are compared to virtual historical cohorts that meet the same criteria and whose outcomes have been tracked and recorded on CHAIN. Gray (2013) noted that the DCLG introduced the four additional metrics as separate payment triggers to incentivise St Mungo's to work with the widest possible spectrum of rough sleepers, and to minimise perverse incentives. However, in response to the observation that rough sleepers won't necessarily use referrals when visiting hospitals, which can distort the quality of data, he stressed the critical role St Mungo's plays in ensuring that planned visits take place. The DCLG is therefore confident that data for this metric is accurately measured.

Data for the remaining three metrics: moves into settled accommodation, employment, and reconnections, are also captured on CHAIN and rely on evidence provided by the service providers. These three metrics do not have a baseline, as they are very low and difficult to measure.

To ensure the independence of data, and to implement an audit process, the GLA undertakes spot checks and makes specific enquiries regarding the metrics. To date some of the outcomes have performed better than others. Gray (2013) notes a mixed spectrum of results, some anticipated and some not, have been achieved thus far. For example, rough sleeping has reduced significantly, while reconnections have not been as successful. Furthermore, there is no current data on health outcomes. He qualified this by stating that "in the end they balance each other out, however it is still too early to give precise statistics." The DCLG will commission an independent evaluation of the SIB at the end of the three years to determine whether or not it has been successful.

#### 6. Process for agreeing to metrics and the metrics used

The negotiation process to agree the basket of metrics included the service providers and commissioners, while investors had minimal input. The outcomes of these negotiations resulted in a basket of metrics designed to encourage the service providers to work with the whole cohort over a three year period. In other words, if payments were based solely on getting individuals within the cohort off the streets, service providers could just move them elsewhere, creating opportunity for perverse incentives to come into play (Bennett, S. 2013). The metrics agreed on are:

- reduction in the number of people within the cohort sleeping rough;
- increase in the number of individuals within the cohort in settled accommodation;

- improved employment outcomes;
- improved health outcomes; and
- relocation to accommodation abroad.

Because the DCLG are primarily interested in improving outcomes over a longer period, the rough sleeping metric is used as a proxy measure to gauge improvements across the other metrics. For this reason, the GLA uses a baseline derived from CHAIN to determine the actual reduction in the number of individuals within the cohort seen sleeping rough. The baseline is based on expected levels of rough sleepers in each quarter over a three year period based on historic virtual cohorts who satisfied the SIB criteria. In order to provide a smoothed baseline profile, the proportion of individuals seen rough sleeping in each quarter has been averaged across each year.

During the negotiations, there were issues around tracking resettlement in the individual's home country. While the DCLG agreed to pay a small amount when someone was relocated, and more if they stay away from the UK for longer than 6 months, investors felt this measure did not add any particular social good. While Bublely (2013) indicated he is representing investors in ongoing negotiations regarding maintaining the metric, it remains an integral indicator of success for the DCLG. Measuring outcomes on this metric has proven difficult for the DCLG, even though they try to establish whether or not the individuals have settled back into their home countries by requesting evidence of employment and tenancies through authorities there (Gray, 2013).

The definition of settled accommodation is flexible and could include a social housing tenancy, a private rented tenancy or moving back with family and friends anywhere in the UK. A return to rough sleeping or leaving accommodation in an unplanned way means that the 12 and 18 month payments (see section 7 below) are not made, though moves from one form of settled accommodation to another are not penalised. The DCLG requires concrete evidence for this metric, including tenancy agreements and proof that the tenancy has been sustained. One particular problem with this metric is that individuals within these cohorts have issues such as alcoholism, and it is difficult to determine the extent to which these issues impact on their ability to sustain a tenancy over a particular period.

## 7. Payment triggers

Gray (2013) noted that, in paying for accommodation, what DCLG is really paying for is the work providers have done in addressing the deeper underlying issues, which can include alcoholism and drug abuse. The payment scales are illustrated in the following table.

**Table 4: Payment Scale for GLA Homelessness SIB**

| Metric   | Small payment  | Mid-range Payment  | Large Payment   |
|--|--|--|---|
| Moves to settled accommodation in the UK       | If the rough-sleeper is moved into settled accommodation.                        | Sustained in settled accommodation for 12 months.  | Sustained in settled accommodation for 18 months.           |
| Relocated to accommodation abroad              | If a move to another country is evidenced.                                       | If there is no return to rough-sleeping in London after 6 months.  |   |
| Increased Employment                           | Sustained period of volunteering or achievement of an NVQ level 2 qualification. | Part-time employment for a period of 13 weeks and 26 weeks.  | Full-time employment for a period of 13 weeks and 26 weeks. |
| Reduced use of Accident and Emergency services |  | Payments are made when there is an annual reduction for a cohort against the baseline provided by the NHS Hospital Episode Statistics. |   |

## 8. Strengths and weaknesses of the SIB

The GLA Homelessness SIB addresses the institutional weakness of the current system that causes this group of persistent rough sleepers across London to fall through the cracks. Early results are positive with all but sixty of the 415 individuals within the one cohort accounted for. Normally up to a third would have drifted away by now. The CHAIN database is therefore a very useful tool, not only because it ensures people are not counted twice. It is also notable that accurately capturing the homeless people within CHAIN is critical due to the fact they are not owed a legal duty since they are not classified as Priority Need.

Given the wide spectrum of characteristics exhibited by rough sleepers, the development of a basket of outcomes motivates service providers to achieve as much as possible with as many individuals as possible over the three year period. For example, individuals with lower needs have proven easier to help in terms of employment and settled accommodation. In contrast, it's much more difficult to help persistent rough sleepers, and the investors won't get a return on their investment unless the number of persistent rough sleepers is reduced. One characteristic of this group is the high number of Accident and Emergency visits they make to health facilities. If investors want payment on the rough sleeping metric, they will need to work closely with the individuals where there is a high correlation of rough sleeping and Accident and Emergency visits. In this way, the DCLG have incentivised both the service providers and the investors to work with the high and low needs individuals in the cohorts.

By paying for outcomes each quarter, the DCLG has reduced the amount of investment needed and the length of time investors' cash is tied up, thereby reducing the level of return necessary to attract investment.

The Dragon's Den event designed to introduce likely bidders to potential investors proved very successful. This type of competitive dialogue procurement process is normally used for complex infrastructure projects. Introducing it into a social service setting is an innovative approach. It allowed the commissioners to facilitate introductions between social investors and shortlisted service providers, discuss the proposed outcome tariffs for the metrics, and explore and comment on service solutions proposed by the shortlisted providers.

Another innovative feature of this SIB is the development of tariffs for specific outcomes, as opposed to a PBR approach based on retention of payment on a block contract (i.e. 80 per cent of the contract paid upfront and the remaining 20 per cent paid on achievement of the outcomes).

One weakness of the SIB is the reconnections metric, in particular the problems the DCLG is experiencing in obtaining information from authorities in other countries. Another is that current assessments refer to risk before and after the intervention. For example, an individual with a high risk of relapsing drug or alcohol addiction is considered to have fallen to low risk following intervention. This clearly involves a degree of subjective interpretation, which may lead to disagreement and contract disputes regarding whether or not, and to what extent, outcomes have been achieved.

Measuring the employment metric has also proved problematic for investors, as one route for homeless people to get employment in London is by becoming self employed as a Big Issue salesperson. The way the metric is constructed makes it impossible for the service provider to claim for payments when a member of a cohort is self-employed. Buble (2013) indicated that negotiations regarding this metric are also ongoing. Gray (2013) elaborated that the metrics have stayed the same throughout the contractual process, but that the interpretation of the employment metric has changed. Gray conceded it is very difficult for this group of rough-sleepers to maintain employment, especially for extended periods.

## **Annexure 4: Case Study Three: The DWP Innovation Fund**

On 12 May 2012 the Government announced a package of measures to help address youth unemployment. Amongst these measures is the Innovation Fund, which commenced in 2012. It supports disadvantaged young people and those at risk of disadvantage, and was commissioned via two rounds. The first round, focused on 14 to 24 year olds, went live with six SIBs being launched in April 2012. The second round commenced in November 2013 with the launch of a further four SIBs.

### **1. Value of the SIB**

The value of the Innovation fund is £30 million over three years. To warm up the market, the DWP launched an extensive marketing campaign and employed innovative strategies, including a speed dating event, to match service providers with potential investors. They also designed a prospectus, and the Secretary of State undertook road shows in Cardiff, London and Edinburgh. These events attracted 65 potential investors, with ten eventually investing over £10 million.

### **2. Impact the SIB set out to achieve**

The Innovation Fund is aimed at reducing the number of young people who go on to become NEET<sup>28</sup> from 16 years and above. Data from Quarter 2, 2011 Labour Force Survey estimated that there were 95,000 16 to 17-year-olds classified as NEET.

In doing this, it is testing new delivery models to support up to 17,000 disadvantaged young people over the three years. It is a targeted, preventative programme aimed at re-engaging disadvantaged young people, improving their employability and reducing their longer-term dependency on benefits.

### **3. Contracting parties**

Ten SIBs have been launched across the UK through the Innovation Fund, with social investors including Big Society Capital (a social investment bank set up by the government in 2012 to help grow the social investment market) and the Private Equity Foundation (a charity providing finance and expertise to organisations working with vulnerable young people) providing the up-front capital.

### **4. Funding arrangements**

In assessing how these SIBs are funded, it becomes clear that there is a wide range of investor motivations. At one end of the spectrum are the smaller local community investors who become intensely involved in the SIB design and are not necessarily motivated by financial return. An example of this is the Perth YMCA project, a round one SIB. Investors were motivated by community building and employment placements offering adolescents on-the-job training and vital work skills, which are difficult to obtain in remote areas like Perthshire, Scotland, with a population size of 40,000. For many investors, they were happy to get their money back, but were more interested in the impact of the project. Similarly, Nottingham Council and a local church, which invested in a SIB working with NEET adolescents, are not concerned about losing money but rather about having a positive social impact.

In contrast, big social investors like Bridges Ventures and CAF Venturesome need to ensure positive social returns are in sync with financial returns. Social investors of this nature, while demonstrating the philanthropic motivations reflected in their long history of social investment, still undertake risk modelling and financial projections to ensure that any investment is financially sound. Ross (2013) explained that, while Bridges Ventures's risk modelling is not as sophisticated as some mathematical models, they run base case scenarios, an upside and downside, and attach probabilities of likely

---

<sup>28</sup> Not in Employment, Education or Training



returns. Bridges Ventures expect a minimum gross return of 8 per cent on investment, and a minimum net return of 5 per cent. Moreover, they try to avoid a capital loss and would not write any investments off as part of CSR. They also undertake their own extensive due diligence on both the SIB as well as the capability of service providers. Ross's comment, that the SPV structures can be likened to management buyouts with service providers being accountable to the board, indicates that the attitudes of large social investors are closer to those of the institutional agnostic investors – interested in pure profit – than that of the local community investor, who is more concerned about impact than return.

Community involvement in this SIB reflects the regional and cultural affiliations in remote communities in the UK. Parallels can be drawn with remote areas of Canada such as Alberta, where a high First Native population of around 100,000 exhibits the classic signs of deprivation, including homelessness and drug- and alcohol-related addictions. For SIBs to be successful in such remote areas, one needs the right type of community with a mix of social problems that can be addressed via a SIB. Both the Perth YMCA SIB as well as interventions in Alberta need a longer period of intervention than the funding provides for. The Perth YMCA SIB, which concludes within the next three years, will still require funds to create employment (Steward, 2014).

## **5. Data management**

In terms of data collection, the DWP introduced stringent collection criteria for both rounds by ensuring that service providers completed standard templates, which include a list of some forty variables on participants in the programme that must be submitted to the DWP on a monthly basis. This covers a range of indicators, including i) demographics; ii) their particular disadvantage, including addictions; and iii) the number of meetings held with advisors. This information is input to a central database and matched with DWP data – the most reliable data source in the UK relating to people at risk of being NEET. Both datasets are then uploaded to the DWP system. It is verified each month before DWP Monitoring Officers approve payments within a 14 day period (Brown). As part of the procurement process, the service providers were required to demonstrate that they had engaged with local stakeholders and understood the data, including how additionality and deadweight were calculated.

## **6. Process for agreeing to metrics and the metrics used**

The DWP and the Department for Education (DfE) took the initiative, prescribing the metric design, and investors provided some input between rounds one and two. The DWP were also driven by tight deadlines during round one, and as a result did not have sufficient time to engage with investors on metric design in the initial stages. Reviewing the Longitudinal Survey of Young People in England, the DWP identified the indicators and determined what they were willing to pay for using an historical cohort. For example, during round one the DWP set prices and outcomes linked to employment and attainment of five GCSEs, based on the historical cohort with regards to the additionality and deadweight they wanted to achieve, i.e. what percentage of young people at risk of NEET have gone into employment or education and training.

Service providers were allowed to choose the outcomes they wanted to deliver from a specified range, and investors could pick and mix the metrics they wanted to be paid for. The DWP also introduced an element of price competition whereby service providers were awarded higher scores the further they were from the maximum price DWP was willing to pay. As a consequence, the service providers and investors had to model their financial projections accurately to ensure their investments were profitable. This process threw up a lot of variation with respect to delivery costs, which is one of the underlying reasons the DWP changed the tariff structure of the metrics between the two rounds.

During round one the DWP was prepared to pay £8,700 based on two years of savings but, following consultation with investors, they tweaked the metrics and increased the maximum price to £11,700 per person over three years in round two. The reason for this change was that the service providers and

investors felt that the outcomes for the most disadvantaged youth were difficult to achieve and represented the most risk (O'Kelly). Investors felt that lower-level qualifications should be included to ensure they could meet the payment triggers. The DWP therefore introduced two proxy metrics they were willing to pay for, and crucially increased the amounts they were willing to pay. These proxy metrics relate to i) truancy and ii) bad behaviour in school. Investors commented that, because these proxies were more achievable, the service partners could realise results quicker, which meant investors didn't have to wait seven or eight years to receive an income, unlike most SIBs in the UK. In addition, whilst investors weren't necessarily receiving a net return, they were still receiving cash flow that they could throw back into the operating model in year one and realise profits in years two and three.

## **7. Payment triggers**

Payments are made on a results basis against a number of agreed outcomes. These include improved behaviour, school attendance, educational qualifications and employment opportunities. This was the first time a government department held an open competition. Interim results have not been published at the time of writing, but the DWP has stated that both rounds have been successful, and that official results will be released during 2014.

The DWP only pays once for each outcome per investor. For example, the DWP will only pay once for the achievement of the first level 1 or 2 National Qualification Framework (NQF) outcome even if a participant achieves multiple level 1 or 2 NQFs. In addition, there is a 26 week run-on period at the end of the contract during which contractors will be able to track and claim for outcomes.

## **8. Strengths and weaknesses of the SIB**

Using a retrospective or historic cohort as a baseline provided several benefits: it took less time to compile; was smaller scale; is better for measuring multiple outcomes; and is more cost effective.

Some of the disadvantages are that some statistics cannot be measured; significant biases may affect the selection of controls and distort outcomes; independent evaluators cannot control exposure or outcomes assessment, and need to rely on third parties for accurate record keeping; the cumbersome and bureaucratic procurement process was time consuming and costly for the commissioner.

Representatives from Social Finance, who worked with service providers in both rounds, and O'Kelly of Barrow Cadbury Trust concurred that the proxy metrics introduced in round two reflected, in part, the learning process around metric design and their relationship to risk for investors. This view was echoed by Ross (2013) of Bridges Ventures, which invested in three of the SIBs, when he alluded to the work that goes into setting up a SIB – which takes about 18 months. The knowledge gained between rounds one and two ensured that the commissioning process was clearer and faster for everybody in round two.

Assessing how the DWP attempted to minimise perverse incentives, Brown mentioned a number of strategies the department employed. Firstly, part of the service providers' performance contract required the service providers to produce an Action Plan for every young person. Secondly, as part of their monthly management information submissions, they are required to include indicators of deprivation. If these fields are empty, the DWP is alerted to the potential that something is not right. Thirdly, the DWP will commission an independent evaluation of the data, which includes a target and control group. This evaluation includes an impact assessment and, while the service providers and investors have been kept informed, they are not allowed to influence the process in any way. The extent to which DWP has been able to overcome perverse incentives depends largely on the quality of data. To the extent that data problems persist, it is reasonable to suggest that the DWP did not sufficiently overcome perverse incentives.



Brown observed that the quality of data provided by the service providers is poor, highlighting the cultural and legislative barriers to data sharing between agencies and service providers. By being prescriptive in the design of metrics and using rigid performance criteria to specify the way in which data should be provided, the DWP were able to circumvent these issues in the short term.

## **Annexure 5: Case Study Four: The Social Enterprise Model: Together Projects**

This case study is included because, while the financial model is not that of a typical SIB, much of the start-up funding originated in SIBs. The “Together projects” include Bristol Together and Midlands Together. They are legally constituted as Community Interest Companies (CICs), and were set up to create employment opportunities for ex-offenders and other long-term unemployed people. Both projects purchase, refurbish and sell properties, and in doing so create pathways to meaningful employment, halting the cycle of re-offending and social exclusion.

### **1. Value of the SIB**

Bristol Together started in October 2011 after they raised £600,000 in investment capital. They raised another £1 million in May 2012 to put together their first SIB. Midlands Together, with assistance from Triodos Bank, raised £3 million through a SIB.

### **2. Impact the SIB set out to achieve**

Bristol Together aims to create jobs for up to 200 ex-offenders over the course of the next five years, and to bring over seventy empty properties back into use. Midlands Together envisions helping in excess of 150 people over the same time period.

### **3. Contracting parties**

Contracting parties include Triodos Bank as the lead advisor, Bristol Together, Midlands Together, and institutional investors including Esmée Fairbairn Foundation, Lankelly Chase and Barrow Cadbury Trust. There are also five service providers, including Aspire and Restore Trust.

### **4. Funding arrangements**

The Together social investment models differ from the SIBs in that they receive no government finance. Both projects are accredited as Community Development Financing Initiatives (CDFIs), a relatively new concept. The remainder of the funding was from individual private investors, who also qualify for the added benefit of Community Investment Tax Relief.

Both projects are split between two series’ of bonds, namely type A and B, offering investors a choice of two different instruments. Type A attracts a 4 per cent yield. Type B attracts a 6 per cent return that, after Corporate Investment Tax Relief is deducted, attracts a 5 per cent return on investment for investors. For both projects a minimum of £20,000 is invested upfront, increasing in £5,000 increments over five years with proceeds from type A financing the refurbishment of properties, while proceeds from type B go towards wages and training of staff members. Both bonds are secured by way of asset debentures (over the companies’ property portfolios), while type A ranks ahead of type B. Both bonds are issued on a first come first served basis, and are transferrable but not listed on any recognisable capital market. Consequently, it may not be possible for investors to sell or realise the bonds ahead of the final repayment date in 2018.

The risk profile of these bonds is much lower than that of a typical SIB, due to the nature of the projects being invested in.

Once refurbished, the formerly empty homes will be sold and the proceeds reinvested in the scheme, allowing further properties to be acquired and redeveloped. The actual metrics for both projects are based on investors earning a return whilst reducing reoffending by a minimum of 5%.

## 5. Data management

An advantage of the social enterprise model is that strict performance contracts have been signed with five service providers who employ the ex-offenders to complete the work to deadline. There is no strict adherence to government targets, which means that systematic data collection and independent evaluation are not required, because investors are developing property. Consequently there are no fixed delivery or business support costs built into the programme.

## 6. Process for agreeing to metrics and the metrics used

The Together projects do not use metrics because they are not dependent on outcomes. Instead, they aim to achieve blended social and financial returns for stakeholders by creating significant paid work for ex-offenders through commercially sustainable business models.

## 7. Strengths and weaknesses of the SIB

An advantage of the social enterprise model is that strict performance contracts have been signed with the service providers Aspire and Restore Trust, who employ the ex-offenders to complete the work to deadline.

Another advantage the social enterprise model has over a standard SIB is that it isn't dependent on outcomes. Consequently the social enterprise model is more attractive, given that it's being more successful and profitable on both the social and financial fronts. O'Kelly remarked that in some ways it's easier for social investors to make a grant as opposed to investing in a SIB where your money is locked in for seven or eight years. Moreover, with respect to grants, investors know they won't get their money back whereas with SIBs investors need to work out whether or not they will get their money back.

The social enterprise model is also easier and quicker to launch than a SIB, which requires extensive pro bono, analytical support work with a range of stakeholders. Finally, while the SIB market is currently larger than the social enterprise market, the latter is expected to grow once more viable products come onto the market.

The success of these two projects is reflected in the current data, which shows that the reoffending rates in these two projects have dropped to 6 per cent in contrast to the national average of 26 per cent.

The social enterprise model only works with an asset-backed project. This a key difference between this model and the SIB model. Neither model can be used in just any situation, and therefore governments may want to use both models but apply them to achieve different objectives.

## Annexure 6: DWP Innovation Fund round one and two outcomes

This table provides a definitive list of the outcomes DWP will pay for; a clear definition of each outcome; the maximum price DWP will pay for that outcome; and the type of evidence Delivery Bodies are expected to collect and store for payment validation purposes.

### Please note:

DfE are undertaking a review of qualifications for students aged 16 years and over. The findings will be available in mid-2012 and may impact on the list of acceptable qualifications which we have provided in this annex. If changes are made following the DfE review, we will discuss the implications and agree any revisions with the selected Innovation Fund contractors at that point. Further information can be found at: <http://www.education.gov.uk/consultations/index.cfm?action=conResults&consultationId=1779&external=no&menu=3>

The total cost of outcomes payable to each individual participant cannot exceed £11,700. This figure is based on a proportion of out of work benefits to a young person over a three-year period.

Whilst the aim of Round Two of the Innovation Fund is to support 14 and 15 year olds, we recognise that successful projects will be working with individuals for up to three years and will therefore also pay for outcomes achieved during this period.

| Nature of outcome by age group of young person | Definition of outcome   | Maximum Price of Outcome | Examples of Evidence required for Payment Validation Purposes                   |
|--|---|--------------------------|---|
| <b>Age 14 and 15 years</b>                     |   |                          |   |
| Improve attitude to school                     | The young person demonstrates a sustained improvement in both their attendance and behaviour at school. This must be verified by a teacher.<br><br>The improvement has to be demonstrated for a minimum of 13 continuous weeks (not withstanding school holidays) to generate an outcome payment.   | £700                     | Confirmation letter from school/teacher/home tutor                              |
| Improved attendance at school                  | 'Persistent truancy' means deliberate absence for days or weeks at a time. This has to decrease to attendance levels associated with the average student in that area.<br><br>The improvement has to be demonstrated for a minimum of 13 continuous weeks (not withstanding school holidays) to generate an outcome payment.  | £1,400                   | Confirmation letter from school/teacher/home tutor or Copy of Attendance Record |
| Improved behaviour at school                   | Poor behaviour at school can be defined as those "whose behaviour is unacceptable, who break school rules or who fail to follow a reasonable instruction (Section 91 of Education and Inspection Act 2006)". Students who have a pattern of this behaviour have to decrease this significantly.<br><br>The improvement has to be demonstrated for a minimum of 13 continuous weeks (not withstanding school holidays) to generate an outcome payment. | £1,300                   | Confirmation letter from school/teacher/home tutor                              |

| Nature of outcome by age group of young person   | Definition of outcome  | Maximum Price of Outcome   | Examples of Evidence required for Payment Validation Purposes  |
|--|--|--|--|
| QCF accredited Entry level qualifications (below GCSE)   | These include the following: Skills for Life at Entry level, Entry level awards, certificates and diplomas, Foundation Learning Tier pathways and Functional Skills at Entry level   | £900   | Confirmation from school or copy of certificate  |
| <b>Age 16 years plus</b>   |  |  |  |
| Improved attitude to school/education  | The young person demonstrates a sustained improvement in both their attendance and behaviour at school. This must be verified by a tutor.<br><br>The improvement has to be demonstrated for a minimum of 13 continuous weeks (not withstanding school holidays) to generate an outcome payment.  | £700   | Confirmation letter from school/teacher/home tutor   |
| Basic Skills   | Obtaining basic skills, with literacy and numeracy focus   | £900   | Copy of certificate  |
| Level One NQF or equivalent  | Up to 1st Level 1 NQF or equivalent  | £1,100   | Confirmation from education/training establishment or copy of certificate  |
| Level 2 NQF or equivalent  | Up to 1 <sup>st</sup> level 2 NQF or equivalent<br><br>(i.e. 5+ A* - C GCSEs with English and Maths, or equivalent)  | £3,300   | Confirmation from education/training establishment or copy of certificate  |
| Level 3 NQF or equivalent  | Up to 1st Level 3 NQF or equivalent  | £5,100   | Confirmation from education/training establishment or copy of certificate  |
| Entry into First Employment (16 or more hours per week) with training element (e.g. an Apprenticeship, or work-based learning) | Entry into employment of 16 hours or more. For under 18's this includes a training element. A training element is defined as at least 280 guided learning hours per year.<br><br>This needs to have lasted for a minimum of 13 continuous or cumulative weeks in order for it to generate an outcome payment.<br><br>Self-employment is also included.<br><i>Please Note</i><br><ul style="list-style-type: none"> <li>• <i>This period begins to accrue from and including the job start date.</i></li> <li>• <i>A person must be in employment and off-benefit</i></li> <li>• <i>Self employment is a person who is gainfully employed 1) in Great Britain and 2) in employment that is not employed earners employment</i></li> </ul><br>Sustained employment is where a customer has been in employment and off benefit for a total of 26 weeks: and specifically where <ul style="list-style-type: none"> <li>• a Job Outcome payment has been paid; and</li> <li>• thirteen <b>continuous</b> weeks in employment have elapsed between the Job Outcome payment date</li> </ul> | £5,500<br>(£3,500 after 13 weeks and an additional £2,000 after 26 weeks sustained employment) | Confirmation letter from employer<br><br>Self-Employment job outcomes will need to be supported by a letter from a recognised business start up organisation which must include a business plan or evidence of trading that is clearly linked to the company and be proportionate to the business. |