



LABORATÓRIO DE INVESTIMENTO SOCIAL

 FUNDAÇÃO
CALOUSTE GULBENKIAN



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RESEARCH NOTE #3 SOCIAL IMPACT BONDS

This research note was written by António Miguel, from the Social Investment Lab, with the scientific supervision of Professor Filipe Santos from INSEAD in order to provide readers with a clear and simple introduction to a new social finance instrument - Social Impact Bonds - and its application to Portugal.

SOCIAL INVESTMENT LAB

The Social Investment Lab is an initiative promoted by the IES-Social Business School and the Calouste Gulbenkian Foundation in partnership with Social Finance UK. It is intended to be a leading knowledge centre in the area of social investment, seeking to disseminate international best practice and innovative financial instruments, and to study its applicability to Portugal.

INTRODUCTORY NOTE FROM THE CALOUSTE GULBENKIAN FOUNDATION

The Gulbenkian Human Development Programme encourages and facilitates the inclusion of the most vulnerable groups in society, through a commitment to social innovation, entrepreneurship and empowerment of people and organisations as keys to development.

There are in Portugal and the Portuguese-speaking world a large number of high impact projects facing numerous financial difficulties which prevent them from achieving their full potential.

Fortunately, financial innovation in recent years has come up with new solutions and tailored them to the specific needs of social organisations and entrepreneurs, particularly in Anglo-Saxon countries. These innovative financial mechanisms are intended to increase the amounts available and diversify sources of capital to finance the social sector.

The main social problems - e.g. the number of children in care, unemployment, school drop-out rates, homelessness, criminal recidivism, social isolation of the elderly and so on - represent a huge economic and social cost. On one hand, we are fortunate to have organisations and social entrepreneurs who devote their effort, skills and professional lives to finding solutions to mitigate these social challenges. On the other hand, there is a lack of appropriate financial instruments to support these entities in the long run and ensure financial sustainability, in order to maximise their impact and improve the quality of life of their beneficiaries.

Calouste Gulbenkian Foundation's support, through the Gulbenkian Human Development Programme, for the Social Investment Lab is fully aligned with our mission and aims to propose solutions for those working with vulnerable populations, so that they can do it in a way that is increasingly efficient, capable and achieves greater impact.

This is a process of learning together, with the involvement of key players in the financial, social and public sectors, to propose solutions that enhance the quality of life of the most vulnerable populations, reduce the level of poverty and strengthen social cohesion.

SOCIAL IMPACT BONDS

“A STITCH IN TIME SAVES NINE”: IS THIS TRUE WHEN IT COMES TO PUBLIC FUNDING OF SOCIAL SERVICES?

A significant proportion of public social services is focused on responding to crisis situations in various areas. If someone is convicted of a crime they will be taken to prison; if a family is considered at risk, the children are normally supported directly by the state under the Law for the Protection of Children and Young People in Danger; if diabetes patients do not receive proper treatment, they will certainly spend more time in hospital emergency rooms.

Currently, as the public funding model for these areas has limited resources, there isn't sufficient capital to invest in preventive measures. Aligning the public funding model with a greater focus on prevention is a complex process and as a result, there is a lack of incentives for social organizations to innovate in the services they provide to their beneficiaries. Social Impact Bonds, explained in detail in the next section, are an innovative response to these challenges. In Table 1, we illustrate the challenges to public funding of preventive services based on the example of criminal recidivism. The topic was chosen due to the fact that it was the first area where a Social Impact Bonds was used.

Obstacles to the public financing of preventive services	Practical Example of Criminal Recidivism
The results of preventive measures take longer to be visible.	The effectiveness of investing in prisoner rehabilitation measured by the reduction in its recidivism rate takes several years to be proven.
The state has difficulty in providing resources for preventive measures because it will have to pay for the response to crisis situations if these measures do not work.	If the rate of reoffending is not significantly reduced, the public sector will continue to incur costs for the use of prisons, courts and police.
Little information is available to inform the state - at central and local level - in deciding which preventive services and early interventions are needed, and especially, how and when they work.	Little information is available about: the recidivism rate in the prison system in Portugal, by segment of prison population; the impact of rehabilitation services in reducing the recidivism rate.
The contracting of services with social organizations, and respective funding is based on the prescription of pre-defined activities and not based on the results achieved.	The funding of rehabilitation services normally stipulates the number of beneficiaries and support activities to be implemented; contracts are rarely made based on the results obtained, for example, based on reducing the recidivism rate in prisons.

Table 1: Barriers to public funding of preventive services and the example of criminal recidivism

SOCIAL IMPACT BONDS: INVESTING IN PREVENTION AND ENCOURAGING INNOVATION IN THE SOCIAL SECTOR

Social Finance UK launched a ground-breaking outcome-based financing model focused on concrete results: Social Impact Bonds (SIB). This model aims to attract funding to help solve social problems through services that work towards addressing the specific needs of the most vulnerable groups in society.

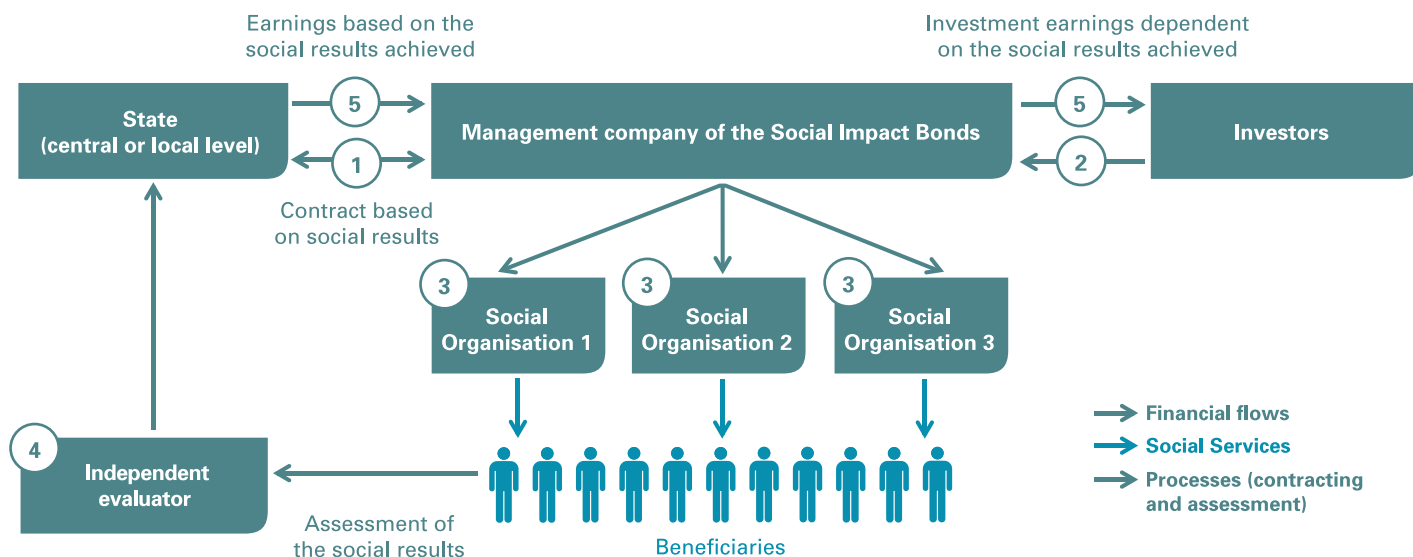


Figure 1 - Illustration of a Social Impact Bond model
Source: IES 2014 adapted from Social Finance 2011 and MaRS Centre for Impact Investing 2013

The SIB is a financial mechanism in which the public sector enters into a contract with a SIB management entity, whose shareholders are the social investors, based on specific social outcomes (1). Under this agreement, investors finance a service or set of services (2) over the medium term, usually 3-7 years, which are implemented by social organisations (3) and which aim to improve the social outcomes of a given target population. If these social outcomes are achieved (4), the public sector compensates investors, through the SIB management entity, with the return of its social investment and a financial return adjusted to the risk involved in the project and potentially to the level of social outcomes (5). If the social outcomes are not achieved, according to a pre-established level in the contract, the public sector does not pay the investors who assume the risk of losing their investment.

Unlike the much-discussed Public Private Partnership (PPP)¹, with a SIB the risk stays with the private investor and the return is on the side of the public sector which only pays the investor if it gets results that indicate an efficient impact in solving the social problem. The great advantage underlying this mechanism is the increasing capacity of medium-term funding for social sector organisations providing public services, through a management company that has incentives to match the allocation of funds to the effectiveness of work, and thus becomes an agent of innovation, measurement of results and transparency for the sector.

SIB focus on the analysis of the economic cost of a social problem

What is the cost of recidivism in the prison system? What is the cost for society of children in care? What does youth unemployment cost?

Through analysis of these economic problems, it is possible to assess the economic value of improved social outcomes in different areas, develop a business model and attract investment to finance services that provide evidence for achieving these social results.

This process involves collaborative work, to build a new, more efficient service in which all stakeholders are confident in the assumptions made and decisions taken.

As well as representing a new way of financing social projects, one of the main value propositions of SIB is that they can align the interests of social organizations, private investors and the public sector.

The first SIB was launched in September 2010 in the Peterborough prison in the United Kingdom. This SIB raised 5 million pounds ¹from 17 social investors (mostly Foundations) to finance a rehabilitation service for 7 years for individuals who are serving short sentences (less than a year). From the moment they are released, 3,000 individuals receive support for 12 months in order to reduce their reoffending rate by 10%. If this reduction is reached, the Ministry of Justice is confident that significant savings are achieved for the public sector. Based on the contract with investors, the Ministry of Justice returns the initial investment plus a financial return (with a cap of 13%), representing a proportion of the savings achieved. If the reduction is less than 10%, the Ministry of Justice does not make any payments and the risk is borne by investors.

CRITICAL SUCCESS FACTORS FOR A SIB: WHERE TO START?

There are ideal areas of opportunity for a SIB: the existence of a social problem where the public sector is spending significant financial resources and where current solutions demonstrate poor quality results. The different features of a SIB include: (1) in-depth analysis of the social problem (2) focus on outcomes rather than activities, (3) transfer and efficient allocation of risk and (4) performance management.

1. IN-DEPTH ANALYSIS OF THE SOCIAL PROBLEM

The starting point of a SIB is a detailed and thorough analysis of a particular societal problem. This analysis entails an in-depth understanding of the economic cost of a social problem, the different segments of the population most affected and which exhibit poor outcomes, as well as those who are more costly to society. To understand a particular problem, it is also necessary to identify the financial and capacity barriers faced by social organisations who are seeking to solve this problem and assess the gaps in service provision.

Peterborough case study: the issue with recidivism

In England, 60% of individuals with sentences of less than 12 months will return to the prison system within one year. This segment of the prison population lives in a revolving door between prison and the community. In total, re-offending represents a cost to taxpayers of about 10 billion pounds. In addition, prisoners sentenced to more than 12 months had statutory support, but those sentenced to less than 12 months do not receive any support after leaving prison apart from a small financial help upon release.

This combination of factors – high cost to society, high re-offending rate and a gap in service provision – helped to identify the target population for the first SIB in Peterborough.

2. FOCUS ON OUTCOMES RATHER THAN ACTIVITIES

An outcome-based contract encourages innovation within the delivery of the contracted service. The absence of a list of prescribed activities allows social organisations to innovate in their activities and adapt their service to the specific needs of beneficiaries.

SIB contracts are usually medium or long term, giving an opportunity for organisations to learn over time and to take informed decisions about the adaptation of the service provided. They also enable organisations to focus on carrying out their mission and are less concerned with seeking annual funding to remain sustainable. Similarly, they reassure beneficiaries that the project has a long-term perspective.

Peterborough case study: service adaptations

Launched in 2010, the intervention model has been adapted and improved over time. After feedback from beneficiaries and data analysis, the service was designed to provide consistent support from the time individuals enter in the prison, and not just at the moment when they return to the community.

Given the 7-year funding, the project offices became a meeting point and place of support for individuals after leaving prison. Moreover, anecdotal evidence from beneficiaries indicate that there is a greater involvement with the project because they feel they can count on this support for longer.

¹- 5 milhões de libras equivalem a cerca de 6,1 milhões de euros (1GBP = 1.22EUR, Fevereiro 2014)

3. TRANSFER AND EFFICIENT ALLOCATION OF RISK

As this is a contract based on results, the risk is based on the possibility of these results being or not being achieved. In the case of a SIB, the contract is signed between the public sector – at central or local level - and social investors, through a managing entity, who bears the risk of failure. Because their own capital is at risk, investors have an incentive to work together with social organisations in order to ensure that the outcomes set out in the contract are achieved. This transfer of risk encourages greater capacity building of social organisations, promoted by the close interaction with investors, usually through an intermediary SIB management entity.

Peterborough case study: the investment terms

Five million pounds was invested in this SIB in a rehabilitation service provided by social organisations. If the 10% reduction in the re-offending rate is not reached, investors do not recover their principal and get no return. Social Finance UK works daily on the ground with social organisations, providing support to service providers and helping them learn with programme data whilst informing their operational decision-making.

4. PERFORMANCE MANAGEMENT

SIBs can be regarded not just as a financial innovation, but a driver of change at operational level in creating incentives for social organisations to have greater social impact on their projects.

There is a heavy focus on performance management through the creation of a system of impact measurement and service monitoring. In this sense, information on the service is introduced using an information system and examined and monitored periodically. As a result, organisations can learn over time about their service and the behaviour of beneficiaries, and adapt current practices according to their specific needs. This enables organisations to understand what works and what doesn't work in the service they provide, helping to create a body of evidence on social impact which can help to attract financing in the future. SIB also lead to closer collaboration between different social organisations, which may offer a more integrated and effective service, where different services complement each other.

Peterborough case study: performance management

Performance management in Peterborough is considered a critical factor for the success of the project, as it allows delivery bodies to identify problems and trends at the time they happen, and respond efficiently. The goal is not to provide a static service, but rather to learn over time and adapt it to the needs of the beneficiaries, in order to reduce re-offending rates.

OVERVIEW OF SIB INTERNATIONALLY AND NEXT STEPS FOR PORTUGAL

The SIB is not a mechanism suited to all situations; there are many cases where traditional forms of financing are the most appropriate. However, the SIB model has an interesting value proposition to the extent that they combine the interests of social organisations, investors and the state.

The aim of SIB is that the focus of public funding is aligned with outcomes and to increase the sources of capital available to finance early intervention services. SIB also allow greater collaboration between different social organisations, which often operate in isolation, and through this mechanism work towards delivery of an integrated service that aims to solve a particular social problem. Moreover, they provide a consistent and sustainable source of income for social organisations, while at the same time encouraging a rigorous performance management approach, using the measurement of social results to build track record for services that work.

When its goals are met, the SIB allows the public sector to have more information to decide what services to include in their social service provision and, mainly, help improve the quality of life of the most vulnerable groups in society. Thus, SIB are a mechanism for the promotion of social innovation in public services whilst also informing public policy in this area.

So far there are 14 SIB in the United Kingdom, in areas ranging from youth unemployment to the rehabilitation of homeless people. Other SIB have been introduced in the USA, Australia and the Netherlands. There are currently over 100 initiatives being developed worldwide.

In Portugal, there are various social areas that have the potential to use a SIB to finance innovative projects, since there are segments of the population that cannot access statutory services, or only access them when the problem is entrenched.

There are a number of social areas - children in care, homelessness, social isolation of the elderly, youth unemployment – that represent a significant cost to Portuguese taxpayers. The implementation of a SIB in these areas can help identify innovative services, capitalising on international experiences. There are good practices at national and international level that can be replicated and scaled, such as: setting up a personalised service to support homeless people to get better access to the housing and health system; a set of integrated support services for ex-offenders to integrate them into the community; innovative services that promote youth employability and create incentives for the hiring of young people.

The Portuguese situation benefits from an existing structure in which various agents play an active role in the provision of social services – the public sector, at central and local level; social organisations and entrepreneurs running projects with high impact potential; social investors, notably foundations, high net worth individuals and corporates through their social responsibility budgets. The next step in Portugal is to align the motivations of these diverse players and foster that alignment through the presentation of strong business cases.

To learn more about Social Impact Bonds:

Social Impact Bond Knowledge Box http://data.gov.uk/sib_knowledge_box/knowledge-box

Harvard Kennedy School SIB Lab <http://hks-siblab.org/>

Rockefeller Foundation <http://www.rockefellerfoundation.org/our-work/current-work/social-impact-bonds>



LABORATÓRIO DE INVESTIMENTO SOCIAL

This research note was developed by the Social Investment Lab under the scope of the project “Portuguese Social Investment Taskforce”, launched in 2014 with the aim of catalysing the social investment market in Portugal. This one-year project was financially supported by the European Commission, through the program: Supporting the demand and supply side of the market for social enterprise finance.

This piece is part of a series developed by the Social Investment Lab, whose contents should reach organisations, social entrepreneurs, investors and various public sector agencies, and help create key knowledge on social investment. The objectives of the research notes are to identify the needs of the sector, introduce new concepts and instruments, to reflect on what has been done in other countries and to promote discussion about the potential implementation of social investment in the Portuguese situation and the Portuguese-speaking world. We invite readers to ask questions, make suggestions and share ideas via email at investimentosocial@ies-sbs.org.



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IES – Social Business School

IES-Social Business School is a non-profit association which aims to stimulate innovation, efficiency and the growing impact of transformative projects that break problems traps in our society. The vision of the IES-SBS is to be the benchmark for social entrepreneurship in the Portuguese-speaking world, fostering innovation, knowledge, learning, and social impact. The work of the IES-SBS is focused on training and promoting high potential social entrepreneurship initiatives, along with exceptional organisations and individuals committed to change the world in the most efficient and innovative way. The mission of IES is to Inspire and Empower for a better world, through Social Entrepreneurship.



Calouste Gulbenkian Foundation

Calouste Gulbenkian Foundation is a private Portuguese institution for public use whose statutory aims are the Arts, Welfare, Science and Education. With over 50 years of experience, the Calouste Gulbenkian Foundation works extensively in Portugal and abroad through its own initiatives or in partnership with other organisations, and through the provision of grants and scholarships. The mission of the Gulbenkian Human Development Programme, created in 2009, is to encourage and facilitate the inclusion of the most vulnerable groups in society.



Social Finance UK

Social Finance was established in 2007 and is a non-profit organisation that works with social organisations, investors and the public sector in the development of financial mechanisms tailored to the needs of the social sector. Social Finance launched the first Social Impact Bond in HMP Peterborough, attracting an investment of £5 million from 17 investors, with the aim of reducing the recidivism rate. The Social Finance team consists of experts from the financial, social, public and private sectors. This team has from the start supported the UK Social Investment Task Force, the Commission of Unclaimed Assets and was involved in the creation of Big Society Capital, the UK social bank.