

Social Impact Bond

The development of SIB
as an alternative financing form

WHITEPAPER
#01

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An aerial view of a modern city skyline, featuring several prominent glass skyscrapers. The buildings are reflected in each other, and the sky is blue with scattered white clouds. In the foreground, there are lush green trees and a small body of water. A red flag is visible in the bottom left corner.

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Preface

The collaboration between government, business and financiers is in many cases still in the nascent stages of development. Budgets are under pressure and there is a growing need for efficiency in governmental projects. The Social Impact Bond (SIB) is one of the recent developments to ensure cost-effective, result-oriented and public-private partnerships. This whitepaper is about SIBs and shows you the advantages and disadvantages. A clear picture of the SIB is obtained through a concrete case provided by the Ministry of Security and Justice. SIB has advantages for government, business and financiers, and offers a win-win-win situation.

In the recent past, there have been seven SIB projects in the Netherlands and the end is not yet in sight. The developments are of interest for the government as well as for the business community.

The foundation for this whitepaper was laid down in 2015 in a master thesis as part of an MBA program. This paper goes a step further and demonstrates the current state of affairs. It is a useful document for everyone with an interest in alternative forms of funding, irrespective of their sector.

It is also a good example of the effect and the impact of an MBA study at The Hague University of Applied Sciences.

*Clemens Berendsen
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Introduction

For a long time now, the government has been contemplating ways to deploy its resources more effectively. Attempts in this connection appear to have been difficult and have so far yielded meagre results. The government is therefore deploying Social Impact Bonds (SIB) in collaboration with private investors and social undertakings, with a view to achieving a higher social and financial return on its investments and expenditures.

In contrast to Great Britain, there is little experience in the Netherlands with this method of financing. Our country has so far only concluded seven SIBs. Most of these SIBs are oriented toward (young people's) participation in the labour force. The point is that the Dutch culture is not oriented toward measuring and understanding. In other words: we have no tradition, as in Great Britain, to integrate the use of quantitative data in policy formulation. Our government primarily uses figures to account for resources deployed, and far less for policy management. We simply do not know what the effects are, as a result of a lot of interference and interventions. Take for example the return to criminality after serving a prison term, a multi-headed monster, for which there are no proven approaches that can be used. At the most, we know that there are certain elements that contribute to the reduction of the phenomenon.

New financing model

The Social Impact Bond is a new financing model that aims at achieving effects and stimulating innovation. SIB is a private-public financing form aimed at resolving social problems from a result-oriented perspective. Of central importance in SIB is control and payouts based on results and outcomes. Possibly, this model can contribute to helping understand (social) results and stimulating innovation.

Social Impact Bond

Most governmental budgets are subdivided on the basis of the budget for the previous year. This financing is oriented toward risk management for the government. But times change, and the Netherlands is in a transition. A shift from a large, responsible central government to a greater devolution of duties and responsibilities on the citizen: the participation society. There is an increasing need for care and interventions on behalf of the socially disadvantaged individuals in society. Simultaneously, governmental budgets are shrinking, leading to a critical view of the public sector among citizens.

A SIB is a financing contract in which payouts are only made if a previously agreed result is

achieved. Thus, SIB binds the government and entrepreneurship to each other. A performance agreement with which stakeholders jointly determine the output and returns. Logically speaking, SIB can only be deployed in cases where there are interventions and processes that can be measured and have proven effective elements. Thus, investment is made in what has been proven to be workable. Unlike a regular subsidy, deploying SIB provides a stimulus to work in a more result-oriented manner. The aim of SIB is to achieve the agreed results. Thus, governmental authorities can direct the achievement of their policy goals with greater clarity.

Seven SIBs have been concluded in the Netherlands within the social domain. The most recent SIB was concluded in The Hague and is aimed at problem families in The Hague.

It concerns heavily indebted families trapped in a web of problems, which only increases their debts and they do not get the care they need!. The first SIB is aimed at unemployment amongst the youth and has produced promising results: The youth of Rotterdam have found employment, and research has shown that, by deploying the SIB approach, the period of benefit payments amongst youth has reduced by 464 days.

Benefits of SIB

- The focus is on social performance.
- Governments can address social problems without themselves having to bear the financial risk.
- The implementing organisation (social entrepreneurs) has the freedom to independently determine how the results will be achieved.



The initial results of Social Impact Bond in Buzinezzclub are encouraging

The first Social Impact Bond (SIB) in Rotterdam has been a success. 59 percent of the first group of youth who participated in the Buzinezzclub via the SIB is now in employment, training or starting up their own businesses faster than was expected. In view of the successful results, the municipal authorities of Rotterdam are launching a second SIB with the Buzinezzclub.

<http://www.persberichtenrotterdam.nl/bericht/1273/Eerste-resultaten-Social-Impact-Bond-bij-Buzinezzclub-positief/>

The results of Social Impact Bond for detainees have proved promising

The first Social Impact bond that was concluded in Great Britain has led to positive results. Detainees with a short prison sentence showed 9% decline in relapses into criminality, and investors achieved a satisfying social return of 3%.

<https://www.dehaagsehogeschool.nl/docs/defaultsource/documenten-nieuws/final-press-releasepb-july-2017.pdf>

The history of SIB

In 2010, the David Cameron government launched the Big Society (Final & Society, n.d.) policy concept. Instead of a large government that would have a centralist top-down approach, decentralisation and opening up public services to social entrepreneurs became the focal point with the aim of increasing involvement and greater public involvement in public services.

Figure 1 shows a schematic representation of how an impact bond works and the stakeholders that are involved in SIB. The founder of this Big Society policy was Phillip Blond, who aimed at cultivating new relationships within society. The primary aim of SIB is to prevent social issues with the help of private or nonprofit capital (Nsob & Bonds, 2014), in which stimulating social outcome is an important objective to be achieved through the collaboration between

government, businesses and investors. The principle is simple. The concerned implementing organisation makes an intervention that is valuable to an established target group. The implementing organisations are financed by the investors. Consequently, the government only has to spend money if the intervention works. Figure 2 illustrates the SIB process.

Stakeholders in SIB

From the very beginning, stakeholders in SIB work intensively with each other in order to formulate a contract on which the implementation of the intervention is founded. There are five stakeholders in SIB, all of which have their own motivation for participation in the SIB.

- 1) **Government:** It makes payments if an intervention appears to work, and the effect (outcome) that was agreed in advance is achieved. From the customer's perspective, SIB is a simple performance contract.
- 2) **Financier:** they pre-finance the intervention and bear the risk in exchange for a return. They develop a new market by providing growth capital to social organisations.
- 3) **Implementing organisations:** they make the intervention that is agreed and are placed in a position to control more than just the output. They anticipate long-term financing and the extension of activities in case the intervention succeeds.
- 4) **Intermediary:** they are the 'brokers' in the creation of the SIB, and keep partners informed about the organisations and reports, in order to ensure that SIB comes into existence.
- 5) **Target group:** the SIB target group is demarcated and these persons benefit from the intervention provided by the implementing organisation.

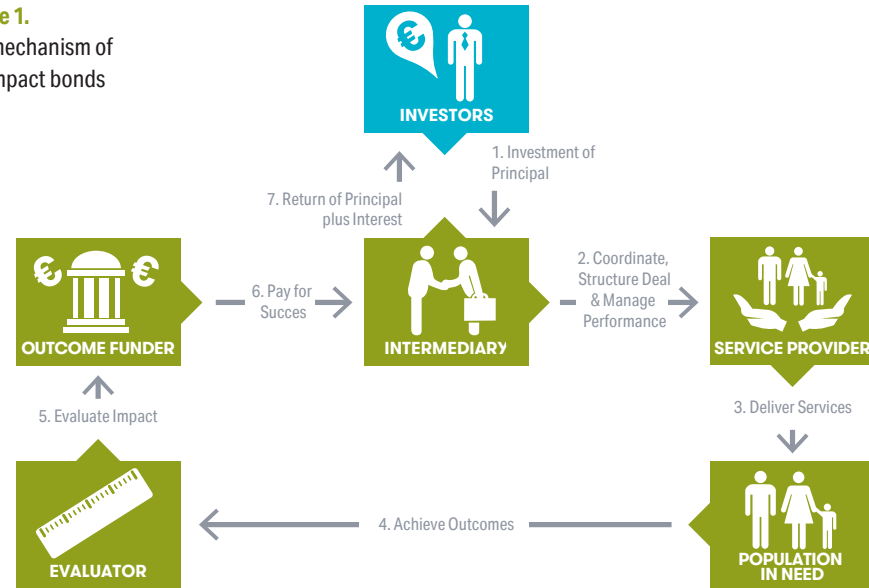
Agreements and earnings model

The contract stipulates the manner in which the established outcome will be monitored independently, and who shall be responsible for the same. The financier agrees on clearly established results with the government in advance. If the implementing organisation is not part of the consultations, a request for quotations is issued for intervention in the established target group. The financier agrees on clearly established results with the government in advance. The government makes performance agreements relating to the results with the financier, and pays the financier if the results (outcome) are achieved. If the results are not achieved, the investor will lose a whole or part of his investment.

The earnings model of SIB is therefore a reward for a performance that creates added value for the public.

The collaboration within SIB is intensive. Jointly determining the result ensures a shared responsibility, the opening up of domains (interdepartmental cooperation). By literally sitting together with each other at a table and sharing each other's knowledge, seems to stimulate the attainment of more creative solutions.

Figure 1.
The mechanism of the impact bonds



The three basic elements, according to Social Finance, of SIB are:

- I. The payment of subsidy is linked to clear, specific results. Payout takes place based on outcome criteria, for example, the completion of a training course instead of simply granting a subsidy to purchase books.
- II. The recipient of the subsidy determines how the results laid down are achieved and the leeway required to achieve the results.
- III. There is a thorough check on the results that the public party delivers before the subsidy is paid out.

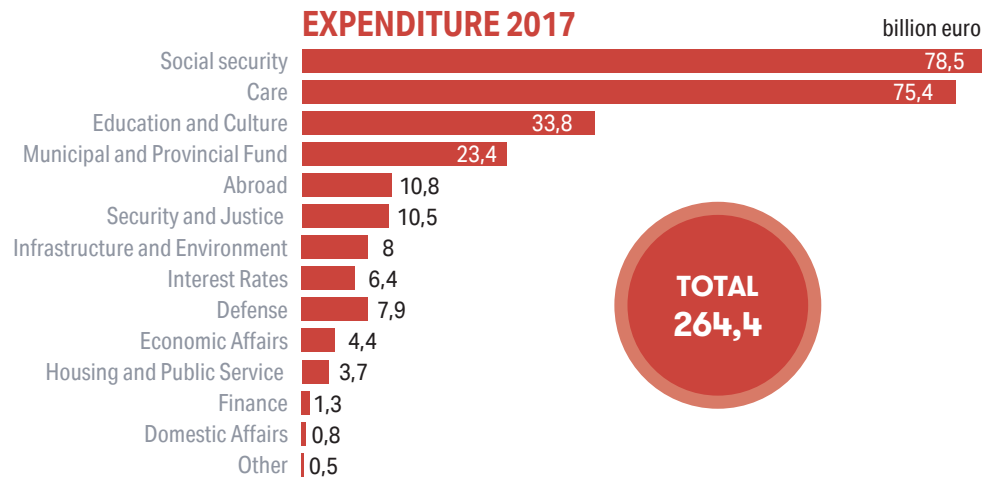
When should a SIB be deployed?

A Social Impact Bond that is linked to a top priority of the municipality or government, is most likely to achieve results. The 'degree of impact' on the priority is the most important criterion for concluding a SIB. Notwithstanding its suggestive name, the SIB is not an obligation. Within private banks, this 'bond' is not seen as a debt loan, because the government does not guarantee the investment. However, it is only to ensure that the result is achieved. Due to its risk profile, the SIB is more often classified under private equity.

Success factors of SIB

According to the research of the Harvard Kennedy school, there are a few success factors for SIB:

- There is an expectation that there are 'benefits' for the taxpayer and the investor
 - It is a strong effort by the government.
 - The implementing organisation is experienced in the delivery of the intervention.
 - There is a strictly defined target population.
 - The target group has the growth potential; progress is possible.
 - It is possible to carry out robust data analyses within a foreseeable period, and consequently the outcome is reliable.
 - There is a safety net for perverse consequences of SIB.
- The business community and the government deepen their engagement with each other's interests.

**Figure 2.**

Government expenditure 2017
(www.rijksoverheid.nl)

Result-oriented working and social interventions

Regular financing models of the government will be implemented according to the Government Accounts Act and are mostly aimed at providing subsidies to institutionalised implementation organisations. Government subsidies and the execution of public tasks are inextricably linked with each other because the task of the government is to fulfil these duties.

The primary function of providing a subsidy is to achieve governmental targets (Figure 3). When providing a subsidy, the Ministry lays down conditions that must be satisfied in order to receive the subsidy. These conditions are mostly aimed at quantities achieved by an organisation and how many activities the organisation provides in return for the subsidy amount.

Social enterprises: The solution for social problems?

Controls based on outcomes is a totally new method of financing for the government. Due to the financial crisis, governmental budgets have come under pressure and less money is available. The government and social organisations are therefore forced to re-examine social issues. Performance and impact measurements can play an important role in the trust enjoyed by the government, and the legitimacy of the services of organisations that are dependent on government subsidies.

In addition, there is now a social trend in which citizens want more information and perceptible effects from the money that the government invests in institutions that carry out public tasks. Due to this development, we see an increase in the social entrepreneurship.

A social enterprise is a business primarily created to generate social results in a financially sustainable way. Social enterprises are not dependent on subsidies or contributions from the government, because these are undertakings that make financial profits.

If the large-scale involvement of social entrepreneurship in social issues appears desirable, it would be worthwhile to examine what they require in order to participate. Since new forms of financing are required for a new form of entrepreneurship in which the profit

achievement and the achievement of social targets go hand in hand. Through an increase in social enterprises, the need arises for more structural financing for these companies.

As a result, private money is used in the social domain. Social enterprises often obtain their financing with difficulty because their visible return on investment is lower than for regular companies.

From this point of view, there is a need for new financing instruments to stimulate social innovation, in which connection SIB is one of the options.



Figure 3. Balance sheet social and financial impact

Case: The first national SIB

The Ministry of Security and Justice wanted to experiment with innovative forms of financing, and commissioned the setting up of a first national SIB. They did this together with the social innovation platform Society Impact, the financier ABN AMRO, and the social investor Start Foundation. Later on, the Oranje Fonds joined in as a co-investor. The stakeholders jointly sought a target group amongst ex-prisoners where there would be a social added value to be gained via an intervention aimed at labour integration and limiting a relapse into crime. This resulted in a SIB which has been called Work-Wise direct, which was implemented by a consortium of Stichting 1800, Exodus and the temp-working agency Restart. It had three hundred participants who had served prison sentences of three to twelve months.

One hundred and fifty participants came in via the treatment group and one hundred and fifty participants came in via the control group. The control group undergoes a regular re-integration procedure. The participants are ex-detainees and come in through ten 'regular' penitentiary institutions in the Randstad. Participation in the process is voluntary. The allocation is done by an independent research agency. The business case is based on two firm commitments: the treatment group must have fewer days of imprisonment, and fewer benefit payment days than the control group.

The ambition according to the business case is that of the 150 persons in the treatment group, 40% must take up employment on a long-term basis, as against the expectation that the control group would find 16% longterm employment. It is agreed that the treatment group must perform 24% better than the control group. The scope of the Work-Wise direct is 2 million. The possible benefits will be received by the municipalities and by the Custodial Institutions Agency (DJI). The measurement period of this SIB is two years.

Employment after serving a prison term

In June 2016, the Ministry of Security and Justice launched a SIB Employment after serving a prison term in collaboration with ABN AMRO, Start Foundation and Oranje Fonds. The aim of the same is to guide 150 former prisoners toward employment or to take up educational training, and therefore to reduce their rate of relapse into crime in 2.5 years.

SIB target groups

Most SIBs are deployed to handle social issues such as unemployment, crime and health care. In principle, each target group is suitable, if the intervention yields both social as well as financial returns, and payouts can be made against the same. If there is no result to be obtained, it is very difficult to conclude a SIB in such case.

The returns

The basis for SIB is a social business case in which all the benefits and costs are specified. This budget is made on the basis of key figures on social problems.

The relationship between financial and social return

There are always more savings, but a choice must be made concerning what can be measured. Additionally, the savings often lie in multiple budgets. Not all the effects can be measured - and they are certainly not cashable. An important role in this connection can be played by the government by providing key figures on social problems.

What is our interest, as a society, in this new development?

- SIB is an option for the government to gain economies without loss of tasks
- The government is thinking more in terms of social results.
- A more effective government, with scarce resources being deployed where they are most required.
- The government spends less and contributes effort 'en passant' to policy targets.
- Banks and (social) investors create value in a sustainable manner and with SIB, they have a positive impact on society.
- Investments are being viewed from a healthy financial perspective, without profit-making being the primary focus.

Costs of SIB

There are currently 7 SIBs in the Netherlands. The creation of a SIB is often a long-term process. The costs leading up to the setting up of SIBs are substantial. If you look at it from a purely financial point of view, it appears advisable to not spend more than 5% of the principal amount towards expenses.

Social return

When entering into a SIB, all the stakeholders assume that the return will not just be financial in nature. Due to the interaction between stakeholders, the motivation of each party is constantly subject to discussion. It is seen as a social benefit if the parties work together towards one goal and where you make it clear what the benefits will be for all the parties together.

Crowdfunding

If the SIB could be linked to crowdfunding, this would be an ideal model to increase the power that society has over the manner in which the government addresses social problems. As a result, the citizen is able to participate in a number of social problems that affect him/her directly or are present in his/her immediate vicinity. This form is on the wish list - certainly so amongst financiers.

Results-based control in the government

At present, performance contracts are being entered into on a small scale. But it seems difficult to account for these performances in terms of outcomes.

Stakeholders are critically viewing the actions of the government. Citizens want to know where the government is investing its money.

The starting point is the government that monitors social problems. If this is well described and what has been agreed can be recorded in great detail, then it is to be seen what the effect this may yield. Control takes place on the basis of measurable social results and which, in the ideal model, can be expressed in terms of money.

The implementing organisation thereby brings a totally different standpoint to the table. SIB is currently extremely useful, discussing results, but it is not a panacea.

Performance control versus subsidy control

At the present moment, the government uses subsidies as a means to control the achievement of its policy targets. The subsidy relationship leads to a certain dependency. Conditions are laid down and calculation is done within a specific framework, thereby enabling the government to take what and how decisions. Concerning the grant of subsidies, a lot of regulation has been drawn up and this gives rise to limitations. The good part of investing private money is that the rules of subsidy do not apply to the executor. It is not per se bound by subsidy conditions, thereby eliminating system-'bugs'. It is possible to try out a concept very quickly in practice, whereby one can simultaneously have a clear view of whether the intervention is effective or not.

Innovation through SIB

Innovation is possible within the current government model, but there is very little space for original ideas amongst parties and persons who are unfamiliar with the market. The need for innovation in the government seems to lie in the financial and social sphere.

It is interesting to investigate whether new ways will be more effective, or whether specifically a proven method can be used. Innovation is necessary for this. When social enterprises want to participate in the discussions, it is necessary to look for new forms of financing. The entrepreneur wants to have people start working and earn money, and in this connection, SIB is a tool for the same.

Apart from innovation, the goal of the SIB can also be to overcome hurdles within the current system.

Conclusions and recommendations

SIB can make a contribution to result-oriented working, since the agreed result is defined by the joint stakeholders. In addition, SIB contributes to defining social problems. Since the results are defined in a business case in financial as well as social terms, there is a link and a healthy balance between the two.

SIB is also an important means of eliminating social hurdles in addressing social problems. A result and an intervention are discussed, but the manner in which the same can be achieved is not a task of either the government or the financier. The implementing organisation can act on the basis of its expertise with the aim of achieving the intended result. Since the result (outcome) is well formulated and established but the manner in which (throughput) it will be achieved is not, professionals in implementing organisations have the space to perform the work more innovatively.

Recommendations

It is important for the SIB to be tested within various sectors. From youth unemployment, to obesity, from refugees to the elderly. A track record with various issues will contribute to greater knowledge and a wider support for the model.

The government can provide an impetus to the development of SIB by providing more key figures on social problems and by initiating SIBs. If the SIB could be linked to crowdfunding, this would be an ideal model to increase the power that society has over the manner in which the government addresses social problems.

In order to ensure that innovations made as a result of SIBs remain a permanent feature, ways should be sought to roll out the same on a wider scale across other sectors. If the government views the situation critically or approves a result-oriented approach, it can be discussed whether modifications are required in the financing of public tasks via subsidies. As a model, SIBs are not the correct tool for this, but this is certainly true of the effect that a model like the SIB delivers. There may be a shift from political and official reality to implementation, due to which result-based control is an effective tool to ensure greater results with government funds.

- ✓ **Joint definition of the result**
- ✓ **A healthy financial view**
- ✓ **Strengthening innovation and scalability**
- ✓ **Catalyst for more result-oriented work**
- ✓ **Testing in various sectors**

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Karin Klaassen wrote her Master Thesis on SIB in 2016 as part of her MBA study at The Hague University of Applied Sciences. She was at that time working in Reclassering (rehabilitation of convicted prisoners) as an Innovation program manager. One of the challenges in her work was to develop an alternative financing structure for the subsidy relationship that rehabilitation of convicted prisoners had with the Ministry of Security and Justice. At present she is working as a manager with the Longfonds.



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