ISSN 1883-6755

INPMS Research Report No.29
2014 UK Study Tour Report

Social Impact Investments, Social Impact Bonds and Impact Measurement in the United Kingdom: Lessons for Japan

Institute of Nonprofit and Public Management Studies
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PREFACE

The Institute of Nonprofit and Public Management Studies (INPMS) at Meiji University has been conducting research on the effects of impact investments on public service provision by nonprofit organizations and social enterprises in the UK, the US and Japan. In particular, INPMS has been exploring the ways in which impact investments, especially social impact bonds (SIBs), affect governments, social service providers, service users, and the quality of social services in the UK and the US. The aim of this research is to gain an understanding of the UK and US experiences and to apply the lessons learned to develop Japanese SIB models.

As part of this research, from October 27 to October 31, 2014, in London, UK, the INPMS project members interviewed ten organizations and two experts of social impact investments, social enterprises, and impact measurement. This report focuses on five interviews which are the most relevant to social impact investments, SIBs and impact measurement. This report is written by Tania Dowhaniuk and editied by Dr. Takayuki Yoshioka.

ACKNOWLEDGEMENTS

This research project is funded by the Japanese Ministry of Education, Culture, Sports, Science and Technology (MEXT) through a grant called “Research Grants to Strategically Build a Research Infrastructure at Private Universities.” The INPMS project members would like to express our sincerest gratitude to the MEXT.

The INPMS project members would also like to extend a special thanks to all of the individuals and organizations who graciously offered their time and shared their knowledge and experiences. The interviewees we would like to thank are as follows: Professor James Alex Nicholls; Sarah Bailey; Collaborate: Dr. Henry Kippin; Business in the Community (BITC): Sue Adkins, Vicky Dodman; PwC Centre for Social Impact: Dr. Mark Graham, Matthew Johns; Nesta: Joe Ludlow; UK Cabinet Office Centre for Social Impact Bonds: Sarah Hickey, Kelly Glaser; St Mungo’s Broadway: Alastair Reeves, Becky Rice; New Philanthropy Capital (NPC): Tris Lumley; The START Network: Sean Lowrie, Tegan Rogers; The Foyer Federation: Jane Slowey, CBE; Office for Public Management (OPM): Hilary Thompson, Dr. Chih Hoong Sin.

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INTRODUCTION TO SOCIAL IMPACT BONDS

In recent years, the impact investment market has grown and awareness about such social values-driven investments has increased among social investors, nonprofit organizations, social enterprises, businesses and governments. Impact investments have been considered a catalyst for innovation in public private partnerships, and provide access for nonprofits and social enterprises to alternative financial resources from that of conventional government funding.

In particular, within the impact investment market, social impact bonds (SIBs) have been generating worldwide interest since the world's first SIB was launched in 2010 at Peterborough Prison in England. According to Nicholls and Tomkinson (2013)[1], "It aims to improve a social outcome through the collaboration of government, service providers and external investors. Put simply, a SIB involves a set of contracts, the basis of which is an agreement by government to pay investors for an improvement in a specific social outcome once it has been achieved" (p.3). More than 40 SIBs have already been operating around the world, aiming to improve outcomes in diverse social service areas. In most cases, these outcomes are related to preventative interventions addressing recidivism, homelessness, youth unemployment, and juvenile delinquency; improvements are connected to cost savings on public services.

In the UK, there are 17 active SIBs in issue areas including homelessness, youth unemployment, recidivism, adoption, and children at risk of requiring out-of-home care. Many more SIBs are in the planning stage and interest is growing in increasingly diverse issue areas; such as youth homelessness, long-term health conditions, and barriers to family reunification or long-term foster care placement.

[1] Nicholls, A. & Tomkinson, E. (2013). The Peterborough Pilot Social Impact Bond. Oxford: Saïd Business School, Oxford University.

INPMS Project Team

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UK Study Tour Participants

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Eunjee Park	Professor of Theory of Financial Statements, Environmental Accounting, Department of Business Administration, Faculty of Economics, Kagawa University
Michiko Takahashi	Project Manager, RCF: Reconstruction Consulting Firm (Intermediary Organization for Regeneration of Tohoku Disaster Areas）

Interview Schedule

	Schedule	Interviewees
10/27 Mon.	**Collaborate** 13:00-14:00 at Clarence Centre for Enterprise & Innovation. 6 St George's Circus, London, SE1 6FE	**Dr. Henry Kippin** (Executive Director)
	Business in the Community (BITC) 15:00 - 16:00 at 137 Shepherdess Walk, London N1 7RQ	**Ms. Sue Adkins** (International Director) **Ms. Vicky Dodman** (International Programme Manager)
10/28 Tue.	**PwC Centre for Social Impact** 12:00-14:00 at 7 More London Riverside, London, SE1 2RT	**Mr. Mark C. Graham** (Director, PwC UK) **Mr. Matthew Johns** (Senior Associate)
	Nesta 15:30 - 17:00 at 1 Plough Place, London EC4A 1DE	**Mr. Joe Ludlow** (Director, Impact Investment)
10/29 Wed.	**Centre for Social Impact Bonds at the Cabinet Office** 10:00-11:00 at 1 Horse Guards Rd London SW1A 2HQ	**Ms. Sarah Hickey** (Senior Policy Advisor, Social Investment & Finance Team) **Ms. Kelly Glaser** (Policy Advisor, Social Investment & Finance)
	Professor Alex Nicholls 14:00-15:30 at Citadines Prestige Holborn-Covent Garden London Hotel	**Dr. Alex Nicholls** (Professor, University of Oxford)
10/30 Thu.	**St Mungo's Broadway** 11:00 - 12:30 at 29 Francis Street, London, SW1P 1QL	**Mr. Alastair Reeves** (Street Impact Team Manager) **Ms. Becky Rice** (Research & Information Manager)
	New Philanthropy Capital (NPC) 14:00-15:00 at 185 Park Street London SE1 9BL	**Mr. Tris Lumley** (Director of Development)
	The START Network 16:00-17:00 at 12th Floor, 207 Old Street, London EC1V	**Mr. Sean Lowrie** (Director) **Ms. Tegan Rogers** (Communications Officer)

10/31 Fri.	**Ms. Sarah Bailey** 10:00-11:00 at Clarence Centre for Enterprise & Innovation. 6 St George's Circus, London, SE1 6FE	**Ms. Sarah Bailey** (Associate Research Fellow at University of Exeter)
	The Foyer Federation 12:00-13:00 at 3rd Floor 5–9 Hatton Wall London EC1N 8HX	**Ms. Jane Slowey, CBE** (Chief Executive)
	Office for Public Management (OPM) 14:00-16:00 at 252b Gray's Inn Road, London, WC1X 8XG	**Ms. Hilary Thompson** (Chief Executive) **Dr. Chih Hoong Sin** (Director, Evaluation, Research and Engagement)

INTERVIEW SUMMARIES

The Centre for Social Impact Bonds in the Cabinet Office

Introduction to the Centre for Social Impact Bonds in the Cabinet Office

Established in 2012, the Centre for Social Impact Bonds (SIBs) is part of the Social Investment and Finance team in the UK Cabinet Office[2]. As UK`s central authority on SIBs, the Centre for SIBs works to increase understanding across governments, and to support the development of SIBs through the following activities: collecting and disseminating information and guidance and providing access to tools to help effectively develop SIBs; providing funding for portions of the outcome payments of new SIBs; building an evidence base of successful case studies and sharing the latest research and media coverage on SIBs[3].

Sarah Hickey (left) & Kelly Glaser (right)

The social investment market in the UK

Currently in the UK social investment market, the greatest volume of transactions is straight loans from investors to charities. There are other types of impact investment structures but they mirror normal investment, for example there are bonds that charities

[2] Centre for Social Impact Bonds Blog (Retrieved June 6, 2015 from: http://blogs.cabinetoffice.gov.uk/socialimpactbonds/about-sib/)
[3] Centre for Social Impact Bonds (Retrieved June 6, 2015 from: http://data.gov.uk/sib_knowledge_box/home)

can raise, and there are some listed on the London Stock Exchange. Infrequently, some charities take equity.

A very small part of the broader social investment market is SIBs, which have been operating since 2012. They are unique in that they are partnerships between the government, investors and the social sector. To date, there are 17 SIBs running in the UK, excluding those going through the procurement process at the time of the interview.

Two significant SIB developments from the past year

1) Social investment tax relief

The recently introduced Social Investment Tax Relief (SITR) applies to individuals who invest in a charity, social enterprise or an SIB. SITR allows qualifying individuals to benefit from a reduction on their income tax bill equivalent to 30% of their social investment and also allows investors to defer a capital gains tax charge if profits are reinvested in a social enterprise[4].

2) 30 million pound fund for two SIBs that work with people 14-24 years old[5]

The first is Youth Engagement Fund, which will help 18,000 young people to get jobs. The second is Fair Chance Fund, which will move 2,000 homeless youth into secure accommodation and help them find jobs.

The role and impact of Big Society Capital (BSC)

BSC was established by the UK Government as an independent, wholesale social investment institution. It has been running for two and a half years, has published its second annual report reflecting on its progress, and also published its three year strategy in May 2014[6]. It aims to catalyze growth in the social investment market by playing two key roles: being a wholesale investor by getting finance into the social sector and building a landscape of lenders; and being a market champion and helping to grow the social investment market by increasing support for and understanding of the market among different stakeholders.

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[4] Social investment tax relief (Retrieved March 16, 2015 from: https://www.gov.uk/government/collections/social-investment-tax-relief)

[5] At the time of the interview these two projects were going through the procurement process.

[6] Big Society Capital: Our strategy for the next three years, May 2014 (Retrieved March 16, 2015 from: http://www.bigsocietycapital.com/sites/default/files/Strategy%20v5.pdf)

Being a wholesale investor - key performance indicators

In order to meet the first objective of getting finance into the social investment sector, BSC uses a set of key performance indicators which it uses to track money as it moves from investors to frontline organizations.

1st indicator: Money going into BSC

So far, BSC has received 225 million pounds from dormant bank accounts and the banks that invest in it.

2nd indicator: Money flowing out of BSC

BSC strives to build a market of lending institutions that are experts in providing affordable and appropriate finance to the social sector. To date, BSC committed 150 million pounds into the landscape of specialist lenders, which includes 30 different intermediary organizations.

3rd indicator: Influence on other investors through matched funding

Another role of BSC is to encourage other investors by showing them that impact investment is viable. When BSC puts money into an intermediary organization, an external organization matches their funding; by the end of 2014, every pound of BSC money going into the intermediary sector was matched by at least another pound of external investment.

4th indicator: Effect on frontline social service providers

Finally, BSC looks at how many frontline social service providers are actually benefitting from the money that was invested. At the end of 2014, about 57 social sector organizations went to intermediaries and successfully took on investment.

Being a market champion – three ways that BSC supports other sectors of the market

1) Being a source of expertise

With BSC and other organizations in the social investment market, a research council was set up in which budgets are pooled and used to commission research to raise awareness and understanding about the social investment market.

2) Informing policy making

BSC pulls together views from the sector to inform policy making, for example it advised the government on what design would be effective for SITR.

3) Identifying and addressing obstacles to market growth

One sign that the social investment market has not reached its full potential in the

UK is that the majority of social sector organizations feel that social investing is not accessible to them. Along with others, BSC has helped identify three obstacles to market growth. The first obstacle is high transaction costs. The loans required by many social sector organizations are too small to be viable because of the high transaction costs. The second obstacle is business capacity gaps. Many social sector organizations lack skills, governance structures or resources to do financial modelling, feasibility studies or other monitoring and reporting requirements requested by investors. These capacity gaps lead investors to feel that some organizations are not suitable investment propositions. The last obstacle is lack of understanding about social investing. Grants have traditionally been sources of funding for social sector organizations and charities. Some organizations mistakenly expect social investing to be similar to grant funding, which is however different since it is repayable finance.

In order to address business capacity gaps in the social service sector, the government set up the Investment and Contract Readiness Fund[7], which provides support for organizations to prepare for investment. Recently the government announced that they will be committing up to an extra 60 million pounds over the next 10 years to support the growth of organizations that are ready to take on social investment.

Interview at the UK Cabinet Office

[7] Investment and Contract Readiness Fund (Retrieved March 16, 2015 from: http://www.beinvestmentready.org.uk/)

Stakeholders in the UK SIB market

1) Commercial investors

In the UK, most investors in SIBs have some sort of charitable mandate; typically they are foundations or social investors that invest for a financial as well as social return. The main organizations that invest in SIBs are BSC, Bridges Ventures[8] and CAF Venturesome[9]. Organizations that invest in an SIB may be willing to accept a lower financial return than a commercial bank would. For example, their target rate of return may be around 8%, compared to around 15-16% for a commercial bank.

In the US, investment banks such as Goldman Sachs and Bank of America Merrill Lynch have invested in SIBs. In the UK, commercial investment banks have shown interest but have yet to make an investment in SIBs. To attract investment from commercial banks, investors with different risk profiles need to participate to limit the commercial investor's exposure to risk. For example, a foundation could provide a guarantee or take a first loss position; the commercial investor's exposure to risk would be limited and would be compensated by the foundation taking on a higher risk.

This structure of a philanthropic organization taking on a higher risk and providing a loan guarantee has worked in the US, exemplified by a loan guarantee provided by Bloomberg Philanthropies on Goldman Sack's investment in the Rikers Island SIB. This is attractive because it leverages money that wouldn't otherwise be available, and is a growing trend among other types of funds besides SIBs.

2) Intermediary organizations

In the UK, the biggest intermediary organization in the SIB market is Social Finance, and Triodos Bank also plays a very active role. These organizations have set up a number of SIBs and pioneered a few new models. They also got individuals to invest in SIBs for the first time and will set up a program to help individual investors to take advantage of the new SITR. Some smaller intermediaries are beginning to emerge; for example Numbers 4 Good[10] and ATQ[11].

The roles intermediary organizations play in an SIB may include program design and development, corporate finance and performance management. First, to design and develop programs, these organizations research what type of intervention should be

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8 Bridges Ventures (Retrieved March 16, 2015 from: http://www.bridgesventures.com/social-sector-funds/social-impact-bond-fund/).

9 CAF Venturesome (Retrieved March 16, 2015 from: https://www.cafonline.org/about-us/media-office/press-releases/2015/2201-social-impact-bond.aspx)

10 Numbers 4 Good (Retrieved March 16, 2015 from: http://www.numbers4good.com/)

11 ATQ (Retrieved March 16, 2015 from http://www.atqconsultants.co.uk/?p=our-services)

done, and undertake financial modelling, feasibility studies and forecast outcomes. Second, these organizations sell the proposition to investors and get investors involved. This can include setting up the Special Purpose Vehicle (SPV) to limit the financial risk. Third, for performance management, intermediary organizations monitor the progress of the intervention and report back to investors. This is a robust role because all SIBs will have performance improvement plans in place in case the targets are not being met. Then the intermediary organization in charge of performance management will work with the charities to improve the outcomes. Typically achieving targets is difficult, especially when a project is in the early stages of implementation.

Plans for the future

BSC has a three year strategy and the government updates its strategy annually. Together their goals for the future are to help grow the market and to make the social investment market mainstream. In terms of the size of market growth, there is no specific target number, but by measuring the amount of money going through intermediaries, it was estimated that the market was growing by 25% each year.

The government's broader aim of making the SIB market mainstream applies both to investors and investees; this means for those who are already investing to invest more, while also bringing in new types of investors. The government is looking at the retail investment market to determine how they can support more individuals with smaller amounts of money to make social investments. On the side of the investees they want to help small and medium charities to get involved in the market and benefit from using social investment.

St Mungo's Broadway

Introduction to St Mungo's Broadway

Formed in April 2014 by the merger of the charities St Mungo's and Broadway[12], St Mungo's Broadway's (SMB) work is focused on outreach and services for the homeless, including accommodation and outreach services. On a single night, they might have two and a half thousand people staying in their accommodations. SMB focuses its efforts on single homeless adults, rather than homeless families or children. At the heart of SMB's work is the belief that no one should be homeless. The services they provide aspire to support, challenge and enable people to live full lives by overcoming the issues that lead to homelessness[13].

Becky Rice

Homelessness in London

In London, most services for homelessness are funded by a *Homelessness Grant* from the central government. According to the level of need in their area, the Greater London Authority (GLA) commissions outreach teams from SMB and other charities to deliver services and provide accommodation. Additional funding is also available from the central government for special projects, for example from the Department of Health as well as by individual members of the public, corporate organizations and charitable trusts.

Because homelessness is a regional as well as a local problem, the GLA formed pan-London services such as London Street Rescue, assessment centers, and the Combined Homelessness and Information Network (CHAIN) Database, a multi-agency monitoring system that records contact with rough sleepers. Teams working with rough sleepers across London record information online about rough sleepers such as contact workers have with rough sleepers, stays rough sleepers have in accommodation and

[12] St Mungo's Broadway website: Our history of helping homeless people (Retrieved June 6, 2015 from: http://www.mungosbroadway.org.uk/about/history)

[13] St Mungo's Broadway website: Our ambitions (Retrieved June 6, 2015 from: http://www.mungosbroadway.org.uk/about/values_and_objectives)

how many people are seen rough sleeping.

According to information gathered on the CHAIN Database, in the last financial year, about 6,500 people were seen sleeping on the streets of London. The profiles of rough sleepers observed are diverse, with most people seen on the streets being first time rough sleepers. Three noteworthy characteristics about the profiles of rough sleepers are that; (1) 70 percent are only seen rough sleeping once and don’t have a lot of the problems with drug and alcohol abuse and mental illness associated with persistent rough sleeping; (2) Rough sleepers tend to stay in a particular geographic area; and (3) Nearly one third of rough sleepers are from Central and Eastern European countries, and they are entitled to different social benefits than other groups.

The Street Impact Social Impact Bond (Street Impact SIB)

Selection of the Street Impact SIB cohort

The original idea of the Street Impact SIB project came from the central government, and the CHAIN team became involved in the project to help identify a target cohort for the project. Information garnered from the CHAIN Database revealed that there was a group of persistent rough sleepers who persistently returned to sleeping rough despite having accessed available supports and contact services. Since there is a lack of funds to innovate with this group of persistent rough sleepers in the currently constrained economic climate, they were suitable candidates for the sort of innovative social service delivery that would be enabled by an SIB.

In 2012 the final SIB cohort was selected, comprised of 830 people who fit the following cohort parameters: seen sleeping rough or staying in a rough sleeping hostel between July and September 2012; had six or more rough sleeping contacts in their entire homelessness history; were not already receiving services from other special projects. To give a sense of the kinds of needs people in this cohort had, according to the CHAIN Database; 48% had problems with alcohol, 29% struggled with drugs problems, and 44% reported having a mental health problem. (SMB considers that the figures underestimated the accurate support needs).

A competitive tender was held, and the entire 830 person cohort was divided geographically, with SMB commissioned to work with 415 people, and Thames Reach, another service provider, in charge of the other half. Part of the reason for commissioning two different service providers was so that their approaches and subsequent results could be compared in order to test the efficacy of the SIB model.

How investors were found and their rate of return

To find investors for the Street Impact SIB scheme, GLA introduced many social investors to SMB. After explaining how they would deliver the service SMB successfully attracted investment from various organizations and a social investment bank. The project was set up so that investors could expect six percent annual return on their investment, paid quarterly, which was almost guaranteed regardless of the performance outcomes. SMB had to report current and projected future outcomes to investors each quarter, a new and challenging experience for SMB.

Advantages and disadvantages of the Street Impact SIB

Typically, service providers that work with homeless populations bid for contracts, and if their bid is successful they receive a lump sum of money upfront to deliver the service. In the case of the Street Impact SIB, SMB would only receive payments according to outcomes; if they did not meet required targets they would lose money in that particular quarter. The project was set up so that SMB were paid retrospectively, so they had to use their own money to get the project up and running.

A disadvantage of the financial structure of the Street Impact SIB was that the financial insecurity of not knowing the budget for the entire project made it difficult to put a staff team together. And since the total amount of money coming in could not be predicted, staff were hired on short term contracts.

Conversely, an advantage of the SIB structure was the flexibility of the Street Impact SIB contract, which allowed for the re-allocation of staff and resources. In a typical contract, monitoring and reporting requirements are minimal, but staff numbers and resource allocation are decided at the beginning of the contract. However, in the case of the Street Impact SIB, because of the monitoring and reporting requirements and the flexibility of the contract, staff and resources could be re-allocated and service delivery methods could be adjusted to achieve better outcomes. One example given was that SMB hired an additional staff member on a short term contract, to help meet the target of helping clients find employment. Instead of continuing with methods found to be ineffective, resources could be responsively re-allocated.

How the service was delivered and why it was unique

SMB hired a team of 10 staff and assigned 25 to 35 clients to each staff member. Each staff member works with their clients regardless of the changing circumstances. This approach allows SMB to take a more long term and focused view of their 415 clients. This contrasts with traditional outreach which tends to focus more on the quantity of clients being serviced, potentially at the expense of the most vulnerable clients with the most complex needs. The unique structure of their approach allows a greater depth of understanding and trust to develop between clients and their service providers. One potential disadvantage to this close working relationship is that the client could potentially become too dependent on their support worker.

To service the multiple and changing needs of their clients, whether to help them retain tenancy or to find employment, SMB needs to access a variety of resources and to offer attractive contracts to experienced staff with a broad skillset. SMB also has to develop relationships with other agencies in London and outside London, for example altruistic or charity affiliated agencies that provide below market rate or subsidized rental units.

Initially, SMB thought the workload would be higher during the first year, when relationships would have to be built with the clients, and during the second and third year the workload would reduce as clients successfully found accommodation and employment. However, rough sleepers' social supports are usually based on their contacts on the street; once away from that environment and placed in accommodation, they naturally gravitate back to the streets for social support. Consequently, the workload did not decrease as anticipated. And it was a much more fluid process because of the amount of work required to keep people in their accommodation and prevent them from going back onto the street.

The Street Impact SIB Contract Framework

Payment by Results (PbR)

<u>The target outcomes</u>

According to the PbR framework, meeting the set targets determines whether or not SMB will receive payment. SMB collaborated with Social Finance in order to determine what target outcomes were appropriate and what baseline figures they could expect. Targets and expected outcomes were established in different ways, including expanding or changing the criteria slightly and comparing the results between the groups. For example, they compared cohorts that had experienced five versus six rough sleeping contacts ever. Another method was to look at data from previous years of a similar

Alastair Reeves

cohort, to determine how many people were seen sleeping rough after certain time periods, or how many accident and emergency room admissions could be avoided. The baseline data collected from this SIB experience can be used to help establish more realistic baseline figures for future projects.

The target outcomes of the Street Impact SIB are: (1) Reduced number of rough sleepers found in each quarter. An individual seen rough sleeping once was counted as a rough sleeper, which SMB found to be problematic since it does not reflect real conditions; (2) Sustained tenancy in long term accommodation; clients have to stay for 12 months in an accommodation that is considered to be long term, which excludes hostels or hotels; (3) Sustained reconnection with a client's country of origin; since 30% of clients were from Eastern or Central European countries, this target could be met by connecting people with support, services and accommodation in their home country to encourage them to return and resettle there; and (4) Getting people into work, training or education.

Advantages of PbR

The flexibility of service delivery is the main advantage of the PbR structure. Traditional contracts are bound by numbers and specifications but with PbR, services could be delivered flexibly and adjusted based on the results of monitoring. Staff and resources could be allocated to different areas in order to achieve better results. The potential to make more money and longer contracts are possible benefits, but not necessarily applicable in SMB's SIB case.

Disadvantages of PbR

One disadvantage is that a PbR contract may discourage service providers from working with the most challenging or complicated clients, and priorities may be based on how to best meet targets in order to make money. This potential conflict of interest resulted in some agencies suspecting that SMB didn't prioritize the clients' best interests.

Another challenge is that the monitoring and evidence required is quite burdensome. The CHAIN team worked to develop the database so that the workers could record achievements, such as uploading tenancy agreement as evidence of sustained accommodation, or pay slips as proof of employment. They had to develop an incredibly complicated spreadsheet which took into account all the dependent factors, in order to determine which clients were eligible for payment. Also, because the client group included in the Street Impact SIB cohort tend to be mistrustful, it is often difficult to convince them to provide this kind of information.

A limitation of PbR is that it tests a mechanism for delivery, not a wider systems change since it provides a service in addition to other existing services. And although a program delivered through a PbR contract may work well for a particular cohort with a particular issue, it is unlikely that the same model could be extended to typical outreach projects and scaled up.

<u>Impression of PbR based on experiences to date</u>

SMB is a charity that deliver services to those in need based on the organization's mandate, but future SIB contracts might be awarded to private companies. The concern over private companies competing for future SIB contracts is that the quality of social service delivery would be reduced if a company was primarily motivated to participate in an SIB by profits. In order to offset the potential risk of service quality being compromised by profit seeking, there could need to be greater financial incentives to work with more difficult clients.

Also, based on SMB's experience 100% PbR was found to be too high because of the burden of risk. A mixed contract of 25% PbR for example, would create a more comfortable risk profile and enable clients who were successful in reaching targets early on to help subsidize working with the more complicated clients.

The Street Impact Special Purpose Vehicle (SPV)

Because the Street Impact SIB contact is 100% PbR, if none of the targets were met, SMB would have lost a lot of money. And as a large charity with many other projects, SMB did not want to put the health of the entire organization at risk. In order to transfer the risk involved in the PbR framework, SMB set up an SPV called Street Impact as a separate private limited company. The protection from the risk may have made it worth the high legal fees initially required to set up the SPV, but if involved in another SIB they expressed that they would reconsider the necessity of taking that step.

All shares in the Street Impact SPV were owned by SMB, meaning that the investors would not receive any of the surpluses made, but also that SMB would be the first to suffer financial losses. SMB's share capital in the Street Impact SPV is 237,000 pounds, and the investors had, at the time of the interview, invested 400,000 pounds. The investors would only start to lose money if the targets were consistently not met, and once deficits exceed the 237,000 pounds that SMB has invested in the company.

The Street Impact SIB was set up in this way because it was thought that the risk would need to be reduced in order to be more financially attractive to investors. SMB decided to invest 237,000 pounds of their own money because they were confident that their results-focused team could succeed in meeting their targets. To ensure success, they manage the contract and monitor the finances on a monthly basis. Additionally, the Street Impact SPV board monitors and forecasts results on a quarterly basis.

Regarding the flow of capital, SMB first invested some of their own unrestricted funds in the Street Impact SPV. Money from investors was also used to run the service until the GLA paid the Street Impact SPV after successful outcomes were achieved. Ultimately the money paid by the GLA would come from the central government. Investors would receive an annual return of six percent, and would get paid interest on their loan each quarter. Their investment will be repaid at the end of three years or earlier if SMB feels that they don't need to hold onto their capital any longer because of the level of surplus.

The operational advantage of setting up a separate SPV was that decisions could be made quickly and flexibly by avoiding the complicated administrative procedures of SMB. One example given was a rough sleeper from India who was successfully re-connected with his home country. In order to encourage resettlement, at the client's request members of the Street Impact team purchased a cow through a credit card transaction, which would have been difficult to quickly get approved through SMB's bureaucracy.

Monitoring and results

At the end of each quarter, the GLA representative carries out a detailed audit to verify the accuracy of the information on the CHAIN Database, and then issues payments according to that information. Because large amounts of money are in question at the end of each quarter and because the payment structure is so complicated, one member of the Street Impact Team is responsible for ensuring that the outcomes and reporting are correctly registered on the CHAIN Database.

Performance to date

The Street Impact SIB proved challenging in respects, such as meeting the targets for rough sleeping and reconnecting people with their home country, since many clients were very entrenched in the UK. However, after the government recently increased restrictions for immigrants and East European migrants to claim benefits, it became easier to reconnect people with their country of origin. SMB exceeded the targets on finding accommodation for rough sleepers, and work training and education. Looking back after two years in operation, although admittedly difficult to evidence, SMB believe that the SIB model allowed better outcomes to be achieved than if a traditional funding model was used.

Office for Public Management (OPM)

Introduction to OPM

OPM is an independent research and consulting organization that works with the public, private and nonprofit sectors to improve public service delivery. OPM was founded 25 years ago and today is fully owned by its approximately 80 employees. OPM provides a range of services, including evaluation, organizational change and people development.

Hilary Thompson

OPM's opinions about social impact bonds (SIBs) are shaped by their experiences working directly with social service providers from the nonprofit sector and private sector organizations that deliver public services.They also work directly with commissioners, including the central and local governments, and health and educational organizations. OPM worked with the UK Cabinet Office on a program designed to improve the government's commissioning practices. As part of this initiative, OPM led some of the commissioning academy's cohorts of public sector employees. The academy's six day program covered outcomes, how to commission a system, market development and funding models like SIBs[14].

SIBs and emerging trends within the impact investing market

SIBs are a form of payment by results (PbR) contract that first started in the UK in 2010 with the launch of the Peterborough recidivism SIB[15]. Generally, SIBs involve at least three distinct parties; the government or outcome payer, the service provider, and social investors who provide the working capital and initially pay the service provider.

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[14] The Commissioning Academy (Retrieved April 21, 2015 from: https://www.gov.uk/the-commissioning-academy-information)

[15] Lessons learned from the planning and early implementation of the Social Impact Bond at HMP Peterborough (Retrieved April 21, 2015 from: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/217375/social-impact-bond-hmp-peterborough.pdf)

The difference between an SIB and a conventional PbR model is that the investment risk falls onto social investors, not the government or service provider. In an SIB model, the government or commissioner will pay the investors depending on the level of success achieved by service providers in meeting the set outcomes. Because investors risk not getting paid if target outcomes are not met, there must be a degree of certainty that the service provider can meet or exceed the pre-determined outcomes.

SIBs started slowly and were not well-known or understood, but SIBs seem to be evolving as they proliferate and many new forms are being introduced into the social investment market. Globally, there are 26 projects that self-identify as an SIB (at the time of the interview), and at least another 100 are in the development phase. The basic framework of an SIB still applies, but different types and variations are emerging.

In the UK for example, the first wave of SIBs were all commissioner led; the social need was identified by the commissioner who designed the SIB with specialist support, and then service providers bid on the SIB contract to deliver the service. Recently, service provider led models have been emerging, where service providers themselves offer their service through an SIB in the social investment market. Action for Children is leading provider driven SIBs in the UK market. Initially Action for Children entered the SIB market in response to a commissioner led bond, but they went on to launch a provider led bond in June 2014[16].

There are also differences emerging with regards to the internal structure and management of SIBs, for example direct SIBs, intermediated SIBs, and managed SIBs. Based on an analysis of the contract management arrangement of 21 SIBs in operation in October 2014, around one third were direct, one quarter were managed, and the remainder were intermediated SIBs. There is overlap between the categories, and some structures shift after the launch to respond to additional support needs, but the primary distinctions between the SIB structures are the parties involved, their responsibilities and relationship to one another[17]. Direct SIBs have one service provider that self-manages performance, and the majority of activities are carried out by the three core parties: the outcome payer, investors, and service providers[18]. Intermediated SIBs have support from a fourth party, an investor-owned special purpose vehicle (SPV), that

[16] Action for Children (Retrieved April 28, 2015 from: http://www.actionforchildren.org.uk/news/archive/2014/june/first-social-impact-bond)

[17] Choosing Social Impact Bonds, A Practitioner's Guide (Retrieved June 3, 2015 from: http://www.bridgesventures.com/wp-content/uploads/2014/10/ChoosingSocialImpactBonds_APractitionersGuide.pdf)

[18] Choosing Social Impact Bonds, A Practitioner's Guide (Retrieved June 3, 2015 from: http://www.bridgesventures.com/wp-content/uploads/2014/10/ChoosingSocialImpactBonds_APractitionersGuide.pdf)

contracts service provider(s), commissions performance measurement, and provides support such as refining the financial model during the development phase[19]. Managed SIBs also have a fourth party, often an intermediary or prime contractor-owned SPV, that contracts service provider(s), undertakes performance management and takes a lead role in managing the SIB, usually from development though to execution[20].

As SIBs proliferate globally, interesting differences between countries are emerging. A big area of difference can be observed between the focus of SIBs in the US and Europe. In the US, the focus has been to scale up proven interventions, especially those validated by a randomized controlled trial. Proponents of SIBs in the US want projects at scale with low transaction costs, and to develop SIBs as a recognizable financial product that can be easily sold on the market. SIBs in the US have also evolved to include tiers of different levels of funding and risk taking from investors. By setting up different modes of investing and risk profiles within an SIB, a greater number and diversity of investors may be attracted to the SIB market. In the UK, there is currently not the same kind of differentiated risk profiles, but OPM reported that social investors had expressed interest in further exploring this model.

In the UK and Europe interventions with very little evidence base have been financed through SIBs; which involves more risk taking for the investor, but supports the testing of new programs and ideas. Some SIBs have scaled up proven interventions, but there are a lot that test new, unproven innovations, or have been proven in the US but not in the UK or Europe. In the Essex SIB for example, the Multi Systemic Therapy (MST) to be delivered through the SIB was subjected to 16 randomized controlled trials, but 15 were from the US, and only one was from the UK. In this case, there may have been sufficient evidence of outcome size effectiveness but the implementation risk in the UK was not reflected.

But the observations about SIBs expressed by OPM were just a snapshot of the current situation, and SIBs are evolving quickly as more are implemented globally. SIBs are evolving to involve types led by providers outside the nonprofit sector, and already there are SIBs based on interventions with little evidence base or non-randomized controlled trials evidence.

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[19] Choosing Social Impact Bonds, A Practitioner's Guide (Retrieved June 3, 2015 from: http://www.bridgesventures.com/wp-content/uploads/2014/10/ChoosingSocialImpactBonds_APractitionersGuide.pdf)

[20] Choosing Social Impact Bonds, A Practitioner's Guide (Retrieved June 3, 2015 from: http://www.bridgesventures.com/wp-content/uploads/2014/10/ChoosingSocialImpactBonds_APractitionersGuide.pdf)

And as more SIBs are implemented, transaction costs of setting up new SIBs can be reduced by using preexisting resources such as databases or legal structures. OPM has observed that with a lot of the new SIBs that are provider led, services are being designed to include all of the required components, including the database and legal structure. This is attractive for commissioners who can purchase a complete service package from service providers via an SIB.

Dr. Chih Hoong Sin

Analysis of SIBs from the perspective of different stakeholders

Government or commissioner

In the context of spending cuts, budget tightening and diminishing financial resources, SIBs have been seen by governments as a way of funding social programs, while shifting the financial risk onto outside investors. But for an SIB to work as intended and provide innovative new solutions to social problems, the governments need to be able to relinquish control. OPM has found that the government often steps in to ask the service providers to make changes. This reluctance to let go of control indicates that a fundamental culture change in the way the government works, plans and commissions services is required if PbR schemes, such as SIB, are to succeed.

The proliferation of SIBs will also influence governments and commissioners to really understand their data and develop analytical systems and processes that allow them to identify and use the data effectively. This is true for any commissioning organization, but is particularly important when different organizations come together; as was exemplified by the Peninsula LIST (Local Integrated Services Trust) SIB. In this case, each commissioner had to overcome internal processing difficulties, and linking data across the four different commissioning bodies also proved to be a challenge.

Social investor

From the evidence gathered by OPM, a lot of investors are motivated to explore ways they can make investments that align with their personal values. Bank of America Merrill Lynch for example, told Dr. Chih Hoong Sin that they had moved into the SIB market because they thought it would be a good business proposition after the results of an annual client survey revealed a growing interest in social investments.

SIBs had typically been initiated by interested governments and philanthropic organizations, but now the market has developed to a stage where different and new types of social investors are moving into the market. Early investment behavior in SIBs resembled the hands-on approach seen in venture capital investments, but as the market matures, especially in the US, SIBs will evolve to become more of a recognizable financial product to be traded; with lower risk and decreased transaction costs. SIBs will continue to offer investors a blended return with different proportions of financial returns and social impacts. OPM sees the market developing in a way that offers a broad range of SIB models; some SIBs may involve higher risk taking with more emphasis on social outcomes at the risk of financial returns, whereas others may target low risk-taking investors. The next step in developing and growing the SIB market is understanding the different kinds of social investors and their motivations.

Intermediaries

Intermediaries provide support to an SIB; which may include consultants and evaluators, legal or HR experts. It is beneficial for SIB development if intermediaries come from diverse backgrounds and work together collectively, so that synergies are created that allow problems to be looked at in different ways so that creative and innovative approaches can be envisioned.

Service provider

Service providers can benefit from SIBs because the focus on outcomes and lack of prescribed process will, in theory, foster innovation and the testing of new service models, unlike traditional government commissioned services where service providers are contracted to provide a particular service according to predetermined methods. Also, the financial structure of an SIB allows resources to be deployed flexibly, and is not tied to the annual government spending cycle. And since allocated funds do not have to be spent according to a set time frame or line item budget, resources can be deployed flexibly and responsively in order to achieve desired outcomes.

Another benefit of SIBs for service providers is the stability of long term funding. Service providers often work under yearly or short term contracts. SIBs are usually for longer term interventions, for example the Essex SIB will be delivered over five years and tracked over eight years.

In theory, service providers do not take on the risk, which is born by the investor. But that distinction is becoming more complicated as service providers are also becoming investors, as is the case with the St Mungo’s Broadway SIB. In some cases service providers will waive part of the right of payment in order to invest in the SIB; thereby demonstrating their confidence in their services to other investors, and also allowing the opportunity to receiving a higher financial return if they successfully achieve the target outcomes.

The outcome measurement data requirements may result in wholesale organizational change for the service providers who deliver services through an SIB. In the past, service providers may not have had an organizational wide approach to evaluation and impact measurement; monitoring for impact if a commissioner requested it, but not doing any if it was not requested. While the evaluation and impact measurement requirements may create a burden at first, once systems and databases are developed they can be applied across the whole organization. This will improve not only the organization’s services, but the social service industry as a whole.

To date, it has tended to be big national charities with very recognizable brands that have benefitted from SIBs. And once in the market, it is easier to increase one’s share, thereby excluding smaller charities and service providers, who have complained that they are not being given equal opportunities. Thus, the chance for participation is not equal across the social sector. While some opportunities for nonprofits and social enterprises may result, participation may be limited to about 10 major players in the UK, such as Action for Children and St Mungo’s Broadway. As SIBs evolve and proliferate, the challenge moving forward will be to develop the market to allow entry by service providers of differing sizes and types.

Also, there may be an inbuilt bias in terms of what interventions are procured, since SIBs favor evidence based interventions. Newer interventions without a long track record and evidence base may not be appropriate to contract through SIB models, thus stifling the innovation that SIBs are supposed to enable.

Members of the public and service users

The benefit of SIBs for service users is that SIBs bring new sources of funding for services that would not otherwise be provided due to the tightening of government budgets. Also, services that are already funded can be scaled up, so that the positive impacts can reach more people.

The Essex and Peninsula LIST SIBs

Essex County Council SIB

The Essex SIB involves the commissioning of a service called Multi Systemic Therapy (MST), a licensed program from the US that is designed to prevent children from going into care by providing support to the whole family so that families can stay together in a healthy environment[21]. The Essex SIB had been running for more than one year and attracts a lot of attention because it was the UK's second SIB. Although OPM was not involved in the project's development, according to Dr. Chih Hoong Sin the planning and development phase of the Essex SIB took 23 months and cost about 300,000 pounds. The lengthy time and high set up costs can be attributed to the Essex case being the second SIB in the UK after the Peterborough recidivism SIB, and the first in the world outside the corrections system; but not every SIB should be expected to that much time and money to set up.

Peninsula Local Integrated Services Trust (LIST)

Peninsula LIST is a Special Purpose Vehicle (SPV) that was set up by four local authorities in the southwest of England; Torbay, Devon, Plymouth and Cornwall; who wanted to have a unified approach to tackle the issue of children going into care. The specific service the four local authorities are looking to provide is Functional Families Therapy (FFT). The LIST SIB is still in the development phase.

Peninsula LIST is the only case in the UK where the commissioners set up the SPV. The original commissioners, the four local authorities, set up the SPV to allow inclusion of other commissioners over time; for example the National Health Service, police or fire service. The Peninsula LIST SPV was initially set up as a nonprofit to allow people to come together in different ways, and to allow the flexibility of changing over time, potentially evolving into more of an investment trust, or generating surpluses.

[21] Essex County Council: Children at risk of going into care (Retrieved April 21, 2015 from: http://data.gov.uk/sib_knowledge_box/essex-county-council-children-risk-going-care)

Lessons learned from evaluation of the Essex and Peninsula LIST SIBs

Consider the implementation challenges in advance

OPM found that with the first wave of SIBs in the UK, most of the focus was on correctly developing the financial instrument. This included determining the form of the financial instrument, payment metrics, and price for social outcomes and measurement that supported the pricing mechanism. In every case, commissioners brought in external experts to provide advice and support, especially in terms of doing financial modelling, understanding the outcome size and designing the payment schedule.

All of the first wave of SIBs in the UK had a very long planning and lead in time, for example Essex took 23 months and Peterborough took 18 months, which was spent largely on developing an appropriate financial instrument. But with the focus largely on finances, little attention was paid to the actual service implementation context and how broader organizational or systems change would be achieved. Because implementation challenges had not been considered in advance, all of the first wave SIBs encountered implementation delays. This may have resulted from the first wave of SIBs all having had very senior people playing strategic roles, who evidently lacked understanding of the implementation context. But for an SIB to succeed, the whole system needs to be understood and all stakeholders consulted, including front line professionals, the public, potential service users and partner agencies. A lesson learned is that besides planning for the financial and contractual terms, the service context and implementation challenges must be clearly understood.

Design outcomes in consultation with front line workers and service users

In commissioner led SIBs, the commissioner has defined the social outcomes, which have largely been associated with cost savings. So far, SIBs have not defined outcomes from the perspective of the service user or beneficiary. The concerns and perspectives of front line workers must also be considered in order for SIBs to succeed. For example in the Essex SIB, the referral pathway did not work as planned because front line social workers decided that they were not going to refer to MST for fear that they might lose their jobs if the therapy succeeded. Another reason the referral pathway failed was because partner agencies lacked understanding of the service and had their own assumptions about what it was. Besides service workers, service users can be resistant to the idea of private companies or investors providing public services for profit through SIBs.

These lessons have been incorporated into the development stage of the Peninsula LIST SIB, and a lot more effort is being made to engage front line workers to hear their perspectives about how the SIB will work and what some of the challenges might be. Moving forward, communication with partner agencies, front line workers and service users will improve the outcomes of SIBs in the future.

Consider the true cost savings and invisible costs when designing the financial model

Financial considerations observed to require further consideration moving forward are cost savings and invisible costs. The first wave of SIBs revealed that if the set up costs are disproportionately high compared to savings, then it is not advisable to set up an SIB. The scale or reach of the intervention and number of service users may be linked, but are not directly proportional to the cost savings. For example, providing a targeted intervention for a small number of service users who represent a large cost to the system can result in massive savings.

Considering the invisible costs was another lesson learned from the first wave of SIBs in the UK and internationally. OPM found that invisible costs were incurred by the service providers, social investors and commissioner that resulted from a lack of understanding of the scale and complexity of the service. As a result, additional time and money had to be spent voluntarily by the service providers, investors and commissioner, in order to mitigate the unanticipated costs.

Currently social investors in the UK and internationally have behaved like venture capitalists and taken a hands-on approach. But what was observed in the Essex SIB, was that out of the approximately eight total investors, two were a lot more active than the others. As a result, the active investors incurred more of the invisible costs, but the improved outcomes that resulted from their efforts would be received equally by all investors. This system did not represent a fair return on investment for the two active investors. In future SIBs, this disparity would be amended by including clarified transactional costs in the financial model from the outset. As part of OPM's three year evaluation of the Essex SIB, a lot of work will be done to clearly identify the different types of invisible costs and to assign a monetary value to them. Investors are particularly interested in having a clear understanding of the true costs.

By working collaboratively, impact measurement, and data collection and management processes can be improved

Regarding data collection, OPM observed an inherent tension being created, where SIBs create opportunities but impose demands that the social sector might struggle to cope with, due to a lack of impact measurement skills. OPM also observed that commissioners, investors, service providers and partner agencies are not working together to define the outcomes and decide on the best way to measure. By focusing on outcomes, having a degree of certainty about measurement processes and working collaboratively, all parties would be pushed to clarify their processes, resulting in a greater degree of foresight about the data collection and measurement tools required to determine the expected outcome.

Since the payment schedule of an SIB is tied to outcomes, clear and robust impact measurement is required. And because of the huge amount of data generated though SIBs, data management was observed to be a challenge. In the Essex SIB for example, data was collected and distributed indiscriminately to everyone in the first nine months. But collecting, sending, interpreting and making decisions based on all of the data was burdensome. To avoid such data overload, the channels for the flow of information should be clearly mapped out to define the purpose, data type and intended recipient of the collected data.

Nesta

Introduction to Nesta

Nesta was established in 1997 with 350 million pounds in funding from the National Lottery. By fostering innovation, Nesta's 150 employees work to improve the lives of citizens in the UK and increasingly internationally. Nesta's three core functions include; policy and research to assist governments make informed policy decisions; an innovation lab that provides early stage investment to help people build prototypes and test innovations; and an investment team that invests in venture capital businesses such as young technology companies, and also a social investment team.

Joe Ludlow

Nesta's social investments are similar to venture capital but prioritize achieving a positive social impact, followed by a financial return. Nesta had always been involved in venture capital, but moved into the social investment market by conducting research and supporting organizations to help scale up projects and develop the market. Nesta also publishes their research and methods, which helps with marketing and securing new investments, but also shapes the wider system of social investment.

In 2008, Nesta started investigating how social enterprises could play an important role in delivering public services. The government in the UK for the previous 30 years had been increasingly outsourcing public service delivery, and Nesta saw a market opportunity for social enterprises and started investing in them. Following the election in 2010, drawing on their previous work in investment funds, Nesta helped the government set up Big Society Capital (BSC). In 2011, Nesta began providing consultancy to help social enterprises grow, started researching to understand what the total social investment market in the UK might be, and encouraging individuals to start making social investments. Nesta decided to launch their own social investment fund in 2012.

Nesta's impact investments

Nesta's Impact Investment fund is managed by a separate fund management company, and is invested in not only by Nesta, but also BSC and the Omidyar Network[22]. The fund is made up of a total of 17 million pounds, of which 4.3 million pounds have been used to fund seven investments. Nesta hopes to make 15 or 16 investments in total. From a finance perspective, the fund works much like standard venture capital; investing small amounts of money in young early stage organizations and putting in more money as they achieve success. The average venture capital investment is seven years in the UK. Nesta expects to work with the organization for five to seven years, but the fund has a minimum life of eight years and can be extended to a maximum of 12 years[23].

The fund's target rate of return is 5% compounded, after the cost of running the fund. The underlying investments is somewhere between 25-35% because it is high risk investing where half of investments are expected to fail. There is a minimum rate of return that Nesta must believe their investment can meet, but the scale of impact is more highly valued. In other words, Nesta would favor high impact with lower financial return over low impact with a high financial return.

Nesta's original idea was to bring together their venture capital, social investment and research and evaluation experience to fund innovations and the development of technology that would solve social and environmental problems, and to bring the benefits of that innovation to everyone in society. Some examples of investments Nesta has made in technological innovations for social benefit include fighting social isolation of older people, improving education, and providing financial services to underbanked people.

Social isolation of older people

Despite technology enabling this generation to be the most socially connected in history, there is a huge problem in the UK of older people living alone and lacking opportunities for social contact. Two investments created to address the social isolation of older people include:

- **Oomph! Wellness** provides health and wellness group-based classes for over 65 year olds, to improve mobility and provide opportunities for social interaction and mental stimulation. Examples of programs offered include chair

[22] Omidyar Network (Retrieved April 23, 2015 from: https://www.omidyar.com/)
[23] Nesta Impact Investments (Retrieved April 23, 2015 from: https://nestainvestments.org.uk/)

cheerleading and chair aerobics. An important feature of OOMPH! Wellness is the research and measurement tools used to track and map health and wellbeing outcomes. The measured results, methods and experiences can then be more clearly understood and shared with other individuals and organizations who work with older adults[24].

- **Casserole** is a network that matches people who are willing to share extra portions of their home-cooked meals with people who are not always able to cook for themselves[25].

Education

In the same way that personal data is collected and used for marketing and by retailers to predict buying habits, education in the UK can be reformed from the current system where teachers broadcast lessons to passive students, to where teaching methods and tools can be personalized to suit the needs of each individual student. Three educational technologies Nesta has invested in include:

- **AI Media** offers technology based solutions to improve communication between teachers, students, parents and principles in the classroom. Some examples of their work include; learning materials particularly useful for those impacted by deafness, autism, auditory processing disorders and learning difficulties; transcripts for parents to understand classroom content; and tools for the professional development of teachers[26].

- **Cog Books** uses adaptive learning technology to personalize students' learning experience by anticipating what a child should learn next[27].

- **Digital Assess** uses various technological tools to improve the accuracy and reliability of assessment and marking of students' work[28].

- **Movellas** is an online community that strives to improve literacy by

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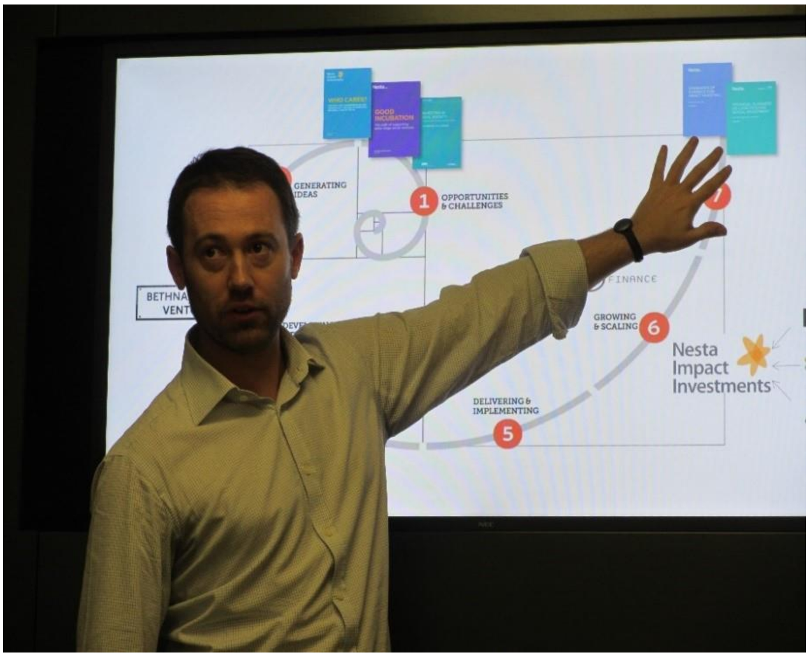
[24] Oomph! Wellness (Retrieved April 22, 2015 from: http://www.oomph-wellness.org/)
[25] Casserole (Retrieved April 23, 2015 from: https://www.casseroleclub.com/)
[26] AI Media (Retrieved April 23, 2015 from: http://www.ai-media.tv/schools/)
[27] CogBooks (Retrieved April 23, 2015 from: http://www.cogbooks.com/)
[28] Digital Assess (Retrieved April 23, 2015 from: http://www.digitalassess.com/)

encouraging teenagers to read and write for pleasure[29].

Alternative to banking

There are eight million people in the UK who are "under banked", meaning that they don't have a bank account or don't use banks because they don't trust them. Under banked people are usually the poorest in society, and pay more for everything by using only cash. To work with under banked people, Nesta invested in and set up Ffrees.

- **Ffrees** helps under banked people set up an account and learn to budget. There are a total of 17 million pounds in the fund, and 4.3 million pounds have been allocated to seven different investments. The fund has a minimum life of five to seven years to allow young early stage projects to be tested, but it may be extend to 12 years if the project proves successful[30].



Joe Ludlow's presentation

Nesta's investment approach

Nesta's approach to investing starts with doing research to understand the social issues they intend to address with their investment. Next, they identify the types of innovations that may be effective by assessing existing evidence on what has worked in the past. Nesta then look for organizations, social enterprises, and unusually private

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[29] Movellas (Retrieved April 23, 2015 from: http://www.movellas.com/)
[30] Ffrees (Retrieved April 23, 2015 from: https://www.ffrees.co.uk/)

companies that can deliver the methods proven to be effective, or help projects that are currently part of the state to become independent. Nesta also receives a high volume of inquiries, so they maintain a database that helps them choose investees. Nesta looks for potential investees who demonstrate the following six prerequisite criteria; outcome focused, innovative, evidence based, inclusive and for public benefit, financially sustainable, and has a strong management team.

Nesta works with entrepreneurs to develop business plans that go beyond the status quo to include a focus on making a positive and inclusive social impact. In order to provide advice, support, monitoring and oversight, Nesta often joins the board of directors of the company they have invested in. Sometimes Nesta makes a loan so that they can have additional controls in the terms of the contract. Nesta's decision to make a loan to an organization is influenced by; the business model of the organization; its stage of development, such as whether it is an early company or in a stage of profit; the market the business operates in; and whether a prospective buyer for the organization could be found. The probability of an organization being sold ultimately depends on the ambition of the management team, since in some cases they may want to sell the company themselves after a set period of time, whereas others may be horrified by the thought of selling the organization. Nesta has not yet sold one of its investments, but when they do, their long term challenge will be to sell to companies who value the social impact as well as the financial return.

Nesta co-invests with venture capitalists, charitable foundations, wealthy individual investors, and in some cases the local government. Nesta has found that it is important to build a syndicate of investors in case contingencies need to be mediated, or so that successful projects can be scaled up. The challenge is to make sure that everyone shares the same intentions for the business, which must include a financial return as well as a social impact. Because if the project encounters problems, goals may diverge and management may not abide by contractual obligations. Rather than focusing on completing a transaction through the terms of a contract, Nesta has found that building relationships with management and ensuring goals are shared are more important than the actual terms of the contract.

Impact evaluation: Standards of Evidence

Central to any investment Nesta makes is the focus on impact, so they consider it before and after investing. Nesta thinks of impact in terms of the effect the service has on people's lives, the proof of that impact in terms of measurement against standards of evidence, the scale or number of people who are impacted, and the financial sustainability of the project.

To assess the impact of their investment, Nesta makes an assessment before they invest, regularly re-assess to see if there are notable changes, and the sum of impacts against each of the four benchmarks determines the overall impact of Nesta's fund. Investors set targets for the fund which include financial return as well as social impact. Nesta actively ensures financial and social targets are successfully met, by providing support from the investment team and from Nesta's other organizational resources.

To facilitate the goal of ensuring financial sustainability and positive impact of investments, Nesta created the Standards of Evidence[31] which were described as follows:

- Level 1: Low scale ventures with little evidence base but a logical arguament about how they will create a social impact. These are the ventures in which Nesta prefers to invest.
- Level 2: Projects have a higher evidence base, such as administering questionaires before and after implementatoin to assess the impact.
- Level 3: Some causation is evidenced, for example through the use of a control group.
- Level 4: An independently performed evaluation has been conducted.
- Level 5: The evaluation has been replicated at several different locations with different people.

Ideally, there would be a smooth scale of evidence, for example as the scale of a project increases, the level of the Standards of Evidence would increase. In reality, the standards of evidence vary based on the project; for example evidence standards are high for health care related ventures and low for education. Mr. Ludlow explained that this low standard for education may stem from teaching being viewed as a craft skill, with individual teachers left alone in the classroom. Another possible reason given was the weak link between teachers and reserachers. Under the last government investment in technology for education was high, with strong commercial incentives for tech companies to sell to schools. This created a market for the sale of products, but little ability to understand whether education improved. This example highlights the

[31] Standards of Evidence: An Approach that Balances the need for Evidence with Innovation (Retrieved April 22, 2015 from: http://www.nesta.org.uk/sites/default/files/standards_of_evidence.pdf)

importance of evidence based impact measurement, in order to allocate resources effectively.

To illustrate the application of the Standards of Evidence, when Nesta first invested in Ffrees, the company was at Level 1, the bottom level, since they had never done any evaluations before. In the first year regular surveys were carried out to determine how using the program's services influenced customer's habits. Now customer results are being compared to the national standard to understand the impact of the program, raising Ffrees to Level 3 according to the Standards of Evidence.

Another example is the evaluation of the Oomph! Wellness program. Oomph! Wellness had never done evaluation work before, so a standard questionnaire was carried out about the quality of life of older people in order to show how using the Oomph! Wellness program was improving their lives. Now Nesta is developing a randomized controlled trial to isolate the effect of the program, since using control and target groups is a more accurate method to evaluate results, rather than using the national average.

Evaluation is a key part of Nesta's investment process, and getting clients to continue to conduct evaluations is a struggle for Nesta. One potential reason given is that clients might be so passionate about their work that they believe they are making an impact and don't think an evaluation is necessary. Also, evaluation is often discontinued when conditions become financially difficult.

Social impact bonds (SIBs)

Nesta has not yet invested in an SIB, but has been looking at two potential projects. The concept of the government paying for outcomes or improvements in people's lives may open up new markets, opportunities and approaches to delivering social services, and could be useful as a source of funding for B Corps or charities, but Nesta is skeptical as to whether or not more innovation and better outcomes really result from the implementaon of an SIB.

Nesta currently prefers to invest in social enterprises directly, to overcome the limitation of an SIB contract being financed as an isolated package. In an SIB contract, all of the investor's risks and returns are concentrated in one SIB contract. But since a social enterprise may have many contracts, the risk would be spread across different contracts if a social enterprise was invested in directly. Also, even if the intervention doesn't succeed the first time, lessons leaned from the the first experience could be applied to additional attempts; and after having paid for the first attempt, an investor should be able to benefit from the success of subsequent attempts.

SIB schemes may provide the opportunity for the social sector to add value to the delivery of public services, but government outsourcing remains controvercial in the UK. One negative perspective is that SIBs are a way for the government to renege on their financial responsibility to provide social services. However, if social services were outsourced to the social sector or social enterprises instead of the private sector, the public might find this practice less controvercial. Also, SIBs are often touted as encouraging innovation and better outcomes, since government outsourcing may leverage specialized knowledge and expertise in the private and nonprofit sectors that may be lacking in the public sector. This idea would be supported by those that hold the view that the government should be the comissioner, not the provider of services, and that skills lost in the public sector would be compensated by capacity being built to comission services and outcomes. Lastly, outsourcing would allow finance to be attracted without increasing public debt.

Conclusion

There is a misconception in the world that impact investing equals SIBs. But there is a much larger market in which an SIB is a peripheral vehicle, and opportunities in the broader market of impact investing, including social enterprises, may be overlooked as a consequence of this narrow perspective. Nesta's approach is to assess social issues, research potential interventions, and assess whether a social service could be delivered as a venture on the market.

Despite the controversy over the outsourcing of public servies, there is a significant market potential created by the government buying services from the private, nonprofit and social enterprise sectors. As Mr. Ludlow stated "Health care, education, care of elderly people; these are not only huge issues, but huge markets" which offer opportunities in the social investment market for a range of organizations. Keeping an open mind about the investment instrument and type of organization used to address social issues will be the most effective way to invest for greater social impact.

New Philanthropy Capital (NPC)

Introduction to NPC

For over ten years, NPC has been providing consulting services, research and support on a range of social issues. Services they offer include developing tools for impact and well-being measurement, leading training sessions, and providing advice and support regarding grant-making and social investment. Their clients include charities and social enterprises, companies, individual families, trusts and foundations, professional advisors and the government[32].

Tris Lumley

To NPC, it is important to analyze new approaches like social investment and social impact bonds (SIBs) in order to be clear about what is really valuable and to be able to recognize and implement effective new ways of delivering services. Impact investment and impact measurement can be important tools used by the government, private sector and nonprofits to improve their practices by focusing on achieving measurable outcomes and improving the efficacy and efficiency of social service provision.

The social investment market: the roles of the government and private sector

Role of the government

In the UK, governments are interested in social investing because new approaches are needed to tackle social needs which cannot be sufficiently met due to budget limitations. And despite the commitment to change by some members of the government, a larger cultural change program is still needed to get the public sector more focused on delivering positive social impacts to their constituents.

In order to catalyze a larger cultural change within public, private and nonprofit sectors, in 2012 the UK government introduced the Public Services (Social Value) Act.

[32] New Philanthropy Capital (Retrieved June 11, 2015 from: http://www.thinknpc.org/our-work/our-services/)

It is an act that requires economic, social and environmental benefits to be considered by public authorities when commissioning public services contracts[33]. The impact of the Act is currently being studied by Social Enterprise UK[34], local government established social value task forces[35], and the government itself is doing a review. Although it may be too early to tell, the results observed suggest that progressive government agencies have used the Act to support and improve current practices; but agencies without socially progressive approaches have not implemented any new commissioning methods.

One potential reason that the Public Services (Social Value) Act may not be having a bigger impact is that although the government aspires to create social value, the reality of limited budgets causes cost savings to become the main consideration when procuring public services. The Act could also be more impactful if nonprofits and social enterprises took a proposition to the government which clearly outlined how they could deliver services with additional social value.

Role of the private sector

Although it cannot substitute the nonprofit sector, which exists because of market failure, the private sector can play an important role in tackling social problems through social investments and SIBs. For example in Japan, the government and local authorities are struggling to meet the service needs of the aging population, in part due to budget restrictions. Private capital, leveraged through social investing, can be one way to fill the service gaps that the current government and nonprofit sectors are finding difficult to fill. But for the private sector to be encouraged to participate in social investments, it has to be financially sensible. If citizens have the expectation that businesses should have a wider social role, then there is a business case to be made in support of social investments.

Impact measurement

NPC's areas of interest include nonprofit management, social enterprise, and impact measurement. Mr. Lumley co-chairs an organization called Social Value International,

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[33] Public Services (Social Value) Act 2012 (Retrieved April 23, 2015 from: http://www.legislation.gov.uk/ukpga/2012/3/pdfs/ukpga_20120003_en.pdf)

[34] The Social Value Guide (Retrieved April 23, 2015 from: http://www.socialenterprise.org.uk/uploads/files/2012/12/social_value_guide.pdf)

[35] Liverpool creates social value taskforce to enforce Act (Retrieved June 11, 2015 from: http://www.civilsociety.co.uk/finance/news/content/14640/liverpool_creates_social_value_taskforce_to_enforce_act), Durham Social Value Taskforce Report (Retrieved June 11, 2015 from: http://democracy.durham.gov.uk/documents/s41424/Durham%20Social%20Value%20Taskforce.pdf)

which was formed from the merger of the SROI Network and Social Impact Analysts Association[36]. There are many different approaches to impact measurement, but at their core they use the same basic steps and principles. To measure social impact, NPC developed the four pillar approach: (1) Map your theory of change, (2) Prioritize what you measure, (3) Choose your level of evidence, and (4) Select your sources and tools[37].

Impact measurement can be beneficial for nonprofits because it may help them to attract investment, but it can also be beneficial to investors. For NPC, the main aim of impact measurement should be to increase impact. Nonprofits could use measurement to get a more realistic picture of their impact and to help them improve their services. Additionally, impact measurement data can be used by nonprofits to build their evidence base to strengthen funding proposals and contract bids to investors and commissioners. For investors and funders, impact measurement can be used to help focus funding to achieve maximum impact. NPC's research and experience indicate that impact measurement is mainly being used on the funding side, and not enough by the nonprofit sector to learn and improve.

Interview at the NPC office

[36] The SROI Network (Retrieved April 23, 2015 from: http://www.thesroinetwork.org/home/social-value-international-uk)
[37] NPC's Four Pillar Approach (Retrieved April 23, 2015 from: http://www.thinknpc.org/publications/npcs-four-pillar-approach/)

NPC considers shared measurement to be an important initiative that would improve the social sector as a whole. Currently improvements are restricted because each organization measures impact in its own way, so the results cannot be compared. One barrier to getting the EU nonprofit sector to adopt shared measurement practices is the pressure on individual organizations to highlight their uniqueness. There is the perception that if an organization measures impact in its own way it can show how effective it is. The ongoing challenge NPC strives to overcome is to reassure nonprofits that they can measure in the same way while still retaining their own unique approach. If a standardized method of measurement was used, results could be more easily compared and best practices could be developed and adopted across the nonprofit sector.

Social Return on Investment (SROI)

SROI is occasionally used to measure impact in Japan, but its use has been the subject of controversy in the UK. According to Mr. Lumley, the controversy is not surrounding the principles of SROI, but the financial ratio used in SROI because the financial ratio means different things to different people. According to the SROI methodology, the financial ratio is supposed to represent the value of an organization's work to its stakeholders. But because the impact created may not always amount to money saved, there is confusion about how to assign a financial value to the impact or outcome.

Assigning a financial value requires robust data on the inputs, outputs and impacts. Qualitative research, such as case studies and anecdotes, can be used to build quantitative outcome measurement data on which financial data can be based. Also, cost savings or effectiveness can be measured by using known values, such as the cost of programs. Ultimately, the financial valuation is only as strong as the quantitative data on which it is based.

SROI could be improved if outcome indices and financial proxies were standardized in order to create a frame of comparison. The G8 taskforce met in Rome from October 28th to 29th to discuss, amongst other things, an international plan to work with Big Society Capital to map outcomes from the top down by creating standards to improve the comparability of results. But to create an accepted measurement framework, a consensus must be reached among organizations themselves by testing and improving methods of measurement from the bottom up. To create the Impact Measurement Guidelines[38], the task force used a low standard as a starting point to welcome wider

[38] Measuring Impact: Guidelines for Good Impact Practice (Retrieved April 23, 2015 from:

participation. Once well established the standard can gradually be raised.

Improving the efficacy of impact measurement

In the private sector, when customers are willing to pay for a product or service the business succeeds. But in the social service sector, nonprofits typically provide service to their beneficiaries, but the services are paid for by someone else. This separation of payment and impact can be addressed through developing a more robust theoretical basis to drive measurement practices. The problematic nature of the separation between payment and impact is exemplified by the current application of SROI; where reporting and results using SROI are used by investors, local authorities or funders, or as self-improvement tools for nonprofits, but are not used by beneficiaries. Also, research usually focuses on the government and funder side, but the theoretical background surrounding the beneficiary side of impact measurement is less developed.

To address this challenge, NPC has been looking at some positive examples from the US, where the voice of the beneficiary is being taken into account. NPC is also exploring the concept of a market research panel made up of beneficiaries, to allow their feedback to be communicated to organizations. Besides the financial ratio, which may abstract the meaning by assigning monetary value to people's experiences, anecdotal evidence can effectively convey what beneficiaries feel is really important. Impact measurement can only be effective when all stakeholders; investors, service providers and beneficiaries; can communicate what is really important to them and when outcomes are compared against those preferences.

http://www.thegiin.org/binary-data/GIIN_impact_measurement_guidelines.pdf)

INPMS Research Report No. 29
2014 UK Study Tour Report

Social Impact Investments, Social Impact Bonds and Impact Measurement in the United Kingdom: Lessons for Japan

 | ISSN 1883-6755 | July 2015

The Institute of Nonprofit and Public Management Studies (INPMS)