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Social Impact Bonds: New financing for the NFP sector?

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Executive Summary

Social Impact Bonds (SIBs) are currently attracting significant attention across Australia, the United Kingdom, the United States, and Canada. SIBs promise to unlock new income streams for social programs and social services in the context of rising demand and limited government revenue. It is no surprise therefore that SIBs are attracting interest and enthusiasm around the world. As discussed in this Information Paper SIBs originate in the UK where there is an established tradition of payment-by-results funding. SIBs are one version of payment-by-results funding for social programs that promise to transfer financial risk from government to investors.

SIBs are still very much in the trial stage. There is, as yet, no evidence of their ability to realise the hopes that they presently carry for governments. Indeed, in response to the untested enthusiasm some proponents of the concept of SIBs have suggested caution in the hopes we carry for SIBs (Mulgan *et al* 2011: 4-5).

In the absence of any clear and concrete evidence of whether SIBs can deliver on their promise, this paper provides a review of SIBs drawn from a sample of the available literature from Australia, the UK and the USA. The paper sets out an overview of the SIB concept, outlines its development in Australia to date, and offers some discussion of the potential benefits and potential risks associated with SIBs as drawn from a review of the literature. The comments and analysis provided here are not intended to be an exhaustive account of SIBs. In large measure owing to their novelty, literature on SIBs is constantly being produced as new developments occur. It will be some time before anyone is in the position to be able to provide a definitive or exhaustive account of SIBs. It is also worth noting that the literature produced on SIBs to date has primarily been produced by independent research centres, and by organisations directly involved in developing SIBs and similar social ventures.

Background and Overview

Social Impact Bonds, (SIBs) also known as Social Benefit Bonds and, perhaps more accurately, Social Impact *Investments*, are an example of 'Impact Investing'. Impact investing is the term given to an emergent trend whereby financial investments are directed towards socially-conscious enterprises and products. In other words, the trend of investing in financial products that will have a social 'impact' (Mulgan *et al* 2011: 13; Levenson Keohane 2013: 2). While impact investing is increasingly well established in global finance (CSI 2011: 24-25), SIBs are only one example of this new trend and are a very recent product that has not yet been fully tested. SIBs originate in the UK, but at the time of writing are also being trialled in the USA, Canada, Israel and in New South Wales.

An SIB provides a distinctive source of funding for a social program by turning the social program into a financial product. This process of turning a service or program into a financial product distinguishes SIBs from established traditions of philanthropy. Unlike established traditions of philanthropy, SIBs promise a potential return on investment in a social program for investors. In brief, the idea behind an SIB is that capital for a service or program is raised through the selling of bonds which are written up as a 6 or 7 year investment. If, at the end of the term of the bond, the social program has been able to generate results that can be shown to have *directly saved government money* – for example, by reducing the number of repeat offenders, or by reducing the number of children in the care system – then, and only then, is a return paid on the bond. The 'return' is paid by government to the private investors who hold the bonds out of savings generated by the SIB program. Ideally, through the use of SIBs as a funding system for social programs, governments would not be required to pay any money towards a social program except as a return on bonds held, and only in situations where the program is shown to achieve direct cost savings for government (Levenson Keohane 2013: 2; Mulgan *et al* 2011: 16; Cox 2012: 960; Keohane, Mulheirn and Shorthouse 2013: 6). Achieving positive outcomes that cannot show evidence of cost savings to government would not be sufficient to generate a return on SIBs.

Because of the need to be able to demonstrate cash savings to government, only few social programs would be appropriate for a SIB. Most social programs are not likely to be able to demonstrate in an uncontentious manner that they achieve a direct cost saving for government, because this is not usually the aim, and is outside of the scope of, most social programs. In particular, programs focused on prevention and early intervention – which save government spending at the acute end, are considered to be the ideal kinds of programs for SIBs. However, even within this narrow field of prevention and early intervention only few programs are likely to be able to achieve the level of successful intervention necessary to ensure a financial return on investment.

It is important to note that, as described in more detail below, the existing literature on the risks involved with SIBs strongly suggests that this ideal scenario, of all financial risk being transposed from government to private investors, could not be maintained in practice and government would likely have to absorb some of the costs involved with the high-risk nature of SIB investment (Centre for Social Impact 2011: 6; Keohane, Mulheirn and Shorthouse 2013: 8). Indeed, on some accounts, rather than save money for government, there is a possibility that SIB programs could be expensive ventures for government, depending on who absorbs associated costs (Levenson Keohane 2013: 6; Keohane, Mulheirn and Shorthouse 2013: 25-26). Considering the levels of financial risk involved in SIBs and outcome-based contracts, Jeffrey Liebman in a paper for the Centre for American Progress, in which he endorses the potential of this new form of funding social programs, puts the issue in the following terms:

> 'In a social impact bond scenario, performance risk is borne mostly by the bond-issuing organization, rather than by the service provider. Because the bond issuer spreads the risk across its bond holders, it will be substantially more risk-tolerant than would be a non-profit service provider in a direct performance contract. Nonetheless, investors will require

> compensation for taking on risk. In cases where a significant fraction of the outcome is outside the control of the bond-issuing organization and its service providers, the government is likely better off using contracts that are only partially performance-based, to avoid paying excessive risk premiums.' (Liebman 2011: 16)

Nonetheless, what a market in SIBs would ideally achieve is to shift the funding of social programs that can be shown to have a direct cost savings to government to the private sector. Government would only pay a return on these investments in situations where a cost saving was first established. Such a shift would involve a dramatic transformation in the way that social programs have been funded and indeed, conceptualised, to date.

Origins of SIBs

SIBs are a novel idea and a novel financial product. SIBs originate in the United Kingdom (UK) where they have been embraced as one aspect of the 'Big Society' policy agenda adopted by the Cameron Government together with their wider austerity policy measures. The appeal of SIBs in the UK is both practical and ideological. The practical appeal of SIBs lies in their potential to create new revenue streams for social programs while cutting government costs.

Along with the UK, other nations where SIBs are currently being trialled are also experiencing a significant reduction in government funding for public services. Australia is not quite in the same position in this regard. While there is a reduction of government funding occurring here, the Australian economy has not suffered in the same way that many other major economies have as a result of the global financial crisis and is performing strongly by comparison (Carmignani 2013; Stiglitz 2013).

The ideological appeal of SIBs resides in the fact that they further entrench market systems into the institutions of social welfare and create a more prominent place (though not a corresponding responsibility) for business in solving social problems (see Keohane, Mulheirn and Shorthouse 2013: 10-11). For the last several decades governments in liberal-democratic countries, such as the UK, the USA and Australia, have increasingly incorporated market-systems in the design and delivery of social programs. This approach, of adopting market systems and market principles to solving social problems, though increasingly commonplace, remains contentious.

Significantly, in the existing literature the origins of SIBs are also in part attributed to the not-for-profit (NFP) sector's frustration with the conditions of government funding (Helbitz *et al*, 2011: 4). SIBs are explicitly outcome-focused and they promise long term funding of up to 6 or 7 years. In Australia the NFP sector has long advocated that government revise its contracting practices and its evaluation models and adopt a system of longer term contracts that are explicitly outcome, not output, focused.

However, on this point, of outcome-focused contracts, it is important to note that the development of outcome-focused funding systems has been quite different in the UK and in the USA to the current situation in Australia. In both the UK and the USA there is an established tradition of what is known as pay-for-success, payment-for-results, or payment-by-results (PbR), funding models. In these models government funding is contingent on outcomes being achieved (Levenson Keohane 2013: 3). A challenge of this funding model has been that NFP organisations are not often in a position to fund programs to the point to which results can be achieved without first receiving initial financial support from government to do so (Fox and Albertson 2012: 356-357). Nor are most NFP's able to absorb the costs and losses if their programs fail to achieve their intended outcomes (Liebman 2011: 2). Such ventures require significant capital and significant investment risk. In many ways, the existing PbR model in the USA and the UK has created the context in which SIBs have been suggested as a potential way of solving this particular funding problem. As Alisa Helbitz and Emily Bolton from Social Finance put it: 'We developed SIBs to allow government to try out new social services on a no-win, no-fee basis' (Helbitz and Bolton, 2013; see also Disley *et al*

2011: 1-2). In Australia, there is no analogous tradition of PbR funding. The point here is that SIBs are not the only way to achieve a shift in focus on outcomes in the government tender process, but rather, that they arise in part out of the specific approach that has been adopted in other countries.

To summarise, SIBs are novel financial products that are designed to fund particular kinds of social programs. Specifically, they are designed to fund programs that are focused on early intervention that can demonstrate a direct cash saving to government. Significantly, not all early-intervention social programs are likely to meet this criteria. SIBs raise private capital investment on which a return is paid by government only when the program can demonstrate that it has achieved a direct cost saving to government. SIBs involve a focus on outcomes, because the condition of investment return is dependent upon proving that the social program achieved a particular outcome. For this same reason SIBs, as described in more detail below, also involve a heavy reliance on evaluation measures and robust research in order to demonstrate program outcomes. SIBs involve longer-term program funding (6 to 7 years).

The interest in trialling SIBs comes from three sources:

1. Investors and intermediaries interested in expanding the market of impact investments who are attracted to SIBs as a new financial product that will help to grow the impact investment market (see Helbitz *et al* 2011: 4; Roth 2011: 1).

2. Governments, faced with sometimes real economic pressures, and sometimes ideological preferences, for shifting to a market paradigm in funding social programs.

3. Not-for-profit organisations that are either unable to attract funding to their programs and/or that are frustrated with the existing conditions of government contracts and seeking new sources of revenue.

The efficacy of SIBs as an alternative mode of funding social programs might, therefore, best be judged by how well they satisfy any or all of these three interests or goals.

In brief:

SIB's turn social programs into financial products: private investors can buy a bond – raising capital for the NFP – in the expectation of a return on that investment at the end of a specified term, usually 6 or 7 years. The conditions governing SIB investment returns mean that only some social programs will be viable as financial products. Programs need to be focused on early intervention and/or prevention and they need to be able to demonstrate through uncontentious evidence that the program outcomes in the area of prevention have saved the government spending in the area of crisis or acute services. Ultimately, if programs cannot meet these two criteria then they are unlikely to attract a return on investment; therefore they will not be viable financial products.

Peterborough – the first SIB

The first Social Impact Bond trial was initiated in Peterborough in the UK and began in 2010. The Peterborough trial is addressing recidivism. By providing a support service to short-sentence offenders (less than a 12 month sentence) it is hoped that The One* Service will positively impact rates of repeat offending in Peterborough. Research demonstrates that short sentence offenders are at a high risk of reoffending (Helbitz *et al* 2011: 7). It is not yet clear whether the Peterborough SIB will achieve its program outcomes as the program has not been running long enough. However, an evaluation paper one year on states that the program 'is too small to deliver substantial "cashable" savings (Disley *et al* 2011: iv).

The Peterborough trial is in some ways the ideal case study for a SIB. Prisons are expensive to maintain and criminal justice presents a good example of where early intervention can directly save government expenditure. This means that the criteria, stated above, of potential to create a direct cash saving to government is met by this program.

What is more, other than the Peterborough SIB program, few if any services are provided to short-sentence offenders in the region (Helbitz *et al* 2011: 2). The reason that this is helpful to an SIB program is that it makes it easier to evaluate the outcome of the service intervention in order to build an evidence base that it is the program, and not some extraneous factor or factors, that has brought about a reduction in recidivism rates. Demonstrating that the program caused the cash saving is necessary for investors to receive a return. In turn, a high likelihood of a return being paid is necessary to attract private investors.

While in many ways the Peterborough trial seems an ideal test case for an SIB and many agree that recidivism is one area where SIBs ought to be trialled because of the potential for demonstrable cash savings (for example Levenson Keohane 2013: 2; Mulgan *et al* 2011: 23, 29-31), not everyone agrees with this view. Some researchers have suggested that criminal justice is not an appropriate field to generate the 'scale of change' required to meet the requirements of an adequate return for investors. Chris Fox and Kevin Albertson argue that: '…evidence from criminal justice evaluations indicates even well-executed projects and programmes often bring about only relatively small changes… If only small changes to outcomes are possible, this potentially creates problems for investors looking for a decent return' (Fox and Albertson 2012: 361-362). In their paper Fox and Albertson also note that: 'not all potential fiscal savings can, in practice, be converted into cash. Not all such costs are marginal – that is, they will not decline proportionally as re-conviction rates fall. The intervention impact which might allow a whole wing of a prison to close might be well beyond the scope of a single PbR model' (Fox and Albertson 2012: 363).

The Peterborough SIB – terms of contract:

'We agreed that we would be accountable for the reoffending behaviour of 3000 short sentenced male prisoners leaving Peterborough prison over a six year period. The investors would receive a return if the number of reconviction events among Peterborough prison leavers, triggered by offences committed within a 12 month period following release, falls by 7.5% or more. If the Social Impact Bond delivers a drop in reoffending beyond 7.5%, investors will receive an increasing return effectively capped at a maximum of 13% per year over an eight year period.'

(Helbitz *et al* 2011: 7)

Developments in Australia to date

In Australia interest has been raised in social investment in most states. But to date it is only in New South Wales (NSW) that SIBs[1] have been trialled.

New South Wales – the first SIBs/SBB's in Australia

The NSW government first declared its interest in SIBs under the Keneally government in 2010. In 2011 the NSW government commissioned the Centre for Social Impact (CSI) to undertake a feasibility study. The CSI released their 'Report on the NSW Government Social Impact Bond Pilot' in February that year. In the Report the CSI state that they felt that there was capacity in NSW to trial a SIB program (CSI 2011: 4, 7). The Report also included three different risk options for the trial in NSW. One option was comparable to the UK example in Peterborough, where the investors carry the risk. In a second option that they outline only the return (the 'reward payment') (CSI 2011: 6) is at risk. The third option, and the one which the CSI recommend is:

> 'an option where there is a balance of risk sharing between government, NPO and social investors. Under this option part of the costs the NPO incurs delivering the program will be paid by government through a standing charge, and the remaining costs and reward payment will be dependent upon the achievement of a successful social outcome.' (CSI 2011: 6)

Following the study the NSW government announced plans to trial SIBs in 2012. The NSW government called for expressions of interest in trialling SIBs in two particular policy areas: recidivism and preventing young people from entering the foster care system. As explained above, for an SIB to attract a return there needs to be a demonstrable saving to government. Recidivism and the foster care system are two areas of acute or crisis spending which take up a large part of government social policy budgets. Programs that offer early intervention and prevention in these areas have the best chance of being able to demonstrate a direct cost-saving to government. This point is articulated in a document by the NSW Treasury: 'The Out Of Home Care pilot will focus on offering parents support to take care of children without the need for foster care, which would reduce public expenditure, while the recidivism pilot will explore the extent to which prisoners can be assisted to return to society and not re-offend' (NSW Treasury 2011).

In March 2012 the NSW government announced that they had chosen three proposals (1 for recidivism and 2 proposal were chosen in relation to children in out of home care) and were going ahead with the trial (NSW Treasury 2012). Currently two trial SIBs are in place in NSW. One trial is the expansion of the Newpin program administered by UnitingCare Children, Young People and Families: 'which aims to break the destructive cycle of family relationships that lead to abuse and neglect.'[2] The Newpin program is directed at keeping children with their families and has raised $7million. The second project is administered by The Benevolent Society and is also directed at keeping children with their families: 'The $10 million bond will operate over a five-year period and will fund intensive work with up to 400 families and their children in the Resilient Families Service (RFS)'.[3]

According to an article appearing in the *Sydney Morning Herald* the process of determining which organisations were successful in applying to undertake a SIB trial was not without controversy (Steffens 2011). It was reported that in a letter written to the NSW Premier, the Chief Executive of

[1] In NSW they use they prefer the term 'Social Benefit Bond', but for consistency Social Impact Bond is used throughout this paper.
[2]<http://www.treasury.nsw.gov.au/site_plan/social_benefit_bonds/social_benefit_bonds_trial_in_nsw_FAQs#faq14>.
[3]<http://www.treasury.nsw.gov.au/site_plan/social_benefit_bonds/social_benefit_bonds_trial_in_nsw_FAQs#faq14>.

the Ted Noffs Foundation criticised the timelines provided in the process, arguing that they did not allow smaller NFP organisations adequate time to put forward competitive proposals:

> ‘While the charity [The Ted Noffs Foundation], which looks after young people with drug, mental health, homelessness and crime issues, sees great promise in social bonds, it has raised concerns that the trial has been compromised in favour of some of the bigger charities such as Mission Australia. A "full discussion" with NGOs about the program's ambitions and processes had failed to take place, claims its chief executive, Wesley Noffs.
> The foundation fears smaller players will be cut out: some of the community organisations it contacted to work on joint proposals had never heard of the pilot. Meanwhile, the Treasurer cited Mission Australia as endorsing its push for social bonds, raising fears it was already considered a key player in the process.
> The concerns go right to the heart of such programs. How will the outcomes be measured? While financial returns can be easily quantified, it's a different story evaluating the social benefit.
> Noffs argues that the two months since announcing the trial haven't been long enough to establish a proper evaluation process.’ (Steffens 2011)

Three SIB programs to be trialled in NSW:

‘On 27 March 2013, the NSW Treasurer, Mike Baird and the NSW Minister for Family and Community Services, Pru Goward announced the NSW Government had signed Australia’s first Social Benefit Bond contract. The Newpin SBB will fund UnitingCare Burnside’s New Parent and Infant Network (Newpin) program that works intensively with struggling families to keep them safely together. On 4 June 2013 Social Ventures Australia announced they had successfully raised the required $7 million to finance the Bond, one month before the scheduled close.

On 13 June 2013, the NSW Government signed the contract for the second SBB pilot – for a Resilient Families Service (RFS) provided by The Benevolent Society. The aim of the RFS is to strengthen family functioning and relationships, and ensure children’s safety and wellbeing in order to prevent children entering into out-of-home-care.

The Government is working on the development of a third SBB pilot to reduce adult reoffending in the criminal justice system. If a viable model can be designed for the benefit of the community, investors and Government, this pilot will also be implemented in 2013-14.’

(NSW Treasury:
http://www.treasury.nsw.gov.au/site_plan/social_benefit_bonds/social_benefit_bonds_trial_in_nsw_FAQs#faq1)

Benefits of Social Impact Bonds

Because SIBs are still in the 'trial and testing' phase it is not yet possible to determine definitively just what the benefits of a SIB funding system will be. However, reviewing the literature, a range of benefits are anticipated and/or hoped for from this funding model and these are described below. Not all of the benefits anticipated to arise from SIBs are likely to be of equal importance to the NFP sector. Rather, they highlight that there are different motivations behind SIBs as summarised above.

Create access to new and substantial revenue streams

From the perspective of both NFPs and governments, the potential to create new and substantial revenue streams is probably the single most appealing aspect of SIBs. There is, however, an open question about the extent to which SIBs can actually realise this potential (Liebman 2011: 5; Disley *et al* 2011: 29). Nonetheless, the ability to attract new revenue streams and the potential to develop and/or extend projects that do not currently attract government funding is a major benefit for NFPs as stated in the existing literature.

Less red-tape and a focus on outcomes rather than outputs

NFPs have long advocated a change to the procurement and evaluation processes followed by governments. Existing systems are felt to be restrictive of the work that NFPs do, miring organisations in red-tape and focusing unduly on outputs and not outcomes. SIBs are outcome-focused in a way that existing government contracts are not in Australia. The flexibility that comes from an outcome-focused funding system is highlighted in the literature as a significant benefit of SIBs (Helbitz *et al* 2011: 9-10; Cox 2012: 968-969).

Create access to government data which leads to better evaluation of projects

In order to turn a social program into a financial product a significant amount of data is needed in order to establish that a cost-saving to government can be made and to ensure investors that their investment will attract a return (Levenson Keohane 2013: 2). In order for there to be confidence in the SIB market NFPs and service providers need access to government data on a scale not previously practiced in Australia (CSI 2012: 6). The role of evidence in SIBs is generally seen as a benefit, in so far as the increased emphasis on evidence would indirectly establish a more extensive research base for social programs as compared to what exists currently (Liebman 2011: 3)

Generate savings to the taxpayer

Because SIBs rely on private capital they do not rely on government revenues except in situations where the SIB program can demonstrate a direct saving to government. It is argued that SIBs therefore create savings for taxpayers (Liebman 2011: 3; Cox 2012: 964). However, the extent to which SIBs are in practice able to be trialed and sustained without any investment from government is unclear from the discussion provided in the existing literature (see Liebman 2011: 5; Disley *et al* 2011: 29). This point is further discussed in the section on financial risk in this paper (p.10-11).

Shift financial risk to the private sector

Government investment in social programs is 'risky' in the sense that there is no guarantee that the financial investment will result in the desired outcomes. In the SIB funding model that risk is borne by private investors not governments (Levenson Keohane 2103: 2; Mulgan *et al* 2011: 16; Cox 2012: 964). Though, again, it remains an open question whether SIBs will be able to attract an adequate number of private investors given how risk-intensive they are (Liebman 2011: 5; Disley *et al* 2011: 29). Geoff Mulgan and colleagues from The Young Foundation, an organisation that is supportive of the SIB concept in the UK, state that: 'Most observers assume that it will take at least

5-10 years for a [commercial] asset class to develop, even with optimistic assumptions about successes in earlier philanthropic and other [SIB] pilots' (Mulgan *et al* 2011: 9).

Better evaluation of programs, benefit of market discipline

For a SIB to work, social programs need to have rigorous evaluations as to whether or not they achieve intended outcomes. This is represented in the literature as one of the benefits of SIBs (for example CSI 2012: 6). Furthermore, in some accounts it is not just the increased research and evaluation that is represented as a marker of quality improvement but accountability to the market and scrutiny of programs by investors are also described as a benefit in and of themselves:

> 'The private investors also perform an important form of quality control. That's because service providers must convince the private investors that their program model and management team are likely to achieve the performance targets. The investors and bond-issuing organization also have strong incentives to rigorously monitor and improve program performance; if performance targets are missed, they will lose the money they invested.' (Liebman 2011: 2)

However it is not clear if the Australian NFP sector would, or should, regard this as a potential benefit of SIBs.

Create new financial products for socially conscious investors

SIBs could potentially serve as one way of developing the impact investment market, creating new products for socially-conscious investors. The expansion of the social investment market is widely represented as a benefit of SIBs, establishing a new asset class and attracting new investors (Disley *et al* 2011, 2, 21; Mulgan *et al* 2011: 16). It is argued that if a large enough market is created for SIBs this would attract new investors into the impact investment market. Potentially, those investors who were concerned with generating profit could invest in SIBs, which promise some return on investment, and philanthropists and investors with a social-values base could still continue to direct their donations at programs that do not lend themselves to the SIB model.

Concerns and/or risks associated with SIBs

Just as with the benefits of SIBs, the extent to which risks and concerns might be realised is still unclear, as SIBs are very much in the trial and testing phase. The section below offers an overview of risks and concerns drawn from the existing literature. While most of the concerns and risks arise from the practicalities of SIBs, some speak to the underlying philosophical implications of this model of funding social programs.

Who really absorbs financial risk of SIBs?

In the literature one of the benefits attributed to SIBs is that this funding model passes risk from government, and ultimately tax payers, to private investors. While this might be true of SIBs as an ideal, the literature also highlights the fact that, in order to attract investors, the risks associated with SIBs need to be nominal, ideally, and just as importantly, calculable (CSI 2012: 10-11). Some literature suggests that the issue of risk may, at worst, involve government paying high risk premiums (Liebman 2011:16). If investors do not have reason to expect that they will receive a reasonable return on their investment they have no incentive to invest. Liebman states this clearly:

> ‘The most significant obstacle to making social impact bonds work is identifying interventions with sufficiently high net benefits to allow investors to earn their required rates of return. If one-third of projects fail, the annualized rates of return on the remaining projects would likely need to be more than 20 percent. Given the history of impact evaluations of government-funded social programs, achieving a sufficient level of success will be difficult.’ (Liebman 2011: 3)

Additionally, it is pointed out by Georgia Levenson Keohane that the term ‘bond’ as applied to SIBs is misleading. Because of the level of risk they attract SIBs are said to be more like equity investments than bonds (Levenson Keohane 2013: 2). Benjamin Cox points out that an SIB cannot pay out incrementally, as is the case with traditional bonds, meaning that the investor has to wait a longer period of time to know whether they will receive a return (Cox 2012: 964). Indeed in South Australia they are not referred to as Social Impact *Bonds* but rather, Social Impact *Investments*. This level of risk inherent to SIBs is worth keeping in mind given that, in their feasibility study the Centre for Social Impact report: ‘potential investors expressed a desire for a stable income over a number of years with few expressing appetite for equity-like risk’ (CSI 2012: 27).

From a close reading of the literature it seems that it is more accurate to say that there are different models for who absorbs the risks associated with SIBs: government, philanthropic investors, or private investors. This is articulated in terms of a tranched structure with tiers of investment, some high risk others lower risk (CSI 2012: 9).

The financial risks associated with SIBs are fundamental to whether they can realise the three main goals identified on page 4 of this paper. If SIBs require investors to carry too much risk than they will only create a small market – this means that they are unlikely to generate the kind of income stream that governments and NFPs are hopeful that they will. As Liebman states:

> ‘In order to determine how ambitious to be in selecting applications, a rigorous assessment is needed of the potential size of the social impact bond market. …if social impact bonds end up combining equity-like risk with bond-like returns, then the market will likely be limited to philanthropic and socially minded investors willing to accept lower returns in exchange for promoting social goods.’ (Liebman 2011: 5)

There is, thus, an open question in the literature about whether SIBs can generate a large enough asset class to really become an additional funding stream for social programs. In literature drawing on the learning from Peterborough this issue is made explicit:

> ‘The risks that [investors] are taking are so immeasurable … that you’re only going to be getting [investment] from people who are interested in the social value … Over time we’re building this track record for this investor base, so that you can broaden it.’ (interviewee cited in Disley *et al* 2011: 29)

If the market for SIBs remains small and is limited to philanthropic and socially-minded investors this would mean that few new income streams would be created. SIBs could still create additional income streams from within philanthropic organisations. For example, some philanthropic organisations are only able to direct a certain amount of their capital to charitable donations and are required to invest a certain portion of their endowment. The creation of SIBs could, therefore, potentially allow them to direct more of their overall endowment towards social programs. Nonetheless, given the size of social policy budgets and the fact that, unlike the UK and the USA, Australia does not have a significant philanthropic sector (CSI 2011: 33), this additional income stream would not be of the size and degree that would make a significant impact on government budgets.

The issue becomes circular. Unless SIBs can attract a new class of private market investors they will not be able to create significant new income streams. In order to attract a new class of private market investors, at least some of the risks associated with SIBs would need to be borne by government or offset in other ways (Keohane, Mulheirn and Shorthouse 2013:27-28). If the risks are borne by government then SIBs do not really pass on financial risk and do not realise the claim of being results-based or outcome-based funding models.

Reputational Risk

Because of the novel nature of SIBs they are attracting significant attention where they are being trialled and a common theme in the literature is the ‘reputational risk’ that flows from this (for example Disley *et al* 2011: 19-20; CSI 2012: 8-9). Put simply, because the evaluation process attached to SIBs is so thorough-going, if these programs do not achieve a return for investors they will be publicly known to have failed to realise the program outcomes that they sought to achieve.

The reputational risk associated with SIBs is not limited to their novelty, taking part in an SIB necessarily involves increased pressures on organisations. Liebman notes that: ‘service providers in a social impact bond-funded project still face more risk than they would in a standard government program. If performance targets are not met, funding will dry up, and the service provider will need to reduce its scale or find new sources of funding’ (Liebman 2011: 17).

In this context of reputational risk a related concern is that the emphasis on preserving reputations will lose sight of the fact that social policy interventions sometimes need to be advanced through a process of trial and error. Additionally, the focus on reputational risk could unintentionally shift attention away from recognising that programs need to be successful primarily because of what they mean for individuals not what they mean for investors or for organisation’s professional reputation.

Philanthropy, market values and NFPs

It might be suggested that creating financial products that have the potential to generate a return on socially-minded investments could create an unfair advantage for SIB programs over social programs that rely on philanthropic funding and that are not able to meet the requirements of an

SIB and that therefore cannot deliver a financial return. However, given the emotive and values-driven nature of most philanthropic investment this does not seem very likely.

A related concern is the idea that creating a private investors market in social programs might compromise the nature of philanthropy and the NFP sector in a more intrinsic way. One of the ways in which the NFP sector has defined itself as distinct from the for-profit sector is by putting process and care for people above outcome and profit. While SIBs might on one hand be welcome in that they shift focus to outcomes, they may also present a challenge to the fundamental way in which the NFP sector has been defined and understood.

This has not been addressed in the literature except briefly and somewhat defensively. Peter Shergold from the NSW government's Social Investment Expert Advisory Group and Gill Callister, Secretary of the Department of Human Services are quoted on this issue in a paper summarising the proceedings of the Australian Social Finance Forum held in 2012:

> 'Shergold also recognised the risks stemming from changing the culture of social service funding. He noted that some people find it "appalling that banks or financial institutions or private investors might be seeking to make a profit, deriving financial return from social disadvantage." Callister drew a parallel with the pharmaceutical industry. "The pharmaceutical industry invests in research and development and we accept that. We need to accept investment and then profit in research and development in social services."' (CSI 2012: 9)

Other considerations

Role of intermediaries

In their feasibility report on SIBs for the NSW government, the CSI concluded that: ‘a social finance intermediary is not necessary for the NSW government SIB pilot although this remains an option for future SIBs (CIS 2011: 5). The three trial SIB programs that have been initiated in NSW involve partnerships between the NFPs and Social Finance (Mission Australia SIB), Social Ventures Australia (UnitingCare SIB), and Westpac and the Commonwealth Bank (Benevolent Society SIB). To date, in Australia partner institutions are seen as providing financial expertise that NFP’s lack.

In literature from the USA and the UK intermediaries are seen as playing a far more central role in the development of the SIB market:

> ‘The social impact bond would also represent a fundamental shift in how service providers are chosen. Today decisions about which providers to fund are typically made by government employees at the local, state, and federal level who review grant proposals and choose providers. With social impact bonds, the private market determines which models and organizations are sufficiently promising to be worthy of financing. The bond issuer and its service providers will be able to raise operating capital only if private investors are convinced that a program’s model and management team are likely to achieve the performance targets. The private investors thus perform an important quality control function. (Liebman 2011: 12; see also Disley *et al* 2011: iii, 13-16; Keohane, Mulheirn and Shorthouse 2013: 43-44)

This view is reiterated, though put somewhat more bluntly, in a paper by the Social Market Foundation:

> ‘It is questionable how far SIBs, operated on a large scale, would create a straightforwardly benign commissioning model for VCS [NFP] delivery organisations. … if investors are to provide large amounts of finance, they are unlikely to be content to allow delivery organisations complete operational independence. The standard SIB model involves an investor-owned special purpose vehicle containing a Performance Director who monitors the activities and performance of the providers and is accountable to the Board and Investors. As a result, the model could acquire characteristics of the prime contractor model with investors setting delivery requirements of providers, for good or ill.’ (Keohane, Mulheirn and Shorthouse, 2013: 25)

Evidence – who pays and for what

SIBs create a greater need for, and reliance upon, a strong evidence base. Because returns on investment will only be made where the program has achieved its intended outcome and there is a demonstrable saving to government, there is an obvious need to measure program outcomes. Without a solid evidence base the ‘attribution risk’ could undermine the appeal of SIBs to investors (see for discussion Keohane, Mulheirn and Shorthouse 2013: 30-31). There is a clear benefit to having well-researched and strongly evidenced social programs and this is why the need for a strong evidence base is listed above as a benefit of SIBs. However, establishing evidence in the area of social programs and social interventions raises multitude challenges and complexities. In the social world casual links are hard to demonstrate. Where more than one social program is available to people it will be difficult to establish with certainty exactly what led to the outcome – was it the SIB program or extraneous factors (Mulgan *et al* 2011: 18; Fox and Albertson 2012: 365-366).

It is also the case that the kind of evidence that will be needed to demonstrate outcomes will likely be highly technical and focused strictly on outcomes as relating to cost-savings. Evaluations will likely adopt quantitative and technical methodologies. It is this kind and this level of evaluation that will establish program outcomes and whether investors will receive a return. Quantitative evaluations of this kind are unlikely to gather any qualitative information on the experience of the individuals who took part in the programs. There is an argument that the focus on outcomes will make service providers more responsive to individual service users throughout the course of the program and this may come to pass. However, the evaluation metrics that will be used are not likely to include, in a systematic way, the qualitative experience of service users.

A final point in relation to the issue of establishing an evidence base is that it is at this point in time unclear who will fund the costs of creating a strong research and evidence base – but how this question is resolved will also have a role in determining which party actually bares the financial costs involved in establishing SIBs. If government bares the costs of the research effort then the expense of social programs is not being shifted to the private sector but rather government is absorbing a significant cost – a cost that does not exist in the traditional funding and delivery of social programs. As Levenson Keohane notes in a paper for the Roosevelt Institute:

> 'The complexity of this process [the need for a strong and transparent evidence base] and others can make pay-for-success instruments expensive to administer, and in some cases, more costly than if the government paid for the service directly.' (Levenson Keohane 2013: 6)

If, on the other hand, the NFP bares the cost than this increases the level of capital and capacity that an organisation would need in order to be able to generate an SIB program. There is an open question in the existing literature about whether small organisations could fund the work involved in establishing an evidence base for programs (Fox and Albertson 2012: 362, 365). If they are required to cover the costs of research and evidence it is unlikely that they could. If the private investor funds the research than this increases costs, and it is suggested, where comparator groups are used as part of the evaluation methodology doing so 'raise[s] … overhead costs of PbR substantially'. (Fox and Albertson 2012: 362)

In some of the existing literature (Disley *et al* 2011: 37-38) there is a reference to randomised control trials as one means for evaluating program outcomes. This methodology requires one group to receive the service/treatment and another group, of otherwise similar characteristics, to not receive the service/treatment (a 'control' group). The randomised control trial methodology originates from clinical trials in the medical industry. While this is widely considered the most effective evaluation strategy in clinical research, there are questions about its applicability in the context of social service provision, a point acknowledged in some of the literature on SIBs (CSI 2011: 42). The deployment of this methodology in the social service context raises ethical questions about denying access to particular programs for certain people in order to serve as the 'control' group. It also raises a question about the nature of access to services and whether individuals remain entitled, as citizens, to equal and fair treatment. As researchers writing on the Peterborough trial report:

> 'According to an interviewee from the Ministry of Justice Analytical Services, the main reason that a randomised control trial was not undertaken was that there was no appetite for a situation where offenders who volunteered or were eligible for SIB-funded programmes would have to be kept out of the programme in order to serve as the control group.' (Disley *et al* 2011: 38)

Experience of other organisations

To date, the literature evaluating SIBs focuses exclusively on the people involved in initiating and administering them. No data yet exists on the experience of organisations that operate alongside SIB programs as to whether having them operate has had any impact on the sector. One paper in which this issue is at least obliquely raised is a report with staff involved in the Peterborough program:

> 'Interviewees from the prison, Social Finance and NOMS all noted that there were some concerns among existing service providers in Peterborough at the prospect of SIB-funded providers starting work in the area. At a time of limited funding for service provision, there was understandable concern about the effects of a new service provider. However, these concerns appear to have been addressed through a significant amount of brokerage and

relationship-building by Social Finance, NOMS and HMP Peterborough…' (Disley *et al* 2011: 48)

The researchers do recommend later in their paper that:

> 'As the SIB is delivered over a longer period of time, it may be important to pay close attention to the ongoing impact of the SIB on other agencies. In particular, it may be important to consider the impact of Social Finance commissioning strategies and whether the SIB is able to provide secure funding and/or fertile ground for innovative work to service delivery agencies.' (Disley *et al* 2011: 51)

Conclusion

Regardless the concerns and potential risks recognised in the literature there is significant enthusiasm about SIBs in Australia as elsewhere. The reason for this is clear: SIBs appear to bring together the competing needs of markets, government, and NFPs in a way that promises to release all from the risks involved in delivering social programs while at the same time delivering benefits to all: new financial products that contribute to the public good; less government spending; and NFPs left free to do what they do best – deliver services.

From the literature there appears to be a question remaining as to whether SIBs really have the potential to release this additional income into social programs. Because of the risks that are involved, there seems to be little confidence that SIBs will attract a significant new tier of private market investors. This view is held even by proponents of SIBs. Writing from the UK, Nigel Keohane and his colleagues from the Social Market Foundation conclude:

> 'In theory, investment into a SIB could come from mainstream investors. But… the economics are such that mainstream investment into prospective SIBs is very unlikely to be forthcoming given the risks and returns likely to be on offer from commissioners. Thus, for the foreseeable future, SIBs are likely to remain reliant on philanthropists and social investors even if risk is minimised…' (Keohane, Mulheirn and Shorthouse 2013: 41)

Because SIBs are financial products the issue of managing financial risk, along with reputational risk, are the dominant ways in which their potential is evaluated in the existing literature. It has been an aim of this paper to present an overview of the major concerns around risk as expressed in the existing literature.

Something that has not been addressed, because it is not an issue that is raised in the existing literature, is the question of the service user in debates on SIBs. SIBs have attracted a lot of interest and enthusiasm because of their potential to bring together market interests, government and NFPs in the context of new and distinctive funding relationships. As described in the sections on the positive applications of SIBs these new funding relationships have the potential to deliver improvements in the delivery of services through long-term funding models; increased evaluation mechanisms; and a focus on outcomes rather than outputs. These wider benefits of the funding model are incidental however – they are not the *reasons behind SIBs*. SIBs are primarily about finding ways to fund programs without relying on public money, they are not primarily about program design, or primarily about program outcomes. In this regard SIBs might be contrasted with Collective Impact, another recent development which has similarly attracted enthusiasm in the NFP sector in Australia. In the Collective Impact methodology the individual service user and the wider community are made central to the redesign process. This distinction is worth keeping in mind when moving ahead with debate and discussion of SIBs as it is a reminder that the pressures to reform and reimagine the way the NFP sector operates come from many different directions.

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