

INVESTING FOR PUBLIC GOOD

Creating social value
through social impact bonds

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The Tomorrow Project is an independent charity undertaking a programme of research, consultation and communication about people's lives in Britain in the next 20 years. Its aims are to help organisations and individuals to think and learn about the future of people's lives in order to gain a better understanding of the present and to learn about the choices which will influence the future. For more information, see www.tomorrowproject.net

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1 Emily Bolton & Louise Savell, *Towards a new social economy: Blended value creation through Social Impact Bonds*, London: Social Finance, 2010.

Executive Summary

Overview of social impact bonds

When all the talk is about slashing services to level the debt mountain, *Investing for Public Good* argues that government can be made both cheaper and better.

It describes a totally new approach to paying for government, called Social Impact Bonds, known as SIBs. SIBs could improve people's lives, while cutting the huge sums government spends on fixing the broken parts of society.

SIBs work by identifying savings government can make from tackling social problems, like crime, at their roots.

Once these savings are identified, capital is raised from private investors to pay for action that will prevent social problems before they arise. Investors receive a portion of the savings in government spending that result, while the government keeps the rest.

Government
can be made
cheaper and
better

Pilot project

To demonstrate the effectiveness of SIBs, the government has, with Social Finance, pioneers in this area, launched an experiment at Peterborough prison. Funds will be raised from social investors to pay for interventions that will encourage short-term, male, young adult offenders to stay off crime when they are released.

Capital raised from investors will pay for mentoring and help for offenders in finding a job, getting off drugs and finding somewhere to live. These forms of support can cut crime dramatically. They avoid the costs of bringing someone to trial and locking them up again.

Paring down the costs of re-offending is expected to produce sizable savings, from which investors will be paid.

Further areas for SIB savings

There are many ways for government to intervene early and save money. For example, employing specialist nurses can halve the number of obesity-related amputations and save four or five times the cost of the extra staff.

More counsellors to treat children with mental health problems would cost an estimated £30 million a year, but could produce savings of up to

Getting financiers to pay for upfront costs should be a ‘no brainer’

ten times that amount by reducing the children’s behavioural problems later on. Getting financiers to pay for upfront costs and rewarding them from the savings that follow should be a ‘no brainer’.

Over the next decade, the government will have to fork out large sums to ‘green’ its buildings as new energy-saving technologies come on stream. SIBs could be a means of getting investors to pay for this. After rewarding them, government would make hefty savings in its energy bills.

What’s wrong?

The traditional approach to these and many other problems has been to pile on bureaucratic solutions. Often these come too late. They address problems after they arise instead of preventing them.

Yet research shows that early interventions, such as intensive home visiting in pregnancy and infancy, can prevent adult crime, antisocial behaviour and antisocial personality disorder. These interventions pay for themselves, and more, by cutting the costs to government of taking action later, when the problems are worse.

Top-down approaches in much of Whitehall stifle innovation. This is because delegation is not easy for central government, which is held to account if things go wrong.

To minimise risks, the centre creates numerous rules and procedures that leave local officials de-motivated and cautious. Outsourcing contracts specify in detail how services are to be delivered, with little room to try something new.

Traditionally, targets have focused on *outputs* that may or may not benefit people’s lives rather than *outcomes*, which bring explicit improvements to the lives of the client group. If the outputs are achieved (more people completed a training course), the contract will be renewed even if the trainees’ lives have scarcely improved (they didn’t find a job).

The third sector has much to offer in tackling social problems because of its close involvement with client groups. But it relies heavily on government grants, which frequently create a feast-and-famine experience.

Grants are typically made for a limited period, and then withdrawn in the expectation that the recipient will have found an alternative income. This creates uncertainty about whether the funding will be renewed and doesn't give enough time for the fruit of the initial work to ripen.

How would SIBs work?

Most SIBs would begin with a pilot, funded by charitable trusts and foundations with an interest in the client group – perhaps young offenders. If the pilot was successful, it would be extended to other areas.

A delivery agent (DA) would:

- raise capital from investors
- bring together agencies with relevant expertise
- coordinate their activities
- arrange for human resource and other services to be provided centrally if necessary
- negotiate a contract with government
- ensure the spread of good practice.

Contracts would concentrate on the outcomes to be achieved rather than the means of achieving them. Outcomes would be measurements of success that are aligned with actual improvements in people's lives. We discuss some of the challenges in measuring these outcomes.

DAs would have room to vary interventions to improve the programme, and would have a strong incentive to do this because they would be paid by results. Payments would only be made once savings had been achieved. Investors would carry the risks. An independent auditor would help the parties resolve disputes if they arose.

To aid cross-departmental collaboration, the Treasury could either encourage the greater pooling of budgets or set up a Social Impact Fund, from which investors would be paid.

We discuss whether savings in departmental budgets would be clawed back by the Treasury and recommend that a senior official within Treasury be given responsibility for promoting SIBs.

Initially, each SIB would be financed through an equity fund, which would be wound up when the SIB reached the end of its life. But as the number of SIBs multiplied, a single fund would be created to finance a wide variety of SIBs and allow the pooling of risk.

How would SIBs improve social outcomes?

SIBs would make it easier to prevent social problems before they arise by bringing new money into the system. Private investors would bear the initial costs. Government would have no obligation to pay investors unless savings were made.

DAs would draw together private and third sector agencies on the ground. They would encourage them to innovate, collect evidence of good practice and share their knowledge.

If the programme was a success, a DA might lobby for the programme to be adopted in other parts of the country, so that good practice was spread nationally. A country-wide programme involving several DAs would have a National Board that would encourage DAs to learn from each other.

Innovation would spread faster than it does now.

Interests would be aligned between clients whose lives would improve, DAs who would be paid only if they achieved outcomes that actually benefited clients, and taxpayers who would gain from

Interests in conflict
would now pull in the
same direction

savings in government spending. Instead of these interests being in conflict, which is often the case now, they would pull in the same direction.

SIBs would strengthen the third sector, enabling it to tackle social problems more effectively by bringing new money into the sector and creating predictable revenue streams: providers who demonstrated success in improving clients' lives would be likely to have their funding renewed.

What impact could SIBs have?

We suggest criteria for identifying where SIBs would work best, and how government could hasten their spread.

If pilots were rolled out nationally, they could benefit a large number of people. But even if no national scheme was developed, pilots could still make a difference. They could change how outsourcing contracts were written. Hybrid schemes might combine both public and private finance.

The SIB concept could be modified for financially high risk situations, such as intervening early in children's lives, where attributing results to specific interventions is difficult and financial savings would take a long time to come through.

Creating a Social Impact Bank and making SIB investments tax exempt would increase private investment in SIBs and widen their impact. Tax exemptions would make financially riskier and long-term SIBs more attractive.

Slashing the cost without slashing the programmes

When so much is being said about cutting government expenditure, the potential exists to improve services and reduce spending at the same time. Might the prospects for tomorrow be surprisingly bright?

CHAPTER 1

Introducing the SIB concept

The Social Impact Bond (SIB) concept is a new way of bringing extra money into public services to tackle long-standing problems. It has the potential

- to encourage innovation
- to tackle social problems at their root
- to overcome budgetary constraints in the public sector

What are SIBs?

The SIB concept is being developed among others by Social Finance Ltd, whose ambition is to bring new investment to address social issues.² Private capital at scale would transform the social sector's ability to meet society's changing needs.

SIBs work by identifying savings government can make from tackling social problems at their roots. Once these savings are identified, capital is raised from private investors to pay for action that will prevent social problems before they arise. Investors receive a portion of the savings in government spending that result, while the government keeps the rest.

Take, for example, re-offending by released prisoners. It costs the government millions of pounds a year to bring someone to trial and lock them up.

A SIB would raise money to pay for the expansion and coordination of agencies able to support ex-offenders so that they didn't commit crime again. This would improve ex-prisoners' lives and save the government considerable sums of money.

Investors would be paid from the savings government makes. The bigger the savings, the higher would be the return to investors.

SIBs are unique in that they link three elements:

² The term was first coined by Geoff Mulgan, and important contributions have been made to the development of SIBs by the Prime Minister's Council on Social Action (CoSA), New Philanthropy Capital, the derivatives specialist Edmond Curtin (now of Cadwalader, Wickersham & Taft LLP), the Young Foundation and others.

- investments by commercial investors, foundations and trusts, and high net worth individuals in interventions that prevent future problems;
- a focus on the desired outcomes for a group of people rather than on the means of achieving these outcomes – for example, on the actual fall in re-offending rates rather than the number people on schemes designed to reduce re-offending. These outcomes are clearly defined in a set of targets. But unlike the public sector's standard outsourcing contracts, how services are delivered is not prescribed. Providers are free to develop the most effective means of meeting their targets;
- payments by government for positive outcomes. If the programmes are successful, these payments cover the costs of the interventions and enable investors to make a return. But if the desired outcomes are not achieved, investors are unrewarded. Investors carry the risks.

As a result, at low risk to the taxpayer, government harnesses expertise in the third and private sectors to improve people's lives. New money is brought into government to finance these improvements. Incentives are created to develop innovative approaches to service provision.

The idea of SIBs has been developed relatively recently by the Young Foundation and in particular by Social Finance.

SIBs as a concept

SIBs were originally conceived as bonds. Government (or some other body) would issue bonds to fund public sector interventions that would improve outcomes for individuals. Bonds would mature on a specified date and pay a fixed rate of return.

As details have been developed, it has become clear that SIBs look more like an equity investment. This is because it is essential to the concept that investors be paid on the basis of outcomes actually achieved. Payments will not be automatic. They will depend on whether people's lives really have improved.

Investors will initially buy into an equity fund, which will be wound up on a pre-determined date. Returns will depend on how the programme financed by the fund performs. In due course, a Master Fund might invest in a number of programmes, with investors buying and selling shares in the Fund.

SIBs are no longer bonds! However, the term 'Social Impact Bond' has become widely used. So to make clear that we are referring to a notion that has evolved from the original bond idea, we have chosen to speak of the 'SIB concept' (sometimes shortened to 'SIBs').

This is a notion that has developed from its bond roots but keeps its other original features – using private capital to fund better outcomes, with investors being paid according to performance.

Some examples

There are a number of examples where the SIB concept could make an impact, though the potential of each would need to be researched carefully.

Resettling prisoners on a short sentence. Social Finance has launched an initial Social Impact Bond with the Ministry of Justice to resettle male offenders in Peterborough prison on sentences of less than 12 months.

There is a strong rationale for helping short-sentence prisoners break the cycle of re-offending. Prison seriously disrupts the life of an offender. A third of prisoners lose their housing, two thirds lose their jobs and a third jeopardise family relationships.³

This disruption encourages re-offending behaviour. Having a job cuts the risk of re-offending by between a third and a half, while living in stable accommodation reduces it by a fifth.⁴

Disrupted lives and lack of support helps trap short-sentence prisoners in a re-offending cycle. Over 70% of short-sentence prison leavers re-offend within two years of walking out of prison.⁵ The figure jumps to over 90% for those under 21.⁶

The costs to society are high. Two fifths of prolific and priority offenders, who generate large volumes of crime, are estimated to have served sentences of under a year.⁷

Yet interventions can be effective. A recent Pro Bono Economics evaluation of a St Giles Trust service showed that its 'meet at the gates' service reduced re-offending by 40%. Pro Bono Economics calculated that, for every pound invested in this St Giles Trust service, the state saves over £10.

Social Finance is hiring a director to select and coordinate experienced third-sector providers, such as St Giles Trust. These providers will deliver services to short-term offenders in prison, at the gates and in the community.

Interventions will evolve during the programme as the most effective initiatives are identified and built upon.

3 *Through the Prison Gate. A Joint Thematic Review by HM Inspectorates of Prisons and Probation*, London: HM Inspectorate of Prisons, 2001, p. 73, 82, 90.

4 *Going Straight. Reducing re-offending in local councils*, London: Local Government Association, 2005, p. 26.

5 *Re-offending of adults: results from the 2004 cohort*, Home Office Statistical Bulletin, March 2007, p. 12.

6 *Reducing re-offending by ex-prisoners*, London: Social Exclusion Unit, 2002, p. 14.

7 *Headline Measures Report*, Home Office, June 2008.

Investors will range from trusts and foundations to high net worth individuals, who will be paid from savings to government when the re-offending rate drops.

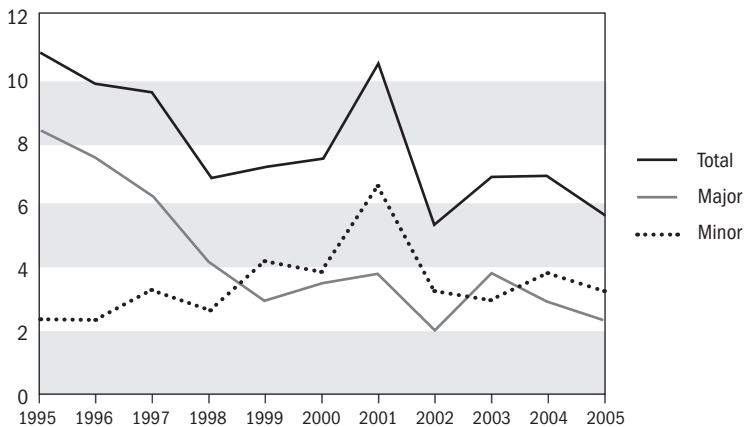
Preventing amputations arising from the mismanagement of diabetes. 2.3 million people are diagnosed with diabetes in the UK. Treating them costs £ 9 billion a year, 10% of the health budget.⁸

Diabetes is the most common cause of non-traumatic limb amputations. 5000 people a year in the UK have a limb amputated as a result of diabetes. It is believed that perhaps half of these amputations could be prevented with greater use of specialist diabetes podiatrists.⁹

For instance, in Ipswich a Specialist Diabetes Podiatrist joined forces with a Diabetes Nurse Specialist who had a special interest in foot care. They initiated twice-weekly visits to all wards to identify and co-ordinate the management of in-patients with diabetes and foot problems. At the same time they educated the medical and nursing staff.

Total amputation rates fell consecutively for the next five years. Savings on bed days alone were four to five times greater than the costs of the team. When the team was withdrawn in 2000, rates started to increase again (see graph below). The Diabetes Nurse Specialist post was reinstated.¹⁰

Amputation rates in Ipswich, 1995–2005
(no. of amputations per 100,000 general population)



Source: National Diabetes Support Team, *Improving emergency and in-patient care for people with diabetes*, March, 2008; p. 22

8 *Diabetes. Beware the Silent Assassin*, Diabetes UK, 2008, pp. 5–6. Treatment costs refer to the NHS in England.

9 National Diabetes Support Team, *Diabetic Foot Guide*, London: NHS, 2006, p.1.

10 National Diabetes Support Team, *Diabetes in the NHS: Commissioning and providing specialist services*, London: NHS, 2007, p. 16.

A SIB would target all in-patients with diabetes within a specific Primary Care Trust. Investors would be asked to fund a specialist diabetes podiatrist, who would visit the in-patients to educate them and the nursing staff in better foot management.

The number of amputations in the target group would be measured against the national average. As the number fell, a portion of the savings would be paid to investors.

Within the NHS discussions are now taking place on 'Health Impact Contracts', which are like SIBs but under a different name.

In addition, the government has announced plans for the Department of Community and Local Government to work with Leeds City Council and Leeds NHS to pilot a SIB to reduce health and social care costs. Might SIBs make a substantial contribution to the NHS?

Treating children with mental health problems could reduce their cost to society by 50%

Adolescents with mental health difficulties. When children with mental health problems get older, they are more likely to struggle with truancy, exclusion from school, unstable employment, crime and social exclusion – some of the most costly problems in our society.¹¹ Around three quarters of the prison population have two or more mental health disorders.¹²

New Philanthropy Capital (NPC) estimates that it would cost an extra £30 million to treat all 28,700 children in England and Wales who have conduct disorder, a mental health problem that involves severe and persistent disobedience and defiance.¹³

Not all treatments would be successful, and some would be only partially effective. Even so, NPC estimates that a comprehensive treatment programme could save between £244m and £376m a year. This would be around half the annual budget of the Child and Mental Health Services, and would represent a return on investment of 810% to 1,250%.

The estimate assumes that children who show an improvement would reduce their cost to society by 50%. Criminal behaviour accounts for the bulk of this cost (70%).

11 Iona Joy, Matthew van Poortvliet & Clare Yeowart, *Heads Up. Mental health of children and young people*, London: New Philanthropy Capital, 2008, p. 1.

12 Nicola Singleton et al, *Psychiatric Morbidity Among Prisoners in England and Wales. Summary Report*, London: ONS, 1998, p. 24.

13 This is the average marginal cost of providing relevant services. Iona Joy, Matthew van Poortvliet & Clare Yeowart, *Heads Up: Appendices. Mental health of children and young people*, London: New Philanthropy Capital, 2008, pp. 3–5.

Given that when a child's conduct improves it is their worst behaviour that stops first, it is reasonable to believe that improvements would be reflected in less criminal behaviour. The criminal justice system would make substantial savings.¹⁴

A SIB would pay for the upfront costs of employing extra staff and reaching children who would benefit from the programme. Investors could be paid a proportion of the long-term savings in the Child and Mental Health Services budget and of savings in the criminal justice system.

The 'greening' of government property. Over the coming decade, huge opportunities will exist for saving energy in government buildings.

Thin-film solar systems, for example, will be based on nanotechnologies that use extremely thin layers of solar-conversion materials. Already, they are cheaper to make than conventional solar panels, use fewer scarce materials, are easier to install and are much thinner. They can cost 20% of conventional panels.¹⁵

An MIT team led by engineer Marc Baldo has developed 'solar concentrators' that move usable sunlight to the edges of windows, where conversion materials create electricity from it. He believes that this collector system will be on the market within three years, and will be particularly effective in office blocks with numerous large windows.¹⁶

Government offices, hospitals and schools will all be under pressure to use technologies such as these to cut both energy costs and carbon emissions. Many experts believe that these technologies will pay for themselves within a few years.

The installation of more energy-efficient street lighting is an example of how energy-saving technologies are developing.

At present, local councils, who are responsible for street lights, can bid for 'PFI credits' from a Department of Transport central fund.¹⁷ The credits are used to pay private contractors over a five year period to renew and improve street lights that are nearing the end of their design lives. Contractors are paid to maintain the lights for a further 20 years.

SIBs could be an alternative to PFI – the Private Finance Initiative. SIBs would be issued to cover the cost of replacing street lights with more energy

14 Iona Joy, Matthew van Poortvliet & Clare Yeoward, *Heads Up: Appendices. Mental health of children and young people*, London: New Philanthropy Capital, 2008, pp. 1–5.

15 'Your solar-powered future', *The Futurist*, May–June 2009, p. 26.

16 Ibid, p. 27.

17 www.dft.gov.uk/pgt/regional/streetlightingpfi/thirdround.

efficient bulbs. Energy savings allow new bulbs to pay for themselves in about five years.¹⁸

If a sum equivalent to all the savings made over seven to eight years was paid to investors, investors would make an annual profit of between 5.7% and 7.5%. The local authority would have no further outgoings beyond maintenance, which it might do more cheaply than the continued payments to contractors under 'PFI credits'.

*The use of SIBs in international development.*¹⁹ Proven and cost-effective technologies exist to raise yields among smallholder farmers in a short space of time. Applying these technologies would boost world food production and tackle poverty.

For instance, in 2005 the Malawi government launched a seed distribution and fertiliser subsidy programme that turned the country from a net importer to a net exporter of maize within just two years.

The programme was directed at smallholder farmers, who could use the fertiliser or sell it on at a profit. Yields doubled in a couple of years. In the 2006–07 season, the harvest reached an all-time high for the country.²⁰

A SIB would raise funds to subsidise the sale of fertilisers and the distribution of seed to farmers in the developing world. Rich-world governments would repay investors with interest if the interventions raised agricultural output. The size of payments would depend on the degree of success.

Governments would make payments not in anticipation of results, but only after the results had been achieved. This could make official assistance to developing countries more publicly acceptable. 'Aid is not being wasted', ministers could more convincingly claim.

Might this help governments move toward the UN target of giving 0.7% of national income in overseas aid?

18 A 2002 estimate put the payback time in New York at less than 4 years to less than 5. *NYSERDA How-to Guide to Effective Energy-Efficient Street Lighting*, New York: New York State Energy Research and Development Authority, 2002, p. 6. The City of Oslo's dynamic lighting project, which includes the automated dimming of street lights, is expected to have a payback time of 5–8 years. Annemiek Planting, 'A new light on saving energy', *European Energy Review*, March/April 2009, p. 70. 'Finance for Energy Efficient Street Lighting', International Finance Corporation, www.ifc.org/fms (downloaded 21/12/09), claims that projects can often pay for themselves in as little as 3 years.

19 This section is based on the concept of Millennium Development Goal SIBs developed for Social Finance by Sara Vicente in 2009.

20 See for example Andrew Dorward et al, 'Towards "smart" subsidies in agriculture? Lessons from recent experience in Malawi', *Natural Resource Perspectives*, 116 (Sept. 2008), Overseas Development Institute; Glenn Denning et al, 'Input Subsidies to Improve Smallholder Maize Productivity in Malawi: Toward an African Green Revolution', *Plos Biology*, 7(1), 2009, www.plosbiology.org.

A public debate?

SIBs are attracting considerable interest. The Brown government made a commitment to pilot SIBs, noting that ‘they have the potential to unlock an unprecedented flow of social finance’.²¹ Three pilots, at different stages of development, were announced in its last Budget. The Conservatives are also supportive.

Iain Duncan Smith, former Conservative leader, and Graham Allen, Labour MP, have called for a political consensus on the need for early interventions that head off social problems later. They want the Treasury and the Cabinet Office to examine how private finance could be used to pay for these programmes.²²

Duncan Smith hopes that bonds could be sold to institutional investors, who would be paid back over 20 years by savings made in the NHS and justice system.²³

The wider policy community is picking up on SIBs. Action for Children and NEF (the New Economics Foundation), for instance, have called for a massive programme of preventative measures to improve the long-term prospects for children and hence for society. They propose that these interventions be financed through SIBs.²⁴

With this growing interest, it is time to look at the concept in some detail. What barriers to good government would the SIB model address? How would it work? How would it improve social outcomes? Does it have the potential to transform government services and hasten the development of a social economy (based on tackling social problems), in which interest is growing?

These questions have been partly considered in policy discussions and in some publications, most recently from Social Finance.²⁵ But they have not been addressed comprehensively and tested more widely. We would like to encourage a public debate.

21 *Putting the Frontline First: smarter government*, cm 7753, London: The Stationery Office, 2009, p. 31.

22 Graham Allen & Iain Duncan Smith, *Early Interventions: Good Parents, Great Kids, Better Citizens*, London: The Centre for Social Justice/The Smith Institute, 2008, pp. 118–119.

23 ‘How to catch children before they go feral?’, *The Times Online*, 6 Sept. 2009.

24 *Backing the Future: why investing in children is good for us all*, London: Action for Children/NEF, p. 27.

25 Emily Bolton & Louise Savell, *Towards a new social economy: Blended value creation through Social Impact Bonds*, London: Social Finance, 2010. See also John Loder, Geoff Mulgan, Neil Reeder & Anton Shelupanov, *Financing social value: implementing Social Impact Bonds*, Working Paper, The Young Foundation, Winter 2009.

CHAPTER 2

What problems would SIBs address?

Over the last quarter of a century, improving public administration has been a major preoccupation of governments. They have applied principles of ‘New Public Management’, such as encouraging competition between service providers, redefining clients as customers and focusing on outputs rather than inputs.²⁶

A central concern has been to secure better value for money from public spending. This search for value will become even more urgent as politicians look for ways to lower the debt mountain without damaging front-line services.

SIBs could be a help. To understand why, we must consider some of the difficulties faced by government and other organisations that seek to address social needs.

Too little, too late

It is widely recognised that wherever possible governments should intervene early to prevent problems. Prevention is generally cheaper than cure, which means that early interventions can deliver financial savings later – and, more important, a better society.

Action for Children and NEF have calculated the costs of a large-scale programme of early interventions to improve children’s lives as they grow up. The measures would cost a touch more than £1 trillion over the next 20 years, including interest on loans to pay for them. Savings would total £1.5 trillion.²⁷

Experience repeatedly shows that prevention can enhance individuals’ quality of life. In the United States, for example, the Nurse Family Partnership for Low Income Women has been found to be highly cost effective in improving the prospects for children.

26 In their classic book on the subject, a summary of what they consider to be the ten principles of New Public Management is provided by D. Osborne & T. Gaebler, *Re-inventing Government*, Reading, Mass.: Addison Wesley, 1992, pp. 19–20.

27 *Backing the Future: why investing in children is good for us all*, London: Action for Children/NEF, p. 26. Estimated costs include interest payments on SIBs, which would be issued to fund the programme. Interest on the bonds is assumed to be 4% a year (p. 68), which many would say is rather low given the risks involved.

Nurses visit low-income women intensively during their pregnancy and for the first two years after birth. They provide support, pass on parenting skills and check on the child's development. The children do so well that they need considerably less support as they get older.²⁸

Concluding a comprehensive review of the evidence, Professors David Farrington and Jeremy Coid claim that research shows how adult crime, antisocial behaviour and antisocial personality disorder can be prevented by early interventions,

*'including intensive home visiting in pregnancy and infancy, preschool intellectual enrichment programmes, parent training, interpersonal skills training, peer influence resistance strategies and anti-bullying programmes in schools. Multiple component programmes that include several of these elements seem particularly promising.'*²⁹

Many public services have prevention at their heart. Health screening programmes aim to prevent disease. A priority for social services is to prevent children coming to harm. The Sure Start programme seeks to help children get the best start in life.³⁰

But it is not easy for government to invest more heavily in prevention. Lack of public support makes it difficult for government to spend more on prisoners, youth offenders and drug addicts for example.

The government has a statutory duty to deal with existing problem groups such as school truants, offenders on probation and children with special needs. These become budget priorities ahead of new steps in prevention. As vice chair of the Prime Minister's Council on Social Action, David Robinson puts it,

'It is difficult to get rid of the ambulance at the bottom of the cliff in favour of a fence at the top.'

Prevention does not always produce the savings expected. Resources released by prevention may be spent on unmet demand. Stopping a crime may allow police to tackle a crime that would not otherwise have been

28 *Benefits and costs of prevention and early intervention programs for youth*, Washington State Institute for Public Policy, 2004, p. 12. For every \$ spent, there were benefits to the taxpayer of an estimated \$2.88 (p. 6).

29 David P. Farrington & Jeremy W. Coid, 'Conclusions and the way forward' in David P. Farrington & Jeremy W. Coid (eds.), *Early prevention of adult antisocial behaviour*, Cambridge: CUP, 2005, p. 358.

30 For further details see www.dcsf.gov.uk/everychildmatters/earlyyears/surestart/.

brought to justice. The hope that savings can be spent elsewhere or lead to lower taxes remains just that – a hope.

Prevention often requires agencies to collaborate across departmental boundaries. Yet despite pooled budgets, units that jump departmental boundaries, targets that are shared between departments and other initiatives, joined-up government frequently remains hard to achieve.³¹

In particular, if one department spends money on prevention, another may reap the financial reward. A school, for instance, has little financial incentive to develop a programme to discourage pupils from committing crime out of school hours.

Should the programme succeed, the budgets of the police, court system and prisons will benefit as fewer offenders come through, but financial gains to the school will be minimal.

Only 3.7% of the health budget goes on prevention

Where a department could benefit, it may not be allowed to keep the savings it makes. Its budget may be reduced on the grounds that there is less for the department to do. ‘Well done, police! You’ve cut crime, so you don’t need to spend so much on fighting crime.’ Financial rules may discourage preventative spending.

Even if the department can keep its savings, these financial gains may not be realised for perhaps several years. In the meantime, the department has to find additional money – over and above its current spending – to fund the preventative programme.

If the pre-emptive interventions fail, the government will find itself paying two sets of costs – the upfront costs of the interventions and the ongoing costs of failing to prevent the undesirable behaviour. Fear of this double hit is a real discouragement.

For these reasons, governments underspend on prevention. Of the £92 billion government devotes annually to health in England, only 3.7% goes on prevention. Against £1.45 billion spent each year on truancy and school exclusions, government allocates just £111 million to prevent them.³²

Public funds are spent on picking up the pieces rather than avoiding the problems. As difficulties emerge, money is poured into managing

31 In 2009 nearly a third of targets were shared across departments. Geoff Mulgan, *The Art of Public Strategy*, Oxford: OUP, 2009, p. 187. Mulgan notes (p. 186) that people are most likely to work together if they know they are likely to have many future dealings with each other.

32 *Prevention and Preventative Spending: Health England Report No. 2*, Health England, 2009, p. 5.

them, which cuts the sums available for prevention, which means that yet more problems appear down the line. It can feel like an impossible treadmill.

Top-down stifles innovation

In every walk of life, it is increasingly recognised that top-down approaches seldom work well. Life has become too complicated to be controlled from the centre. Talent and energy are more likely to be released if individuals and teams within organisations are given greater discretion.

Government is no exception. The growing diversity of British society means that drawing up detailed policies in Whitehall is fraught with difficulty. Tackling unemployment in the Lake District is very different to Birmingham. It can be almost impossible for Whitehall to devise a response that works everywhere.

The science of influencing behaviour suggests that

‘the best behaviour change strategies draw on careful analysis of what is shaping behaviour to devise detailed interventions tailored to the very different motivations that people have. Crucial to this is detailed market research, quantitative analysis, and qualitative research using psychological profiling techniques to segment the population. To influence obesity, for example, populations have to be segmented not only according to their health status and current behaviour but also according to their capacity and willingness to change. Then, targeted strategies can be introduced for each group, combining the right mix of incentives and peer pressure, individual encouragements and group encouragements, alongside reinforcing messages from opinion leaders.’³³

These tailored interventions are usually best developed through innovation at a local level, where local traditions and circumstances can be taken into account.

Yet while the value of decentralisation is widely recognised inside and outside Whitehall, delegating decisions is not easy for central government. Local discretion runs up against the fear that it will lead to divergences in the quality of public services – ‘post code lotteries’, which undermine equity.

It makes the centre nervous: ‘what happens if things go wrong, such as an IT failure, or the budget overruns or there are other forms of mismanagement? Say there is a hue and cry in the press.’

33 Geoff Mulgan, *The Art of Public Strategy*, Oxford: OUP, 2009, p. 205.

Local discretion also bumps into central government's accountability to Parliament. What happens if Kings Lynn tries an innovative approach to crime prevention, but it doesn't work? Will the National Audit Office blame the Ministry of Justice for losing control?³⁴

People no longer
see government
as a friend

To minimise these and other risks, Whitehall creates rules and procedures that hem in local officials, leaving them de-motivated and over-cautious. In particular, outsourcing contracts specify in detail how services are to be delivered, giving little room to innovate.

A vicious circle emerges. The delivery of government services feels bureaucratic and inefficient. People who come into contact with these services get disillusioned. They no longer see government as a friend. Serving groups most in need then becomes more difficult, which increases the likelihood that these groups will feel let down.

A side-by-side approach would increase discretion and encourage innovation. In side-by-side organisations, the 'top' draws alongside the 'bottom' in collaboration.

Both team up to create and maintain a system in which front line staff are encouraged to take the initiative, try novel solutions and share what is being learnt within a framework of strategic objectives that satisfies those who hold the organisation to account.³⁵

The Brown government began to move in this direction (by reducing the number of centrally imposed targets, for example), while the Conservative Party has talked in a similar language.³⁶ In 2008, the Cabinet Office's *Excellence and Fairness* report declared:

34 Despite these difficulties, Whitehall has sought to encourage experimentation. It has made funds available, such as the Invest to Save Budget, which provides funds to encourage two or more public bodies – including those at a local level – to jointly initiate new processes to provide better modes of service. See www.isb.gov.uk. However, the sums for experimentation are relatively small, not least because experiments can take years to produce results, while the government has a multitude of pressing demands that require spending now.

35 See Michael Moynagh & Richard Worsley, *Going Global. Key Questions for the 21st Century*, London: A & C Black/Guardian Books, 2008, ch. 9.

36 Eg *Control Shift. Returning Power to Local Communities*, Policy Green Paper No. 9, London: Conservative Party, 2009; *NHS Autonomy and Accountability. Proposals for legislation*, London: Conservative Party, 2007.

*'We know that services need clear standards but that....persisting with too many top-down targets can be counterproductive; we know services must value professionals if we are to foster innovation and excellence; we know that while central government must be a key player in driving better public services there are limits to what it can achieve and if it seeks to do too much it will stifle local initiative; and we know that vital though user choice is, it needs to be complemented with other approaches if we are really to empower citizens.'*³⁷

In chapter 4 we argue that SIBs could contribute to this cross-party agenda by offering government a powerful lever to decentralise its activities and encourage local innovation.

Outputs rather than outcomes

Since the early 1990s governments have increasingly used targets as a way of directing and controlling public expenditure.

Targets have been a way of holding the various levels of government to account, comparable to performance objectives in the private sector. But they have been roundly criticised, not least for their frequent complexity.

A particular problem in how targets were originally used is that they tended to focus on outputs (which may or may not benefit people's lives) rather than outcomes (which lead to more explicit improvements in the lives of the client group). If the outputs were achieved, the contract would be renewed.

A youth training scheme, for example, was evaluated on the basis of how many young people attained a certain level of qualification. This was one of the scheme's *outputs*.

The hope, which was the desired *outcome*, was that better qualified young people would go on to get jobs. But this outcome was not made a condition for renewing the contract.

One problem with these output targets was that providers might be rewarded for services their clients didn't especially want. Most unemployed young people are interested in qualifications only if they are a route to work. But often they are not. Training schemes, and the qualifications they offer, then get a bad name.³⁸

Secondly, government could appear paternalistic. 'We know what will

³⁷ Cabinet Office, *Excellence and fairness: Achieving world class public services*, Norwich: HMSO, 2008, p. 11.

³⁸ See for example Professor Wolf's trenchant criticisms of the government's new diplomas. Alison Wolf, *Diminished Returns: How Raising the Leaving Age to 18 Will Harm Young People and the Economy*, London: Policy Exchange, 2007, pp. 15–16.

work for you. Get a qualification and you'll then get a job.' But this we-know-best attitude was out of sync with today's culture, where the emphasis is on empowering individuals and expanding choice.

It overrode local experience, which might be at variance with received wisdom in the centre. Despite the Whitehall view, for example, many young people in high-unemployment spots have seen that qualifications don't open doors to work because there are not enough jobs anyway.³⁹

Thirdly, a focus on outputs encouraged the wrong sort of innovation. It encouraged service providers to find better ways of achieving the agreed outputs rather than attaining the desired outcomes.

A training provider would get as many young people through their qualification as possible because it was paid on that basis. It might offer the easiest possible qualification to jack up the numbers who passed, even if the qualification was of no help in finding a job.

The provider had no incentive to develop innovative approaches that actually got people into work because it was not rewarded for doing so.

Finally, output targets tended to rely on cost-plus calculations. Government agreed with the training provider the cost of delivering the specified outputs, and paid the cost plus a small premium (as a profit or contingency).

Output targets have ignored value for money

This ignored value for money, which is the basis on which the rest of the economy operates. Someone will decide to do an evening class not just because of the cost, but because they think it is good value for money. All purchases are based on value – except, it seemed, where government bought services on a cost-plus arrangement.

Cost-plus takes value out of the equation. Costs determine payment rather than the value produced. So, government had an incentive to select the lowest cost provider rather than the one offering best value.⁴⁰ The quality of public services was jeopardised.

Outcomes bring value back into the picture. Outcomes represent value to the client group – the value of getting a job, of better health and of other improvements to the quality of life. Whereas outputs were a means to an end, with outcomes the government pays for the desired end.

The disadvantages of targets based on outputs are widely recognised. As a result, the Brown government began to move toward a more outcomes-based approach.

39 Robert Macdonald & Jane Marsh, 'Missing School: Educational Engagement, Youth Transitions, and Social Exclusion', *Youth and Society*, 36(143), 2004, p. 155–157.

40 EU procurement rules may be a further complication.

Its Public Service Agreements were almost entirely outcome focused, and departments were encouraged to find ways of translating these high-level outcomes into outcomes tied to specific programmes.⁴¹

Public administration is on a journey from inputs (how much did we spend on training?), to outputs (how many completed the course?) to outcomes (how many found jobs?). But there is still a long way to go, especially in finding outcome measurements for individual programmes.

Focusing on outcomes is far from easy. The required data may not be available or sufficiently reliable. For example, if you wanted to concentrate on a particular housing estate using a variety of interventions and measuring a variety of outcomes, you might find that the data was not collected on a neighbourhood basis.

Evidence about what has improved outcomes is often ambiguous at best. Did this group of young people find jobs because of a government training scheme, or because a large retailer opened nearby, or because a youth worker had introduced them to photography, which increased their general motivation?

A journey
from inputs
to outputs to
outcomes

In addition to these and other methodological questions is the problem of over-prescriptive contracts when outsourcing services. The detailed provisions in these contracts are meant to ensure quality – ‘making clear what should be done, and how, will protect clients.’

The trouble is that these details effectively become output measurements, which cut across the more healthy emphasis on outcomes.

As we argue later, SIBs are not a quick answer to these difficulties, but they have the potential to speed up the search for solutions, particular to the methodological problems, so hastening the journey from outputs to outcomes.

The third sector struggles

The importance of the third sector is widely recognised. Social sector organisations, from religious groups to environmental campaign bodies to not-for-profit enterprises, provide meaningful links between the individual and society. Many have a lot of experience in tackling social problems.

⁴¹ For example, as part of the NHS Next Stage Review, the government sought new cost-effectiveness measures based on health outcomes for primary care. See *Developing the Quality and Outcomes Framework: Proposals for a new independent process*, London: Department of Health, 2008, p. 29.

To deliver effective services, government needs to harness the wisdom and energy of third sector agencies that know the local terrain and understand the client group well.

Yet government finds it hard to engage with many of these agencies. Often they lack the capacity to deliver contracts alone, while contracting a coalition of local organisations to work together can be complicated.

Contracts are therefore likely to go to larger, often private organisations that have the resources but not much local knowledge or engagement.

With pressure to make a profit, and without social motivation and a commitment to the local community, private sector organisations may be less effective in serving the client group than the third sector.

If priority is repeatedly given to the private sector, the vitality of the third sector will be at risk. Fewer agencies will survive to compete with the large ones, which will then be under less pressure to improve what they do.

Over time, government will find it harder to strike good deals. Officials will be at the mercy of large providers because there will be fewer alternatives to turn to. Providers will push up their prices and taxpayers will lose out. We may be well down this path already.⁴²

In addition, revenue streams for the third sector are often irrational. Government grants frequently create a feast-and-famine experience.

They are typically made for a limited period, and then withdrawn in the expectation that the recipient will have found an alternative income. This creates uncertainty about whether the funding will be renewed, while short time scales prevent the fruit of the initial work from ripening.

Funding not infrequently goes to organisations with the most inspiring CEO or with the best story to tell. Charisma and anecdote substitute for robust evidence of what works and why.

Charisma and anecdote substitute for robust evidence

A third problem is lack of collaboration.

Improving people's lives often requires a variety of interventions. To assist young people into jobs, you may have to work with them on their literacy, help them off drugs, address mental health problems and encourage them to travel further to work than they expected.

Agencies may specialise in only one of these. Despite Herculean efforts, these organisations often struggle to coordinate their activities. Sometimes they even compete with each other, as they seek to cream off the clients who

⁴² This certainly seems to be the case with the Private Finance Initiative (PFI). One third of PFI contracts attracted two bidders or fewer between 2004 and 2006. Allyson Pollock, 'Uncovering the true costs of PFI', 23 Sept. 2009, www.guardian.co.uk

are most likely to complete their programmes and help them reach targets that satisfy their paymasters.

The result of these weaknesses is that the third sector is less long term in its approach, less engaged in delivering public services and less cohesive than it has the potential to be. It could play a bigger role in delivering the government's social objectives, but it is not in a position to do so. Might SIBs help to change this?

CHAPTER 3

How would SIBs work?

The SIB concept could make a big difference to the problems we have just described. Before discussing how, we suggest one way in which the model could work.

The first steps

Imagine that a third sector organisation saw the potential to reduced re-offending among young adults. We envisage that it would research the possibilities and seek a grant for this purpose from a charitable trust or foundation.

If this research confirmed the potential, it would approach the Ministry of Justice to run a pilot. The pilot would have the ingredients of the SIB programme that we describe below.

Because it was a new venture in a context where SIBs had not previously been tried, the pilot would almost certainly be too risky to attract commercial investors. It would more likely be funded by a trust or foundation, or by high net worth individuals wanting to use their money for a social purpose (often in areas where they lived).

Funding would normally take the form of an investment. Trusts and foundations would either put in a small proportion of their capital or invest in lieu of making a grant.

This would have obvious attractions. Once money has been given in a grant, it can never be given again. But a £ successfully invested gets returned to the charity and can be invested once more.

Investors would be paid a proportion of the savings government made from the fall in the re-offending rate – fewer people would be coming through the criminal justice system. If the pilot was successful, investors would get all their money back plus a return.

Though this would be perhaps the most usual way to start a SIB programme, there could be other routes in. The initiative might be taken by:

- a government department and financed with public funds;
- a private company like Serco, again with its own finance;
- a partnership between a local authority and a third sector organisation, with a combination of public and charitable funding.

In all cases, the first steps would be researching the potential and running a pilot. If the pilot was successful, the programme could be extended to other areas.

Delivery Agents

At the heart of the SIB concept is the idea of delivery agents (DAs), which would be owned by investors. A DA would raise capital, bring together agencies with relevant expertise and run the initial pilot. If the pilot was repeated in another area, a separate DA would be created to run this second programme.

The DA would negotiate a contract with local or central government, defining:

- *the target population* – for example, offenders over 18 years old leaving prison after a sentence of less than 12 months and returning to a specified geographical area;
- *the success metric*. This is the outcome measurement that will indicate success, such as the number of offenders in the target population who re-offend within a year of leaving prison. The lower the number, the better the outcome;
- *the value of success* – the proportion of cost savings to government resulting from improved outcomes that will be returned to investors. The DA would have to agree a figure for the potential savings for each person who does not re-offend in the first year, and what proportion of these savings would be paid to investors.

On the basis of this contract, the DA would approach potential investors. Following a successful pilot, these would be investors wishing to diversify their portfolios.

The DA would draw on the services of public, private and third sector organisations, which would deliver a package of interventions to improve the lives of the target group.

If necessary, the DA would buy in or provide IT, human resources and other central services for the organisations involved. It would coordinate their activities, hold them to account, encourage innovation and best practice, and pay agreed fees out of the income it received from investors and government. Resources would be pooled and coordinated.

The DA would be overseen by a Board, whose members would be accountable to investors and chosen on the basis of their expertise.

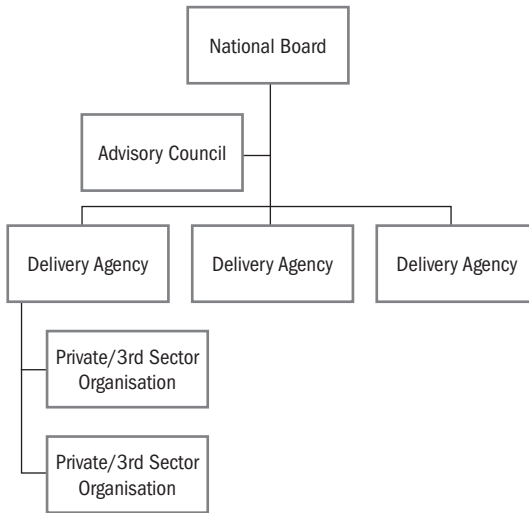
It would be served by an advisory council representing statutory

authorities engaged with the target group, participating organisations and, most importantly, experts able to speak on behalf of the target population.

The advisory council would act as a counterweight to investors. Though Board members would represent investors, they would through the council be constantly exposed to the perspectives of the population group the investors were seeking to serve.

If a pilot worked and was turned into a national programme, a DA might be set up in each local authority or city where the programme operated. The Boards of individual DAs would be linked together by a National Board, with a small supporting staff, whose principal and key task would be to hasten the spread of best practice.

The various elements would fit together like this:



Programmes tackling different problems would have their own structures. So a country-wide programme to reduce re-offending would have its structure with a National Board, while a programme to increase youth employment would have a separate structure and Board.

The structure of DAs would vary considerably – and indeed the model we have described is only one possible approach. A national scheme to reduce re-offending among short-term prisoners might rely on a series of regional DAs, while a programme to reduce obesity-related amputations might have a single, national DA.

Would all SIBs have a DA? The Young Foundation has suggested that a local authority or Local Strategic Partnership might raise capital directly.⁴³ While this is possible, a DA at arms-length from central or local government is likely to work better in practice.

- Since the DA would represent investors, it would more easily gain investor confidence and raise capital.
- It would be clearer that the sums borrowed were not part of the public debt. The contract with the DA would make it explicit that the government was not liable for payments unless savings were made. Debt would be held by the DA, not government.⁴⁴
- A DA would have an incentive to roll out a successful programme in other parts of the country – scaling up would provide further opportunities to generate social and financial returns. A local authority with its local horizons would have less reason to go national.
- A national programme with linked DAs would accelerate the spread of good practice. This would be harder for local authorities working independently.

Negotiating a fair deal

The government would be responsible for negotiating contracts with DAs that covered the operations of all the organisations involved. These contracts would ensure that government remained democratically accountable for the services delivered.

Elected bodies would hold the executive responsible for the outcomes negotiated and for making sure these outcomes were delivered.

Contracts would protect the public interest. In some respects, the contracts would be like any agreements between government and independent service providers. There would be penalties, for example, if the DA walked away from the contract before the expiry date.

43 John Loder, Geoff Mulgan, Neil Reeder & Anton Shelupanov, *Financing social value: implementing Social Impact Bonds*, Working Paper, The Young Foundation, Winter 2009, pp. 6–7.

44 However, the question of what does and does not count as public debt is highly technical, and there could be an argument that because government was highly likely to make payments through SIBs, these liabilities should be accounted in full on the government's books, especially if the total SIB investment became large. There has been a similar debate about the treatment of PFI liabilities. Social Finance believe, given the risk transfer out of Government, that SIBs would not be considered government debt.

However, unlike the detail in traditional outsourcing contracts about how services are to be delivered, contracts would focus on the outcomes to be achieved rather than the means of achieving them.

DAs would have room to vary interventions to improve the programme. They would have a strong incentive to do this because they would be paid by results. Improve their performance, and their income will go up.

One benefit of giving DAs greater discretion is that the employees (and volunteers) whom they oversee would have greater responsibility for the services they delivered. Workers and volunteers would feel more engaged. As a result, they would be less likely to turn a blind eye if their colleagues mistreated clients.

Clients would be protected through the focus on better outcomes

Clients would get a better deal than if services were delivered by workers with low morale, who feel hedged in by rules over which they have no control and who see little hope of making things better. Improving employee engagement is a better way to protect clients than negotiating detailed and disempowering contracts.⁴⁵

In particular, clients would be protected through the focus on better outcomes. Outcomes would be measurements of success that are aligned with actual improvements in people's lives.

So in a programme to discourage re-offending, success would not be measured by the number of ex-offenders who see a mentor or who attend a drugs clinic. Success would be indicated by the decline in the re-offending rate.

Clients' lives would have been improved because, to secure this decline, released prisoners would have been helped off drugs and into accommodation and jobs.

Clients' interest (and the public's) would also be protected through competition between DAs. As the SIBs market matures and more organisations specialise in the delivery of SIB programmes, DAs would need constantly to raise their game to compete for contracts and this would feed through into better service delivery.

Like government, the interests of investors would be protected through

⁴⁵ For evidence that greater employee engagement leads to improved organisational performance in the private and public sectors, including better customer service, see *Engaging for Success: enhancing performance through employee engagement*, A report to Government by David MacLeod and Nita Clarke, London: Department for Business, Innovation & Skills, 2009, pp. 34–65.

the details of the contract. The DA Board would be accountable to investors for negotiating and delivering the contract.

In short, SIBs would score over outsourcing contracts by aligning the interests of all involved more closely, particularly investors and clients. Securing a return on investment and improving the lives of the client group would amount to the same thing.

Which outcomes?

Clearly, a key aspect of these contracts will be the outcomes. But agreeing how outcomes are to be measured presents a number of challenges.

First, ideally, you need outcomes that are simple and quick to assess. Everyone involved should be clear about what is being measured and why. They should be able to express it in a few words. How can you motivate people if the goal is not clear?

Clarity and speed of assessment is especially important for government (so that it knows how much to pay out) and for investors (so that they know what returns are likely).

Secondly, outcomes should capture as far as they can improvements on the ground. Measuring the number of people who re-offend within a year of leaving prison tells you a great deal, but it does not reveal everything.

It does not show the number of offences a person has committed. Someone awaiting trial for burglary might steal again before the hearing. Maybe a social impact programme has had greater success than the modest decline in the number of re-offenders suggests: the number of crimes committed by the client group has dropped more sharply.

Ideally, an outcomes approach would measure the number of offences as well as the number of offenders. In the absence of that data, the number of convictions may be the best measurement. (Someone may be convicted of another offence while on a community order.)

A significant by-product of SIBs could be improvements in the scope and fit-for-purpose quality of the statistics collected by government.

Thirdly, as far as possible outcome measurements should avoid creating perverse incentives. For example, it is impossible to measure teenage pregnancy rates directly because we don't have figures for the number of abortions. You can only use the figure for live births.

Yet using live births may create an incentive to encourage teenagers to have abortions – 'at least we've kept down the live births rate and met our target.'

SIBs could
improve
government
statistics

In a case like this, the contract should prohibit undesirable ways of achieving the target and specify some way of monitoring this (eg spot checks).

Fourthly, might it in the long term be possible to broaden the measurement of outcomes? Rather than a single outcome, might a ‘balanced scorecard’ approach be helpful?

In the case of ex-offenders housing, employment and drug use measurements (as well as convictions) might be taken into account on the grounds that they measure real improvement in individuals’ lives and indicate whether re-offending is likely in future.

A broader range of measures would capture the value added more fully – including the wider social gains. Improving the prospects for groups like young offenders has social benefits that go way beyond the savings on departmental budgets.

A broad range of measures would capture the value added

Addressing the roots of crime, such as drug addiction, will not only help the individuals concerned to have more fulfilling and healthy lives, society as a whole will gain. There will be fewer victims, insurance premiums will be lower, and individuals and organisations will spend less on security.

The concept of a Social Return on Investment (SROI) seeks to capture these wider benefits. In the early 2000s, the Treasury did work on a ‘Green Book’ of methodologies for measuring SROI, which was never published. The aim was a better means for comparing investment in programmes like Sure Start, training teenagers and higher education.

The hope was that it would provide a similar guide to what exists for capital investment in such things as roads and railways. But a number of the methodologies have proved difficult to apply in practice.⁴⁶

As SIBs prove their worth, the private and third sectors will have a growing interest in refining SROI methodologies in ways that the Treasury finds compelling. Using these, organisations could appeal more convincingly to a wider range of benefits when making the case for a preventative programme.

⁴⁶ The Office of the Third Sector is leading a three-year project (2008–11) to develop SROI methodologies. As part of this, it will be working with the Treasury to explore how the results can be integrated into the Green Book methodology.

The question of attribution

A big challenge will be to ensure that outcomes improved because of the interventions that the SIB financed rather than for other reasons.

Take a programme for ex-offenders on short sentences. The one-year conviction rate drops by 3% in the area covered by the programme.

Was the fall due to the programme itself? Or was it because crime more generally declined? If the latter, the government would pay for interventions that, despite appearances, made little difference.

Or imagine the conviction rate went up because the number of police increased. It would be harder to reach outcome targets, and investors would suffer.

It will not be possible to eliminate all such risks, but they can be minimised. The key thing is to have some benchmark against which to judge outcomes, such as national or regional trends.

For instance, if the conviction rate was to fall by 3% in the area where a programme operated but the national rate rose by 0.4%, investors could be rewarded for an improvement of 3.4% (or vice versa if the national rate fell). The baseline for judging performance would be adjusted to allow for the national trend.

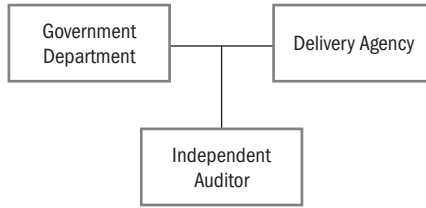
This could work well so long as the programme was confined to one or two regions. But if a local programme was successful and was repeated across the country, the national benchmark would no longer work. SIB-financed interventions would affect the one-year conviction rate nationally.

An alternative benchmark would be needed – perhaps the conviction rate for short-term offenders who have been out of prison for more than one year, for example.

Other influences will be more difficult to allow for, such as a police decision to target certain crimes or changes to sentencing policy. More community rather than custodial sentences would increase the opportunity to offend, and so be likely to reduce the sums paid to investors.

One solution could be an independent auditor

One solution would be to have an independent auditor. The auditor would verify claims that the target had been reached (or otherwise), and it would ensure that the flexible baseline – the benchmark – had been adjusted fairly.



It would also hear appeals from either side, government or investors, based on claims that there had been a significant change in circumstances.

The auditor would assist both parties in reaching agreement on the nature of the change and its affect on the baseline. Conceivably, if agreement was impossible, the auditor might arbitrate as a last resort.

The auditor would be an independent body set up for this purpose. A single body could develop a consistent approach across the country and across programmes. It would accumulate expertise. As its competence grew, parties in dispute would be more likely to accept its findings if arbitration became necessary.

Is this too complicated?

Measuring and attributing the outcomes would be some of the most challenging elements of implementing SIBs. The danger is that arrangements for doing this might get so complex that agreeing and administering SIB contracts would become very time-consuming and costly.

There are three answers to this. First, it may well be that in a number of instances a more rough-and-ready approach to measurement and attribution would be necessary. In this case, much would depend on how far investors and especially government were willing to tolerate uncertainty.

Simpler, more rough-and-ready arrangements would be likely to increase the risks to investors, who would then need a higher return, which would cut government's share of the savings.

At the same time, a rough-and-ready approach would likely reduce government's certainty that it would make savings. Government would be hit twice over: it could expect a smaller portion of the savings, which it would be less confident in achieving.

Government would need to take a strategic decision. If a rough-and-ready approach was what was needed to get SIBs under way, would the potential overall gains in preventative government outweigh the greater uncertainty surrounding individual contracts?

Would the long-term benefits to client groups, taxpayers and society at large outweigh the risks that from time to time savings would be smaller than might otherwise have been expected? We believe that this is likely to be the case.

Secondly, however, government would not have to come to a firm conclusion about this at the beginning. Rolling out a series of pilots would enable government to test the water. If evidence accumulated that the benefits of SIBs really were substantial, the government might feel justified in tolerating a higher level of uncertainty over individual contracts.

Thirdly, pilots could be used to test the degree of uncertainty for individual programmes. There might be two or three pilots before a programme was expanded nationally to assess the extent and nature of the uncertainties involved, and to test the parties' likely tolerance of them.

If the uncertainty proved unacceptably high, a pilot might be used as a laboratory experiment to seek ways of reducing uncertainty.

Cashable savings

Interventions may produce agreed outcomes, but can these outcomes be turned into cashable savings?

The issues may be more complex than they first appear. Reducing the number of offenders in prison will cut the costs of the prison budget. But by how much?

Almost certainly it will be less than the average daily costs of a prisoner. Average costs will include food, supervisory staff, heating and lighting, maintaining facilities and the original costs of building the prison.

Some of these, such as heating and lighting, maintenance and construction, are fixed costs. They hardly vary according to the number of prisoners at any one time. Reducing the number of offenders could mean that some cells have fewer prisoners, but fixed costs would be scarcely affected.

Savings will be made on marginal costs

Instead, savings will be made on marginal costs – the extra cost of housing each additional prisoner. These costs will include food. They may include staff if the number of offenders falls sufficiently for the prison to need, say, one less officer. They may also include the costs of overcrowding (eg moving prisoners) if the prison is too full.

This means that initial savings from reducing the re-conviction rate may be relatively small. But as numbers who are kept out of prison grow, larger savings will be achieved – it may become possible to close a prison wing.

When calculating potential savings to government from a SIB, it is important to remember that savings will be in marginal costs, which typically are lower than average costs.

It is all too easy to say, 'The average daily cost of a prisoner is this, so if there are five fewer prisoners the saving will be five times the average cost.' That is the wrong calculation. You have to ask, what is the marginal cost of each prisoner?

What about unintended consequences?

The risk is that there are second round effects that reduce the bankable savings. For example, imagine that prison places have been freed up by interventions through a SIB. These places might be filled by other offenders, who have been caught because the police are no longer chasing the ex-offenders involved in the SIB. Savings can't be cashed in.

This danger can be reduced if departments are explicit about how savings will be made in their budgets, how these savings will be spent and what the second round effects are likely to be.

The Ministry of Justice, for example, might note the likely effect of a SIB ex-offenders programme on police time. It might agree that SIB savings will be spent in allowing the police to catch more criminals, some of whom will end up in gaol.

Or the police might agree to devote their increased capacity to crime prevention. Some of the savings from having fewer offenders in gaol will be spent on increasing the number of bobbies on the beat.

Departments could be required to provide this information when making bids to the proposed Social Impact Fund, discussed in the next section.

A Social Impact Fund?

Government budget holders will have an incentive to support and cooperate with early interventions if they can see tangible benefits for themselves.

So, a decline in re-offending will lighten the workload of the police, courts, prisons and probation service. If budgets stay the same, these services will have some spare capacity. They could use the slack to improve the quality of what they do and take some new initiatives.

But imagine the services don't keep the savings. The Ministry of Justice uses them to spend more on human rights, or the Treasury creams them off to wind down the public debt.

The budgets of those involved would fall, weakening their desire to get involved. 'What's in it for me?' the police might ask. 'You aren't

helping me to achieve my targets (which are based on the number of crimes solved, not the number prevented). And if you succeed, I could lose a policeman.'

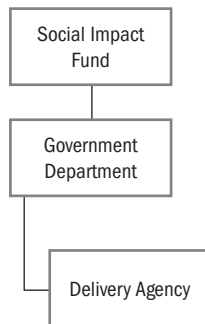
To encourage budget-holders to collaborate, one possibility would be to encourage the pooling of budgets. The government has started down this path with, for example, the Total Place Initiative. This is a pilot programme looking at how public money is spent in a local area and how it can be used more efficiently to improve services.

Pooling budgets could be taken a lot further in the context of SIBs. Take young people not in education, employment or training (the so-called NEETs). Improving their work prospects would almost certainly benefit their health, make them less inclined to offend, cut benefit payments and lower teenage pregnancy rates.

Pooling budgets
could be taken
a lot further

All sorts of budgets would benefit, but in different departments. Individual budget holders might sit down together, calculate what they actually spend on NEETs, see if they could get better results by pooling their resources through SIBs, and share their savings (after payments to investors) on a pro rata basis.

An alternative would be for the Treasury set up a Social Impact Fund. Departments would bid for allocations from this central Fund.



If a SIB was effective, payments to investors would be made from the Fund and the departments would keep all the direct savings in their budgets. Instead of budget-holders making payments to investors, payments would come from the Treasury. Departments would make bigger savings.

This would make SIBs substantially more attractive to departments than under the pooled-budgets approach. Especially in the early years, take-up would be faster. A central Fund would give SIBs a kick start.

The Fund could be financed by raising taxes (or cutting them by a smaller amount), by reducing the amount available for spending elsewhere in government or by doing both.

Say less was available for spending elsewhere. Departments might think, 'If our budgets are suffering because social impact programmes work for other bits of Whitehall, hadn't we better get in on the act?' There would be an incentive to take part.

A central Fund would be especially helpful where interventions are likely to produce significant savings spread over several budgets, but the savings in each case would be relatively small.

Budget holders might not feel it was worth their while to devote time and effort to working jointly on a SIB. But the staff of the Social Impact Fund might see the potential and have the authority to encourage a joined-up approach.

Treasury would need to act with a degree of restraint

In the long term, as the number of SIBs multiplied, the costs of the Fund could be partly clawed back during public spending reviews. If the Ministry of Justice bid for more police spending, Treasury could ask why the extra was not being funded out of savings from the re-offenders SIB programme.

No doubt the Ministry of Justice would argue that if Treasury clawed back all the savings, there would be little incentive to introduce more programmes. A compromise would hopefully be reached. Treasury would recoup some of the savings without removing the incentive for departments to promote SIBs.

This would be a tricky area to get right. Treasury would need to act with a degree of restraint if SIBs were not to be seen as a vehicle for cutting departmental budgets.

One way to help strike the right balance might be to appoint a senior civil servant within Treasury to oversee the Social Impact Fund and promote the SIB concept within central and local government. The voice of an influential SIB champion within Treasury could be heard during spending reviews.

As part of this work, the SIB champion might commission research on the financial benefits to the taxpayer of SIB programmes. To what extent had programmes increased revenue or reduced the pressure on other budgets?

For example, a programme to lessen re-offending might include helping ex-prisoners to find jobs, which would boost income tax and National Insurance contributions. Ex-offenders might be helped off drugs, reducing demands on the NHS.

Second-round effects, giving an additional fillip to tax receipts, would also be likely. Helping offenders into work would give them more money to spend in the shops, pushing up VAT receipts. Retailers would pay more corporation tax.

These wider benefits could then be included in calculating the actual costs to the taxpayer of the Social Impact Fund. Might these benefits, plus some claw back, enable the Fund to pay for itself in the long run?

Although costs of the Fund would be substantially offset in the longer term, initially the Fund would be an extra expense. Of course the Fund would be small to begin with. But even so, spending more when purse strings are tight may seem a lot to ask.

The cost can be justified by the large potential benefits:

- The Fund would leverage into government money that was not otherwise available, money that would enhance people's lives.
- It would enable departments to make savings that could be used to improve services on the front line.
- Second-round effects would bring considerable benefits to society as a whole, such as lower rates of crime that feed through into insurance premiums and other costs.

The Fund would be an investment in smarter government – in getting better value for the people government serves.

Paying investors

Investors would be paid on a sliding scale – the more people who benefited, the higher the per capita payment. This would take account of the fact that the first clients to be helped are often easier to reach than later ones.

If you work with 100 ex-prisoners, for example, it may be relatively easy to discourage the first 10 from re-offending. The last 10 will be much more difficult.

Output-based contracts tend not to distinguish between individuals who are easy or harder to work with. Payments per head are the same provided the target is met, such as a specified number of ex-prisoners on a drugs programme. This rough-and-ready approach has made it easier for the parties to reach agreement.

But if payments are based on outcomes, distinguishing between ‘easy’ and ‘harder’ clients becomes more important. Getting the ten ‘most difficult’ ex-prisoners on to a drugs programme (the output approach) may be much simpler than helping them not to re-offend (the required outcome).

Contracts would have to stipulate, therefore, the thresholds at which payments per head increase – so much per head for the first 1%, more for the next 1% and so on.

It will be important to avoid stepped payments. With stepped payments, a DA might receive so much per ex-offender if re-offending rates fell below say 73%, more per head for the next group of offenders if rates dropped below 70% and even more per head for a third group if rates dipped below say 67%.

These arrangements would create perverse incentives. If the rate fell to 69% and seemed unlikely to get below 67%, the DA would have a limited incentive to get it down to 68%.

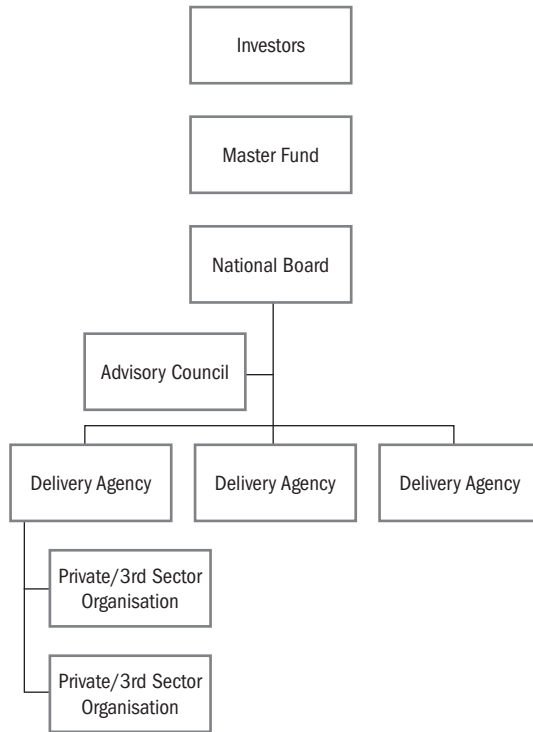
But if payments were on a sliding scale, so that the per head rate for *everyone* went up for each percent drop in the re-offending rate, the incentive to get that small improvement would be greater.

How will the finance be raised?

Pilots would be funded mainly from charitable sources, as we have seen. Social Finance has received expressions of interest in supporting initial pilots from trusts and foundations and high net worth individuals.

If the pilot was successful, its proven track record would make it easier to raise capital for subsequent programmes from a wider range of investors.

Capital would be raised through a Master Fund, which would be established as a limited liability partnership. Investors would be partners who owned an equity stake in the Fund. The Fund would appoint the National Board that tied the DAs for each programme together.



A Master Fund would be created for the first national programme. Investors would not get payments till the end of five years, when (if the expected savings in government spending were achieved) they would get their capital back with interest – effectively the Fund would be wound up.

Subsequently, different funds could be created for different programmes, or – more likely – there would be a single fund to spread risks.

In the long run, it is expected that investor demand for SIBs would come from:

- trusts and foundations, who would invest some of their capital in activities that further their social mission;
- funds with an interest in ethical investment;
- hedge funds wanting to diversify into new asset classes;
- other commercial investors who see profitable opportunities, combined with confidence in the state as a guarantor.

What would happen at the end of the SIB contract?

When the contract covering a programme expired, government would have three options if the interventions had been successful:

- The government might decide that the programme had been so worthwhile that it would now fund the interventions itself. It might supervise this spending directly, or ask the DA (which would have expertise and an existing set of relations) to do so on its behalf, or invite the DA – along with others – to tender for this new contract.
- The government might invite the DA (perhaps following a competitive tender) to raise another SIB on the basis of a new set of outcome targets. Say the conviction rate had been cut by 10%. The government might negotiate a new set of payments – for keeping the rate at its current level and for reducing it further.

This would be an opportunity to update the metrics if better measurement methods had been developed, and to take account of what had been learnt during the life of the SIB.

For example new methodologies, making it easier to achieve the desired outcomes, might allow the government to be more demanding. Equally, the scale of the challenge in going beyond what had already been achieved would be better understood.

- The government might adopt a hybrid approach. It might channel public funds through the original (or another) DA to maintain the existing level of activities, but invite the DA to raise new capital to secure further improvements in outcomes.

These possibilities would reduce the risk that, near the completion date, the DA would limit its horizons to the short term – ‘let’s finish the contract and move on.’ They would give the DA an incentive to end on a high note so as to be well placed to win the next contract and enhance its reputation.

CHAPTER 4

How would SIBs improve social outcomes?

In Chapter 2 we saw that improving people's lives is hampered because government spends insufficient on prevention, has stifled innovation by being top-down, has focused on outputs rather than outcomes and is unable to harness fully the potential of the third sector. This chapter looks at how SIBs would help address these shortcomings.

More prevention

As we pointed out, government spends colossal sums treating the symptoms of social problems without tackling their roots.⁴⁷ Budgets are so tied up in crisis expenditure that there is not enough to deal with underlying causes.

SIBs would make it easier to develop preventative approaches by bringing new money into the system. Private investors would bear the initial costs. Government would have no obligation to pay investors unless savings were made, so arguably there would be no addition to the public debt.⁴⁸

Yet how cost free would this be? Wouldn't government be paying a premium for these interventions by sharing the savings it makes with investors? Wouldn't it be better if government paid for the interventions itself and kept all the savings?

This would be a strong objection if government was in a position to increase substantially what it spends on prevention.

But even in the recent past, when public spending was racing ahead, there have been serious constraints. The larger sums devoted to prevention (such as Sure Start and screening programmes in the NHS) have been small compared to what is urgently needed.

SIBs would bring new money into the system

47 For example, 'The House of Commons Library estimated that the average cost to the state of an individual lifetime on benefits is at least £430,000. This figure does not take into account any additional benefits that such a person may receive nor the contribution to, for example, tax revenues that a person would have made had they not been on benefits.' Graham Allen & Iain Duncan Smith, *Early Intervention: Good Parents, Great Kids, Better Citizens*, London: Centre for Social Justice/Smith Institute, 2008, p. 33.

48 But see Note 45 above.

Given the coming squeeze on departmental budgets, new spending on a large scale is hard to imagine. SIBs offer an alternative.

In particular, SIBs would lower the risks to government of intervening earlier. Government would no longer face the possibility of two sets of bills – one for early intervention and one for remedial action because the intervention failed and the problem remained.

This risk would be shifted to investors. Government would only pay out to investors when agreed outcomes, which solved social problems and yielded savings to government, had been achieved. Payments would start when savings began.

SIBs would encourage greater collaboration between government agencies. Lack of collaboration can hinder the preventative work that government already seeks to undertake.

When organisations are not joined up, individuals can slip through the net. For example, families served by Children’s Centres may not be on the books of social services. So social services may be unaware of needs that come to light in a Centre – the mother suffers from depression and from domestic violence, perhaps.

SIBs would bring agencies together

Through DAs, SIBs would help to close these gaps by bringing agencies together. They would give Local Strategic Partnerships a new tool for encouraging service providers to collaborate at a local level.

They would encourage the pooling of budgets because budget-holders would not have to risk their budgets up front; payments would only be made once collaboration had been shown to work. They would support the ‘Total Place’ initiative, which is piloting a ‘whole area’ approach to the delivery of public services.⁴⁹

One Nottingham is an example of the potential. As a Local Strategic Partnership, it is pulling together all the organisations in Nottingham – from the large (such as the Police, the Local Health Service and the City Council) to the small (such as community and voluntary groups).

It aims to tackle deprivation and under-achievement through ‘prevention, pre-emption and early intervention’. Organisations work together to teach every primary school child effective social behaviour, support the 50 most difficult families in Nottingham, introduce a welfare-to-work scheme for the city and much else.

⁴⁹ www.localleadership.gov.uk/totalplace/

They are exploring how to develop strategies to curb crime and help parents of nought- to two-year-olds improve their parenting skills.⁵⁰

Imagine that One Nottingham could raise money through the SIB model. It would be able to afford additional interventions to enhance what it was already doing. The honey pot around which organisations gather would be even larger.

By funding prevention, SIBs would help government tackle the causes of social problems and spend less on the symptoms.

Savings would be clear because they would be specified in agreed outcomes. They could be used to improve services, cut tax or invest in further prevention. Might we end up with a virtuous circle: investment leading to savings, which lead to more investment, which produce further savings?

More innovation

As we noted in chapter 2, there is wide agreement that more decentralised government would encourage greater innovation. The problem is getting there. SIBs offer a way forward.

DAs would draw together private and third sector agencies on the ground. They would encourage them to innovate, collect evidence of good practice and share their knowledge.

If the programme was a success, a DA might lobby for the programme to be adopted in other parts of the country, so that good practice was spread nationally. A country-wide programme involving several DAs would have a National Board that would encourage DAs to learn from each other.

Contracts with DAs would encourage innovation by giving discretion as to how services are delivered. Paying DAs more per head the more lives they benefited would provide an incentive to try new approaches. If doing it differently helped just a few people, per capita payments for everyone would go up.

The executive would remain democratically accountable, but it would no longer bear the risk of an experiment that failed. The risk would now lie with the DA and its investors. So long as civil servants had agreed a proper contract with clear outcomes, they would have a reasonable defence if things went wrong.

Risks would lie
with investors

Central government would be able to set strategic priorities for prevention (such as reducing obesity), but allow more discretion in their implementation. This would be very different to the traditional top-down approach, and

50 www.onenottingham.org.uk/

would be in keeping with the direction the main political parties want to travel. Initiatives would be developed ground up.

Local discretion would lead to variation in how problems were tackled, which means that some places might be served more effectively than others. Obesity programmes might work better in Falmouth than Folkestone. Might this be grist to the mill of those who fear that decentralised government would widen inequalities?

National Boards
would encourage
the spread of
good practice

The structure of DAs would address this by using National Boards to encourage the spread of good practice. Learning from new ideas, which is often frustratingly slow in government,⁵¹ would be quicker and this should level up performance, as laggards catch up with front runners. Rather than getting wider, inequalities of outcome might narrow.

Effectively, SIBs would increase spending on public sector R and D. SIB programmes would be laboratories in which service providers experimented with different approaches.

More evidence

The desire for evidence-based government is common sense. High quality research on the effectiveness of social interventions is vital to ensure sensible investment decisions by government and investors.

However, developing effective measures of social impact is notoriously complex, as we have seen. SIBs have the potential to speed up the process – ‘if we can come up with a decent target, investors might finance a new programme.’

To help with this and with learning from the experience of SIBs, providers would almost certainly draw in social science academics to design action-based research projects, evaluate what was happening and develop better methodologies for measuring outcomes.

This would lead to greater understanding, improved record keeping, a better definition of outcomes and closer links between researchers and practitioners.

SIBs would ‘put evidence at the heart of the process. As payments depend on proof of efficacy, SIBs can only succeed if they generate high quality

51 Keith Ruddle, David Varney & Mary Harris, ‘Chapter Four. Community-Owned Government’ in Philip Collins & Liam Byrne (eds.), *Reinventing Government Again*, London: Social Market Foundation, 2004, pp. 69–70.

evidence along the way. SIBs will help to promote an evidence based culture in social provision.⁵²

Aligning stakeholder interests

Central to the SIB concept is the alignment of government, investors and client interests to produce benefits for society. Client interests would line up with those of service providers because outcomes would be measured by actual benefits to clients' lives.

These improvements would not be the number of medical treatments, but better health; not the number of ex-prisoners in de-tox, but how many stopped re-offending; not figures for parents in Children's Centres, but the number of children reaching the expected standard at primary school.

Investors would be paid only if clients' lives improved. Government would make payments only if savings in public spending were achieved. Society would benefit from the reduction in social problems.

Investor, client and taxpayer interests would coalesce round outcomes that measured tangible benefits to people. The opportunities for service providers to play the system, by finding quick ways to reach a target but without benefiting the client, would be reduced.

So the executive would have less need to be over-prescriptive in its contracts to ensure service providers didn't cheat. Departments would also stand to gain by making savings on their budgets.

Society, through its elected representatives, would be better able to tolerate the risks of innovation because it would know that its interests and those of the executive, clients and service providers were bound together.

Diversity of high quality social providers

In Chapter 2, we noted that smaller social sector organisations struggle to compete for public service contracts with larger, often private sector service providers.

Over time this limits the choice of potential providers within the market, which in turn reduces the pressure on remaining organisations to manage their costs effectively and improve the quality of their services.

52 John Loder, Geoff Mulgan, Neil Reeder & Anton Shelupanov, *Financing social value: implementing Social Impact Bonds*, Working Paper, The Young Foundation, Winter 2009, p. 13.

The SIB concept would help to maintain a diversity of high quality providers first by creating predictable revenue streams for the third sector. Because SIB investors would only be interested in achieving social outcomes, providers who demonstrated success in improving clients' lives would be likely to have their funding renewed.

Their effectiveness, rather than the size of their organisation or the cost of the output they generate, would determine how much they were paid. Small organisations, heavily dependent on government funding, could anticipate a long-term flow of revenue.

Rationally allocated income would help service providers grow

Secondly, the availability of rationally allocated, impact-based income would enable service providers to innovate and grow.

Trusts and foundations, for example, could invest in organisations that were exploring SIB opportunities. If a possibility materialised, the investment would be a catalyst for a venture that was privately financed in the long run. 'What do we do when the grant runs out?' would be less of a problem.

Trusts and foundations would know that if they funded an organisation that could demonstrate its impact, they would have a good chance of securing a return on investment that could be used to finance other opportunities. By supporting a venture that subsequently attracted private finance, they would bring new money into the third sector.

Finally, the outcomes focus of SIBs would encourage service providers to collaborate with each other.

Improving people's lives often requires a variety of interventions. To assist young people into jobs, you may have to work with them on their literacy, help them off drugs, address mental health problems and encourage them to travel further to work than they expect.

Agencies may specialise in only one of these, but have to compete with each other for contracts that would be more effectively if the work was done jointly.

DAs, on the other hand would bring agencies together. They would negotiate a contract on behalf all participating, often small agencies, enabling each to focus on their core strengths.

In these ways, the SIB concept would strengthen the third sector and enable it to support government more effectively in tackling social problems.

CHAPTER 5

What impact could SIBs have?

We have looked at how the SIB concept is appearing on the political radar, some of the problems SIBs seek to address, how SIBs would work and how they would improve social outcomes.

Now we ask: how big a step forward could SIBs be? Could they eventually propel government toward pre-emptive action on a wide scale and strongly encourage the growth of the social economy, based on the third sector?

Let the model
prove itself

In Chapter 1, we quoted Action for Children and NEF. They have called for a massive programme of preventative measures to improve the long-term prospects for children, including children's quality of life as adults. Interventions worth £1 trillion over 20 years would be financed through SIBs.⁵³ Are SIBs on anything like that scale feasible?

The short answer is that we don't know. Measuring outcomes is hard. Finding bankable savings can be difficult. Scaling up successful pilots is often problematic – high quality staff recruited to the pilot may not be easily cloned elsewhere, for example.

Risky investments will require commensurate returns. Will government make enough savings to afford the necessary payments?

Rather than over-egging the potential, it is better to proceed prudently on a step-by-step basis, pilot by pilot and programme by programme. As the model proves itself, its long-run possibilities will become apparent.

But in taking these initial steps, a long-term perspective may be helpful. A vision for the possibilities may encourage Ministers to commit resources to developing pilots and scaling them up. It may persuade them to rework the model and develop it in fresh ways, even if some of the initial results are disappointing.

So in this chapter we take a longer-term view. We ask: where might SIB pilots work best? What is the potential for extending pilots to new contexts? In what ways could these pilots change how government works and

⁵³ *Backing the Future: why investing in children is good for us all*, London: Action for Children/NEF, pp. 26–27.

improve social outcomes? How could private investment be encouraged? Is a commercial better than a philanthropic approach? How would the social economy benefit?

Where might SIBs work best?

SIBs are not a solution to every problem, and will work better in some situations than others. In the early stages, therefore, it will be important to find opportunities where SIB pilots have the best chance of being effective.

SIB pilots are most likely to succeed when the following conditions are met:

- *The target group for whom the programme is designed is clearly defined*, such as offenders over 18 on short sentences.
- *There are robust outcome metrics*. Outcome measurements must be clear, relatively easy to obtain and reliable. Preferably, at least in the initial pilots, there should be just one, such as a drop in the number of convictions.
- *The costs of early intervention are significantly less than the costs of not intervening*. Reducing the number of offenders, for example, may be considerably cheaper than dealing with them in the criminal justice system. The more the costs of not intervening exceed the costs of early intervention, the bigger will be the long-term savings in public spending and the larger the returns to government and investors.
- Savings are tangible. Cost savings need to be assessed to see if they generate actual money. If fewer offenders come through the courts, can this saving be turned into cash? Picking opportunities where tangible savings are possible will reduce uncertainty in the calculations, which will increase investors' confidence: they will be sure government can make savings. Bankable savings will allow departments to decide how to use the money to improve front-line services.
- Savings can be made in a reasonably short period – say five years. This will be attractive to both investors and government.
- Savings accrue to a small number of budgets, preferably in the same government department. Addressing truancy could be difficult, for instance, if it was done with the department responsible for schools while the financial benefits of less crime from less truancy went to the Ministry of Justice. Tackling re-offending, on the other hand, would involve working with the same department that gained financially.

- *Savings can be clearly traced to the interventions.* Is the impact on the re-offending rate, for instance, greater in the area where the programme was introduced than in areas without the programme?

It will be important for pilots to meet these conditions so that they have the best chance of working. Success will increase confidence in the concept, perhaps making it possible to relax some of these requirements later on.

What is the potential for extending pilots to new contexts?

In chapter 1 we suggested five contexts in which SIBs could make a difference – prison-leavers on short sentences, diabetes-related amputations, adolescents with mental health difficulties, energy-saving in government property and food production in the developing world. Conversations with public-sector professionals suggest there could be many more.

Each possibility would need careful research before resources were committed to a pilot. If the pilot was a success, it could be replicated.

Learning from one pilot should make it easier to start another in a different field. As methodological issues were tackled, a corpus of knowledge would emerge that would resource the development of further pilots.

Learning from
one pilot should
make it easier
to start another

Charitable grants to organisations exploring the possibility of a SIB would most likely include funds for research. The research might be undertaken by a local university department. In time, a new field of academic knowledge could be available to practitioners.

DAs that had run a successful pilot and programmes derived from it would be likely to look for new opportunities. A DA that had successfully reduced convictions by short-term offenders over 18 might ask whether their expertise could be applied to other groups – to offenders in prison for up to two years, then five years and eventually perhaps longer.

What about juvenile offenders? Maybe the DA would start a pilot among convicted 17-year-olds and then move down the age range. In the process it might identify teenagers excluded from school and start working with them, saving local authorities the considerable costs of providing for them.⁵⁴

Likewise, a pilot among adolescents with mental health problems might include a variety of interventions, from therapy to parenting support groups

⁵⁴ The cost of educating a child in a pupil referral unit is about three times that of a normal pupil, according to expert Professor Carl Parsons, 'Excluded pupils cost three times as much to educate', *Times Online*, 28 May 2009.

to mentoring, focused on a specific housing estate. Payments to investors would come from spending less on excluded pupils and youth crime.

If the pilot worked, the DA might extend its activities to teenagers on the estate not in employment, education or training (NEETs).

In time it might develop a more ambitious preventative programme, starting with very young families and expectant mothers. The DA might coordinate existing government spending on the estate and bring in some additional investment.

Perhaps new income streams would be developed to help investors see a return earlier. Local schools might think it was worth making payments for improved pupil behaviour – it would be easier to attract and retain staff. Methods of measuring these improvements would be developed.

Extending SIB pilots in such ways would be encouraged by:

- the availability of new money for doing things better;
- DAs wanting to build on their experience;
- third and private sector organisations spotting opportunities;
- trusts and foundations seeing new ways to further their aims and objectives;
- officials and politicians wanting to improve the quality of government;
- staff in the Social Impact Fund, if it was created, seeking to encourage maximum use of the Fund.

Government could do several things to speed up the process. For example:

- as part of a spending review, it could require departments to produce evidence that they were developing a number of pilots, learning from them and pioneering further ones;
- it could earmark part of its social science research budget for the development and trial of methodologies for measuring social outcomes;
- it could encourage major trusts and foundations to collaborate with one another, with academics and with civil servants in identifying opportunities for pilots and refining methodologies;
- as suggested in chapter 3, it could appoint within the Treasury a senior official whose prime task was to encourage the development and spread of the SIB concept throughout government. To jump practical and bureaucratic hurdles, efforts will need driving from the top.

How might pilots make a difference

If a pilot worked and was replicated country-wide, it would have a substantial impact on people's lives. Even if it was not rolled out, it could still make a difference – in a number of ways.

First, pilots would make an impact in their own right. Social Finance will be raising £5million for the Peterborough pilot – a significant sum.

Secondly, a pilot could change how government deals with service providers. Lessons from a pilot might encourage government to change the terms of future PFI contracts, for example. A prison contract might stipulate that the management run a preventative programme for offenders on short sentences.

Thirdly, a pilot whose results were modest might be revised and tried again in a different area, or a pilot might be extended in a hybrid way.

Maybe a national scheme would lack an adequate control group. Government might put up 70% of the funds and ask the DA to raise the other 30%, with investors receiving a proportionate share of the savings achieved.

The hybrid concept could be taken further

Banking a larger proportion of the savings would compensate government for the increased risk that savings were due to extraneous factors.

Finally, taking the hybrid concept further, a SIB might be modified for financially high risk situations, such as intervening early in children's lives.

In these situations, attributing results to specific interventions is difficult and financial savings (in fewer school exclusions, lower crime, higher employment and fewer teenage pregnancies) take a long time to come through.

In such a case, government might recruit a DA to manage the programmes it was running on a large urban estate, for example. The programmes might include giving parents books to read to their children, tackling child obesity, extra help for children who are falling behind at primary school, parent support groups and so on.

For reasons described in Chapter 2, these programmes might well be uncoordinated, innovation limited and evidence for the effectiveness of each intervention relatively weak.

The DA would raise additional funds for start-up costs, filling in some of the gaps in provision, improving cooperation between providers, developing better practice and paying interest to investors in the early years.

Government would make interim payments to the DA on the basis of a series of intermediate milestones. These would be desirable outcomes that were achieved before the final outcomes – the outcomes that actually saved the government money.

On the basis of the available evidence, intermediate milestones would be indicators that the final outcomes were likely to be achieved. They might include improved performance at primary school, higher participation in obesity programmes and greater take-up of parenting support groups.⁵⁵

After 10–15 years, some of the final outcomes might start to appear – such as lower offending and teenage pregnancy rates, fewer obesity-related diseases and more young people in jobs. Government would start to make savings and payments to investors would increase. A new SIB could be issued to continue the management and coordinating task.

The SIB concept would have been adapted to a particularly difficult set of circumstances from investors' point of view.

Different types of SIB

Clearly, then, the SIB concept could give rise to a number of models that would improve outcomes for people in a variety of ways. SIBs could differ depending on whether they were:

- *national or local government-based*. Resettling prisoners on a short sentence would be a national scheme involving the Ministry of Justice. Introducing more energy-efficient street lighting, another of the opportunities discussed in chapter 1, would be a task for local authorities, with the Department of Transport in a supporting role;
- *multi-agency or single agency*. Resettling prisoners would involve a number of agencies in each region – agencies specialising in mentoring, re-housing ex-offenders and so on. Preventing amputations through the mismanagement of diabetes, on the other hand, would involve only one agency – the Primary Care Trust, though it might involve several trusts in a region;

55 Obesity and parent support groups might seem like output targets. But they can be defended on the grounds that they provide evidence that the programmes are being successfully rolled out, a prerequisite for the final outcomes to be achieved. During the programme, metrics could be refined for measuring the effectiveness of the obesity and parenting programmes.

- *area based or less geographically bounded.* Supporting adolescents with mental health difficulties on a specific housing estate, for example, would make it easier to combine a variety of complementary approaches such as parenting courses, group therapy and personal mentoring. In the case of better foot care for patients with diabetes, however, there would be few gains from targeting a neighbourhood;
- *single outcome-based or multiple outcomes.* Investors in a SIB to resettle prisoners, for instance, would be paid on the basis of a single outcome – reduced conviction rates. But for a programme to improve social outcomes for adolescents with mental health difficulties on a disadvantaged estate, payments could be based on reduced school exclusion rates, higher youth employment and reductions in youth crime;
- *private investment only or private and public investment combined.* As we have seen, in some cases the government could decide to put up some of the money itself.

Attracting private investment

If the SIB model is to come into its own, it will have to appeal to investors. Tapping commercial investors for capital should be possible once pilots are turned into national programmes. The pilots will have shown that investors can make a return.

National programmes are likely to be on sufficient scale to be of interest to fund managers. If the Peterborough pilot was extended to most of the country, for example, over £50 million would have to be raised.

Smaller programmes, on the other hand, might have to be bundled together to produce a big enough package for investment funds.

We have suggested that capital for each national programme (or package of small programmes) would be raised through a Master Fund. It is envisaged that at the end of the first programme, the fund would be wound up and capital returned to investors. Different funds could be created for different programmes.

As soon as practicable, however, it would make sense to grow a single fund covering a variety of programmes. The size of the fund and the number of programmes, each coming to maturity at a different time, would have big advantages.

Dividends could be paid annually, they would be based on payments from all the programmes in which the fund had invested, and investors could buy

and sell shares in the fund at any time. An organisation like Social Finance might launch a market place for these shares online.

A single large fund, which might become several competing funds if enough money poured into the SIB sector, would lessen the risks to investors, lowering the cost of capital.

A single large fund would lessen risks

It would also become easier to raise funds for programmes that were unlikely to make significant payments for a long time. If these programmes were 'lost', as it were, in other programmes that generated returns over shorter periods, investors could receive regular (though lower) dividends till the long-term

payments come through.

The potential for combining short and long-term investments may be surprisingly large. In Chapter 1, we noted that over the coming decade huge opportunities will open up for 'greening' government buildings.

The time is rapidly approaching when energy-saving technologies will pay for themselves over a relatively short period. The returns will be calculated relatively easily.⁵⁶

Financing 'green' investment through SIBs should be attractive both to government and investors. Returns will be relatively secure, the timings of payments predictable and the capital required will be substantial – think of all those buildings! The potential exists to create a large Master Fund.

Add in other SIB programmes that yield returns over a shortish period, and the fund could be large enough to support schemes that produce savings over a longer time scale. Financing some of the 'slow burn' interventions envisaged by Action for Children and NEF might become feasible.

How could the flow of private investment be encouraged?

The creation of a government-backed Social Investment Bank could increase the funds available for SIB programmes. In 2007 the Commission on Unclaimed Assets recommended that funds from UK bank accounts that had been unused for at least 15 years should provide the capital to launch a Social Investment Bank.

This bank, with a suitably large capital base, could:

⁵⁶ The main uncertainty will be future movements in energy prices. But these sorts of calculation are being done all the time in the investment world, and risks can be reduced by basing estimated returns on cautious assumptions about prices.

- stimulate non-government investment in SIB programmes by providing capital on commercial terms;
- increase the pool of investors open to considering SIB opportunities by bringing into the market more social investment advisors;
- make SIB offerings easier for potential investors to evaluate by supporting the creation of independent research organisations, who would produce high quality, independent analysis of the value of social investment opportunities.

To make SIB programmes more attractive to investors, government might also consider the creation of tax incentives.

As with the tax benefits applied to Venture Capital Trust investments, SIB investors could be given immediate income tax relief, tax-free dividends and capital gains exemption on exit. This would increase returns substantially, especially for high-rate taxpayers.

Like Venture Capital Trust investments, these tax concessions would recognise the level of risk investors were taking and the broader social and economic benefits of the investment.

Any concern about investors being subsidised by other taxpayers can be turned on its head. Individuals would be encouraged to invest in measures that would bring savings to all taxpayers later on. Investors would do everyone a good turn!

The cost to the Treasury of tax exemptions would be offset by the savings in government spending that resulted. Tax exemptions would pay for themselves.

Tax exemptions
would pay for
themselves

A commercial or philanthropic approach?⁵⁷

Bringing in private investment on scale can be described as a commercial approach to SIBs. In time a fully-fledged market would develop. SIBs could be rolled out at scale, which is the advantage.

But there are two possible drawbacks: it would take a long time for this market to mature while finding new ways to fund government remains urgent, and investors may be reluctant to back high risk interventions.

An alternative philanthropic approach would rely more heavily on charitable funding. This would have the advantage of providing support for activities with a more uncertain financial return and step-by-step progress could be made straight away. But scaling up SIBs would be much more difficult.

⁵⁷ We are grateful to Geoff Mulgan for encouraging us to make this distinction.

We are suggesting something of a hybrid. Charitable trusts and foundations would pay for innovative pilots to provide proof-of-concept. If successful, these would be scaled up using private capital. Risks could be spread by combining high and low-risk investments in a large Fund.

Our approach is a hybrid in a second way. It leaves the door open for a combination of public and private finance, such as a privately-funded DA that manages several streams of public spending in a given area. It may well be that these public-private hybrids will be how SIBs develop in the long term.

How would the social economy benefit?

The SIB concept is part of a new industry, social finance, which uses private investment to tackle social problems. Globally, social finance could be worth approaching \$500 billion by the end of the decade.⁵⁸

Interest in this new sector is rising up the political mast. It appeals to investors looking for new ways to make money, individuals wanting to do well financially by doing good socially and to those hoping for more enterprising government.

As part of this trend, SIBs are one of several innovations in funding government services. It has some similarities to the Private Finance Initiative (PFI), which employs private capital to fund the building and maintenance of schools and other government projects.

The big difference is that with PFI government is committed to extra spending for 20 years or more to meet capital and maintenance costs.

SIB payments on the other hand depend on cost savings that result from private investment. Government only makes payments if savings have been achieved. Whereas PFI is a future cost to government, SIBs are a future saving.

PFI is a future cost to government, but SIBs are a future saving

Likewise, the SIB concept has some parallels to Tax Increment Financing, which relies on future revenues to pay interest to investors and repay their capital.

A public project such as a road, school or hazardous waste clean-up will often increase the value of surrounding land and perhaps bring new investment to the area. Higher property values and the new investment boost tax revenues in the long term – the ‘tax increment’.

⁵⁸ This would represent about 1% of estimated professionally managed global assets in 2008. Jessica Freireich & Katherine Fulton, *Investing for Social & Environmental Impact*, New York: Monitor Institute, 2009, p. 9.

Loans are raised to pay for the project on condition that the tax increment is used to repay the capital plus interest. The SIB model would work a bit like this, except that the income stream would be generated by savings in government spending rather than higher tax receipts.

The model has echoes of the local bonds pioneered by Sheffield. Individuals and employers who want to invest in the city without making a profit can buy the Sheffield Investment Bond, with the guarantee of getting their money back after five years.

The interest generated from the investments is used to provide unique 'joined-up' services to those whose lives are blighted by debt.

Like these bonds, the SIB concept would appeal to private investors who want to put their money to a social good, but unlike the bonds investors would get a return on their capital if the programmes were successful.

SIBs would boost social finance by bringing new money into the third sector, making the revenue stream more rational and predictable, stimulating a more diverse social market of private and third sector organisations, and encouraging innovation.

Might the values of the social economy begin to permeate the commercial world? As the market for SIBs expands, commercial investors would have more opportunities to buy bonds with a social purpose. Investors and analysts would become more aware of social need.

As they engaged with the third sector, might some of the sector's values rub off on them, be transmitted to the investment community and give global capitalism a stronger social hue?

CHAPTER 6

Conclusion

There is wide cross-party support for pre-emptive government. Intervening to prevent problems clearly makes sense – it is better for the people involved, and often it is a lot cheaper than fixing the problem after it's broke. The difficulty has been paying for early interventions on top of all the government's other commitments.

Social finance
will be a growth
industry in the
coming decade

SIBs have the potential to help square the circle by bringing in funds upfront. They would bring new money into the system, harness the resources of the third and private sectors, encourage innovation, help government to become more decentralised and speed up the development of output measurements that demonstrably improve people's lives.

In the process they would give a strong fillip to the social economy. Social finance is set to be one of the growth industries of the coming decade. By aligning investor and government interests, SIBs could create a huge market for this new form of activity.

But they are not a panacea. In their pure form, SIBs would be effective only in situations where the taxpayer could make clear savings. Programmes would have to be designed with care. Identifying and developing output measurements would need particular attention.

Work remains to be done. It includes piloting the concept, learning from the experience, researching further the scope for introducing SIBs (how widely could they be applied?) and drilling down to the details of how SIBs would operate.

We believe it is important for those in government, the third and private sectors, and the policy community to debate the issues involved, and we offer our proposals as a contribution.

When so much is being said about cutting government expenditure, might we be approaching a point where spending to improve people's lives can be actually increased? The prospects for tomorrow would be surprisingly bright.