Making Sense of Social Impact Bonds for Companies

By Alex Parkinson, Senior Researcher and Associate Director, The Conference Board

Social impact bonds (SIBs)—also known as pay-for-success contracts—have emerged as a financing mechanism that brings to the government and nonprofit sectors the performance incentives and monitoring standards of private enterprise. In SIB projects, governments and other social welfare payers raise capital from the private sector for nonprofit-led social interventions, by offering the possibility of a financial return, as well as social impact. This Giving Thoughts article describes SIBs, highlights challenges and opportunities, and considers the role corporate social investing might play.

What is a SIB?

SIBs were first launched by Social Finance UK in 2010 as a public-private partnership to improve public sector efficiency. The UK Cabinet Office Centre for Social Impact Bonds, one of the early proponents of the model, defines SIBs as: “A new tool that unlocks private finance and public investment so that organizations which are best placed to tackle social problems can do so on a payment-by-results basis.”

The model funds proven social interventions that can be scaled by government to reach more people and the repayment structures, through which governments return investment based on a project’s success, require very precise social impact measurement, often including the use of a counterfactual (see page 5).

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Governments involved in SIBs typically seek to understand whether the social intervention will be successful if scaled to a larger number of participants. In that regard, all current SIBs are in some way a pilot—a risk-free way for government to experiment with potentially scalable projects. SIBs have the potential to encourage government to reallocate funds from remediation of social issues to their prevention.

Through SIBs, private investors bring a sense of discipline to the social sector. When investors, governments and service providers’ expectations are all aligned, SIBs (and pay-for-success models more broadly) will create the rigorous feedback loop required to correctly allocate government’s abundant social sector resources.²

Some believe that this scalability is the most important criterion for deciding whether to develop a SIB or not. SIBs are complex deals, and the effort and expense that goes into arranging them is only valuable if there is a realistic opportunity that the intervention will be scaled into a larger (e.g., state- or nation-wide) initiative.³

### Pay-for-success models

The “pay-for-success” (or payment-by-results) aspect of SIBs is important to highlight. Pay-for-success is not a new idea. Daniel Stid notes that performance-based contracting has been around in government since the 1980s, so many of the difficulties that SIBs face are not new.⁴

The difference with SIBs is that in traditional pay-for-success programs, nonprofits must be financially solvent enough to undertake the program because the funding comes at the end, when success has been achieved. But in the case of SIBs, nonprofit funding is delivered up front by private investors who then receive repayments from the project commissioner (in the case of SIBs, the government) at the end of the successful project, eliminating the financial risk to the nonprofit service provider.

### How SIBs work

SIBs are a complex, nascent financial product. They are constantly evolving, and each new deal is different from the last, often featuring unique characteristics or nuances that break from convention. Considering these complexities, it is difficult to present a single formula for how SIBs work, but there are some common attributes and functions. For example:⁵

- A SIB is a contract typically with a public sector agency in which the agency commits to pay for improved outcomes if a threshold level of performance is achieved. The contract outcomes and payment threshold are determined based on data related to the historic performance of the selected social intervention.
- On the basis of this contract, investment is raised from private, usually socially motivated or “impact,” investors.
- This investment is used to pay for an intervention that has been demonstrated to improve the contracted social outcomes.
- If social outcomes improve to the agreed threshold level, investors will receive payments from the commissioner. These repay the initial investment plus an agreed financial return, depending on whether the investment assumes low risk or high risk (current agreed returns have ranged anywhere from 2 percent for the lowest threshold of impact, up to 30 percent for outperformance).
- If the program does not achieve the threshold level of social impact, investors lose their money.

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² George Overholser and Caroline Whistler, “The Real Revolution of Pay-For-Success: Ending 40 Years of Stagnant Results for Communities,” Community Development Investment Review, volume 9, issue 1, 2013, pp 5-11.


Figure 1 shows a SIB model in its simplest form.

Within the basic SIB structure, there are four key groups, each of which plays a unique role:

- **Government agency** The government agency (or payer) identifies the social problem for which it is seeking a cost-effective solution and issues a request for proposal. These typically come from nonprofits with documented experience of success at addressing the issue, or from financial intermediaries experienced in convening impact investment deals. The government agency will also return capital to investors upon achievement of agreed social impact goals.

- **Intermediary** The convener of the deal, the intermediary will develop a SIB proposal, identify potential partners and investors, raise the capital for investment, and coordinate and finalize the contracts. It also manages the project through to the end, ensuring the appropriate direction of returns to investors. An intermediary may also be responsible for raising the capital and for providing ongoing investor relations and performance management services.

- **Investors** Investors assume the risk, provide the capital and receive the outcomes-based payments from governments.

- **Service provider** The service provider is typically a nonprofit organization with a proven intervention that has demonstrated success at addressing the identified problem.

This diagram excludes a key fifth group—the independent evaluator—which verifies the service provider’s success against its social impact goals. Using an independent evaluator, rather than simply relying on the results of the service provider, brings rigor and credibility to the impact assessment process. The project’s goals and the way in which they are assessed is negotiated by all parties during the structuring of the deal (it can be a complex task, particularly because it requires people and organizations from very different areas to agree on social impact—a largely intangible concept). The evaluator is appointed by the deal’s intermediary. Evaluators typically seek to prove the impact of a program by comparing the cohort that has received the intervention with a similar cohort that has not, thereby demonstrating the important “counterfactual” component of social impact measurement—or what would have happened if a particular program had not occurred.⁶

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Figure 2 depicts a complex model and outlines where potential contractual agreements could be developed. Roger Dugger predicts that “in a fully developed social investment, there are at least ten areas of contractual agreement.” He believes the five most important are shown as the black ovals in Figure 2.\textsuperscript{7}

This model highlights the variety of partners that must come together—often from differing viewpoints and experiences—to agree a range of parameters that will bring the SIB to fruition.

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Note: flow of funds represented by arrows and needed contract agreements by ovals.

Source: Adapted from Roger Dugger, “Success Begins With a Feasibility Study,” Community Development Investment Review, volume 9, issue 1, 2013, pp. 85-89.

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Social impact measurement

The development of final, agreed-upon success metrics and the ability to measure progress against them is integral to each SIB.

**Developing impact metrics for SIBs** Ian Galloway of the US Federal Reserve says that the “big idea” behind the social impact bond isn’t actually the bond itself; it’s that the social sector should be held accountable through ex post payments for evidence-based results rather than ex ante payments for promising programs. For those ex post payments to be accurate and fair to all parties, the impact targets and evaluation metrics must be rigorous and accurate, which means establishing similar comparison groups and evaluating their performance against that of the participants receiving the intervention.

**Establishing comparison groups** Much of the testing and experimentation that is taking place with the current SIB pilots is focused on how best to undertake a credible impact assessment using a comparison group as similar to the intervention group as possible. To increase the attractiveness of the model to investors, impact assessments need to be as accurate as possible to reduce risk and eliminate the possibility of conjecture surrounding the true nature of the impact achieved.

Although some SIBs operate without a comparison group, the Harvard Kennedy School Social Impact Bond Technical Assistance Lab (Harvard SIB Lab) places considerable importance on this part of the process, saying: “If there is no credible approach to establishing a counterfactual outcome for a particular intervention, then a SIB may not be feasible.”

It suggests that there are a number of ways of doing this, including:

- Randomized controlled trial (RCT), which compares populations receiving an intervention with a control group of identical individuals who did not receive the intervention.
- Regression discontinuity design, which compares outcomes of those just below and just above program eligibility thresholds.
- Difference in differences comparison of changes in outcomes in populations offered an intervention to similar populations that were not offered the service.
- Historical baseline comparison to past outcomes for similar individuals.

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Current SIB Pilots

This research identified 38 SIB pilots in operation in Australia, Europe, and the U.S. The following table provides summary information on each of these deals.

<table>
<thead>
<tr>
<th>CURRENT OPERATIONAL SIB PILOTS, BY COUNTRY</th>
<th>CONTRACT DETAILS</th>
<th>KEY PLAYERS</th>
<th>SOURCES</th>
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<td><strong>Issue</strong></td>
<td><strong>Location</strong></td>
<td><strong>Total investment</strong></td>
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**EUROPE**

|                             | **Issue**       | **Location** | **Total investment** | **Public sector payer** | **Intermediary/structuring organization** | **Service provider** | **Evaluator** | **SOURCES** |

Note: This table represents best efforts to identify the full breadth of active social impact bond pilots in Australia, Europe (including the United Kingdom) and North America (including Canada and the U.S.) launched before July 31, 2015. All information has been taken from public materials. Interested parties should access reference documents, or contact the appropriate intermediary for complete details of each contract.

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11 This research was limited to these three regions (Australia, Europe, and the U.S.), as this is where the majority of activity is taking place. It should be noted that other countries (including South Korea and Peru) might have initiated SIB contracts, but there is a lack of available information in English.
### CURRENT OPERATIONAL SIB PILOTS, BY COUNTRY (continued)

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<th>Service provider</th>
<th>Evaluator</th>
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| Adoption                | United Kingdom (national program) | £5.5 million (~$9.04 million) | Privately issued. Local authorities | “It's All About Me” service from the service providers | Baker Tilly UK | N/A. Local authorities (LAs) spot purchase the service for each child, and the savings to LAs are already known if each child reaches its milestones, therefore no comparison group is necessary. | “It’s All About Me” - The CVAA Service for Harder to Place Children,” Baker Tilly UK, Accessed February 11, 2014 (http://www.bakertilly.co.uk/publications/Its-All-About-Me.aspx)  

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<td>Homelessness</td>
<td>London</td>
<td>Up to £5 million (~£8.3 million) Final amount depends on outcomes achieved and costs incurred.</td>
<td>Department for Communities Local Government; Greater London Authority</td>
<td>Social Finance UK; St Mungo’s; Thames Reach</td>
<td>ICGHK</td>
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<td>Loneliness</td>
<td>Worcestershire</td>
<td>£2.02 million (~£3.15 million) Worcestershire County Council</td>
<td>Social Finance UK</td>
<td>Age UK Herefordshire and Worcestershire</td>
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<tr>
<td>Out-of-home care</td>
<td>Essex County</td>
<td>£3.1 million (~£5.1 million) Essex County Council</td>
<td>Social Finance UK</td>
<td>Action for Children Essex County Council and Social Finance</td>
<td>Not available</td>
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<td>Youth Homelessness</td>
<td>Kirklees, Calderdale, and Wakefield</td>
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<td></td>
<td>Birmingham, Coventry, Solihull, Walsall and Wyre Forest</td>
<td>Social Finance</td>
<td>St Basils</td>
<td>“Fair Chance, Rewriting Futures is a Social Impact Bond delivering support and community engagement to reduce youth homelessness,” Bridges Ventures, August 3rd, 2015 (<a href="http://www.bridgeventures.com/portfoliolist/st-basils-fair-chance-rewriting-futures/">http://www.bridgeventures.com/portfoliolist/st-basils-fair-chance-rewriting-futures/</a>)</td>
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Results to date

As of the summer of 2015, some SIB projects have already returned interim investor capital (such as the Teens & Toddlers and Adviza Social Impact Bonds in the United Kingdom, and the Early Childhood Education program in Utah), while others have been cancelled or prematurely closed for other reasons.12

The SIBs that have returned investor capital to date have all delivered only interim results, so it is difficult to analyze the results with confidence. It is the short-lived projects that are perhaps more interesting to investigate, because of the analysis a completed project invites (whether or not it is considered a successful or unsuccessful completion).

The world’s first SIB, the Peterborough Prison project in the United Kingdom, funded the One Service, a project specifically designed for the contract and managed by the project’s intermediary, Social Finance UK. The One Service aimed to “measurably reduce reoffending among male, short-sentenced prisoners released from Her Majesty’s Prison (HMP) Peterborough.”13 The program offered intensive support to 3,000 short-term prisoners both inside prison and after release, to help them resettle into the community.

The pilot was closed early by the U.K. Ministry of Justice (MoJ) before its full completion (although two cohorts of prisoners participated in the project). The MoJ says it plans to introduce country-wide reforms to prisoner probation, and the intervention used in the SIB pilot will be subsumed by those reforms.14 The MoJ says the winding down of the SIB is not a reflection of the pilot’s failure—early MoJ data in fact showed positive impact trends as a result of the intervention.

The pilot was canceled after three years of attempted intervention programs demonstrated no reduction in recidivism rates. Goldman Sachs, the sole original investor, registered a $1.2 million loss. With the project lasting three years, Goldman’s commitment topped out at $7.2 million and Bloomberg Philanthropies provided a $6 million grant to guarantee a portion of the investment.16

There are two perspectives on what the cancellation of the Rikers Island project means. On one side, some consider it evidence that SIBs are fundamentally flawed as a model because, for example, there are factors other than the funded intervention that can contribute to the outcomes or lack thereof. The National Union of Public and General Employees says: “According to the organization that was contracted to deliver the SIB project, two factors that contributed to the failure were conditions in Rikers Island jails and the lack of services for inmates after they were released. The fact young people released from Rikers Island couldn’t get mental health care, drug treatment programs, and housing assistance in the community were all identified as serious problems.”17

On the other side, proponents argue the structure enabled city officials to experiment with a new intervention without risk to taxpayers.18


14 GIVING THOUGHTS MAKING SENSE OF SOCIAL IMPACT BONDS FOR COMPANIES www.conferenceboard.org
The Role of Philanthropy in SIBs

Philanthropy is the traditional provider of risk capital to the social sector, seeding innovative approaches and models that, when successful, can be handed off to government to be scaled up. The SIB model is one such innovation that, with the right early financial support, could attract large numbers of social investors and blossom into a successful, scalable model.

That’s where philanthropy comes in.

Whereas some commentators fear that pay-for-success projects could direct funding away from social innovation by rewarding only successful, proven interventions, others argue that SIBs are an innovation in social financing in themselves, and that the model should be nurtured to allow it to grow.

The question of how long philanthropy will be needed to support SIB market development is a difficult one. Some say that the small size of projects, which do not appear to yield supernormal returns, means that “continued philanthropic support of both intermediaries and government capacity may be needed for quite some time.”

Options for philanthropic support

With new deal structures constantly emerging, the role of philanthropy in SIBs is always changing and often expanding. Social Finance USA identifies four main roles for foundations in supporting the creation of a SIB ecosystem:

• Making grants to support capacity building among key market participants, conduct research and encourage learning, develop proof-of-concept projects, pay for outcomes, and mitigate risk.

• Investing directly in SIB transactions, recoverable grants, and other forms of investment.

• Fostering partnerships among stakeholders by helping to bring together the various and diverse actors in this space, and helping to unite them around shared goals.

• Advocating and educating to influence policy, attitudes, and knowledge, both among the general public and among those directly involved in SIBs, such as government officials and service providers.

Social investment funds

Investing in a financial model as nascent as a SIB is risky. Some foundations are diluting that risk by investing in deals through social investment funds. Such an approach offers the appeal of exploring the opportunities that SIBs offer while not exposing large amounts of investment to an unproven model. This style of SIB investing appears to be generating the most interest from philanthropists, judging by the number of foundation and other philanthropic investors listed by the major SIB funds. Bridges Ventures in the United Kingdom and Living Cities in the U.S. are two of the main SIB fund managers.

Bridges Ventures’ Social Impact Bond Fund Launched in April 2013, this is a £25 million (~$39 million) fund that has Big Society Capital, an investment vehicle created out of money left in dormant bank and building society accounts, as its “cornerstone” investor.

The fund invests in a number of SIB pilots in the United Kingdom. It aims to “support charities and to deliver programs designed to improve social outcomes in areas such as education, therapy, adoption and care for vulnerable young people.”

Living Cities’ Catalyst Fund Launched in 2008, the Catalyst Fund has made $35 million in below-market rate loans to “finance innovative efforts in the areas of neighborhood stabilization, energy efficiency retrofits, public education and access to fresh foods and health care.”

The Catalyst Fund invested in the Massachusetts youth recidivism project and the New York state workforce re-entry project.

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Backing nonprofit service providers

An interesting approach to structuring a SIB involves the nonprofit service provider taking a stake in deals by deferring a portion of their revenue payments until the SIB successfully meets its social impact targets. However, many nonprofits do not have the financial capacity to defer large amounts of revenue for what can sometimes be many years, so the structure opens the door for philanthropic funders to subsidize nonprofits until the delayed revenue is paid. Doing so allows philanthropists to be invested in a SIB, without necessarily being contracted into it.

Such a structure means the benefits of successful projects could accrue to all parties. In particular, nonprofits could earn higher revenue through interest paid on successful projects, and philanthropic backers, which do not necessarily expect a return from their grants, could achieve greater social impact from their funding by allowing their nonprofit partners to reinvest the returns into their programs, helping the organization to build a sustainable financing model.

Guaranteeing investments

One of the most explicit uses of philanthropy to support the nascent SIB model is to essentially “underwrite” the contract, so that philanthropic funding takes most or all of the risk, allowing investors an opportunity to take part in the deal without the potential of losing their investment. Such a structure has been used to varying degrees in the early U.S. SIBs, with foundations such as Bloomberg Philanthropies and the Rockefeller Foundation providing the backing.24

The nature of philanthropic backing has evolved into a subordinate loan structure in newer SIBs, such as the Massachusetts youth recidivism deal. In that example, the “senior” loan, for which Goldman Sachs has provided financing, will be repaid first and will receive a higher interest rate—despite shouldering less risk—than the “junior” loans, for which philanthropic institutions have provided financing.

Like other uses of philanthropic funding mentioned previously, the main benefit of this structure is to allow a range of different investors to take part in the model with a minimal amount of risk.

Challenges of the SIB Model

A financial model in its infancy faces several challenges that are important to consider. For SIBs, such challenges include:

- **Capacity** If the SIB model is to be successful, capacity building across government, service providers, and intermediaries is vital.25 Skills and expertise are required in a number of areas, not least in data capture and analysis, especially among service providers. Unfortunately, according to the Social Market Foundation, a UK-based think tank, few community sector organizations have the capability to absorb and deploy large amounts of investment effectively.26

- **Complexity and expense** Uniting the very different worlds of private investment, government, and social service providers is a complex process that involves a large number of individuals who perceive the world in different ways. The expense and effort that goes into contracting mean that there should be large potential impact to make the process worthwhile.

- **Government commitment** Building government capacity requires dedicated staffing and expertise, and new political regimes might choose to manage contracts differently, disrupting the passage of SIBs.27

- **Transaction pipeline, allocations, and liquidity** Steven Godeke notes that the current lack of deal flow is a concern for investors, many of whom are also “uncomfortable with the prospect of being locked into an illiquid multiyear position.”28 He adds: “A sustainable investor market for PFS [pay-for-success] financing will require a set of successfully executed deals to provide adequate data to price the risk and to standardize elements of a PFS transaction where possible.”

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24 In Australia, this structure has been introduced into the financial model more formerly through medium- and high-risk investment tiers. The structure of The Benevolent Society out-of-home care SIB, which has Westpac Bank as its intermediary, is such that there is a pool of capital available to protect medium-risk-tier investments.


• **Risk transfer** While one of the most appealing aspects of SIBs is the transfer of government risk to investors, in the long run it might be necessary for governments to share more of the risk to achieve impact, as the pool of capital available and the number of policy areas where it will be possible to convince investors to take on all of the risk are likely to be limited.  

• **Significant ramifications for failures** Service providers face added reputational risk that goes beyond a single contract if they fail to meet the goals of a pay-for-success contract. McKinsey & Company consultants Laura Callanan and Jonathan Law say: “Once outcome targets have been set and measured under one contract, funders, investors, and others doing due diligence before selecting a service provider are likely to ask, ‘so, did you achieve your goals?’ A positive answer should go a long way toward cementing a new relationship, but results that don’t measure up will sour the discussion fast.”  

### Corporate Involvement

Corporations have been slow to embrace SIBs. To date, mainstream financial institutions are noticeable investors in SIBs in Australia and the U.S. Their involvement is either as a traditional “social investor,” such as the Goldman Sachs Urban Investment Group, which invests in three of the current U.S. deals (having taken a loss on the Riker’s Island project), or through their foundations, such as the Westpac Foundation in Australia, which invests in The Benevolent Society out-of-home care deal. Bank of America Merrill Lynch played a third role—that of placement agent—when it placed the New York State transaction on its wealth management platform and facilitated the investment of their clients.

The companies that have shown interest—financial or otherwise—are tending to test the waters through investment pools or investments guaranteed by philanthropic contributions (see page 16), and few have come out publicly in support of the model.  

Beverage alcohol producer and marketer Brown-Forman, which owns brands such as Jack Daniel’s, Woodford Reserve and Casa Herradura, is the first non-financial company identified by this research to be considering a SIB structure to address a business-critical social issue, in this case alcohol addiction and substance abuse treatment and recovery (see “Core CSR Issue Prompts Brown-Forman To Explore SIB” on page 18).

### A business case

Apprehension on the part of most corporations could reflect the range of challenges the model faces in its formative years, as well as the fact that there is not yet a particularly compelling business case for corporations in the developed world projects. For banks, there is the prospect of a new financial product that could interest clients and other investors, as well as the requirements of the Community Reinvestment Act in the U.S. For others, the social issues that have been addressed to date, such as prisoner recidivism and out-of-home care, do not necessarily have a clear business benefit alongside the social benefit (also known as “blended value” or “shared value”).

An argument could be made that any of the issues addressed by current SIBs help with community building, which in turn benefits local economies and ultimately provides a more stable and attractive business environment. But companies are more strategic with their support for social causes, as demonstrated by the tendency for corporations to develop community or corporate social responsibility “pillars” or focus areas.

Until SIB projects fall into companies’ community or corporate responsibility strategies, they might remain the purview of private social investors—or at the least, financial institutions.

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30 Laura Callanan and Jonathan Law, “Pay for Success: Opportunities and Risks for Nonprofits,” Community Development Investment Review, volume 9, issue 1, 2013, pp. 79-84.


32 According to the Federal Reserve, “The Community Reinvestment Act is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound operations.” More information is available at http://www.federalreserve.gov/communitydev/cra_about.htm/.
Core CSR Issue Prompts Brown-Forman To Explore SIB

Louisville-based beverage alcohol producer and marketer Brown-Forman has a well-established corporate vision: “To enrich the experience of life, in our own way, by responsibly building beverage alcohol brands that thrive and endure for generations.”

According to Rob Frederick, Brown-Forman’s vice president and director of corporate responsibility, alcohol addiction completely contradicts that vision. “The last thing we want is to have someone’s health and well-being ruined by drinking,” says Frederick. “We’ve focused on helping people with addiction for a long time because it’s very relevant to us as a business.”

Much of Brown-Forman’s work on addiction has been in partnership with The Healing Place, a Louisville-based nonprofit that aims to reach men and women suffering from drug and alcohol addiction, provide the tools for recovery, and restore productive lives. The Healing Place is recognized as one of the country’s most effective long-term social model recovery programs. With 75 percent of its alumni remaining sober after one year, the organization boasts a success rate five times the national average for recovery facilities.

Ripe for a SIB There is a confluence of factors in Kentucky and Brown-Forman’s approach to addressing addiction that makes a social impact bond (SIB) an appealing option. These factors include:

- **A health crisis** Kentucky is in the middle of a heroin crisis and there is much attention on the issue and many approaches surfacing on how to best address it. Nowhere is this manifesting itself more than in the Louisville Department of Corrections, where the jail is increasingly serving as a short-term detox unit. Frederick acknowledges that it has been a challenge for Brown-Forman to get comfortable with heroin and alcohol addiction being lumped together, but at the end of the day, he says, “addiction is addiction, and addicts often use more than one substance.”

- **Cost-effective, measurable solution** Addiction is a huge drain on community and government resources, and a cost that far outweighs the cost and benefit of recovery. At a cost of $25 a day and free to clients, The Healing Place’s intervention is cost effective and proven through measurable outcomes. Moreover, the organization deals with constituents who are most in need of assistance—those who are deep into addiction and have had many personal consequences.

- **Government inefficiency** The alcohol industry is heavily taxed, which is an ongoing legacy of prohibition that was established to reduce harm. But, according to Frederick, government needs to better address the problem of addiction and the SIB model provides an opportunity to improve the use of limited government resources.

- **Multi-stakeholder response** The issues related to addiction and the benefits of recovery affect so many different branches of society that no one party or sector can deal with it alone.

Partnerships between the government, private and nonprofit sectors are crucial. Frederick says: “No one actor can or should solve the addiction problem alone, and a SIB is a way to do it in partnership. It’s a really good stakeholder engagement tool.”

Having read about New York City and New York State SIBs, Frederick led Brown-Forman into discussions with local partners, including Louisville Metro Government, the Community Foundation of Louisville and James Graham Brown Foundation, to explore the possibility of developing a project in Kentucky to tackle addiction. The basic premise is to provide treatment to a target population from the local jail that will reduce recidivism and other burdens on local government services. Placing inmates who are ready for treatment will create cost savings, cost avoidance and community benefit. The project reins have been handed over to Louisville Metro to develop the idea further. The explorations have not yet yielded a contract, but they are fairly advanced and have included experts from the Harvard Kennedy School Social Impact Bond Technical Assistance Lab and Third Sector Capital Partners.

**Company-led project** To have a company act as convener of a SIB is unique—contracts are typically instigated by government. But having a company at the helm of discussions could become more common, particularly if corporations look at their core social issues and decide that something needs to be done in partnership to achieve a level of impact that they can’t on their own.

Frederick acknowledges that the multi-stakeholder aspect and full system approach of a potential project is part of the appeal, but also adds to the complexity. For instance, one of the challenges that the partners will have to address is that the potential cost-savings of reducing addiction can accrue to many parts of the community and therefore several areas of government. Building a measurement framework and repayment schedule to reflect that is not going to be easy.

Although Brown-Forman has not yet decided whether or not it will invest in any future SIB on addiction in Kentucky, the idea that a SIB could help shift Brown-Forman’s philanthropic mindset from being one of “donation” to “investment” is appealing to Frederick. He says: “You could potentially tap into a much bigger source of funding and significantly scale up our contribution to the issue. It’s a way to have a bigger financial contribution to something that’s accountable and which matters to us.”

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b "Our Purpose," The Healing Place, accessed on September 9, 2015 (http://www.thehealingplace.org/our-purpose/).
Development Impact Bonds

The current SIB model assumes that local or state governments issue the bond, but the emergence of some alternative approaches suggests an evolutionary model. In future SIB models, the commissioning organization could be any party that seeks to shift the risk of funding social services to the private sector. This could mean institutions like corporations, or large international donors essentially playing the “outcome payer” role that has to date been fulfilled by government.

A movement has emerged that advocates the use of the “impact bond” financial model for international development funding. These so-called development impact bonds (DIBs) follow a very similar approach to SIBs, but donors such as the U.K. Department for International Development act as the outcome payer. The need for such a model in the international development sector is similar to why SIBs have started to appear: to counter inefficient allocation of capital, improve cost-effectiveness, and improve the nonprofit sector’s focus on results.

Early activity In June 2014, the world’s first DIB launched. Led by Instiglio, an international development intermediary, the DIB focuses on girls’ education in Rajasthan, India. The payer in this project is the Children’s Investment Fund Foundation, and the UBS Optimus Foundation is providing working capital to the service provider, Educate Girls, a Rajasthan-based nonprofit that instigated the idea for the DIB. The organization has a strong history of collecting data on its performance, having measured its impact in the past using a randomized controlled study, which it believes made it a strong candidate for a DIB.

Other funding commitments and advanced explorations include:

- **Mozambique** International development consultancy Dalberg is working with three corporate partners to launch the Mozambique Malaria Performance Bond, which aims to address the funding gap for malaria interventions by increasing funding and efficiency for malaria interventions (see “Corporations Unite to Fight Malaria with Unique DIB” on page 20).

- **Uganda** The UK Department for International Development has announced that it will launch a DIB to invest in the prevention of sleeping sickness in Uganda. This process will begin with a £1.5 million (~$2.3 million) inception project that will research and design the final bond.

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Corporations Unite to Fight Malaria with Unique DIB

There is something fundamentally different about the Mozambique Malaria Performance Bond (MMPB) from any other SIB pilot or DIB under exploration: a strong business case for corporations’ participation. This is according to Lily Han, an Investment Principal at D. Capital of Dalberg, the project’s financial intermediary.

In an interview with Devex Impact, Sherwin Charles, a Director at Nando’s and Sonhos Social Capital, expands on this idea: “I think what is great about the model is that it shows there is a compelling business case for corporates doing business in an endemic malaria country to invest in eliminating malaria in those communities. Because, at the end of the day, for anyone who is doing business there, there is an incredible upside and return on getting rid of malaria. It raises the GDP of the community, it frees up health resources to deal with other illnesses, and it makes a huge impact on education because malaria has a big effect on kids who suffer from malaria at a young age.”

Corporate involvement Although the MMPB has not officially launched, a pilot program is under way to test the intervention. The pilot has secured initial grant funding and technical support from corporate partners including Nando’s, a South African based casual dining restaurant with a Portuguese/Mozambican theme, BHP Billiton and the Coca-Cola Foundation. A total of $600,000 was raised from corporate support and used to build a team of implementers that launched the intervention.

Each of these companies has a business interest in supporting an effective model for eradicating malaria in Mozambique:

• Nando’s sources chili peppers there;
• BHP Billiton has operations there; and
• A healthy, prosperous Mozambican population will be a large consumer base for Coca-Cola.

Han says that these companies have all spent significant resources over many decades trying to counter the economic burden of malaria, but the bond will allow them a financial mechanism to pool their resources and have a stronger impact. “The MMPB has a strong value proposition,” she says. “Where similar business rationales lie for companies to participate in DIBs, I would encourage them to explore those, rather than construing DIBs as irrelevant to the private sector or a pure corporate philanthropy effort.”

Public sector involvement Dalberg and the rest of the partners, which have strong connections with the Mozambique government, have been working closely with the Ministry of Health and donor agencies in Mozambique. The Mozambican government was also heavily involved in the setup process. It fostered a policy environment in which Indoor Residual Spraying (IRS) activities—the intervention used to address malaria—could function efficiently. The government also approved the district operations, and provided the implementers with the insecticide used in the IRS spraying rounds. The intervention not only piloted the malaria control program but also the private-public partnership that is unique to this intervention, and one which should be strengthened and expanded to maintain the gains made in malaria control. The strong relationships that have been built between corporates, implementers and the government is one of the major drivers behind the positive results achieved.

Pilot results The pilot intervention was primarily focused on prevention through the implementation of an IRS regime in the Boane District, Maputo Province. The IRS spraying was led by Francios Maartens, a veteran expert with over 15 years’ experience in malaria control, and his team at the Goodbye Malaria Foundation. Francios’s experience working on the Lubombo Spatial Development Initiative (LSDI), a highly successful cross-border malaria control program, has been a key factor driving the success of this pilot.

After two years of spraying, the parasite prevalence rate in Boane District has reduced by 72 percent from an initial 13.75 percent to 3.75 percent. There has also been a 33 percent reduction in the number of malaria cases reported, from 29,305 (2013) to 19,704 (2014). The second round of spraying was completed in April, 2015, and the final parasite prevalence survey will take place in November 2015. The results in Boane have proven that this type of intervention produces strong results and should be replicated further to protect more people.

Based on these results, the Goodbye Malaria Foundation, in conjunction with D. Capital, has designed a scale-up plan to expand the project from Boane to all eight districts in the Maputo province over the next three years. The proposed program scale-up will be funded through a DIB, with the aim of providing a clearer understanding of whether a DIB is an effective financial mechanism to fund efforts to eradicate malaria at scale in an emerging market.

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Conclusions

Whereas many believe the SIB model offers a practical way for governments to experiment with interventions risk free, others are less willing to expound SIBs’ potential. With two early closures already logged and the industry largely unsure what to make of them, SIBs are experiencing some growing pains. Nonetheless, pre-contract SIB activity continues to flourish around the world and high-profile government support—including support from the White House—suggests that will continue.36

Philanthropy has been an important support for the model’s experimentation with financing structures, and it will no doubt continue to be as the field searches for the most compelling model to attract investment.

It is, however, the ability of SIBs to create or enhance social impact that will likely dictate whether they will continue to be used. Each party currently involved is seeking impact in the most efficient way, and if SIBs can help them achieve that, then there could well be a proliferation of projects in future.

No one-size-fits-all approach

A variety of structures are being implemented in current SIB pilots, despite the small number in operation. To a degree, this is a reflection of market nuances. The philanthropy sector in the U.S. is more mature than either Australia or the United Kingdom, where other SIB pilots exist. As such, early U.S. pilots have had considerable backing from prominent philanthropy organizations, and the deals are built to focus on the pay-for-success model and less about a new financial product.

In Australia, however, there seems to be more focus on generating a market for SIBs as a financial instrument, so more effort has been put into creating comprehensive structured finance deals with considerably more investors. The United Kingdom, which developed the SIB model out of a large pool of government capital earmarked for social investments, seems to have continued with this approach, launching funds to develop the market and attracting some individual and organizational investors along the way.

Meanwhile, the emergence of DIBs has generated a different model that does not necessarily require government to fulfill the role of outcome payer.


Experimentations like this will likely continue, and the future SIB/DIB market could be one in which a variety of structures become the norm.

Corporates need a more compelling business case

Although expressions of interest abound regarding corporations’ involvement in SIBs, there is still a relatively low amount of activity from the corporate sector in the model. Companies that are taking part are doing so largely because there is a business case for them. That means that the majority of corporate involvement is coming from banks, for which SIBs and DIBs present the opportunity to develop a new financial product and to engage investors.

There is potentially a more robust business case for companies in DIBs, particularly those with operations, employees, or consumers in the developing world. The social issues that DIBs attempt to address are more systemic poverty-related issues, such as health and education. Improving the performance of the developing world on such issues could help to create a safer, more attractive market in which to do business, and therefore has corporate interest.

The emergence of healthcare as a social issue for which SIBs might be an effective funding mechanism presents an interesting proposition in terms of a business case, particularly in the U.S. where healthcare costs for corporations are significant. Brown-Forman has emerged as the first company to lead explorations into a SIB, focusing on addiction and recovery. It is a social issue that the company has been involved in for decades and one which is core to its business. The example could provide a pathway for other companies tackling social issues through a multi-stakeholder approach.

Nonprofits face public scrutiny

As nonprofit service providers attempt to figure out their potential role in SIBs, it is important to note that the prospect of new funding also carries with it the prospect of a very public examination of their impact. Embarking on a SIB is a large reputational investment, and the reputational damage that failure might bring could heavily affect a nonprofit’s potential to fundraise in future.
About Giving Thoughts

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