Social Impact Bonds: A paradigm shift in the method of financing the Social Sector

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Abstract
The world of finance has been testimony to dynamism and innovation. Result Based Financing Approach (RBFA) or Payment by Result is a recent financing paradigm that is unlike the traditional approach of funding for the input requirement. Here the finances are provided for pre-agreed outcomes. Under the umbrella of RBFA tools, the paper focuses on Social/Development Impact Bonds (SIB/DIB) only. The objective of the paper is to analyze the trend and the sectors in which SIB/DIB are utilized around the globe, study the scope of employing DIBs in India through the study of Educate Girls and Uganda DIB and recommend ways to pool private investors’ fund. The concept being relatively new and still unproven, secondary data has been used. The cases when analyzed revealed that the efficient use of data in delivering the outcome report helped in channelizing the funds for widening the scope of the program. The functioning of SIB/DIB in the international sphere provides lessons to stimulate market growth. Measures like subsidizing cost and increasing investor awareness are important suggestions. Since government has been a catalyst to social change, the structure to finance social welfare programs through a mixture of public, private and philanthropic finance is a budding concept that needs to gain more ground. Financial return on achieving social objectives is a reward that should attract investors; comparison of DIB with other financial schemes reveals it to be riskier investment. But the ability of Dasra in recouping 40% of the initial investment is a success in itself. Issues of independent and efficient social impact assessment organizations, risk of outcomes and variety of social issues remain the hurdles to growth of DIB in India. The paper concludes with policy suggestions.

Keywords: Innovative Finance, Social Impact Bonds, Development Impact Bonds, Result Based Finance, Social Finance

1. Introduction
The world of finance has been testimony to dynamism and innovation. In the horizon of investments, a new approach to investing opportunities was invented where financial and social returns became important criteria for financing decisions rather than the factors of input. Impact investing or Payment by Results is a public policy that channels funds into organizations focusing on returns that are measurable. Impact created is evaluated by an independent authority. The aim here is to earn dual returns; one is the fulfillment of the social or environmental objective and financial gains which here becomes the secondary objective. These investments are directed at both emerging and developed markets primarily addressing the crucial issues like innovation in technology, affordable necessities and services, sustainable agriculture etc. When this model is utilized for social returns strictly it is named Social Impact Bonds (SIBs) in developed countries. The same when applied to developing nations it is termed as Development Impact Bonds (DIBs). Against the backdrop of financial crunch faced by the government in attaining the social objectives, involvement of private players was strongly advocated. This led to the innovation in financing mechanism. The first ever SIB project was adopted in UK back in the year 2010. In order to reduce the rate recidivism at Peterborough Prison, Cambridgeshire the program Social Finance UK was launched which promised to repay investors if the rate of recidivism was reduced by 10%1 within the year 2016. The concept spread to US in 2012 through the initiation of the program Manpower Demonstration Research Corporation2. The developed nations have been experimenting and exploring the dimensions of this innovative finance mechanism to reduce the burden of the government and improve social impact. India is a nation with issues pressing the society and the concern of the government. Efforts to alleviate the situation have been ongoing on and funds allocated each year rarely bring the desired result. This brings about the need to study SIBs/DIBs in India.

1.1 Related Literature
Pay for Success contracts have been around for a long time in countries like US. Its use has been found in the form of performance clauses in construction contracts utilized by the Department of Defense. The main aim of these clauses was to get over the barriers in the working procedure, besides gaining financial returns and increasing productivity. There may be variations in the models under use depending on the outcome aimed at by the government or the concerned party. (Azemati et al., 2013). Criteria necessary for funding through SIB are: the benefits should be high enough to allow taxpayers and investors to realize them, outcomes should be measurable, a well-defined treatment population, safeguarding the population that is treated and credible impact assessments. (“A Guide for State and Local Governments,” 2013) By pooling the private investment capital, SIBs allow access to flexibility and patient working capital at a large scale. There are many areas which coincide and do oppose problems that makes SIBs case specific. (Ragin & Palandjian, 2013) There have been debates over the cheapest way of financing social issues. The governments can at any time fund its requirements through taxes or bond markets at lower rates of interest. To negate this observation and to emphasize the applicability of SIB, a strong argument

1 https://www.rockefellerfoundation.org
lies in SIBs being more effective and outcome focused that actually deals with the problem headstrong. But high costs of policy failure, problems of design and understanding the scenario of social issues remains. (European Commission’s DG Employment, Social Affairs and Inclusion.) SIBs always work either on the frontier of innovation and intervention risk or as a mainstream commissioning structure. For the former the barriers include market signals that blunt out the desired innovative impacts of the SIBs. While for the latter narrowing the gap between the returns and the price of the commissioners is a demanding issue. (Keohane, Mulheirn, Shorthouse, & Foundation, 2013)

All these working papers and policy papers have been a part of the developed country’s framework to finance the social sector focusing on their problems and underlying risks, such work in India till now is in a nascent stage. The paper thereby attempts to provide literature and study the first case of DIB in India.

1.2 Objectives of the Study
1. To study the role of SIB around the world in overcoming social issues
2. Analyze the case of Educate Girls and draw lessons and applicability of DIBs in India

2. Methodology
Secondary data has been utilized from various sources to provide sufficient relatable data on the case. Sources of data have been mainly the websites of Instiglio and Educate Girls.

2.1 SIBs around the world
SIBs around the world have been divided into various stages of implementation they are:
Exploration stage: This stage covers projects where governments, donors, service providers or other parties have expressed interest in SIBs and DIBs, but the project fails at least one criterion required for inclusion in the design stage.
Design stage: This stage covers projects that meet all three criteria, but where services have not started. The criteria are: 1. Public information of a SIB being designed. 2. Publicly available information about the social issue and the population that the program is targeting. 3. Publicly available information about the location where the program will be implemented.
Implementation stage: This stage covers projects in which service provisions have already started.

Following is a chart showing the stages of SIBs around the world:

<table>
<thead>
<tr>
<th>Country</th>
<th>SIB In Design Stage</th>
<th>SIB in Implementation Stage</th>
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<tbody>
<tr>
<td>United Kingdom</td>
<td>9</td>
<td>24</td>
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<tr>
<td>United States</td>
<td>9</td>
<td>8</td>
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<tr>
<td>Israel</td>
<td>5</td>
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<td>Australia</td>
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<td>South Africa</td>
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<tr>
<td>Uganda</td>
<td>1</td>
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<td>Total</td>
<td>28</td>
<td>44</td>
</tr>
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</table>

3. Cases
3.1 DIB in Uganda
The eastern part of Africa is the developing ground for acute and fatal illness like sleeping sickness (Human African Trypanosomiasis). Uganda poses a serious risk of potential health issues in the future, since it is the only place where both the East African and West African forms of sleeping sickness exists. It is hard to diagnose and even difficult to treat. The affect is not only limited to humans it also extends to the cattle, which indirectly effects the livelihoods of the
farmers. Through study it has been revealed that the cattle are the main reservoirs of the east African sleeping sickness. At present 9 million people are affected in Uganda. This is transmitted to the humans through tsetse flies. Social Finance intervened into this scenario to even the odds and improve the lives of the masses by treatment of the cattle in fifty at-risk districts. The Model, This DIB model differs from traditional approaches in being more transparent and impact oriented.

The investors here provide the necessary working capital required to provide treatment facilities for 8 million cows across 50 districts. The Department for International Development (DfID) is providing 1730,350 pounds for the purpose. The project was initiated in May 2014 with an estimated end date of September 2016. The model provides a clear management and governance structure. After a pilot survey and research on 150 villages, a calibration of payment triggers was calculated. Further a communications plan for the beneficiaries was designed to keep them informed from time to time. There is a specific independent evaluator to report on the success of the funding and the impact so created. Since the repayment is performance based, there is an eager monitoring of the delivery systems.

3.2 Educate Girls DIB
The first of its kind financial mechanism to be adopted in India is the Educate Girls Development Impact Bond. Educate India is a program piloted by the award winning NGO Dasra. An attempt to pool private investments and also yield them returns, a 100% outcome focused investment fund was designed. This project was implemented to provide a ‘proof of concept’ about the benefits of the DIB and help provide a model to base future decisions on. The details of the project are outlined below:

- Independent Evaluator – IDinsight
- Outcome Payer – Children’s Investment Fun Foundation
- Investor – UBS Optimus Foundation
- Social Objective Implementer – Dasra, Educate Girls.
- Project Management Company - Instiglio
- Aim - General improvement in various schools for 18000 children, 9000 being girls through improvement in operations of 166 schools in 140 villages in Bhilwara District, Rajasthan
- Duration – 3 years, 2015 to mid 2018

3.3 Model
The framework as to how the various stakeholders will be combining their activities in achieving the ultimate outcome has been illustrated below.
4. The participants

4.1 UBS Optimus Foundation: Owing to its wide networking it helps streamline donations to improve the future of the children. Through high impact and innovative programs it funds these initiatives by pooling donations from around while it itself bears the administration costs.

4.2 Children’s Investment Fund Foundation: An independent organisation that works to alleviate the issues faced by children in developing countries. It has headquarters in London and offices in Nairobi and New Delhi. To achieve sustainable impact it works high quality data and evidence to measure the progress of the partnered firms or organisations. Instiglio: It is a game changer in the field of financing social causes. It builds a direct relationship between funds and impact created. It is responsible for technical assistance in implementing DIB or SIB.

4.3 IDinsight: This is a research firm that provides decision making material in the form of data and evidences to help transform the social sector funding mechanism. Other participants include Dalberg Global Development Advisors (an international development consulting firm responsible for recording lessons from the implementation of DIB), Linklaters (international law firm will be providing drafting counsel work) and Reed Smith (international law firm providing service of review counsel).

The illustration displays the flow of funds and the mechanism through which the investor, the outcome payer, the independent evaluator, the project management company and the social objective implementer are involved in alleviating the social issue. UBS Optimus Foundation is a socially motivated investor who wishes to invest in a social cause and earn both financial and social returns. To achieve this objective the service provider Educate Girls is engaged to work on the social issue. Instiglio is a project management company that supports Educate Girls in carrying out their activities. It is also responsible for the design of the outcomes, financial model and the payment structure. On successful achievement of the target, the outcome payer Children’s Investment Fund Foundation (CIFF) will refund UBS the principal amount along with certain added returns.

4.4 The Decision Committee

The group working on the formulation of DIB is divided into two. They are:
1. DIB Advisory Group: This is formed by a team of experts hailed from outside. They help in planning and structuring the DIB model that is applicable depending on the case under study.
2. DIB Working Group: UBS, CIFF, Educate Girls, Instiglio and IDinsight are the main members of the working group. They design the implementation roadmap for DIB.

4.5 Role of the Independent Evaluator

The independent evaluator divided the outcomes into two, learning outcomes and enrolment outcomes.

Learning outcome: A student’s performance which is a test of basic numeracy and literacy called the ASER test conducted...
in a randomized controlled trial is used to measure the learning payment metric. IDinsight is the independent evaluator measures the impact created by Educate Girl’s intervention. The ASER test provides grades from A to E which is conducted in the classrooms. A+ score in the subject of Hindi because a ceiling effect was noticed on the performance of this subject. The students are divided in two groups, the treatment group and the control group. After repeated tests students learning gains are calculated to understand the level of improvement.

Enrolment Outcome: IDinsight through sampling of the enrolment lists and visits to the schools and households is able to capture the true picture of enrolment and drop out of the girl students. The eligible girls are between the ages seven and fourteen. This helps the evaluator in finding the proportion of students enrolled to the proportion yet to be enrolled.

4.6 Payment Structure
With an aim to earn around 15% return over three years, UBS over three years will invest a capped amount of USD 422,000. The payment has been fixed in Indian Rupees to protect the interest of Educate Girls from foreign exchange fluctuations. A service provision cost is estimated at INR 17,332,967. 40% will be invested in spring 2015 and rest in spring 2016. Out of this 80% will be for learning and the rest for enrolment purposes. Return on investment is expected to be between 10% to 15% IRR (before incentive payment to Educate Girls). A part of the return earned by UBS will be shared with Educate Girls depending on the success of the program. It is at present calculated as 32% of the amount by which the outcome payment exceeds the initial investment principal. Thereby passing only the upside risk to the service provider.

4.7 Progress Report
DIB financing model changed the way impact was being delivered to the target. Bhilwara being a village of diverse culture and economic needs, a tailor made financing approach that focuses on outcomes is ideal to bring innovation in the medium of delivering success. The aim was to enhance education by general improvement in various schools for 18000 children, 9000 being girls. 166 schools in 140 villages in Bhilwara District, Rajasthan was targeted owing to the poor ratio of girls’ education. Educate Girls in partnership with Lionbridge Technologies developed a mechanism through which real time data on enrolment can be collected. Other than enrolment many learning hazards have been removed using this application, thereby allowing Educate Girls to allocate resources to priority areas and also identify loopholes in the curriculums. Educate Girls has also been utilizing the help of Team Balika in collecting information through field staff. One such incident was enhancing the Maths curriculum that created bottlenecks in the study. This ongoing process of evaluation is not an added cost but rather an added benefit. Through standardized measurement practices, creating reports and making them available has become easier and faster. On independent assessment, IDinsight reported that 44% of the girls identified in the first year under the category ‘out of the school girls’ have been enrolled. 23% of the total target for learning progress has been achieved.

4.8 Learning Outcomes
1. DIB is case specific and thereby generalization of the theory as to whether it could be successful or not is subjective. Similar approach may be utilized but as seen from the two cases, modifications in the models are required to suit the needs of the problem.
2. DIB helps to transform social issues into opportunities for attracting investment especially pooling the private funds.
3. It works as an aid to the government in working against the social problems of the country with a surety of the impact.
4. Markets for DIBs need to be created to generate awareness among the investors about the feasibility and success of DIB financing models.
5. This may as well serve as a distinct activity of a company’s CSR activity.

4.9 Limitations of the Study
This is the first time DIB is implemented in India, which makes it difficult to learn the outcomes or measure its performance and also understand the applicability of the concept to our country.

6. Conclusion
From the above cases the huge potential of DIB in solving issues of the world especially in developing countries is easily understandable. This being a relatively new concept of financing, the concept needs to be understood first and the concerned agencies need to be made aware to utilize its benefits in turning the social issues into business opportunities.

7. References