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Paying for success: An appraisal of social impact bonds

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ABSTRACT

A social impact bond is a type of pay-for-success initiative that shifts the financial risks associated with pursuing public purposes to private investors. Governments throughout the world are hopeful that they can be relied on as a politically feasible policy tool for tackling difficult social problems. Despite the excitement surrounding them, there is very little empirical scholarship on social impact bonds. This article takes stock of this new phenomenon, noting the many reasons for their widespread appeal while also raising some concerns that researchers and practitioners would do well to consider before adopting them. We do so by appraising them through the lens of three dimensions: accountability, measurement, and cost-effectiveness. Throughout, we draw comparisons to conventional government contracting.

Efforts to increase competition, efficiency, and accountability in governments are now the norm (Box, 1999; Brown, Potoski, & Van Slyke, 2006; Dunleavy, Margetts, Bastow, & Tinkler, 2006; Kettl, 1997; United States Government Accountability Office, 2015), and private actors such as for-profit corporations have grown increasingly interested in addressing what have long been considered public concerns (Carroll, 2008; Cooney & Shanks, 2010; Vogel, 2005). Out of this mix of evolving sector roles and public openness to new innovations to address social problems has emerged a distinct type of cross-sector collaboration—the social impact bond (SIB). While SIBs have some appeal, it is useful at this early stage to engage in a critical evaluation of their merits. To that end, this article documents recent developments in SIBs and appraises them according to three dimensions—accountability, measurement, and cost-effectiveness. We conclude that while there is much to like about SIBs, it is important to be clear-eyed about where they fail to provide obvious advantages over more traditional strategies for dealing with social problems.

Social impact bonds (also known as "Pay for Success Bonds") are a unique cross-sector collaboration where private investors provide early funding for initiatives prioritized by governments, often implemented by nonprofit organizations (McKinsey & Company, 2012). SIBs are not bonds in the traditional sense but, rather, work as a type of "pay-for-success" agreement between a government agency, investors, and service providers (Shah & Costa, 2013).[1] Although every SIB is unique, service delivery organizations often provide an intervention that the government pays for—with interest—*only if* the intervention is determined to be successful. The obvious advantage for governments is that the private investors—instead of taxpayers—assume the risks associated with funding potentially ineffective interventions (United States Government Accountability Office, 2015).

Because SIBs shift the financial risks associated with failed policy interventions to the private sector (Baliga, 2013), they are seen as promising solutions across the political spectrum. They can generate popular support for dealing with widespread problems, but

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[1] Only in the broadest terms—as financial assets defined by a contract whose redemption date is a year or more past its issue date (Black et al., 2012)—can SIBs be thought of as bonds. For SIBs, the payout is conditional on certain performance metrics being met. This is not true for conventional bonds, where the returns are typically fixed (McHugh et al., 2013).

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politicians have cover if the initiatives fail and, additionally, constituencies are not left paying for interventions that do not work. As a proof of concept, legislators who are hesitant to fund untried initiatives outright might be amenable to a SIB instead. Then, if the SIB is successful, a legislature would, arguably, be more inclined to allocate taxpayer money to fund (via reimbursement to its private sector partner) the now-tested initiative.

SIBs are noteworthy because they do not depend on the public-spiritedness of private actors. Unlike other cross-sector collaborations that might be contingent on corporate philanthropy or on a corporation's commitment to social responsibility, SIBs work even if they appeal solely to investors' pecuniary interests. While the prosocial aspect may be an added benefit—and indeed may be a motivating factor for some—the success of the SIB is not contingent on it. In this way, a SIB may work as one of many investment products for clients, similar to socially responsible mutual funds.

SIBs are also seen as promising to the extent that they improve on traditional contracts, which governments rely on regularly (Brudney, Cho, & Wright, 2009; DeHoog & Salamon, 2002; Kelman, 2002), notwithstanding their drawbacks (Savas, 2000; Sclar, 2001). The appeal of contracting is that it allows vendors to compete for the opportunity to provide goods and services on behalf of the government (DeHoog & Salamon, 2002; Van Slyke, 2009) with the expectation is that this will ultimately lower the costs of the services provided (Brown et al., 2006). Relying on vendors can also reduce the apparent size of government as agencies contract with other organizations, such as nonprofits or private firms, that have the additional advantage of being closer to the communities being served.

One of the main concerns about contracting, however, is that it complicates government accountability (DeHoog & Salamon, 2002; Savas, 2000). Contracting is especially risky when outcomes are hard to monitor, as in contracting for social services (Brown & Potoski, 2005). Contracted vendors have an opportunity to shirk in their execution of the contract, and government agencies may lack the motivation, resources, or expertise to monitor them closely (Brown et al., 2006; Kelman, 2002). Some observers regard SIBs as able to improve upon the shortcomings of contracts while retaining their benefits, an issue we consider throughout the article.

SIBs explained

In the SIB pay-for-success model, a government identifies a target population and a meaningful outcome and then, with the necessary legislative authority, enters into a contract with a private intermediary organization to oversee an effort to produce the outcome (Liebman, 2011; Shah & Costa, 2013; Social Impact Investment Taskforce, 2014). The intermediary organization—the node of the SIB network—may contract with other organizations, such as nonprofit service providers, to implement the intervention. Critical to this SIB arrangement, the intermediary also enters into agreements with private investors whose investments provide the financial support for implementing the intervention and for service delivery. Thus, investors, not the government, pay for the intervention. If the intervention is determined to be successful, the government then makes funds available to the intermediary organization, which then reimburses the investors—with interest. If the intervention is unsuccessful, the government does not refund the intermediary and investors do not receive a return of their principal or interest. Whatever the outcome, the service delivery organizations receive support for their efforts (an improvement on traditional pay-for-success initiatives, which penalized the service provider if the outcomes were not met). See Fig. 1.

Apparent from this short description, SIBs are fundamentally collaborative efforts whose startup costs may be substantial (Warner, 2013). Unlike simpler forms of contracting, where a government agency decides internally what services need to be provided and issues a request for proposals accordingly, SIB creation requires coordinating among a number of different entities. Adding to the startup costs, these entities—the government agency, the intermediary, the evaluator, and so on—must come to consensus on what outcomes should be measured, how they will be measured, how those results will be validated and communicated, what cost savings might be expected if the intervention is successful, and how this relates to the return that investors might expect. In most cases, these arrangement need to be established *prior* to introducing government legislation or related actions that would formally create the SIB.

To illustrate how SIBs can work in practice, consider two of the first SIB initiatives to have been approved by legislatures, proceeded through the initial stages of intervention, and to have reported preliminary data. The first is the Peterborough SIB in the UK, which is generally regarded as the first social impact bond (Baliga, 2013; Social Impact Investment Taskforce, 2014). In 2010, organizations such as charities made funds available to an intermediary organization, Social Finance, to facilitate interventions for prisoners serving short-term sentences at Peterborough Prison (Disley, Rubin, Scraggs, Burrowes, & Culley, 2011). The goal of the intervention, assessed by independent researchers, was to reduce the recidivism rate for offenders (Disley & Rubin, 2014). If the recidivism rate for prisoners who received the intervention was reduced by 10% in comparison to a matched group that did not receive the intervention, then the government would provide a return (between 7.5% and 13%) on the initial investment to the organizations that provided the funding (Disley et al., 2011).

To date, early results based on the Peterborough SIB are mixed. Recidivism rates among the first intervention cohort were 8.4% below the control group, which failed to meet the 10% benchmark and to thus trigger repayments to investors (Jolliffe & Hedderman, 2014). Initially, if the recidivism rates combined across the intervention cohorts were 7.5% below the control group by 2016, then the outcomes would have been considered met (Social Finance, 2014). However, the Peterborough intervention has been folded into a national rehabilitation initiative that does not include private investors, so the true success of this particular SIB may never be known (United States Government Accountability Office, 2015).[2]

The second example comes from the State of Utah. Officially known as the Utah School Readiness Initiative ("Utah school readiness initiative," 2014), the bill creates the School Readiness Board, a part of the Governor's Office of Management and Budget, and the School Readiness Account, which provides the necessary funding for the bill's enactment (cf. United States Government Accountability Office, 2015). The bill gives the Board authority to enter into agreements with eligible providers of early education (e.g., school districts, charter schools, private preschools) and private investors in the form of results-based contracts. The intervention targets low-income, preschool-age students who score "at or below two standard deviations below the mean" on an assessment of "age-appropriate cognitive or language skills." The outcome for a child is considered met if the intervention is

[2] Officially, the new rehabilitation initiative was framed by the UK government neither as an indictment nor an endorsement of the Peterborough SIB. The fact that it failed to meet one important benchmark and was ended early provides evidence to critics that the SIB did not live up to its promise. Advocates, however, felt that the SIB was on its way to meeting the next benchmark, observed that the national rehabilitation initiative would continue with some pay-for-success elements (but without funding from private investors), and at least one commentator framed the termination of the Peterborough SIB simply as a casualty of larger policy changes (Cahalane, 2014; Cook, 2014; Ganguly, 2014; United States Government Accountability Office, 2015).

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