Commissioning Better Outcomes Fund Evaluation
Update Report

Summary Report Targeted at Investors
James Ronicle, Tim Fox and Neil Stanworth
December 2016
Introduction

This report provides a summary for investors of the findings to date from the Commissioning Better Outcomes (CBO) Fund Evaluation undertaken by Ecorys UK in partnership with ATQ Consultants (ATQ), on behalf of the Big Lottery Fund (BLF). The report focuses on the key findings that are of relevance and interest for investors currently involved in, or interested in, social impact bonds (SIBs).

The CBO evaluation is focusing on the following three areas:

- Advantages and disadvantages of commissioning a service through a SIB model, the overall added value of using a SIB model and how this varies in different contexts;
- Challenges in developing SIBs and how these could be overcome; and
- The extent to which CBO has met its aim of growing the SIB market in order to enable more people, particularly those most in need, to lead fulfilling lives, in enriching places and as part of successful communities, as well as what more BLF and other stakeholders could do to meet this aim.

This report draws on the main findings from the following strands of the CBO evaluation:

- A literature review drawing together what is already known about SIBs;
- Stakeholder consultations with organisations centrally involved in the policy development, strategic development and operational delivery of SIBs in England;
- Surveys with investors, commissioners¹ and service providers² either involved in or very informed about the SIB agenda;
- In-depth review reports produced for the Ways to Wellness and Reconnections SIBs; and
- A case study report focussed on a potential SIB in North Somerset.

All of the reports listed above, and other reports produced as part of the CBO Fund evaluation, can be found on the Big Lottery Fund website: https://www.biglotteryfund.org.uk/research/social-investment/publications.

The report includes the following sections:

- Summary of CBO Fund to date;
- Advantages of SIBs;
- Disadvantages of SIBs and challenges to their development;
- Other SIB observations; and
- Conclusions and recommendations.

¹ A commissioner is an organisation which funds or contracts for delivery of a service.
² A service provider is an organisation which is contracted or funded to deliver a service.
It should be noted that this research is in its early stages and we have not yet collected sufficient evidence to conclude on the overall effectiveness of the SIB model or CBO Fund. Instead this summary report describes the early experiences of those developing SIBs; as well as the immediate, and potential future, advantages and disadvantages of the approach. Where possible we have compared the approach with alternative commissioning models. This is based on reflections by stakeholders on their prior experience of different models; however, in the future the evaluation will test different models through quasi-experimental counterfactual\(^3\) approaches where possible.

Policy context

A SIB is essentially a type of payment by results\(^4\) (PbR) contract. Like other types of PbR, a commissioner (usually one or more public sector bodies) agrees to pay for outcomes\(^5\) delivered by service providers, and unless those outcomes are achieved, the commissioner does not pay.

Where a SIB differs from a PbR contract is that the provider involved in a SIB does not use their own money to fund their services until they get paid – instead, money is raised from so-called ‘social investors’, who receive a return if the outcomes are achieved. And usually – though not always – the provider is paid up-front by a third party body which holds the contract, rather than holding the contract directly.

At present, there is not one accepted model of a SIB - beyond needing to involve payment for outcomes and that any working capital required should be raised from social investors. Those involved in outcomes-based commissioning such as Voluntary, Community and Social Enterprise (VCSE) organisations and social investors, are currently trying to innovate and develop new contractual and financial structures. Therefore, any attempts to constrain the definition of a SIB are likely to stifle such innovation, within a relatively new and developing area of contracting for services.

There is no definitive source on the number of active SIBs, but according to the Centre for SIBs, as of July 2016, 32 SIBs had been implemented in the UK to tackle a range of social issues, including: homelessness, youth unemployment and children in care. Four of the thirty two are part-funded by the CBO Fund.\(^6\)

Summary of CBO Fund to Date

The CBO Fund is funded by the Big Lottery Fund, with a mission to support the development of more SIBs in England. The details of the progress of the project pipeline are shown in the table below.

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<tr>
<th>Table 1: CBO Fund: Summary of progress to date</th>
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<tr>
<td><strong>Task</strong></td>
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<tr>
<td>CBO/ SOF EoI agreed</td>
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<tr>
<td>Development grants agreed</td>
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<tr>
<td>Full awards agreed by CBO</td>
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</table>

Source: Big Lottery Fund

\(^3\) A counterfactual is the estimate of what would have happened either a) without the intervention, or b) with an alternative intervention, to provide a comparator. A quasi-experimental design identifies a cohort with similar characteristics as to the cohort being support by the intervention (treatment group), and compares the outcomes achieved by the treatment group with those that did not receive the intervention (comparison group). See: https://www.unicef-irc.org/publications/pdf/brief_8_quasi-experimental%20design_eng.pdf

\(^4\) Payment by Results is the practice of paying providers for delivering public services wholly or partly on the basis of results achieved.

\(^5\) An outcome is a result or change experienced by a person, family or community, for example improved parenting.

\(^6\) See: https://data.gov.uk/sib_knowledge_box/home
22 actual full awards (including in-principle awards that potentially may not progress) have been provided by CBO. 14 of the 22 full awards are commissioner-led, five are provider-led and three are currently led by intermediary management agents. All of them involve the VCSE sector.

The role of the ‘social investor’ in SIBs

The number and type of investors, who have invested in SIBs to date, varies and information on who has invested in specific SIBs is not always publicly available.

Where information is available, the majority of investors in SIBs fall into two major categories. These are:

- **Charitable Foundations and Trusts:** Most of these give grants to VCSEs to deliver interventions. However, a number of Foundations and Trusts have chosen also to invest in SIBs. A number of Foundations invested in the Peterborough SIB (the first SIB in the UK) (The Tudor Trust, Barrow Cadbury Charitable Trust, Esmée Fairbairn Foundation, Friends Provident Foundation, The Henry Smith Charity, Johansson Family Foundation, LankellyChase Foundation, The Monument Trust, Panahpur Charitable Trust and Paul Hamlyn Foundation) and many of the same investors, plus others, invested in the Essex SIB.

- **Specialist fund managers:** These operate in a similar way to conventional institutional fund managers in that they raise funds from other investors (such as high net worth individuals) and invest them on their behalf. Some Foundations or Trusts have opted to fund SIBs via a specialist fund manager, as this allows them to access the necessary due diligence expertise. Investors in SIBs are mainly specialist fund managers of funds with specific social objectives and include:
  - Big Issue Invest;
  - Bridges Ventures Social Impact Bond Fund;
  - Bridges Ventures Social Entrepreneurs Fund (now closed) CAF Venturesome;
  - Impact Ventures UK; and
  - Social Venture Fund.

Additionally, Big Society Capital (BSC), while mainly a wholesale investor, has invested directly in seven SIBs. In its primary role as wholesaler, it has also supported SIB-specific investment funds including the Bridges Social Impact Fund and Social Finance’s Care and Wellbeing Fund.

The two CBO-funded SIBs that we have studied in depth to date show very different investment models. The Ways to Wellness (WTW) SIB in Newcastle and Gateshead received £1.65m investment from Bridges Ventures Social Sector Funds. This is a fully at risk investment with no fixed coupon and if, and only if, outcomes exceed base case the estimated money multiple over 7 years will be c.1.38 times the initial investment. If outcomes achieved are lower than base case the multiple could be much lower and conceivably all investment could be lost.

The Worcestershire Reconnections SIB has access to up to £850,000 of social investment, returns on which will be dependent on the SIB’s performance. £450,000 of the investment comes from Nesta Impact Investments, £350,000 from the Care and Wellbeing Fund – a fund with investment from Big Society Capital and Macmillan Cancer Support – and a further £50k from Age UK – which is investing specifically to support the development of the project and the learning from it, with any returns put back into its charitable work.

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7. An intermediary is a party that offers intermediation services between other parties. In a social impact bond, that means an intermediary is not the commissioner, service provider or investor. Intermediaries have offered different services to the social impact bonds developed so far. Services that can be provided by intermediaries include: introducing parties to the deal; gathering evidence and producing feasible options; facilitating negotiations between parties; raising investor capital; establishing a special purpose vehicle; and managing performance.

8. An intervention is the activities undertaken with the intention of producing the desired outcome.

9. For example, David Burnett, who invested in the Essex SIB via the Charities Aid Foundation.
Advantages of SIBs from an investor perspective

The views from investors generally informed about SIBs paint a broadly positive picture. Those spoken to who have invested in SIBs, or are considering doing so, reported that they were resource intensive but worth the effort – though it is too early to state the full impact of the SIBs or their return on investment – both social and financial. Those that have had prior involvement in SIBs have, on the whole, had a positive experience so far and the majority are likely to choose get involved in SIBs in the future. An investor described SIBs in the Investor Survey as a potential “win, win, win” – a win for the investor, a win for the commissioner and a win for the service provider.

The table below summarises the main advantages linked to SIBs for investors as reported by investors, commissioners and service providers either considering, developing or involved in SIBs.

<table>
<thead>
<tr>
<th>Advantage</th>
<th>Reason for Advantage</th>
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<tr>
<td>Better alignment of financial and social returns</td>
<td>Investors are able to achieve social outcomes and receive a return on their investment – what is sometimes termed a ‘blended return’. Foundations and Trusts surveyed reported that this was a key reason for investing, as they sometimes felt that investing in more traditional markets was at odds with their social objectives.</td>
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<td>Alignment of interests between commissioners, service providers and investors</td>
<td>Linking payments to outcomes leads to an interest from all parties to improve delivery and achieve better outcomes and financial returns. The close partnership can also bring together distinct expertise and addresses knowledge gaps across the partners.</td>
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<td>Offers potential to grow social investment market more broadly</td>
<td>Some investors see SIBs as having the potential to catalyse and grow the social investment market. For example, Barrow Cadbury state that their social investment, including in SIBs, is designed both to generate blended returns as above and also to ‘further the development of the market place in social investments’10.</td>
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Disadvantages of SIBs and challenges to their development from an investor perspective

Despite the reported advantages and the existence of CBO, SIB development has been slower than some anticipated and few local SIBs have been developed outside of central government programmes. Stakeholders interviewed during the research did not understand why more SIBs had not been developed.

However, our research to date has found a number of challenges in the process of developing a SIB. When asked about challenges, investors indicated that SIBs are a “good solution in the right place” but are not universally applicable to all circumstances.

The table below summarises the main disadvantages of, and challenges linked to, SIBs for investors, as reported by them, commissioners and service providers either considering, developing or involved in SIBs.

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Reason for Disadvantage/Challenge</th>
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<tr>
<td>Long time to develop</td>
<td>SIBs can take a very long time to develop and circumstances can change in that time that can curtail their development (e.g. a key member of staff leaving).</td>
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<td>Challenge</td>
<td>Reason for Disadvantage/Challenge</td>
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<td>SIB myths inhibiting their development</td>
<td>There appears to be a mystique and set of ‘myths’ surrounding SIBs. In some cases, these have led organisations to ignore normal/best practice on issues such as conflicts of interest, project management, and risk management during procurement. In a small number of instances these misconceptions have contributed to the commissioner/service provider abandoning their SIB development. Some of these myths relate to the investor, such as:</td>
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|                                         | • SIBs offer disproportionate returns to investors  
|                                         | • An investor will demand large amounts of time from the commissioner                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
| Lack of understanding of investors      | Interviews with commissioners revealed their misconception as to investors’ expected rates of return. Two commissioners reported that they felt misled by intermediaries/advisors, and were led to believe that investors would only require a marginal, if any, rate of return. In contrast, one commissioner reported that it had not been easy to find an acceptable balance between investor expectations and what the CCG would find a reasonable cost of money in relation to the delivery of a public service, with the commissioner describing the investors as “hard-nosed”.                                                                                                                                                                                                 |
|                                         | Investors we have consulted counter this in two ways. First, they argue that most SIBs do not guarantee any return to investors – as noted above they are not a Bond – and that actual returns could vary from relatively high, if outcomes exceed expectations; to all the investment being lost, if outcomes are not achieved. Secondly they argue that commissioners and service providers would struggle to find more favourable rates of return from more traditional lenders – indeed such lenders would be unlikely to invest at all in high risk social outcomes.  
|                                         | In our opinion this difference of view reflects the fact that most commissioners and providers are unfamiliar with social investment being used to fund contracts, and do not understand investor expectations. Many commissioners and providers do not fully understand the difference between a guaranteed return and a variable return on what is in effect a quasi-equity investment. Moreover, commissioners do not compare returns with those that a traditional lender would demand, but with a conventional contract where only a profit or surplus would be payable (albeit one that might include a cost of money that was not visible to them), and seem more reluctant to pay a return to investors than to pay a profit or surplus. In addition, service providers are more familiar with receiving unrepayable grants than loans, and therefore any ‘rate of return’ appears high.  
<p>|                                         | This is compounded by the fact that some commissioners and investors involved in SIBs seem reluctant to openly discuss potential “returns” for investors, meaning there is limited public information available on what they might reasonably expect to pay. While we understand the reasons for commissioner and investor nervousness to openly discuss returns, given the perceptions discussed above, we believe that it is important |</p>
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<tr>
<td>Challenge</td>
<td>that investors more openly challenge these and are clearer on their expected rates of return and manage commissioners and service providers' expectations early on.</td>
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<td>Agreeing contracts to suit all parties, including the balance of risks</td>
<td>Agreeing contracts is a challenge for all parties involved in SIBs. From an investors’ viewpoint though: there has sometimes been too much risk transfer, which can deter their involvement; or too little, which removes many of the benefits of SIBs compared to conventional fee for service contracts. Some investors in the Investor Survey felt that the risk / reward balance ‘is wrong’ i.e. the rewards to investors (especially where capped by commissioners) do not balance the risks, and for some this has discouraged them from investing in SIBs. To overcome the perceived imbalance of risk a number of investors argued for some kind of ‘first loss’ finance (where government or another funder guaranteed to return investors a defined proportion or value of their investment, irrespective of impact achieved) which would reduce investment risk and enable institutional investors to become more easily and readily involved – along the lines of the type of finance that has been used to support SIB type models in the US and Australia.</td>
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<tr>
<td>Policy uncertainty</td>
<td>Some investors observed that national and local policy changes (such as changes by the coalition government to the GCSE marking system) could affect outcome metrics, and ultimately impact on the potential to achieve outcomes and payments.</td>
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<td>Illiquidity</td>
<td>Some investors reported in the Investor Survey, that for wider investor adoption of SIBs, there would need to be a greater deal flow and track record built up; as well as a means of trading into and out of SIBs. Currently, a SIB is an illiquid investment often over a minimum timeframe of several years.</td>
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<tr>
<td>Over-prescription</td>
<td>Some investors responding to the Investor Survey criticised central government-led SIBs, such as the Department for Work Pensions (DWP) Innovation Fund, Fair Chance Fund (FCF) and Youth Engagement Fund (YEF), because these funds prescribed what providers and investors could and could not do to meet the terms of each Fund – for example the FCF encouraged co-investment by providers, while the YEF forbade it.</td>
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<td>Limited evidence base for achievement of outcomes</td>
<td>Seven respondents to the Investor Survey highlighted that the limited evidence base for the achievement of outcomes was a challenge in completing due diligence. Where only limited evidence was available, investors tended to fall back on two other routes to satisfy themselves of the security of their investment, namely:</td>
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<td>• Hands-on review of the delivery capacity and capabilities of the service provider organisation(s): This was sometimes supported by prior experience and working knowledge from earlier grant-funding relationships; and</td>
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12 A fee for service contract is one where payment is based on service levels or outputs delivered, rather than outcomes.
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<th>Challenge</th>
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<tr>
<td>- Encouraging the use of ‘High Fidelity’ Evidence-based Programmes: This is where providers deliver a prescriptive and process-driven intervention that allows investors to substitute confidence in the intervention for due diligence of the provider. However as of late, this appears to have become less of a priority, and investors instead focus on the aforementioned review of the delivery capacity and capabilities of the service provider(s).</td>
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**Current rates of return for investors**

There is limited publicly-available information on the rates of return investors are receiving from the SIBs they have invested in, accepting that any information on returns would need to be qualified to reflect the range of potential returns investors might achieve depending on the outcomes, as discussed above.

However, the information that is available suggests that investors (in UK SIBs) are receiving their initial investments. For example:

- the Ministry of Justice reported in 2014\(^{13}\) that the results from Peterborough SIB were likely to lead to investors receiving impact payments once the results of the analysis of outcomes from the second (and now final) cohort came available in 2016;
- an article in the Pioneers Post in July 2015\(^{14}\) reported that three SIBs as part of the DWP Innovation Fund had repaid investors earlier than planned after agreed social outcomes were met; and
- a number of investors responding to the Investor Survey gave broad indications that they were happy with progress to date, and in some cases indicated that they had been receiving outcome payments.

We believe this relative shortage of information is contributing to the lack of understanding of investors and their expectations amongst service providers and commissioners, and we would encourage investors to be more public in relation to rates of return, even if they need to heavily qualify what they make available.

**Other SIB Observations**

As well as the main advantages and disadvantages currently associated with SIBs, our research has revealed some other interesting findings:

- **It is important for investors to be engaged early in the process:** The importance of engaging early with investors is widely endorsed across most SIB feasibility studies and business cases we identified in the literature review (e.g. Manchester 2012). Additionally, stakeholders involved in the Ways to Wellness SIB felt that early engagement with the investor (Bridges Ventures) was a key strength of their SIB development.

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• **Diverse nature of SIBs:** One of the main aspects our surveys highlight is how diverse the wants and needs of those involved in SIBs are. Because of the multiple partners that exist within a SIB, this most likely means that the combination of wants and needs from those involved varies relatively widely from one SIB to another. This will likely have consequences for the future development of SIBs: most notably that a ‘one-size-fits-all’ approach to SIB development and implementation will be less likely to work.

• **The ‘five success factors to encourage social investment in SIBs and PbR’:** A joint report to Government by Big Society Capital and Bridges Ventures in November 2012 drew on lessons from SIB development and procurement to identify five success factors to encourage social investment in SIBs and PbR:
  
  ► Early and direct involvement by commissioners with investors to avoid roadblocks during later stages of the commissioning process.
  
  ► Ensuring that, if social impact is achieved, investors receive a positive return. The paper argues that, ‘payment profiles that could see meaningful social impact translate into a negative financial return are not investible. Similarly, a cap on returns for outstanding social performance without a corresponding floor to losses can create a very difficult profile to invest in.’
  
  ► The provision of early and continuous data, in as much detail a possible, to help investors evaluate the risk they are taking on. Information that is valuable to investors includes details on the target cohort and current outcomes achieved, and the impact or otherwise of existing interventions.
  
  ► Filtering the number of bidders, and/or creating a reserve list, to avoid investors having to do due diligence on a large number of proposals. Commissioners ‘should only invite a very small number to bid. Alternatively, firm investor commitment can be sought after the selection of successful bidder, but a reserve list should be maintained in case no firm commitment is forthcoming.’
  
  ► Adjusting standard contract terms to reflect the nature of PBR, and to reflect fair terms given the outcome payments context – avoiding for example short notice termination clauses.15

While this report is now four years’ old, our research indicates that its conclusions remain valid.

• **The investor played a major, hands-on role in developing the Ways to Wellness SIB:** Stakeholders viewed the investor’s (Bridges Ventures) contribution as being valuable, especially in developing contracts. This appears to be in contrast to the Reconnections SIB, where such investor-commissioner close working did not take place to the same degree, although both sets of commissioners agreed that it was preferable for commissioners and investors to communicate – so that commissioners can help investors understand both the local context and the workings of the commissioner, and to support investor due diligence and performance monitoring.

15 Big Society Capital and Bridges Ventures 2012
Conclusions and Recommendations

SIBs are still in the relatively early stages of development and the evidence base is limited, although the number being developed is increasing. Those involved in SIBs confirm their potential benefits are being achieved: they not only bring in upfront capital to fund services, they also improve the capacity of service providers and allow for more innovative service delivery. There is also an appetite from more members of each group to get involved.

Findings do suggest, however, that SIB development has been slow – particularly local SIBs outside of central government-supported programmes. People developing SIBs face multiple challenges, mostly in understanding their complexity and, for commissioners and service providers, working with investors, whose expectations are not well understood.

However, despite these challenges, there are four points to note that could suggest their development will increase:

- Many commissioners and service providers involved in SIBs are likely to choose to become involved in future ones;
- Support is available and has been well received;
- Some stakeholders believe most challenges are solvable;
- Some stakeholders involved report they are getting quicker to develop.

Furthermore, some of the challenges faced are likely to subside as the market develops and as commissioners, service providers, investors and advisors/intermediaries get more used to working together. This emphasises the importance of ensuring stakeholders involved in SIBs are transparent about their work and share their learning with other stakeholders. This evaluation will play a crucial role in ensuring the lessons learnt from the CBO-funded SIBs are shared.

In light of these findings we have the following recommendations for investors:

- **Be transparent about current deals to manage expectations amongst commissioners and service providers:** There is a misconception amongst commissioners and service providers as to investors’ expected rates of return, especially if outcomes exceed ‘base case’. To overcome this we believe it is important that investors are clearer on their expectations and manage commissioners and service providers’ perceptions early on.

- **Focus on building networks with service providers and commissioners and ‘demystifying’ the investor:** There is a group of investors, commissioners and service providers who are willing to become involved in SIBs yet are often being held back because of a lack of understanding of, and communication with, each other, particularly the investor.