

A case for social impact bonds: critical learnings for potential stakeholders

In 2015/16, one of Tshikululu's clients approved funding towards the establishment of a pay-for performance platform (or social impact bond) in partnership with a provincial Department of Health (DoH). The focus of this bond was funding home-visits to mothers and children in the first 1 000 days of the child's life. This was to ensure pregnant women gave birth without complication and raise children that are well nourished, healthy and developmentally on track.

What is a pay-for-performance model?

Figure 1 below provides a high-level description of a pay-for-performance platform. This is a type of social impact bond where initial private investors provide funding for the delivery of social programmes. This funding is used by "operators" to deliver social programmes, with the goal of reaching predetermined outcomes. If these outcomes are achieved (and verified by an external party), an "outcomes funder" pays the initial investors back. If the outcomes are not achieved, no outcomes funding is paid. In other words, the initial investors expect both a social and financial return on their investment but take the risk that a return (of either kind) is not guaranteed.

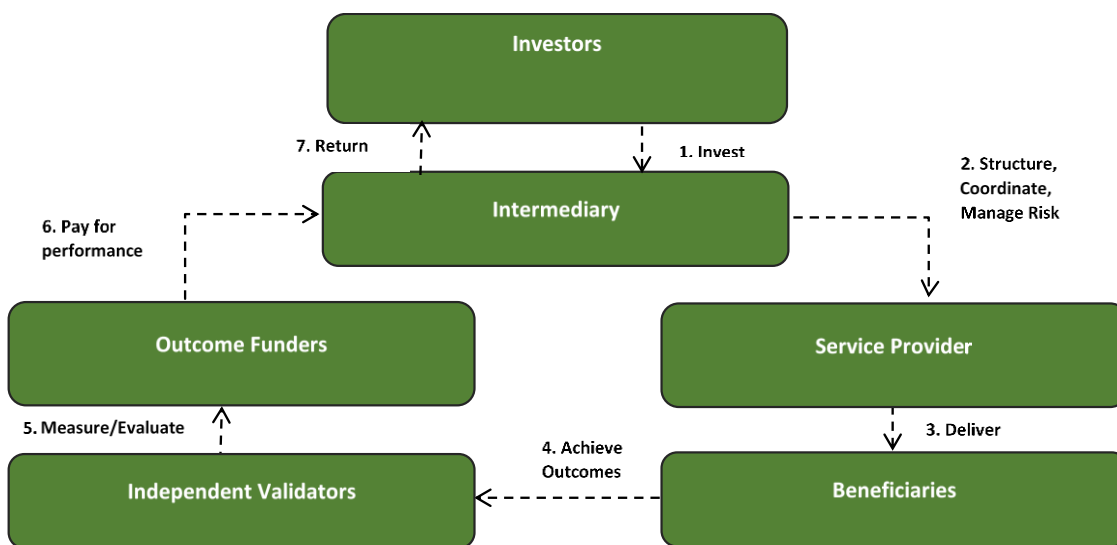


Figure 1: Pay-for performance model

In the case of the DoH bond, a substantive list of potential outcomes metrics was considered and refined by various government, academic and practitioner working groups. These reinforced existing community-based service package requirements: Catch and Match pilot data capture points and the Road to Health Booklet. They related to adequate antenatal care, reduction of mother-to-child transmission of HIV, encouraging exclusive breastfeeding, adhering to full immunisation schedules, achieving correct weight and height for age, and early stimulation.

Pay-for-performance is a relatively new financing model, although more than 100 structures of this kind have been launched across the globe in the past few years. In South Africa, several bonds are either in development or have already been launched (focused on ECD, youth employment and tertiary education to name a few). Unfortunately, the DoH bond outlined above was not able to get off the ground. However, through the process the client, Tshikululu and other involved stakeholders learned several valuable lessons.

Working with government is important but can be challenging

Any investor wanting to work in partnership with the state needs to understand that processes and decision-making in government departments can have long lead times. In the case of the DoH, social impact bond approval processes were protracted and required numerous high-level meetings to make decisions for funding commitments, procurement and outcomes measures to be agreed upon. This may have been compounded by a limited understanding by departmental officials of pay-for-performance models and mechanisms.

One key lesson is a need to workshop the concept thoroughly with the government stakeholders to ensure technical understanding of the concept. In addition, due to government resources being allocated towards outcomes funding, the procurement of an implementer had to follow the rules of an open tender as prescribed by the Public Finances Management Act, resulting in further delays. Limited understanding of the social impact bond concept by *potential implementors* also led to a low number of competitive bid responses.

Social investors wanting to partner with government in such projects need to have a full grasp of the requirements and decision-making process this will require.

Key-man dependency

Drumming up support for new and innovative concepts throughout the team within the government department is important. In the case of the bond, this was not adequately done resulting in key-man dependency. Within the provincial DoH, the chief director for health programmes was instrumental in driving the bond internally. However, with her departure from the department, continued support for the project dwindled. This was mainly due to lower level of understanding of and limited involvement in the project by the broader team in the initial discussions around the transaction.

Risk aversion from investors proved to be a stumbling block

Due to social impact bonds being a new phenomenon in South Africa, investors were reluctant to engage before demonstration of a final product. Although expressions of interest were obtained early in the process, investors did not provide formal commitments during the structuring phase. As a result, there was a substantial turnover in the pool of investors, with the intermediary eventually having to source new investors. Once investors were eventually brought on board, they refused to finance the initial setup costs associated with the intermediary, requiring grant funders to close this gap. In the latter stages, lead times for investment committee approval and reviewing of legal agreements were significant.

The simpler the structure of the bond, the better it is for everyone involved

Setting the incentive structure and specification of outcomes is a complex undertaking, making it imperative to ensure that complexity is minimised. Highly variable indicators, cohorts, and methods of assessing individual indicators made it difficult for stakeholders (particularly investors) to engage with the concepts and led to them overestimating associated risks. Significant parts of design input/request for modifications regarding the balance of outcomes vs outputs and indicator definitions only happened post-procurement. In future, when structuring vehicles of this kind, obtaining such feedback and iterating the design ahead of procurement will help keep implementation timelines more reasonable.

Inter-organisational relationships were a major challenge

Notwithstanding all the challenges mentioned above, inter-organisational dynamics were the central cause of the DoH social impact bond collapse. The service provider appointed through the DoH's procurement process felt that the relationship between itself and the intermediary was unequal, accountability was not well-defined, and transparency was not reciprocated.

Within social impact bond structures, the role of an intermediary is twofold. First, it convenes all stakeholders involved in the mechanism to strike agreements regarding the transaction process (including agreeing on and conducting monitoring and evaluation throughout the process), and, in general, it assumes a supervisory role on behalf of stakeholders (i.e. investors and outcomes funders). Second, in some cases intermediaries can be responsible for raising capital. Thus, the concern of the service provider was that the intermediary played a more “central and strategic” role in the bond. Although this *is* how bonds of this kind are generally structured, the service provider found it to be unpalatable.

In the end, this conflict resulted in a major communication breakdown and lack of cooperation between the two parties. Unfortunately, a government-led, confidential arbitration process was unable to salvage the relationship and led to the decision by the department to cancel the project altogether.

In conclusion, the lack of precedent in social impact bond development and implementation was a key challenge for all stakeholders. Deciding on technical aspects without previous experience and adopting a learning-by-doing approach is a time-consuming endeavour, which may also entail financial costs. Although one of the main narratives around social impact bonds is that they transfer government risk to investors, governments may also encounter unintended risks or perverse effects in this process, especially when they impact the most vulnerable beneficiaries.

Despite the challenges faced, Tshikululu believes this is a space that social investors – and government – should continue to explore. With social impact bonds being a new concept in South Africa, there were bound to be teething problems. Who else, if not social investors with access to risk-free capital, can take on the role of helping to build this exciting ecosystem?