reform scotland

Investing for Good:

Why Social Impact Investing is right for Scotland

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TRANSFORMING SERVICES

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About Reform Scotland

Reform Scotland, a charity registered in Scotland, is a public policy institute which works to promote increased economic prosperity, opportunity for all, and more effective public services. Reform Scotland is independent of political parties and any other organisations. It is funded by donations from private individuals, charitable trusts and corporate organisations. Its Director is Chris Deerin and Alison Payne is the Research Director. Both work closely with the Trustee Board, chaired by Alan McFarlane, which meets regularly to review the research and policy programme.

Reform Scotland's Trustee Board

About The Growth Partnership

The Growth Partnership, a charity registered in Scotland, supports the use of Social Impact Investment working with partners in the Public, Private and Social Sectors to maximise the delivery of effective services for some of the most vulnerable members of our communities. We believe that Social Impact Investment can bring a transformational system change to how we deliver services making a real difference to real people in real communities. Our Chief Executive is Ian Marr who works closely with our Trustee Board.

The Growth Partnership's Trustee Board

Context

As Scotland begins to look towards a post-pandemic world, the Scottish Government has committed to delivering a new 10-year National Strategy for Economic Transformation[1] and has recently formed a Council for Economic Transformation. This offers an opportunity to set a bold and ambitious vision and "*build an economy for everyone by delivering greater, greener and fairer prosperity*".[2]

However, such ambition faces many obstacles, not least the ending of the furlough scheme which is likely to see more people facing unemployment and greater demands on Scottish Government resources. And with 70% of its tax revenue coming from a single source - non-savings non dividend income tax - and restrictive borrowing powers, its ability to find additional revenue to fund new programmes will be an uphill struggle.

As a result, it is likely that the Scottish Government is going to face difficult decisions as it tries to juggle ensuring value for taxpayers' money, and ensures that investment achieves its aims and entrepreneurship is encouraged.

There is also a danger that in the tight fiscal environment we face, finite resources are focused more on fire-fighting and addressing problems as they happen, while preventative spending has to take a back seat. This paper, therefore, considers that challenge and outlines the opportunities that Social Impact Investing could offer in addressing the gap.

Social impact investment involves a partnership between delivery, investment and outcome partners. The delivery partner is usually an organisation in the social sector who designs and delivers a service in the community to address an identified social issue. The investment partner provides the working capital to cover the cost of the service delivery in the first instance, until outcomes are achieved. The outcome partner, usually local or central government, only pays for outcomes after they have been achieved, when the investment partner is repaid. Preventative spending programs are often speculative, so funding them through a Social Impact Investment also ensures taxpayers' money is only spent following positive outcomes.

As we look to rebuild post-Covid we need to think differently. In order for the Scottish Government to fund everything that it wants to within its current revenue powers it needs to look outside the box and consider new ideas. Social Impact Investing should be part of that discussion.

[1] https://blogs.gov.scot/scotlands-economy/2021/07/09/working-to-deliver-economic-transformation/
[2] https://www.gov.scot/news/delivering-economic-transformation/

The Challenge

Scotland is in a precarious situation. Although societal restrictions continue to ease and more activities can return to pre-Covid levels, the furlough scheme will also end in September.

At the end of June 2021, 141,500 people were still furloughed in Scotland. Although this was down 35,000 on the previous month and part of an ongoing decline, [3] there is no guarantee that these individuals will all have jobs to return to when the scheme ends. Many of the industry groups with the highest level of people on furlough are based around tourism, including air passenger transport.[4] While recent changes to rules around entry to the UK along with broader relaxations may help the industry, it is highly unlikely that everything will be back to pre-Covid levels on September 30. This means people will be facing redundancy, hardship, potential re-training and the need to secure new employment.

The number claiming unemployment-related benefits dramatically increased as a result of the pandemic and exceeded 200,000 for part of 2020. Although it fell to 176,000 in July 2021, this remains 60,000 higher than in March 2020.[5]

Fewer people earning, or earning as much as they did prior to the pandemic, will lead to a decline in non-savings non-dividend income tax accruing to the Scottish Government, which will in turn impact on the expenditure decisions it can make, at a time when more people are likely to need services.

A lot has been said of 'building back better' and the importance of the 'wellbeing economy', but the ability of the Scottish ministers to invest in such programmes and look at preventative spending will be hampered due to the limited options open to them to raise money.

Preventative spending programmes, where public money is invested to avoid negative social outcomes, are not new - for example polio vaccines, drink driving campaigns, or free prescription charges.

When resources are squeezed, preventative spending programmes can come under pressure as decision makers prioritise dealing with today's problems, over the longer term.

While we try to re-build Scotland post-pandemic, address the fall-out of our health emergency, tackle the consequences of lost jobs, lost education and a struggling

[3] https://www.bbc.co.uk/news/uk-scotland-scotland-business-58010860
[4] https://www.bbc.co.uk/news/uk-scotland-scotland-business-58010860
[5] https://fraserofallander.org/pandemic-recovery-a-review-of-the-key-labour-market-trends-and-issues/

economy, the need for preventative spending will be greater, but the resource available to do so is under even more pressure.

The Scottish Government has limited options in terms of raising additional revenue. Devolved taxes, along with how much they raised in 2020/21, are detailed below:[6]

- Non-Savings Non-Dividend Income Tax, £11.85bn
- Non-Domestic Rates, £1.82bn
- Council Tax, £2.6bn
- Land and Buildings Transaction Tax, £0.52bn
- Landfill Tax, £0.1bn

As the figures indicate, NSND Income Tax accounts for 70% of all devolved revenue raised in Scotland. Being so heavily dependent on a single tax creates an unhealthy fiscal situation and can hamper policy development. In addition, the SNP's 2021 manifesto gave a commitment to freeze income tax rates and bands over the course of the parliament. This means, should the Government want or need to raise additional revenue, that there are minimal options to find that additional revenue through its tax powers.

The Scottish Government has no ability to borrow money for discretionary resource spending, with its non-capital borrowing restricted to up to £600m per annum (a cap of £1.75bn), but only for 'forecast error' and 'cash management'.[7]

So where can revenue for additional expenditure be found?

While constitutional arguments around powers and independence will continue - should Scotland have more borrowing powers? More tax powers? Should we be independent? – even if the answer to some or all of these questions is ultimately yes, it doesn't change the situation Scotland faces now.

There are important long-term discussions to have about powers and where they rest, but as we look to the immediate situation and try to 'build back better' following the pandemic, we can only use the tools available to us at the moment.

While there are other traditional ways to fund expenditure projects in Scotland, they tend to be aimed at capital projects. Examples include:[8]

[6] https://www.gov.scot/publications/government-expenditure-revenue-scotland-2020-21/
[7] https://fraserofallander.org/fiscal-stimulus-plus-a-note-about-borrowing-powers/
[8] https://www.gov.scot/policies/government-finance/infrastructure-investment/

- **Scottish Futures Trust**
  The Scottish Futures Trust was established by the Holyrood government in 2008 to help ensure better value for taxpayers' money in the delivery of vital public infrastructure projects. It is a limited company owned by Scottish ministers, whose activities are overseen by a board appointed by Scottish ministers. The organisation's aim is *"to improve the efficiency and effectiveness of infrastructure investment and use in Scotland by working collaboratively with public bodies and industry, leading to better value for money and ultimately improved public services."*[9] One of the outcome aims of the organisation is to find innovative funding approaches which can help make infrastructure spending affordable and sustainable.[10]

- **NPD and PFI projects**
  The Scottish Government provides funding or part-funding for a number of Non-Profit Distributing (NPD) and Public Private Partnership/Private Finance Initiative (PPP/PFI) projects in Scotland. PFI projects are where the private sector finances the upfront capital costs of the project. Once it is completed, the public sector makes annual payments to the private sector contractor to cover construction costs, interest costs and maintenance/service charges, usually for 25-30 years.[11] The NPD model was developed as an alternative to PFI in Scotland. Contractors and lenders are still expected to earn a normal market rate of return as in any other form of privately-financed PPP deal, but the model aims to eliminate uncapped equity returns associated with the traditional PFI model.[12]

- **Tax Incremental Financing**
  Tax Incremental Financing is a means of funding necessary public sector infrastructure which may be otherwise unaffordable to local authorities. TIF uses the future additional revenue gains from taxes that would accrue due to the development to finance the borrowing required to fund the infrastructure. The Scottish Government explains that "*when a public project such as a new road system is constructed within a specific area, it may increase the value of the land and encourage new property and business investment. The increased site value and investment generates increased tax revenues, called the 'tax increment', which will pay off the money borrowed to construct the road*." The Scottish Government is supporting a maximum of six pilot projects to test Tax

[9] https://www.scottishfuturestrust.org.uk/page/the-scottish-futures-trust
[10] https://www.scottishfuturestrust.org.uk/storage/uploads/corporateplan20192024a.pdf
[11] https://spice-spotlight.scot/2018/01/30/private-financing-of-scotlands-infrastructure/
[12] https://www.scottishfuturestrust.org.uk/storage/uploads/Explanatory_Note_on_the_NPD_Model_(Updated_March_2015).pdf

Incremental Financing in Scotland and where the extra tax revenues would come from non-domestic rates only.[13]

While all of these structures are useful in financing capital infrastructure projects we also need innovation in financing social infrastructure – financing the services which support those experiencing disadvantage in our communities and underwrite the implicit social contract which is fundamental to a Wellbeing Economy. Social impact investment could provide this. Indeed, Social Impact Investment has been doing this in increasing measure since first being introduced in the UK in 2010 under the then Labour administration. Social Impact Investment is already financing over 200 services globally which have raised nearly $500m of investment and are providing services to over 850,000 citizens.

What is Social Impact Investment?

Social Impact Investment is an innovative financial tool designed to mobilise additional resources across our communities, increasing the cost effectiveness of public services which enhance the quality of life for all of our citizens. Social Impact Investment creates equitable partnerships bringing together the skills and expertise of the public, private and social sectors to effectively address some the most pressing and demanding social issues faced in our communities.

'*Only a crisis – actual or perceived – produces real change. When that crisis occurs, the actions that are taken depend on the ideas that are lying around*'. [14]

In the past 15 years Scotland has experienced two significant economic 'crises', in the financial collapse of 2007–08 and the pandemic of 2020–21.

To assume that we can depend exclusively on our pre-existing financial structures to continue to drive positive social change in the face of these critical experiences is akin to assuming that we can service our future fleets of electric and hydrogen vehicles with the toolbox used on the internal combustion engine for the past 100 years.

Social Impact Investment emerged in the aftermath of the earlier financial crisis, it has developed significantly since that time and is now one of 'the ideas that are lying around' for use as we emerge from the health and economic crisis of the Pandemic.

We also face the demographic pressures of an ageing population, the need to achieve a just transition to Net Zero and the well-publicised funding gap in achieving the UN Sustainable Development Goals. These are real challenges and they demand change.

[13] https://www.gov.scot/policies/government-finance/infrastructure-investment/
[14] Milton Friedman, preface to 'Capitalism and Freedom, 1962

Failure to address these effectively runs the risk that the possibilities of the future will be held hostage by the pressures of the present.

At its core, Social Impact Investment is a relationship between partners taking accountability for results based on clear and shared incentives, it creates space for service providers to innovate and iterate to achieve shared outcomes – engaging the active use of data and measurement as the basis for that iteration – and it provides a structure to effectively allocate risk across the partnership.

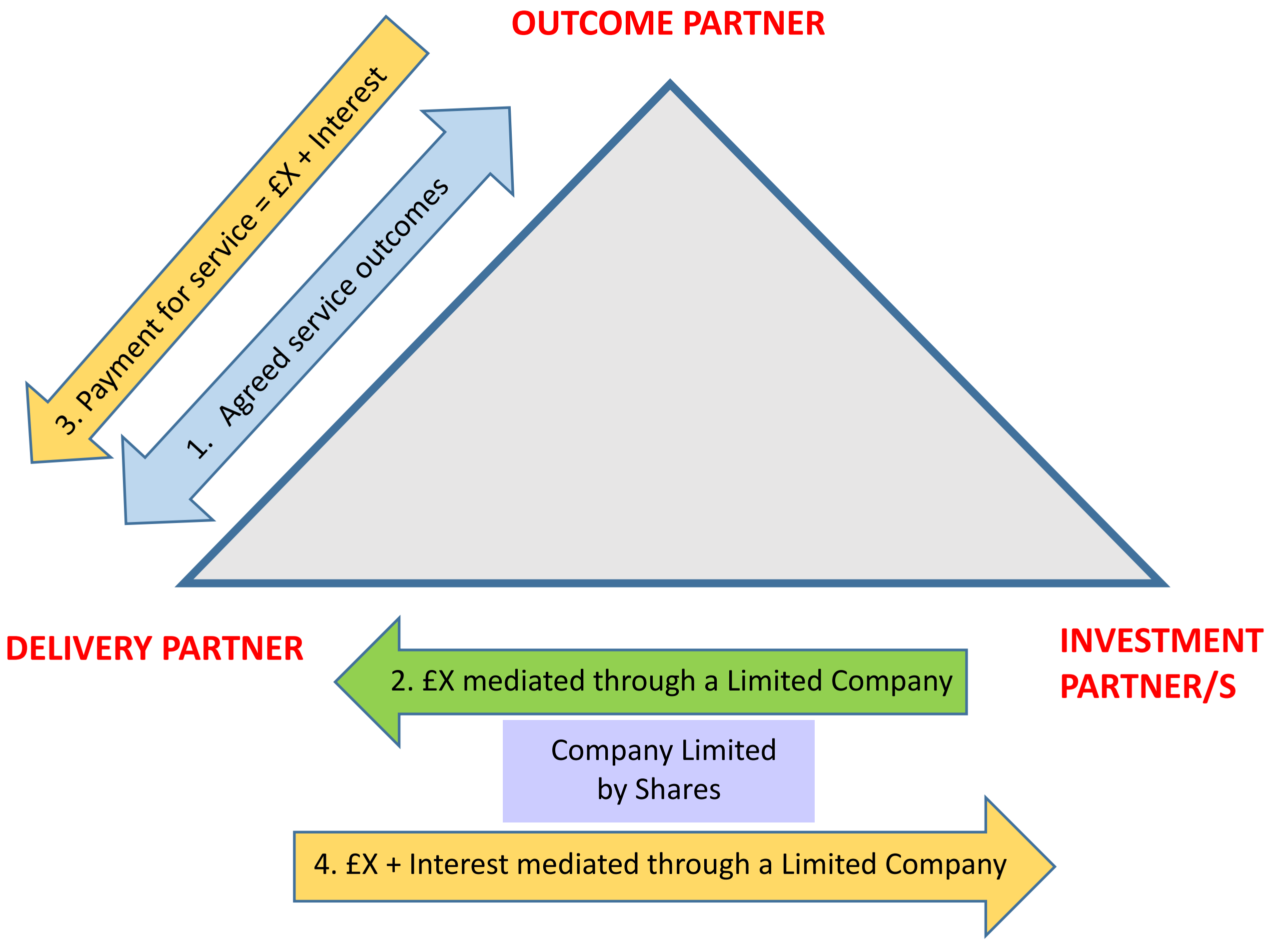
How does Social Impact Investment work?

Based on the experience of using Social Impact Investment in Scotland, the Social Impact Investment Partnership (SIIP) has been developed as a structural framework to utilise the model.

Essentially, a SIIP involves a committed partnership between three parties:

- **The Delivery Partner**, usually in the social sector, who designs and delivers a service in the community to address an identified social issue e.g. homelessness, mental health, unemployment etc.
- **The Investment Partner(s),** who provide the working capital to cover the cost of the service delivery in the first instance until outcomes are achieved. Investment partners can be private individuals, philanthropic foundations or institutional investors.
- **The Outcome Partner**, usually in the public sector, who agrees a set of mutually desirable outcomes with the delivery partner. When these outcomes are achieved then the outcome partner pays for those outcomes allowing the investment partner(s) to be repaid with interest.

This is captured in Diagram One below



Social Impact Investment is not a debt instrument, it is more closely aligned to an equity instrument and, like any good equity instrument, it is designed to add value to the service where the investment is placed.

The SIIP structure has a number of key strengths:

- **For the Outcome Partner**
    - It provides a unique source of third-party capital to invest in social infrastructure.
      Traditionally, government has paid for this kind of investment through
        a) taxation
        b) public borrowing
      In a post-pandemic environment where the economy is firmly in recovery mode it would be very challenging to increase taxation as a source of capital for investment in social infrastructure.
      Equally, the pandemic has created unprecedented levels of public debt which would make further borrowing for investment in social infrastructure problematic.

Social Impact Investment provides an alternative, effective, accessible source of investment capital.

- It provides a 100% guarantee of the effective impact of their spend. If the service doesn't work the outcome partner, in government, doesn't pay.
  The financial risk of non-completion is effectively transferred to the investment partner(s).
  This is an example of how Social Impact Investment allocates risk across the partnership: investors, by their nature, are seeking a degree of financial risk while government seeks to mitigate financial risk. In return for their risk the investment partners receive a modest level of interest on their capital.
- It offers the opportunity to create a service on the ground quickly and at no immediate cost to government. This is a key consideration as we emerge from the pandemic, when there will be a surge in demand for multiple services which will coincide with constrained public finances.
  Social Impact Investment invests in the service immediately and government only makes payment at a later date when the economy – and with it tax receipts – is recovering and the outcomes have been achieved and verified.
- It provides a bridge to preventative spending. This type of spend is always, essentially, speculative – it is made in anticipation of a given outcome. If the service fails to deliver the outcome then the spending is lost. By using Social Impact Investment the outcome is guaranteed prior to the payment, which makes it much easier to justify preventative spending.
  In the absence of preventative spending future budgets will inevitably contain sink holes resulting from having to 'fix' things that need not have been 'broken' had the right preventative measures been in place. The recurrence of these sink holes will ensure that recovery and lasting systemic change consistently dip just beyond the horizon.

- **For the Delivery Partner**
  - It provides working capital and a consistent revenue stream in the medium term, allowing investment in strategic growth and the development of service provision for the benefit of service participants.
  - It provides the opportunity to innovate and iterate in improving service provision.
  - It creates a focus on outcomes, ensuring that the participants' evolving needs remain central to an adaptive service.
  - It demands enhanced performance and data management, which is in the interests of the service participants and the ongoing culture of the delivery partner.

- **For the Investment Partner**
    - It provides a social and financial return on their capital, allowing them to create lasting value in the communities around them.
    - It provides an opportunity to utilise their skills in understanding and supporting effective services based in the wider community.

How is Social Impact Investment different from existing funding structures?

Traditionally, public services have been funded by: public spending based in tax revenues or borrowing; philanthropic donations to charitable organisations; or, more recently, by mainstream social investment.

All of these structure will continue to be utilised, and rightly so, but we need new tools in our toolbox.

Public spending based on tax revenues and borrowing.

We have already noted that we are facing new, and significantly increasing, levels of demand for services in an environment of unprecedented debt and a recovering economy, both of which make it extremely challenging to anticipate adequate capital being secured from tax or borrowing to meet demand. We need additional, new sources of capital.

Social Impact Investment offers that additional, new source of capital which has the significant advantage that it doesn’t have to be repaid by government if the service fails. As noted above, Social Impact Investment provides government with a 100% guaranteed impact of its spend – if it doesn’t work government doesn’t pay.

Philanthropic donations

This will remain an important source of funding support for some services, particularly as risk capital to develop new models of service provision, often on a local scale, providing invaluable learning and development. But in reality philanthropic sources of finance in Scotland exist on a relatively modest scale in light of the levels of need which we increasingly face as a society. Philanthropy can never be expected to meet this scale of demand.

Mainstream Social Finance

This is essentially a debt instrument where money is loaned to social enterprises as businesses which have a positive social impact in their communities. This type of finance often provides uniquely patient capital, sometimes at sub-market rates, and allows innovative organisations to provide highly impactful services. Those services must be capable of producing sufficient revenue to service the agreed level of debt.

In reality there are a great many services which are fundamental to our communities which simply cannot be structured to generate revenue in order to service debt finance. For example, reducing the number of people in Scotland who tragically die as a result of substance abuse, or reducing loneliness and isolation in the elderly, or supporting those who are experiencing poor mental health.

In the context of constrained public finances, the issues we face are on a scale which philanthropic donations and debt-based social finance alone cannot address. Even when utilising the value of these financial structures, two fundamental questions remain:

- How do we access capital at the scale required to allow investment at the levels which will meet demand going forward?
- How do we use that capital in a creative partnership across the public, private and social sectors to deliver services on the requisite scale?

Social Impact Investment offers a significant tool to answer these questions.

- It provides access to working capital investment at scale from outside government - potentially combining investment by private individuals at a modest scale, alongside significant levels of investment from institutional investors.
- It provides a structure which allows delivery partners who are embedded in their local communities to deliver services effectively, based in established relationships and trust through social franchising. One delivery model can be used by multiple local delivery partners, combining investors from their local community alongside pooled investment at scale from institutional investment partners.

Creating Value

'Investment' can often be viewed through a negative lens of those wishing to promote a 'get rich quick scheme' but that is a process whereby the investor engages in 'extracting' value from the organisation where the investment is placed.

Real investment is focused on creating value in the organisation where the investment is placed e.g. by creating new jobs or enhancing the environment etc.

Social Impact Investment is entirely focused on investment which creates value: value for the individual service participants, their families and wider communities, and which releases value for the public purse - funds which can be used in other ways, as illustrated in more detail later in this paper in the example of the Host Homes Service Proposal.

This focus on creating value in our communities places Social Impact Investment very much in keeping with the long standing Scottish traditions of the value of community, of equity and social justice and prudence, and indeed in the traditions of Adam Smith in The Theory of Moral Sentiments and of Henry Duncan, founder of the Trustee Savings Bank.

The capacity of Social Impact Investment to facilitate preventative spending is also very much in line with Scotland's Christie Commission on the Future Delivery of Public Services, which outlined the need to:

> '*Maximise scarce resources by utilising all available resources from the public, private and third sectors, individuals, groups and communities. Prioritising preventative measures to reduce demand and lessen inequalities.*' [15]

Social Impact Investment also has the potential to offer a unique and powerful tool for use by the recently formed Scottish Council for Economic Transformation in creating transformational systemic change in how we deliver services in our communities. At its core Social Impact Investment is a relationship between partners taking accountability for results based on clear and shared incentives, it creates space for service providers to innovate and iterate to achieve shared outcomes – engaging the active use of data and measurement as the basis for that iteration – and it provides a structure to effectively allocate risk across the partnership.

In summary Social Impact Investment:

Requires	all parties to be willing to 'think' and 'act' a little differently than they normally would. Everyone has to be willing to step out from their 'normal' practice and culture to engage and act in new ways. All parties to respect the skills, experience – and limitations – of their partners in a Social Impact Investment Partnership in order to work collaboratively in achieving those outcomes which are in the best interest of the citizens being served.

[15] APS Group Scotland (June 2011) Commission on the Future Delivery of Public Services p. ix

Is driven by a shared, clear focus on creating value for individuals, their families and their wider communities.
That 'value' can be captured in monetary terms and released to support positive, community-enhancing public service in key areas like education and affordable housing.

Offers the Prize of high-quality, person-centred, sustainable, cost-effective services which can bring transformational systemic change in how we deliver services in our communities.

Social Impact Investing in action

The effectiveness of Social Impact Investment has been demonstrated in a Scottish context in the Living Balance Service at YMCA in Perth.

Living Balance Service

In this Service YMCA in Perth committed to support at least 100 unemployed, disengaged young people per annum over a three-year period and at least 60 of these participants each year would progress to secure and sustain employment, further education or training.

Private Investors invested over £300,000 to cover the initial cost of the service delivery.

The Department of Work and Pensions (DWP) paid a fee for each young person who secured and sustained a positive destination in employment, further education or training. These fees were used to repay the original investors with interest over the three-year period.

This meant that the DWP only paid for outcomes that were definitely achieved, ***after*** they were achieved. The DWP was effectively guaranteed 100% impact of its spend; it only paid – in arrears – for what actually worked. If it didn't work, the DWP didn't pay.

The Living Balance Service was unique in that 85% of the investors lived in the local communities of Perth and Kinross and invested between £5,000 and £50,000.

Of the participating young people:[16]

- 47% had three or more significant risk factors indicating potential serious consequences in the young person's life trajectory.

[16] Thomas. A, 'Living Balance: A Qualitative Evaluation', 2018

- 39% had a lack of aspiration.
- 24% faced either drug or alcohol issues, were experiencing poor mental health, had criminal records, suffered homelessness or had involvement with the care system.

Notwithstanding these burdens:[17]

- 77% of participants achieved one or more of the defined outcomes for the service.
- 56% of school leavers made their first entry into employment.
- 61% of job starters successfully maintained their employment for at least 26 weeks.

All the investors in the Living Balance Service were repaid all of their capital with the agreed interest at 7%.

One of the investors noted that he could have invested £10,000 in a global corporate organisation and possibly made much higher returns but he invested in Living Balance because he wanted to change young lives in his own community. He commented:

> *"We decided to invest in the Living Balance Service primarily because the funds were to be used in supporting young folk in Perthshire, including some from our locality in Aberfeldy. We also knew the members of the YMCA management team and were confident that they had the experience and commitment to deliver the outcomes of the funded program. We earnestly believed that this project would make a difference to many young folk and what greater incentive to invest our funds?"*

Most of these local investors indicated that they would invest again in a similarly financed service and 90% donated the interest they received to other local charities, with one initiating a debt advisory service.

<u>The impact of the service on one participant.</u>

David was in his early 20s and had never been in employment due to experiencing poor mental health and neurodevelopmental limitations. David's anxiety meant that he rarely left his home.

Given that the focus of the service was entirely on outcomes, rather than process, it meant that the staff at YMCA had flexibility to take whatever action was necessary to support David to reach a positive outcome. They were focused on creating value for

[17] *ibid*

David and they were enabled to think and act a little differently to support individual participants. Staff initially met him in his own home and supported him to begin attending sessions at YMCA for 2–3 hours a week in the first instance.

Over time this developed into part-time engagement, which increased to full time.

David was particularly skilled in ICT which led to a work experience opportunity with a private company which required someone to develop its use of 3D printing. To support this work experience, staff at YMCA developed a virtual reality video of the bus journey to reach the employer's premises, which David was able to watch and familiarise himself with. After using this interactive video, David was accompanied by staff on the bus over a number of days until he was confident enough to make the journey independently.

David went on to become a member of staff with this local company and one of his younger siblings joined the Living Balance Service at YMCA.

This progress and development for David was achieved over a period of nearly two years.

It's important to note this time scale. The nature of the Social Impact Investment financing structure meant that, provided YMCA maintained the target of 100 participants per year and 60 achieving a positive outcome, it was able to provide this sustained support to David over the time necessary. Some participants could reach their outcome in 6–9 months whereas others could take 18–24 months, allowing YMCA to provide a genuinely person-centred service of high quality in a sustainable and cost-effective manner. The focus on outcomes allowed YMCA flexibility in the process of achieving those outcomes.

Financing 'outcomes' rather than 'process' is a key feature of Social Impact Investment, releasing the delivery partner to ensure the best possible service and to maximise the effective outcomes of the service.

The Host Homes Service

This is a potential Scottish service financed using Social Impact Investment which has been created by The Growth Partnership working with delivery partners and potential investment and outcome partners. Delivery partners are committed to providing this service and a number of potential investment partners have indicated their commitment to invest in principle, subject to the service securing the commitment of an appropriate outcome partner.

The Scottish Government's high-level Action Plan to address homelessness, 'Ending Homelessness Together', places a strong emphasis on the importance of creating preventative services and indicates interest in trialling the use of community hosting as a model to address youth homelessness in particular.

The Host Homes Service has been developed to utilise community hosting in Scotland, financed using Social Impact Investment. It is designed to support up to 760 young people experiencing homelessness over a five-year period in six Scottish geographies. It requires initial capital investment of £1.3m and the preventative nature of the service will release a net value of £41m to the public purse – capital which can be used to invest in other areas e.g. health or education, or in building homes for affordable rent with the unit cost of such a home in Scotland being approximately £150,000. [18]

An example of the value released by this potential service is seen in the tragic issue of youth suicide – 'youth experiencing homelessness are more likely than their housed peers to report suicidal ideation and suicide attempts' (Edidin et al., 2012; Merscham et al., 2009; Toro et al. 2007). A literature review by Edidin et al. (2012) reported that between 40% and 80% of youth experiencing homelessness had suicidal ideation and between 23% and 67% had made at least one suicide attempt. [19] If we take the mid-point in the range for those who have made at least one suicide attempt this would be 45%. Each non-fatal suicide attempt creates a cost to the state of £75,348 (£66,797 updated for inflation [20]) which is made up of 14% A&E costs and a further 70% of psychiatric in- and out-patient support. [21] If just 45% of successful participants in the Host Homes Service across all delivery areas avoid just one non-fatal suicide attempt this will release value of £19,289,088.

Social Impact Investing overseas

Brabant Outcomes Fund: Astrid Kaag, Policy Officer with Provincie Noord Brabant in the Netherlands, has outlined how Social Impact Investing is operating in the Netherlands:

"*Established in December 2018 by the regional government of the Province of Noord-Brabant (The Netherlands), the Brabant Outcomes Fund serves as an exploration tool to transform government systems from a siloed approach, towards integrated and multidisciplinary policy making. The complex challenges of today's societies, such as the climate crisis, do not stop at regional or national borders, do not concern one policy field only, and are too substantial to be solved by the public or private sector solely. Therefore, the Government of Brabant, in collaboration with investors and social enterprises, on-*

[18] Scottish Government (2020), Affordable Housing Supply Programme Out-turn Report 2018 – 19 p. 19
[19] Journal of the Society for Social Work and Research volume 5 number 23 (2014) p. 363
[20] Bank of England Inflation Calculator https://www.bankofengland.co.uk/monetary-policy/inflation/inflation-calculator
[21] University of the West of England (March 2014), "Measuring the economic impact of Wellspring Healthy Living Centre's Social Prescribing *Wellbeing Programme* for low level mental health issues encountered by GP services" p. 7

boarded on a learning-by-doing journey to scale the best solutions to contemporary societal issues.

"The Brabant Outcomes Fund was created as a learning-by-doing process in response to three main obstacles that social entrepreneurs in Brabant are confronted with on their path to creating an inclusive and green society. The politicians and policy-officers of the regional government realised that these obstacles could only be solved if they themselves started do things differently. In fact, they realised that because they are part of the problem they can also be part of the solution!

"With the Brabant Outcomes Fund, the government of Noord-Brabant learns in practice about the value of results-based contracts as a sustainable financing too for societal solutions, complementary to its subsidy granting tradition. In this way the fund wants to encourage other governments in the Netherlands and abroad to steer on results and to scale proven solutions across policy domains. The Province of Noord-Brabant has understood that complicated challenges don't stop at regional or national borders, and is therefore dedicated to collaborate across borders with other provinces in The Netherlands and beyond."

Social Impact Bonds, Belgium: Ian Dewae, Researcher at the Research Centre for Sustainable Organizations, HOGENT, University of Applied Sciences Ghent, realized the first two SIB's in Flanders and is currently working on a study to simplify the implementation of SIB's in a world where government expenditures have to be made more profitable. Below is an overview of how work was done to set up this first SIB's. The vision and the model used are now part of the ongoing project research

The first service to be implemented using Social Impact Investment in Flanders was commissioned by the Public Employment Service. In an innovative adaptation of existing practice in Social Impact Investment this service did not seek a standalone Delivery Partner in the first instance. Instead, they sought a 'service provision' in which the service provider and the investor established a committed partnership prior to engaging with the public employment service. The intention was to generate a new dynamic partnership model across the social service sector and the investment market - the social service provider acted as an entrepreneur, the investor acted as a committed and socially engaged partner providing working capital. This was to allow the Delivery Partner and the Investment Partners to bring their respective skills and experience to build a new strong partnership based in greater mutual understanding and commitment to address complex social issues.

The intention of this approach is to create a market mechanism that works in the same way as mainstream risk-investment markets. This means that entrepreneurs in the social service sector can find risk-capital to engage the market, in this case the market being represented by the government. If the service provider can convince the investor, the *government is assured that the latter will do his homework before risking his money. This way, not only the financial risk is outsourced, but also the analyses of service provider is left to be the responsibility of the investor. (This also increases the likelihood of success of a project, it will be carefully structured as a calculated risk.)*

The first lesson we learned in Flanders was that it's not a good idea to negotiate about goals, objectives and assurances with Government. Rather there should be set values where negotiation with Government is limited to the impact targets and their consistent achievement. The detail of delivery – how and when delivery is structured should be negotiated between the investor and the service provider. Negotiation with Government should be about what the service will achieve not how it will be achieved.

Something to consider for the future is a more focused selection of partners at the outset and then negotiate only about terms with the parties who will definitely implement the service. This will make the negotiations more effective. Otherwise, you get several parties in a long negotiation process involving a great deal of time and effort where the service provider/investor partnership has no certainty that they will be selected leading to significant time wasting.

One of the dangers in using Social Impact Investment is that parties become too focused on the process of negotiation and on the financial structure rather than focusing primarily on addressing an identified social challenge. This can lead to everyone involved having decided that the service has to be a success – so much time has been invested in it. The need to succeed then drives everyone involved begins to chip away at the risky edges of the service model to ensure its success with the result that an excellent, innovative, system changing idea can be reduced to 'a sure thing'. The role of intermediaries to provide assurances is important here, particularly between service providers and investors and also in support of Government.

To ensure the quality of the service evaluation in Flanders the evaluator was appointed together with the Delivery and Investment Partners so no extra audits were necessary and this added value to the service. Involving the evaluator at an early stage is useful.
This type of financial structure to ensure service provision is new, but it complements the usual partnerships that government engages in. Social Impact Investment can facilitate innovative and system changing projects. This new form of funding opens the doors for new partnerships between the Public, Private and Social Sectors enabling Government to tap into new sources of capital against the background of constrained public finances. With advancing insight, further research is now being done to simplify the implementation of Social Impact Investment in Flanders.

Policy Recommendation

The Scottish Government to pilot the use of Social Impact Investing as a funding mechanism. Other public bodies, such as local authorities and NDPBs should also consider how this funding option could help deliver policy programmes.

FAQs

Are people willing to invest?

Yes.
90% of the Investors in the Living Balance Service in Perth indicated that they were keen to invest in new services using Social Impact Investment, indeed some of their associates indicated that they would like to invest in future services.

A number of established social investors have indicated that they are interested in principle in investing in services proposed in Scotland subject to the commitment of an appropriate outcome partner.

Additional parties with a new interest in social investment have indicated interest in investing.

Why does the Government not simply fund these services directly?

Many of the services where Social Impact Investment is the most appropriate financing tool are preventative in nature. We noted above that while investment in prevention is very attractive to government because it removes potential sink holes from future budgets, it is also very challenging because it is – essentially – speculative. Social Impact Investment, on the other hand, ensures the positive outcome of a preventative service – like the Host Homes Service – before payment is made, providing a 100% guaranteed impact of Government spending.

We also note above that capital for investment of this kind in social infrastructure is traditionally provided from tax-raised revenue or borrowing. Increasing tax or public borrowing in the current environment would be very challenging, particularly given the Scottish Government commitment not to raise income tax in this parliament and its constrained borrowing powers.

Additionally, even if government were able/willing to incur additional borrowing such funds would require to be repaid ***irrespective of the outcomes of the services which***

they funded. By using Social Impact Investment, government would only pay in arrears for outcomes which have definitely been achieved.

Why should Government use tax-raised revenue to pay interest to investors?

We have noted above the difficulties involved in securing capital for investment in social infrastructure, particularly securing it at sufficient scale to address the level and complexity of social issues which we face in our communities. Social Impact Investment provides access to third-party capital to facilitate the transformational systemic changes we need to make to ensure the ongoing provision of high-quality, person-centred, sustainable, cost-effective services. As with any third-party capital it is necessary to pay interest to achieve access to the funds.

Given that Social Impact Investment ensures that government only pay for outcomes which have definitely been achieved, then:

a) There is no wastage of funds paying for services which didn't work.
b) The services created using Social Impact Investment are preventative in nature, thus they remove sink holes from future budgets, releasing significant value to the public purse which can be invested in services which further enhance the lives of citizens and communities. A modest level of interest on the capital is justified in light of the significant value released.
c) We have seen, in the case of the Living Balance Service in Perth, that investors who engage in this kind of financing are keen to do so again, which has the potential to create new services in the future. The payment of interest encourages this ongoing positive use of third-party capital.
d) Most government purchases involve the payment of an element of incentive to the party providing the product or service. For example, the payment for utilities at government offices will include an element of incentive payment to the utility provider – it may be an element that is used by the provider to pay a dividend to shareholders or to meet the cost of debt financing by the utility company. These costs are routine costs of doing business, without which the utility providers could not exist and continue to provide the service.
   In Social Impact Investment that incentive element to the investment partners is simply more transparent than in most transactions. It is no less legitimate for being more transparent.

Is Social Impact Investment not treating people as commodities for profit?

Social Impact Investment will not be attractive to every potential investor and will never create the kind of financial returns equivalent to those seeking quick and high returns from commercially based venture capital-type investment. That is not the purpose of Social Impact Investment.

Any parties using Social Impact Investment to finance a service in the community have the responsibility to ensure that they only engage investment partners who have a shared commitment to the best interests of the citizens and communities who will be served by the services created.

Not only will Social Impact Investment not be attractive to avaricious investors, it does not have to accept them – there are sufficient sources of socially motivated investment available to ensure that the capital does not treat our fellow citizens as commodities.

Is Social Impact Investment not just increasing Public Debt?

No.

Debt finance used by Government to create services in the community would have to be repaid whether the service was effective or not and the interest on that debt finance would have to be paid.

Social Impact Investment does not have to be repaid if the service is not effective in achieving the agreed outcomes. The risk of non-completion of outcomes has been transferred to the investment partners.

Isn't Impact Investment just contracting out to the private sector?

No. Social Impact Investment is essentially a group of relationships between parties with a common purpose of providing an effective service in communities with the service itself provided by a not-for-profit social sector organisation. These relationships are the key to the shared purpose and effectiveness of the service provision where all parties respect the skills, experience and limitations of their partners and work collaboratively to achieve in the best interests of the citizen.

It's worth noting that in over 200 services being delivered using Social Impact Investment during the pandemic we are not aware of any which reverted to legal actions to enforce service delivery or adherence to contractual obligation – the nature of the relationships created in the mutual partnership of a Social Impact Investment service meant that people worked together to find the best possible solutions for citizens being delivered by delivery partners embedded in their local communities where they are respected and valued.

Also, by using social franchising as the route to scale Social Impact Investment can ensure that these local roots of service delivery are maintained.

Will the influence of private sector Investment Partners not effectively make this a private sector service driven by profit?

No. The Investment Partners input will be valuable in helping to ensure effective, outcome focused performance and data management practice but the services will be delivered by Social Sector, not for profit organisations. The focus of the performance and data management is to ensure the best outcomes for the service participants, it is not focused on increasing profit for the Investment Partners.

The experience of the Living Balance Service in Scotland was that the Investment Partners were predominantly local citizens whose investment was socially motivated, not profit driven. Working with Investors this service was able to deliver very much in keeping with the four pillars of the Christie Commission – Prevention, Performance, Participation and Partnership.

Investment Partners will conduct appropriate due diligence before deploying their capital in this kind of investment but the Delivery and Outcome Partners will also conduct their appropriate due diligence to ensure that potential Investment Partners understand the nature of the service and their primary role in supporting effective service delivery.'