Researching Capital Markets and Financial Services

Investment Research Report
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Social Impact Bonds in South Africa

The risks and returns of innovative finance for social change

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Researching Capital Markets and Financial Services

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- The Impact Bond Innovation Fund
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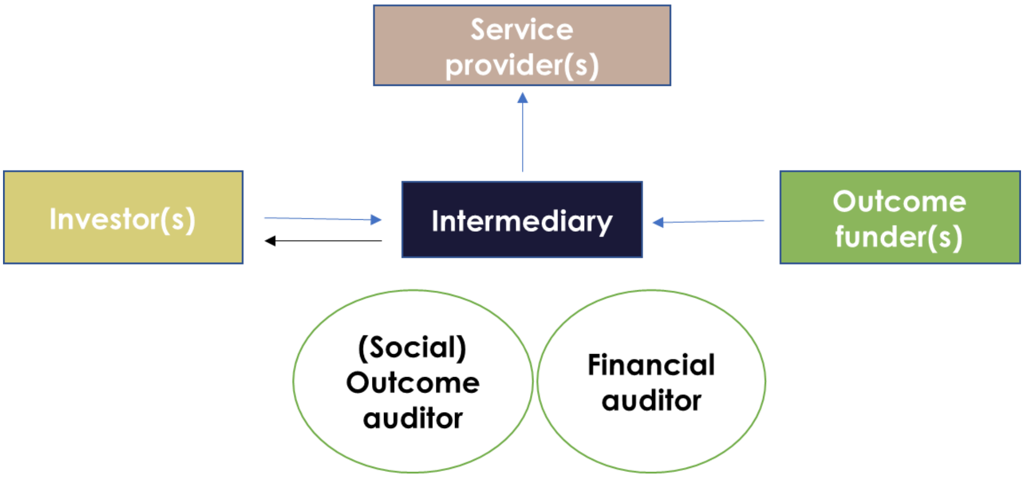
Executive Summary

Introduction: What are Social Impact Bonds?

Social impact bonds (SIBs) are seen by many as carrying the potential to revolutionise the way that some social services are governed, delivered, and financed. The first two SIBs in South Africa were launched in 2018: the Inclusive Youth Employment Pay For Performance Platform (also known as Bonds4Jobs, or B4J), and the Impact Bond Innovation Fund (IBIF). In this report, we provide an overview of the financial and social performance of these two SIBS, and assess whether the hype is justified. Are SIBs the golden ticket to better social services and to better collaboration between the public and private sectors? And what does the experience in South Africa imply for the future of SIBs, in South Africa and elsewhere?

Figure 1: Social impact bond structure



SIBs are a sub-set of payment by results financing models (PbR). Investors provide working capital upfront to delivery agents, typically NGOs, to provide social welfare services[1]. If the NGO successfully meets predefined outcome targets – such as placing a certain number of work-seekers into jobs – outcome funders repay the investors. Outcome funders in SIBs always consist of government entities, with or without the additional presence of private actors like donors or philanthropic foundations[2]. If unsuccessful, outcomes funders do not pay, and investors do not earn returns and could also lose their capital[3]. Success or the lack thereof is confirmed by an independent outcome auditor, with the financial management

[1] This transfers the risk of social service failure from service providers to private investors. This distinguishes SIBs from other PbR models. In results-based aid, service providers or governments are only paid by donors when the outcomes of their services have been verified. With conditional cash transfers, a recipient of a cash transfer to support childcare might only qualify for continued receipt of that benefit if their children perform well in school, or if the caregiver attends a set number of clinic visits. Performance risk is retained at government and beneficiary level respectively.
[2] Impact bonds where the outcome funders are donor agencies or development banks are termed "development impact bonds", or DIBs.
[3] In practice, NGOs rarely fail completely, and payments are typically made in proportion to the amount of success achieved.

audited by a financial auditor. An intermediary typically manages the relationships between the different participants.

Conceptual framework: the benefits of SIBs

A large literature points to the potential benefits of this structure. We condense these benefits into a conceptual framework, summarised below:

- SIBs' **focus on the results of services** and measuring these results leads to more effective services and knowledge about what works in difficult service areas, provided credible impact assessments are used.
- **Intermediaries** can provide valuable oversight and capacity -building for service providers, increasing the odds of successful service delivery. But the set-up of SIBs is often lengthy and complex, and it can be difficult to find the right partners. Ongoing **governance** is also complex and costly.
- Because investors bear **service failure risk** by providing working capital to service providers upfront, service providers are freed to experiment and innovate to meet outcomes. Governments only pay for successful services, leading to greater efficiency in public expenditure. But impact-washing is a threat. This is the practice of over-stating achievements or misleadingly claiming success.
- SIBs can be a tool to bring **additional private capital** into social delivery, in a global context where many governments feel that their capacity for social expenditure is constrained. Because SIBs often target areas with a history of policy failure, and because they encourage innovation, SIBs may also lead to the achievement of **additional social outcomes** that would not have been obtained otherwise.

We tested this conceptual framework through interviews with almost eighty participants in the respective SIBs and by analysing secondary documentation relating to their design and implementation.

The South African evidence: do SIBs work as promised?

The two South African SIBs focused on human capital development at opposite ends of the traditional learning spectrum. The IBIF provided early learning services to preschool-aged children, and B4J provided skills and employment services to unemployed young adults. Their implementation shows that:

- Both SIBs were effective in meeting their outcome targets. The IBIF delivered early learning services to roughly 4,000 children over three years. A locally-developed assessment tool – the Early Learning Outcome Measure (ELOM) - was also used to assess the performance of the early learning programme. Though this target was missed at both points it was assessed, the service provider achieved improvements in learning scores year over year. In B4J, service providers placed 1,800 unemployed youth from disadvantaged backgrounds into relatively complex and well-paying jobs. In both SIBs, extensive new monitoring systems, the freedom to rapidly adjust and innovate, and the imperative to achieve results led to effective service delivery. However, more complex impact evaluations, rather than the simple outcome verification in both SIBs, could provide a fuller understanding of the true effects of SIB programming.
- The intermediaries in both SIBs built service providers' capacities to deliver results, for example by introducing new M&E systems or new curricula. But set-up and ongoing implementation was costly. Attracting traditional profit-first investors proved difficult, as did securing outcome funders' commitments to future SIBs.
- In the IBIF, early learning services were expensive compared to what the government usually spends. The opposite is true on B4J, where people were placed in jobs far more efficiently. Our conclusion is that quality early learning programming is expensive in the shorter term, and government must decide if the costs are justified by the longer-term benefits. Conversely, a lot of money spent on post-secondary education could be redirected to cheaper, quicker alternatives.
- While there is no evidence of impact washing, there is evidence to suggest that outcome targets were not ambitious enough. Outcome funders in both cases faced an almost certain schedule of outcome

payments. This goes against the principle of risk-sharing with the private sector and associated incentives to innovate.

- In the IBIF, investment capital would probably have been invested in early childhood development (ECD) in the absence of the SIB by the philanthropic funders. In the case of the impact fund, capital invested in the IBIF might not have gone to ECD specifically but certainly to another area of social impact. In B4J, approximately half of the investment capital *was* additional to the social sector: it is money that would have been invested in alternative, high-yield, fixed income opportunities *without* any impact considerations. In the latter, the use of a blended capital stack with commercial investors ranked senior to more philanthropy-oriented investors is probably the one factor that tipped the commercial investors' decision to invest.
- Both SIBs also demonstrated effective policy innovations in areas that have long suffered from service failure. In the case of the IBIF, these innovations were made possible by the SIB, and would likely not have happened in the absence of the SIB. This is also true, to an extent, in B4J.
- The future of SIBs may lie in (a) expanding the capacity-building role for intermediaries, (b) using SIBs to test novel, high-risk interventions and provide the working capital to NGOs to do so, and (c) scaling up proven interventions using government funding outside of the SIB structure.

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Abbreviations, Definitions and Glossary

B4J: Bonds4Jobs (refers to either the SPV set up for this SIB, or serves as shorthand for the SIB itself).
CFLC: Catalytic First Loss Capital
DFIs: Development Finance Institutions
DIB: Development Impact Bond
ECD: Early Childhood Development
ELOM: Early Learning Outcomes Measure
ESG: Environmental, Social and Corporate Governance
FCW: Western Cape Foundation for Community Work
FiF: Family in Focus Programme
GPG: Gauteng Provincial Government
IBIF: The Impact Bond Innovation Fund, the first SIB to be negotiated in South Africa and the second to begin service delivery.
M&E: Monitoring and Evaluation
m2m: mothers2mothers
NGO: Non-governmental Organisation
NPC: Non-profit Company
PbR: Payment by Results
PPP: Public Private Partnership
PYEI: Presidential Youth Employment Intervention
SES: Socio-economic Status
SIBs: Social Impact Bonds
SMMEs: Small, Medium and Micro-sized Enterprises
SPV: Special Purpose Vehicle
SDGs: Sustainable Development Goals
UK: United Kingdom

Introduction

In 2010, the first social impact bond was launched in the United Kingdom (UK) to finance a rehabilitation programme for prisoners[4]. The next few years saw a proliferation of SIB transactions in the global North[5]. The first (and ultimately successful) SIB in a developing country was launched in 2017 in Colombia[6]. Its aim was to place vulnerable people into jobs through results-oriented employability training. Unemployment rates for certain groups - like youth, women and those displaced by armed conflict – had been persistently high for several years. And programming to alleviate unemployment tended to focus on outputs (for example providing a training programme to someone) rather than outcomes (the training leading to a job).

A similar context in South Africa motivated the launch of the country's first SIB – Bonds4Jobs (B4J) - a year later, in Johannesburg in April 2018. Set to conclude at the end of 2022, B4J aimed to test alternative social delivery mechanisms for getting systematically excluded young South Africans into their first jobs, using the unusual payment by results (PbR) structure encapsulated in the SIB. Youth unemployment was and still is extremely high, with the input-oriented skilling system seemingly incapable of delivering jobs.

Four months later, the country's second SIB, the Impact Bond Innovation Fund (IBIF), was launched in Cape Town. The IBIF tested the efficacy of a home-based early learning programme for pre-primary school age children and their caregivers in low-income areas in the Cape Town metropolitan area. For most people in these communities, formal early learning services at pre-schools are either expensive or of low quality. The lack of access to high quality early learning in our formative years makes later learning and progression through school more difficult. And in the longer term, as young adults, the most likely outcomes are either unemployment or low-paying and menial work. The IBIF thus aimed to deliver easily accessible, high-quality educational programming for young children such that they would be adequately and measurably prepared for their first year of primary schooling.

In both SIBs, clear outcome metrics were chosen to measure the success of the social programmes. Successful delivery of services in both SIBs justified the repayment of investors' capital along with competitive returns on those investments. Despite successful implementation, B4J terminated two years early, in June 2020. This was due to the Covid-19 pandemic and the ensuing national lockdown, which had shut down almost the entire economy in March. The pandemic posed an impossibly difficult challenge for a SIB focused on job placements.

The IBIF was less affected by Covid-19. The service provider maintained delivery of early learning services to young children and their caregivers over the phone during the final year, rather than visiting them in their homes. This successful adaptation allowed for the IBIF to run until the planned end date in November 2020 despite Covid-19.

We have written two separate reports on the IBIF and B4J, where we thoroughly examine performance of each SIB as individual financial instruments and social interventions[7]. In this report, we consolidate our views on the model, rather than the details of individual implementations.

[4] Social Finance, *Social Impact Bonds*. In this report we use abbreviated footnote references which are expanded fully in the bibliography section at the end of the report, as per Chicago Manual of Style Online, "Notes and Bibliography".
[5] Spera Connect, "List of Social Impact Bonds".
[6] Government Outcomes Lab, "Colombia Workforce Development".
[7] See https://www.intellidex.co.za/reports/.

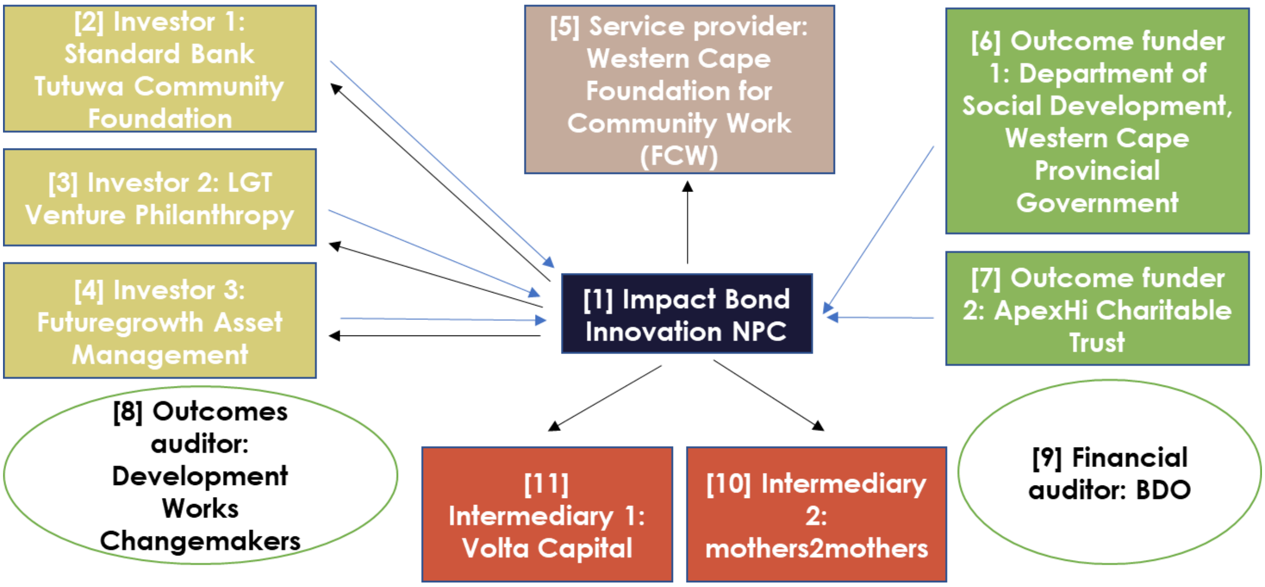
SIB enthusiasts expect that SIBs will deliver a range of benefits, from more effective services to a crowding in of private investment to social causes. The first objective of this report is therefore to assess the extent to which the two South African SIBs have achieved these benefits. To do this, we construct a conceptual framework based on the international literature that describes how SIBs are expected to work and assess South Africa's experience against it. The second objective is to speculate as to what this experience implies for the development of SIBs and impact investing in South Africa and elsewhere. We hope this will build transparency in this young sector and improve understanding among investors and the broader public of innovative mechanisms to tackle persistent social problems.

Overview of the two SIBs in South Africa

In this section we summarise the design of the IBIF and B4J SIBs as well as their respective financial and social performance.

The Impact Bond Innovation Fund (IBIF)

Figure 2: The Impact Bond Innovation Fund (IBIF)



In the IBIF, three investors [shown in Figure 2 at 2, 3, 4] paid into the Impact Bond Innovation NPC [1], a special purpose vehicle (SPV) set up to house the SIB. These funds were then used by the Western Cape Foundation for Community Work (FCW) [5] to deliver home-based early learning services for children aged three to five and their caregivers in two low-income communities outside Cape Town. Poverty and unemployment are prevalent in these areas, and many children come from families without the means to send them to pre-school. This can detrimentally affect later learning and progression through formal schooling. FCW's educational service, delivered by home visitors, aimed to ensure children are school-ready once they enter formal schooling at age five/six. It also sought to build the capacities of caregivers to contribute to the process of early learning in their children.

If FCW were to be successful in the delivery of these services, one public [6] and one private [7] outcome funder would repay the investors their capital and an interest rate above normal market rates (shown in Table 1 below). Success was measured by (1) recruiting and retaining a certain number of children into the programme, (2) ensuring they attended a set number of sessions over the course of each delivery year, and (3) improvements in the "Early Learning Outcome Measure" (ELOM), a test administered at the end of each intervention year. It measures "what children of particular ages and stages should know and be able to do"[8], via a 45-minute test administered by a qualified ECD assessor. The test assessed, in a random sample of IBIF children, gross motor development, fine motor coordination and visual motor integration, emerging numeracy and mathematics, cognition and executive functioning, and emerging literacy and language. The score of each group that was assessed was compared to a reference sample of South African children

[8] Dawes et al., *Early Learning Outcomes Measure.*

of similar socioeconomic status (SES) and age. Being able to demonstrate better performance when compared to the reference group formed the third outcome measure.

Success on these three measures was verified by the outcome auditor, Development Works Changemakers [8]. Financial intermediary Volta Capital [11] managed the investments, the outcome payment model and process of soliciting investment alongside technical intermediary mothers2mothers (m2m) [10], which also worked with FCW to build capacity and ensure social delivery was on track. Together they managed relationships between all participants and SIB reporting. The financial transactions of the SPV were audited by BDO [9].

The IBIF was successful. FCW, with the support of the intermediaries, over-achieved on the recruitment and retention and attendance targets. Early learning services were delivered to approximately 4,000 children and their caregivers, who attended the target number of sessions in their given year. The target number of children for these two performance targets was 2,000.

They were less successful on the ELOM measure and were unable to achieve targets relative to a reference group in both years in which assessments were run (though in the second assessment scores improved). This meant outcome payments for ELOM were not made (however, as we describe later, this constituted less than 10% of the overall schedule of payments). Our conclusion from the interviews with service providers, intermediaries and evaluators (including those who designed the ELOM measure) is that the reason for failure on this score was that the ELOM targets were very ambitious. The reference group that was used to define the targets was made up of children attending daily centre-based pre-schooling as opposed to those receiving once-weekly services from a home visitor.

This performance translated into financial performance as follows:

Table 1: Financial performance of the IBIF

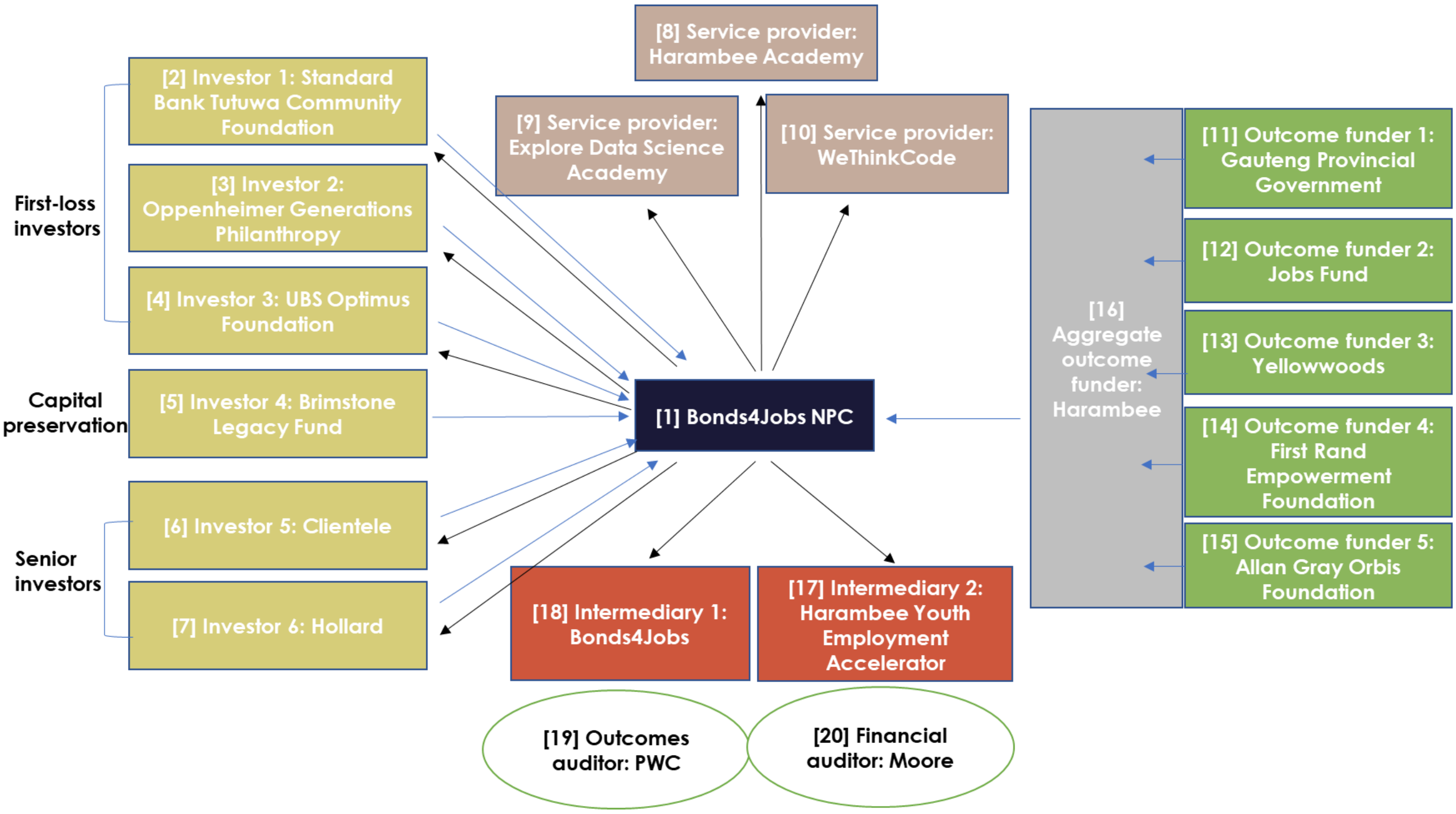
Maximum interest rate return associated with achievement of 100% of the social targets	16%
Annual interest returns earned to October 2020	14%: 1. Maximum payment received for recruitment and retention, paid per child beneficiary; 2. Maximum payment received for attendance, paid per child beneficiary; and 3. No payment made for the missed ELOM targets, paid on a cohort basis.
Comparison: FTSE/JSE All Bond Index (ALBI): annualised returns from July 2018 – October 2020	6.25 %[9]
Comparison: Annualised returns on interbank swaps, July 2018 – October 2020	7.39%[10]
Comparison: Annualised returns on the government bond curve, July 2018 – October 2020[11]	7.68%[12]

[9] Data obtained from https://www.bloomberg.com/markets/rates-bonds
[10] Ibid.
[11] It is important to note that unlike 'normal' bonds, SIBs are (typically and certainly in these instances) unlisted and non-tradeable. Investments of this nature tend to be associated with project finance-type risk thresholds, which would probably lie between 12% and 15%.
[12] Ibid.

The IBIF thus delivered strong financial returns while carrying clear social benefits: delivery of quality early learning services to 4,000 children (and their caregivers) in areas where such access is limited.

The Inclusive Youth Employment Pay for Performance Platform (Bonds4Jobs)

Figure 3: Bonds4Jobs



Bonds4Jobs (B4J) was divided into two delivery cycles. In the first cycle, which ran from April 2018 to January 2019, three investors [2, 5, 7] supplied working capital to the B4J SPV [1]. These funds were then transferred to the Harambee Academy [8](the training division of Harambee Youth Employment Accelerator) to deliver employment services (profiling, job matching and training) to unemployed young people (aged 18-35) from disadvantaged backgrounds.

Broadly speaking, people who fulfil the criteria of disadvantage used in B4J (having gone to a low-income school, low household income, or receipt of public social assistance) face very poor prospects in the labour market. B4J aimed to test if these prospects could be radically improved via the provision of quick, cost-effective and demand-led services (that is, services developed in consultation with employers), rather than relying on the traditional route into a job. This would be expensive university or other post-secondary education or resorting to training for unemployed youth outside of the formal education system, which tends to be ineffective and not tailored to the concrete needs of employers. B4J also aimed to test whether eventual placement could be into well-paying, complex jobs that might meaningfully change the trajectories of the young people's lives.

When the Harambee Academy achieved its targets for job placements in January 2019, two public and two private outcome funders [11, 12, 13, 14] repaid the investors, which were arranged in a blended capital stack. This meant the senior investor [7] was paid out first, with the highest interest rate, followed by investor [5], whose capital was guaranteed with zero interest, and finally investor [2]. Had Harambee Academy underperformed in the first performance cycle, investor [2] would have been the first to absorb these losses. Underperformance would have to fall below approximately 30% of the target before the senior investors would begin to suffer losses.

In the second performance cycle, planned to run from January 2019 until June 2022 but terminated in June 2020 due to Covid-19, additional first loss [3, 4] and senior [6] investors were brought on board, as well as an additional (private, philanthropic) outcome funder [15]. To achieve larger numbers of job placements, two additional service providers [9, 10] also joined B4J, replicating the Harambee Academy's service delivery model. Harambee Youth Employment Accelerator[13] acted as the technical intermediary [17] and provided capacity-building and monitoring services to the additional service providers, set performance targets using its market research, and managed reporting to the various participants. The financial intermediary, Bonds4Jobs [18] solicited and managed investments. The auditors [19, 20] assured the service delivery and financial performance respectively.

The table below shows how the service providers fared against the job placement targets:

Table 2: B4J social delivery

	Year 1	Year 2	Year 3	Year 4
Target placements	600	1,400	2,000	2,000
Actual placements	600	1,209	N/A	N/A

Harambee met year one's target three months early, and in the second year achieved 86% of the performance target (along with the additional service providers) despite the national lockdown. Job retention was not tracked in B4J. This translated into the financial performance indicated in the following table (and from this point onwards we anonymise the investors):

Table 3: B4J financial performance

	Investor	Type of investor	Principal	Annual interest rate
Round 1 (year 1)	1	First loss	R11,321,400	7.5%
	2	Senior	R11,321,400	11%
	3	Capital Preservation	R11,321,400	0, + inflation
	Total round 1 investment: R33,964,200		*Blended interest rate: 6.17%*	
Round 2 (years 2-4)	**Investor**	**Type of investor**	**Principal**	**Annual interest rate on three-year investments**
	1	First loss	R15,000,000	6%, serviced semi-annually
	4	First loss	R10,000,000	7.5%, serviced annually
	5	First loss	R15,500,000	7%, serviced quarterly
	2	Senior	R20,000,000	11%, serviced annually
	6	Senior	R10,000,000	11%, serviced quarterly

[13] The direct delivery of services to young people is carried out by the Harambee Academy, a separate division within the Harambee Youth Employment Accelerator. For the rest of the report, when we refer to "Harambee", we are referring to the entire organisation. The specific sub-divisions are named where required.

	3	Capital Preservation	R20,000,000	Split: R10,000,000: interest free R10,000,000: 5%, serviced quarterly
	Total round 2 investment: R90,500,000		*Blended interest rate: 8.29%*	

As with the IBIF, B4J offered competitive financial returns, especially to senior investors. Unlike in the IBIF, slight under-performance against the outcome targets had no impact on investors' returns. Due to the early termination of the SIB, B4J decided to use its reserves to pay out investors in full: their principal plus full interest up to the end of year two.

Methodology

A case study methodology[14] was used to collect data and analyse it. This involved interviews with close to 80 people who participated in either (or occasionally both) SIBs.

In the next section we specify the conceptual framework that guided our data analyses, before moving into a comparison of our empirical findings from both SIBs against it. The development of a conceptual framework assists with analytic generalisability: the extrapolation of theoretical propositions to different contexts. This involves pointing out features of the South African SIBs and their implementation that are similar to or different from the "model SIB". The model SIB is the way one would expect a SIB to unfold based on the literature about how SIBs are structured. We hope that these comparisons assist the reader in gauging the suitability of SIBs to their own contexts.

For more details about our methodology, please consult the individual reports for each SIB at https://www.intellidex.co.za/reports/.

[14] Yin, *Case Study Research.*

Conceptual framework

We constructed the conceptual framework below based on our literature review[15]. In the next section, we evaluate the South African experience against the factors defined in the framework.

Figure 4: Conceptual framework

Effects of the results orientation

- Focusing on service outcomes (eg jobs) rather than inputs (eg training) leads to more effective services.
- Measurement and ongoing performance management increases the evidence base about what works, can redirect public resources to where they will have the most impact, and improves accountability in the use of public money.

However:

- Outcomes must be clear and easily measurable.
- Credible impact assessments are needed.

Governance

- The set-up of SIBs is lengthy and complex due to the need to align interests of many diverse stakeholders.
- Ongoing transaction costs are also high.
- Intermediaries enhance rigour in service delivery and build capacities of service providers.
- SIBs must target the right people: outcome funders committed to achieving outcomes; socially conscious investors (who can also catalyse profit-first investments); and capable service providers.

Risk distribution

- Investors providing working capital to service providers upfront shifts the risk of performance failure to investors.
- Service providers are freed to experiment and innovate to meet outcomes while bearing no (or only limited) financial risk.
- Governments (outcome payers) only pay for successful services, leading to greater efficiency in public expenditure.

However:

- The temptation for impact washing puts the public at risk of subsidising and/or receiving sub-optimal social services.

Additionality

- The sustainable development goals envision a central role for the private sector in meeting the world's social development challenges.
- SIBs can be a tool to bring private capital into social delivery.
- By focusing in areas with a history of policy failure (whether in design or implementation) and a need for innovative new solutions, SIBs may also lead to the achievement of social outcomes that would not have obtained otherwise.

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15 Arena et al, "Flash in the Pan"; Dowling, "Financialisation"; Edmiston & Nicholls, "Social Impact Bonds"; Fraser et al, "Narratives of Promise"; Hills, "When is the Right Time?"; Jain, "Social Impact Bonds"; Maier and Meyer, "Social Impact Bonds"; McHugh et al, "A Wolf in Sheep's Clothing"; Roy et al, "Social Impact Bonds"; Warner, "Private finance for public goods"; Social Finance, "Social Impact Bonds".

Applying the conceptual framework

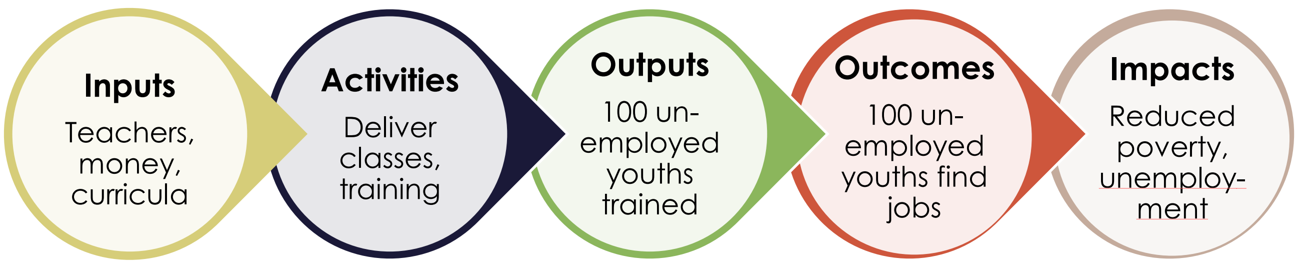
Effects of the results orientation

More effective services and accountability

> *"I don't believe that in South Africa we're really short of money and that people are poor because we don't have enough resources. It's how those resources have been managed and how that capital is being deployed for very few quality outcomes."*

This quote from an investor exemplifies a common view across our interviews: expenditure on social welfare in South Africa does not seem to achieve much. In education this is certainly a fair assessment. The South African state spends roughly 7% of GDP on all levels of education, which is significantly more than global averages[16]. This percentage excludes the billions spent on education by the private sector and civil society[17]. Yet the country consistently records youth unemployment rates that are among the highest in the world. Though the early learning sector receives far less than higher education[18], even here, where early learning services are delivered, their value to the children receiving them has been questioned[19]. The consensus view is that this status quo is upheld by a misguided and inordinate focus on the inputs, activities and outputs relating to service provision. The outcomes, as seen in the shorter- and longer-term effects of these services, tend to be ignored.

Figure 5: Inputs to impacts



Public administrations across the world are biased towards orienting services around inputs (the left side of the figure above). Public budgeting processes allocate funds from higher (eg National Treasury) to lower levels (eg provincial education departments). These funds typically need to be spent and, if not, returned to the national fiscus. Members of the public service are therefore motivated to record expenditures and to

[16] For upper-middle- and middle-income countries, the average is 4%. World Bank, "Government Expenditure on Education".
[17] For example, education receives approximately two thirds of the operating budgets of the country's largest philanthropic foundations (see Kruger et al, *Understanding Empowerment Endowments*"). In addition, half of the private sector's estimated R10.2 billion in corporate social investment (CSI) spending was directed at education in 2019 (see Trialogue, *Trialogue Business in Society Handbook 2019*).
[18] In 2018, 1.5% of GDP was spent on ECD and only 6,5% of that amount was spent on early learning, nutritional support and responsive parenting. Ilifa Labantwana, *Early Childhood Development*.
[19] Ibid.; Van der Berg et al., *Introduction of Grade R* and *Binding Constraints in Education*; Hall et al., *Early Childhood Review*.

prove that public funds have been spent on what they have been allocated for. More practically, inputs – like teachers, facilities and resources – have to be paid. Abstract, future outcomes and impacts do not.

The South African public service is aware that this structure of incentives has diverted attention from a proper reckoning with the effects of their operations. This is evident in the extensive performance management systems that have been introduced to rectify it. But overwhelmingly, they do not go far enough to the right of the figure above, settling on output measures. For example, targets for universal primary school enrolment have largely been achieved; substantial progress has been made in getting children into grade R; and several public employability programmes (like the EPWP) have performed well against targets to train set numbers of unemployed young people.

But these kinds of targets are blind to the quality of the services. Education provided by the private and NGO sectors suffers similar shortcomings. Large companies are incentivised by the BEE framework to spend on skills training but not to monitor whether that training leads to anything. Reporting to the regulators takes the form of reporting on amounts spent. NGOs are also required to report on expenditures rather than outcomes and impacts achieved.

The next frontier in the delivery of education and training is thus in ensuring that the quality of services is improved such that the services fulfil their ultimate objectives: better education and better life chances, rather than simply having received an education. SIBs are widely viewed as the perfect mechanism to use to get there. This is because payments are structured explicitly around outcomes – like job targets or improvements in early learning scores – and as a result, service delivery is transformed as stakeholders rally around these objectives. The advantage of SIBs over other payment-by-results models is that the provision of working capital upfront by investors covers the costs of inputs and activities. Service providers need only focus on doing what needs to be done to get them over the line.

We see this in both IBIF and B4J. Both SIBs were very effective on their own terms. Service providers almost completely met their performance, or outcome, targets, coming up with innovative strategies that not only enhanced their ability to meet the targets but will also likely improve their organisational performance in the longer run (like superior M&E systems and better support to staff). As a result, investors earned their full returns in B4J, and almost complete returns in IBIF.

Rarely for public expenditure, in the case of the two SIBs, taxpayers' money (which formed the bulk of the outcome funding) can be accounted for in terms of its effects on the beneficiaries of that expenditure: 1,809 medium- to high-complexity job placements for unemployed youths, and 4,000 pre-primary school children provided with home-based early learning services of a demonstrably high quality. In both cases, beneficiaries were clearly from disadvantaged backgrounds. In the absence of the SIBs, their odds of achieving similar outcomes would have been significantly lower[20].

Measurement and performance monitoring

Evidence about what works: the use of clear outcome measures and better M&E

The services at the centre of the two SIBs were effective because the service providers and intermediaries achieved the outcome targets that were set during the contracting phase. This implies that the SIB participants were able to unambiguously measure and agree upon performance against the chosen outcomes. Without this, the performance of the social providers would be unverifiable, and determining when outcome funders needed to repay investors would be impossible.

[20] This is not a comment about the efforts of the individuals and their families. Many South Africans from low-income households continue to beat extraordinary odds in making it through formal education and performing well academically. However, structural factors like the unaffordability of high-quality education for the bulk of the population in an economy that doesn't generate enough employment mean that too few beat those odds.

The South African SIBs introduced clear and easily verifiable outcome measures for complex social issues faced by significantly disadvantaged populations. In the IBIF, service providers had to recruit a set number of pre-school age children and their carers from Delft and Atlantis (socioeconomically deprived communities in the Cape Town metro area) into a home-based early learning programme, retain them over the implementation year, and reach targets in early learning test scores. In B4J, there was only one outcome target: getting a job. But as with the IBIF, substantial complexity was built into the target. To count as a placement, jobs had to be of medium to high complexity (measured by the type of job and the job description), for young people who could reasonably be classified as economically excluded and facing poor prospects in the labour market. Stakeholders (including investors and outcome funders) put in a lot of effort to ensure that the outcome targets were reasonable, relevant to context, and that they captured meaningful social change.

To ensure outcomes would be met, intermediaries introduced new M&E systems that promoted learning about where service delivery and working conditions needed to be improved. This led to changes to service delivery that many interviewees feel contributed substantially to the later success of the service providers. This process of organisational learning was initiated due to both the need to plan for outcomes, and by the injection of cash from investors at the start of the delivery cycle. In addition to these internal changes, in B4J we see how principles of Harambee's training model are now being implemented more widely – for example in the Presidential Youth Employment Intervention, which has adopted Harambee's pathway management approach[21] to delivering employment services.

Credible impact evaluations

As we have already stated, both SIBs were successful on their own terms. By this we mean they both set their own targets and (mostly) met these targets. However, as is common to SIBs everywhere, the success of service delivery is limited to a verification of reported outcomes. The service providers (or intermediaries) report their progress – for example *x* children enrolled, or *y* trainees placed into jobs – and the external outcome auditor simply verifies whether these numbers are accurate or not. This process resembles corporate audits more than real impact evaluation, which are two different things, as explained by an M&E expert involved in the design work for the IBIF:

> *"I think probably the investors didn't understand anything about monitoring and evaluation. They understand nothing about the difference between a bench line target on a dashboard, on a spreadsheet, that's showing you met your targets, your sales targets or something, like you would in a corporate sector, and a developmental target in a social programme. If you're going to say you're going to meet a developmental target in a social programme, you do not require a spreadsheet and a dashboard. You require an evaluation. And you don't require an auditor. You require an evaluator. So, I felt like they were speaking this corporate language and I suspect the auditors did not understand the complexity."*

For example, after an audit we can confidently say that 100 people got jobs. But would they have got the jobs without Harambee? How do similar unemployed youth fare in the labour market when compared to the B4J graduates? How much did the early learning programme contribute to positive early learning test scores for the group and how much of it was due to a change in families' material circumstances that might have had nothing to do with the IBIF? Which groups of beneficiaries benefit most from the programmes, and which components of the programmes work best for different types of beneficiaries?

[21] This involves detailed profiling of work-seekers and matching them with opportunities that are most appropriate for them. It also involves an effort to set up platforms where employers and service providers can interact as per Harambee's modus operandi.

Impact evaluations would provide answers to these more complex questions. Most SIBs avoid them[22] due to a desire to cut costs and to keep the tracking of social outcomes as simple as possible for investors who are more used to looking at clear financial metrics. Future SIBs will have to balance these considerations against the need to generate real evidence about the impacts of the programmes and how exactly they work. The costs could be built into the working capital costs. The longer-term benefits of doing so would surely outweigh the shorter-term costs.

An over-reliance on quantitative outcomes – like jobs and contribution of Harambee to getting it – has its dangers though. The IBIF was designed to house *two* SIBs: one focused on early learning (a subject of this report) and one on the health of pregnant women and infant children (that did not reach implementation stage). Designing a simple schedule of appropriate outcome measures for responsive care and infant health proved difficult. A healthcare expert in the Western Cape provincial government noted that outcomes are only the end point of a chain of activities and milestones that are important ends in themselves, some of which are more qualitative and less amenable to concise quantification[23]:

> *"Telling a funder to measure outcomes is only one piece of the pie. You really need to understand the pathway… what support is needed by community healthcare workers? What supervisory model is needed? Are you reflecting once a week with the community healthcare workers? Are you giving them some debriefing and reflective supervision? [You also] need to balance technical measurements with relational measurements. They want hardcore items, but they don't understand that the value add is soft things. It's relationships, it's emotional support. And now there's much more evidence [in the scientific literature demonstrating how essential these are to maternal and infant health]."*

An impact evaluation that builds in qualitative components and proper attention to causal pathways towards outcomes could mitigate some of these concerns. But one can easily imagine how adding (realistic) complexity to a theory of change for an intervention can lead to unwieldy outcome frameworks.

Transparency

Though participants in both SIBs were responsive to requests for information, contracts and outcome audits are not publicly available and remained strictly off-limits to the research team. The intermediaries informed us that the reason for this was contractual clauses mandating non-disclosure (and we do not know which parties required these clauses or why). In many cases, respondents feared disclosing information, being unsure of who the information and intellectual property belonged to. In a minority of cases actors chose not to disclose financial details about their participation. This is despite substantial public funding in both SIBs. This is not uncommon from a global perspective[24] but is inconsistent with principles of transparency and accountability in the use of taxpayers' funds.

Transparency is also seemingly an internal problem: for both SIBs, a series of bilateral contracts were signed between the SPV (managed by the intermediaries) and all other parties to the SIBs, leading in some circumstances to some stakeholders not being fully aware of all the details of the transactions to which they were not co-signatories[25].

One of the investors hints at a potential reason for this. In many other SIBs, details of contracting and of service models is kept secret due to intermediaries' desire to position themselves as market leaders:

[22] Edmiston and Nicholls, "Private Capital in Outcome-Based Commissioning".
[23] The quote cited here is about maternal and child health specifically, but the broader point applies to the measurement of any social outcome.
[24] Studies of US and European SIBs show lack of transparency to be an unfortunate norm. See for example Hevenstone & von Bergen, "Facilitating competition or hindering transparency?", and Iovan et al, "'Pay for Success' projects".
[25] Intermediaries have since informed us that stakeholders did have the right to review all contracts their organisations were not party to even if not all stakeholders were aware of this right.

> *"Maybe it's a competitive thing, I'm not sure. But ideally, one would have wanted the contracts to be placed in the public domain. And I can recall having a conversation with both sets of parties about this. And there was just this flat refusal to do so. And what that means then, is that you're almost starting again each time."*

Governance

Set-up and ongoing transaction costs

The international experience demonstrates that SIBs are expensive, both in their establishment and ongoing management. The South African SIBs were consistent with this experience.

The costs of getting IBIF off the ground were high, and for the intermediaries proved to be far higher than anticipated. The SIB officially launched in August 2018, almost two years after negotiations with investors began (and this followed a lengthy design phase). For government entities and investors alike, conducting due diligence was not a straightforward exercise. Participants had no comparable prior experience, and the SPV soliciting investments and outcome funders – the IBI NPC – had no independent track record either. Though set up by organisations that are well-respected experts in maternal and child health and ECD on the one hand (m2m) and finance on the other (Volta Capital), neither the SPV (which as the name implies was set up specifically to house IBIF) nor the intermediaries had run a SIB in South Africa before. Outcome metrics also had to be agreed by many stakeholders. Negotiations thus took a long time to conclude.

In B4J, design and negotiation concluded more quickly (six to nine months). Interviewees attributed this to (a) intermediaries leveraging existing relationships (eg, Yellowwoods founded Harambee and B4J; Yellowwoods investees Hollard and Clientele came in as the senior investors; and Harambee redirected existing grants into outcome funding contracts), (c) having watched negotiations on IBIF from a distance and learned from this experience, and (d) Harambee's tested and trusted service model. There was already significant evidence that Harambee could achieve job placements on a large scale. It was, as a Jobs Fund representative explained, testing an unknown financial instrument (the SIB) on a known implementation model. In the IBIF, service provider FCW had a much longer track record than Harambee. However, the outcome chosen for the IBIF was entirely new, with no evidence that FCW (or indeed anyone) was capable of achieving it.

The conclusion of deals is not the end of the transaction costs. For both SIBs, intermediation and ongoing stakeholder management were costly. The intermediaries felt these functions were not adequately budgeted for. In the IBIF, this is despite allocating over R3 million at the outset (roughly a quarter of FCW's nearly R13 million budget for service delivery to 4,000 children and their caregivers). In B4J, intermediation costs were roughly 14% of the budgeted (and paid for by outcome funders) cost per job: R10 000 of R74 000.

All intermediaries perceive set-up and ongoing transaction costs as unavoidable, though perhaps not always on the same scale. For Volta, which has served as an intermediary in impact bonds in other parts of the world, having an extensive set-up period was not hugely surprising; managing multiple stakeholders "from very different worlds" is *always* difficult, certainly in comparison to normal bilateral contracts. The lengthy approvals and negotiations with government also fit with experience elsewhere, where governments – as agents of the public - are often slow and risk-averse in contracting and budgeting. On B4J, though set-up was shorter, legal and design costs remained. Finally, each social problem and each social context is different, meaning performance metrics and measurement will always need to be adjusted and reworked.

However, the bulk of those who participated in these two SIBs felt that the experience of having done it once would make doing it again a bit easier. Two NPCs are in place, which have proven to be feasible vehicles for managing the multiple relationships that are necessary to any SIB. This will save at least the costs of having to set up a new structure. In addition, and perhaps more importantly, both NPCs now have a track record in successfully transacting a SIB. This is the first step towards maturation of this market. As the SIB market matures and as investors, lawyers, governments and intermediaries become more experienced, most expect that the costs as a proportion of the total transaction will fall as procedures become more standardised and as costs become more quantifiable. This could be in the form of rate cards, which list set prices for providing services to certain groups, now that benchmarks exist for how much the B4J job categories cost, and costs of providing quality home-based early learning services. Generic contracts could also be used. But the development of the SIB market relies on more open sharing of information.

The investors tend to feel that complexity, while irksome, will likely be better managed in future projects as the market matures, making future participation in SIBs smoother. But for some outcome funders, the complexity is reason enough to withhold participation in future projects entirely. One of the governmental interviewees would simplify the SIB model by cutting out all parties to the transaction except the government and the service provider, who would contract using a PbR model to retain the benefits of the focus on service effectiveness. A philanthropic outcome funder was also "not convinced that all of that contracting is worth it", thinking it would be simpler to fund the service provider directly.

Intermediaries

Cutting out the intermediaries would, however, close off what would seem to be one of the clearest benefits of both SIBs. This is the capacity-building work carried out by the technical intermediaries with the service providers. In the IBIF, m2m helped FCW to significantly improve its M&E capacities and in turn its abilities to detect and solve problems. m2m also helped FCW to pivot towards an outcome orientation, for example through using the ELOM measure. In B4J, Harambee worked with additional service providers in the second investment and performance round to reorient them towards demand-led and employment-focused training for youth from disadvantaged backgrounds. This led to significant improvements that will be carried into future operations (for at least one of these providers[26]).

These successes lie behind the suggestion of several interviewees that the future of SIBs and their SPVs is as capacity building mechanisms, especially for smaller NGOs. Investor capital could be used to cover service and intermediation costs. This would be particularly useful for the bulk of the country's NGOs which are perennially underfunded, operating on small budgets and at small scale. It would also be useful, in the context of employability, for small businesses who cannot afford employer fees for training[27].

Harambee has already begun the work of capacity building and system change outside of B4J and a SIB structure, building on the SIB experience. It has begun holding workshops with smaller community-based organisations focused on youth development that are aimed at "enabling others to do the work that we do rather than we do it". This seems a smart move that recognises that one organisation cannot do everything, especially given the scale of the unemployment challenge.

Targeting the right people

Service providers

Service providers with strong track records and a desire to innovate make strong contenders for SIBs. An interviewee informed us that during the open selection process for a service provider for the IBIF, many

[26] Only one of the two additional service providers in B4J agreed to an interview and we cannot speak to the experience of the other.
[27] The additional service provider on B4J that we interviewed recognised the importance of having to develop relationships with small as well as large employers and attempting to place graduates in both types of businesses. But smaller businesses are less able to pay for the training costs. Our respondent at this organisation saw the SIB structure as potentially taking care of this problem.

NGOs thought participation would be a headache. They did not want the hassle of having to introduce new M&E systems, to report on selected outcomes, or to be instructed by a technical intermediary around adjustments to their programmes. Seeing participation in a SIB as an opportunity for organisational learning and to gain demonstrable evidence[28] of their impact is a critical precondition (or must be sold to NGOs in this way). The attitude taken by FCW is summarised by a technical intermediary: "Having this incredibly strong spotlight on their performance and data, I think it was uncomfortable to start off with. But they've got used to it." The same dynamics played out in B4J, and Harambee had similar views of the additional service providers.

Philanthropy

The natural place to start when soliciting investments into SIBs would be with philanthropic foundations. Their often large amounts of capital are usually deployed for social impact as grants, but the idea of using the investment portfolio itself as a way of advancing a social mission is often new to foundations. In both SIBs, the foundations' investments that were used by service providers to roll out novel and ultimately successful interventions were repaid with interest and redeployed to other social causes. In B4J, for example, earnings from the first round were recycled into the second round by the foundation investors.

However, in making the investment case to these foundations, clarity around regulation must be established and clearly communicated. Our experience is that foundations have often been hesitant to engage more purposefully in impact investing through fear of losing their tax exemption status due to investing philanthropic capital and earning income from it. The SIB-participating foundations considered here needed to put in additional due diligence on these legal requirements that many other investors would probably not be bothered with.

Commercial investors

But foundations redirecting grants (or redirecting a portion of their endowments) into investments in a SIB do not necessarily represent an increase in the amount of money that is dedicated to tackling social problems. The promise of SIBs, according to their proponents, is in drawing investment capital, and not philanthropic capital, to social causes that otherwise would be invested in purely financial instruments[29]. Though we discuss the success of the South African SIBs in doing this in the "additionality" section, here we discuss how intermediaries went about negotiating with investors we might classify as "profit-first". This was more challenging than engaging with the impact-first end of the spectrum represented by foundations.

The financial intermediaries on both SIBs found that the dominant interpretation of fiduciary duty amongst major institutional investors precluded risk-taking on uncertain social performance. This applied even to impact funds, which tended to take a narrow, infrastructural view in their mandates:

> *"[The impact funds] have high return expectations and very low tolerance of risk, despite calling themselves an impact fund... it was interesting to me in the early days of conceptualising this and talking to people who have impact funds in the title of their fund, they would talk about it as if it is impact capital. But really what they mean is, it's a normal fund expecting normal commercial, or even higher than normal commercial return, taking limited risk and just investing in things that, you know, as a sort of almost intrinsic basis can be called impact as in, it's infrastructure, or it's a school, if you know what I mean… I'm not sure that there are lots of examples, yet, of those who are prepared to deploy capital, and [say], 'I do need a return, but it's a lower return in exchange for some large social*

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[28] It would be misleading to say that the SIB led to impact itself: FCW had been running programmes for decades already. But besides numbers reached, and anecdotal evidence that children in their programmes do better in later schooling, FCW couldn't point to concrete, quantitative improvements in early learning, due to resource scarcity and a corresponding inability to conduct rigorous M&E.
[29] To some extent this also applies to foundations, who typically manage their endowments through traditional asset management frameworks, and the line between a "grant" and an "investment" can be ambiguous from a foundation's perspective. The possibility of opening up new pools of capital for social causes is tied to traditional investors, from insurance companies to asset managers.

> *impact'. So the only people who seem to be doing that are people who are effectively deploying what otherwise might have been philanthropic capital."*

The preceding quote highlights an interesting tension in the literature on sustainable investing. On the one hand, a common narrative is that in the pursuit of social impact, profit-first investors *do not* need to forgo financial returns. Various studies even claim *superior* financial performance of sustainable or socially responsible investments[30].

But the view in the quote above – exemplifying the dominant view among our interviewees and the investors they approached – is emblematic of the opposing school of thought. This views social impact and financial return as fundamentally divergent forces, at least in the short term[31]. Indeed, social return is seen as an objective of investors that can be traded off against financial returns, implying that such investments should have lower-than-market financial returns with the discount representing the "price" investors are paying for the social impact. The IMF reviews the global evidence and finds "no conclusive evidence in the literature that sustainable funds consistently out-or underperform conventional funds"[32]. The contradictory evidence is due to differing definitions of what sustainable investments are. Some take an expansive view, including funds that have screened out investments that are obviously environmentally or socially harmful. Others limit samples only to impact investments: those that actively set out to promote and measure social change. Even definitions of what ESG factors are can diverge markedly, and "greenwashing" and "social washing" add to this complexity (the intentional mischaracterisation of an investment as environmentally friendly or socially conscious)[33].

[30] See for example Stevens, "Investing with a Conscience"; Trelstad, "Impact Investing"; Deutsche Asset and Wealth Management, "ESG and Corporate Financial Performance".
[31] Armstrong notes that the realistic time horizon of most investors is 20 years: the time from acquiring significant assets to retiring. Over this time horizon, non-ESG investments may perform better. Over the much longer term this is less true – financial returns to investments in coal, for example, would be meaningless on a planet that is uninhabitable due to climate change. "None of this suggests that investors should not put their savings behind the things that they care about. It means only that they should not think of this as a wealth maximising strategy. Indeed, accepting the possibility of lower returns in return for the promise of positive social outcomes, such as a healthier environment or less poverty, can make a positive impact by putting resources to work where an "efficient" market would not."
[32] IMF, "Sustainable Finance", p.85.
[33] Marsh, "Social Washing is Becoming Growing Headache".

Figure 6: The spectrum of capital (source: modified from G8, Allocating for Impact)

	Traditional investing	***Socially responsible investing***	***Sustainable investing***	***Thematic investing***	***Impact investing***	***Impact first investing***	***Philanthropy***
Objective	Seeks financial return regardless of ESG factors	Investments are screened out based on ESG risk in order to protect value	Financial returns and sustainability factors that may enhance value drive investment selection	Targeted themes and financial returns drive investment selection	Seeks to generate competitive financial return, may deliver below market return for investors	ESG factors take precedence over financial returns, will deliver below market return for investors	Seeks ESG solutions that cannot generate financial return
Approach	Mainstream investment analysis and due diligence	Negative screens for tabaco, alcohol, weapons, gambling, pornography, nuclear energy	Considers carbon footprint, resource use, waste reduction, compen-sation, product safety, gender equality	Seeks solutions for climate change, population growth, urbanisation, water scarcity, food systems	Augment and expand proven commercial models that deliver ESG outcomes	Aims to support innovation and risk taking, proof of concept/ pilots, enabling environments, commercial capital leverage	

For social impact bonds specifically, financial performance has generally been good. The OECD has found, in a review of 43 SIBs transacted up to 2016, that only one investor had lost its investment (Goldman Sachs, in the Rikers Island SIB in New York), 75% of which was nonetheless guaranteed (by Bloomberg Philanthropies). Gustaffson-Wright et al, in a review of the 47 *completed* SIBs up to the start of 2020 (that is, those where service delivery had ended), show that 24 repaid the principal and paid positive returns; 15 were either still in evaluation or not yet public; and only 2 had failed completely with no repayments to investors (the remainder of the SIBs paid back portions of the initial outlay)[34].

For South Africa's first two SIBs, knowledge about the SIB instrument and impact investing more broadly was limited. The view that investing for impact requires subordination of financial returns prevailed. Our prior research[35] with South African institutional investors has shown that impact investing is perceived as complex and opaque, while the lack of standardised monitoring and evaluation methods to measure impact also tends to generate concern. There also just aren't enough opportunities available to invest.

In the IBIF, the participating investors were ultimately two foundations and an institutional investor experienced in impact investing. In B4J, financial intermediaries induced profit-first investors to participate by employing a form of credit enhancement called catalytic first loss capital (CFLC). CFLC is used when investment opportunities have the potential to achieve social impact but they are perceived as risky financially. In the case of the SIBs, this was largely due to the coupon and principal repayments being contingent on unknowable social performance and to the lack of a track record of both the SIB SPVs and

[34] Gustaffson-Wright et al, "The global impact bond market".
[35] Theobald et al, "Investing for Impact".

the SIB instrument itself. These investments are typically only funded by development finance institutions (DFIs), foundations and governments. Credit enhancement like CFLC can therefore "encourage the flow of capital to these investment opportunities by improving their risk-return profiles and, thus, incentivising more investors to invest" [36]. This in turn leverages more capital to social impact and can demonstrate the viability of a new market.

In B4J, three first loss investors provided CFLC in a "blended capital stack" that protected senior, profit-first investors from downside. The first-loss investors – all three of which were foundations – agreed to be the first to absorb losses and the last to earn returns. This meant that performance had to drop quite substantially before the senior investors made any losses. This provided these investors with the risk profile they needed[37].

In the IFC's model of market development[38], the period of time corresponding to the South African SIB negotiations would be the very early establishment phase where new business models and financial instruments need to be proven. As the SIB and impact investing market grows, and as investors, regulators and intermediaries become more accustomed to new ways of investing, the need for CFLC gradually diminishes until market maturity. At this point, concessional finance in the form of subsidies to investors can outweigh the public benefits evident in earlier phases of market development. IBIF and B4J have both proven that socially conscious SIBs can be viable commercial investments. This track record could perhaps smooth the path for future commercial investors, and potentially without the need for CFLC.

Outcome funders

However, even if profit-first investors were to suddenly find SIBs attractive and queue up to invest in them, outcome funders would still be needed to guarantee those investments. Philanthropy acted in both SIBs here, providing approximately half of the outcome funding. However, the major constraint to SIB expansion – that is, more SIBs that serve many more beneficiaries - is viewed by many of our interviewees as government's willingness to pay for results.

In B4J, the service providers proved that job placements can be made in a way that is far cheaper than most alternatives. This was certainly encouraging for the governmental outcome funders. The only criticism voiced by one of these interviewees was that the service providers had perhaps gone as far as they could with large businesses and now needed to replicate their successes in small businesses – the growth engine of the economy with largely unrealised potential.

But in the IBIF, the opposite occurred: demonstrable improvements in early learning are costly to achieve, and certainly would be unobtainable on the very small budgets that most ECD organisations (including FCW prior to the IBIF) have to find ways of working with. A representative of one of the intermediaries noted that IBIF has shown how much it costs to deliver quality programming per child, per year. But is government willing to pay this price? The choice faced is, in his words, "I can deliver quality services to 100,000 children or I can deliver some services of indeterminate quality to half a million children".

Unfortunately, at the time that we were interviewing for the IBIF, towards the end of its implementation period, the DSD had not committed to participation in a new round of IBIF with potentially more beneficiaries and more service areas. One of the other outcome funders on the IBIF said:

> *"in the mind of [key people at] the Department of Social Development, this was an interesting experiment that can be entertained when there's funding available…But the moment the chips were down and they had to cut budgets by 5% across the board, I think it was 5%, something like that, they didn't see the social impact bond as a potential solution to their reduced budget. They saw it as a*

[36] GIIN, "Catalytic First Loss Capital".
[37] Other features of B4J that investors would have liked to see on the IBIF include the possibility of getting capital back and reinvesting it annually (rather than the three-year term in IBIF), and the ability to negotiate individual coupon terms (like the rate and frequency).
[38] IFC, "Blended Finance – A Stepping Stone to Creating Markets".

> *drain on their reduced budgets and so immediately said, we're out for IBIF 2. And I thought, oh, that was, that was a bit of a blow really, for me, from a development finance perspective, because it was seen as a burden, not an opportunity."*

The reason for not seeing the SIB as a "solution" to reduced funds was the failure to adequately account for long-term costs. In the long term, what are the costs of another generation of children who have not been given adequate early learning, who progress more slowly through school and underachieve for the rest of their lives? What kinds of problems – and costs in remedial programmes – will be prevented for these children? How much in future tax revenue could potentially be gained from economically productive citizens? These costs are simply not built into cost calculations, reflecting the short-termism of both traditional investment *and* governmental decision-making.

Risk distribution

Shifting performance risk to investors

Conceptually, SIBs are attractive because they shift the risk of programme failure away from the public sector and taxpayers to private investors. Governments only pay for programmes that demonstrably improve social welfare. In the literature, sometimes there are suggestions that SIBs should, to attract investors, use programmes with a firm evidence base that are known to have low risk of service failure[39]. Many have taken this route.
But, and as others have noted, if this strategy is deployed, there is no sharing of performance risk[40]. A purported benefit of SIBs is that they can be used to test innovative and new service delivery models for persistent social problems where the public sector has run out of ideas and/or risk-taking appetite. Indeed, private investors should face the risk of loss, triggering enhanced oversight and innovation to avoid those losses. If proven interventions are used, SIBs are instead sure bets for investors and could be funded more cheaply via direct relationships between outcome funders and service providers.

In the IBIF, the ELOM performance target was very ambitious. It was a new measure that had not been widely used prior to the IBIF and is a true outcome measure: improvements in learning and functional competences. However, performance against this target was tied to less than 10% of the outcome payments. The balance was for meeting recruitment and attendance targets that were regarded by most interviewees as being quite easy to meet, given FCW's prior track record. A representative of one of the intermediaries said:

> *"The only way investors are going to lose money on this one is if things are a complete disaster, which no one anticipated to happen […] in the next kind of iteration of these things, we need to make sure that we're getting to a point where risk is more evenly shared and investors are standing to lose money based on outcomes […] I think we need to push more towards that, so that it's a good deal for the outcome funders, right? Because for them, the value proposition is, you guys are going to pay a little bit more if success is achieved… and if it doesn't, then good news. You don't have to pay for something that doesn't work, right? Someone else is taking that risk."*

It must be stated, however, that as the first SIB to be *negotiated* in South Africa, intermediaries faced an uphill battle convincing investors to participate. Ending up with a balance of risk tilted too far in favour of the investors was perhaps unavoidable.

In B4J, the targets were less ambitious. In the year preceding B4J's first year of implementation, Harambee placed more young people (922) into the same types of jobs targeted by B4J than the target set for B4J's first year (600). However, some interviewees argued that the pre-B4J and B4J jobs were qualitatively

[39] For example, Iovan et al, "'Pay for Success' projects", and Hills, "When is the Right Time?"
[40] For example, see Brown, "The Hidden Costs of Social Impact Bonds", and Maier et al, "Paradoxes of Social Impact Bonds".

different. The B4J jobs were intended to be of a higher complexity than what had been offered previously. Training and placement for certain jobs would also be delivered by external partners, working with Harambee for the first time. Nonetheless, the absence of comparative data on, for example, job descriptions, training curricula and wages makes it difficult to assess just how different the jobs in the two periods are, and in turn, how ambitious the B4J targets were.

Innovation and flexibility

Without the need to extensively track and account for the use of inputs, SIBs (and other PbR models) are expected to free up service providers to experiment and innovate to meet outcomes while bearing no financial risk (though the service providers and intermediaries certainly faced reputational risk). In the IBIF there is a lot of evidence to show that FCW and m2m innovated to ensure effective services were delivered. For example, starting psychosocial support groups for home visitors and rapid adaptation during the Covid pandemic and lockdown to ensure services continued. Having working capital upfront and the autonomy to decide how to use it played a large role in this innovation, as explained by a representative from m2m:

> *"I think, having more budget, it's the same with any human being as well as an organisation, if you have more income, it gives you more freedom to relax and be creative and innovative. So, they've been quite inspirational at times in coming up with creative ways to mitigate challenges and to make really big steps forward, given the cushion of having more funding."*

We saw innovation in B4J too, where staff at the service providers had the flexibility to change things as they went along and to do whatever was necessary to achieve the outcome (placements). For example, they could increase psychosocial training where they thought it was necessary, or run boot camps on specific technical skills with trainees who were struggling. There wasn't a strict schedule of activities that they had to adhere to.

There was however somewhat less flexibility for Harambee as the lead service provider and technical intermediary managing reporting on behalf of the service providers. It still had to prepare extensive input and expenditure-based reports for governmental outcome funders, and "account for every cent". In this case the promise of a lighter administrative burden due to having to account only for outcomes did not materialise.

Efficiency

Another promise of SIBs is that by providing evidence of what works, and by governments paying only for successful programmes, service delivery becomes more efficient. Almost every governmental interviewee noted that their budgets were increasingly constrained despite ever-growing social need. They also noted that social service delivery is often ineffective and inefficient – large amounts are spent for little outcome. The idea of paying investors for assuming the social performance risk was widely viewed as a benefit of SIBs.

However, as explained earlier, when the provincial government of the Western Cape was faced with a declining budget and the choice to reinvest in the IBIF, the benefits of greater efficiency did not figure prominently in the decision to not reinvest. This is largely due to the difficulties in costing abstract, future costs and benefits associated with having prevented a problem and having secured lifelong improvements in beneficiaries' lives.

Perverse incentives

SIBs carry the risk that service providers and intermediaries, due to the imperative to achieve results, face pressures to distort their performance in various ways. These 'perverse incentives' include:

- "Cream skimming" and "parking": This is picking beneficiaries who are most likely to be successful after an intervention, and who may not even need it in the first place, while delaying (parking) service delivery to those most in need of assistance who are less likely to achieve service outcomes. There is substantial evidence of this in other SIBs[41]. Active Labour Market Programmes that serve the unemployed are particularly vulnerable to these practices[42].
- Setting unambitious performance targets: Again, several SIBs outside South Africa have been guilty of this[43], including settling on output targets (like providing a service to 100 children) rather than outcome targets (like better reading ability for those 100 children). Outside of the SIB framework and closer to home, performance management frameworks in the South African public service have been found to set the bar for success very low, with weak accountability when failures are recorded[44].
- Assuming fixed outcomes: Outcomes are measured at one point in time, with success at that point taken to be a permanent success[45].

In B4J and the IBIF, there is no evidence of cream skimming or parking. Groups of people that were *more* difficult to serve were chosen intentionally by the intermediaries and others involved in the design of the SIBs. Furthermore, aptitude tests or other ways of evaluating who would be more or less successful within those groups did not form part of selection criteria used by the service providers for the SIB services. Finally, indicators of disadvantage were built into B4J's outcome measure (a placement only counted if it was someone who met certain demographic criteria, as explained above).

In the IBIF, despite avoiding cream-skimming and parking, two of the outcome measures chosen were actually outputs, and constituted about 90% of the overall service delivery targets. An intermediary explained why they did this, and his aspiration to be more ambitious with true outcome measures in future:

> *"[Choosing output targets] is particularly true in education projects [because] there are so many other factors that can influence learning outcomes or performance on an assessment, [so] it's much harder to attribute impact. Health projects are much easier to use outcome measures because there are clear and agreed-upon measures to do so for most health interventions, or there is such strong evidence of an input's effectiveness to cause desirable outcomes, that you don't even need to measure the outcome (eg vaccines – which are an input – you can just measure if a child was vaccinated or not and be 99% sure that child and its community will be protected from that particular negative health outcome as a result). While outputs are preferred for these reasons, it is important that for impact bonds to truly live up to their potential, it is critical that we push always to make these focused on true outcomes as much as possible."*

Finally, the assumption of static outcomes is evident in B4J, where retention of jobs was not measured. This is unfortunate in the context of the population served (where attrition in employment is high) and the macroeconomic environment (recession)[46]. In the IBIF this is less relevant: though it would be useful to see whether children progress well through school and later learning, these are much longer-term outcomes. Reversal in learning and other developmental capability is, moreover, unlikely (at least in the shorter term).

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[41] For example, see Edmiston and Nicholls, "Private Capital in Outcome-Based Commissioning" and Arena et al, "Flash in the Pan".
[42] For example, see Garlatti, "Outcome Measures and Blame-Avoidance".
[43] SIBs incentivise the setting of low success thresholds and overly generous terms for investors. See Maier and Meyer, "Social Impact Bonds and the Perils of Aligned Interests".
[44] Ijeoma and Sambumbu, "Improving Public Accountability"; Hendricks and Matsilitza, "Management of Employee Performance"; Brown, "Compliance Culture"
[45] Edmiston and Nicholls, "Private Capital in Outcome-Based Commissioning"
[46] The technical intermediary informed us that the reason for not tracking retention was that for the first phase of B4J (rounds 1 and 2) the primary objective was placement, and improving the throughput rate from training to placement. Retention would be tracked in later rounds.

Additionality

SA's social welfare policy framework is committed to welfare pluralism: the promotion of social welfare by multiple actors. This often manifests as an over-reliance by the state on NGOs[47]. SIBs could therefore (a) expand the private sector's role in welfare provision, and (b) assist perennially underfunded NGOs that are providing essential services. However, "in the 10 years since the first SIB was launched, only $424m total financing has been achieved"[48]. This is partly because most SIBs have appealed predominately to philanthropic rather than traditional investment capital[49], for reasons we have explained above. Where profit-first investors have been involved, it has often been subsidised by philanthropic capital, as in B4J. And philanthropic capital is not as costless as much of the literature suggests. As Brown notes, foundations receive significant tax breaks due to their social purpose. If these funds are spent on "sweetening business deals for private investors"; deals that do not carry enough social benefit, this represents foregone tax revenue that *could* have been used solely the public good[50].

In South Africa, additional private sector capital to fund additional social outcomes was perceived by the governmental outcome funders as a particular benefit of SIBs. Notwithstanding the criticism that outcome funders may need a better deal in future SIBs, the consensus on the IBIF was that the SIB did not succeed in bringing new capital to the ECD sector. This is because the investors – two foundations and one impact fund - would have probably invested in this area in the absence of the IBIF (and for the impact fund, if not in ECD, then certainly in another social area). FCW was also serving the same populations in the same areas prior to IBIF. However, the IBIF iteration of services were likely of a higher quality. This is demonstrated by the various adjustments made to regular FCW programming to promote better outcomes for beneficiaries and better working conditions for staff. These *are* additional outcomes – that is, outcomes that would likely not have been possible without the SIB, and the technical support provided by intermediary m2m and the large injection of cash from investors.

The experience of B4J is different. Harambee did not need the SIB structure to provide upfront working capital to cover large delivery and monitoring costs in the same way as FCW. But they succeeded in bringing in commercial investors who explicitly stated that the funds used on B4J were not CSI funds; they would have otherwise gone into comparable high-yield, fixed income opportunities without the social objectives. So while the capital was not needed, and thus cannot be said to be responsible for social outcomes that wouldn't have happened otherwise, the SIB did demonstrate that it was possible to draw additional private capital to the fight against unemployment. In the case of the additional service providers, it is possible that the shift to a results orientation in these organisations may have catalysed immediate and longer-term positive change.

This is connected to one of B4J's major aims: those who designed it did not believe that the employability and skilling sector needs additional capital. Instead, there was too much money being spent with very little to show for it. In demonstrating how much it costs to deliver an outcome (a job) for vulnerable groups in the labour market (unemployed youth), it has been successful. The IBIF has had similar success in demonstrating how, and at what cost, to deliver quality early learning services. How these lessons are acted on in the delivery of ECD and employability services in other areas of the country remains to be seen.

[47] Patel, Social Welfare and Social Development.
[48] Jain, "Social Impact Bonds"
[49] Iovan et al, "'Pay for Success' projects"; Brown, "The Hidden Costs of Social Impact Bonds".
[50] Brown, "The Hidden Costs of Social Impact Bonds".

The future of SIBs in South Africa

Below, we redraw our SIB conceptual framework, filling it in with the experience in South Africa as described in the body of this report.

Figure 7: The conceptual framework revisited

Effects of the results orientation

- The focus on outcomes ensured effective services.
- Evidence about what works in youth employability is redirecting resources to where they will have more impact.
- Outcomes were clear and easily measurable.
- In-depth evaluations are missing.

Governance

- The set-up of the SIBs was lengthy and complex (more so in the IBIF than in B4J), with high ongoing transaction costs.
- Intermediaries enhanced rigour in service delivery and built capacities of service providers.
- Both SIBs engaged diverse groups of committed stakeholders.

Risk distribution

- The risk of not meeting outcome targets was low. Risk-sharing between public and private sectors was minimal.
- Service providers were freed to experiment and innovate to meet outcomes.
- There is no evidence of impact washing. But targets could have been more ambitious.

Additionality

- B4J brought in additional private capital to youth employability by using a blended capital stack.
- Both SIBs enabled social outcomes that might not have obtained otherwise (the IBIF does better here).

The pioneering IBIF and B4J SIBs have provided a wealth of data and experience from which to build. In this final section, we speculate about the growth of the SIB market and of innovative social service public-private partnerships more broadly.

In South Africa and elsewhere, commercial investors have found it difficult to commit to SIBs. One of the reasons for this is the transactions tend to be small, and not worth the disproportionate transaction costs (particularly lengthy due diligence). In the IBIF, the total investment size was R7.5 million. B4J was much bigger: roughly R125 million across investment cycles. This bigger amount balanced out the additional costs of the new and untested financial instrument.

However, bigger investments imply more service delivery. And for meaningful social change to happen, the kinds of services delivered in the IBIF and B4J would need to be delivered to many more people. Getting the state to adopt some of the models that have been proven with the SIBs seems to be the only feasible way to scale the social impact. However, both SIBs have demonstrated that technical intermediation that builds capacities of service providers is possible. Scaling up these sorts of partnerships thus seems like a viable model. This is especially so given (a) lack of capacity within the state in terms of human and financial resources and (b) a very small number of NGOs that are large enough to participate in SIBs directly. A SIB could certainly be used to structure these relationships. The focus on results and M&E, the freedom to innovate and the upfront working capital were all very helpful in the IBIF and B4J.

Another reason for the low uptake of SIBs is they are viewed as high-risk investments among commercial investors. Now that the IBIF and B4J have built a track record – in managing successful service delivery and in repaying investors with competitive returns - this risk perception should drop substantially. But the market is still new. B4J's strategy of employing a blended capital stack seems a good way of making SIBs more attractive. The GPG, after its participation in B4J, is already exploring ways of adopting blended finance in other areas of governance, notably in SMME finance. Other ways of building the SIB ecosystem – such as markets for tradeable SIBs (as in the UK) and the development of social stock exchanges (as in Singapore) - seem a bit far off.

However, the danger remains that in de-risking SIBs for investors, they do not take enough risk. In future SIBs, more of the outcome payments should be attached to harder-to-achieve social outcomes. In addition, targets should be set with reference to service providers' past performance and capability, even if performance is not against exactly the same targets. A fairer balancing of risk would provide greater incentives to the public sector to commit to more SIBs. SIBs present an opportunity to test interventions in areas that have suffered from significant failure, and where financial constraints, risk aversion or simply having run out of ideas prevent public administrations from trying out new ideas. To deliver on this promise, however, we also need NGOs (and other service providers) to have a social entrepreneurship orientation, willing to innovate in partnership with commercial investors. If they work, the public sector could scale such innovations up in simpler and more direct contracting relationships.

But a critical pre-condition for that is the willingness to pay for higher quality services. If governments (and taxpayers) are not willing to do that, SIBs in many sectors – including ECD - do not face a bright future. This issue speaks to the ways in which cost is conceived. Spending more on young children now – besides having any moral value – is a precondition for a thriving society and for a productive, healthy citizenry. Incurring short-term costs to ensure it happens will save governments in the longer term. But these future gains are not currently factored into the calculations of governments (or investors) and work needs to be done in finding ways to do so.

There was a view that cutting out the intermediaries could be a way of simplifying SIBs. But this is perhaps too simplistic. Both SIBs demonstrated the benefits of intermediaries' work in capacity building for service providers, in managing multiple relationships, and in soliciting investments. Without an intermediary, the work of introducing new M&E systems, gearing workstreams to outcomes, and reporting and liaising with investors and outcome funders would still need to happen. In a direct bilateral PbR contract, many of these important features would remain. The role of SPVs like the IBI NPC and the B4J NPC in capacitation is thus one we think should be expanded.

Finally, most of the investors and philanthropists in the IBIF and B4J saw innovation and working together as the greatest benefit of these SIBs. This is in a context where they perceive that the private sector's role in social delivery has become an inert, box-ticking exercise. The following extract from an investor's interview summarises this view:

> *"What was imaginative and new and innovative in 2003, 2004, 2005, 2006, has now probably become quite operationalised and lost some of its... we've reverted into certainly, as a financial services industry and perhaps in other industries too, the idea of, 'how do we comply optimally or tactically?', and less thought is given to, 'are we really solving problems and societal challenges?' I think falling*

> *within that bracket, unfortunately, are corporate contributions through CSI money. It's a very fragmented world and there's not a lot of collaboration like we've seen on these bonds projects, where companies tend to - and I'm unfortunately a little cynical about this, and my own organisation does this - but I think too much good money flows after bad ideas."*

The SIBs have proven to be promising ideas. Subject to minor changes, we hope the SIB structure, with its focus on service efficacy, innovation, collaboration and capacity-building, will be replicated more widely.

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