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Mechanisms Behind Social Impact Bonds

A Potential Manual To Develop Social Impact Bonds



- Social service agencies are largely funded by donations and government grants. Such funding comes with terms and conditions, which can make them inflexible or inaccessible for use on certain projects.
- Social impact bonds are an alternative funding source that can help to diversify the non-profit sector's income streams. They are an innovative form of impact investment that is outcomes-focused, and issued for specific social causes.
- A unique trait of social impact bonds is that investors will be repaid through a blend of financial compensation and social impact metrics.

IN MY PREVIOUS ARTICLE¹, published in the October issue of this journal, I had proposed the use of social bonds as part of social investment for the People sector. Social innovation for the People sector is a necessary step for the next stage of progress for this sector as it helps the sector to become more sustainable and resilient for the new challenges ahead. Social innovation consists of two main components: social capital, and social ROI. Under social capital, the elements mentioned in the October article were, namely, social bonds, social equity, and social revenue. However, as the concepts presented may be new to the sector, this article seeks to explain the why, what, and how of utilising social impact bonds, as well as those which can be implemented quickly.

COMPELLING REASONS FOR SOCIAL IMPACT BONDS

As mentioned in the October social investment article, the non-profit sector is undergoing substantial transition. Based on my research, the

causality for change boils down to three major concerns echoed by the People sector: (i) increased sophistication of philanthropists; (ii) rigidity of grants; and (iii) dwindling donations.

Firstly, our research has revealed that the philanthropists of today are more sophisticated than ever before as their expectations towards their donations and endowments have evolved. They want to see their contributions creating sustainable impact in people's lives. Furthermore, they expect a multiplier impact to their charitable giving, that is, they want their donations to "roll over" several times.

Secondly, as mentioned in my previous articles, our studies show that social service agencies (SSAs) are currently undergoing transitional changes. Hence, they need funding that can quickly adapt to their ever-changing requirements. However, grants, which are the preferred method for financing for these SSAs, have terms and conditions that ringfence capital into narrow categories of use. For instance, with the implementation of Healthier SG, SSAs focusing on healthcare need to quickly



shift their approach from cure to prevention, and this may involve a complete review of current infrastructure and processes. The ringfencing limits SSAs' ability to be adaptable, as much of the capital cannot be used for other purposes and are not immediately available for use.

Thirdly, based on our literature review, donation rates have been on a general downward trend in recent years. In a study by the National Volunteer & Philanthropy Centre (NVPC)², the donation rates have dropped by more than 30% between 2018 to 2021. This trend reflects the current challenging business climate, which

leads to Singaporeans becoming more prudent and selective, and resulting in a reduction in their overall rate of charitable giving.

All three concerns combined together will lead to an unsustainable social sector operating model. The impact of all three concerns is compounded by the sector's over-reliance on donations and government grants as their main funding sources, which leaves the sector vulnerable to global economic uncertainties. Therefore, new funding sources will need to be explored, to diversify the non-profit sector's income streams; one such potential pathway is the concept of social impact bonds.



¹ https://journal.isca.org.sg/2023/09/27/creating-and-quantifying-social-impact-investments-for-the-people-sector/pugpig_index.html
² <https://cityofgood.sg/wp-content/uploads/2022/11/NVPC-Individual-Giving-Study-2021-Report82.pdf>

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WHAT ARE SOCIAL IMPACT BONDS?

Social impact bonds are an innovative form of impact investment that is outcomes-focused, and issued for specific social causes. A unique trait of social impact bonds is that investors will be repaid through a blend of financial compensation and social impact metrics. The proportion of financial compensation to social impact is agreed upon during the creation of the bond.

Compared to grants, social impact bonds are more flexible as the funding is provided upfront to SSAs for immediate use. The bonds have greater utility as there is no ringfencing regarding the use of the money. As a result, the bonds can drive service innovation within the non-profit sector by helping to fund projects that are essential but may not meet the criteria of government grants. Bonds also drive innovation as SSAs would need to optimise their processes in order to meet the payment requirements.

From a giver's perspective, social impact bonds are more financially sustainable than grants as bond buyers are still expected to repay investors with some degree of monetary compensation. This implies that the bonds may

be recyclable as investors may choose to reinvest their financial returns into the same or similar social impact bonds, ensuring that their money would help generate continuous social impact.

Our studies show that with a payment split of 50% monetary payment and 50% social return-on-investment (ROI), the initial investment can be reinvested by donors at least two times. Moreover, social bonds allow for more collaboration between the people, private, and public sectors. The bond can also serve as a culture-building tool as it provides a platform for everyone in society to participate in it, thus creating a sense of belonging and community. Therefore, for SSAs which are looking for alternative funding mechanisms, a possible strategy is to develop and utilise social impact bonds.

For SSAs which are interested in developing social impact bonds, I would like to propose a five-step guiding framework that is tailored to SSAs (Figure 1). These steps include identification, planning, implementation, evaluation, and completion.

FIGURE 1 FIVE-STEP GUIDING FRAMEWORK FOR SSAs CONSIDERING IMPLEMENTING SOCIAL IMPACT BONDS

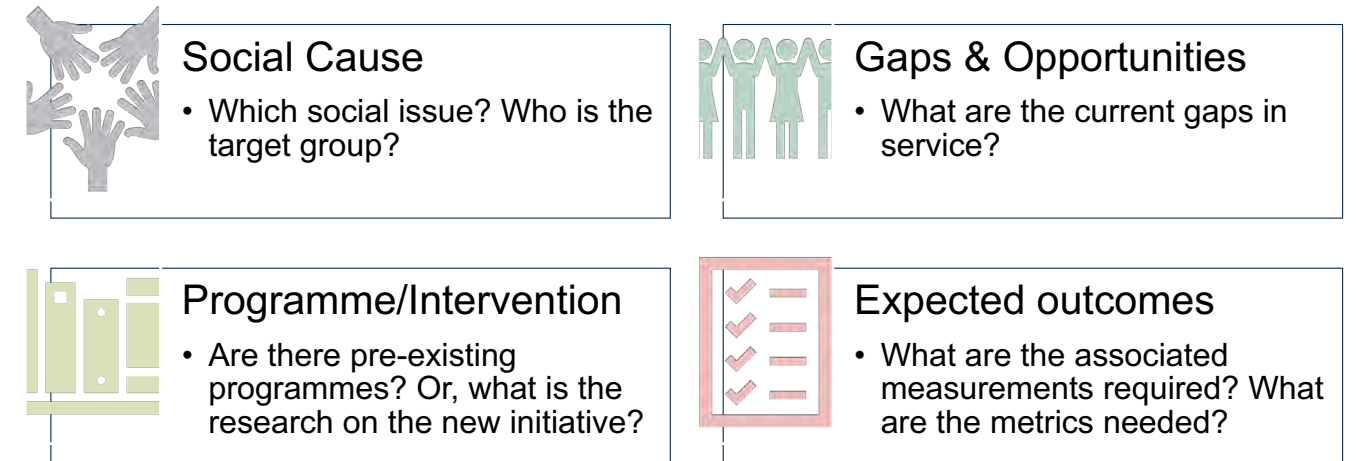


Philanthropists of today expect a multiplier impact to their charitable giving



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FIGURE 2: NEEDS ANALYSIS: FOUR KEY CONSIDERATIONS FOR SSAs, BEFORE EMBARKING ON A SOCIAL IMPACT BOND PROJECT



Step 1: Identification

The first step of the social impact bond creation process is identification, which is to gain clarity about the purpose of the bond. In this respect, agencies should answer several key questions covering four different categories, that is, social cause, gaps and opportunities, programme/intervention, and expected outcomes (Figure 2).

In terms of social cause, the SSA should identify which social issue it wishes to address and who the target group is. Under gaps and opportunities, the key question to answer is whether there are gaps in service delivery, and what the pain points are. In terms of programme/intervention, the most important question the SSA needs to answer is what pre-existing programme the social impact bond would be used for and, if it is a new programme/intervention, whether there is supporting research which indicates that the programme/intervention would likely be successful. In terms of expected outcomes, the main question to answer is what the required key metrics and associated measurements are.

These four key questions form the needs analysis which would aid the SSA in gaining a better idea as to why it is considering creating a social impact bond. Also, it is at this planning stage

that the SSA can re-evaluate the project, to determine if a social impact bond is the right type of social investment.

Step 2: Planning

Once an SSA has attained a level of clarity about the purpose of the social impact bond, the next step is planning, which is to establish a business case for the social impact bond.

There are two main reasons why an organisation needs to create a business case for its social impact bond. Firstly, creating a solid business case would allow the organisation to gain clarity about the feasibility of the social impact bond. As creating such a bond requires a significant amount of resource investment including money and manpower, the SSA needs a compelling reason to prioritise the social impact bond project. Therefore, creating a strong business case would enable the SSA to convince the management – specifically, the board – to invest already finite resources in the social impact bond.

Secondly, a strong business case is critical when trying to raise capital from potential investors who are looking to invest in products that are profitable to them. This is especially

important as social impact bond repayment strategies generally have an aspect of financial compensation and thus, revenue generation is key to the bond's financial sustainability. To convince investors to invest in the social impact bond, it is critical that the bond makes good business sense and is able to generate both social and financial profits.

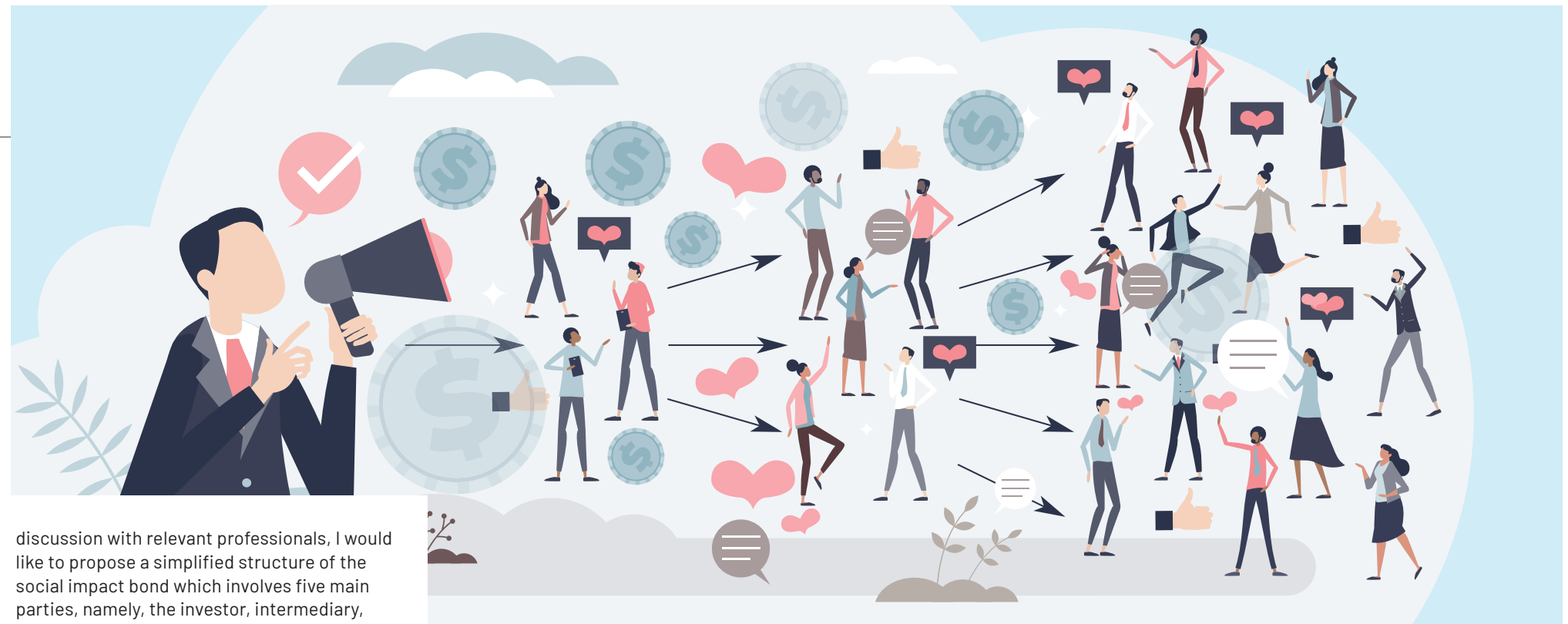
To create a strong business case, a principal tool to utilise is the business model canvas. A standard business model canvas comprises nine different elements that need to be addressed, in the following order: value propositions, customer segments, channels, customer relationship, key activities, key resources, key partners, cost structure, and revenue sources³.

Through the business model canvas, the organisation can quickly visualise the structure of the social bond that it is trying to implement as all the relevant information are presented in a single-page document.

Step 3: Implementation

After the essential parameters of the social impact bond have been established and are deemed feasible in the social finance aspect, the next step of the process is implementation of the business model.

For the smooth implementation of the social impact bond, it is paramount that the relevant parties have clarity about their roles. After



discussion with relevant professionals, I would like to propose a simplified structure of the social impact bond which involves five main parties, namely, the investor, intermediary, service provider, beneficiary, and evaluator (Figure 3). The structure is driven by the need to address key national issues such as the ageing population.

Role of investor

Investors are parties interested in providing upfront capital to fund a programme that addresses a key national issue, such as elderly loneliness. Depending on the type of investor, the type and size of the capital investment may differ. For instance, if the investor is the government, it is likely that the capital investment would be given in the

form of grants or bonds. Philanthropists, on the other hand, could contribute large sums to the process in the form of bonds. Investors may also come from the community, where the everyday Singaporean can contribute smaller amounts (for example, \$50), as all the contributions will be given to the intermediary, who would collate them and structure the investment into proper bonds. Over and above its investor role, the government can facilitate the social impact bond process by serving as a partial guarantor for the bond, thereby reducing the overall bond risk. This is especially important when the bond targets critical national issues.

Role of intermediary

The intermediary is the party that helps create the marketplace for the bond. They issue the social impact bonds to the SSAs on behalf of the investor and importantly, create the structure for the social impact bond. This means that the intermediary develops the payment schedule for the bond, craft the contract for the bond and the social outcome metrics. Hence, to facilitate this, the intermediary also serves as the coordinator, helping to negotiate with all the stakeholders of the bond. The intermediary also receives

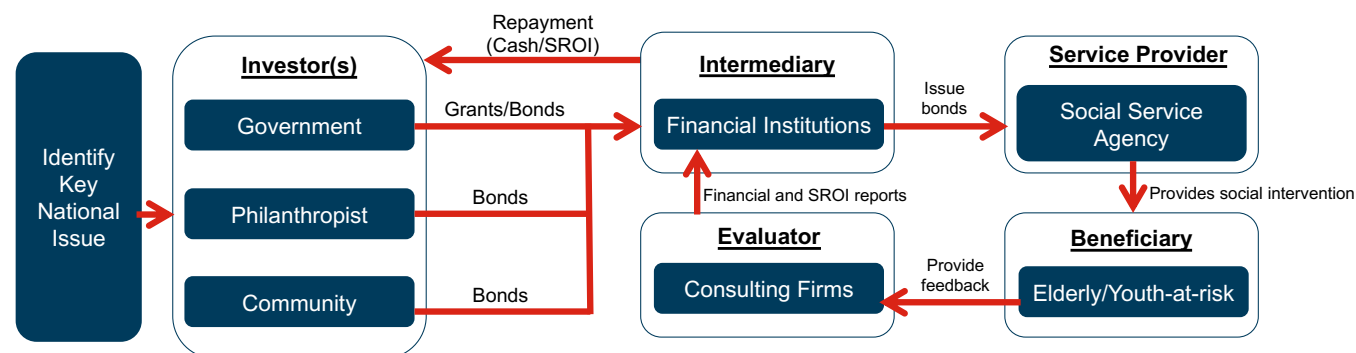
the financial and social ROI reports from the evaluator, and is required to communicate the results of the reports to the investors.

Once the bond is completed, it is also the duty of the intermediary to repay the investors via the social ROI created, because of the bond and cash compensation. Therefore, financial institutions and commercial banks, which are well versed in the financing structures of bonds, are suitable to serve as the intermediary for social impact bonds.

Role of service provider

Service providers, such as SSAs or charities, implement the social service programmes or intervention that would generate the social impact and financial revenue. These programmes are funded by the upfront capital provided by the investors who would have to be repaid. These service providers would purchase the bonds and commit to achieving the pre-determined social outcomes through a programme or project. An example of a social service programme or project would be a child activity centre that invests in technology to improve the literacy skills and cognitive development of children from low-income families through technology-assisted learning.

FIGURE 3 FLOWCHART DEPICTING A RECOMMENDED STRUCTURE FOR THE SOCIAL IMPACT BOND WHICH INVOLVES FIVE DIFFERENT PARTIES



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³ <https://www.masterclass.com/articles/business-model-canvas-explained>



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Role of beneficiaries

Beneficiaries receive the social intervention implemented by the service provider. On top of receiving the social intervention, they also will be consulted by the evaluators to provide feedback on their experience. The feedback can be collected through surveys and focus group discussions, where participants would be asked about the changes to their circumstances pre- and post-programme. This feedback would shape the evaluation of the overall bond. Beyond the feedback, beneficiaries are also encouraged to pay it forward, such as by volunteering to help other families.

Role of evaluator

Evaluators work with the intermediaries to develop the social outcome metrics, apprise them of the outcome of the intervention based on the pre-agreed metrics, and provide the evaluation report to the intermediaries. They approach beneficiaries to determine if the social outcomes produced by the social intervention meet the outcome metrics that were developed initially, in collaboration with the intermediary, service providers, and beneficiaries. As such, it is critical that the evaluators have strong competency in the area of social outcome metrics. It is also important

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Evaluators provide a comprehensive and unbiased review on the social outcomes of the social impact bonds

that evaluators maintain an independent stance in the entire process, as they need to provide a comprehensive and unbiased review on the social outcomes of the social impact bonds. An example of an evaluator organisation would be universities which have the relevant expertise.

With the clear delegation of roles for all involved parties, the bond can be rolled out and run as smoothly as possible. However, on top of understanding the roles of each party, another key aspect of successful implementation is cooperation. Therefore, clear and frequent communication is critical to reduce the likelihood of miscommunication.

Step 4: Evaluation

Importantly, while executing the intervention, it is critical to keep track of the social impact created as a direct result of the social intervention. There are several ways to quantify social impact, and one such method is called social ROI.

For a more detailed breakdown of what social ROI is, please refer to my social impact investment article published in the October 2023 issue of this journal.

Step 5: Completion

Upon completion of the social impact bond, there are two considerations for SSAs. Firstly, they should be concerned about their own liquidity. While social impact bonds are partially repaid via the social impact that they generate, there is still a portion of social impact bond where the repayment is in the form of financial instalment. Depending on the finalised payment structure, the financial instalment may be a large portion of the repayment strategy. The frequency of the financial repayment reinforces the importance of financial liquidity management for the duration of the social

impact bond, to ensure that investors are paid. Therefore, SSAs need to be clear about their financial standing to ensure that they can commit to the bond. Otherwise, a renegotiation of the social impact bond would be required. In the worst-case scenario, this infraction may be considered a breach of contract.

Secondly, organisations need to be prepared for the possibility of alternative exit pathways for the social impact bond. In the best-case scenario, the social intervention linked to the bond can be completed in time, and the bond is able to raise enough funds to pay the interest and the principal investment amount of the investors. However, as the COVID-19 pandemic has demonstrated, unforeseen circumstances can arise, and thus, the People-sector organisations need to ensure that this risk is mitigated as much as possible by planning for alternative pathways beforehand.

For example, in case the social impact bond undergoes early redemption, the system needs to be prepared for that. A scenario which necessitates an exit strategy could arise if a charity's target beneficiary group changes, or when the main intervention programme changes due to a shift in organisational focus. A solution is to have clauses incorporated in the social impact bond agreement that details the standard operating procedure that will be activated in the unlikely scenario where early redemption or bond renegotiation is required.

CALL TO ACTION

We would be conducting a pilot using the above social impact bond structure with interested parties that are keen to co-develop best practices and a playbook for the People sector. If you are interested in piloting social impact bonds, please reach out to me via ISCA or the Centre of Excellence for Social Good. Together, let us help create a more sustainable People sector. ISCA

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