POLICY LEVERS AND OBJECTIVES

Explanatory note for Governments

SOCIAL IMPACT INVESTMENT TASKFORCE

Established under the UK's presidency of the G8

September 2014

GLOSSARY

BSC	Big Society Capital (United Kingdom)
CIC	Community Interest Company (United Kingdom)
CRA	Community Reinvestment Act (United States)
CSR	Corporate Social Responsibility
DIB	Development Impact Bond
ERISA	Employee Retirement Income Security Act (United States)
ESG	Environmental, social and governmental
EU	European Union
G20	Group of Twenty (Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom, the United States and the European Union)
G8	Group of Eight (Canada, France, Germany, Italy, Japan, Russia, the United Kingdom and the United States)
GDP	Gross Domestic Product
GIIN	Global Impact Investment Network
GIIRS	Global Impact Investing Ratings System
GRI	Global Reporting Initiative
IPO	Initial Public Offering
IRIS	Impact Reporting and Investment Standards
MRI	Mission-related investing
NAB	Taskforce National Advisory Board
OAS	Organisation of American States
OECD	Organisation for Economic Co-operation and Development
PRI	Programme-related investing
SASB	Sustainable Accounting Standards Board (United States)
SEC	Securities and Exchange Commission (United States)
SIB	Social Impact Bond
SME	Small and medium-sized enterprise
SRI	Socially responsible investment
SSE	Social Stock Exchange
WG	Taskforce Working Group

Consistent with the main Taskforce report, this note uses the following terms and definitions:

Impact-driven organisations
Organisations that hold a long-term social mission, set social outcome objectives and measure their achievement, whether they be social sector organisations or impact-driven businesses.

Impact-driven businesses
Profit-with-purpose businesses or Businesses-seeking-impact that set significant outcomes objectives and maintain them in the long-term. They have no asset lock.

Social sector organisations
Impact-driven organisations with partial or full asset-lock. For example: charities that do not engage in trading; charities and membership groups that trade but do not distribute profits; social and solidarity enterprises; cooperatives; and other profit- or dividend-constrained organisations.

Profit-with-purpose businesses
Businesses that lock in social mission through their governance and/or embed it in their business model.

Businesses-seeking-impact
Businesses that set and maintain social outcome objectives for a significant part of their activities, without locking in their mission.

Social impact entrepreneur (also known as social entrepreneur and impact entrepreneur)
Entrepreneur leading an impact-driven organisation, be it a social sector organisation or impact-driven business, to achieve social impact.

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The Social Impact Investment Taskforce is an independent taskforce launched in 2013 under the UK's presidency of the G8. Over the last fourteen months, it has brought together government and sector experts from the G7 countries, the European Commission and Australia to fulfil its mandate to report on 'catalysing a global market in impact investment'.

This explanatory note complements the main Taskforce report and provides further details about the challenges to the development of domestic social impact investment markets and the potential opportunities for action by governments. It does not necessarily reflect the individual opinions of members of the Taskforce, its Working Groups or its National Advisory Boards, or the official positions of the organisations and governments they represent.

EXECUTIVE SUMMARY

The Social Impact Investment Taskforce has set out a compelling case for the need to catalyse the global social impact investment market. Recommendations are addressed to a wide range of actors including governments, philanthropy, business and social sector organisations, as well as individual savers who want to use their money to help build a world fit for their children and grandchildren to live in.

The purpose of this explanatory note is to complement the main Taskforce report[1] and provide further explanation about the challenges to the development of domestic social impact investment markets and the potential opportunities for action by governments. The aim is to act as a resource for government policy makers considering the development of their own social impact investment market.

This note is the result of analysis conducted on the existing and potential ecosystems in the countries of the Social Impact Investment Taskforce. It draws on the findings of the Taskforce's National Advisory Boards and Working Groups, and a cross-country expert group provided further guidance and input.

The policy levers outlined in this note will need to be considered and applied within the historical and institutional context particular to each country. Hence, the specific opportunity for each government will differ according to overarching policy priorities and the existing nature of social service provision. In all cases however, government has an opportunity to increase innovation in the delivery of social services, achieve 'better impact for money' and harness new sources of capital.

To maximise benefit and see social impact investment thrive, government has an important role to play as a **market builder**. As a large purchaser of social services it is also a **key actor in its own right**. Government also has responsibility, as a **market steward**, to remove barriers and ensure that the positive intentions of social impact investment are safeguarded over time.

Policy makers who seek to catalyse social impact investing will need to ensure that all aspects of the ecosystem are enabling the market to succeed. In addition, visible government support for social impact investment through the appointment of a senior-level minister, supported by a dedicated government team and resources, has been shown to be crucial in helping build the market and support the sector in meeting numerous challenges. Government knowledge and expertise about the existing social impact investment ecosystem is critical, as is ensuring opportunities for social impact investment are targeted towards policy areas where it can have greatest leverage in the local context.

1 "The Invisible Heart of Markets: How Impact Investment can Harness Innovation and Capital for Public Good", September 2014.

KEY OPPORTUNITIES

One of the more direct roles governments can play is as an *impact-seeking purchaser*, providing a source of revenue that underpins investment in impact-driven organisations. In many countries, government is the biggest funder of social services; and as such increasing the effectiveness of government's role as an outcomes commissioner is a potentially powerful way of developing the market. Yet the shift to purchasing outcomes, from purchasing outputs, is for many a new way of thinking and requires significant cultural and capability changes.

Beyond providing a direct source of revenue, governments can support *impact-driven organisations* by helping build their capability, increasing access to a range of different types of capital (including seed funding, early-stage risk capital and growth capital) and enabling the flow of talent into the sector. Furthermore, governments can ensure there is an appropriate legal and regulatory framework that enables impact-driven organisations to operate in the way that best suits their approach, whether by locking their social mission into their business model or enabling social sector organisations to generate revenues.

Channels of impact capital connect investors to impact-driven organisations in situations where investment does not flow directly to impact-driven organisations. Such intermediaries provide an effective way of allocating capital to impact-driven organisations, and enable the development of a strong social impact investment sector and culture. While government does not necessarily need to act directly to develop intermediaries, experience demonstrates that a bootstrapping role can be very helpful to trigger the engagement of others. Hence, an important objective for government is support for the building of a developed social impact investment culture, and a range of intermediaries managing impact capital and providing professional advice and services to the sector.

Governments can also play a significant role in enabling new *sources of impact capital* into the market. The Taskforce's Working Group on Asset Allocation found that removing constraints on flows of capital, including through clarification of fiduciary duty, is a priority for social impact investment to thrive. Government can use a number of policy levers to this end, including the removal of regulatory obstacles around fiduciary duty that currently deter potential impact investors; and, where possible, providing tax incentives, regulatory incentives, supplying catalytic capital and building market infrastructure.

INTRODUCTION

The way to deal with society's problems used to be clear. Government had a defined role alongside philanthropy and the charitable sector. Yet in the 21st century, the scale and complexity of problems faced is so great that it requires innovative thinking and new sources of capital.

Change is already underway and the emergence of 'social impact investment' represents a new force that brings impact as a third dimension in investment decision-making alongside the traditional measures of risk and return. New partnerships are developing between entrepreneurs, investors, governments, charities, philanthropists and big business to harness the forces of entrepreneurship, innovation and private capital for tackling today's social challenges.

> “Recognising there is no 'one size fits all' approach, policy makers need to consider their own historical and institutional context and the policy opportunities most suited to their particular environment.”

INTERNATIONAL ACTION

The Social Impact Investment Taskforce was established under the UK's presidency of the G8 to consider ways to catalyse the development of a global market in social impact investment. After over a year's work, and the involvement of more than 200 sector and government representatives, the Taskforce has now reported its findings.

The work of the Taskforce, its Working Groups and National Advisory Boards has found a high level of commonality on the issues surrounding social impact investment. At the same time, while recognising the need to work within local contexts, there is potential to learn from the different approaches and existing efforts underway in Taskforce countries. There are a number of potential policy opportunities for governments – working alongside entrepreneurs, charities, investors and philanthropists to harness and expand the power of social impact investment in their own country and help deal with the social problems they face.

AN OPPORTUNITY FOR GOVERNMENTS

The Taskforce has made a number of important recommendations to all those involved in social impact investment. The purpose of this paper is to provide further explanation about the challenges to the development of the domestic market for social impact investment, and to highlight potential opportunities for action by governments.

The aim is to draw together the common themes that have emerged across Taskforce countries, and thereby act as a resource for government policy makers in these and other countries as they begin to consider the development of their own social impact investment market.

In line with this, a number of policy objectives and recommendations are identified for policy makers to consider. Among these there are some, like easing the introduction of outcome-based government contracts and removing the constraints on flows of capital, including through clarification of fiduciary duty, which appear to be priorities for social impact investment to thrive.

Recognising there is no 'one size fits all' approach, policy makers need to consider their own historical and institutional context and the policy opportunities most suited to their particular environment. In particular, the specific opportunity for governments from social impact investment will differ according to overarching policy priorities and the existing nature of social service provision.

In all cases however, government has an opportunity to secure greater innovation in the delivery of services and achieve 'better impact for money'. To maximise benefit and see social impact investment thrive, government has an important role to play as a **market builder**. As a large purchaser of social services, it is also a **key actor in its own right**; and has responsibility, as a **market steward**, to remove barriers and safeguard the positive intentions of social impact investment over time.

In all three of its roles, government can make a number of policy decisions.

Market Building role

As a market builder, the first question for policymakers is whether there is sufficient ministerial leadership to champion the market within government and more widely. Such leadership can play a very important role in catalysing engagement across the spectrum of participants.

> “Social impact investments are those that intentionally target specific societal objectives along with a financial return, and measure the achievement of both.”

Source: Report of the Social Impact Investment Taskforce, September 2014

Government then needs to assess its role in supporting the development of constituent parts of the eco-system. For example, are there policies in place to help enterprises become contract and investment-ready; and are there grants available to support the development of infrastructure such as advisors or impact measurement organisations?

Crucially, there is a role in seeding the investment market, such as creating a social impact investment wholesaler and capitalising it potentially through dormant bank accounts or other assets where available, or providing specific support to early stage ventures through tax credits, loan guarantees and match funding to improve the risk-return balance and crowd-in commercial investors.

Market Steward role

As a market steward, government should consider how to facilitate the allocation of capital to social impact investment, by adjusting rules on how trustees consider their investments and by allowing foundations to invest from their endowments in achieving their mission.

Governments should also enable different corporate forms to play a role – for example allowing charities to generate trading revenue, or providing a legal form of mission-lock for profit-with-purpose businesses.

Market Participant role

Government’s position as a large purchaser of social services gives it an important role as a participant in the Social Impact Investment ecosystem. First and foremost, policymakers need to determine what portion and form of government spending is addressable by social impact investment.

Then, as a market participant, government needs to support social entrepreneurs in focussing on priority policy areas where social impact investment can provide greatest leverage – such as where there is a gap in provision or where early intervention could prevent poor outcomes. It can play this role through its commissioning process, and also by providing investment capital.

OUTLINE

This note provides further explanation of the objectives and recommendations made to governments in the main Taskforce report and uses consistent terminology.

It is the result of analysis conducted on the existing and potential ecosystems in the countries of the Social Impact Investment Taskforce. It also draws on the findings of the National Advisory Boards, Working Groups[2] and a cross-country expert group provided further guidance and input.[3]

Chapter two describes the structure of the social impact investment ecosystem and sets out the leadership challenges and the range of policy opportunities that policy makers have to address them. Later chapters consider the specific components of the ecosystem in turn. A summary of all objectives and recommendations is provided in the conclusion.

2 These include the National Advisory Boards for G7 countries and Australia, and Working Groups on Asset Allocation, Impact Measurement and Mission Alignment.
3 Members of the expert group are listed in the annex.

THE SOCIAL IMPACT INVESTMENT ECOSYSTEM

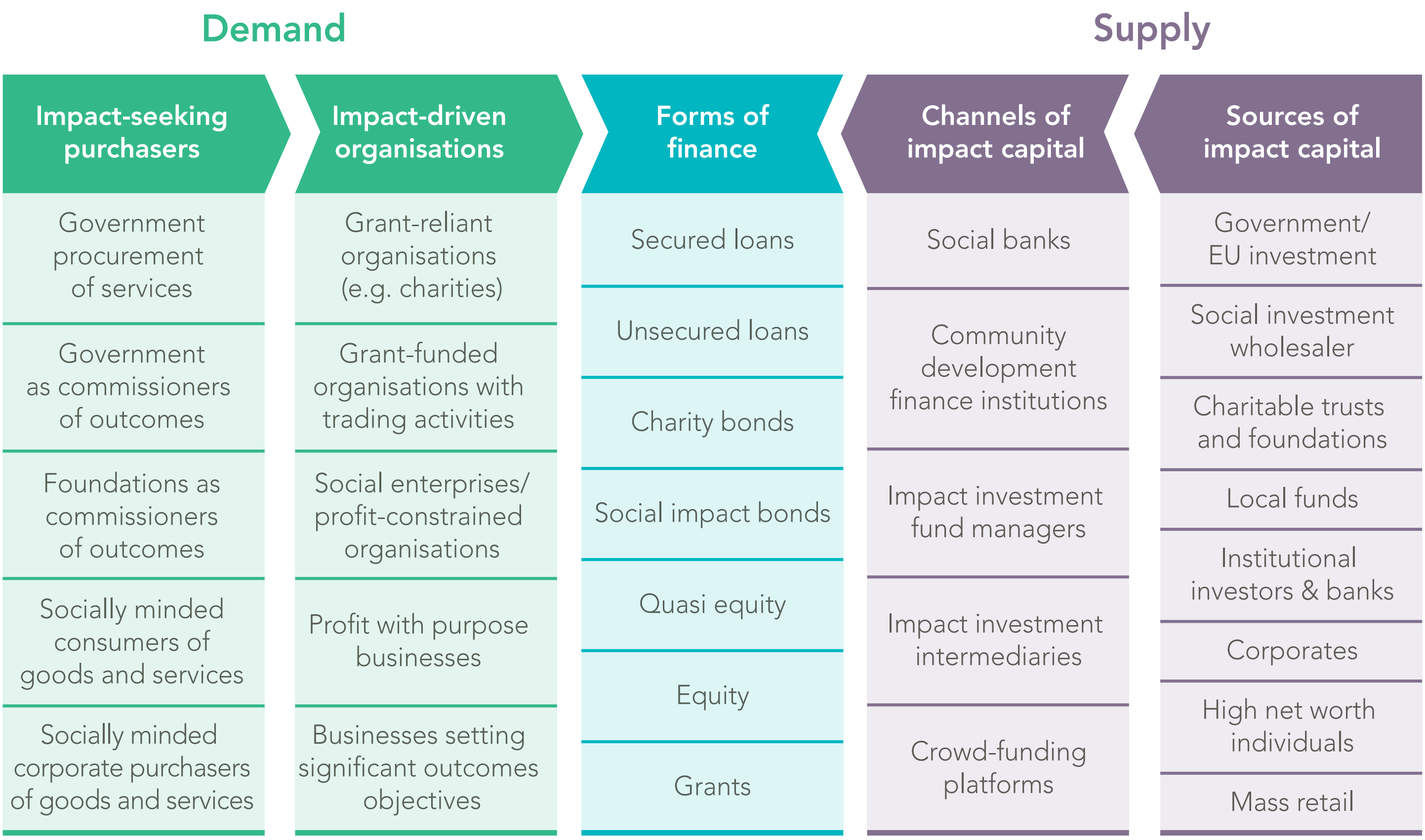
The social impact investment market, like any market, can be thought of in terms of **demand** (for capital to finance activities that deliver social impact), **supply** (of impact capital) and **intermediaries** between the two.

Analysis of the market in Taskforce countries has shown that the distinct signature of each impact investment transaction is set within a broader national ecosystem. The growth of the social impact investment market is dependent on the expansion of this ecosystem, which is itself influenced by the existing structure of social service provision.

The chart below sets out the principal components of these ecosystems as:

- **Impact-seeking purchasers** – these provide the sources of revenue that underpin investment in impact-driven organisations. Such purchasers can include governments, consumers, corporations or foundations.
- **Impact-driven organisations** – which need to balance growth and focus on impact. They include all types of organisations that have a long-term mission, set outcome objectives and measure their achievement. These can be social sector organisations (especially those with trading activities); profit-constrained businesses such as social enterprises, mutuals and cooperatives, which either pay no dividends or are restricted in how they pay them; profit-with-purpose businesses, whose primary social mission is legally protected, but can otherwise freely distribute any profits to investors; and businesses that set significant outcome goals, but whose 'impact mission' is not legally secured.
- **Forms of finance** – which need to address a range of different investment requirements;
- **Channels of impact capital** – to connect investors to impact-driven organisations in situations where the sources of impact capital do not invest directly in impact-driven organisations;
- **Sources of impact capital** – to provide the investment flows needed.

CHART A:
SOCIAL IMPACT INVESTMENT ECOSYSTEM



In each country, the ecosystem varies according to the nature of social service provision and the respective roles of government, foundations, the private sector, individual investors and the social sector. These differences influence the driving force behind social impact investment. For example, in France, and Italy the social sector is the driving force whereas it is large corporations in Japan.

Enabling aspects of regulation and infrastructure, related to impact-driven organisations and their financing, influence the effectiveness of the social impact investment ecosystem. Certain aspects are starting to emerge across Taskforce countries. On the demand side, these include legal forms for impact-driven organisations, capability building programmes for commissioners of outcomes and impact-driven organisations, innovation support programmes, impact measurement approaches, best practice sharing and accelerators and incubators. On the supply side, these include tax relief for impact investors, networks for impact entrepreneurs and investors, research houses and product reviewers, legal reform (on issues like crowdfunding) and capability building grants.

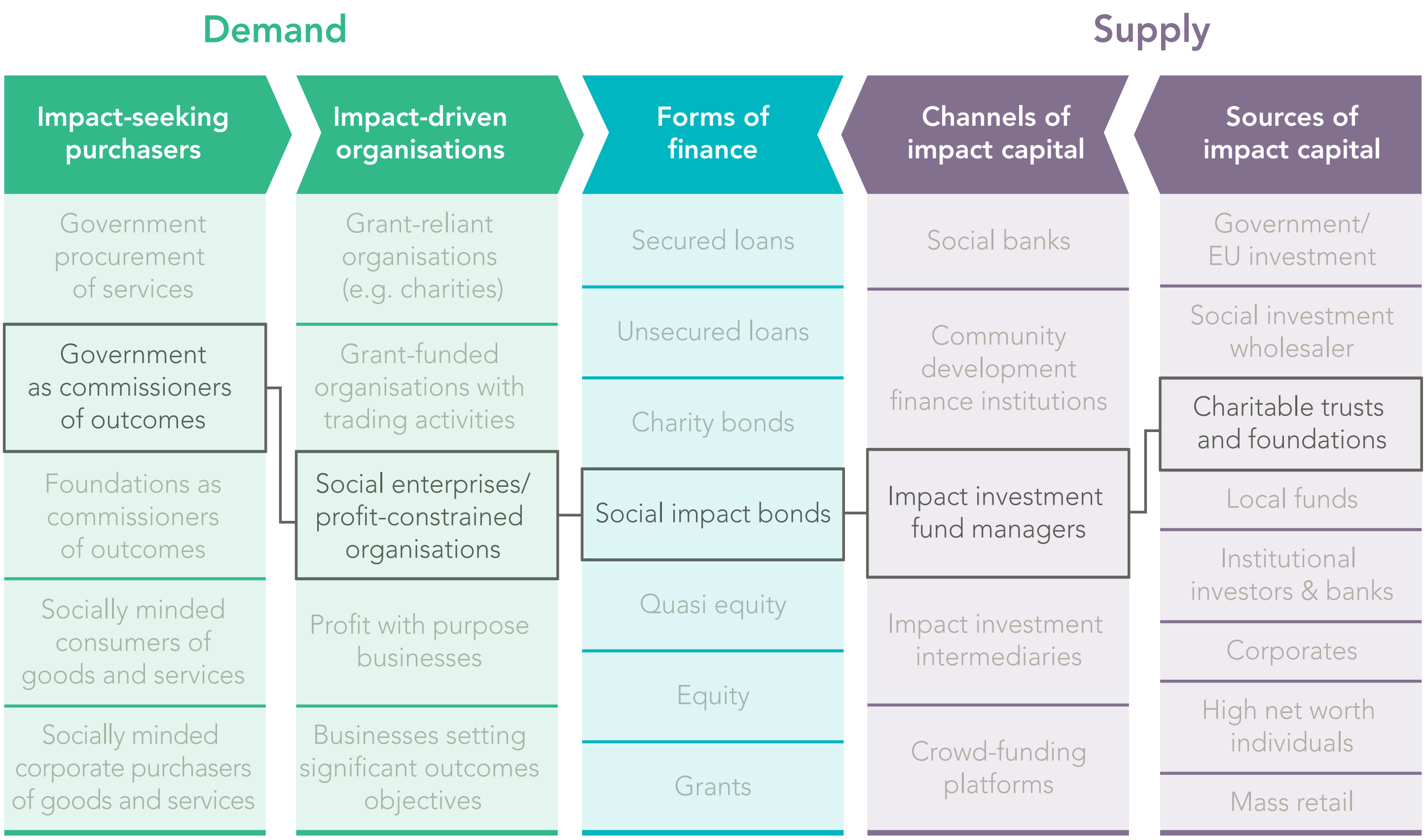
Each social impact investment can be characterised by its signature and the combination of components involved in the ecosystem. For example, chart B shows how a social impact bond typically has government as an impact-seeking purchaser and a profit-constrained organisation delivering impact on the ground and charitable trusts and foundations provide impact capital through a specialist impact investment fund manager.

THE OVERALL CHALLENGE

Government is key among a number of different actors that help to shape the ecosystem. The challenge government faces is how to identify the most effective policy levers, given its specific national context. To help address this challenge, it is worthwhile for policy makers to consider explicitly the range of policy options that address challenges in each of the different components of the ecosystem.

The nature of the ecosystem presents policy makers with a question about where to start.

CHART B:
EXAMPLE SOCIAL IMPACT INVESTMENT SIGNATURE



In particular, the unique historical and institutional context in each country makes it difficult to simply adopt the same policies. The driving force in the ecosystem can also differ from place to place, which requires a difference in emphasis among the components. Existing political and administrative structures within government may also leave social impact investment – as a cross-departmental effort – without a natural home, while the levels at which social services are provided – national, provincial, state, or local government – can create a multi-agency problem. And then, the degree of existing outsourcing and involvement of non-state actors in social service delivery can affect the 'space' for social impact investment. Data collection can also become a particular challenge – especially from the investor side where there is often a desire to keep commercial information confidential.

In addition to considering specific components, policy makers are called to address leadership challenges in terms of the overall ecosystem. This is the focus of the rest of this chapter.

POLICY LEVERS AND OBJECTIVES

Visible government support for the development of the social impact investment market has been shown to accelerate growth of the market, thereby harnessing innovation and attracting new sources of capital to address public policy priorities. As a market actor and builder, government is well placed to champion social impact investment and bring it to the attention of mainstream investors. It can also design appropriate policies to ease the introduction of social impact investment into areas where it can complement or improve existing social service provision. To do this, government has a number of policy levers at its disposal, including its ministerial and departmental organisation, as well as its published material and information.

Building the Ecosystem

Objective: Political leadership for the sector, with a dedicated government team and resources.

Recommendation: *Appoint a senior-level government minister to act as champion within and beyond government, helping to formulate and implement appropriate policies that build market infrastructure and support the sector in meeting numerous challenges.*

UK experience, with its dedicated Minister for Civil Society, has shown the value of cabinet participation in guiding government commissioning, capacity building, release of unclaimed assets, regulation and tax incentives. Government policy on these fronts is crucial in encouraging new partnerships between government and entrepreneurs, investors, charities, philanthropists and big businesses that harness effectively the power of entrepreneurship, innovation and private capital in tackling social issues.

The US has found that appointing an experienced social entrepreneur[4] as Special Assistant to the President and head of the Office of Social Innovation and Civic Participation has helped galvanise government efforts to boost impact investing as part of a broader effort to leverage human and financial capital to elevate community solutions.

Objective: Greater government knowledge and expertise about the existing social impact investment ecosystem.

Recommendation: *Develop a clear assessment of the different components of the social impact investment ecosystem at a national level, and monitor development over time.*

At a high level it is possible for any country to map its ecosystem onto a version of the schematic overview shown in chart A. In Japan, for example, the analysis found that the majority of social impact investment was in the form of loans and the corporate sector was a driving force.

Going further, Taskforce countries found it helpful to think about the ecosystem alongside a number of contextual factors, in a comparable way. Factors to consider include the existing legal and regulatory framework for impact organisations, existing government policy (where it exists) and incentives for social impact investors. The Italian National Advisory Board also found that an analysis of strengths, weaknesses, opportunities and threats (SWOT) was a helpful approach in determining their policy opportunities.

Clarifying and communicating government's role as participant

Once the existing ecosystem is mapped, and its key drivers are determined, then the areas where policy makers can most effectively support growth of the overall market are more easily identifiable. These areas can then be targeted by policy makers – especially given government's major role as a participant in the market for social outcomes.

Objective: Opportunities for social impact investment targeted towards policy areas where it can have greatest leverage in the local context.

4 Jonathan Greenblatt and Sonal Shah who have played important roles in the Taskforce's work have both held this post.

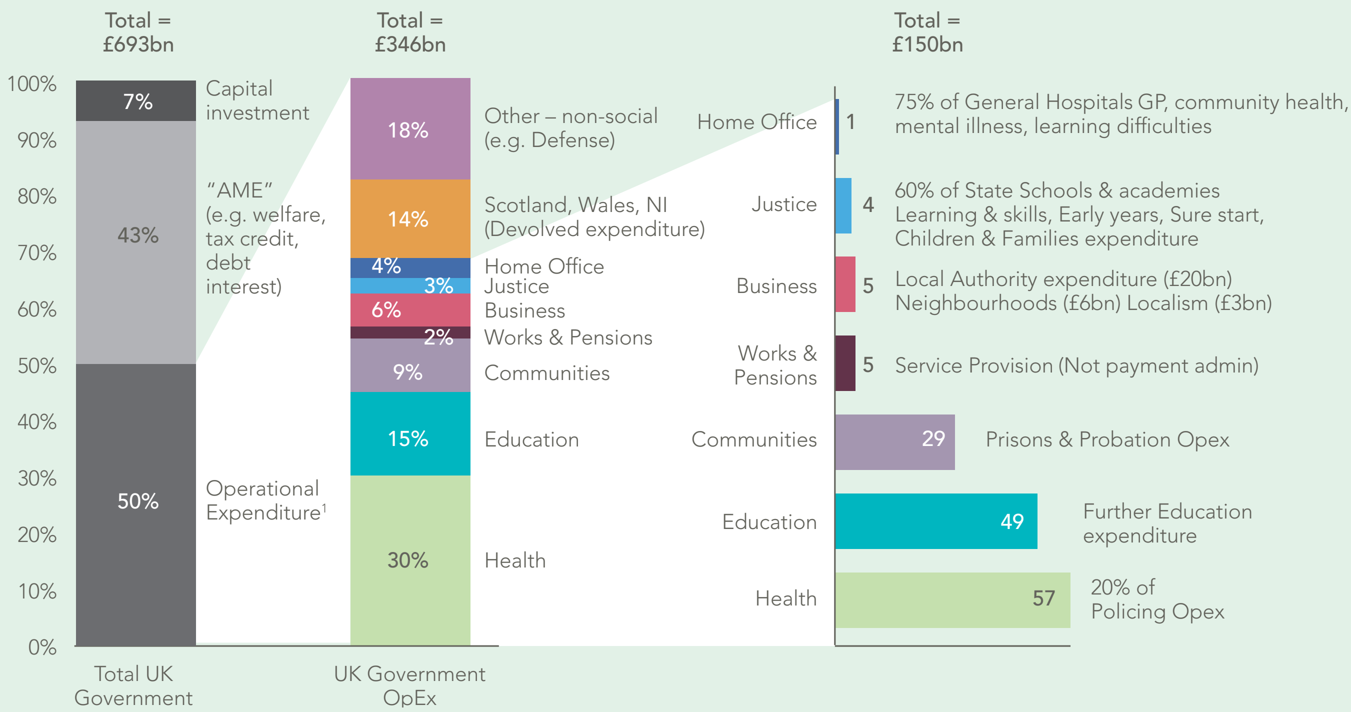
UK GOVERNMENT MARKET FOR SOCIAL IMPACT (CURRENT AND POTENTIAL)

Note 1: Sources NCVO cited in Barclays Charity Review 2012, The First Billion – BCG
Note 2: Social Enterprise annual turnover is £163bn – so assume non Value-sponsorship revenue is primarily trading (need to remove grant revenue)

UK GOVERNMENT EXPENDITURE 2011-12 (£BN)

ACCESSIBLE MARKET FOR UK IMPACT INVESTMENT

(INCL SCOTLAND, WALES, N IRELAND)



Note 1: Resource DEL in Government Accounts. Sources Government Budget Tables for 2011/12 (April 2013) and Guardian Public Spending Chart for 2011/12

Recommendation: *Identify the size and area of government spending where there is greatest need for innovation and/or funding challenges.*

Not all areas of government spending are addressable by, or appropriate for, social impact investment; and not all social impact investment concerns government. However, the public sector part of the social impact investment market is an important area of focus for policy makers, given government has direct control over it. The existing structure of the social economy in each country will have an important bearing on the 'space' for government-led social impact investment. Therefore it is important that policymakers identify where social impact investment will have the most leverage and will best complement existing service provision.

An assessment should cover both areas where there have been historic funding or structural challenges, and areas where early intervention could prevent poor and socially and financially costly outcomes.

In Germany, where state funding for the majority of the social economy is legally codified and delivered on a local or municipal level by a large and powerful non-profit sector, the space for social impact investment has been identified specifically as areas where innovation and prevention is needed and where statutory financing is often unavailable.

In Canada, the Government of Saskatchewan identified child and family services as an area where an early intervention programme, financed through a social impact bond, could prevent children being taken into care, saving both money for the government and distress for the families and children involved.

In addition to the priority policy areas, the size of the addressable public sector market is an important factor that government should communicate to stakeholders, as this will be a driver of interest in, and need for, impact investing.

In the UK, for example, with £250 billion a year of social service delivery funded by government, high-level analysis (shown in the box below) suggests that up to £150 billion could potentially be used to leverage social impact investment.

The public sector is, however, just one segment of the social impact investment market. In some countries, the private sector is the driving force in promoting impact that is consistent with the national interest. While not a direct actor, government has an important role in this segment of the market to create an enabling environment for private sector-led social impact investment. Given this, there is merit for government or others to estimate the total size of future impact investment flows from the supply-side. It is likely that a bottom-up analysis might not be possible, in which case it is possible to use top-down methods involving growth rates from more developed markets as an indicator, cross-checked with figures on social need, to determine the potential size of the whole market. For example, in Australia, top-level analysis by impact funds suggests that their whole market could reach $32 billion in a decade.[5] In Italy the National Advisory Board predict that their social impact investment market could reach more than €150 billion by 2020.[6]

CONCLUSION

The evidence from countries where social impact investing has gained the most traction shows that government leadership, supported by a strong team and resources, is a critical factor in the market's evolution. Government is called to play a powerful convening role and to set standards and expectations so as to engage other parties. The following chapters of this report expand on the role government can play in helping strengthen each component of the ecosystem.

5 See IMPACT-Australia 2013
6 Report of the Italian National Advisory Board. Available at: www.socialimpactinvesting.org

IMPACT-SEEKING PURCHASERS

Impact-seeking purchasers provide a source of revenue for impact-driven organisations. These revenues can provide a surplus for delivery organisations and a return for investors; and as such they are a key component in the ecosystem. The strength of the current and future revenues of impact-driven organisations underpins investor confidence in the market. Government policy can play an important role in enabling the development of these revenue streams.

SOURCES OF REVENUE

The most basic and traditional source of revenue for social sector organisations has been grant making and donations, from individuals, corporations and government. In most countries they still form a major source of revenue for many social sector organisations. For example, 55% of social sector revenues in Japan are from donations, and 58% of these come from corporations.[7]

Impact-driven organisations themselves can also raise revenue through the sale of their goods or services to consumers. For example, the San Patrignano centre for drug rehabilitation in Italy raises revenue through the sale of goods produced by the young people living there and following its programme.

Finally, impact-driven organisations can secure revenue from governments, charities, philanthropic foundations and corporations in return for providing a social service or outcome. This can be based on a fee-for-service approach, where a certain number of services or goods are purchased for an agreed price upfront. Or instead, the revenue can be earned only when a particular social outcome has been achieved.

GOVERNMENT AS AN IMPACT-SEEKING PURCHASER

In recent times there has been an increasing focus on outcomes in the public policy arena. This includes greater emphasis on measuring social outcomes, and paying for services in whole or in part through outcomes payments. This approach can help transition to a more preventative service model, thus reducing future dependency on state-funded services and ultimately reducing costs to the taxpayer. At the same time, outcomes-based payments can increase the focus on service effectiveness and help limit spending on ineffective programmes.

From the work of the Taskforce, this movement is expected to continue to grow and to develop a wider range of models and practice. It represents a key opportunity for social impact investment, both because it creates a need for working capital for organisations delivering services while waiting for outcomes payments, and also because it creates a strong alignment between social value created and social return, with returns increasing as more impact is generated.

Typically, the purchaser of the social outcome (government, philanthropic foundation or corporation) enters into a contract with the impact-driven organisation, which will be financed by investors, potentially aided by a professional intermediary. In such contracts, commonly known as pay-for-success contracts (often financed by a social impact bond), the purchasing of outcomes starts with an 'impact value equation' that balances the interests of all partners. For Government, the fiscal and social value of a successful outcome must exceed the price it pays for it. For the delivery body, the success rate of interventions must be such that the total cost of all interventions is less than the revenues from successful outcomes. For investors, the difference between the delivery cost and the government price per successful outcome must be sufficient to deliver an appropriate return, given the timing and risk associated with the payment. For all parties, the value equation needs to be underpinned by

7 Report of the Japanese National Advisory Board. Available at www.socialimpactinvesting.org

clear metrics and robust measurement against an agreed baseline, which are agreed upfront in the contract. The diagram below illustrates how the impact value equation plays its role at the core of pay for success contracts.

THE MARKET CHALLENGE

For policy makers, the key challenge is to ensure that government plays a constructive role as an impact-seeking purchaser in encouraging pay-for-success while supporting the development of the ecosystem at the same time. The shift in thinking from purchasing outputs to purchasing outcomes creates a number of challenges.

Reform of government purchasing is a challenge

In many countries, governments, as large purchasers of services, are an important source of revenue for impact-driven organisations. Typically, grant funding has played a big role, but in some countries these arrangements are transforming from pure grant-based models into matching funds or fees for service. In fee-for-service arrangements where up-front funding is provided for contracts, there can be little direct need for additional capital.

The purchasing or 'commissioning' of outcomes takes the relationship a step further, as it focuses on increasing the number of successful interventions and the savings that can result from them. It pays out only when a social outcome has

CHART C:
IMPACT VALUE EQUATION IN OUTCOMES-BASED CONTRACTS

been achieved. As a result of the later payments (and therefore greater risk for the impact-driven organisation), there is a need for (private) finance to provide working capital and risk capital to impact-driven organisations.

For many involved in the purchase of services, the focus on commissioning outcomes and involvement of private investors is a new way of thinking. Traditional approaches would be prescriptive in their specification of the processes required, and would consider that introducing a return to investors and/or a surplus to delivery organisations involves unnecessary layers of additional costs. Pay-for-success approaches focus on prescribing desired outcomes only, leaving freedom to innovate in service delivery in order to increase the number of successful interventions at the most effective cost per intervention.

As a consequence, the shift from input cost efficiency to outcome effectiveness will require many cultural and capability changes among commissioner organisations and beyond. In some cases, there may be pushback from existing social service providers in the 'space' that social impact investment could inhabit, as they could see their source of government revenue threatened. In yet other cases, there may be cultural barriers against the generation of profit in the provision of social services. Government can help address such concerns by emphasising the objective to improve social outcomes, the longer-term nature of an outcomes-based funding contract and freedom for service providers to adapt during the course of the contract with a view to realising outcomes rather than reporting on interim activities.

Officials not skilled at commissioning outcomes

The ability of government departments to commission pay-for-success outcomes, by way of social impact bonds or bilateral contracts with delivery organisations, means that officials must adjust their commissioning processes. New requirements include the setting of metrics, benchmarks, levels of success-led reward for investors and charitable organisations, and an appropriate share of potential savings for government. In addition, officials will need to draft new legal agreements that are flexible and outcomes-based and not constrained by existing processes and procedures. During the transitional period, as officials move away from standard purchasing templates, this may prove even more of a challenge.

The cost savings of improved outcomes is unknown

Once the case is made for the need for new approaches – focusing on innovation, prevention and outcomes – and commissioners are equipped with the necessary skills and tools, the government and other commissioners must also determine the appropriate value of an outcome. The direct fiscal value of such outcomes can often be derived from the cost savings resulting from other government services not being called upon – such as less demand on police and court time if a prisoner is rehabilitated. The broader economic and social benefits can be more challenging to quantify and may require comparative analysis with other expenditure in the same area, which may not be straightforward to analyse.

Savings caught up in silos

An additional challenge is that the cost savings from better social outcomes often accrue to multiple budget holders across different agencies, and layers of government. As a result there can be a simple, yet profound, 'wrong pockets' problem, where the commissioner with the authority to make change happen on the ground is not able to justify it within its own budget envelope, and the transaction costs of coordinating all the departments that benefit is too high.

POLICY LEVERS AND OBJECTIVES

Linking reliable revenue streams and social impact provides the platform for developing social impact investment. In many countries, government has played a historically strong role in determining the income sources of social sector organisations. In order to support the development of social impact investment, one of the policy levers that government has is how it commissions services as an impact-seeking purchaser. In its market-building role, government has additional levers at its disposal: the publication of data, information and guidance.

Objective: Increased effectiveness of government's role as an outcomes commissioner.

Recommendation: *Focus government commissioning processes on social outcomes where appropriate.*

CHART D:

EXAMPLES FROM UK GOVERNMENT UNIT COST DATABASE

Child Protection	Child taken into care average cost per year	£64,819
Unemployment	Job Seekers Allowance per claimant per year	£10,025
Youth Offending	Yearly average cost of a first time entrant to the criminal justice system	£21,268
Care for the Elderly	Residential care for older person per year	£28,132
Homelessness	Local authority intervention per individual per year	£8,391
Education	Exclusion from school per pupil per year	£11,192
Drug Misuse	Drug-related offending and health per addict per year	£3,631
Domestic Violence	Health and Criminal Justice cost per incident	£2,776

Source: www.data.gov.uk/sib_knowledge_box/toolkit

The most powerful driver is for government commissioning to shift more towards paying for social outcomes achieved, rather than just outputs or services delivered. In particular, this will require greater clarity on the policy goals of government and how success should be measured, as well as the creation of a form of commissioning that enables innovation and recognises impact-driven organisations as partners for delivery. There are three ways in which this can be done. Governments can simplify their commissioning process, ensure bid sizes suit impact-driven organisations, and modify their purchasing rules to include a social impact agenda. If commissioning is streamlined and pay-for-success contracts can be issued in three to four months instead of a year or more, which is currently the case in the UK, then their issuance will expand to fill more of the addressable market.

Recommendation: *Create domestic consolidated outcomes funds for use by government departments that are unable to recognise the full value of social outcomes they achieve.*

There are two ways that this can be done. First, government can create a specific fund for a particular outcome, like the UK's Department for Work and Pensions Innovation Fund that pays for successful outcomes for high-school students who are at risk of becoming unemployed and not in education or training (NEETs). Second, government can create an outcome fund, which any department can access. For example, the US administration has included in its budget $300 million for outcome funding, which government departments access to supplement their own resources.

In the UK, the Social Outcomes Fund (Cabinet Office) and Commissioning Better Outcomes (Big Lottery Fund) were designed to help increase innovative solutions to social problems through pay-for-success contracts. They act as a 'top-up' fund for commissioners of social services in complex policy areas where the benefits from a pay-for-success contract make it worthwhile but fall beyond the lead commissioning body so that they cannot justify making all of the outcomes payments. These 'top-up' outcome funds effectively act as a proxy for the other parts of the public sector that benefit from the outcomes as well as the savings generated by a pay-for-success contract.

PAYING FOR SUCCESS THROUGH A SOCIAL IMPACT BOND

A social impact bond is an innovative tool to finance pay-for-success contracts. By providing up front funding for early intervention or prevention services social impact bonds can accelerate progress on deeply entrenched social problems.

How does it work?

Through a social impact bond a government body, charity or philanthropic foundation commissions a particular social outcome it wishes to achieve.

Private investment is then sought to pay for an early intervention or prevention programme. The commissioner enters into a contractual agreement with an investor or intermediary that can raise funds from other investors to target the social outcome. A service provider with a proven track record is appointed to execute the programme. Outcomes targets are agreed upfront along with the methodology and approach for measuring the outcomes.

If the desired outcome is achieved in the agreed timeframe then the commissioner pays out a financial return to investors. There is a sliding scale linking impact with return: the greater the improvement, the greater the return. Conversely if outcomes do not improve then investors do not recover their investment.

Benefits for all

With payment from the commissioner only coming if the intervention is successful it also removes the risk of scarce public or charitable funds being wasted on unsuccessful interventions. The payment also typically represents a cost saving as prevention is often cheaper to fund than dealing with the social breakdown that can otherwise occur.

For investors the social impact bond provides a tool for those that want to use their money to achieve social impact.

For service providers the social impact bond provides guaranteed payment upfront. In earlier models of pay-for-success contracts the burden of risk was traditionally with the service provider. As such it was prohibitive for smaller providers who struggled to cover the upfront costs themselves and couldn't take the risk of not being paid if the programme didn't deliver.

Peterborough as pioneer

The first social impact bond was developed by Social Finance UK for the criminal justice sector. The targeted outcome was a reduction in prisoner reoffending. The £5million Peterborough social impact bond was launched in September 2010. This pilot, which is still underway, has catalysed the growth of the UK social impact bond market and sparked interest around the world. There are now around 30 social impact bonds in place, dealing with issues like adoption, child protection and homelessness, including in Australia, Canada, and the US.

Building the Ecosystem

Recommendation: *At a corporate level, provide capability-building support to departments and local government, in order to support commissioners seeking to pay for outcomes.*

There is capability-building support for UK government commissioners through the Big Lottery Fund, which provides funding for external professional support for commissioners who wish to develop outcome-funded contracts that would be underpinned by social investment.

Australian State governments in particular have been active in commissioning reviews and starting to explore more systematic opportunities for payment by outcomes, for example, commissioning reforms in Queensland and Western Australia. Also there are some significant outcomes-based contracting approaches in Australia, including for employment services.

Recommendation: *Calculate and publish the cost to government of social issues, as a way to place a value on prevention, and encourage the market to bring cost-effective solutions.*

The UK government has recently posted on the Cabinet Office website the costs of 640 social issues. This level of transparency can provide an important signal to impact-driven organisations about the areas where they may be able to deliver outcomes more effectively and create savings for government. For example, the creation of a social impact bond to prevent children being taken into care can use the cost estimate provided – £64,819 per child per year – to act as a proxy for social value. A programme that can prevent say 100 children being taken into care could therefore be said to have a 'value' of just over £6 million in one year. This value can provide the basis for determining appropriate outcome payments.

Recommendation: *Support the development and adoption of standards in impact measurement by ensuring government adopts them in its own reporting and contracting requirements.*

The Taskforce's Impact Measurement Working Group identified principles and practices for measuring impact in a more systematic and uniform way, which will be critical for investors and commissioners alike. Governments should encourage the development of these standards.

Governments around the world have great influence over the standards and norms adopted by wider stakeholders, simply on the basis of how they expect others to adopt and interact with them. So, by requiring all those who contract with them to adopt these measures, governments can exercise a leadership role in the wider adoption of these approaches.

Shaping the Environment

Recommendation: *Clarify government accounting conventions to support the use of outcome payments.*

For example, governments could ensure that obligations to make an outcome payment accrue only when the outcome has been measured. In the UK, this was an important step in the facilitation of social impact bonds, as it meant that government balance sheets were not encumbered by liabilities to pay until the social impact had been confirmed.

CONCLUSION

In many countries, the government is the biggest funder of social outcomes, whether through its own activities or the funding of services delivered by others. Hence, it has the potential to be a major driving force in the development of the social impact investment market. How it exercises its role as an outcome funder will be a critical determinant of the market's growth. The more government seeks to commission social outcomes from impact-driven organisations and publicises the necessary information for the market to function, the faster the market will grow.

IMPACT-DRIVEN ORGANISATIONS

Impact-driven organisations are the impact-creating force in the ecosystem. They span a wide spectrum, from social sector service providers at one end to impact-driven businesses at the other. Their ability to grow and to commit to focussing on impact is critical to the success of the overall ecosystem.

Profit-with-purpose businesses are those that embed their mission in their business model or secure it through appropriate legal form. They can use a number of different models to achieve impact. There are those businesses like One Water and Warby Parker that focus on generating profit, in order to deliver impact elsewhere. For every bottle of water or pair of glasses bought, another bottle or pair, or cash equivalent, is provided to a community in need. There are also businesses – like Jamie Oliver's Fifteen in the UK and the StrEAT cafes in Australia – that achieve impact through the process of their operations. By employing and training unemployed, vulnerable or disadvantaged people their business impacts directly on these particular groups. Finally, there are also businesses – like Oomph!'s provision of exercise classes to the elderly, and Revolution Food's supply of organic and nutritional food to schools – where impact is embedded in the product or service itself.

Another type of impact-driven organisation has emerged for the purpose of contracting with outcome funders and raising investment – the impact finance intermediary. These organisations take on outcome-based contracts with governments, and then oversee and help service delivery by social sector subcontractors through a combination of upfront payments and performance management arrangements. As a result, the subcontractors are shielded from the challenges of financing and government contracting, but are very much expected to deliver outcomes. These impact finance intermediaries typically issue a social impact bond to raise capital. An example is Children's Support Services Ltd (CCSL) in the UK, which manages the contract for the Essex social impact bond to keep adolescents out of care. Another version of such an organisation would be a Social Prime contractor, which would provide scale efficiencies in contract bidding and management, as well as capital raising, and subcontract part of its work to impact-driven organisations.

THE MARKET CHALLENGE

With the emergence of a new generation of 'millennials' who increasingly want to 'do good and do well' and the rise of the 'grey wave' of experienced professionals who want to give back to society, there is a large potential pool of impact-driven entrepreneurs and social sector innovators to be encouraged into the market. However many face challenges, both in entering to the market and in growing their organisations.

Poor connections to capital markets

Rising to the challenge of fulfilling increasing demand for social service delivery requires the social sector to scale its ability to deliver. Traditionally, social sector organisations have grown very slowly, relying on funding from donations and revenues from shops and other trading activities. They often struggle to access appropriate finance. This is a problem at both the start-up phase (where traditional small business support is usually closed to social sector organisations) and when successful impact-driven organisations want to pursue a growth strategy. Venture capital and growth capital are both lacking, with many investors still seeing the risk/return profile of impact-driven organisations as too high.

This lack of access to capital has slowed the growth of existing social sector organisations hugely relative to business. Figures for the US suggest that over the past 25 years or so, 50,000 businesses have passed the $50 million sales level, while only 144 charitable organisations have been successful in doing so. The lack of early stage risk capital is a considerable barrier to many wanting to start up in the sector. Results from the JP Morgan survey of 125 impact investors in 2014 found that only 11% of investors surveyed offer early stage risk capital.[8]

Out-dated legal and regulatory framework

The Taskforce's Mission Alignment Working Group found that, in many countries, the legal and regulatory framework has yet to evolve to reflect the blurring of the lines between the social and commercial sectors. Cultural norms and regulatory structures ensure that the traditional divide between social sector organisations and mainstream businesses often still exists. This is largely unhelpful to organisations operating in the social impact investment market. Social sector organisations can be left unable to engage in many commercial activities, and sometimes face stiff penalties for doing so. Commercial organisations can lack the mechanisms to secure their social mission into their operations in a way that ensures its longevity over time and change of ownership and run the risk of 'mission drift'.

Limited access to business support and professional services

Impact-driven entrepreneurs and innovators in the social sector require skills and know-how to prepare business plans, financial accounts and legal documents, and to navigate employment, tax and health and safety regulations. While there are often business support programmes in place for small and medium-sized enterprise (SMEs), they are often restricted to commercial organisations and exclude social sector organisations. Without large financial resources with which to pay for these services, many would-be impact entrepreneurs face a steep learning curve.

Competition for talent

Impact-driven organisations can face stiff competition in recruiting the brightest and best. While there appears to be appetite for more impactful work, there are sometimes challenges in the way of those wanting to commit their lives to doing good – the loss of a professional salary and/or corporate benefits for some can be too much of a risk. In addition, there may be few successful role models and little awareness about the work of impact-driven organisation in the economy from which to draw inspiration.

POLICY LEVERS AND OBJECTIVES

As outlined in the previous chapter, ensuring that there are significant potential revenue streams for impact-driven organisations is an important starting point. However this alone will be insufficient if such organisations do not have the ability to respond to such opportunities or access the appropriate capital to grow. To increase the capability, scale and overall number of impact-driven organisations, policy makers have a number of levers to use in their market building and market stewarding role. These include institution-building, adjusting the legal and regulatory system, capability-building and support programmes and tax incentives.

Building the Ecosystem

Objective: Increased resources and support for impact-driven organisations to strengthen their operations and grow.

Recommendation: *Provide capability-building funds for impact-driven organisations.*

Capability-building can be supported in a number of ways. At its simplest it could be through an incubator fund. More specific funding could also be used to provide technical support for enterprises that are seeking to contract with government, or raise investment capital. This could also be achieved through partnering with corporations to create incubators, accelerators and other capability programmes.

In Japan, the government has provided a $210 million grant for social innovation during 2010-2012 under the 'New Public' initiative, of which $86 million has gone to support 800 start-up impact-driven organisations, while 14 intermediary organisations run a series of capacity building, internship and seed funding programmes.

The UK government has created an initial pool of £20 million to be deployed in capacity-building grants for investment readiness. This consists of a £10 million 'Investment and Contract Readiness' fund, which helps established social ventures access social impact investment of at least £500,000, or win contracts over £1 million; and a £10 million 'Social Incubator Fund' to support social incubators to provide investment and support to early stage social ventures. To date, the Investment Readiness programme has helped 116 frontline social ventures become contract ready and created 10 social incubators, which will support over 600 start-up ventures.

8 "Spotlight on the Market: The Impact Investor Survey", May 2014, JP Morgan and GIIN.

Recommendation: *Provide more opportunities for impact-driven organisations to access different types of capital, including seed capital, early-stage risk capital and growth capital.*

Government has a number of legal and regulatory levers it can explore for this purpose. In France the 2014 Social and Solidarity Bill aims to facilitate the financing of social sector organisations, while an investment fund for social innovation is about to be launched by "Banque Publique d'Investissement" (a State-owned bank) and regional government entities to make loans to social innovators. The Italian Prime Minister has announced the creation of a Social Fund to finance impact-driven businesses; and a provision to include social enterprises in legislation is being discussed in the Italian Parliament.

In the USA, the Jumpstart our Business (JOBs) Act has made it easier for enterprises to raise capital from non-accredited investors.

Small changes in existing policies could also increase the capital available at start-up-phase. For example, the US "EB5" visa programme allows foreign investors to get green cards if they invest $500,000 and create at least 10 jobs in economically troubled areas. In 2012 alone, this programme generated $1.8 billion of early-stage investment. With a few small tweaks around the rules for qualification, the pool of investment generated through this programme could be expanded and channelled towards impact-driven organisations.

Recommendation: *Expand SME business support to impact-driven organisations.*

In Canada, the MaRS Discovery District provides office space, venture support, access to capital, networking opportunities and expert advice for a range of different entrepreneurs, including social entrepreneurs. They have found that the cross-fertilisation of ideas has helped enterprises from all areas improve their businesses and achieve impact. This is an example of how an institution can be expanded to incorporate impact-driven entrepreneurs.

Objective: Increased flow of talent to build and grow impact-driven organisations.

Recommendation: *Encourage existing impact-driven entrepreneurs and new entrants by celebrating success in the sector and offering rewards for innovations.*

Not only could this act to encourage the impact investment sector itself, but also to raise awareness within the wider community so that demand for 'impact products and services' increases. In France, for example, there are around 30 social entrepreneur contests a year, either state supported or organised by business schools, entrepreneurs' networks, newspapers, or corporate foundations.

Recommendation: *Consider tax incentives for impact-driven organisations and their employees.*

Government could consider offering tax relief for impact-driven organisations similar to the relief provided to charities and other social sector organisations. This could include sales tax, corporation tax and even potentially lower income tax for employees.

Shaping the Environment

Objective: An appropriate regulatory and legal framework for impact-driven organisations.

Recommendation: *Provide legal forms and support accreditation systems to allow profit-with-purpose businesses to lock in their mission.*

For example, there has been the creation of some enabling corporate structures like the Community Interest Company (CIC), which has been available in the UK since 2005, and is now in certain Canadian provinces. Since 2010, the UK government has supported the formation of Public Service Mutuals to take over the running of government services. In the US, there has been growth in the number of companies incorporating as a Benefit Corporation, a new legal structure for profit-with-purpose businesses first adopted in Maryland in 2010 and now law in 27 states.[9]

The B-Corp, also in the USA, but distinct from the legally defined Benefit Corporation, is an accreditation system for companies that have been independently evaluated by non-profit B Lab and found to meet the highest standards of social and environmental performance, accountability, and transparency. The B-Corp is starting to take hold. There are now an estimated 1,000 B-Corps across 34 countries and 60 industries. These include Bullfrog Power in Canada that provides renewable energy for homes and Whole Kids in Australia that makes organic, additive free healthy snacks for children.[10]

Recommendation: *Relax restrictions on social sector organisations engaging in revenue-generating activities.*

For example, reform of the legislative and regulatory environment governing social sector organisations is one of the key policy recommendations of the National Advisory Board

9 www.benefitcorp.net
10 www.bcorporation.net

in Canada. The current Canadian rules do not recognise the value of revenue generating activity among social sector organisations. In some cases, administrative guidance and interpretive rulings have gone so far as to imply that social sector organisations cannot intend to generate a profit. This can inhibit the adoption of entrepreneurial or innovative models, which are important for those wishing to use social impact investment models in the social sector.

CONCLUSION

The objective for policy makers is to introduce measures that help establish more impact-driven organisations that can deliver impact at scale and offer a secure investment. Experience shows that policy should focus on allowing organisations that wish to lock in their impact-driven mission to do so, without having to be constrained in the type of capital they can utilise in distributing any surplus.

This will involve creating supportive legal and regulatory frameworks, for social sector organisations to ensure that the rules governing them do not inhibit entrepreneurial risk-taking and innovation, and for impact-driven businesses, to ensure that they can if they want maintain their social mission through appropriate legal forms. The key to scaling the sector is to provide a variety of ways in which impact-driven entrepreneurs can construct their organisations.

CHANNELS OF IMPACT CAPITAL

New channels of capital, or intermediaries, are a key component in the ecosystem, as they help connect impact-driven organisations and investors. There is a need for these specialist intermediaries to play at least as big a role as they do in mainstream finance and to satisfy growing investor demand.

Intermediaries can take many different forms depending on their purpose and the origins of their investment. Sizeable investment vehicles will be needed that can assemble significant portfolios of investment opportunities to deliver attractive combinations of financial and social returns at acceptable levels of risk.

There are examples of well-established social investment funds like Bridges Ventures in the UK, Acumen in the US and ESFIN – IDES in France with around £500 million, $88 million and €60 million under management respectively as well as social investment wholesalers Big Society Capital (UK) and Bpifrance (France).

There are also examples of smaller specialist funds, like Social Venture Fund in Germany that focuses on growth capital for successful impact-driven organisations across Europe. Community Development Finance Institutions (CDFIs) have a big role in particular countries, with over 1,000 CDFIs in the US providing $60 billion of finance to underserved communities. Other organisations exist to provide financing and support to organisations owned by individuals from particular populations like the Aboriginal Financial Institutions in Canada. Crowdfunding platforms have emerged to connect retail investors to impact-driven organisations through the internet. Social stock exchanges are in the process of development in many places.

Just as with venture capital and private equity previously, a profession of impact investment managers will need to be created in order to deploy significant capital. Alongside investment managers, a new set of impact finance advisers is developing fast, including Social Finance (UK, USA, Israel), the Centre for Impact Investing (Canada), Imprint Capital (USA), Third Sector (USA), ClearlySo (UK) and France Active (France).

THE MARKET CHALLENGE

The field of social impact investment intermediaries is still an emerging one despite their growth (in number and size) in some countries in recent years; and there remain a number of challenges to overcome in establishing intermediaries.

An emerging market

Even in the more developed social impact investment markets like the UK and US, involvement of mainstream investors is still the exception rather than the rule. The leading impact investors are generally philanthropists, high net worth individuals and some large foundations. Capital flows and transaction sizes are still relatively small. This can create a short-term sustainability issue for impact investment funds, and those involved in capital raising and offering advisory services. The low potential revenue from small transactions and the high level of effort to raise capital can create a situation where the business is unsustainable without some form of additional grant support. In the UK, the Investment and Contract Readiness Fund has been an important source of income for advisory services, especially where the small scale of transactions would have otherwise meant such support would have been uneconomic.

Limited financial products and mechanisms

The range of financial mechanisms and products on offer both for investors and impact-driven organisations is still very limited. In many countries, it is confined to bank loans. Some interesting private equity deals for social impact are emerging; and the social impact bond is currently one of the more innovative products in the market. It finances a pay-for-success contract for delivering measured social outcomes by investors providing the capital up-front and taking on the outcome risk. There are now about 30 social impact bonds across a handful of countries, with about half in the UK.

More traditional bonds have also been used to frontload capital for the financing of infrastructure for charities or community ventures, as well as for scaling up international vaccination programmes. However, the depth and breadth of 'charity, social or community' bonds is limited, especially when compared with 'green bonds', which totalled about $20 billion in the first half of 2014.

Lack of industry standards

It takes time for professional standards, accountability and certification to develop. This is certainly true in the social impact investment market, where questions of definition continue to impact on the development of the necessary terms, systems, standards and certifications for the market to successfully govern itself. For the most part, time and a process of evolution will be needed for these to develop. Social impact investment is not yet at this stage and the lack of agreed standards creates a challenge for investors who seek assurance that the fund or organisation in which they invest is permanently creating impact.

Few exit opportunities

Following on from this, while an impact investor may be in it for the long term, most investors want to know that there is a route to liquidity. Currently there are few options for social impact investors to exit from financial commitments. While there have been some successful exits by funds through sales to strategic purchasers, social stock exchanges are need to improve the prospect of exit.

POLICY LEVERS AND OBJECTIVES

In order to develop a vibrant ecosystem, a range of professional impact investment managers and advisers is needed to connect investors with impact-driven organisations. Government can help to create the right conditions to enable them to develop. Policy makers have a number of market-building levers to help achieve this. These include institutional development and the funding of intermediaries, regulatory reform and the establishment of standards and labelling.

Building the Ecosystem

Objective: A developed social impact investment culture, and a range of intermediaries managing impact capital and providing professional advice and services to the social impact investment sector.

Recommendation: *Create a social impact investment wholesaler to act as a market champion, potentially financed by dormant assets in bank accounts, insurance companies and pension funds.*

The UK created a social investment wholesaler, Big Society Capital. It was launched in April 2012 by Prime Minister David Cameron, with a commitment to ensure new and additional sources of capital enter the market (see box on page 22).

Other countries have taken different routes to help create specialist impact intermediaries. In France, savers can choose to put their money into 'fonds d'investissement solidaires dits 90/10' (90/10 solidarity investment funds), which allocate at least 90% to traditional mainstream investments and the other 10% or so to funding social enterprises, mostly with long-term loans at low interest rates. The social investment portion of "90/10" funds mostly flows through three well established social investment intermediaries, while the new dedicated financing tools of Bpifrance may enable it to play a championing role similar to that of BSC. In the USA, the Small Business Administration has launched a $1 billion Impact Investment Initiative.

Recommendation: *Consider early-stage support to specialist social impact investment funds, intermediaries and advisory firms.*

In the early stages of market development, government can also help catalyse the development of specialist social impact investment funds directly. For example, in 2002, the UK government provided £20 million of match funding (in the form of a loan and equity investment) alongside investment from the private sector to help establish Bridges Ventures, which now manages about £500 million in impact equity funds.

Governments can also improve the sustainability of advisory firms and others working to support the development of specialist funds and transactions. The UK's £10 million Investment and Contract Readiness Fund not only helps social ventures directly access impact investment, but also offers financial support to investment advisory providers with a track record in supporting social ventures to investment and contract readiness.

Recommendation: *Support efforts to enable access to a social stock exchange.*

There are a number of examples where social stock exchanges have begun to emerge. The oldest and most established is the Impact Investment Exchange (IIX) in Asia, which was established in 2005, and was developed to be Asia's first private and public platform for social enterprises to raise capital. In 2013 it incorporated Nexii, a social stock exchange in South Africa. It aims to help direct much-needed growth capital to social businesses

BIG SOCIETY CAPITAL – A SOCIAL IMPACT INVESTMENT WHOLESALER

In order to build up impact intermediaries, the UK took the initiative in April 2012 of creating Big Society Capital (BSC) as an independent social investment company that is both a significant wholesaler of capital and a champion of the sector. BSC's equity capital has been funded by £400 million from unclaimed bank assets (from 15 year-old dormant bank accounts) and £200 million from the UK's leading banks, Barclays, HSBC, Lloyds and RBS.

BSC has already played an important role in investing in new investment management organisations, helping to strengthen existing ones, and increasing the understanding of impact investment among the relevant actors in the UK. Most exciting of all, BSC is helping to unlock innovation and entrepreneurship from a whole new generation of organisations and individuals tackling social issues across the UK.

Its experience over the past two years is instructive. It has committed £150 million to 31 social investment managers and a social bank, which together deploy unsecured debt, secured debt and equity, and has attracted an equal amount of matching investment from third parties. In the process, it has helped mainstream investment managers such as LGT, which has set up a joint venture with the Berenberg Bank of Germany to manage a £20 million impact venture fund in the UK, and Threadneedle, which has created a joint venture with the Big Issue to manage a cash equivalent impact bond portfolio, the UK Social Bond Fund. It has also supported the UK's first retail social investment offering and Retail Charity Bonds Plc, which will provide a platform for charity bonds to be tradeded on the London Stock Exchange. It has worked with the UK government to design tax incentives for investors that extend to social impact funds the longstanding incentives for investors in venture capital trusts, which currently attract several hundred million pounds a year.

across Asia and Africa. The Social Stock Exchange in London (SSE) was launched in 2013 to connect social enterprises with impact investors. A team in Berlin is in the process of developing a German social stock exchange, NExT SSE. In Canada, the SVX has been created as a platform for connecting social ventures, impact funds, and impact investors.

Recommendation: *Support the use and development of new and innovative social finance products, including social impact bonds.*

One approach is to support the development of social impact bonds through financing an organisation that can champion them and provide capability building for all the participants in social impact bonds (commissioners, enterprises, investors). In the UK, the Big Lottery Fund provided Social Finance, the originator of the social impact bond model, a £5 million grant to develop the social impact bond market. Thereafter, the Cabinet Office has established a 'Centre for SiBs', dedicated to working with commissioners, delivery organisations and intermediaries to overcome the specific challenges faced in developing social impact bonds. This support has seen the development of seventeen social impact bonds to date, with many more in the pipeline. These approaches are effective in accelerating the issuance of social impact bonds at this early stage. In the USA, the Harvard Kennedy School of Government has established a SIB Lab that provides technical assistance to state and local governments using social impact bonds. The SIB Lab is currently assisting ten state governments in the US and the State of Utah is establishing its own SIB Lab.

Recommendation: *Support efforts to establish a 'kitemark' or labelling system that identifies social finance products for particular segments of the market.*

For example, retail investors with an interest in impact may like to easily know which products are classified as 'impact products'. In France, solidarity financing products are clearly identified through the Finansol label, which was created in 1997. The label is assigned by an independent committee of experts, and acts to assure the general public that their savings in such products really are helping to finance activities that generate social and environmental benefit. To date, there are more than 120 solidarity saving products labelled Finansol.

CONCLUSION

The need to bridge the gap between investors and social entrepreneurs is as great (if not greater) for social impact investment as it is for mainstream investment. Without functioning intermediaries there will be no effective way of allocating capital to impact-driven organisations. While government does not need to act directly in this market, experience demonstrates that a bootstrapping role can be very helpful, and a material trigger for the engagement of investment capital.

SOURCES OF IMPACT CAPITAL

Through social impact investment, government has the opportunity to engage a wide array of investors to help meet the needs of society, ranging from large financial institutions and pension funds to philanthropists and retail customers. Government has at its disposal a number of policy tools to encourage these investors including tax and regulatory incentives, its own investment and clarification of laws and guidance related to different investors.

Today, for most countries in the Taskforce, the dominant sources of social impact investment are government, community finance institutions, credit unions, philanthropists and their foundations, and high net worth individuals.

The wider public's involvement in social impact investment is still relatively limited. There are some examples like the solidarity savings products in France, the Calvert Community Note in the US and online crowdfunding platforms in several countries that enable individual savers to get involved in impact investing. Triodos Bank has published a paper to stimulate policy discussion in this area. The paper outlines a number of benefits from expanding the market in this way such as increasing diversity in the market, building a more resilient investor culture, stimulating more long-term-thinking and encouraging inclusive participation.[11]

A number of traditional investors have engaged in impact investment. Large financial institutions including Goldman Sachs, JP Morgan, UBS, Credit Suisse, Deutsche Bank and Morgan Stanley have impact funds. Insurance companies such as ACA in France, Prudential in the US and Zurich in Switzerland are making commitments to impact funds. Pension funds in many markets are beginning to engage, including the retirement savings funds in Quebec (including Fonds de Solidarite and Fondaction) are engaged in some social impact investment, as well as the Teachers' Retirement System of the City of New York (TRSNYC). In Australia, which has the fifth largest amount of superannuation (pension) assets in the world, some like the Christian Super and Local Government Super have already made some impact investments and others are interested and engaged. In June 2014, five of the largest UK local authority pension funds together committed £152 million to social impact investing through a joint 'Investing 4 Growth' fund.

Large corporations have largely yet to get involved outside of Japan, where corporate impact investment funds from the likes of Mitsubishi Corporation are one of the main sources of social impact investment. A number of corporations are however engaged in other ways, such as supporting the development of impact-driven products or organisations, including Vodafone with M-PESA and Danone with Grameen.

THE MARKET CHALLENGE

The Taskforce's Working Group on Asset Allocation has made a number of observations about the barriers that exist to bringing investors into social impact investment. These include the potential heightened risk factor, conflict of duty and emergent nature of the nascent sector.

A Risky Proposition

While successful impact investments have been made in many places around the world, it is still seen as a relatively risky investment to the mainstream finance industry, which is inherently conservative in nature. The Asset Allocation Working Group found that different types of investors are affected by different risks, in different ways. For example, for pension fund managers, capital risk was a key concern given their need to grow the capital base over the long term; while liquidity risk, the need to quickly access capital invested, was less of a priority. For foundations, impact risk was a critical factor. For independent financial advisers, the unquantifiable risk of new products is high given their need to benchmark track record against others.

11 Triodos, 2014, "Impact Investing for Everyone: A blueprint for a new culture of long-term retail social investing"

An uneven playing field

Social impact investing also suffers relative to other investment disciplines, due to its position as a nascent market, which has yet to attract the support of government in many places. The Asset Allocation Working Group found that a lack of specialism, a lack of appropriate opportunities and disproportionately high transactions costs are all barriers to greater allocation. As a consequence, the social impact investment market cannot compete with more established investment sectors, especially those that benefit from tax incentives. For example, governments often provide tax relief to companies they wish to help raise finance e.g. young enterprises/ green companies. Similar schemes usually do not apply to impact-driven businesses.

Barriers for potential investors

The Asset Allocation Working Group also found that conflict of duty is an important barrier for many investors. Many managers of capital feel they are unable to make social impact investments because of regulation. An important example lies in the definitions of the duties of trustees of charitable foundations and pensions funds.

Restrictions on Philanthropists

A number of philanthropic foundations have engaged in supporting the development of impact investment and the use of endowment assets, such as the Laura and John Arnold Foundation, Bertelsmann, Case, Esmee Fairbairn, Ford, Gates, Robin Hood, Kellog, MacArthur, Omidyar Network, Pershing Square, Rockefeller and Skoll. In Italy, huge banking foundations such as Cariplo, which together hold €42 billion in total assets, are picking up the challenge.

However, in many countries legal or regulatory definition around the duties of trustees of charitable foundations create an impediment to their investing their endowments in impact-driven organisations in order to support their overall mission. For example, in the UK, the Law Commission concluded in its recent consultation paper "that the law concerning charity trustees' powers to make social investments is not as certain as it should be, and would benefit from being put on a more solid footing".[12]

Restrictions on Pension Funds

Pension funds are a huge potential source of impact investment capital. The worldwide shift now underway towards defined contribution pension plans creates the possibility for significant personal savings to be directed into impact investment and giving the general public the ability to allocate an appropriate portion of their portfolios to it.

However, in many places pension funds are yet to get involved due to restrictions, perceived or statutory, on their trustees around fiduciary duty. For example, the Employee Retirement Income Security Act (ERISA) rules in the US, and similar rules elsewhere can be taken to mean that investing for any reason other than maximising financial return is irresponsible or imprudent. However, this need not be the case. Impact investing does not automatically equate to a trade-off between financial return and social impact and many impact investments, including in care for the elderly, energy and health, can be considered as highly prudent from the point of view of future pensioners' interests.

There is a need for a clear 21st century definition of fiduciary responsibilities, setting out the duty to factor impact into their investment decisions and their reporting. In some places, this will require legislative or regulatory changes. In others, it will require the clarification of existing laws and regulations.

Restrictions on Retail investors

Retail investors are often restricted from investing in funds – by regulations intended to protect them. In particular, crowdfunding platforms face problems with securities laws that are designed to protect investors from fraud. These laws have left even large platforms like Kiva from being able to offer any financial return, without becoming a licensed trading entity. Often financial promotion rules set minimum investments at a level that is beyond the reach of most savers; and there are relatively few social impact investment products specifically designed with retail investors in mind.

POLICY LEVERS AND OBJECTIVES

Governments have historically played a significant role in influencing the development of capital markets, through regulation and tax incentives. We expect that it has an equally important role in the development of the sources of capital for impact investment. To encourage new investors to strengthen the ecosystem, policymakers have a number of levers across all three roles. These include government resources, guidance and regulation, and tax and regulatory incentives.

Acting to Increase Investment

Objective: Increased supply of commercial investment for impact-driven organisations.

Recommendation: *Provide matching finance to pump-prime the impact investment market, where it is emergent, or provide first loss facilities*

12 UK Law Commission Consultation Paper "Social Investment by Charities".

and other guarantees, and capitalise a social impact investment wholesaler or other impact investment funds.

Government, by using its resources, has a role in helping improve the credit worthiness of impact-driven organisations to help crowd-in commercial investment. Such measures are commonly used in traditional financial markets; yet they remain limited in social impact investment. Philanthropic foundations have a potential role to play in directing part of their grant financing into such facilities, but governments too can use its resources to leverage impact investment. For example, the Australian Government's Community Finance Fund for Social Entrepreneurs provides a grant of up to 37.5% to social entrepreneurs in low-income communities to help improve their credit worthiness, enabling them to access capital from elsewhere.

In the UK, Big Society Capital has been mainly financed by government through legislation to utilise unclaimed assets. The ruling party of Japan is proposing legislation to use unclaimed banking assets for social purposes, including the reconstruction of the Tohoku area hit by tsunami, earthquake and nuclear disasters in 2011, as well as education, care of the elderly and community regeneration throughout Japan.[13]

Building the Ecosystem

To encourage more impact investors, governments can also use incentives as a lever. Incentives can increase the flow of tax-advantaged and regulation-advantaged capital.

Objective: New investors entering the social impact investment market.

Recommendation: *Provide tax incentives for social impact investment.*

In the USA, the New Markets Tax Credits have for years provided a tax incentive for investment in underserved communities to the tune of $3.5 billion a year.

In its 2014 budget, the UK government extended the tax incentive offered for investment in SMEs to include investment in charitable organisations. Investment by way of quasi-equity, social impact bonds and unsecured debt now benefit from the Social Investment Tax Relief, which enables investors to set-off such investment against income tax liabilities at a rate of 30%, and allows any losses to be set-off against income or capital gains tax.

Recommendation: *Provide regulatory incentives for social impact investment.*

In the USA, the Community Reinvestment Act (CRA) was established in 1977 to channel capital from banks to underserved communities through Community Development Financing Institutions (CDFIs). It has proved a powerful regulation-advantaged lever, which saw a total of $55 billion channelled through CDFIs in 2013 alone.[14]

Recommendation: *Examine specifically what can be done to bring social impact investment to the mass retail market.*

In addition to tax relief, the mass market can be encouraged to invest in impact, provided they have the means to do so. Funds that are specifically aimed at retail investors could be considered. For example, the Triodos Fair Share Fund is funded by retail investors in the Netherlands, and has invested over €200 million of both debt and equity in microfinance institutions around the world. Charity bonds are another way that the public can invest in social impact. The UK's leading disability charity, Scope, raised £2 million through a bond in 2012.

In France, legal reform in 2008 required that every employee be given the choice of an impact investment product in their savings or pensions plan through the "fonds d'investissement solidaires dits 90/10". Making it mandatory, along with highly positive media coverage, is thought to have boosted the market from €478 million of assets under management in 2008 to €3.7 billion in 2013, around 6% of which is currently invested in some 2,300 social enterprises.

Shaping the Environment

There is a need for a clear 21st century definition of the responsibilities of trustees, setting out their duty to factor impact into their investment decisions and their reporting. In some markets this will require legislative or regulatory changes. In others, it will require the clarification of existing laws and regulations.

Objective: Fewer legal and regulatory barriers in the way of potential social impact investors.

Recommendation: *Adjust fiduciary duty of pension funds to allow them to account for impact when making investments.*

The US National Advisory Board has recommended that the Internal Revenue Service (IRS) should consider updating its standard for so-called "jeopardising investments" with language from some state legislation to allow consideration of "an asset's special relationship or special value, if any, to the charitable purposes of the institution".

13 Policy paper of the Liberal Democratic Party 2013. Available at: http://jimin.ncss.nifty.com/pdf/sen_san23/j-file-2013-06-20-3.pdf. See also National Council for Utilising Unclaimed Assets: http://kyumin.jp/media/pickup/
14 www.cdfi.org

South Africa has altered its fiduciary regulations to require that investors "consider any factor which may materially affect the sustainable long term performance of the investments including those of an environmental, social and government character".[15]

Recommendation: *Remove legal restrictions on philanthropic foundations, to allow them to direct more of their investments towards social impact investment.*

In some countries, foundations have already begun to direct more of their investments towards impact. F.B. Heron Foundation in the United States has taken the decision to invest all of its endowment in achieving impact and the KL Felicitas Foundation is on track to have a 100% impact investment portfolio by the end of the year. In the UK, the Esmée Fairbairn Foundation has implemented an allocation to impact investment that already reaches 3%. In other countries, this may require the introduction of a supplementary statutory power to allow foundation trustees to make impact investments.

Recommendation: *Reduce restrictions on retail investors engaging in social impact investing, e.g. through crowd-funding and other measures.*

So far, France and Italy are among the few countries with a law regulating crowd-funding. In France, regulations have been changed to allow the public to invest up to €1 million in impact-driven organisations through crowd-funding platforms. In Italy, a law has been passed that specifically concerns equity crowd-funding platforms. The US Jumpstarting Our Business Startups (or JOBS) Act, passed in September 2013, modernised regulations that were put in place almost 100 years ago to, among other things, enable crowd-funding platforms to make investments in small companies.

Recommendation: *Encourage pension funds and providers of other tax-advantaged savings schemes and products to provide social impact investment options as part of their offering.*

In France, legislation was passed six years ago to require pension fund managers and providers of tax-advantaged savings schemes to offer the option of making impact investments. In particular, the shift in pensions to defined-contribution plans opens up a major opportunity for pensioners to allocate an appropriate portion of their portfolios to impact investment.

Recommendation: *Investigate how social impact investments can be integrated into existing regulatory frameworks for banks, insurance companies and investment funds.*

As well as pension funds, philanthropic foundations and the mass market, there other large sources of potential impact investment from banks, insurance companies and mainstream investment funds. Once the market is sufficiently developed, it is expected that all these investors will incorporate impact across their entire portfolios. In the meantime, a review of regulation and standards in place to direct and protect these investors may identify places where adjustments could enable increased opportunities for social impact investment today. For example, such a review of regulation could encompass the Basel Accord, the global regulatory standard in place to protect the banking sector.

CONCLUSION

Many of the barriers to impact investment identified by the Taskforce's Asset Allocation Working Group can be removed by enlightened policymaking. The key policy levers that governments can use to facilitate impact investment include removing regulatory constraints on fiduciary duty that currently deter potential impact investors, and, where possible, providing tax incentives, regulatory incentives, supplying catalytic capital and building market infrastructure. Use of these policy levers will free up large pools of capital to address pressing social needs.

15 Amendment included in Regulation 28 of the South African Pension Funds Act No. 24 of 1956, effective from 1 July 2011.

CONCLUSION

It is clear that there are a number of opportunities for policy makers to help impact investment develop as a powerful force through Government's roles as a market-builder, a key actor in its own right and a market steward responsible for removing barriers and safeguarding the mission of impact-driven organisations.

Government is called upon to make a number of important overarching policy decisions. A number of objectives have been outlined in previous chapters, along with specific recommendations as to how they can be achieved. These are summarised below. Whilst the focus is domestic, many policy actions can also be considered in an international development context.

		Policy Roles and Recommendations		
Ecosystem Component	**Policy Objective**	**Market Building**	**Market Participant**	**Market Steward**
Overall Ecosystem	Political leadership, for the sector with a dedicated government team and resources	Appoint a senior-level minister to act as champion within and beyond government, helping to formulate and implement appropriate policies that build market infrastructure and support the sector in meeting numerous challenges		
	Greater government knowledge and expertise about the existing social impact investment ecosystem	Develop a clear assessment of the different components of the social impact investment ecosystem at a national level and monitor over time		
	Opportunities for social impact investment targeted towards policy areas where it can have greatest leverage in the local context		Identify the size and area of government spending where there is greatest need for innovation and/or funding challenges	
Impact-Seeking Purchasers	Increased effectiveness of government's role as an outcomes commissioner	At a corporate level, provide capability-building support to departments and local government, in order to support commissioners seeking to pay for outcomes	Focus government commissioning processes on social outcomes where appropriate	
		Calculate and publish the cost to government of social issues, as a way to place a value on prevention, and hence encourage the market to find cost-effective solutions	Create consolidated domestic outcome funds for use by government departments that are unable to recognise the full value of social outcomes they achieve	Clarify government accounting conventions to support the use of outcome payments
		Support the development and adoption of standards in impact measurement by ensuring government adopts them in its own reporting and contracting requirements		

Ecosystem Component	Policy Objective	Policy Roles and Recommendations: Market Building	Market Participant	Market Steward
Impact-Driven Organisations	Increased resources and support for impact-driven organisations to strengthen their operations operations and grow	Provide capability-building funds for impact-driven organisations		
		Provide more opportunities for impact-driven organisations to access different types of capital, including seed capital, early-stage risk capital and growth capital		
		Expand SME business support to impact-driven organisations		
	Increased flow of talent to build and grow impact-driven organisations	Encourage existing impact-driven entrepreneurs and new entrants by celebrating success in the sector and offering rewards for innovation		
		Consider tax incentives for impact-driven organisations and their employees		
	An appropriate regulatory and legal framework for impact-driven organisations			Provide legal forms and support accreditation systems to allow profit-with-purpose businesses to lock in their mission
				Relax restrictions on social sector organisations engaging in revenue-generating activities
Channels of Impact Capital	A developed social impact investment culture, and a range of intermediaries managing impact capital and providing professional advice and services to the social impact investment sector	Create a social investment wholesaler to act as a market champion, potentially financed by dormant assets in bank accounts, insurance companies and pension funds		
		Consider early stage support to specialist impact investment funds, intermediaries and advisory firms		
		Support efforts to enable access to a social stock exchange		
		Support the use and development of new and innovative social finance products, including social impact bonds		
		Support efforts to establish a 'kitemark' or labelling system that identifies social finance products for particular segments of the market		

Ecosystem Component	Policy Objective	Policy Roles and Recommendations: Market Building	Market Participant	Market Steward
Sources of Impact Capital	Increased flow of investment from mainstream investors to impact-driven organisations		Provide matching finance to pump-prime the impact investment market, where it is emergent or provide first loss facilities and other guarantees, and capitalise a social investment wholesaler or other impact investment funds	
	New investors entering the social impact investment market	Provide tax incentives for social impact investment		
		Provide regulatory incentives for social impact investment		
		Examine specifically what can be done to bring social impact investment to the mass retail market		
	Fewer legal and regulatory barriers in the way of potential social impact investors			Adjust fiduciary duty of pension funds to allow them to account for impact when making investments
				Remove legal restrictions on philanthropic foundations to allow them to direct more of their endowments towards social impact investment
				Reduce restrictions on retail investors engaging in impact investing, e.g. through crowdfunding and other measures
				Encourage pension funds and providers of other tax-advantaged savings schemes and products to provide options to include social impact investments as part of their offering
				Investigate how social impact investments can be integrated into existing regulatory frameworks for banks, insurance companies and investment funds

ANNEX

This paper was prepared by Aimie Cole and Stephen Brien in their roles as members of the Chair's Executive Team for the Social Impact Investment Taskforce.

It is the result of analysis conducted on the existing and potential ecosystems in the countries of the Social Impact Investment Taskforce. It draws on the findings of the National Advisory Boards and Working Groups, and a cross-country expert working group provided guidance and input throughout the development of this paper.

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