Rotterdam experiments with social impact bond

Social investor helps long-term unemployed

Els Sol

The first social impact bond (SIB) in the Netherlands got off the ground recently in Rotterdam. It takes the shape of a new financing instrument, with private investors providing municipal capital to help vulnerable groups in the labour market find employment. The greater the rate of success, the higher the yield. But, according to Els Sol, this approach is not void of risk. Investors looking for quick returns need to be avoided.

Dutch municipalities have been assigned responsibility for resolving a multitude of social problems including those related to healthcare and benefits. In many cases, the people concerned face multiple problems. The solution requires money and knowledge, neither of which are sufficiently available to the municipality. Take work reintegration for example. Municipalities find themselves facing harsh budget cutbacks in this field. Re-employment programmes, especially those for the unemployed facing multiple problems, are expensive and often require an approach that spans clearly defined municipal budget years. Not surprisingly, driven by budgetary discipline and deep cutbacks, municipalities have shifted their focus to reintegrating unemployed people who can find jobs relatively cheaply and easily. Consequently, more people at a greater distance from the labour market are being left out in the cold. Additionally, municipalities – especially the smaller ones – suffer from a lack of knowledge as to which labour market interventions actually succeed best in guiding their citizens into paid employment. This also ties in with budgetary disciplines that hamstring programmes spanning several years or requiring scaling-up, therefore generating insufficient information to adequately test whether the interventions are successful.

Social investor

The SIB promises to provide a solution to these problems. It is an investment product that uses private funding to solve social problems, thus introducing a new player in the municipal arena: the social investor. The investor offers service providers working capital and, in so doing, carries the financial risk. Together with government, several concrete goals are formulated in advance and potential yields are only paid out once these predetermined goals are actually achieved. If performance exceeds the goals set, government pays out higher amounts and the investor earns a higher yield. However, if the predetermined goals are not achieved, the investor suffers a loss on part or the overall investment. Statistical methods are used to measure target group improvements in order to ensure the results are achieved.

The rationale behind the SIB has caught on worldwide and expectations are that policy makers and innovators will be keenly interested. Most SIBs target children
and youths without an education, training or a job. However, there are also SIBs for rehabilitating former prisoners and the homeless. Over the past four years, a total of twenty-six SIBs were launched in eight different countries in the world. Fifteen SIBs are currently ongoing in the United Kingdom, where the first SIB was established. SIBs have also been launched in the United States (5), Australia (2), Canada (1), South Korea (1), Belgium (1), Germany (1) and the Netherlands (1). Although the first investments in the UK originated largely from non-profit foundations, a broader group of investors has gradually developed: commercial banks including the ABN AMRO in the Netherlands and Goldman Sachs in the US, institutional investors in Australia and social investment funds in the UK.

Rotterdam

The Dutch SIB was established on 17 March in Rotterdam with the aim of helping youths make the transition from benefits to lasting employment or studies. The programme supports 160 youths aged between 17 and 27 starting their own companies, finding paid employment or a suitable study. Most of the youths do not have any basic qualifications, are often facing debt and come from a troubled past. The organisations involved are the Municipality of Rotterdam, the social investor Start Foundation and ABN AMRO. The Buzinezzclub organisation was selected by the Municipality of Rotterdam as the service provider based on its successful experiences in the past when placing youths. The Social Impact Bonds Rotterdam Foundation is also involved for managing the flows of funding and Deloitte and Ortec Finance for (interim) monitoring and evaluation. ABN AMRO and the Start Foundation have together invested EUR 680,000 in the Buzinezzclub programme. The Buzinezzclub also runs a risk if the youths are not placed (no cure, less pay), and just like the investors, earns more if they are placed more quickly than agreed (quicker cure, more pay).

Yield

The arrangement is that the municipality pays the investors and the implementing party back using yields based on the number of benefits the municipality saves as a result, measured against a reduced benefit duration. The yield can amount to as much as 12% annually. The quicker the youths leave the programme successfully, the greater the yield for the investor. The experiment will run for two years. As is the case for all SIBs, this SIB has its own characteristics. Internationally speaking, the Rotterdam SIB is still relatively limited in scope and duration. The first SIB that was launched in the UK has a duration of seven years (2010-2017). The Rotterdam case is exceptional because the reintegration company also generates a yield if the programme books success. It is unclear whether investors can deduct potential losses from their tax burden in the form of a gift.

In Rotterdam, 160 youths aged 17 to 27 are receiving support in finding employment or a suitable study.
Benefits
The SIB delivers a number of interesting benefits. Vulnerable citizens receive help they would otherwise not have. Banks generate a yield while being socially engaged as well. The SIB solves municipal liquidity problems and prevents red figures from appearing in the municipal budget.

SIBs attract criticism due to suspicions surrounding private investors.

It serves as a way to borrow money without it appearing as such in the books. If the SIB proves successful, this leads to better social outcomes and more efficient public spending. As such, SIBs supplement existing publicly-financed programmes. Another equally important benefit is that the instrument obligates municipalities to validate and respond to the results achieved, preventing each of the respective municipalities from having to reinvent the wheel as is currently the case in the municipal arena. What’s more, a well-organised SIB creates space for front-line employees to focus on the ‘right goal’, not only driven by their basic instinct or individual assessment, but an explicitly created theory in use, where creative data is continuously gathered and presented. In short, the SIB is a promising instrument. Its appeal hinges on the involvement of private investors bringing new capital into the social sector, scaling up effective programmes and social innovation, and contributing towards building a social infrastructure.

Complex affair
Nonetheless, SIBs present a number of catches. Financing an SIB is a complex affair in legal and operational terms, demanding the involvement of parties with the necessary research-oriented and financial expertise. In order to convert the effect of the SIB into a financial yield, it is important to correctly measure the outcomes of the services provided. It should also be clear what earnings the investors receive in relation to the results. An SIB therefore requires knowledge of the costs and benefits of the different interventions; knowledge that is by no means readily available. The lack of a track record complicates finding the most suitable supplier for the envisaged service. A possible solution to this problem is to organise a tendering process. Furthermore, its success will depend strongly on the integrity of the data used; the administrations of the participating municipalities will therefore need to be in order. If not, there is a danger of creaming on the part of the service provider.

Quick profits
SIBs have attracted international criticism due to suspicions surrounding the private investors who came up with the idea for this new investment product. Fears are rife, especially in the Anglo-Saxon world. For example, the trade unions see SIBs as a way to quietly privatise public services without lowering government costs or improving service provision. Another drawback identified relates to the additional costs of yet another layer of private bureaucracy coupled with costs
arising due to the yield that has to be paid out to the private investor. Also, because of the tendency towards making quick profits, there is a danger that the help will not reach those that need it most. A situation in which commercial investors determine the conditions governing the services to be provided must be prevented. This would create a scenario in which the goal would not be ‘making a profit by helping the most vulnerable’ but ‘making a profit at the expense of the most vulnerable’. One way to prevent this would be to ensure the involvement of a social investor such as the Start Foundation in Rotterdam.

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