Financial instruments for social impact: Social Impact Bond for Lombardy

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The feasibility analysis for a SIB

Objective
Set the basis for a systemic approach on social impact investing by using SIB as a catalyst.

Content
A step by step approach to the key decisions and process for a SIB deployment including:
- the analysis of the key technical aspects, success factors and constraints
- the identification of the preliminary condition at regional level
- the compliance with ESIF rules
- the definition of an overall regional strategy and set of options on impact investing
Key questions for the configuration of a SIB

A decision tree approach
✓ What is a SIB?
✓ Why use a SIB?
✓ When to use a SIB?
✓ Is the ecosystems ready?
✓ What are the market failures?
✓ Who are the stakeholders? Are they ready?
✓ What are the financial gaps?
✓ What governance options?

The Feasibility analysis for Lombardy region
❖ Why would it make sense for our region to implement a SIB–based approach?
   ❖ Are we ready for a SIB?
   ❖ What market failures to address?
   ❖ What intervention model?
❖ What do we want to achieve at the end?
What is a SIB?

A Social Impact Bond (SIB) is an innovative, payment-by-results instrument, to achieve social impact involving: public authorities, private investors, social organisations.

The public payment is subject to the delivery of pre-defined and measurable social outcomes.
What is a SIB? The stakeholders role

**SOCIAL INVESTORS**

Make the *initial investment* to provide social organisations the working capital necessary for the innovative social intervention. Investors *assume the financial risk* and get a *risk premium*

*Examples of social investors:* Foundations, Individual Philanthropists, Companies (CSR), Banks/ Funds

**SOCIAL ORGANISATIONS (implementing entities)**

With that initial investment, *develop an innovative social intervention*, directly addressing the results *(social outcomes)* contracted between the SIB’s parties.

*Examples of implementing entities:* Social Enterprises, Associations, Cooperatives, NGOs, ...

**PUBLIC AUTHORITIES (commissioners)**

Pay the social investors a specific amount for that contracted result (social outcome), *once (and only if) the result has been achieved.*

*Commissioners are the central, regional or local public entities directly responsible for the public policy domain being addressed by each SIB*

*(INTERMEDIARIES)* Setting a SIB may also require intermediaries (consultants, service providers) to aggregate investors, perform due diligences, negotiate and develop required contracts or to manage the SIB throughout its implementation

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Why to use a SIB?

**CRITICAL ISSUES**
- A growing trend but still limited cases (few within ESIF)
- **Complex** structure and set-up (transaction costs)
- **Regulatory constraints** both at national and European level
- Lack of competence and experience in **impact measurement**
- **Knowledge/cultural barriers at both P:A. and Investors side**

**ADDED VALUE**
- For the P.A: a controlled platform for testing new services and innovative approaches. No upfront payment
- For Social organisations: access to stable financing, assessment on results not on prescribed input/output models
- For Social Investors: blending financial returns with social impact. Possible revolving effect

**KEY ISSUES**
- SIBS are effective **instrument to promote innovation in public policies and build broad partnership**
- Stimulate a **better analysis of the social issues** and a **co-creation** approach between all stakeholders,
- SIBs are **not “grant as usual”**
- There is no one size fits all but **different implementing options (flexibility)**
- Perspective for **scaling** : from stand-alone to SIB programme (on market terms)
- Need for a **common language**
When to use a SIB?

Not all social interventions can be financed through SIBs

SIBs pre-conditions

- a specific social problem with a preventive approach
- public commissioner with budget allocation
- complementary to mainstream public policies
- clearly identify population target groups
- expected outcome must be measurable and clear (i.e. % reduction of NEETS)
- availability of data on the targeted social intervention
- methodologies and metrics for measuring outcomes must be agreed in advance by all parties and included in the initial SIB contract

Potential demand for SIB in Lombardy

- Is Lombardy Public Authority responsible for public policy and/or budget?
- What is the top social challenge?
- Could it be addresses by a SIB?
- What would be an effective outcome?
- What indicator/ metric could be used?
- Are data-set available? (target population, dimension of the social issue, costs, expected outcomes etc.)
# Market Assessment - Key questions

<table>
<thead>
<tr>
<th>Market maturity</th>
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<tbody>
<tr>
<td>• Is the impact investing market mature or at an early stage?</td>
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<tr>
<td>• What innovative social interventions are there in the chosen SIB domain?</td>
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<td>• How are these interventions being funded? By who?</td>
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<table>
<thead>
<tr>
<th>Demand side</th>
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<tbody>
<tr>
<td>• What type of entities are implementing social intervention? (social organisations, social enterprises, social start-ups? National, regional or local)</td>
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<tr>
<td>• Which of them are implementing innovative interventions?</td>
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<td>• How experienced? (track record / past results / credibility)</td>
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<td>• Are there impact measurement methodologies in place?</td>
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<table>
<thead>
<tr>
<th>Supply side</th>
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<tbody>
<tr>
<td>• What about social investors? Philanthropic vs. non-philanthropic. Risk profile/Focus/Type of investment/criteria?</td>
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<tr>
<td>• Are they willing to invest in SIBs? Under what conditions?</td>
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<td>• SIB by SIB or through a Pre-financing Fund? Other alternatives – crowdfunding, social stock exchange?)</td>
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Market Assessment - Lombardy

The Lombardy ecosystem

Maturity of the market of Impact Investing

- Emerging and fast growing phase
- Increased awareness from private investors, economics/management research centre (Politecnico, Bocconi), cooperative and third sector representative

Demand side

- High number of social organisation and social projects
- Low level of Impact investment readiness of social enterprises
- Differentiation between legally recognized social enterprises and de-facto enterprises
- Mainly grant approach

Supply side

- High number of foundations (30% of the whole country)
- An emerging group of impact investors and intermediaries: banks, impact funds, social accelerators, social crowdfunding platform, philanthropic investors, family office

The Italian market for impact investing in 2018 was EUR 210,5M with an estimation of a growth of up EUR 400M in three years time

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The gap analysis- Lombardy

**Social Impact Bond**

**Public Authority**
- Outcome payment stage
  - Limited awareness (SIBs)
  - Short budget cycles
  - Limited scope for public sector innovation and experimentation

**Social Organisation**
- Implementation stage
  - Limited “SIBs-readiness”
  - No mechanisms to identify “SIBs-aligned” social organisations and projects
  - No instruments to improve its “SIBs-readiness”

**Social Investor**
- Pre-financing stage
  - Limited awareness (SIBs)
  - High risk perception (SIBs)
  - Strong demand for mainstream support instruments (donations)

**Gaps to SIBs Set-up**

**Proposed Solution**

- Outcome payment initiative
  - “Delayed grant” instrument

- Capacity-building initiative
  - Grant instrument

- Pre-financing initiative
  - Financial instrument

**Social Impact Intermediaries**

*“Partnership for Social Impact and Social Outcomes Contracting” (ecosystem development)*

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A systemic approach for impact investing in Lombardy (1)

1. CAPACITY BUILDING INITIATIVE FOR SOCIAL ENTERPRISES (GRANTS)
   - Provide qualified support on impact measurement and investment readiness, to social enterprises with a proof of concept for a social intervention
   - **Co-creation** approach for impact
   - Create a pipeline of qualified projects

2. A PILOT INITIATIVE FOR A REGIONAL SIB
   - Testing a new approach **outcome versus output**
   - Identify the *regional social challenge* and data metric
   - Define the operational model and ESF compliance
   - Policy to **attract investors**

3. PRE-FINANCING INSTRUMENT
   - Ideally structured as a Pre-financing Fund providing initial capital for SIB deployments as well socially oriented project:
     - **co-investing** directly in a portfolio of SIB with Social Investors
     - Providing loans to social organisation or to social investors
     - Providing guarantee (protecting part of the initial capital invested in SIB)

*Partnership for Social Impact and Social Outcomes Contracting (ecosystem development)*

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A systemic approach for impact investing in Lombardy (2)
The path towards SIB deployment

Ideally develop a short SIB, pilot project providing evidence and lesson learned for the next programming period

- The objective should be fully line with the relevant ESF Regional OPs (youth unemployment, reduction of school drop-out, etc).
- Beneficiaries should belong to the social economy.
- Ideally, as first trial, investor should be a philanthropic foundation
- Budget expected: appx EUR 1,5m (equal to 3 SIBs) – a balance between the minimum dimension to dilute the transaction costs while not requiring a large initial capital to investors

Finance the outcome contracting-payment initiative, in the form of “delayed grants” paying for SIBs validated outcomes. Following outcome validation, each payment would be made under a pre-contracted lump sum value, set per validated outcome. This can be done on a SIB-by-SIB basis or structured as an Outcome Fund, combining ESIF budget with several sources of Public Sector budget.
SIB and ESIF: key issues

- **Type of instrument**: A financial instrument? A grant? Or both? How can they be combined?

- **Cost options**: current cost options (including all simplified cost options) are still not well adjusted to paying for results / impact measurement mechanisms, *adding an extra layer of complexity when implementing SIBs under ESIF financing.*

- **Eligible costs**: SIBs costs are not fully compatible with eligible costs *i.e. how to cover the investors risk premium?*

- **Content**: societal challenges are complex and crosscutting, *beyond the traditional ESF/ERFD domains and silos.*

- **Duration**: average SIBs duration longer than the duration of regular ESIF projects. *Current decommitment rules are not fully compatible with SIBs financial flows.*

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Trends and next steps

The context

- Improvement in the next ESIF *i.e.* financing not linked to costs but on achievement of results
- Invest EU + ESF Plus
- A general broader consensus and attention on social impact (*i.e.* Business roundtable document)
- Growing market for impact investing

Desired actions

- Wider opportunities for public sector to experiment, test and adjust the intervention
- From feasibility analysis support to call for implementation pilot measure
- A community of practice for peer to peer learning
Thanks for the attention

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