Gordon Institute of Business Science
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Exploration of Social Impact Bonds to fund social development in South Africa

A research project submitted to the Gordon Institute of Business Science, University of Pretoria, in partial fulfilment of the requirements for the degree of Master of Business Administration.

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ABSTRACT

This research explores the feasibility of Social Impact Bonds (SIBs) as a funding mechanism for preventative social development and intervention programmes in South Africa.

Persistent structural inequality in societies compounded by the difficulty of traditional public policies to cope with new economic and social challenges begs the question, how far the third sector can help to meet these challenges and consider taking over from public authorities in some cases. Public services is facing two major challenges; declining productivity and increasing competing needs for public expenditure.

This has signaled a paradigm shift for social programmes, social finance and the third sector.

SIBs are an innovative outcomes-based financial product to fund government social programmes in which private investors provide upfront capital to the service providers, the third sector, to implement interventions to improve specific, targeted social outcomes based on agreed contracts; expected savings from the intervention should exceed the project cost plus the return to the investors.

"*For future success, think big and act small, it is easier to achieve success this way.*" A conducive environment is necessary, each sector requiring different conditions to be met, to increase the feasibility or probability of SIB issuance in South Africa.

Key Words

Social finance
Social impact bond
Social innovation funding
Social funding
Social bond

DECLARATION

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirements of the degree of Masters in Business Administration at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination at any other university. I further declare that I have obtained the necessary authorisation and consent to carry out this research.

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Zakithi Gqibelo Dandala

9th November, 2015

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Chapter 1: INTRODUCTION TO THE RESEARCH PROBLEM

1.1 Purpose

This research explores the feasibility of Social Impact Bonds (SIBs) as a funding mechanism for preventative social development and intervention programmes in South Africa. SIBs are a new financial product currently being piloted across the UK, the US, Canada, Belgium, the Netherlands, Germany and Australia, with many more being considered by other countries.

1.2 Background

Economic austerity in the wake of the 2007-2008 economic crisis in the West (Evans and Fanelli, 2013) created declining social budgets in the face of increasing social needs. This created social deficits which thrust the third sector, diverse non-governmental organizations, into the spotlight as governments looked to them to fill the deficits (Ishkanian & Szreter, 2012). The third sector are organizational forms located between the governments and the private, for-profit world; which include nonprofit organizations (NPOs), private voluntary organizations, philanthropic and operating foundations (Anheier, Seibel 1990). Emerging theories of nonprofits in the 1970s cited government failure, market failure or some combination of public and private deficiencies in the delivery of quasi-public services as the catalyst for the formation/ emergence of nonprofit organisations.

This is in line with the current social, economic, cultural and political roles / functions which nonprofits continue to play in society today; helping to shape and formulate policies at local, regional, national and even international levels (Anheier, Seibel, 1990). This multi-function role has been met with a positive response at the international level (Defourny, Hulgård & Pestoff, 1990), particularly when examining the economy from a tri-polar perspective, each pole representing a different sector of society, namely government / public sector, private sector and households and the civil or third sector. In society today, the third sector is involved in the allocation of resources through the production of many quasi-public goods and services and the redistribution of those goods and services, through voluntary contributions, in cash, in kind or through volunteering (Defourny et al,1990).

1.3 Problem

Persistent structural inequality in societies, compounded by the difficulty of traditional public policies to cope with new economic and social challenges, begs the question, how far the third sector can help to meet these challenges and consider taking over from public authorities in some cases. The increasing Gini-coefficient in South Africa is a case in point. This is exacerbated by public services across the world facing two major challenges: declining productivity of public services and increasing competing needs for public expenditure, despite increasing public expenditure (Keohane N., Mulheirn I., and Shorthouse R., 2013). Thus the challenge has been to increasingly get more for less in public services. Governments require innovation premised on enhancing operational autonomy of frontline professionals and practitioners to encourage new thinking. However, this requires flexibility, which separates financial accountability from control over the service provided, an aberration of the financial accountability and control of public service by the government.

This has signaled a paradigm shift for social programmes, social finance (or social service funding) and the third sector (Stoesz D., 2014). Social programmes needed to transform from unconditional entitlements to evidence-driven policy (Edsall, 2012) and social service finance required flexibility; it could no longer be the responsibility of the government alone.

The solution to most crucial social problems facing contemporary societies has been the collaboration and co-ordination between the public, civil and private sector (Bryson and Crosby, 2006). The requirements of the new paradigm further alleviate the twin problems of falling productivity and long-term fiscal pressures.

1.4 Context

Traditional funding sources for NGOs have been steadily declining in South Africa, particularly international funds, as South Africa is viewed as a middle-income economy (Kabane, N., 2011). Many international institutions, such as the European Union, have opted to either no longer fund South African NGOs or to channel their funds through

South African government ministries, by way of bilateral and multilateral agreements. Yet the government's inadequate expenditure of funds has led to a further decrease in donor funding (Kabane, 2011). In 2013, 30% of South Africa's NGOs were forced to close due to funding constraints!

However, issues of poor management, lack of transparency, poor planning and strategy have been major contributors to decreased funding. Failure to adapt to the increased requirement to adhere to monitoring and evaluation standards, which has forced many NGOs to corporatise, has decreased access to funding (Pratt, B., Myhrman, T., 2009). Furthermore, the emergence of the 'report culture' has placed more emphasis on measuring and counting activities completed, performance indicators met and output achieved. Unfortunately, these demands for rigorous standards of accountability, transparency and financial self-sufficiency imposed by donors have had the unintended consequence of distancing NGOs from the very communities they are meant to serve (Charities Aid Foundation, 2012).

The recession reduced private and corporate donor funding (Charities Aid Foundation, 2012), which has led to an increased reliance on government funding. However, accessing government support and forming partnerships with government has proved difficult for many NGOs seeking to obtain funding and build capacity to fulfill their mandates (Habib A., Taylor R., 1999). This inaccessibility has been exacerbated by the lack of transparency or standardised criteria for government financing of social services, which has led to discrepancies in the allocation of funds to NGOs (Lombard A., 2008). This has continued to put strain on the sustainability of NGOs in South Africa, and has increased the competition for shrinking funds, winners being determined largely by their ability to professionalise their services.

1.5 Motivation

The Bryson and Crosby (2006) approach, informed by the strong mandate of the public sector, the flexibility of the private sector and the community and localisation orientation of the civil sector, ushered in the next era of evidence-based social programme funding through the structure of Social Impact Bonds (SIBs) (Stoesz, 2014). SIBs are a type of payment-by-results (PbR) approach. Under PbR, the provider of public services receives payment once certain, pre-agreed outcomes have been achieved. They receive part / none of the payment upfront, the balance being contingent upon achievement of specific outcomes. PbR was an attractive approach to policy makers, because government devolved operational autonomy as providers assumed the financial risk. Providers, in turn, were permitted to design their own interventions, which government hoped would inspire innovation. Government leveraged private investment upfront.

There are three types of PbR approaches, their differences being determined by the source of finance for the reward-funded programme or PbR, while government funds all the reward payments irrespective of source of finance. The three models are (Keohane, Mulheirn and Shorthouse 2013):

1. Public finance, government delivered
2. Public finance, non-government delivered
3. Private finance, non-government delivered

Under the first model, public money is used to finance interventions and public bodies provide the services. Since financial risk of failure is retained within the public sector, the incentives are likely to be limited and risk of failure is unlikely to act as a major spur to improvement. It is further questionable how credible it would be to cut public spending on services that are performing poorly, as this could raise questions around efficiency, rather than the importance of public service.

Under the second model, the service is outsourced to a private, voluntary or community sector, such as nonprofits or social enterprises. This model carries payment risk for the service provider as payment is contingent upon certain outcomes being achieved. While this model increases the potential pool of service providers, it also requires them to provide their own upfront capital. The third model increases the risk to service providers and cost to government, as government must demonstrate a big enough pay-off for investors to want to get involved, whilst transferring greater risk to service providers. This, in turn, offers the sharpest incentives to service providers to find better ways to deliver, and is usually accompanied by large amounts of finance being required upfront to fund the services. This automatically excluded smaller and less resourced service providers unable to bear the risk, irrespective of their capability to deliver. This reduced the performance risk and financial responsibility of government.

A variation of the third model of PbR are Social Impact Bonds (SIBs), a financial instrument that links private capital with social service providers (Disley et al., 2011;

Social Finance, 2011; McKinsey & Company, 2012; Third Sector Capital Partners, 2012).They are an innovative outcomes-based financial product to fund government social programmes (Joy M. & Shields J, 2013) whose design incorporates incentives to maximise the social benefits from the sought-after outcomes. They represent a cross-sectoral collaboration in which private investors assumed financial risk by providing upfront capital to the service providers, usually the third sector, to implement interventions to improve specific, targeted social outcomes based on agreed contracts (Warner, M, 2013).

The SIB concept is straightforward:

I. Inject private-sector capital into traditionally public-sector activities, producing more cost-effective practices in both sectors.
II. Private investors put up capital to fund interventions that are too big or too risky for the public sector.
III. Performance targets are established,
IV. and if the private sector delivers, investors are rewarded with profits.
V. If the performance targets are not met, the government does not have to pay for the services delivered (Roman J., 2013).

The appeal of SIBs is that everybody could win; philanthropically-oriented investors have an opportunity to leverage their endowments with the potential to receive a profit, allowing them to reinvest those funds in future in another cause. Investors accomplish their goal to make a socially beneficial investment even when they do not earn a profit. Where the programmes or inventions are effective and successful, the government pays for a risky intervention or programme, funded by private investors, that otherwise may not have been tried (to the detriment of society). This provides a future cost saving to government by way of future payments no longer having to be made (because of the successful intervention programme). Civil society or nonprofit service providers receive multi-year funding upfront to deliver programmes with quantifiable outcomes.

SIBs can ease the tension and the limitations of the three PbR models. They seek to resolve some by the possibility of the following benefits:

- Pluralism: SIBs expand the sources of investment or diversity of investors, beyond just private investors, and make funding available to a wider range of capable organisations. SIBs facilitate the expansion of providers by providing direct cash to overcome cashflow problems which usually make expansion or scaling difficult.

- Specialism: SIBs bring greater expertise by allowing smaller and more specialist organisations to get involved in delivery without cash flow hindrances.
- Information: SIBs allow policy makers to evaluate the effectiveness of interventions during the delivery, whilst allowing service providers to provide learning on the job. This continuous information gathering and evaluation speeds up the typical process from small-scale pilot to evaluation to implementation/scaling (Liebmann, J.B., 2011).

The rationale for the development of SIBs was that incentivising public service improvement through performance contracts would focus service providers' efforts on the issues that mattered most to policy designers (Warner, M., 2012), as contracts being linked to specific outcomes encouraged goal clarity. It is important to note that SIBs were seen to be useful for scaling proven, not promising or untested, interventions, whose impact would be measured in total benefits to society, not just financial benefits (McKinsey and Co, 2012).

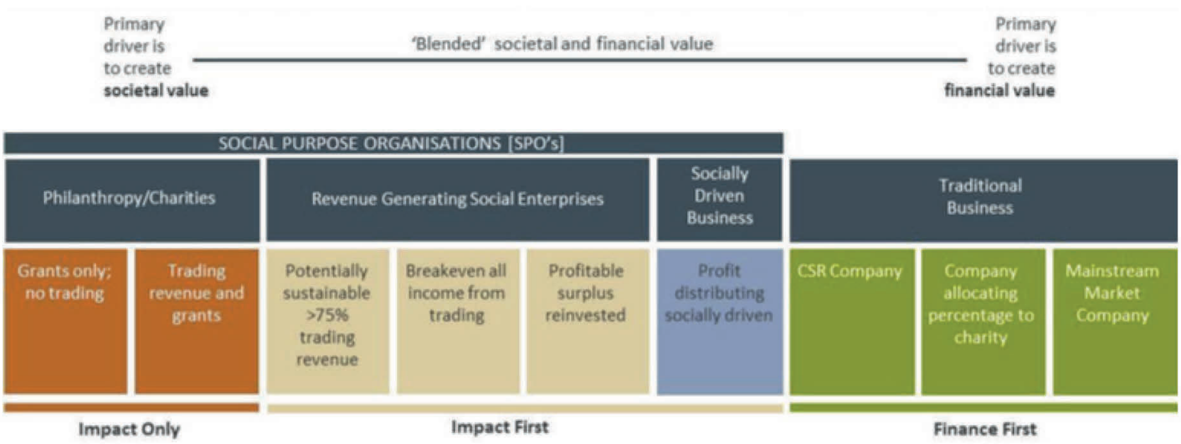
Furthermore, SIBs allow government to invest in prevention programmes among societal groups typically lacking a voice and visibility in the broader political system in which they usually underinvest (Warner, 2012). They infuse private capital into under-resourced sectors to create a social service infrastructure that reduces the harms experienced by those in crisis, while simultaneously reducing their burden on the state. However, such programmes require positive spinoffs to attract a diverse pool of investors. The goal is not to replace the public sector (Roman 2013).

Private investors receive their return on their investment from government when the service providers meet the predetermined social outcomes. The returns are paid from the savings from future budgets that government makes, due to not having to fund these social ills which the agreed outcomes addressed. Returns to investors accrue on a sliding scale with an upper-limit; thus an increase in social value correlates with the increase in investor returns (Disley, E., Rubin, J., Scraggs, E., Burrowes, N., & Culley, D. M., 2011).

The monetization of social outcomes is a challenging task. The challenge is premised on determining how to quantify social returns that accrue from social services into financial compensation for private investors. Furthermore, the novelty of the SIB structure brings with it concerns on the profiteering from social development and complexity in terms of SIB design, set up and implementation, costs and associated risks (Warner, M., 2012; 2013). Because of the need to quantify and monetise returns for investors, SIBs rely on positivistic evaluation designs that maintain a control group, based on the belief that what is important can be known and measured objectively (Guba and Lincoln, 1994).

The first SIB was issued in September 2010 by the United Kingdom government in partnership with Social Finance Ltd (Disley et al, 2011). It was an impetus for SIB design and development in the USA and across the world where SIB projects were being piloted (Warner, M., 2013). Limited academic papers on the efficacy of SIBs or their impacts are available, as the first SIB matured in September 2015, but there is considerable research on the lessons learnt regarding SIB planning and implementation, which can inform the launch of future SIBs (Disley et al, 2011; Disley, E., Rubin, J., 2014). The mid-term findings of this first SIB show that service providers are delivering agreed social outcomes, putting investors in line to receive the return on investment (Disley, E., Rubin, J., 2014). The location of SIBs on the investment spectrum, illustrated in Table 1 below, is as yet unconfirmed. What is clear is that SIBs provide a blended value to the various SIB actors.

Table 1: The Investment Spectrum



Source: Wilson, K. E. (2014) (Adapted from EVPA, 2011)

1.6 Business Need

Business today is under increasing pressure to adopt or improve its corporate social responsibility (CSR), and this pressure has strategic and moral imperative (Boulouta, I., Pitelis, C.N., 2013). The argument here is that business has obligations to their shareholders and to multiple stakeholders, including the society at large, and hence they have a role to play in addressing some of the 'ills of globalization' as they were and are the primary beneficiaries of this globalisation (Freeman, 1984; Wood, 1991; Carroll, 1999). In South Africa, a private-civil sector approach is used in the form of BEE, which requires companies to invest 1% of post-tax profits into the civil sector, with no or limited government participation.

Whilst this has had a positive impact on society, and has to some extent improved the financial sustainability of NGOs in South Africa, the disjointed approach has limited the impact of these funds on society at large. This is despite the formation of organisations such as Tshikululu Investments to pool these funds from different businesses. SIBs present an opportunity to pool funds, for measurable and agreed upon impact, giving the investors a financial return, a unique feature currently not found in CSR spending focused on social upliftment / development in South Africa. Returns in the development sector are associated with social entrepreneurship or social impact investing.

1.7 Objectives

SIBs represent an important social finance innovation in South Africa. No SIB has been released in South Africa to date, although exploratory studies are currently underway. The African Investing for Impact Barometer (2014) study revealed that 93 out of 213 private equity funds, equivalent to R203m, and 132 of 951 asset management funds to the value of R514m, combine financial returns and positive impact on society through "investing for impact" (IFI) strategies. However, 28% and 13%, respectively, of the funds are directed to responsible funding. Thus while the IFI space represents a significant part of the South African investment industry, this has not staved off the funding crisis plaguing the third sector in South Africa. Thus this research presents an exploratory analysis of SIBs in social service finance by exploring whether:

1. opportunities exist in South Africa for the use of SIBs;
2. SIBs are a viable investment and social development tool;
3. SIBs could attract investors in the South African market.

1.8 Scope

In this report, the basic structure of the SIB will be presented, which will include an examination of how SIBs work, the scenarios where they work, the parties involved and their roles. This will be followed by a study of the theoretical perspective of SIBs, or the evolution of social service finance to SIBs and lastly a critique of SIBs. The requirements to make SIBs attractive to investors will then be discussed alongside a discussion on the feasibility of SIBs to the South African market, guided by responses from interviews with potential South Africa SIB market participants. This discussion will be informed by the lessons learnt from the emerging SIB market worldwide.

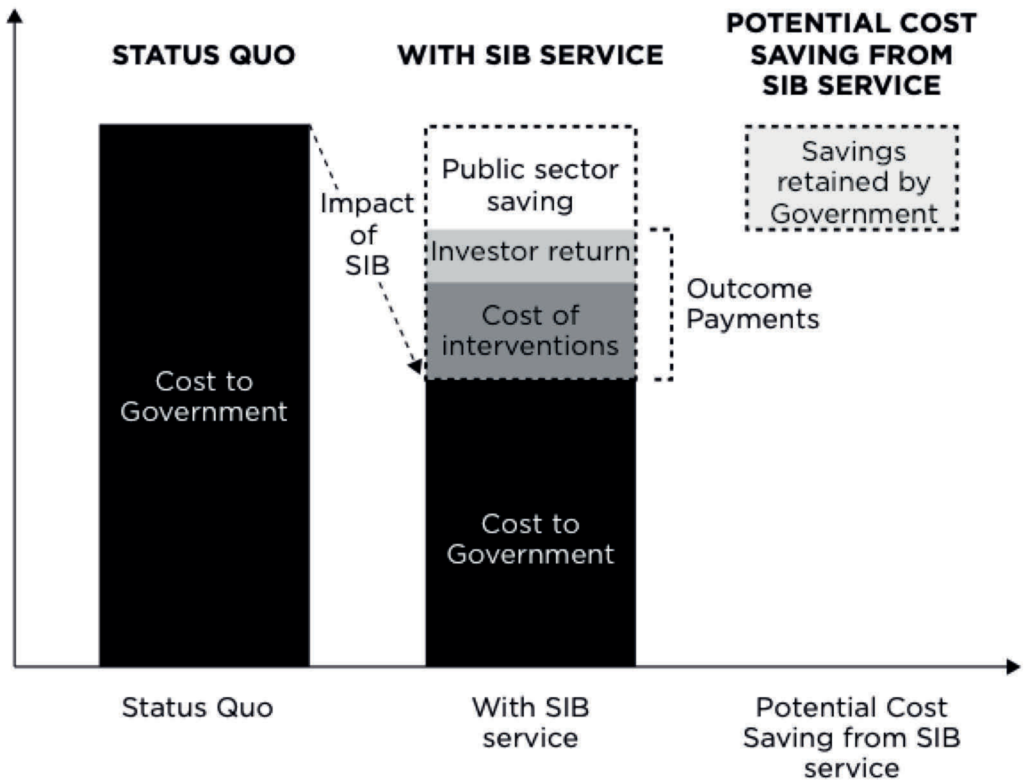
Chapter 2: LITERATURE REVIEW

2.1 Introduction

This report examined the publicly available theoretical and empirical literature on SIBs. As this is a new innovation, there is little empirical data on the implementation, evaluation and impact of SIBs. The majority of SIB related texts are grey literature, non-academic reports and policy papers produced predominantly by the third sector and governments, focused on the lessons and observations made from the design and implementation of existing SIBs. As a result there remain proponents and critics of SIBs, both among academia and the third sector (civil sector). Academic literature was wider in scope, offering a critical look at the antecedents of SIBs and offering considerations and insights for the future design and implementation of SIBs. Critical lessons for the future use of SIBs are explored from existing research, despite the dearth of research in this field in South Africa.

The rationale for SIBs from a public sector perspective is that both financial and social value must be created, and that expected savings from the intervention should exceed the project cost plus the return to the investors. Figure 1 below is a graphical representation of this benefit:

Figure 1: Savings from a SIB



Source: Social Finance UK.

2.2 The Basics of SIBs

2.2.1 Definition

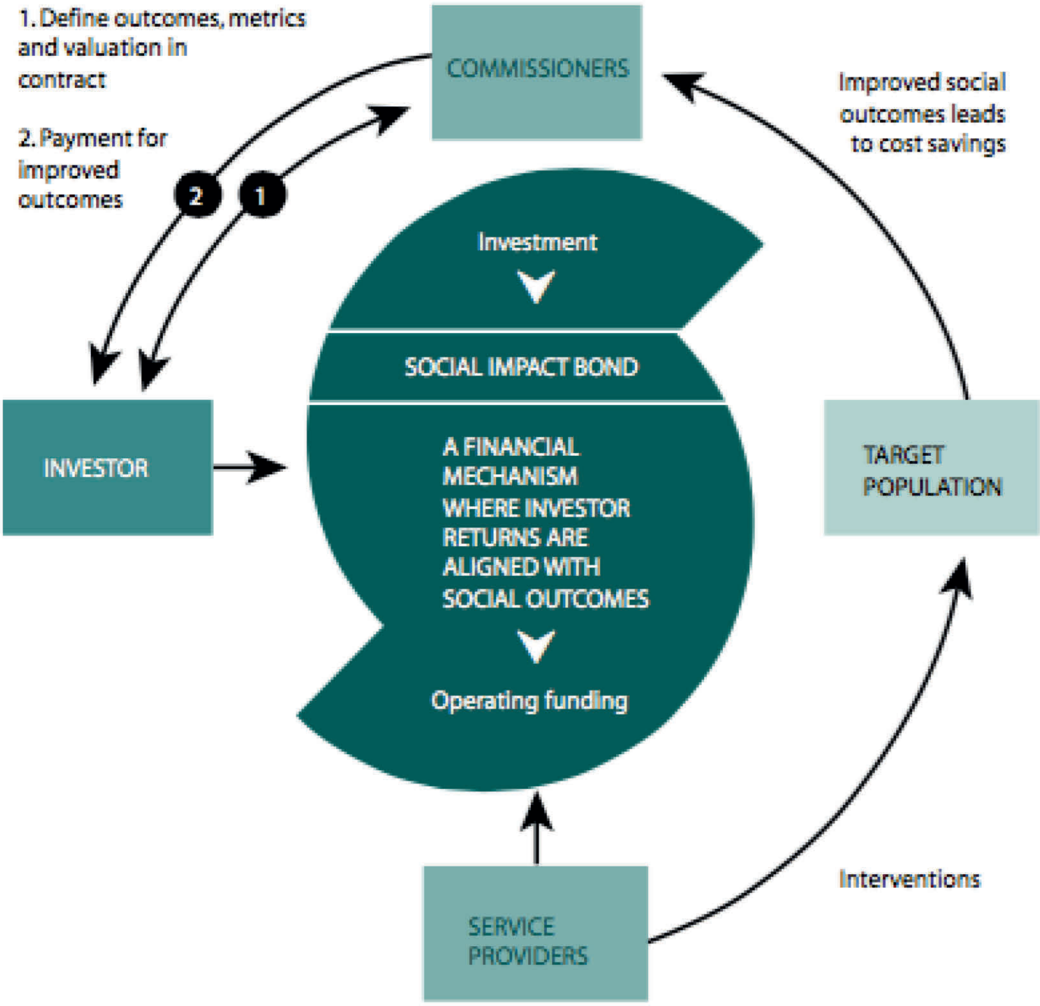
SIBs are not a bond in the real sense; they are innovative social programme finance meant to attract private investors to invest in social service interventions that have a positive society-wide payoff. SIBs are an innovative social funding method that integrates philanthropy, venture capitalism, performance management and social finance (Warner, 2012) into a new mix. This funding model places emphasis on the changes that result from social intervention programmes, the outcomes, than on the activities or outputs. As such, the financial reward (to investors) within SIBs is contingent upon pre-agreed outcomes being met.

An important characteristic of SIBs is the funding of preventative rather than remedial interventions and programmes, the rationale being the preventative interventions will circumvent the need for remedial programmes in future. This ties in with cost implications for government budgets, that paying for preventative programmes today will significantly reduce the need (and associated cost) to pay for remedial programmes in future. This is the social value creation proposal of SIBs: “when the price paid for the social value is more than the cost of creating that social value financial value is created” (Brown, A., and Norman, W. 2011), as represented by the following equation.

Financial value = Price paid for social value – Cost of creating that social value > 0

SIBs are deliberately disruptive, as they introduce the rigour of private sector investors, the standards of scientific evaluations and the practise of market mechanisms to determine the allocation of risk and thus associated payment. They open up the social services sector to new financialization, previously seen with physical infrastructure in Public-Private Partnerships (Warner, M. 2012, McKinsey and Company 2012). Below is a graphical representation of the flow of funds in a SIB. It highlights how the funds flow through the commissioner/intermediary, which is effectively the cog that holds the spokes (participants) of the SIB together.

Figure 2: Example of the flow of money in a SIB



Source: Social Finance (2012)

The cross-sectoral collaboration structure of the SIB has resulted in the process of setting up the SIB being a long and complex process, generally taking up to 2 years to set up from inception to execution (Warner, M, 2012). The process for developing a SIB can be seen in Appendix 1.

2.2.2 The environmental requirements for SIBs

SIBs provide governments with an opportunity to address key social issues in situations where the following exist (Bertha Centre, 2014):

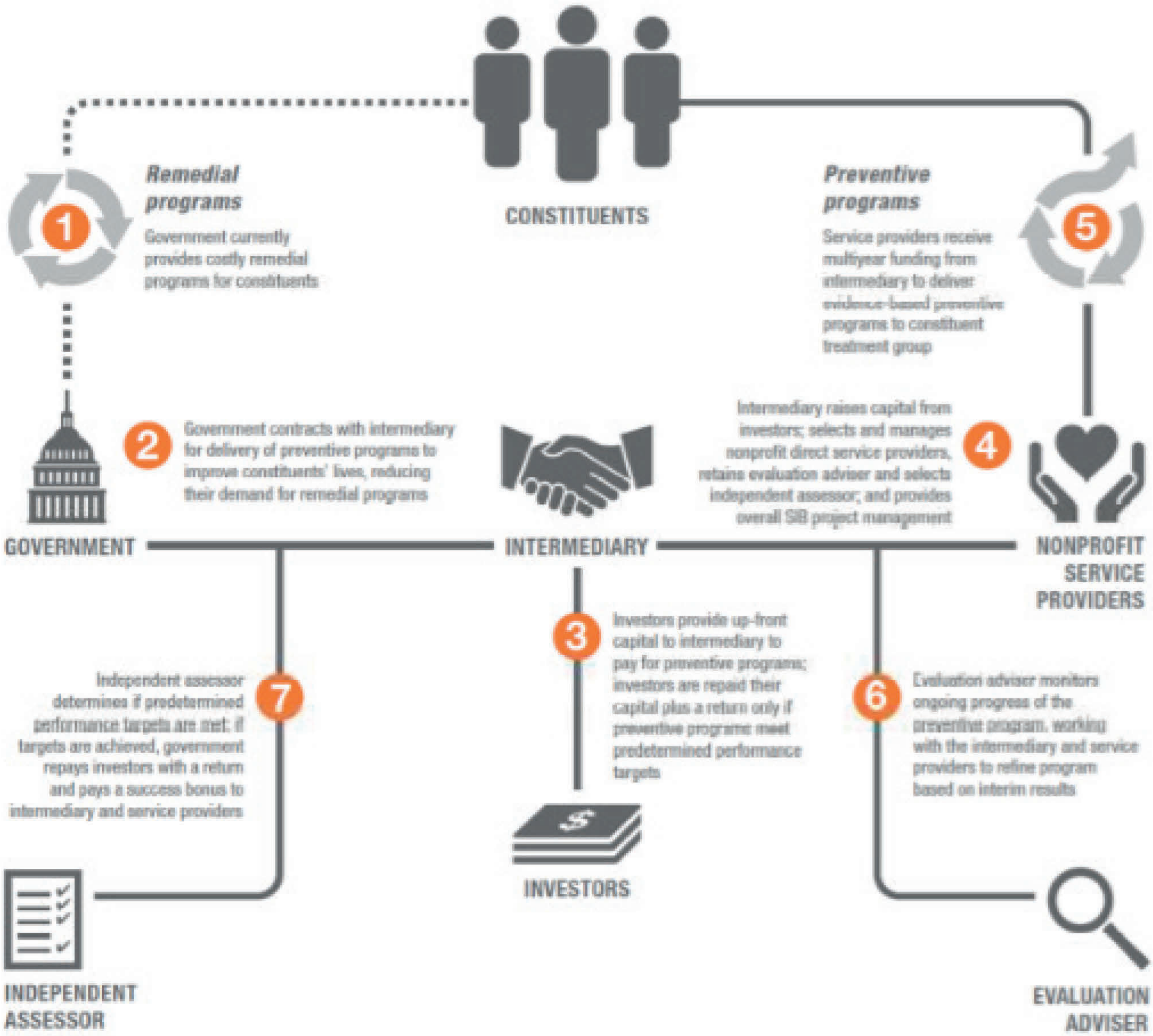
I. a pressing, identifiable social challenge which requires an intervention than remedial action

II. an identifiable, sufficiently large target group to whom intervention will be delivered
III. evidence-based intervention that has been tested and shown to be effective
IV. robust outcomes metrics with identifiable measures to which success can be attributed
V. benefits which are measurable and can be monetized into a viable investment proposition for investors
VI. willing actors from the public, civil and private sector
VII. the potential of the programme to scale.

2.2.3 The structure of SIBs

While there are a few ways that SIBs may be structured, they share similar features. The typical structure of the SIB network is represented below in Figure 3, highlighting the primary actors within the SIB structure and the flow of actions, numbered one to seven:

Figure 3: The typical structure of the SIB



Source: McKinsey and Company (2012)

2.2.4 SIB Actors

SIBs are complicated in nature as they involve collaboration and, by necessity, contracts across different actors, creating a network connected by a series of contracts and performance-linked payment schemes. Some stakeholders in society contend that the private sector, whence investors come, should assume responsibility for improving their communities. Indeed, Porter and Kramer (2006) posit that firms can gain economic returns by tackling social issues that in turn provide advantages for the firm. As such, each actor in a SIB is driven by different motives, as summarized below:

1. *Constituents*: As the heart of a SIB's work, they are the direct beneficiaries/recipients of the social interventions funded and scaled through a SIB.
2. *Government*: identifies the social issue to be addressed and the desired outcomes, and pays at the end of the contract period if agreed outcomes are achieved, reducing the financial risk of paying for non-performance. SIBs could not happen without government support.
3. *Service providers*: they receive multiyear funding, and their motive is to fulfill the outcomes-agreements. They face reputational risk should they fail.
4. *Investors:* their motive is to receive a risk-linked return on their investment to mitigate the risk of non-payment. The transfer of financial and implementation risk to investors has limited the appeal of SIBs to philanthopric investors. They receive a blended return – financial and social returns on their investment (Mulgan, G., Reeder, N., Aylott, M., & Bo'sher, L., 2011). Investors provide up-front capital for preventive programs; investors are repaid their capital plus a return only if preventive programs meet predetermined performance targets.
5. *Intermediary:* they manage the SIB throughout the entire life cycle, including coordinating and overseeing the design and implementation, contracts and payment agreements between various parties. As such, they must possess expertise in the relevant social issue, financing skills, and project management capabilities. On the financing side, they must know how to conduct due diligence, raise capital from investors, and structure deals. Within project management, they require portfolio management and multistakeholder partnership management experience to also select the appropriate service providers. Furthermore, they provide technical assistance and build capacity for service providers and other SIB participants. All payments happen via the intermediary as they are the link among all the SIB actors. Consequently, trust is an important characteristic that the intermediary must have.
6. *Evaluator:* the efficient and effective performance of this actor measures the achievement of outcomes and subsequent payment streams. Evaluators monitor ongoing progress of the preventive program, working with the intermediary and service providers to refine program, based on interim results.

7. *Independent Assessor:* involved in setting the evaluation approach and defining performance outcomes. They review the constituents relative to a counterfactual, determining and then reporting whether the predetermined performance target outcomes have been achieved. Government determines the pay for investors based on the assessor's report, and according to the terms of the SIB.

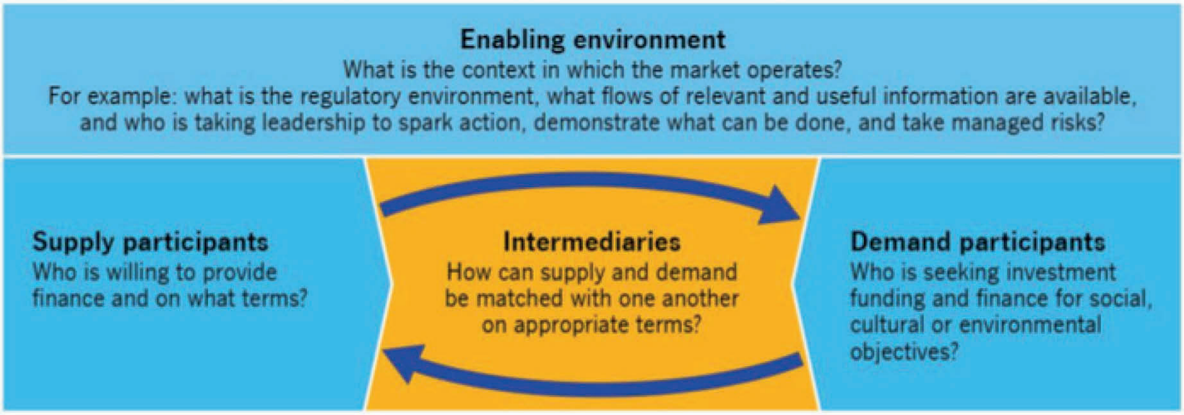
2.3 Antecedents of SIBs

On a continuum of funding activity, on one end stand grants/gifts with no expected return except for reporting, while on the other end are investments for which a return is expected, commercially-based investments (Disley at al, 2011). SIBs fall along this continuum as a social investment for which a financial return, though small, is expected (Kingston and Bolton, 2004). There exist various funding mechanisms which governments have used and continue to use to fund social programmes. The similarities and differences between the different funding mechanisms and SIBs are examined, and the unique opportunities offered by SIBs explored.

2.3.1 Social impact investing

Social impact investing, a term coined in 2007 by the Global Impact Investing Network (GIIN), is intentional private investing to create positive social change and financial returns. Social impact investing, unlike socially responsible investing which is an investment protocol that seeks to avoid producing social or environmental harm, seeks to proactively invest in organisations, firms and funds that create positive social impact in addition to financial return. Despite being estimated to be worth USD 36bn as at 2013, this is a nascent market estimated to grow to USD 400 - 1000bn by 2020. (Bain & Company, 2012). This type of investing seeks below-market or market-related returns, which was a departure from grant funding which carried no expectation of financial return (Martin, M, 2013). SIBs provide agreed market returns, contingent on outcomes of performance targets being achieved. Goldman Sachs, the singular non-philanthropic, traditional investor thus far in a SIB, required a guarantee, which was issued by a philanthropic foundation, to mitigate this risk (Warner, M, 2012). The ecosystem of social impact investing is illustrated in figure 4 below:

Figure 4: The social investment market



Source: Addis, R., J. McLeod, and A. Raine (2013)
(adapted from Freireich and Fulton, 2009)

As depicted in figure 4 above, the players within this ecosystem are (Jackson ET & Associates, 2012):

1. Various capital funders on the supply side;
2. capital recipients and service providers, often referred to as social enterprises, or the demand side whose role is to provide demand for socially responsible investment opportunities for investors;
3. intermediaries who provide links between the supply and demand players, and other parties in the social impact market;
4. government, which is responsible for creating an enabling environment for the social impact investing market to develop.

The innovate network structure of SIBs provides a node which allows each actor to implement tasks best suited to their strengths for collective social and financial benefit by transferring roles in which they traditionally underperformed to other actors within the SIB network (Baliga S, 2013).

2.3.2 Privatization

The impetus for privatization was to outsource a public social service that was traditionally the responsibility of government. Similarly, government outsources the implementation of social services to an external party with SIBs. However, SIBs tie profit to socially valuable results, thereby insulating government from the risk of paying upfront costs even if the social intervention fails. This risk is transferred to investors who provide upfront funding (Baliga, S, 2013).

Limited budgets perpetuate the practice of funding entrenched social programmes at the expense of lesser known programmes which serve historically unpopular groups (Johnson, N, Oliff, P & Williams, E, 2011). Privatization is an entrenched practice, benefiting private companies with no agreed social outcomes or targets. SIBs provide funding for lesser known, alternative, innovative programmes with a proven track record and social outcome targets (Liebmann, 2011; McKinsey and Company, 2012). McKinsey and company (2012) argue that SIBs are best for proven interventions while Liebman (2011) suggests they could be used for new interventions with evidence of effectiveness. Irrespective, initial investigation suggests that SIBs provide a more socially and financially viable option for social service delivery than privatization, while foundations and philanthropic sources generally fund new, untested approaches to addressing social problems (Kimbrell, 2014).

2.3.3 Payment for performance (P4P) or Payment by results (PBR)

SIBs are the intellectual descendants of new public management's emphasis on markets, customers and performance management (Warner, M, 2012). As such, SIBs are considered a form of PBR, but with a focus on outcomes than outputs. (Literature on P4P provides little evidence that P4P are an effective funding vehicle for social services (Stefanie Tena et al, 2015).

Previous and existing social funding mechanisms include payment-by-result schemes based on target-based performance management which sought to "focus service providers efforts on those issues that mattered most to policy designers." However, this mechanism has been beset by complications.

P4P schemes place implementation risk on service providers who receive funding at the end of the programme, if performance targets are met. Within this structure, government selected the social service provider and provided project oversight. This structure excluded smaller and less wealthy non-governmental organizations, despite their ability to effectively deliver on the project. Empirical evidence provides limited evidence of impact or change in behavior among service providers following the introduction of P4P schemes. (Magrath, P. and M. Nichter, 2012).

SIBs on the other hand transfer this financial risk to investors as service providers being paid upfront for the duration of the project. Furthermore, government oversight is delegated to a third party, the intermediary, thereby allowing smaller, effective and efficient smaller non-governmental organizations to participate and freeing up government time and resources. Few studies focus on the cost effectiveness of P4P programmes; instead most focus on their economic efficiency (Emmert, M., Eijkenaar, F., 2012), while SIBs are premised on outcomes-performance and cost effectiveness. An extended comparative analysis between SIBs and P4P highlights the extent to which SIBs can mitigate the shortcomings of P4P schemes, despite the challenges posed by SIBs.

2.3.4 Public-Private Partnerships (PPPs)

Another existing social funding mechanism is Public-Private Partnerships (PPPs), which have not only often increased the cost to the public sector, but have also struggled to effectively transfer risk from the public to the private sector (Whittington, 2012). Research, however, has shown that the private sector is uncomfortable with the prospect of bearing public service delivery risk, with high probability of failure, without commensurate return (Warner, 2012).

SIBs may also be viewed as a derivation of PPPs, through which the private sector is able to fund government infrastructure projects. This private sector investment relieves public sector budgets, which in turn accelerates project development (Geddes, R, 2011). In return private investors garner user fees for long timeframes (25-75 years) which are incongruent to the life of the asset, and transfer the risk associated with this asset to the government (Dannin, 2010). SIBs are based on shorter terms that are aligned to the social outcomes desired.

The inadequate understanding by the public service partners of the true costs of the PPP structure led to government assuming more risk than was planned, at a higher cost than anticipated (Sclar, 2009; Ashton, Doussard and Weber, 2012). SIBs transfer financial and performance risks to investors, as returns are paid on the achievement of outcomes that are measured by rigorous evaluation methods. The transfer of the performance risk to private investors is mitigated by the rigorous design of the SIB network of contracts and payment agreements. This risk is further mitigated by the practice of structuring SIBs on lower success models than what proven programmes and non-governmental organizations would indicate (Warner, M, 2012). This risk is further mitigated by the SIB payout structure which discourages investors lacking in social mission.

Although government and service providers (non-governmental organisations) do not bear the financial risk, they bear reputational risk, which will determine the viability of future SIBs; the success of SIBs being contingent upon attracting investment to fund additional SIBs (Warner, 2013).

2.4 Challenges and Concerns Regarding SIBs

Despite the significant growth and potential of the social impact investment market, significant challenges remain. Investors are concerned by the lack of track record of successful investments; the market must attract more and new investors to fulfill its growth potential as few established players currently dominate it. Within SIBs, the nascence of this market provides scope for flexibility in addressing concerns of investors and other actors. The first SIB issued has, to date, exceeded the agreed outcome measures contingent for investor returns (Disley, E., Rubin, J, 2014).

Limited social impact investment opportunities are another concern for investors, compounded by a lack of universally accepted ratings of social impact investments (Martin, M, 2013). SIBs offer an investment opportunity beyond the normal mandate of government-provided social development programmes, through innovative interventions focused on under-served and marginalized populations.

The inextricable link between the achievement of desirable social outcomes and achievement of returns necessitates rigour in the structural design and implementation of SIBs. The cessation by government of some powers and responsibilities within SIBs creates an arms-length transaction, which places greater accountability and responsibility on the network, which in turn increases the rigour in the implementation and monitoring and evaluation. Subsequently, the need for a SIB intermediary to espouse trust and transparency is crucial. This SIB structure, theoretically, increases the probability of financial and social success, or value creation.

However, little empirical data and few academic studies exist at present to support the practices and assumptions embedded in the SIB structure. Some issues of concern are:

2.4.1 Government over-reliance on network partners

Despite the rationale to maintain arms-length distance, over-reliance on the intermediary may shield government from full knowledge, creating opportunities for collusion among other SIB network actors. The risk of no payout for investors and the intermediary is a strong incentive for positive evaluation results. The powers held by intermediaries may create an industry of "dealmakers and brokers and accountants and lawyers…making a lot of money…taking this money off the top before it makes it to underpaid nonprofit workers or the beneficiaries of the program" (Rosenman, M, 2013).

This warrants further research into the difference between the actual and predicted behavior of SIB network parties. While this study is not available for the next few years, a sociological institutional approach to this difference among SIB antecedents may provide useful insight and cautionary signals to ensure that private motive does not upend the social motive of SIBs, as was the case with PPPs (Warner, M, 2013).

2.4.2 Stifling innovation

A key characteristic of SIBs is innovation – how this very innovation is at risk in the medium term. Agreed interventions are in place for the duration of the SIB, hence the diffusion of innovations, even proven innovations, may be slowed to ensure evaluations and measures of targeted outcomes of existing SIBs remain unchanged. This delay in diffusion is mitigated by the short terms of SIBs, which allow for quicker diffusion and lessons learnt to be incorporated in future SIBs.

2.4.3 Performance measurement

SIB design places great reliance on performance measurement, which is based on agreed outcomes that create financial savings to government. Warner, M (2012; 2013) cautions about the difficulties of accurate measurement in social policy as attribution and outcome measurement is complex, which requires extensive thought to assuage the danger of relying upon a oversimplified approach to evaluation**.** To ensure that the government does not pay for an outcome that would have eventuated anyway, the design of the outcome metric must capture the improved social outcome resulting from the intervention. Designing such appropriate outcome metrics to align the incentives of the intermediary and investors to achieve genuine improved social outcomes is time consuming, data-intensive and would require statistical analysis skills (Disley et al, 2011).

Critics of SIBs argue that interventions with quantifiable social benefits that may be monetized are more attractive than interventions that are difficult to monetize, despite their positive track record (Stoesz, D, 2014; Warner, M, 2013). This requirement to codify performance measurement and link financial return to rigid metrics may further privilege interventions with proven metrics at the expense of experimenting with more interactive programme designs and could stifle further innovation. Rigid adherence to existing evaluation models creates the risk of creaming and ignoring downstream effects on related interventions (Warner, M. 2013).

Creaming (or skimming) is the recruitment of top achievers into a service program to raise results, and attributing the results to the programme. This is a valid concern as SIBs rely on effectively measuring (attributable) social outcomes. As a result of creaming, the provision of services is shifted from more needy people to less needy people and can create superfluous government spending for inaccurately reported or even falsified results (Leifer, J, 2013).

The solution is in creating a system where intermediaries, investors, and service providers have no direct control over outcomes for which they are accountable. Fortunately, the independent evaluators who advise government on the development of the SIB are highly skilled in outcomes measurement and evaluation methodologies, and they develop outcomes-based contracts that can mitigate creaming and minimize the incentives for service providers to distort results (Leifer, J, 2013). None the less, SIBs run the risk of distracting from more meaningful social policy reforms by being misused to superficially advocate for an issue without delving into long-term and systematic solutions (Barajas, A, 2014).

2.4.4 SIB Design and structure

The complex network of contracts and performance-linked payment schemes among SIB actors is time-consuming and expensive. The first SIB took 18 months from inception to launch. This included actor identification, discussions, agreement of terms and the finalization of legal documents, which informed SIB design, implementation and target outcomes. Parallel discussions were conducted with different actors to gauge interest and participation (Disley et al, 2011), which created shared risk and responsibility among the network actors. As the SIB market grows in size, understanding and usage, shared knowledge will facilitate standardization, which will reduce set-up costs and time.

Setting up the SIB structure is expensive, and relatively high for current SIB pilots but these costs are affordable for bigger SIBs in excess of Euro 20m. (Vennema, B, Koekoek, R, 2013). Even more pressing is the consideration whether countries with smaller investor markets, like South Africa, can successfully launch SIBs? An option for smaller investor markets is packaged SIBs that are risk diverse because of the different projects that could be packed (Vennema, B, Koekoek, R, 2013).

2.4.5 Metrics

Data collected for constructing metrics must be understood by all involved. As this data should be complete and accurate, ideally it should be drawn from existing official government databases, because metrics must be underpinned by comprehensive databases. Investors should be included in the development of metrics as it is critical that everyone understand what level of performance will be rewarded and how. Metrics must be structured so that they encourage the use of the intervention rather than a short-cut to receiving a payout (perverse incentives).

The cost of data collection and the intervention the SIB will support must be understood. Furthermore, any barriers to data sharing or limitations to implementation of the intervention programme need to be taken into account when designing metrics. In setting the scope of the SIB, there must be a large enough target population, so that potential monetary rewards are large enough to attract investors.

2.4.6 Solution to challenges

To help promote the market for SIBs, policymakers and government need to address and reduce informational uncertainty. As within all financial transactions, natural information asymmetry exists. SIBs are best suited for areas and interventions where credible baseline data is available (Werneck, F and Havemann, T, 2013). This places great importance on the need to improve upon the outcomes measurement and to strengthen the attribution of interventions to outcomes (Keohane, N, et al, 2013).

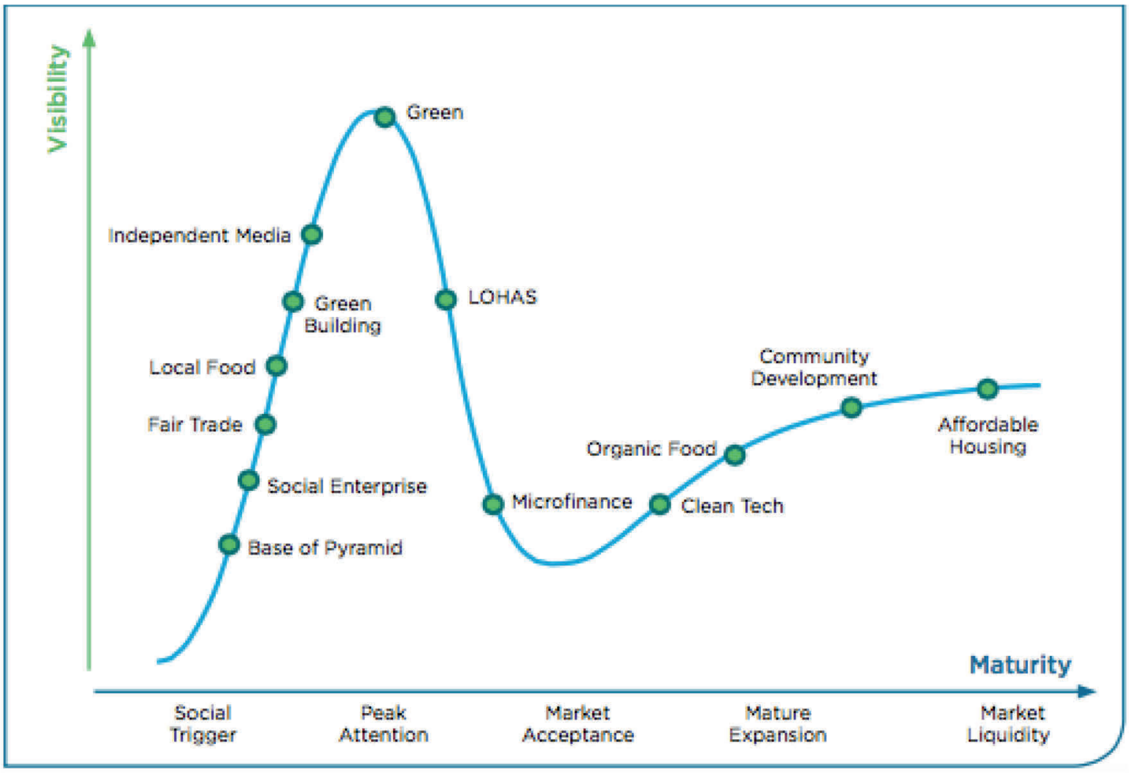
It is the role of the intermediary and government to increase market knowledge and understanding of SIBs, because increased understanding by investors reduces their uncertainty, hence the required return/cost of SIB is potentially reduced. Intermediaries would need to subsidise SIBs by offering large enough rewards to attract the appropriate level of investment. Hence intermediaries ought to proactively take action to reduce the risk gap between the price intermediaries are willing to pay and the returns would-be investors would demand.

2.5 Risk and Return vs. Impact

The rewards from SIBs are both financial and social. But the principal innovation of SIBs is the transfer of financial risk to the private sector, away from the public sector, while allowing greater freedom to service providers and investors in the design of services. Under a typical construction, the government has a contingent liability to repay investors should the programme succeed, failing which investors lose their money. Thus the investors take full execution risk and receive a small interest payment and a share of the non-financial benefits linked to promoting social goods. Investors require transparency and a strong say in the process to mitigate this risk (e.g. the ability to replace the program manager) (Werneck, F and Havemann, T, 2013). They seek compensation for this risk through a risk-adjusted return (RAR) in line with the integrity of the cost-benefit analysis (Warner, M, 2013).

SIB investors need to determine the extent to which the risk of investment is real versus perceived. As such, when something is different, new or as yet unknown, it is perceived as increasing investment risk, irrespective of the actual risk profile of the investment. This has perpetuated the perceived risk associated with SIBs (Emerson, J.). Observing the relative rapidity of the evolution of impact investing from the concept and practices, impact investing has moved from the fringe to a sustained trend as presented in the Attention Curve below:

Figure 5: The Attention Curve



Source: Collective Intelligence, produced for Good Capital 2007

The Attention Curve above presents the process of market acceptance and adoption. As new investment categories are developed and introduced to mainstream markets, they move through stages of awareness, acceptance and expansion as investors adopt them. This demonstrates how investors are addressing the challenge of distinguishing perceived risk from true risk (Emerson, J). Thus is can be deduced that SIBs will go through a similar cycle, reducing perceived risk in the process, making SIBs more attractive to potential investors. Whilst it is unclear where SIBs fall on the Attention curve, it is clear that significant awareness of SIBs is still required. Increased awareness and educating the public on the overall benefit to society and taxpayers may further mitigate the challenge of delayed impact that the SIB has (McKinsey and Company).

2.6 Criticism

According to McKinsey, the risk of losing all capital / principal investments is unlikely to be offset by the potential financial upside, even though, in absolute terms, a strong maximum rate of return may be offered. Government's willingness to offer such returns is doubtful, hence investors who care about the social bottom-line are the only probable investors to care about SIBs (McKinsey and company, 2012). The risks that deter would-be investors from SIBs, which subsequently increases the return demanded, are

a) the statistical uncertainty that the achieved results are in fact attributable to the prevention programme. This uncertainty emphasises the importance of the independent assessor, evaluation advisor and information symmetry from the inception to the execution of the SIB.
b) the statistical uncertainty translates, financially, into attribution risk which highlights the need for robust evidence about the contribution made towards the desired outcomes. As such, intermediaries must establish a baseline, based on:
    a. comparative performance between the control group and others
    b. historical performance against trends
    c. comparative performance against other contemporaneous outcomes
c) as SIBs are still relatively new, innovative and little known, investors are faced with inherent uncertainty and innovation risk.

Social service providers and critics are concerned that annual appropriations mean that funds allocated to SIBs may displace other social service funds, as governments are unlikely to "appropriate additional funds based on a projection of future savings" (Kimbrell, A, 2014). They argue that tying financial incentives to social goals creates a situation ripe for corruption and concerns that governments are essentially paying for programmes that already work using more complex and more expensive models to finance them (Costa, 2012). Some stakeholders fear a public backlash against SIBs as 'privatization' of government savings being tantamount to giving the savings away to wealthy individuals (McKinsey and Company).

2.7 Lessons for South Africa

While the ability to upscale and replicate successful interventions is a significant selling point of SIBs, experience has shown that few rigorously proven models exist for preventative programmes that are the highest priority for governments (Azemati, H., Belinsky, M., Gillette, R., Liebman, J., Sellman, A., and Wyse, A., 2013). Furthermore, most socially beneficial interventions are unable to yield budgetary savings. Thus it remains to be seen whether governments would pursue SIBs where interventions produce limited budget savings along with non-monetizeable social benefits. As such, the possibility of cross-departmental commitment to outcome payments should be considered for SIB funding. Furthermore, in undertaking analysis of the investment market relevant to a SIB in South Africa, identifying potential funders is important.

A sufficiently large number of people must be served by the intervention programme to determine if an outcome is attributable to the intervention. Sample sizes, serving at least 200 people (Azemati et al), are also critical for programme economics, as overhead costs of the SIB funding mechanism are primarily fixed costs, hence will constitute a smaller proportion of the project costs as the programme participants increase. Finding such a sample size may however be difficult. As such, it should be considered whether several interventions may impact on outcomes for the proposed target group, rather than a single intervention. This could have implications for determining what would have happened in the absence of the SIB-funded intervention, the counterfactual.

The SIBs currently in issue around the world are in countries with very different governance structures to South Africa. Thus while South Africa stands to benefit from a willingness to share knowledge with the global emerging SIB market, this would be particularly useful with a country with similar characteristics to South Africa such as Canada. Canada has a similar provincial governance structure to South Africa where intermediaries, service providers and investors need to engage with different levels of government, unlike the UK's central government. Both countries have large regional and cultural differences and large wealth disparities (Mulvaney, M. and Kriegler, L., 2014).

Although South Africa is regarded as having world-class, transparent and sophisticated budget processes, exemptions from certain requirements, such as the requirement that government contracts should be limited to a period of three-years, need to be reviewed to enable contracting processes associated with SIBs to be used.

2.8 Conclusion

Existing SIB literature is predominantly from non-academic sources and relatively few academic sources from the UK and the USA. Existing pilot SIBs have been issued from western 1st world countries, and none from developing countries. SIBs are an opportunity for a multi-sectoral collaborative approach, with financial and social benefits. A nascent market, it is well placed to address the emerging public services expenditure gap projected by a study by Accenture and Oxford Economics. According to the study, governments across the world will be unable to pay for the demands for social services, a gap projected by 2025 to be worth USD 170 billion and USD 940 billion in the UK and US, respectively. Private capital will be critical to addressing this emerging gap, to yield social and financial benefits.

South Africa faces the same risk, which is exacerbated by the dichotomous society, with divergent social needs that cannot be addressed by government alone, a burgeoning welfare system and less than 7% of the population contributing 99% of personal income tax (Le Roux, P., 2013). The compulsory CSI investment is insufficient, donor fatigue is rife and many non-governmental organizations are still reliant on donor and grant funding. There exists an opportunity for a collaborative approach to engage these and other players, in creating sustainable and effective social interventions, with mutual benefit for society and investors alike.

Chapter 3: RESEARCH QUESTIONS

3.1 Introduction

This research sought to explore whether SIBs are a feasible social development funding model in the South Africa context, because no SIB has been issued to date in South Africa. SIBs launched throughout the world thus far have been launched in western and first world economies; none have been launched in emerging economies.

This research is premised on four research questions, which were answered through the process of primary and secondary data collection and review. The foundation of these questions was built on the objectives of this research, which were to

- garner a comprehensive understanding of SIBs as an emerging social development finance tool, to explore whether SIBs are a viable investment and social development tool
- determine whether opportunities exist in South Africa for the use of SIBs
- determine if investors in the South African market would be attracted to SIBs
- determine if the civil sector would be interested in participating in a SIB
- determine government willingness to explore the use of SIBs as an alternative / additional social development funding model

3.2 Research Questions

While the majority of the research objectives are focused more at a macroeconomic level, to determine whether an enabling environment exists for SIBs in South Africa, the research questions focus on the micro-level, the firm level, at which organisations, be they in the private, public or civil sector, can participate. The research questions are:

1. In terms of fiduciary duties, are traditional investors and institutional investors driven by a financial-value approach or blended value approach? If it is a blended value approach, to what extent do the profit and social motive affect investment decisions?
2. Would one of the 8 South African City Metropolitan Municipalities consider issuing a SIB?
3. How would upfront funding affect the efficacy of the civil sector?
4. What constraints for each of the three parties (investors, municipalities and civil sector) would limit / prohibit their participation in a social impact bond?

Chapter 4: METHODOLOGY

4.1 Introduction and Purpose

The purpose of this research was to determine whether SIBs have an opportunity to succeed in the South African market. SIBs are a new financial instrument in the social investment and social development space. Between 2010 and 2013, twenty SIBs came into operation in developed countries, and interest regarding their use in emerging markets is growing (Barder, Eccles & Littlefield, 2013). The research questions and topic focused on South Africa, a third world country, brought new light to this topic. As such, this research was exploratory in nature, hence a qualitative approach was utilised.

Whilst SIBs are a new phenomenon in the social investment and social development space, there are many financial instrument predecessors that informed their development. Thus scientific methodology is crucial to frame the universe whence the tenets of SIBs come. This clarified the development of theory and the associated rationale for adding, removing, adapting and changing tenets of antecedents of SIBs. Understanding the short-comings of the antecedents guided the exploration of the feasibility of SIBs, while cognizant of tenets of predecessors which were undesirable.

Philosophical ideas remain largely hidden in research (Slife & Williams, 1999). However, this research was influenced by the transformative worldview, as the research explored an action agenda, exploring a new funding mechanism, to assist social development and associated partners.

4.2 Proposed Research Method

This research was qualitative in nature as it is an exploratory study of a financial instrument that derives value from social benefits. It is a new subject worldwide, with limited research coming out of South Africa.

This concept was new, little known or understood and as yet untested in the South African market. Blumberg, Cooper and Schindler (2008) recommend an exploratory approach when the researcher is unsure about the problems to be uncovered by the research. Meaningful insight was sought from experts in the investment and social development fields who would be likely actors in a SIB issue, because of the limited academic literature from South Africa. Consequently, there is no secondary quantitative data available to compare and contrast any correlations made.

Long, White, Freidman and Brazeal (2000) suggest that the research method selected is based on the beliefs of the researcher. Thus the research topic, and associated objectives and questions, was largely to be based on the insights of the various participants in the SIB market across the public, private and civil sector. Meaningful insights were sought from experts in the investment and social development fields who would be likely actors in a SIB issue. Consequently, the data was subjective. Hence the qualitative method was best suited for this research. Corbin and Strauss (2008) agreed that qualitative research is a discovery process into the world of participants by the researcher.

The feedback from respondents necessitated an inductive approach and analysis. The process of research involved emerging questions, data collection in the participants' setting and data analysis inductively building from general to particular themes across the different population groups (JW Creswell, 2014). The inductive approach and analysis was suitable for the nascence of this topic, which revealed additional considerations requiring further research or investigation.

4.3 Research Design

De Vaus (2002) argued that research design ensures that the answers to the initial research question are as unambiguous as possible. Empirical research on the viability of SIBs as a social funding mechanism was limited as SIBs in issue are in pilot phase, hence no conclusive research exists. Existing empirical research provided guidance on areas for focus in the research, hence a two stage design was utilised:

A. The first stage was exploratory, to "seek new insights, ask new questions and to assess (the) topic(s) in a new light" (Saunders & Lewis, 2012): to understand the emerging SIB industry in general and the insights and lessons applicable to South Africa

B. The second stage comprised interviews with likely actors in the South Africa SIB market.

The first stage involved extensive literature review and studying secondary data of the existing and emerging SIB market. This was to gain an understanding of the current practices, lessons garnered thus far and importantly to question whether these practices could be applied within the different context of South Africa. This helped to focus the questions contained within the interview schedule.

4.3.1 Qualitative technique

A cross-sectional methodology with semi-structured interviews was employed, a common approach in qualitative study (Bryman, 2006). The rapidly evolving SIB market necessitated that a cross-sectional approach be used to focus on the current "snap-shot" of the South African context, which is likely to change as the SIB markets across the world increase, and SIBs become more widely known and understood.

In the second stage, data was collected via in-depth expert interviews. When Gillham (2005) said "*there is a wide recognition of the special importance of narrative as a mode through which individuals express their understanding of events and experiences" (p.68),* he illustrated the value of interviews as a data collection method. The data was collected using the narratives of the interviewees. Both Blumberg et al (2008) and Gillham (2000) agree that expert interviewing is an appropriate method of gathering information from experts or authoritative individuals on the topic researched. Semi-Structured interviewing was used to give the interviewee room to opine on the topic (Blumberg et al, 2008) within the context of the research topic and questions.

Some of the interviews were conducted face-to-face, while some were done via telephone, as limited by the schedule of the interviewees, hence the corollary was that observations inherent to qualitative research may have been lost.

4.4 Population

The universe of this study was limited to potential / likely participants in the SIB market, within the private, public and civil sectors, respectively. When the research sample is relatively small, Malhotra (2010) suggests using qualitative methods to gain insight into the questions, such as is the case of this report. The population of each sector is described below:

In the public sector (population 1), City Metropolitan Municipality officials will be targeted. These officials must be within the treasury department, and must have experience in debt-capital markets and bonds. In particular, the city of Johannesburg and city of Tshwane officials will be most ideal because of their proximity and the history of the two Metros in issuing successful and competitively priced municipal bonds. The target number of officials to be interviewed is 4.

In the civil sector (population 2), officials from non-governmental organisations with a turnover/income of at least R2m per annum will be interviewed. The R2m threshold is to ensure that the organizations engaged have proper procedures and policies in place, as R2m would be difficult to achieve without proper governance in place. 4 Officials from at least 3 different organizations will be engaged.

In the private sector (population 3), a total of 3 investment professionals will be interviewed, from either banks or private investment companies with no less than 5 years of investment experience in debt-capital, or social impact funding.

4.5 Sampling Method and Size

Non-probability purposive sampling was used to identify the populations because the perceptions among potential SIB participants were as yet unclear. This method is the most appropriate because of the specific qualifying characteristics respondents must have. Critical case purposive sampling was used because of the uniqueness of the different populations. Each population represented a diametrically different perspective, with the potential to significantly affect the outcome of the research.

The researcher held a total of 11 interviews. For all non-probability sampling techniques, barring quota samples, the issue of sample size is ambiguous, hence the logical relationship between sample selection technique and the purpose and focus of research is more important (Saunders & Lewis, 2012).This is important to allow peer reviewers to make judgment on the adequacy of the sample. The length of interviews ranged from half an hour to an hour, depending on the availability of the interviewee.

4.6 Unit of Analysis

The unit of observation will be the individual responses for all the populations. The unit of analysis will be at two levels; the respective population group level and overall universe level.

The respective population group level is to determine similarities and differences within the group, identifying trends and deviations within the group. The second unit of analysis is to determine trends and deviations between the groups. This observation level provides an overall analysis observations from the universe perspective. This observation is crucial to the research objective, as collaboration, commonality of purpose and shared outcome "*may help to ameliorate concerns arising from power differentials and goal alignment problems"* (Warner, 2013 pg. 314) among the different SIB participants.

4.7 Research Measurement

Blumberg et al (2008) proposed that the search for secondary literature is the first step to an exploratory study. They asserted that it provides the researcher with background to the subject, and highlights emerging themes and patterns which, in turn, help frame the research questions. The researcher reviewed academic articles, published articles, websites and published reports and documents on the emerging SIB market, to develop the initial questions of the interview schedule.

Separate interview schedules were developed for each of the three population groups. The interview schedules were tested on three people, one person from each of the population groups who are current participants in each of the three respective sectors, to ensure that the researcher gets the questions right, rather than get the interview right (Gillham, 2000). As a result, the interview schedules for two population groups, the private sector and civil sector, were modified.

Semi-structured interviews were used in the process of data collection. The questions were open-ended, to allow interviews to provide answers whilst also giving scope for them to provide additional information that they deemed relevant to the question. (Blumberg et al, 2008). Patton (2002) stated that the interview schedule guide (schedule) provided boundaries within which the researcher could build the conversation, whilst ensuring that the same questions were asked of each interviewee. The interview schedule is attached as Appendix 2.

4.7.1 Interview guide design

The semi-structured interviews were recorded, with permission, and thereafter transcribed. To observe the interview protocol, for telephone interviews, interviewees were asked to verbally declare their consent to participate in the interview. In face-to-face interviews, the interviewees signed the consent form before the interview recording resumed. The researcher also took manual notes to mitigate any potential data loss.

The researcher spent time at the start of each interview explaining the concept of the SIB, with particular reference to the participants and the theoretical benefits thereof, and clarifying any questions regarding the basic structure of the SIB. The interview commenced after the explanatory introduction. The interview questions were designed to be asked in sequence to allow data collection to be systematic. Unanticipated insights from interviewees also emerged from their questions during the process of explaining the SIB concept.

4.7.2 Reliability and validity

Raimond (1993) asks whether the evidence and conclusions of the research would stand up to the closest scrutiny. Saunders and Lewis (2012), in response, posit that research method is important in preventing the researcher from deceiving themselves about their "creatively formed subjective hunches which have developed out of the relationship between me and my material." Thus, although the researcher may not have an answer, *"reducing the possibility of getting the answer wrong means that attention has to be paid to two particular emphases on research design: reliability and validity"* (Saunders and Lewis, 2012).

Reliability refers to data collection methods that would produce consistent or similar findings. Reliability was achieved by the designing and use of interview schedules. The sequential ordering of the interview questions sought to create consistency in information gathered. Participant bias may have been a threat to reliability; bias based on the similarity of seniority of participants in their respective organizations, or bias based on commonality of organization. The seniority bias was, to some extent, alleviated by 9 of the 11 interviewees having previously worked at different, lower levels within their respective organisations, thus possessing insight from various levels within their respective organizations. The organizational bias was mitigated by the fact that none of the interviewees came from the same organization.

Validity is concerned with the causal relationships between variables. In this research, internal validity, the extent to which findings are a true reflection of reality (Brink, 1993), was mitigated by interview schedule design. Leinger (1991) holds that researchers need to be trusted before they will be able to obtain any accurate, reliable or credible data. This informed the sampling, wherein the interview subjects had a pre-existing relationship with the researcher, or with the individuals who referred the researcher to them. External validity concerns the degree or extent to which such representations or reflections of reality are applicable across groups (Brink, 1993). This concern was mitigated by the interviewees all coming from different organisations within the public sector, private sector and civil sector, respectively. However the nascence of the research topic suggests that the data gathered is a snap-shot of current reality, and hence may be applicable across the various sectors in the short to medium term.

4.8 Data Collection

The researcher contacted the potential interviewees by telephone to request for an interview. An email was sent to each of them. Attached to the email was a two page document, which gave a brief explanation of the concept of SIBs. This was followed by a call to confirm the date and time of the interview, and determine whether the interview would be face-to-face or via telephone.

The researcher conducted eleven expert interviews; six of the eleven interviews were face-to-face, while five interviews were conducted over the phone. Four interviewees came from the public sector, four from the civil sector and three from the private sector. The interviews were conducted over a period of 15 days. All the interviewees were in senior positions within their organisations; the minimum duration within their existing organization was three years.

4.9 Data Analysis

According to Rudestam and Newton (2001), data should be reduced into manageable sections for a more logical interpretation thereof. In determining which data collection techniques and analysis procedures to use, Bryman (2007) found that there was no absolute way to determine this. Rather researchers were likely to be influenced by a number of factors, among them expectations of those likely to form the audience for the findings and methods with which the researcher feels comfortable. Data collection and analysis was iterative, to enable the researcher to define recurring themes observed in the interviews. The interviews were recorded, and supplemented by handwritten notes by the researcher. This analysis allowed the researcher to gain deeper insight into the interviewee's perspective (Blumberg et al, 2008). As such, responses were mapped to identify themes from collected data.

Narrative analysis was applied after the interviews, to capture the interviewees responses. The notes were analyses as part of the content analysis to organise content into categories (Gillham, 2000). This process included looking for recurring words, phrases and combinations from which inferences could be made. The frequency of occurrence of particular words, phrases and combinations was determined by identifying words and counting references to similar words. The aim of this analysis was to extract the intention and meaning of text (Blumberg et al, 2008).

The interactive nature of data collection and analysis allowed the researcher to recognise important themes, patterns and relationships in the process of data collection (Saunders & Lewis, 2012) as they emerged. The nascence of the SIB market necessitated a deductive approach, as existing theory and literature was used to formulate the research question and objectives (Yin, 2003) as a means to devise a framework to organise and direct data analysis. There is debate, however, about applying this approach to qualitative analysis, as prior specification of a theory may introduce premature conclusions on the issues to be investigated (Bryman, 1988). However, the data analysis followed an inductive process whereby patterns and common phrases emerged from individual interviewee observations and responses to build up a theory that was adequately grounded in the data collected.

4.10 Limitations

The possible limitations of this study include:

- Geographic location: the focus of the study is South Africa as a whole, rather than one region within South Africa. All the interviewees were based in Gauteng, ten out of eleven being based in Johannesburg and the last being based in Tshwane. Whilst difficult to determine, this may have led to some bias in their responses, which could potentially affect the applicability of the lessons from this study across South Africa

- Research design constraints: The SIB structure is comprised of several different actors or participants. The research was focused on three most important participants, the public sector (City Metros), private sector (investors) and the civil sector (nonprofit service providers), as determined by the researcher. A similar study on other SIB participants may yield different results; hence more studies of this nature need to be conducted engaging several different SIB participants.

- Time constraints: The limited availability of some of the interviewees necessitated telephonic interviews to be conducted, rather than face-to-face interviews.

Chapter 5: RESULTS

5.0 Introduction

The findings from research conducted using the methodology described in chapter 4 are presented in this chapter.

A total of eleven semi-structured expert interviews were conducted, the preliminary research having been conducted from secondary data or extensive literature review. The sample population for the interviews was selected from three distinct groupings:

1. *Civil*: Nonprofit or non-governmental organisations which are active participants in civil society
2. *Public*: Category A government municipalities (metropolitan municipalities in South Africa)
3. *Private:* Private companies involved in investing or investments as their primary business focus.

The responses to the research questions in chapter 3 will, where applicable, be separated into responses from the three different populations which will be useful to gain a deeper appreciation of the interplay between the different parties to the social impact bond. The conclusion of this chapter will highlight the similarities both between and within the different group of respondents.

5.1 Demographics of Interview Participants

The table below provides a summary of the profiles of the expert interviewees.

Table 1: Profiles of Expert Interviewees

Respondent	Sector	Level	Organization
A	Private	CEO	Foundation
B	Civil	Chairperson	Coalition of nonprofit organisations
C	Civil	Founder	Nonprofit social enterprise
D	Civil	Chairperson	Charitable trust
E	Government	City Treasurer	Category A Municipality
F	Government	City Manager	Category A Municipality
G	Government	Senior manager	Category A Municipality
H	Private	Chairperson	Listed company
I	Private	Senior Business Development Analyst	Investment company
J	Private	Investment manager	Government parastatal
K	Government	Finance manager	Provincial Government: Finance department

5.1.1 Private sector

Interviewees are all currently working in for-profit private companies, which typically seek to maximise shareholder or investor returns or value. The companies are diverse, yet all fall within the spectrum of investment being the core or among the core activities of the company.

- Respondent A comes from a foundation, which is registered independently of the company from which it receives funding or revenue. This separation of registration allows the foundation to take advantage of legislation applicable to Not-for-Profit (NP) or Non-Governmental-Organisations (NGOs), such as tax exemption. Currently the CEO of the foundation, respondent A has many years of experience working in the nonprofit civil sector, both within independent NGOs reliant on donor and government funding, and within the private sector from a funder perspective. This respondent had previously heard of SIBs and, even though little, showed an understanding of SIBs.

- Respondent H is the chairperson of a listed property company.
- Respondent I is a business development manager at an investment and portfolio management company. This respondent is familiar with SIBs, and has previously engaged the subject at the Bertha Centre through the information evenings and presentations that the Bertha Centre has previously hosted.
- Respondent J works in a parastatal, in particular an investment management company fully owned by the South African government. It is tasked with making investments to maximise returns for the investors and subsequently the parastatal too. The parastatal is reconstituted and incorporated in terms of recognised South African legislation. The scope of the investments according to the investment mandate is varied, and closely linked to the strategic imperatives of South Africa as a country.

5.1.2 Public sector

Interviewees came from Category A municipalities, also known as Metros, which are the largest metropolitan areas in South Africa. Eight municipalities fall under this category, and they are City of Johannesburg, Buffalo City, Mangaung Municipality, City of eThekwini, City of Cape Town, Ekurhuleni Metropolitan Municipality, Nelson Mandela Bay Municipality and City of Tshwane.

- Respondent E is the current treasurer of one of the Metros, having worked in various treasuries within parastatals prior to joining the current treasury team which she ultimately led and continues to lead. Although familiar with the concept of bonds and debt capital markets, this respondent had not heard specifically of SIBs.
- Respondent F is the current City Manager of another Metro, whilst also being the former treasurer of a different metro. This respondent is respected industry-wide, having been a member of the executive team when two respective Metros issued inaugural municipal bonds. While conversant with bonds and debt capital markets at municipal level, this respondent was not au fait with SIBs specifically
- Respondent G served as a deputy director-general in a government department, working closely with the Department of Social Services for approximately four years in the delivery of core and non-core services to communities. This respondent has

worked in numerous national government positions and had never previously heard of SIBs.

- Respondent K is a finance manager within a non-finance department at provincial level. Respondent K is privy to the investment strategy and mandate, and has been present when such decisions have been taken. This respondent works at a different metro to respondent E and respondent F, respectively, and has never previously heard of SIBs.

5.1.3 Civil sector

Interviewees came from Not-for-Profit organisations, registered in different formations.

- Respondent B is a founder of an NGO, which has evolved into the lead organisation in a coalition of organisations. The coalition was a deliberate strategy to pool together the resources of smaller organisations to seek funding as a coalition rather than as individual, smaller organisations. This respondent had basic rudimentary knowledge of SIBs, based, according to the respondent, on casual secondary research.
- Respondent C is a founder of a nonprofit social enterprise. While this enterprise generated an income as part of its activities, it was still largely reliant on donor funding. The long-term strategy of this enterprise was to increase self-generated funds and reducing reliance on donor funding. This respondent had not heard of SIBs previously.
- Respondent D is a serial social entrepreneur, with over 20 years experience in founding, building and leading revenue-generating NGOs. He is currently the chairperson of two different multi-million Rand charitable trusts. This respondent had never heard of or about SIBs previously.

5.2 Findings

The research process comprised interviews with the different sector experts, who would be likely participants in a SIB issue in South Africa. As such, the questions were the same across interviewees within the same sector, but were different across the different sectors. The questions sought to determine feasibility from the sector perspective of the interviews, as each sector plays a different role and has different stakeholders, hence different issues to consider when determining the feasibility of their participation in a future SIB within South Africa.

In all the interviews, several questions were asked to get a holistic response. Research question one was focused on the private sector. Research question two was focused on the public sector. The third research question focused on the civil sector. All interviewees were then asked to address the fourth research question. Appendix 2 is a schedule of the interview questions for each of the respective sectors.

5.2.1 Research question 1

Research question 1: *In terms of fiduciary duties, are traditional investors and institutional investors driven by a financial-value approach or blended value approach? If blended value approach, to what extent do the profit and social motive affect investment decisions?*

5.2.1.1 Results for research question 1

Interview Questions:

1. **What are the core issues and considerations of your investment mandate?**
2. **What informs these considerations? (For example, financial returns, social impact, angel investment or legislative requirements.)**
3. **To what extent do socio-economic issues have an impact on the determination of the investment mandate?**

- Respondent A: "*As a philanthropic investor, the issue is when we invest, there must be a social return and unfortunately we don't work with a ten year horizon; we work with a two year horizon which is terrible. In other words we want to put in money and see what happened with the funds."* This is informed by the foundation's incorporation as a section 18A organisation, which necessitates that every investment made is to achieve a social mandate or have social impact.

- Respondent H: *"The primary consideration is maximising shareholder returns."* The respondent then clarified that though this was the key consideration, other social considerations were important in the manner in which they operated their business. According to the respondent, there was a direct positive correlation between the maximisation of shareholder wealth with the maximisation of social value the company could create. The company had a charitable trust from which social grants to NGOs were made, thus as profits increased, maximising shareholder wealth, the allocation to the trust similarly increased. However, in terms of direct investments, the company invested to achieve maximum returns on investment, the only consideration being that the investee should be compliant with South African regulations such as employment equity, B-BBEE and CSI requirements.

- Respondent I: *“Our mandate is to invest our clients’ money where it will yield the greatest return. Clients come to us to make them money. Generally they don't ask us about the social impact considerations of their investment with us.”* This respondent was well versed in the concept of SIBs, having attended several presentations on them presented by the Bertha Centre. Clients rarely made mention of social impact considerations for their investments, according to respondent, and when they did the issue of return was key. Therefore the clients thus far would not consider social impact investing in any form as part of their investment portfolio if the returns on social impact investing were not commensurate with returns on non-social impact investments.

- Respondent J: By virtue of its incorporation and constitution, the investment mandate of the parastatal is to have a fund that is “*return seeking…(with) targeted investments…that earn reasonable returns for the fund and that, in addition, have exceptional and direct social, economic or environmental benefits for South Africa.”* The return sought is inflation plus 1% (CPI + 100 basis points), which is not an aggressive performance target; instead significant emphasis is placed on social impact. The investment mandate is informed by the Socially Responsible Investment (SRI) policy statement of the parastatal which states: *“Investment capital can and should be put to use other than for the pursuit of returns and only returns; and that sound investments can be combined with socially useful outcomes.”*

4. Would you invest in social impact bonds if the anticipated returns met your investment mandate requirements?

- Respondent A: “*From a corporate view, we were already going to invest this money, only now we have government coming in and buying in. So if its something that falls within our strategy, something we want to be associated with in terms of the programme itself, I don't see a challenge.”* Respondent A (an investor) believed that with wider public awareness, SIBs *“could be a lever for broader social change.”*

- Respondent H: The respondent said all things being equal, they may consider making an investment. However the nascence of SIBs as an investment option would make it difficult because of the unfamiliarity and associated uncertainty. SIBs would, according to the respondent, fall into the social impact investment category which is traditionally not considered by market-related investors such as themselves and would rather be considered by philanthropic investors. "*I think these things always have a social context. So something like this is more likely to work in the US where there is a very strong philanthropy tradition and trajectory, and lots of organisations doing it. Its almost part of their DNA, for example most Americans put money back into their universities, huge money goes back into the universities from the alumna, you haven't got that here. The South African culture is not conducive, is not supportive of this kind of thing. In a more generous environment, and we're not in that at the moment, big companies like the mining companies all have a social responsibility activity, but they haven't really cracked the idea of doing it in a manner that is sustainable, its still in the charity model…companies seem to be happier to put money into a black hole (give grant without return).*"

  The respondent further stated that the current use of the charity model is a pattern associated with social development funding in South Africa which will be difficult to change. Whilst intuitively sound, this historical pattern of funding would take time to change, as do all new ideas. He further explained that the private sector is more comfortable with the charity model with no financial return; receiving a financial return is perceived as non-charitable and rather driven by economic profit. Convincing the private sector that SIB could offer both an economic and social return would require extensive time.

- Respondent I: This respondent referred to their fiduciary duty to their clients to take due care in the application of funds across investments. This, she added, was not only a financial or economic consideration, but also a consideration to comparable investments. Thus the answer was contingent upon the availability of alternative investments options and tools and their associated risk-reward profile. She did, however, add that they do not currently present the social impact of investment opportunities to their clients; it is still economic benefit based. There could be an opportunity and possible responsibility on them, as the investment managers, to educate their clients about such social impact invest opportunities such as SIBs and offer them as a viable investment opportunity with positive social impact.

- Respondent J: *"Absolutely. We have a relatively low IRR at CPI + 100 basis points so should these bonds exceed that target, I don't see why not. Besides, our investment mandate already has a strong social development and impact focus, so for us to invest in social development that may positively affect the very people whose pension funds we invest would be a double win for us."* The respondent further highlighted that the current investment policy rests on four pillars, namely:
    a) investment in critical economic infrastructure in traditional priority sectors such as energy, commuter transport and logistics, manufacturing, agriculture and agro-processing, ICT and telecommunication to name a few
    b) investment in social infrastructure looking at, for example, healthcare, affordable housing and education
    c) investment in job creation through the creation and support of SMMEs, the employment of women and youth and broad-based Black economic empowerment
    d) investment in the greener economy in the form of renewable energy.

He surmised that if the SIB investment opportunity fell within the four pillars, the probability of investing in a SIB would be high, as it would not be in contravention of their investment mandate.

5. The average SIB lasts 5 - 7 years. Would this duration affect your investment decision in any way?
   1. If yes, how would it affect the investment decision.
   2. If no, what would affect the investment decision besides financial returns?

- Although their typical investment horizon is significantly shorter, Respondent A believed that it need not affect the investment decision, saying "*I don't think that investors will completely be investing all funds into something like that (SIBs). I believe that you can invest a portion, and a portion you still keep."* Looking at the previous attempts by government to raise private funding for collaboration with private sector on some of its programmes, such as the NECT (National Education

Collaboration Trust), the private investor take-up was lower than expected, respondent A said. Thus, he continued, in terms of these type of social investment programmes with room for private sector and government participation, investment horizon alone won't affect the investment decision. *"I'm for it (SIBs) but I think the country still needs to grow into something like that, in terms of understanding and appreciating the contribution that this type of initiative can make, (understanding) the government processes in terms of the guarantees they can make and (knowing) where the budget for this will sit and how the whole thing (SIB) is put together. People (investors) need to understand this (SIB) system wise and attitude wise because people are used to short term CSI (corporate social investment) thinking."*

- Respondent H: "*Everything needs time to cook…5 years is not too long, I would not have a problem with it. The mind-set of the majority of social investors in this country seems to be the mindset of politicians that need quick returns."* Referring back to a previous comment, the respondent reiterated the importance of context, and the perception that the South African investment environment may view this duration as too long for an uncertain investment. The respondent therefore believed that the duration would negatively affect the investment decision.

- Respondent I: The respondent similarly cited the duration being too long for an uncertain investment. She asked if the SIB could be traded on a secondary market. Upon learning that the SIB could not be traded on a secondary market like ordinary bonds, she believed that investors may be unwilling to invest in SIBs because of this perceived illiquidity which would tie them in for the entire lifetime of the SIB with little or no exit option.

- Respondent J: This would not affect the investment decision, according to respondent J, as their current investment profile is 5 years. A longer investment period would require justification and may require special authorisations, but as mentioned previously what would be more important would be the SIB opportunity falling within their investment mandate.

6. Would you invest in SIBs with returns being contingent upon social development goals being met?

   1. If yes, please explain your answer.

2. **If no, would a government guarantee on returns make SIBs more attractive?**

7. **Do you perceive SIBs as being a higher or lower risk investment? Should there be a commensurate return for investing in SIBs? (higher risk-higher return; lower risk-lower-return)**
8. **Should the social impact of SIBs lower or increase the returns demanded?**

- Respondent A: Their investment mandate is social development focused, hence they would probably invest in SIBs, and do not view them as being a necessarily more risky investment. Rather, his focus was on determining whether the appropriate reporting, monitoring and evaluation structures would be put in place to keep them, as investors, up to date on the developments of the NGO service providers during the life of the SIB rather than receiving reports and feedback only at the end. His assertion was that if the selection process is reliable, and the NGO service provider vetted as per agreed processes, the investment need not be necessarily more risky, hence the required return for them (SIBs) need not be increased.

  In general, he posited, corporates are looking for social impact from their CSI spend, not financial returns. Therefore, matching the returns of SIBs to other financial instruments would not necessarily be a greater motivation, according to the respondent. He, however, believed that the combined social and economic narrative of SIBs, would be more viable for (high-net worth) individual investors.

- Respondent H: The respondent was of the opinion that without a change in the culture of giving and donations in the country, the private sector would not be likely to invest in SIBs. He perceived SIBs as being riskier from an economic perspective, because of the contingency clause, which would, according to him, make investors demand a higher return to compensate for the high risk. This would drive up the price of SIBs to a level that would be too expensive and possibly unviable for government to want to participate. He speculated that government would most likely opt for a better priced social-impact investment solution than a SIB. This risk perspective would be exacerbated by the fact that this is a new and therefore unknown and little tested funding model. The setup structure of the SIB is very important, he stated, as this would determine how much influence the investors have. The issue for him was whether the investors would have a say in the selection of the NGOs and the monitoring and evaluation process.

- Respondent I: This respondent answered as follows, "*Definitely more risk, yes! We ourselves don't know how well the SIB model would work, so it would make it difficult for us to pitch it to our clients. Even a government guarantee would not help because what would it be guaranteeing exactly? That investors would get their capital back, even if the NGOs did not meet their goals? What investor invests his or her money only to get the capital back? They want returns, and if the initial proposed return on the SIBs is not high enough for them, then no government guarantee will help. If the initial proposed return IS high enough, the guarantee would be that they'll get at least below their desired IRR? I think this is something that requires further clarification if private, non-philanthropic capital is to be seriously considered as investors in SIBs.*"

- Respondent J: *"We would need to have a look at the business case of each individual SIB to decide whether or not to invest, and if we perceived there to be additional risk."* This respondent added that the organisation was not necessarily averse to risk. Furthermore, because of the relatively low IRR requirement, the key consideration would be a thorough understanding of the particular SIB and specific associated risk. They would then put this through their evaluation and assessment process to determine whether the SIB fell within their investment mandate and criteria, and if it did so also determine the risk and investment appetite level.

5.2.1.2 Conclusion for Research Question 1

Investors are driven by economic motive, however the extent of the influence of other factors varies among the investors. Hence the approach used is varied from the financial approach to the blended value approach. Traditional investors prefer the financial-value approach as their primary incentive, which outweighs the social motive. The social motive, when and if applied at all, does not increase the viability of SIBs as an investment option for these investors. Rather the uncertainty which the social motive does create in the case of SIBs, coupled with the uncertainty of SIBs being a new, little tried and little known product, is cause for higher risk which investors want to be factored into the financial structure of SIBs. Thus the fiduciary obligations of traditional investors are driven by economic considerations and the maximisation of financial returns.

Investors with an existing social motive in their investment philosophy are more willing to consider SIBs as an investment option. As such, this type of investor employs a blended value approach in the delegation of their fiduciary duties. This type of investor has moderate economic return expectations and high social impact considerations. Respondent A in particular believed that the presence of government in this structure may be an incentive for investors to get involved as the SIB structure effectively says "*government is supporting what you are doing, and they (government) will partner with you, which is what most initiatives and programmes look for - having a firm partnership with government."*

5.2.2 Research question 2

Research question 2*: Would one of the 8 South African City Metropolitan Municipalities consider issuing a SIB?*

5.2.2.1 Results for research question 2

Interview Questions:

1. **Are social impact bonds (SIBs) currently being considered by the Metro as an alternative funding instrument for social development spending? Why or why not?**
2. **Does the Metro consider SIBs to be a more or less risky funding model? Why or why not?**

None of the interviewees from the public sector had previously heard of SIBs. As such, an explanation of SIBs was given to each public sector interviewee prior to the interview. At the commencement of each interview, the interviewer verified the understanding of SIBs from the pre-interview information sent. This was followed by an explanation of the concept of SIBs. Their prior knowledge of bonds and capital markets in general enabled them to quickly grasp the concept of SIBs. Having understood the difference between traditional bonds and SIBs, the interviewees confirmed that they had not previously heard of SIBs.

- Respondent E stated that the metro issued a green bond in 2014, which the respondent believed was a step towards issuing a SIB in future. Prior bonds had been issued in response in operating expenditure and capital expenditure needs, while the green bond was issued to fund the City's green projects, and in fact became the first bond in South Africa listed on the JSE. This, she said, was not surprising as the metro was the pioneer of municipal bonds. Therefore, with the direction in which the municipal debt profile was progressing, "*we would definitely explore these bonds (SIBs) as I think they could be a natural progression from what we're currently doing*."

- Respondent F stated that the metro had not considered SIBs as an alternative funding model because of being unaware of them. With this new knowledge, the metro would definitely be looking into them. *"There is no credit risk for the metro and the performance risk is carried by the investor. This is absolutely something the metro would consider."* However, despite government not carrying any risk, he added, its important that government should be careful to not set impossible targets which they themselves would not otherwise meet. They must balance the measures with their achievability; a probable imbalance could be mitigated by selecting an NGO with a credible track record. Not doing so would jeopardise the credibility of future SIBs, and a negative reputation could increase the cost of SIBs and render them unfeasible for the metro.

- Respondent K said they weren't currently being considered as they were unknown. Despite posing less financial risk for the government, the current uncertainties coupled with an unknown track record could make them challenging to issue. None the less, plans to issue the first bond in the municipality were currently underway. Respondent G shared this view, adding that the risk of this model was not financial for government, it was social; delivering on the promise of increased and improved social impact.

3. Does the government believe that there are indeed significant cost savings to be made from the use of SIBs? Why or why not?

- Respondent F stated that costs were an important consideration in determining whether the metro could or would issue future SIBs. It was important that the SIB be cheaper than government giving NGOs money directly, performing the services themselves or any other current practise, otherwise there would be no point in issuing SIBs from a budgeting perspective. Furthermore, he added, current government development work is focused on societal impact, not financial impact.

Thus even where savings could be made, wider societal impact would be an important consideration in the use of SIBs.

This respondent contended that the inclusion of community based organisations (CBOs) into the SIB structure would inadvertently lead to investment in the communities, as these organisations were usually staffed by members of the respective communities. Thus each community would receive the services of the SIBs and the investment from the SIB investors. This would create an effective saving for the government. He believed that CBOs should be deliberately included, alongside NGO.

- Respondent G addressed this question by asking how the savings would be measured. This would determine the possible cost savings he said.

- Respondent E did not necessarily believe the SIBs would lead to government savings, as government was already spending these funds anyway. However, she conceded that they may lead to improved service delivery of social programmes, the financial impact thereof being unknown.

- Respondent K believed that the cost savings were dependent on the social service being addressed by the SIB; the anticipated social outcome and the impact thereof. Thus she believed that the cost savings would be outweighed by significant social benefits from SIBs.

4. Is there sufficient technical skill and expertise to dedicate to the use of SIBs? Please explain your answer.

- Respondent E and F both said that they did not have a skills shortage, as their metros have previously issued bonds, and even have bonds currently in issue at the moment. The vast experience and knowledge of the teams with bonds provides sufficient required skill. The challenge is the setting up of a team dedicated to SIBs. Respondent E suggested having individuals seconded from the different departments to form teams, similar to the current practise of having multi-skilled teams dedicated to a specific bond.

- Respondent G did not believe that sufficient skill and expertise were the challenge, rather it was the regulation surrounding the formation of SIBs and a lack of political will / leadership. Buy-in from government leadership would, he said, assist in setting up and facilitating teams with the necessary skills.

- Respondent K stated that the metro was currently working with other metros and the private sector, exploring the issue of an inaugural bond issue in the metro. Thus she was unsure of the depth of technical skill and expertise at present within the metro. She intimated, however, that the bond issue was a priority for the metro, hence they may increase in-house skills, or supplement them with external partners.

5. Does the Metro believe that there is sufficient public knowledge and understanding of SIBs to attract the investor market interest? Please explain your answer.

All the respondents agreed that significant marketing would be required to make the investment community aware of SIBs as a new investment opportunity. Respondents E and F, having participated in the launch of inaugural bonds in their respective metros, did not see this as a significant issue or challenge. Rather, they said, this would require a roadshow to introduce SIBs and their investment potential to the investment community. Respondent E added that an extensive public relations campaign, possibly including an extended investor roadshow programme, would most likely be required to increase knowledge and understanding about SIBs. Previous campaigns and roadshows had been a combination of internally driven communications and commissioned communications.

The positive track record and credit profile metros have with investors, never having defaulted on a payment, be it for a coupon payment or redemption at maturity, would bode well for a potential SIB issue, respondent G added. Respondent F mentioned the Ambassador’s programme in the metro, where successful metro initiatives are celebrated to increase the profile of the metro. These Ambassadors helped to increase the profile and activities of and within the metros. They were also significant investors in the metro. Respondent F believed that they and their networks would be potential SIB investors.

6. Would the Metro be willing to hand over significant control to intermediaries, as per SIB model, should a SIB model be used?

All the respondents mentioned, in varying degrees, the importance of government participation in the structure of SIBs. The arm's length relationship of the current structure was deemed inappropriate. Closer co-operation between government and NGO service providers was necessary.

Respondent E stated that as the metro already had existing significant dealings and relationships with many NGOs, the metro would want to continue maintaining these relationships. Where new NGOs would participate in SIBs, she stated that it would be important for government to build similar relationships. This respondent did not see the need for an intermediary, rather she suggested a core team, or pseudo executive committee, with representation from all the parties and external, independent third parties, to effectively undertake the duties of the intermediary. Respondent K echoed this sentiment, adding that current legislation and funding policies need to be examined to determine whether government could issue an effective guarantee for an external third party transaction over which they only had an arm's length relationship.

Respondent F and G both highlighted the need for a clear, transparent and agreed communication policy / process to be put in place, to regularly update all the SIB participants on the developments. This, Respondent G stated, should be set up alongside the setting up of the SIB from inception to maturity. According to respondent F, the credibility and success of the SIB structure would have a direct impact on the reputation of the metro and government in general, hence government must have a meaningful relationship with the intermediary, which he also suggested should be a core team, rather than external third party.

7. It takes on average 2 years to set up a SIB; would this be fine or a deterrent from undertaking a SIB?

- Respondent G stated that the duration of the entire life of the SIB, from conception to launch to maturity could be a deterrent. He explained this position, stating that the successful launch would be dependent on the continuity of leadership vision, which should not be changed or affected by a change in guard (national leadership) during the set-up period. The current challenge, he said, is the instability of leadership and policy which changes relatively quickly, thus not giving policies sufficient time for the potential impact to be effected.

- Respondent E said that the duration to set it up was too long, and would need to be reduced, even though she conceded that it would be longer than the duration to set up an ordinary municipal bond, which took no longer than 6 months. Having issued a green bond and several pioneering municipal bonds previously, she asserted that the set-up period need not be that long.

- Respondent F said the duration was not a problem, and could even be longer to ensure that the structure of the SIB was well thought out. He emphasised the need for municipality-specific considerations to be taken into account when structuring the SIB. One such consideration is that "*community based organisations and nation building organisations must be built into the design of SIBs because these organisations tend to do the work that falls between the work of NGOs and government. These organisations are of the people and for the people, hence their deliberate inclusion in the SIB structure would add to the credibility of SIBs in South Africa as encouraging active citizenry.*"

- Respondent K thought that 2 years is appropriate, especially as the metro had not to date issued any form of bond. She was, however aware of debt capital markets and ordinary bonds. The metro is currently undertaking a study on the possibility of issuing a bond, she said. She believed that after the launch of the inaugural bond in the metro, the response from investors would determine whether and when another bond would be issued.

5.2.2.2 Conclusions for research question 2

South African metros have not been exploring SIBs as a funding alternative for their social programmes, as most were not aware of SIBs. There was, however, consensus that SIBs ought to be explored as a potential funding mechanism. There were mixed opinions about the extent to which SIBs could bring about budget or cost saving for government; the transfer of credit or financial risk from the government to investors as performance risk was however still an attractive feature of SIBs.

Despite ambivalence about cost savings, there was a common perception that SIBs could bring about significant social impact. While the availability of the required technical skills and expertise varied across different metros, there was a recognition to increase or supplement these skills in some metros where necessary, because of the possible importance of SIBs to the metros. The lack of public and investor awareness about SIBs was not a hindrance to their feasibility; it required a public and investor awareness campaign.

The metros expressed concern about having arm's length participation in the SIB, as per usual SIB structure. The respondents shared a similar view that government should have a closer and more active role in the SIB structure than arm's length. Despite varied opinions on the appropriate duration for setting up a SIB, there was none the less a recognition that setting up a SIB would take longer than the set up of normal bonds.

5.2.3 Research question 3

Research question 3: *How would upfront funding affect the efficacy of the civil sector?*

5.2.3.1 Results for research question 3

Interview Questions:

4. **How is the impact of your core activities measured?**
5. **Is Monitoring and Evaluation conducted internally or by an external third party?**
6. **Do you submit or keep up to date official documents (Annual financial statements, activity reports, annual reports)?**

All three respondents confirmed that their monitoring and evaluation processes are internally determined and conducted, a common reason being that there had never been a need or requirement for external evaluation, previously. The funders were satisfied with the submission of annual financial statements and annual reports, as per requirement of the Department of Social Services to maintain their nonprofit status. They currently conduct their own monitoring and evaluation.

According to Respondent D, whilst the organisation was a nonprofit organisation, it was also a non-loss organisation. This organisation was involved in revenue-generating activities. The key to their financial success was in ensuring that every member of the organisation, irrespective of position or level, knew and understood the revenue generating model of the organisation, and how their position or specific job contributed to the model. This made every individual accountable for the success of the model, and reduced nonproductive behaviour. The uninterrupted cashflow cycle, unhindered by unsatisfied, non-paying or late paying customers, was of itself a systemic monitoring and evaluation process with direct impact on the organisation's revenue generation ability, according to respondent D. The stability of the cashflow cycle was a testament of the social impact of this organisation. External monitoring and evaluation was on a business improvement basis, rather than on social impact monitoring and evaluation.

Respondent C was also involved in a revenue-generating NGO. The impact of the organisation was measured in numerous ways:

a) individual skills acquired (there were specific skills that the programme has identified as being key deliverables)

b) digital literacy

c) entrepreneurial skills.

The impact measurement and evaluation process was agreed to by the funders prior to funding, and evaluated at the conclusion of the activities, even though these were short-term measures.

The organisation of Respondent B was one of a few organisations which had formed a coalition with other NGOs and sought collective funding, and thus did not have a specific impact or outcomes agreement with funders. The nature of their work made it difficult to quantify the impact. She admitted to recognition that funders were increasingly requiring external impact reports despite the practise not being common among most NGOs in South Africa. External monitoring and evaluation requirements, according to the investor respondents, forces increased vigour in NGOs which increases the comfort of private sectors.

7. Does fundraising take away time from delivering your core services? Please explain your answer, giving estimates.

The unanimous response was "yes" among all the respondents, but the time taken relative to core activities varied across the organisations. The variance was largely a factor of the existing funds or a capital base, and the extent of the fundraising skills within the organization.

Respondent C stated that 70% - 80% of their time was spent fundraising at the onset. This time did not reduce significantly even when the revenue split became 65% self-generated and 35% donor given. Respondent D admitted that receiving a significant initial donation put them ahead of their peers, as they could focus on developing their core activities, and on building their nonprofit, non-loss operating model. Respondent B stated that up to 80% of their time is spent on fundraising, the inverse of what she believed the ratio should be, 20%:80% (fundraising: core activities). Respondent B was a part of their small fundraising team while Respondent C was the lead fundraiser of the organisation.

8. **If funding for core activities were received upfront for a period of 5 years, how would the impact be affected?**
9. **If funding for core activities were received upfront for a period of 5 years, would the impact be a 1:1 ratio or would it be larger? Please explain your answer.**

- Respondent A, a philanthropic investor, supported the concept of SIBs as he believed that upfront funding would allow NGOs to plan better for the next 5 years, in terms of operational and strategic plans. This, he said, would allow NGOs to get into longer term agreements on more favourable terms, even enabling them to leverage these funds to access additional funding.

- Respondent D stated that they received a large donation upon inception, which put them ahead of similar organisations at the time and significantly improved their impact. *"In 1994, the organization received R50million which was a lot of money then, which is now worth just over a billion, in properties not cash."* As a result, he believed that receiving this funding upfront allowed them to quickly learn, adapt and scale up their activities. The learning, and associated mistakes (or learning opportunities), happened in a relatively safe environment where funding would not be withdrawn because of said mistake.

- "*90% of our time would be spent on core activities, and 10% on managing the funds and associated governance requirements"* according to respondent B should they receive five year upfront funding, the ratio being no less than 1:4. This would significantly increase the impact of their activities. Traditional donor funding was decreasing, hence she believed that this upfront funding would have a significant impact on the development sector in general. Both South African and foreign donor funding had been decreasing, having watched peers shut their doors, which placed additional strain on fundraising activities and increased the time spent on fundraising.

- Respondent C believed that the ratio of income to output with five year upfront funding would be at least 1:3 or significantly more! Most importantly, upfront funding "*would have accelerated our ability to scale up because more funds mean you can work with more people, and that directly has an influence on your ability to increase your impact.*" She added "*it would affect our ability to negotiate with suppliers and improve our revenue earnings.*"

5.2.3.2 Conclusions for research question 3

The respondents confirmed that none had undertaken external measurement and evaluation previously, and that current impact evaluations were undertaken internally based on internally generated measures. They had, however, been submitting required annual documents, such as financial reports and annual reports. Existing funders accepted this practice.

The respondents unanimously agreed that upfront funding would reduce the time spent on fundraising, and provide leverage to increase the impact of their activities, hence all opined that the ratio of upfront funding to impact would be at least 1:3 or more. Upfront funding would also improve operational and strategic planning of the NGOs.

5.2.4 Research question 4

Research question 4: *What constraints for each of the three parties (investors, municipalities and civil sector) would limit / prohibit their participation in a social impact bond?*

5.2.4.1 Results for research question 4

II. Private sector: Investors

- Respondent A mentioned that when organisations make a donation or particular investments, they receive B-BBEE (broad-based black economic empowerment), CSI (corporate social investment) or SED (socio-economic development) points, according to current legislation. This money is given without expectation of return, hence current legislation does not as yet deal with the return of said funds. Nonprofit organisations may receive funds, and for-profit companies receive points for the disbursement of funds. This poses an administrative challenge as no legislation exists to address for-profit companies which reimbursed these funds. Neither is there legislation on the allocation of points earned from funds previously donated.
- Respondent G and other respondents all spoke of the need for the culture of investment to evolve, as the private sector is currently employing the CSI grant funding model. There seems to be resistance to the act of being refunded money previously donated as financial returns are associated with investments while donations are associated social investment / impact. *"The idea of endowments and patient capital is familiar in the USA, not here (South Africa). Most funders and donors are very reluctant to put money into a capital base because they would say that they want to see immediate results with their money; they want to fund programmes and not salaries."*
- Some respondents spoke of the requirement that funders often have to get involved with the (donor) recipients or beneficiaries. This is not the case with SIBs. However, some investors expressed a desire to stay closer with the NGO service provider to *"interact with, share and learn together with the NGOs during the course of the SIB."*

III. Public sector: Government

- While Respondent E did not see any contradiction or conflict between the municipality and the mandate of national treasury, she stated that permission would be neither necessary nor forthcoming from treasury. They would, however, inform treasury of the SIB.
- Respondent F echoed this sentiment, and added that the requirements of the government investment frameworks or guide must be examined against the role

expected of government within the SIB structure, to ensure seamless integration and no conflict.

IV. Civil sector: NGOs

- Respondent C believed that NGOs should understand and be comfortable with the terms and targets set in the SIB structure, and ensure that they are able to meet the targets set before participating in the SIB, which targets had to be reasonable and attainable, according to respondent F.
- Respondent C said it is important that all stakeholders to the SIB must recognise that success is dependent on more than one stakeholder. Therefore, the necessary stakeholders (including beneficiaries, direct and indirect) must be engaged and ensure that they buy into the process that will ensure the success of the SIB. Therefore, co-creating the process of the SIB would, she continued, increase the probability of success.
- Respondents from the civil sector thought it important that government consider *"a way to incubate innovative social development models by new social development practitioners to get them ready to create a space for new, younger social development practitioners so that they may participate in the SIB structure and be investor ready. While many long-standing social service providers have proven methods, they may not necessarily be keeping up with current trends and practices,"* added respondent C.
- Respondent B reiterated the need for a leadership or management structure of the SIB, such as a board, to be set up and agreed upon upfront, wherein all the different sector participants would be represented and have equal say. She emphasised the equal say, as the current donor funding models provide little room for NGOs to have a say or make a contribution.

5.2.4.2 Conclusions for research question 4

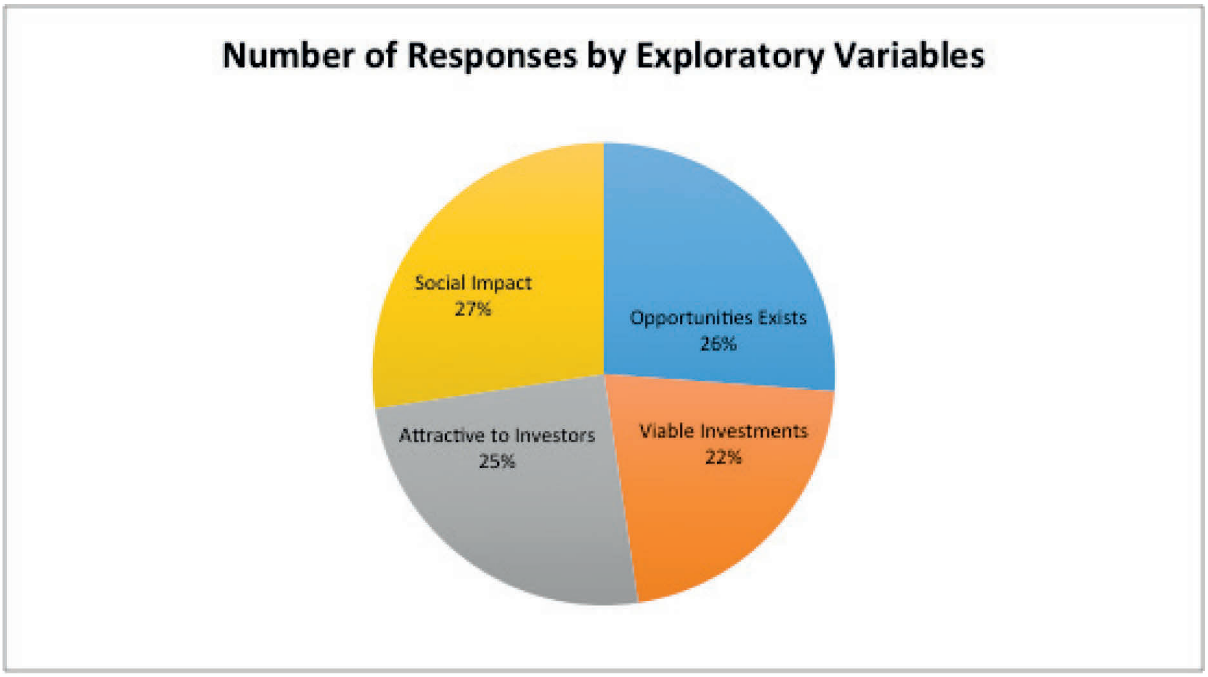
Respondent D summed up research question four with the statement: "*For future success, think big and act small. It is easier to achieve success this way.*" This statement alluded to the fact there remained many issues of varying importance that needed to be effectively addressed if SIBs were to be issued in South Africa, and the metropolitan municipalities therein.

The key hindrance for investors was the lack of a legislative framework for dealing with the uniqueness of the SIB structure. This was probably the greatest prohibitor among all the different sector players. There was no real constraint for the public sector, merely a need to ensure that the SIB structure was not in contravention of any public finance management guideline. The constraint for the civil sector was around fully understanding the SIB structure and their role within it, and their internal capability to deliver. All the respondents agreed that participation in the formation of the SIB structure from inception is necessary for all participants, wherein the contributions would be considered equally.

5.3 Data Analysis Results via Atlas.ti

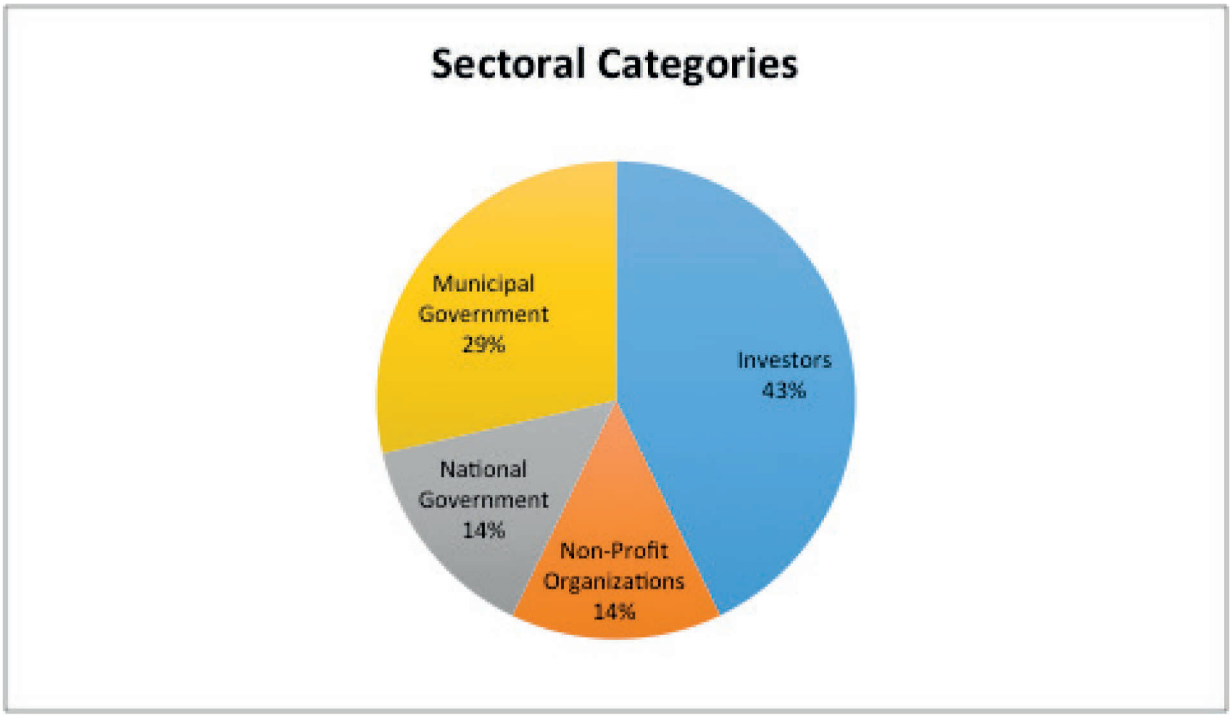
The software programme Atlas.ti is a qualitative analysis tool that was used to examine the probable responses of the respondents who had been interviewed. The data analyzed for this research was interviews that had been stored in audio and transcribed into written records. The desired information, or exploratory variables, sought to determine the general key motivation for possible participation in the SIB structure, and the motivating factors by sectors that would encourage participation in a SIB structure.

Figure 6: Exploratory Variables



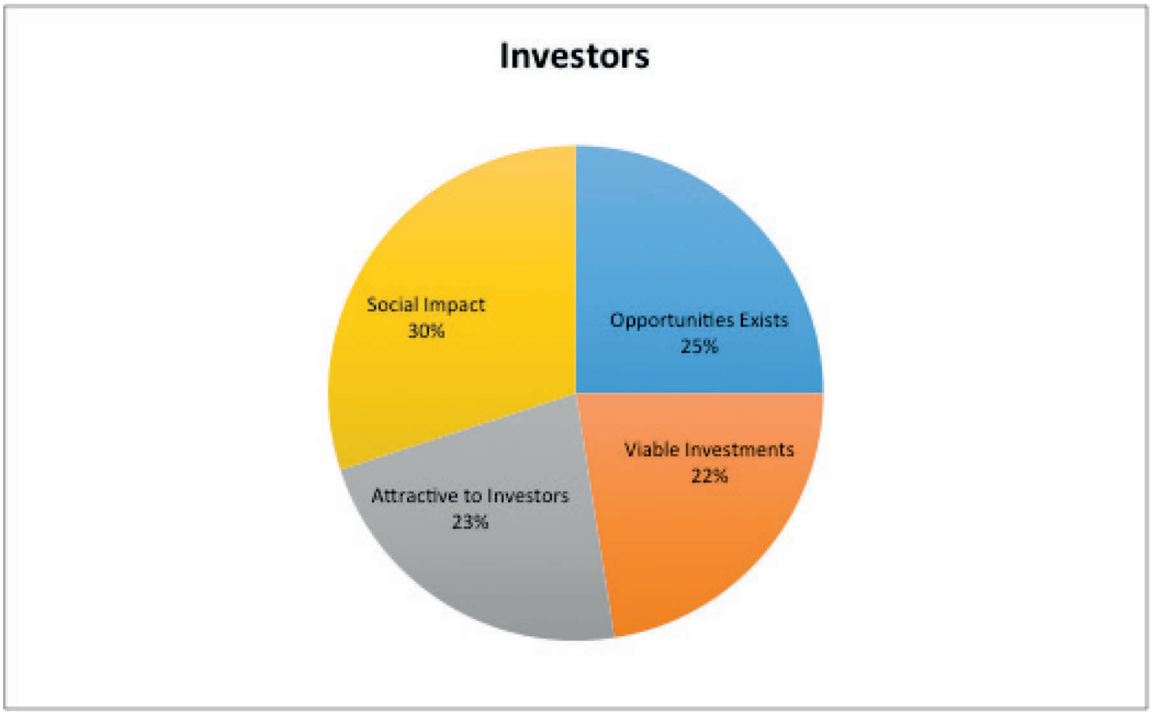
Looking at Figure 6 above, it is evident that social growth is of paramount importance in the stability of citizenry and the ideals of living to achieve greater prosperity. The inference that can also be drawn is that impact investing alone is not a solution, but in conjunction with public, private and philanthropic capital, as well as an improved business environment in SA, it can help make a considerable difference in addressing some of our day to day challenges we face as society.

Figure 7: Sectors in Society



Looking at Figure 7 above, the population of the sector which identifies the aspects of social growth as important to drive sustainable development is the business fraternity. Thus for such to thrive, the country requires a more intentional and proactive partnership between government and the private sector. The greatest challenge is the lack of a robust ecosystem with a confluence of reliable actors, institutions and mechanisms to support the sourcing, facilitation, securitization, intermediation, structuring and promotion of the infancy of the impact driven investment market in South Africa, which has yet to be developed in line with societal dynamics today.

Figure 8: Exploratory Variables by Investor



In Figure 8 above we illustrate the exploratory variable relative to sectoral category, which gives a perspective of desire to drive social growth within the context of private resource allocation, not as just a donation, rather with the end goal in mind to achieve sustainable societal upliftment. The social impact percentage is expressing the appetite the investors have to achieve positive outcomes, improved lives and benefits for all citizens as a point of reference, other than just having an attractive investment potential. The opportunity for impact investment is SA can be considered a green field to further bridge the gap between the higher quartiles and lower quartiles in societal disjuncture we are confronted with in South Africa. This opportunity for Impact investment, however, takes place within the charity model than the investment funding model, where investors make donations/grants without expectation of a financial return

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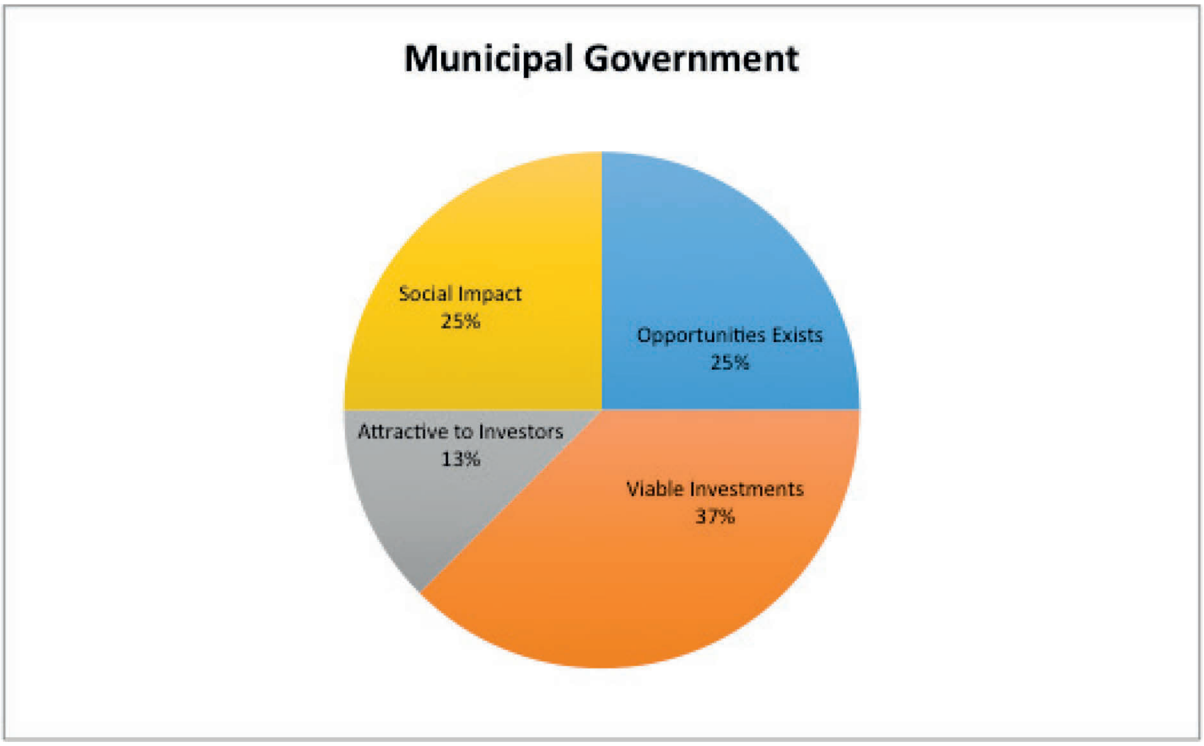
Figure 9: Exploratory Variables by NPO

Most NGOs in South Africa are seen as professional beggars to industry, given the landscape of societal challenges since the dawn of democracy in 1994. This is more especially since statistically the gap between the haves and the have-nots has grown significantly, as illustrated by the increasing Gini-coefficient in South Africa. In Figure 9 above, civil society is in the midst of identifying opportunities to drive social development. This informs us that if time were spent focusing on the innovative and measurable outcome-based activities driving societal improvements, without efforts in seeking funding, then a cohesive and consistent results-driven civil sector could be built.

Figure 10: Exploratory Variables by Local Government



The local municipality sees investment viability in driving service delivery to the citizenry using alternate means to fund expenditure. Figure 10 above tells us that where there is an opportunity to impact society, there is an equal reaction to drive investment dynamically, thus a SIB can be seen as another option to drive social balance. It is critical to influence the market to attract more players to increase diversity in the investor base to eliminate any potential threat to societal stability and growth in citizen potential. There are pockets of excellence visible in the local authorities as evidenced in the responses received.

Conclusively, as it is, the failure at the social front in the era of liberalization has been translated into increased inequality and social unrest. While the GDP growth is sluggish, and yet an absolutely essential tool for societal development, it should be seen more in terms of hitherto unseen social opportunities. For South Africa to achieve inclusive and participatory growth, focus should be on substantial investment in human capital to ensure efficient delivery through good governance and create opportunities for economic participation at all levels in society. This can be achieved through the design and implementation of relevant, impactful social development and intervention rather than remedial programmes, that could be funded by SIBs.

Chapter 6: DISCUSSION OF RESULTS

6.0 Introduction

The results from research as presented in chapter 5 are discussed in this chapter, against the body of publicly available theoretical and empirical literature on SIBs, as presented in chapter 2. The examination of these results is to answer the research questions presented in chapter 3. This chapter then presents a comparative of these results, making inferences between and within the respondent groups to determine and identify salient themes and, where necessary, divergence in the South Africa SIB context from current practice and existing literature.

According to Jackson et al (2012), the key players within the social investment ecosystem, which includes SIBs, are capital funders (investors), capital recipients (NGOs), government and intermediaries. As such, the results discussed in this chapter are from respondents who are either investors, working in NGOs or working within government. The issue of identity and / composition of intermediaries within the South Africa SIB context brought about discussion, and in fact some consensus from the respondents. These intermediaries will be discussed later in this chapter.

6.1 Research Question 1

Research question 1: *In terms of fiduciary duties, are traditional investors and institutional investors driven by a financial-value approach or blended value approach? If blended value approach, to what extent do the profit and social motive affect investment decisions?*

6.1.1 Results for Research Question 1

Interview Questions:

1. **What are the core issues and considerations of your investment mandate?**
2. **What informs these considerations? (For example, financial returns, social impact, angel investment or legislative requirements.)**

3. **To what extent do socio-economic issues have an impact on the determination of the investment mandate?**

The primary motive for South African investors is the same as that of their international counterparts; to receive a risk-linked return on their investment to mitigate the risk of non-payment. This has similarly restricted the appeal of SIBs to more philanthropic investment (Mulgan et al, 2011) as SIBs transfer government credit risk to investors who now carry performance risk.

There is, however, a significant difference for South African investors' resistance to SIBs. Firstly, SIBs are little known as no SIB has been issued in South Africa or any other developing country to date, which creates uncertainty, which fuels a perception of risk. Secondly, the social investment culture in South Africa is very different from the social investment culture in many developed countries. In South Africa, it is mainly driven by legislation and business governance practices, such as B-BBEE, SED and CSI, which require that companies account for their social investment / development spend on an annual basis. Companies are then assigned points based on their adherence, and receive a score without which they may not do work with government. Companies are not only required to spend 1% of pretax profits on social development or 'investment', but they also receive a tax benefit as all funds donated are tax deductible. This entire set-up is designed to support and perpetuate an annually based charity / social 'investment' model. Even when companies get into multi-year agreements with NGOs, the governance and tax process must be undertaken on an annual basis. The existing legal framework and tax system support this model; hence changing the investment culture would not merely be an exercise for investors alone, but a change in the entire legal and tax system.

4. **Would you invest in social impact bonds if the anticipated returns met your investment mandate requirements?**
5. **The average SIB lasts 5 - 7 years. Would this duration affect your investment decision in any way?**
    1. **If yes, how would it affect the investment decision?**
    2. **If no, what would affect the investment decision besides financial returns?**

Uncertainty about SIBs is a major concern for traditional investors, hence their demand for risk-adjusted, commensurate returns. While the literature highlighted a concern about the small pool of investors, and the need to grow this pool to fulfill the growth potential of SIBs, South African investors did not highlight this concern. Meeting their investment requirements was insufficient; their concern was the issue of liquidity, and the inability to trade SIBs on a secondary market for the duration of the SIB, which was usually five to seven years. This issue was especially relevant because of the nascence of SIBs. The literature did not address this concern.

The other important issue for South African investors was concerning the SIB structure, and in particular the selection of NGO service providers, whose performance was paramount to achieving their investment objectives. The investors wanted to somehow participate in the selection of NGOs and wanted to maintain a closer than arm's length relationship with the NGOs, from conception and throughout the life of the SIB. Critics of SIBs could view this active involvement as creating an opportunity for collision with other SIB network players (Rosenman, 2013). The lack of universally accepted ratings of social impact investments and social impact investment opportunities, as mentioned by Martin (2013), were not an issue for South African investors. This was perhaps a consequence of the existing social investment culture in South Africa which is focused more on immediately identifiable social outcomes and financial contribution via donation, grant or gift than on social impact.

The notion of monetisation of social benefits is neither a widely held nor condoned social model in South Africa. It is also a challenging task. However, Respondent D, from the civil sector, said "*in the most informal and poorest parts of the population, there's always a market operating…in squatter camps…even in prison. So its a misperception that social activities are not marketable."* If this opinion could be proven, it would contradict the assertion by Stoesz (2014) and Warner (2013) that interventions with quantifiable social benefits that may be monetized are more attractive and thus prioritised over interventions that are difficult to monetize, despite their positive track record.

Respondent D's opinion, supported by extensive literature on the economic wealth and potential embedded in the bottom of the (economic) pyramid (poorest of the poor communities), suggests that investors would invest where they would make the greatest economic profit, with lesser (than economic) regard for the social impact imperatives. "*Low-income markets present a prodigious opportunity for the world's wealthiest companies – to seek their fortunes and bring prosperity to the aspiring poor"* (Pitta D., Guesalaga R. and Marshall P., 2008). In the book *The Fortune at the Bottom* *of the Pyramid: Eradicating Poverty through Profits*, C.K. Prahalad (2004) succeeded in planting the perception that consumers with low levels of income could be profitable customers by painting a picture of the double bottom line: social goals combined with the business objective, profit.

6. **Would you invest in SIBs with returns being contingent upon social development goals being met?**
    - ii. **If yes, please explain your answer.**
    - iii. **If no, would a government guarantee on returns make SIBs more attractive?**
7. **Do you perceive SIBs as being a higher or lower risk investment? Should there be a commensurate return for investing in SIBs (higher risk-higher return; lower risk-lower return)?**
8. **Should the social impact of SIBs lower or increase the returns demanded?**

Looking at the responses of South African investors, SIBs do not necessarily fall on the continuum of (social benefit) funding activity, discussed by Disley (2011). Funding activity in South Africa ranges from grants / gifts with no expected return (except for reporting), on the one hand, to commercially-based investments on the other hand, as discussed by Disley (2011). The challenge in South Africa is that of a different investment culture, where the investment is either economically-driven or social impact driven. Where it is social impact driven, the investor is a type of philanthropic investor such as an angel investor or patient-capital, not a traditional investor. Therefore, a guarantee does not necessarily encourage traditional investors.

A guarantee, issued by a philanthropic foundation, managed to convince Goldman Sachs, the singular non-philanthropic investor, to invest in a SIB. Interestingly though, the guarantee was not to mitigate non-performance risk by the NGO, it was to mitigate non-payment risk by the government (Warner 2012). Contrary to this perceived risk, South African government and South African municipal bonds have performed well to date, and have never reneged on their payment responsibility, and thus have a good credit record in the investment market.

South African investors are concerned about non-performance risk and loss of investment, and subsequently view SIBs as a higher-risk economic investment tool, with reduced regard for the social impact. As a result, South African investors seek (higher) commensurate risk-adjusted returns. Porter and Kramer (2006) support this by arguing that firms can gain economic returns by tackling social issues, based on gaining an advantage for the company, and thus not necessarily driven by the importance or even the impact of social investing. As such, it could be argued that the investors described by Porter and Kramer (which could easily include South African investors) are not necessarily seeking a blended-value approach; rather they view social investment as a means to an economic rather than social end, for which a risk-adjusted return is sought.

McKinsey and company (2012) suggest that the risk of losing all capital is unlikely to be offset by a potential upside, making it a deterrent to would-be traditional investors. Hence altruistic investors are the only probable investors. While this may hold some truth for South African investors, the mitigation of non-performance risk through the introduction of rigour to NGOs could, in time, reduce this perceived risk, and thus the cost of SIBs. Philanthropic investors would not be dissuaded by the performance risk, as their focus is primarily social with economic profit being either equally important, or even secondary.

6.1.2 Conclusion for Research Question 1

The appetite and probable support for SIBs, as a new and as yet untested social investment model, by traditional South African investors has been low, and significantly higher for philanthropic investors. This is in line with the findings of Kimbrell (2014) who found that foundations and philanthropic sources generally fund new, untested approaches to addressing social problems. According to Kimberly (2014), SIBs provide a more socially and financially viable option for social service delivery than privatization, an antecedent of SIBs.

Interestingly, both traditional and more philanthropic South African investors, have previously and continue to participate in the antecedents of SIBs. Philanthropic investors have been following a social impact investment model, by virtue of their legal constitution and investment mandate, while traditional investors continue to follow a socially responsible investment model. The difference is that socially responsible investing is an investment protocol that seeks to avoid producing social or environmental harm, while social impact investment seeks to proactively invest in organisations, firms and funds that create positive social impact in addition to financial return (GIIN, 2007). The SIB model places emphasis on the changes that result from social intervention programmes (Warner 2012), while the investor model places emphasis on financial return, without or minimising the harm done in the process.

Business today is under increasing pressure to adopt or improve its corporate social responsibility (CSR), and this pressure has strategic and moral imperative (Boulouta, I., Pitelis, C.N., 2013). As the primary beneficiaries of the 'ills of globalization' (Freeman 1984; Wood 1991; Carroll 1999), business has obligations to multiple stakeholders, including the society at large. Hence they have a role to play in addressing some of the ills as they were and are. In South Africa, there is a particular need to correct the ills of the legacy of Apartheid which included systemic segregation and economic exclusion for the majority of the population.

It is not clear from the research whether in South Africa the impetus to adhere to this pressure of corporate social responsibility / investment, whether via B-BBEE, SED or CSI, is driven by the need to have these points to enable companies to do business with the South African government or by a recognition of the need to correct said ills. Government may view such transacting with business as outsourcing a public social service by means of privatisation whose goal is to deliver social outcomes. The private sector seems to view privatisation, described by Liebmann (2011), as an entrenched economic transaction with no agreed social outcomes, as an economic transaction whether social benefit is a byproduct of the transaction, rather than the primary objective.

All the investors interviewed had previously been a part of a PPP arrangement. While the more philanthropic investors recognised the scope for social impact, and were attracted to the PPP arrangement because of the additional social impact, the traditional investors participated for economic reasons. Had they participated primarily for altruistic reasons, government would not have assumed more risk at a higher cost than was originally anticipated (Sclar 20009, Ashton et al 2012).

The SIB structure mitigates government's struggle to transfer risk to the public sector (Whittington 2012) in PPP arrangements by transferring the performance risk to investors. Had they (investors) had altruistic motives for doing business with government, they would not demand higher returns adjusted for 'uncertainty' or performance, as SIBs are structured on lower success models than what proven programmes and NGOs indicate (Warner 2012). Furthermore, the timeframe of SIBs is significantly shorter than that of PPPs, which should further reduce the risk and therefore cost of SIBs.

Thus while the literature suggests that SIBs could be a viable social investment vehicle, the South African context, beset with social investment legacies, would need a systematic and systemic overhaul before being suitable or appropriate for a SIB issue.

Initial investigation further suggests that foundations and philanthropic investors, who generally fund new, untested approaches to addressing social problems would more likely have an appetite for SIBs, while traditional investors would have a greater appetite for privatization (Kimbrell, 2014).

6.2 Research Question 2

Research question 2: *Would one of the 8 South African City Metropolitan Municipalities consider issuing a SIB?*

6.2.1 Results for Research Question 2

<u>Interview Questions:</u>

1. **Are social impact bonds (SIBs) currently being considered by the Metro as an alternative funding instrument for social development spending? Why or Why not?**
2. **Does the Metro consider SIBs to be a more or less risky funding model? Why or why not?**

While none of the metros were considering the use of SIBs because of having no prior knowledge about them, they agreed with the Bertha Centre's (2012) view that SIBs would assist where a pressing and identifiable social challenge requiring intervention rather than remedial programmes was identified. Respondent F in particular spoke of the challenge of nyaope, which destabilised society at large but was difficult to fund because it (nyaope addiction) was perceived as being self-inflicted, and hence did not merit government assistance. This perception confirmed Warner's (2012) suggestion that SIBs could allow government to invest in prevention programmes among societal groups typically lacking a voice, popularity and visibility in the broader political system.

Some respondents indicated that they were familiar with traditional bonds, as the metro had previously issued them. Thus they were familiar with the first two of the three types of PbR systems discussed by Keohane et al (2013), namely:

a) public finance, government delivered
b) public finance, non-government delivered (such as PPP and Privatisation)
c) private finance, non-government delivered.

Respondents with previous bond issue experience felt that SIBs "*could be a natural progression"* to the existing funding models, including the two types of PbR above. They also admitted to already using the PbR to fund some of their projects, which supports Disley's suggestion that SIBs can be viewed as a derivation of the third model, linking private capital with NGO service providers (Disley et al 2011).

Respondent F cautioned that despite government bearing neither the credit nor performance risk, government would bear reputational risk, echoing the same sentiment as Warner (2013). Both respondent F and Warner (2013) recognised that non-performance by the NGO service providers would jeopardise the reputation of future SIBs, whose success is contingent upon attracting investment (or investors) to fund future additional SIBs (Warner, 2013).

3. Does the government believe that there are indeed significant cost savings to be made from the use of SIBs? Why or why not?

The social value creation proposal of SIBs, as presented by Brown and Norman (2011) in the following equation :

"Financial value = Price paid for social value – Cost of creating that social value > 0"

They were ambivalent about the cost savings, but supported the potential for SIBs to bring about significant social impact.

A suggestion by one respondent to deliberately include CBOs in the SIB structure, could bring about effective savings through each community receiving the services of the SIBs and the community receiving investment from the SIB (through investment in the CBO service provider). Defourny et al (1990) supports this suggestion, stating that in society today the civil sector is involved in the allocation of resources through the production of many quasi-public goods and services, and the redistribution of those goods and services through voluntary contributions, in cash, in kind or through volunteering.

4. **Is there sufficient technical skill and expertise to dedicate to the use of SIBs? Please explain your answer.**

All the respondents declared that they possessed sufficient in-house financial skill and technical expertise, and where necessary would seek external assistance. However the SIB structure places the greatest responsibility for possessing various skills on intermediaries, as they are the link among all the SIB actors.

5. **Does the Metro believe that there is sufficient public knowledge and understanding of SIBs to attract the investor market interest? Please explain your answer.**

While it is the role of the intermediary and government to increase market knowledge and understanding of SIBs, respondents were of the opinion that the government should take the lead in an extensive public relations campaign and investor roadshow, whether by doing it internally, commissioning it or both. The confidence and suggestion came from their previous experience of launching inaugural bonds in their metros. Government believed that understanding by investors would reduce uncertainty, hence the cost of the SIB would be reduced. They had witnessed this pattern with the launch of municipal bonds, which became less costly with each new additional bond issue.

Warner (2013) believed that the success of any SIB would attract additional investors to invest in future SIBs. Interestingly, the respondents from the metros which had previously issued traditional bonds believed that their good credit record would bode well for imbuing confidence in and attracting investors to invest in SIBs.

6. **Would the Metro be willing to hand over significant control to intermediaries, as per SIB model, should a SIB model be used?**

The literature and current practise in SIB structuring is for government to maintain an arm's length relationship with other SIB participants, especially the intermediary to whom government oversight is delegated. The rationale is that cessation by government of some powers and responsibilities within SIBs creates an arms-length transaction which should reduce government interference or influence and create a transparent meritocracy structure. However, this structure was deemed inappropriate by respondents. Respondents did not see a reason for government to cede the oversight responsibilities because of their already existing dealings and relationships with many NGO service providers. Government wanted to continue maintaining these relationships, rather than place greater accountability and responsibility on intermediaries, as the literature suggests.

According to the literature, intermediaries need to know how to conduct due diligence, raise capital from investors, and structure deals. They manage the SIB throughout the entire life cycle, including coordinating and overseeing the design and implementation, contracts and payment agreements between various parties. They select the appropriate service providers and provide technical assistance and build capacity for service providers and other SIB participants. All payments happen via the intermediary. Critics of SIBs and Rosenman (2013) cautioned that overreliance on intermediaries may shield government from full knowledge, making the SIB structure susceptible to collusion among the various SIB actors, at the expense of NGO service providers. Some respondents added that this overreliance was not ideal as the reputational risk of the SIB was borne by the government, and not the intermediary, nor did they believe that a single party could espouse the trust and transparency required of the intermediary.

To mitigate this overreliance, both government and civil sector respondents agreed that a core team, or pseudo executive committee, with representation from all the sectors and external, independent third parties, should effectively undertake the duties of the intermediary. This would address respondent K's concern regarding whether current legislation and funding policies permitted government to issue a guarantee, or participate in an external third party transaction over which it only had an arm's length connection or influence.

7. It takes on average 2 years to set up a SIB. Would this be fine or a deterrent from undertaking a SIB?

The first SIB took 18 months from inception to launch, which included parallel discussions with different actors to gauge interest and participation (Disley et al, 2011). This created shared risk and responsibility among the network actors. In general, SIBs take approximately 2 years to set up, because of the embedded complexity which takes time to resolve (Warner, 2012). The respondents generally agreed that 2 years would be an appropriate length of time to set up the initial SIB. Respondent G cautioned that there needs to be a consistency in the leadership during this period for the set up to be successful.

Respondent E on the other hand differed, saying that the process need not be so long as the bond set up period is significantly shorter, and this SIB was a development or variation, albeit more complex, of funding models the metro was currently employing. Disley et al (2011) supports this respondent's opinion, suggesting that as the SIB market grows in size, understanding and usage, shared knowledge will facilitate standardization, which should reduce set up costs and time. The Attention Curve, which presents the process of market acceptance and adoption as new investment categories are developed and introduced to mainstream markets, adds credence to the opinions of respondent E and Disley et al (2011). Liebmann (2011) added that SIBs provide information which would allow policy makers to evaluate effectiveness of interventions during the delivery, whilst allowing NGOs to learn on the job. This continuous information gathering and evaluation would speed up the typical process from small scale pilot to evaluation to implementation / scaling.

6.2.2 Conclusions for Research Question 2

The goal of SIBs is not to replace the public sector (Roman, 2013). Similarly, respondents did not see SIBs as an alternative to the public sector. Instead, they would consider issuing SIBs which they viewed as a means of assisting them (government) to source additional capital, to create a social service infrastructure whose already identified programmes would be aligned to the municipal, provincial or national imperatives or priority areas. The perception that SIBs carried reputational risk but no credit or performance risk for government ratified this view.

6.3 Research Question 3

Research question 3: *How would upfront funding affect the efficacy of the civil sector?*

6.3.1 Results for Research Question 3

__**Interview Questions:**__

1. How is the impact of your core activities measured?

2. **Is Monitoring and Evaluation conducted internally or by an external third party?**
3. **Do you submit or keep up to date official documents (annual financial statements, activity reports, annual reports)?**

The Bertha Centre (2014) identified seven characteristics which need to be present in any situation for the issuance of a SIB. Three of these characteristics are:

1) evidence-based intervention that has been tested and shown to be effective,
2) robust outcome metrics with identifiable measures to which success can be attributed,
3) benefits which are measurable and can be monetized into a viable investment proposition for investors.

The admission by the respondents from the civil sector that none had previously undertaken external monitoring and evaluation suggests the civil sector may not yet be ready for a SIB issue. Warner (2012) suggested that SIBs introduce the rigour of the private sector, the standards of scientific evaluations and the practise of market mechanisms to the civil sector. Indeed, the increased rigour is deliberately disruptive to the civil sector (Warner (2012), and could open the civil sector up to new financialization. The practise of nonprofit and non-loss employed in respondent D's organisation was testament to how employing increased rigour to an NGO can yield superior social impact and economic returns.

According to Werneck and Havemann (2013), SIBs are best suited for areas and interventions where credible baseline data is available. This places great importance on the need to improve upon the outcomes measurement and to strengthen the attribution of interventions to outcomes (Keohane N. et al, 2013). The lack of impact assessments and external monitoring and evaluation among respondents is an important source of concern, as SIB payment is contingent upon achievement of targets, based on an existing baseline study. To mitigate this challenge, existing internally generated monitoring and evaluation processes could be tested to approximate an initial proxy baseline point.

Persistent structural inequality in societies, compounded by the difficulty of traditional public policies to cope with new economic and social challenges, begs the question how far the civil sector can help to meet these challenges and consider taking over from public authorities in some cases. The current social, economic, cultural and political roles / functions which the civil sector continues to play in society today help to shape and formulate policies at local, regional, national and even international levels (Anheier, Seibel 1990). Government respondents believe that SIBs present a opportunity for the civil sector to increase the social impact of their work. However, failure to adapt to the increased requirement to adhere to monitoring and evaluation standards has decreased the civil sector's (and therefore NGOs') access to funding (Pratt, B., Myhrman, T., 2009), thus diminishing their ability to fulfill their role within society today. This increased requirement for impact reports is a practise among international funders and not South African donors, who request the annual report and annual financial statements that respondents submitted.

4. Does fundraising take away time from delivering your core services? Please explain your answer, giving estimates.

While the literature did not directly address the issue of time foregone to fundraising activities, Liebmann (2011) alluded to the time savings by NGOs when stating that SIBs can ease the tension and the limitations of the three PbR models by introducing Specialism. Specialism allowed smaller and more specialist organisations to get involved in delivery without cash flow hindrances. The major hindrance to NGOs within the PbR model was that NGOs received payment once the government ratified achievement of pre-determined goals. Failure to achieve goals meant non-payment, hence NGOs assumed both performance and credit risk in the PbR model. Thus smaller, specialist organisations were automatically excluded from the PbR model, irrespective of the credibility and impact of their work.

Liebmann (2011) and McKinsey and Company (2012) both agree that SIBs could provide funding for lesser known, alternative, innovative programmes with a proven track record and social outcome targets. However, McKinsey and company (2012) argue that the interventions must be already proven while Liebman (2011) suggests new interventions with evidence of effectiveness could be funded by SIBs. Liebmann's argument would enable innovative, specialist and newer NGOs to participate in the SIB structure, thereby negating the critique that entrenched interventions with easily quantifiable social benefits are more attractive than these newer, specialist NGOs with a positive track record (Stoesz, D., 2014; Warner, M., 2013). Selecting programmes with performance that is easy to codify and link to financial return could stifle further innovation, and rigid adherence to existing evaluation models creates the risk of creaming and ignoring downstream effects on related interventions (Warner, M., 2013). This can create superfluous government spending for inaccurately reported or even falsified results (Leifer, J., 2013). The introduction of newer, innovative, specialist NGOs may mitigate this risk.

5. **If funding for core activities were received upfront for a period of 5 years, how would the impact be affected?**
6. **If funding for core activities were received upfront for a period of 5 years, would the impact be a 1:1 ratio or would it be larger? Please explain your answer.**

Accessing government support and forming partnerships with government has proven difficult for many NGOs seeking to obtain funding and **build capacity** to fulfill their mandates (Habib, A., Taylor, R. 1999). Traditional funding sources for NGOs, particularly international funds, have been steadily declining in South Africa, as South Africa is viewed as a middle income economy (Kabane, N., 2011). The funds are now channeled through government via bilateral agreements, yet the government has inadequate expenditure of funds, which has led to a further decrease in donor funding (Kabane 2011). The lack of transparency or standardised criteria for government financing of social services, has led to discrepancies in the allocation of funds to NGOs (Lombard A., 2008), further limiting NGO access to government funding. This challenge was cited by civil sector respondents, none of whom utilise government funding.

According to Kabane (2011), 30% of South Africa's NGOs were forced to close due to funding constraints in 2013. Respondent B echoed this sentiment, having watched peers shut their doors. While Pratt and Myhrman (2009) cite issues of poor management, lack of transparency, poor planning and strategy as major contributors to decreased funding, the research did not necessarily prove this conclusively as the reasons for closure were merely cited as lack of funding, and the reason thereof (the lack) was not stated. Charities Aid Foundation (2012) believes that the demands for rigorous standards of accountability, transparency and financial self-sufficiency imposed by donors have had the unintended consequence of distancing NGOs from the very communities they're meant to serve. No evidence to support this was found in the research. Rather the experience of respondent D exemplified the contrary.

The literature alluded to the increased social impact that upfront funding would facilitate among NGOs, with Azemati et al (2013) stating that a significant selling point of SIBs is the ability to upscale and replicate successful social intervention programmes. Respondents all confirmed that upfront funding would help them to upscale their programmes. Whilst the literature did not explicitly identify the extent of increased social impact, all the respondents believed that upfront funding would leverage the social impact so that the increase in social impact resulting from SIB year upfront funding would be on a ratio of 1:3 or more. The literature did not address this potential for upfront SIB funding to leverage social impact. Nor did the literature address the view by respondent D that upfront funding provides NGOs with room to quickly learn from mistakes, adapt and scale.

6.3.2 Conclusions for Research Question 3

Social service providers and critics are concerned that annual appropriations mean that funds allocated to SIBs may displace other social service funds, as governments are unlikely to *"appropriate additional funds based on a projection of future savings"* (Kimbrell, A., 2014). Liebmann (2011), on the other hand, in further addressing the tension and the limitations of the three PbR models, introduced Pluralism. This suggested rather that SIBs could expand the sources of investment or diversity of investors, beyond just private investors, to make funding available to a wider range of capable organisations. This suggestion was supported by respondent A, who did not believe that investors would redirect all their funds into SIBs, and further believed that the combined social and economic narrative of SIBs could attract high net worth individual investors.

Liebmann (2011) continued that Pluralism could facilitate the expansion of providers by providing direct cash to overcome cashflow problems which usually make expansion or scaling difficult. This view was echoed by all the respondents, who all believed that the upfront funding provided by SIBs would increase the impact and efficacy of their work, allowing them to upscale and replicate their work.

6.4 Research Question 4

Research question 4: *What constraints for each of the three parties (investors, municipalities and civil sector) would limit / prohibit their participation in a social impact bond?*

6.4.1 Results for Research Question 4

I. Private sector: Investors

The need to change or evolve the mindset of the local investment community was not addressed by the literature, despite being iterated by respondents on a few occasions. South Africa, unlike many countries, has legislated social development policies, such as B-BBEE, CSI or SED. Adherence to these policies has a direct impact on business' ability to conduct business, therefore giving an economic motive for social development. While this was intimated by Porter and Kramer (2006), it was not extensively addressed by the literature, probably because of its specificity to the South African private sector. These issues could be constraints for private sector participation in SIBs.

II. Public sector: Government

Similar to the respondents' perspective, the literature did not identify specific hindrances to government participation in SIBs. The hindrances to participation were system wide, and beyond the immediate control of government, for example the lack of evidence-based intervention that has been tested and shown to be effective. The government merely had many considerations to take into account before setting up a SIB.

III. Civil sector: NGOs

Civil sector respondents shared the same sentiment as Warner (2012) in their recognition that SIBs are a cross-sectoral structure. Respondents recognised and acknowledged that the solution to most social problems facing contemporary societies lies in the collaboration and co-ordination between the public, civil and private sector (Bryson and Crosby, 2006).

Respondents, however, added a stakeholder, direct and indirect beneficiaries, whose buy-in and agreement they believed was paramount to the success of the SIB. The respondents believed that NGOs should understand and be comfortable with the terms and targets set in the SIB structure. The literature mitigated this issue by stipulating that the social intervention programme to be funded by a SIB should have a proven track-record.

Respondent C believed that if governments sought innovation premised on enhancing operational autonomy of frontline professionals and practitioners to encourage new thinking in social intervention programming, then they ought to consider a social incubator model. This incubator would be to make, test and develop new social intervention innovation models and make them investor and SIB structure ready. No literature addressed this insight.

The instability of leadership within government during the set-up period was a concern highlighted by respondent D, who believed that buy in from leadership such as the president or presidency may mitigate this concern. Again, this was an issue quite specific to South Africa, hence not addressed by the literature.

6.4.2 Conclusions for Research Question 4

"*For future success, think big and act small; it is easier to achieve success this way.*" This summation by respondent D was supported by Vennema and Koekoek (2013) who suggested that countries with small investor markets like South Africa should consider packaged SIBs that are risk diverse because of the different projects that could be packed into a single SIB issue. Otherwise, the cost of issuing SIBs could be prohibitive, judging by the cost of existing pilot SIBs. A conducive environment is necessary, each sector requiring different conditions to be met, to increase the feasibility or probability of SIB issuance in South Africa. The development of this environment requires time and associated legal, taxation and business structures / principles to be developed and be in place.

6.5 Data Analysis Results via Atlas.ti

The software programme Atlas.ti was used to compare the responses of the respondents who had been interviewed with findings from literature.

Figure 6: Exploratory Variables

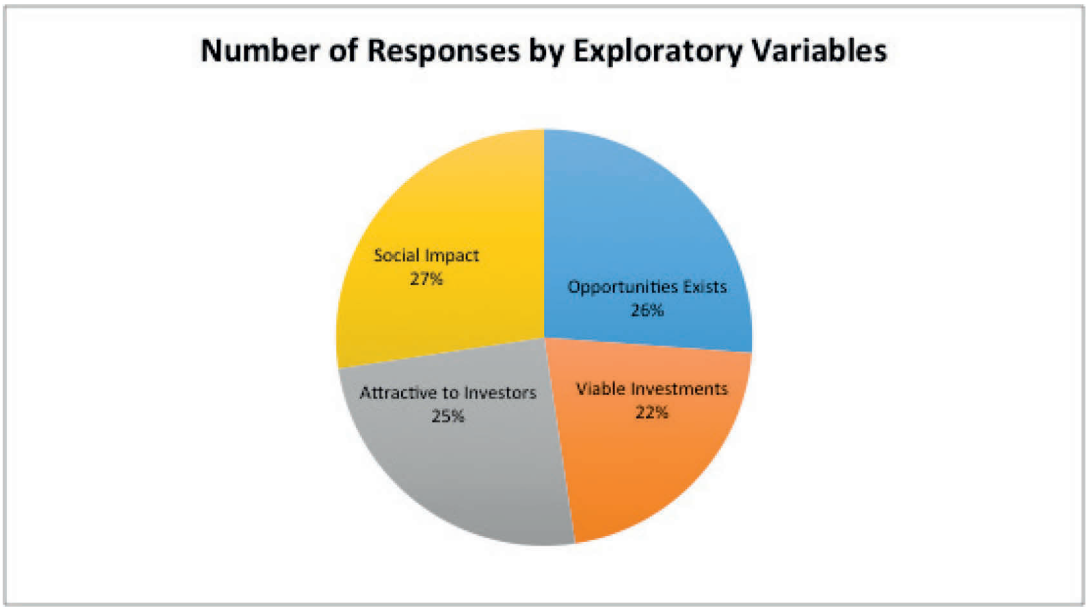
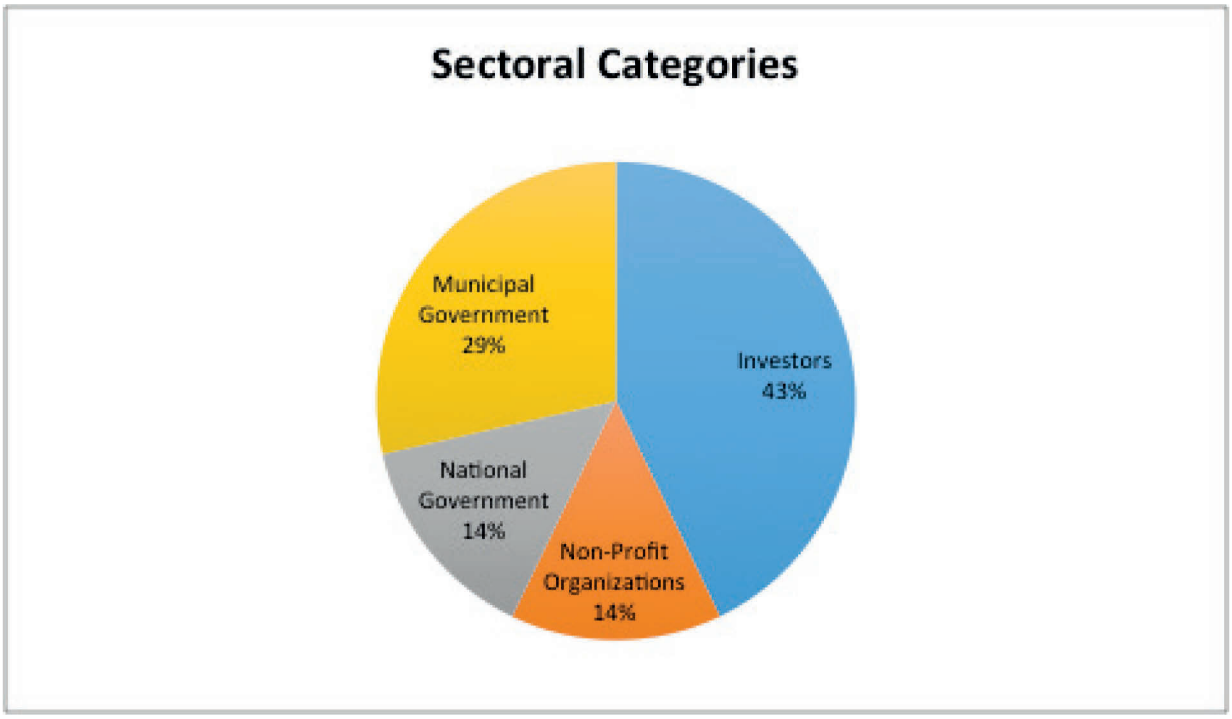


Figure 6 above suggests that the SIB imperative was deemed to be primarily social impact. This was closely followed by opportunity to exist and attractiveness to investors. The closeness of the 3 variables suggests that if the research was widened, participants may influence or change the order of these variables. The literature suggests that in environments with entrenched social investment norms, such as the USA, social impact could be the primary SIB imperative. In South Africa, it is not clear whether the "social impact" investment is a result of altruist intentions or business norms as per social development legislation in South Africa.

Figure 7: Sectors in Society



Similarly, in figure 7 above, it is not clear whether the private sector respondents identified the aspects of social growth as important to drive sustainable development for altruist reasons, or as Porter and Kramer (2006) suggest, to gain economic returns by tackling social issues to gain an economic advantage for the company.

Figure 8: Exploratory Variables by Investor

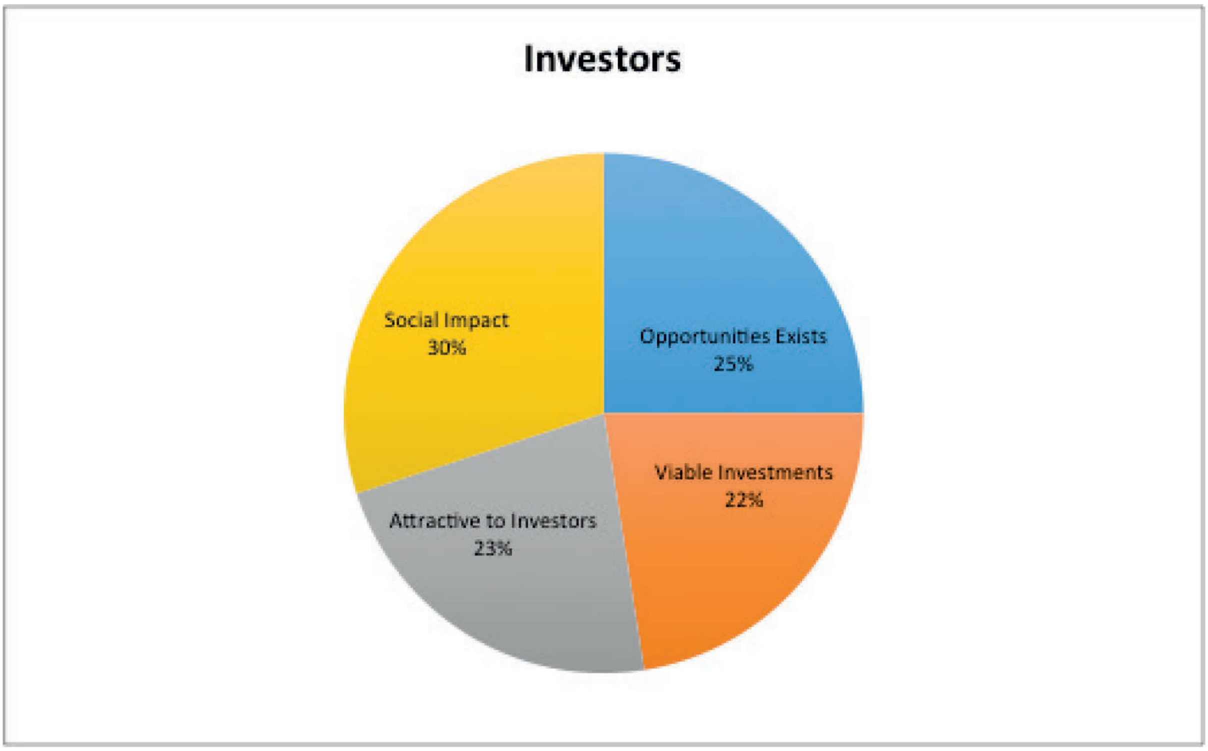


Figure 8 above illustrated the desire by the private sector to drive social growth within the context of private resource allocation not as just a donation, but rather with the end goal in mind to achieve sustainable societal upliftment. While this would suggest a green field opportunity to further bridge the gap between the higher quartiles and lower quartiles in societal disjuncture we are confronted with in South Africa, this is still based on the charity model, with no economic return for the investor. Literature suggests that the SIB model, with built-in economic returns for private investors, is an aberration for South Africa private investors.

Figure 9: Exploratory Variables by NPO

Figure 9 above suggests that civil society is seeking innovative and measurable outcome based activities that will drive societal improvements, without efforts in seeking funding. The literature supports this exploration, suggesting that SIBs could be such an option.

Figure 10: Exploratory Variables by Local Government

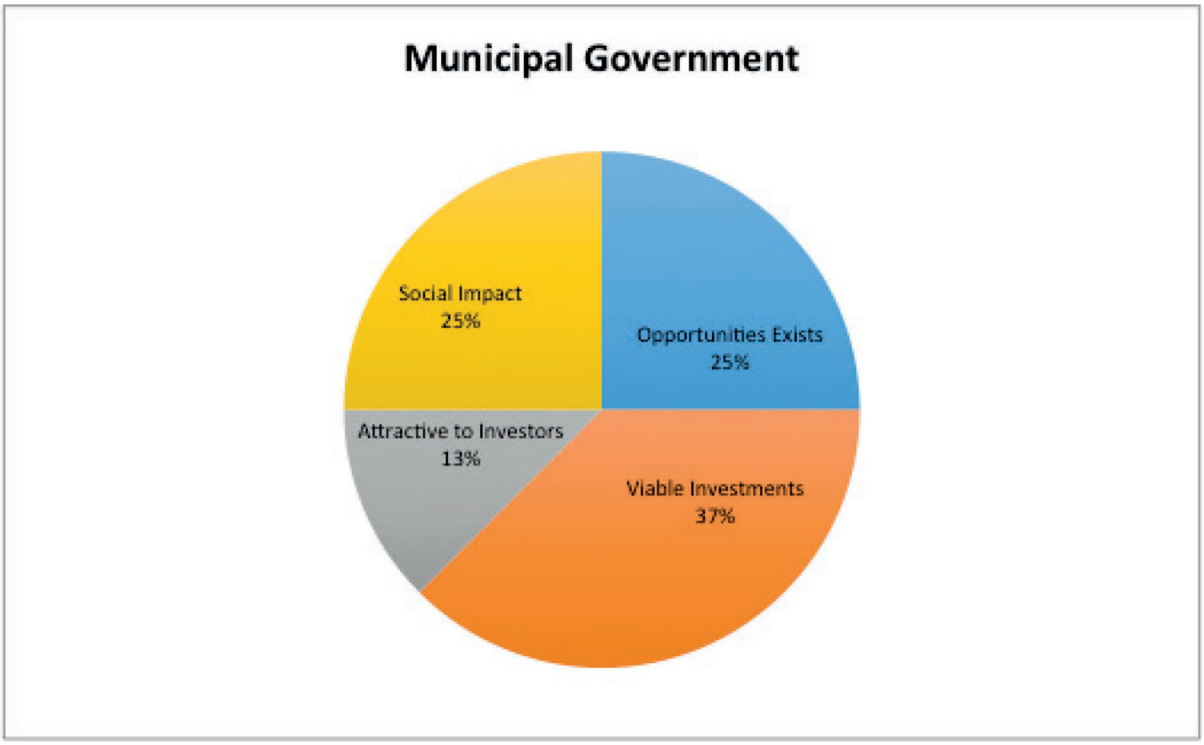


Figure 10 above tells us that municipalities see investment viability in driving service delivery to the citizenry using alternate means to fund local expenditure. The literature supports this finding, despite there being concerns, not hindrances, that municipalities should consider prior to the issue of a SIB.

Chapter 7: CONCLUSION

7.1 Introduction

This research sought to explore whether SIBs are a feasible social development funding model in the South Africa context. SIBs are an innovative outcomes-based financial product, based on a cross-sectoral collaboration model to fund government social programmes (Joy, M. & Shields, J, 2013; Warner 2013). This model allows each actor, be they beneficiaries, government, nonprofit service providers, investors, intermediaries, evaluators or independent assessors, to implement tasks best suited to their strengths for collective social and financial benefit by transferring roles in which each respective actor traditionally underperformed to other actors within the SIB network (Baliga 2013). The SIB model is as yet untested in the South African context.

The main findings of this research are presented in this chapter. As the research focused on three actors within the SIB structure, the findings are presented for each respective sector. The recommendations and implications of these findings are similarly presented by sector. The limitations of this research are discussed, followed by suggestions for future research on the subject of SIBs in the South African context.

7.2 Principal Findings

The principal findings highlight the considerations that must be made, by respective sectors, in determining the feasibility of a SIB issuance in South Africa. It's important to note that the insights, despite perhaps being varied by sector, are equally important because the success of a SIB depends on the availability of willing actors from the public, civil and private sector (Bertha Centre, 2014). This would therefore suggest that the findings for each sector be considered with equal measure.

7.2.1 Private sector: investors

The South African private sector is more comfortable with the charity model which presents no financial return. They are not familiar with the notion of social investing with an economic profit benefit. When referring to social investment, they were referring to the charity model where the returns are social impact. Introducing a financial return changed their perspective to that of employing their fiduciary investment mandate /principles, which made their SIB participation contingent on the alignment between their investment mandate and the risk-reward profile of the SIB.

The economic returns of SIBs presented a challenge regarding the treatment and allocation of social development points and associated tax implications, which fall beyond the mandate of private sector to address. Addressing these challenges would require public, private and civil sector participation, contribution and collaboration (Warner 2013).

Philanthropic investors were more amenable to SIBs, and were the likely initial investors. Traditional investors were not comfortable with bearing performance risk, where they don't have a direct relationship with the implementor upon whose performance their returns are contingent. SIBs are viewed as being more risky than traditional bonds, hence mitigants are required to attract the traditional investor market whose increased participation would fuel the South Africa SIB market.

The nascence of the SIB structure made it susceptible to information asymmetry, which in turn increased perceived risk and thus cost of SIBs. Addressing this uncertainty would bode well for investor participation in SIBs and reduce the risk-reward demand of the investors.

7.2.2 Public sector: government, including metropolitan municipalities

The South African public sector is familiar with and has experience working with antecedents of SIBs. They perceive SIBs to be relatively risk-free, barring reputational risk for both them and the NGO service providers. Hence it can be concluded that they are interested in developing and possibly employing the SIBs structure as an alternative social development funding model.

While purported savings were not the primary driver of public sector interest, the potential for increased social impact alongside absence of credit risk increased the interest in the feasibility of using SIBs in future. The nascence of SIBs was not a deterrent. Rather, the perceived risk and concern was about the over-reliance on intermediaries, a concern intimated by the other sector participants as well.

Another insight was that despite the interest in and amenity of the SIB structure, and prior experience in setting up bonds, the public sector would require longer periods for the set up of SIBs.

7.2.3 Civil sector: the nonprofit sector which includes NGOs, CBOs and philanthropic foundations

The upfront funding to service providers was the primary source of interest for the civil sector as it removed performance and credit risk usually associated with public sector engagement such as PbR. Upfront funding negated NGO cashflow problems which then allowed NGOs to spend the bulk of their time on the mission which in turn helped NGOs upscale and replicate their programmes faster (Warner 2013), which increased the social impact of their programmes. Thus upfront funding did more than address cashflow problems; it became a lever for greater social impact.

Another important insight was the need to include the civil sector in SIB conception from the start, and have representation on the management structure as an equally regarded SIB actor.

The area of concern is the current monitoring and evaluation process, devised and tested internally by organisations, which is sufficient for South African donors. International donors and traditional South African investors, however, require more rigour and transparency than the civil sector is currently employing, which has been met with mixed responses in the civil sector. This implied that the need to increase the number of eligible civil sector organisations must increase, to increase the number of investment worthy social impact programmes, in terms of robust metrics, measurable social impact and monetizable benefits, without which the SIB structure would not succeed.

7.3 Recommendations

The recommendations are presented according to the different sectors. It is however important to note that these recommendations would effectively be for government's consideration, as the most likely initial custodian of the SIB structure before other actors join, are recruited or invited to participate. The list of recommendations is exhaustive, hence the recommendations in each sector are limited to no more than three recommendations identified as being of priority in the sector.

7.3.1 Private sector

The aim of the following recommendations is to attract traditional private sector investment to participate in the SIB structure.

7.3.1.1 Amended tax regulation

The current taxation system allows tax deductions for non-refundable financial contributions made to registered nonprofit organisation. The first recommendation is that this tax deduction be permitted on the funds invested in SIBs.

Funds are effectively refunded with interest or a return in a SIB structure. Thus the additional recommendation is that tax deductions be permitted on the economic gains, and at a lesser rate on the capital, if the funds from a matured SIB are re-invested in registered nonprofits.

The third recommendation is that SIB funds should not be taxed for either capital gains tax or income tax, if the funds are wholly reinvested in a registered nonprofit or other social development structure, such as another SIB. Taxation would ultimately happen when the funds are not reinvested in a social development vehicle.

7.3.1.2 Social development points allocation

The next recommendation is that investing in a SIB should enable an investor to claim relevant social development points for CSI or SED. Upon SIB maturity, similarly, they may claim new points for the profit portion of the funds and half the points on the initial capital portion. This recommendation seeks to address the re-allocation of social development points upon social investment maturity.

7.3.1.3 Liquidity

The last recommendation is that a secondary market, such as SAFEX (the South African Futures Exchange), be developed to create liquidity, with the aim of decreasing the risk perception and increase the appetite for SIB within the South African investment market.

7.3.2 Public sector

7.3.2.1 Incubation of social development programmes

The first recommendation is for government to devise a structure to incubate, pilot and develop innovative social programmes whose social impact is rigorously tested. The incubation period is to get the programmes ready to be scalable and replicable. The point would be to get them investor ready, for participation in a SIB or with any other investor. This has the potential to increase the number of quality, tested, scalable civil sector organizations and programmes eligible, irrespective of inclusion in the SIB structure, with potential to make effective social impact.

7.3.2.2 Eliminate risk of capital loss

Credit risk being borne solely by the private sector makes SIBs a hard-sell to private investors who seek commensurate returns for bearing this risk. There are numerous ways in which government may spread this risk, primarily the risk on non-payment. The recommendation is for government to eliminate the risk of capital loss, and offer capital protection by making capital guarantees of initial investment a standard feature of the South Africa SIB.

7.3.2.3 SIB Options

With the growth, development and understanding of SIBs, offer SIB options whereby investors may opt for guaranteed fixed income (capital and return) or accrue returns on a sliding scale with an upper-limit correlating an increase in social value correlates with the increase in returns (Disley et al 2011). The aim is to position SIBs as an investment alternative to the risk averse investors, to increase the participation of investors in the SIB structure.

7.3.3 Civil sector

7.3.3.1 Introduce increased rigour to the civil sector

Civil sector participants must submit annual reports, including financial reports to the Department of Social Development to maintain their nonprofit and tax exemption status, without which nonprofits cannot fundraise and receive money from donors. Government can induce increased rigour by requesting a more rigorous report to be submitted annually. Importantly, government should offer training and support to nonprofit organisations to meet this new requirement.

7.3.4 General recommendations

7.3.4.1 Communication structure among SIB actors

It is recommended that a communication structure or plan must be determined and agreed to by all the SIB actors. This is to reduce information asymmetry at any point during the life of the SIB. Thus full information on programmes being funded, including risks, and on all the SIB participants, must be made known to all the SIB actors, to reduce uncertainty and associated perception of risk. This is to reduce over-reliance on any single SIB actor for information.

7.3.4.2 Inclusive, participatory management structure than an external intermediary

As per the suggestion of many of the research respondents, it is recommended that a management structure, or an 'intermediary board referred to as the board' with representation from the various SIB actors should be set up to replace the external third-party intermediary. The board could have external third parties as members, but importantly each actor should have a representative on the board. The recommendation is based on the recognition that there is extensive reliance on the SIB network for the success of the SIB; the success of the SIB actors leads to the success of the SIB.

7.4 Limitations of this Research

The primary limitation of this study was the nascence of the topic; hence many of the respondents, though relevant to the study, were unfamiliar with the concept. Thus their opinions were bound by their relatively new knowledge and understanding of the topic. This does not, however, limit the inferences that can be made from their comments as they each have extensive, respective, knowledge in the sectors, supported by many years' experience. Furthermore, many of the respondents have varied experience in different senior positions within their respective sector.

The second consequence of this nascence was the relative scarcity of South African literature on this topic. As such, the first step of the research design was premised primarily on non-South African literature review. This may have influenced the research focus to non-South African key issues of the SIB structure.

7.5 Recommendations for Future Research

There remain many unresolved issues and questions within the SIB structure. While there are a few ways that SIBs may be structured, evidenced by all the SIBs currently in issue being tailored to the needs of their respective investment markets, they share similar features (Bertha Centre 2014). There remain many issues to be addressed regarding the feasibility of SIB as a social development model for the South African context. As such, suggestions for future research include:

1. A mixed qualitative and quantitative study to examine what types of social preventative programmes would be suitable for SIBs, determined by the greatest social impact relative to budgetary savings.
2. An inductive qualitative study to determine whether SIBs could be an alternative savings mechanism for individuals, by pooling funds of individuals to fund SIBs. This could have a dual benefit of providing a new savings vehicle for individuals, not necessarily only high net worth individuals, while giving SIBs a new market of potential investors.
3. A deductive qualitative study to determine whether introducing increased rigour in the civil sector would distract nonprofits from their social mission or if it would increase their social impact?
4. A study to determine the feasibility of monetising social benefit vs. finding an alternative method to assign financial value to social impact / benefit.

7.6 Closing Remarks

This research forms part of a body of work that is addressing the feasibility of employing the SIB model to fund social development in this country. South Africa is unique and very different to many countries where the SIB model has been piloted. The uniqueness of the myriad of social challenges suggested that this and other studies may just be scraping the tip of the true potential of the SIB model, tailored to suit the socio-economic challenges and the investment market climate of South Africa.

Indeed, South Africa may yet teach and show the world even more inventive and innovative uses for the SIB structure. The scope and uses of the SIB structure may be extended to other African countries, hence South Africa is uniquely positioned to take the lead in SIB structures on the rest of the continent.

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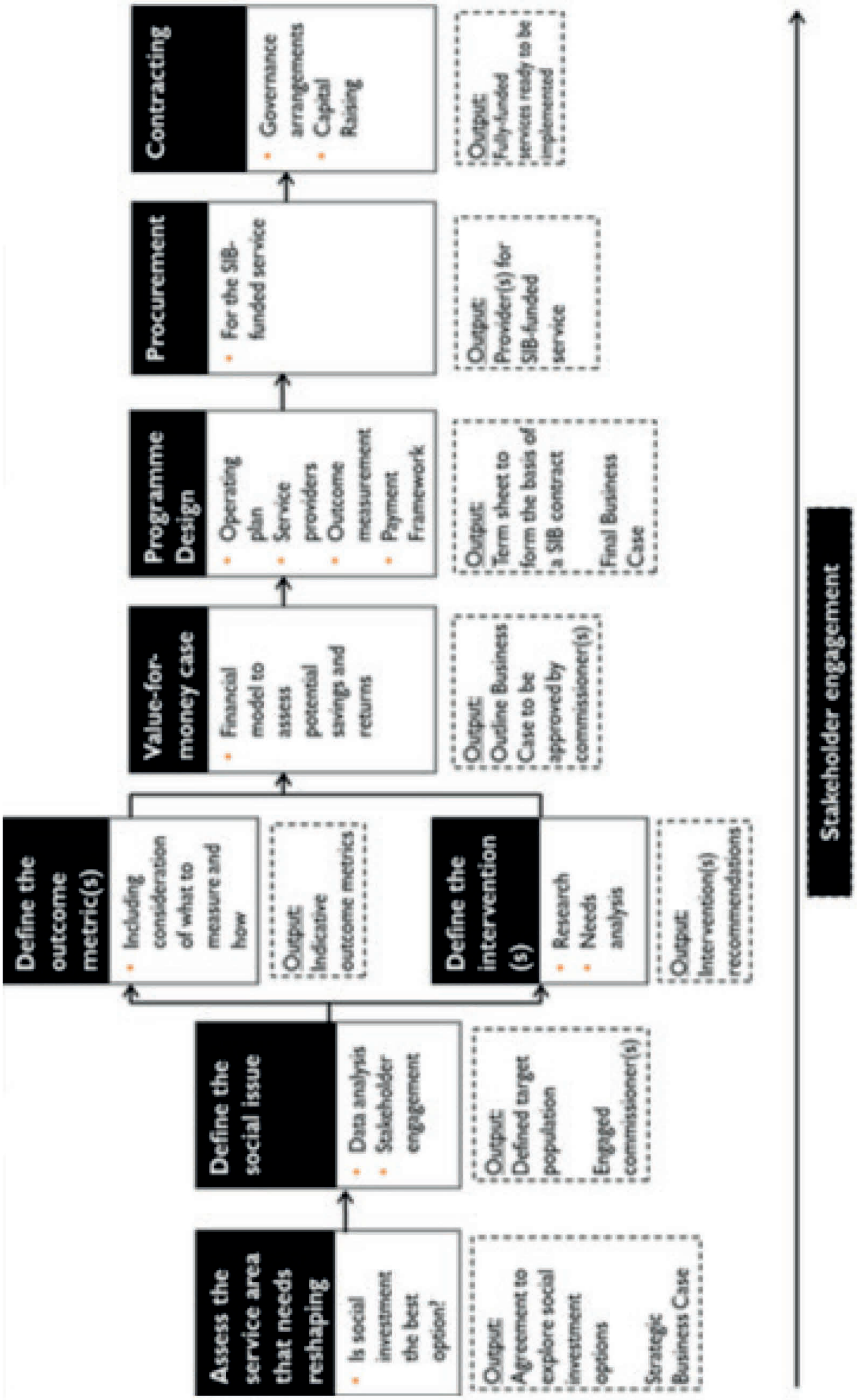
Appendix 1: PROCESS FOR DEVELOPING A SIB



Source: Social Finance

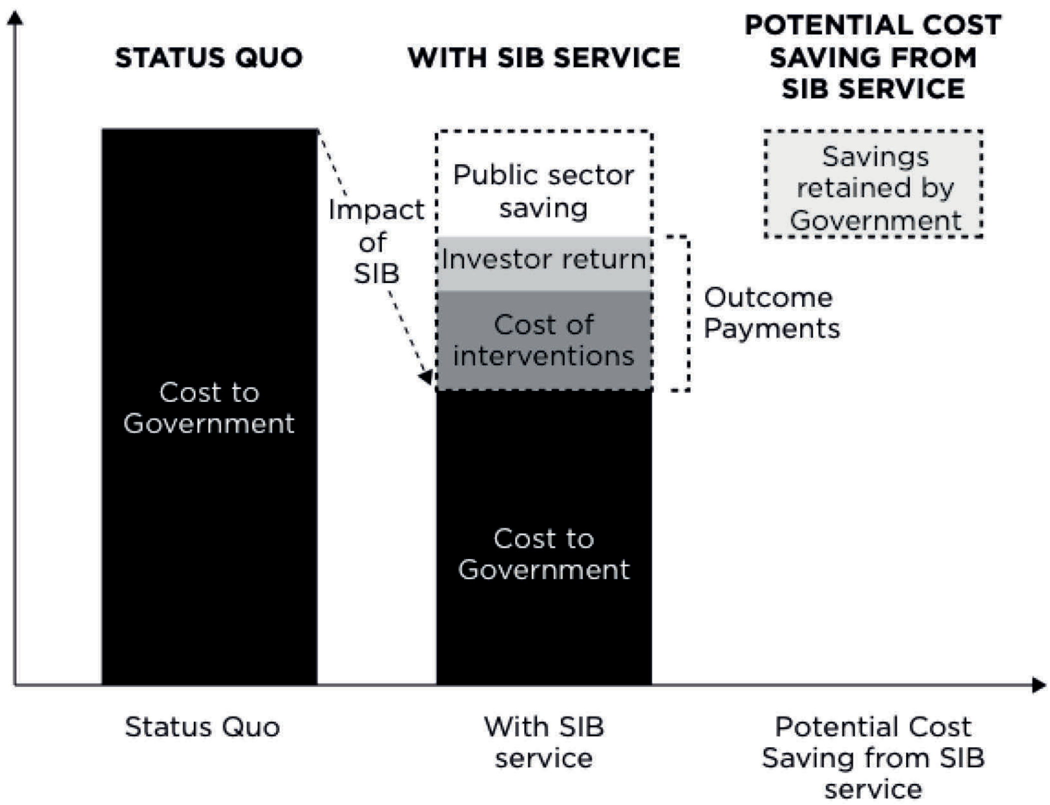
Appendix 2: QUESTIONNAIRE (GOVERNMENT)

Background

Social Impact Bonds (SIBs) are an innovative outcomes-based financial product to fund government social programmes. They represent a cross-sectoral collaboration in which private investors assumed financial risk by providing upfront capital to the service providers, usually the third sector, to implement interventions to improve specific, targeted social outcomes based on agreed contracts. The SIB concept is straightforward:

- inject private-sector capital into traditionally public-sector activities, producing more cost-effective practices in both sectors.
- Private investors put up capital to fund interventions that are too big or too risky for the public sector.
- Suitable (preventative) programmes are selected,
  - performance targets are established,
  - civil sector service providers with track-record are selected,
  - civil sector receives upfront funding to deliver a programme,
  - and if the civil sector delivers, investors are rewarded with profits.
- If the performance targets are not met, the government does not have to pay for the services delivered.

The appeal of SIBs is that everybody could win; philanthropically oriented investors have an opportunity to leverage their endowments with the potential to receive a profit, allowing them to reinvest those funds in future in another cause. Investors accomplish their goal to make a socially beneficial investment even when they do not earn a profit. Where the programmes or inventions are effective and successful, the government pays for a risky intervention or programme, funded by private investors, that otherwise may not have been tried (to the detriment of society), which provide a future cost saving to government. These savings to government are by way of future payments no longer having to be made (because of the successful intervention programme). Civil society or nonprofit service providers receive multi-year funding upfront to deliver programmes with quantifiable outcomes. Below is a graphic representation of SIBs savings:



Interview Questions

1. Are social impact bonds (SIBs) currently being considered by the Metro as an alternative funding instrument for social development spending? Why or why not?
2. Does the Metro consider SIBs to be a more or less risky funding model? Why or why not?
3. Does that government believe that there are indeed significant cost savings to be made from the use of SIBs? Why or why not?
4. Is there sufficient technical skill and expertise to dedicate to the use of SIBs? Please explain your answer
5. Does the Metro believe that there is sufficient public knowledge and understanding of SIBs to attract the investor market interest? Please explain your answer.
6. Would the Metro be willing to hand over significant control to intermediaries, as per SIB model, should a SIB model be used?
7. It takes on average 2 years to set up an SIB; would this be fine or a deterrent from undertaking a SIB?

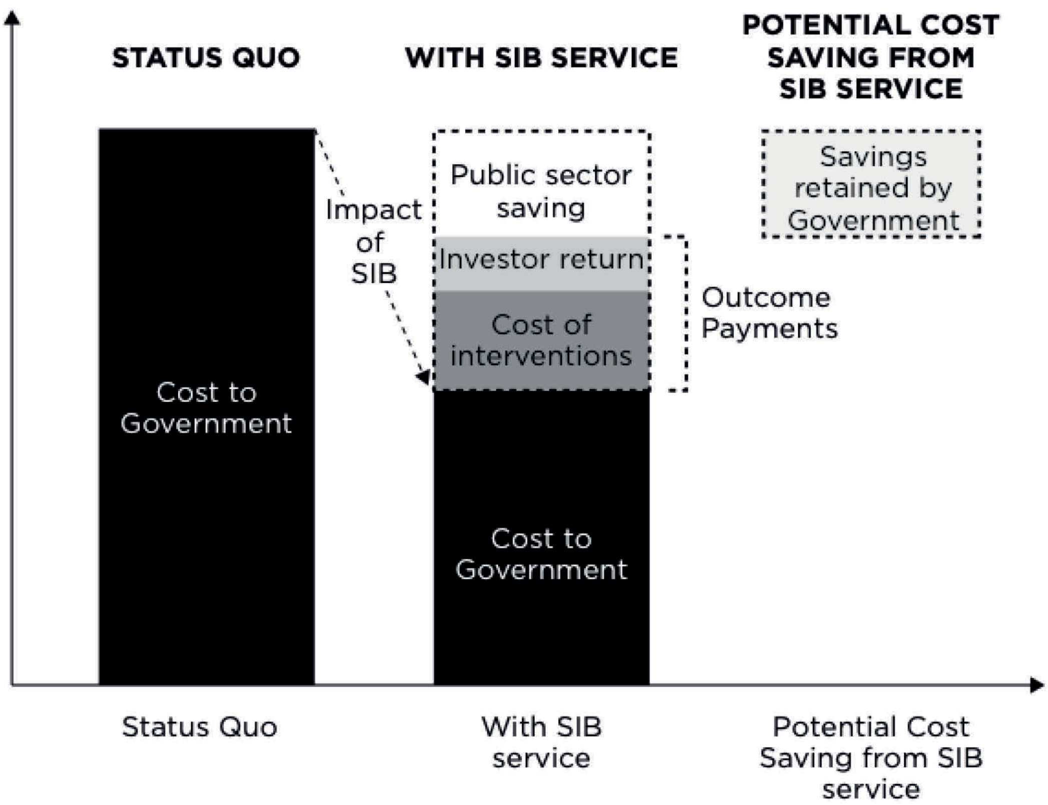
Appendix 3: QUESTIONNAIRE (NGO)

Background

Social Impact Bonds (SIBs) are an innovative outcomes-based financial product to fund government social programmes. They represent a cross-sectoral collaboration in which private investors assumed financial risk by providing upfront capital to the service providers, usually the third sector, to implement interventions to improve specific, targeted social outcomes based on agreed contracts. The SIB concept is straightforward:

- inject private-sector capital into traditionally public-sector activities, producing more cost-effective practices in both sectors.
  - Private investors put up capital to fund interventions that are too big or too risky for the public sector.
  - Suitable (preventative) programmes are selected,
  - performance targets are established,
  - civil sector service providers with track-record are selected,
  - civil sector receives upfront funding to deliver a programme,
  - and if the civil sector delivers, investors are rewarded with profits.
  - If the performance targets are not met, the government does not have to pay for the services delivered.

The appeal of SIBs is that everybody could win; philanthropically oriented investors have an opportunity to leverage their endowments with the potential to receive a profit, allowing them to reinvest those funds in future in another cause. Investors accomplish their goal to make a socially beneficial investment even when they do not earn a profit. Where the programmes or inventions are effective and successful, the government pays for a risky intervention or programme, funded by private investors, that otherwise may not have been tried (to the detriment of society), which provides a future cost saving to government. These savings to government are by way of future payments no longer having to be made (because of the successful intervention programme). Civil society or nonprofit service providers receive multi-year funding upfront to deliver programmes with quantifiable outcomes. Below is a graphic representation of SIBs savings:



Interview Questions

1. How is the impact of your core activities measured?
2. Is Monitoring and Evaluation conducted internally or by an external third party?
3. Do you submit or keep up to date official documents (annual financial statements, activity reports, annual reports)?
4. Does fundraising take away time from delivering your core services? Please explain your answer, giving estimates.
5. If funding for core activities were received upfront for a period of 5 years, how would the outputs be affected?
6. If funding for core activities were received upfront for a period of 5 years, how would the impact be affected?

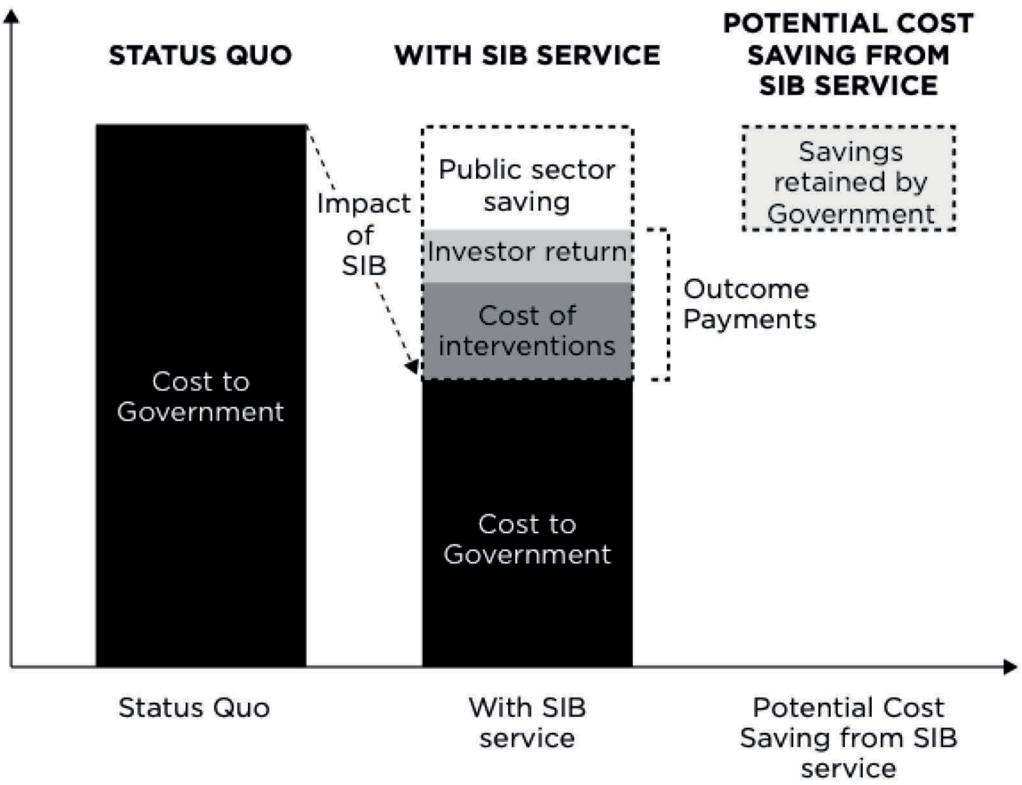
Appendix 4: QUESTIONNAIRE (INDIVIDUAL)

Background

Social Impact Bonds (SIBs) are an innovative outcomes-based financial product to fund government social programmes. They represent a cross-sectoral collaboration in which private investors assumed financial risk by providing upfront capital to the service providers, usually the third sector, to implement interventions to improve specific, targeted social outcomes based on agreed contracts. The SIB concept is straightforward:

- inject private-sector capital into traditionally public-sector activities, producing more cost-effective practices in both sectors.
- Private investors put up capital to fund interventions that are too big or too risky for the public sector.
- Suitable (preventative) programmes are selected,
- performance targets are established,
- civil sector service providers with track-record are selected,
- civil sector receives upfront funding to deliver a programme,
- and if the civil sector delivers, investors are rewarded with profits.
- If the performance targets are not met, the government does not have to pay for the services delivered.

The appeal of SIBs is that everybody could win; philanthropically oriented investors have an opportunity to leverage their endowments with the potential to receive a profit, allowing them to reinvest those funds in future in another cause. Investors accomplish their goal to make a socially beneficial investment even when they do not earn a profit. Where the programmes or inventions are effective and successful, the government pays for a risky intervention or programme, funded by private investors, that otherwise may not have been tried (to the detriment of society), which provides a future cost saving to government. These savings to government are by way of future payments no longer having to be made (because of the successful intervention programme). Civil society or nonprofit service providers receive multi-year funding upfront to deliver programmes with quantifiable outcomes. Below is a graphic representation of SIBs savings:



Interview Questions

1. What are the core issues and considerations of your investment mandate?
2. What informs these considerations? (For example financial returns, social impact, angel investment or legislative requirements.)
3. To what extent do socio-economic issues have an impact on the determination of the investment mandate?
4. Would you invest in social impact bonds if the anticipated returns met your investment mandate requirements?
5. The average SIB lasts 5 - 7 years. Would this duration affect your investment decision in any way?
    1. If yes, how would it affect the investment decision.
    2. If no, what would affect the investment decision besides financial returns?
6. Would you invest in SIB with returns being contingent upon social development goals being met?
    1. If yes, please explain your answer.
    2. If no, would a government guarantee on returns make SIBs more attractive?
7. Do you perceive SIBs as being a higher or lower risk investment? Should there be a commensurate return for investing in SIBs? (higher risk-higher return; lower risk-lower-return)
8. Should the social impact of SIBs lower or increase the returns demanded?