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Video Transcript

ENTREPRENEURSHIP IN NONPROFITS

How does a Social Impact Bond work?

[Georg von Schnurbein] Social Impact Bonds or SIBs have become a very popular method of the pay-for-success model, especially for preventative social services. But you will also find slightly modified versions such as development, humanitarian, or ecological impact bonds. In this video, I want to present the structure of a SIB and discuss some pros and cons of this model.

In the center of the SIB lies the intermediary that organizes the functioning of the SIB. Then we have a commissioner, usually a state agency, that commits to pay for improved social outcomes for a social project. The intermediary raises the money from private investors, for instance foundations or individuals. Then a nonprofit or a social initiative is commissioned to provide the services to the target community. Finally, there's an evaluator who analyzes the project and measures the outcome and impact.
Based on this report, the commissioner pays back the money to the private investors. Key issues of an SIB are the service provided, the definition of the target group, a defined time frame of the project, the definition of outcomes in advance as benchmark for the payouts, an objective evaluation of the project outcomes.

The SIB offers many advantages for all parties involved. First of all, the state agency as commissioner can be sure to either finance a well-functioning service or save the money for other tasks. The private investors know that they support an innovative project and, therefore, are ready to take the risk of failure. But they will get a good evaluation of the project and take learnings out of it.
The nonprofit as service provider gets support for its innovative prevention project, which the state agency would not have financed otherwise. So a nonprofit can prove that its theory of change is right. For the general public, there's the chance that more private money is used for social purposes and that the preventive social service reduces social costs in the long run. Finally, the target group gets a better service than without the SIB.

However, there are some pitfalls in this system. First of all, it is a rather complex system with many parties involved. Many parties always means higher costs.
Second, the nonprofit service provider has a moral hazard for cream skimming when selecting the participants in the project. This means that predominantly participants are selected that are more likely to fulfill the defined outcomes. Thus, the less advantaged get less support.
A third issue is the period of duration. Usually, it's about five to seven years. Now, if legislation or a government changes, there is always a danger that the conditions of the SIB are changing and outcomes are tainted.
These pitfalls have to be taken into account when organizing a SIB. But in general, it is a good example how impact investing is thought about and developed today.