Growing Social Impact Finance: Implications for the Public Sector

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Introduction

Social impact finance (SIF) is the provision of finance with the explicit expectation of a measurable social, as well as financial, return (Clarkin and Cangioni 2015; G8 Social Impact Investment Taskforce 2014; Höchstädter and Scheck 2014; Oleksiak et al. 2015). SIF is within the broader spectrum of social finance and is characterized by two distinguishing properties: first, social and environmental returns are not incidental, but they are pre-defined and ex-post measured; second, investors expect at least the repayment of the invested capital. The actual SIF market is notably smaller if compared with the traditional finance, but experts believe in its power to address the societal challenges of our century (Daggers and Nicholls 2016). For this reason, the participation of the public sector has been evoked since the beginning of the SIF movement. SIF is not about the unloading of public responsibilities nor a mean to withdraw public welfare's policies. Instead, given the urgency to review the government's spending, SIF should play an additional role both in terms of generated capitals and outcomes, wherever the government's budget does not fit the social demand. Moreover, governments might embrace the new investing approach to get efficiency from their social service providers. In addition, an enabling legal framework, i.e.: the definition of hybrid legal entities or certifications systems, could lower the information asymmetry in the market and open up new investment opportunities. Finally, advocates have often acknowledged the usefulness of running pilots to test new financial instruments that are able to attract a wider spectrum of investors with different risk/return preferences. In light of these potential benefits, the government could be a key partner in SIF, and even assume a role of director in the development

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of the market. However, up to date, there are sporadic pieces of evidence about how these recommendations have been operationalized in practice. Therefore, the aim of this research is to investigate the role that the public sector practically plays in the SIF market. In particular, the paper answers the following research question: what policies have been already enacted to promote SIF?

In order to achieve the aforementioned purpose, this work conducts a thematic analysis of the documental materials produced by the G8 Social Impact Investment Taskforce and its National Advisory Boards. Started in 2014 and still ongoing, the work of the Taskforce has connected hundreds of experts and prominent SIF players and has stimulated an organic thought around SIF, which flew into several regional and international reports.

The rest of this paper is articulated as follows. After the review of the roles that the public sector can theoretically play in the SIF market (section "Roles of Government in SIF Development"), we go through the methodology adopted (section "Methods"). Then, we outline the results and explain how the theoretical roles are being addressed in practice (section "Results"). Thus, we discuss the results and conclude by suggesting areas of further research (section "Conclusion").

Roles of Government in SIF Development

The SIF literature is still dominated by practitioners' research, while academia has approached the topic only a few years ago (Hazenberg et al. 2014). In order to pave the way, this section reviews the academic and professional literature, which discusses the role of the public sector in the SIF market. About academic papers, we rely on the references identified by Daggers and Nicholls (2016), who realize a review of 73 papers about SIF. In doing so, they provide the most exhaustive picture to date about the existing academic literature on SIF. To what pertain practitioners' research, we consider the reports written by the Global Impact Investing Network (GIIN), OECD and World Economic Forum. Indeed, they are devoted to producing a body of knowledge that synthesizes heterogeneous views, while at the same time being impartial. Moreover, they have played an essential role in establishing the concepts of SIF and giving the first evidence about SIF initiatives (Daggers and Nicholls 2016).

Both academics and professionals acknowledge that the public sector has a pivotal role in building the market (Addis 2015; OECD 2015). Addis (2015) resumes three main roles that governments can play to create the enabling conditions for SIF. They are market's builder, steward, and participant. The first role—the market builder—consists in creating the demand for SIF by enabling the birth of new social enterprises or scaling existing ventures. Governments can launch capacity building initiatives to make social ventures investible recipients. The public sector can use its funds to set up incubation and acceleration programs and advise social organizations with a sustainable business model. Indeed, they usually suffer a lack of organizational and leadership skills and financial literacy (Addis 2015). A specific area that shows a relevant demand for capacity building is the measurement of the social impact produced by SIF investments (Addis 2015; Clarkin and Cangioni 2015; Brandstetter and Lehner 2015; Geobey et al. 2012; Hebb 2013; Lehner and Nicholls 2014; Mendell and Barbosa 2013; Moore et al. 2012a; Oleksiak et al. 2015; Ormiston et al. 2015). Indeed, enterprises need metrics and standards to measure their social outcomes and demonstrate their performances to investors (Mendell and Barbosa 2013). The public sector should promote the cooperation among market actors in order to identify an agreed measurement framework and support its diffusion.

The second role—market steward—pertains to the strengthening of the market's infrastructure, by ensuring the suitable legal framework, removing the barriers and systematizing the existing efforts (Addis 2015). On the regulative floor, the most urgent issues are the reform of social organizations' legal status (Clarkin and Cangioni 2015; Mendell and Barbosa 2013; Ormiston et al. 2015), the clarification about the fiduciary duties of institutional investors (Glänzel and Scheuerle 2015; Mendell and Barbosa 2013; OECD 2015; Ormiston et al. 2015), the protection of retail SIF investors (Lehner and Nicholls 2014; Mendell and Barbosa 2013; Nicholls and Emerson 2015; OECD 2015).

In addition, governments can be a participant in the market by directly or indirectly investing (Addis 2015; Steinberg 2015; Wells 2012). Through direct investments, public authorities can lower the risk of SIF investments by co-investing with private actors (Hebb 2013). As an indirect investor, governments can give up a revenues' quota, for example in terms of tax incentives, or improve public procurement's procedures in order to favor the selection of social enterprises as service providers (Nicholls and Emerson, 2015).

Finally, the participation of the public sector in the market might have a signaling role and lower the risk for investors. Indeed, even if the involvement of pension funds and insurer is decisive to grow the market (Brandstetter and Lehner 2015; Oleksiak et al. 2015; WEF 2013), large institutional investors substantially remain at the margins and still report a lack of infrastructures in terms of intermediaries and financial products (Brandstetter and Lehner 2015; Glänzel and Scheuerle 2015; Hazenberg et al. 2014; Mendell and Barbosa 2013; Moore et al. 2012b). It causes high transaction costs and limits the entrance to the market (Geobey et al. 2012; Moore et al. 2012a; OECD 2015; Oleksiak et al. 2015; Ormiston et al. 2015; WEF 2013).

To sum up, different roles that governments should undertake emerge from the literature review: as market builder, the public player can reduce the level of information asymmetry and promote the development and diffusion of information; as market steward, it can adapt the existing legal framework and strengthen the market's infrastructure; as market participant, it should directly co-invest with private actors or indirectly support innovative social service providers through the public procurement. The extant literature depicts how the public sector can support the SIF market theoretically. However, there is not a structured analysis about how these roles translate into practice, apart from some anecdotal evidence.

Methods

To the aims of this paper, we realized a thematic analysis (Marshall and Rossman 1999). It is an accessible and theoretically-flexible method to map an intellectual field into themes and sub-themes (Attride-Stirling 2001; Braun and Clarke 2006; Jones et al. 2011).

Indeed, it consists in the identification of latent and semantic findings recurring in the text, which can be summarized under thematic headings (Dixon-Woods et al. 2005). Marshall and Rossman (1999) suggest a protocol for the thematic analysis. The first step is the organization of data. The analyzed documents were written by the G8 Social Impact Investment Taskforce and its National Advisory Boards during the period 2014–2016. The Taskforce, instituted to catalyze a global SIF market, has engaged more than 200 people across the world, such as representatives of the social and private sectors, government officials, representative of Development Finance Institutions and OECD. Locally, this group[1] originated the National Advisory Boards (NABs), composed by domestic members, and Working Groups (WG), focused on specific topics such as measuring impact, asset allocation, the mission in business and international development (G8 Social Impact Investment Taskforce 2014). The output of their work was collected into reports and documents. In 2015, the Taskforce was transformed into the Global Steering Group (GSG). This transition has also entailed the entrance of new countries such as Brazil, Israel, India, and Mexico. We classified documents by type, which can be report produced by NABs and WGs, state of the art of SIF diffusion country by country, recommendations' trackers of the status of application of the Taskforce's advice, minutes of the Taskforce's meetings; geography, which is local if documents mainly refer to a special geographic area, or global if they analyze the SIF phenomenon worldwide. Documents were organized in the classification matrix reported in the following Table 1:

Then, we defined the codes of analysis. They were deducted from the literature: the roles that the public sector can play to structure the market as a market builder, market steward and market participant (Addis 2015; Clarkin and Cangioni 2015; Mendell and Barbosa 2013; OECD 2015; Ormiston et al. 2015). Thus, in the following steps, documents were coded through the software NVivo. After a literal reading, we did an interpretative reading, searching for recurring patterns in data. Firstly, we coded separately. Then, we compared our coding and discussed any discrepancy. Finally, we searched explanations for the results and triangulated them with the standing theory.

[1]It became G7 after the desertion of Russia.

Table 1 Document's classification matrix

	National AB report	State of art	Recommendations' tracker	Meetings' minutes
Local focus	1 Australia 1 Brazil 1 Canada 1 France 1 Germany 1 Italy 1 Japan 1 Portugal 1 UK AB 1 US AB	3 Brazil 1 India 2 Israel 2 Mexico 2 Portugal 1 South Africa	3 Australia's updates 2 Brazil's updates 3 Canada's updates 5 France's updates 5 Germany's updates 2 Israel's updates 4 Italy's updates 4 Japan's updates 2 Mexico's updates 2 Portugal's updates 6 UK's updates 5 US's updates	–
Global focus	1 WG asset allocation 1 WG measuring impact 1 WG international development 1 WG mission alignment 1 G8 international report 1 G8 Explanatory notes for Governments	–	–	6 G8 meeting's minute

Results

Results are organized according to the two main themes emerged in the analysis. Before going deeper into them, we provide a brief overview of the state of the SIF market as revealed by this investigation.

It is still not easy to understand the dimension of the SIF phenomenon and quantify the market's size. When the G8 nations have tried to figure the actual size of the market, they ended up with "first attempt" estimations. SIF market size ranges from 42 billion dollars in the US, to 247.7 million dollars in Japan, 10.6 billion dollars in Portugal and 300 million dollars in Mexico. Although the discrepancy in figures, assessors foresee a tantalizing positive growth of this market that at the moment is still is immature and small if compared with the mainstream finance. Indeed, general interest from investors and number of initiatives are signs of an increasing growth of the SIF market. However, they are often counterbalanced by a significant discretion and heterogeneity in instruments that prevents replication and scaling. Generally, SIF market appears highly disconnected and "different types of intermediaries are needed to developing new ways of financing social organizations", in several nations. Debt generally prevails over equity and is provided by banks, funds and foundations, rarely by peers through crowdfunding. Currently, investors are mainly well-established organizations with a high philanthropic imprint. SIF appears still biased toward grantmaking, with foundations and charity that are the champions of SIF market and have played a pioneering role in its development, especially in US and UK. Besides philanthropy, also some innovator financial intermediaries are embracing the SIF approach, with banks leading the development of products or services for social enterprises. Thus, banks and foundations are heading the SIF practices, but there are also some exceptions. In Japan and US, large corporations "play a significant role in the development of social investment". Moreover, new experimental patient funds have been set, with the capacity to attract capitals and commit them to SIF. Thus, the resulting picture is that of a disconnected niche but extending market, led by foundations, banks and new pioneering funds, which offer mainly debt over equity. The analysis of the documents also revealed the ambition to open the market to insurance companies, pension funds and to capture the interest of HNWIs. Besides the general information about the state of the SIF market, two main themes emerged from the analysis, in regard to the role that the government can play in fostering SIF: *public leader* and *outcome buyer*.

Public Leader

Currently, with the exception of US and UK, the SIF market is led by the private initiative. The public sector has done little to catalyze the market, and government's leadership arose as a priority. Governments have remained substantially neutral to SIF and, in particular, several documents call for a "removal of legal barriers", such as restrictions about the retails' involvement, constraints on profit's distribution by social enterprises and adaptation of the fiduciary duties of pension funds. Thus, one way through which governments might take the SIF movement's leadership is promoting smart regulation. At the moment, governments have mainly intervened on the demand side, regulating hybrid legal forms of social businesses: Israel has defined the parameters that identify a company as a social business; in Italy B-corporations have been introduced by law, special benefits has been appointed to tech start-ups which have also a social aim, and the Social Enterprise Bill is a few steps from the approval; in Japan the new legal form labelled "Local Management Company" is under discussion; in US "28 States have passed legislations authorizing new social enterprise enabling corporate forms"; in Canada, the Ontario Not-for-Profit Corporations Act aims to change the legal framework of non-profit organizations; in France, the Social and Solidarity-based Economy Act "sets out new legal forms based on commercial company status which meet a number of requirements compatible with equity financing".

On the supply side, instead, an emerging trend is the creation of tax incentives for investors in social purpose organizations. This could be realized through the proposal of tax credits in favor of social enterprises or authorization of tax reliefs convenient to social investors. Only the UK and the US have made a move: in the UK, the government has approved the Social Investment Tax Relief, which offers tax breaks to whom invests in social sector organizations; the US has discussed the extension of the New Market Tax Credit, which incentivizes investments in underserved communities and the Congress is also on the path to "provide tax incentives that lower corporate tax rates for qualified impact businesses". A third action could be the adjustment of pension funds' fiduciary responsibility, to compel pension funds' managers to offer their clients at least one alternative solidarity choice by law. In France, through the 90/10 Rule, managers of corporate employees' pension funds have to offer the opportunity to invest in funds that allocate the 5–10% of their capital into social enterprises. In the US, the new guidance on the Employee Retirement Income Security Act (ERISA) admits that private pension funds consider environmental, social, and governance factors in the investment decisions. However, besides these two pioneering examples, "in many places pensions funds are yet to get involved because of restrictions, perceived or statutory, on their trustees around fiduciary duties".

Beyond regulation, governments have additional levers at their disposal to facilitate the SIF diffusion acting as market-building leaders. They entail the coordination of works and platforms to develop guidelines; the realization of feasibility studies and successful case-study analysis; information's sharing and communication; aggregation of networks and hubs; diffusion of SIF culture; creation of dedicated departments able to provide technical assistance. A less diffuse practice is that of capacity-building programs: they involve public guarantee funds inspired by the experience of the UK government which, in early 2015, launched the Impact Readiness Fund. The Impact Readiness Fund provides grants and helps social organizations to showcase their impact. In Portugal for example, the Portugal Inovação Social is expected to launch a capacity-building program during 2016. Countries, such as Canada, Germany, Israel are evaluating similar programs.

Lastly, governments can invest in the market directly or indirectly, with the objective to "provide catalytic capital, matching investments and assume first loss layers' positions", stimulating the intermediary market playing a matching role in investments and creating funds of funds. In Italy for example, the creation of a Social Fund is under approval by the Parliament. Several other initiatives are grant programs: in Japan, under the New Public Initiative, government committed 86 million dollars to support social start-ups; in the UK, through the Investment Readiness Programme, £10 million were allocated on the Investment and Contract Readiness Fund, which helped social ventures to access impact investments, and £10 million on the Social Incubator Fund, which supports early stage social ventures; in Portugal, the Fund for Social Innovation is expected to "co-finance the creation of new social innovation funds by market players"; in Israel, a government tender offered 22 million dollars to match funds from private investors; in the US, the Impact Investment Small Business Investment Company Initiative (SBIC) has "committed 1 billion dollars in matching capital for funds managers who invest more than 50% of the fund in impact deals". Other remarkable examples are the Chantier de l'économie sociale Trust's endowment, made up by investment from the Government of Canada, Government of Quebec and a group of foundations, and the 1 billion dollars Social Innovation Endowment Fund which is going to be launched by the government of

Alberta. Governments can invest also indirectly through agencies or public-owned wholesalers. However, the unique reference model is that of Big Society Capital in the UK, where the government regulated the use of unclaimed assets to establish a market wholesaler.

Outcomes Buyer

The second theme that came out from the analyzed documents concerns how changing the existing public commissioning's procedures might advance the SIF market. Also in this case, the UK practice is the landmark, where "more than 80% of government funding received by charities is in the form of contracts for delivering services rather than grants". The analysis has pinpointed two main approaches to this issue.

A first growing trend is that of local or national governments that commit their resources to experiment pay for success bonds (PFS), such as in UK, US, Israel, Portugal, Germany, Mexico, Canada, Australia. In this form of contract, the buyer pays for significant social outcomes. "Pay for success" (PFS) implies a contract between the government and a private provider of social services where the government pays when results are obtained as opposed to up-front payments for services. A specific financing mechanism to support PFS contracts is Social Impact Bond (SIB) (Arena et al. 2016). In the reference model, non-government, private investors agree to provide the upfront capital to finance the delivery of a social program by service providers. Then, they enter a contract with the government commissioner, which commit itself to repay their principal plus interests only if the intervention is successful, i.e., the social program accomplishes certain pre-defined and agreed social outcomes. On the contrary, if the outcomes are not reached, investors do not recover their investment. An independent assessor is in charge of defining the evaluation methodology, assessing and reporting on the target outcomes. Israel has launched four social impact bonds (SIB); in Japan, "several local governments are in the process of securing the budget for SIB from 2017" and some pilots have been put in the pipeline; the Portugal Inovacao Social has finalized the design of a central outcome fund for SIBs' experimentation; the UK has already launched 32 SIBs; in US 7 deals currently "channel over 80 million dollars of private capital to solve social problems", by adopting PFS. Australia has launched the Newpin Social Benefit Bond that in summer 2014 returned to investors with a yield of 7.5%. Japan, Israel and France expect the launch of new SIBs in the short term.

A second rare trend is the adjustment of traditional bilateral procurement's contracts into new forms that embed social criteria in the selection process. Again the UK is pioneering the way: at the end of 2015 the government announced a renewed focus on the Social Value Act, which requires who commissions public services to secure also wider social, economic and environmental outcomes. However, besides the hype, outcome-based procurement seldom has achieved a sustainable dimension and usually remains in the form of pilots and experimentations. This is typically ascribed to a lack of specific skills in the public sector. However, the analysis showed another factor causing this problem is the difficulty of quantifying social costs and, as a consequence, the outcome achieved. After that UK government has filled in and published a public database of the main social costs, other countries want to follow this example.

Conclusion

Through a thematic analysis of 77 documents produced over the period 2014–2016 by the G8 SIF Taskforce and its National Advisory Boards, this paper identifies two themes that describe the actions that the public sector can put in practice to advance SIF market.

At the state of the art, SIF appears still a niche and disconnected market, whose economic and financial estimations are often imprecise. However, results show that market operators and experts recognize a positive trend of growth in terms of investors' interests, number of initiatives and investments' value. However, even though SIF is usually described as a set of new financial instruments (Moore et al. 2012b), till now, results showed that, with the exception of SIB, there is a lack of financial instrument's innovation and SIF is largely implemented through well-established instruments and investment schemes across a variety of asset classes.

Thus, against the fragmentation of the debate about the future of SIF, this paper tried to move beyond pure anecdotal evidence and to provide a structured interpretative framework of how public sector is supporting the SIF market. It unveils several policies that are influencing the development of SIF market and shows several practices that policymakers have put in place in order to address them.

The findings of this research show that the public sector actually can assume two main roles to build the SIF market. The first, taking the leadership of the movement, consists in endorsing the growth through regulation, incentives and subsidies, thus setting a positive institutional environment for the SIF development. Secondly, it can play a role through the innovation of its procurement's procedures, experimenting innovative models and securing social criteria in the purchasing processes.

The first theme emphasizes the governments' neutrality to SIF (Addis 2015; OECD 2015). With the exception of the Anglo-Saxon example where the Prime Minister has endorsed the SIF cause and the government has supported the market's development through wholesalers, regulation, investments and procurement, in the other countries the public sector has done very little to catalyze the market. Thus, the current trend is the prevalence of the private initiative, with investors and investees that together experiment some piloting tests in an adverse and tricky regulative environment. However, the actual picture is expected to change, given that several governments have accessed the path towards fiscal reforms, regulation of company's hybrid legal status, and regulation of unclaimed assets' use, such as Italy, Canada, France, Japan, Portugal, Israel and Mexico. Furthermore, while since now fiduciary restrictions have limited pension funds' commitment to SIF, there is a growing interest around pension funds' involvement, for example by clarifying the fiduciary responsibilities of pension funds' managers by law, as happened in US and France. Finally, the UK Impact Readiness Fund is inspiring other governments worldwide to launch capacity-building grants or programs.

The second theme discusses PFS diffusion and use (Arena et al. 2016; Fox and Albertson 2011; Jackson 2013). Results show that PFS mechanisms are still in an embryonic phase of testing, but their diffusion is growing, with new countries that are incrementing the pipeline and the first cost databases published. In particular, SIB resulted to be the mainstream approach to social public procurement. Furthermore, a less prominent trend emerged from our results, that is the use of traditional procurement's contracts enriched with social criteria for the selection's procedures.

In conclusion, the lack of large-scale private initiatives, which still prevents the market to move forward to the next level, is only partially compensated by public policy initiatives, notwithstanding the relatively high degree of attention that most governments are paying to SIF. Public support can be potentially articulated in many different forms but now it is still confined to prototypes and small-scale initiatives. With the sole exception of Anglo-Saxon countries, worldwide governments are still very cautious in endorsing the SIF market development, whilst it would benefit from a public intervention directed to lower the level of risks of SIF and provide capacity building funds. In the Anglo-Saxon practices, public sector supports the SIF development also by improving its social services' procurement process. Following this example, other governments are undertaking a more innovative approach testing the instrument of SIB, the diffusion of which is growing worldwide.

The themes highlighted in this paper help to outline the SIF research agenda for the next future. Indeed, the authors suggest that this paper contributes to the academic literature on social impact finance by providing practice-based, structured insights for future research. Researchers are offered a restricted set of open issues relevant for policymakers and relatively uncovered by academic research with the aim to produce actionable knowledge to increase the ability of the public sector to intervene in the SIF market. Few of specific topics deserve urgent attention. The first theme *Public leader* calls for studies aimed to understand the effects of changes in the legal and administrative framework for SIF. For example, would the presence of an ad hoc discipline or regulation for hybrid organizational forms help in building a more robust pipeline? The second theme *Outcomes buyer* calls for academics' contribution to developing accounting and performance measurement systems of social value. The degree of sector-specificity in measurement standards and governance schemes are two crucial future research themes and the advancements of knowledge in this field are likely to determine the pace of diffusion of outcome-based instruments and to ensure the comparability of deals in SIF market.

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