SOCIAL IMPACT BONDS AS A FINANCIAL INNOVATION – AN EVOLUTIONARY APPROACH

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Abstract

By the end of July 2017, the Peterborough Social Impact Bond (SIB) pilot, the world's first SIB, was declared a success. This is expected to spur future SIB activities. Against this backdrop, we examine Social Impact Bonds with respect to typical structures of this financial innovation, its delimitation from comparable financial products, and early market development. Furthermore, an evolutionary economic analysis of SIBs is conducted in order to explain the different market stages, conditions and patterns of SIBs in various countries. Analyzing the respective institutional change, we identify various drivers of SIBs' evolution so far.

Keywords – Public Sector Innovation, Private Investment, Social Impact Bonds, Social Services

JEL Classification - H53, L31

Introduction

The qualification of children with learning disabilities, the rehabilitation of reoffending juvenile delinquents or the integration of migrants are examples of current social challenges, for which necessary institutional structures are widely underdeveloped. Even in so called developed countries, governments find it increasingly difficult to offer appropriate (social) services in these areas, as numerous crises put their budgets under severe stress. Social Impact Bonds (hereafter: SIBs) could represent a welcome (financial) in-

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novation to solve the increasing asymmetry of amounting governmental obligations and stagnating public funds.

SIBs – also called "pay-for-success" financing – offer an innovative way to finance particular, preferably preventive programs in the social sector with the help of private investors. The repayment of invested capital is undetermined insofar as it depends on the success of the financed project (impact investing). Unfortunately, the term “bond” is misleading in a financial context. Traditionally, a bond means that a corporate or sovereign body raises debt capital by issuing tradable securities, thus called “public” debt. SIBs however, are no variation of the aforementioned public debt securities. Instead, they represent an innovative form of private, more equity-like venture capital based on an intersectoral cooperation or multi-stakeholder partnership (Fraser et al., 2016; Arena et al., 2015; Charlton et al., 2013; McHugh et al., 2013; Nicholls and Tomkinson, 2013): Involved parties usually are at least one social service provider, private investors, and the tsate. The aim of their (financial) cooperation is to ex ante prevent or ex post alleviate a specific social problem (Edmiston and Nicholls, 2017; von Schnurbein et al., 2015; Scheuerle et al., 2013; Liebman, 2011).

The aim of this article is to depict the structures, market development and drivers of the evolving of this financial innovation. After differentiating SIBs from comparable financial instruments, we present a first classification of SIBs (part 2). Based hereupon, part 3 presents an analysis of the evolving SIB market. Finally, an evolutionary economic analysis of this financial instrument is conducted, focusing the problems of “social entrepreneurship”, “knowledge” and “emergence of new infrastructures”, to help explain the rather heterogeneous state of SIBs in different countries or regions (part 4). The fifth and final chapter concludes.

STRUCTURES AND DELIMITATION OF SOCIAL IMPACT BONDS

According to *Social Finance* (an intermediary organization in the UK designed to bridge funding gaps and raise external social investment to fund preventative programs), a SIB is an institutional design that is based on a financial contract between one or several private investors with an institution of the public sector in which a commitment is made to pay for improved social outcomes that result in public sector savings (Social Finance, 2010). As in other financial structures, several players are involved in a standard SIB financing, who might not be part of its financial sphere, but nevertheless are interested in benefiting from the project (Child et al., 2016; Gustaffson-Wright et al., 2015):

- The favored target group for whom social services are provided (e.g. long-term unemployed, young people with behavioral problems; short-term prisoners).
- The social service (social entrepreneur), who provides the service. This could be a non-profit organization as well as a profit-/return-/value-oriented supplier.
- The investors who finance the intervention and take the default risk. The investors are at least interested in the social impact of the project, and most probably also in the financial return this project success means for them.

- The state that hopes to cut costs and thus guarantees the payment of the investors (only) in case of success. It therefore takes no financial risk for a possible failure of the SIB.
- Financial intermediaries (e.g., banks or foundations) that examine the feasibility of a SIB and help synchronize supply and demand or capital for social projects at the SIB market. Additional services can include the modeling and creation of the financial instrument as well as the supervision of the investment over the term.
- In addition, independent experts who either monitor and refine the intervention during the implementation phase or check in how far the agreed impact was achieved with the help of key figures, may be involved.

Based hereupon, figure 1 illustrates the general layout of a standard SIB.

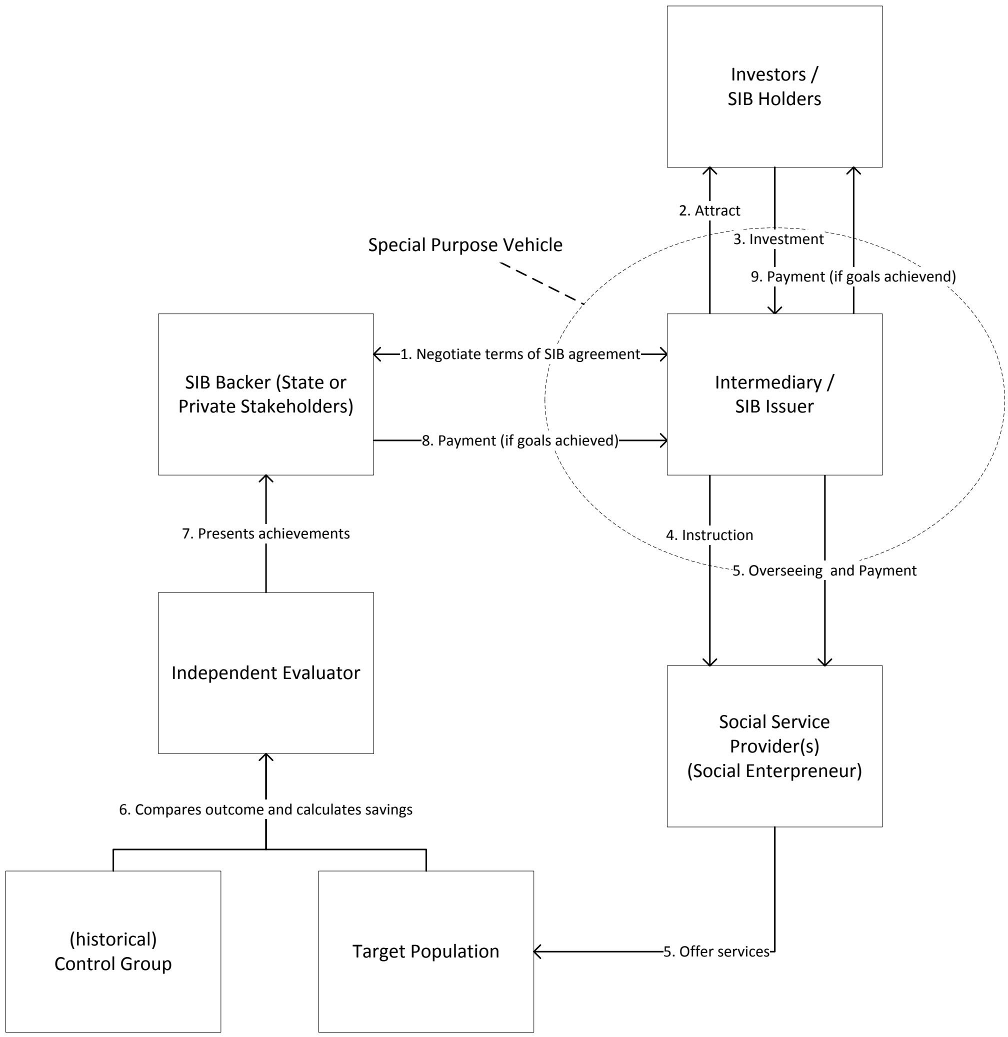

Figure 1: General structure of an SIB agreement (ABN Amro, 2015; Tan et al., 2015)

In its financial core part, a SIB is a private funding (steps 2, 3) of a project in the social sector (e.g. education), which has been negotiated between a special purpose intermediary and a responsible government institution ("SIB backer", e.g. the ministry of education, step 1). Based hereupon, a social entrepreneur is chosen as a servicing agent and mandated to execute the project (steps 4, 5). If the entrepreneur's actions achieve the intended success for the target population (according to independent rating institutions, steps 6, 7), the SIB backer pays the special purpose institution (step 8), which in turn pays the SIB investors (step 9). Consequently, investors receive payments only insofar as a) the originally intended social impact and b) cost savings for the government are achieved, while the party paying the SIB issuer (and, indirectly, its SIB investors) can be either the service organisation itself or the governmental body which had financed the project otherwise and now has profited from lowered expenditures (Scheuerle et al., 2013). Figure 2 illustrates the main actors and processes of a SIB with regard to the intended cost savings:

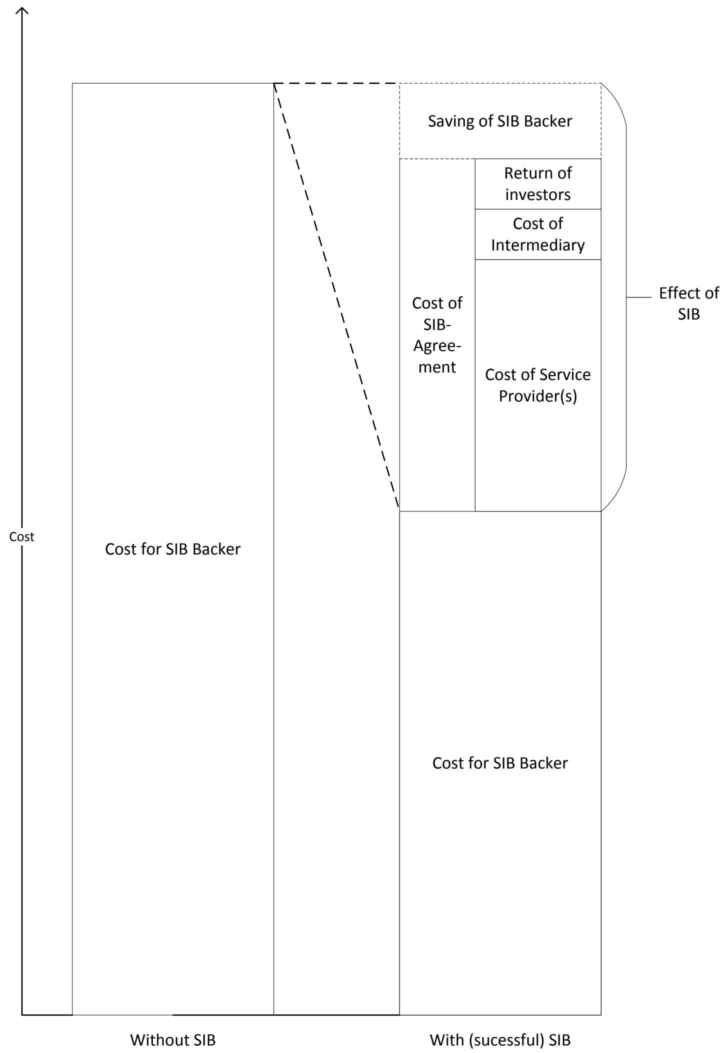

Figure 2: Cost comparison (Weber and Petrick, 2013)

In addition to efficiency gains, SIBs' stakeholders can benefit from various advantageous features of SIB financing. E.g., investors could benefit from returns that are comparably high (given the quasi-sovereign bond in a low interest environment) or correlations with standard asset classes that are comparably low. As well, the impact-oriented use of public funds conforms to the preferences of the state and the taxpayer, while the preventive instead of repairing approach is preferred by the social entrepreneur, the state, and society alike (CNBC, 2017; Gustaffson-Wright et al., 2015; Schäfer and Höchstötter, 2015; McHugh et al., 2013). As any (particularly: investment) project, SIBs promise these benefits not without antipodes. The risk potential of SIBs is particularly due to the newness of this kind of institution and the consequential lack of knowledge.

Although the expression "bond" suggests that SIBs are based on debt, the financing's character in fact is mezzanine (Bolton and Savell, 2010): Pure debt financing (Brealey et al., 2016, pp. 597-617) would include:

- a nominal amount provided,
- which is repaid after a fixed maturity;
- interest payments that do not depend on the debtor's economic success;
- being shielded against debtor's loss by the subordination / liability of equity investors
- no management power.

SIB investors contribute nominal amounts based on a contract with limited maturity and have no decision rights (steps 1, 2, 5). However, their returns explicitly depend on the success of the project they financed. Furthermore, they bear the financial risk in case of the project's failure, as debt service would cease in case of the project failing. Both features (3, 4) make an SIB-investment more equity- than debt-like, so that a SIB is a mixture of both, i.e. a kind of hybrid or mezzanine finance (for the mixed character of mezzanine capital, see Nijs, 2013).

Compared to other forms of finance that combine (features of) equity and debt, SIBs shows similarities as well as differences, making it a (mezzanine) financial structure of its own kind:

- With regard to the core institutional design, SIB financing resembles *project financing* insofar as in both cases, debt service payments to investors depend on the success of one particular project and are paid by a project-specific organisation (special project/purpose company or social services provider). However, project finance is as well cashflow-based as return-oriented (recently, Subramanian and Tung, 2016), while "success" in a SIB-context depends on other than classic economic key figures (e.g. in an improved employment rate).
- The not-for-profit-attitude of investors resembles *donations* (and types of *crowd financing* based hereupon, see e.g. Belleflamme et al., 2014). Donations represent a seminal type of private investments in the social sector, and could be provided in monetary and non-monetary ways, e.g. as voluntary work (Spiess-Knafl and Jansen, 2014). Unlike SIBs however, donations are not attached to a repayment obligation. Furthermore, (donation type) crowd financing differs from SIBs by the number of contributors (and the amount per contribution), which is usually large (small) in crowdfunding and small (large) with SIBs (Lawton and Marom, 2013).
- Finally, the involving of private investors in a task or project that were traditionally conducted by a governmental body, is a common feature of SIBs on the one hand and *Public Private Partnerships* (hereafter PPP) on the other. But while in

a PPP the state acts as principal / direct contract partner of the private partner (Delmon, 2014; Moszoro and Gasiorowski, 2008) and shares the projects' risks with them, it takes no risk of failure of a SIB project, but leaves the respective risk exposure to SIB-investors.

With respect to their financial side, SIBs can be distinguished from these traditional financial structures as illustrated in subsequent Table 2:

	Impact-oriented financing / SIB	**Project financing**	**Public-Private Partnership**	**Crowd financing**	**Donation financing**
parties involved	investor, social service organization, state, intermediary	originator, investor(s), special purpose vehicle (SPV)	investor and the state	investors, company / artist, platform intermediary	investor and company / foundation / artist
type of investor	institutional and private investors	institutional investors	institutional investors and the state	numerous, small-scale private investors	private investors
objective	financed undertakings should have a measurable social impact	classic economic key figures: return, value	efficient performance and oriented towards social welfare	financing of niche projects (economics, esp. arts)	altruism / to do good
level of complexity of structures and contracts	high	high	high	rather low	very low
role of the state	realize intended goal with help of private sector actors, take low risk; pay a portion of the savings back when the social measures have intended effect	junior, e.g. as provider of licenses, infrastructure, tax advantages	contractual partnership with institutional investor, but takes low risk	no particular role, possibly: regulation of new intermediary type	junior, e.g. encouraging donors by offering tax advantages

carrier of financial risk	investor	equity and debt investors of the SPV (project partners)	mostly the institutional investor	investor and company/artist	no one

Table 2: Impact-oriented financing versus similar forms of financing

Obviously, not any governmental project or task is suitable for SIB finance. Instead, a project has to show certain characteristic features which qualify it for a SIB solution (Azemati et al., 2013; Liebman, 2011):

- Measurable net benefits (outcome for taxpayers and investors)
- Measurable outcome / impact (for the target group)
- Sufficient popularity and (risk-adjusted) return to attract investors
- Well defined treatment populations, outcomes etc.
- Credible impact assessments
- Credible debt service commitment of governmental body
- Safeguards against harming the treatment population

The more certain and distinctive those features are for a project, the less risks have to be taken into account by involved stakeholders (e.g. financial risk of the government, transaction cost and information risks of the social service provider, political/budgetary risk of the investor, e.g. Gustaffson-Wright et al., 2015; McHugh et al., 2013). The riskier the project, the more crucial is the question if the government would take part of the financial risk or support alternative risk management solutions. After having presented the aforementioned definition, characteristics, and criteria, we now can describe and evaluate the evolution of SIB markets as of today.

MARKET DEVELOPMENT - THE EARLY YEARS

The first SIB was launched in March 2010 in the UK by Social Finance (which itself had been founded in 2007) and the Ministry of Justice in order to finance a rehabilitation program for prisoners of the Peterborough prison of a scheduled program volume of 5 million £ (Social Finance, 2010). The aim of the project named ONE Service was to break the cycle of re-offending and re-imprisonment of short-sentence prisoners. The SIB raised sufficient investment money to fund the intended services for 3,000 prisoners leaving Peterborough prison (in the planned period from 2010 to 2016), while investors faced an impact-dependent payment scheme (Nicholls and Tomkinson, 2013):

- investor would receive a financial return of 2.5 percent p.a. if there was a 7.5 percent reduction in re-offending when measured against a matched control group
- higher reduction rates in re-offending would generate higher financial returns, staggered to a maximum of 13.3 percent p.a.
- reduction rates of less than 7.5 percent would cause not only zero interest, but also zero repayment, distinguishing this SIB significantly from a classical bond:

> “If the outcomes do not improve, investors lose their investment.” (Dorsett 2017, 4).

The results for the first two cohorts of 1.000 prisoners each in 2014/2015 demonstrated an average final 9 percent reduction compared to a control group, so above the overall 7.5 percent, but lower than the 10.0 percent for immediate payments (Ministry of Justice UK, 2014). In 2015, the premature termination of the project was decided (the Peterborough SIB was originally intended to operate until 2016) due to the roll-out of Transforming Rehabilitation reforms to probation. The latter was incompatible with the SIB’s layout as it made supervision for short-sentenced prisoners mandatory. Besides, measuring the SIB’s success was distorted by the national comparison cohort now receiving governmentally funded support. Consequently, the SIB was terminated, and investors were refunded already in 2015 before the total program volume of 5 million £ had been drawn down (Disley et al., 2015; Disley & Rubin, 2015). While key parties involved have declared this pilot SIB a complete success as well as a blueprint for further SIBs (e.g. former British PM Brown, 2017; Social Finance, 2017), the cutoff as well spurred negative assessments doubting the success and innovative impact of the Peterborough SIB (e.g. The Guardian, 2014; Sharman, 2016). Although Peterborough worked as a door-opener for numerous SIBs in the UK and elsewhere hereafter, it also made the key problem of measuring the success of social projects – i.e. defining and measuring success indicators correctly and unambiguously – obvious (Dorsett, 2017, with respect to Jolliffe and Hedderman, 2014; see also The Guardian, 2014).

Paralleling the British pilot project, SIBs had spurred the interest of US authorities even on the highest level: Already in February 2010, President Obama suggested to provide US$ 100 million from the federal household budget of 2012 for the testing of impact-oriented financing instruments (Liebman and Sellman, 2013; McKinsey, 2012). After this initial proposal was rejected by US Congress, he repeated his attempt by requesting US$ 109 million for 2013, and was rejected again. But meanwhile, SIB-directed activities on the local and state level had turned out successful: The first SIB in the US was commissioned in 2013 with a volume of US$ 9.6 million by the city of New York to reduce recidivism of ex-prisoners. This project was discontinued in August 2015 due to the falling apart of the control group, the pulling out of non-financial stakeholders and general budget cuts (Cohen and Zelnick, 2015).

Further pilot SIBs were launched in different countries inside and outside the European Union: In Australia the first SIB (volume AUS$ 7 million) was initiated by the financial authority of New South Wales (NSW) in 2013 with the aim to avoid out-of-home care for 400 families with at-risk children. The early success of the NSW based project has led governments across the country to rethink how they fund, test and deliver social services with a boost from private investors (Wilkes, 2017). In the Netherlands, which hereafter turned into another important SIB market according to total SIB volume, the first SIB was launched in 2013, helping 160 unemployed young people in Rotterdam without basic qualifications to get a job or go back to school. The project caused early successes in such a way that many members of the target group found new jobs or started their own businesses and has subsequently led to further SIB projects (ABN Amro, 2015).

CURRENT STATE OF AFFAIRS

Although the issuing of SIBs has increased rapidly since 2013, SIBs are still among the most recent financial innovations. And while interest is growing, their number and scope remains easy to survey. Table 3 includes those 60 SIBs, which were announced from 2010 to (June) 2016 worldwide, amounting to a total financial volume of more than US$ 200 million (Social Finance, 2016), by country of origin, number, and volume of SIBs.

Country	Total volume in mill. US$	Number of SIBs	Year of first issue
US	121.4	10	2013
UK	57.4	31	2010
Australia	16.0	2	2013
Netherlands	8.7	5	2013
Israel	7.6	2	2015
Sweden	1.2	1	2016
Austria	1.1	1	2015
Canada	0.9	1	2014
Finland	0.7	1	2015
Germany	0.3	1	2013
Belgium	0.3	1	2014
India	0.3	1	2015
Switzerland	0.3	1	2015
Peru	0.1	1	2015
Portugal	0.1	1	2015

Table 3: Total volume in mill. US$ and number of SIBs worldwide as of June 2016 (Bertelsmann Stiftung, 2016; Social Finance, 2016; Gustaffson-Wright et al., 2015; von Schnurbein et al.; 2015)

- Numbers of SIBs by country: In the beginning, SIBs were mainly observed in Anglo-American countries as the UK, USA, Australia and Canada (McHugh et al., 2013; Weber and Scheck 2012; Liebman, 2011). While between 2010 (launch of the first SIB) and 2012 just 14 SIBs were issued, the number has more than tripled to altogether 46 SIBs worldwide between 2013 and Mid-2016. As SIBs still are in an early stage of development, their majority is still to be found in the aforementioned countries, with their majority (31 SIBs) located in the UK.

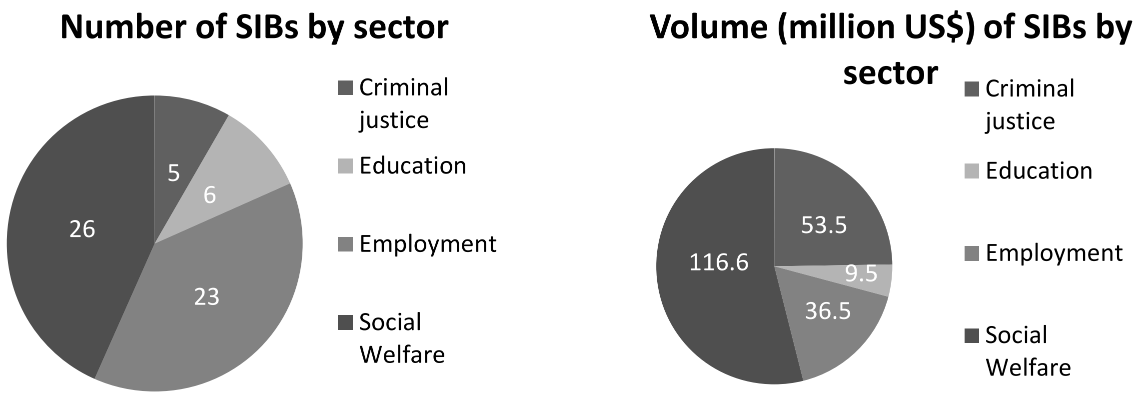

Figure 3: Number and volume in million US$ of SIBs worldwide by sector as of June 2016 (Social Spider CIC, 2017; Social Finance, 2016)

- Number of SIBs by sector: Figure 3 mentions only four social services areas, illustrating that so far most SIBs were developed for social welfare activities and employment projects, whereas SIBs in the areas of criminal justice and education exist, but are still rather underrepresented. Other fields of social services – e.g. welfare of the elderly, welfare of the mentally ill, or fire services – have not featured a SIB project yet.

- Volume of SIBs by sector: The Social Welfare sector shows the highest volume with US$ 116.6 million, followed by the Criminal Justice sector with US$ 53.5 million (here above all two large-scale ex-offenders projects in US with a volume of US$ 13.5 mill. and 21.3 mill.). Although the Employment sector can prove a higher number of SIBs, volume (US$ 36.5 mill.) is lower than for Criminal Justice. The Education sector has a volume of only US$ 9.5 million.

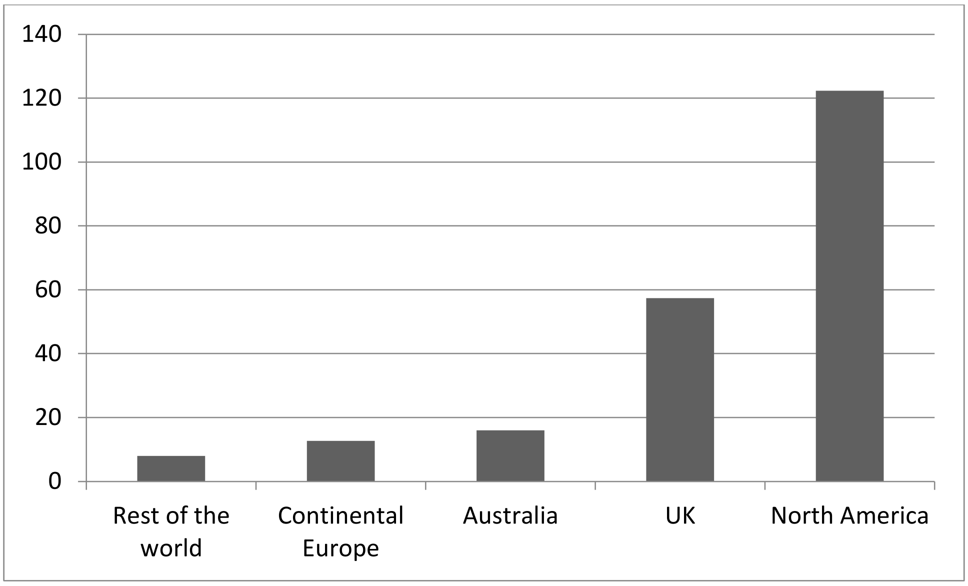

Figure 4: SIB capital raise by issue (in million US$) by region as of June 2016 (Social Finance, 2016)

- Volume of SIBs by region: So far, most SIB capital has been raised in North America (the USA and Canada) as Figure 4 above demonstrates, including the largest single SIBs worldwide, totalling US$ 21 million in January 2014, and US$ 30 million in February 2016. Compared herewith, a rather different dimension of European SIBs becomes obvious, as the typical European SIB ranges from € 100.000 to 1.2 million in continental Europe and from £ 1 to 2 million in the UK. Consequently, the United States are the largest SIB market, if transaction volumes instead of transaction numbers are considered

While the previous numbers already show important patterns of SIB development, further insights can be derived from a project perspective. However, a respective synopsis is limited by the reporting behavior of SIBs. As of mid-2016, only 22 projects worldwide have reported performance data (information about social impact), with 21 projects indicating positive social outcomes and 4 projects (three in UK and one in US) already having fully repaid investor capital (Social Finance, 2016). 16 of the 22 projects use administrative data for measuring success (based on past government data, but no direct comparison), while the others refer to comparative data, i.e. to a comparable group of people not benefitting from the activities funded via the respective SIB. The subsequent table 4 assembles the aforementioned 22 reporting SIBs in a synopsis with regard to their available financial results.

Program name	**Sector**	**Country**	**Year of contract signing**	**Intermediary**	**Success measure**	**Financial results**
ONE Service	Criminal justice	UK	2010	Social Finance UK	Comparative	Investors were to be refunded already in 2015 due the premature termination of the project although repayment was not foreseen until 2016.
Triodos New Horizons	Employment	UK	2012	Triodos Bank UK	Administrative data	As of July 2015, investor capital has been repaid in full.
Think Forward	Employment	UK	2012	Think Forward (non-profit organization)	Administrative data	The Social Impact Bond provided a full return of capital plus a return to social investors.
Nottingham Futures	Employment	UK	2012	Nottingham City Council	Administrative data	In 2015, the Social Impact Bond led to a £ 2.5 million in outcomes payments.
Living Balance	Employment	UK	2012	Indigo Project Solutions	Administrative data	In its first six months, this Social Impact Bond worked with 86 young people alongside 7 secondary schools, helping 68% of participants into employment with 100% job retention. Financial data is not available.
T&T Innovation	Employment	UK	2012	Social Finance UK	Administrative data	The Social Impact Bond was fully repaid to investors with final returns anticipated in 2016.
Energise Innovation	Employment	UK	2012	Social Finance UK	Administrative data	Investors have been fully repaid with final returns anticipated in 2016.
Street Impact	Social Welfare	UK	2012	Triodos Bank UK	Comparative	Payment against targets is increasing consistently by quarter and is in line with targets.

Thames Reach Ace	Social Welfare	UK	2012	Social Finance UK	Compa-rative	Mixed performance across the five outcomes, but payment against targets is increasing consistently by quarter. Outcome payments are in line with targets.
Essex Family Therapy	Social Welfare	UK	2012	Social Finance UK	Compa-rative	Outcomes payments have been made to the Social Impact Bond holding company and will be recy-cled to pay for ongoing ser-vice delivery.
Manchester City Council Vulnerable Children	Social Welfare	UK	2014	Man-chester City Council	Adminis-trative data	Early payments from Manchester City Council to the Social Impact Bond vehicle have been made and recycled into the cost of program delivery.
Fair Chance St. Basils	Educa-tion	UK	2015	Social Finance UK	Adminis-trative data	St. Basils have moved more than 100 young people into stable ac-commodation and more than 50 have entered education. Financial data is not available.
Fair Chance Depaul	Educa-tion	UK	2015	Social Finance UK	Adminis-trative data	More than 70 young people have moved into stable accom-modation, more than 20 have en-tered education. Financial data is not available.
Fair Chance Local Solu-tions	Educa-tion	UK	2015	Social Finance UK	Adminis-trative data	Local Solutions have moved more than 50 young people into stable accommodation. Financial data is not available.
Youth en-gagement Teens & Toddlers	Educa-tion	UK	2015	Social Finance UK	Adminis-trative data	Improved behavior and attitude at school for the first cohort of 161 at-risk 14-15 year olds. Financial data is not available until late 2017.
Ways to Wellness	Social Welfare	UK	2015	Social Finance UK	Adminis-trative data	Worked with 1,126 new patients, 3% above target in year 1. 83% of patients have continued in year 2. On average, wellbeing has im-proved by four points for 197 pa-

						tients based on the Well-being Star (a tool/scale for measuring well-being).
Rikers Island Recidivism	Criminal justice	US	2013	Man-power Demon-stration Research Corpora-tion (MDRC)	Compa-rative	No payments were made on the only investor Goldman Sachs' $7.2 million investment, triggering Bloomberg Philanthropies' $6 million guarantee due to premature termination of the project as of August 2015.
Utah High Quality Pre-school Pro-gram	Educa-tion	US	2013	United Way of Salt Lake	Adminis-trative data	Total savings calculated in year 1 for Cohort 1 are $281,550, based on a state resource special educa-tion add-on of $2,607 per child. Investors received a pay-ment equal to 95 percent of these sav-ings.
Chicago Child-Parent	Educa-tion	US	2014	Illinois Facilities Fund (IFF)	Adminis-trative data	Investors received a success pay-ment of $500,000 based on the kindergarten readiness results for the first cohort.
New South Wales Child and Family Welfare (Be-nevolent Society)	Social Welfare	Aus-tralia	2013	Westpac Institu-tional Bank	Compa-rative	Results from the first 21 months show that the principal metric, the numbers of entries into care, was 27% lower than the control group, with helpline and safety assess-ment metrics again showing an increase. Final investor returns will not be calculated until 2018.
New South Wales Child and Family Welfare (Uniting Care Burnside)	Social Welfare	Austra-lia	2013	Social Ventures Australia	Adminis-trative data	As of June 2015, investors have received returns of 8.9% p.a. based on a cumulative restoration rate for the first two years of 61.6%.
Unemployed Youth	Employ-ment	Nether-lands	2013	No inter-mediary during the pro-	Adminis-trative data	Initial results demonstrate that 59% of the first cohort (80 total participants) are no longer on ben-efits. Financial data is not availa-

				cess of building.		ble.

Table 4: Overview of the 22 worldwide SIB´s with first social impact information as of June 2016 (based on data taken from Social Spider CIC, 2017; Social Finance, 2016; Gustaffson-Wright et al., 2015)

Considering the market developments in the aforementioned countries until mid of 2016, it seems obvious that each country is in a different development stage with regard to the number and volume of SIBs, the experience so far and the number of investors. Hence, an evolutionary economic analysis of these circumstances is carried out in the next chapter.

EVOLUTIONARY ECONOMIC ANALYSIS

As shown above, usage and reception of SIBs differ among different countries so far. To explain this heterogeneity and to deduct reasons and recommendations for those who want to support SIB development, economic theory provides useful insights. As we focus the evolution of a new institutional design, in particular evolutionary economic approaches appear promising. Evolutionary Economics fully emerged in the 1980s, focusing the role of knowledge, its transformation and its limitations for the economy (Nelson and Winter, 1982), while it was based on the seminal contributions of the Austrian School and others, in particular the theory of entrepreneurship of Schumpeter (Schumpeter, 1934), the market process theory of von Hayek (von Hayek, 1945) and the theory of institutional change of North (North, 1990).

The evolutionary approach with reference to the SIB markets in UK, US and Germany is to be hypothesized and analyzed below under various relevant criteria which can explain the triggered system change:

- the concept of the social entrepreneur,
- the knowledge component by human actors,
- the market-ready implementation of knowledge,
- favorable (or unfavorable) conditions,
- the design of formal and informal rules.

Based on the “creative destruction” of the Schumpeterian entrepreneur, that mainly refers to a new combination of production factors by this human actor, combined with a displacement of old structures within the economy (Schumpeter, 1934), social entrepreneurship means an entrepreneurial activity, which is used in an innovative and long-term way to solve social problems and includes a social mission, meaning that mission related impact becomes the central criterion instead of wealth creation (Dees, 1998). Other than the business entrepreneur, the environment of the social entrepreneur offers no clear definition of products and prices. Furthermore, the test of successful business entrepreneurship is the creation of a viable, growing, and wealth generating business, while the test of social entrepreneurship, in contrast, maybe a change in the social dynamics and systems that created and maintained the problem (Alvord et al., 2004). The concept of entrepreneurship not only applies to the entrepreneur in the classical sense, but also to actors in governmental institutions (High and Pearce, 1993; North, 1990, pp. 73-104). According to the evolutionary approach, the state is represented by its human representatives, who do not act in the public interest, but their own interest. Consequently, these actors also try to be innovative to enhance their personal success, being measured by their salary, the size of their budgets or their personnel, the number of votes or other indicators of their political or bureaucratic career. This view could therefore help explain the supposedly public promotion of SIBs by human action (seminal, von Mises, 1949, pp. 242-260 and passim).

In accordance with Schumpeter, five types of innovations can be distinguished (Schumpeter, 1934, p. 66): product area, process area, organizational changes, new business models and technological changes. According to this systematization, SIBs stand for an innovation in many ways. It is a new problem solution for an old problem, namely the implementation of social tasks by the state. To this end, a new organizational structure (multi-stakeholder partnership) is being developed by the state (which adapts its business model to this extent). The desired result is also attempted in other ways (process). As a result, new (investment) opportunities for investors are created (product).

Social entrepreneurship, as already defined and delimited, has a particular tradition in the UK (Türk et al., 2013). With the start of the new millennium, UK social enterprises have become the most established (measured by the number) in Europe (Volkmann et al., 2012). In the year 2000 the first Social Investment Taskforce was constituted (UK National Advisory Board, 2014*)* to support social entrepreneurs in the creation and growth. Accompanying, in 2002, the UK government developed a definition which describes social enterprises as follows: „A social enterprise is a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximize profit for shareholders and owners" (Department for Trade and Industry UK, 2002). In order to promote a further increase of social enterprises, the British state has also taken a number of measures. For example, a Social Entrepreneurship Unit has been set up on government level, which is intended to improve the framework conditions for social enterprises in close cooperation with stakeholders in the sector (Türk et al., 2013). Thus, in the UK favorable conditions for social entrepreneurship and thus a foundation for a social culture (as an informal rule according to *North*) were set by the government comparably early.

A further relevant point for explaining the advantageous circumstances in the UK and the US is the individual willingness to donate (which is driven by personal motives, but also by tax incentives for donations provided by the government). Traditionally, UK and also US citizens donate significantly more than people in other countries (GfK, 2011). Analysing donor behavior in UK and US in detail, it can be observed that education is of great importance, with at least 10 percent share of the total donations (Europe as a whole 5 percent). In Germany, on the other hand, more donations are spent for disaster relief and religious organizations (27 percent) than for poverty reduction and health research. Closely related to the donation behavior in UK is the Gift Aid decree from 1990, which was substantially amended by the Finance Act 2000 (UK Government, 2016). Gift Aid is a UK tax rule designed to incentivize donations by individuals to charities (in the UK, and, since the Finance Act 2010, also for non-profit organizations in the EU). A further measure, which has been launched by the UK government in this context is the Social Investment Tax Relief (SITR) introduced by the Finance Act 2014. The objective is to encourage individual investment in small social enterprises and to provide a 30 percent income tax deduction for the amount invested. SIB investments are eligible in this context (GAA Accounting, 2015).

The development of a SIB market and the establishment of knowledge in the sense of von Hayek (von Hayek, 1937) require coordination and networks. In the US and the UK, financial experts have already been cooperating for considerable time with state actors and the third sector to establish institutions that allow for a functioning SIB market and thereby incentivize the inflow of capital into social projects, as they promise more attractive risk-return-positions than in earlier scenarios (Social Finance, 2016; Weber and Scheck, 2012). Most foundations that conduct impact investing in the US are either sponsored by Ashoka (a non-profit organization to promote social entrepreneurship founded in 1980) or are members of the Mission Investors Exchange (hereafter MIE), which is an information and advanced training platform (tools, studies, webinars, training) as well as a network of foundations (meanwhile the network covers over 250 foundations and affiliate members, see Mission Investors Exchange, 2016). The MIE as a SIB-specific organization enhanced awareness of Mission Investing (inter alia through PR campaigns) and also acts as a lobby organization (Johnson and Lee, 2013; McKinsey, 2012) so that information asymmetries between interested parties can be reduced. Likewise, the knowledge of impact investing can be shared and developed, according to insights of market process theory.

In the UK, *Social Finance* was founded 2007 (closely linked to the beginning of the financial crisis) with the aim to develop the market for social investments (see chapter 3). The nonprofit organization was funded by various philanthropists and foundations and works with an interdisciplinary team of experts, including investment professionals, strategy consultants and experts from the social sector (Social Finance, 2010). On the one hand, the mission of this team is to develop innovative financial products, such as the launch of the first SIB or other vehicles in the form of venture capital funds or funds of funds. On the other hand, Social Finance should act as adviser to investors, product providers, socially-motivated companies and the government, and publish in those fields (Social Finance, 2010; 2016). Thus, Social Finance (meanwhile there is *Social Finance UK, Social Finance US and Social Finance Israel*) contributes as a classic intermediary that reduces transaction costs (e.g. search costs) and information asymmetry between the parties involved by collecting, processing, and providing information (on theories of intermediation, see Greenbaum et al., 2015). Thus, intermediaries like Social Finance can help to enhance investor confidence by valuing specific outcomes and by providing transparency, standardization and scalability of SIB processes (allowing for programs being replicated and adapted to multiple geographies). Besides Social Finance, a further intermediary called *Bridges Ventures* as a private investment firm (founded in 2002) plays an important role in the British SIB market (e.g. Bugg-Levine et al., 2012). The *Bridges Social Impact Bond Fund* was launched in April 2013 and provides investment and support (e.g. with advice) to charities and social enterprises (Bridges Ventures, 2015). So it can be stated that in the sense of evolutionary thinking the human actors behind these institutions in US and UK first have seen the new environment and the opportunities given by SIBs. This knowledge was then translated into action on the market, represented by an innovation.

The largest European economy (measured in terms of GDP), namely Germany, is weakly developed in the impact investing market (only one SIB since 2013 as shown in table 2), but due to numerous national initiatives, the market has gained momentum since 2012 (Bertelsmann Stiftung, 2016). Some players (e.g. *Bertelsmann Stiftung, Ashoka*

Deutschland, BMW Stiftung, Kreditanstalt für Wiederaufbau and GLS Bank) are already active and prove that SIBs and impact investing have the potential to contribute to social change in Germany, too (Bertelsmann Stiftung, 2016; Weber and Scheck, 2012). However, it still lacks the necessary institutional infrastructure (e.g. standardized investment products, investable social projects and intermediaries) compared to the US and, above all, the UK, to attract a sufficient number of investors in order to achieve a significant market size and penetration (Glänzel and Scheuerle, 2016). These challenges are not specific for Germany, but follow a pattern that can also observed in other emerging impact investing markets (Social Finance, 2016). Accordingly, there is a lack of funding and public contracts on the demand side and, therefore, a simultaneous lack of sufficiently attractive investment opportunities on the supply side. For political actors involved, incentives are missing to launch costly initiatives, whereby an institutional change with new formal and informal (e.g. social culture) rules according to *North* becomes difficult. In developing further a functioning market in Germany, the state should be positioned in different roles, e.g. legislator, provider of infrastructure, investor and customer of social services.

Finally, the most promising chance for an institutional change by SIBs was established on a transnational level in 2013, with the Social Impact Investment Taskforce (hereafter SIITF) being established under the UK´s presidency of the G8 (Daggers and Nicholls, 2016). The reason for the founding of the SIITF was the insight of the G8 states (especially pushed by the UK in form of the former prime minister *David Cameron*) that the market for impact investing needs to grow even faster referring to the worldwide challenges in the social sector (Social Impact Investment Taskforce, 2014). This politically independent taskforce comprises twenty-two people, including one government official and one representative of the social or private sector from seven countries and the EU, as well one observer from Australia. In addition, on the national level of the G8 countries (Australia, Canada, France, Germany, Italy, Japan, UK and US) National Advisory Boards were established, which consist of representatives of the social economy, finance, foundations, academia and the public sector, whereby a deep networking of the SIB topic can take place. Ultimately, four international expert working groups were implemented to address in depth the particular challenges of measuring impact, asset allocation, mission in business and international development (Social Impact Investment Taskforce, 2014). Meanwhile, the Global Social Impact Investment Steering Group (hereafter GSG) was established in August 2015 as the successor to the SIITF. The GSG is continuing the work of the Taskforce in catalysing a global social impact investment market across a wider membership and is working to increase momentum by promoting a unified view of impact investment, facilitating knowledge exchange and encouraging policy change in national markets (Global Social Impact Investment Steering Group, 2016). Thus, a global basis for an institutional change can be created. The example of the SIITF (and subsequently GSG) shows that, in the evolutionary sense, the knowledge (or the known protrusion) about the SIB theme was bundled by the British government especially in the form of *David Cameron* (who once again can be seen as a social entrepreneur by the state with its own interests).

The subsequent table 5 summarizes the essential evolutionary triggers for a positive (or slow) system change according to the SIB markets in UK, US and Germany.

Evolutionary trigger	UK	US	Germany
Relevance of social entrepreneurship	Pioneering role in Europe; even a Social Entrepreneurship Unit was set up by the government	Strongly present (social entrepreneurship has been a fixed term since the 1980s mainly through the work of Bill Drayton, founder of Ashoka)	Less pronounced than in Anglo-Saxon countries (only popular since the end of the 1990s due to the start of the Schwab foundation)
Incentives by tax laws	Gift Aid (1990/2000), Social Investment Tax relief (2014)	none	none
Donation readiness	Strongly directed to education, poverty control and health research	Strongly directed to education, poverty control and health research	Strongly directed to disaster relief and religious organizations
Existence of a social culture	Good conditions, which were established early by the state	Rather promoted only by the former President Obama	Less strongly present and promoted by the state
Important intermediaries and human actors	Social Finance, Bridges Ventures, David Cameron	Mission Investors Exchange (MIE), Ashoka, Barack Obama	Bertelsmann Stiftung
Investable social projects	yes	yes	yes, but less available than in UK and US
Failed SIB projects	none	Rikers Island (the first SIB project in US)	none
Innovation readiness	high	high	high, but rather in classical industries
Attitude towards entrepreneurship	positive	positive, high reputation of entrepreneurship, high risk affinity	Entrepreneurship is still less accepted than in Anglo-Saxon countries
Incentive of the state as a social entrepreneur	State takes on different roles: legislator, provider of infrastructure, investor or customer of social services	Rather was relevant by the former President Obama	Understanding of the state as a social entrepreneur is still missing
Learning by past SIB	Strongly given due to a large number of projects	Given, despite the failed Rikers Island project;	Not available due to only one project since

projects	since 2010	unlike UK less SIBs but more volume	2013
Member of the SIITF / GSG	yes	yes	yes
Budget shortage	None	Programs of former President Obama were rejected by the US Congress (2012/2013)	none
Networking between the state and munici-palities	Strongly present	Strongly present	Still hardly work to-gether despite federal structures

Table 5: Evolutionary triggers for the SIB markets in UK, US and Germany

CONCLUSIONS

SIBs provide an innovative way to finance preventive measures in the social sector with the help of private investors. In this article, various examples from international markets have shown the feasibility of impact investing based on SIB structures. Nevertheless, the occurrence of SIBs is disproportionately allocated, with selected countries (as the US and the UK, where 41 out of 60 existing SIBs are located) acting as frontrunners, while others (such as Germany) lag behind – in spite of the size and the importance of their financial markets and social system even on a global scale. Although the necessary know-how, the evidence for the feasibility and first practical experiences exist, information is still scarce. To overcome this Catch 22 situation, governments could provide particular startup assistance and rulebooks. If the Catch 22 of no-SIB-investments-without-further-SIB-knowledge / no-further-SIB-knowledge-without-further-SIB-investments should prevail, temporary governmental support could start with information (most basic, by publicly declaring SIBs as desirable initiatives enhancing general welfare, more sophisticated by the collection and provision of information). On a financial level, the government could enhance SIB attractiveness by amending taxation rules, and also by offering subsidizing assistance, e.g. by risk-taking or even subsidizing a project. On an institutional level, it could make its commitment visible by joining supranational SIB initiatives (like SIITF).

During the next five years, several of the current SIB projects will mature, so that more data on results (e.g. benefits and costs) of the first generation of SIBs will be obtainable

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– including both successes and failures. Probably, the evaluation of (returns and risk of) this pilot generation will influence the attitude of potential participants significantly. So far, SIBs seem to offer a new solution to old and new challenges in the social services sector. However, it is still uncertain if they represent the new standard or just a niche solution, or if they might disappear from the investment and finance universe completely, because other options are deemed more attractive.

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