SOCIAL IMPACT BONDS: AN INNOVATIVE WAY TO COMBAT YOUTH UNEMPLOYMENT

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Abstract

Purpose: To explore whether the so-called social impact bonds (innovative financing of social interventions) are a desirable and feasible alternative in combatting youth unemployment.

Approach: Literature study and semi-structured interviews.

Findings: Social impact bonds are an important addition to the existing employment measures.

Limitations: Sole focus on the situation in the Netherlands; limited expertise.

Value of the paper: The paper offers an understanding of a new instrument that leads to fundamental changes in the way social issues are tackled. In relation to positive management, social impact bonds call upon the corporate social responsibility of private parties to invest in social interventions.

Keywords: social impact bonds, employment measures, youth unemployment, corporate social responsibility, positive management

Paper type: Conceptual paper with case study
1. Introduction
Unemployment has risen fast during the recent crisis and remains a big problem for Dutch society. The unemployment rate is the highest in the age group from 15 to 24 years with an average of 15.9 percent in 2013 (CBS Statline). The Dutch government has responded to this situation by introducing a programme with measures to lower the unemployment rate amongst youth. In addition, the government is open to innovative solutions. An example is the first Dutch social impact bond in Rotterdam, focusing on lowering youth unemployment rates. A social impact bond is a new finance mechanism that aims to tackle social issues under the responsibility of the government. This article questions whether social impact bonds are a desirable and feasible alternative to combat youth unemployment in the Netherlands.

Firstly, the research approach is mentioned. Then social impact bonds (SIBs) are described. In view of their innovative nature, a comprehensive definition and the limitations in applying SIBs is not yet possible. However, the application of SIBs in the Netherlands is discussed (third paragraph), in particular the context, their effectiveness and the pilot in Rotterdam. Fourthly, this application has resulted in some points of consideration. The latter indicates that adaptations will be necessary for use in other states. Finally, some wider aspects are discussed, such as the dynamics of SIBs, the flexibility of the instrument and its sustainability.

2. Methodology
The research contributes to combatting youth unemployment through discussing the pros and cons of social impact bonds. Its primary aim is to explore whether social impact bonds are a desirable and feasible alternative to the existing measures against youth unemployment. This has been mostly realised by a qualitative approach, in particular a wide ranging literature review, supplemented by three semi-structured interviews and a written exchange of information with experts.

The literature review deals with an analysis of youth unemployment in the Netherlands, the employment measures used to reduce youth unemployment in the Netherlands, their effectiveness, and the way social impact bonds function. The documents used for the literature review consist of written sources, government databases and websites concerning specific information on individual SIBs. The written sources include books, scientific articles and reports which were carefully picked, taking into consideration the use the most recent and best cited sources.

The semi-structured interviews focus on the experiences of experts involved in SIBs in the Netherlands. At the time the research started there was one active Dutch SIB. The aim was to interview the stakeholders involved in this social impact bond, which is located in Rotterdam. This resulted in interviews with respondents working for the municipality of Rotterdam (as government organisation) and investor ABN AMRO Bank. It also resulted in a written
exchange of information with the social service provider (The Buzinezzclub) who couldn’t participate in an interview due to time constraints. Furthermore, a third interview was conducted with the project leader (Deloitte) of a social impact bond that was being implemented at the time of the interview. All interviews were recorded, transcribed and verified by the respondents.

3. Description of Social Impact Bonds

Social impact bonds may be described as an innovative method of financing (Costa et al., 2012), a partnership (Vennema and Koekoek, 2013) and a pay-for-performance contract (Callanan et al., 2012). They commit governments, private investors and social service providers to a social issue.

The structure of SIBs is shown in figure 1. The investor pays for the activities of a social service provider (1), thereby taking the financial responsibility for tackling a social issue. The social service provider conducts an intervention on a target group that suffers from a social issue (2). The intervention aims at achieving social results (i.e. improvement of the situation of the target group), resulting at the same time in government savings. An independent assessor measures the target groups outcomes (3) and reports the SIBs progress (4) and final results (5). The service provider can use the progress assessments to adapt and improve the intervention. Based on the SIBs final results, which are predefined in a contract signed by all stakeholders, the government pays part of its savings to the investor (6) (Social Finance, 2009; Vennema and Koekoek, 2013). Lunes e.a. (2013) stress that the ultimate goal of a social impact bond is to improve the social position of the target group.

An example may clarify this process. A service provider offers an intervention, aimed at helping unemployed people to find a job. Reduced unemployment results in government savings on unemployment benefits. The government pays a part of these savings to the investor. Due to this payment-by-results approach, better results lead to greater government savings and higher returns for investors. On the other hand, a failure in delivering results generates no government savings.
and the investor doesn’t receive a payment. In such a situation, the investor loses his money.

Social impact bonds offer opportunities to the parties involved. The government may transfer the financial risk of resolving social issues to private investors. ‘No cure no pay’ ensures that governments only pay for proven results, which also clarifies the effectiveness of the intervention. Investors get the chance to demonstrate their corporate social responsibility and may obtain returns on social investments. Social service providers are offered a long-term investment that may be used to design and implement their interventions on a larger scale (Lunes et al., 2013).

The first social impact bond was launched in the United Kingdom in 2010. Currently, 53 social impact bonds have been implemented in 14 different countries (Finance for Good, 2015). They aim to improve many different types of social issues, such as unemployment, homelessness and preventing recidivism amongst former prisoners.

4. Application in the Netherlands

The municipality of Rotterdam started its own experiment with the first social impact bond in the Netherlands in 2014. Three other Dutch social impact bonds followed in 2015, two in Utrecht and one more in Rotterdam. All Dutch social impact bonds focus on reducing unemployment (Gemeente Rotterdam n.d.; Gemeente Utrecht, 2015; Deloitte, 2015).

Below, the application of social impact bonds to reduce youth unemployment is discussed, starting with its context and the effectiveness of current employment measures. This is followed by a description of the pilot project in Rotterdam and information on the desirability and feasibility of social impact bonds in the Netherlands.

4.1. Context

Internationally, youth unemployment is structurally higher than the unemployment rates in other age groups (OECD, 2008; Choudhry et al., 2012). The periods of recession and the overall height of youth unemployment in Figure 2 indicate that these findings also apply to the Dutch labour market.

Unemployment leads to direct costs for governments due to unemployment benefits. Indirect costs relate to disturbance of public order, criminality and health. Contact with the police is more than twice as high amongst unemployed youth in the Netherlands (Traag and Marie, 2011) and international studies show that youth unemployment leads to mental and physical health problems (Bartley, 1994; Murphy and Athanasou, 1999; Lakey et al., 2001). The costs of these indirect consequences of youth unemployment are, however, very difficult to calculate.
In 2013 the Dutch government introduced a programme to tackle youth unemployment. The regional approach of this programme offers municipalities the opportunity to carry out their own local employment measures. This regional approach focuses on measures that encourage youngsters to start working or enroll in education (Visser et al., 2014). The efforts in question may be categorized into employer incentives, job search assistance, educational programmes, social return [1] and several subsidized local projects. Although the Dutch government spends a lot of money on these measures, their effectiveness remains a point of attention.

4.2. Effectiveness of the current Employment Measures

Effectiveness may be applied in several ways. The effectiveness of employment measures on the target group is defined as the effect on micro level, and it distinguishes gross- and net effects [2], and short- and long-term effects [3]. The effectiveness of measures on macro level is the effect on people outside the target group, for example substitution [4]. It is also possible that the effectiveness differs per target population, like per age group or qualification level (De Koning et al., 2005).

Figure 3 summarises the results of recent Dutch studies on the effectiveness of employment measures on unemployed youth. This overview indicates that the effectiveness is largely unknown.

The research institute Panteia informs the Dutch parliament about the progress of the regional youth employment programme. The reports in question enhance the understanding of the implementation and effects of the efforts concerned. The 2015 report mentions the gross effect of 11,600 job placements (Bouma et al., 2015). Other effects, like placements on internships, are mentioned, but not measured if they do not result in regular jobs. The measurement doesn’t pay any
attention to the net effects, long-term effects or substitution. Therefore, the report lacks the information required for an opinion on the effects of the employment measures. However, the report is used in Dutch parliament, which raises the question whether or not the evaluation of the programme is based on too limited information.

4.3. Pilot in Rotterdam

The first Dutch social impact bond aims at reducing unemployment amongst unqualified youth in Rotterdam who receive unemployment benefits. The parties involved consist of Buzinezzclub (a social service provider), the municipality of Rotterdam (government), Start Foundation and ABN AMRO Bank (investors), and Deloitte (independent assessor).

Buzinezzclub offers the target group guidance and training on starting a business and provides a workspace, network and role-models. This should lead to a faster outflow from unemployment to entrepreneurship. The intervention also
promotes the development of a passion for a specific profession. Participants may look for a job or education related to this profession if they don’t manage to start their own business (Vennema and Koekoek, 2013).

Starting a business leads to the creation of new jobs. This will reduce the risk of substitution effects amongst people outside the target group. The social impact bond also includes an incentive to promote sustainable effects, because the Buzinezzclub receives payments if the amount of participants that return to unemployment benefits is reduced (Vennema and Koekoek, 2013). The investors have invested €680,000 in the social impact bond to assist 160 unemployed youth over a period of two years. The estimated costs are €4,000 per participant and €40,000 is available for extra costs (Vennema and Koekoek, 2013).

Interviews with experts involved offer more clarity about the conditions for payment by the government to the investors. Previous results of the Buzinezzclub have led to the presumption that the period of unemployment benefits decreases from 22.7 to 15 months if the youth in question engage in the intervention of the Buzinezzclub, as opposed to no intervention. Furthermore, the reduction of the amount of unemployment benefits was expected to save the government €39.70 per person per day (i.e. the average cost per person per day of all unemployment benefits paid by the municipality of Rotterdam in 2013). These presumptions led to agreements on the amount to be paid, up to a maximum return for investors of 12 percent per year. A longer average period of unemployment benefits gradually leads to lower payments. The final payment follows two years after the intervention, if it turns out that the participants are still working.

The programme starts with assessing potential participants on a few variables (e.g. whether or not the participant has a diploma and whether the participant received unemployment benefits in the past), in order to judge the time required for that person to get a job. This prevents the selections of participants that would have also found a job without the intervention. In this respect the social impact bond pays attention to the net effects of the intervention.

4.4. Desirability

The SIB pilot in Rotterdam has resulted in quite some interest from other parties. Several municipalities and ministries in the Netherlands have specific plans to implement social impact bonds, e.g. the municipalities of Amsterdam, The Hague and Eindhoven, and the Ministry of Security and Justice, the Ministry of the Interior and Kingdom Relations and the Ministry of Social Affairs and Employment. In a more general sense many municipalities showed an interest in the concept at a congress for Dutch municipalities.

Over a period of six months up to 50 social service providers contacted the municipality of Rotterdam, inquiring about the possibilities to participate in a social impact bond. The service provider in the first Dutch social impact bond,
the Buzinezzclub, also mentioned to be interested in rolling out social impact bonds in the other municipalities where it is active. Dutch investors that show serious interest in financing social impact bonds consist primarily of banks and foundations. These results from interviews indicate that social impact bonds are very desirable in the Netherlands.

4.5. Feasibility

The legal position of municipalities should be taken into consideration in the application of social impact bonds. Regarding the topic of employment, Dutch municipalities are relatively autonomous from national authorities. In the Dutch social welfare system unemployed youth may apply for unemployment benefits at local and national authorities.

A respondent indicated that unemployment benefits from local authorities are the most suitable for social impact bonds, because measuring the savings on these benefits is relatively easy. Furthermore, only one governmental authority needs to be involved, because the budget for these benefits is the sole responsibility of municipalities. This makes the construction of a social impact bond relatively straightforward.

If unemployment benefits at the national level would be used in a social impact bond, national authorities have to work together with municipalities. Such co-operation makes the implementation of a social impact bond more complex (an additional party in the negotiations). Respondents do expect that SIBs are effective for this target group, but recommend proving the concept in a more straightforward setting before implementing more elaborate constructions.

Social impact bonds appear not to be effective when assisting unemployed youth without any unemployment benefit, because helping people in this target group doesn’t lead to direct government savings on unemployment benefits. Such efforts may well lead to savings on crime and healthcare costs caused by youth unemployment, but these costs are very difficult to calculate. Furthermore, people in this target group do not have to report themselves to a governmental organization and governments don’t have their contact details. This makes selecting them to participate in an intervention impossible.

5. Wider Aspects of SIBs

Looking beyond the situation in the Netherlands some wider aspects of SIBs may be discussed, including direct and indirect costs, dynamics, flexibility and sustainability.

5.1. Points of Consideration

Social impact bonds require direct and indirect costs for the intervention. The latter refers to measuring the results, drawing up contracts and due diligence of
the service provider. In addition, investors want to see a return on their investment. Because payments to investors are paid out of government savings, these savings need to be sufficient to cover the direct costs, indirect costs and return for investors. This also means that a successful social impact bond will be more expensive than financing the same intervention directly (e.g. by a government subsidy) because additional indirect expenses are made.

On the other hand direct financing by governments has the disadvantage that the government carries the financial risk if the intervention fails. Furthermore, measuring the results isn’t a part of the finance method of governments. A respondent indicated that the government should finance interventions directly, if success of the programme is assured beforehand. Social impact bonds are an alternative when the chance exists that an intervention does not result in the envisioned results; the financial risk of a failed intervention is transferred to private investors. If the government takes the chance of failure into account when judging whether or not to finance an intervention, then the social impact bond can be an interesting alternative.

5.2. Dynamics

Social impact bonds have a highly dynamic nature and their design is not limited to the structure, shown in Figure 1. They are applicable to many social issues, multiple social service providers may participate in one social impact bond and an intermediary can be hired to manage the interests of the different parties involved. Other possibilities include the provision of guarantees to reduce the risk for investors and the replacement of the role of the government by, for example a health insurance company (in case of a healthcare SIB). The latter would lead to savings on healthcare costs.

5.3. Flexibility

Flexibility may be enhanced because social impact bonds transfer the focus from performing activities to achieving results. A respondent described the example of government subsidies, which bind service providers to perform prescribed activities. If these activities do not generate the expected results, then the intervention cannot be modified halfway through. Because social impact bonds put the focus on achieving results, an incentive is created to alter the intervention if the activities do not achieve the results desired.

5.4. Sustainability

Interventions are traditionally financed from annual government budgets. Under a social impact bond governments make payments out of savings, resulting in a new source of payment for governments. Annual budgets restrict the effect of interventions because the duration of financing is only
guaranteed for one year. Social impact bonds on the other hand always offer service providers a long-term investment, covering several years. For this reason employment programmes may be developed with a longer-term duration. The second social impact bond in Rotterdam may serve as an example. It evolves around an intervention that combines education with on-the-job training. Long-term unemployed people enroll in this programme that takes two years to complete per person. An interviewee mentioned that the companies, in which the participants work, would not have participated if the project was financed by government subsidies. The reason for this lies in concerns about the continuity of the intervention, because continuity of subsidies cannot be guaranteed. The long-term finance, offered by social impact bonds appears to lead to a long-term vision that surpasses the traditional focus on short-term effects and annual budgets.

6. Conclusion
In the last few years some interventions to reduce youth unemployment in the Netherlands are financed through social impact bonds. SIBs are more expensive than directly financing social interventions by governments, due to additional costs for measuring results, negotiating contracts, due diligence and, if successful, investors return on investment. However, unlike traditional employment measures, a crucial element in a SIBs structure is the measurement of results. As such, they pay attention to long-term effects and take the net effects into account, which are largely neglected in traditional employment measures.

The innovative nature of social impact bonds does not only include the necessity to measure the effectiveness of the intervention, but also allows governments to make payments out of government savings instead of traditional spending based on a system of annual budgets. Furthermore, the financial risk for tackling social issues is transferred from the government to private investors and SIBs call upon the corporate social responsibility of investors. For all these reasons social impact bonds result in an approach that fundamentally differs from traditional employment measures. Social impact bonds have a big potential and they’re being met with great interest.

7. Recommendations
Unemployed youth in the Netherlands can apply for unemployment benefits at local and national authorities. This research has shown that Dutch SIBs are most suitable for unemployment benefits from local authorities, because their government savings are easier to measure and they only involve one municipality. Unemployment benefits from national authorities are more complex as multiple governmental authorities need to be involved, which complicates the structure and negotiations. Therefore, it is recommended that the concept of social impact
bonds is first widely implemented and accepted as an established employment measure, before applying it in more complex and elaborate structures.

Although SIBs appear to have the potential to combat social issues through market instruments, they need to be tailored to the specific circumstances in a country. Government spendings and structures differ from country to country, resulting in the fact that a successful SIB in one country may not be plausible in another country. This calls for caution with their implementation. Hence, careful and time-consuming preparations should be made in order to prevent unnecessary and undesired failures.

Nevertheless, the realisation of SIBs is indeed recommended. In view of the strained financial position of many governments, alternative approaches to tackling social problems need to be considered. In addition, an exchange of information regarding all initiatives in this field needs to be realized to enhance the effectiveness and efficiency of SIBs, as well as to inspire others to take a similar path.

Notes
[2] The gross effect is the amount of participants that obtain a job after an intervention. The net effect takes into account the amount of participants that would have also obtained a job without the intervention. This means that the gross effect can be very high, but if all participants would have obtained a job anyway, then the net effect is zero. Hence, the net effect is positive if an intervention results in a higher chance of getting a job.
[3] The short-term effect indicates whether or not an intervention leads to a job and the long-term effect is the sustainability or duration of the employment relation.
[4] Substitution occurs when positive effects on the target group lead to negative job prospects for people outside the target group. In these cases, interventions don’t create jobs and ultimately have no effect.

References


