Social investment and outcomes contracting as a tool for an outcomes focused public sector? Learnings from the Swedish context

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Introduction

During the previous eight years, about 70 local authorities and a few regions in Sweden has pooled internal funding in so called social investment funds, amounting in total to about €100 million. A national initiative based at the Swedish Association of Local Authorities and Regions (SALAR) has been working together with the leading actors in order to drive development of both strategic and operational use of these funds as a tool for public sector investment in prevention and early intervention as well as in implementing a more systematic approach to innovation and improvement of service delivery.

Connected to work on social investment, the first Swedish Social Impact Bond (labelled Social Outcomes Contract, SOC) was developed in 2016 between the local authority of Norrköping and investor Leksell Social Ventures. The target group is children and youth in institutional care and the aim is to improve services and reaching better educational outcomes. From a public sector perspective, the logic behind this initiative is to explore if the SOC model leads to better rigour in data analysis, incentives models, performance management and evaluation of outcomes.

Work with the second SOC in Sweden started in 2017 as a pre-study in collaboration between SALAR, RISE, the European Investment Bank (through its European Investment Advisory Hub) and Kommuninvest with support from consultancies Lumell and Impact Invest Scandinavia. The social challenge is health at the workplace, focusing on the public sector workplaces. Initially, the idea was to finance the SOC through a novel financial instrument named *Sustainability Bond with Impact-linked Return (SBIR)*, combining a loan with a SOC in order to achieve an investment volume and risk profile suitable for institutional investors. From investors, there was interest in investing in the SBIR but from the Swedish local authorities the appetite was more limited. In the end, the two local authorities who implemented the SOC, Botkyrka and Örnsköldsvik, chose to invest by themselves. The decision in this case might reflect the local authorities’ trust in the intervention model and that they preferred the financial risk over experimenting with private investors and a more complicated accounting structure. In order to preserve a contractual relationship aligned with the SOC model, the contractual partners are the finance and the HR departments in the respective local authority as well as the intermediary organisation (RISE and SALAR). External service providers are procured with a pay-for-performance (P4P) model in which providers have significant skin in the game. In bidding for the contract, one of the main parameters for evaluation was risk appetite - providers could bid for a share between 25 and 75 % of reimbursement to be dependent on outcomes.

The table below provides an overview of the two current SOC examples in Sweden.

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2 Kommuninvest is an organisation with a majority of Swedish local authorities and regions as its members. The main role of Kommuninvest is to help its members with financing, using the combined size and the high credit ratings of members to emit bonds with low interest.
Preliminary learnings on Social Outcomes Contracting

As the number of operational cases are still few, the scope for learning and conclusions are limited. However, the current Swedish SOC examples have some unique features when compared to examples in other countries. These features have partly been driven by circumstances in each case and partly by contracting principles believed to be most beneficial for driving improved outcomes in both the short and long term. Below is a description of these characteristics and any particular observations that may be connected to them.

**Agnostic view on public vs. private funding**

With the two current cases, there is a variation in the type of funding – the first case having a private investor (although one with a philanthropic mission) and the second having the local authorities investing their own funds with the only financial risk sharing being with the external service providers. For Impact Investing purists, the second example may be viewed as something that breaks with the principles of the model. From an economic perspective, it could be argued that the source of funding is of less relevance. Indeed, from a model perspective, funding can be a crucial issue if it affects the ability to deliver the intervention model and reach the best possible outcomes, but apart from that there are many other mechanisms that could affect the behaviour of involved actors.

**The public sectors’ crucial role in implementation**

Another feature is that the SOC models are designed in such fashion that a significant proportion of investment goes to interventions provided by the local authorities in combination with private service providers. The service providers are commissioned with pay for performance contracts with a mix of fixed and outcomes based reimbursement. This means that intervention management is the formal responsibility of the local authority, but operational support for performance management and monitoring outcomes are still provided by the intermediary organisation (SALAR and RISE). While this format may challenge the ability to control interventions and may seem like higher risk for private investors, it does mean that the local authority gets a more active role which should benefit long term commitment, learnings and ultimately the potential of SOC contributing to systemic change of organisation and operations. However, the challenge of creating long term change within organisations to become more pro-active and outcomes focused should not be underestimated. To find the mechanisms that can support such a transformation should therefore be top on the agenda for those driving public sector innovation and reform. Preliminary results in Sweden indicate that

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**Figure 1: Overview of current Swedish SOC examples.**

<table>
<thead>
<tr>
<th>Investor</th>
<th>Leisell Social Ventures</th>
<th>Finance departments in Botkyrka and Örnsköldsvik</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investor risk</td>
<td>60 % plus max 20 % ROI</td>
<td>65-75 %</td>
</tr>
<tr>
<td>Size</td>
<td>~1 MEUR</td>
<td>~4 MEUR</td>
</tr>
<tr>
<td>Duration</td>
<td>August 2016-Mars 2020</td>
<td>October 2018-November 2021</td>
</tr>
<tr>
<td>Target group</td>
<td>Children and youth in institutional care (80 individuals)</td>
<td>Employees and work places in risk (12 000 in total)</td>
</tr>
<tr>
<td>Control</td>
<td>Historic reference</td>
<td>Historic reference</td>
</tr>
<tr>
<td>Internal service provider</td>
<td>Dedicated multiprofessional team</td>
<td>Dedicated HR team to support work places at risk</td>
</tr>
<tr>
<td>External service provider</td>
<td>Tutoring team</td>
<td>Health support (early detection, screening, monitoring and data visualization)</td>
</tr>
<tr>
<td>Service provider risk</td>
<td>20 % of reimbursement</td>
<td>50-75 % of estimated service cost plus premium (capped at risk x 0.5)</td>
</tr>
<tr>
<td>Financial outcome measure</td>
<td>Social service costs</td>
<td>Direct costs short term sick leave (day 1-14)</td>
</tr>
<tr>
<td>Social/health outcome measure</td>
<td>School performance*, mental health, inclusion, substance abuse</td>
<td>Sustainable Employee Engagement, productivity</td>
</tr>
</tbody>
</table>
the SOC model at least makes these issues explicit and provide some evidence on what is needed to decision makers.

Financial risk sharing to align incentives
Another feature, also reflecting the larger role of the public partner, is that all actors involved shares financial risk for not achieving outcomes. Financial risk is thus shared between investor, public sector and service provider. Alignment of incentives is supported by having the share of financial risk determine the share of cost savings payed back to each actor so that all reach break-even at the same point. Profits are shared up till a cap on maximum return set for investor and service provider. Another part of incentives alignment is to have a close monitoring of data and to build common understanding of data between actors.

The intermediary as a neutral part
With the strong role of the public sector as has been described above, it is important to balance the model with an intermediary function. The intermediary provides analytical, design and implementation support capacity, which typically both public and private actors are lacking. Equally important is that the intermediary is viewed as neutral towards the other actors, having only the interest of getting as good ‘true’ outcomes as possible, that is without gaming the contract and the defined outcomes.

Capacity building
The work on social investment has been supported by a government funded project based at SALAR. While this position has been beneficial as regards the connection to local authorities and regions, the scope for long term capacity building has been limited. In 2018, RISE Research Institutes of Sweden initiated Social and Health Impact Center (SHIC), in order to create a national knowledge and capacity hub. Through SHIC, RISE will be part of development and experimentation with social investment and social outcomes contracting as tools for driving public sector innovation focusing on prevention and early intervention but working with all welfare sectors – health, public health, social welfare, employment, education and criminal justice.

The national government has instructed the National Agency for Public Procurement, The Swedish Agency for Economic and Regional Growth and the Swedish Innovation Agency to contribute to development of new contracting models including SOC. With public procurement amounting to more than €60 billion annually, it is somewhat surprising that outcomes based (P4P) contracting is not more widely developed. One factor could be that public procurement is often viewed as outsourcing rather than collaboration. As is shown by the SOC examples, an outcomes based financial model typically creates interdependency between commissioner and provider, because all actors have to do their part to create real outcomes and not just process outcomes. There are signs that interest from public procurement professionals in the SOC model is growing and this could potentially contribute to a more sophisticated utilization of contracting between commissioner and provider.

With these developments, there is an opportunity to build capacity and to create an eco-system over the coming years, provided that interest from the public sector continues and preferably facilitated by some strategic initiatives being made, see last section.

Investor and private sector interest
All the major banks as well as insurance companies are following the development on SOC and some have expressed explicit interest in investing in these kinds of products. Several are concerned about investment volume and the risk profile, and therefore it may be necessary to develop financial instruments such as the SBIR described above to mainstream this market.
The issue of housing connected to social and health outcomes and equity is a growing concern and there are early discussions between investors, real estate developers and local authorities on the possibility to develop social bonds combined with social outcomes contracts in this area.

As is indicated by the procurement of services with pay-for-performance (P4P) contracts there is readiness from at least some providers to experiment with the SOC incentives model. However, from the service provider dialogues it can also be noted that there is scepticism from some providers to engage in contracts where the ability to achieve outcomes payments is dependent on all actors, including the public sector, working together towards common goals.

Socially minded entrepreneurs are showing interest in the SOC model to challenge the system and to focus on the social and health outcomes achieved. An issue to be clarified is how to work with small size businesses and charities in contracts when payments are not guaranteed and are in any circumstance delayed until evaluation of outcomes. Perhaps, there is a role for private investors in these circumstances with contractual formats guaranteeing investments from both public (on commissioner side) and private (on SME/charity side) actors.

The way forward

More operational examples and national strategy
There is a need for more empirical examples on how to use social investment strategies and social outcomes contracting. What works, in which context and how transaction costs can be kept at an acceptable level are some of the questions that are looking for an answer. RISE SHIC is initiating several pre-studies to launch new SOC examples. To support this development, it is important to explore the future role of the national government, both as a potential outcomes funder and as a guarantor of capacity, competence and that learnings are shared and used wherever relevant. Specifically, the potential of national, and possibly European, outcomes funds should be investigated.

Networking and support
The opportunity to take part of experiences from other Member States as well as from EU policy initiatives regarding for instance structural funds, public procurement and financial instruments is helpful for the Swedish development. Especially at this early stage, the number of people with experience in Social Outcomes Contracting is limited, thus the EU can contribute to learning by gathering experts in networks and structured learning exchanges. It is important to acknowledge that the topic of SOC concerns strategic and policy issues as well as rather technical issues on outcomes definitions and contracting – and these aspects are equally important. Sitra and RISE is leading and creating a Nordic network on Social Impact Investing and Outcomes Commissioning as an arena for learning exchange and there may be similar networks in other parts of Europe. Such regional networks could be connected to a European format in order to ensure information flows and flexibility to meet needs at the national, regional or European level.

RISE, IESE Business School in Barcelona and University of Oxford are driving a EIT Health funded project to pilot a course concept called Designing for Outcomes. The idea is to use the course as a framework for building a community of practise focusing on public sector managers, policy makers and commissioners. The course will be piloted in 2019 in Oxford, Stockholm and Barcelona. The course is centred on the process leading to an outcomes based model for investing, delivering and procuring social and health services. This process is shown in the figure below.
Figure 2: Structure of the three day pilot course Designing for Outcomes

The transaction costs for establishing a SOC are high as the maturity of stakeholders is typically low and as complex social issues demand robust business case modelling. A funding mechanism, perhaps connected to some technical assistance capability, dedicated for pre-study and contracting phases of SOC business cases could be a tool to drive development and create a case bank for learning across EU member states.

As part of the agenda to make EU and its member states more innovative and socially and economically robust, the learnings from work on Social investment and Social Outcomes Contracting should be viewed as strategic elements with implications to many policy areas.