

Are ‘payment by results’ and ‘social impact bonds’ efficient ways to advance social goods?

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Abstract

Over recent years there has been increasing interest in ‘Payment by Results’ (Pay for Success in the US) as a model for commissioning innovative services in the public sector. A Social Impact Bond (SIB) (Pay for Success Bonds in the US) is a class of PbR contract where the finance needed to make the contract work is provided by private investment, usually social investors, rather than the service provider. These models blur the boundaries between public and private sector delivery of services. A stated aim of most PbR and SIB schemes has been to encourage innovation in service design and delivery and find new ways to address ‘wicked issues’ in social policy. This paper asks whether PbR and Social Impact Bonds are an effective way to encourage innovation in the design and delivery of services and, in a UK context, what future they have in the new government’s thinking. The paper includes three main sections. First, we set out a brief history of PbR and SIB and chart its recent growth, particularly in the UK. Secondly, we report on provisional results of a review of the literature on PbR and SIB. Although formal evaluations of both PbR and SIB are still limited some evaluation findings are starting to be published and some tentative conclusions on the potential for innovation are drawn from the review. Finally we consider key theoretical issues raised by the growth in PbR and SIB, again with a particular focus on the UK. A key question is the extent to which PbR and SIBs are part of re-alignment of the role of the state in the provision of welfare services.

Key words

Payment by Results, Pay for Success, Social Impact Bonds, Pay for Success Bonds, Social Investment, Evidence-based policy

1. Introduction

Over recent years, there has been increasing interest in ‘Payment by Results’ (PbR) (Pay for Success in the US) as a model for commissioning services in the public sector. A PbR contract links payment to the outcomes achieved, rather than the inputs, outputs or processes of a service (Cabinet Office 2011). By making some or all of payment to a service contingent on delivering agreed outcomes, PbR supposedly reduces ‘micro-management’ on the part of the commissioner, encourages innovation and transfers risk away from the branch of government commissioning the service towards the service provider because government will only pay if outcomes are achieved. From government’s perspective payments for service are deferred. Given the need to reduce public sector spending, both the transference of risk and deferring payment for services are attractive propositions for government.

PbR might encourage innovation by focusing attention on outcomes and freeing up providers to innovate when designing services best able to deliver those outcomes. It might also encourage innovation by encouraging new market entrants. In a PbR contract investing in social goods must be carried out before any results – success or otherwise – can be observed and hence payment be received. Deferred payment may favour some classes of organisations (those with large capital reserves or those that can raise capital) at the expense of other classes of organisation (those whose constitution places restrictions on how they use capital reserves or those that cannot raise capital). It is partly to address this issue that Social Impact Bonds have been developed. A Social Impact Bond (Pay for Success Bonds in the US) is a class of PbR contract where the finance needed to make the contract work is provided not by the service provider but by private investment. To date, these have usually been social investors.

This paper asks whether PbR, and in particular Social Impact Bonds (SIBs), is an efficient way to unlock new capital investment in order to advance social goods.

In the remainder of the paper the rise of PbR, particularly in the UK is described. This is followed by a more detailed examination of Social Impact Bonds, their development, their potential advantages and the challenges they pose. We present a brief review of the emerging evidence base for the effectiveness of this approach and draw out conclusions.

2. The rise of Payment by Results

PbR is not a new phenomenon, dating back, in education at least, to Victorian England (Mitch 2010). Although there was some success at first in the Victorian application of PbR, in the end, the experiment was abandoned, in part because the Treasury felt the costs of administration and evaluation made the overall project inefficient. There were also concerns that the system was unfair to some church and volunteer run schools and liable to corruption in the “results” measure (ibid.).

The return of PbR can be traced back at least to the 1990s with early examples in the healthcare sector (Flodgren et al. 2011). The UK Coalition government (2010 – 15) committed to “introducing payment by results across public services” (Cabinet Office 2011: 9) and has introduced schemes across diverse areas of policy including welfare to work, substance misuse, criminal justice, family interventions and overseas development. In a thorough review of the current situation in the UK, the

National Audit Office (NAO) (2015) identified over 50 schemes worth a combined total of at least £15 billion. Subsequently the re-organisation of probation services and creation of Community Rehabilitation Companies involved a PbR element (Ministry of Justice 2013).

While many PbR schemes involve private sector providers, sometimes working in partnership with the not-for-profit (NFP) sector, this is not always the case. The Troubled Families programme, for example, uses a PbR model (NAO 2013).

Example: The Work Programme

This was a welfare-to-work programme for people who have usually been unemployed for between nine and 12 months. It was commissioned by the Department for Work and Pensions, and approximately 2.1 million people were referred to it between June 2011 when it started and March 2016 when referrals finished. The programme itself runs until 2020 and is delivered by 17 prime contractors and about 850 subcontractors drawn from the public, private and voluntary sectors (NAO 2015). The prime contractors are responsible for delivering 40 Work Programme contracts across 18 areas across England, Wales and Scotland with at least two providers in each area (DWP 2010). These contracts were based on a PbR model with three main payments: an attachment fee paid when a benefit claimant starts on the programme, a job outcome fee paid when claimants enter work, and sustainment payments paid for keeping claimants in work (Work and Pensions Committee 2011). A range of tariffs was set for different customer groups, reflecting the need to create incentives for prime contractors to address the increased difficulty of placing some groups in employment (ibid.). The overall budget for the Work Programme is £3.3 billion over 9 years and DWP expects 80% of payments to be outcome-based over the life of the programme (NAO 2015).

When the Work Programme was first introduced, there was some evidence it was, in fact, less effective than the public services it had replaced. By 2014 the National Audit Office (2014) found that:

- performance in getting people into work had improved with Work Programme performance comparable to previous welfare-to-work programmes;
- people on the Work Programme appeared to spend less time on benefit compared with previous welfare-to-work schemes, although the reasons for this were not known;
- support for harder-to-help participants was lower than for those with better employment prospects, possible evidence of so-called 'parking and creaming' (see below);
- linked to the previous point, the Department expected to save £450 million in benefit payments compared to the baseline; and
- the Work Programme had reduced risks to the Department of paying for low performance.

The National Audit Office also highlighted various difficulties experienced by the Department in setting and managing contracts including having to change its approach to maintaining minimum levels of service, paying prime contractors for potentially invalid sustainment payments and flawed contractual performance measures meaning the Department would have to make incentive payments to even the worst performing contractors.

More recently, the Work and Pensions Committee (2015) concluded that, although the Work Programme has streamlined the procurement of welfare-to-work and created a stable welfare-to-work infrastructure, outcomes for mainstream participants remained similar to those achieved under previous programmes. Further, the Committee was critical of the fact that nearly 70 percent of participants were completing the Work Programme without finding sustained employment and that the Work Programme was not working well for people with more complex or multiple barriers to employment who need more intensive help.

3. Social Impact Bonds

Social Impact Bonds (SIBs) are not strictly speaking a bond (that is to say, a debt instrument), but rather are a class of PbR contract where the up-front finance for the contract is provided by third-party investors (for example, social investors) rather than providers. In this sense SIB funded provision of public services may be similar to the UK's Private Finance Initiative (PFI) funded provision of public infrastructure, as we discuss below.

SIBs have several distinct elements:

- An investor. To date investment has tended to come from so-called social investors, investors who consider both social and financial returns (Ronicle et al. 2014), but need not (Mulgan et al. 2010, Social Impact Investment Taskforce 2014);
- A programme of actions to improve the prospects of a target group (Mulgan et al. 2010), that is to say, a group in need of public services; and
- Commitments by a commissioner (usually national or local Government) to make payments linked to particular social outcomes achieved by the group (Mulgan et al. 2010).

Although, different models of SIB are possible (see for instance Mulgan et al. 2010 and Ronicle et al. 2014), a common model is a SIB that is delivered through a Special Purpose Vehicle (SPV). A SPV is a legal entity, owned by investors or an intermediary or both, created to undertake specific objectives while insulating the owners from financial risk. The SPV holds the contract with the commissioner (payer) and contracts with one or more organisations which will provide the interventions required to achieve the outcome(s) specified in the contract between the SPV and the commissioner. This structure was used in the first SIB at HMP Peterborough (Disley et al. 2011).

The UK Cabinet Office's Centre for Social Impact Bonds¹ reports that there are currently 32 Social Impact Bonds in the UK, supporting interventions in areas such as: youth unemployment; mental health; and homelessness (Ronicle et al. 2014, Tan et al. 2015). Ten SIBs have been launched in the United States clustered in three areas: criminal justice; early childhood education; and homelessness (Nonprofit Finance Fund 2016). Globally, there are an estimated 65 SIBs implemented across the world as of August 2016 (Rizzello & Carè 2016). The UK accounts for nearly half of all SIBs worldwide, but only about one-ninth the finance, with an average of approximately US\$700,000 in each project; by contrast, North America accounts for around one-fifth of the SIBs issued and around half the finance (ibid.).

¹ https://data.gov.uk/sib_knowledge_box/home [Accessed 13 June 2017]

Ronicle et al. (2014) note that a key difference between UK and overseas experience is that SIBs outside the UK have tended to be funded by institutional rather than social investors; for example Goldman Sachs in the US and ABN AMRO in Holland. They suggest this, in part, reflects a relative lack of a social investment market in these countries and, in part, the way some SIBs have been constructed to attract institutional finance providers.

Example: HMP Peterborough Social Impact Bond

In the UK, rates of re-offending for prisoners released from short prison sentences of under 12 months has been consistently high over many years. Around 60 percent of prisoners re-offend within one year compared to approximately 45 percent of all prisoners released from prison (Ministry of Justice 2016). The SIB begun at HMP Peterborough in 2010 was the first SIB to be established. The Ministry of Justice and the Big Lottery Fund undertook to fund the social outcomes sought. They signed a contract with Social Finance (2010) to attempt to reduce the reoffending of three cohorts of 1,000 adult males who would be discharged from HMP Peterborough having served sentences of less than 12 months in custody. The ONE Project, led by St Giles Trust provided offenders with co-ordinated advice and support services including support from trained mentors. The outcome measure was binary: whether offenders were reconvicted or not (Disley et al. 2011: iv). Social Finance² report that £5 million of capital was raised from from 13 charitable trusts to fund rehabilitation work and that they might earn a return of up to £8m from the government and the Big Lottery Fund if re-offending fell by 10 percent per cohort, or, if the rate of re-offending for all 3,000 offenders fell by at least 7.5 percent. If a reduction in re-offending beyond 7.5 percent were delivered investors would receive an increasing return capped at 13 percent over an eight year period (Social Finance 2011: 3). Conversely, if offending did not fall sufficiently, investors would potentially lose all their money. The vulnerability of such social investment is indicated by the fact that changes in national criminal justice policy led to the HMP Peterborough SIB being curtailed after two cohorts.

An independent evaluation of the SIB used a counterfactual design which matched 936 offenders released from Peterborough (the first cohort) with 9,360 released from other prisons. The analysis found an 8.39 percent reduction in reoffending rates within the first cohort, which was insufficient to trigger payment for the first cohort (Jolliffe and Hedderman 2014). Based on this reduction the Ministry of Justice (2014: 2) reported: "This means that the provider is on track to achieve the 7.5% reduction target for the final payment based on an aggregate of both cohorts". However, interim analysis published by the Ministry of Justice (2016) based on 12 month re-conviction for all eligible offenders compared to offenders in *all* local prisons (except Peterborough and Doncaster) found that the July 2012 – July 2014 cohort had a frequency of reconviction events of 149 per 100 offenders compared to national frequency of 160. This is slightly short of the 144 needed to trigger payment on Cohort 2, but it is important to note that the analysis does not come from the independent evaluation team and uses a slightly different methodology. The final results from the independent evaluation are long overdue but had not been published at the time of writing.

² <http://www.socialfinance.org.uk/database/>

Infrastructure to support Social Impact Bonds

A substantial infrastructure has developed to support the adoption of SIBs much of which is grounded in a broader strategy framework for social investing (HM Government 2011, 2014, 2015). Various market-building initiatives were launched following the strategy. In 2012 an Investment and Contract Readiness Fund (ICRF) was launched. An evaluation of the ICRF (Ronicle and Fox 2015) reported that 155 social ventures received £13.2 million in grants to help them get investment and become contract ready. The evaluation concluded that half the ventures supported (78 out of 155) successfully secured at least one contract or investment as a consequence of the support they received. Other capacity building funding has included:

- In the UK health and social care sector, nine projects – collectively known as the SIB ‘Trailblazers’ – received seed funding from the Government’s Social Enterprise Investment Fund (SEIF) in 2013 to undertake an analysis on whether or not to implement a SIB and, if appropriate, to set it up (Tan et al. 2015).
- Big Potential funded by the Big Lottery Fund aims to raise awareness of the social investment market and support voluntary, community and social enterprise organisations who want to prepare themselves for social investment. Grants are awarded for specialist business support to help raise repayable investment³.
- The Commissioning Better Outcomes Fund funded by the Big Lottery Fund has a mission to support the development of more SIBs in England (Ronicle et al. 2016).

Also in 2012, using £600 million from dormant UK bank and building society accounts, topped up by contributions from high street banks, the UK government launched Big Society Capital (BSC) with a specific mission to grow the social investment market, including by investing in ‘repayable finance’ (Big Society Capital undated). Big Society Capital was a social investment ‘wholesaler’ providing finance to other social investment organisations that then make social investments.

Some funding has been targeted on specific policy issues. For example, In 2011 the Department for Work and Pensions made funding available via an Innovation Fund that funded ten SIBs. Funding has also been made available for feasibility studies on potential SIBs. In the UK health and social care sector, nine projects – collectively known as the SIB ‘Trailblazers’ – received seed funding from the Government’s Social Enterprise Investment Fund (SEIF) in 2013 to undertake an analysis on whether or not SIB funding was appropriate and, if appropriate, to set it up (Tan et al. 2015). Tan et al. (2015) reported that, as of December 2014, two projects were operational, five projects were still in negotiation and two did not become SIBs, illustrating the sometimes protracted length of time taken to establish such funding. It must be borne in mind that the cost of establishing an SIB/PbR intervention must reduce (from the point of view of the state) any cost savings likely to accrue.

Early results

A number of Social Impact Bonds are reported as having been completed and to have made a return for investors. Social Finance, in their database report that the following SIBs have been completed with some success:

- The Nottingham Futures SIB came to an end in May 2015. Investors received £2.5 million in

³ <http://www.bigpotential.org.uk/learn>

outcomes payments against an investment of £1.7 million

- The Greater Merseyside New Horizon's SIB is completed and as of July 2015, investor capital of £1.5 million had been repaid in full.
- The Think Forward SIB in East London was completed provided a full return of the £0.9 million of capital plus an unspecified return to social investors.
- The 2012 Teens and Toddlers SIB in Greater Manchester as part of the DWP Innovation Fund was completed. Investor capital of £0.8 million was repaid in full and a further return was anticipated.
- The Adviza SIB was completed . Investor capital of £0.9 million was repaid in full and a further return was anticipated
- The St Mungo's Rough Sleepers SIB in London has been completed. Investor capital of £1.2 million and income has been returned to investors.

Currently, no SIB is known to have failed, although the Peterborough SIB did not meet the target for its first cohort and a final analysis of the second cohort has not been published.

4. Potential advantages and challenges for the implementation Payment by Results and Social Impact Bonds

In this section a range of advantages of and challenges for the implementation of SIBs and PbRs are described.

Advantages

The Audit Commission (2012) suggests that although there may be subsidiary objectives, PbR schemes generally have one of three main aims: improving outcomes or service quality; reducing costs or improving value for money; or, stimulating innovation or transformational change. Deferring payment, improving accountability, and/or transferring risk from commissioner to provider are probably also important, albeit unstated, aims (Battye and Sunderland 2011, Fox and Albertson 2012, Edmiston and Nicholls 2017). Notwithstanding, the NAO (2015) argues that PbR approaches are both risky and costly for commissioners. They suggest that this extra expense might be justified, but only in the case of credible evidence, not only that the intervention promoted by PbR works, but that PbR itself is justified (ibid.). PbR therefore logically stands or falls depending on the validity of the evidence base.

Ronicle et al. (2014, 2016) whose focus is primarily on commissioners, investors and service providers, review the literature and identify a number of potential benefits of SIBs:

1. *More innovative and flexible service delivery*: stemming from the focus on outcomes rather than outputs resulting in less prescription about how service providers choose to deliver. While innovation was a feature of the list of possible benefits identified by Ronicle et al. (2014), by 2016 they had revised their view:

“There is, ... some evidence that the interventions commissioned via SIBs are not always as innovative as might be perceived or expected. We have found, as have others researching SIBs, that some interventions are relatively

conventional in approach and/or are similar to other programmes which are not SIB funded.”

Instead, Ronicle et al. (2016) draw more attention to the flexibility within the delivery model.

2. *Better contract management, creating more efficient delivery*: linked to the requirement to evidence outcomes and the alignment of interests between commissioners, investors and service providers. Two key ideas are encapsulated in this argument. One is that SIBs offer greater efficiency through the correction of misaligned incentives. The second relates to collaboration, and the Cabinet Office (undated) highlights the potential to support collaboration between different sectors and facilitate coordination between organisations working on overlapping problems.
3. *Ability to bring in additional, external investment*: replacing the need for the commissioner or service provider to provide up-front working capital. Early proponents of SIBs took this idea a step further. They recognised that social investors might be individual philanthropists or a charitable trust, but, looking ahead saw the potential for private finance to replace philanthropic or public finance, thus creating a new asset class in which banks, pension funds and others might invest (Mulgan et al. 2010). Writing in 2010, they acknowledged this situation would take five to ten years to develop. More recently the Social Impact Investment Taskforce (2014) continue to stress the potential of private sector social impact investment to tackle social problems. They argue that investors are increasingly adding a third dimension of ‘impact’ to risk and financial return in their decision-making and that there is “a considerable pool of capital looking for opportunities to invest in achieving measurable social impact” (Social Impact Investment Taskforce 2014: 18).
4. *Potential savings to current budgets, both cashable and non-cashable*: when outcomes achieved by the SIB prevent the need for further intervention. Various commentators have argued that SIBs represent a particular opportunity to increase funding for early intervention and preventative programmes (for example, Mulgan et al. 2010, Allen 2011, Fox and Albertson 2012, Cabinet Office undated). This stems from the potential for SIBs to address misaligned incentives in current service provision and to develop, fund and deliver preventative services that can save costs down the line and achieve a better result from the system as a whole (Mulgan et al. 2010). However, as Ronicle et al. (2016) note the idea that ‘SIBs must save money’ is a myth that sometimes impedes the development of SIBs.
5. *Better alignment of financial and social returns*: because investors are able to achieve social outcomes and receive a return on investment. Foundations and trusts may well have funds to invest, but have been deterred from investing in more traditional markets which may fund activities at odds with their social objectives (Ronicle 2014, 2016).

6. *Enabling smaller service providers to participate in PbR contracts*: when they might otherwise be excluded from 'traditional' PbR contracts because they do not have sufficient working capital to fund an intervention prior to payment or are not able to accept the financial risks of a PbR contract.
7. *Embedding a more outcome-focused culture*: because of the focus on evidencing outcomes to trigger payments. Some commentators have extended this idea and argued that PbR in general and SIBs in particular have the potential to improve the evidence base for social services and accelerate the expansion of evidence-based programmes (Cabinet Office undated, Fox and Albertson 2012).

Other commentators place more emphasis on benefits for beneficiaries (service users). For example, the Cabinet Office (undated) argue that SIBs may enable better programmes and better results for the people who participate in them because a focus on outcomes rather than outputs improves "the likelihood of delivering real and sustainable solutions to important social challenges" and making effective interventions available to "far more people in need than the number that can be reached through traditional state contracts and philanthropy" (Cabinet Office undated, unnumbered). This will particularly be the case where the public sector is seeking to reduce its expenditure in line with current austerity agendas (Edmiston and Nicholls 2017).

Challenges

A number of challenges have been identified, many of which relate both to PbR and SIB, some of which are distinct to SIB. Key challenges are as follows (based in part on Ronicle et al. 2014):

1. *The balance of risk*

Ronicle et al. (2014) in their review of SIBs undertook a small-scale survey that found that a quarter of service providers not yet involved in a SIB cited financial risk as a challenge to getting involved. It should be borne in mind that, in general, the for-profit sector, and particularly small enterprises, are likely to be significantly more risk averse than government (Fox and Albertson 2012); governments and large financial corporations are too big to fail, small enterprises are not!

2. *Complexity*

Complexity and consequent time and cost of development are key themes in the literature on PbR and SIB. Complexity comes from different sources including:

- *Multiple actors*. A potential advantage of SIBs is that they bring together new and different actors to tackle social problems. But some commentators argue that the increased number of actors involved in SIB delivery is likely to increase transaction costs (e.g. Demel 2013).
- *Avoiding perverse incentives*. A problem of all performance management systems is that they encourage service providers to concentrate on achieving those outputs and/or outcomes that are included in the reward system. In doing so, service providers have an incentive to ignore or neglect other outcomes even where these are also important (Hoverstadt 2011). The government might seek to minimise such perverse incentives by replacing specific targets with more generalised outcome measures (ibid.). However, as Hoverstadt (2011: 1) arguing from a systems thinking perspective explains: "... merely

shifting the level of abstraction of what is being measured upwards from activities to ‘outcomes’, doesn’t alter the systemic structure and the same unfortunate consequences are likely to ensue.”

- *Gaming*. A persistent critique of PbR and SIBs is that they increase the risk of ‘gaming’ and in particular ‘creaming’ or ‘cherry-picking’ whereby providers might select ‘easy’ cases to work with and ‘parking’ where they ignore ‘hard’ cases; thereby maximising their returns without accepting fully the transfer of risk or undertaking the intervention envisaged by the public sector commissioner (Battye and Sunderland 2011). These issues can, in part be ameliorated by segmenting the population receiving the service and giving providers higher payments to work with more challenging cases.
- *Segmentation and tariffs*. Segmentation and tariff systems can counter perverse incentives, but can also add to the complexity of the contracts. A balance will need to be struck between segmenting populations enough to be confident that services will be tailored sufficiently to the needs of particular groups (Battye and Sunderland 2011) and defining groups that are large enough for statistically robust conclusions to be drawn about any outcomes achieved (Fox and Albertson 2012). Different models of segmentation are possible. The relatively simple model used in the UK Work Programme (based on benefit types) has been criticised by Carter and Whitworth (2015) who go on to outline a number of different pricing structures which have the potential to minimise ‘creaming and parking’, including progressively higher payments as they ‘reach further into their caseloads’ and ‘claimant leverage’ or voice (Carter & Whitworth, 2015). The crude segmentation of the *Work Programme* participants into claimant types is also compared unfavourably with Australia’s Jobseeker Classification Instrument (JSCI) (ibid.).
- *Creation of new roles*: It is likely that the process of assessing client needs and allocating them to different segments will need to be undertaken by a different organisation to the one offering treatment so as to avoid the potential for gaming. This approach was criticised in PbR contracts for Drug and Alcohol Recovery Pilots where an independent third-party made assessed new service users. As well as introducing extra cost and bureaucracy into the treatment system, the need for third party assessment placed an additional barrier in the way of those seeking help –it was no longer possible for them to access treatment directly (Webster 2016).

The complexity of PbR increases transaction costs and this, combined with their inherent risks, has the potential to result in a cost premium being placed on services delivered. If, as many of their proponents hope and expect, investors come increasingly from the for-profit as well as the philanthropic sector this premium is likely to increase. As Fox and Albertson (2012) note in general, private investors have a higher discounting factor than government, that is, they expect to see their investments yield returns in the short-term, yet the social return on any social investment is likely to be relatively long-term.

3. *Limitations in the evidence about ‘what works’.*

When bidding for PbR and SIB contracts service providers can struggle to generate evidence that demonstrates the effectiveness of their interventions to investors and commissioners (Fox and Albertson 2012, Ronicle et al. 2014). There is an increasing body of evidence in the form of

systematic reviews of ‘what works’⁴. However, interpreting and making use of this evidence is not straightforward. The evidence is often patchy and, from a European perspective, heavily skewed towards US studies.

4. *Evidence that outcomes have been achieved.*

When delivering contracts service providers struggle to evidence outcomes and ensure that they are independently and objectively verified (Ronicle et al. 2014). We must bear in mind that, although the commissioner seeks results, what they will ultimately be taking delivery of is a set of statistics. Whether the statistics adequately and fairly reflect the result can not be taken for granted.

The challenge of measuring outcomes is a substantial one, particularly in sectors where outcomes are difficult to define and evaluate. Once outcome measures are agreed, evaluation raises further challenges. Key to PbR and SIBs is the ability of a commissioner not only to be confident the desired outcome has been achieved but that it was achieved because of the actions of the commissioned service provider (Fox and Albertson 2012). Thus, experimental and quasi-experimental evaluation designs with high levels of internal validity (see for instance Shadish et al. 2002) will be preferred to those with lower levels of internal validity. Such evaluation designs can be expensive. The NAO (2013) report on the Troubled Families programme concluded that the incentives under PbR were not working as DCLG had anticipated. The aim of the programme to ‘turn around’ families was cited as an example of the extreme difficulty of ensuring that outcomes on which to base payments align with overall aims and can not be attributed to factors such as improving economic conditions or other programmes.

On top of this, there is the issue of the distortion over time of the indicator chosen as a “result”. As Campbell (1979: 85) has noted, any indicator which becomes a target cannot then be used as an indicator. The risk is that the SIB/PbR process will, overtime, converge on the most efficient way of producing desirable, and saleable, statistics rather than the originally desired outcome. As Stout (2012) has pointed out, pay for performance has an inherently corrupting influence on the service provider.

5. *Identifying financial benefits.*

When developing the business case for a SIB it can be challenging to identify the financial benefits and/or savings that commissioners and others will make (Ronicle et al. 2014). Fox and Albertson (2012) note that the UK government has argued that PbR must be based on a “full understanding of the value of the potential results” (Cabinet Office 2011: 18). By this they mean:

Understandings of value should be driven by citizens and communities, wherever appropriate. This will enable commissioners to focus services on the social, environmental and economic priorities of the people they serve.

In economic terms, this would imply that the viewpoint to adopt when valuing outcomes in a PbR contract should be a broad one in which the full social value is considered. This is likely to be crucial, in a SIB involving social investors; however, this is also one of the main paradoxes of the SIB

⁴ See for instance the work of the Campbell Collaboration www.campbellcollaboration.org

approach (Fox and Albertson 2012). If SIBs are to become widespread they will rely on the commissioning organisation being able to realise a monetary saving from which to pay for results. These monetary savings must be sufficient, not only to cover the cost of the intervention, but also the additional cost of adopting the SIB/PbR commissioning mechanism and subsequent evaluation (Edmiston and Nicholls 2017). This implies taking a relatively narrow view of value, one in which value is limited to the fiscal benefits realised by the commissioning organisation over the lifetime of the PbR contract (ibid.).

6. *Agreeing contracts to suit all parties.*

This can be a challenge, particularly for commissioners who need metrics to reflect the benefits of change and that avoid perverse incentives (Ronicle et al. 2014). Metrics also need to be easy to measure (Ronicle et al. 2014). However, keeping outcomes simple, while attractive to government as a commissioner and to politicians wishing to cut through the complexity of public service commissioning, also has the potential to undermine the co-creation of solutions to complex social problems that involve both service providers and service users (Crowe et al. 2014). The SIB/PbR incentive structure is such that it is likely innovation may be curtailed to those interventions for which an effective metric is available. There is also a concern that, as governments seek to attract investors utilising the SIB/PbR approach, they will implicitly offer the corporate sector an increasing say in public policy design (Joy and Shields 2013). Market pressures are likely to drive social innovation towards those interventions which are easiest to fund, rather than towards those interventions which might lead to the greatest social benefit.

5. The evidence base for PbR and SIB

In the UK the current evidence-base on the effectiveness or otherwise of Payment by Results is limited, despite the UK government's considerable investment in PbR schemes. This is the case both in terms of evaluations of the social impact of programmes commissioned through PbR (the 2nd challenge) and evaluations designed for the benefit of the wider sector (the 3rd challenge). The NAO, in its review of current PbR programmes concluded that "Most operational PbR schemes have yet to finish so there is not yet enough evidence to evaluate the effectiveness of either individual schemes or the PbR mechanism itself" (NAO 2015: 6). In some cases evaluations of PbR have been cancelled or modified before being completed or evaluation plans became impractical because rapid public sector reform 'contaminated' potential control areas or policies were rolled out nationally making rigorous, comparative evaluation impossible (Webster 2016). The NAO note that "neither the Cabinet Office nor HM Treasury currently monitors how PbR is operating across government" (2015: 8).

As with PbR more generally, the evidence-base in relation to SIBs is limited; there are few formal evaluations of SIBs to draw on. Much of the literature is either analysis of the concept (e.g. Mulgan 2010, Fox and Albertson 2012) or reviews of the literature, sometimes combined with small-scale surveys of stakeholders (e.g. Ronicle et al. 2014, Jackson 2013). In a recent, structured review of the literature on SIBs, Tan et al. (2015: 5) searched a number of databases but found "little empirical data about SIBs has been produced to date". They found "a much larger academic, policy and 'grey' literature focused on the theoretical impacts of SIBs in funding and providing public services" (ibid.).

In this section we set out some headline findings from a structured review of the evidence base for PbR and SIBs in the UK. A fuller description of the methodology and the results is set out in Albertson et al. (forthcoming).

Approach

We identified 14 PbR programmes commissioned by the UK government. We excluded PbR programmes commissioned by the Department for International Development which have been delivered overseas, predominantly in sub-saharan Africa. We identified 32 SIBs that have been commissioned in the UK. We excluded SIB projects still in development. For each programme we then identified all published empirical evaluations linked to the programme.

Twelve of the 14 PbR programmes had evaluations associated with them. We identified 29 evaluation reports of which 23 were mainly or exclusively implementation evaluation reports and 6 were impact evaluation reports. In a number of cases multiple evaluation reports were published on a single programme, typically interim and final reports of the same evaluation.

We could not identify any evaluation relating to three of the 32 SIB programmes. For another 10 SIBs evaluation was underway but no evaluation reports had yet been published. We identified 15 evaluation reports associated with the remaining 19 SIBs of which 13 were mainly or exclusively implementation evaluation reports and 2 were impact evaluation reports. In some cases one evaluation covered a number of SIBs (for example, Griffiths et al. 2016 covered 10 SIBS commissioned as part of the DWP Innovation Fund).

We assessed the methodological rigour of each evaluation report. Most evaluations were qualitative, implementation evaluations and we used Spenser et al.'s (2003) *Quality in Qualitative Evaluation: A framework for assessing research evidence* as a framework for the assessment. For the impact evaluations we have used Sherman et al.'s (1998) Scale of Scientific Methods (the Maryland Scale). This is a fairly broad scale which prioritises causal inference and internal validity in impact evaluation design. Most implementation evaluations were defensible although common areas of weakness tended to be around limited or non-existent development of theories of change, limitations in sampling strategies and limited or no mention of ethical procedures. The impact evaluations mostly used quasi-experimental designs. Several used 'matched pairs' designs with Propensity Score Matching to match pairs.

Results

Outcomes.

Currently there is no strong evidence for PbR delivering better outcomes compared with the public service provision model. Where robust impact evaluations have been undertaken results have tended to be negative. For example, Mason et al. (2015) in an evaluation of the impact of paying drug treatment providers for outcomes found that Following the introduction of the pilot scheme, service users treated in pilot areas were 1.3 percentage points less likely to complete treatment compared with those treated in comparison areas. Service users treated in pilot areas were 0.9 percentage points more likely to decline to continue with treatment compared with those treated in comparison areas. In the Doncaster Prison PbR programme the Ministry of Justice (2015) found that

while PbR targets were achieved for the first cohort, they were missed for the second cohort. As described above a number of SIBs have been completed and most have paid out to investors. However, in most cases these SIBs have not been subject to an evaluation of their impact, instead, pay outs have been based on the achievement of agreed outcome metrics. For example, several SIBs target children in local authority care considered hard to place into adoption. One is the 'Its All About Me' (IAAM) Adoption Bond, in relation to which the Cabinet Office states: "This cohort of children is very unlikely to have found a home in the absence of this intervention given the rates of adoption and their characteristics. Therefore we assume that none of the cohort would have been placed without IAAM, and deadweight is therefore nil."⁵ The qualitative evaluation of the ten SIBs funded through the Department of Work and Pensions Innovation Fund pilot (Griffiths et al. 2016) reported that project deliverers, investors and intermediaries perceived the pilots to have been a great success, with targeted numbers of outcomes met or exceeded and investments largely repaid to social investors. There was a widespread belief that projects had achieved better results than they would have done had the pilot been commissioned using more traditional methods.

Financial and non-financial benefits

The evidence suggests that this model of commissioning does not in and of itself produce financial savings. For example, the 56 organisations delivering the Work Choice PbR programme were surveyed about the impact of the commissioning model on aspects of their activity. They generally reported negative impacts including on financial stability (Purvis et al. 2013). In a survey for the Work Programme evaluation (Department for Work and Pensions 2014) providers were asked about the effect of the commissioning model on their financial turnover, efficiency and ability to deliver services on a scale of 1 - 10. Most respondents were in the middle of the range ie it had only a small or no effect. In the Youth Contract PbR programme Newton et al. (2014) found that prime providers stated that the level of their own and subcontractors' upfront investment in the Youth Contract was higher than expected.

In relation to SIBs there is some evidence that this model of commissioning increases the resources flowing to an intervention. There were several examples, of SIB investors bringing additional expertise and, in some cases additional funding, to SIBs they were involved in. For example, in the Essex Multi-Systemic Therapy SIB the evaluators (Roberts and Cameron 2015) noted the continual engagement in the SIB investors brought had added value to the programme above and beyond their initial financial investment. Particular investors had continued to be heavily involved with the programme and invest time and resources to support its success. However, SIBs also take significant time and resource to set up and commissioning process is generally much long and involves more organisations and contracts than for comparable commissioning processes.

Risk transfer

There is some evidence for PbR allowing commissioners to transfer risk. Several of the PbR programmes in the UK have involved private sector and some NFP providers raising substantial working capital to set-up and run services subject to PbR contracts. However, a consistent theme from evaluations of PbR is that providers find taking on additional risk challenging. For example,

⁵ https://data.gov.uk/sib_knowledge_box/node/183

in the Work Choice PbR programme where 70 percent of payments were through an up-front fee and 30 percent were based on outcomes the evaluators (Purvis et al. 2013) found that The upfront service fee was overwhelmingly seen as positive by both prime providers and subcontractors. Whereas in the drug treatment PbR programme the evaluators (Mason et al. 2015) found that the PbR scheme and the structure of the payments may have led providers to be more risk-averse in discharging service users from treatment and thus recording them as completed successfully, compared with previous financing arrangements. Griffiths et al. (2016) in their evaluation of the ten Department for Work and Pensions Innovation Fund SIBs found that paying a high rate for an outcome will not incentivise intended behaviour if investors perceive the risk of pursuing that outcome to be too great.

Innovation

There was relatively little evidence that PbR and SIBs increase innovation in the design of services. Very few of the programmes for which evaluation evidence is available involve the development of programmes that can truly said to be innovative. A number of evaluations looked for innovation and concluded that, generally, services being delivered were not innovative. For example, the the evaluation of the Work Programme the Department for Work and Pensions (2014: 121) concluded that, overall, there was little evidence of innovation: "The black box model allows for a provider to innovate within the limits of the contract in order to test out new ways of working, however, there appeared to be limited evidence of innovation in service design and delivery at the prime provider or subcontractor level."

In its review, when looking at innovation, the NAO (2015: 21) was sceptical of the potential for PbR to stimulate innovation:

[W]e found expert opinion differs on the extent to which using PbR promotes innovation. Government has typically used PbR to tackle difficult social problems that lack ready solutions – such as reducing reoffending. Some commissioners hope PbR will give providers the freedom to innovate, which might lead to new, long-term solutions to intractable problems. However, some providers told us that, given the risks associated with it, PbR is best suited to issues to which there are known solutions and where the commissioner’s overarching aim is to reduce costs; they indicated that PbR is unlikely to encourage innovation because exploring new approaches is costly and increases the provider’s risk. This suggests that where commissioners want innovation, providers are likely to expect additional financial incentive.

While few PbR and SIB programmes demonstrated significant innovation in service design many SIBs involved delivering services to target populations not previously eligible for a service (eg the Peterborough Prison SIB delivered a service to prisoners serving sentences under 12 months) or in new settings (eg the London Homelessness SIB developed new models of community outreach).

Performance management

A consistent feature of evaluations of PbR and SIB programmes is the adoption of new and more rigorous approaches to performance management. To some extent these were changes required to give commissioners and investors confidence that outcome metrics were being measured in an

appropriate and timely manner. However, several evaluations highlight that improving performance management was linked to the introduction of new management practices. So, for example, Wong et al. (2015) highlight that in the Youth Justice Reinvestment Custody Pathfinder, a PbR programme, improvements in performance management were part of a focus on service improvement through delivering marginal gains. In the 10 SIBs funded through the Department for Work and Pensions Innovation Fund the evaluators (Griffiths et al. 2016) found that there had been a great deal of direct and 'hands-on' involvement in projects from social investors, particularly in the areas of performance management, client tracking, and outcomes-profiling systems. They concluded that the SIB funding model appeared to have created a high intensity of focus on performance across all projects and, within this PbR, was widely seen as having incentivised the achievement of outcomes with projects being highly dynamic and a 'continuous improvement' approach being incentivised.

6. Theoretical and ideological concerns.

If the primary aim of PbR/SIBs is to drive innovation, then they raise interesting theoretical and ideological questions. The UK Cabinet Office (undated, unnumbered) is clear that they expect "SIBs shift financial risk of new interventions away from the public sector, towards investors, resulting in innovation and diversification of service provision." However, the public sector retains the obligation to coerce investors and (potential) innovators through manipulation of the incentive structure. This is, indeed, the very core of the SIB/PbR premise.

New Public Management

In the UK there has always been a mixed economy in the provision of 'public services' in terms of the balance between public and private provision, finance and control (Hills 2011). But for many commentators, the rise of PbR and SIBs represents an extension of market power extended by commissioners towards private providers of social services and might be seen within the New Public Management (NPM) paradigm (Lowe and Wilson, 2015).

New Public Management is a broad set of governance and managerial public sector reforms often associated with 'New Right' governments since the 1980s (Hood and Peters, 2004) and as an offshoot of 'neo-liberalism' (de Vries, 2010). NPM arguably reached a peak under the 1997-2010 New-Labour government (Wallace, 2013), the administration under which the first SIB at HMP Peterborough commenced (see below). In practice different conceptions of NPM emphasise different (and sometimes conflicting) themes.

Ferlie et al. (1996) summarised NPM as being about the three Ms of markets, managers and measurement, conversely Dunleavy et al. (2006) suggest three 'chief integrating themes' of (1) disaggregation, that is splitting up large public bureaucracies to create a greater number of smaller, flatter organisations; (2) competition, particularly introducing a purchaser-provider split and enabling different forms of provision and (3) incentivisation, with a greater emphasis on specific performance-based payment. PbR often involves a mix of each of these themes, with a particular focus on the third theme of incentivisation. This extension of market power can only be operationalised by the commodification of public goods, or at the least, the statistics pertaining to such goods are commodified (Albertson 2014).

De Vries (2010) has described NPM as an ‘abstraction that suggests a unity of ideas’. It is both a means of describing and categorising public sector reform, but also of criticising it. Thus Dowling and Harvie’s (2014: 869) critique of social investment as “deepening of capitalist disciplinary logics into the social fabric”. Whether or not one might share Dowling and Harvie’s misgivings, what is clear is that the PbR/SIB framework implications for the purpose and shape of the future welfare state. As we have noted above, quantifiable financial and ultimately cashable (i.e. economic) results are required for a well-functioning SIB/PbR.

Funding the big society

Further to develop the theory of the SIB/PbR approach, we must consider at a finer detail the motivation of the players in the market: government, society and investors.

The use of SIB/PbR funding in public services is motivated, or so it is claimed, by the needs of the “Big Society” (Dowling and Harvie 2014), the supposed alternative to “Big Government” (Cameron 2009). Cameron argued that the way to do this was through the redistribution of power (including financial power) to local communities. The SIB/PbR approach was developed, in part, to aid this redistribution of financial power – with the government as the deal broker (Dowling and Harvie 2014). However, in practice, implementation was impeded by the market based approach which was promoted; this has led rather to the further disempowerment of communities (Civil Exchange 2015).

The original vision of the big society was hardly that of a “top down” approach in which the state would subcontract for the provision of social goods, but rather that of promoting (and facilitating) social action (Public Administration Committee 2011). This is not so much outsourcing it is rather more like providing the third sector with a prospective new source of funds, in order to upscale already successful interventions. Such a collaborative production approach is rather more likely to lead to increased entrepreneurial activity than a centrally planned approach (Civil Exchange 2015).

We must also consider the motivation of the provider of social investment (Fraser et al. 2016). Some funders are big businesses or banks engaging in Corporate Social Responsibility activities. The motivation in this case is not necessarily to do good, but to be seen to do good. Investors, in this case, may be prepared to accept a below-market rate of return, which saves the taxpayer money.

Other investors may have private reasons to “do good”, that is, to take part of the return from their investment in social outcomes, rather than purely in dividends. To the extent to which the social substitutes for market returns, the taxpayer (the ultimate funder) is likely to achieve savings.

Ultimately, however, investors may simply be seeking a competitive rate of return, in which case the investment is not sold on its social impact, but rather on its worth as a market investment. One would expect such investments to cost the taxpayer more than if they are funded by socially minded investors, as all the returns are financial.

In sum, the efficacy of the SIB/PbR approach ought not to be considered at a national, or even policy, level, but rather on a case by case basis. At present the discussion on this innovation ignores such fine details, yet it is often in such matters that the value of an innovation lies.

A cautionary tale – Private Finance Initiative in the UK

There are some parallels between the development of PbR models in the UK and the private provision of public infrastructure under the so-called Private Finance Initiative (PFI) in the UK. Under PFI, groups of private investors undertake to design, build, finance and operation public infrastructure, for a fee.

Trailed in the Autumn statement by then Chancellor, Norman Lamont, the purpose of PFI was supposedly to “increase the scope for private financing of capital projects.” (Lamont 1992: 998). Other supposed benefits of PFI included: the transfer of risk of provision to the private sector; improving efficiency; encouraging the development of new private providers; encouraging innovation; increasing productivity; incentivising performance; and improving due diligence (prudence and accountability) (House of Commons 2011a). These are essentially the same benefits said to arise from SIB/PbR financing. Alongside of this, there is the political benefit that future payments on PFI contracts do not appear in government debt or deficit figures.

PFI proved very popular with governments and investors; however, it failed to provide good value for the taxpayer (House of Commons 2011a, b). By way of illustration, consider that in 2016 it was reported in Parliament (Creasy 2016) the UK government was committed to pay £232bn by 2050 on assets worth only £57bn. Although PFI has since been “replaced” with PF2, there remains concern that the poor value for money issues remain unaddressed (ibid.).

However attractive in theory, the government’s implementation of PFI failed to deliver for the public as the case for relying on public finance was based in part on “ill founded comparisons and invalid assumptions” (House of Commons 2011b: 3). Further, it has been suggested the government did not consider adequately the tax implications of the approach, given the level of foreign ownership of many PFI investment funds. (ibid.). On top of this, compared to the private sector, the public sector supposedly lacked the commercial skills to get the best value out of such contracts (ibid.).

On the basis of the public sector’s previous record in achieving efficiency through the accessing of private finance, it seems reasonable to view with some degree of caution the case for SIB/PbR. The rationale for the private provision of public infrastructure is very similar to the rationale of SIB/PbRs and many of the reasons for the initiative’s failure to deliver value for money appear equally likely to apply to the private provision of public services.

7. Conclusions

Payment by results models have a place in the provision of services. Models that encourage innovation are attractive to governments concerned that public provision of services is resistant to reform and/or inefficient. The outsourcing of risk, both financial and political, is attractive to government. In some parts of the public sector, where the potential client group is fairly large and homogenous and service provision is highly integrated, measurement of outcomes is straightforward and the fiscal return on achievement of outcomes is easy to establish, a PbR mechanism might be attractive to commissioners.

It must be borne in mind, substantial public resources and political capital have been directed to the development of these models. The potential benefits of maintaining the whole approach must take

into account such sunk costs – yet they are included in no evaluation. The investment, particularly political investment, in this ideology implies we should be especially careful “Payment by Results” does not evolve into “Results by Payment”. Given that there is likely to be a role for PbRs in the public sector, it is of concern that the evidence base is not yet sufficiently developed.

Social Impact Bonds provide opportunities to unlock new capital investment and advance social goods over and above other models of PbR. The potential to bring in additional, external investment replacing the need for the commissioner or service provider to provide up-front working capital opens up new opportunities for innovation both in the interventions that are implemented and the collaborations between organisations delivering them. The introduction of social investors together with the potential for SIBs to address misaligned incentives in current service delivery and fund new preventative services that can save costs down-stream raises the prospect of real advances in tackling complex and entrenched social needs. However, as Ronicle et al. (2014) conclude, to date, their development has been slow and relatively complex and the evidence-base for their effectiveness is limited (Tan et al. 2015).

We suggest the question “To PbR or not to PbR” presupposes an unnecessary binary choice. Rather, the issues are: how prevalent should SIB/PbR contracts be; when are PbR/SIB contracts most appropriate; of what scale should they be – macro-commissioning vs micro-commissioning, for example – ; what are realistic alternatives; can we be sure transactions costs, governance costs and evaluation costs are not so great as not to outweigh efficiency gains; how may distortion of the system be minimised; and how can real innovation be fostered without putting the viability of small providers at risk. We argue the potential of the SIB/PbR approach may not be as an innovative form of commissioning, but rather as an innovative form of enabling.

Going forward there is a clear need for more and better evaluation of both approaches. This includes further evaluations of the implementation of PbR and SIB, building on studies such as Disley et al. (2011) and Foster et al. (2014) and methodologically robust outcome evaluations along the lines of Jolliffe and Hedderman (2014).

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