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# **SOCIAL IMPACT BONDS: THE APPLICABILITY IN LATVIA**

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# **Social Impact Bonds:**

The applicability in Latvia

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## Abstract

Social Impact Bond (SIB) is a relatively new and innovative concept that has the ability to bring together the private and the public sectors for close cooperation with a social cause at the centre of the mechanism. It is said to have the capability of bringing benefits to the government through risk transferring as well as provide investors with an investment opportunity characterised not only by a social contribution but also by financial returns. From a broader perspective it has the capability of improving the effectiveness of provided services and money contributed to them, increase the coverage of social issue addressing and achieve more social goals met in a shorter time-frame. The mechanism has already proven to be successful in some parts of the world and is being considered in the less economically developed countries.

Bearing in mind that Latvia lacks sustainability and effectiveness in both preventative and remediation programmes in the social area, the authors of this paper set out to investigate whether the benefits of the SIB concept could be captured in this country. Putting forward a research question regarding the current state of elements that have an effect on the applicability of a Social Impact Bond in Latvia the authors focus on four aspects, namely political will, investor perspective, service providers and problem propriety. Within each aspect the goal is to investigate whether there are problems that would signal that the SIB setup is not appropriate in the context of Latvia and assess their severity in a sense of whether they could be overcome. In order to fulfil the objectives, the authors perform a qualitative study with interviews as the main means of data collection and publicly available governmental and other sources as secondary.

The main conclusion of the paper is that there are certain drawbacks and underdevelopments in the social, political and economic spheres that need to be addressed before the concept could be considered in Latvia. The obstacles that are most difficult to overcome currently are coming from the Political Will pillar, whereas issues concerning other pillar readiness are of moderate level and can be addressed relatively faster. As research of Social Impact Bond mechanism applicability in Latvia has not yet been brought forward by the existing literature, the contribution of this paper lies in aggregating information from 16 interviews with representatives of most influential stakeholders within the setup and interpretation of the insights while taking into account the international experience with Social Impact Bonds.

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## List of abbreviations

- CSR – Corporate Social Responsibility
- FFG - Finance For Good
- HF – Housing First
- LSA – Latvijas Samariešu Apvienība<sup>1</sup>
- MRR – Market rate of return
- NGO – Non-governmental organisation
- OECD - Organisation for Economic Cooperation and Development
- PPP – Private Public Partnership
- PW – Political Will
- RCC – Riga City council
- SIB – Social Impact Bond
- SP – Service Provider
- SOE – State Owned Enterprises
- WM – Welfare ministry

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<sup>1</sup> Biggest and said to be the most efficient NGO in Latvia operating as a service provider in several social and health care areas.

## 1. Introduction

The very first payment-by-results mechanism that is a Social Impact Bond was firstly introduced in 2010 by a social investment bank Social Finance UK. (Travis, 2010) Since then 8 SIBs have reached the implementation state (in US, UK and Australia) and 32 are in design stage (in US, UK, Australia, Uganda, Israel, India and 5 other countries). (Instiglio, 2015)

The most basic setup of a SIB is the following: investors make payments for certain activities that are to address the underlying social issue, the intermediary organization or few of them use that money to develop and implement a respective preventative program within a pre-set timeframe, which, relating to the concept of bonds, can be referred to as the time to maturity. If the outcome satisfies the pre-determined goals, the government commissioner repays the initial investment plus the compensation for the risk undertaken, known as return, to the investors, whereas in case of unmet goals the investors end up losing the invested money. (Social Finance, 2012)

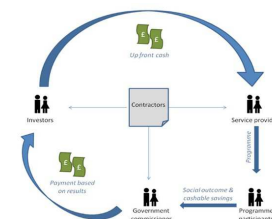


Figure 1 SIB structure (Cabinet Office, 2013)

The concept is considered to bring mutual benefits for the parties involved as well as solve problems associated with lack of effectiveness on a broader macroeconomic level. To the government it provides the opportunity to address social problems in the country at the same time performing risk transfer to the private sector. To investors it creates an opportunity to engage in a considerably attractive investment while simultaneously contributing to a social cause. From a broader perspective, it enables tapping into private sector funds to improve the welfare of the society, increases effectiveness of the investment by shifting the focus from remediation to preventative programs as well as incentivizes more efficient means of addressing respective social issues by putting the focus on impact rather than activity. (Instiglio, 2015)

The implemented cases of SIBs were tackling a number of social problems, mainly concentrated within four broad areas - youth engagement, homelessness/adults with complex needs, criminal justice and welfare of children and young people. Within the timeframe of four years, the SIB concept has achieved impressive results by attracting cumulative investments of more than a 100 million U.S. dollars and engaging types of investors that were beyond the initial investor profile, which was initially thought to be limited to philanthropic foundations and endowments. Even more so, the introduction of Social Impact Bonds, referred to as Pay for Success Bonds in the U.S. and Social Benefit Bonds in Australia, encouraged developments of its extensions, such as Development Impact Bonds (DIB) aiming at providing an international investment opportunity to tackle social problems in

developing countries. (The Global Social Impact Bond Market, 2014) However, despite its rapid growth, up to this date this innovative financial tool is faced with a great deal of uncertainty and receives its fair share of constructive criticism. The image of an attractive "pay-only-in-case-of-success" investment is often complemented by warnings about the underlying risks, including, among others, those arising from complex mechanisms behind it and the lack of understanding it to the fullest, which by many people is instantly associated with the financial crisis of 2007-08. (The Economist, 2012)

The authors of the work want to explore SIB framework's applicability in Latvia. The budget of the WM suggests that the majority of social support is ensured in monetary terms, indicating a gap in the social care system for preventative and rehabilitation programmes. (Labklājības Ministrija, 2014) The authors aim to test if the SIB could close the gap and deliver an efficient solution by providing social impact. Therefore, the following research question is stated:

- ***What is the current state of the elements that have an effect on the applicability of a Social Impact Bond as a means of addressing social issues in Latvia?***

In order to answer the research question the authors look into the current state of political system, investment environment and social problem related aspects in Latvia that are relevant for an innovative social tool to be accepted and work. The authors aim at identifying the level of acceptance for each of the aspects, identify the existing problems and motivating conditions for overcoming them. This is achieved through performing a qualitative research by analysing the respective theoretical concepts, holding 16 interviews with the decision makers in the representative areas and analysing data from the publicly available government's sources.

The study is structured to cover four main parts. The first part presents the overview of existing literature on the SIB concept and the factors affecting the applicability of this mechanism. The second part provides a description of the methodology followed throughout the paper. The third section is data description and interpretation of results, which firstly presents the conducted interview insights and secondary data and then provides the authors' interpretation of the findings in the light of the SIB mechanism. This part includes 3 sub-sections addressing the broad areas of interest, referred to as pillars throughout the work, namely political will, investors, and the third being service providers and the choice of problems. Finally, the last section concludes the findings and includes further suggestions for the government.



## 2. Literature Review

The following section includes an overview of literature existing on Social Impact Bonds and their history, a summary of papers that lead to determination of the main factors affecting the SIB's implementation process, and consequently the chosen research focus and research question.

### 2.1. Literature on Social Impact Bonds

As a result of achieving rather impressive outcomes given the innovativeness of the approach, over the years the Social Impact Bond concept, that was able to bring together private funds, public social issues and the expertise of different parties involved, has attracted a great deal of publicity. Taking into account the fact that the concept is rather new and that there is not yet sufficient amount of data to rely on, it is not surprising to find that this phenomenon faces a lack of academic research done about it. However, the concept has to a great extent been covered by many debates and discussions in the press as well as explanatory and informative reports by social investment experts and organisations. Some of the literature turns more to discussing the details and the mechanism behind this instrument, while others focus on untangling the benefits, drawbacks, opportunities and struggles associated with it, or even provide guidelines for constructing SIB cases. An overview of the educational and informative literature on SIBs, literature taking the form of discussion of the mechanism's features as well as guides for SIB preparation and evaluation are presented below, whereas papers that were relied on when determining the main examined dimensions when drawing on the tool's applicability in Latvia are described in more details in the following sub-section.

The first type of papers that can be found among the literature about the Social Impact Bonds is the informative publications providing in-depth descriptions of the instrument and its features. One of the examples of such is a publication by the innovatory organization, Social Finance Limited, called *Introduction to Social Impact Bonds*. (2012) The publication, firstly, provides a rather simple and down-to-earth explanation of the setup behind the SIB - it positions the Social Impact Bond as a means to raise investment for funding the unmet needs of the groups within the society and briefly explains the most basic setup of the instrument. In addition to that, Social Finance representatives also provide the reader with a more complex framework of a real life SIB, consequently, letting them know that the mentioned basic setup is not all there is to the instrument, but rather many details within each case can be adjusted according to the circumstances. The publication by the social investment bank also turns to

explaining the novelty and the contribution of the financial tool naming its ability to facilitate investing in prevention, improve the quality of the program addressing the issue by transferring this responsibility to an independent organisation and encourage innovation when tackling the problem from the service providers' side. Relying on the very first SIB implemented by the authors themselves, the paper is complemented by an outline of the SIB development process including factors that were considered at each stage. All of them diverge to the purpose of meeting five objectives of SIBs in general. The mentioned objectives are - closer, more direct alignment of the public sector funding with improved outcomes (1), enabling collaboration of a wider diversity of service providing organisations (2) and increasing the certainty of revenue streams for effectively acting ones (3), an increase of the capital pool when it comes to funding preventative programs (4), contribution to development of a more rigorous performance management method involving measuring the results achieved by the program and consequently, also to the construction of an evidence base more convenient for distinguishing methods that are efficient (5). The paper is concluded by general remarks on the financial and the operational sides that were considered when building the Peterborough Prison SIB back in 2010, for instance, practical implications of how the instrument could operate as well as the financial model of the SIB including the estimation of the program related costs, outcome values and the time horizon for investment return realization.

Other papers that have the informative purpose on the topic of the Social Impact investment take more or less similar forms to that released by Social Finance. The report Jeffrey B. Liebman from the Center for American Progress (2011) provides a more comprehensive description of this financial tool and points out the same objectives of SIBs. However, this report allocates more attention to the challenges faced by the instrument, namely the limited applicability of it due to difficulties in measuring the outcomes of prevention programmes and obtaining a credible assessment of the outcomes in absence of the proposed programme. The paper also discusses the necessity to develop well-thought-through contingency plans in case of financing or performance failures to ensure no harm being done to the treatment populations if the programme is terminated early. As this work was released quite early in the Social Impact Bond existence period, the work also includes some observations and suggestions for the future plan of developing SIBs in the U.S. as well as tasks to be carried out to be able to adopt this concept and potentially, overcome some of the named drawbacks. The author then concludes that SIBs seem to be an important breakthrough that has the potential of speeding up the process of solving the most pressing

social problems in the nation and that any innovation as promising as this has to deserve careful consideration from the involved parties.

There are more papers to be found that provide the reader with the opportunity to familiarize with the innovative tool combining financial means and social focus, such as that released by Social Finance US (2012) or by the Early Intervention Foundation (Griffiths & Meinicke, 2014) that even presents a summary of some of the carried out SIBs. Some of them concentrate more, and in some cases even solely, on the educational aspect, whereas others also discuss the strengths of this investment tool building on the rationale behind its employment as well as/or the weaknesses and suggestions to overcome them. For instance, the article *Social Impact Bonds: A Wolf in Sheep's Clothing?*(2013) by Neil McHugh et al. focuses on a rounded critique on the SIBs with respect to the three harmful effects they might cause. The first drawback, is based on the measurement of outcomes - the authors claim that it is practically impossible to put the results of the programme in a numerical, measurable form for most of the social problems, whereas, if it is indeed an option, it is impossible to distinguish whether the positive effect was actually stimulated by the actions undertaken by the service providers. At the same time, the authors emphasize that this issue is of major significance due to SIB returns being based on performance and outcome measurements. The second argument is concerned with the third sector of the economy, also called the Voluntary sector and comprised of non-profit and non-governmental organizations, and its incentives to focus on the most topical issues within the society. The authors hypothesise that extensive implementations of Social Impact Bonds might drive the focus of the third sector away from the most pressing matters to ones that are more easily quantifiable. Lastly, McHugh and his colleagues are concerned with deterioration of governance and accountability as well as reduced capability for oversight from the government arising due to transferring of the service providers' choice to the SIB Delivery Agency. (McHugh, Sinclair, Roy, Huckfield, & Donaldson, 2013)

Among the existing literature, there are also papers touching upon the regulatory aspect of the SIBs, such as *Not Your Older Brother's Bonds: The Use and Regulation of Social Impact Bonds in the United States* by K.Humphries (2014). The key take-away from the paper is the argument that due to the underlying potential and a promising setup the SIBs might be facing a widespread use in the future, which poses crucial policy concerns about how the market for the instruments should be regulated and whether there is a need for that at all. (Humphries, 2014)

The line of literature on SIBs that is especially relevant for the purpose of this research are papers that take the form of guides in the bond's development process as, among other specifics, they bring the reader's attention to the conditions that should be desired for an effective and most promising SIB implementation outcome. An advisory department of sustainable and impact investment fund Bridges Impact+ recently released a paper under the name *Choosing Social Impact Bonds: A Practitioner's Guide* in which the organization recites and describes the benefits associated with each of the parties involved in the SIB setup, followed by a list of design features that have been observed to increase the likelihood of these benefits being realized, and rounded by a checklist once again laid out for each party separately. (Goodall & al., 2014) Another example of such works is the *Social Impact Bond Technical Guide for Service Providers* composed by the MaRS Centre for Impact Investing. This work is rather focused on the SIB structure from the service providers' point of view including a discussion of benefits and risks faced by this party attributable to SIB financing, service provider-oriented guidelines for dealing with SIB development process, and other aspects worthwhile to consider. The paper suggests taking into account such benefits as a stable revenue stream for program development through provision of the initial working capital that, in turn, allows the organizations to reduce their undertaken financial risk. On the other hand, it reminds about the certain risks: reputational risk, risk associated with collaboration in between the parties and others. (So & Jagelewski, 2013)

Literature that has the capacity of providing more valuable suggestions for the analysis of current state of conditions in Latvia that are of importance for a successful applicability of a SIB, takes the feasibility study approach positioning it as research that is most closely related to this paper. A feasibility study on housing SIB developed in cooperation between Social Finance UK and MaRS Centre for Impact Investing revolves around the propriety of this financial mechanism to improve the lives of homeless people with mental disabilities in Canada. The study takes the following steps - firstly, it examines the backgrounds of both problems in Canada and establishes a connection between them. Then, it specifies the intervention model, that is, the introducers of the SIB come up with specific actions of the program that would improve the life quality of the target group most significantly. The determination of the actions that the program should include is based on the prior research that was already carried out in 2008. It is by the authors referred to as the pilot project, funded by the Canadian government with 110 million dollars, and conducted within four years by employing an experimental trial design on more than 2000 participants divided into several groups. As people in all of these groups were faced with the same problems that are at

the core of this paper, and the only variable different within groups was the intervention itself, the pilot study was perfect for distinguishing the most effective means for tackling the problem. Based on the findings from 2008, the Housing First (HF) SIB initiators specified the exact structure of the ties in between all the parties involved and going through key features of the problem at stake concluded that a SIB would be applicable in this set up. The HF paper was concluded by a presentation of the case and its few different scenarios. (Miguel & Abughannam, 2014)

## **2.2. Factor determination**

In order to determine the factors, current state of which should be assessed in Latvia so as to draw conclusions about the feasibility of Social Impact Bonds, the authors rely on several existing practicability studies that aim at achieving a similar goal in different contexts.

The paper's *Assessing the opportunity to improve social outcomes through the use of social impact bonds* by Finance for Good main purpose is demonstration and application of an evaluation process that could be used on a SIB proposition to study its viability. (Finance for Good, 2013) The assessment takes a form of a six pillar approach providing a framework for evaluation of regional strength of factors required to support a SIB. The six elements within this work are identified as "Service Provider Capability", "Political Will", "Measurable Impact", "Investor Appetite", "Potential for Impact" and "Economic Links". Employing the chosen methodology each of the factors is assigned a value of "Weak/Low", "Moderate" or "Strong/High". In case any of the factors is identified as "Weak/Low", the SIB is concluded to be an inappropriate mechanism for that particular case, whereas "Moderate" values indicate that the commissioner of the contract will have to pay more attention to the areas of medium strength.

The "Service Provider Capability" element refers to the existence of organizations that would be able to efficiently and effectively implement the prevention program with the provided funds in the area and provide measurements of their achieved impacts. The authors evaluate the respective pillar by addressing each service provider's relations with the government, capability to manage the funds, the competence of its leadership and management, strength of its partnerships and its position towards the community. After evaluating the main service providers in the area, the rating is assigned to the element - "Strong" if there are three or more organizations that would be capable of efficiently and

effectively operating as a service provider for a SIB, "Moderate" if there are only two or one of such organizations and "Weak" if there are none.

"Political Will" element is concerned with the willingness of the government and other authority figures to address the issue at stake and allocate attention and resources to it. The information on this factor is gathered through interviews with public sector officials and previous data available. The relevant data is considered to include but not be limited to: previous programs addressing the issue, appointment of more staff and high position officials to it, accordingly allocated funds, public announcements about support for the problem. Three criteria are highlighted and researched through interviews - Political Must, Political Want and Political Can. The ratings are defined as: "Strong" - the government support for the issue is ensured through a direct communication or supported with concrete evidence by the data, "Moderate" - it is found that the issue is the public sector priority via second-hand information or there is no reason to conclude such fact, "Weak" - when there is no information helping to determine whether it is or is not a priority.

"Measurable Impact", according to the authors, is an important part of the elements as it is one of the core requirements in the mechanism's setup. Finance for Good points out that when considering this factor, the evaluators must take into account the measurement effect on the service delivery incentives, possible external factor bias of the measurement, the possible adverse incentives that a poorly chosen method of quantifying could create. Three measurement requirements are then raised in the report - quantification and transferability, required for a successful demonstration of results and calculation of pay-outs as well as comparability with other interventions, reliable and repeatable data collection methods, and the mutual agreement of all of the parties about the raised goals and the propriety of the measurement. A "Strong" rating in the context of the measurable impact element means that there is a commonly accepted means of measurement and the data required is collectable, "Moderate" informs that there are ways of quantifying and measuring the impact in such field, it has proven to work elsewhere, but has not been tested locally, whereas "Weak" rating signals an absence of a measure for the particular social issue.

The fourth element turns to the initial provision of the funds - the investors. "Investor appetite" is meant for assessing the alignment with investor interest and is primarily examined through interviews with prospective investors. Alternatively, the authors point out, the investor interest could be indicated by the historic regional philanthropic activity trends - the attention allocated to the issue in question throughout the years. The authors then define the "Strong" position if it is possible to identify potential investors, "Moderate" if they were

not identified but there is strong evidence of support to the issue in the past, and "Weak" if does not seem likely that the SIB on the issue will receive sufficient support from the investors.

"Potential for Impact" pillar is included in the evaluation process as in essence it is assessing the need for the SIB - the effect the change in the model could have on the interest group. Considering three key criteria - the theoretical side of the change from the possibly implemented interventions, including understanding the specifics of the target demographic, also measuring the numbers of people currently in need for help and the number of people that could benefit if the issue was addressed by a SIB - the authors investigate whether there is space for improvement over the current model. Based on the three criteria the authors assign one of the values to the pillar: "High", "Medium" or "Low".

The "Economic Links" element is concerned with a project assessment according to a standardized framework enabling independent cases to be compared, and particularly focused on the financial return to government. The authors list the potential sources of government financial return, such as direct cost savings or cost avoidance, changes in taxes paid, increased income and others. For the purpose of measuring this pillar the authors employ an adjusted Social Return on Investment (SROI) framework. Both primary and secondary research in this paper are performed while keeping in mind few evaluation criteria - economic outcomes being quantifiable, such as the possibility to quantify the financial benefit for the government, time needed for the financial benefit to be realized, the risk associated with the case. In this setup, "Strong" value is assigned to cases when there is strong evidence suggesting measurable and likely financial benefit for the government, "Moderate" - when there is reason to believe that the issue could have an indirect financial benefit, and "Weak" when the evidence suggests that the issue has no or minimal financial implications.

Other feasibility studies that can be found in the literature support and append the elements listed as the main ones by Finance for Good. In the rigorous and data-driven analysis presented by McKinsey & Company in the report *From Potential to Action: Bringing Social Impact Bonds to the US* the SIB ecosystem is disaggregated into various stakeholder parties, namely Government, Investors, Intermediaries, Evaluators and Assessors. The features, experience and capabilities required for each are identified that must be possessed so as to conclude that favourable conditions are in place for a successful SIB implementation. (Callanan, Law, & Mendonca, 2012) Prioritizing a goal of assessing whether a SIB would work for a specific problem rather than recommending actual SIB specifics and

usage, the authors structure their analysis around four base questions, to their mind crucial to assessing before considering a SIB framework: whether a different approach might offer significant improvements, in terms of economic savings, over the current remedial and preventative cost scale, whether preventative interventions that could address the social issue with great efficacy exist, whether there are potential service providers that could and be willing to undertake the preventative programs in the region, whether the SIB would target at helping a meaningful number of people in need. The authors evaluate these questions as well as the stakeholder capabilities and willingness, including their ability to engage in partnerships successfully, through interviews, collection of government provided, academic sources and other publicly available data. The authors conduct analysis, such as cost-benefit analysis of the overall forecasted economic benefit for the society, projected returns for the stakeholders and others.

Reflecting on the above described literature on Social Impact Bonds, the authors have identified four elements that will be considered as central for a SIB to be feasible in Latvia. The elements that will be researched and analysed in this paper in order to determine the current state of each of them in Latvia are the following: political will, investor profile, service provider capability and choice of problem, the latter two of which are analysed less in-depth than the first ones and discussed jointly in the section Service Provider pillar. The process of the element specification and the rationale behind the deviation from the original study by Finance for Good is elaborated on in the methodology section of this paper.



### 3. Methodology

Reflecting on Robert K. Yin's book *Case Study Research: Design and Methods* (Yin, 2014), the study of Social Impact Bond applicability in Latvia could closely be associated with the case study design as it involves an extensive analysis of a single case, that is an exploration of the dimensions needed to be of sufficient levels and specifics for a single mechanism to work in a single context. The case study design is quite commonly employed under the choice of the qualitative research design as the narrow area of interest specified by the case allows for in-depth investigation by conducting unstructured interviews or semi-structured interviews and/or subject observation, whereas, vice versa, research methods commonly undertaken in qualitative research generate results required for intensive case studying. However, the scope of the research was limited by time and data availability, thus instead of taking the very detailed form of a case study, it rather follows a quasi-case study design.

16 semi-structured interviews were held with the representative parties of investors, political will participants, public service providers and NGOs. A full list of interviewee profiles can be viewed in Appendix 1. To protect the interviewee opinion and ensure their unbiasedness the authors of this paper chose to keep the interviewee identity anonymous. Sample interview questions were drafted prior to the interviews basing on the conducted literature review and authors' knowledge within the concept. However, the majority of the questions were developed during the individual interviews based on the respondents' answers following the semi-structured interviewing principles. For the majority of the interviews the average meeting time was approximately an hour, majority of the interviews were recorded.

As the authors undertook a study that is based on the overall SIB applicability in Latvia rather than made an analysis for a specific SIB case, the previously described 6 pillar model had to be modified to touch upon 3 pillars as well as include theories of Public Private Partnership (PPP) and others. The study revolves around 4 main aspects (2 of them grouped into the third pillar) the development stage of which contribute greatly to whether a delivery-for-success mechanism could be accepted in Latvia. The pillars were determined reflecting on the work by Finance for Good (2013), and narrowed down to Political Will, Investors and the Service Provider pillar partly also addressing the specific problem choice aspects. A deeper analysis of Measurable Outcome, Potential for Impact and Economic Links is not necessary for the scope of this work as they all require focusing on specific social issues rather than assessing the mechanism's applicability on the broader, national, level. Thus, the Measurable Outcome aspect was partly addressed in the Service Provider pillar. Potential for

Impact, or in other words identifying the gaps in the current model, was addressed throughout all three chosen pillars, whereas the main factor of Economic Links pillar – financial return to the government was only addressed in a sense of investigating its importance within the Political Will pillar. As there are many aspects to consider within each of the chosen pillars, the authors aimed at looking at each of the pillars from various perspectives suggested mainly by the above mentioned article and interviews with experts that had been conducted in the earlier stage of the study.

### ***3.1. Political will***

For a SIB implementation, one of the milestones is its acceptance by the government. In the context of this work, Political Will is defined as government officials' capability, standpoint and willingness towards addressing certain social issues, potentially with an innovative solution. This factor was analysed to understand the strength of political will factor in Latvia in the context of Social Impact Bonds. In order to do that, the authors collected the information through interviews, as well as used publicly available data. The authors aimed at looking at various aspects affecting or supporting/rejecting the presence of Political Will:

#### ***Government structure features***

As a Social Impact Bond is to a great extent comparable to any Public-Private Partnership, some conditions required for the latter to work also are relevant, but not limited to, for the purpose of this work. Following the methodology of successful PPP (EC, 2003) which suggests the importance of local political institution's strength and stability when it comes to entering a partnership with the private sector, the authors analysed the stability and consistency of political power, the aspect of strategic sustainability and view into the future.

#### ***Current public sector's acceptance and attitude towards innovations***

During the interview with a representative of Social Finance UK, the pioneer organization of SIBs, and one of the expert interviewees in the context of this work innovative nature of the SIB mechanism as well as the necessity of welcoming authorities' attitude towards innovative approaches were emphasized. (Anonymous 15, 23 April, 2015) Therefore, during the interviews the authors aimed at gaining insights of government's

attitude towards innovations and defining the factors that from the government's perspective could be motivating towards accepting innovations.

### ***Social entrepreneurship***

Above mentioned interviewee, a representative of Social Finance UK who has extensive experience with SIB implementation process, also revealed that good proxies for evaluating the extent to which the mechanism would be welcomed in a particular country are the development levels of social investment and social entrepreneurship sectors. (Anonymous 15, 23 April, 2015) Taking this into account, the authors briefly overviewed the current state's activities towards creating a ground for social entrepreneurship concept's introduction in Latvia and attitude towards the concept overall.

### ***Private-Public Partnership***

By conducting the interviews with the public sector participants the authors gained insights of the overall standpoint of the chosen government representatives towards establishing a close partnership with the private sector. This is worthwhile investigating as, having mentioned that a SIB is closely comparable to a Public-Private Partnership in general, if there was a strong positive/negative attitude towards PPPs one could hypothesize that most likely it is a motivator/warning when it comes to SIB readiness in Latvia.

### ***Financial perspective***

The financial aspects and calculations regarding any program, including the Social Impact Bond, highly concern the government officials as it should. (Anonymous 15, 23 April, 2015) Unfortunately, in the scope of this paper due to limited time and other resources the authors were not able to go in depth regarding few potential social issues and present efficiency improvement and financial benefit calculations. Therefore, this section rather focuses on the current fund attraction methods. Such approach is still fit given the nature of the work as it is suggested by the Finance for Good (2013) paper that looking into the gaps in the current model and potential for impact is just as important and might signal the need to look at alternative solutions. Reflecting on the interview with State Treasury representatives the authors also identified the differences between using the SIB model for project financing and the current approach.

### ***SIB specifications – smaller scale possibility***

Given that the SIB project scale is not strictly defined as well as reflecting on the international experience cases (Anonymous 15, 23 April, 2015) the authors analysed the potential of SIB introduction on a smaller scale – municipality level.

### ***3.2. Investors***

In order for a SIB framework to work, a sufficient number of investors that would be willing to engage in the initial funding and the agreement with the government must be present in the region. In order to evaluate the strength of this pillar, some of the potential investors currently engaged in philanthropic activities must be and were identified and interviewed with the purpose of assessing whether social issues at the centre of the SIB are to a sufficient extent aligned with the investor interests, what the investors' attitude is towards cooperation with the government. The secondary source of information used for this pillar was the historic tendencies of social investments oriented towards social issue addressing.

### ***International SIB cases***

In order to create the SIB common practice context for the reader and compare the usual scale of this mechanism to the scale that would seem to be reasonable in the context of Latvia, the authors aggregated and overviewed the information available about the investment amounts, returns on an international level as well as provided a brief international investor overview. These observations were further reflected on as a benchmark for the assessment of SIB specifics in Latvia.

### ***Investment overview in Latvia***

As mentioned before, literature on SIBs as well as the expert interview suggest that social investment level in the country prior to the SIB is a relevant indicator of the ease with which such a tool could be successfully implemented. (Anonymous 15, 23 April, 2015) Hence, the authors chose to look into this aspect from the investor perspective in the Latvian context. The paper provides an overview of amounts donated for social causes, the biggest companies that donate to Social Benefit organizations as well as a more general overview of the investment environment, including the current trends and likely changes in this area.

### ***SIB aspects***

The section takes the form of a discussion of the following factors – appropriate return, issue alignment importance, openness to innovations and unfamiliar setups, cooperation with the government that were highlighted by the international experience and literature about SIBs to be important determinants for investor appetite. (OECD, Finance For Good) By drawing on the interview insights the authors analysed the role they would play in the context of Latvian investors and reflected on certain issues or strengths that would have to be taken into account if SIB was pursued regarding each of them.

### ***Investor feedback on SIB setup***

This section provides the reader with other, more general, comments from the investor point of view that could have weight on the successful implementation of a SIB. Following the example of SIB feasibility studies carried out in other countries the authors investigated the motivators that would be most relevant to ensure attraction of sufficient investor numbers and investment amount. (Deloitte and Mars Centre for Impact Investing, 2014)

### ***Potential investor groups***

As the Finance for Good paper (2013) described in the Literature Review section indicated it is crucial to identify the potential Social Impact Bond investors, their number and whether it would be sufficient to support the mechanism. Unlike the mentioned work, this paper's aims do not include investigation of SIBs for a specific social issue, thus the exact institutions and organizations cannot be named. Instead, relying on the international experience and suggestions gained through interviews, the authors present a discussion of potential investor groups in the SIB mechanism in Latvia.

### ***3.3. Service providers***

In the context of this work, service providers are defined as government or privately run institutions that operate in the field of prevention and treatment and/or could deliver the preventative programs the funding of which comes from the private investor and government agreement. This factor was analysed to understand the strength of Service provider capabilities in Latvia. The capability includes assessment of the agents' ability to efficiently and effectively implement preventative programs, including innovative programs that could offer improvement over the current model. For a SIB mechanism to succeed a number of such institutions capable of delivering to the requirements and keen to engage in such a setup

must be present. In order to identify such institutions and assess their ability the authors collected the information through interviews and publicly available information.

### **3.3.1. Public versus Private Service Providers**

As many papers on SIBs suggest, a distinctive feature of the mechanism is that it offers not only a shift from remediation programs to preventative ones, but also that it includes transferring the services usually performed by the public sector to the private organizations. (Instiglio, Finance for Good) However, for the latter shift to be implemented successfully and efficiently the private sector SPs have to be capable to offer an improvement over the current approach, namely be able to perform the duties more effectively and efficiently. (Finance for Good, 2013) Thus, the authors chose to focus on the following three areas concerning the public and private SPs.

#### ***Shift in the model***

This section provides an overview of the current situation in the social Service Provider sector and the shift from private to public SPs that has already started in the healthcare area. The fact that such a shift has already been initiated and is in progress is important and worthwhile to consider when investigating country's readiness for a SIB, hence, the authors investigate who were the initiators of the shift, what were the concerns from the government's perspective as well as include a short overview of the current Public and Private SP model.

#### ***Environment for NGOs***

The Finance for Good article (2013), among other things essential for private SP capability, emphasize the communication and cooperation with the government capabilities' necessity. The private SPs have to keep the same or better cooperation level than the subordinate public ones maintain. Therefore, the authors of this thesis chose to analyse the NGO cooperation with the public sector environment from the NGO perspective.

#### ***Comparison***

Finally, the subsection is concluded with comparison of the public and private service providers on the basis of innovation, efficiency and capacity, motivators (aims) and the existing cooperation with investors.

### **3.3.2. Impact potential and measurable outcome**

At the core of the critique for SIBs one of the arguments is that the impact when addressing some social problem can rarely be reliably quantifiable, which implies that for a specific Social Impact Bond to work, the impact measurement has to be clearly defined, reliably measured and the parties have to agree on its propriety. (McHugh, et al, Finance for Good) This also requires a well-defined target group at the centre of attention of the social issue. The impact potential part is concerned with whether the outcome affects a sufficiently large number of people, thus the impact would be noticed and realized by various parties. In the article *Social Impact Bonds: Lessons Learned So Far* the authors especially emphasize the importance of the potential of impact element. According to the article, the SIB framework requires sustained attention of the officials over the mechanism's time frame and simultaneously there are other crucial demands for the time and attention of these top officials within the country, state or the city that has undertaken the SIB. Thus, the SIB has to possess either a large scale of the impact at the very beginning, has to have a realistic embedded option to be expanded to larger scales in the latter stages, or should play a part in a larger initiative and have positive spill-over effects onto the other parts to be worth undertaking. (Azemati, et al., 2014) Even though it is not possible for the authors of this thesis to go into such depths regarding specific social issues due to a more general nature of the approach chosen, it is still worthy to touch upon these aspects from a broader perspective. The data obtained for this subsection was primarily from the interviews with various stakeholders.

#### ***Measurable outcome***

The authors deliver insights of how the current social project measurements are taking place from the government's perspective, identify the forms of potential measurement, investor and public sector attitudes when it comes to trust in the measurements. These results bring value to the paper by investigating the current development level of the measurement issue as well as providing basis for hypothesizing whether there is a possibility that a mechanism heavily based on the measurement metrics (like the SIB) might be accepted in Latvia.

## **4. Sample description**

### **4.1. Experts from the NGO sector**

The authors started data collection by approaching experts, coming from the NGO sector, that have extensive past experience regarding social innovation implementation, such as, the concept of social entrepreneurship, by closely working on it together with either the public or the private sector to achieve more successful and efficient innovation introduction. Out of these interviews, the authors wanted to (1) get prior insights of the individual interviewee's past experience cooperating with either private or public sector that would give the authors overview and understanding of the cooperation model and experience that helped for research construction as well as further interview construction (2) identify individuals from the public and private sector that are working or have worked with innovative models that would represent the opinion of the true decision makers in the respective areas.

Therefore, the authors approached an advisor from the Latvian Association of local and regional governments, who has been involved in social entrepreneurship development in Latvia and has played a supportive role in other innovative activities. The interview gave insights on the cooperation with the public sector, as well as gave the idea of SIB implementation on a regional level. The authors also approached experts from foundation „Dots“(previously „Soros Foundation“) and Business Development Foundation. The organizations have previous experience with public sector and could comment on the Political Will's innovation acceptance as well as have a clear understanding of the existing investors and funds available in the region. Moreover some of the interviewees could also provide insights in SP capabilities in Latvia. To get a better comparison and insights of international experience, project manager from Social Finance (the creator organization of SIB concept) was approached.

### **4.2. Investors**

By contacting investors the authors aimed to identify investor attitude towards opportunity of social investments, attitude towards entering a partnership with the government and test the current state of other factors that have to be present for a SIB mechanism to be implemented. The authors started by interviewing the manager of Latvia of an international bank operating in Latvia as a small/medium size bank. The specific bank was chosen following the authors' knowledge about the bank's investment strategies (supporting



social projects while avoiding reputational gain from the activities) gained from previously carried out researches. According to SIB literature, companies that heavily invest in CSR activates by supporting social projects can be considered as potential SIB investors. Further on, after performing market research of companies operating in Latvia that most actively participate in programs with social causes, the authors identified additional two interviewees – a Latvian manufacturing company and an international bank operating locally. To get valid interview results the interviews were held with company representatives responsible for social projects the companies invest in.

### ***4.3. Political will participants***

By holding interviews with Political Will decision makers, the authors set to investigate and understand the attitude towards SIB mechanism. The authors held 2 interviews with people from the public sector that are currently working on social entrepreneurship pilot project creation and social policy development.

To understand the State's attitude towards the mechanism from the financial perspective, interview was held with the State Treasury representatives. Approaching State Treasury was also suggested by Anonymous 5.

Additionally, a member of Saeima (the Parliament); previous minister of Welfare was interviewed. From this interview authors could retrieve not only understanding of country's strategy in Welfare development and legislation creation but also strong insight of the political environment as such.

Following the suggestion by the expert from the Latvian Association of local and regional governments, one of the biggest City Council Welfare department deputy director and the head of Employment department were interviewed to get insights of having SIB on a regional level.

### ***4.4. Service providers***

To test the service provide capabilities and identify the topical problems in Latvia that should be addressed as well as understand the existing cooperation model with the government both private and public service providers were approached. The authors faced limitations regarding increasing the interviewed service provider sample as several other interviewees declined or ignored the authors' request for meeting due to limited time

resources and suspicion towards social innovative models. However, authors managed to arrange an interview with the director of one of the largest NGO – SP in the country that not only could comment on the relationship with the government but also provide authors with an overview of the private sector providers and identify the existing problems in the system. Moreover, the authors held an interview with the director of a Public SP to get insights of the current social issue addressing models from SP perspective.

## 5. Discussion of results

### 5.1. Political Will

The section focuses on analysing the SIB applicability from the Political Will's perspective. The authors look in to the overall existing situation followed by innovation acceptance by the public sector including overview of the on-going social entrepreneurship activities. It is followed by giving insights of the PPP experience and commenting on the most preferable fund attraction means. Additionally, authors investigate SIB applicability on a regional level.

#### 5.1.1. Overview in Latvia

Among aspects of political will that could have the power to affect the Social Impact Bond implementation in Latvia, and were raised during the interviews with the political will pillar representatives, is the fact that the social care focus is rather limited and many urgent social problems are already demanding immediate attention from the governmental sector. (Anonymous 6, March 27, 2015) The Welfare ministry's resources both time wise, in terms of human resources as well as in financial terms cannot primarily be focused on the long term sustainability which is not in favour of Social Impact Bond implementation likelihood.

Unstable governmental position could pose a potential threat for the SIB implementation which could in turn be caused by a change of authorities. However, it was commented by the parliament representative that this risk is not so much present anymore. In the past, that could have been the factor though now it should not be an obstacle. 10 years ago in Latvia there were clear interest groups with 3 big players. Currently there are not as strong individuals and the overall political environment is more stable.

Overall, from the interviews (Parliament, WM) the authors conclude that the political environment is moving in the more socially responsible direction and will eventually be more welcoming to such social innovations. In the current system, the companies that perform large scale investments in fixed assets (starting from 3 million LVL) that are afterwards used for operational activities receive tax benefits for a certain amount of time. (Ekonomikas Ministrija, 2014) However, this does not hold for large scale social investments. This is viewed as lack of consistency in the model, a gap that simply was not thought through. There are plans for it to be corrected from the legal perspective in the upcoming time. (Anonymous 6, March 27, 2015) The authors can say that introduction of such tax benefits would support attraction of private investment in the social sector.

### **5.1.2. Innovation acceptance**

The basic rule of economics tells us “Once there is demand, there will be supply”. As the economy develops, the private market players have become more educated, and have demanded changes in the state system, to which the state is trying to respond. However, there are several drawbacks in the current processes that prevent the supply from keeping up with the need for changes.

Overall all ministries support new ideas, however, quite often the public sector lacks consistent structure of who should take the responsibility and to some extent the ministries and departments avoid taking direct responsibility. (Anonymous 3, March 6, 2015) One of the problems arising from the issue is postponing the project consideration. To some extent the private sector participants feel that the government is using the postponing tool to avoid interaction. The support is received on a theoretical level, however, it lacks action that would support the initiatives also on a practical level. All of this combined creates a slowly developing environment – with lots of procedures and approvals needed. However, one of the perceptions from the government perspective is that introduction of new models to some extent is “playing” with tax payers money as the government cannot be completely sure that the launch of the project will be successful. Moreover, this is a sensitive question in Latvia where the resources overall are limited. (Anonymous 7, 30 March, 2015)

However, there are several key points that could strongly motivate the innovation consideration on state level. One of them is the example of international experience of what results the same initiative have brought in foreign countries. The other tool is trial of a pilot project as the initial action towards implementation. Though an expert from a local NGO admits that also getting pilot project acceptance is quite hard, time consuming and for the private sector always a fear exists that the idea could be cut at any moment by the government. (Anonymous 4, March 6, 2015)

### **5.1.3. Social entrepreneurship**

According to research carried out by Providus, the estimated number of social enterprises in Latvia is up to 100. (Lešinska, 2015) As examples of social entrepreneurship in Latvia can be mentioned fashion company MAMMU that cooperates with young mothers in Latvia targeting the mother inability to fully participate in the labour market (MAMMU, 2014) or Lude that employs retired people and creates design rugs (Lude, 2014) However, there is not a legal supportive ground for social entrepreneurship created in Latvia so far. In October 30<sup>th</sup>, 2014 the Cabinet of Ministers in Latvia approved the start of development of

“Social entrepreneurship introduction possibility in Latvia”. (Cabinet of Ministers, 2014) Currently Social entrepreneurship concept is only being developed in Latvia under the responsibility of labour policy department of Ministry of Welfare. The first step towards the concepts’ introduction is creation of a pilot project which still is to be finalized. The pilot project in cooperation with Altum is expected to start in 2016. (Anonymous 7, 30 March, 2015) The second step will be the analysis of the pilot projects’ success. If the results satisfy the governments’ expectations, respective modification in the jurisdiction will be created and the concept will be implemented. From the interviews (Public SP, WM, Parliament) it can be concluded that pilot project is an acceptable and to some extent tried out tool for introducing innovative models.

#### **5.1.4. Public-Private partnership**

From the past experience, the government has suspicion regarding entering a contract with the private sector player. The overall perception is that the private sector is profit-seeking and initiation of social benefit seeking is unusual, therefore considered with caution. (Anonymous 3, March 6, 2015) In the government representatives’ eyes PPPs are complicated mechanisms and they have to be complex to achieve value for money. Moreover, the benefits for the State have not been truly discovered, and looking at the past cases, the deals have been more in favour for the private sector. (Anonymous 8, April 1, 2015) In Latvia there are previous examples of PPP in the areas of transportation, construction and others. (Baltic Institute of Social Sciences, 2010) However, the authors can conclude that none of the projects are with an aim to support social/health care sector. Representative of the Parliament believes that in the upcoming years there will be such contract established and the industry is moving towards it.

#### **5.1.5. Fund attraction means**

The members of State Treasury shared their opinion of SIB as a tool of attracting financing for the social projects, however displayed more preference towards the plain vanilla instruments (Bonds, T-bills) as a means to attract investors. The reasons will be discussed in the following paragraphs.

Plain vanilla instruments are clearly understandable to the investors. Moreover, they are comparable to bonds issued by other countries as well as they are liquid. As a consequence, for the regular bonds the investors from the very beginning can evaluate the underlying risks due to previous knowledge and due to international comparable data availability.

In comparison to bonds, SIB mechanism is more complex. Firstly, it would cause problems attracting investors as more explanation is needed regarding the structure, benefits and risks regarding the concept. Secondly, from the governments' perspective the complicated mechanisms are more expensive and with a SIB model introduction (especially if it is performed on a smaller scale) it is not clear if the benefits of having such mechanism would compensate for the initial costs of creating it. Therefore if possible they would preferably avoid participation in complicated set-ups. Thirdly, the current project management is more efficient and from the operational perspective a SIB would require a shift from the “managing one pool of assets” to “managing every project individually”. (Anonymous 10, April 1, 2015)

### **5.1.6. SIB specifications**

#### ***Lower level of political will participation***

A senior advisor at Latvian Association of Local and Regional Governments, shared the opinion that it might be hard to get acceptance of SIB on a national level, however, that a SIB contract with a municipality could be considered. This is due to municipalities usually being closer to the people that they are representing and thus more open for discussion regarding changes. (Anonymous 1, 27 February, 2015) This interview lead the authors to a consideration whether the SIB could be created with an aim to operate within the municipalities' region where the representative of the public sector is the municipality.

Every individual municipality operates within the framework of their budget. The regulation states that the total debt level that the municipality can undertake is 20% of the total budget. If the municipality fails to operate within the limit, it is overtaken by the Regional Development Agency. (Anonymous 8, April 1, 2015) Due to this rule two crucial limitations arise regarding municipality participation in a SIB deal. First, due to the limit the municipalities fear undertaking any project in a form of debt. The second being that even if the individual municipality can afford leveraging up it has to receive an approval from the ministry of Finance. However, as the experience of Local city council shows, they are quite negative towards increasing debt level.

Overall the municipalities do not have complete freedom to manage their budget. If the individual municipality is strongly in favour of undertaking the project, the best they could do to increase chances of receiving support from the government is to make their suggestions – economic and social calculations, analysis of the benefits. This procedure is very strict when

it comes to PPP, however, if the project does not come from the financial accounting perspective in the form of debt, the municipality can operate more freely. Moreover, if the government sees the project as PPP, the municipality needs to follow PPP legislation that includes market analysis, a lot of evaluations, preparations and documentation. Overall PPP projects are viewed as expensive and time consuming. However, at the same time Local City council's attitude was welcoming – they understand that private SPs could ensure more efficient services and are open towards partly shifting the health care and social care responsibilities to the private sector participants. To achieve this efficiency, however, a substantial amount of investment is required. Unfortunately, not always the municipality has the capability to attract the funds individually, therefore a SIB mechanism would be beneficial to close the gap.

## **5.2. Investor pillar**

The following section is aimed at investigating the extent to which a Social Impact Bond mechanism could attract initial investment from the private sector in Latvia. The authors first turn to the international experience for an overview of the investor-related aspects that are common for SIBs to give the reader a grasp of what needs to be present for it to work. The section then turns to secondary data and interview result analysis to see whether the social investment sector in Latvia is of sufficiently developed level and what the gaps that need to be closed are in order to be ready for the underlying SIB framework to work.

### **5.2.1. International SIB cases**

#### ***Returns and investment scale***

Initial contribution from the investors for the Social and Development Impact Bonds in the development and implementation stages historically has been in the range of 1.4 to 35 million U.S. dollars. The upper bound are the social investments being put together in the developing countries, like Mozambique, Pakistan, Uganda and others where the amount of money raised has to be sufficient to address especially ornery problems. The principal raised for the SIBs in already the implementation stage ranges from 6.4 to 18 million U.S. dollars (Instiglio, 2015) However, the initial contribution depends on the needed actual amount to solve the chosen issue, therefore the scale is flexible and can be scaled down to fit the social investment levels in the respective economy. It should be noted though, that the international experience suggests smaller SIB scale usually implying smaller returns for investors. (Anonymous 15, 23 April, 2015)

The return on a Social Impact Bond varies greatly depending on the location where the SIB is implemented, the involved parties, the underlying social issue and the case-by-case circumstances. (OECD, 2015) However, there has been a great deal of discussion on the appropriate range of the return for social impact investing. (WGAA, 2014) The OECD suggests the upper and lower bounds for the expected social investment returns in their paper *Social Impact Investment: Building the Evidence Base*. (2015) The lower bound is characterised by donations that imply that the contributed money is not returned to the investors, and that by definition cannot be regarded as investments. The upper part is capped by the risk-adjusted market rate of return as investments characterized as having such a high or higher return could not be differentiated from the mainstream profit-oriented investment opportunities. The OECD paper authors note that in some cases the return of social impact investments exceed the MRR benchmark. However, the key idea of social impact investing is



contributing to a social cause. Thus, such a high return should not be incorporated in the investor expectations as else way it would violate the essence of social impact investing. Table 1 presented below provides a summary of eligibility attributes for Risk Adjusted Return Expectation used in the paper by OECD. The interview with a representative of Social Finance UK, revealed that most commonly the total return investors receive when it comes to Social Finance UK projects has been in the range of 6 to 8 percent. (Anonymous 15, 23 April, 2015) In the potential SIB investor research carried out in Canada prior to the introduction of this mechanism, the surveys revealed that most of the respondents characterised as potential Canadian SIB investors expected return in the range of 5 to 10 percent, and a close runner-up being 10 to 15 percent range. (Deloitte and Mars Centre for Impact Investing, 2014)

CHARACTERISTICS	Attributes of the Characteristic	Eligibility*
Return expectation	Grants	OUT
	Return of Capital	IN
	Profit =< market RR	IN
	Profit > market RR	OUT

Table 1 Eligibility attributes for Risk Adjusted Return Expectation. Table created by OECD. (OECD, 2015)

### ***Investor profile***

On an international level the following investors have joined the SIB mechanism so far:

- Goldman Sachs
- Bloomberg Philanthropies
- Bank of America Merrill Lynch
- Robin Hood Foundation
- Rockefeller Foundation (Pay For Success, 2014)
- Fair Chance Fund
- Help for Single Homeless fund (Civil Society, 2014)

Concluding the current SIB participant list from the international experience the biggest investor groups that can be identified are investment banks, philanthropic investors and foundations. Researches focusing on investor profile in other countries showed that the features of a SIB that attract the investor interest most and create positive associations were: the possibility of social contribution, effectiveness and innovativeness of the approach, shift from remediation to preventative programs, financial return, and the underlying form of partnership (presented in a descending order). The international investors were open for consideration of a wide variety of social issues as potential target for a SIB. The biggest threats and concerns coming from the investor perspective included the rather young age of the investment mechanism itself, and thus a perception of lack of concept's development, impact measurement difficulties, regulation issues as well as transaction costs. (Deloitte and Mars Centre for Impact Investing, 2014) What could be mentioned about previous investors

in SIB overall is that they come from countries with sufficiently developed social investment sectors (Anonymous 15, 23 April, 2015), which, given that Latvia does not fall into this category, suggests a potential obstacle for fund attraction for a SIB in Latvia.

### **5.2.2. Social investment overview in Latvia**

In 2011 the total amount donated for social benefit organizations was 35,9 million LVL out of which 24 million LVL was donated by private companies and 2,6 million by individuals. The Social benefit organizations that received the biggest donations were – “Latvijas Pašvaldību Savienība”, “Latvijas Olimpiskā komiteja”, “Fonds “Ziedot””, “SOS bērnu ciemati”. (VID, 2013) In the same year the top 5 donators to invest in CSR activities were the following – Latvijas Valsts Meži, Latvenergo, Latvijas Dzelzceļš, Rīgas Siltums, Latvijas Hipotēku un Zemes banka. (Delfi, 2011) A conclusion can be drawn that the majority of investors that are investing through CSR activities are state owned enterprises. However, SOEs would not have a rationale to enter a contract with the government (with the potential to receive a return from it) which is an obstacle that limits the amount of potential investors for a SIB mechanism even more. The takeaway that the pool of investors is limited when it comes to social investments/donations was also supported by the interview results. (Anonymous 3, March 6, 2015) Yet private sector market players that care about the welfare and social development in the country, are constantly seeking for new opportunities, more innovative and result achieving projects, and are open to consider various proposals are also present. Moreover, for these institutions/companies available funds for future activities are expected to increase. (Anonymous 16, April 27, 2015)

### ***Changing economic situation***

In the pre-crisis period the profits one could receive from the real estate market were insanely big. In no other place in Europe one could have experienced the same financial performance. The returns could have been compared to the returns of operating in the market of illegal activities. (Anonymous 6, March 27, 2015)

However, currently almost all of the potential areas where investors could retrieve fast and large return are exploited. Therefore, the perception of what adequate profit ratios are will have to change. Currently health care and social care are not seen as potentially holding opportunities for profitable business, however, in reality they can bring stable long term income. (Anonymous 6, March 27, 2015) Additionally, the representative of the parliament provided an argument supporting her opinion that socially responsible investment tendencies

should change in the favourable direction by pointing out that Latvia is facing an aging population issue. It has to be taken into account that in a few years this problem will already have economic and financial implications on the pension system and consumption structure in turn affecting institutional investors, such as private companies, directly. It will be realized by these investors, and that could be a factor encouraging social investing from their side. (Anonymous 6, March 27, 2015)

### **5.2.3. SIB specifics**

#### ***Appropriate return***

The interviews with potential social impact investors in Latvia revealed that even though such a mechanism would still be primarily viewed as a social contribution vehicle, the average Latvian investor might consider the financial return feature as a great motivator. It was described by the investors as a “package deal” offering actual return in the current environment of remarkably low returns on government bonds, and suggested that it most likely will be viewed, by at least some investors, as a “business opportunity”. The latter has several implications. (Anonymous 5, March 6, 2015) Firstly, it implies that the return specification would be an important determinant of the amount of funds this mechanism has the potential to attract in Latvia. Secondly, it informs that calculating and presenting exact return a particular SIB would offer is required in order to tell the specific number of investors and, consequently, identify them.

The interviewing process also lead to various parties commenting on what, to their mind, would be an appropriate return for a social impact investment in Latvia. An expert from the NGO sector, who has extensive experience with social entrepreneurship and social innovations in Latvia, expressed the view that even though there is a perception that a social return should be equal to 0 percent, there is an apparent gap in the number of socially minded investors in Latvia already. Based on her experience, the interviewee believes that introducing a return aspect could help change people’s perception that the social contribution can only be “giving money away” and motivate more people to get involved. (Anonymous 3, March 6, 2015) However, the mentioned interviewee as well as multiple others pointed out their concern that the return should not be too impressive either. According to a representative of the Welfare Ministry, too big of a return might not be understood by the investors and could even be an obstacle to attracting investment – given the Latvian mentality it would most likely be associated with unreliability, shady deals and schemes. A research by

Tālis Putniņš and Arnis Sauka (2011) identifies high level of shadow economy in the country (38,1% of GDP) which is almost twice the amount comparing to other Baltic countries, as well as level of bribes is extensive. Thus such associations are not uncommon and could be said not to be surprising. As a benchmark for the upper bound the interviewee mentioned below 15 percent, and emphasized that what, to her mind, investors would be looking for in this and would be attracted to is a return that is not big but rather stable in the longer term. The investors backed up the point about the size of the return by commenting that in order to attract attention of a broader audience though still not cause suspicion and caution, it should be somewhere in between the Latvian government bond yields and the yield offered in the equity markets. (Anonymous 5, March 6, 2015) It is in line with the financial economics concepts emphasizing the risk signalling feature of high returns. Moreover, the investor comments and takeaways are consistent with the suggestions brought forward by the OECD. (OECD, 2015) From these observations combined with the return presence to a great extent increasing the probability of attracting Latvian investors the authors conclude that the most appropriate return for a Social Impact Bond in Latvia would be above the long term government bond yields and the equity market return.

### ***Issue alignment importance***

In the paper *Assessing the opportunity to improve social outcomes through the use of social impact bonds* (Finance for Good, 2013) it is emphasized that an attempt to attract funding through a Social Impact Bond mechanism has to be supported by targeting an appropriate social issue. In the light of investor perspective that implies being in tact with investor interest. Such a necessity arises due to the majority of investors being more philanthropically driven rather than solely weighting this investment opportunity based on risk-return relationship. The authors investigate the social issue alignment importance in Latvia by looking at the insights obtained in the interviews with potential investors and experts that have experience in cooperation with them.

From the interview results the authors conclude that the choice of the specific social issue might have a slightly smaller impact on the investor attraction aspect than it usually does, as in Latvia the return on a social investment is a new concept and it could function as a counterweight for some investors if the issue of choice is not perfectly aligned with their primary interests.

However, the alignment of the issue with the investors' interest is still an essential point. The specific interests of institutional investors depend largely on their internal values

and restrictions, regulations within the institution when it comes to social investments. (Anonymous 12, April 1, 2015) Nevertheless, the interview results suggest that there are certain things to be considered here that play a role on a more macroeconomic level. The authors conclude that a reputational consideration is strongly present among the investors in Latvia. It was uncovered during the interviews that one of the reasons why at least some companies contribute to social causes is to improve the company's reputation, even if that does not play the central role, it has weight in the decision making process, and, consequently, would have several implications on a SIB introduction in Latvia. Firstly, it could be hypothesized that it is not the most acute issues that stand the chance of attracting sufficient investment, but rather the ones that are at the centre of attention in the society. Further on, the first statement combined with the interview insights about the Latvian mentality allow to narrow the range of social issues that are most likely to be funded even more. The interview with the head of a public SP, brought the authors' attention to the fact that there are certain inveterate perceptions in the society, investors not being an exception, that some of the social causes are more noble to contribute to, such as supporting children, and thus, having the potential to raise the contributor's reputation more effectively. In the investor context, this informs that the issue alignment with the society's view should also be considered as choosing a controversial issue to address at this stage in Latvia could cause struggles to attract financing. This point was also supported by the head of another public SP, who has experience with both attracting investors and tackling various social issues, and said that it has to be taken into account that a lot of time has to pass until the society is ready to really accept some of the social issues, like mentally disabled people integration in the society, and be tolerant towards it not only on a theoretical but also on a practical level. For investors that implies that sometimes supporting such issues might mean that they will be held responsible for bringing this issue closer to the society that would otherwise stay ignorant in this aspect. (Anonymous 13, April 7, 2015)

Although the reputational importance seems to be supported by many interviewees, it has to be noted that it is not the case for all of the potential investors. There are still companies in Latvia that donate or in some other way contribute to social causes without publicly announcing it. (Anonymous 5, March 6, 2015) For them, as it was pointed out during interviews, the question of reputation would not be a determinant of which problem to contribute to. Rather it would then be determined by either the actual sensitivity and topicality of the issue, alignment with internal interests, the return profile or, most likely, a certain mix of these.

### ***Openness to innovations and unfamiliar setups***

A Social Impact Bond usually takes a complex setup and a form that is not present in Latvia. This implies that certain willingness to engage in unfamiliar and innovative projects and arrangement has to be displayed by the government and the potential investors as well as, to a lesser extent, service providers. In order to explore whether such openness is present among the potential investors the authors addressed this question during the conducted interviews.

The takeaway from the interviews is that from the investor point of view the innovativeness of mechanisms is not a crucial obstacle. It might not come as a surprise as it is a common view that businesses have to be open and even innovation seeking in order to stay competitive in the market. Some investors have also displayed an opinion that for many companies this mechanism, while being of a different nature, would still not be the most complex setup they have dealt with. (Anonymous 12, April 1, 2015) However, when talking about attracting attention to unfamiliar investments, as a SIB is, it is at the same time essential that the investors get gradually introduced and familiarized with the concept, structure, the underlying processes and risks to be willing to invest in it. It is also important to note that for investors it matters that not only they fully understand the mechanism but also all other involved parties. (Anonymous 5, March 6, 2015)

### ***Cooperation with the government***

An important issue that could pose a threat to the implementation of a Social Impact Bond if not present is investor willingness to engage in a deal with the government. A SIB is in essence a financial contract between the two parties which requires a close cooperation over the contract's lifetime. Since in Latvia the topic of corruption and schemes is still vivid and receives a lot of attention, the authors investigate whether this issue could pose a threat for investor participation during the interviews.

Even if the perceptions about high level of corruption are stagnated and outdated to some extent, not reflecting the actual nowadays situation, solely the perceptions themselves can be an obstacle for a SIB implementation as in the end they are what determines the willingness to participate in contracts as such. According to the representative of the Parliament (March 27, 2015) Public-Private partnerships in general in Latvia can to a great extent be said to have a negative reputation when it comes to the level of transparency and integrity due to questionable experience in the past. The previous Welfare minister, pointed out that some of the most vigorous examples come from the financial crisis period of 2007-

2008. It is apparent that the corruption risk and the fear of corruption could pose a serious threat to more complex mechanisms, as it comes from both of the parties central to this agreement and it damages the trust in the counterparty's intentions and fair conduct.

(Anonymous 1, 27 February, 2015) On the societal level this problem, however, cannot be changed very easily, quickly, there is no clear way how to do it. It requires time in combination with continuous effort from the government in the form of programmes addressing the ingrained views that "PPP is only about stealing". (Anonymous 6, March 27, 2015)

The interviewees from the investor side have also pointed out the doubts surrounding the possibility to enter a public-private partnership. However, in addition to that several other points were raised. Firstly, it should be noted that investors displayed interest in rational solutions to that. For instance, it was noted that the possibility for the investors to supervise the process could be a significant means of addressing this issue, such as involving investor representatives into the activities of the intermediary that organizes and supervises the process. (Anonymous 5, March 6, 2015) Moreover, the framework of the SIB usually also involves independent parties, the sole purpose of which is to supervise the entire process and ensure its quality and fairness, which could work as a sufficient guarantee for the investors. (Centre for Social Impact Bonds, 2013)

Another viewpoint of investors that should be noted is that this particular setup is not so much about the trust in the government but rather belief in the service provider capability and fairness as it is them that are directly trusted with the capital and whose effectiveness essentially determines the investors' return. (Anonymous 12, April 1, 2015) Thus, the chosen supervisory body has to also have the capability to reach the preventative programme implementation level of the SIB framework and ensure that investors' money is being put into the best use. Regarding the trust in the government, the mechanism can once again be considered to simply be a financial agreement between the investors and the government as a promise to repay the principal and the promised return. If simplified this way, it would imply that it all comes down to investors' belief in the government's ability to repay the promised money, which is at the core of regular government bonds, and as it can be seen from the report by the State Treasury of Latvia there is demand in the bond market. (Valsts Kase, 2014)

#### **5.2.4. Investor feedback about SIB setup**

Some of the interviewees were presented with an explanation of the Social Impact Bond mechanism specifics. Apart from the above presented points there were other issues raised and feedback given by the investors that are worthwhile to consider.

The investors have expressed their opinion on what they think government's standpoint should be towards this setup. The consensus in the opinion was reached, namely emphasizing that logically the government should display interest in the SIB as it is an alternative means for addressing social issues which is addressed either way, and if put in a very primitive way it simply offers them avoiding paying for failure. However, investors seemed to think that it is not that much about the government being able to see the benefits of the mechanism but that it rather comes down to them being open to innovation and change. (Anonymous 12, April 1, 2015) The openness to innovative and creative solutions would in turn signal to the society that the government really cares about the society and is searching for more efficient ways to solve existing problems. (Anonymous 5, March 6, 2015)

Several takeaways could also be highlighted when it comes to the exact SIB features formulation and the form in which they should be presented so as to appeal most to the investors. Firstly, in addition to knowing the exact return on their investment, the investor representatives also pointed out that in order to conclude whether they would be considering such an investment they would pay most attention to other calculations like efficiency of service providers, their capability assessment. International experience, success rates and outcomes turned out to be of secondary importance within this pillar as it seems that people are sceptic about the result transferability due to apparent economic development differences between the countries where the SIB has already been implemented and Latvia.

Just like the governmental sector representatives, the investors have commented on the appeal and benefits of a gradual introduction and implementation of projects that have a somewhat comparable profile to a SIB. The authors can, hence, draw conclusions that a pilot project would be accepted by both sides and might help the concept gain trust and familiarity.

#### **5.2.5. Potential investor groups discussion**

##### ***CSR companies***

Companies heavily working on their CSR activities can be considered as one of the potential investor groups. The private investors revealed that there are often restrictions within the companies' CSR policies stating that whenever the activity aims at increasing the company's reputation, it cannot be viewed as CSR but rather as a promotional activity.



(Anonymous 12, April 1, 2015) If this applies to a sufficient number of socially responsible companies, that would imply that attracting CSR companies as investors for a SIB could solve the reputational problem pointed out by the investors.

For the majority of the private companies the CSR projects are created both by an internal and external initiative. However, each of the projects has to be approved by the board of directors. A key point for the activity is to have the same mission and values as determined by the company. However, in reality the company identified CSR interest areas are quite wide and a lot of projects can be tied under the core idea. (Anonymous 12 and Anonymous 16)

### ***Investment Banks***

Latvia due to its financial market limitation could not follow the international experience and attract major investment banks as investor sector participants for the SIB mechanism. In fact, there are quite few possible investment banks that could be considered in Latvia – the role could be filled by banks operating on local level through their risk management projects.

### ***Foundations/Funds***

There are several foundations that could potentially be interested in such investment – “Vītoli fonds”, “Oak funds” and others. However, their previous donations have not exceeded 0,5 mil. EUR limit, thus considering such investors would support the necessity to attract a pool of investors.

### ***Others***

Foreign NGOs, investment banks and private companies could be a potential target group. However, from the experience of LSA it can be concluded that attraction of foreign financing is time consuming. (Anonymous 13, April 7, 2015)

Overall, the authors can conclude that even though there are some potential investors in Latvia, the investment size that they have the capacity to undertake would be on a smaller scale than the average one on the international level. Moreover, most probably a pool of investors would need to be created to attract the full financial amount needed.

### **5.3. Service Provider Pillar**

#### **5.3.1. Public versus Private Service providers**

##### ***Shift in the model***

In USSR regime all social/health care sector was operated by the public sector. After regaining independence in the early 1990s NGO Latvijas Samariešu Apvienība initiated a shift to private SPs. The very beginning was quite rough; following the leftover ideology the government stakeholders could not understand why one would even suggest such shift.

(Anonymous 13, April 7, 2015)

The shift took approximately 20 years and it was delayed due to the following factors:

- Public sector fear of the private SP ensured quality and how the model would function in the long term;
- Municipalities were used to the old system that let them feel safer as they held the power of the industry quality and they could perform close monitoring.

(Anonymous 13, April 7, 2015)

The authors can conclude that initially there were extensive trust issues from the state's perspective towards the capabilities of private service providers, however, now the trust issues are gradually being resolved and the cooperation has become more open when it comes to social and health care.

Riga and Ventspils municipalities have the most extensive service provider outsourcing from the private sector. (Anonymous 13, April 7, 2015) And the cooperation takes place in several forms – ministries and private sector, municipalities and private sectors, state agency and private sector, municipality together with state agency and private sector. (Anonymous 2, 3 March, 2015) Overall the state is operating by the method “money follows the individual” – where the patient has the opportunity to choose where to receive the treatment, in private or public institution. When making the cooperation with private sector institutions a negation is made that the state covers the patients' expenses to the extent they would in a public SP, the difference has to be covered by the individuals. (Anonymous 6, March 27, 2015) The authors conclude that the current move towards openness to private SPs signals that the government could be welcoming towards shifting the responsibility to private SPs which is a crucial part of SIB mechanism.

##### ***Environment for NGOs***

From the data gathered from the interviews with the Parliament, Ministry of Welfare and the biggest NGO in Latvia – LSA, the authors can conclude that the NGO in the current

system operates as a player between the private sector (investors) and the public sector (government, municipalities). NGOs individually identifies a problem and creates a solution for it and afterwards hold negotiations with the public sector trying to achieve the idea's implementation. The head of private SP says that they are creating the programme how to achieve the goal, they create the legal and administrative framework that is given to municipalities for them to even start considering the new approach. However, from his insights the authors conclude that the overall environment for NGOs is not stimulating because a lot of effort is required to achieve government's consideration for the chosen opportunity. Due to this a lot of NGOs are closed down or become inactive and only the biggest and strongest NGOs with an extremely strong will carry on their operations. (Anonymous 13, April 7, 2015)

### **5.3.2. Comparison**

#### ***Innovation perspective***

“Overall the function of NGOs is really interesting – they are created when the society understands that some problem is not solved or that there are efficiency issues” (Anonymous 13, April 7, 2015) Demand for the shift from Public SP to Private SP was initiated by NGOs, the social entrepreneurship concept is initiated by both – NGOs and entrepreneurs. These are few examples that NGOs participate in achieving innovations in the whole operational system among the three players – private sector, private companies and NGOs.

Additionally in Latvia several NGOs have created innovative projects in social and health care not only on national but also international level. A great example is LSA project “Aprūpe mājās” where instead of taking people from sparsely populated areas and transporting them to regional care centres, the organization built a machine which operates a health care centre on wheels. This model is an innovation on an international level. (Anonymous 13, April 7, 2015)

Also private SPs that operate with a larger profit margin have the capability of innovation perspectives and are moving towards the philanthropic area. As an example can be mentioned the Centre of aesthetic surgery where besides cosmetic correction, facial surgeries and other plastic surgeries, people can also receive hand microsurgeries that are supported by state-funded programme. Here though, the authors have to highlight that it was achieved by performing a research of how much higher the government's expenses are (by taking sick

leaves, becoming disabled) if the problem is not taken care of at the initial stage.

(Anonymous 6, March 27, 2015)

The authors can conclude that private sector players are more innovation seeking which lead to more efficient outcomes achieved regarding the ensured services and outcome measurement methods. Private NGOs in Latvia have the capability and will to create new service that can outstand in the local as well as international market.

### ***Efficiency and capacity***

The question of efficiency is still an open-debate and the opinion differs from private to public sector. In 2005 Riga city council let LSA overtake the service of home care. In 2006 with the same financial resources LSA as a SP achieved two times better results – the number of people served. (Anonymous 13, April 7, 2015) However, at the same time it is not clear whether the introduction of private sector is the answer to the current model's gaps.

(Anonymous 6, March 27, 2015) Even though the shift to private SPs is complex, they can potentially ensure efficiency in the long term. (Anonymous 10, April 1, 2015)

One of the aspects on which private SPs overcome the public ones is continuity. Public SPs lack a united system in between each other so that if an individual is moved from one union to another he would receive continuous support. For example, a mother is living in the crisis centre for 3 months, during the time she is provided with public service, she establishes a future plan, etc. However, once she leaves the centre, the support is monitored by another institution. There is a gap in how one institution continues the work of the other. Due to this many people cannot fully integrate back in the society and experience relapse coming back to the crisis centre. (Anonymous 13, April 7, 2015)

Currently NGOs operate in the local level, LSA explained that they would have the operational capacity to provide the whole country with its services in certain areas – for example home care. However, the required investments to expand are quite substantial and as the investment attraction takes a long time, the expansion on national level would take several years.

### ***Result***

From various interviews with the NGO representatives the authors can conclude that in some occasions the determined aims from the government perspective are blurred and unidentified. Regarding the service providers and understanding how problems are solved in practice, a difference in underlying aims of public and private service providers can be

identified. For the government the key point is to ensure the service while for the NGOs it is important to actually achieve the set result. Ensuring the service is a part of achieving the result. As an example can be mentioned the operational strategy of private/public crisis centres. For public ones the aim is to ensure that everything is in order for the individuals to successfully live in the centre. While for the private crisis centres the aim is to achieve that people once leaving the centre are integrated back in the society. In Private centre “Māras centrs” 80% of the individuals return back to the society, the average ratio for public centres is only approximately 40%. (Anonymous 13, April 7, 2015)

Another key point is the debate of preventative versus rehabilitation programmes. The public SPs focus on rehabilitation rather than the prevention. (Anonymous 2, 3 March, 2015) The individual has to be diagnosed with a problem, he is grouped with others and then within the group the public SPs provide the service. These are the consequences of social regime and its effect on people’s line of thought. On one hand, social workers should be able to predict the accidents before-hand and work on preventative programme creation. On the other hand, the emphasis is not encouraged by the government. The current model is easier to operate with because the state has to work only with the problem once it has already happened. Moreover, technically it leaves a place for hope that the need for prevention could be avoided completely. However, within the mechanism of SIB an emphasis is put on the preventative step and in Latvia private SPs focus both on rehabilitation and prevention. According to the head of a private NGO SP in all areas there are NGOs that could operate in the preventative area.

From the interviews and gathered data the authors come to a conclusion that the majority of support (77%) from the state to the individuals come in the monetary form. (Appendix 2, table 2) Moreover, this is the highest ratio in Europe. If we look at this aspect on an international level, US, UK, Japan and Australia invest almost the same amount of support in form of cash as in the form of service. (OECD/European Union, 2014) Additionally, Latvia has one of the lowest ratios of health care spending as % of GDP. (Appendix 2, table 1). The existing WM budget distribution strategy has an additional drawback – from experience one of the SP pillar interviewees could comment that the money not always is used by the receiver personally but rather the individuals’ relatives and perceived as additional income.

### ***Cooperation with the investors***

The current cooperation model is based on the following means:

- Financial support
- Support by providing with goods
- Support by investor actively taking part in the target achievement

Attracting financing from the private sector for NGOs is time-consuming and a hard process. The NGOs themselves always need to initiate the cooperation. Also for the majority of the projects the form of cooperation NGOs achieve is only project based. (Anonymous 13, April 7, 2015) Moreover, a conclusion can be drawn that the companies, that invest most in social projects, are state owned enterprises as for them one of the missions is to give back to the society through CSR investments. (Anonymous 12, April 1, 2015) Once inviting the company to contribute to a social problem, there are several cases when the company internally creates a supportive project to the problem and that is their form of involvement. Also companies support the projects by providing with the company manufactured goods, for example chairs, repairmen tools etc.

NGOs in Latvia also attract financing from international partners – foundations and private companies. This is achieved through participation in international exhibitions, seminars and fairs. Though the support from bigger foundations is limited as Latvia has quite a strong NGO sector while other countries do not, therefore, the big foundations prefer to support the NGOs that are in a bigger need. For example, Samaritan International would rather support NGOs in Lithuania, Georgia and Ukraine where the organizations are still in the development stage. Also for these organizations LSA contributes donations in several forms. (Anonymous 13, April 7, 2015)

Municipalities also try to attract financing individually for social investments from the private sector, however, they have different means. However, if they cannot reach their target groups, the experience shows that they approach NGOs that could help them by attracting financing through their pool of contacts. An example of such cooperation model is the creation of night shelter in Ventspils, where the initial investments to build the shelter were attracted by LSA.

### **5.3.3. Problems**

#### ***Measuring outcome***

One of the key points for reaching a successful model is the ability to measure the impact. The measurement according to OECD (2014) can take one of the following forms:

- Qualitative (for example improving education availability);

- Quantitative (for example decreasing the number of people that increase drug addiction relapse after treatment);
- By the monetization of outcomes (for example adding an additional benefit for all of the treated individuals and society as a whole).

A key point for all results is to have impact measurement in order to understand the project and investment's actual social impact. (OECD/European Union , 2014)

From the interviews with Parliament and WM representatives the authors conclude that the current approach of how the state measures their activities' success lacks sustainability and efficiency. The used methods are taken from international experience, however, the previous Minister of Welfare admitted that it has been hard for their ministry to show the Ministry of Finance the calculations of economic and social benefits for projects.

(Anonymous 6, March 27, 2015)

As it is not a common approach to provide extensive after-project analysis due to lack of competence. (Anonymous 1, 27 February, 2015) Therefore, the numerical measurement system could be viewed with caution by all of the parties involved when it comes to SIB introduction.

As a conclusion, the authors can say that the calculation framework would need to be provided by the intermediary while taking into account that in-depth explanations are needed as the majority of involved parties would not be aware of such concept beforehand. By having clear explanation and argumentation, mutual acceptance of the measurement can be hoped to be achieved.

### ***Choice of the problem***

In Latvia people happily donate to certain society groups such as pensioners, small children. However, experience shows that the support is carried out until the kid reaches the age of 18. (Anonymous 13, April 7, 2015) Nevertheless, a bigger number of organizations and individuals that currently are contributing to addressing social issues related to pensioners and children could signal that these social problems might have a better chance of attracting sufficient investment in Latvia if chosen as the target for a SIB. Moreover, these are the fields which have been previously addressed by a SIB in other countries, thus, simplifying the challenge to define the measurability metrics and process as well as helping gain the trust of the involved parties.

Regarding choices of other problems, from the interviews held with SP, the authors can conclude that people are quite intolerant towards certain groups of the society that are in need

of help. For instance, disabled people and drug addicts are stigmatized with respect to support from the society. Inhabitants refuse to, for example, allow construction of stigmatized people care centres in the neighbourhood. (Anonymous 6, March 27, 2015) Thus, such problems might face difficulties in attracting investors as well as gaining society's acceptance if considered as a SIB target.

However, some of these stigmatized problems are especially acute in the context of Latvia. For instance, youth drug addiction - Estonia, Latvia, Greece and Lithuania are the countries with the highest number of HIV cases per million inhabitants and the overall number of cases since 2009 has increased in Latvia. At the same time Latvia stands out as one of the countries where individuals in a need of treatment from drug addiction do not receive it (only 5% is said to be rehabilitated). (EMCDDA, European Drug Report, 2014) In Latvia prevalence cannabis usage among the 15-16 year old group schoolchildren has increased from 16% (2003) to 24% (2011) and the increase is one of the highest of ESPAD countries. (EMCDDA, Country overview: Latvia, 2014) Currently the treatment is provided by both – public and private service participants, however, their capacity does not fulfil the demand. Such numbers suggest that an innovative and effective solution in such area would be especially beneficial, thus, it is important to already now take measures, for example, educative programs, that could address the negative perceptions in the society which might prevent such noble and urgent causes from attracting the funds that are needed to address it.



## 6. Limitations and Implications for further research

Due to limited time and resources available the work is facing several limitations that the authors see as potential directions for further research.

Firstly, the authors do not consider constraints for the SIB implementation from the legal perspective due to lack of knowledge in the area and the time-consuming nature of the option to perform a legal analysis. However, it was raised by several interviewees as a crucial point, thus, an implication for further research might be to research the legislation that has to be in place and the legislation changes that have had to take place in other countries to make the legal environment ready for the SIB.

Secondly, the authors of this work believe that this area of research in Latvia could be further improved by complementing the interviewee list. For instance, interviewees from the investors pillar included foundations and corporations investing in CSR, however, the interviewee list could be improved by adding more bank representatives, specifically people in such positions that could look at the SIB mechanism from a more extensive investment perspective. As another example it could be said that the work could be improved by adding more large corporations that operate on the international level and are also present in Latvia. As these companies are usually taking up some socially-minded initiatives as well as have the capability to operate with larger funds, it would be value-adding to find out what their attitude towards SIBs would be. Additionally, the authors were not able to arrange an interview with a direct representative of the Ministry of Finance that would give better insight of the government's perspective from the financial standpoint. The same limitations on the interviewee list can be mentioned when it comes to the Service Provider pillar – the authors faced a difficulty in arranging meetings with direct representatives of some of the NGOs that could be considered as potential SPs for a SIB. Thus, further developments of the work could provide interview list improvements in this field.

Lastly, as the aim of the work was to determine the overall SIB mechanism applicability rather than focus on an individual problem, the authors could not go into much detail when it comes to problem-specific aspects of the SIB. However, having the necessary means and resources it would be value-adding to also employ the latter approach as then exact economic and social benefit, efficiency improvement calculations could be provided, specific service providers, investors and measurement metrics could be identified as well as more precise investment amounts and returns could be proposed. Then the government attitude representation as well as recommendations could be more accurate and unique for each social issue.

## 7. Conclusions

Many countries have already set out to or are considering the possibility to achieve improved efficiency and outcomes in the social care sector through the use of a Social Impact Bond. The authors of this work aimed at exploring if the current conditions in Latvia are of sufficient readiness for such a mechanism to be considered as a realistic one as SIB benefits might be one of the options to address the existing lacks of efficiency and sustainability of social programs. By looking at three pillars, namely Political Will, Investors and Service Providers (last one also including the problem choice aspect), and following the brought forward research goals and methodology, the authors investigated the development level, identified the biggest threats and obstacles as well as the difficulty with which they could be addressed within each of the pillars.

From the political will perspective, it is concluded that at this stage there would be a sufficient level of resistance to engage in such an innovative social impact investment mechanism coming from the higher level of the public sector. The resistance is considered to be arising mainly from the lack of experience with public-private partnerships, the complexity inherent to them and from current priorities laying elsewhere. The situation, however, is changing and it is believed to be moving towards an environment that would be more welcoming for the SIBs. This shift can be expected to be slow as it requires, among other things, a change in mentality and views that are stagnated in the society. The change could be smoother and to some extent faster if supported with respective educational programs and possibly a pilot Social-Impact-Bond-like project. The idea that a Social Impact Bond could be implemented on a municipality level is partly rejected due to constraints on the municipality budget management.

As for the mechanism's ability to attract private investment in Latvia the authors conclude that it is possible but on a smaller scale in monetary terms than it is common for a SIB concept worldwide. This is mainly due to less socially aware investors present and a less developed social investment/contribution environment in general. However, there are still groups of institutional investors that could even at this point be potential investors in social impact bonds, namely companies that extensively invest for the CSR purposes, foundations and foreign NGOs. The initial contribution would still most likely come from a pool of investors. The return that is concluded to be most appropriate in the Latvian context is in between the governmental bond and equity market yields.

When it comes to the Service provider and problem pillar, the authors conclude that private sector SPs have the capacity to provide efficient supportive programmes both on preventative and rehabilitation levels, however, to achieve that and utilise this capability to the fullest a substantial investment would be required. In line with the SIB framework, the private SPs in Latvia rather focus on the result, while public SPs on ensuring the service. Speaking about the social issues aspect it was revealed that quite many social groups in the country are stigmatized; the state needs to work not only on their integration but also on the society's acceptance. Overall, regarding SIB applicability it can be said that Service Providers have the capability to ensure support on a national level. Even though still the majority of SPs are public, the interview insights and the concept "money follows the individual" prove that the political will towards collaboration with the private SPs when it comes specifically to healthcare is open for discussion and possible.

Overall, the attitude about the mechanism itself is controversial: slightly negative from the government's point of view due to perception of complexity, high expenses and difficulty in monitoring, whereas investors' attitude does not possess negativity on the same level. The crucial obstacles that prevent the mechanism from being considered as realistic in Latvia at this point are coming from the political sector. The investor and service provider parties could be summarized as also having several obstacles when it comes to SIB applicability in Latvia, but they are less meaningful and could be addressed or changed more easily. The authors have looked into and analysed Political Will, Investor and Service Provider aspects, have identified potential obstacles, their origins, severity and whether they could be overcome, hence, addressing the raised research question. The novelty of the topic combined with the fact that no such research has been carried out in Latvia contribute to the significance of the findings and make them relevant to the reader as this paper is a starting point for investigating the fit of one potential option that could address the existing difficulties in the social care sector.

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## Appendices

### Appendix 1. List of the interviewees

Profile	Company/ Organization	Interviewee	Position	Date of interview	Type of interview
NGO	Latvian Association of local and regional governments	Anonymous 1	Senior Advisor	27.02.2015.	Open-ended interview in person
Public SP	Public SP	Anonymous 2	Director	03.03.2015.	Open-ended interview in person
NGO	Foundation "Dots"	Anonymous 3	Project manager	06.03.2015.	Open-ended interview in person
NGO	Foundation targeting business development	Anonymous 4	Project manager	06.03.2015.	Open-ended interview over phone
Investor	International bank	Anonymous 5	Manager of Latvia	06.03.2015.	Open-ended interview in person
Political will	Parliament	Anonymous 6	Deputy of Saeima, Minster of Welfare	27.03.2015.	Open-ended interview in person
Political will	Ministry of Welfare	Anonymous 7	Representative at labour market policy department	30.03.2015.	Open-ended interview in person
Political will	Local City Council Welfare Department	Anonymous 8	Deputy director	01.04.2015.	Open-ended interview in person
Political will	Local City Council Welfare Department	Anonymous 9	Head of Employment Department	01.04.2015.	Open-ended interview in person
Political will	State Treasury	Anonymous 10	Representative of Financial risk management department	01.04.2015.	Open-ended interview in person
Political will	State Treasury	Anonymous 11	Representative of Financial Resource Department	01.04.2015.	Open-ended interview in person
Investor	Latvian manufacturer actively participating in CSR activities	Anonymous 12	International Branding	01.04.2015.	Open-ended interview in person
NGO Service Provider	Private NGO/SP	Anonymous 13	Director	07.04.2015.	Open-ended interview in person
Political Will	Ministry of Welfare	Anonymous 14	Representative of Social Policy Planning and Development Department	20.04.2015.	Open-ended interview in person
NGO	Social Finance UK	Anonymous 15	Project manager	23.04.2015.	Open-ended interview over Skype
Investor	International bank	Anonymous 16	Public Affairs Manager	27.04.2015.	Open-ended interview in person



**Appendix 2.**

**Ministry of Welfare – Budget 2015, Health expenditure as share of GDP, 2012**

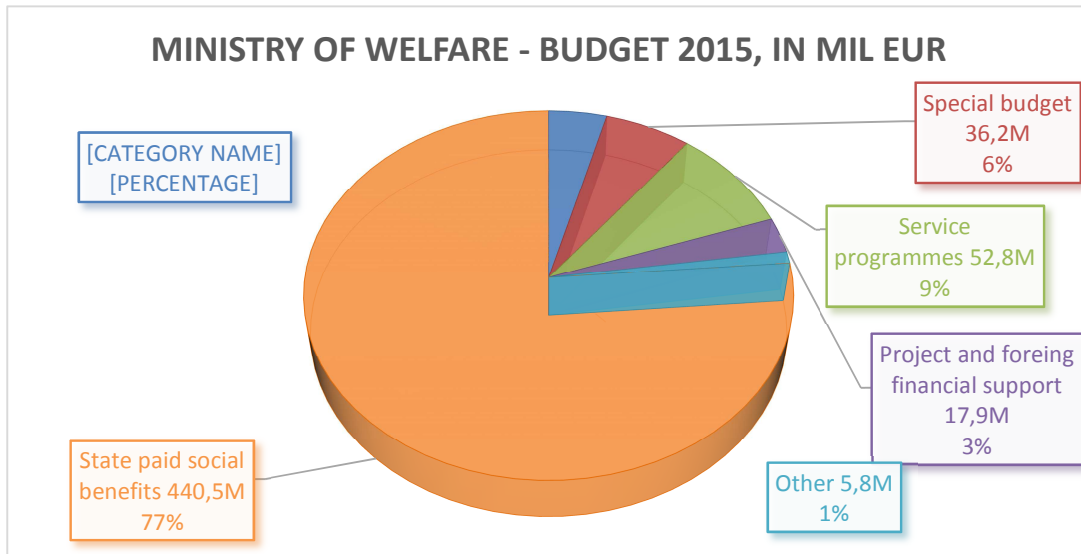


Table 1. Budget of Ministry of Welfare 2015. Graph created by the authors based on the publicly available information (Labklājības Ministrija, 2014)

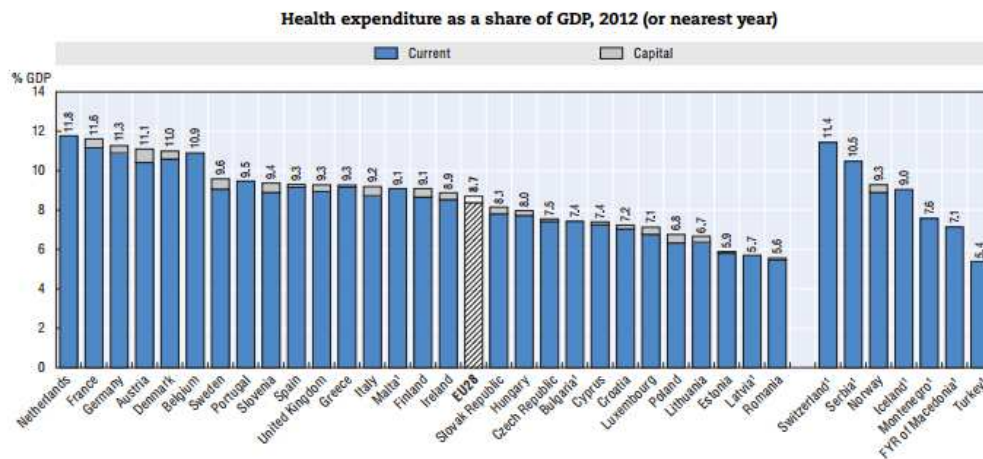


Table 2 Table created by OECD (OECD/European Union , 2014)

	General government excluding social security funds	Social security funds	Private insurance enterprises (including private social insurance)	Private household out-of-pocket expenditure	Non-profit institutions serving households	Corporations (other than health insurance)	Rest of the world
Belgium	10.5	65.5	4.2	19.7	0.2	0.0	..
Bulgaria (*)	17.7	38.5	0.5	42.6	0.5	0.3	0.0
Czech Republic (*)	5.4	77.9	0.2	15.3	0.9	0.3	..
Denmark (*)	84.6	0.0	1.7	13.7	0.1	0.0	..
Germany	6.9	70.1	9.7	12.4	0.5	0.5	..
Estonia	10.7	69.4	0.3	17.8	0.0	1.4	0.4
Ireland	..	..	..	..	..	..	..
Greece	..	..	..	..	..	..	..
Spain	68.2	4.7	5.7	21.1	0.3	..	..
France	3.7	73.5	14.4	7.7	0.0	0.7	..
Croatia	..	..	..	..	..	..	..
Italy	..	..	..	..	..	..	..
Cyprus (*)	42.0	0.1	5.7	50.2	2.0	0.0	0.0
Latvia (*)	59.7	..	0.8	38.8	0.3	..	0.5
Lithuania	9.5	61.3	0.6	28.2	0.0	0.0	0.3
Luxembourg (*)	8.5	73.9	3.5	13.7	0.4	0.0	0.0
Hungary	8.5	56.1	2.7	26.8	1.9	4.2	..
Malta	..	..	..	..	..	..	..
Netherlands	8.1	77.5	5.6	6.0	1.2	1.7	0.0
Austria	32.3	44.9	4.5	17.0	1.1	0.1	..
Poland	6.3	64.5	0.7	24.0	1.3	3.1	..
Portugal	64.2	1.3	4.9	28.9	0.1	0.5	..
Romania	12.7	66.2	0.1	20.7	0.1	0.3	0.0
Slovenia	1.8	71.3	13.7	12.2	0.1	1.0	0.0
Slovakia	7.2	66.5	0.0	23.6	1.0	1.7	0.0
Finland	60.2	15.1	2.2	19.5	0.8	2.2	..
Sweden	81.6	..	0.3	17.2	0.2	0.8	..
United Kingdom	..	..	..	..	..	..	..
Iceland (*)	51.1	29.3	..	18.2	1.4	..	..
Norway (*)	72.3	12.4	..	15.1	..	0.2	0.1
Switzerland	18.9	45.9	8.6	25.6	0.8	..	..
Japan (*)	8.6	71.6	2.5	16.3	0.0	1.1	0.0
United States (*)	5.8	43.3	34.7	12.3	3.7	0.2	..

Table 3 Healthcare expenditure by financing agent, 2011 (% of current health expenditure). Table created by Eurostat (Eurostat, 2011)