Social Financing And New Models For Public-Private Partnerships In Malaysia

Feasibility Study Report

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Feasibility Study: Social Financing And New Models For Public-Private Partnerships

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Table of Contents

List of Figures, Tables and Boxes

1. Introduction

1.1. Social challenges faced by Malaysia

Malaysia has achieved much economic progress in recent years. The per capita income for 2014 is expected to reach RM34,000 compared with RM25,000 in 2009, while the unemployment rate remains low at 3%. Global austerity has, however, had its consequences, and the latest reported level of government debt to GDP rose close to the level of 55% that is deemed prudent; public spending is likely to be subject to substantial restraints if fiscal consolidation is to be achieved (World Bank, 2013: 21).

Relative success in macro-economic performance does not, however, automatically correspond to wider social progress. The Malaysian Well-being Report 2013 outlines an improvement from 100 to 133.3 in its index of economic well-being between 2000 and 2012; but in the same period, social well-being rose from 100 to 121.0, while family well-being rose the least from 100 to 104.6 with an increase in divorce rates, juvenile crime and non-communicable diseases over the 12-year period.

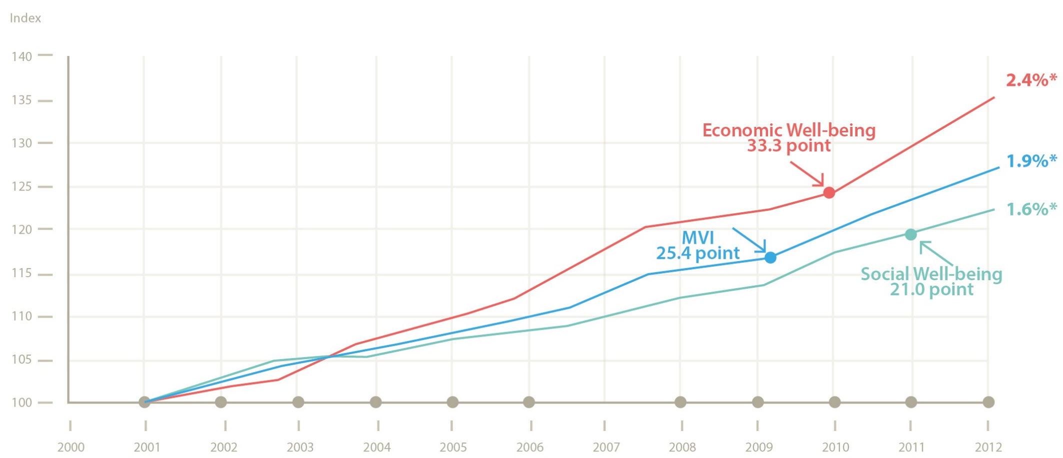

Figure 1: Malaysian Well-being Index, 2000 – 2012 *(from Economic Planning Unit)*

Comparisons with a range of countries on social progress also show room for improvement:

- As of August 2013, the youth unemployment rate (ages 15-24) stood at 10.3%, compared to Thailand at 2.8% and Singapore at 6.7% with the highest number of unemployed persons (40% of total in the country) between the age of 20-24.
- In education, the 2012 PISA survey of mathematics, science and reading ability showed substantial scope for better performance by Malaysian pupils, despite education spending on par with competitor countries (World Bank, 2013: 4)

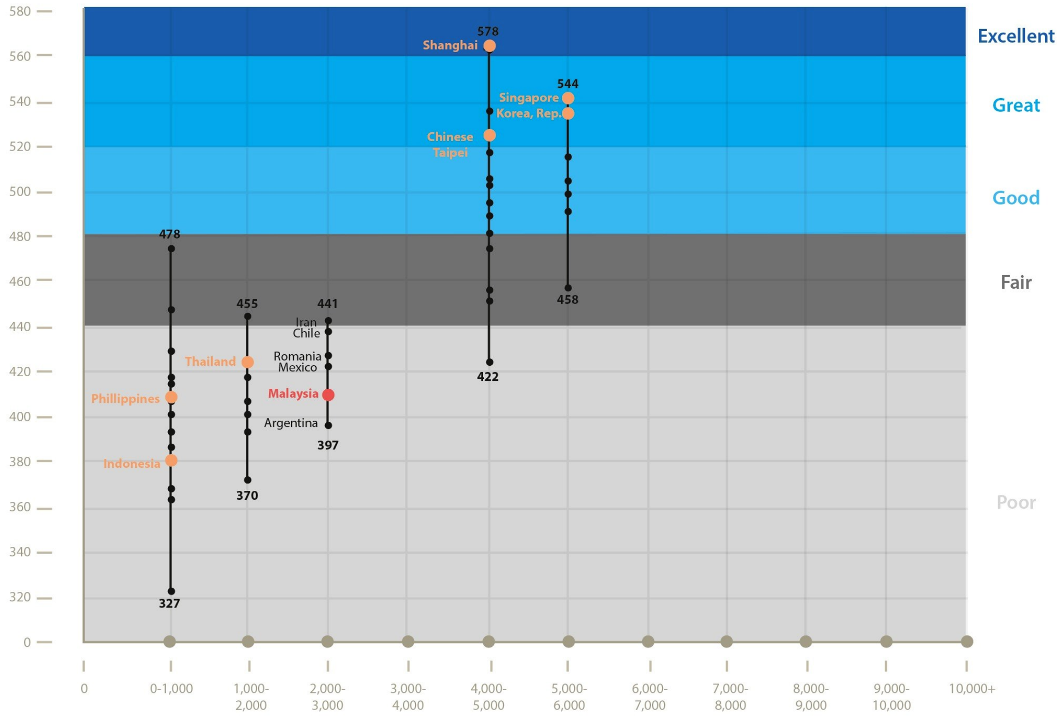

Figure 2: PISA Scores grouped by education spending *(from World Bank)*

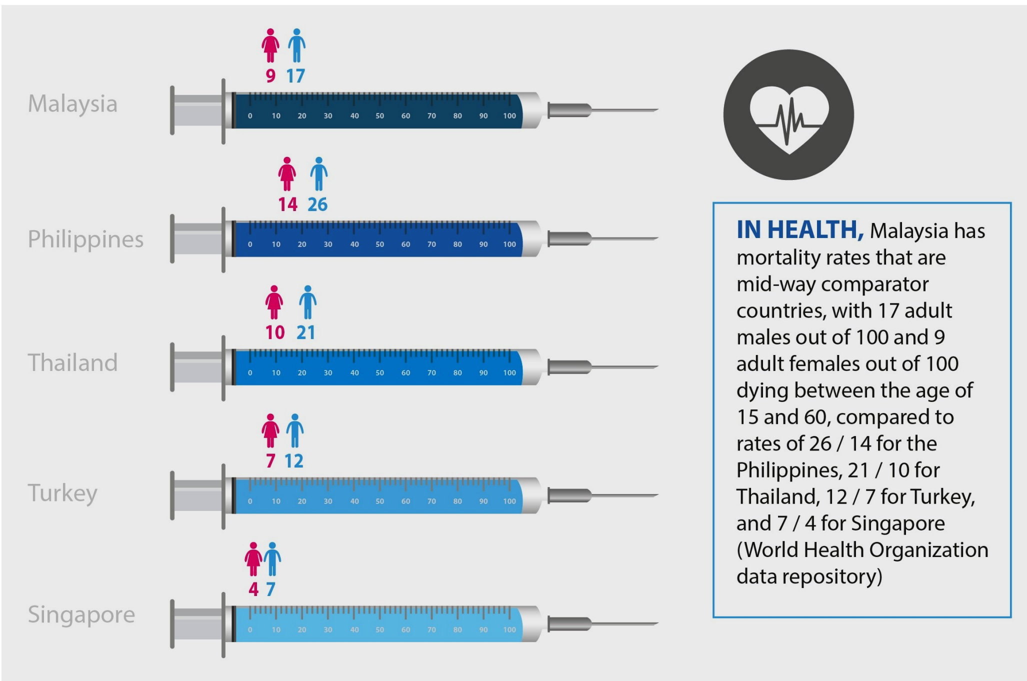

Figure 3: Comparison of mortality rates *(from World Health Organization)*

- Malaysia was ranked 45th in the 2014 Social Progress Index (socialprogressimperative.org). Despite excelling in providing for basic human needs such as water, sanitation and access to basic knowledge, Malaysia could benefit from greater investments in personal rights, tolerance and inclusion.

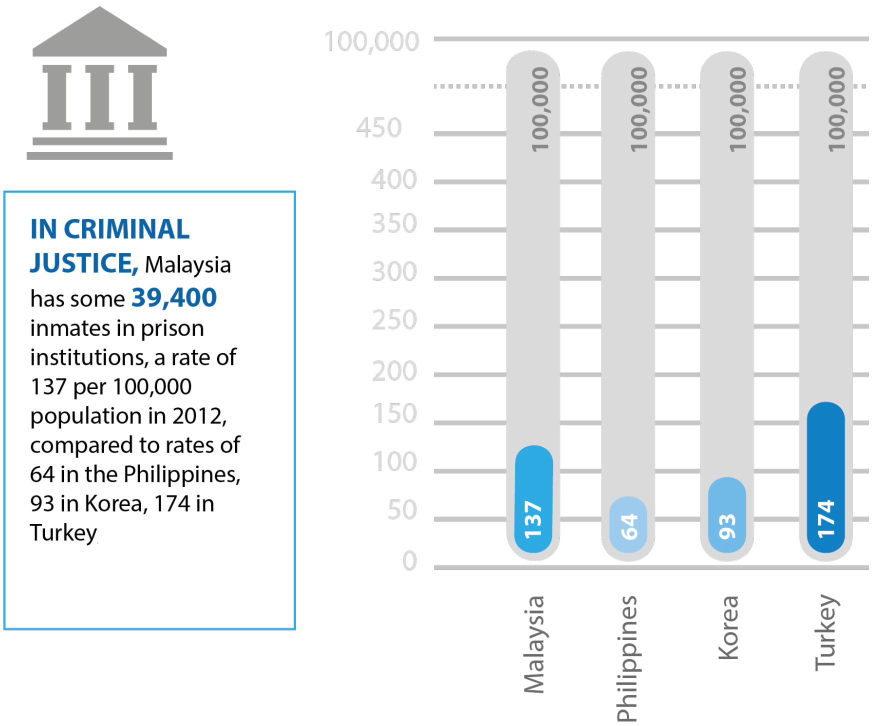

Figure 4: Incarceration rates per 100,000 population *(from UNODC)*

Strikingly, in a survey of social entrepreneurship between countries (Global Enterprise Monitor, 2011), the documented proportion of the working age population engaged in social activities was 0.02% in Malaysia, compared to an average global figure of 2.8%. Malaysia's ability to tap into the passionate commitment of those that want to 'make a positive difference to their country' is far from ideal, and this is a massively underused opportunity for social progress.

These raise a number of key questions: Would Malaysia benefit from a stronger collaboration between the public and social sectors? Are there potential lessons to be learnt from public service reforms carried out elsewhere? Are such lessons applicable to Malaysia? What are the particular implications for the contracting and financing of public services in Malaysia? What are the potential benefits of partnership with the private sector for public service financing?

Answers to these questions are outlined further overleaf, with a discussion of possible options and actions outlined in Section 2 and beyond.

1.2. International perspectives on public service reform

Recent reports from academia and think-tanks from Europe and North America provide a useful checklist of the strengths and weaknesses, opportunities and threats faced by Malaysia as it renews its efforts to improve public services. We would cite four themes in particular:

- Tapping into the enthusiasm and expertise of the *social sector*, both in terms of social entrepreneurship and social innovation;
- Proceeding to manage public services more with regard to the achievement of improved *outcomes*, as opposed to an assessment of outputs;
- Reacting to inevitable uncertainties by ensuring that public services are resilient to shocks, and by giving a greater priority to '*prevention rather than cure*' activity, so that the risk of adverse shocks is reduced;
- Underpinning strategies, plans and contracts for public services by the increased use of *evidence and analysis* and tapping into the growing field of social investments.

Social sector

The social sector consists of non-profit organisations, charities, foundations and social enterprises. Social enterprises are organisations that are driven to create social and/or environmental outcomes using business models to deliver their mission. Social entrepreneurship has gained in prominence with the recognition that a culture of entrepreneurship can be linked to activities that directly promote benefits for the public. Younger people particularly, but certainly not exclusively, are often hugely attracted to the approach of generating financially sustainable answers to diverse social problems. Globally, social entrepreneurship has gained popularity and a growing acceptance into mainstream business judging by the numbers of events, and the organisations and participants who attend them.

Although the Global Social Business Summit 2013, one of the world's leading forums for social business took place in November 2013 in Kuala Lumpur, the figures previously quoted on social entrepreneurship suggest that Malaysia lags far behind other countries in terms of its ability to inspire business for social purposes, and for innovation that recognises the social dimension. The risks that this carries can be seen from the results of the Netherlands' Innovation and Competitiveness Monitor for Top-Priority Sectors 2012-2013 (Rotterdam School of Management), which estimated that 23% of the Netherlands' innovation success resulted from technological innovation, whilst 77% of innovation success was dependent on social innovation.

Social or impact investment has also received much attention from policymakers around the world, with the recognition that individuals with at least some desire to assist society to invest in, or have chosen intermediaries to invest in financial assets that achieve measurable social good, represent a potentially huge source of capital available at below-market rates.

The G8 Task Force for Social Investment (now G7) was established in 2013 to explore and advance the potential of impact investment as a means to tackle significant social issues. It aims to facilitate a more effective policy framework, establish a more consistent approach to measuring social outcomes, and to encourage greater engagement across foundations, institutions and private investors. A key agenda is that social investors are able to deploy 'critical friend' advice to those organisations that they invest in, as well as their financial assets, to enhance social outcomes.

Outcomes perspective

Outcome-based budgeting and Payment by Results (PbR) have been long established approaches in North America, the UK, Australia, New Zealand and Scandinavian countries with examples of programmes as early as the 1980s in Sunnyvale, California. In a radical reform programme, the UK's current central government has introduced Payment by Results processes covering welfare-to-work schemes, probation activity for low- to medium-risk offenders and, to a lesser extent, hospital treatment. In doing so, it is able to draw upon an outcome-based budgeting approach that goes at least as far back as 1997. A focus on outcomes would align with best practices for public service management and spending besides achieving results that would benefit citizens.

Prevention rather than cure

There is increasing evidence that the maxim 'prevention is better than cure' has a strong business case as well as an intuitive appeal in fields as varied as early years programmes (as evidenced in the work of distinguished economist James Heckman), crime reduction (such as the analysis by the Washington State Institute for Public Policy), and catering to the health needs of older people (such as the UK's Partnerships for Older People pilot study). Unfortunately, in practice, longer-time considerations are often crowded out by immediate problems. Further, this difficulty is compounded by a frequent mismatch between organisations that undertake work that helps to solve the problem, and those organisations that gain from the work.

Evidence and analysis

McKinsey (2013) argued that better evidence for decision-making through benchmarking and the use of controlled experiments is fundamental to improved public services. This in turn is based on a wide range of viewpoints including OECD's analysis (Barrados and Mayne, 2003), the experience of the Cabinet Office Behavioural Insight Team in the UK, and MIT's Jameel Poverty Action Lab (Banerjee and Duflo, 2011) whose exploration of findings from randomised control trials showed a high potential for revealed knowledge to drive progress.

1.3. Much action already underway, but some weaknesses are apparent

Taking the four issues identified above, it is evident that there is scope for improvement, to a differing but still substantial extent. Indeed, in a 2013 World Bank survey of major issues facing Malaysia, 54% of respondents cited public sector reform as a development priority – making it the most cited topic (second was quality of education, cited by 45%, and third was anti-corruption, cited by 28%).

Social sector

The use of NGOs and the private sector in the provision of public services has been relatively downplayed in Malaysia. Most social services are provided by government agencies, but some groups are under-served (or are perceived to be under-served) and a disparate array of NGOs has been established. Helping Hands, for instance, started as a web portal to link services for the low-income Indian population and now provides a range of social services from its own staff team. Despite being poorly resourced, such organisations still play a trusted role in addressing peoples' problems, though standards of performance are often unregulated and highly variable. Yet feedback from a range of NGO service providers has indicated a lack of communication between themselves and government agencies, at both policy and case levels.

Outcome-based perspectives to public sector management and budgeting

A study of the outcome-based budgeting (OBB) practices of six countries (Brazil, Canada, Malaysia, New Zealand, Panama and South Africa) argued that the 'outcome-based budgeting journey for Malaysia has just started', though 'incremental, evolutionary' initiatives were 'starting to yield many positive outcomes', noting a plan for full implementation of OBB in Malaysian government departments by 2016 (KPMG, 2011). Payment by outcome contracts entail even more analysis and culture change, and this aspect of reforms, though technocratic, should not be underestimated.

Prevention rather than cure

Malaysia's aspirations to achieve high-income nation status by 2020 very much recognise the importance of preventative action. The National Key Results Areas in the Government Transformation Plan, for instance, include much wider accessibility to quality pre-school and early childcare, as well as action to reduce the risk of recidivism by those leaving prison. A vital agenda is the 'invest to save' principle, and the 'transformation fund' outlined in the New Economic Model that has a potentially highly useful role to play in facilitating preventative activity that in turn reduces the need for later, more expensive, government action.

Evidence and analysis

The development of the type of insights that such analysis increasingly provides as a matter of course appears to be hampered by some cultural factors in Malaysia. This is because the emphasis can be on 'need to know' rather than 'reason to withhold', and because where there is some availability, data is often inconsistently collected across different offices and regions, using different collection methodologies, and only on a broad-brush level. All of this makes the processes of evaluation and learning from good practice much harder than ideal, even though the New Economic Model highlights the need for 'academia, business, the civil service, and civil society' to 'work together in partnership for the greater good of the nation as a whole' (New Economic Model, Part 1, p. 68).

1.4. Innovations to address social challenges

The World Bank survey suggests that the status quo for Malaysia's public services is not adequate; innovation is an important theme if this problem is to be overcome. In particular, various forms of contracting and/or financing have been instigated in recent years internationally as a means of overcoming such major challenges as constraints on providing finance in the short-term, to transfer risk to parties outside government, or to encourage a diverse market of provision. These innovations include reforms to the Private Finance Initiative, encouragement of impact investing, and Social Impact Bonds. These agendas are considered in turn, below.

Reforms to the Private Finance Initiative (PFI)

Under PFI, government commits to making long-term payments to a private provider in return for the design, build, finance and operation of public infrastructure (such as a hospital) and ensuring that it runs smoothly. In the UK, this approach has been used for over 700 projects across a broad range of sectors, with an associated private sector investment of around GBP60 billion. PFI in Malaysia was officially implemented by the Malaysian Government through the Ninth Malaysia Plan (2006-2010) under the National Privatisation Plan (Economic Planning Unit, EPU, 2006) and is overseen by the Public-Private Partnerships Unit, UKAS in the Prime Minister's Office.

PFI has been shown to have an ability to bring in project management skills, innovation and risk management expertise. It also, however, has various drawbacks. A recent review of the UK track record found that the procurement process has often been slow and expensive, that contracts have been unresponsive to changing needs, and that risk has proven to be harder to transfer than thought. The response in a recent reform by the UK central government has been to improve transparency on liabilities, to renegotiate contracts, to reduce the implicit subsidy that PFI schemes previously had in the past, and to curb the ability of investors to generate excessive profits, by taking a joint equity partnership approach.

Yet it is questionable how relevant PFI is to such themes as youth unemployment or crime prevention, where the challenges relate more to changes in mindsets and behaviours than to the timely construction of new buildings or transport infrastructure. Such a 'soft infrastructure' perspective, as the 10th Malaysia Plan (p. 332) describes it, is more in line with impact investing and Social Impact Bonds.

Encouragement of impact investing

One increasingly influential concept is for governments and associated institutions to encourage impact investing, with its emphasis on measurable social and or environmental returns as well as financial returns.

Investors' choices range from taking equity shares in businesses that have a strong social ethos and are increasing job opportunities for those in deprived communities, to providing loans at low interest rates to companies working in sectors that they positively support – such as local theatres or environmental conservation. The Asian Development Bank, for instance, has taken a keen interest in the agenda, with ongoing social investment work including support for inclusive business and social enterprises.

Government actions to shift 'fiduciary duties' onto asset managers (Wood 2013), shape the development of open performance standards, and promote effective markets in public service delivery (Thornley et al., 2011) - all have key roles to play in boosting investments. A further route taken in the UK has been the release of GBP600 million in unclaimed assets at banks, to form an asset pool that resources the investment portfolio of the Big Society Capital bank.

Social Impact Bonds (SIBs)

This agenda, which is a sub-set of impact investing, and has a firm emphasis on evidence-based performance, has many potential advantages. It has the scope to bring in fresh sources of financial capital for social programmes, to focus attention on preventive action, to transfer risk on new interventions, and to provide an impetus for NGOs and social sector organisations to demonstrate their capabilities. SIBs are also known as Social Benefit Bonds in Australia, and Payment for Success Bonds in the USA and has various other names elsewhere.

In a SIB, a payer (usually government, at a federal, state or local level) agrees to pay for measurable improved outcomes of social projects that lead to tangible public financial savings (such as less crime). This prospective income is used to attract the necessary funds from investors to pay for the upfront costs of the activity that will achieve those better results.

In a 'pure' SIB, payments are determined solely by whether the required outcomes have been achieved. In 'hybrid' versions, a portion of payments is made on the basis of whether activities have been undertaken, and the remainder of the payments are dependent upon results. Figure 5 (overleaf) shows the basic activities in a Social Impact Bond.

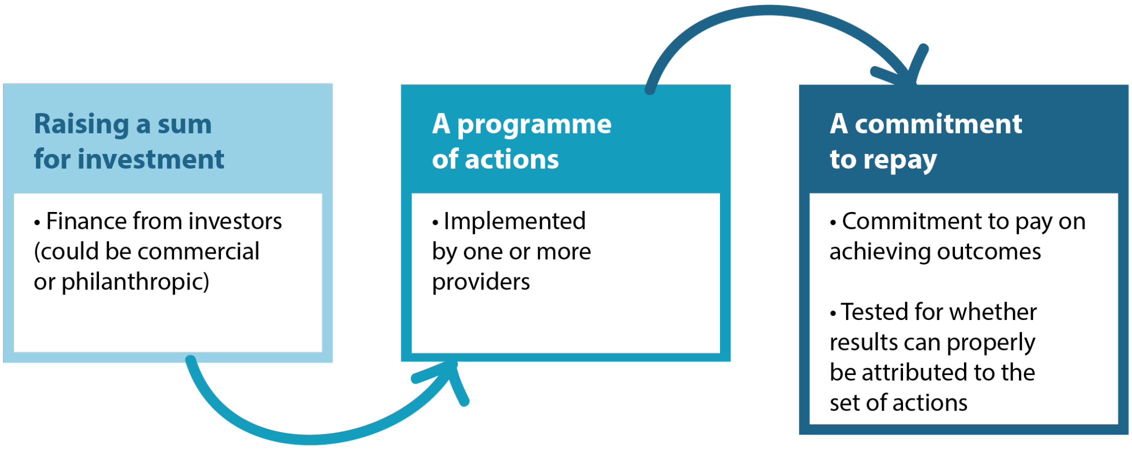

Figure 5: Basic activities in a Social Impact Bond

Since the first SIB was instigated in 2010, they have generated a widespread sense of potential in a diverse set of countries (see Figure 6 overleaf). Nonetheless, SIBs come with extra transaction costs, due to their three-way structure and requirement for deep levels of analysis.

We agree with the McKinsey (2012: 57) assessment that SIBs can be a relatively expensive way to finance the scaling-up of preventative programmes, but that this expense is justified if they help to galvanise new transformative approaches to issues where conventional options are not working well. Box 1 sets out the details of experiences in designing and operating the first SIB.

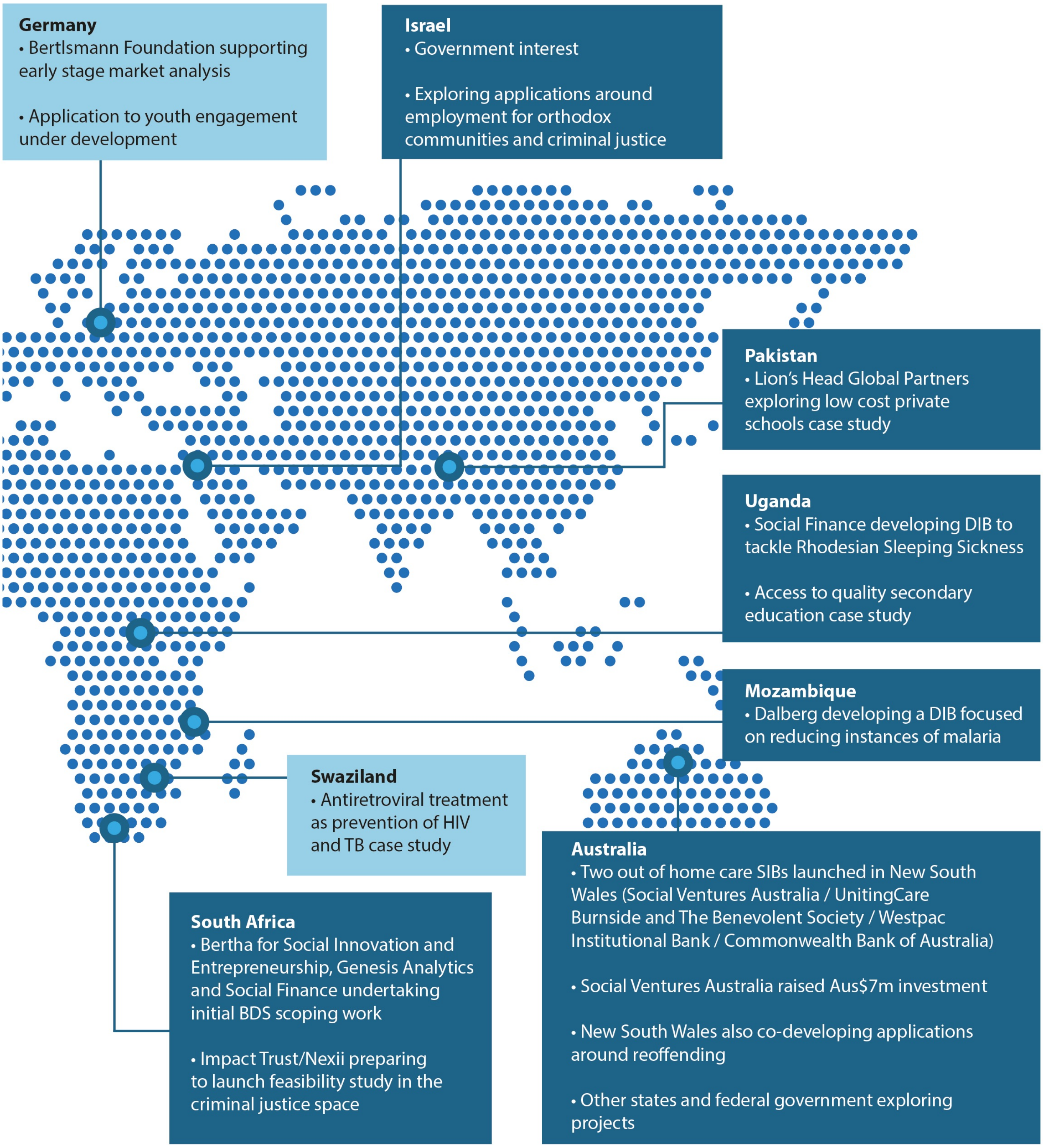

Figure 6: Planned and actual Social Impact Bond projects in a variety of countries

(from Center for Global Development and Social Finance, 2013)

Box 1: The experience of the Peterborough Social Impact Bond

The first Social Impact Bond to be developed relates to a programme to reduce reoffending by those leaving Peterborough Prison in the UK. It is a Payment-by-Results model that raises funds through, and shifts risk to, non-governmental investors, many of whom had philanthropic perspectives and/or a desire to promote innovation. Those investors in turn control a legal entity that project manages activity to reduce reoffending.

An evaluation (Disley et al., 2011) found that interviewees perceived contractual relationships to be complex but successful in terms of transferring risk to the investors. The business case is not seen as overwhelming however, with a key challenge being the ability to generate cashable savings by achieving major improvements that can facilitate closure or partial closure of the prison.

A prominent feature in designing the SIB was the need to engage and negotiate with different stakeholders, using skills and insights in negotiation, finance, policy and law. For instance, the design of the SIB includes a mechanism specifically aimed at reducing incentives to 'cherry-pick'. Such requirements raise the effort needed by analysts to produce satisfactory models of effects, and to develop adequate evidence of attributable outcomes.

Interim figures for the Peterborough SIB suggest positive effects on outcomes. There has been a 12% decline in the frequency of conviction events per 100 prisoners since 2008 in Peterborough. By comparison, the national figure had increased by 10%.

It is possible that the SIB has had important policy consequences, as the type of former offenders supported by the programme are now to be routinely covered on a national basis by the end of 2014, as part of recent 'Transforming Rehabilitation' reforms in the UK. The policy change, in turn, means that the SIB is to be concluded earlier than originally planned.

Social Impact Bonds have not met with universal acclaim, however. Some commentators have compared the high rates of return that investors can receive if the project is successful against the lower rates of return on government bonds, and come to the view that the best solution to funding preventative action is simply to increase government borrowing. But such reasoning is flawed; the effect of a government taking on a risky individual debt is to increase the level of risk of the totality of its borrowing, and although this effect is harder to spot than is the case for a private investor, it still exists. Government should only borrow to fund an investment when there is a sound economic case for the investment.

Nonetheless, other arguments have been made that do have potential validity. It has been argued that Social Impact Bonds can accrue high transaction costs, that they can involve complex partnership arrangements, and that they can require difficult measurement assessments to be made.

These points have all been recognised in the Social Impact Bond literature from the outset, and need careful consideration in any pilot or programme. In particular, they indicate that the most promising arena for Social Impact Bonds is for mid-stage innovations, with early stage innovations better funded by grants, and direct procurement being a useful route with respect to late-stage adoption.

1.5. Remainder of this report

The remainder of this report focuses on the question of how innovation in public services can be supported through innovation in contracting and financing arrangements. Key themes in consideration of options are: the ability of transparency of performance to sharpen incentives to achieve better outcomes, the use of evidence to learn from mistakes and highlight ways to improve, and the role that third party finance can play.

Section 2 therefore examines options for public-private partnership solutions, including consideration of priority sectors, case studies, options in partnering, and a possible pathway to catalyse improved public services in Malaysia. Section 3 concludes.

2. Options for public-private partnership solutions

In line with the New Economic Model, which calls for partnerships between the state, private sector and civil society, this section considers potential improvements to current approaches, options for partnering, and associated contracting and financing arrangements, before setting out a possible pathway to improvement.

2.1. Sectors for consideration

In considering solutions that generate better social outcomes and reduced public costs, a useful guide to the agendas where the most promising opportunities lie is to observe the themes that have been identified as fruitful areas for Social Impact Bonds. The main themes that have been proposed and implemented across the world are:

- *Young people* - considering such issues as reducing the need for children to be taken into care, improving schools, and also action to prevent youth un- and under-employment by improving students' ability to gain skills and preparedness for work;
- *Tackling crime* - reducing crime by more proactive interventions with offenders to reduce the risk of reoffending, and more proactive interventions with those entering the criminal justice system to ensure that they diminish their negative behaviours;
- *Homelessness and local community* - reducing homelessness by more active interventions that identify those at risk of becoming homeless and by achieving a quicker response to repatriate and re-integrate those that do become homeless;
- *Health* - various schemes have been considered to reduce the prevalence of diseases and/or manage long-term conditions;
- *Economy* - support for the development of small and medium enterprises (SMEs), with some form of profit-sharing being achieved for those providing financial and/or non-financial support earlier on.

Annex 1 provides more details on these schemes.

A further important theme in social investment relates to the environment, with support for such schemes as subsidies for rainforests to remain unlogged (e.g., the United Nations REDD programme), and investments in the design and operation of renewable energy sources.

The Malaysian government has many of these themes as priorities, and descriptions of key activities in relation to young people and reducing crime are provided in Box 2 and Box 3, respectively. Yet interviews with a range of NGO and academic stakeholders, as well as a literature review, have revealed a scope for preventative activities that could yield social dividends above and beyond existing plans.

Box 2: Actions underway and proposed in respect of young people

Program Remaja Berwawasan (Character-Building Activities After School To Help At-Risk Youth) is an initiative targeted at secondary school children with problematic behaviour. The Malaysian Armed Forces and the Royal Malaysian Police jointly conduct character building activities for these school children with the help of 1Malaysia for Youth (1M4U) volunteers and other agencies. Such a programme is in line with some of the recent UNICEF recommendations on youth justice in Malaysia, which calls for strengthening community-based alternatives for supervision and rehabilitation of child offenders, as well as introducing new strategies for handling "beyond control" children without institutionalisation (Ministry of Women, Family and Community Development Malaysia and UNICEF Malaysia, 2013)

Only a fraction of young people descend into troubled behaviour. Yet there is a spectrum of other needs where public service support can make a vital difference to lives. These include the development of parenting skills training and peer support programmes that parents experiencing difficulties with their adolescents can access voluntarily, better coordination and referral mechanisms between school counsellors and social welfare officers, the development of interactive programmes for teenagers involved in substance abuse or that are exhibiting behaviour problems, and improved access to vocational skills training, career counselling and job placement support for school-leaving adolescents.

Box 3: Actions underway and proposed in respect of tackling crime

An innovative approach is being undertaken to rehabilitate petty criminals through a programme identified in Malaysia's National Blue Ocean Strategy. Prisoners who have less than two years to serve and who were involved in minor offences are being placed at five low-security community rehabilitation centres (CRCs) within army camps. They are required to cultivate skills and be involved in productive activities, such as basic camp maintenance, farming and fishery projects together with moral, religious education and counselling sessions.

The project has reduced the need to build additional prisons, and since the total cost to build five conventional prisons is approximately RM250 million, while the cost to build five CRCs is only RM30 million, capital expenditure savings are in the order of RM220 million. The project has also saved RM9 million in maintenance work, and brought in RM2 million in farming revenues.

Interviews with NGOs have also raised the possibilities of strengthening actions in relation to health (for example, by minimising the rate of infection of HIV/AIDS amongst communities and providing care and support for those with the disease), and also with respect to homelessness (by providing advice, shelter as well as food to the homeless and the urban poor in Kuala Lumpur).

However, the case studies (below) focus on the themes of youth unemployment and youth crime, reflecting the positive attributes of these sectors for a social financial instrument approach.

The studies set out indicative estimates of the total scope of the issue and the extent to which outcomes can be improved (a full set of criteria that would need to be considered for a full scale implementation of a social investment approach is set out in Annex 2).

	Importance of the agenda	Ability to recoup savings later on	Able to measure effects	Service providers available
Young people – unemployment	✓✓✓	✓✓	✓✓✓	✓✓✓
Young people – crime	✓✓	✓✓	✓✓✓	✓✓
Homelessness	✓	✓	✓✓✓	✓
Health prevention	✓✓✓	✓✓	✓✓	✓✓
Economy - SMEs	✓✓✓	✓✓	✓✓	✓✓

Table 1: Sectors for action and criteria for consideration

2.2. Case studies involving the use of public-private partnerships

Case study 1: Youth Crime

Prison is expensive. In addition to staff costs (comparator countries have a prison staff:inmate ratio that varies between 3 in Korea to 20 in Thailand), there are building costs and the loss of income taxes previously paid by the offender (if and when they were employed).

Evidence for effective interventions to reduce reoffending has become increasingly developed over the past 30 years. Meta-reviews, such as Lipsey and Cullen (2007), show good results across many interventions. Key aspects of rehabilitation include the provision of support before and after release, with a case worker who can 'steer' offenders into a proper path and away from adverse peers, as well as close attention to soft skills development (such as anger management and an increased sense of empathy to victims) through techniques that can vary from Cognitive Behavioural Therapy to amateur drama and poetry writing.

The impact on reoffending rates can be readily measured by an independent body: Universiti Sains Malaysia (USM), for instance, has developed an approach to assess the success of parole. Given such, the cost-effectiveness of action to reduce reoffending will depend on:

- Cost of prison per day, which we estimate at RM45, adjusting figures in Yaacob (2012) for inflation;
- Average sentence length, which is not readily available, but which is 14.8 months in the UK;
- Intervention effects, estimated to be in the order of 10%;
- Margin for start-up and other costs, in the order of 33%; and
- Cost of the NGO pilot scheme

Under these assumptions, the savings to the prison system would exceed costs, with a break-even point occurring if average sentence length was in the order of 9.6 months.

There is a particularly good case for reducing reoffending in the case of youth. Approximately 3,000 juveniles and youth between the ages of 14 and 21 were in the care of the Prison Department of Malaysia either as inmates, or as students at the Henry Gurney schools at the end of 2004. More recent figures, reported in the 14 April 2014 Borneo Post newspaper article, "Juvenile violent crime up 47%", can be found in Table 2 (below).

Item	2013	2012	Increase
Total # of juvenile crime cases	7,820	3,700	111%
Student involvement in juvenile crime	1,630	1,040	57%
Non-student involvement in juvenile crime	6,180	2,660	133%
Student involvement in violent juvenile crime	540	370	47%
Non-student involvement in violent juvenile crime	2,010	850	137%

Table 2: Selected juvenile crime statistics (2012-2013)

Analysis indicates that prison can be counterproductive, acting as an education in a lifestyle of crime rather than as a deterrent. Taib (2011) indicates that prison staff endorse approaches that shape attitudes among offenders to be socially responsible upon their return to society. Complementary support activities involving treatment for drug and alcohol addiction and/or mental health problems will be crucial additional elements of successful rehabilitation.

This leaves open an opportunity for tailored support, based on individualised assessment undertaken by professionals with training, supplemented with experiential learning by the young offenders to develop empathy, ethics, and attitudes towards leading positive lives. Such support would need to complement – and integrate – with support offered by the Ministry of Youth and Sports, the Ministry of Women, Family and Community Development, the Ministry of Home Affairs and the Ministry of Education at different points of conflict. A possible approach for consideration in any prototyping phase is the Malaysian Care NGO scheme, which works with juveniles and youth aged 14 to 20 using techniques such as involvement in the arts to provide young people with tools to communicate, be more positive, avoid drugs, and avoid gang engagement.

Case study 2: Youth Unemployment

The number of young people who leave school and do not enter further education, training or employment with career prospects and development is a major problem. Malaysia's net secondary school enrolment rate is only 66% (World Development Indicators 2011, World Bank). International Labour Organization (ILO) data show that the unemployment rates of those young people with only primary education tend to be around double those of young people with secondary education (ILO, 2013). Malaysia's youth unemployment rate in 2013 was 11.1% (ILO).

While this compares quite unfavourably to the country's overall unemployment rate of 3% (as of March 2014 - Department of Statistics Malaysia), of greater concern is the unemployment rate of graduates of institutions of higher learning (IHL). A Ministry of Higher Education tracer study conducted in 2011 of graduates from 253 IHLs consisting of public and private universities and colleges, polytechnics, community colleges, and technical and vocational institutions found that 24% of graduates from these institutions were unemployed 3-4 months after graduation (MOHE, 2012). The highest graduate unemployment rates were for those that had attended community colleges (35.4% unemployed), those that had studied in the sciences (29.5% unemployed), and those that had only obtained certificates (29.6% unemployed). Among graduates indicating that they wanted to work, the reasons cited for their unemployment included: still looking for work, jobs offered were not suitable, had family responsibilities, lack of self-confidence to enter the work environment, taking a break, health problems, and waiting for placements to further their studies. From the employer perspective, the 10th Malaysia Plan quotes employer association views that many young people lack the necessary work ethics, communications, team work and leadership skills leading to employability. This is supported by a November 2011 study conducted by JobStreet in which employers revealed the following (see overleaf):

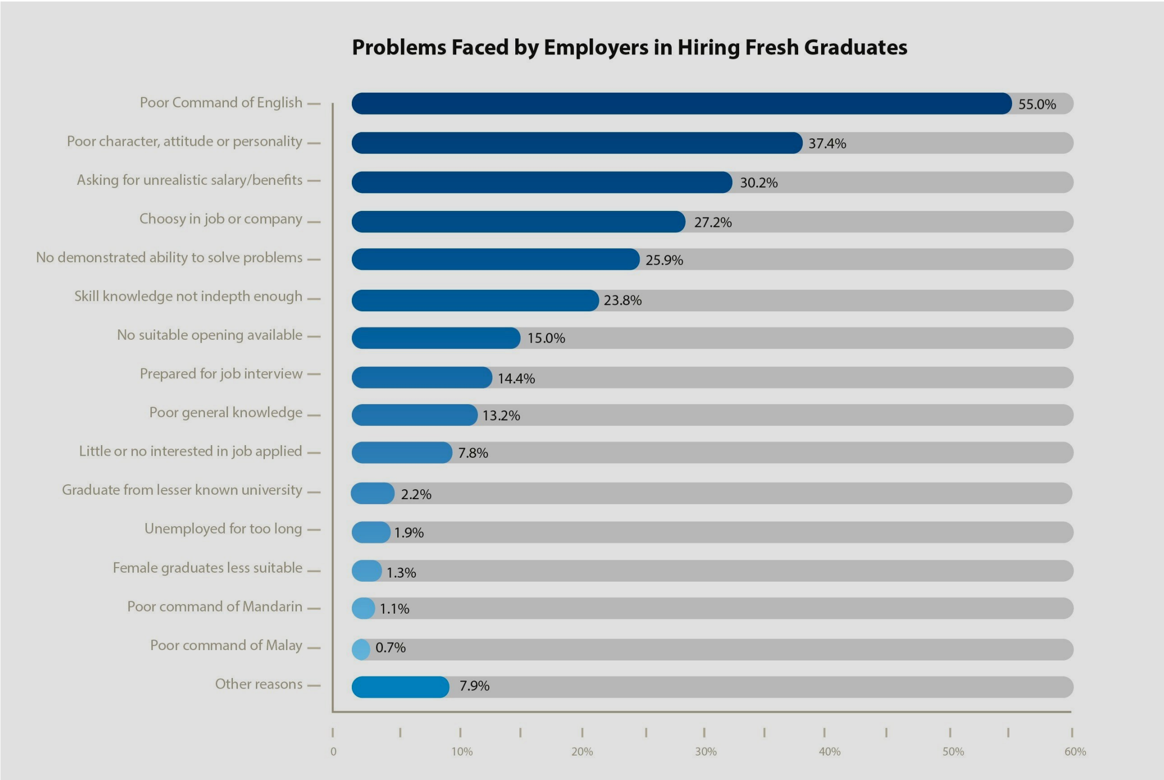

Figure 7: Problems Faced by Employers in Hiring Fresh Graduates *(from JobStreet)*

The financial burden of young people becoming unemployed or underemployed falls largely on the central government, through increased welfare costs, lower taxes and re-skilling costs. However the types of initiatives that can turn young people's lives around tend to be more local in nature and/or have a more informal perspective, as is the case with some NGOs.

Metrics can examine such issues as motivation to study and soft skills development, as well as educational achievement and employment status. ILO data show that the unemployment rates of those young people with only primary education tend to be around double those of young people with secondary education (ILO, 2013). If tax revenues are equivalent to those in the UK, then over a three year period, and with a 10% intervention effect, savings in the order of 0.7% of GDP/capita (approximately RM235 per client) could be achieved. If public sector costs in respect of criminal justice and health for young unemployed people are of a similar proportion to GDP/capita to those of the UK, there would be a further RM190 savings achieved, making a total of RM425 per client.

Possible approaches for consideration in any prototyping phase are the Hope Worldwide Malaysia and the SOLS 24/7 NGO schemes. These aim to provide holistic life skills through structured programmes to enable young people to become more dynamic, disciplined and self-sustaining. Also vital is to signpost career paths more effectively; in a 2012 survey by the Asia Foundation, 73% of young people strongly agreed or somewhat agreed with the statement that "In Malaysia, the problem is not in getting a job, the problem is in getting the job that you like."

2.3. Options in partnering between the public, social and private sectors

Options potentially exist both in terms of closer connections to social organisations and social investors, and with respect to corporate CSR agendas. There are grounds to believe that scope for effective partnership exists, provided that such partnerships are designed and executed carefully.

NGOs - Many if not most NGOs act on a basis in which funding is a combination of grants and donations. There is scope for a movement towards a more contractual basis, in which NGOs are given outcome targets, with a (small) claw-back and (small) positive incentive depending on performance. However, many NGOs are still in a 'youthful exuberance' stage, rather than a 'scale and maturity' stage. As with outcome-based budgeting for departments, to be successful it is likely that there would need to be a process of culture change (both on the commissioner and provider sides), as well as a process of building up knowledge of how to set up and monitor outcome targets, and how to assign reasonable levels of incentives for the provider. Such a process takes time to bed down, and so it is probable that a rapid full scale dissemination of NGO activity would carry substantial risks.

Charitable funders - Through a process of dialogue, some charitable funders may be interested in linking investment strategies more closely to their grant-giving. By doing so, they may be able to achieve a deeper set of improvements than previously, since they would be obtaining resources back for reinvestment. In addition, a focus on measurable impacts may increase the ability of charitable foundations to attract donations from the public, as donations are reused on visible, accountable and sustainable projects. A stronger source of leverage, however, would be an ability to offset investments against a 5 percent minimum endowment payout requirement, with the rule put in place to prevent foundations from simply receiving gifts, investing the assets and never spending any funds on charitable purposes.

Large corporations and Government-Linked Companies (GLCs) - In response to the Government's request for large corporations to increase CSR activity and make a deeper commitment to better social outcomes, several investment banks have structured financing concepts such as *sukuk* to address such mandates. Having spoken to several financial organisations, we believe there is some potential for GLCs and top tax-paying corporations to be brought together with government departments and service providers to implement programmes designed to accomplish defined outcomes.

A key question, however, would be the extent to which they would be released from overall CSR obligations; the business case for this would need to be examined carefully by the government. What is also clear is that some corporates are wary of being 'entangled by bureaucracy', and partnerships would be more likely to succeed if relevant government officials were prepared to endorse an entrepreneurial approach to problem solving. A further issue is that CSR obligations – and the way that those obligations are met – are not always transparent, which reduces pressure on corporates to act effectively.

2.4. Options in contracting and financing

A fundamental question to be asked in implementing a financial instrument for social purposes is: who leads the task of setting it up and controlling it? There are at least three different answers to this question, with different roles for investors, providers and government. See Figure 6, below, for an illustration of a basic partnership model:

Figure 8: Example of a basic partnership model

A second fundamental question is what specific mechanism might be used to fund a project to deliver social outcomes? The identification of such a mechanism and the funding or financing required for implementation of a project will involve an examination of:

1. The necessary establishment costs for the NGO as the service delivery agency to start-up the project, and
2. The necessary funding needs for project implementation.

Considerations in the selection, structure, and use of a financing mechanism capable of meeting both these needs include:

1. Recovery of establishment costs might not be possible should the project fail;
2. Funders might have to consider the risk of loss of funding extended to the project in the event of project failure;
3. If there are successes, the return on the funding extended might not be commensurate with normal investment or financing returns (depending on the degree of success of the project).

In Malaysia, funding could be provided under either conventional (interest-based) financing mechanisms, or Islamic financing mechanisms.

Conventional Financing Mechanisms

As per precedents in the UK or US, projects are funded from investments through the issuance of SIBs based on the composite structure of a loan, equity and fixed income instrument, with risks moving from the extreme of loss of investment, to the upper end of fixed income returns based on pegged rates. Midway, should there be some degree of success, there will be payments likened to dividends on equities.

Many projects are not funded via straight borrowing because of the need for flexibility in writing off the debt in the event of loss or the short-payment of interest on the loan. A lack of flexibility could result in long dispute resolution process possibly involving court action.

Islamic Financing Mechanisms

In the context of Islamic financing, the route to be taken by the NGO to start-up the project could be considered via *mudharabah* (profit sharing) where one or more investors place funds on trust with the NGO for investment into a specified project. Profits are shared between them in pre-agreed proportions in the event of success, while losses are totally absorbed by the investors in the event of failure.

Bearing in mind of the type of risk associated with the project, the most promising mechanism in the context of Islamic finance appears to be one of a joint venture *musharakah* between partners.

Musharakah

Musharakah is profit and loss sharing joint venture partnerships and, is to some extent, a form of debt-equity. It is based on a risk-sharing structure, whereby principal investment can be forgiven under genuine loss situations, or profits shared between the investors and managers if they are achieved. Globally, investors from both conventional and Islamic institutions are familiar with the structure. In a *Musharakah* SIB context, the joint venture partnership between investors, operators and the public sector brings complementary resources and expertise that will benefit all parties. In the figure below, the Government and NGO (Partner A) brings resources such as program delivery expertise and experience and an established service delivery infrastructure to the Social Impact Partnership, while the investors (Partner B) bring risk finance, management and commercial expertise.

The Partnership provides an SIB to the investors, and delivers the target social project. An independent body verifies project results (outcomes) for government, which then provides a payment to the Partnership based on the verified outcomes. The financial return passed on to the investors will depend on the success of the project. As illustrated, the model could be further supported with funds generated through cash *waqaf* or donations, with no expected returns, for the purposes of funding the operational needs of the assets mobilised for the social project. These assets are normally those provided by the government agency itself.

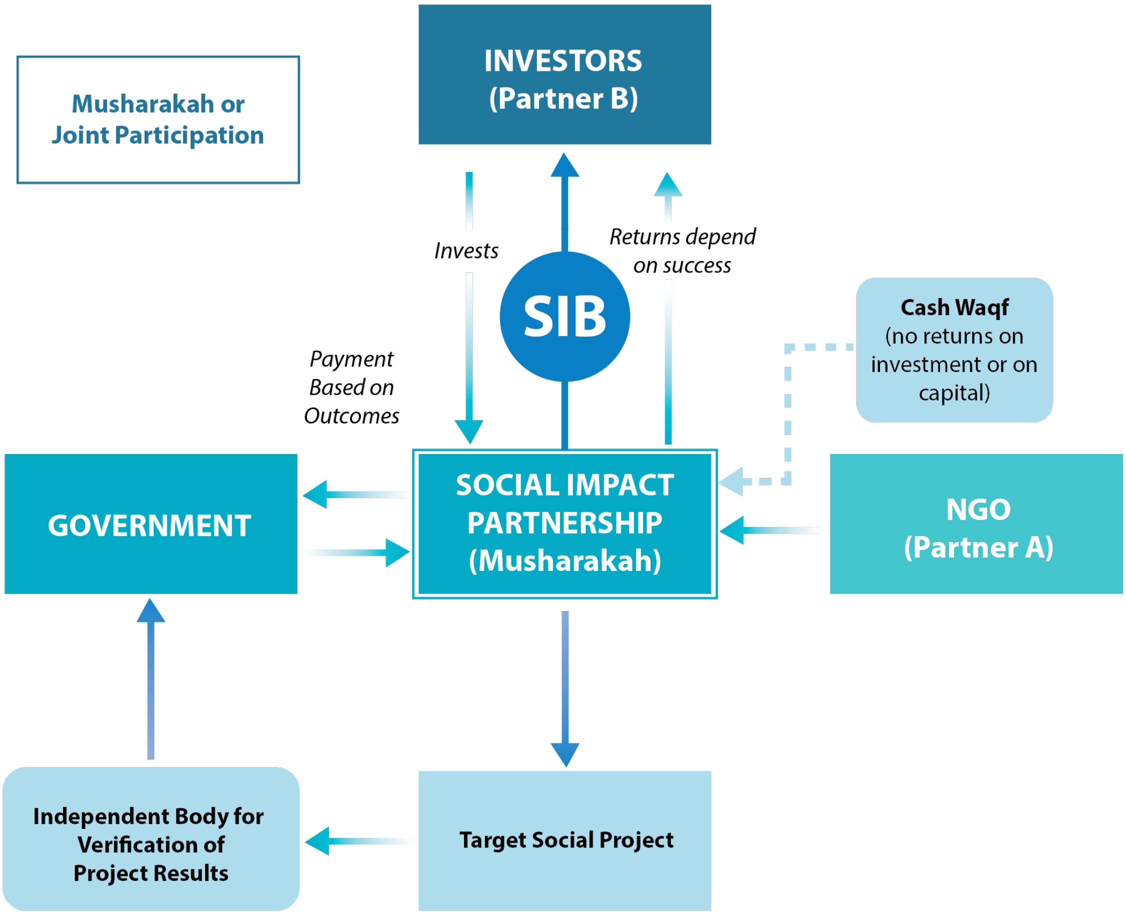

Figure 9: Musharakah or joint participation funding mechanism

Waqaf

Alternatively – or additionally – some form of *waqaf* could be set up to channel donations from foundations and corporations (potentially including GLCs) into a pool that could be used to fund such projects, with government payments for results being funnelled back into the pool to fund additional projects. Two examples of cash *waqaf* that have been used in Malaysia include Bank Muamalat's Cash Waqaf and KPJ's Cash *Waqaf* (where collections of cash donations are utilised to support the operational needs of health clinics). Unlike normal *waqaf*, whereby assets are donated in perpetuity for religious needs and purposes, cash *waqaf* enables the giving of cash assets on an ongoing basis as a means of supporting general charitable works.

Debt structure

An alternative to the *musharakah* would be to utilise a debt structure, in which the government issues *sukuk* to raise funds. Investors' contributions are on agreed ratios between investors and the issuer; the capital (fund) is then used to fund activities which in turn generate revenue, the revenue is distributed to investors and the issuer based on the pre-agreed ratio (though any profit generated will be channelled to the trustee), and the trustee uses the profit as a rollover capital for the programme of activity, to fund additional projects, or a continuation of the first project.

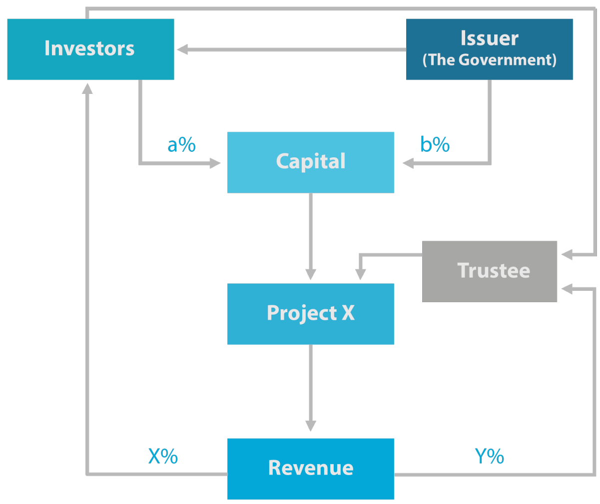

Figure 10: Example of a *sukuk* funding mechanism

Under this structure, the NGO (labelled Trustee in the diagram) is engaged purely as a service provider and is paid for services rendered. The entire financial responsibility rests on the government itself.

This approach may require changes to regulatory rules with respect to ratings for the issuance of *sukuk*, and the requirement for a minimum asset size, in order to achieve the go-ahead for a relatively small-scale pilot. By contrast, we understand that Khazanah Nasional Berhad is seriously considering a *social impact bond* approach to social investment, potentially in the field of education or health, and an operator on that scale would be less likely to be impeded by regulatory barriers.

Incentive mechanisms for partnerships

One alternative involves an incentive mechanism, based on the achievement of better outcomes, to be shared by partners with at least one shared goal. This is a different approach to a Social Impact Bond, since instead of a new delivery agent, it can be undertaken by existing players who agree to expand or change their ways of working (possibly by bringing in an NGO as a sub-contractor). However it still has the same driver of reform, namely the search for improved productivity, as indicated by a case study in the UK, in which one government agency (the Ministry of Justice, which runs courts and prisons) agreed to give local government and police forces a share of any savings achieved by a reduction in the amount of crime and criminals entering prison and being given community sentences.

A related approach is to sharpen the incentives for public sector owners of assets to maximise the use of those assets, either through a challenge process of civil servants and ministers, or by applying a 'cost of capital' charge to assets to departments. This would mean that unused assets would be seen as an inefficient use of public sector budgets.

There appear to be significant opportunities in Malaysia to use public-private partnerships to develop land holdings under asset *waqaf* (land) that can generate economic activities, and then to use the earnings to fund social projects or directly create social impacts through employment or entrepreneurship opportunities. A key example internationally include Bencoolen Street in Singapore, which raised a *musharakhah sukuk* for *waqaf* land (the building contains a mosque and shopping mall, and has returns linked to the rental income), and in Malaysia, the land-swap model in Kampung Pandan by the Ministry of Youth and Sports to create a youth centre in partnership with the private sector.

2.5. Stakeholder Feedback

Service providers

We interviewed 14 social non-government organisations (NGOs), of which 2 had been in operation between one and five years, 6 for between 5 and 10 years; and 6 for more than 10 years. 8 of the 14 NGOs or their leadership have won awards or have received other recognition of their work from community, state, national or other organisations.

There was a variety of scale among the organisations: of the 8 NGOs for which financial data was provided, 2 had revenue of between RM0.1 million to 0.5 million, 5 had revenue of between RM1 million and 5 million, and 1 had revenue above RM5 million.

In terms of financing and contracting, there was a much greater emphasis on donations and grants rather than contracts for outcomes. The ability to measure outcomes, and changes in outcomes, was scarce. Many NGOs did, however, see contracts for outcomes as potentially having advantages, in that they could provide a firmer base from which the NGO board and management could plan ahead, and also one that would enable overheads to be properly financed.

There was also a widespread feeling that there were opportunities to improve social outcomes being missed, with short-term funding constraints taking a much higher priority than long-term growth. There was, however, optimism that growth could be readily achieved if resources were available, even though the acquisition of skilled staff was noted as a constraint for some NGOs.

Many NGOs felt that there was a gap in perception between themselves and government, and called for greater dialogue and a higher priority among public services for support for citizens to take more of a role in solving their own problems – “teaching how to fish” rather than “giving a fish”.

Government

We spoke to a range of government ministries, departments, and agencies, including among others, the Ministry of Finance, the Ministry of Women, Family and Community Development, the Ministry of Health, Bank Negara Malaysia, and Khazanah Nasional Berhad. A range of views – mostly positive – was expressed, as were some important caveats.

A key theme was that the government is in fiscal strengthening mode, which means that approaches that will provide savings for the government and do not ‘crowd out’ private sector funding are of interest.

Ways to generate increased skills development, self-identity (patriotism, self-resilience and volunteerism) and leadership among young people were particularly welcomed by stakeholders. Several examples of social innovation in Malaysia were raised in the discussions, including Johor Corporation and its An-Nur medical clinics funded using a cash-*waqaf* model, a land-swap model used in Kampung Pandan by the Ministry of Youth and Sports to create a youth centre in partnership with the private sector, and KeTTHA’s launch of Yayasan Hijau to encourage ‘green lifestyles’.

There were, however, views that it would be crucial to carefully review how investors will recoup financing in the context of social outcomes that are not backed up by physical assets (as is the case of PFI and infrastructure development). One ministry questioned whether the margins that would be paid to investors in a fully expanded scheme – as opposed to during an innovation pilot – would be worthwhile. It was felt that this issue was compounded by the practical barriers of achieving a workable legal contract, defining and measuring clear outcomes, and defining and measuring cost savings.

2.6. Possible pathways to improvement: financial considerations

A key route forward is to commence discussions with possible funders, on both the charitable and GLC/corporate sides. A first point to note is that, if *sukuk* were to be considered as a funding mechanism for a project to fund social outcomes, the appetite for such an issue would likely be limited – perhaps in the order of not more than RM5 million. Even then, with respect to GLCs and corporations, it is likely that substantial incentives with respect to CSR and/or tax would be needed, as indicated by the rates of returns on corporate bonds set out in Table 3. It should be noted that SIBs, generally, would incur greater risk than any of these instruments.

5 year Sovereign/Quasi-Sovereigns	
Malaysian Government Securities (MGS)	3.6%
5 year MYR PDS/IPDS in accordance with ratings	
AAA	4.1%
AA	4.5%
AA-	4.8%
A+	5.8%
A	7.0%
A-	8.2%

Table 3: Typical bond/sukuk yield rates for products in Malaysia

It should be noted that the level of incentives rises as and if, the level of risk increases. In particular, a 'pure' SIB model is likely to result in investors requiring a higher risk premium, and is also likely to tilt the process more in favour of large private firms with access to normal capital markets and/or large reserves.

Capital Class	Investment Risk	Description	Target return per annum	Maximum downside
Class 1	Low	Full capital protection	2%-5% target return p.a	0% return (full return of capital)
Class 2	Medium	Partial capital protection	3%-10% target return p.a	-50% return (return of half of the capital)
Class 3	High	100% capital at risk if agreed outcomes not achieved	10%-20% target return p.a	-100% return (full loss of capital)

Table 4: Typical categorisation of investment risks and premiums in Malaysia

2.7. Possible pathways to improvement: suggested processes

In their most extensive form, financial instruments involve complex negotiations across the public, private, and social realms. As each has its own culture, the scope for misunderstandings and/or loss of momentum is considerable. The approaches most likely to succeed will have the following processes as illustrated below:

Figure 11: Next steps beyond feasibility study

Based on the assessments presented earlier, for the initial phase we propose an analysis of two potential pilot projects. This phase should undertake:

- *Idea progression* – making use of workshops and prototyping capabilities to determine effective ways for delivery to solve the set social issues;
- *Delivery organisation identification* – assessing not only who can deliver the right approach, but also who could be brought along the journey of becoming more entrepreneurial and accustomed to an outcome-based approach to service delivery;
- *Structure design* – determining which form of financial instrument and which funding mechanism is most appropriate and cost-effective for the task;
- *Development of financing* – consultation with foundations and appropriate parts of government on financing for the pilot projects, including the assessment of requisite profit shares; and
- *Pilot management preparation* – developing the outline business case, and reviewing how to develop a transparent system of performance management.

If and when the pilot project is successful, we would then propose moving to a full financial instrument approach, with commercial interest in financing and an intermediary taking forward the process if that is felt to be the most cost-effective route. The second phase would need to develop rigorous answers to the following issues:

- Ways of establishing credible track records of performance of service providers, catering for optimism bias as appropriate;
- Development of outcome metrics, as funders and government must be confident that the metric used in an SIB has no systematic bias and is, on average, a fair measure of performance;
- Ways in which changes in outcomes can be attributed to the service provider, such as the use of an independent control group;
- Financial modelling, including a clear link between outcomes and future cost savings, and a test that the SIB will not displace existing spending and interventions by providing incentives for existing funders or providers to cut spending or provision;
- Development of suitable incentives for funders;
- Contract development, setting a competition based on quality (including ways to reduce the risk of awarding contracts to providers that adopt a low price but that will not incur major penalties if they walk away from contracts that turn out to be difficult to achieve) and the price that the providers quote for a unit improvement in the outcome;
- After contact, the process would then move on to service delivery, and contract and performance management.

We also propose that the Ministry of Finance, in conjunction with stakeholders including Bank Negara Malaysia, review options for sharpening incentives for ministries to make more effective use of unused land assets, with freed up resources used to address priority social issues.

We further propose that appropriate government stakeholders, including the Ministry of Finance, examine the scope for sharpening accountability for corporate CSR behaviour by ensuring that the metrics that are used are sufficient for the purpose and links to national development priorities and goals that take into account local needs.

3. Conclusions

New forms of financial instruments for social issues are now being considered in many parts of the world, including the US, Australia, Europe and Africa. Their apparent simplicity is clearly appealing, even if their execution is likely to be more complex.

Our assessment is that their main advantage is not so much the wider access to social investment capital, but to the catalytic effect that they have on wider public services and the social sector. A pilot that has clear performance information, a deep underpinning evidence base and an enthusiastic social entrepreneurship capability is likely to have much more of an effect than general exhortations via transformation programmes to managers in the public and social sectors to improve. The innovator's dilemma effect identified by US academic Clay Christensen (1997), in which traditional ways of working are clung onto by established organisations, carries lessons for the public sector as well as for private markets.

A pilot process will, however, take much effort, and a pro-active entrepreneurial stance by government and NGOs alike. Conceptual and analytical skills are particularly important in conducting the research and modelling that is needed in the first phases of any programme design. Strong relationship management skills are also vital, so that the perspectives and concerns of policy makers, social sector organisations and social investors can be taken on board effectively.

Analysis and creativity, stakeholder management and programme management skills, negotiating abilities and accounting expertise are not straightforward capabilities to deploy. But they are increasingly being recognised as vital competencies for world-class government sectors.

It could be argued that social investors in Malaysia are not easy to identify, and hence that this whole route should be ignored. It could also be argued that the level of social entrepreneurship in Malaysia is very low, so Malaysia should accept a slow pace of social development. Such arguments do, however, run the risk of being self-defeating, and ignore the dangers of stagnation in failing to adapt to change and opportunities. For the most important benefits of pilots would not so much be their direct outcomes, and direct savings, but the learning that would come for public services as a whole from the encouragement of a stronger outcomes focus, a stronger evaluation focus, and a stronger partnership focus of the public, NGO and private sectors in addressing social problems.

Recommendations for government agencies

- Review ideas where preventative action would potentially be beneficial, and highlight ideas of social outcomes and the ability to gain savings to reimburse up-front investment;
- Review ways to sharpen incentives for agencies to make effective use of land and other assets;
- Review ways to incentivise and strengthen the accountability of corporates to fulfil corporate social responsibility (CSR) programmes;
- Instigate co-creation or similar workshops between social sector organisations and government agencies on areas of interest within community and social development;
- Fund a process of business plan development and/or a platform for generation of socially innovative solutions and prototypes to solve social problems;
- Instigate an innovation fund to cover the costs of the pilots and build the capacity of social sector organisations to be contract- and/or investment-ready

Recommendations for NGOs and social sector organisations

- Review ideas where a move to outcome-based contracting would lead to greater productivity and scope for a growth in activity and impact;
- Sharpen up capabilities to move to an outcome-based contracting approach involving better performance management systems to track and report on activities and impact of programmes;
- Participate in co-creation or similar workshops with the public sector and/or innovation competitions to test ideas, solutions and prototypes of services

Recommendations for social investors

- Explore the benefits and possibilities of risk-sharing and/or co-funding/co-investing with the public sector for the delivery of social programmes either under the CSR banner or as strategic investments, highlighting approaches that are likely to be the most beneficial for both sides;
- Begin the process of consultation with 'contract- and/or investment-ready' and willing social sector organisations to move towards a social investment approach
- Provide opportunities for skills-based volunteering programmes that utilise business and industry competencies as a pathway for employee engagement and retention, working with social sector organisations preparing to be contract- and/or investment-ready

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NO.	ORGANISATION	NAME(S)	DATE	
	POTENTIAL GOVERNMENT STAKEHOLDERS			
1	Department of Prisons	Darussalam Bidin, Ajidin Salleh, Zainah Pardi (all Rehabilitation & Treatment Dept, Prisoner Management Division) & Nizam (Policy Dept)	18-Mar-14	
2	Economic Planning Unit, Prime Minister's Department	En Saiful Anuar Lebai Hussen (Social Section Chief)	18-Mar-14	
3	Economic Planning Unit, Prime Minister's Department	En Allaudin Anuar, Pn Zakiah Jaafar, Pn Norsiah Uddin (Macroeconomics Section)	1-Apr-14	
4	Economic Planning Unit, Prime Minister's Department	Ms Tan Lee Cheng (Human Capital Section Deputy)	28-Mar-14	
5	Iskandar Regional Development Authority (IRDA)	Prof Datuk Ismail Ibrahim (CEO), Isma Ezwan	20-Mar-14	
6	Registry of Societies (for Johor)	Pn Lim Jit Ngoh	30-Mar-14	
7	Ministry of Defence (viz. Malaysian Institute of Defence and Security)	Colonel Zulkefli Abdullah	1-Apr-14	
8	Registry of Societies (for the Federal Territories, Selangor, Kedah, Perak)	Pn Zuliana Mohd Akob (WP-KL); En Noraffendy Bin Abd Khalid (Selangor); En Anuar Bin Isa (Kedah); Pn Amirthavalli a/p A.V. Muthiah (Perak) - all state Directors	3-Apr-14 4-Apr-14	
9	Ministry of Finance	Mr Chou Ai Hong; En Syed, Emilia: (National Strategy Unit) & Dr Khalid Abdul Hamid (Economics Unit)	14-Apr-14	
10	Ministry of Youth and Sports	En Zahidi Bin Hj Mohd Daud	14-Apr-14	
11	UKAS - PPP Unit, Prime Minister's Department	Dato' Hj Baharuddin Bin Mahyuddin; En Ahmad Zamri Bin Khairuddin	15-Apr-14	
12	Ministry of Urban Wellbeing, Housing and Local Government	En Mohammad Ridzwan Bin Abidin	17-Apr-14	
13	Securities Commission Malaysia	En Noraizat Shik Ahmad; Pn Aida Jaslina Jalaludin	17-Apr-14	
14	Public Service Department	Tan Sri Dr Sharifah Zarah Syed Ahmad	18-Apr-14	
15	Ministry of Women, Family, and Community Development; Department of Welfare	Datuk Harjeet Singh; Pn Rosmahwati Binti Ishak Dr Rozita Tun Hussein; Dr Aida; Thomas Chew	21-Apr-14 24-Apr-14	
16	Ministry of Health	Adnan Zaylani Zahid, Redza Minhat, Izzat Haziq	28 Mar 14	
17	Bank Negara Malaysia	Hamdan, Esvinia Litia Choo (Investment Operations & Financial Market Department) Dr Hamim Shayrum Ahmad Mokhtar, Hariul Azmie	22 Apr 14	
18	Bank Negara Malaysia	Abdul Aziz, Abdul Hamid Akbar Ali (Islamic Banking & Takaful Department)	31-Mar-14	
19	Ministry of Rural and Regional Development	Abdul Malique Abdul Razak (Community Empowerment & Infodesa Dvision), Mohd Ali Sebran (Strategic Planning Division), Nik Sufiah Nik Soh (Economic Empowerment Division)	31-Mar-14	19
	POTENTIAL SERVICE DELIVERY ORGANISATIONS/CIVIL SOCIETY LEADERS			
1	Perkhidmatan Sosial dan Pembangunan Komuniti (PSPK)	Mr Henry Sandanam	20-Mar-14	
2	Teach for Malaysia	En Dzameer Zulkifli	21-Mar-14	
3	Pusat Kebajikan Penyayang Malaysia	En Jailani Sulaiman; Ir Rosli Idrus; En Yusoff Latif	24-Mar-14	
4	Institute for Democracy and Economic Affairs (IDEAS)	Ms Tricia Yeoh	25-Mar-14	
5	Protect and Save the Children (PS The Children)	Ms P. Nagasayee Malathy	25-Mar-14	
6	Voice of the Children	Ms Joti Kohli	25-Mar-14	
7	Kechara Soup Kitchen	Mr Justin Cheah	26-Mar-14	
8	Malaysian Care	Mr. Kenneth Wong Tuck Weng	28-Mar-14	
9	Malaysian Mental Health Association	Datin Dr Ang Kim Teng	28-Mar-14	
10	PT Foundation	Mr Raymond Tai	28-Mar-14	
11	Yayasan Chow Kit	Ms Ananthi A/P Rajasingam and Ms Katherine	28-Mar-14	
12	SOLS247	Danusha and Tim Spijker	1-Apr-14	
13	Hope Worldwide	Mr Darick Wong	4-Apr-14	
14	EcoKnights	Ms Yasmin Rasyid	17-Apr-14	
15	Malaysian Environmental NGOs (MENGO)	Ms Yasmin Rasyid	17-Apr-14	
16	Independent/UN Humanitarian Fund	Tan Sri Jemilah Mahmood	29-Apr-14	16
	POTENTIAL INVESTORS			
1	Amiri Capital	Mr Nash Jafer	Mar-14	
2	CIMB Islamic Bank	En Badlisyah Ghani	Mar-14	
3	HSBC Amanah	En Rafe Hameef	Mar-14	
4	RHB Investment	En Yazit Yusof	Mar-14	
5	The Islamic Banker	Mr Mushtak Parker	Mar-14	
6	Hong Leong Foundation	Ms Jasmin Johnson	11-Apr-14	
7	Khazanah Nasional Berhad	Tengku Dato' Sri Azmil Zahruddin bin Raja Abdul Aziz; Mr Jiv Sammanthan; En Wan Abdul Aziz Ariffin	16-Apr-14	
8	Sime Darby Foundation	Pn Arifah Sharifuddin; Pn Hjh Yatela Bt Zainal Abidin; Pn Muzdalifah Binti Mohd Nasir	21-Apr-14	8
		TOTAL NO. OF INTERVIEWS		**43**

Annex 1: Actual & Proposed Social Impact Bonds Globally

Issue	*Source of idea*	*Details*
Reduce need for adoption and fostering by strengthening parenting skills	SIB underway commissioned by Essex County Council, UK and in New South Wales, Australia	Essex SIB - Social Finance has been awarded a contract by Essex County Council to deliver a SIB to provide therapeutic support and improve outcomes for 11 to 16 year olds at risk of going into care. Investment is £3m, to fund a five year programme to provide intensive support to approximately 380 adolescents and their families, with a target to divert around 100 adolescents from entering care. If the interventions deliver successful outcomes, expected returns are in the range of 8-12% pa. Australia – In 2013, some 18 months after a request for proposals, the NSW Government announced that the first Social Benefit Bonds Agreement in Australia had been executed with Uniting Care Burnside. Funding from the SIB will help expand its already successful programme to support families with children in foster care and group homes. The US $7.3 million SIB provides financial terms (including a guarantee to return 75% of any given investment) intended to appeal to a broad array of private and institutional capital providers.

Reducing crime	SIB underway at Peterborough Prison, UK aiming to provide greater support to those leaving prison after short sentences; also applied in Rikers Island, New York, USA	The Peterborough SIB project began delivering services in September 2010, supported by an investment of £5m. The SIB project offers intensive support to 3,000 short-term prisoners, both inside prison and after release, to help them resettle into the community. The intervention is managed by One Service, an organisation created specifically for this SIB. If the SIB reduces reoffending for the cohort within a year of release by a threshold of 10% for any of the three cohorts of 1000 ex-prisoners or 7.5% across the entire 3000, investors will receive a payment from the Ministry of Justice (MoJ), part of which may come from their savings. The maximum payouts are capped at 13% IRR, some £8m. The Rikers Island SIB project – known as the Adolescent Behavioral Learning Experience (ABLE) – is funded by Goldman Sachs through a US$9.6 million loan to MDRC, who will oversee the project's day-to-day implementation. Bloomberg Philanthropies is providing a US$7.2 million grant to MDRC to guarantee a portion of the investment. Should the project reduce re-admissions, the Department of Corrections will pay MDRC the associated cost savings, and in turn, MDRC will repay the loan.
Increasing educational attainment and reducing later youth unemployment (mainly aged 16 years and up)	Scheme commissioned by Department for Work and Pensions in various locations in the UK, and similarly occurring in Rotterdam	The Innovation Fund is a pilot initiative aimed at supporting disadvantaged young people, and those at risk of disadvantage, aged 14 years and over. It is based on a Payment by Results approach, with applicants required to identify sources of social investment and possibly also a financial and project management intermediary. The first six projects went live in April 2012 and a further four began delivery in November 2012. Prices for outcomes are set out below: Improved attitude toward school £700 Improved behaviour £1300 Improved attendance £1400 Entry level qualification £900 Entry into employment £3500 Sustained employment £2000

	Low cost private schools in Pakistan (Development Bonds report)	Low cost private schools in Pakistan, run by owner-entrepreneurs responding to local needs who charge between US$2-$20 per student per month, have demonstrated that even low income families value and are prepared to pay for quality education for their children. With better access to finance, the low cost private school sector could potentially offer a scalable and sustainable solution to education in Pakistan. The proposed capital requirement is US$25 million, to be distributed in the form of a standard loan per school of US $5,000 allocated to some 5,000 schools, each with 35 children per class, so creating 175,000 new school places at a cost of US$143 per child.
	Access to quality secondary education in Uganda (Development Bonds report)	The capacity of the Ugandan secondary school system is not currently sufficient to enable access to all eligible children. A lack of schools – particularly in rural areas – and limited infrastructure in existing schools means that transition rates for pupils leaving primary education and entering secondary education are around 65%. One of the key drivers behind the insufficient number of affordable secondary school places in Uganda is a limited supply of capital to build or expand secondary schools. The proposal is for an investment of £23m, with outcome payments of £23 – £35m over a 10 year term. The proposal aims to construct 50 new schools in years 1 to 4, with 750 additional student places in each new school, and enrolment and quality outcome metrics established for the target schools. The business case assumes repayment of principal with a 3% IRR on the basis of school attendance, with an additional return of up to 5% IRR based on above baseline exam results.

Increasing school readiness (3 to 4 year olds)	Scheme commissioned in Utah, with financing from Goldman Sachs	The Utah High Quality Preschool Program delivers a high impact and targeted curriculum to increase school readiness and academic performance among 3 and 4 year olds. As a result of entering kindergarten better prepared, it is expected that fewer children will use special education and remedial services. Goldman Sachs and JB Pritzker provide loans of up to US$7 million to the United Way of Salt Lake, which oversees implementation of the programme at a cost of around US $2,600 per child. Private capital and other public funding sources provide Pay-for-Success payments to repay the loans, based on the cost-savings associated with the reduced use of special education and ancillary services. Pay-for-Success payments will be made equal to 95% of the avoided costs or US$2,470 per child for every year, Kindergarten through Sixth Grade, to repay the senior and subordinate debt plus a base interest rate of 5.0%. Thereafter, Success Payments will equal 40% of the savings, or US$1,040 per child per year of special education services avoided, to be paid as Success Fees to Goldman Sachs and Pritzker.
Reducing homelessness	Extra support for those relatively new to living homeless on streets of London, UK	The Mayor of London has initiated a £5m SIB to reduce the amount of rough sleeping. The aim of the SIB, which started on 1 November 2012 and runs for three years, is to improve outcomes for a cohort of about 800 people who move in and out of rough sleeping. Two voluntary sector providers - St Mungo's and Thames Reach - have been commissioned in order to reduce rough sleeping, support clients into stable accommodation, support client progress towards employment, and support clients to better manage their health.

Issue	*Source of idea*	*Details*
Reducing the need for hospital care	Telephone support for those with chronic medical conditions enabling them to avoid crisis hospital admissions – based on a UK pilot study (NeuroResponse)	NeuroResponse uses telephone, video and e-mail to improve the ability of multiple sclerosis patients to manage their condition. By supporting patients to self-manage aspects of their condition, hospital visits are significantly reduced and cost savings are achieved. The team at NeuroResponse aims to divert 80% of hospital treatments to the at-home service. An SIB would enable this project to expand, provided also that there was sufficient demand from commissioners to pay for such an approach.
	Rhodesian sleeping sickness in Uganda (Development Bonds report)	Rhodesian sleeping sickness threatens 9 million people in Uganda, mostly in poor, rural areas. It is expensive and difficult to diagnose and treat in humans. As a result it is often fatal. There is an existing network of local partners focused on sleeping sickness in Uganda and a programme has supported delivery of a number of small scale interventions. It is argued that a DIB could rapidly scale interventions to reduce Rhodesian sleeping sickness. It is envisaged that success payments would be triggered by: 1) Effective delivery of the mass treatment programme in years 1-3; and 2) A sustained reduction in the human infective parasite prevalence rate in cattle in years 4-8. Capital requirement: US$20-30 million; outcome payments: US$0-40 million; impact objectives: approximately 65% of cattle in high risk districts treated in years 1 to 3, with a significant reduction in human infective parasite prevalence from Y0 baseline in years 4 to 8. Base case assumes that parasite prevalence is reduced from 5% to 1.5%, with gains of more than 80,000 DALYs, and corresponding social benefits (animal and human health) greater than US$70 million.

Issue	***Source of idea***	***Details***
	Treatment as prevention of HIV and TB in Swaziland (Development Bonds report)	One factor contributing to the HIV/AIDS crisis is that too many individuals do not know that they are HIV-positive and do not seek treatment until they fall ill and are highly infectious. More could be done to identify all individuals in a population living with HIV and offer them treatment upon diagnosis. Returns to investors would initially be based on interim metrics of testing, treatment, retention and viral suppression, which assist in estimating the reduction in new HIV infections over the 3-year implementation study, as well as projecting the potential impact of new HIV infections on a national level, if scaled up.
Strengthening economy	SME pipeline (Development Bonds report)	Impact-oriented investors and funds often find it uneconomical to support and manage investments in SMEs, given the relatively small transaction size (typically US$50,000 – $500,000) compared to average deals and the significant resource commitment needed to source high-quality SMEs and get them investment ready. An investor-backed fund to pay for business development services, with outcome payments triggered if Business Development Service (BDS) providers successfully support local businesses to raise and repay third party finance could incentivise the provision of higher quality BDS, increase the availability of investible opportunities and potentially reduce the transaction costs of small deals to investors.
Energy supply	Improving energy efficiency (Development Bonds report)	More could be done to improve energy efficiency if some upfront capital was available to make energy efficiency investments and clear up some of the informational asymmetries preventing a commercially viable market from forming. One option is to invest in an energy services company (ESCO). An alternative is to undertake investment via local lending intermediaries.

Annex 2 Key criteria for a successful Social Impact Bond

The nature of SIBs means that careful consideration needs to be given to where it is and is not appropriate to use the instrument. Commentators' assessments of the success factors for an SIB vary, but tend to congregate around the following themes:

Theme	***Comment***
Preventative intervention	Intervention is preventative in nature and sufficient funding for the intervention is currently unavailable
Evidence of efficacy in solving social problem	The intervention is supported by evidence of its efficacy and impact, giving funders confidence in the scheme's likely success
Measurable impact	Whether it is possible to measure the impact of the intervention accurately enough to give all parties confidence in the intervention's effect, including a sufficiently large sample size, appropriate timescales and impacts that are closely related to the savings and relatively easy to measure
Aligns incentives	A specific government stakeholder achieves savings as a result of actions undertaken by others. These savings need to be cash releasing and provide an actual saving to government stakeholders
Few overlaps with existing public programmes	In a world with no public spending, SIBs would be relatively straightforward. However, target groups, such as young people under 18, are often already in receipt of at least some public support. As SIBs depend on demonstrating a causal link between additional spending and outcomes achieved, this means that either contracts and measurement systems have to become complex (and require other public agencies not to cut or change existing programmes), or some form of partnership agreement is needed which ties in with other public providers.
Savings greater than costs	The savings need to exceed the cost of the intervention and transaction costs, and provide a margin of return. Note that a long delay between investment and future savings priced at a rate at or anything close to a commercial discount rate will greatly reduce the apparent benefit of a future impact.
Suitable structure available	For a scheme with an independent 'Delivery Agency', it is estimated that the contract should be at least £5m, and ideally £10m or more to cover set up and operating costs (Social Finance, 2011, p. 11). This is substantial, and indicates a need for flexibility in the adoption of simpler models in the case of relatively small-scale pilots.
Government preference for an SIB and capabilities in commissioning an SIB	Government policy is keen on, or at least open to, an SIB, and is able to draw upon adequate expertise in setting up and running an effective procurement process.

The Centre for Social Impact, in designing the New South Wales SIB, adopted these criteria to the task of selecting programmes and organisations, and came up with the following list:

Selection of programme	***Selection of delivery organisation***
Difficult social problem that is priority for both government and social investors	Capacity to scale up operations
Suitable programme and length of assessment	Relationship with government agency
Sufficient measurable savings generated	High profile and strong reputation
Programme evaluation and evidence base	Existing relationship with social investors
Cost of programme suitable	Track record of social innovation

Annex 3 Managing risk in the implementation of a pilot

Our proposed financial structuring and programmes are very much at the path-finder stage, with no set of established good practice to follow. This implies that a careful approach to risk management is needed. We can broadly identify four types of issues:

Figure 12: Risk management issues

These are considered in turn below.

Contract process risk

The process of designing a suitable scheme will require the deployment of a range of skills: analysis and creativity, stakeholder management (covering awareness of the different needs of policy makers, service providers, investors, and commissioners of services), programme management skills, negotiating abilities, legal and accounting expertise. A key way to mitigate risk will be to ensure that the instigators of the intervention have that expertise available when required.

When the required form of intervention has been established, the commissioners of the intervention will need to test the ability of bidders to deliver the outcome (see also Delivery risk below), whilst recognising that sub-contractor arrangements may well be new. In such cases, other mitigation will be needed, such as an examination of the ability of potential providers to effectively procure and manage sub-contractors and/or whether they have tested the market for suitable sub-contractors.

Sufficient time will need to be allowed in the procurement process to establish new delivery arrangements, and also to establish relationships between investors and the service deliverers. Commissioners will need to recognise that investors will generally only provide an 'in principle' commitment to work with a particular provider at the initial bidding stage. They should allow time for commitments to be finalised through a more detailed process of due diligence during the procurement process. A further issue is around ensuring that the contracts enable the partnership to change providers or even to terminate the service in the event that poor delivery is leading to significant loses for investors.

Delivery risk

Moving from a promising idea through to medium scale implementation often requires a strong combination of leadership determination, effective idea, willingness to adapt on the basis of feedback, project management expertise, and a sustainable source of finance (Mulgan et al., 2007).

The difficulty of obtaining all these attributes together frequently contributes to results being lower than planned, which is why New Economy (2013: 26) argues that planned benefits underpinned by secondary evidence from a similar type of intervention should be discounted by 25% in business cases.

Such risks can be mitigated by:

- Identifying areas where positive factors for outcomes clearly outweigh negative factors (for instance, a lack of similar activities underway, local leaders in favour of the scheme, scheme is suited to the culture of the locality, etc.);
- Ensuring that the management team that would lead the strategy and operations has the right experience, expertise and level of resourcing;
- Ensuring that market research and marketing assessments can justify assumptions as to revenue streams and outcomes;
- Reviewing the track record of the initiative;
- Ensuring that the providers have incentives to ensure that difficult transition phases are seen through and prepared for.

Measurement risk

A key issue in Payment by Results projects is how to measure the impact fairly. Funders and government must be confident that the metrics are a reasonable measure of performance. This in turn means that the measurement system should be measuring those outcomes that are important (not just those outcomes that are easy to measure), and should be taking into account outside factors as a way of assessing what effects are attributable to the intervention.

Where the intervention is the main influence for a particular group (such as former offenders leaving prison), the effects are easier to assess. Where there are a range of influences, the link is more problematic. To manage this risk, partners should ensure the business case identifies the range of interventions underway, and use a control group with similarly high levels of existing interventions.

For confidence that progress really has been made, it is important to show that the changes in outcomes are statistically significant. This in turn is easier to assess with a larger cohort size and/or greater effect per client. Statistical modelling should be used to determine whether anticipated effects will be properly identifiable given proposed sample sizes.

System effectiveness risk

Achieving 'real' savings for government can be difficult. It may be that major changes have to occur for savings to be achieved (for instance, closing down a prison), or it may be that the specific government stakeholder may not benefit from the saving even if government as a whole saves money. It is therefore important to:

- Ensure the process of making savings is clearly identified and agreed at the beginning of the project;
- Ensure that those who will benefit from the improved outcomes all have processes to identify those improvements and are active in introducing plans to recoup savings.

A further challenge is ensuring that the intervention does not displace existing spending and interventions by incentivising existing funders or providers to cut spending or provision. This is particularly challenging where considerable overlaps exists with existing public provision. To manage this risk, it is important to include existing providers in the process, either as formal partners, or as signatories to formal agreements to maintain current level of spending or program delivery.

Measurement processes should also be careful to take into account wider system effectiveness issues (for instance, by assessing whether any problems have been 'displaced' into neighbouring areas).

A final challenge around system effectiveness is that the scale of the project should be sufficiently high to ensure that start-up costs are proportionate. Any disproportionate start-up costs need to be carefully identified and mitigated in advance to ensure that the business case remains positive.

About Agensi Inovasi Malaysia

Agensi Inovasi Malaysia (AIM), a statutory body established by the Government through an Act of Parliament was formed to jump start wealth creation through knowledge, technology and innovation. The agency's mission is to stimulate and develop the innovation ecosystem in Malaysia, commercialise local intellectual properties and create positive impact in society, to achieve the economic as well as social goals enshrined in Vision 2020.

AIM's main objectives are to:

- Generate additional revenue to contribute to Malaysia's GDP
- Provide additional jobs for the Malaysian workforce
- Inspire and produce a new generation of innovative entrepreneurs
- Facilitate the evolution of Malaysian companies into major global players
- Encourage enterprising activities amongst the population

For more information, visit: www.innovation.my.

About Scope Group

Scope Group is an international impact consultancy and social design firm, specialising in systems innovation, shared value, corporate responsibility, and strategic advisory for the public, non-profit, development and philanthropic sectors. Scope Group's mission is to create impact by design through harnessing the power of social innovation and partnerships. For more information, visit www.scopegroup.asia

About the authors

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Shariha Khalid is Executive Director and Co-Founder of Scope Group with over 15 years work experience in roles in the public, private and non-profit sectors in the UK, Denmark, USA, Sri Lanka and Malaysia. An experienced clinician, management consultant and social designer, she focuses on policy design, systems innovation and partnerships for impact.

George Bohlender is Senior Consultant, Impact Projects at Scope Group. He has over 20 years experience in community economic development, managing and delivering grant and loan programmes and employment training programmes for governments and NGOs in aboriginal communities across north western Canada and Malaysia.

Wan A. R. Kamil is an Islamic capital markets expert who is sought after internationally. He currently serves as a Consultant to the Securities Commission Malaysia, as associate consultant at Scope Group, and as a non-executive director of Alkhabeer Capital. He previously worked for Bank Islam Malaysia, and was Chief Executive Officer of Abrar Discounts Berhad. He is a lecturer on sukuk, liquidity management, treasury, and related Islamic finance.