
Building the Capacity for Impact

A report on the capacities needed by the social sector
to deliver the aims of the social investment market

Prepared by Impetus – The Private Equity Foundation

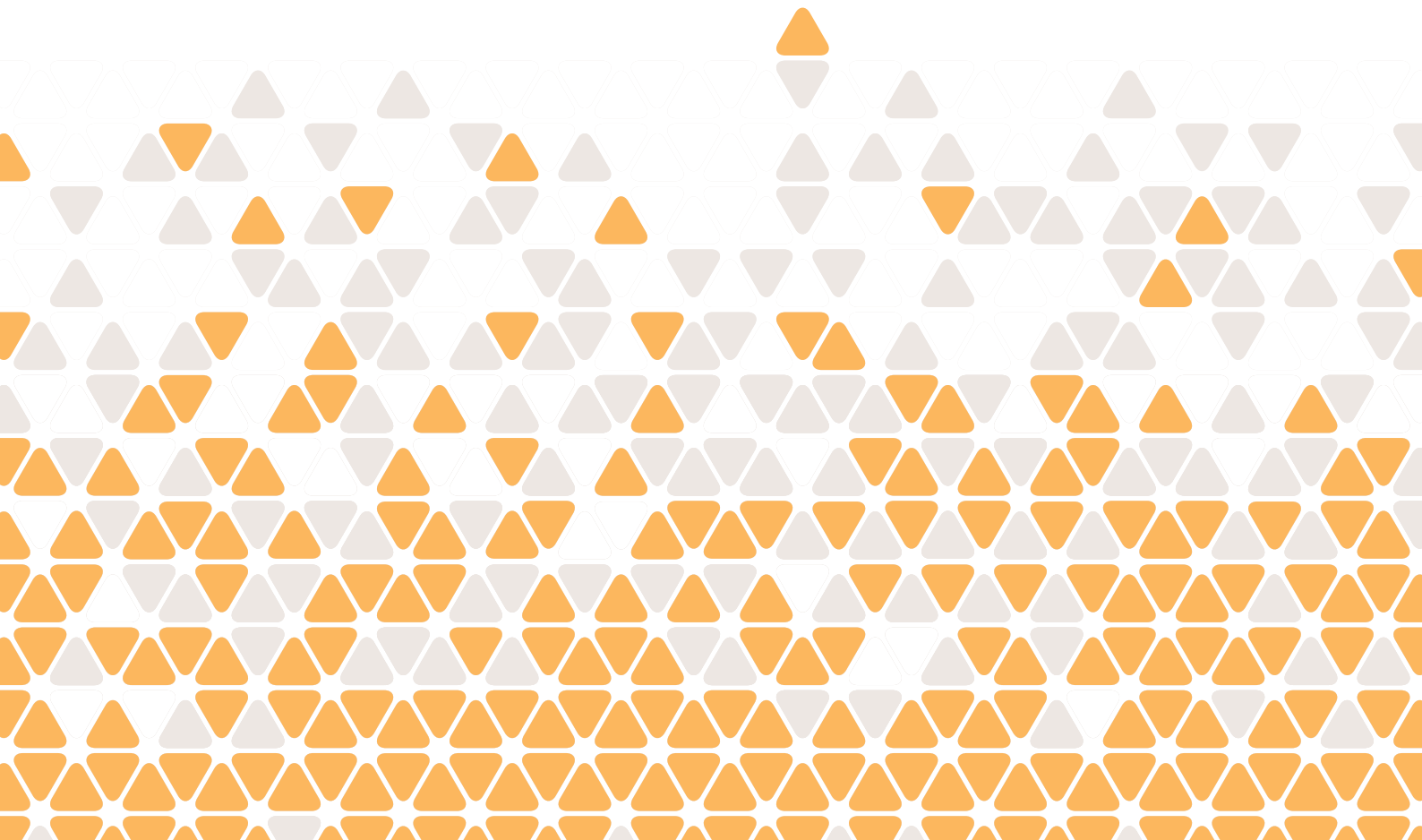


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This report has been guided and informed by the Capacity-Building Working Group, which was set up to support the UK Advisory Board to the G8 Social Impact Investing Taskforce. The group was chaired by Impetus-PEF, and membership was drawn from the Advisory Board. Full membership can be found in the Appendix One.

Executive summary

- 'Investment-readiness' to date has not taken into account the ability of investees to reliably deliver social outcomes, even though much of what is needed to enable and support the production of social outcomes would strengthen the social investment market's overall robustness and effectiveness.
- There is a greater need to focus on and invest in 'impact-readiness' (as defined below), so that social investment is able to deliver robust social, as well as financial, return. For clarity, this is *not* addressed by just measuring social impact: first, social outcomes need to be reliably *produced*. The ability, incentives and skills to do that are a key capacity gap we need to address.
- By building 'impact-readiness' capabilities, a market for social outcomes can be created, and investors would then be able to reliably invest in a predicted social outcome, as much as they now expect a certain financial return from a mainstream investment.
- Compared to 'transactional' or 'operational' capacity-building (such as governance, finance, processes, etc.), there is less availability of 'impact-readiness' provision and skillset – and implementation takes longer. However, failure to deliver on social impact undermines the very notion of social investment. Ultimately, both types of capacity-building are needed, but this paper highlights the importance of increasing the supply of the latter type.
- This paper (item 9) has a series of recommendations for government, commissioners, investors and grant-makers, which aims to begin to tackle this issue head-on.

1. Introduction

There are two types of organisational capacity-building required by the social sector – one is around building strong resilient organisations which can grow sustainably. The other is around building organisations which can reliably and predictably produce meaningful social outcomes, eventually for large numbers of people. Both are crucial for the social investment market to flourish, but the latter has been neglected in attempts to develop the market.

This report:

- considers the reasons for this neglect, and its longer-term implications.
- concludes that the gap in funding and support for the development of ‘outcome-producing’ capabilities is a threat to the development of an effective social investment market which uses finance to solve social problems.
- makes recommendations designed to help build sector capacity, and align incentives, to produce social outcomes.

In theory, ‘impact-readiness’ should be part of being ‘investment-ready’, as the social investment market, by its very definition, should aim to produce both financial and social returns. However, a narrow, finance-driven conception of ‘investment-readiness’ as a proxy measure for successful capacity-building exacerbates the neglect of outcome-producing capabilities. The report proposes that a concept of ‘impact-readiness’ be used to describe an organisation capable of replicating social outcomes for a defined population. This will help guide all those who wish to pay for outcomes – whether investors, commissioners, or grant-makers, and those who wish to produce them.

The report considers both the capacities associated with sustainable organisational growth, and those which lead to the reliable production of social outcomes. We based our findings on:

- wide consultation with relevant stakeholders
- international and domestic examples of successful philanthropic capacity-building
- examples of organisations developing these capabilities to ensure they can successfully deliver on social investment deals.

Crucially, we have differentiated organisations which might be considered candidates for social investment on the basis of their potential to produce meaningful social returns. We have considered their different capacity-building needs. Our aim is that these findings and recommendations will accelerate progress towards a cadre of high-performing social sector organisations, facilitated by a thriving social investment market.

2. The purpose of social investment

The development of a social investment market is predicated on the belief that there are organisations which can produce social outcomes (sometimes called ‘social returns’), and that for some investors, investing to fund these outcomes can also result in a financial return.

This report focuses the majority of its attention on the organisational capacities which are key to producing social returns, as distinct from financial or management capacity. This is where the capacity-building gap appears to be greatest – there is greater funding and supply of skills available to help organisations build financial and management capacities, than there is to help them build capacities essential to reliably producing social outcomes. We also reflect on the fact that the wider funding and commissioning environment does not incentivise organisation to focus resources on these skills.

It is important to bear in mind that simply securing investment - making more deals happen - is not the final outcome in the development of a social investment market. Rather, its most passionate proponents speak of seeking to successfully resolve the most pressing social issues by building organisations able to tackle these. Social investment is the facilitating step as a source of rational, non-erratic funding, to facilitate growth and sustainability. As a final step, to sustain the market, organisations will also need to produce financial returns.

3. Investible organisations?

The development of the social investment market has shown that there are different 'types' of organisations which are considered candidates for investment. While investing in any of them may have benefits for the economy and for society, not all organisations considered to be in the 'social sector' are equal in terms of their ability to produce meaningful social outcomes or in terms of the distinctiveness of their offer to social investors.

We have divided the market into three categories (see below). It should be noted that these categories do not correspond to the different legal forms of social businesses. The majority of legal forms available would be suitable for organisations in any of the categories. Our categorisation is on the basis of an organisation's route to social outcomes.

- D **The Donation Model:** an organisation which commits to donating a proportion of its profits to a social cause, which could be an entirely separate organisation. In this case, the organisation has no clear route of accountability for actually delivering the social outcomes. An example might be Patagonia clothing.

- S **The Side-by-Side Model:** an organisation which commits to producing social outcomes (or at least social outputs) at pace with sales, or service delivery. Examples might include the employment of vulnerable people in the workforce, or the distribution of a needed product. An example might be Tom's Shoes.

- E **The Embedded Model:** an organisation whose business is producing social outcomes, and whose ability to generate revenue (should) depend on their ability to consistently produce these outcomes, though they are also very likely to be in receipt of grants. This includes organisations who aim to get the long-term unemployed into work, stop offending behaviour, and increase academic attainment in target populations. An example might be Tomorrow's People. For-profit organisations outside the social sector – for example, A4E - also fit into this bracket, highlighting that this is a field where there is great competition for resources even though we would argue that many of the available resources do not incentivise impact. It would also include organisation that trade solely to fund social programmes.

D, S, and E are all candidates for social investment. D and S though, as well as for-profit Es, might also be credible candidates for mainstream investing. Not-for-profit Es have, historically at least, often been candidates for grant funding, either from governments, foundations, or public donation. These funding sources are notably erratic and somewhat irrational, and have very rarely been driven by evidence of social outcomes being reliably produced.

However, in a more rational funding market, it is notable that, of the three types, only E's ability to make financial returns actually depends on its ability to produce tangible, measurable social outcomes (as distinct from outputs). There is growing

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evidence that to reliably produce social outcomes E requires some distinctive performance management knowledge and capabilities which D and S do not necessarily need. Potential investors need to be aware of these, and able to identify when organisations have these capabilities. Failure to do so leaves investors exposed.

The difference between D&S and E has been summed up as: 'For D&S, social outcomes are a currency, not a commodity'. Social outcomes increase their appeal to investors, over and above their main competence or revenue-generating activity. But for E, social outcomes *are* the commodity, and it is the strength of their ability to produce these that they will trade. D, S, and E all have value to the economy and *may* all produce meaningful social outcomes. The government is, and should be, concerned with developing the capacity, including the 'investibility' of all three types.

But if we treat the three types as though they all have the same capacity-building needs, there is a strong possibility of ending up with no Es, or at least not ones which can consistently deliver meaningful social outcomes. We would strongly argue that, in attempting to stimulate a social investment market that achieves its key goals of securing improved outcomes for public health issues, disadvantaged people and communities (thus relieving pressure from taxpayers' funds), government, and its limited resources, should be *most* concerned with developing Es.

4. From ‘investment-readiness’ to ‘impact-readiness’

Since 2010, there has been growing interest in ‘investment-readiness’ – what it is and how to develop it in organisations which might be candidates for social investments, particularly E organisations. The July 2012 report ‘Investment Readiness in the UK’ defines (social) investment readiness as:

“An investee being perceived to possess the attributes, which makes them an investible proposition by an appropriate investor for the finance they are seeking.”

This definition recognises the fact that ‘investibility’ is, to some extent, in the eye of the beholder, and will vary from investor to investor.

Few attempts have been made to identify the attributes of an ‘investment-ready’ organisation have been made, and these have largely focused on organisational and managerial competences, as well as knowledge such as where to find appropriate finance, and how much to ask for. Considerations of social impact capabilities are usually limited to ‘social impact reporting’ or ‘measurement’, and then then not prioritised as an attribute, as opposed to an impressive business plan.

One such attempt to list the attributes by the University of Northampton, based on interviews with Social Investment and Finance Intermediaries (SIFIs), reports that SIFIs often ‘use intuition in assessing the social mission of a social enterprise’. It is possible to rigorously assess an organisation’s impact, or at least the plausibility of their Theory of Change, and results to date. The “Standards of Evidence” developed by NESTA are a useful, and user-friendly guide. Using ‘intuition’ to do this does not indicate that the capabilities needed to produce social outcomes have been understood.

This focus on building financial and management capacity is also evident in the £10 million Investment and Contract Readiness Fund, the government’s major initiative in this area which launched in 2012. The Fund, which is managed by the SIB Group describes itself as providing ‘grants to social ventures that have the potential for high growth and delivering positive social impact for the purchase of specific capacity building support to help facilitate that growth’.

A recent interim evaluation of the ICRF shows there have been 42 investment readiness grants totalling £4 million and 51 contract readiness grants totalling £4.8 million awarded (plus one additional grant marked as both investment and contract readiness). The average amount requested was therefore around £100,000 for both investment and contract readiness applications.

A survey of 85 fund applicants, asked about their motivations for applying to ICRF, found all were actively looking for support to raise investment or win contracts. To support this, nearly half were looking to define or build the case for growth, and a third were looking to perform financial accounting or cash flow modelling. Less than a quarter were looking to measure their social impact or develop their social mission strategy.

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However, nearly two-thirds were confident that, prior to application, they *already* had the skills to win contracts and perform financial accounting or cash flow modelling. Less than a quarter were confident that they had the skills to measure their impact or develop their social mission strategy (22%).

Anecdotally, it has been reported that impact measurement and social mission capacity building was particularly likely to be removed, or scaled down, in project scopes.

To become successful organisations (which may seek investment), D, S, and E are likely to need capacity-building, which may well include the types of capacity successfully funded under ICRF. However, an unintended consequence of this, has been a recent tendency, within the social sector, to use 'investment-readiness' as a proxy measure more generally for whether capacity-building has been successful. This is problematic because 'investment-readiness' includes a desire on the part of an organisation to take on repayable finance. In fact, a successful capacity building programme might well build an organisation's ability to deliver social outcomes whilst producing financial returns whilst not developing this particular desire or need. Therefore 'investment readiness' is a poor proxy for successful capacity-building unless building the desire to take on repayable finance was the original aim, or for an explicitly transaction-focussed fund such as ICRF. 'Investment-readiness' is, however, a fair description of a discrete piece of work that may be needed after an organisation has built its capacity in several areas, including its outcome-producing areas if it is a E organisation.

We propose a new term: 'impact-readiness'. This would capture an organisation's capacity to produce its outcomes (e.g. to reliable secure sustained employment for the long-term jobless) and indicate its suitability for scaling (such as expansion to new locations), once outcomes had been proven.

Genuine production of, and then growth in, outcomes does not happen without a tightly defined:

- set of long-term, and shorter-term social outcomes to be achieved
- target population the organisation will serve
- programme with some evidence-based claim to produce these outcomes.

This blueprint for outcomes must then be operationalised alongside intensive performance management. This takes specific organisational capabilities neglected by capacity-building programmes to date. Some organisations (Ds and Ss) do not need to dedicate significant resource to building their social outcome-producing capabilities, and their priority is to grow whilst ensuring they have the financial and management capacity to make their growth sustainable, and whilst safeguarding their social mission. Es may progress more slowly through these 'growth in size' capabilities whilst they prioritise the 'growth in outcomes' skills.

5. Building ‘impact-readiness’

There is disproportionately more capacity-building support for organisations at start-up and early stage, as can be seen in the proliferation of incubator funds and programmes. The Investment and Contract Readiness Fund is distinctive and looks to be successful at providing transaction-focused support.

But this is not the same (and was not intended to be the same) as building capabilities for long-term impact growth, or even on delivering the capabilities organisations need *after* the deal has been made. Certainly, in the recent ICRF evaluation, no organisation appears to have accessed funding to build the capabilities, or diagnose the need for them, that we have identified as essential in the matrix towards the end of this report.

There is, therefore, not only a significant gap between exit from an incubator and readiness for the ICRF (this gap is sometimes referred to as ‘Death Valley’ for social organisations), but also a real lack of support for E organisations looking to build their outcome-producing capabilities – their ability to reliably produce meaningful social outcomes. This should worry government in particular as these are the organisations, and those are the skills, needed to successfully commission high-quality public service provision – whether via Social Impact Bonds, Payment By Results contracts, or fee-for-service contracts.

D, S, and E have many shared capacity needs, particularly at early stage. This overlap, which can be seen in the matrix below, has probably contributed to the lack of visibility, understanding, and support for the distinctive capacities needed by E organisations to reliably produce social outcomes.

Additionally, this is an area of emerging knowledge and understanding, which is less widely shared than knowledge about how to scale an organisation. It took several decades to develop and build a consensus on what profit-driven businesses need to grow and scale successfully, and the social sector has been able to borrow greatly from this learning.

To grow a social organisation’s impact requires *new* skills, practices, and techniques, which are more distinctive to the social sector. However, its principles are visible in high-performing social sector organisations (particularly in the US), and in the performance and data management skill sets, the ‘retro-fitting’ of which has been a condition for success for organisations delivering Social Impact Bonds.

Social investment organisations can play a really useful role in bringing these capabilities to prominence. In doing so they would play a crucial role in the reliable production of social outcomes. Encouraging more organisations to develop these capabilities, and encouraging government and other interested funders, to provide funding for this, will benefit the development of the social investment market through the growth of robust E organisations, able to take on Payment by Results contracts, offer quasi-equity, and act as the delivery partner in Social Impact Bonds.

This social investment will primarily allow meaningful social outcomes to be produced for more people, but will also allow organisations to continue to develop

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and refine their performance management, allowing for future growth in outcomes, and in scale. In this way, the market will meet its overarching ambition – *to use markets and financial products as tools to incentivise and drive the growth of organisations which provide genuine social outcomes to pressing social problems.*

6. Lessons from investment to date

The immaturity of the social investment market means that there is little published evidence to date on which capacities have proved to be most important to a successful investment i.e. one that actually delivers predicted or better financial and social returns.

It is very important that this learning is captured. Early investors may make ‘eye of the beholder’ judgments, but we would expect future investments to draw on the lessons of past investments and invest in organisations which ‘look like’ those that have successfully produced returns. Indeed, as mentioned above, the examples of the SIBs to date suggest that social investment can play a part in reconfiguring the incentives of the sector, so that financial reward is aligned with the production of genuine social impact.

It is important to note that, in referencing learnings from SIBs, we are not suggesting that this form of social investment is necessarily more likely to lead to impact than other forms of finance. We believe that the performance management (as defined below) visible in some SIBs can, and should, be replicated cross other types of social investment, and beyond.

From the available evidence, and from conversations with SIFIs, it is apparent that performance management (despite its absence from the ‘investment-readiness’ literature, or funding) is crucial post-investment. Performance management, in a social sector context, might be defined as the internal processes by which an organisation maintains and assures the consistent production of specific social outcomes for a defined target population. As the production of these outcomes should be crucial to the production of financial and social returns, building the performance management of organisations as part of their ‘outcome-producing’ capabilities is integral to increasing ‘impact-readiness’ and developing a successful social investment market as originally envisaged.

Some investors, particularly those less experienced in social impact, are less well-placed to interrogate social returns, or the performance management capacity of a potential investee. This lack of capacity on the part of investors increases the likelihood that social return will be a ‘box ticking’ exercise, and reduces the likelihood of the sector’s performance management capacity increasing. However, where a commissioner, or purchaser, is an arm of government, this should not be the case, and investors and intermediaries should take very seriously the need for organisations to be able to manage to the social and financial outcomes they claim to produce.

Social Finance, who are involved in several Social Impact Bonds, described the process of performance management in three parts:

1. **Data analysis:** data gathered on all individual clients to map their progress towards the short term and intermediate outcomes that were set at the beginning of the investment to trigger payments. These should be aligned with outcomes that are socially significant for the client group. This data is analysed in real times, allowing feedback loops with the frontline so that

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work with clients can be tweaked if they are not making expected progress.

2. **Strategic project management:** data should inform day to day activity at the frontline, but should also be used by management to ensure the larger intervention does not proceed 'blindly'. In one SIB, managers noted that attendance was declining at certain points and altered the programme design to include more 'sticky' activities which maintained attendance and engagement.
3. **Contract management:** this is the element of performance management that social organisations don't *have* to develop in-house, as it can be provided by a SIFI, which ensures that commissioners and investors have timely access to accurate information on the likely returns or results they can expect to receive. However, if a social venture wants to develop capacities that mean they can do without SIFI support in the future, they will need to include this.

Social Finance has had to 'retro-fit' these processes into several organisations engaged in Social Impact Bonds, and notes that, although, essential for the successful running of the Bonds, it is a costly process, and one which not all SIFIs might have the resources, or inclination, to do. It is also important to bear in mind that there is not yet evidence that these capacities, fitted in mid-investment, and usually without reference to a tightly defined operational blueprint, will be robust enough to endure post-investment. However, we would hope that they will provide a firm base of performance management skills for an organisation to build on, with or without future social investment.

It seems evident that the process described above will be essential for:

- a. Investors and commissioners having confidence that an organisation can consistently produce the social outcomes they say they can, and on which payments depend.
- b. The consistent replication of social outcomes, independent of the imperative of repayable finance.

Social Finance felt that any social organisation could develop the first two elements of performance management, and that doing so was probably essential to producing social impact. However, they were uncertain that any social organisation would, without the stimulus of repayable finance and the demands of a SIFI or investor.

It seems likely that organisations which have embedded this performance management will be increasingly likely to secure future investment, and that examination of performance management will become a feature of investors' due diligence – *if* the market demands genuine social return.

Equally, organisations that have invested time and resource in developing these capabilities pre-investment will not only be more likely to attract social investment, but

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more likely to attract funding of all types. This is because they will be better able than their peers to reliably deliver social outcomes, whoever is paying for them.

In September 2013, Big Society Capital hosted a roundtable called 'Embedding Impact'. Its purpose was to allow social sector and social investment leaders to discuss how to be effective in reliably achieving targeted outcomes and delivering impact. The roundtable concluded that most social organisations did not use data to performance manage their programme, and improve impact for beneficiaries, and that a root cause of this was a lack of clarity about an organisation's targeted outcomes, and intended beneficiary population.

One participant asked "do we really care as a sector if we are not investing enough to really get organisations to a position where they can deliver?" This is a gloomy, but understandable view, given the traditional grant-driven social funding environment, where organisations could be rewarded without clear evidence of impact, or of performance management to drive replication of impact. It will only start to change if the social investment market ties financial return to clear evidence of social return. The example of the government-commissioned SIBs indicates that where both are demanded, performance management is an essential part of organisational capacity.

7. The role of funders and commissioners

There is no doubting the high ambitions and great intentions of E-type organisations on behalf of the people they serve. The problems they are tackling are complex and entrenched. However, the lack of understanding and acquisition of outcome-producing capabilities is a key cause of E organisations not-being as effective as they should be in achieving long-term outcomes. The external environment – funders of all stripes and commissioners – has significantly contributed to this lack of capacity.

Grant-makers, including philanthropic foundations and government departments, have been keen to incentivise, and reward, efforts that result in growth in activities (for example, increasing the number of people you serve), but less so efforts that result in growth in outcomes (for example, increasing the rate of success at securing long-term outcomes). Alignment with a funder's or department's own priorities is also frequently rewarded with funding, even if it is likely to pull an organisation off-mission, which reduces its chances of creating impact.

Even where funding for Es is not grant-based, i.e. commissioned services, it is often not frequently outcome-based, with many contracts still paid on an outputs basis, and little work done to assess the long-term outcomes – or lack thereof. In such an environment we should not be surprised that there are gaps in outcome-producing capabilities, as there are few immediate incentives to fill them. In a world of scarce resources, E organisations rationally respond to incentives, putting resources into growth. More positively, we might expect that, if founders and commissioners do begin to demand and incentivise the development of outcome-producing capabilities, and the production of outcomes, organisations will respond to these too.

The social investment market is not yet a rational funding environment – indeed it is not yet really a 'market' – but there are positive signs, not least in the effects that Social Impact Bonds have had in stimulating the development of outcome-producing capabilities, including performance management, in delivery organisations. It is crucial that, to continue this, the Social Investment market must influence the grant-making and commissioning markets, and not be influenced by them. That is to say, all markets should develop to incentivise the production of the right outcomes for the right populations, rather than simply delivery of activities, or scaling of services.

In this way, we can see that the development of the social investment market can be a helpful tool in incentivising, and then building organisations which produce social outcomes, apart from the funding with which it may provide them. Both a developed and flourishing social investment market and an external funding environment which incentivises impact require the same antecedents in terms of revenue models which link payments to social outcomes.

8. The capabilities for impact-readiness

The matrix below summarises the capacities needed by organisations to both grow sustainably and be impact-ready. We have differentiated between D, S and E organisations. All organisations share the need for managerial and organisational capabilities and these need to be improved and 'scaled' as the organisations grown in size and complexity. However, evidence from the social sector, and from the delivery of the early SIBs, shows that E organisations have distinctive needs around the performance management of their programme's delivery to beneficiaries, around evaluation and evidence, and around the production of data to direct resources towards the most cost-effect outcome-producing activities. We have also differentiated the capabilities needed for growth in outcomes, and growth in size, by the stage an organisation is at. What an emerging venture needs to grow is different to what a flourishing organisation needs.

The matrix is not exhaustive, but summarises the most crucial capabilities in the view of the Working Group. It is not intended to claim that growth in outcomes – or size – will automatically follow from one stage to another. Rather the matrix attempts to describe, briefly, the minimum behaviours and characteristics an organisation will exhibit as it grows in a way which is sustainable in terms of outcome-production, and scale. We would argue that assuming an organisation is able to either reliably produce outcomes, or sustain its existence in the long-term, before it exhibits 'late stage' behaviours is not backed up by experience, and would be unwise.

This matrix draws on Impetus-PEF's 'Criteria for Highly Effective Organisations' which goes into significantly more detail about the capabilities and practices social organisations need to reliably produce social outcomes (a summarised version can be seen in the Appendix Two). It is also based on consultation with stakeholders from the voluntary and private sectors, and widely available models of good growth drawn from the private and social sector.

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Matrix of capabilities for the production of social outcomes and growth at different organisational stages

Capability	Organisational type	Start-Up	Early Stage	Growth Stage	Later Stage
Revenue Model	D/S/E	Product or Service Idea	Refined product/service and mission - Good business model and financial predictions	Strong business model presents convincing financial case for growth	External opportunities and internal capacity are facilitating scale.
Social Programme Design	E (not as essential for D&S though highly desirable from growth stage)	Social Mission (social change one aims to achieve) <i>may</i> be loosely defined, but can be clearly articulated by leader	Operational blueprint <i>being defined</i> specifying: social mission, target population, long-term outcomes, short and intermediate outcomes, programme design, performance management processes	Programme is codified, with a view to drive reliable production of social outcomes	Programme is successfully managed and refined using real time and retrospective data
Resource Focus	D/S/E	Resources are deployed <i>ad hoc</i> to short term timescales	Leadership has identified core value-producing (for D&S) or outcome-producing (for E) activities, distinct from non-core activity	Leadership is committed to driving resource towards core activities, and to building the capacity of the organisation to do core activities increasingly well	Resources are focussed on the core, and expansion activities are planned with sufficient resource to prevent dilution of the value proposition (for D&S) or prevent impact from being diminished (for E)
Leadership & Team	D/S/E	Committed, driven entrepreneur	Backable leader and recruitment plan for medium-term. Developing board	Strong leader focused on performance, and emerging top-team. Full-strength board with most competences represented	Highly-effective leader and top team relentlessly pushing for improvement. Highly effective Board.

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Financial capacity & Risk Management	D/S/E	Basic financial skills	Better financial skills. Risk management procedures being scoped. Better knowledge of broader sources of finance and understanding of which types are relevant.	Strong financial skills, accurate and efficient reporting, risk management systems in place.	High levels of financial competence, tried and tested reporting, embedded and effective risk management
Performance Management	E (not as essential for D&S though highly desirable for their social programmes from growth stage)	Operational data is collected, but individual judgment drives service delivery decisions	Relevant datasets are identified to allow tracking of progress against outcomes, and individual client progress is routinely discussed during staff supervision	Relevant datasets are clearly defined and routinely collected. Staff and managers review individual client progress with reference to these. Org'n can design and use feedback loops in service delivery so that staff can 'course-correct' with individual clients.	Data collection is routinely used to performance manage and improve work with clients. Feedback loops are leading/have led to tactical changes to delivery (individual client level) and strategic change (codified programme level)
Evidence of Impact	E (D&S should plan to progress through lower stages but are unlikely to reach QED or RCT stage)	Anecdotes suggest positive outcomes are generated	Internally collected data substantiates apparent effectiveness	Rigorously collected outcomes data are benchmarked positively against relevant external populations (e.g. other programmes). External formative evaluation provides clarity about which outcomes are being reliably produced.	External RCT or QED indicates that the programme is responsible for consistently producing meaningful lasting outcomes for the target population.

9. Recommendations

Several recommendations have emerged from the Working Group process. At the heart of all of them is the need to explicitly incentivise the development of outcome-producing capabilities, and the production of outcomes. As outlined in the report, the social investment market will struggle to be effective if it does not influence the wider social sector funding environment to realign incentives in this direction. Therefore, we have made recommendations for government, commissioners, and other funders.

Funding for capacity-building

This report states that there are a number of funds aimed at 'capacity-building' in the social sector, some aimed at specific organisation type and stage. We believe the building of 'outcome-producing' capabilities is distinctive, and requires a dedicated fund committed to generating, and supporting, long-term work to do this.

1. Cabinet Office Impact Readiness

We recommend a long-term fund be established with the aim of (a) supporting providers' ability to build impact-producing capability in organisations and (b) increasing frontline organisation's ability to reliably deliver social outcomes in *priority areas of social need*. It would be crucial to minimise the risk that frontline organisations did not use the funding to build outcome-producing capabilities. We would recommend that a portion of facilitating funding be payable only on evidence that the development of these capabilities was in progress.

2. Big Potential Fund

Big Lottery Fund's £10 million Big Potential Fund launched this year, and is managed by the SIB Group. Its stated aims are to raise awareness of the social investment market and support VCSEs who want to prepare themselves for social investment. As this report makes clear, preparation for investment, particularly for E organisations, requires careful design and management of outcome production, as well as financial and management capabilities. We recommend that, at any review opportunity, the investment panel considers seriously how to incentivise and support bids from providers and frontline organisations which will increase impact readiness, i.e. focus in developing *outcome-producing capabilities*, and not just transaction-focused ones.

Commissioning

Commissioning and procurement practice has significant implications for the social investment market, and for more social sector organisations to become effective at producing social outcomes, both commissioners and investors must become more skilled at recognising and rewarding outcome-producing capabilities.

1. Move to outcomes-based commissioning

Realigning the incentives on E-type organisations to incentivise a focus on outcomes requires action beyond social investment. Commissioners can

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contribute to this by taking a more focused approach towards outcomes-based commissioning. This does not have to mean a wholesale switch to payment-by-results models, but we recommend a greater proportion of spend overall, and a greater proportion of individual contracts, be attached to outcomes. It is important to acknowledge that current efforts, whilst welcome, fall still short of where they need to be: for example, most public service contracts and PBRs are still 'output-based' (as opposed to outcome-based) and do not provide for perverse incentives (i.e. often insufficient incentive to target those who are hardest to reach/ have more complex needs, no measure of 'distance travelled' by a particular beneficiary or group, transaction sizes which make it harder for smaller organisations to participate). Equally, commissioners need to be upskilled on this new approach in order for it to be effective and more pervasive.

A considered and purposeful approach to more outcome-based commissioning would have multiple benefits: greater clarity on the discrete social outcomes which are prioritised by commissioning bodies can build experience and capability in the sector, and greater transparency and accountability on where spending is effective in its aims. In the longer term, it should yield savings for the public purse, as commissioning would be done based on long-term value, rather than short-term cost. Most crucially for this agenda, it would complement the move, led by the social investment market, for rational funding which incentivises, and follows, outcomes.

2. Outcome-producing capacity to be a clear criteria for commissioners

Under an outcomes-based commissioning framework, it is ideal for organisations to propose delivering rigorously-tested programmes, e.g. those which have been through a Randomised Control Trial (note that RCTs need to be done at the right time in a programme's life). However, experience has shown that, it is not enough for an organisation to deliver a proven approach if they want to reproduce past outcomes. They must also have the outcome-producing capabilities we specify in this paper. Understanding of these is still not widespread and they can be hard for commissioners to specify, and even harder to assess whether their requirements are met.

We recommend that commissioners looking to commission services for social outcomes be provided with expert resource and training to help them diagnose organisational capabilities as part of pre-contract due-diligence. We recommend that this support be piloted, and its effects evaluated.

Investors

1. Investors to be educated in funding outcome-producing capacities

If investors fully understood and demanded strong social outcomes, and valued those as strongly as they value financial returns, front line providers would need to pay more attention to producing reliable social outcomes. Some of the financial surplus generated from social investment could be ploughed back into organisations for better performance management, i.e. the capacity building to produce social outcomes. Therefore it is critical that a long term view is taken of any potential financial returns.

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Social fund managers also need to resist the pressure of selling deals that resemble the mainstream financial market, but for an added social element. We recommend that they explicitly acknowledge and inform investors that the process of producing some social outcomes is longer than the production of financial returns alone – and the potential trade-offs investors may incur in their choices.

Grant-making

Grant-makers, which include government departments, trusts and foundations, and individual philanthropists are motivated to facilitate social outcomes. However, it is clear that there is room to improve their impact. We propose a new approach to what funders seek to support.

1. Grant-makers to understand, and commit to, funding outcome-producing capacities.

Investors and commissioners are not the only important sources of funding for E organisations. Grant-making is crucial to the social sector, and grant-makers have an important role to play in incentivising and supporting the building of outcome-producing capabilities, and the production of outcomes. In this way, they build the pipeline of organisations which could deliver social outcomes at scale, including via social investment.

We recommend that grant-makers examine their practice and identify whether they are funding organisations to genuinely understand and improve their practice, or merely to sustain and grow their operations. Ideally, we would support a convening of large grant-makers to work on this issue together, and determine how they can restructure some of their funding to incentivise outcome-producing focus.

Appendix One

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Appendix Two

Impetus-PEF's Criteria for Highly Effective Organisations

This table is an abridged version of an Impetus-PEF document, which is used to assess organisational suitability for investment, and to manage the Impetus-PEF process of developing organisations' capabilities over time. This table summarises the headings on the criteria used.

	Indicator	Definition
1	Strategic Leadership	Extent to which the CEO is clear on the organisation's strategic priorities and their alignment with mission
2	Performance Leadership	Extent to which the CEO inspires staff commitment to mission and goals, and dissatisfaction with failure to achieve them, and is open to change and driving continuous improvement
3	Board	Effectiveness of the Board in supporting achievement of the mission and strategy, contributing to strategic development, holding the CEO to account, raising funds and providing fiduciary oversight
4	Senior Management	Quality of individual functional leadership and collaboration within the SMT, and demonstrated operational management to enable high performance
5	Clarity of Mission	Extent to which mission is specific and articulates the organisation's intended impact and value proposition, and guides daily operations and accountability
6	Programme Design	Extent to which the programme or elements of the programme have been validated by external research
7	Evidence of Impact Delivered	Strength of the evidence that organisation achieves socially significant positive impact against its intermediate or long-term outcomes
8	Codification	Extent to which programme specifications in operational terms exist, guide daily delivery and provide the basis for monitoring process
9	Strategic Performance Management	Extent to which the organisation is a learning organisation, and systematically reviews data to make adjustments at programme and organisational level
10	Tactical Performance Management	Extent to which frontline staff and their managers use performance data day-to-day to plan, deliver, review and adapt services to ensure individual service users progress

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		towards targeted outcomes, and implementation, quality and performance standards are met
11	Resource Focus	Extent to which the organisation deploys its resources (human and financial) against core outcome-generating activities, and building the capacity needed to deliver against its mission
12	Accountability	Extent to which staff at all levels are held accountable for performance, with clarity of performance expectations, performance transparency, HR practices that support accountability, and monitoring of performance
13	Data Quality	Extent to which relevant and reliable performance data are collected, as required to monitor progress against mission and goals
14	Data Systems	Extent to which data systems provide timely access to performance data and enable strategic and tactical performance management at all levels of the organisation
15	Competitiveness	Extent to which the organisation is differentiated against others serving a similar target population, with similar outcomes, and able to mobilise resources as a result
16	Financial Health	A sufficient level of financial resources to deliver high quality services, viability of business model, and able to mitigate funding risk

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