

Does doing good pay off?

Social impact bonds and lessons for Islamic finance to serve the real economy

Syed Marwan

*Institute of Islamic Banking and Finance (IIBF),
International Islamic University Malaysia, Kuala Lumpur, Malaysia, and*

Mohamed Aslam Haneef

*Kulliyah of Economics and Management Sciences,
International Islamic University Malaysia, Kuala Lumpur, Malaysia*

Does doing
good pay off?

23

Received 4 December 2018
Revised 9 April 2019
Accepted 10 May 2019

Abstract

Purpose – The purpose of this paper is to examine the world's first social impact bond (SIB) and the lessons that can be learned for the Islamic finance industry to fulfil its true objectives.

Design/methodology/approach – The Peterborough SIB was recently announced to be successful in achieving its targeted social and investment outcomes, reducing recidivism by 9 per cent and paying back investors a 3 per cent pa return. The paper compares Peterborough SIB with socially responsible investment (SRI) *sukuk* in terms of form and substance, and finds that there are various lessons from the Peterborough SIB that can be useful for future development of Islamic financial products.

Findings – Innovative social financial tools such as SIB exemplify the true spirit of risk sharing and social responsibility, which is arguably missing in current practices of the Islamic finance industry. With the growing interest towards SRI strategies and increase in socially motivated investors, such financial tools may not only help the sustainable growth of the Islamic finance industry, but also fill in the gap between its theory and practice.

Practical implications – As such, the paper also proposes a social impact *sukuk* model which integrates the key aspects learned from Peterborough SIB. This includes prioritising social impact, measurable success indicators, data and management systems, flexible contracts, third sector integration, risk sharing and fostering the culture of innovation.

Originality/value – The findings can offer some practical insights in dealing with the issue of Islamic finance practice being overly concerned with its formal adherence with Islamic legal rules whilst neglecting its true fundamental values.

Keywords Social impact bonds, SRI *sukuk*, Social impact *sukuk*, Social responsibility

Paper type Research paper

1. Introduction

Social impact bonds (SIBs) are innovative mechanisms that bring together the public, private and voluntary sectors to address social issues that focus on delivery of outcomes. SIB is a commissioning tool where social investors provide the initial funding for a social project and receive returns based on the impact or results achieved from the project (UK Government, 2012). Broadly speaking, SIBs are a part of the “social finance” discourse that is happening especially in the western world. The term “social finance” can be described as any investment activity that generates financial returns and considers social and environmental impact which comprises four main strategies: socially responsible investing, environmental finance, development finance and impact investing (Davis Pluess *et al.*, 2015).

JEL Classification — G10, G23, P43, P34, M14. KAUJIE Classification — K19, R48, I43, I73, L4

© Syed Marwan and Mohamed Aslam Haneef. Published in *Islamic Economic Studies*. Published by Emerald Publishing Limited. This article is published under the Creative Commons Attribution (CC BY 4.0) licence. Anyone may reproduce, distribute, translate and create derivative works of this article (for both commercial and non-commercial purposes), subject to full attribution to the original publication and authors. The full terms of this licence may be seen at <http://creativecommons.org/licenses/by/4.0/legalcode>



Islamic Economic Studies
Vol. 27 No. 1, 2019
pp. 23-37
Emerald Publishing Limited
1319-1616
DOI 10.1108/IES-05-2019-0001

The world's first SIB was launched in 2010 in Peterborough, UK, addressing the issue of recidivism. The Peterborough SIB was recently concluded and was successful in reducing reoffending of short-sentenced offenders by 9 per cent, above the target of 7.5 per cent. When the programme was designed, national reoffending rates for such prisoners were at around 60 per cent. It also managed to repay the investors a 3 per cent return per annum over five years (Social Finance, 2017). Since the first SIB implementation, there has been significant interest in the SIB model. The most recent database show 132 SIBs have been launched around the world with an estimated overall value of more than UD431m and 1,064,030 lives touched (Social Finance, 2019).

These launches reflect growing interest towards socially responsible investment (SRI) trends and emergence of socially motivated investors in the wake of the global financial crisis. Recent figures show that the SRI sector has grown to approximate US\$8.72 trillion in the USA alone, and more than €20 trillion in Europe (Eurosif, 2018; US SIF, 2018).

The Islamic finance industry is also showing significant interest towards SRI and has made some progress in impact investing. This is not surprising, as Islamic finance and SRI share common ethical values and strive towards similar goals. However, there is still much contention of what is being practiced in the industry – Balz (2010) argues that there is a “formalist deadlock” whereby Islamic finance practice has been more concerned with the formal adherence to Islamic legal rules while putting the substance and its true objectives of at the back seat. Whilst the conventional and Islamic finance practices have various commonalities, the worlds of SRI and Islamic finance, unfortunately, have rarely overlapped over the early years of its development until much recently (Moghul and Safar-Aly, 2014). Nonetheless, progress is certainly being made, with SRI developments such as Green *sukuk*, vaccine *sukuk* and SRI *sukuk* over the past few years (Haneef, 2016; IFFIm, 2014; MIFC, 2016) With the growing interest towards social impact investing, various calls have also been made for the development of “social impact *sukuk*” (SIS) (Bennett and Jain, 2014), “social *sukuk*” and “Islamic SIB” (Mohamad *et al.*, 2016), as well as “Shariah-compliant SIB” (Ng *et al.*, 2015).

As such, this paper also seeks to explore the potential development of “social impact *sukuk*” (SIS) by looking at the lessons learned from the implementation of Peterborough SIB. These lessons can be useful for two main ideas – first, as a reference for the future development of SRI within the Islamic finance industry, and, second, in working towards breaking the formalist deadlock (having form but without substance) of Islamic finance practice in achieving its true social objectives.

The methodology of this paper is critical review of literature. This includes a case study of Peterborough SIB which is compared with recent SRI development within the Islamic finance industry, specifically the SRI *sukuk*. From the analyses, as an output, the paper proposes a general SIS structure and highlights key lessons for future SRI development in Islamic finance.

The structure of this paper is as follows: Section 2 will provide a general overview of the SIB model as a precursor to Section 3 which discusses the Peterborough SIB case study. Section 4 then discusses the recent development of “SRI” within the Islamic finance industry including the SRI *sukuk* framework, Ihsan SRI *sukuk* and the “formalist deadlock” in Islamic finance. Section 5 then discusses the potential development of a SIS and key lessons that must be taken into account. A conclusion is provided in Section 5 which summarises the paper.

2. Social impact bonds

SIB is a financial mechanism that helps raise investments to alleviate social problems. SIB development is often credited to a not-for-profit organisation called Social Finance, based in the UK. Social Finance was set up in 2007 to better understand the shortfall in funding the social sector. As things began to progress, Social Finance gained valuable insight on the

fundamental issues relating to funding social services. With this, Social Finance (n.d.) designed various structures that would offer flexibility and long-term funding, encourage innovation, and deliver impact – this eventually led to the SIB model.

2.1 General SIB structure

In an SIB, investors pay for a set of interventions to improve a social outcome that is of financial interest, usually to a government-commissioner. If the intervention is successful in improving the social outcome, the commissioner repays the investors their capital plus returns depending on the magnitude of the success. If the outcomes do not improve the condition, then investors may not get back their investment and returns (Social Finance, 2015). Figure 1 illustrates a general SIB model.

In this structure, after the government identifies the social area for intervention, it commissions an intermediary or an SPV to raise funds for the initial capital of the intervention programme. The intermediary issues “bonds” which are invested by private investors. The funds raised are channelled to social service providers which delivers the necessary services to the targeted population that are in need. Independent assessors will then measure the success of the programme and report the outcomes to the outcome payer, usually the government. Depending on the degree of success, the investors will get their capital plus returns. However, if the programme is not successful, investors risk losing all of their investment.

2.2 Stakeholders

As seen in the general SIB structure, there are various stakeholders involved in the model. They play various important roles that are essential to the success and sustainability of the SIB. The table below summarises the roles and examples of these stakeholders: Table I.

3. Risks and limitations of SIB

Although there are plenty of theoretical and proven benefits of SIB from initial pilots, the SIB model is not free from risks and limitations. McKay (2013) highlights that the risk shifting from the public sector to the private sector that is anticipated from SIB may not occur on a substantial scale as there is a lack of an investment market that tolerates a high degree of risk in outcomes for social programmes.

Böhler (2014), points out the substantial initial cost that the government must bear when selecting partners and designing the contracts. Even though pilot SIBs can be a source reference, the contracts and agreements are untested in many respects (Azemati *et al.*, 2013;

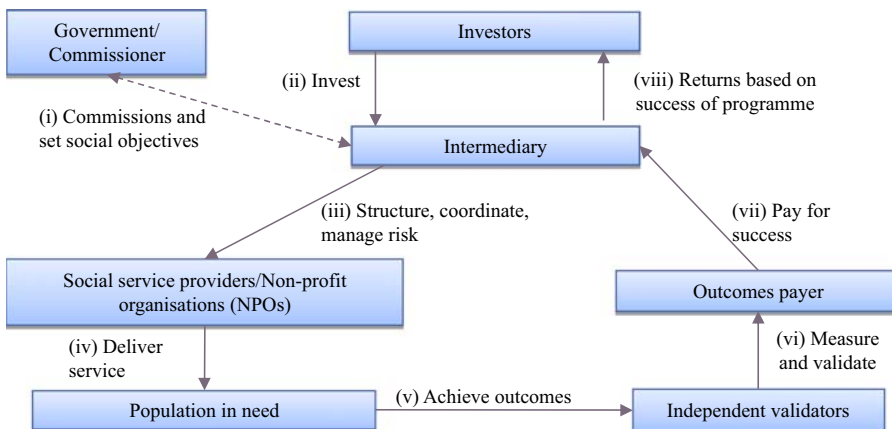


Figure 1. General social impact bond model

Stakeholder	Roles	Examples of stakeholders
Service provider	Provide social service in transaction Examples: provide capital for social service and provide data related to service provision and outcomes	Non-profit or non-government organisation (NGO), public sector service provider, cooperative, non-profit or for-profit social enterprise, for profit business
Investors	Provide capital to service providers upfront or over the duration of the contract Examples: senior lenders: investors with highest priority in repayment if outcomes are met Subordinate lenders: investors with lower ranking priority in repayment Grant makers: investors who are not repaid regardless of outcomes being met	Individual, trust, foundation, investment firm, commercial bank, credit union, public sector entity, NGO (including service providers themselves), government agency (other than outcome funder)
Intermediaries	Example: raise capital, structure deal, establish company (SPV/LLC), manage partners, receive outcome payments and pay investors, conduct performance management of service provision	Non-profit (financial structuring entity or social policy research organisation), commercial bank, impact investment firm, government agency, business
Outcome funders	Pay for outcomes Example: determine outcome metrics and repayment terms	Government, foundation, development agency
Evaluators	Assess outcomes of programme	Independent evaluation firm, research institution, university, government agency
Validators	Validate rigour of evaluation to assess outcomes	Independent evaluation firm, research institution, university, government agency
Lawyers	Advise on structure of deal, represent various actors involved in deal	Law firm
Technical assistance providers	Advise outcome funders (governments) and service providers on design and implementation of deal	NGO, university, development agency

Table I. Stakeholders and roles **Source:** Gustafsson-Wright *et al.* (2015)

McKay, 2013). The complex nature of SIB contracts, which involves a variety of stakeholders, also significantly limits the flexibility to renegotiate contracts, especially in the case of unforeseen circumstances (Azemati *et al.*, 2013; McKay, 2013).

The high-stakes, high-return outcome from SIB may also cause distortions in evidence and implementation. As such, direct stakeholders involved in SIB programmes may only select areas for which data are available and more likely to succeed, while neglecting the areas that are harder to improve (McKay, 2013; Shah and Costa, 2013).

Indeed, there are risks and limitations to SIB, as any financial instrument should. Arguably, these risks substantially come from financial risk towards investors of losing their return and capital, as well as the execution risk of failing to achieve the social impact envisioned. Nonetheless, stakeholders may find that the rewards outweigh these risks as the social impact gained may be more valuable than the money invested. Furthermore, there may be considerable cost savings as they focus on preventative intervention measures. Public funds are shifted towards early intervention which will reduce the need to spend on treatment programmes (Barclay and Symons, 2013; Nicholls and Tomkinson, 2013).

4. Case study: Peterborough SIB

In 2010, the world's first SIB was launched in the UK with support from its Ministry of Justice. Using the SIB mechanism, approximately £5m was raised from 17 investors to fund an intervention called "the One Service". The intervention programme aimed to reduce

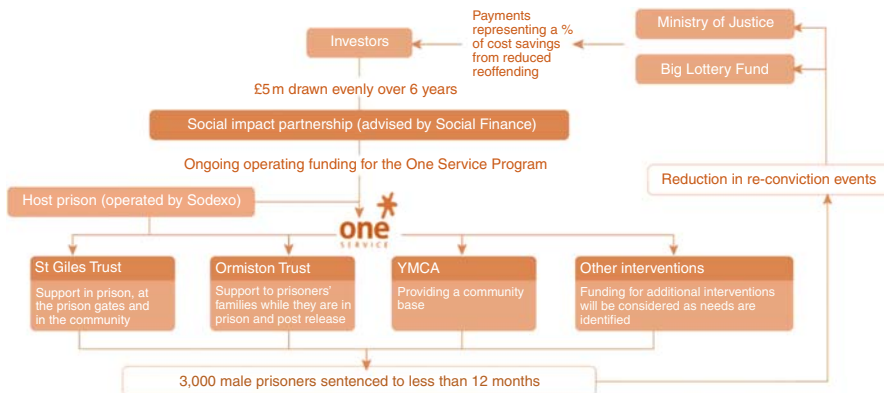
reoffending by short-term prisoners (less than 12 months) who have been released from HMP Peterborough. It was identified that reoffending rates within a year of release for short-term prisoners were as high as 60 per cent in the UK. This happened because upon release, most of these people did not have a place to live, no job, no family waiting for them and often ended up mixing with the same crowd (Helbitz *et al.*, 2011).

At the institutional level, there was no funding available for a comprehensive programme for these short-term prisoners. Existing programmes were usually one-off and inconsistently funded. Furthermore, existing programmes were fixed to a certain service without considering the individual's condition and the actual needs of each person. Additionally, the outputs of the programmes were usually based on the services provided and not on the long-term success of improving the conditions of the individuals. The existing programmes were also only limited during the time in prison and there were no follow ups of continuity when released (Helbitz *et al.*, 2011).

As such, the Peterborough SIB was developed to address these issues and to test whether an alternative and innovative programme would be successful in reducing the reoffending rate. Under the SIB, four social service providers were contracted to deliver different types of services to the prisoners. This includes their immediate needs once released from prison such as accommodation, medical services, family support, employment and training, as well as financial advice (Helbitz *et al.*, 2011). Two independent assessors were chosen to analyse the impact of the programme. Success of the SIB is measured by comparing the reduction of reconviction among short-term prisoners from Peterborough prison to the national average across the UK (Helbitz *et al.*, 2011). Figure 2 illustrates the Peterborough SIB structure in further detail.

In 2014, the programme managed to reduce reoffending rates by 8.4 per cent for the first cohort of 1,000 prisoners (Helbitz *et al.*, 2011). Theoretically, the impact achieved could benefit the government as the cost of crime can be avoided – this includes the cost of resources, such as police investigation, court cases, imprisoning cost, destruction of property and hospital costs, which can be dedicated for other areas. Thus, a proportion of these savings is used to pay back the investors (Dorsett, 2017).

The initial plan was for the Peterborough SIB programme to serve three cohorts of 1,000 people which would run until 2017. However, due to a reform in the probation system which introduced a national rehabilitation scheme called “Transforming Rehabilitation”, the Peterborough SIB was concluded earlier than planned to avoid duplication of services which would nullify the impact measurement and comparison. Under this scheme, mandatory statutory supervision was given to all short-term prisoners in the UK (Dorsett, 2017).



Source: Social Finance (2011)

Figure 2. Peterborough SIB structure

In the final press release, it was announced that independent evaluation determined that the Peterborough SIB managed to reduce reoffending of short-term offenders by 9 per cent overall. Hence, the investors were repaid in full, with a return of over 3 per cent per annum for the period of investment (Social Finance, 2017).

4.1 Experiences learned from the Peterborough SIB

In a report commissioned by the Ministry of Justice, Disley *et al.* (2015) produced several key findings regarding the Peterborough SIB. First, it was found that the programme led to better outcomes of reduced reoffending. It positively improved prisoners' past experiences of post-release support. This was because the services offered were individualised and responsive to the needs of the prisoners, addressing the practical problems that they face, offered through the gate services, and actively supported the service users to engage with other agencies for help. The services were also flexible in changing and adapting the approach according to the situation.

Second, the Peterborough SIB produced many improvements beyond the targeted outcomes. Not only did the SIB exceed the minimum target, it also helped social agencies to provide more services for prisoners as compared to before. It also provided opportunities to learn about collecting and using the appropriate data to measure impact. Innovative elements from the Peterborough SIB were also easily and usefully adopted by other agencies outside of the programme.

The third key finding found that the programme led to many pioneering innovations and increased efficiency. Apart from being the first intervention funded by SIB, the programme also filled in a gap in existing government services. The mechanism was flexible and agile, unlike existing services. Additionally, several innovative features from the programme were conveniently and usefully adopted by other service providers.

Fourth, from a contractual standpoint, the model assisted the service providers from voluntary and third sector greatly in terms of not having to bear outcome risk. This was because in the contracts, payments made to them were stable on a fee-for-service basis and not based on the outcome of the programme.

The fifth key finding outlined valuable lessons for future SIB implementations. Among the key lessons is that a dedicated service director is essential to coordinating and facilitating the partnerships. Furthermore, flexibility of funding and adaptation of services according to the situation allowed for individualised support which was essential to the success of the programme. While volunteers also played a key role in the programme by complementing the paid case workers and provided additional support to the service users. However, finding and retaining the right volunteers was challenging and required lengthy procedures and effort.

These key findings are certainly useful for consideration when developing social finance instruments or mechanisms in the Islamic finance ecosystem. The next section discusses the SRI development in Islamic finance in further detail.

5. SRI development in Islamic finance

The SIB model is commonly linked with "SRI", which is a generic term used as an acronym for sustainable, responsible and impactful investments (CIWM, 2015b), SRIs (Bennet and Iqbal, 2013; Renneboog *et al.*, 2008), and sustainable and responsible investment (CIMB, 2015; Securities Commission Malaysia, 2014a). All these terms vary but almost connote the same meanings. Generally, it can be understood that SRI encompasses social, sustainable, responsible, impactful investments or strategies. In this paper, "SRI" is used as a general representation of all the terms.

Over the past two decades, the SRI industry has seen tremendous growth with an estimated value of US\$8.72 trillion in the USA (US SIF, 2016), and more than €20 trillion in Europe (Bennet and Iqbal, 2013; Eurosif, 2016; MIFC, 2015). Because of the generic nature of

SRI, these estimations have come from various definitions of investment strategies including negative-screening, norms-based screening, engagement and voting, environmental, societal and governmental (ESG) integration, positive screening, sustainability themed and impact investing (Eurosif, 2016). During this period, we have also coincidentally seen the growth of the Islamic finance industry which is estimated to be worth US\$2.1 trillion at the end of 2016 (S&P Global, 2016). This similar growth trend is not surprising considering that Islamic finance and SRI practices share overlapping objectives. Both arguably originate from religious doctrine, which promotes an individual's moral responsibility and ethical activities, as well as consideration for societal wellbeing (Bennet and Iqbal, 2013).

SRI development in Islamic finance is often associated with “Shariah-compliant” tools and investments (CIWM, 2015a). This has been made evident through “negative-screening” practices where investment decisions are made by excluding socially and environmentally detrimental practices. Under Islamic finance, this also includes the prohibition of things related to interest (*riba*), gambling, alcohol and many others (Balz, 2010; Barom, 2013). In recent times, a more proactive approach of “positive screening” has been adopted to reflect active and conscious search to invest in that are considered positive to ESG concerns (Barom, 2013).

A prime example of the shared values of SRI and Islamic finance has been translated in the form of the SRI *sukuk* framework in Malaysia.

5.1 SRI *sukuk* framework

The SRI *sukuk* framework was launched in 2014 to promote socially responsible financing and investment ((Securities Commission Malaysia, 2014b). The framework allows for the issuance of SRI *sukuk* to raise funds that aim to:

- (1) preserve and protect the environment and natural resources;
- (2) conserve the use of energy;
- (3) promote the use of renewable energy;
- (4) reduce greenhouse gas emission; and
- (5) improve the quality of life for the society.

The framework further describes eligible SRI projects through four categories:

- (1) Natural resources – projects relating to:
 - sustainable land use;
 - sustainable forestry and agriculture;
 - biodiversity conservation;
 - remediation and redevelopment of polluted or contaminated sites;
 - water infrastructure, treatment and recycling; and
 - sustainable waste management projects.
- (2) Renewable energy and energy efficiency- projects relating to:
 - new or existing renewable energy (solar, wind, hydro, biomass, geothermal and tidal);
 - efficient power generation and transmission systems; and
 - energy efficiency, which results in the reduction of greenhouse gas emissions or energy consumption per unit output.

- (3) Community and economic development projects relating to:
 - public hospital/medical services;
 - public educational services;
 - community services;
 - urban revitalisation;
 - sustainable building projects; and
 - affordable housing.
- (4) *Waqf* properties/assets – projects that undertake the development of *waqf* properties/assets.

With the establishment of this framework, the world’s first ringgit-denominated *sukuk*, Ihsan SRI *sukuk*, was launched with the aim of improving the quality of education of schools in Malaysia.

5.2 World’s first ringgit-denominated SRI *sukuk*: Ihsan SRI *sukuk*

The Ihsan SRI *sukuk* was launched by Khazanah Malaysia Berhad (Khazanah) on 18 May 2015 with a total issuance programme of RM1.0bn nominal value and a tenure of 25 years from the first issuance (Khazanah Nasional, 2015). The first issuance managed to raise RM100m and offered a 4.3 per cent return per annum for a seven-year tenure (The Star Online, 2015). The *sukuk* is structured according to the Islamic principle of agency with the purpose of investment (*Wakalah bi-Al-Istithmar*) which allows the issuer to utilise a combination of commodities and tangible assets, making it asset efficient and suitable for the use of the issuer, SPV and Obligor (CIMB, 2015). Figure 3 illustrates the Ihsan SRI *sukuk* structure in further detail.

Under this structure, Ihsan as the *wakeel* invests the *sukuk* proceeds into tangible assets and commodity *murabahah* investments. The proceeds from the *sukuk* investments are then utilised to fund Yayasan AMIR’s Trust Schools Programme, which focusses on improving accessibility to quality education in Malaysia through various aspects including; school leaders, teachers, students, parents and the community (Khazanah Nasional Berhad, 2016).

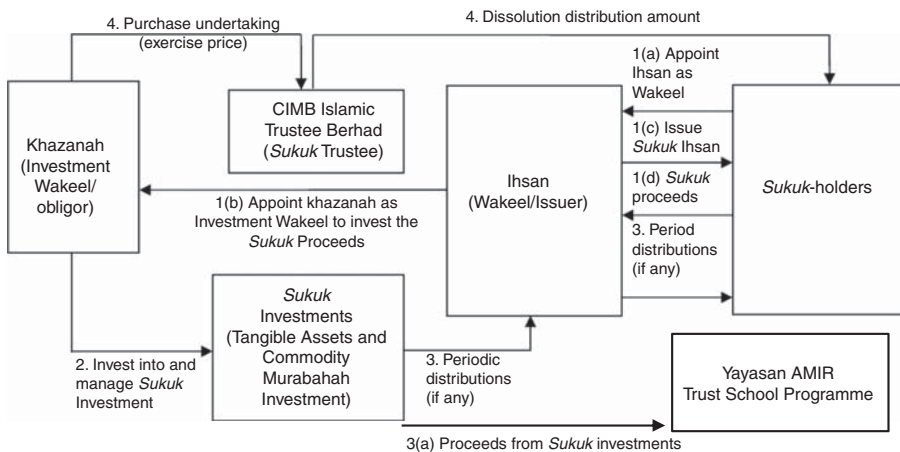


Figure 3. Ihsan SRI Sukuk structure

Source: Adapted from CIMB (2015)

A payment by results (PbR) mechanism is integrated in the *sukuk* structure where returns are based on four main key performance indications (KPIs): a minimum number of schools selected; proficiency of the teachers; proficiency senior leadership; and proficiency of students (Ghani, 2015). Based on the PbR feature, RAM Ratings (2015) argues that Ihsan SRI *sukuk* is a form of SIB as the rate of returns is contingent upon the results of the KPIs. Indeed, the development of Ihsan SRI *sukuk*, together with SRI-driven instruments such as green *sukuk* and vaccine *sukuk*, is encouraging. However, there are arguably various areas that can be improved in order to embody the true spirit and intentions of Islamic finance. The following section will discuss the dilemma of form over substance in Islamic finance.

5.3 The “formalist-deadlock” in Islamic finance

The “formalist-deadlock” is a term referred to by Balz (2010) regarding the practice in the Islamic finance industry which is more concerned with formal adherence to Islamic legal rulings whilst putting Islamic business values at the back seat. Balz (2010) posits that Islamic finance practice has mostly been about mimicking conventional financial products by simply making them *Shariah*-compliant, resulting to an industry that has failed to establish a financial system that is actually based on genuine Islamic values.

Balz (2010) argues that contrary to what has occasionally been claimed, SRI and Islamic finance practices have limited overlap. For example, SRI puts emphasis on values, whereas mainstream Islamic finance practices tend to be more rule-oriented. Another example put forth is that SRI and corporate social responsibility practices are stakeholder oriented whilst Islamic finance is concerned about legal principles. Nonetheless, enhancing cooperation and development between SRI and Islamic finance can be beneficial, and Balz (2010) provides several suggestions on what mainstream Islamic finance can learn from SRI. This includes the need for reorientation of Islamic finance to stakeholder perspective and focussing on values instead on making things rule-based.

Recent progress of Islamic finance has been slightly encouraging with the development SRI *sukuk* and its socially-driven objectives. However, there are still a number of shortcomings and questionable issues that can be improved. For example, under the Ihsan SRI *sukuk*, capital and returns to the investors are fully guaranteed by Khazanah Nasional Berhad (2016) as an obligor despite the future outcome of the programme. Therefore, there is arguably no financial or default risk for investors, virtually nullifying the “risk-sharing” principle often touted in Islamic finance.

What is more conflicting is the “step-down” approach under Ihsan SRI *sukuk* where higher returns are awarded to *sukuk*-holders if the programme fails to achieve the KPIs (4.6 per cent as opposed to 4.2 per cent if KPIs are achieved) (CIMB, 2015). Essentially, investors are rewarded more if the programme fails to achieve the KPIs. In contrast, under SIBs, the success of the programme is rewarded with financial returns, while the failure to achieve KPIs will result in investors not only getting zero returns, but also risk losing their capital investment (true risk sharing).

This is arguably a prime example of a “formalist deadlock” in Islamic finance where formal adherence to legalistic rules and profit orientation is given priority, neglecting the spirit and higher objectives (*maqasid al-Shariah*) of Islamic finance. Therefore, there is a need to develop “real” socially-driven financial instruments in the Islamic finance that can help break this “formalist deadlock”. In doing so, we can learn from the experience of Peterborough SIB and propose the development of an SIS. This is discussed further in the following section.

6. Development of SIS and key lessons from Peterborough SIB

This section expands on the idea of a general SIS model and proposes the key elements that must be taken into account when developing this instrument. These key elements are extracted from the lessons learned from the Peterborough SIB case study.

6.1 Social impact sukuk

The Ihsan SRI *sukuk* paints a picture of the possibility of an SIS that is based on Shariah principles, rulings, and contracts. Aspects of Ihsan SRI *sukuk* such as risk sharing, PbR and measurable social impact can certainly be improved through an SIS model. Calls for such models have already been made in the past few years.

Indeed, Bennett and Jain (2014) highlighted the potential for a SIS for purposes such as combating the transmission of Malaria by using the proceeds to purchase and lease bed nets to a government. Based on the success of distribution of nets and reduction of Malaria cases, savings are calculated and the government proceeds to repay investors. While *Shariah*-compliant SIBs have been proposed based on profit and loss sharing partnership contracts (*musharakah*, *mudharabah*), fee-based contract for specific service rendered (*jualah*) and integration of third sector *waqf* institution (Ng *et al.*, 2015; Reeder *et al.*, 2014). Figure 4 illustrates an example of a SIS based on *musharakah* structure.

This structure is similar to a general SIB model with the exception of the underlying contract and integration of *waqf*. In this model, the NPO or private organisations comes in as a partner that provides their expertise in delivering social programmes (labour), while investors who provide the capital (finance) can consist of the government and a number of private investors. The profit and loss are divided between the investors based on the pre-agreed ratio, subject to the success of the social programme. The “*waqf*” element can come in different forms such as the *waqf* institution being part of the partnership, returns on *waqf* capital used to invest in SIB, or *waqf* beneficiary being part of the targeted social project under the SIB. A *waqf* institution can even possibly play the role as a commissioner or intermediary of the SIS. Furthermore, elements that are prohibited under the *Shariah* such as interest (*riba*) and uncertainty (*gharar*) must be mitigated with clear guidelines. When developing SIS, lessons learned from Peterborough SIB can be used as a reference as highlighted in the following section.

6.2 Extracted lessons from Peterborough SIB for SIS development

6.2.1 “Social Impact” as a key component. In current Islamic finance practices, there is still disengagement of fund mobilisation for genuine social impact purposes. A majority of Islamic finance funds such as *sukuk* still focus on traditional physical infrastructure usually seen in public-private partnerships and performance contracts without addressing the social impact. In contrast, SIBs focus on the delivery of human services that provides positive impact to society. With the growth of SRI and socially motivated investors, there is an opportunity for Islamic finance to unlock fresh capital from new private actors and develop

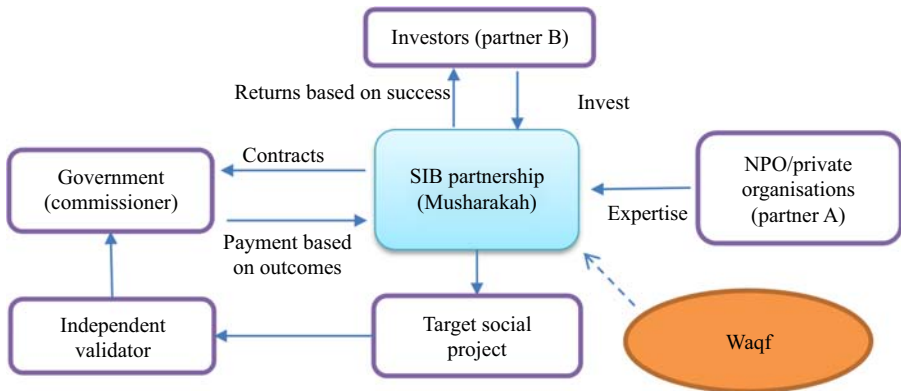


Figure 4. Social impact *sukuk* based on *Musharakah* contract

Source: Adapted from Ng *et al.* (2015) and Reeder *et al.* (2014)

a financial instrument that can provide values in both monetary and social terms. Therefore, SIS must put “social impact” as a key priority and objective in its structure and mechanism.

6.2.2 Measurable success indicators. In most times that the term “social impact” is mentioned in Islamic finance, it is represented in abstract terms and often incalculable. Similarly, terms such as “benefit to the ummah”, “helping the Islamic economy” and “fulfilling *maqasid* Shariah” are thrown around without any meaningful and measurable outcomes. The Peterborough SIB has underlined the importance of meaningful and measurable outcomes where the KPIs may represent cost avoidance or potentially fiscal savings to the government. The KPIs also utilised reasonable time horizons and were assessed by third parties to ensure independence and validity (Disley *et al.*, 2015; Gustafsson-Wright *et al.*, 2015; Tomkinson, 2015). The propensity score matching (PSM) method was used to estimate impact and was subsequently reviewed and compared to other methods to measure its effectiveness. This shows the importance of not only the tools to measure the outcomes, but also the systems that are put in place and continuously reviewed to accurately and consistently measure the outcomes (Dorsett, 2017; Gustafsson-Wright *et al.*, 2015). These factors must be put into consideration when developing SIS.

6.2.3 The importance of data and management systems. A significant aspect of SIB is the data collection and analysis that it gathers from the programme. For Peterborough SIB, a case-managed system was developed to allow all partners/stakeholders to input information so that the service can offer a tailor-made course of action for the specific person. This feature is a great progress as the data can be shared with several service delivery organisations at a time when sharing between prisons and external parties were unusual (Helbitz *et al.*, 2011). The data dashboards show everything from how being met at the gates affects reoffending rates to month-on-month comparisons of case workers’ activities (Tomkinson, 2015). In this era of information technology and “big data”, Islamic finance must also keep up with the development of management systems and data collection. Financial technology or “fintech” has been touted as the next progressive step in Islamic finance. As such, the development of financial tools such as SIS must also take into consideration the management systems and technologies that can measure social impact as shown in the Peterborough SIB.

6.2.4 Integration of the third sector and stakeholder collaboration. The Peterborough SIB improved the conventional economic model of public and private sectors and put into practice the three-sector model by integrating a third “volunteer sector”. The service in the programmes was delivered by a mix of paid caseworkers and trained volunteers from various non-profit organisations. These volunteers played various roles including offering basic advice, guidance as well as emotional support that led to the success of the SIB (Dorsett, 2017; Helbitz *et al.*, 2011). This third sector model is not alien to theories of Islamic economy as Islam emphasises on the individual striving towards the way of Allah to obtain welfare of the hereafter. Muslims, therefore, are urged to spend their wealth and energy towards improving the community (Faridi, 1983). The “third sector” can take many forms, including charities, non-government organisations, social enterprises, volunteer groups and even *waqf* organisations (Aslam *et al.*, 2013; Nahar and Aslam, 2016). However, an effective integration of the three-sector model in Islamic finance practice is yet to be seen. Therefore, the SIS may provide the avenue such practices.

6.2.5 Practice of the risk-sharing concept. The Peterborough SIB, as with the general SIB model, stipulates that investors may lose some or all of their investments if agreed outcomes are not achieved (Disley *et al.*, 2015), whilst the PbR mechanism allows for investors to gain returns if the programme succeeds in reaching the KPIs set. This truly embodies the concept of risk sharing often promoted in Islamic finance theories but is arguably still missing in Islamic finance practice. The Ihsan SRI *sukuk*, for example, still guarantees capital and returns for investors notwithstanding the outcomes of the programmes (CIMB, 2015). The SIS must therefore take this into consideration and integrate a “true” risk-sharing mechanism.

6.2.6 *Foster new ideas and innovation culture.* The SIB model allowed for stakeholders to rethink how we resolve the challenges that our societies face and successfully unlocked new capital to fund social interventions. The Peterborough SIB and subsequent launches of other SIBs demonstrate the celebration of new ideas and innovation especially in the western world. Unfortunately, the same cannot be said for Islamic or Muslim-majority countries and the Islamic finance industry which are still playing “catch-up” with the West. Often than not, there is no reliable platform to translate good ideas into practice and the “old ways” are seen as the only way. This has caused rigidity towards the culture of innovation. Therefore, it is not surprising to see Islamic finance instruments mimicking the conventional counterparts by simply making them Shariah-compliant whilst neglecting the *maqasid al-Shariah* of Islamic finance. This is not to say that this is something bad and should be avoided, but rather there is much more that can be done. Indeed, goodness or “*khayr*” learned from the conventional finance is something that can be replicated by the Islamic finance industry including from SIBs.

7. Conclusion

This paper raises the question to whether “doing good pays off?” The case studies of Peterborough SIB and Ihsan SRI *sukuk* show evidences that doing good does indeed pay off, not only monetarily but also towards the social context. The paper also highlighted the encouraging growth of the SRI sector within the Islamic finance industry. However, the paper argues that there are still weaknesses and shortcomings of the progress of SRI development in Islamic finance practice where they mimic their conventional counterparts by making instruments “Shariah-compliant” whilst neglecting the true values and substance of Islamic finance such as risk sharing and social impact. As such, the paper argues for the need to break this formalist deadlock and revive Islamic finance values through innovative developments that give priority to measurable social impact. Taking key lessons from the experiences of Peterborough SIB, the paper proposes SIS as a possible innovative tool. In doing so, the future development of SRI in Islamic finance and specifically SIS must put into consideration several aspects: social impact; measurable success indicators; data collection and management systems; flexibility of contracts; integration of third sector and stakeholder collaboration; the practice of true risk-sharing concept; and the culture of fostering new ideas and innovation. With more comprehensive and genuine SRI considerations, Islamic finance can truly play a greater role in contributing towards the Islamic economy, and provide holistic solutions to social problems that are impactful and can bring benefit to the whole universe (*rahmatan lil ‘aalamiin*).

References

- Aslam, M.H., Nahar, M., Mohd Arshad, Mustafa Omar, M. and Gairuzazmi, M.G. (2013), *3 Sector Socio-Economic Transformation Model: Exploring the Conceptual and Practical Dimensions* (R. Paper, Trans.), Centre for Islamic Economics, IUM, Kuala Lumpur.
- Azemati, H., Belinsky, M., Gillette, R., Liebman, J., Sellman, A. and Wyse, A. (2013), “Social impact bonds: lessons learned so far”, Community Development Investment Review, Federal Reserve Bank of San Francisco, San Francisco.
- Balz, K. (2010), “Breaking the formalist deadlock? Islamic investment and corporate social responsibility”, in Ali, S.N. (Ed.), *Islamic Finance: Innovation and Authenticity*, Islamic Finance Project, Harvard Law School, Cambridge, pp. 247-264.
- Barclay, L. and Symons, T. (2013), “Introduction to social impact bonds workshop”, workshop paper, Social Finance, available at: www.local.gov.uk/documents/10180/5659908/Introduction+to+Social+Impact+Bond+Lisa+Barclay.pdf/4b504b98-3e36-4fb3-97b5-3eded504756e (accessed 27 October 2014).

- Barom, M.N. (2013), "Socially responsible dimension in Islamic investment: a survey of investors' perspective in Malaysia", Paper presented at the 9th International Conference on Islamic Economics and Finance (ICIEF), Istanbul.
- Bennet, M.S. and Iqbal, Z. (2013), "How socially responsible investing can help bridge the gap between Islamic and conventional financial markets", *International Journal of Islamic and Middle Eastern Finance and Management*, Vol. 6 No. 3.
- Bennett, M. and Jain, A. (2014), "Social impact sukuk: a new frontier for Islamic finance", available at: www.islamicfinancenews.com/social-impact-sukuk-a-new-frontier-for-islamic-finance.html (accessed 19 December 2014).
- Böhler, N.J. (2014), *Social Impact Bonds in Emerging and Developing Countries (Bachelor)*, University of St Gallen, St Gallen.
- CIMB (2015), *Ihsan Sukuk Berhad: Information Memorandum*, CIMB.
- CIWM (2015a), "Special Edition 2013-2015 Bulletin", Lorong University A, Kuala Lumpur.
- CIWM (2015b), "SRI & the case for Islamic investment funds", in Malaysia, B.N. (Ed.), Centre for Islamic Wealth Management, BNP Paribas, & INCEIF, available at: www.mifc.com/repository/0186SRI%20e-Book.pdf
- Davis Pluess, J., Govan, S. and Pelaez, P. (2015), "Conditions for scaling investment in social finance", available at: www.bsr.org/reports/BSR_Conditions_for_Scaling_Social_Finance_2015.pdf
- Disley, E., Giacomantonio, C., Kruithof, K. and Sim, M. (2015), "The payment by results social impact bond pilot at HMP Peterborough: final process evaluation report", Ministry of Justice Analytical Series ed., Ministry of Justice, available at: www.justice.gov.uk/publications/researchand-analysis/moj
- Dorsett, R. (2017), "HMP Peterborough social impact bond – learning exercise", available at: www.societyimpact.nl/wp-content/uploads/2017/08/peterborough-social-impact-bond-learning-report.pdf (accessed 12 July 2017).
- Eurosif (2016), "European SRI study 2016", Eurosif, Brussels, available at: www.eurosif.org/wp-content/uploads/2016/11/SRI-study-2016-LR.pdf
- Eurosif (2018), "European SRI study", Eurosif, Brussels.
- Faridi, F.R. (1983), "Islamic economy: a three-sector model", in Ahmed, Z., Iqbal, M. and Khan, M.F. (Eds), *Fiscal Policy and Resource Allocation in Islam*, International Centre for Research in Islamic Economics, King Abdulaziz University, Jeddah, p. 343.
- Ghani, M.I. (2015), "The world's first ringgit-denominated SRI Sukuk", in Reuters, T. (Ed.), *Thomson Reuters - RFI Responsible Finance Report 2015: The Emerging Convergence of SRI, ESG and Islamic Finance*, Thomson Reuters, Edinburgh.
- Gustafsson-Wright, E., Gardiner, S. and Putcha, V. (2015), "The potential and limitations of impact bonds: lessons from the first five years of experience worldwide" (Brookings ed.), Brookings Institute, Washington, DC, available at: www.brookings.edu/wp-content/uploads/2015/07/impact-bondsweb.pdf
- Haneef, R. (2016), "Retail sukuk and SRI sukuk: the Malaysian experience", Paper presented at the 1st Annual Islamic Finance Conference, Jakarta, available at: www.irti.org/English/Research/Documents/Conferences/IDB-AM-41/Retail%20Sukuk%20and%20SRI%20Sukuk-The%20Malaysian%20Experience.pdf (accessed 17 May 2017).
- Helbitz, A., Powell, J., Bolton, E., Ashman, S. and Henderson, S. (2011), "The one service, one year on: reducing reoffending among short sentenced male offenders from Peterborough prison: social impact bonds" (S. Finance Ed.), Social Finance, London.
- IFFIm (2014), "International finance facility for immunisation issues first sukuk", Raising US\$ 500 million. Retrieved from available at: [www.iffim.org/Library/News/Press-releases/2014/International-Finance-Facility-for-Immunisation-issues-first-Sukuk-raising-US\\$-500-million/](http://www.iffim.org/Library/News/Press-releases/2014/International-Finance-Facility-for-Immunisation-issues-first-Sukuk-raising-US$-500-million/)
- Khazanah Nasional (2015), "Khazanah to issue first ringgit-denominated sustainable and responsible investment sukuk", [Press release], available at: www.khazanah.com.my/Media-Downloads/News-Press-Releases/2015/Khazanah-to-issue-first-Ringgit-denominated-sustai

- Khazanah Nasional Berhad (2016), "Ihsan SRI sukuk prospectus", available at: www.khazanah.com.my/getmedia/a3a86adc-755e-4ec1-855d-d01be56f7e99/Ihsan-Sukuk-Berhad-Prospectus.aspx (accessed 2 January 2017).
- McKay, K.A. (2013), *Evaluating Social Impact Bonds as a New Reentry Financing Mechanism: A Case Study on Reentry Programming in Maryland*, MD.
- MIFC (2015), "Islamic finance prospects and challenges", Bank Negara Malaysia.
- MIFC (2016), "SRI & green sukuk: challenges & prospects", Bank Negara Malaysia.
- Moghul, U.F. and Safar-Aly, S.H.K. (2014), "Green sukuk: the introduction of Islam's environmental ethics to contemporary Islamic finance", *The Georgetown International Environmental Law Review*, Vol. 27 No. 1, pp. 1-60.
- Mohamad, S., Lehner, O. and Khorshid, A. (2016), "A case for an Islamic social impact bond", *ACRN Oxford Journal of Finance and Risk Perspectives*, Vol. 5 No. 2, pp. 65-74.
- Nahar, M.M.A. and Aslam, M.M.H. (2016), "Third sector socio-economic models: how waqf fits in?", *Institutions and Economics*, Vol. 8 No. 2, pp. 75-93.
- Ng, A., Mirakhor, A. and Ibrahim, M.H. (2015), *Risk Sharing and Social Impact Partnerships Social Capital and Risk Sharing: An Islamic Finance Paradigm*, Palgrave Macmillan, New York, NY.
- Nicholls, A. and Tomkinson, E. (2013), *The Peterborough Pilot – Social Impact Bonds*, University of Oxford, Oxford, p. 50.
- RAM Ratings (2015), "Credit FAQs: rating Khazanah's Sukuk Ihsan", RAM Holdings, Kuala Lumpur.
- Reeder, N., Khalid, S., Bohlender, G. and Kamil, W.A.R. (2014), "Social financing and new models for public-private partnerships: feasibility study report", Agensi Inovasi Malaysia.
- Renneboog, L., ter Horst, J. and Zhang, C. (2008), "Socially responsible investments: institutional aspects, performance, and investor behavior", *Journal of Banking and Finance*, Vol. 32 No. 3(2008), pp. 1723-1742.
- S&P Global (2016), "Islamic finance outlook: 2017 edition".
- Securities Commission Malaysia (2014a), "Guidelines on sukuk".
- Securities Commission Malaysia (2014b), "SC introduces sustainable and responsible investment sukuk framework [Press release]", available at: www.sc.com.my/post_archive/sc-introduces-sustainable-and-responsible-investment-sukuk-framework/
- Shah, S. and Costa, K. (2013), "Social finance: a primer", Center for American Progress, Washington, DC, p. 19.
- Social Finance (2011), "Peterborough social impact bond: short summary", available at: www.socialfinance.org.uk/sites/default/files/SF_Peterborough_SIB.pdf (accessed 26 May 2014).
- Social Finance (2015), "Introduction to social impact bonds", London, available at: www.socialfinance.org.uk/wp-content/uploads/2015/05/Introduction-to-Social-Impact-Bonds.pdf (accessed 2 January 2016).
- Social Finance (2017), "World's 1st social impact bond shown to cut reoffending and to make impact investors a return", [Press release], available at: www.socialfinance.org.uk/wp-content/uploads/2017/07/Final-press-release-PB-July-2017.pdf (accessed 29 July 2017).
- Social Finance (2019), "Impact bond global database", available at: <https://sibdatabase.socialfinance.org.uk/> (accessed 2 January 2016).
- Social Finance (n.d), "History: social finance", available at: www.socialfinance.org.uk/about-us/history/ (accessed 15 August 2017).
- The Star Online (2015), "Khazanah's RM100m sustainable sukuk priced at 4.3%", available at: www.thestar.com.my/Business/Business-News/2015/06/04/Khazanah-RM100m-sustainable-Sukuk/?style=biz (accessed 4 June 2015).

Tomkinson, E. (2015), "Delivering the promise of social outcomes: the role of the performance analyst", *Laboratorio De Invesmento Social, Impetus, and Think Impact*, available at: https://impetus.org.uk/assets/publications/Report/2015_02_10-delivering-the-promise-of-social-outcomes-reports.pdf

UK Government (2012), "Guidance: social impact bonds", available at: www.gov.uk/guidance/social-impact-bonds

US SIF (2016), "US sustainable, responsible & impact investing trends 2016", The Forum for Sustainable and Responsible Investment, Washington, DC.

US SIF (2018), "Report on us sustainable, responsible and impact investing trends 2018", US SIF, Washington, DC.

Corresponding author

Syed Marwan can be contacted at: syedmarwan@iium.edu.my

For instructions on how to order reprints of this article, please visit our website:

www.emeraldgrouppublishing.com/licensing/reprints.htm

Or contact us for further details: permissions@emeraldinsight.com