Measuring social impact is complicated and may create dysfunctional incentives

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Increasingly, people who work for the good of humanity speak the language of business (G8, 2014). Social impact reporting has become best practice for many social enterprises, which use metrics such as ‘social return on investment’ as a means of quantifying their success. ‘Social impact’ can be seen as the social sector analogue of ‘profit’ in the corporate sector, in that it specifies organisational objectives and is often used as a yardstick for success.

Where has this new approach come from? My research finds that the main impetus for the adoption of social impact reporting has come from an elite group of social investors who argue that measuring the effectiveness of social enterprises is a necessary precursor to improvements. Social investors focus on social impact measures because they intend their investments in social projects to generate a blend of financial and social returns. Such measurement might quantify the savings to the local community of an after-school club that reduces truanting, improves educational attainment and increases employment opportunities for those young people who attend (NPC, 2011).

The market for social investment is growing, albeit from a relatively small base. Social investors play a key role by providing capital, while social investment intermediaries structure new ways of channelling funds to social enterprises. New financing institutions, such as Big Society Capital and its offshoot, Access, aim to stimulate investment, while think tanks and specialist consultancies enhance the view that social impact measurement represents best practice in the social sector through their research work and training activities.

A significant proportion of the managers and advisers of these organisations have previously worked in a cluster of private equity or investment banking firms. Many of them attended prestigious universities or have an MBA from a top business school such as Harvard, where they cut their teeth on case studies on investment analysis and business strategy. These social investment professionals want to improve the effectiveness of social enterprises by focusing on their ability to deliver social impact. And to manage social impact, they need to be able to measure it. In addition, the growth in pay-by-results 'social impact bonds' has contributed to the drive towards the measurement of social impact because payments to social investors are triggered by the attainment of specific target outcomes, such as reductions in re-offending rates.

In theory, social impact measures facilitate better funding decisions by revealing the ability of social enterprises to meet their objectives and enabling investors to allocate resources to the most effective organisations. In practice, though, social impact measures may be misleading. For example, it is well known that the relationship between social interventions and particular outcomes is extremely difficult to establish. Double-counting can occur where several social enterprises claim credit for a particular element of social impact. Even if these technical problems are overcome, social impact measurement is often prohibitively costly. As a result, smaller social enterprises which lack the budget for impact measurement may be unable to report their social impact and consequently miss out on social investment.

What is more, focusing too heavily on social impact measures may create dysfunctional incentives for social enterprises. A social enterprise facing short-term performance targets may be tempted to skew its social interventions towards easy-to-solve problems that generate reliable results in the short term, thereby enabling them to report higher success rates. As a result, more complex social problems that require longer term solutions may receive less attention even though they are important.

Consider the problem of homelessness: it is far easier to provide a short term solution by providing accommodation for an individual, than to provide long-term counselling to address the underlying drug and mental health issues. Worse still, some social enterprises claim to engage in social impact reporting merely as a means of marketing to potential investors, without any intention of using the data to focus their operations on the most effective interventions. I label this image-management practice 'business washing'. Another potential problem is that staff at social enterprises may find the language of social impact demotivating, because it describes their moral actions in terms of performance metrics. Preliminary evidence suggests that the reporting of their activities in terms of its ability to generate investment returns may taint their intrinsic motivation.

Where does all this leave us? In an age of austerity, it might make sense to believe that social impact reporting can be used to encourage good decision-making and to make social enterprises more accountable. Certainly, the community of social investment professionals argue that this is the case. But the introduction of this new approach to measuring effectiveness is not without risks and evidence of its potential benefits is mostly anecdotal. Social enterprises often tackle hard problems that have no easy solutions, where success in achieving objectives is notoriously difficult, if not impossible, to quantify. The possibility that some social enterprises will be tempted to 'game' their impact measures or focus exclusively on short-term projects is a potential concern. Similarly, business-washing will simply waste resources and mislead investors. Given all these issues, perhaps we should be somewhat guarded in our optimism about the ability of these new performance measures to deliver on their promise of increased effectiveness in the social sector.

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Notes:

- *This article is based on the author's paper Elite networks and the rise of social impact reporting in the UK social sector (2016), Working paper.*
- *The post gives the views of its author, not the position of LSE Business Review or the London School of Economics.*
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