Social return on investment: three technical challenges

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Abstract

Purpose – The purpose of this article is to explore three technical challenges and misconceptions involved in measuring social return on investment (SROI). Although there is considerable information available about the conceptual framework of SROI, its application is a relatively young discipline. As a result, there is great variability in how SROI is applied across interventions. This makes robust and consistent comparisons across social ventures difficult, while rendering the validity of SROI measures vulnerable to contestation. This article looks at some of the least discussed yet significant technical challenges and misconceptions in working with SROI, based on the authors' experience of measuring social investment returns.

Design/methodology/approach – The authors' approach is economic, and they approach the misconceptions and challenges of using SROI from a technical standpoint. Specifically, they identify three technical issues: the use of discount values, the incorporation of overhead costs and determinations of the counterfactual.

Findings – The authors offer some solutions to these technical challenges and highlight wider issues around the drive to isolate social impact to attract funding for social enterprise.

Research limitations/implications – Limitations of the paper relate to the authors' own inability, at this stage, to test out their solutions to these technical challenges with case studies.

Practical implications – The practical implications of this paper are that the authors offer social enterprises and social impact practitioners an understanding of little-understood technical challenges related to the SROI process. They also highlight how these might be solved through alternative methods.

Originality/value – The originality of this paper is that the authors use an economic analysis to highlight little-understood technical challenges with SROI.

Keywords Social enterprise, SROI, Social impact

Paper type Research paper

Introduction

There is increasing pressure for providers of public services, including social entrepreneurs, to evidence their social impact. Because social entrepreneurs are expected to deliver both social and financial returns – or "blended value" (Kramer, 2011) – credible, externally valid measures of social impact are now as important as evidence of financial health (Nicholls, 2009). Social impact assessment is important not only to monitor performance, but for resource acquisition, mission reinforcement and general stakeholder accountability. Although often thought of as related to the start-up and scale-up stages of social

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enterprise, social impact assessment is increasingly recognised as a lifelong performance indicator of social enterprises and social ventures more generally.

In this article, we explore some of the technical challenges and misconceptions involved in measuring Social return on investment (henceforth referred to as SROI), considered to be the pre-eminent means of evaluating net social (including environmental) impact. Although there is considerable information available about the conceptual framework of SROI, its application is a relatively young discipline. As a result, there is great variability in how SROI is applied across projects. This makes robust and consistent comparisons across social ventures difficult, while rendering the validity of SROI measures vulnerable to contestation. This article looks at some of the least discussed yet significant technical challenges and misconceptions when working with SROI, based on our experience of measuring social investment returns.

Before expanding on these three key misconceptions about SROI, we will briefly provide an overview of social impact assessment and the particular features of SROI as the pre-eminent means of social impact assessment in the UK.

Social impact assessment

Social impact assessment has spawned an industry over the past ten years, and as the social investment market grows, so the social impact assessment is likely to grow also. Social impact assessment is considered important for three principal reasons:

(1) to monitor performance;

(2) to attract external funding; and

(3) to reinforce the missions of social ventures (indicating that it is applicable across the spectrum of social venture, from grant-funded charity to income-generating enterprises).

It is also generally important to adequately recognise the social value added by social enterprise and develop comparable, less esoteric measures of added social value. The development of robust social impact assessment methodologies is also important because they can enable social enterprises to compete effectively with private sector businesses in the tendering process for public sector service contracts (Ryan and Lyne, 2008, pp. 223-224).

Social impact assessment feed into a process that gives support to decision-making processes while also serving as a tool for organisational self-legitimation (New Philanthropy Capital, 2010). More specifically, social impact assessment serves three principal functions: performance measurement (both for internal and external purposes) to attract funding (and other resources) and to reinforce organisational mission. As Nicholls (2009) points out, these distinct functions map on to distinct "disclosure logics": positivist, critical theorist and interpretative, respectively (756). There are a range of performance measurement systems available to social enterprises, including cost–benefit analysis, SROI, social accounting and auditing (SAA), enhanced social audit and CIC34. Different assessment techniques and methodologies are better suited to particular strategic objectives.

Cost–benefit analysis has traditionally been used for evaluating the costs and benefits of policies and programmes by Government, with more recent work, such as Fujiwara and Campbell (2011) looking to incorporate social and well-being considerations into the policy tool. While it is true that social impact assessment (or

reporting) is "emergent and dynamic", consistent with wider trends in innovative practices in the social enterprise sector (Nicholls (2009)), SROI has undoubtedly grown into the pre-eminent means of evaluating net social returns. SROI is characterised by Nicholls (2009) as particularly suited to meeting resource acquisition objectives (765).

What is SROI analysis?

SROI is an economic analysis derived from the cost–benefit analysis which attempts to take various types of impact into account in the evaluation of an organisation's activities (Nicholls *et al.*, 2009; New Philanthropy Capital, 2010). SROI comprises six stages: identifying key stakeholders, mapping outcomes, evidencing outcomes, establishing impact, calculating the SROI and reporting, using and embedding the report. Although it is technically similar to the cost–benefit analysis, it attempts to be more holistic. As with the conventional cost–benefit analysis, SROI combines, through an illustration of cash flow, the ratio of SROI discounted costs and benefits over a certain period of time.

It is considered to be the favoured methodology for social impact evaluation by the Cabinet Office and the Office of the Third Sector, as evidenced by the recent publication of the Cabinet Office's own Guide to SROI (written by the founders of the SROI Network). There SROI is described as a framework for measuring and accounting for a "broader concept of value" which can go beyond financial returns to incorporate, social, environmental and economic costs and benefits. The report claims that SROI is "much more than just a number" and is a "story about change, on which to base decisions, that includes case studies and qualitative […] information" (Nicholls, 2007; SROI Network, 2011). While it is undoubtedly the case that SROI is more involved than the generation of a quantitative value of social impact, it is the calculation of a comparable, standardised headline ratio which is the most attractive feature of SROI evaluations. It is for this reason that in this article we are concerned with the technical challenges of producing a quantitative calculation of social returns using SROI methodologies.

SROI has been the subject of considerable attention due primarily to its combination of a holistic approach and monetised language. As with other metrics of social impact, it has been critiqued for attempting to meet too many strategic objectives at once (see Mulgan, 2010). At an ethical level, there has been concern from third-sector organisations that "something always gets lost" during SROI analysis. There are also technical challenges, related to concerns about the considerable potential to over- or under-claim because of various issues in the calculation of SROI. We understand, however, that SROI is a young discipline at an evolutionary stage and that meeting its perceived limitations requires consideration of both ethical and technical challenges. It is also critical to note that the SROI Guide indicates that while SROI ratios are useful to track progress over a time for a particular organization, "comparison of social return ratios [between organisations] are unlikely to be helpful" (Nicholls *et al.*, 2009, p. 77). The problem is that for many organisations the strategic objective served by the SROI analysis is resource allocation, and so there is an inevitability (acknowledged by the SROI network as well) that SROI ratios will be used in a comparative context, even though the recommendation is that any comparison should only be based on the full analysis entailed by the framework – engaging stakeholders, understanding what should be measured and constructing a theory of change (SROI Network, 2012).

In this article, we focus on the technical challenges and three issues in particular:

(1) discount rates;

(2) the allocation of overhead costs; and
(3) determining the counterfactual.

We begin with a discussion of discount rates.

Discount rates

Costs and benefits that accrue in the future must be converted into present value ("PV") terms for any SROI analysis. Often costs for a project are incurred upfront, whereas benefits accrue over a longer period. The value of £100 of benefit in a year's time is less than getting a £100 benefit today because by waiting a year, the benefits that would otherwise have accrued over the year are lost. Therefore, future values are converted into PV by discounting them by a social rate of time preference ("SRTP") of 3.5 per cent in real terms, as recommended by HM Treasury's Green Book (2003)[1].

This means that all costs and benefits must first be converted from current prices (in cash terms) to constant prices (real prices, or cash prices adjusted for inflation). Only then can a 3.5 per cent discount rate be applied. In April 2012, consumer price index (CPI) inflation in the UK was also 3.5 per cent[2]. Therefore, the right discount rate to apply to costs and benefits in current prices would be 7 per cent, not 3.5 per cent[3]. We have seen many instances where SROI studies have either not made clear that cash flows are already in constant prices or have explicitly applied the SRTP to current prices.

Table I below illustrates the impact of using the wrong discount rate can be to substantially overstate the SROI – in this example, by 15 per cent. If this stream of benefits was extended to 20 years, the overstatement would be 30 per cent.

In our experience, the SRTP as a concept is not well used. The 3.5 per cent number is easily identifiable because it is consistent across government projects and has been in official HM Treasury guidance since 2003. However, the way individuals value their time today relative to future years may have changed fundamentally since then. It may be that, conceptually, some future benefit streams should not be discounted at all using the SRTP. It may also be the case that a sensitivity analysis is needed as a fundamental part of the SROI analysis.

The advantage of the 3.5 per cent figure is that it is familiar to public policy professionals. However, we believe that to use it without understanding what an SRTP is attempting to encapsulate and how it is different from discount rates, such as the weighted average cost of capital in a financial valuation context, leads to potentially incorrect SROI results.

Year (cash flows in £000s)		1	2	3	4	5	6	7	8	9	10
Costs	Current prices	(75)									
Benefits	Current prices	20	20	20	20	20	20	20	20	20	20
Discounted at 3.5 per cent	Constant prices	20	19	19	18	17	17	16	16	15	15
Overstated SROI						£1:£2.30					
Discounted at 7.0 per cent	Constant prices	20	19	17	16	15	14	13	12	12	11
Correct SROI						£1:£2.00					

Table I.
Discounting cash flows

Selecting an appropriate time horizon for the project

This discount rate issue is inextricably linked with the time horizons of social ventures, which are typically much longer than for commercial projects. For projects where costs are incurred upfront, but benefits accrue over potentially a long period of time, the selection of an appropriate time horizon is crucial to avoid overestimating benefits. Often, different projects within the same organisation may require different time horizons[4].

For example, consider a welfare-to-work scheme aimed predominantly at 16-21 year olds not in education, employment or training (NEETs). For a 20-year-old who has been a NEET for, say, three years, a successful employment outcome that lasts for more than six months, as a direct result of the scheme will certainly benefit the individual at the time of employment and possibly in the near future, in finding further employment. However, the benefit, through a decrease in probability of future unemployment, will only last for the rest of the individual's working life *if* that initial employment experience has had a marked positive effect on his self-motivation and attitude to work. If the successful job outcome is a part-time job with few or no transferable skills, the time horizon over which benefits accrue is likely to be minimal.

In the context of business valuations using discounted cash flow models, two approaches are used.

The first approach is to take the economic value of future benefit streams only over an explicit period. This could be defined with reference to the timescale of the business plan or the stated planning horizon of the key stakeholders. The second method is to project the benefits into infinity using a terminal value. A terminal value reflects the PV at a future point in time of all future benefit streams when a stable growth rate in the benefits is expected.

The table below shows an illustration of how the results could vary between both methods. The first method assumes that the same benefits accrue every year for 20 years. The second method assumes the same benefits accrue every year for the first five years, after which, projecting benefit streams is sufficiently uncertain to be able to use an approximation. The terminal value at Year 5 is the cash flow in Year 5 divided by (discount rate minus growth rate), where the growth rate is the anticipated year-on-year growth in benefits which, in this case, is assumed to be zero (Table II).

Although the second method gives a higher SROI, we believe, it gives a more robust result in this example. Forecasting changes in the probability of unemployment several years hence is impractical and exposes such projections to a variety of uncertainties limiting their validity and credibility to institutional investors.

What we can see, therefore, is that the application of the discount rate stipulated in the Green Book is problematic for several reasons, but also that in a social investment decision-making process where investors use SROI to compare projects, discount rates and time horizons become critical factors. We know, for example, that there are comparability issues when social ventures with non-commercial time horizons – particularly relevant to those early project ventures for intractable problems, such as youth unemployment and mental illness – stand disadvantaged in the measurement of real social returns. This is because the application of a standard discount rate discriminates against social enterprises which generate a higher proportion of late benefits (towards the end of its time horizon) compared to enterprises that generate early benefits and which are discounted only by three, four or five years (Ryan and Lyne,

Year (cash flows in £ 000s)		1	2	3	4	5	...	20
Costs	Current prices	(75)					...	
Benefits	Current prices	20	20	20	20	20	...	20
Discounted at 3.5 per cent	Constant prices	20	19	19	18	17	...	6
SROI > 20 years of same benefits accruing each year					£1:£3.02			
Discounted at 7.0 per cent	Constant prices	20	19	17	16	15	...	11
Terminal value		–	–	–	–	218	–	–
Discounted at 7.0 per cent		–	–	–	–	155	–	–
SROI more that five years of same benefits accruing each year, thereafter additional of terminal value					£1:£3.24			

Table II.
Benefit streams over an explicit period versus terminal value

2008). In addition, by placing greater value in the benefit accrued today than that accrued in future generations, discounting for social ventures may be inequitable. This is especially true when decisions made by today's generation impact future generations in a significant way, such as in the case of climate change policies (Dattani, 2012).

What is less understood is how using the discount cash flow rates without the incorporation of inflation rates can overestimate social returns. Similarly, the current methodology for calculating the economic value of future benefit streams might not be optimal, and in some cases, will lead to the underestimation of social returns. As social enterprises are increasingly compared to each other on the basis of social impact analysis, developing more sensitive yet standardised measures will become ever more important.

Cost allocation of overheads

Activity-based costing is an accounting treatment that seeks to assign the cost of each activity within an organisation to all products and services according to the actual consumption by each. This cost allocation is fundamentally a problem of linking costs with one or more cost objectives that cause it.

In the third sector, this is particularly important when additional funding from external sources is made available for a particular new project. Just taking into account the *direct* costs of the project underestimates the true costs, and therefore overstates the SROI. The common, or joint, costs are incurred for common, or joint, organisation objectives and must also be taken into consideration. This provides a more relevant and useful SROI figure, in that it offers helps to improve internal decisions around resource utilisation and rationing of finite resources.

As an example, an organisation with a surfeit of spare resources that receives extra funding for another project is likely to incur little extra *opportunity cost* in excess of the direct funding provided. An organisation which is resource-constrained may (inadvertently) use some of the additional funding from new projects to fund existing activities. An economist's treatments of cost allocation may differ from the SROI treatment. An economist may consider the first example as part of the project's costs. An SROI practitioner may instead include a qualitative adjustment for displacement or substitution, as percentage deductions from the benefits.

Making cost allocations requires the allocation to be fair, logical and proportionate in terms of effort in calculating to the sums involved. For a small organisation or project, a complicated cost-allocation exercise is onerous and detracts from actual delivery of outcomes.

To allocate the appropriate common costs, appropriate cost drivers are required. The funding for the new project may include marketing and management expenditure, making allowances for new hires. However, it will not make an allowance, for example, for the extra time the **IT** manager takes to set up back-office support for the new hires or the time taken by the **CE**O to interview candidates, hire and then market the new project to internal and external stakeholders[5]. These costs must be included in any SROI calculation. This processes need not be as sophisticated as those carried out by regulators, accountants and economists in regulated industries, but omitting these costs could be a significant reason for overestimating the SROI for "stand-alone" projects.

The following table gives an example of a cost-allocation exercise for the joint cost centre "Administrative Expenses" (Table III).

The table shows that for a new project called "Training Course 2" delivered by the organisation, there is a proportion of the Administrative Expenses cost centre that must be directly allocated to it, based on the time spent on that activity. However, the other activities, such as "General management support", assist in providing all business services, including the course. Therefore, part of this activity, via an allocation based on time division within that activity, should also be allocated to Training Course 2.

The simple example shows that the allocation process is based on cost drivers which could vary between cost categories. Instead of time taken for each activity, headcount, sales and assets are all examples of drivers that could be used to allocate different common costs as appropriate between the project and rest of the organisation.

Determination of the counterfactual

The third and final aspect of SROI that we will explore is the determination of the counterfactual. What would have happened anyway if the project did not take place? This is the question that the determination of a counterfactual, control group or

Cost centres	Activities in the organisation	Allocation	Allocation method (driver description)
Administrative expenses	General management support	All services	Survey of time spent
	Liaising with external and government agencies	All services requiring external and government agencies liaison	Survey of time spent
	Manage facility infrastructure	All services	Survey of time spent
	Developing Training Course 1	Training Course 1	Fully allocated to Training Course 1
	Developing Training Course 2	Training Course 2	Fully allocated to Training Course 2
	Manage contracts	All services	Survey of time spent

Table III. Cost allocation for administrative expenses

"But-For" scenario seeks to answer. The definition of the counterfactual plays an important role in damage calculations in litigation cases, public policy as well as in history, political science, philosophy and psychology. In SROI analyses, the percentage difference between the factual (what actually happened) and the counterfactual is known as the deadweight.

A perfect counterfactual is often not available, and therefore measuring deadweight is often an estimate. This could be based on data for the population available from the Office for National Statistics ("**ONS**") or government departments. The greater the similarity between the counterfactual and the factual, the more robust the determination of the deadweight.

In other fields where a counterfactual is used, it is usually calculated alongside the factual case. With SROI, the deadweight is calculated at the end of an evaluation, as a percentage that the gross benefits are reduced by.

This approach, without a dedicated analysis of the counterfactual, could lead to anchoring bias. Anchoring bias occurs when individuals overly rely on a specific piece of information to govern their thought process. Once the anchor is set, there is a cognitive bias toward adjusting or interpreting other information to reflect the "anchored" information. In SROI analyses, this manifests through using deadweight percentages from previous studies for consistency and in the absence of specific new research. An initial error, or indeed an important caveat, could be ignored over time in subsequent uses of that deadweight because of anchoring bias.

Take our earlier example of the NEETs welfare-to-work scheme. The typical counterfactual outcome would be to look at the rate at which the NEETs come off benefits or enter successful NEET outcomes, in the future, by using regional statistics from government sources. In many cases, this will be the correct counterfactual to use. However, in certain cases, it may miss necessary adjustments to the counterfactual, as discussed in the following table (Table **IV**).

These considerations highlight the risk of using "out-of-the-box" deadweight assumptions. Clearly, there are multiple scenarios which have an impact on the estimation of deadweight and the corresponding estimation of SROI. Unless the SROI analysis is conducted in-house or by an analyst with familiarity with either the ecology of the project or the profile of the participants, these differential scenarios are unlikely to be identified. Yet, as we see from the table, without careful consideration of alternative scenarios and their likelihood, significant distortion is possible. For these reasons, the validity of the SROI analysis is dependent not only on consistent application but also on the information available to SROI analysts. In practice, data availability is a key determining factor in whether these adjustments can, in fact, be made. Many organisations commissioning SROI analyses do not have ready access to the data required to avoid these pitfalls.

Attribution

Another important element of the impact of outcomes in the counterfactual is attribution risk. Outcomes are changes that happen over the lifetime of a project, such as a welfare-to-work scheme leading to job outcomes. Because SROI's claim for analytical distinction is that it focuses on stakeholder-defined outcomes, understanding and accurately claiming outcomes is vital to the credibility of the overall SROI figure. Such outcomes depend on the isolation of the specific impact of a particular social project,

Possible considerations for determining counterfactual	Impact on deadweight of not considering
If participants in the scheme are self-selected, they are likely to immediately be more motivated and self-starters. Therefore, they would have been more likely than the average NEET in that region to gain a successful EET outcome in the counterfactual	Deadweight underestimated; SROI overstated
If participants are referrals, then the referring body may have been able to refer them to another similar organisation, had this scheme not existed	Deadweight underestimated; SROI overstated
If the funding for the scheme came from a targeted government source, without this scheme, there could have been a near-perfect substitute scheme available elsewhere	Deadweight likely to be near 100 per cent; SROI significantly overstated
The participants are not "average" NEETs. The incentive mechanism underlying the government funding may incentivise targeting the "easiest-to-reach" NEETs	Deadweight underestimated; SROI overstated
The participants are not "average" NEETs. They are the "hardest-to-reach" because of associated drug, alcohol, crime and teenage pregnancy issues	Deadweight overestimated; SROI understated
The scheme is an "enabler" of other schemes. The participants also benefit from other community initiatives, but this scheme "unlocks" the full benefits from those schemes (related to attribution discussion below)	Deadweight overestimated; SROI understated

Table IV.
Possible adjustments to counterfactual

whereas understanding attribution demands an appreciation of other potential projects either prior to that under analysis or consequential to it.

We know, for example, that public services tend to work best when a network of complementary organisations work together to achieve a social aim (Kramer, 2011). Sometimes these networks are inter-sectoral, and sometimes they are intra-sectoral. The former represents a supply chain of social action where individual projects along such a chain "unlock" the next project so that each is dependent on the completion of the former, forming what might be termed a critical path of projects. This means that individual organisations along a supply chain of social action who independently produce SROI studies could overclaim by failing to separate the positive impacts of other organisations[6] that "unlock" the benefits of their scheme under consideration. We believe that such considerations are important particularly for services that have a caring or social element, such as support for victims of domestic violence or for those with learning difficulties and least important for public goods where a natural monopoly exists, such as delivering postal services.

Figure 1 below shows a hypothetical example of a 17-year-old single mother who has recently left school and become a NEET. The steps of engagement with different organisations produce catalytic benefits because the benefit of the previous project are now fully "unlocked". The correct benefits to attribute to the training scheme are the direct benefits of the scheme as well as (part of) the catalytic benefits of the childcare that have now been unlocked.

A more detailed consideration of attribution risk is likely to become more important over the coming years as payment by results becomes a public service mantra with, for

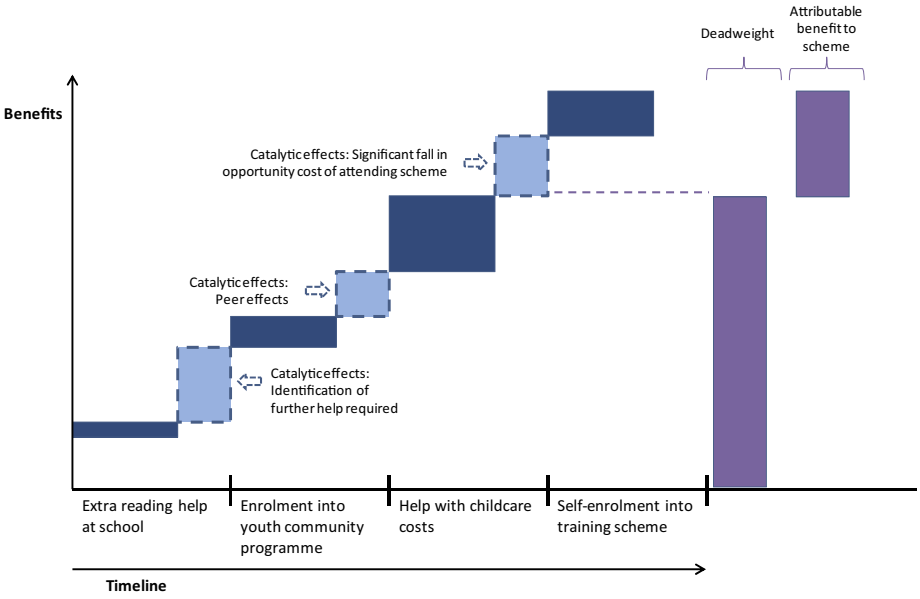

Figure 1.
Benefits accrued at different steps of engagement and associated catalytic effects

example, the Department of Work & Pensions (DWP's) Work Programme and the emergence of payment-by-results financial instruments, such as social impact bonds, where the calculation of government savings are dependent on estimations of the isolated impact of specific projects.

Where successful projects rely on the complementarities with other organisations, determining the impact of just one project will be difficult to measure robustly. It is here perhaps that the equitable involvement of stakeholders in the SROI process needs to be given fuller consideration, a point highlighted by Ryan and Lyne (2008). As discussed, this would necessarily expand the range of stakeholders involved in the process of defining outcomes and the objectives of the project/venture to include those practitioners or users who might not be direct beneficiaries or contributors, but impart value either upwards or downwards in the "social supply chain".

Attribution for a project could change over time, particularly important if the benefits of a project are measured over many years, for both exogenous and endogenous reasons. The diagram below shows a similar example to the one above, but shows that different projects matter to different degrees over time. If the benefits of the welfare-to-work scheme are uncertain but declining, the calculation of the PV of benefits could include a terminal value at Year 2, using a negative growth rate (instead of the zero growth used in the section above) Figure 2.

The conceptual arguments introduced in this section about deadweight and attribution also apply to other concepts under the umbrella of "additionality" in SROI. This has been a largely theoretical discussion, but in terms of practical applicability, real life does not lend itself to creating perfect experimental control groups where these effects can be adequately measured. The problem with SROI is that it is designed, primarily, for comparability: to isolate the impact of individual social projects (Kramer,

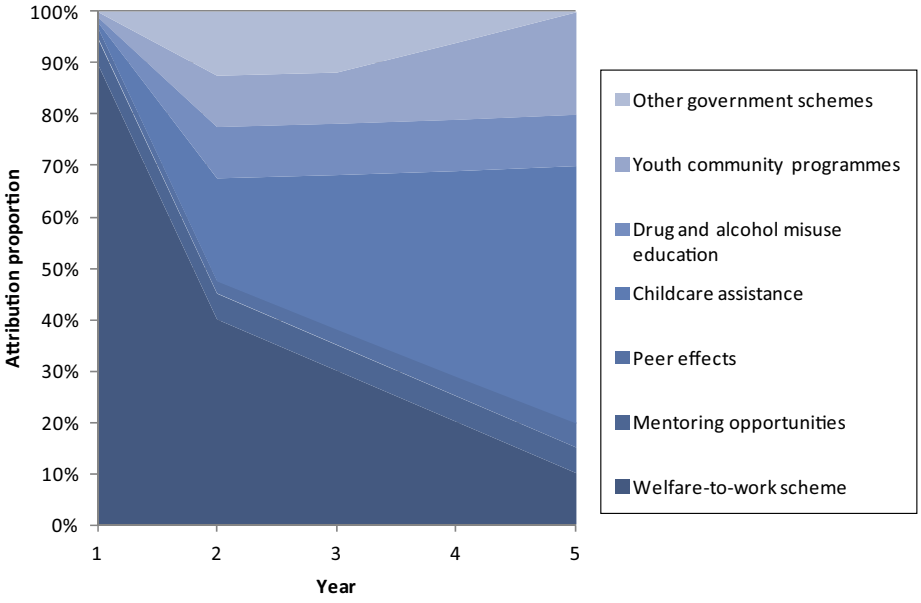

Figure 2.
Change in attribution over time

2011; Mulgan, 2010). We understand that SROI is an evolving practice and suggest that as part of its evolution, it needs to be more attentive to what we have termed the ecologies of social enterprise and investment, of which complementarity and social supply chains are one aspect.

Conclusion

The importance of SROI as a tool to measure outcomes for the strategic purposes of performance tracking, resource acquisition and mission reinforcement is gaining recognition. It is being taken up across a range of social ventures, and its popularity is only likely to increase over time as it replaces esoteric and idiosyncratic means of assessing impact (Nicholls, 2011). With the growth of the "social investment state" and the gradual phasing out of grant-giving to the third sector, we anticipate that measures of social impact will become increasingly central to resource acquisition in particular. Used properly, it also provides an engaging narrative of the organisation's impact. Nevertheless, SROI has its critics, and others have identified issues with the SROI process. These include assurances about the equitable consultation of stakeholder involvement, the sheer cost of administrating SROI calculations (in terms of both time and financial resources) and the identification and availability of suitable proxies for the estimation of cost savings (Ryan and Lyne, 2008).

Here we have highlighted three specifically technical challenges that have not received much attention, but have a significant potential to distort SROI calculations either by undervaluing or overvaluing the impact of social projects. There is great variance in the application of assumptions and inputs in many of SROI analyses, and these introduce a sufficient element of subjectivity that makes comparison across SROI figures problematic.

The key technical challenges as we understand them relate to three areas. First, discount values often fail to incorporate inflationary rates, which result in bloated SROI claims. The lack of clarity regarding the calculation of cash flows in constant prices or not is a key issue. Ensuring consistency in the application of discount values is vital to comparability across social ventures using SROI. Relatedly, the selection of appropriate time horizons for social ventures is a critical issue, particular for forecast SROIs. This is especially the case of those projects where benefits occur over a long period of time. Calculating the economic value of benefit streams over explicit periods potentially distorts the SROI by underestimating social returns. We have offered an alternative, using a terminal value to project benefits into infinity, which offers a more robust result because forecasting benefits several years into the future is impractical and fails to recognise the sheer number and diversity of uncertainties which can limit the validity of such claims of future benefits.

Second, neglecting to incorporate overheads into cost allocations can again produce overstated SROIs by failing to register full operational costs. Again, in our experience of SROI, this is a common occurrence. While we are not suggesting that the process of including the indirect costs of the project need to be sophisticated as that in regulated industries, we do believe that they must be included in any SROI calculation to ensure validity and rigour.

Finally, there are issues surrounding the determination of the counterfactual. We have broken these down into two areas: estimation of deadweight and recognition of attribution risk. With the former, we have identified anchoring bias and the need to make adjustments to the counterfactual based on intimate knowledge of beneficiaries and their entry points into the specific social project. With the latter, we have identified attribution risk which results from a tendency to neglect the position of a specific project in a "supply chain of social action" or of the complementarity of different projects in securing defined outcomes. To remedy this issue, we have recommended adopting an ecological approach which first begins by expanding the scope of stakeholders involved in initial SROI consultations beyond direct contributors and beneficiaries.

In practice, poor data availability and a lack of experience in the third sector provide barriers to reducing some of these potential biases, at least in the short term. One of the pressing issues facing the government, especially after the launch of Big Society Capital[7] and the desire to fund more social enterprises through institutional (and potentially retail) investment, is building capacity in the social enterprise and third sector to measure social impact. At present, the cost of SROI analysis, as with others in the social impact toolbox (such as enhanced social audit) is prohibitive, and there is insufficient in-house expertise in many third-sector organisations and small-to-medium–sized social enterprises. Facilitating the readiness of social enterprises for investment is an essential if financially unrewarding aspect of building the social investment market (Joy, 2011). Making such a commitment will be important if the social investment market expands to the degree that the government predicts and hopes it will (Social Investment Task Force, 2010; Westall, 2010).

There has been a recent spurt of research activity on social impact measurement and SROI in particular, but this needs to be deepened with a wider appreciation of the challenges faced by social enterprises in conducting such analyses on the ground. We have listed some of the technical challenges they might face, but there are also operational issues regarding stakeholder involvement, the fit between different

analytical frameworks and strategic objectives and the "impact of impact" measurement on organisations (isomorphic pressures). Because social impact practices are nascent in the UK, we expect that research will evolve as the discipline expands and embeds itself in the life of social enterprise.

Notes

1. The Green Book sets out a framework for the appraisal and evaluation of policies, programmes and projects for the Central Government. It describes how the economic, financial, social and environmental assessments of a proposal should be combined, such that there is consistency and transparency in the appraisal process throughout the government.
2. ONS, www.ons.gov.uk/ons/rel/cpi/consumer-price-indices/march-2012/index.html (accessed 19 April 2012).
3. For simplicity, this assumes that the current CPI inflation rate would persist over the lifetime of the cash flows.
4. See, for example, paragraph 4.9, FTI Consulting, "Measuring the social impact of the Tomorrow's People welfare to work and youth programmes between 2006/07 to 2010/11", 10 June 2011.
5. There is an important distinction with opportunity cost here. The new project may affect, for example, the IT manager's workload in two ways: devoting more time to the project by reducing time spent on existing projects which is an opportunity cost and working longer (without extra pay) without compromising his other responsibilities – this is a time cost attributable to the new project that an analysis in cash terms would not capture.
6. Third-sector organisations could have an inherent bias in their estimation of isolated versus collective impact because they are mission-driven to an extent that private and public sector arguably are not. Alternatively, informational asymmetries between organisations do not allow each other to clearly identify the complementarity between their services. These ideological and technical barriers can compound to further obscure attribution and thus increase attribution risk in the calculation of isolated impact.
7. Big Society Capital is a state initiative to kickstart a national social investment market, funded through money resting in the dormant accounts of the "Merlin" banks and match funded by the government. The amount raised through this process is estimated to be circa £600 million. Funds are not distributed directly by government, but disbursed through the investment decisions of approved social investment finance intermediaries.

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