Social Return on Investment (SROI): a review of the technique

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ABSTRACT There is an increasing need and request from society to account for the social, economic, and environmental value that results from organizational activities. This trend has led organizations to initiatives like, e.g., Integrated Reporting (IR) and Corporate Social Responsibility (CSR). Nevertheless, at the level of investment projects, the focus of traditional investment appraisal techniques (like, e.g., Net Present Value) is still on future quantifiable operational cash flow after tax. Social or environmental effects of the investment are often not included in the calculation because these effects are typically hard to quantify. Social Return on Investment (SROI) is an investment appraisal technique that is explicitly designed to include these social and environmental effects into the project assessment. In this contribution, the SROI technique is introduced and reviewed. Results from literature, and interviews with four experts indicate that SROI has strong points. However, there is still room for improvement in areas like capacity (and experience) building, verification of the projects, and in fine-tuning of the technique itself.

PRACTICAL RELEVANCE Organizations, especially in the not-for-profit area, may be confronted with investment projects that have social and / or environmental benefits that are hard to quantify. Social Return on Investment (SROI) can help these organizations to include these effects in the project assessment. This paper is valuable for practitioners that want to be introduced to SROI and to its most important pros and cons.

1 Introduction

We live in an age where transparency, accountability, and sustainability are becoming more and more important for all organizations. There is an increasing need and request from society to account for the social, economic and environmental value that result from organizational activities. This definition of value does not longer consider only financial aspects but it includes the different dimensions that are affected by organizational activities. Thus understanding and managing a broader concept of value is becoming increasingly important for the public and private sectors alike.

In spite of this social pressure, the activities (or projects) of organizations are mostly measured with respect to the financial value (wealth) they create for the organization. In many cases, financial value creation is in fact the key objective of the project that is undertaken.

For many decades, traditional investment appraisal techniques like, e.g., the Net present Value (NPV), Internal Rate of Return (IRR), or payback period, have focused on the assessment of the *operational cash flows* (financial value) of an investment project. Potential project benefits that cannot be easily translated into cash, are usually not included in the traditional investment appraisal techniques. The same applies to the potential *negative effects* that cannot be translated into cash. What about a project that has a positive NPV but damaging effects on the environment where it is executed? The latter effects are hard to quantify and thus often not included in the NPV calculation. At the best, these effects are labeled as "qualitative" and presented apart from the NPV calculation. As stated before, there is a pressing demand from society for the incorporation of these unquantifiable effects in the project assessment. And this is not only the case at the level of investment *projects*. The whole idea of *Integrated Reporting* (IR) is that *organizations* account for both the financial and non-financial effects of value creation in the short and medium term, as well as for the long run. One may also refer to *Corporate Social Responsibility* (CSR) here. See, e.g., *The Capitals Background Paper for <IR>*, published in 2013 by the Association of Certified Chartered Accountants ACCA and De Nederlandse Beroepsorganisatie voor Accountants (NBA).

This paper focuses on the *social value* that investment projects may have. Social value is the value that stakeholders experience through changes in their lives. Some, but not all of this value is captured in market prices. The key question is *how to incorporate hard-to-quantify social value into the financial project assessment?*

According to Krlev, Münscher and Mülbert (2013), the social impact assessment method that is mostly chosen, is *Social Return on Investment* (SROI). "SROI is widespread (...), because it is project-oriented, enables organizations to prove and improve the social, environmental and economic benefits they create and it helps to identify positive and negative externalities" (Krlev et al., 2013). SROI is a relatively new technique with less than 15 years of existence in which it has been improved by an international and multidisciplinary team. Although its apparent popularity, it should be noted that similar approaches have been developed over time, see, e.g., Phillips and Pulliam Phillips (2007), and Pathak and Dattani (2014).

In this contribution, SROI is reviewed. First, the SROI method is briefly explained in Section 2. A literature review on SROI, focusing on its strengths and weaknesses, is included in Section 3. Section 4 deals with the views of four interviewed Dutch SROI experts. The paper ends with conclusions (Section 5).

2 What is SROI?

SROI was first devised by the Roberts Enterprise Development Fund in the USA as an attempt to capture and monetize the full value creation of their employment services programs in San Francisco. The objective was to develop a technique for the financial calculation of the often unreported benefits of work integration activities that could then be set against program investments to form a more holistic (and, therefore, realistic) cost-benefit analysis. In the last 10 years, the technique has been further developed in Europe by the New Economics Foundation (NEF, UK), the Scottish government and the SROI Network. (It should be noted that the SROI network has recently changed its name in Social Value UK). According to Krlev et al. (2013), the use of SROI has grown exponentially in the last years.

This contribution will focus on SROI as it has been developed by The SROI Network (Nicholls, Lawlor, Neitzert & Goodspeed, 2012). These authors define SROI as follows: "Social Return on Investment (SROI) is a framework for measuring and accounting for a much broader concept of value; it seeks to reduce inequality and environmental degradation and improve wellbeing by incorporating social, environmental and economic costs and benefits." (p. 8).

SROI is a tool to help people answer the basic question: "how much value are we creating?" It is meant for any organization that seeks to make a difference in people's lives (Nicholls et al., 2012). SROI is about value, rather than money. As it is mentioned by Lawlor et al. (2008, p. 20): "The outcomes that are measured are the ones that get managed and valued. If outcomes for people and communities are not being measured they are unlikely to be taken into account, and social organizations will continue doing what it assumes to be good work without really knowing if it is working effectively."

SROI is a technique which measures socio-economic and environmental impact and combines cost-benefit analysis, stakeholder engagement, financial proxies and project improvement. The technique can be used for an entire organization, a project, or a small activity, and for almost any kind of sector: profit, not-for-profit, and governmental organizations. It can be applied from two perspectives:

- Evaluative or retrospective studies: these assess the already realized outcomes (results and impact) of the project or activity.
- Forecast or prospective studies: these aim to predict how much social value will be created if the activities meet their intended outcomes. This type of studies is especially helpful for planning; strategy development, and selection of projects (in order to maximize impact).

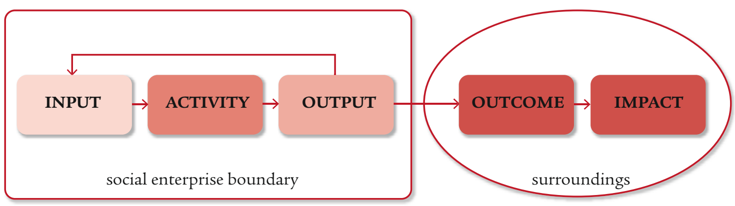
SROI principles and stages

According to the SROI network, SROI consists of a set of principles that are designed to ensure that the evaluation or implementation process is robust, transparent, and engages stakeholders. These 7 principles are: involve stakeholders; understand what changes; value the things that matter; only include what is material; do not over-claim; be transparent; verify the result.

These principles are the foundation of a six-step approach: In Stage 1, the scope or boundaries of the project are defined and the main stakeholders are selected and involved. In Stage 2, the involvement of stakeholders supports the development of an *impact map* as shown in Figure 1. This impact map draws relationships between the inputs (resources), outputs (results of the change process), outcomes (these are the effects that will immediately occur), and impacts (these are the long-term effects of the change process per year. It considers additional factors affecting the effect).

Once the outcomes have been identified, the next step (Stage 3) is to value them via indicators. Because some input/outcomes will not have a direct financial value (they are for instance non-traded goods), SROI uses fi-

Figure 1 Impact map



nancial proxies. Four additional and important scenarios are evaluated in Stage 4: (a) *deadweight* (the amount of outcome that would have happened even if the activity had not taken place); (b) *displacement* (what are the possible unintentional outcomes) and (c) *attribution* (an assessment of how much the outcome is caused by other projects). These scenarios are also valued via indicators. (d) a fourth scenario is calculated as well, which is the *drop-off*. This deals with the question how long the benefits will last, in other words: the deterioration of the outcome over time. SROI makes explicitly use of *proxies*; these are estimations of a value in case an exact measure is impossible to obtain. In Stage 5 the SROI (ratio) is calculated. For this, it is necessary to draw up a projection of the inputs and benefits over the project horizon. By adding up all the benefits, subtracting all negative outcomes or scenarios (deadweight, displacement and attribution) we calculate the *impact* per year. By using a discount rate, one can calculate the Net Present Value (NPV).

At the end, the SROI ratio is then calculated as follows:

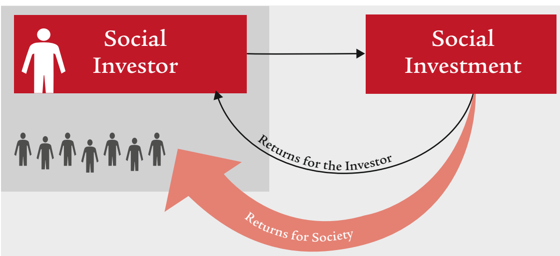
$$\text{SROI}= \frac{\text{(Net Present Value of Impact)}}{\text{(Net Present Value of Investment)}}$$

Once the ratio is calculated, it is advised to perform a sensitivity analysis to identify its robustness. The last step (Stage 6) entails the communication of the results to stakeholders and the embedment of good outcomes. Verification is advised but it is not obligatory.

But what does this ratio mean? A SROI ratio of 3:1 means that for every euro invested, the project will generate a social benefit of three euros. The ratio alone does not indicate the social value. Qualitative and descriptive evidence should accompany the number. Figure 2 shows an illustrative representation of the ratio. It is not only about monetary value, but also about social benefits to the society.

A short example will be given to illustrate the approach. A social project aims to bring job opportunities to long-unemployed people via the training of a specific profession. In this case, the *input* is the training course; the main *stakeholders* are the unemployed people, the people who will execute this activity, and the government who is paying the welfare of the unemployed people. The training sessions are the *activity;* the *output* is "trained people with more skills"; it is assumed that with this training course they will improve their skills and increase their self-esteem to finally find a job (*outcome*). Additionally, if they find a job, they receive income (direct outcome) and the government will stop paying welfare and will receive taxes (secondary positive outcome). *Displacement* is the possibility of taking the job opportunities of other candidates. The possible *deadweight* is that if this social project would not be executed, some people would probably continue being unemployed whilst others will work as volunteers to learn the same new skills. *Attribution* is about how much of the outcome (finding a job) was caused by the project itself or by other external factors (e.g., previous work experience). *Drop off* measures how long the benefits will last. In this case, if the unemployed do not find a job during the first year, the training course will have less value in the second year and maybe there is no value in the third year. At the end, taking into consideration all the benefits and the different scenarios, the *impact* per year is calculated. Using an appropriate discount rate and the net present value of the investment will lead to the SROI ratio. This ratio and the story behind it should show weather this is a cost-effective activity that will benefit for society.

Figure 2 Illustrative representation of the ratio, taken from (Krlev et al., 2013)



How can financial proxies be used in this project? If for this project people's self-esteem is of relevance, then the project will set up specific activities to improve the confidence of the unemployed and use proxies to give a financial value to it. Assuming that people with high self-esteem will be more active and motivated, they will probably be less sick. Thus the number of visits to the physician per year (and all costs associated with it) will be reduced. Comparing the number of visits (and all cost related) before and after taking the training course will be an indication of the financial benefits of this project (and the costs that are saved for society).

The above example is deliberately kept rather concise. For instance, it should be noted that when it comes to assessing the value of training people inside organizations, there is literature available, see, e.g., Aragón-Sanchez *et al.* (2003) or Arthur *et al.* (2003). One could also discuss the relationship between self-esteem and absence from an academic point of view, but that is beyond the scope of this example. More examples on SROI are available on the internet, see, e.g., the website www.socialvalueuk.org where one can freely download a comprehensive guide to SROI. This paper will now continue with a critical review of SROI.

3 SROI in the literature

There seems to be a general consensus on what the strengths, benefits, as well as on the limitations and controversial aspects of the SROI technique are.

The strengths include:

- *Holistic approach based on theory of change*
  The SROI is based on a holistic approach to analyze all positive and negative impact (and unintended consequences along the implementation) of the project in three aspects: economic, social and environmental. The method considers also the influence of other external factors or projects. In general, it helps to understand how and why impacts occur (Arvidson, Lyon, McKay & Moro, 2013; Krlev et al., 2013).

- *SROI is based on stakeholder involvement along the whole analysis process*
  Stakeholders are involved from the very start to define the project objectives, to identify the outputs and outcomes of the project (Krlev et al., 2013). By involving the most important stakeholders, the project empowers them (Arvidson et al., 2013). This is a strong point from a change management perspective.

- *SROI is useful as a management tool*
  It is said that SROI provides the basis for forecasting, planning and managing social activities. It can help to direct resources to areas with the greatest impact and to clarify strategy and mission. It additionally guides the organization to identify indicators to track progress, clarify what you do and establish clear aims and objectives. The active participation of the users and other stakeholders on this process analysis, foster organizational learning (Krlev et al., 2013; Arvidson et al., 2013).

- *Accountability, transparency and communication across stakeholder groups*
  SROI studies are meant to be open and transparent documents. The calculations of the different scenarios (deadweight, displacement, and attribution) and assumptions to identify indicators, or financial proxies, are clearly explained and communicated to the stakeholders (Krlev et al., 2013). It helps to get key stakeholders, like investors, on board. In this way, SROI takes an investment perspective, thus it may serve as a tool to close a potential gap between social projects at the one hand, and (public and/or private) investors at the other (Arvidson et al., 2013; Krlev et al., 2013).

The literature also deals with the weaknesses, limitations and controversial aspects of SROI. Seven problem areas may be distinguished.

- *Resources needed to perform a SROI study (time, money, information and expertise)*
  The necessary resources are not only monetary costs but also time of people, expertise of the practitioners, and the required information which is not always available (e.g., inexistent standardized indicators, or financial proxies). It is also argued that SROI is subjective and its success depends on the experience and judgment of experts to identify indicators and financial proxies (Lawlor et al., 2008; Arvidson et al., 2013; Jönsson, 2013). This lack of expertise is especially a constraint for small organizations.

- *Difficulties to quantify the value of benefits via indicators and financial proxies*
  The challenging need for reliable indicators and financial proxies is frequently found in the literature. The choice of indicators is not only influenced by expert judgment but also by (1) the access to good-quality data (like financial proxies databases), (2) time constraints, and (3) resources available for carrying out the evaluation (Arvidson et al., 2013). It is criticized that soft-aspects are difficult to measure and sometimes, they are relegated (Arvidson, Lyon, McKay & Moro, 2010).

- *Difficulties to measure deadweight, displacement and attribution*
  Pathak and Dattani (2014) argue that there are many outside factors that cannot be controlled, like, e.g., the impact of other outside activities, which take place before or at the same time than the project or other external factors that can affect the project. Therefore the judgment of the practitioner is very important (Pathak & Dattani, 2014). Krlev et al. (2013) comment that SROI should put more emphasis on including a control group (a social group outside the influence of the project) and measure and compare outcomes at the beginning, during and at the end of the project to be sure that attribution is properly measured.

- *Financial and accounting aspects*
  Another critical aspect is the allocation of costs. Critics argue that only direct costs (and not overhead costs) are included in the SROI. In this way, the full costs associated with the project are underestimated and the ratio is overstated (Pathak & Dattani, 2014). Besides this, social projects are often executed in an environment where accurate cost accounting systems are not available. Discount rates have also been mentioned as critical: Pathak & Dattani (2014) conclude that the discount rates used are often too low because one frequently fails to incorporate inflationary rates.

- *The ratio and the legitimacy of the report*
  Some authors argue that there is too much emphasis on calculating the ratio which can affect the legitimacy of the report: While the ratio is only an indication of the study, it should be supported by a strong story. As mentioned before, it is suggested that assurance of the reports should be done, but it is nevertheless not mandatory. Since the ratio is used in certain countries like the UK and the USA to select projects and get subsidies, this can lead to inflated ratios in order to get resources and thus deliver very poor quality reports (Arvidson et al., 2013; SROI, n.d.; Jönsson, 2013; Krlev et al., 2013).

- *No comparability of projects based on the ratio*
  It is only possible to compare two projects when they target the same market, have similar objectives, activities and have followed the same methodology. This is the case, e.g., for an organization which runs the same project in different locations. Otherwise, it is unlikely to compare two or more projects based on the ratio (Jönsson, 2013; Arvidson et al., 2010; Krlev et al., 2013). Besides, Pathak & Dattani (2014) have observed that there is a high risk when one wants to judge these kinds of projects based only on the ratio, because many projects are long-term oriented. And the long term impact makes the NPV of the benefits smaller. A small ratio does not mean that the project has fewer benefits for society or it is not attractive to invest on. In general, it is not for nothing that the SROI network indicates that besides the ratio, the story behind needs to be considered when taking decisions (Nicholls et al., 2012). In defense of SROI, it should be noted here, that classic investment appraisal techniques, like, e.g., the Net Present Value (NPV) approach, have the same problem when it comes to comparing projects on the basis of the calculated NPV figures. For instance, when two projects differ in lifetime, their Net Present Values cannot be compared.

- *Limitations on replication and scaling up*
  In the literature, it is argued that SROI projects cannot be replicated easily and this hampers the scaling up of successful projects. In other words: the technique needs to put more emphasis on identifying the real reasons of change and the process involved (Arvidson et al., 2013). Besides this, users should pay more attention to post-investment analyses as these may contribute to a body of knowledge about successful SROI applications.

The reaction of the SROI network to these criticisms
According to the SROI network, some of the mentioned criticisms are very often about misunderstanding and misrepresentation. In the report *SROI myths and challenges* (n.d.) the organization points out that as other common techniques like accounting, the results are based on professional judgement (estimations and assumptions). It clearly mentions that financial proxies are just means and not the goal of the study. It is emphasized that SROI ratio is just a reference, only meaningful when the context around the project is understood. Indeed, the SROI ratio of different projects cannot be compared, it is only the way the application of the principles and how the methodology was executed.

The network acknowledges that SROI requires the investment of time and money but it states that the analysis should be commensurate with the audience and purpose (in other words: do not do more than is required). Finally, it stresses the importance of the assurance process to verify the results which can be done by an accredited party. This assurance process is key to reduce variation, inconsistency and to mitigate risk (tackling in this way some weaknesses mentioned before like inflated ratios, poor quality of reports, the proper allocation of costs, just to mention some).

In order to get a deeper insight in these problem areas, and the current status of SROI in the Netherlands, it was decided to conduct interviews with Dutch SROI experts in the field.

4 SROI evaluated by Dutch experts

At the end of 2014, four Dutch SROI experts were interviewed. These experts have ample practical experience in the field. They support the use of SROI on local, national, and international projects.

Interviewing experts may bring about risks of potential biases (e.g., attribution errors). It is likely that the interviewees will have at least a non-neutral (i.e., positive) attitude towards SROI (given the fact that they are professional experts in the field). It is for this reason that the results of the interviews should be interpreted carefully.

The interviews were performed by phone or email and aimed to discover the broad opinion of the SROI experts. It focused on three main topics: a) the reasons for organizations to use SROI; b) the main benefits and obstacles that organizations and society encounter when using it; c) areas of opportunity and suggestions to improve SROI. During the interview some additional topics were covered according to the expertise and interest of the interviewee. Appendix I includes the applied questionnaire.

The answers were analyzed following a standard procedure for qualitative data: in an iterative way, the answers were codified, identifying similar categories and patterns. Moreover, some interconnections were found among questions. At the end, clear statements about every category were identified.

In general, the interviewees recognize the strong and weak points that were discussed in Section 3. Next to those, the interviewees made the following remarks and comments.

- *Small projects are the most suitable to use this tool.*
  Up till now, the SROI technique is more applicable for small scale social projects than for large corporations. The smaller the project, the less time is needed to create the impact map, involve stakeholders, collect data and do the research. For these small projects it is recommended to use the forecast-type, because of all the benefits mentioned above.

- *Mindset is a challenge when using SROI*
  People need time to understand the concept (and its added value). This particularly applies to important concepts like deadweight, attribution and drop off. It is indeed challenging to provide a financial value to soft aspects like, e.g.,"self-confidence".

- *Useful for society at large*
  Despite, the remark on small projects mentioned above, the interviewees feel that SROI is a powerful tool that ideally should lead to more efficient use of resources in times of financial constraints. It can help governments to make better decisions and focus on the most important social challenges. It is the perfect tool because it combines cost-benefit analysis, stakeholder engagement, financial proxies and project improvement.

- *Main points for improvement on the use of this tool (and its implementation).*
  Besides the need for reliable information like financial proxies, the experts coincide in that the two most important aspects to improve on this tool are in the first place, the ratio. It does not tell the story but can lead to a lot of misunderstandings and opportunism. Besides, as mentioned before, it cannot help to compare two different projects. The second aspect that was mentioned, is capacity building and awareness creation. Education and extra supporting resources (e.g., a database with indicators) are needed to spread the knowledge and make better use of the technique. This will reduce time and investment needed to implement SROI in the projects and will have a positive impact on the learning curve of the practitioners.

- *Trends about SROI*
  The opinion of the experts about SROI-trends is diverse. Some mention that the SROI technique will be improved in the coming years, and that in the short term the number of SROI projects will increase. Others fear that, given the above difficulties and the problems, SROI will get a negative connotation and its popularity will therefore decrease. In the end, all interviewees agreed that it is and should be a tool to motivate people to think differently about investments.

5 Conclusions

SROI is positioned as a powerful and holistic technique which measures socio-economic and environmental impact. The literature review and the interviews lead to the following concluding remarks.

SROI is one of the social impact assessment techniques that combines cost-benefit analysis, stakeholder engagement, project improvement, and financial proxies. It proved, up till now, mostly suitable for small projects; but it can also be applied on a larger scale. It can support project management and strategy definition (especially the forecast type) and be the communication tool for stakeholders, financial institutions, and others entities. In these times of financial constraints, it could help governmental institutions to make more efficient use of resources, make better decisions and focus on the most important social challenges. These are indeed strong points.

However, SROI is still in its starting phase. In the last years SROI has been criticized in areas like the selection and measurement of financial proxies; the subjectivity of the experts in the process of making assumptions and estimates; an exaggerate focus on the SROI ratio, and the resources needed for its implementation. These problematic areas have been found in the literature and they are in fact recognized by the SROI network as well as the interviewed Dutch experts.

It is felt that these symptoms are rooted in three main problems: the still deficient *capacity building*, the reluctance to *verify the studies*, and the lack of *improving and fine-tuning* the technique. Capacity building, which here refers to training courses, awareness creation, and the availability of extra resources (like a knowledge base), will help the proper implementation and use of SROI. Proper training will help organizations to understand the benefits of the tool (changing mindset) and the best way to use it. The lack of additional resources like databases (with SROI studies, indicators, and financial proxies), which are requested by users, is delaying the implementation and the learning process of the practitioners. The second aspect, verification or assurance of the report, is of high importance as well. As the SROI Network emphasizes, verification by an accredited party will reduce variation, inconsistency and mitigate risk. It will give legitimacy to the report. At the moment, verification is voluntary and not obligatory. The third aspect is the lack of improvement and fine-tuning of the technique by experts. SROI needs to be improved in several aspects to make it clearer to the practitioner on how to properly use it, advising on how to define the discount rate or how to select the most appropriate financial proxies.

SROI is still under construction but it certainly has the potential to support organizations to make better decisions. Its use should lead to the enhancement of more dimensions of value creation, rather than only financial value. Even the trend about its use and implementation is uncertain; we agree with the Dutch experts that SROI should be a tool to motivate people to think differently about investments in general. ■

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Appendix 1 Questionnaire used

Expert views about SROI:

Reasons to use SROI:

1. What are the reasons for leaders of organizations/social programs to use this methodology to measure social impact?

Experience when applying this tool

2. What are the main obstacles that these organizations/programs (and your organization as consultant) encounter when they apply this methodology?
3. What are the main benefits of the project owners and stakeholders when using this tool?

General review :

4. In your opinion, what are the main benefits to use this tool (from the project but also society perspective)?
5. What do you think are the main points for improvement of this tool?
6. Who are the key players to further improve SROI? (or the information needed for this tool?)
7. In your opinion, what are the trends around SROI with respect to the organizations that can benefit from it, fields of application, quality & comparability, target groups, etc.?