Stanford SOCIAL INNOVATION Review

Field Report

A New Form of Capitalism

By Sarah Murray

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PROFILES OF INNOVATIVE WORK

Peer counselors with St. Giles Trust help people disadvantaged by homelessness, long-term unemployment, and past criminal convictions.

A New Form of Capitalism

The Peterborough Social Impact Bond was the first of its kind. Does its success in improving recidivism rates while rewarding investors herald a new way of using finance for social impact?

BY SARAH MURRAY

Rob Owen knows what it takes to keep people out of prison. "It's having somewhere to live, something to aim for—which is a job—and someone to support them on their journey," he says. "If you get those three things right, reoffending rates drop. It's not rocket science."

But funding those comprehensive services is another matter, Owen says. As CEO of the St. Giles Trust, he leads a UK charity that helps severely disadvantaged people (including ex-offenders) find jobs, homes, and other support, so that they can change their lives and make a positive contribution to society. So when he learned about a new mechanism designed to pay to lower prison recidivism rates, he was keen to participate.

The mechanism was the world's first social impact bond (SIB), a financing tool that promised to raise capital for government social interventions from private investors without risking taxpayer dollars. SIBs are structured as contracts between an "outcome funder" (usually a government agency or an international donor) and investors. Investors provide the upfront cost of a proven social intervention. The outcome funder repays them when the objectives set out in the contract have been met.

The SIB launched in 2010 to raise funding for a coalition of charities, including St. Giles Trust, that would provide services intended to reduce recidivism among short-sentenced prisoners leaving a prison in the eastern British city of Peterborough.

In July 2017, Social Finance—the UK nonprofit that designed the Peterborough SIB—announced the pilot program's success: It cut reoffending by 9 percent, exceeding the 7.5 percent target set by the UK's Ministry of Justice when the bond launched. As a result, investors were repaid in full, along with a return equivalent to slightly more than 3 percent a year for the investment period.

With this outcome, the Peterborough SIB marked an important step in the evolution of social financing. By linking financial returns to outcomes, it saved taxpayer dollars, lowered risk to government, and met growing pressure in the social sector to shift from measuring outputs (numbers of people served) to measuring outcomes (lives changed). With the repayment of funds to investors with a return, the SIB had demonstrated that rethinking how to tackle—and pay for—social services could lead to new ways of addressing some of the challenges facing society.

INNOVATION IN SOCIAL FINANCING

When the Peterborough SIB launched, recession and UK austerity policies were putting intense pressure on funding for social programs. Alternatives needed to be found. A Social Investment Task Force, established in 2000, was working to create a market for social investment and was also seeking ways to engage the financial sector in addressing social problems.

Sir Ronald Cohen, cofounder of Social Finance and task force chair from 2000 to 2010, recalls first discussing the idea for a social impact bond when two members of his team asked what he thought about the idea of funding programs to prevent prisoners from reoffending by linking improved numbers to a financial return. "Wow," he responded, "you've found the key to connecting the capital markets to social entrepreneurs."

While it was philanthropic investors—including the Rockefeller Foundation—backing the Peterborough bond, they hoped a return on their money would prove that the SIB's principles could work, and thus attract private investors. If successful, its backers believed, it could demonstrate the

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potential for private investment to transform the way social programs were funded.

"We thought it was an incredibly exciting innovation in the financing of social solutions," says Antony Bugg-Levine, who, as Rockefeller Foundation managing director from 2007 to 2011, led its impact investing initiative.

The investors raised £5 million ($6.96 million) and set goals. Before the Ministry of Justice would pay investors, reoffending rates needed to drop by at least 7.5 percent. If the rate exceeded this goal, the return rate would rise, with a maximum of 13 percent and a cap of £8 million ($11.1 million).

In 2010, when the project began, about 60 percent of prisoners were reconvicted within a year of release. In August 2014, the first report on the Peterborough SIB was encouraging. The program had reduced reconviction rates among the first group of 1,000 ex-prisoners by 8.4 percent compared with the national average.

The program, originally designed to run for seven years with three cohorts of 1,000 prisoners, ended in 2015 after only two cohorts, due to changes in UK probation laws that made it impractical to continue. However, Bugg-Levine argues, the deal's impact continued beyond the SIB itself, since it prompted the national rollout of a program to rehabilitate short-sentenced prisoners. "We need to remember that social innovation is a means to an end," he says. "And that is vulnerable people getting the services needed for a better life."

FROM OUTPUTS TO OUTCOMES

For a number of reasons, prison recidivism was an appealing choice for a social financing pilot. First, powerful economic incentives existed to address the problem. "It's very expensive to incarcerate someone," says Tracy Palandjian, CEO and cofounder of Boston-based Social Finance, sister organization to Social Finance in the United Kingdom. "That dollars and cents argument around criminal justice savings was compelling."

Even more important was that results could be quantified: Records on rearrests and reconvictions made it possible to see who benefited and to measure the program's costs and savings. "The clean data aspect of this was exciting," Palandjian says. "When people get the wraparound services and jobs, the potential outcomes are a much better life post incarceration—we have evidence around that."

The focus on measurable data was a key component of the model. "There were really strong empirical data from the NGOs on their outcomes," says Judith Rodin, then Rockefeller Foundation president. This enabled the SIB to attract investors, reduced risk for government, and established investor-payout rates. So while the Peterborough SIB was a pilot, the innovation was in social financing, not social impact.

"This critical fact sometimes gets lost," Rodin says. "When it was called an 'experiment' or a 'pilot,' people assumed they were piloting the intervention. That's absolutely not what should be done for a social impact bond because otherwise you don't have the strong actuarial data that allow you to figure out what the right payout should be."

Moreover, tracking outcomes improves decisions on how and when to intervene to address problems such as homelessness or youth unemployment, says Andrew Park, senior policy advisor at the Centre for Social Impact Bonds, part of the UK government's Inclusive Economy Unit. "We need to rethink how we do service design with something that anchors it to outcomes and moves away from the government obsession with counting things," he says.

This need for measurable data means that SIBs do not offer a silver bullet for solving social problems. While they can be applied to issues such as education, homelessness, and prisoner recidivism, problems such as domestic violence or lack of palliative care yield less clear data on outcomes. "There is a category of social issue that's too qualitative to be able to hang a payment on the metric," Cohen says.

Since the launch of the Peterborough SIB, about 100 SIB deals have been closed, raising more than $390 million. In 2013, for example, J.B. Pritzker, a venture capitalist and philanthropist, and Goldman Sachs raised a total of $7 million to fund high-quality early education programs for children from low-income families in Utah. With fewer children requiring special education, public sector savings of more than $281,000 in 2013-2014 triggered the first SIB payment to US investors.

The model has also inspired the creation of development impact bonds (DIBs) that address issues such as malaria or post-disaster reconstruction. In 2017, for example, the International Committee of the Red Cross announced a $27 million "humanitarian impact bond" to fund rehabilitation services for people with disabilities in conflict-affected countries.

SIBs have been criticized for being complex to structure and hard to replicate because the potential savings on which investor returns are based and the results that trigger payments are specific to each intervention. The rigorous measurement they require is also beyond the capacity of many organizations. Nevertheless, Cohen believes they can provide a sizable chunk of social funding. "SIBs may end up being 10 percent of the impact investment market," he says.

Cohen sees SIBs as part of a rethinking of global capital markets. "Social impact bonds are the first expression of how you optimize risk for return and impact," he says. "In the 19th century, we measured just financial return. In the 20th century, we measured risk and return. And now—because of the enormous scale of social and environmental issues, the inability of government to throw more money at it, a millennial generation that wants meaning, and investors who want more than financial return—the thinking is shifting."

In this respect, he believes that in achieving a reduction in reoffending and delivering a return to investors, the Peterborough SIB heralds a new form of capitalism. "That's a very powerful expression of optimizing risk, return, and impact," he says. "What we're doing here is altering capital flows in the whole system." ■