

The Rhetoric and Realities of Social Impact Bonds

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# The Rhetoric and Realities of Social Impact Bonds

Nina Sabarre

## ABSTRACT

As the rhetoric of collaborative governance continues to gain popularity in the discourse of public affairs, both scholars and practitioners advocate cross-sector partnerships as a strategy to replace the vertical hierarchy of government with the horizontal approach of governance through a network of actors. This research explores the potential of *social impact bonds* (SIBs) as an instrument of collaborative governance. An SIB is an approach for broadening social programs, in a multi-faceted partnership among private investors, governments, and nonprofits. In this cross-sector partnership, private investors take on the financial risk of expanding evidence-based social programs provided by nonprofit organizations. In return, the government agency repays investors if the interventions meet measurable goals that demonstrate social impact (McKinsey & Company 2012, 15). Actors involved in the development of SIBs have published the majority of the scholarship to support them. Therefore, much of the literature informing the creation of future bonds is biased, and governments appear hesitant to try them before seeing any results. This study investigates possible disconnections between the arguments for and the practice of SIBs through textual analysis and elite interviewing. I identify three major disparities between the rhetoric and realities of SIBs: measurement of social impact, complexity of partnerships, and transfer of risk.

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## CHAPTER ONE: INTRODUCTION

*As the nonprofit director read thank you cards from children who completed the youth intervention program, her stomach tied into knots. After a year of tireless efforts and tenacious dedication from her staff, the program—despite its successes—will be cut.*

In the nonprofit sector, scenarios like this play out every day. According to the National Center for Charitable Statistics (2012), an estimated 1.6 million nonprofit organizations existed in the United States in 2010.<sup>1</sup> Of these organizations, more than forty-five percent operated on budgets of less than \$100,000 a year, while another thirty percent spent less than \$500,000. Compare this to the world's largest private firms with consolidated revenues exceeding \$100 billion in the 2012 fiscal year, such as Wal-Mart (\$469 billion), Exxon Mobil Corporation (\$408 billion), and Royal Dutch Shell (\$236 billion).<sup>2</sup> While the majority of nonprofits struggle to obtain sufficient funding to meet their goals, many multi-national corporations flourish in the age of globalization. Given such resource constraints, nonprofits face difficulties achieving their missions of producing lasting social change. Meanwhile, government agencies frequently spend money on poorly designed or implemented remedial programs for critical social ills such as homelessness or criminal recidivism (McKinsey & Company 2012, 8). Today, collaborative efforts are being made to stir social innovation that will address this paradox.

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<sup>1</sup> This figure includes all nonprofit organizations that are registered with the Internal Revenue Service (IRS) under Internal Revenue Code 501(c)(3). Registered organizations exclude nonprofits with less than \$5,000 in annual revenue.

<sup>2</sup> According to CNN Money (2013). Accessed on: <http://money.cnn.com/magazines/fortune/fortune500/>



Recent public affairs discourse has emphasized collaboration among the public, private, and third sectors, as societies experience a shift from government to governance (Osborne 2010, Rhodes 1997, McQuaid 2010, Sirianni 2009). David Harvey defines *government* as “state power on its own” and *governance* as “a broader configuration of state and key elements in civil society” (2005, 77). The private sector includes for-profit organizations, the public sector includes governmental institutions, and the third sector includes nonprofit/nongovernmental groups (often referred to as civil society).<sup>3</sup> In today’s increasingly globalized and interconnected world, the boundaries that once separated the public, private, and third sectors have blurred, and the complexity of social problems necessitate cooperation of the three. As Koenig-Archibugi argues, within governance systems “problem solving is not the preserve of a central authority able to impose solutions on subordinate agencies and individuals, but the result of the interaction of a plurality of actors who often have different interests, values, cognitive orientations, and power resources” (2003, 319).

In 2010, Social Finance, an organization that seeks to develop the social investment market in the United Kingdom, introduced the first Social Impact Bond<sup>4</sup> (SIB) as an innovative tool of collaborative governance.<sup>5</sup> An SIB is a new approach for scaling social programs, in a multi-faceted partnership among private investors, governments, and nonprofits. In this cross-sector partnership, private investors take on

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<sup>3</sup> Public affairs scholars and practitioners sometimes refer to “private” partners as any entity outside of the government, clustering for-profit and nonprofit/nongovernmental organizations into one category. For the purpose of this research, I separate the two, referring to for-profit organizations as the “private sector” and non-profit/nongovernmental organizations as the “third sector.”

<sup>4</sup> It is worth noting that the term “social impact bond” technically is a misnomer. SIBs are not “bonds” in the conventional sense of the term. Financial bonds generally have an unconditional and guaranteed rate of return, while social impact bonds are contingent on performance, and return rates may vary depending on the contractual agreements.

<sup>5</sup>For more information, visit: [www.socialfinance.org.uk/](http://www.socialfinance.org.uk/)

the financial risk of expanding evidence-based social programs provided by nonprofit organizations. In return, the government agency repays investors if the interventions meet measurable goals that demonstrate social impact (McKinsey & Company 2012, 15). SIBs leverage the private sector to “fund prevention and early intervention programs that reduce the need for expensive crisis responses and safety-net services” (Social Finance 2012, 5). Proposed projects target social problems such as homelessness, unemployment, and environment health hazards that could be mitigated with preventative interventions (Azemati et al. 2013, McKinsey & Company 2012, Social Finance 2012). This seemingly symbiotic relationship is intended to benefit all three sectors, as SIBs have the potential to (1) enable nonprofits to expand successful social interventions, (2) ensure governments spend taxpayer dollars more effectively by only paying for what works, and (3) help impact investors reach their double bottom line—financial rewards and positive social impact.

Although the SIB developed in the U.K. in 2010 is the first of its kind, the concept is rapidly generating global interest. Conversations exploring SIBs have emerged all over the world—in countries as varied as Australia,<sup>6</sup> Canada,<sup>7</sup> Columbia,<sup>8</sup> India,<sup>9</sup> Ireland,<sup>10</sup> Israel,<sup>11</sup> and the United States (Azemati et al. 2013). In the 2013 fiscal

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<sup>6</sup> Australian School of Business Center for Social Impact (2011) “Report on the New South Wales Social Impact Bond Pilot,” accessed on: [http://www.csi.edu.au/project/Social\\_Impact\\_Bonds\\_for\\_NSW.aspx](http://www.csi.edu.au/project/Social_Impact_Bonds_for_NSW.aspx)

<sup>7</sup> Human Resources and Skills Development Canada (2013) “Harnessing the Power of Social Finance,” Accessed on: [http://www.hrsdc.gc.ca/eng/consultations/social\\_finance/report/index.shtml](http://www.hrsdc.gc.ca/eng/consultations/social_finance/report/index.shtml)

<sup>8</sup> Instiglio, (2012) “Adolescent Pregnancy in Colombia,” accessed on: <http://www.instiglio.org/the-innovation/projects/>

<sup>9</sup> Instiglio, (2012) “Gender Gap in Education in India,” accessed on: <http://www.instiglio.org/the-innovation/projects/>

<sup>10</sup> Clann Credo (2011) “Research to Identify High-Potential Social Impact Bond Areas in Ireland,” accessed on: <http://www.clanncredo.ie/default.aspx?m=30&mi=217>.

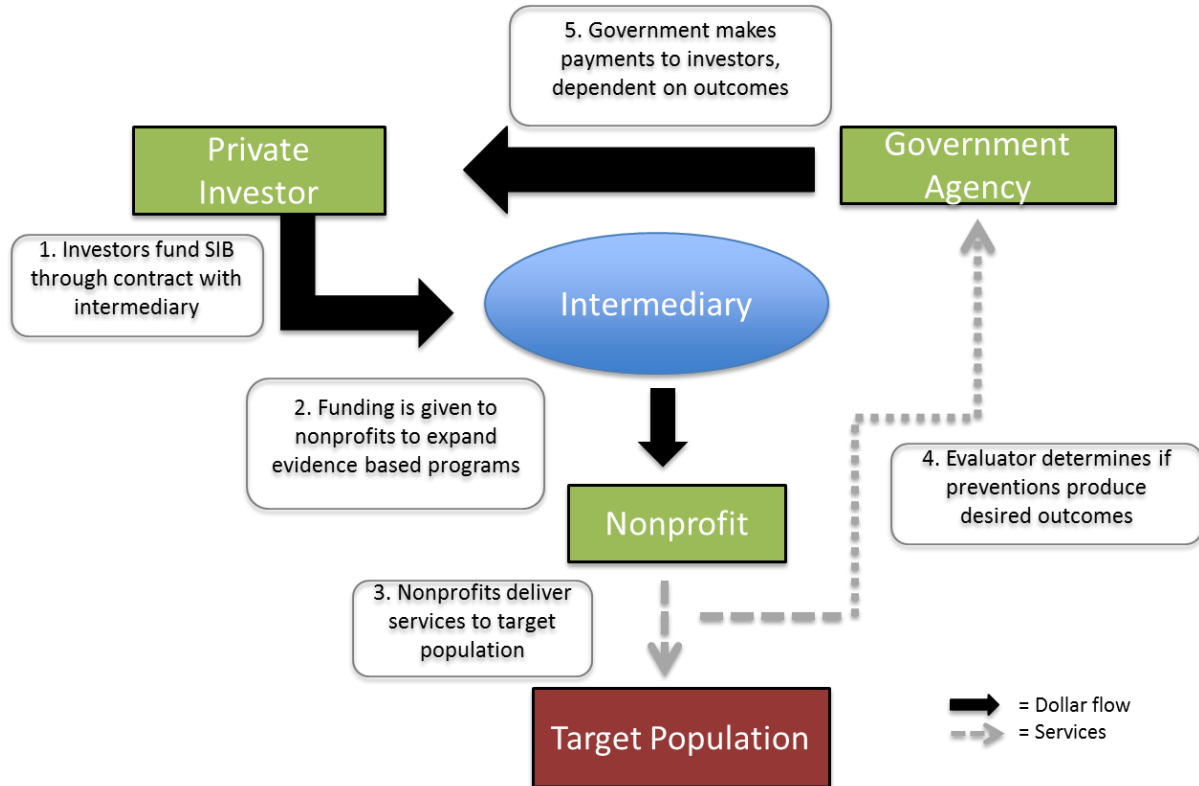
<sup>11</sup> The Portland Trust (2012), “Innovative Financing to Deliver Sustainable Funding for Israel’s Social Sector,” accessed on: <http://www.portlandtrust.org/projects/financial-infrastructure/social-investment-and-social-finance>.

year, the Obama administration allocated up to \$109 million<sup>12</sup> to fund SIB pilot programs in the United States, known as Pay for Success initiatives, across seven program areas, including workforce development, education, juvenile justice, homelessness, drug addiction, unemployment, and care of children with disabilities (Office of Management and Budget 2013). In its 2014 budget proposal, the Administration significantly increased support, requesting nearly \$500 million to support Pay for Success SIBs (Shah and Costa 2013). In a publication for the Center of American Progress, Shah and Costa (2013) report that about \$200 million of this request is for “analogous program areas” from the previous year’s budget. An additional \$300 million is intended to incentivize state and local governments to develop SIBs, which the Treasury Department will administer (Shah and Costa 2013). Figure 1 shows the basic design of an SIB contract.

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<sup>12</sup> These are part of innovation funds in the Department of Education, the Social Security Administration, the Department of Justice, the Department of Labor, and the Corporation for National and Community Service. For more information, see: <http://www.whitehouse.gov/omb/factsheet/paying-for-success>

**Figure 1. Basic Design of SIB Contract<sup>13</sup>**



## Purpose

This research explores the potential of social impact bonds as an instrument of collaborative governance. Ansell and Gash (2007) define collaborative governance as bringing “multiple stakeholders together in common forums with public agencies to engage in a consensus-oriented decision making” (543). As the rhetoric of collaborative governance continues to gain popularity in the discourse of public affairs, both scholars and practitioners advocate cross-sector partnerships as a strategy to replace the vertical hierarchy of government with the more horizontal approach of governance through a network of actors. According to Teisman and Klijn (2002), partnership “gives government a new legitimacy: the efficiency of the private sector and the involvement of

<sup>13</sup> Source: McKinsey & Company (2012, 14).

civil society” (197). The potential benefits of cooperation are frequently reiterated, as the term *partnership* continues to permeate the public rhetoric of elected officials and administrators (Teisman and Klijn 2002, Falconer and McLaughlin 2000).

Looking more concretely at the reality of governance, however, some scholars claim that public-private partnerships are neoliberal schemes of “contracting-out” rather than enabling collaboration (Klijn and Teisman 2000, Hood 1991, Bevir et al. 2003). Although contemporary discourse emphasizes the shift from government to governance, critical theorists would argue that hierarchical structures of government (Foucault 1975, Gramsci 1971) prevent any mode of “governance” from operating outside its control. Proponents advocate SIBs as a more horizontal approach of governance, arguing that networks of cross-sector actors allow more deliberation about public needs and encourage collaborative solutions. However, opponents remain skeptical about the “horizontality” of these partnerships. Critics argue that the bonds will reinforce a “one-dimensional approach” and carry out “vertical management of socioeconomic problems” (Mendell and Gruet 2012). They believe decisions made about public needs would still be managed by hierarchical government structures, under the guise of “collaborative partnerships.”

By situating social impact bonds in the conversation, this research contributes to the debate surrounding collaborative governance. An empirical basis for the discussion will be provided through in-depth examinations of the world’s first social impact bond in the U.K. and the first U.S. social impact bond in New York City. Due to the relative newness of SIBs, actors who have been involved in their formation have produced much of the published work. Therefore, much of the work informing future SIBs is biased,

highlighting their advantages and advocating their potential. This study aims to provide a less biased and more practical perspective, by investigating the connection (or lack of connection) between the theory and practice of SIBs. Using data collected from interviews with staff at the Fairfax County Office of Partnerships, I will discuss the promises and pitfalls expressed by practitioners when considering the potential of SIBs in their local community.

### **Research Question**

The primary question driving this research is: *What are possible disparities between the rhetoric and the realities of a social impact bond as a tool of collaborative governance?* Through a multi-stage qualitative research design, including a textual analysis of an evaluation of the world's first SIB, exploratory case studies of SIBs in the U.K. and New York City, and elite interviews, I uncover possible contention between the arguments for and the practice of SIBs in order to better understand conditions that would help partnerships meet their predefined goals and achieve the “metagoal” of lasting social impact.

### **Significance of Research**

Although much literature exists on theories that support or oppose SIBs, virtually no scholarship examines the bonds empirically. This research takes a skeptical approach at analyzing SIBs through an integration of theory, other scholarship, published documents (such as press releases and newspaper articles), and elite interviews.

Furthermore, this research is significant to the discourses of partnerships, as SIBs offer the rare intersection among *all* three sectors. Previous literature has analyzed two-way relationships between public-private partnerships (involving the privatization of

collective goods), private-third sector partnerships (emphasizing the importance of corporate social responsibility), and public-third sector partnerships (probing the relationship between the state and civil society). However, little research has been done on the intersection of all three.

### **Overview of Thesis**

Following this introductory chapter, Chapter 2 reviews the theoretical perspectives that set the stage for collaborative governance. In this chapter, I engage discourse from both public affairs and political science to differentiate between *government* and *governance*. I delve into the contemporary literature on societal governance by providing overviews of three regimes of policy implementation and public service delivery: Public Administration, New Public Management, and New Public Governance (Osborne 2010, Introduction 1-16). Then, I situate social impact bonds in the context of neoliberalism to argue that neoliberal ideology drives cross-sector collaboration.

Chapter 3 examines the scholarly grounding of partnerships. The first half of the chapter provides a historical overview of traditional, two-way partnerships. The latter half explores the concept of “three-way” partnerships, through an analysis of each partner involved in the world’s first social impact bond, *ONE Service*, implemented at Peterborough prison (HMP Peterborough) in the United Kingdom.

Chapter 4 outlines the research design used to empirically analyze SIBs. This chapter elaborates on the qualitative methods this study employed, including textual analysis and elite interviewing.

In the first half of Chapter 5, I discuss key findings RAND Europe’s evaluation of the development and implementation of the first SIB in the United Kingdom (Disley et al. 2011). I also integrate press releases and news publications about the first SIB in the United States with the “lessons learned” by RAND Europe, in order to investigate how efforts in the U.K. may inform the development of SIBs in the U.S. In the second half of Chapter 5, I report findings from interviews with professionals who manage cross-sector social partnerships. To gauge what these practitioners think about the potential of SIBs in their local community, I interviewed four individuals from the Fairfax County Government Office of Public and Private Partnerships, who expressed their insights on the promises and pitfalls of SIBs.

I conclude there are three major gaps between the theory and practice of SIBs: the measurement of social impact, the complexity of partnerships, and the transfer of risk. Chapter 6 elaborates on these and explains why they are significant. In this chapter I also discuss limitations encountered and suggestions for future research.



## **CHAPTER TWO: THEORETICAL PERSPECTIVES**

This chapter discusses two theoretical perspectives that underpin the emergence of social impact bonds. The first half provides a brief historical background of the concept of governance. In the latter half, I argue that the transition from government to governance in the U.S. has been reinforced by the rise of neoliberalism. Although SIBs are a product of neoliberalism, they have some characteristics that depart from neoliberal practices.

### **Shift from Government to Governance**

A common thread weaving through much public affairs scholarship has been the shift from government to governance. Governance enables cross-sector partnerships and the interaction among formal and informal institutions to substitute for, complement, and sometimes even replace hierarchical, centralized government (Smith 1993, Rhodes 1996, Richards and Smith 2002, Bevir and Rhodes 2003, Greenaway et al. 2007,). As Kettl notes, the U.S. national government has undergone “a steady, but often unnoticed, transformation,” as it now shares responsibility with other levels of government, private companies, and nonprofit organizations (2000, 488).

Even during an era of partisan gridlock, neither Democrats nor Republicans can deny the conversion of government to governance in policy-making. Sorensen and Torfing point out, “in order to compensate for the limits and failures of both state regulation and market regulation new forms of negotiated governance through the formation of public-private partnerships, strategic alliances, dialogue groups, consultative committees, and inter-organizational networks have mushroomed” (2007, 2). Public

governance is no longer confined to the realm of formal governmental institutions; rather policy-making and implementation increasingly take place through interaction in networks of public, quasi-public, and private actors (Sorensen and Torfing 2007, 3). This does not mean that state powers are completely “hollowed-out,” as the state still plays a critical role in local, national, and transnational policy processes (Hirst 1994, Pierre and Peters 2000, Sorensen and Torfing 2007). The frequently hierarchical nature of government is being strongly contested by more cooperative models of governance, an approach that some argue results in greater autonomy and democracy by “creating flatter, higher-performing organizations that can better use the experience and ideas” of individuals (Rothschild 2000, 197).

“Governance” as an accepted concept for public management is widespread, although not universal (Hill and Lynn 2005). Hill and Lynn (2005) contend that the transformation of hierarchical government to horizontal governing instead reflects “a gradual addition of new administrative forms that facilitate governance within a system of constitutional authority that is necessarily hierarchical” (173). Kettl (2002) argues: “it is not so much that horizontal relationships have supplanted the vertical ones, but rather that the horizontal links have been added to the vertical ones” (128).

Perhaps the most common argument in favor of cross-sector governance is that problems arising in advanced industrialized societies are complex and multi-dimensional, requiring diverse inputs from stakeholders involved in delivering social, economic, and physical development (McQuaid 2010). Recent scholarship on governance is grounded in “the widespread recognition of the increasingly fragmented, complex, and dynamic character of society” (Sorensen and Torfing 2007). According to Sorensen and Torfing,

“Fragmentation increases as a result of the functional differentiation of society into relative autonomous subsystems and the proliferation of relatively independent public and private organizations” (2007, 5). Meanwhile, complexity increases as societal problems are complicated by contextual understandings of the nature of problems and the contentious solutions that affect a diversity of stakeholders (Jessop 2002).

Cosmopolitanists, like David Held (2000, 2010), argue that the restructuring of public governance is congruent with the interdependence of an increasingly globalized world. According to Held, we are witnessing a new regime of government and governance “that is displacing traditional conceptions of state power as an indivisible, territorially exclusive form of power” (Held 2000, qtd. in Osborne 2010). Rather than leading to the end of the state, globalization is stimulating a more “activist state” through a range of governance strategies (Kennett 2010, Held 2000). Today the state is neither autonomous nor irrelevant in the context of a new cosmopolitanism (Kennett 2010). Drawing on Held (2000), Kennett argues that globalization has given way to a new “paradigm” of public policy, which he called “*New Public Governance.*”

### **New Public Governance**

One stream of contemporary literature on societal governance suggests policy implementation and public service delivery have evolved through three regimes: Public Administration, New Public Management, and New Public Governance (Osborne 2010). From the late nineteenth century through the early 1980’s, public administration (PA) was the dominant paradigm for public policy (Hood 1991, Osborne 2010). Hood (1991) contends that the regime of PA was dominated by the “rule of law.” The key elements of PA include an emphasis on administering rules and guidelines, a central role for

bureaucracy in decision-making, and the hegemony of the professional in public service delivery. During this era, the state was confidently expected to meet all public needs of citizens, “from cradle to the grave” (Osborne 2010, 3). According to Osborne, “PA was to be the instrument of this brave new world, with a focus on administrative procedures to ensure equality of treatment” (Osborne 2010, 3). However, publics demanded more than government resources could provide. Chandler (1991) argues that PA entered a “terminal decline,” while Rhodes (1997) asserts it became a “bystander” to the practice of public policy implementation and public service delivery, paving the way for the rise of new public management (Osborne 2010).

Osborne argues that New Public Management (NPM) was more of a “transitory stage” in the evolution from Public Administration to New Public Governance (2010, 1). According to Osborne, NPM describes the last two decades of the twentieth century—“a relatively short-lived and transient one between the statist and bureaucratic tradition of PA and the embryonic plural and pluralist tradition of NPG” (Osborne 2010, 2). During the era of NPM, proponents argued that the managerial techniques of the private sector were superior to those of the “command-and-control” bureaucracy of PA. NPM assumed that the application of private-sector techniques would result in more efficient and more effective public service delivery. Key elements of NPM included attention to lessons from the private sector, growth of hands-on management, focus on entrepreneurial leadership, emphasis on input and output control, evaluation and performance management, competition, contracts, and resource allocation (Osborne 2010, 4).

Some scholars argue that both PA and NPM failed to capture “the complex reality of the design, delivery, and management of public services in the twenty-first century”

(Osborne 2010, 5). The New Public Governance (NPG) regime moves beyond the dichotomy of *administration* versus *management*. NPG allows for a more comprehensive framework to study the theory and practice of societal governance. Key elements of NPG include institutional and network theories, a pluralist state—with interdependent actors contributing to public service delivery and multiple processes informing policy-making, and inter-organizational relationships (Osborne 2010, 7). NPG emphasizes negotiation of values and relationships, in response to the increasingly complex, plural, and fragmented nature of public policy implementation and public service delivery in the twenty-first century.

As an innovation in cross-sector collaboration, social impact bonds illustrate NPG in practice. Although some in public affairs discuss three perspectives of PA, NPM, and NPG, many other theorists contribute to the discourse of collaborative governance. For example, some have traced the emergence of SIBs to the rise of neoliberalism. These critical theorists argue that neoliberal ideology is the driving force behind the privatization of public services, first introduced by NPM and later engaged by NPG (Harvey 2005, Osborne 2010). I argue that SIBs are a *product* of neoliberalism, but not necessarily a *practice* of neoliberalism, because programs are funded by investors but not privatized by them. Through these partnerships, the third sector can use aspects of neoliberalism to its advantage by increasing capital, yet avoiding privatization.

### **The Neoliberal Context**

Some contend that since the 1980s, neoliberalism has permeated many societies. Neoliberalism proposes that human wellbeing can be advanced by “liberating individual entrepreneurial freedoms and skills within an institutional framework characterized by

strong private property rights, free markets, and free trade.” It has become the “central guiding principle of economic thought and management” that has permeated the public, private, and social spheres (Harvey 2005, 2). Actors in the nonprofit sector recognize that they cannot operate outside of the system of neoliberalism. Therefore, they actively seek innovative strategies to work within the neoliberal framework and generate operating funds. As the opening in Chapter One illustrates, nonprofit organizations cannot function without sufficient funds. Social impact bonds are mechanisms for third sector organizations to tap into the financial resources of the private sector and operate within the neoliberal context. Unlike traditional relationships between investors and nonprofits, nonprofits in an SIB are able to obtain funding without the oversight and control from investors. SIBs allow nonprofits to leverage financial resources from the private sector through the contractual agreement of the intermediary.

### **Social Impact Bonds as a Product of Neoliberalism**

In 2010, the first SIB was introduced in the United Kingdom as a tool to bridge the public, private, and third sectors (McKinsey & Company 2012, 11). Since its inception, the concept has generated considerable global interest as it enters the timely discussion of governance. Political philosopher John Ehrenberg (1999) claims that governance of social issues mainly occurs in the realm of civil society. Much American thinking about civil society is motivated by categories drawn from de Tocqueville’s observations in *Democracy in America* (1835). He claims that associational life embodies the spirit of democracy through greater participation, deeper commitment, and heightened solidarity (Tocqueville 2003). Ehrenberg argues, “Contemporary thought is characterized by a pervasive skepticism of the state,” resulting and sometimes reinforced

by in the emergence of civil society associations (1999, 233). Harvey (2005) would attribute this “skepticism” to the rise of neoliberalism. Under neoliberalism, deregulation of markets and the shrinking role of the state set the stage for a “third sector” to assume responsibility for social issues. He argues that non-governmental and grassroots organizations have proliferated under neoliberalism, “giving rise to the belief that opposition mobilized outside the state apparatus and within some separate entity called ‘civil society’ is the powerhouse of oppositional politics and social transformation” (2005, 78). Proponents of SIBs share this notion of skepticism towards the state, and they criticize government institutions for spending money on ineffective remedial programs to address critical social issues (McKinsey & Company 2012). Rather than remedial programs, SIBs implement preventative programs that aim to achieve lasting social impact. Furthermore, proponents claim that the government will spend taxpayer dollars more effectively by only paying for what works.

Skepticism about the state and renewed attention to civil society indicate that SIBs are direct products of neoliberalism. Ironically, although neoliberalism is consistent with the creation of SIBs, it can be argued that neoliberalism also created the societal problems that SIBs seek to address. Under neoliberal ideology, responsibility for one’s wellbeing is the individual’s. According to Harvey,

As the state withdraws from welfare provision and diminishes its role in arenas such as health care, public education, and social services, which were once so fundamental to the embedded liberalism, it leaves larger and larger segments of the population exposed to impoverishment (2005, 76).

SIBs can only usefully address social problems if 1) preventative programs can alleviate the problems, and 2) the implementation of such programs will save the government

money in the long run. The most probable social issues to address with social impact bonds evidently include unemployment, crime and recidivism rates, homelessness, and drug addiction. It can be argued that these social ills are at least in part consequences of inequities reinforced by neoliberalism. As Harvey (2005) contends, although neoliberal theory emphasizes ideals of human dignity and individual freedom, many have become enslaved by its practices.

### **Taking Advantage of Neoliberalism**

Neoliberalism demands that the state favor strong individual property rights, and by extension, “the freedom of businesses and corporations (legally regarded as individuals) to operate within the institutional framework of free markets” (Harvey 2005, 64). As a consequence, the neoliberal state has restored power to a narrowly defined capitalist class (Harvey 2005, 38). If neoliberalism confers freedoms on the elite class, why do others participate in the system? Antonio Gramsci (1971) would argue that the neoliberal state’s hegemonic ideology has disguised its practices as “common sense” to ground consent. For Harvey, “Common sense is constructed out of long-standing practices of cultural socialization often rooted deep in regional or national traditions” (2005, 39). In this view, liberal democracies like the U.S. have fallen victim to a belief that few plausible alternatives exist to the all-encompassing hegemony of neoliberalism. Since it is seemingly impossible to address social issues outside the realm of neoliberalism, SIBs can be seen as an innovative strategy to work *within* the system in ways that reap its rewards, without themselves becoming a completely neoliberal practice.



With an SIB, private investors—not a government—provide capital for nonprofits to broaden the reach of social programs (McKinsey & Company 2012). Through the lens of neoliberalism, the nonprofit organization is able to attain funds from private investors that are interested in reaching a double bottom-line—financial rewards *and* social impact. The promise of social impact may be a façade for neoliberal aims, as businesses revel in the idea of “corporate social responsibility” to increase their legitimacy and favorability among consumers.

Although the private actors take on the financial risk, they do not actually *privatize* the public service. Implementation of the social programs is left up to the evidently more “public-regarding” nonprofits. Harvey contends that “competition—between individuals, between firms, between territorial entities (cities, regions, nations, regional groupings)” is a primary virtue of neoliberalism (2005, 65). Neoliberal theory holds that “privatization and deregulation combined with competition, it is claimed, eliminate bureaucratic red tape, increase efficiency and productivity, improve quality, and reduce costs, both directly to the consumer through cheaper commodities and services and indirectly through reduction of the tax burden” (Harvey 2005, 65). SIBs have the potential to secure the aforementioned advantages, *without* necessarily facing competition. Therefore, even though SIBs are a *product* of neoliberalism, they are not necessarily a *practice* of neoliberalism. Harvey writes, “In many of the instances of public-private partnerships, particularly at the municipal level, the state assumes much of the risk while the private sector takes most of the profit” (2005, 77). However, this is not the case for SIBs. Here, the state assumes no initial risks, and the private sector will only make a profit if the nonprofit’s programs are effective in reaching measurable goals.

## **Competition among Partners**

Although an SIB allows the third sector to avoid the pressures of competition with for-profit actors, competition may arise among the three sectors. According to Hutchinson and Campbell, “partnerships bring together a coalition of interests drawn from more than one sector...” (1998, 9 in Osborne 2010, 129). Competing interests in and among the three sectors create potential tensions among partners. McQuaid discusses many potential challenges of partnerships, such as organizational difficulties, differences in philosophies and ethics, and complex power relations among partners (2010, 137). If partnerships are to be effective, then mutual benefit and reciprocity are important. Actors must believe that there are benefits for their own organizations compared to the costs of involvement (McQuaid 2010, 141). In the case of SIBs, the focus on how governments and private investors can achieve “mutual benefit” could hinder the third sector entities from focusing on their primary purpose—lasting social impact.

In the following chapter, I engage scholarship on traditional two-way partnerships and then explore the more novel idea of “three-way” partnerships through an in-depth analysis of the HMP Peterborough social impact bond in the U.K. By focusing on the cross-sector partnership as my primary unit of analysis, I will revisit the notion of competing interests that may cause contention among partners involved in an SIB.

## CHAPTER THREE: TYPES OF SOCIAL PARTNERSHIPS AND THE FIRST SIB

As scholars and administrators alike continue the discourse of public governance, the concept of *partnership* has enjoyed a worldwide resurgence. Although cross-sector partnerships have gained global interest and support, few people agree on what the term actually means (Hodge and Greve 2007). Although some see partnerships as a practical governance tool, others view them as a pawn in political language games. Osborne (1998) questions if “partnership” is anything more than a buzzword to “sprinkle liberally through funding applications” (Osborne 1998, 290). As Hodge and Greve point out, many seem to use the terms “contracting” and “public-private partnership” interchangeably (2007, 545).

At least since the 1990s, cross-sector collaboration has become more prominent and extensive, resulting in “stunning evolutionary change in institutional forms of governance” (Alter and Hage 1993, 12). The most popular form of collaborative engagement is partnership among businesses, government, and civil society to address social problems (Selsky and Parker 2005, Waddock 1991). As Waddock describes, social partnerships include “the voluntary collaborative efforts of actors from organizations in two or more economic sectors in a forum in which they cooperatively attempt to solve a problem or issue of mutual concern that is some way identified with a public policy agenda” (1991, 481-482).

I distinguish among four types of social partnerships:

*Type 1:* between the private sector and public sector, in which for-profit groups help fund and implement public infrastructure projects;

*Type 2:* between the private sector and third sector, often a tool to fulfill corporate social responsibility;

*Type 3:* between the public sector and third sector, referred to as the “third-way” of governance;

*Type 4:* that involves actors from all three sectors, such as the interaction among partners of a social impact bond.

The term “public-private partnership” often is used to discuss various types of cross-sector collaboration. In many cases, administrators refer to “private” partners as entities outside of the government, clustering for-profit with nonprofit/nongovernmental groups. As Chapter One discussed, here I separate the two, with for-profit institutions termed as the “private sector” and nonprofit organizations the “third sector.”

Cross-sector partnerships have clear benefits, as each sector benefits from the strengths of the other in areas such as knowledge and expertise, accountability, resources, and both financial and social capital. As McQuaid (2010) suggests, partnerships have the capability to implement new and innovative approaches, as stakeholders come together from a range of different policy perspectives to produce “greater dynamism through the sharing of ideas, expertise, and practice, and risks can be contained” (131).

The public sector draws attention to “public interest, stewardship, and solidarity considerations” (Rosenau 1999, 11). It may well be armed with local knowledge and legitimacy, and public organizations are more accountable to public scrutiny.

Meanwhile, some believe the private sector is more creative and dynamic, benefitting from access to financial resources, managerial efficiency, and entrepreneurial spirit. The private sector is better at “performing economic tasks, innovating and replicating successful experiments, adapting to rapid change, abandoning unsuccessful or obsolete activities, and performing complex or technical tasks” (Rosenau 1999, 11). Lastly, the third sector may excel in areas that require compassion and commitment to individuals. This sector, also known as the nonprofit or voluntary sector, focuses on grassroots efforts to attend to social problems that need hands-on personal attention.

In theory, a cross-sector partnership is intended to reap the advantages of each sector. In practice, however, partnering is not so straightforward; “policy ethics and managerial ethics imply obligations that are not entirely the same” (Rosenau 1999, 11). Effective partnerships challenge existing approaches by utilizing the benefits from each sector in a collaborative effort to address the complexities of many pressing problems.

A social impact bond is an example of a *Type 4* partnership—the three-way collaboration of organizations from the public, private, and third sectors. SIBs gain legitimacy from the public sector, funding from the private sector, and expertise from the third sector. This chapter elaborates on each type of partnership, and concludes with a discussion of the cross-sector partners involved with the original SIB, developed to reduce criminal recidivism in Peterborough prison (HMP Peterborough) in the United Kingdom.

### **Type 1: Public-Private Partnerships**

Public-private partnerships (PPPs) are usually what first come to mind in regards to cross-sector collaboration. PPPs can be loosely defined as “institutionalized

cooperative arrangements between public-sector actors and private-sector actors” (Greve and Hodge 2010, 150). The most common form of PPP is the formation of long-term contracts for public infrastructure projects. In a PPP, one or more government agencies collaborate with businesses to “design, finance, build, own, and operate infrastructure projects” (Greve and Hodge 2010, 151). Both public and private actors work together toward a common purpose. Van Ham and Koppenjan define PPPs as “cooperation of some sort of durability between public and private actors in which they jointly develop products and services and share risks, costs and resources which are connected with these products” (Van Ham and Koppenjan 2001, 598). This definition emphasizes *durability*, as most contractual periods last up to thirty or forty years (Greve and Hodge 2010, 151).

PPPs flourished in the United States during the last two decades of the twentieth century. This also was the time that NPM and NPM’s association with the privatization and outsourcing of government functions resulted in the rapid increase of policy partnerships (Osborne 2010, Selsky and Parker 2005). The primary motivation for the formation of PPPs was pressure for more efficient government through reliance on private sector practices.

Many argue PPPs can be constructed as both a political symbol and a policy tool (Linder 1999, Selsky and Parker 2005). As Selsky and Parker note, the meanings ascribed to PPPs include “reforming how government functions, transforming public service delivery, shifting government risk in response to fiscal stringency, restructuring of the public service, and *moral regeneration* in bringing government closer to the virtue of the market” (2005, 859).

Public-private partnerships in U.S. prison systems, for example, experienced resurgence during the rise of NPM. In the 1980s, increasing crime rates, along with changes in public policy, resulted in rapid increase in incarceration (Schneider 1999). The increase in prisoners produced overcrowding in prisons and jails across the United States—during a time when almost all states faced serious financial problems and budget shortfalls (Schneider 1999, 199). These factors created a crisis in criminal justice policy, and public officials turned to the private sector to reduce the costs of prisons. Private companies operate a secure adult facility for prisoners and seek contracts with local, state, and federal agencies. The for-profit organization usually is paid based on the number of prisoners it houses or the number of places it has reserved for a jurisdiction. Most state contracts require that private firms offer the service at 5 percent to 10 percent below what it would have cost the state (Schneider 1999). The biggest concern with relying on PPPs for prison management lies in the private sector’s interest to maintain long-term contracts by keeping offenders behind bars. Reviewing the scholarship on this topic, Schneider notes, “the studies virtually never explain how or why the private prison manages to have lower costs even though they have the added responsibility of making a profit” 1999, 203).

Despite the advantages of partnering with the private sector, many argue that PPPs have a strong role in the language games that actors play when considering contracting out public services (Selsky and Parker 2005, Schneider 1999, Linder 1999). Public-private partnerships have been criticized for as long as they have existed (Selsky and Parker 2005). Although some advocate PPPs as instrumental tools for governance, others argue they are too results-oriented and often neglect externalities (Selsky and

Parker 2005, Bovaird 2004, Rosenau 1999). By narrowly defining indicators of success, PPPs may exchange values like equity, access, or democracy for demands for lower cost and greater efficiency. Some see PPPs as a disguise for privatization or public outsourcing, distancing government from its responsibilities (Selsky and Parker 2005, Farank 2004). As PPPs in U.S. prisons illustrate, the primary concern is that they lead emphasis to shift from the public good to the interests of the private sector when burden is transferred from the government to businesses. Rather than protecting rights of the imprisoned and enhancing public safety, private partners are motivated by the contractual agreements.

## **Type 2: Private-Third Sector Partnerships**

Collaboration between private and third sector organizations is also increasingly popular, as competitive businesses seek to improve their *corporate social responsibility* (CSR). CSR has rarely been more topical in the business realm. Killian argues that CSR is more than a fad; it is becoming, “something with which all firms, large and small, manufacturing and service will have to engage” (2012, 30). CSR emphasizes the “triple bottom line,” first popularized in John Elkington’s 1998 book *Cannibals with Forks: Triple Bottom Line of 21<sup>st</sup> Century Business*. The phrase triple bottom line encourages businesses to expand their mission to focus not only on profit, but also on their impact on people and the planet (Killian 2012). Googins, Mirvis, and Rochlin (2007) outline five stages of CSR: compliance, engagement, innovation, integration, and transformation. Compliance takes place when businesses meet basic standards of jobs, profits, and taxes. Engagement occurs when a firm participates in philanthropic efforts, with a strategic objective to improve its reputation. The next stage is reached when businesses become



involved with the innovation of social causes and stakeholder management. Firms become "integrated" with CSR when they actively pursue the triple bottom line. The last stage of CSR, transformation, occurs when businesses leave legacies of lasting social change (Googins et al. 2007).

Although CSR may be "the new normal," conspicuous efforts to reach the triple bottom line reinforce the private sector's top priority—profit. In order to maintain a competitive edge, businesses must strive to improve their CSR. Both theory and evidence suggest a corporation's socially responsible behavior can positively affect consumers' attitudes towards the corporation (Lichtenstein et al. 2004). Through CSR practices, businesses can enhance their corporate image, garner social capital, access social networks, increase sales, and attract and retain desirable employees (Selsky and Parker 2005, 855).

Companies that recognize CSR as a key to success and nonprofits that have ever increasing needs for resources are both promoting CSR initiatives (Lichtenstein et al. 2004, 16). Huxham and Vangen (1996) suggest partners have three levels of motivation: metagoals that encompass the common cause, the goals of each partner, and the goals of the specific individuals involved. Research on cross-sector partnerships focuses on the middle category—individual partners' goals. The third sector tends to be motivated by altruism, whereas business partners are more likely to pursue interests that will provide competitive market advantage (Selsky and Parker 2005).

The partnership craze among businesses is "tempered by nonprofits' cautious hesitation or even outright opposition for partnering with the private sector" (Selsky and Parker 2005). The very dichotomy of their labels—nonprofit vs. for-profit

organizations—calls attention to their inherently different motives. As Lichtenstein et al. (2004) note, “CSR initiatives can be particularly risky for nonprofits, which usually are the less powerful partner, and they may not ultimately serve the nonprofit’s long-term interests” (17). Despite their concerns, however, many nonprofits view entering into cross-sector partnerships as necessary tactic. Even the most dedicated organizations cannot achieve their mission without sufficient funding or other resources. Although most studies assume nonprofits and businesses have very different priorities, recent research reexamines this assumption. Similar to the reputational benefits of CSR for for-profits, nonprofits may view cross-sector partnerships as an instrumental tool to increase their influence on social change. Nonprofits can leverage reputational capital to attract new resources and expand their scope (Selsky and Parker 2005).

Private-third sector partnerships typically form during the *engagement* or *innovation* stages of CSR (Googins et al. 2007). Reaching out to an existing nonprofit organization provides corporations with access to the third sector. In general, businesses are more attracted to direct-impact partnerships, such as education, environmental sustainability, or job development, than to those with indirect impacts, such as social mobilization or advocacy (Selsky and Parker 2005). An example of a private-third sector partnership focused on direct impact is the alliance between the private company Serco and the nonprofit Catch 22. Since 2006, this partnership has provided welfare-to-work services to ex-offenders in England through a program called Path2Work.<sup>14</sup> The organizations have a formal partnership based on a memorandum of understanding (MOU). In order to satisfy each partner’s goals, the MOU was drawn up after

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<sup>14</sup> For more information about Path2Work, see: <http://www.serco.com/media/pressreleases/2011/turningpoint.asp>

discussions about values and principles and was translated into a formal contractual agreement (ACEVO 2010). In a review of private and third sector public service partnerships in the U.K., the Association of Chief Executives of Voluntary Organizations (ACEVO) describes the partnership between Serco and Catch 22 as one between equals—with joint bidding and operational teams, shared decision making, and an agreement to use common business governance. ACEVO (2010) notes that building partnerships and trust takes significant time and energy, often needing several years to develop. In many cases, subcontracting between the private and third sectors can become a genuine partnership, in which the arrangement delivers mutual benefits and partners combine their knowledge to develop new products and services (AVECO 2010, 4).

Implementing a shared vision among partners typically means developing a common culture held together by shared values, common interests, and clear communication (Selsky and Parker 2005). Shared metagoals, such as those outlined in the MOU between Serco and Catch 22, build the identity of the cross-sector partnership. Difficulties in the development of a common culture may be overcome by focusing on the metagoals, realigning partner expectations, or giving appropriate credit to each partner's experience and expertise (Selsky and Parker 2005, AVECO 2010, Waddock 1991).

### **Type 3: Public-Third Sector Partnerships**

Since the Reagan administration, the devolution of responsibility for federal domestic programs to the states has given states “progressively more latitude in how they may arrange major domestic programs, especially in human services” (Milward and Provan 2003). As Elaine Kamarck (2002) observes, the years of decentralization and

devolution have led to a world of “networked government,” as state governments increasingly turn to contracting out services to nonprofit organizations (Kamarck 2002, Milward and Provan 2003).

Public-third sector partnerships, also known as “third-way” partnerships, are formed primarily through *manufactured civil society*, which Hodgson describes as “groups that are funded, at least initially, through some type of state initiative. Often these groups are directly answerable to the state and have to address certain criteria and meet targets set by government” (Hodgson 2004, 145). In third-way policies and governance, governments actively seek engagement with civil society. Public administration literature on third-way partnerships also emphasizes the New Public Management principles that are evident in these partnerships (Selsky and Parker 2005). As Smith and Smyth observe, the attraction of contracting with third sector organizations reflects many factors: “pressure to contain costs, new attention to civil society organizations and their potential to build social capital and community, and the influence of NPM, which seeks to improve the efficiency and effectiveness of public services” (Smith and Smyth 2010, 270). There are also political motivations for government agencies to partner with the third sector. Many third sector organizations are driven by grassroots support, which also means that these organizations have electoral support and lobbying influence. Thus, government contracting with the third sector may be a strategy for governments to reach out to particular groups or constituencies (Smith and Smyth 2010).

With the rise of NPM, the “government reform” movement has had a widespread effect on the third sector and its relationship with the public sector (Smith and

Smyth 2010). There has been a noticeable growth of diverse third sector organizations that provide an array of social services. Smith and Smyth (2010) argue that indirectly, the government reform movement has facilitated an increased interest in voluntarism, citizen participation, and community service. The expansion of third-way contracts also has encouraged third sector organizations to become more politically active by becoming involved in electoral politics and lobbying officials. Public agencies have transformed from the direct *providers* of social services to the *enablers* of social services. This shift towards the government's role as the "enabler" fits with the emergence of NPM that stressed "steering rather than rowing" for public agencies (Smith and Smyth 2010, 274).

Such third-way governance has numerous advocates. For example, Sirianni (2009) contends that collaborative governance through third-way partnerships is the most promising way to foster more democratic citizenship in the United States. Sirianni points to three main reasons that require the public sector to become a more "strategic, systematic, and effective enabler of civic engagement": (1) cultural transformation, (2) the growing diversity of the public, and (3) the rising costs of self-governance (2009, 2). Studies conducted by political scientist Robert Putnam (2000) suggests that at the turn of the 21<sup>st</sup> century, grassroots volunteering and membership in associations began declining. Putnam argues deep social transformations underlie these trends, such as technological advancements, increased pressures of time and money, and suburbanization (in Sirianni 2009, 4). Sirianni argues that the emergence public-third sector partnership has helped reverse the cultural transformation of apathy, drawing citizens toward political activism and grassroots associations.

A second reason Sirianni maintains that government should focus its attention on collaborating with the third sector is that communities are becoming increasingly diverse in terms of race, ethnicity, socio-economic status, and other identities. Sirianni fears “such diversity raises the costs of negotiating interests, aligning perspectives, and building ongoing relationships of civic trust” (2009, 16). He argues governments should play more active roles as the enabler of third-way governance, in order to avoid the hyper-pluralism and fragmentation that can lead to conflict, stalemate, and suboptimal policies (2009, 16).

Lastly, Sirianni points to the rising costs of self-governance as a critical motivation for third-way partnerships. He argues, “Without commensurate and strategic investments by government, the nation will fall considerably, even dangerously, short of revitalizing our civic infrastructure and problem-solving capacities” (2009, 10).

Although public-third sector partnerships encourage grassroots participation in societal governance, they also create new challenges for third sector organizations. Tensions over power and control over decisions in such partnerships are evident (Selsky and Parker 2005). Hodgson (2004) argues that the state’s creation of manufactured civil society is a means of controlling civil society. Government contracts increase the specificity and the level of performance expectations for third sector partners. Smith and Smyth contend that “heightened interest in performance has a number of implications for the governance of third-sector organizations” (2010, 278). The framework of “results based accountability” found in government contracts forces nonprofits to prioritize outcomes over their actual practices (2010, 278). This often pressures nonprofits to “professionalize” the administrative infrastructures of their organizations, which can

distort their underlying mission and focus. Many third sector organizations start as community initiatives, driven by grassroots support and local knowledge. Government accountability measures, such as performance-based contracts, however, often require agencies to adopt new administrative procedures and add professional expertise (Smith and Smyth 2010, 279).

Smith and Smyth assert, “This shift to professionalization and performance contracting can be especially consequential for the relationship between the third-sector organizations and their clients” (2010, 279). For example, if a nonprofit organization is publicly funded to reduce criminal recidivism rates, the nonprofit may cater to criminals who are easier to rehabilitate. Since the contract specifies measurable outcomes, the nonprofit may “shift its programmatic focus toward short-term goal sand client groups at variance with their original community interest” in order to reach its goal (Smith and Smyth 2010, 280). If the contract defines “success” by a recidivism reduction of 10 percent, the nonprofit may focus its attention on rehabilitating those with minor offenses to reach that goal. Furthermore, “the more recent shift in government funding toward performance contracting and standardization makes it more difficult for agencies to go beyond the expectations of the contract” (Smith and Smyth 2010, 281).

#### **Type 4: Tri-Sector Partnerships**

Similar to the other types of partnerships, motivations for tri-sector collaboration can be viewed as a blend of self-interest and altruism. Recent research, however, suggests that a major impetus is “partner awareness of the growing number of complex and multi-layered social problems that cut across societies, combined with the desire of each sector to contribute to global problem solving” (Selsky and Parker 2005, 863). Most

scholars do not distinguish between bisector and tri-sector partnerships, so it is often difficult to separate the literature into the appropriate categories (Selsky and Parker 2005). The biggest challenge in tri-sector research and practice is establishing outcome criteria, because the arrangements differ for the private, public, and third sector organizations. Although many view three-way partnerships as tools to address multifaceted social issues, some scholars are more critical, arguing that the complex goals of such projects are unrealistic or unachievable (Boguslaw 2002, Turcotte et al. 2008).

Most scholarship on tri-sector partnerships appears under the umbrella of network governance (Smith 1993, Rhodes 1997, Bevir and Rhodes 2003, Greenaway et al. 2007). As Greenaway et al. (2007) note,

Cross-sectoral partnerships and multi-layered points of policy making are seen as replacing the hierarchical centralized state. In this connection, policy networks are one of the key theoretical organizing approaches, since it is suggested that there is a shift from government by the unitary state towards governance by and through a range of networks of various kinds (717).

The problem with studying cross-sector partnership through the lens of network governance is the tendency to neglect the distinctiveness of each sector: the public sector seeks to represent the public good, the private sector is primarily driven by profit, and organizations from the third sector support specific social causes. Although a tri-sector partnership may be formed around a common “metagoal,” partners from each sector are motivated by diverse incentives and benefit in different ways.

The most distinguishing feature of tri-sector partnership is the frequent presence of a “bridging” organization to convene or manage the cross-sector relationships (Selsky and Parker 2005) and to protect the individual interests of each partner. Milward and



Provan use the term “network administrative organization” to refer to the supra organization that “effectively manages” partners in a network (Milward and Provan 2003, 6). Social Finance is an example of a bridging or network administrative organization in the U.K. that brings together expertise from the public, private, and third sectors to redesign public services and address social problems. In late 2007, Social Finance first developed the idea of social impact bonds out of the frustration of the third sector in the U.K (Social Finance 2011). Both the U.K. and U.S. have run into a number of obstacles in financing social programs. Many third sector organizations are forced to spend a majority of their time securing grants, instead of focusing their efforts on serving those in need (Social Finance 2011). Meanwhile, governments often spend taxpayer dollars on less effective remedial programs, rather than sustainable preventative programs (McKinsey & Company 2012). Furthermore, government contracts pay organizations to deliver *outputs*, instead of rewarding them for achieving *outcomes* (Social Finance 2011).

Out of this frustration rose innovation. Social Finance came up with a strategy to identify social outcomes that could be clearly measured and valued. As an intermediary organization, Social Finance leverages resources from public, private, and third sector organizations in order to create social impact bonds. A social impact bond is a tri-sector contract, in which preventative social programs are funded through future savings the government would accrue from not having to pay for acute services. Risk is transferred from the public sector to the private sector, as businesses invest in nonprofit organizations to deliver public services. In an SIB contract, the public sector commits to pay back private investors if improved social outcomes are achieved. These payments repay the initial investment, in addition to a financial return that depends on the degree to

which the outcomes improve. The novelty of the social impact bond as an example of tri-sector partnership lies in the alignment of investor interest with social returns, establishing a mutually beneficial relationship for all partners.

### **The First Social Impact Bond: ONE Service**

The first SIB was launched in September 2010 to fund the *ONE Service* program working with 3,000 short-sentence prisoners discharged from the Peterborough prison over the following six years. A report published by Social Finance exactly one year after the SIB's formation noted: "Criminal justice was an obvious choice" when looking at areas of social need where little to no money was spent on preventative programs (Social Finance 2011, 6). Reoffending rates among short sentenced prisoners (those who had been imprisoned less than one year) are extremely high. According to the National Audit Office (2010), 60 percent of offenders are convicted of at least one offense within one year after their release. In 2007, each short sentenced prisoner who reoffended within one year also was convicted of *five* further offenses (National Audit Office 2010). After the offender left prison, he or she had no one with statutory responsibility following him or her. A very high proportion leave prison with nowhere to live, no waiting job, and no family, only to return to prison a few months or weeks later (Social Finance 2011, 6). Social Finance identified the following challenges that led to high re-offending rates of short sentenced prisoners:

- Insufficient funding was available to enlarge programs that work with short-sentenced prisoners.
- Government contracts specified certain services without taking into consideration the individual nature and complex needs of each client

- Outputs based on contracts focused on immediate results rather than “sustainable rehabilitation”
- Contracts did not provide organizations with incentives to work with offenders who cause the volume of crime
- Short-term contracts did not allow time to learn and evolve (Social Finance 2011, 7).

In search of a solution, Social Finance drew up a contract with the Ministry of Justice to launch the first social impact bond. The contract defined the target population as 3,000 short sentenced male prisoners leaving HMP Peterborough over a six-year period. The contract stipulates that investors would receive a return on their investment if the number of reconvictions among the target population falls by 7.5 percent or more. If the SIB delivers a decrease in recidivism that exceeds 7.5 percent, investors will receive an increasing return capped at 13 percent per year over an eight-year period.

### **Private Sector Partners**

Social Finance raised £5 million (approximately 6.5 million U.S. dollars) from 17 investors, including the Barrow Cadbury Trust, Esmee Fairbairn Foundation, Friends Provident Foundation, the Henry Smith Charity, Johansson Family Foundation, LankellyChase Foundation, the Monument Trust, Panahpur, Paul Hamlyn Foundation, the Todur Trust, and a number of high net-worth individuals who have not been identified (Disley et al. 2011). Although many of the investors in the first SIB are charities and foundations, these organizations can be considered “private” funders as they are generally supported by private individuals. Social Finance hopes that over time a wider investor base will develop, including more private individuals, banks and financial

institutions, pension funds, and corporate social responsibility funds (Social Finance 2010, 23). In an interview conducted by RAND Europe, Social Finance officials expressed that one of its goals was to bring in new sources of funding for public services. Social Finance reported “over half the investment (by value) and half the investors (by number) in the Peterborough SIB are either using their endowment or investing in the U.K. criminal justice area for the first time” (Disley et al. 2011, 25).

One can conceive of a continuum of funding, ranging from grants or gifts, for which nothing is expected in return, to commercial investments, for which a financial return is expected. An SIB falls in the middle of this spectrum. Social investment is “distinct from a grant, in which money is given away, in that a financial return, however small, is expected” (Kingston and Bolton 2004, 113-114). Investors in the HMP Peterborough SIB invested through different channels. Some made grants, while others funded the SIB through endowment capital. Analysts at RAND Europe observe, “There appeared to be an appetite among the investors to use mission-aligned investing rather than making a grant” (Disley et al. 2011, 26). From interviews with investors, RAND Europe reports that respondents gave the following reasons for investing in the HMP Peterborough SIB:

- The desire to support SIBs as innovative payment-by-results financial products—they were attracted by its potential to benefit the public, by improving the criminal justice system and its application to other areas
- Charities’ desire to invest money “more ethically” and in “ways that were more aligned with their missions”
- Confidence in the nonprofits and Social Finance

- The opportunity to learn about social investment
- Attracted to the idea of delivering upfront funding to providers
- Estimation by investors that there was a good chance of receiving a financial return on their investment (Disley et al. 2011, 28).

The investors expect to achieve a double bottom line of financial return and social impact if the ONE Service intervention meets its aim of reducing recidivism.

However, beyond investing, the private-sector partners do not play an active role in the SIB partnership. Unlike a Type 2 (private-third sector) partnership, investors are not given the authority of management or oversight of the third-sector organizations responsible for delivering the services.

#### **Third Sector Partners: St. Giles, Ormiston, YMCA, SOVA**

Four contracted nonprofits deliver the ONE Service program at HMP Peterborough: St. Giles Trust, Ormiston Children and Families Trust, YMCA, and SOVA. The first two, St. Giles Trust and the Ormiston Trust, focus on the immediate needs of an offender before and after he is released from prison, including medical services, family support, employment and training, and financial advice. After that, SOVA and YMCA assign a volunteer to support him over the subsequent months and continue to work on longer term objectives (Social Finance 2011, 9).

Work with the offender begins in HMP Peterborough before his release. A series of meetings and workshops are conducted to collect data on the client, in order to develop a case managed system that yields the best course of action for the individual involved (Social Finance 2011, 9-10). This is done with the Peterborough prison resettlement team. Social Finance states, “Engagement with the local Peterborough community has

been instrumental in securing a wide range of additional services for the clients, including training and local support groups” (2011, 10). The SIB funding structure brings “flexibility and innovation” to the project. The flexibility granted by sufficient financial resources allows innovation in terms of service provision, as the nonprofits are judged by outcomes rather than outputs (Social Finance 2011, 10).

The nonprofits are not evaluated using a binary measure (whether the offenders reoffend), but rather with a frequency measure (the combined number of reconviction events per cohort). This encourages ONE Service providers to work with all clients, including those who are the most frequent reoffenders. The mean number of reconviction events from those participating in the ONE Service program is compared to the mean number of reconviction events in a matched comparison group. The mean number of reconviction events in the Peterborough group is then subtracted from the mean number of reconviction events in the control group to calculate the difference. The data for these measures are drawn from the Ministry of Justice extract of the Police National Computer (Disley et al. 2011, 33).

During the life of the HMP Peterborough SIB there will be three cohorts of approximately 1,000 eligible men, who are at least 18 years of age and sentenced for a period of less than 365 days. A prisoner will be counted as a member of the cohort whether or not they participate in SIB funded services. Interviews conducted by RAND Europe with service providers suggest that “the inclusion of those who do not engage in the intervention removes any incentive for the service provider to cherry-pick the easiest offenders with whom to work” (Disley et al. 2011, 35). Each cohort will be compared to a matched control group, which is drawn from all short sentenced prisoners released

within the same time period from other prisons nationally. One-to-many propensity score matching will be used to select the control group. Each cohort prisoner will be matched with up to 10 prisoners in the control group. The strength in using propensity score matching (PSM) to build the control group is that it allows assessors to control for different characteristics of the offenders (Disley et al. 2011, 36).<sup>15</sup>

### **Public Sector Partner: Ministry of Justice**

For governments, an SIB removes the upfront costs of service delivery and shifts financial risk to private investors. Under usual circumstances, government departments select contractors through a competitive tendering process that is viewed by governments to guarantee the best value for contracted money. The Ministry of Justice and Social Finance did not enter into a contract with Social Finance through such a process. Instead Social Finance approached the Ministry of Justice with the proposal, and according to Social Finance, “there was high-level departmental support” to undertake a “proof-of-concept” pilot (Disley et al. 2011, 14). In a more conventional tendering process, governments often find it difficult to spend money on longer term preventions over immediate outputs because of the uncertainty of whether the preventions will yield lasting results. By removing the financial risk, however, social impact bonds may allow governments to pursue more innovative solutions that consider sustainable solutions instead of immediate results.

SIBs will not apply to all circumstances. In many areas, traditional funding will remain the most appropriate (Social Finance 2013a, 5). For instance, activity-based

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<sup>15</sup> The independent assessor will make a decision on the final variables to be included in the propensity score matching (PSM) and the need for assessing interactions and non-linear effects in the final PSM model. The contract between the MOJ and Social Finance specifies that only statistically significant explanatory variables will be included in the final PSM model (Disley et al. 2011, 36).

funding (AFB) allocates funding to hospitals based on the type and volume of services they provide adjusted for the patient population they serve (O'Reilly et al. 2012). In this instance, it is more appropriate to fund based on activity rather than outcome in order to satisfy the immediate public demand. In other cases, the public sector may want to pay for results rather than activities, for the primary purpose of encouraging better performance within an existing approach. In such cases, funding from private investors is unnecessary. For an SIB to appeal to public sector officials and agencies, there must be evidence that an existing approach is not working. In areas where public needs are consistently unmet, the public sector can benefit from the bond's new funding mechanism that allows for experimentation. To garner support from the Ministry of Justice, Social Finance argued that the problem of short-sentenced recidivism resulted in a number of public consequences with no effective solutions in place. Not only does the problem of recidivism add to the public costs of incarceration, but it also prevents individuals from being productive members of society. Analysts at RAND Europe observed:

Given the extent of media coverage and interest in the pilot, the Ministry of Justice may gain beneficial profile as well as being subject to attendant reputational risk. In agreeing to test the SIB at HMP Peterborough, the Ministry has taken a leading role in testing alternative payment-by-results funding mechanisms, and this has boosted visibility and interest in its work from other departments and parts of government, both nationally and internationally (Disley et al. 2011, 21).

According to the SIB contract, the Ministry of Justice will make the outcome payments only if the reoffending rates are reduced by 10 percent in each cohort or 7.5 percent over all three cohorts compared to the matched control group (Social Finance 2011, 8). This



was an unusual agreement, in that the supplier (Social Finance) was agreed on *before* the final negotiations were made (Disley et al. 2011, 18).

In the simplest understanding of the ONE Service SIB, Social Finance acts as the intermediary among the Ministry of Justice (the public sector), the 17 investors (the private sector), and the four service deliverers (the third sector). However, taking a closer look at the SIB model, the partnership is much more complex and nuanced, resulting in some gaps between the rhetoric and realities of SIBs.

In the following chapter, I outline the research methods used to further examine the SIB partnership at HMP Peterborough and investigate the developing SIB in New York City. I also discuss elite interviews with professionals who manage cross-sector social partnerships in order to gain practical insight into the development and implementation of SIBs.

## CHAPTER FOUR: RESEARCH DESIGN

This research employed a multi-stage qualitative research design to empirically investigate the potential of social impact bonds in the United States. Since the ONE Service SIB is the first of its kind, it is too soon to tell if it will succeed in significantly reducing the recidivism of short-sentenced prisoners. Meanwhile, much speculation about SIBs has made its way through the global grapevine, as international stakeholders are curious about whether the bonds might work in their own communities. On August 2<sup>nd</sup>, 2012, Mayor Michael R. Bloomberg, Deputy Mayor for Health and Human Service Linda I. Gibbs, and Correction Commissioner Dora B. Schiro announced that the City of New York awarded a contract for the nation's first SIB. As part of the Young Men's Initiative, the contract supports an evidence-based program to rehabilitate adolescent males at Rikers Island detention center (City of New York 2012). Following New York City's lead, a plurality of states, including Massachusetts,<sup>16</sup> Illinois,<sup>17</sup> Texas,<sup>18</sup> Maryland,<sup>19</sup> California,<sup>20</sup> and New Jersey,<sup>21</sup> are at various stages of exploring how they

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<sup>16</sup> The Rockefeller Foundation (2011) Press Release, "The Rockefeller Foundation Grants Social Finance, Inc. \$500,000 to Develop Social Impact Bond Market in the United States," Accessed on: <http://www.rockefellerfoundation.org/newsroom/rockefeller-foundation-grants-social>

<sup>17</sup> The Rockefeller Foundation (2013) Press Release, "Governor Quinn Announces Illinois is Second State to Launch SIB Program," Accessed on: <http://www.rockefellerfoundation.org/newsroom/governor-quinn-announces-illinois>

<sup>18</sup> Texas Legislature Online (2013) House Bill, "Relating to pay-for-performance contracts for certain Health and Human Services," Accessed on:

<http://www.legis.state.tx.us/BillLookup/History.aspx?LegSess=83R&Bill=HB1689>

<sup>19</sup> Maryland Legislature Online (2013) House Bill, "Task Force to Study Social Impact Bonds," Accessed on: <http://mgaleg.maryland.gov/2013RS/bills/hb/hb0951F.pdf>

<sup>20</sup> California Legislature Online (2012) House Bill, "Social Innovation and Entrepreneurship," Accessed on: [http://www.leginfo.ca.gov/pub/13-14/bill/sen/sb\\_0001-0050/sb\\_9\\_bill\\_20121203\\_introduced.html](http://www.leginfo.ca.gov/pub/13-14/bill/sen/sb_0001-0050/sb_9_bill_20121203_introduced.html)

<sup>21</sup> New Jersey Legislature Online (2012) Press Release, "Fuentes Social Impact Bill Advanced by Assembly Panel," Accessed on: <http://www.njleg5.com/Content/FUENTES-SOCIAL-IMPACT-BILL-ADVANCED-BY-ASSEMBLY-PANEL>

might use SIBs. This research analyzed the nation's first SIB in New York City by applying "lessons learned" from its precedent in the U.K.

This study investigated possible connections between arguments for and the practice of SIBs. Through textual analysis and elite interviewing, I aimed to answer: *What are possible disparities between the rhetoric and realities of a social impact bond as a tool of collaborative governance?*

### **Textual Analysis**

To explore the development of SIBs in the United States, I analyze the New York City project through the lens of the "lessons learned" from ONE Service. First, I analyzed the text of the report commissioned by the Ministry of Justice, "Lessons learned from the planning and early implementation of the Social Impact Bond HMP Peterborough" (Disley et al. 2011). The aim of the report was to identify early lessons from the development and implementation of the SIB at HMP Peterborough. It was released in May 2011, as the first independent evaluation of the program. The report is based on findings from interviews with 22 individuals from organizations involved in the development and implementation of the SIB.<sup>22</sup> A team of researchers at RAND Europe collected and analyzed the data.<sup>23</sup>

The starting point for the analysis here was a bottom-up approach to summarize and categorize each paragraph each as an "affirmation," "concern," or neither. Paragraphs were coded as an "affirmation" if the authors praised a particular practice (in development, contractual agreements, or program delivery), mentioned benefits to

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<sup>22</sup> See Appendix B for a list of interviewees interviewed in *"Lessons learned from the planning and early implementation of the Social Impact Bond HMP Peterborough"* (Disley et al. 2011).

<sup>23</sup> The RAND Corporation is a nonprofit institution that helps improve policy and decision-making through research and analysis. For more information, see: [www.rand.org](http://www.rand.org)

stakeholders, or encouraged replication. Paragraphs were coded as expressing a “concern” if the evaluators suggested that there was room for improvement, recommended reconsidering a particular practice, or commented on concerns for future SIBs. “Neutral” paragraphs were narrative or informative and did not include evaluative remarks. Of the 183 substantive paragraphs<sup>24</sup> in the 57-page report, I coded 25 percent as an “affirmation”, 28 percent as a “concern”, and 47 percent as “neutral”.<sup>25</sup>

After the textual analysis, I took a more top-down approach by categorizing paragraphs into recurring themes, such as affirmations or concerns about contractual agreements, models of intervention, structure of investments, and outcome measurements. Then, I integrated the “lessons learned” from HMP Peterborough with data collected from press releases, media publications, and other public documents on the New York City SIB. To analyze texts on the New York City case, I categorized paragraphs of each document as either *similar* or *different* from practices of the ONE Service SIB. In the following chapter, I examine both SIBs in order to see how the efforts in the U.K. compare to the development and implementation of SIBs in the United States

### **Elite Interviews**

In order to gain firsthand insight on what practitioners in the United States may think about SIBs, I conducted four semi-structured interviews with experts who manage cross-sector social partnerships in the U.S. Background research on local cross-sector partnerships in the U.S. pointed me in the direction of the Fairfax County Office of Public Private Partnerships (OP3). OP3 is a local government entity that develops

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<sup>24</sup> Substantive paragraphs do not include the executive summary, appendices, tables, or figures.

<sup>25</sup> See Appendix A for textual analysis criteria and breakdown of data.

partnerships among the Fairfax County government, business organizations, and local community organizations to address critical needs in Fairfax County and to encourage civic involvement and responsibility.<sup>26</sup> Although its name specifies *public-private* partnerships, “private” refers to any entity outside government, including for-profit and nonprofit organizations. The office coordinates organizations and resources from the three sectors to address community problems that affect the “quality of life” in Fairfax.

The interviewees were selected based on a convenience, snowball sample due to resource constraints limiting the research. Interviews were conducted face-to-face from April through June 2013. Each interview lasted approximately one hour. I first e-mailed the Executive Director of OP3, who agreed to participate and connected me with additional respondents. All four individuals I contacted agreed to participate. Respondents had little to no knowledge about social impact bonds prior to our discussions. I began the interview by presenting a brief overview of the concept, and describing the partnerships formed in the SIBs at HMP Peterborough and Rikers Island.<sup>27</sup> Then, I asked respondents a series of questions to gauge their reactions to the feasibility of SIBs based on their experience with cross-sector partnerships in Fairfax County. Using semi-structured interviews provided respondents with an opportunity to raise issues not included in the interview protocol.<sup>28</sup> To analyze responses, I revisited notes transcribed during the interviews. By clustering similar responses, I organized the conversations according to the “promises” or “pitfalls” of SIBs as told by the interviewees. Hereafter, I refer to the individuals by their respondent codes 1-4.<sup>29</sup>

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<sup>26</sup>For more information, visit: [www.fairfaxcountypartnerships.org](http://www.fairfaxcountypartnerships.org)

<sup>27</sup> See Appendix C for overview of SIBs presented to respondents during fieldwork.

<sup>28</sup> See Appendix D for interview protocol.

<sup>29</sup> See Appendix B for a list of OP3 interviewees’ respondent codes and titles.

This multi-stage qualitative research design was selected to empirically study SIBs, given the lack of evidence on their outcomes. By situating a developing SIB (in Rikers Island) in the context of an SIB in progress (the Peterborough SIB), I compare the rhetoric and realities of the two. The interviews allowed me to gather unbiased and uninformed reactions to the topic, as most of the scholarship on SIBs are published by actors involved in their development. The following chapter presents findings from the textual analyses and elite interviews into themes that help unravel the complexities of SIBs.

## CHAPTER FIVE: AN EMPIRICAL LOOK AT SOCIAL IMPACT BONDS

The first half of this chapter discusses some of the most common affirmations and concerns drawn from RAND Europe’s consultation of the ONE Service SIB after one year of its implementation. In the following sections, I integrate the “lessons learned” with press releases and media reports on the more recent SIB in New York City in order to compare differences and similarities of the two and examine how the efforts in the U.K. may inform the development of SIBs in the U.S. The latter half of the chapter examines the views of professionals at the Fairfax County Office of Public-Private Partnerships about the possible promises and pitfalls of SIBs in their community.

Of the 183 substantive paragraphs analyzed in “Lessons learned from the planning and early implementation of the Social Impact Bond HMP Peterborough” (Disley et al. 2011), about half (53%) provided lessons that can be broadly applied to the development and implementation of future SIBs (25% were coded as *affirmations*, 28% were coded as *concerns*). These findings either praise a practice of the ONE Service SIB or note possible limitations for future SIBs.

### **Importance of the Intermediary**

A common theme throughout the interviews that RAND Europe conducted was Social Finance’s ability to “engage and negotiate” with cross-sector stakeholders (Disley et al. 2011, 53). Social Finance approached potential investors through existing contacts and networks early in the development stage. Since Social Finance was the one to propose the idea to the Ministry of Justice, it was important for it first to contact investors to “test the possible funding waters” and gain confidence that it could raise sufficient

capital if the Ministry of Justice agreed to participate in the SIB (Disley et al. 2011, 27). Social Finance first secured investment from several key foundations, which drew upon their networks of funders interested in criminal justice. This process was different for the SIB developed in New York City. In the case of New York City, the city government facilitated the SIB partnership as part of its commitment to the Young Men’s Initiative. The Young Men’s Initiative was announced in August 2011 as New York City’s comprehensive effort to enhance opportunities for young minority men by connecting them to educational, employment, and mentoring opportunities.<sup>30</sup> New York City’s Department of Corrections (DOC) selected MDRC, a nonprofit nonpartisan social research organization, to be the intermediary of the nation’s first SIB. DOC approached Goldman Sachs<sup>31</sup>, a global investment banking and securities firm, to fund the bond through a \$9.6 million loan to MDRC (City of New York 2012). In the SIB at HMP Peterborough, the intermediary, Social Finance, is at the center of the contractual agreements. However, as the SIB in New York City demonstrates, other arrangements also are possible. Given that SIBs remain experimental, “the emergence of multiple models is promising since we do not know which models will work best, and it is likely that different structures will be most effective in different circumstances” (Azemati et al. 2013, 26).

Although the city government initiated the cross-sector partnership in New York City, it recognized the importance of having an external intermediary. According to analysts at RAND Europe, the range of skills associated with a successful intermediary

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<sup>30</sup>New York City (2011) “Young Men Initiative,” Accessed on: <http://www.nyc.gov/html/yimi/html/home/home.shtml>

<sup>31</sup>Goldman Sachs (2013) “Urban Investments Social Impact Bonds,” Accessed on: <http://www.goldmansachs.com/what-we-do/investing-and-lending/urban-investments/case-studies/social-impact-bonds.html>



may include technical skills (in negotiating contracts), financial knowledge (selling a financial product), expertise in the relevant policy areas, and experience in managing cross sector partners. In the U.K., Social Finance had “credibility in the eyes of investors” (Disley et al. 2011, 53), and there was “high-level departmental support in the Ministry of Justice” to undertake Social Finance’s proof-of-concept pilot (Disley et al. 2011, 14). Social Finance played an important role in negotiating the contractual agreements and protecting the interests of each individual partner. In the New York City case, the DOC negotiated the contracts among its private and third sector partners; however, MDRC is responsible for overseeing day-to-day implementation of the project and managing the two nonprofits, the Osborne Association and Friends of Island Academy, delivering the intervention programs (Costa and Kholi 2012). It is possible that development of an SIB may come initially from any of the three sectors, whether it is from a service provider, corporate leader, or elected official. However, Social Finance argues that, regardless of where the SIB is initiated, it is important that an intermediary assure that “the range of stakeholders is consulted through the process” (2013, 9).

Interviewees from the Ministry of Justice and the National Offender Management Service told RAND Europe that there is interest in seeking potential intermediaries through a competitive proposal process for future SIBs. Social Finance suggested that, “developing this wider competitive market will be essential if SIBs are to be used on a larger scale” (Disley et al. 2011, 14). Azemati et al. (2013) from the Kennedy School of Government argue: “the competitive procurement process offers benefits from a transparency and legitimacy perspective and may allow the state to identify high-quality providers that it would otherwise not have been aware of” (29). Although competitive

procurements are often slower than noncompetitive processes, “establishing an SIB requires months of data analysis and other preparation within the government, as well as a process to obtain legislative authority, work that can occur at the same time as the procurement process” (Azemati et al. 2013, 29). Thus, the delay caused by a procurement process may be minimal.

How the DOC contracted with MDRC is not public knowledge. As Costa and Kholi (2012) from the Center for American Progress note, “the negotiations and calculations for New York City’s social impact bond were largely conducted behind closed doors. So when it came time to announce the deal, most of the details were finalized” (5). Working with the New York City Mayor’s Office and DOC, MDRC is designing the program and contracting with the Osborne Association and Friends of Island Academy to deliver the services, called Adolescent Behavioral Learning Experience (ABLE). ABLE is a cognitive behavioral therapy program for 16-to-18 year-olds detained at New York City’s Rikers Island. Its goal is to reduce the high recidivism rate for this population by focusing on personal responsibility education, training, and counseling (City of New York 2012).

### **Potential for Savings**

The SIBs in both the U.K. and New York City are geared towards reducing criminal recidivism, an area of social need that is both consequential and frequently neglected. Around 60 percent of short-sentenced prisoners in HMP Peterborough (Social Finance 2011) and 50 percent of juvenile offenders in Rikers Island (Costa and Kohli 2012) return within a year of their release; in both settings, virtually no money was spent on preventative solutions prior to the creation of the SIBs.

When identifying areas of social need that would benefit from an SIB, there are a number of conditions to consider. SIBs are not a panacea (Disley et al. 2011). In a webcast hosted by the Stanford Social Innovation Review in December 2012, Tracy Palandjian, CEO and co-founder of Social Finance, outlined the following criteria for “successful SIB applications”: potential for significant government net savings, “proven models of intervention,” a definable target population, “measurable outcomes against counterfactuals,” an acceptable time horizon, and no harm to service users or public.<sup>32</sup>

For SIBs to be useful in addressing a social issue, there first must be potential for significant government savings. In theory, the SIBs at HMP Peterborough and Rikers Island have the potential to save governments money through reduced costs of policing, court cases, and prison beds (Disley et al. 2011, 3). Yet, interviewees told RAND Europe that they considered the ONE Service SIB a “small-scale SIB” that is unlikely to deliver *substantial* monetary savings to the Ministry of Justice (Disley et al. 2011, 8). Monetary savings can be achieved only by more “significant reductions in the prison population.” Although savings likely will be minimal at best in this “proof-of-concept” project, the Ministry of Justice remained interested in the non-monetary benefits to the public and potential victims if the Peterborough cohort reoffends less (Disley et al. 2011, 8); it also sought to find out if SIBs were feasible. One Ministry of Justice respondent told RAND Europe,

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<sup>32</sup>Stanford Social Innovation Review webcast (2012), “Social Impact Bonds in the United States: Their Promise and Future” (December 12, 2012). Presented by: Tracy Palandjian, CEO and Co-founder, Social Finance, Inc. and Sonal Shah, Fellow, Harvard University Institute of Politics, and former Director of White House Office of Social Innovation and Civic Participation; moderated by: Tamara Straus, Senior Editor, *Stanford Social Innovation Review*

I think we all want to see how it works, and I don't think it's in anyone's interest for it to fail. That's not what we're about. We actually want to see huge cuts in reoffending. If we can deliver significant reductions in reoffending in a way that we can measure, we can attribute and we can transfer, we'd be very happy. So I think we have a huge amount of goodwill around it. –Interviewee 7 (in Disley et al. 2011, 20).

Since the Peterborough SIB is the first of its kind, Social Finance proposed a “small-scale” intervention program at HMP Peterborough. However, building upon its predecessor in the U.K., the first SIB in the U.S. was developed on a larger scale. The ABLE program will be delivered to more than 10,000 young people at Rikers Island (Osborne Association 2012), more than three times the target population of the ONE Service SIB. Unlike the Ministry of Justice, the City of New York expects substantial long-term savings if its projects can exceed their goals of reducing reconviction. This is probably due to the additional savings the City expects to generate from intervening with offenders at a young age. In a fact sheet published by the City government, MDRC and the Department of Corrections project that the City could save up to \$20 million, contingent on the ABLE program's rate of reduction (see Table 1).

**Table 1. Outcome Payments<sup>33</sup>**

<b>Reduction in Recidivism</b>	<b>City Payment to MDRC to Goldman Sachs</b>	<b>Projected Long-Term Net City Savings<sup>34</sup></b>
≥20.0%	\$11,712,000	\$20,500,000
≥16.0%	\$10,944,000	\$11,700,000
≥13.0%	\$10,368,000	\$7,200,000
≥12.5%	\$10,272,000	\$6,400,000
≥12.0%	\$10,176,000	\$5,600,000
≥11.0%	\$10,080,000	\$1,700,000
≥10.0%	\$9,600,000	\$ ≥ 1,000,000

### **Models of Interventions**

Intervention models must exist for SIBs to be applicable in an area of social need. Although Social Finance and the Ministry of Justice initially implemented a modest SIB, SIBs are actually intended to expand evidence-based interventions on a larger scale (as the ABLE SIB is doing in New York City). Although many nonprofit organizations are already creating *some* social impact their community, SIBs bring new sources of funding to help organizations expand their impact in a way that may yield substantial savings for governments. Although Social Finance emphasizes the need for “proven models of intervention,” RAND Europe clarifies that SIBs would not apply to existing approaches that already are of the desired scope (Disley et al. 2011, 2). SIBs are intended to “improve outcomes and quality of life” by funding services that have proven practices, but are not yet prioritized by government funding.

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<sup>33</sup> Source: City of New York (August 2012), “Bringing Social Impact Bonds to New York City,” available at [http://www.nyc.gov/html/om/pdf/2012/sib\\_media\\_presentation\\_01022012.pdf](http://www.nyc.gov/html/om/pdf/2012/sib_media_presentation_01022012.pdf)

<sup>34</sup> This column reports savings *after* repayment and continued funding for program delivery

St. Giles Trust, the primary nonprofit service provider, previously was commissioned by the London Probation Service (as well as by other locations across the country) to deliver the Through-The-Gate interventions that ONE Service replicates (Disley et al. 2011, 44). St. Giles Trust’s approach focuses on establishing a working relationship with each offender while they are in prison, and continuing to strengthen the relationship once the offender is released into the community, by providing support and advice about accessing the services and resources available to avoid reoffending (Disley et al. 2011, 66). The Osborne Association, the primary nonprofit service provider for the ABLE SIB in New York City was selected to deliver similar individualized services to young offenders at Rikers Island. MDRC chose Osborne and its partner, Friends of Island Academy, for their long history of serving individuals with current and previous involvement in the criminal justice system.<sup>35</sup> Osborne has an 80-year history paving the way for services that improve the lives of “currently and formerly incarcerated men, women, and children and families, affected by the incarceration of a loved one.”<sup>36</sup> RAND Europe emphasizes the importance of service providers with track records of success to gain the confidence of potential investors (Disley et al. 2011, 28).

### **Structure of Investments**

RAND Europe found that the structure of investment was critical for the development of the first SIB, which many investors saw as a “proof of concept” rather than a “pilot” program (Disley et al. 2011, 30). During interviews with investors, RAND Europe reported the following reasons for investments in the ONE Service SIB: the

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<sup>35</sup> Osborne Association (2012) “Osborne Chosen to Lead Service Delivery of Nation’s First Social Impact Bond,” Accessed on: <http://www.osborneny.org/post.cfm?postID=75>

<sup>36</sup> New York State Senate (2013) Press Release “Osborne Association Moves Fulton Street,” Accessed on: <http://www.nysenate.gov/press-release/osborne-association-moves-fulton-street>

desire to support development of the SIB as “a new kind of payment-by-results financial product or asset class,” the desire of foundations to invest money “more ethically and in ways that were more aligned with their missions,” and an estimation by investors that “there was a good chance in receiving a return on their investment” (Disley et al. 2011, 28). SIBs offer investors a new opportunity for a “blended return” (Mulgan et al. 2010) of both “financial and social” benefits.

In the Peterborough SIB, if reconviction events are reduced by 10 percent or more in cohorts 1, 2 and/or 3, investors will receive an outcome payment. If a 10 percent reduction in conviction has not been detected for any of the three cohorts, the three cohorts will be evaluated together. If a 7.5 percent reduction in conviction events (as a whole) is detected, investors will receive an outcome payment. Developing the payment model for the ONE Service SIB demanded considerable analytical time and resources from the Ministry of Justice and Social Finance. To determine the outcome payment, Social Finance and the Ministry of Justice negotiated and agreed on an (undisclosed) value for each reduced reconviction event (Disley et al. 2011, 40). The Ministry of Justice placed a cap on the outcome payments, ensuring that its liability is limited. The following section discusses measurements more fully.

Although there are 17 investors in the SIB at HMP Peterborough, Goldman Sachs is the sole investor in the SIB in New York City. This makes a vast difference in the structure of outcome payments. The 17 investors in the ONE Service SIB were mostly socially motivated. A representative of one investor told RAND Europe that even if it did not receive a financial return, the worst-case scenario would be that it “supported the delivery of quality services to offenders” and the development of a new form of social

investment (Disley et al. 2011, 30). Many investors in the original SIB were charities or foundations, in which any financial returns likely would be used for future social investments. The investors interviewed did not mention any reputational or financial risks to themselves. According to RAND Europe, “Although investors are keen for the SIB to succeed, they are aware that, regardless of outcome, they will have fulfilled their mission by investing in the SIB” (Disley et al. 2011, 19).

Goldman Sachs faces more financial risk. It invested \$9.6 million in the ABLE program at Rikers Island. The money loaned to MDRC came from the Urban Investment Group at Goldman Sachs, which was established in 2001 to deploy the firm’s capital by making investments and loans to benefit urban communities.<sup>37</sup> According to consultants at the Center of American Progress, the City government “displayed remarkable transparency about repayment levels and estimated government savings at different outcome thresholds” (Costa and Kholi 2012, 5). If MDRC achieves a 10 percent reduction in reconviction, the City will pay \$9.6 million, leading Goldman Sachs to break even. If the recidivism rate drops more than 10 percent, the City’s payments will gradually increase, and Goldman Sachs will receive a return of up to \$2.1 million. Similar to the contractual agreements of the ONE Service SIB, much of the press coverage about the agreement focused on the actors involved, but the details of the negotiations and calculations have not been disclosed to the public.

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<sup>37</sup>For more information about UIG, see: <http://www.goldmansachs.com/what-we-do/investing-and-lending/urban-investments/>



The loan is not a substantial amount for Goldman Sachs, which reported net revenues of \$1.57 billion in the first quarter of 2013.<sup>38</sup> However, the Urban Investment Group (UIG) at Goldman Sachs may consider it a risky move, as it typically does not fund policy interventions. Over the past decade, the UIG has helped revitalize inner cities through financing projects that support infrastructure, development, or public service delivery.<sup>39</sup> To alleviate some of UIG's financial risk, Bloomberg Philanthropies guaranteed the loan by making a grant of \$7.2 million to MDRC over the four-year timeframe of the SIB. MDRC will use the funds to pay a portion of the loan to Goldman Sachs if recidivism does not fall by 10 percent. If ABLÉ does reduce recidivism, the guarantee fund will remain at MDRC to facilitate future SIBs in New York City (City of New York 2012). Instead of risking all \$9.6 million of its investment if the program fails, as investors in the ONE Service SIB do, the maximum loss for Goldman Sachs is \$2.4 million.

For the HMP Peterborough SIB, the Ministry of Justice will mostly feel the financial pressure if the program achieves reduction in reconviction rates. In spite of the SIB's purpose to transfer financial risk to the private sector, the SIB at HMP Peterborough creates some financial burden on the Ministry of Justice. Interviews with Ministry of Justice officials indicated that, "the value of the payment-per-reconviction event was perceived by some within the Ministry of Justice to be generous, and in this sense, some felt that the Ministry of Justice was taking on some risk" (Disley et al. 2011,

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<sup>38</sup> Goldman Sachs (2013) "Goldman Sachs Reports First Quarter Earnings Per Common Share of \$4.29," Accessed on: <http://www.goldmansachs.com/media-relations/press-releases/current/pdfs/2013-q1-results.pdf>

<sup>39</sup> Goldman Sachs (2011) "Urban Investment Group 10 Year Anniversary," Accessed on: <http://www.goldmansachs.com/what-we-do/investing-and-lending/urban-investments/case-studies/10-year-anniversary.html>

18). Similar to Bloomberg Philanthropies backing in New York City, the U.K.'s Big Lottery Fund is backing the Ministry of Justice (Disley et al. 2011, 41). The amount that the Big Lottery Fund will provide to assist the Ministry of Justice in making the outcome payments to investors is unknown. An interviewee from the Big Lottery Fund told RAND Europe, however, that “its decision to part-fund the outcome payments was made on the basis that the SIB was innovative, and would be funding something not already provided by government, thereby fitting with its principle of additionality—that is, supporting the pursuit of new or additional outcomes” (in Disley et al. 2011, 41). The Lottery Fund is responsible for distributing £600 million each year from the money raised by the National Lottery to community groups and projects that improve health, education, and the environment (Big Lottery Fund 2010).<sup>40</sup>

The Big Lottery Fund in the U.K. and Bloomberg Philanthropies in the U.S. are involved in the two SIBs to alleviate some financial risk from the public and private partners, since the outcomes of the programs remain uncertain. The key difference between the investment structures in the U.K. and the U.S. is financial risk. In the U.K., the investment is split among 17 investors; if the program fails, each investor experiences less of a loss. If the program achieves the predetermined outcomes, however, the Ministry of Justice would confront the financial pressure of paying back investors. For this first pilot project, the Big Lottery Fund is backing the Ministry of Justice, reducing its financial burden. In the New York City SIB, UIG at Goldman Sachs is the sole funder of the program. If the program fails at Rikers Island, Goldman Sachs would suffer a much larger loss than the 17 investors in the U.K. In this case, Bloomberg Philanthropies has offered to back Goldman Sachs by guaranteeing \$7.2 million.

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<sup>40</sup> For more information about the Big Lottery Fund, see : <http://biglotteryfund.org.uk/>

Future SIBs are likely to eliminate such financial backing, since it is not part of the SIB concept. Prospective projects would first need to evaluate the results from the pilot SIBs to determine if financial backers are necessary.

### **Measuring Outcomes**

RAND Europe believes the detailed analytical work supporting the monetary value assigned to each outcome measurement is critical for the contractual agreements of future SIBs. An interviewee from the Ministry of Justice told RAND Europe that the cost calculations took into account “the broader societal benefits of reduced reoffending” (Disley et al. 2011, 42). According to RAND Europe, interviewees admitted that metrics to quantify social outcomes do not exist. Conventional financial markets do not price social value creation; consequently, “there is a lack of comparable performance information to support the creation of a new or modified social investment marketplace” (Disley et al. 2011, 30). Since quantifying social values is subjective at best, RAND Europe reiterated the importance of the Ministry working with the National Offender Management Service, the HM Treasury, and Social Finance to determine the value of reduced reconvictions. Details of the methods used to calculate the societal benefits of reduced reconviction, however, are unavailable. Although the most basic understanding of an SIB involves partnership among private, public, and third sector actors, it is apparent from the many actors involved with the ONE Service SIB that a diverse array of organizations ought to be involved in the development of the contractual agreements. RAND Europe observed: “The development of a methodologically robust outcome measure, which had the confidence of all stakeholders, was a time-consuming and analytically complex process” (Disley et al. 2011, ii), suggesting that developers of future

SIBs “may wish to consider the extent to which equally—if not more—robust cost data are available or can be developed” (Disley et al. 2011, 43).

Outcome measurements are perhaps the most contested aspect of SIBs. In a critique of SIBs, Jon Pratt refers to Campbell’s Law, “The more any quantitative social indicator is used for social decision-making, the more subject it will be to corruption pressures and the more apt it will be to distort and corrupt the social processes it is intended to monitor” (Campbell 1976, in Pratt 2013). Since it is impossible to fully standardize metrics of social values, it is difficult to that ensure the intermediaries and evaluators are setting appropriate benchmarks of social impact. Outcome measurements can easily be designed to achieve payment goals. Pratt, the executive director of the Minnesota Council of Nonprofits, argues, “While the intense internal logic to SIBs work conceptually quite well in pilot programs, each implementation will deserve serious scrutiny and transparency, and acknowledgement that results may differ from the promotion” (Pratt 2013).

In a report about the potential of SIBs in the U.S., McKinsey & Company (2012) used data from the U.S. Census Bureau to estimate that in 2007, governments spent approximately \$80,000 per incarcerated adult and \$30,000 per incarcerated youth. These calculations took into consideration “all correctional and confinement institutions that hold prisoners for more than 48 hours, as well as probation activities, parole and pardon boards and programs, and halfway houses” (2012, 33). However, McKinsey & Company also noted that the cost of incarceration for each individual varied, depending on three main factors: the amount of medical attention needed, length of stay, and security requirements (2012, 33). Even with these data on corrections spending, it is challenging

to quantify the social value of recidivism because the cost of each inmate can differ so greatly as do costs to potential victims.

### **Complexity of Contracts**

RAND Europe reported that another common concern of respondents was the complex contractual issues of involving many different stakeholders. Drawing on experience with private finance initiative contracts, the report concluded “Complexity in some instances meant that the actual transfer of risks is not clear” (Disley et al. 2011, 54). According to the interviews, RAND Europe identified six contractual relationships within the SIB contract:

- Ministry of Justice and Social Finance
- Social Finance and investors
- Social Finance and nonprofit organizations
- Ministry of Justice and independent assessors
- Ministry of Justice and Peterborough Prison Management Limited
- Social Finance and the Big Lottery Fund (Disley et al. 2011, 13)

Interviewees described the contractual agreements as “complex” and “time-consuming,” requiring significant resources in the development stage. Although SIBs are advocated as collaboration among public sector, private sector, and third sector actors, there are many more stakeholders involved.

The Ministry of Justice appointed an independent assessor through a competitive process. The independent assessor has identified the control group to compare reconviction events with the three cohorts of short-sentenced prisoners identified at HMP Peterborough. For the ABLE SIB in New York City, the City government appointed the

Vera Institute of Justice as its independent assessor. “The SIB structure only works if your evaluator is independent,” noted Regal Daly, Associate Research Director for the Center of Youth Justice at Vera, “We’re keeping that distance, independence, and objectivity” (in Lee 2012). According to Daly, the Vera Institute will use a similar methodology as the ONE Service evaluations by comparing each juvenile’s reconviction rate to a comparable inmate in the control group (Lee 2012).

It is clear in both SIBs that quantifying outcomes and payments are nuanced and subjective, necessitating analytical teams that will ensure outcome payments are made only if the reduction in reoffending is statistically significant. The reduction must be “large enough to provide confidence that it is significantly more likely to be due to the intervention, rather than chance” (Disley et al. 2011, 37). The size of the cohort is critical for statistical significance and must be considered by developers of future SIBs.

Although conducting the SIB in several prisons to get greater numbers of offenders leaving prison could have been desirable, “there was also consideration of the need to keep the level of upfront funding and outcome payments achievable” (Disley et al. 2011, 37). RAND Europe notes that future SIBs must consider the costs of such analytical resources.

RAND Europe also pointed to another concern: the ONE Service SIB’s potential to affect multiple governmental departments. Both the U.K. and U.S. SIBs fail to take into account how savings might be generated across national and local government departments. Future SIBs should consider how outcome payments may be shared among government entities. Cross-departmental outcome payments, however, would further complicate contractual agreements (Disley et al. 2011, 56).

## **Affirmations and Concerns**

RAND Europe underscored the importance of the intermediary and the criteria for areas of social need to be applicable to SIBs. Regardless of how an SIB is initiated, the presence of an intermediary is essential to oversee contractual agreements, guide development, and manage implementation. The SIB is not a panacea for all societal ills. However, it may apply to areas of social need that would benefit from the expansion of evidenced-based practices and have the potential to produce substantial savings for governments. Criminal justice meets both these requirements, which made it an easy choice for the first SIBs in the U.K. and U.S.

RAND reported that interviewees were mostly concerned about the complexity of contracts and the quality of measurements of the SIB. An SIB is made up of a complicated web of contractual agreements bridging investors, governments, nonprofits, independent assessors, the intermediary, and other stakeholders. Protecting the interests of all stakeholders, while preserving the meta-goal of social impact, creates challenging intricacies in the SIB contracts. Designers of future SIBs must be aware of the considerable time and analytical resources necessary to draw the contractual agreements.

The quality of measurements is also a major concern for future projects. Perhaps the most challenging stage in the development of SIBs is quantifying social value. In order to determine if the SIB has achieved its desired impact on society, partners need to determine measures of success and monetize the value of their work to demonstrate government savings. This is the most contested aspect of SIBs, as many may question the validity and reliability of monetizing social outcomes.

## **Practical Insight from Staff of the Office of Public-Private Partnerships (OP3)**

The remainder of this chapter presents findings from interviews with staff of the Fairfax County Office of Public-Private Partnerships about the potential of SIBs in their local community. After being provided with a brief overview of the funding mechanism and the cross-sector partnership involved in an SIB, the respondents generally reacted with interest and uncertainty. All four participants appeared eager and willing to discuss the “fascinating and appropriate”<sup>41</sup> idea. SIBs attempt to answer a question that all policy makers face during adverse economic times: *How do we invest in promising new solutions when we can't even afford to pay for what we are currently doing?* Respondent 4, the Coordinator of Grant Research and Training, reported that over the past several years, OP3 has made a conscious effort to transition from managing successful public-private partnerships to also developing new partnerships in areas that might currently receive little attention. The respondents agreed that SIBs offer a technique to pursue this goal.

### **Budget Concerns**

All four respondents initially expressed concern about the government's outcome payments. The Executive Director's first reaction was to inquire, “Where does the money come from?”

We are constantly looking for investments that will allow us to do things that we cannot do now... but if the government is going to pay for outcomes anyways, it has to be something that really cuts costs. There has to be an honest discussion about if it is really worth it. –Respondent 1

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<sup>41</sup> Respondent 4



Respondent 4 elaborated, noting that governments are not unilateral bodies. They are complex and often bureaucratic entities that must adapt to sometimes capricious public needs: “Government does not have the luxury to select an area of social need and only focus on it.”<sup>42</sup> Governments must work with the available resources to address the most pressing needs of their constituents. Respondents believed that a major challenge for governments would be allocating money in a future budget. Respondents 1 and 2<sup>43</sup> mentioned that governments would be hesitant to commit years of funding to a preventative strategy while public needs are ever changing. According to Respondent 1, a government is more likely to allocate long-term funding for public infrastructure projects with immediate returns, like public roads or buildings, while shorter term funding is usually allocated for social programs.

Although diverting upfront costs from the government to private investors is an attractive strategy, respondents expressed concern about how governments would be able to cover costs at the end of the contract. Respondents 1 and 4 questioned the need for a three-way partnership. Respondent 1 believes a “pay-for-outcome” contract between the government and nonprofits may be more practical, while Respondent 4 observed that a private-nonprofit contract could be an effective strategy to save the government money.

A common argument in support of the three-way partnership is that an SIB may be useful in funding preventative interventions or other kinds of public services that governments might not prioritize for funding, especially in a time of limited resources (New Philanthropy Capital 2010). Overall, respondents believed the three-way funding

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<sup>42</sup> Respondent 4

<sup>43</sup> Interviews with respondents 1 and 2 were conducted at the same time.

mechanism has “interesting potential,”<sup>44</sup> but it would take “more lobbying, more advocacy, and most importantly, more proof”<sup>45</sup> to get a local government like Fairfax County to pursue the idea.

### **Different Government Cultures**

Respondents agreed that certain governments will be more supportive than others. Respondent 1 raised a concern that Dillon’s Rule could create challenges for implementing an SIB in Virginia. In Dillon Rule states like Virginia, local governments have limited powers.<sup>46</sup> State courts have concluded that local governments in Virginia only have “those powers that are specifically conferred on them by the Virginia General Assembly, those powers that are necessarily or fairly implied from a specific grant of authority, and those powers that are essential to the purposes of government—not simply convenient but indispensable.”<sup>47</sup>

Respondent 4 observed “a lot of variability in the willingness to test something new.” She predicted more “progressive” governments, in states like Massachusetts, Colorado, Michigan, California, and New York, would be more likely to pursue social impact bonds. Respondents described Fairfax County as being both conservative and progressive<sup>48</sup> at the same time. Fairfax County remains fiscally conservative. As the second wealthiest county in the nation,<sup>49</sup> it has a triple-A bond rating<sup>50</sup> and according to

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<sup>44</sup> Respondent 3

<sup>45</sup> Respondent 1

<sup>46</sup> Virginia is one of only 11 states in the U.S. that adhere to Dillon’s Rule.

<sup>47</sup> More information about the Dillon Rule in Virginia can be found at:

[www.fairfaxcounty.gov/government/about/dillion-rule.htm](http://www.fairfaxcounty.gov/government/about/dillion-rule.htm)

<sup>48</sup> Although the term “progressive” has become synonymous with “liberal,” the respondent used the term to describe the County as “forward-looking.”

<sup>49</sup> According to the U.S. Census Bureau’s American Community Survey (2011), Fairfax County is the second richest county in the country, only behind its neighboring county, Loudon County.

respondents, the county government is very unlikely to take financial risks. In Respondent 2's experience, (as director of R.E.A.C.H,<sup>51</sup> a partnership supported by OP3), Fairfax County "values consistency and reliability" when it comes to public funding for social programs and would be reluctant to take the risk of long-term outcome payments for a new program. Although fiscally conservative, the County is relatively progressive in its views of development. Respondent 4 described the County as a "capitalist engine" with "smart growth practices." Fairfax County has a thriving and robust business community, and SIBs might well appeal to the local business sector.

### **Measuring Social Return of Investment**

Respondent 3, a former executive director of OP3 who served from 2004 to 2012, noted that during her tenure, she experienced increased emphasis on "discipline and expectations" in the development of social partnerships. Virtually all sectors and stakeholders increasingly press for focusing on the value of each dollar spent.<sup>52</sup> During times of heightened austerity, an instrument like the SIB in which governments only pay for what works would be appropriate. Respondents agreed, however, that evaluating outcomes would be the biggest challenge in determining "what works" and encouraging governments to use SIBs.

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<sup>50</sup> According to the Bankers Almanac (2013), "An obligor rated 'AAA' has extremely strong capacity to meet its financial commitments. 'AAA' is the highest Issue Credit Rating assigned by Standard & Poors." Accessed on: [www.bankersalmanac.com](http://www.bankersalmanac.com)

<sup>51</sup> Fairfax REACH supports "innovative solutions to address unmet or under-resourced needs of individuals and families impacted by mental illness, substance use disorders, and intellectual or developmental disabilities." For more information, see: [www.fairfaxcounty.gov/cbs/reach](http://www.fairfaxcounty.gov/cbs/reach)

<sup>52</sup> Respondents 3 and 4

OP3 continually seeks to improve its measurement of Social Return on Investment (SROI). SROI is a form of social accounting<sup>53</sup> for nonprofit organizations that developed in the 1990s as a “response to the increased emphasis on accountability and on philanthropy as a social investment. Like other approaches to social accounting, social return on investment has attempted to broaden the concept of return to include social impacts” (Quarter et al. 2003, 65). Social accounting helps “nonprofits and cooperatives better tell their story” (Quarter et al. 2003, 2) by monetizing social outcomes. The Fairfax County respondents believe the need for social accounting is justified by the limitations of conventional accounting for social organizations. Conventional accounting can be misleading, because it downplays an organization’s significance by excluding “broader economic effects” (Quarter et al. 2003, 43). In the case of SIBs, although nonprofit organizations do not produce any financial revenue, their services have broader economic effects if it can be demonstrated that the preventions will save government money in the long run.

Respondents mentioned that OP3 uses SROI to value the work of social partnerships. There is no universally accepted metric for quantifying SROI, however, because the value of social impact is subjective. Respondent 4 used Fairfax County’s Medical Cabinet Clean Up project as an example. Medical Cabinet Clean Up (MCCU) is a cross-sector effort by local pharmacies, the Fairfax-Falls Church Community Services Board, Neighborhood and Community Services, Health, Police, Fire, and Rescue, Public Works and Environmental Services, and OP3. To evaluate the project’s SROI, OP3 must consider where social value begins and ends. Many ways exist to calculate benefit: the

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<sup>53</sup> Quarter et al. define social accounting as, “A systematic analysis of the effects of an organization on its communities of interest or stakeholders, with stakeholder input as part of the data that are analyzed for the accounting statement” (2003, 2).

immediate benefits of residents cleaning their medicine cabinets to avoid using expired medications, the intermediate benefits of protecting the environment by preventing residents from pouring old medicines down the drain, and the long term health benefits of ensuring a cleaner water supply. The challenge of calculating SROI is finding metrics to quantify immediate, intermediate, and long term benefits, in cases where “there is no obvious price tag.”<sup>54</sup> Overall, respondents believe that developing quality evaluations will be the most essential factor for the implementation of SIBs.

### **Potential Areas for SIBs**

Respondents had varying opinions when asked about areas of social needs that would most benefit from SIBs. Respondent 4, who seemed to be the most concerned about outcome measurements, stated that SIBs would work best in areas supplemented with ample research. She believes that “some social problems lend itself better to the application of SIBs.”<sup>55</sup> For example, in March 2013, the California Endowment awarded Social Finance a \$660,000 grant to launch an SIB in Fresno, California to improve the health of low-income children with asthma.<sup>56</sup> According to Tim Tyner, President of the Central California Asthma Collaborative, “Asthma is the leading cause of emergency room and hospital encounters for children in Fresno” (qtd. in Social Finance 2013b). Every day in the city, nearly 20 children suffering from asthma end up in emergency rooms and at least three are hospitalized, at an estimated annual cost of \$35 million (Social Finance 2013b). Respondent 4 commented that asthma is “over-studied” and is therefore a promising topic for an SIB.

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<sup>54</sup> Respondent 3

<sup>55</sup> Respondent 4

<sup>56</sup> Social Finance (2013) Press Release, “The California Endowment Awards Grant to Social Finance and Collective Health,” Accessed on:  
[http://payforsuccess.org/sites/default/files/fresno\\_asthma\\_demonstration\\_project\\_press\\_release.pdf](http://payforsuccess.org/sites/default/files/fresno_asthma_demonstration_project_press_release.pdf)

However, Respondent 3, who seemed to be the most optimistic about SIBs, believed that they would be more applicable to critical areas of social need that are neglected by funding and may be *under-studied*. She sees SIBs as offering an exciting opportunity to stir innovation in areas such as mental health where there are more questions than answers.

Respondents 1 and 2 agreed that SIBs would be a promising avenue for testing new ideas. However, they think an SIB would work best in an area that already receives private funding and would generate even more interest with a double bottom line for investors. As an example, Respondent 1 mentioned an SIB would work well with the Virginia State Lottery, a for-profit enterprise that already contributes funds to public education. The key for her was that an SIB offers a cutting-edge idea to the area of interest in order to spark increased support that would allow evidenced-based practices to expand its mission.<sup>57</sup>

Respondent 1 mentioned that SIBs could provide the longevity needed to address a critical need. She observed that many organizations, whether they are for-profit, governmental, or nonprofit, tend to pursue whatever social issue is “trendy.” For example, in recent years, there was a push towards rehabilitating youth in gangs in Fairfax County. She admitted this was an extremely small percentage of the youth in the County; however at the time, gangs were a “hot topic” in the news across the country, so that was where the money was going. A benefit of SIBs is that the long-term contract binds partners to a particular social cause.

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<sup>57</sup> Respondents 1 and 2

## **Cross-sector Tensions**

Respondents agreed that the state of the economy in mid-2013 necessitated continued exploration of cross-sector collaboration. In their experience managing public, private, and third sector partnerships in Fairfax County, respondents mentioned the tensions that may arise among partners. Respondents 1, 2, and 4 noted that the complex relationships within an SIB could be strained by the inherent differences of each partner's styles, range of stakeholders, resources, motivations, and measures of success.

Respondent 4 believed the most apparent difference among the three sectors is who they are accountable to. Governments are accountable to taxpayers, businesses are accountable to customers or clients, and nonprofits are accountable to targeted social groups. "In the world of philanthropy, differences [among sectors] become crystallized even further."<sup>58</sup> In U.S. governments, officials cannot make autocratic decisions about deserving areas of social need. In the private sector, however, the CEO can single-handedly decide on a social issue that he or she wants to invest in. Respondent 4 described how most private investors are familiar with "more efficient" (or more "top down") decision making, while governments are accustomed to a "dialogue of problem solving." Differences become obvious while working on grants for OP3. She explained that, when writing a government grant, one must use key words like "evidence-based" and "best practice"; however, the rhetoric for a private foundation grant includes buzzwords like "innovative" and "groundbreaking."

Respondents thought that in some ways, SIBs could mitigate cross-sector tensions through the roles of independent intermediaries and assessors. When I asked respondents

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<sup>58</sup> Respondent 4

if they thought OP3 could serve as an SIB intermediary, they stated the office does not have the legal and financial knowledge necessary to mediate such complex contractual agreements. However, Respondent 4 mentioned she could see OP3 playing a role as an independent evaluator, given its experience monitoring and evaluating partnerships.

### **Promise of SIBs**

With their experience cross-sector social partnerships, respondents provided useful insight into the potential of SIBs. Although they expressed concerns with the scarcity of government funding and the uncertainty of measuring SROI, they recognized potential advantages of SIBs under the right conditions. Respondents seemed eager to follow up on the progress of SIBs in the United States in order to better understand the conditions that will stimulate the success of SIBs. There was a general consensus among respondents about the potential for SIBs in Fairfax County; however, there must be a well-coordinated effort to educate and inform stakeholders about the complex contractual agreements and partnership arrangement.

In the following chapter, I synthesize findings from the textual analyses and elite interviews into themes that describe the disconnection between the rhetoric and realities of SIBs. The chapter also discusses the limitations and future implications of this research.



## CHAPTER SIX: CONCLUSION

Social impact bonds are compelling, provocative, and timely policy instruments that have emerged as public affairs shifted from government to governance during a time of fiscal austerity. The research here is but the “tip of the iceberg” in the discussion of SIBs. Interest in SIBs continues to circulate, as local and state governments consider new approaches to fund social programs. However, further research needs to be done to supplement such interest. This research reached its aims of answering: *What are possible disparities between the rhetoric and realities of a social impact bond as a tool of collaborative governance?* The findings highlighted three major disparities:

1. Measurement of social impact
2. Complexity of partnerships
3. Transfer of risk

This chapter examines these and explains their significance. It then discusses limitations of this work and ideas for future research.

### **Measurement of Social Impact**

In theory, the purpose of SIB interventions is to yield substantial government savings by preventing social ills. In practice, it is difficult to determine the social impact of SIBs, because there is no accepted systematic way to measure monetary worth of social good. For both the HMP Peterborough SIB and Rikers Island SIB, the intermediaries, evaluators, and government agencies must rely on available data to determine outcome measurements and schedule payment cycles. Although Social Finance and MDRC argue that they spent considerable time and resources calculating

estimates to set the programs' goals and financial values, the given timeframe is not long enough to determine if the preventions will result in lasting change and long-term savings for governments. Further analysis will be necessary to examine whether any government savings are due to the SIB intervention and not to other intervening variables.

SIBs are created under the assumption that successful preventions reduce the use of remedial services for a target population. In the case of criminal justice, for example, SIB programs work with offenders to reduce reconviction rates. Although there may be some correlation between preventions and reconviction rates, however, a number of other variables outside the scope of SIB programs (such as poor economic conditions) also may influence recidivism.

### **Complexity of Partnerships**

According to its most basic definition, an SIB is a financial arrangement among governments, nonprofit organizations, and private investors. In practice, however, many complex partnerships are at play. In its early evaluation of the first SIB, RAND Europe observed six contractual relationships, including those between Social Finance and the Ministry of Justice, Social Finance and investors, Social Finance and nonprofit organizations, the Ministry of Justice and independent assessors, the Ministry of Justice and Peterborough Prison Management Limited, and Social Finance and the Big Lottery Fund. In addition to actors involved in the contractual agreements, National Offender Management Service, HM Treasury, and an advisory group consisting of a former chief constable, a magistrate, and individuals with legal and financial expertise also provided analytical support and resources (Disley et al. 2011, 22). An SIB is much more than a three-way cross-sector partnership; it involves a network of actors with divergent stakes

and frequently competing interests. An intermediary is indispensable to manage the numerous investors, government agencies, and nonprofits that may be involved in a single SIB.

All partners involved with SIBs will be concerned with reputational risks at stake, especially as up-and-coming projects test the waters. Partners will have different motivations to see an SIB succeed in meeting its predetermined goals. For example, governments will want to show constituents that they are using tax payer dollars as effectively as possible, private investors will seek to portray their corporate social responsibility in pursuit of a double bottom line, and nonprofits will look to the results of the SIBs as reflections of their capabilities and performance. Intermediaries and independent evaluators will play critical roles in ensuring that the meta-goal of social impact (serving both the target and general populations) is still the priority of the SIB programs.

### **Transfer of Risks**

SIBs are advocated as a strategy to shift financial risk from the public sector to the private sector. Advocates propose SIBs as creating a win-win situation for the public sector; in theory, governments only pay for what works, while saving money in the long run. Although up-front costs are transferred to investors, SIB developers must bear in mind that risk remains for governments. If the interventions meet the predetermined benchmarks, then governments are responsible for paying back investors. Meanwhile, substantial government savings will not be realized until longer term data are available to show that social impact was monetized appropriately.

Interviews with staff at the Fairfax County Office of Partnerships revealed that practitioners are somewhat hesitant about the long-term commitment required of governments. Respondents expressed concerns about the feasibility of guaranteeing that future government budgets would be reserved for paying back investors. It may be particularly challenging as government decision makers experience election cycles and term limits.

### **Limitations and Future Research**

The uncertainty of SIB performance is the most obvious restriction limiting this research. Results from the SIB at HMP Peterborough will not be released until the ONE Service contract is finished at the end of 2016. Therefore, there is no evidence upon which to draw firm conclusions about whether these types of partnerships would be replicable in other contexts. Even if the program succeeds in meeting its measurable goals, it remains to be seen if and how lower recidivism will generate longer term savings for the Ministry. Future research should be done to evaluate its outcomes and reassess the benefits for the stakeholders involved. Research should examine any benefits experienced by the public sector for transferring financial risks, whether the private funding allowed nonprofits to better achieve their missions, if investors received any financial and/or social returns, and finally, if and how the local community benefitted as well as what if any costs it experienced. Without evidence about the success or failure of the pilot program, it is impossible to make any generalizations about future SIBs in the United Kingdom, the United States, or elsewhere.

This research would have benefited from access to the models used to monetize social values and measure program outcomes. Without these models, there is no way to

determine if meeting the predefined metrics is consistent with lasting social impact. In a future study, researchers should conduct a pro-forma analysis by developing their own SIB models based on available data. After the given timeframe of an SIB, the hypothetical model should be compared to the SIB outcomes to evaluate the reliability of the SIB models. Since SIB models may differ depending on the context of social need, future research also should investigate the inner workings of SIB arrangements and explore how various arrangements affect payments or social outcomes. For example, the distinct investment structures used in HMP Peterborough and New York City influence the method of outcome payments. A closer look at different SIB arrangements should inform intermediaries and future SIB developers to better ensure that appropriate contracts are designed for the given circumstances.

Since the pilot program in the United Kingdom is the only SIB in existence with material available on its implementation, I used it as a foundation for looking at the SIB in New York City. However, this research does not infer that the two settings are directly comparable. The differences in politics, publics, cultures, and economies create limitations when studying the two SIBs side by side. It is important to note that this research employed the “lessons learned” from the SIB at HMP Peterborough as a frame to conceptualize the New York City SIB, but not to predict or assume any similarities. I selected the case in New York City since it is the most developed SIB in the U.S. As more SIBs are implemented across the country and elsewhere, future research might include additional case studies to better understand how different environments may influence the development of an SIB.

As it is too soon to comment about the practice of the SIB in New York City, I conducted interviews to gain practical insight from professionals who manage tri-sector social partnerships in the United States. However, for the same reasons one cannot compare Rikers Island to Peterborough, it should be noted that generalizations cannot be made about the United States based on the perceptions of a handful of officials in one unit in Fairfax County, a suburban jurisdiction that is relatively wealthy compared to the rest of the nation. The convenience sample also limits the external validity of this research. Although each interviewee provided insight on the topic, their responses likely were shaped by their similar experiences and backgrounds. In subsequent studies, I recommend interviewing diverse experts from all three sectors to more fully understand how perspectives may differ from various partners and stakeholders involved in an SIB contract.

Advocates of SIBs argue that all three sectors benefit from the partnerships. My research suggests this may not be true for the public sector, as there is more financial risk for governments than the rhetoric of SIBs implies. Future research should continue to explore disparities between the arguments for and practice of SIBs. The rhetoric also contends that SIBs allow nonprofits to leverage financial resources from the private sector without oversight or control from investors. In theory, this type of partnership provides nonprofits with more independence than traditional two-way partnerships. Future research should investigate whether the SIB contract allows for such independence or if it results in some forms of micromanagement.

## Potential for SIBs

As staff of the Fairfax County Office of Public-Private Partnerships concluded, SIBs have promising potential to replace less effective remedial programs with preventative programs. On the surface, this kind of cross-sector partnership should utilize resources from the private sector, save governments money, and generate social benefits. However, respondents express some skepticism that the SIB model is “too good to be true.”<sup>59</sup>

This study exposes possible disparities between the rhetoric and realities of SIBs, highlighting areas that would benefit from further empirical research. I suggest that SIBs have potential to address areas of need that can demonstrate possible government savings through appropriately scaled intervention. Given the gaps between the arguments for and the actual development of SIBs, however, future studies should explore the extent to which such potential can be realized. Research on SIBs cannot be done without more empirical evidence of their application.

In the United States, interest in SIBs from local and state governments continues to escalate. Massachusetts announced the selection of “initial successful bidders” for SIB contracts during the same week in August 2012 that New York City announced its SIB agreement (Costa and Kholi, 2012). The process is well underway in Massachusetts, where a partnership is being developed to pursue efforts to tackle chronic problems with homelessness and juvenile justice. The New Jersey state legislature has commissioned the Economic Development Authority (EDA) to broker an SIB that will address public health crises plaguing Camden City (New Jersey Legislature, 2012). In Fresno,

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<sup>59</sup> Respondent 4.

California, Social Finance has developed an SIB partnership to improve health conditions of low-income children with asthma and reduce medical costs for asthma-induced emergencies (Social Finance 2013b). Legislation to authorize SIBs also has been introduced in Connecticut, Maryland, and Texas (Costa and Kholi, 2012).

The only way to extend and improve the future application of SIBs will be to evaluate the successes or failures of the first wave of SIB projects in the United States and elsewhere. Current and developing SIBs will need to demonstrate whether:

- SIBs work in different cost environments and under diverse government structures;
- SIBs apply across various areas of social need;
- SIB interventions reduce the use of remedial services;
- Governments are able to uphold their responsibility to pay back investors

This research is an exploratory look at the concept of SIBs and their potential in the United States. Although some disparities appeared between the arguments for and the practice of SIBs, in-depth case studies over time and space would help practitioners and future SIB developers better understand the realities of social impact bonds.



**APPENDIX A: TEXTUAL ANALYSES**

**Table A1: Framework for paragraph analysis**

<b>Affirmation</b>	<b>Concern</b>	<b>Neutral</b>
<ul style="list-style-type: none"> <li>▪ RAND Europe supports a practice (part of the process, contract, relationship of partners, or an aspect of the ONE Service intervention)</li> <li>▪ RAND Europe recommends replication</li> <li>▪ RAND Europe implies approval or seem optimistic about future results</li> <li>▪ RAND Europe discusses benefits/advantages</li> </ul>	<ul style="list-style-type: none"> <li>▪ RAND Europe suggests future SIBs should reconsider a particular practice (part of the process, contract, relationship of partners, or an aspect of the ONE Service intervention)</li> <li>▪ RAND Europe suggests there is room for improvement</li> <li>▪ RAND Europe implies disapproval or seem pessimistic about future results</li> <li>▪ RAND Europe discusses a negative consequence</li> <li>▪ RAND Europe notes potential concerns</li> </ul>	<ul style="list-style-type: none"> <li>▪ Background information</li> <li>▪ Details about the contractual agreements, progress, or service delivery</li> <li>▪ Timeline of events</li> </ul>

**Table A2: Frequencies**

Page	Number of paragraphs coded as <b><i>Affirmation</i></b>	Number of paragraphs coded as <b><i>Concern</i></b>	Number of paragraphs coded as <b><i>Neutral</i></b>	Total number of paragraphs per page
1	0	0	4	4
2	0	0	1	1
3	0	0	3	3
4	0	0	4	4
5	0	0	1	1
6	0	0	5	5
7	0	0	6	6
8	0	2	0	2
9	0	2	0	2
10	0	0	3	3
11	0	0	5	5
12	0	0	0	0
13	0	0	3	3
14	0	2	0	2
15	0	2	1	3
16	1	0	0	1
17	0	0	0	0
18	2	1	0	3
19	1	0	3	4
20	2	0	0	2
21	3	0	0	3
22	1	0	1	2
23	0	2	2	4
24	2	0	2	4
25	2	0	2	4
26	1	1	2	4
27	3	0	0	3
28	2	0	1	3
29	0	2	2	4
30	1	1	1	3
31	0	3	0	3
32	3	2	0	5
33	0	0	5	5
34	0	0	2	2
35	2	1	0	3
36	1	1	1	3
37	0	1	2	3
38	0	3	0	3
39	0	1	0	1

**Table A2: Frequencies (continued)**

40	0	0	5	5
41	1	2	1	4
42	0	2	3	5
43	0	2	0	2
44	0	0	3	3
45	0	0	2	2
46	0	0	0	0
47	2	0	1	3
48	2	1	0	3
49	2	1	2	5
50	3	0	3	6
51	1	3	0	4
52	3	0	1	4
53	0	2	1	3
54	2	3	0	5
55	0	5	0	5
56	0	3	2	5
57	2	1	0	3
<b>Total</b>	<b>45</b>	<b>52</b>	<b>86</b>	<b>183</b>
<b>% of Total:</b>	<b>24.59%</b>	<b>28.42%</b>	<b>46.99%</b>	<b>100%</b>

**APPENDIX B: INFORMATION ON INTERVIEWEES**

**Table B1: “Lessons Learned” Interviewees**

Interviewed by RAND Europe (2011)

<b>Respondent Code</b>	<b>Organization</b>	<b>Position</b>
1	National Offender Management Services	Regional Manager for Commissioning
2	St. Giles Trust	Director
3	Ministry of Justice	Senior Civil Servant
4	Social Finance	Director
5	Social Finance	Director
6	National Offender Management Services	Director of Offender Management
7	Ministry of Justice	Policy Advisor
8	Ministry of Justice	Representative from Analytical Services
9	Big Lottery Fund	Deputy Director
10	Treasury	Member of Home and Legal Spending Team
11	Ministry of Justice	Senior Civil Servant
12	National Offender Management Services	Director of Service Development
13	Ministry of Justice	Representative from Procurement
14	St. Giles Trust	Head of Community Services
15	St. Giles Trust	Community Services Manager
16	Panahpur	Investor
17	Social Finance	Reducing Reoffending Director
18	HMP Peterborough	Director
19	HMP Peterborough	Deputy Director
20	LankellyChase	Investor
21	HMP Peterborough	Former Director (at time of SIB development)
22	Esmee Fairbair Foundation	Investor

**Table B2: OP3 Interviewees**

<b>Respondent Code</b>	<b>Position</b>	<b>Date of interview</b>
1	Executive Director	4/17/13
2	R.E.A.C.H Director ( <i>Resilience, Education, Advocacy, Community, Hope</i> - partnership supported by OP3)	4/17/13
3	Former Executive Director	5/23/13
4	Coordinator of Grant Research and Training Center	6/12/13

## APPENDIX C: OVERVIEW OF SOCIAL IMPACT BONDS

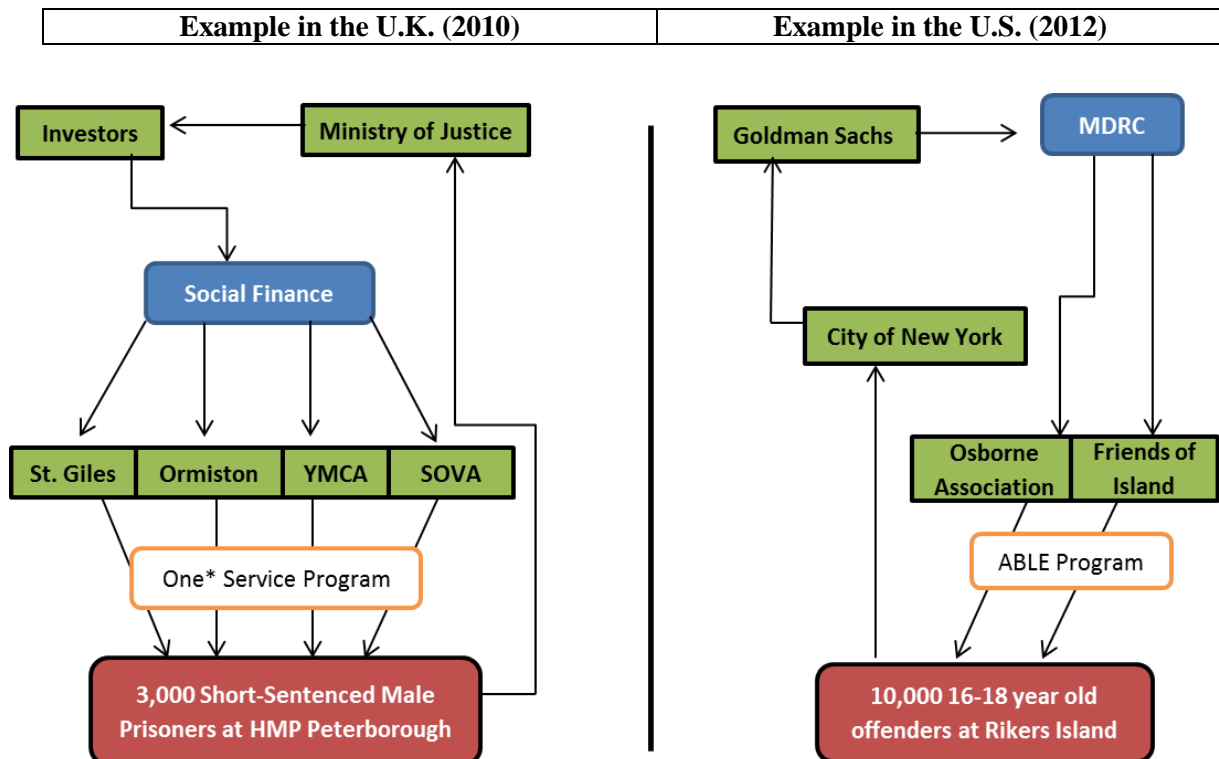
### What is a Social Impact Bond?

A social impact bond is a new approach for scaling social programs in a tri-sector partnership among private investors, governments, and nonprofit organizations. In this partnership, investors take on the financial risk of expanding evidence-based social programs provided by nonprofit organizations. In return, the government agency repays investors if the interventions meet measurable goals that can demonstrate social impact (McKinsey & Company 2012, 15).

### Key players:

1. An intermediary to facilitate partnership, manage contractual agreements, and oversee development and implementation
2. Investors to fund the interventions up front.
3. Nonprofit organizations to implement evidence-based interventions and deliver services
4. Government agency to make outcome payments to investors if the program meets the predefined goals.
5. Beneficiary population who receives services
6. Independent assessor to evaluate outcomes.

Figure C1: Case studies



## **APPENDIX D: INTERVIEW PROTOCOL**

### **Approved by Virginia Tech IRB (Protocol 13-370)**

#### **Verbal Consent Script:**

Thank you for participating in my research. Please keep in mind that your participation is voluntary and I can supply you with contact information about this study upon request. My name is Nina Sabarre, and I am a graduate student studying Political Science at Virginia Tech. I am interested in your experience with cross-sector partnerships in Fairfax County, and I want to discuss the possibility of social impact bonds in the area. This research is being conducted to gain a more comprehensive understanding of existing cross-sector partnerships in Fairfax County and how they might benefit from social impact bonds.

Your participation will only be needed for an hour at most. By proceeding with this interview, you are consenting to be quoted in any publication that may result from the study. I will not identify you by name; however, I may use your title. This conversation is not being audio-recorded but notes will be taken and stored in a secure location. You may choose not to answer any question. Do you have any questions before we get started?

First, I want to start by going over this overview of Social Impact Bonds...

#### **Interview Questions:**

1. What programs do you think could benefit from the implementation of social impact bonds in Fairfax County?
2. In your opinion, what conditions would allow a social impact bond in Fairfax County achieve its goals?
3. What would you perceive to be the biggest challenges faced when implementing a social impact bond in Fairfax County?
4. What would you perceive to be the biggest advantages?
5. Who usually initiates cross-sector partnerships for social programs in the county?
6. In your experience, what are the relations between partners? Are there any major differences when one is for-profit and another is non-profit?
7. How do cross-sector partners differ in regards to their primary interests and measures of success?

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