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Getting Back More Than a Warm Feeling

Chris Radburn/Press Association, via Associated Press Images
Social impact bonds are in use at Her Majesty's Prison Peterborough in Cambridge, England.

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THE seven teenagers sit with their feet tucked under tan desks in a classroom in New York City's Rikers Island jail, taking turns answering "icebreaker" questions they've fished from an envelope.

"What's your favorite thing to do with your time?" asks one young man, the rowdiest of the group. He answers himself: "Reading."

"Really?" says Joyce Gendler, their peppy 22-year-old instructor, with just a hint of incredulity. "Good." A few minutes later, she begins to engage them in the day's activity, making sympathy cards for people who are sick.

The adolescents are part of a new program aimed at building personal responsibility and life skills, with the goal that fewer of them will re-offend. The program is financed by an innovative mechanism called a social impact bond, one of a handful of ways that philanthropy is trying to tap new pools of funding to produce measurable social results. If the program succeeds in significantly reducing recidivism, the "investors" paying its upfront costs — in this case, Goldman Sachs, with backing from Bloomberg Philanthropies — will be repaid by the city with a modest return. If the program falls short, the investors lose their money, sparing taxpayers the costs of the program.

The "social impact bond," also known as a "pay for success" bond, is the latest — and most discussed — tool in a broader playbook philanthropists are using to blend business and charity to make a bigger difference. Sometimes known as impact investing, these approaches include providing low-interest loans to nonprofits, making equity investments in companies that tackle social problems and investing a portion of a foundation's endowment in enterprises that produce measurable benefits to society and a financial return."There's a recognition that philanthropy and government can't solve all the social problems," says Judith Rodin, president of the Rockefeller Foundation, which has spent $40 million since 2009 to develop the field of impact investing. "And then you have investors who maybe didn't want as bright a line between their charity and philanthropy on one side and their financial investments on another, and they began to look for blended opportunities."

While many of these opportunities focus on microfinance, farming or other fields in which there is an obvious way to generate revenue, social impact bonds offer something new. They pay back investors through the savings a government could accrue if a preventive program succeeded in its goals of reducing recidivism or keeping children out of foster care, bringing an opportunity for financial returns to a new set of society's knottiest problems.

The bond concept has drawn interest from many government officials and some nonprofits eager for new financial support. But it has also stirred concerns among people who say the idea is impractical, ignores political realities and risks putting profits ahead of what is best for society.

The bonds were first tried in Britain two years ago, to finance a program for 3,000 prisoners at Her Majesty's Prison Peterborough. In Britain, 60 percent of prisoners who serve short sentences land back in jail within a year; by helping parolees find housing and other support, the program aims to reduce the recidivism rate by 7.5 percent.

Initial results won't be available for another two years, but Alisa Helbitz, director of research and communications at Social Finance, in Britain, says anecdotal feedback has been positive. Participation rates are high — the program is optional for prisoners, though organizers are trying to reach as many people as they can — and some local police say they are pleased with the project. The "investors," in this case, included philanthropies like the Rockefeller Foundation.

Since then, the social impact bond idea has spread at a pace that has surprised some in the slow-moving world of philanthropy.

“There’s been a gold-rush mentality,” says Daniel Stid, a partner with the Bridgespan Group, which provides consulting services to nonprofits.

The federal government and the states of Connecticut, Massachusetts and New York, as well as Cuyahoga County, Ohio, and Fresno, Calif., are introducing or exploring social impact bonds. Most of the programs focus on problems like helping parolees find jobs or housing the chronically homeless, where a preventive approach could produce obvious savings.

Nonprofits and foundations are investigating other ways to use the bond idea. Health impact bonds, for example, could finance the upfront costs of retrofitting homes to reduce asthma rates. Development impact bonds might provide a new way to pay for foreign aid programs.

“If we’re successful,” says Tracy Palandjian, co-founder of Social Finance, a sister organization of the group in Britain, “social impact bonds will create a pathway for great nonprofits to access capital from capital markets.”

Still, she and others stress that the bonds are just a tool that will suit only certain programs, not a replacement for government or philanthropic dollars.

The bonds work by bringing together investors, nonprofits and government to agree on a social program and how long it will take to produce savings. In New York City’s case, Goldman is lending $9.6 million to MDRC, a nonprofit group that oversees the work of two charities running the jail program. A fourth nonprofit evaluates the results of the four-year program.

If recidivism rates drop by 10 percent, Goldman gets its money back. The bank could make up to $2.1 million if the rates fall further. (Bloomberg Philanthropies is guaranteeing $7.4 million of the loan, leading some to say the New York City deal is not a true test of the bonds’ appeal to commercial investors.)

All those additional layers drive up the costs of a program. Proponents say it is worth it because governments can rarely find the money to pay for preventive programs, and the rigorous evaluations demonstrate a program’s effectiveness and encourage future spending on projects that work.

Government officials like Linda Gibbs, New York City’s deputy mayor of health and human services, see social impact bonds as a way to strip away some of the “inefficient and ineffective” spending that is caught up in running governments. Governments could close jails and emergency shelters for homeless people if they could find others to pay for the preventive programs they say they can’t afford.

“Government is often unwilling to try unproven approaches because taxpayers rightfully don’t want money being wasted,” says Mayor Michael R. Bloomberg. “Social impact bonds are unique because they repay the investor only if a program’s goals — like New York City’s aim to reduce recidivism — are actually met.

“They’re exciting because they have the potential to be a new financial tool that can empower governments to innovate in ways they wouldn’t otherwise attempt.”

Nonprofits leaders’ reactions to the bonds, meanwhile, have been mixed. Ideally, they say, governments would finance these programs directly. They also worry that donors will drift toward these profit-generating models and away from outright giving.

Elizabeth Gaynes, who has led the Osborne Association, one of two groups running the Rikers Island program, for 28 years, takes a realist’s approach.

Ms. Gaynes said she doubted that without this experimental financing mechanism, her organization would have found the money to aid so many young people. The group has a mandate to serve all of the roughly 3,000 young people who pass through Rikers each a year.

“We’re serving black and brown people who got arrested and went to Rikers Island,” says Ms. Gaynes. “There isn’t a lot of clamoring to give them services.”

Whether investors will see the bonds as a viable way to make money remains a big question, however.

Andrew Sieg, head of global wealth and retirement solutions at Bank of America Merrill Lynch, says he believes the bonds can generate interest from investors beyond philanthropy. “I’m very bullish about the concept of social impact bonds,” he says.

Others are more cautious.

Ron Cordes, a former wealth manager and now a philanthropist who describes himself as a “pro bono evangelist of impact investing,” says the concept is great. But, he added, “Putting my investor hat on, what we need now is a number of pilots that demonstrate they work.”

While efforts to harness capital markets for social good aren’t new, more donors say they are exploring such investment approaches as they struggle to have a bigger impact.

Jean Case started the Case Foundation with her husband, Steve, co-founder of AOL, in 1997. This year, the foundation hired Sonal Shah, former head of the White House Office of Social Innovation, to study how the foundation might help to expand the number of private investors who seek social as well as financial returns.

Ms. Case has invested personal money in technology businesses in the West Bank and in a company that helps charities raise money online, for example. She says she wants to do more.

“It’s time to try something new because we’re not seeing the impact in too many areas we’ve wanted to see, for too long,” says Ms. Case.

One question that dogs these kinds of approaches, meanwhile, is whether they make a real dent in social problems.

Dave Peery, who manages his family’s foundation, says he worries that investors may be kidding themselves that their contributions to social enterprises are getting at the roots of poverty.

“Generally, they are happy if they can get their money back, while helping a business with meager social returns,” he wrote in an e-mail. “For example, a taxi business in Guatemala, a laundromat franchise in India. These create a few jobs, but they assume the simple creation of access to goods and services can be deemed as social impact. Just because people have access to modern laundry services doesn’t mean their lives are demonstrably better.”

Mr. Cordes says the key is knowing when to make a pure charitable gift and when to seek a return. He invests part of his foundation’s endowment in microfinance groups, he says, seeking a return. But in parts of rural Africa, where the institutions are newer and still developing, he provides money with no expectation of repayment .

Luther Ragin Jr., chief executive of the Global Impact Investing Network, says the obstacle to impact investing is not the difficulty of marrying financial and social returns, but of a lack of data on how to identify and assess quality nonprofits and socially minded businesses. His group and others are trying to develop that information; for example, they are creating a way to standardize information on organizations’ social, environmental and financial impact.

For some people in the nonprofit world, social impact bonds stir fresh concerns.

Mark Rosenman, an emeritus professor at Union Institute and University in Cincinnati, urges caution when mixing profit and purpose.

“When we seek to introduce the profit motive, we begin to abandon who we are as a people and abandon our responsibility for the common good in pursuit of private profit,” he says.

He cites the example of for-profit colleges, which have been criticized by some in Congress for focusing less on educating students than on marketing, recruitment and other strategies aimed at pleasing shareholders.

Mr. Rosenman says he is also perplexed as to why the Rikers Island bond deal, involving less than $10 million in financing, has generated so much “hoopla.” He says a proposed tax on financial transactions, known as the Robin Hood tax, could raise far more money and provide the resources for broader change. Tools like social impact bonds, he says, are “tinkering at the margins.”

Peter York, chief research and learning officer of the TCC Group, says the idea that social impact bonds can prove a program’s effectiveness, and help replicate it elsewhere, is more complicated than proponents admit.

A program that works in Oklahoma might not work in Oakland, Calif., he says. Or, what succeeds in helping a 65-year old parolee might not work with a 19-year-old. Assessing whether a program strengthens families or puts young people on a track to success, he says, is not like testing “pills or clinical interventions.”

Mr. York also says he has concerns about government paying for programs after the fact. He worries that government leaders who favor fewer social service programs will push the metric of success for social impact bonds, the reduction in number of homeless people seeking emergency services, for example, to unrealistic points. The programs then might never get off the ground.

Christopher Stone, who leads George Soros’s Open Society Foundations, agrees, calling social impact bonds “a bubble.” Newly elected politicians who face the prospect of paying off investors who’ve arranged bond deals with their predecessors in office will have every incentive to say a social program didn’t work, he says.

Advocates, though, say many of these challenges will be overcome in the design of individual “deals.”

Ms. Rodin says concerns around the role of profit in social programs are “highly legitimate.” But she says market-based approaches to financing social programs are not exploitative.

“Yes, someone is making money, but they are not making money off the backs of the poor,” she says. “They are making money by the poor or the person who is homeless or who has just been released from jail having a higher probability of getting a proven and effective program, of getting cared for in the most effective way rather than thrown back into society and ignored.”

Ms. Palandjian sees it as a “philosophical divide.” In her view, social impact bonds are a way to begin to rewrite the “social contract” with government, in which the for-profit world takes on a bigger role in easing social problems.

Traditional ways of raising money have their own drawbacks, said Ms. Gaynes of the Osborne Association.

“Frankly, the old model of charity throwing dimes at people on the street, the Lady Bountiful model, isn’t any more respectful of the lives of the people we’re serving,” she says. “Or what about philanthropists who are using their money to tell you what to do? This is a tough business.”

On Rikers Island, a new model for financing charity is in its early days.

As the afternoon session wraps up, one of the youths, his attention drifting, is tasked with collecting Crayola markers and pencils the teenagers have used to create sympathy cards. Ms. Gendler adds their cards to a pile from earlier classes.

Most of the cards bear messages like “Get Well” and “Stay Healthy.” One young man has written, in skinny blue-and-red letters, a message to other teenagers like him: “Stay out of Jail.”

Goldman Sachs, Mayor Bloomberg’s foundation and all of philanthropy will have to wait until 2016 — when the program’s results are revealed — to learn how many of the young men decide to follow that advice.

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