Envisioning a $1 Billion Social Investment Fund

A Speech Delivered by George Overholser at *America Forward's "Gathering of Leaders"* on February 12, 2007

Introducing the concept of pay-for-success financing, Overholser proposes that a $1 billion investment fund be created to advance proven interventions that provide a combination of social returns to beneficiaries and fiscal returns to government. He suggests that private dollars be to provide "money back guarantees" to government for social programs with evidence-based outcomes. Investors would pay back government in the event that a program did not achieve targeted outcomes, making government-led social investment more politically viable and opening up vast new financial resources for nonprofits.

Introduction

Good afternoon! My assignment today is to engage with you—some of the world's great social innovators—and to facilitate a conversation about the possibility of creating a billion-dollar Social Investment Fund.

Now this is likely to be a humbling experience for all of us –very smart people have been working on this problem for more than a hundred years, often with far more than a billion dollars at their disposal, I might add. And we've got about two hours!

$1 billion does seem like a lot of money, but of course we all know that compared to the social problems we hope to address, it is a very small amount of money. Did you know, for example, that America's public schools spend a billion dollars every 192 minutes?

Not a new idea, but to have any real impact at all, we're going to need to influence how other people allocate their financial resources. In particular, we're going to need to influence how our government allocates its vast sums of social outlays. How else could we make a significant difference with our "mere" $1 billion?

We also need staying power. The problems we face can't possibly be solved overnight. Traditionally, philanthropic staying power comes in the form of an endowment. Create a billion dollar bank account, and that throws off $50 million a year that we can deploy, forever. OK. How many minutes of school does that buy? (about 9.5 minutes)

Today, we'll be discussing a different approach – getting our staying power not from an endowment bank account, but rather from using our money to build social purpose institutions that have staying power of their own.

Question is, how do we do that? And how could we possibly use them influence truly large sums of government resources?

Washington State Institute for Public Policy

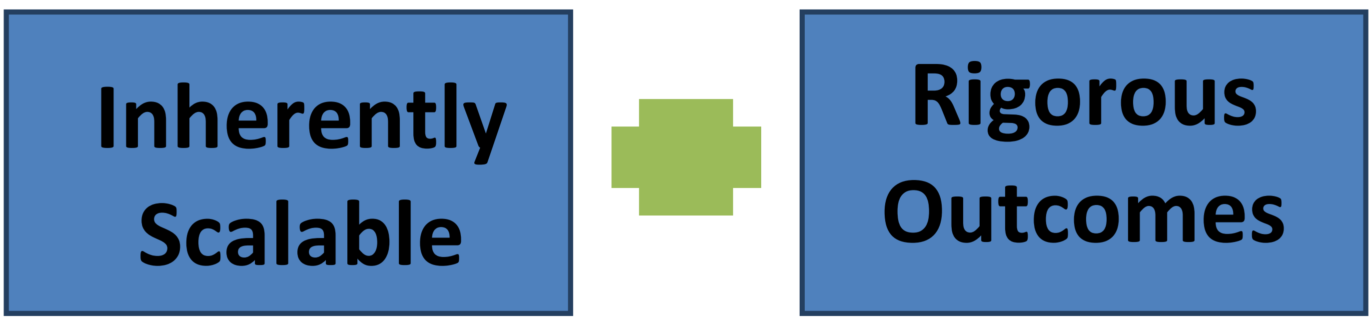
Well, there is something going on right now in Washington, that offers an interesting hint. Not Washington, D.C., mind you, but the state of Washington. Not long ago, the legislative body of that fine state decided to change the way they go about their funding of youth services.

They said this: Let's go shopping. And to help us shop, let's create the Washington State Institute for Public Policy, with the following marching orders: Find us programs that really solve social problems, and that save the taxpayers money as a result.

The legislators sent the Institute on a search, not just state-wide, but nation-wide, for as many youth-serving programs as they could find, so long as each one had the following two characteristics:

First, each of the programs needed be inherently scalable. That doesn't mean they needed to have already scaled—but they did need to be designed with scaling in mind.

And second, each of the programs needed to have rigorous scientific evaluations of social outcomes.



The Institute found no less than 59 youth-serving programs that fit the two-part description. Inherently scalable and rigorous about measuring outcomes.

Then came the special part. Instead of accepting the cost-benefit stories that each of these individual programs cooked up for themselves, the Institute developed a single shared methodology that can be used to compare the cost-benefits consistently, across the 59 programs. And they kept it simple: we won't try to put a number on all the good things a program is able to accomplish, they said. Instead, we'll focus on just seven types of outcomes.

"Standard Yardstick" Cost-Benefit Methodology

1. *Reduce crime*
2. *Lower substance abuse*
3. *Improve educational outcomes such as test scores and graduation rates*
4. *Decrease teen pregnancy*
5. *Reduce teen suicide attempts*
6. *Lower child abuse or neglect*
7. *Reduce domestic violence*

There are two things I really like about this approach. First, they looked nationwide for programs that were both scalable and used to delivering some kind of measurement or outcome. That means they were automatically dealing with people who were interested in growth and capable of furnishing impact metrics. Second, the Institute created a standard. A standard way to measure and compare outcomes-based progress, without getting into mind numbing methodological debates.

Without this standard yardstick, no one was going to get anywhere. And, incredibly, among the top 34 programs on their list, the place they got to was a 7 to 1 payback for taxpayers. Let me be clear about what I'm saying – it means that for every 1 dollar of government funds spent to execute these programs, taxpayers eventually experienced a 7 dollar reduction in the overall taxpayer burden.

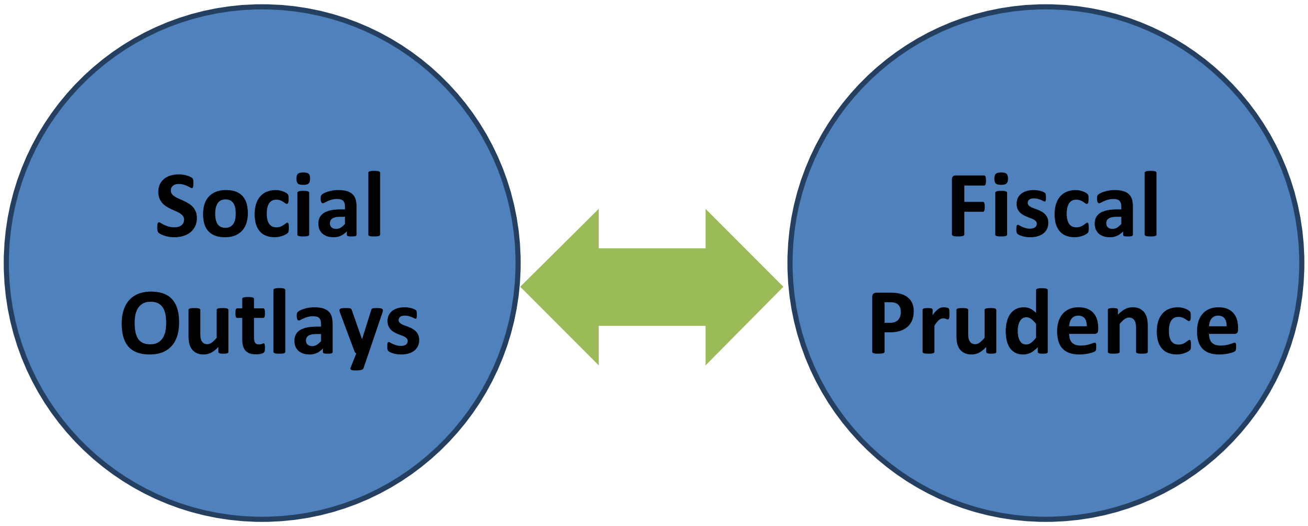
And that was just the taxpayers. The communities served directly by these programs did much, much better than that!

In a minute, I will share some of the details. But first I'd like to step back and reflect on how the experiment in Washington points towards a change in the landscape for all of us.

New Landscape

Forever, it seems, America's mainstream has viewed social spending through an either/or lens.

Third Sector
capital partners



Either you attempt to address social ills with outlays, or you work to maintain fiscal prudence. But not both.

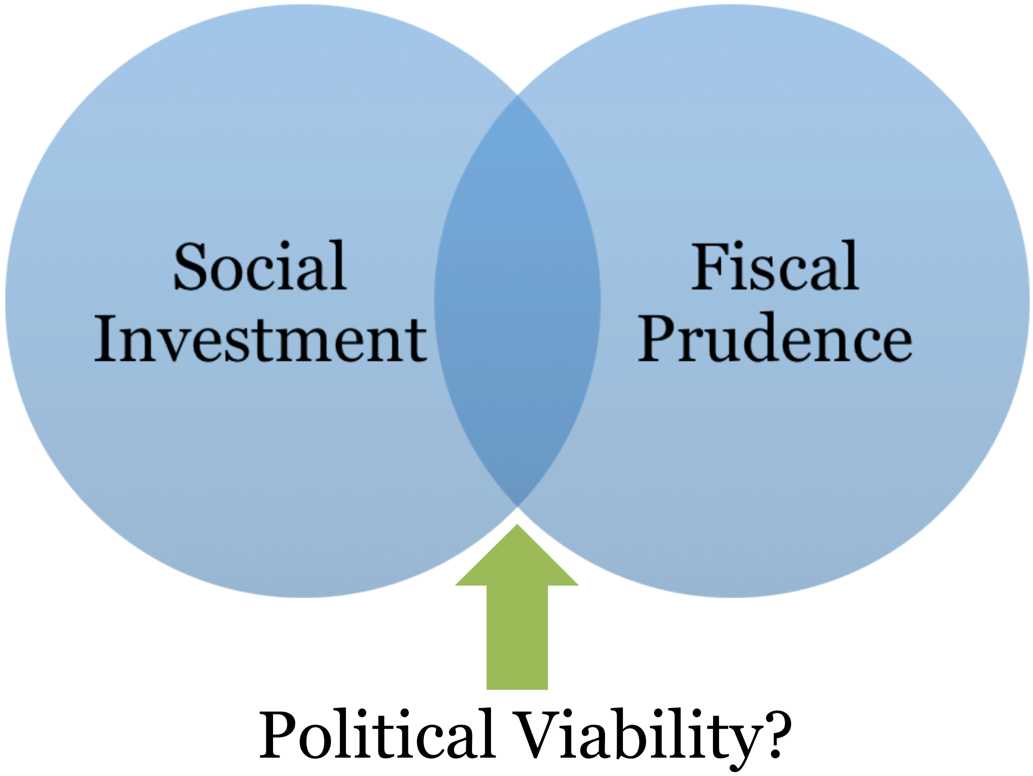
After seeing what's going on in Washington, am I crazy to think that the either/or mindset is beginning to evaporate?   That the concept of Social Investments—not Social Outlays—but Social Investments with measurable returns, is on the rise?

We seem to be on the verge of redefining how to think about social returns. More and more of us have woken up to the fact that the returns we are talking about don't only go to the low income communities who are served directly by social investment.

Return on investment also goes into voters pockets, indirectly, in the form of a lower tax-payer burden. Not immediately of course, but ultimately, in a large and measurable way, as our most successful social investments yield communities that are more productive, less crime-ridden, less in need of chronic support.

The circles are beginning to overlap. And as a result, the political viability of funding social investments may be getting much stronger.

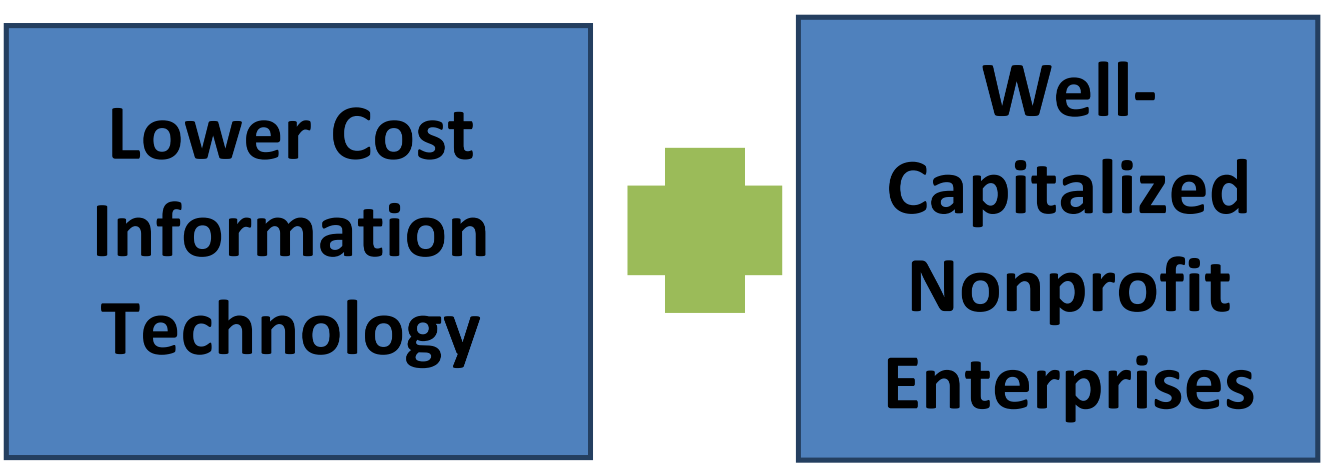
Third Sector
capital partners



Why would this be happening now, of all times? It's not as if the idea of linking social investment to taxpayer benefits is new. What, if anything, is different now than before?

Two New Phenomena

Well, I'll hazard to mention two phenomena that I see, aside from the obvious one that if you keep working at something long enough, you are bound to get better at it.



One phenomenon, something we've heard about ad nauseum, is the Information Technology Revolution. Here's the thing: at long last the costs have come down so much that not just big corporations, but now even midsized nonprofits can afford to use info tech in their day to day operations.

This is very important, because technology not only helps us to be more scientific in the way we innovate, but also more sure-footed in the way we replicate those innovations.

It's a big deal because without technology, even well-proven programs are exceedingly difficult to replicate faithfully at scale. It's a little like playing the telephone game – remember that? – each kid whispers a phrase into the next kid's ear? A lot can get lost in the translation!

Information technology, with its amazing ability to coordinate minute-to-minute activities, is gradually transforming the way social purpose organizations are able to operate. For the first time, without going seriously broke, they are able to monitor quality in real-time, across hundreds of locations, and to track and control expenses as well.

It all adds up to an ability to scale programs faithfully and consistently—critical requirements in being able to deliver on the promise of a so-called "proven" program design.

But please don't get me wrong! Despite the massive cost reductions, it still takes an awful lot of capital to deploy the type of information technology we're talking about. And even more to pay for the patient process of trial and error that the technology enables.

Which brings me to the second phenomenon.

Philanthropists seem to be doing a better job lately at recognizing the role that growth capital—or as I like to call it, "patient" capital—needs to play in giving rise to evidence-based social purpose firms.

Program Demonstrations → **Enterprise Demonstrations**

$10's of millions of Equity-Like Patient Capital

The nonprofit capital markets are coming alive. As a field, we have begun to think less in terms of demonstrating programs that work, and more in terms of demonstrating enterprises.

That's a buzz term – what do I mean when I say "enterprise"? Well, think of it this way: it's the business end of things. The capacity to generate reliable ongoing revenues, the capacity to monitor quality, to attract and develop talent, to measure outcomes, to plan for growth, to forecast, to manage cash flow, to craft strategies and to deploy information technology… all of these things that surround a program and keep it healthy!

In recent years, philanthropists have gotten better at using their money in a way that more closely resembles equity capital than it does traditional program demonstration grants. This is making it possible to build industrial strength evidence-based enterprises that would otherwise have become trapped in a never-ending cycle of short-term funding crises.

We've done a better job lately of realizing the price-tag of an evidence-based enterprise— it often takes several tens of millions of dollars of equity-like patient capital to build to one of these things.

This is the nonprofit capital market. As we've discussed at previous Mohonk Gatherings, and as demonstrated by many of you in this room, the nonprofit capital market is clearly beginning to come into its own.

So… the cost of information technology has plummeted and our ability to capitalize nonprofit firms has grown – at long last, the lines have crossed! That, to me, seems like big news.

But how, you might ask, does all this translate into a powerfully better allocation of government resources? Isn't that what we're here to discuss?

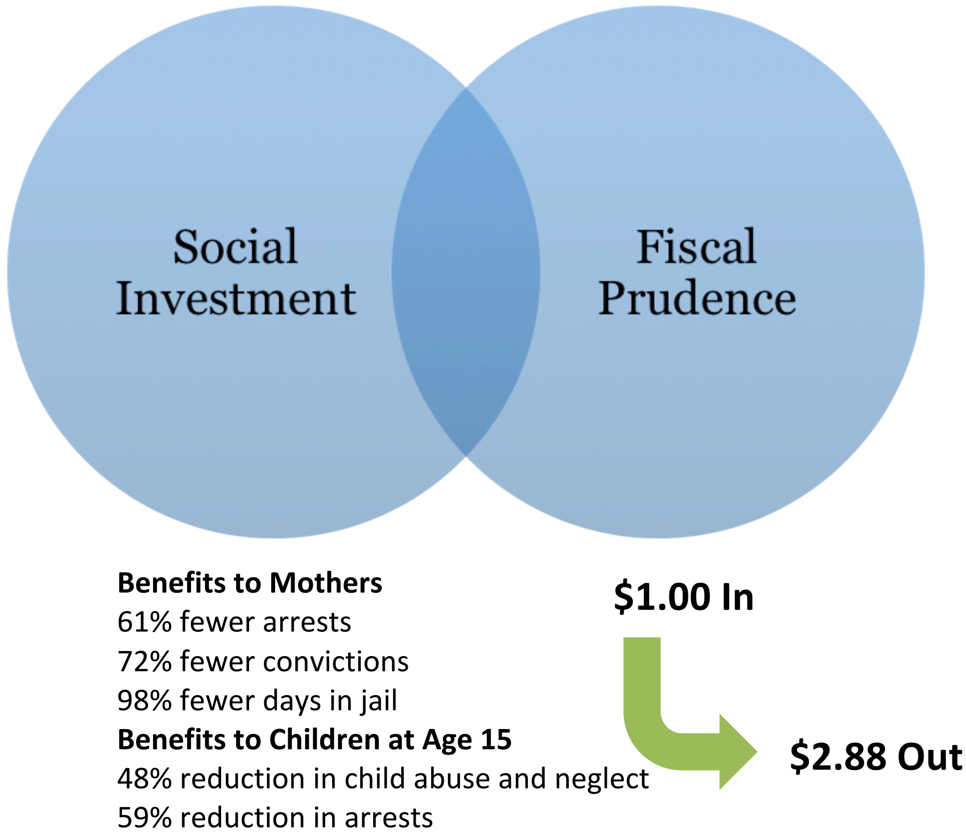
Nurse Family Partnership

Let's turn back to Washington. Here's an example of one of the organizations: Nurse Family Partnership:

Nurse Family Partnership was originally launched in Elmira, NY by David Olds, who came up with the idea that first-time, low-income moms were a particularly vulnerable population, and that they might benefit from the type of emotional support and sound medical advice that could be provided by a professional visiting nurse. Being a trained social scientist, David went about his work in a very scientific way – conducting random assignment trial evaluations of his program in no less than 3 cities, with 3 different types of beneficiary population, at 3 different times of our nation's history.

It took 30 years! Talk about staying power!

The results were (and continue to be) stunning.



Irrefutably, the Nurse Family Partnership brings about powerful outcomes for mothers and kids alike.

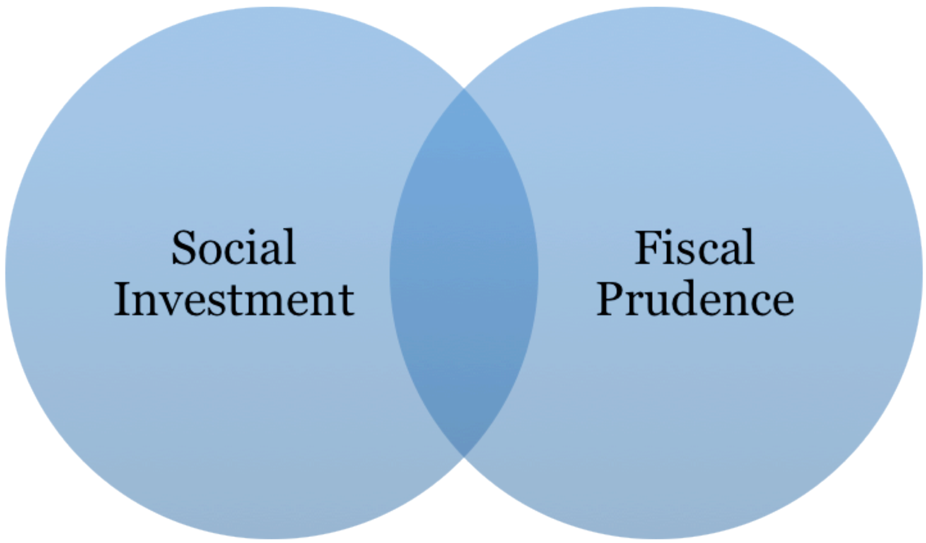
And here's the political selling point: beyond its terrific social impact for young moms and their families, the Washington Institute's methodology estimates that every dollar invested into Nurse Family Partnership results in $2.88 of savings for the taxpayer. Not bad! You can see how the political aspects of this thing just got quite a bit easier.

David and his team would be eager to point out, by the way, that the State of Washington methodology seriously <u>understates</u> the tax savings, since it focuses on only seven outcomes, and ignores the rest. For instance, it gives no fiscal credit for Nurse Family Partnership's 69% reduction in emergency room visits. A more complete analysis from Rand puts the taxpayer savings at $5.70. This number is higher, and probably closer to the real taxpayer savings – but then again, the Rand number is difficult to use when comparing to other programs, since everyone uses different methodologies to do cost-benefit analysis. And that's the magic of the Washington State approach – a standard yardstick. Wrong size maybe…but standard!

<u>The Rest of the 59 Programs</u>

So, even though it was undercounted, the taxpayer return for Nurse Family Partnership came out to be quite compelling. How about the rest of the 59 programs?

It turns out that despite the systematic undercounting of impact, an impressive 34 out of the 59 programs were shown to generate a positive return not only to low-income communities, but also to taxpayers. It's almost jaw-dropping to see how powerful the tax-payer benefit calculations came out. Among the 34, the median payback per dollar invested was just shy of $7! In other words, half of the 34 programs paid back more than $7 to taxpayers for $1 of taxpayer investment. 14 had taxpayer payback ratios of more than $10 to $1! And only 3 of them failed to offer at least a double-your-money proposition.

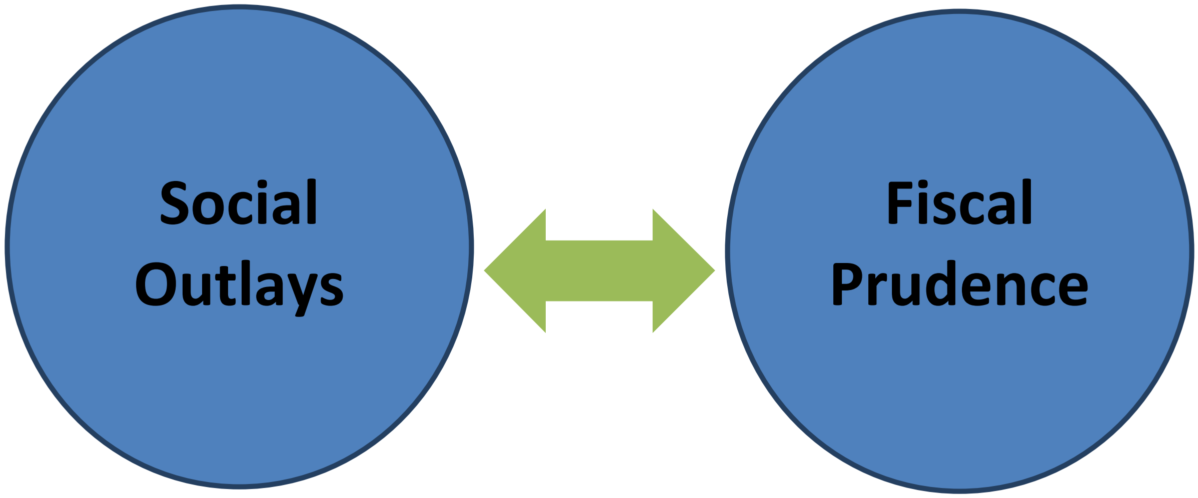


Early Childhood Education **$2.36**
Nurse Family Partnership **$2.88**
Multidimensional Treatment **$10.88**
Foster Care
Big Brothers/Big Sisters **$3.28**
Life Skills Training **$25.61**
Minn. Smoking Prevention **$102.29**

So, what's not to like? Well, there's this little detail that despite all of the wonderful nerdy analysis—the experiment in the state of Washington does not seem to be changing funding behavior in any big way.

<u>It Isn't Working!</u>

Based on some informal phone chats, I get the sense that while legislators are paying a fair amount of attention to what the Institute has to say, they aren't doing a whole lot that is radically different in the way changing their allocation of resources. For at least the following two reasons, I'm told:



"Not Enough Evidence!"
"Show Me the Money!"

First: from the legislators' point of view, there just isn't enough evidence to displace the status quo. Just because some program claims to be scalable, and seems to have worked well ten years ago in Tulsa, that doesn't mean it is worthy of an investment today in Washington. Where's the evidence that it can be replicated? Where's the evidence that there's an enterprise that's capable of scaling this thing with quality, and capable of continuing to deliver the program at the same level of cost benefit that was achieved way back when?

The truth is, despite all the encouraging data on initial outcomes, few of the programs offer strong proof of an ability to re-produce those outcomes, at scale and with quality.

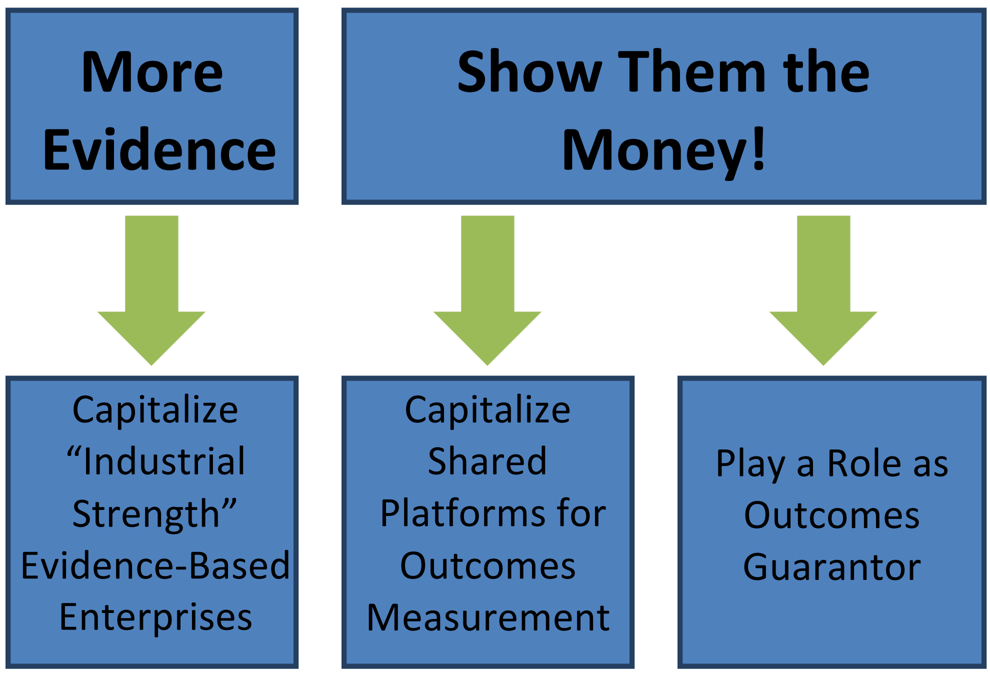
The Second big objection: "Show me the money!" Its all fine and good to claim a $7-to-$1 fiscal payback, but, if that payback is scheduled to take place sometime in the distant future, and as some part of the far-flung governmental universe, its an awfully hard thing to run on as a politician: "Let me get this straight," says the politician, "I spend a bunch of taxpayer money this term, and then I run for reelection without anything to show for it?" As a friend once put it, when it finally comes time to show off all these wonderful outcomes, IBD/YBD….. I'll be dead, you'll be dead!

Now I certainly don't pretend to have glib answers to these two thorny issues – and, no doubt, there are plenty of other issues in this thorn patch.

Clearly, there are major limitations to an evidence-based approach – I certainly don't mean to present it as a cure-all, or to imply that a program can't be good if it doesn't fit into the evidence-based paradigm. But then again, science does have a way of shining a light on the matter. And, over time, as we go through the patient process of rigorous testing and learning, evidence has a way of leading us to breakthroughs that might never have been otherwise discovered. Plus, as I've been repeating incessantly now, there's this political angle…

<u>A Proposal to Consider</u>

So, here's one version of how we could use the billion dollar fund. What if we spend half of our fund to capitalize 10 to 20 social-purpose enterprises that actually <u>are</u> <u>probably</u> capable of generating the large-scale, evidence-based outcomes government funders seek? And what if we use the other half to literally "show them the money", by creating robust and <u>standardized</u> measurement platforms, and by actually providing, in some cases, financial guarantees that the outcomes will happen?

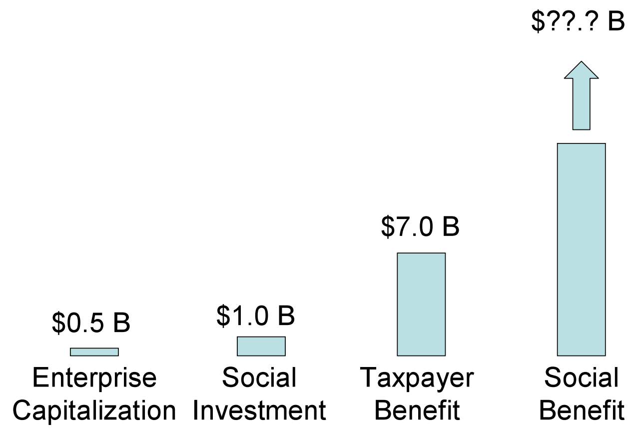


These are both pretty big ideas, so let me take them one at a time.

Capitalizing Industrial strength evidence-based enterprises. I would estimate that $500 million provides more than enough equity-like capital to launch 10 or 20 truly "industrial strength" evidence-based enterprises that go on to be sustained by a mix of government (and also private) funding. In my mind, some of these enterprises would be recent innovations, in need of expansion capital – and others would be some of our already existing nonprofit mainstays – the community-based institutions that already form the bedrock of so many communities – and may be poised for an infusion of what we might choose to call "transformation capital".

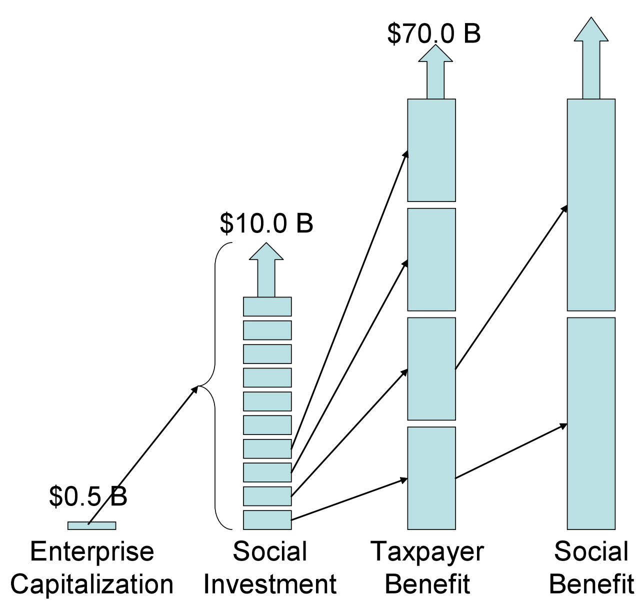
For sake of argument, lets say, over the course of several years, we actually manage to pull off just 10 successful investments –that each of these 10 social purpose enterprises finds an evidence-based way to attract $100 million per year in government funding, under a sustainable set of business economics. What scale of total impact would that bring about?

If we could pull it off, our ½ billion of enterprise capitalization would be parlayed into – let's see, 10 enterprises times $100 million – that's $1 billion of social investment paid for by the government, which, if we hit just the median payback ratio, results in $7 billion of taxpayer benefit and, since the direct outcomes are generally so strong, way more social benefit to the communities we care so much about.

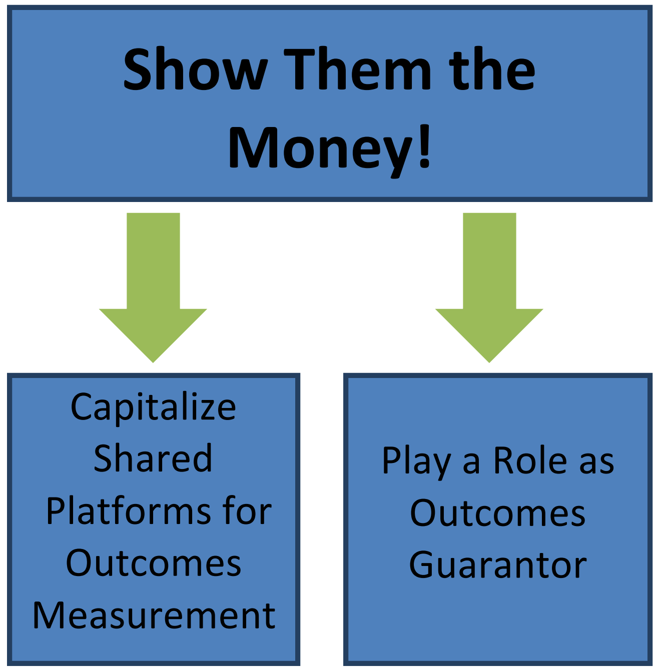


Oh, but wait! That's just one year's worth. The next year would generate another $7 billion, and another $7 billion after that, and another $7 billion after that – all of which, conceivably, could be reinvested back into these types of programs.

Pulling back, we can begin to see the power of playing the equity-like, build-the-enterprise capitalization role, and how it differs so profoundly from simply covering an organization's budget for a while. In this sketchy example, our $500 million of enterprise capital was parlayed into $70 <u>billion</u> in taxpayer benefit – a 140-fold leverage factor.



Now, let's talk for a moment about the other half of the fund, which targets the "this is too slow, show me the money now" problem.



I believe we could, in a not insignificant way, quite literally use $500 million of our fund to "show them the money". Here's what I mean. Think of your credit card. Have you ever bought a defective good and gotten the credit card company to get you your money back? This type of buyer assurance plan, as it's called, makes you more willing to buy things – particularly from vendors you don't know very well, or for products you don't fully trust. Really, it's what's called a warrantee. The product works, or we'll get you your money back!

Now the key to the warrantee business is that the product really does work! And what warrantee companies do is study up on whether a product truly is at least reliable <u>enough</u> to make for a very good bet. If they decide that it <u>is</u>, they are willing to provide a financial guarantee to the buyers of that product. Not only that – and here's where the leverage kicks in – if they are really confident, they can guarantee hundreds of purchases for every one purchase that doesn't turn out as everyone had hoped. See where I'm going?

I could imagine half of our billion dollar fund as being used to provide warrantees of a sort to government funders. Example: if College Summit fails to raise the college going rate in your town by at least 5%, we'll get you your money back. It's a money-back guarantee.

This is a powerful idea, and some of the more financially oriented folks in the room may recognize an opportunity to unlock municipal bond funding with something like this. But it could only work with a mature evidence-based enterprise, because, without an outcomes tracking system, how could you otherwise know whether or not College Summit actually hits the 5% target?

But suppose, for a moment, that we did have an outcomes tracking system that everyone agreed was the "standard yardstick". And, suppose that we – the social investment fund—really did come to see a reliable track record of raising the college-going rate from College Summit, as it went from town to town. Doesn't it seem conceivable that we could begin to get into the business of providing those towns with a money back guarantee? And if we did, wouldn't this make it easier for politicians to sell the idea to their more fiscally conservative constituents?

There's a lot of "ifs" here, but I believe the answer may well be "yes". We could show them the money, in the form of a financial guarantee, and that would help to make the whole thing more politically viable.

Summary

Ok. Now that everyone is thoroughly confused, let me review the big picture:

At the 30,000 foot level, we've said this.

- The Washington experiment is very interesting, but it isn't changing behavior… yet!

- To get the behavior to change, we need more evidence, in the form of well-capitalized evidence-based enterprises (not just programs, but enterprises that can scale them faithfully) – that's one potential role for the social investment fund.

- Also, to get behavior to change, we need, literally, to show funders the money, perhaps in the form of financial guarantees – that's another potential role for the social investment fund.

- Both of these roles are highly leveraged, in the sense that they influence large amounts of other people's resource allocations. And, both, as we are about to see, have at least some basis in practical reality.