Funding Revolutions

Report Summary

A model for addressing the challenges of upstream investment in human services

Social Enterprise Manitoba
An initiative of the Canadian CED Network

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Full report available at **www.socialenterprisemanitoba.ca**

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Introduction

There is an emerging consensus across the political spectrum that investing in the *prevention* of social problems has a greater impact and is more cost effective than spending on the symptoms of social problems. However, investments in prevention face many challenges and have not met the pace or scale desired by those working against social problems. On-the-ground practitioners are understandably frustrated as they see powerful opportunities go underinvested.

As a recommendation of the Manitoba Social Enterprise Strategy, this report presents a model for a publicly financed pay-for-success investment fund, specifically designed to invest in innovative, preventive initiatives. Centrally located in the provincial government, the fund would be in a unique position to find cross-departmental opportunities. The fund would be a revolving fund, meaning the savings it creates for departments through its investments would replenish the fund. The result would be greater resources towards prevention, at a scale much greater than the status quo.

The first areas of investment recommended for the fund include:

- High-risk recidivism and rehabilitation
- Employment and labour market attachment

Manitoba is already a leader in the development of social enterprise as a driver of community economic development and an enterprising approach to address local needs. The creation of a pay-for-success revolving fund in Manitoba is an opportunity to be a global leader in deepening the relationship between social enterprise and the public sector, and transforming social services towards prevention for the public good.

Recommendations and Key Findings

- Without significant leadership and structural change, Manitoba is unexpected to shift course towards greater investment in prevention and to reduce demand for acute care.
- There are persistent structural and inherent challenges to investing in prevention that have limited the investment opportunities within the current departmental-agency system of government.
- Publicly financed Pay-for-Success (PFS) can be used to overcome challenges limiting investment in prevention.
- A revolving fund structure could act as an effective internal investment mechanism for PFS projects, being replenished through contracted outcomes payments with commissioning ministries to grow and redeploy resources towards prevention.
- Such a new entity would need independence by being outside a specific agency or human services department in order to prevent political motivations from disrupting a focus on financing the most promising interventions.
- Manitoba has a successful history of using independent entities such as crown corporations and the Crown Corporations Council that can meaningfully inform implementation.
- There are budding centers of activity within Manitoba that could act as a natural starting point for a Special Purpose Office to manage the revolving fund, but to overcome wrong-pocket challenges it should be centrally located.
- This Special Purpose Office should start with a narrow focus on some sectors and grow to consider other sectors as it develops a track record; high priority sectors were identified as thematic starting points for financing activity, namely:
    - High-risk recidivism and rehabilitation
    - Employment and labour market attachment

Challenges to Preventive Investment

There are five challenges highlighted as barriers to preventive investments:

1. The Wrong Pocket

A "wrong pocket problem" occurs in any large organization, including world-leading companies and governments, when an activity that would benefit the organization as a whole does not benefit the department or division who must undertake the action. For instance, department X may make an investment in an activity which provides the greater organization with savings, but the savings are in department Y. Unless viewed from a total organizational perspective, department X sees the activity as a cost without any return to their budget. As a result of the wrong pocket problem, worthwhile upstream investments are not always made in the public sector.

2. Cash Timing

Generally, the more "upstream" an investment in human services is made, the greater the reward. For instance, quality childhood development is expected to pay its largest return on investment in adulthood. Although governments are institutions guaranteed to operate long enough to reap these rewards, these rewards will not occur within one administration's term and are subject to the volatility of the political cycle.

3. Cash Saving Realization

Despite knowing that upstream investments can have big social outcomes, these investments do not immediately translate into cash savings that can be redeployed. Some big-investment institutions, such as hospital or prisons, do not smoothly 'ramp-down' from a decrease in demand. Rather, these institutions 'step down' as facilities can partially close, and overall staff demand is reduced.

4. Uncertainty

Prevention-focused investments in human services have an inherent uncertainty. It is only recently that the economic impact of preventive investments in social services has been understood. Furthermore, social issues are dynamic with shifting causes, which is difficult for traditional social service agreements that are not built for fast changes. This can discourage decision makers from making the necessary upfront investments in prevention in the face of competing priorities.

5. Budget Process

A budget process that starts from previous year's spending and makes incremental changes has a tendency to reinforce the status quo. This is in contrast to "zero-based" budgeting, where all spending gets zeroed each year and has to be re-justified each year. Furthermore, cost-benefit analysis are limited due to the complexity and scale of the analysis.

These challenges showcase that there is big opportunity for a model that can transcend these barriers and unleash the full potential for preventive investments.

Pay for Success to Enable Prevention

Pay-for-success has emerged as a means to overcome some of the challenges of investing in prevention. A key opportunity pay-for-success presents is enabling cross-departmental collaboration, and coordinating payments for outcomes. Initiatives commonly funded through pay-for-success programs are those with social outcomes that are easier to measure, such as preventing recidivism or improving employment outcomes.

The majority of pay-for-success initiatives to date have been largely privately funded, which has generated criticism and barriers of **political risk** and **mission lock**. **Political risk** refers to views that pay-for-success is a step towards privatizing social services, particularly when involving private capital in social service and when targeting a change in core public services. **Mission lock** refers to problems over where the cost-savings are directed after the successful pay-for-success initiative: many argue these savings should be reinvested in more preventive interventions, rather than providing a return to a private investor.

A publicly financed pay-for-success program would be able to overcome these challenges by aligning the desires of the "investor" (the public dollar) with those of the government.

How does it work?

The fund proposed here would consist of an Operating Unit whose mandate would be to make "upstream" investments. The fund would be capitalized once, and use the savings generated from its investment to refill the fund — a revolving fund.

The fund would operate as follows:

1. A government department identifies a critical social issue with historically poor outcomes and agrees to pay only if successful outcomes against that issue are delivered.

2. The pay-for-success program (Operating Unit) provides up-front working capital to non-profit service providers who are working with the targeted problem.

3. The non-profit service provider receives the funding to deliver the services, aiming to meet or exceed pre-determined outcomes.

4. Outcomes are tracked by an independent evaluator.

5. If successful, the government department will replenish the pay-for-success program its initial investment, plus any agreed upon rate of return to capture additional resources for future investment.

Using the example of recidivism, the Operating Unit would form a contract with a non-profit service provider and the Justice department to prevent the recidivism of criminalized individuals, thereby reducing costs for the Justice department. If the non-profit service provider is successful in achieving the agreed upon goals, then the Justice department would replenish the Operating Unit with a portion of the savings it received from the investment.

This differs from *output*-based contracts in that output-based contracts pay for a task to be performed, not for success to be achieved. For more details on the make-up of this Operating Unit to administer the pay-for-success fund, please see the full report at socialenterprisemanitoba.ca.

Manitoba Application

A revolving fund may be the most efficient structure for a pay-for-success preventive investment unit in Manitoba. Establishing a Special Purpose Office (to fulfill the role of the Operating Unit referenced earlier) would allow a revolving fund to focus on preventive investments using the structures Canadian provinces *already have at their disposal.*

There are many scenarios where outcomes cannot be cost-effectively measured, and traditional granting may be the best funding tool. Further, once an initiative has demonstrated success under a pay-for-success contract, traditional funding arrangements may be the most cost-effective way to continue and grow the initiative.

A revolving fund in the public sector is a permanent entity with the ability to roll-over unused funds or surpluses to future years. It does not need to replace existing government funding tools, including regular granting and contributions, performance-based budgeting, or other pay-for-performance contracting.

Importantly, a pay-for-success revolving fund can operate within existing government budget structures, while having the multi-year permanence necessary in order to make longer-term partnerships and investments.

Activities

It is important to define the types of investment activities the fund would engage in. Through consultations with local stakeholders, the following investment activities and themes were identified, notably reducing recidivism and supporting labour market attachment for individuals facing barriers to employment.

Investment Activity	Near Term	Long Term
Expand *existing* preventive social services and social enterprise activities.	Funding for: 1. Employment and labour market attachment 2. Rehabilitation for high-risk offenders	Fund across all sectors
Trial new preventive social services and social enterprise activities	Limited Funding for: 3. Employment and labour market attachment 4. Rehabilitation for high-risk offenders	Continue to trial and experiment with new theories of change across all sectors.

Management

It is expected that the individuals selected to run the fund will come with the bias of their particular field. For instance, health experts will be most inclined to focus on preventive health initiatives. Therefore the management should maintain balance by having managers with experience in multiple fields, and the fund should sit with a central government office (not a particular department). Centrally locating the fund will avoid the narrow mandate of other departments, and enable cross-departmental thinking that is often a feature of prevention initiatives. Internationally, special offices under Treasury Board and cabinet have had the vantage point necessary to consider potential cross-departmental opportunities.

Capitalization

The key element of a revolving fund is that it is initially capitalized with a one-time commitment from government, then operates on its own revenue.

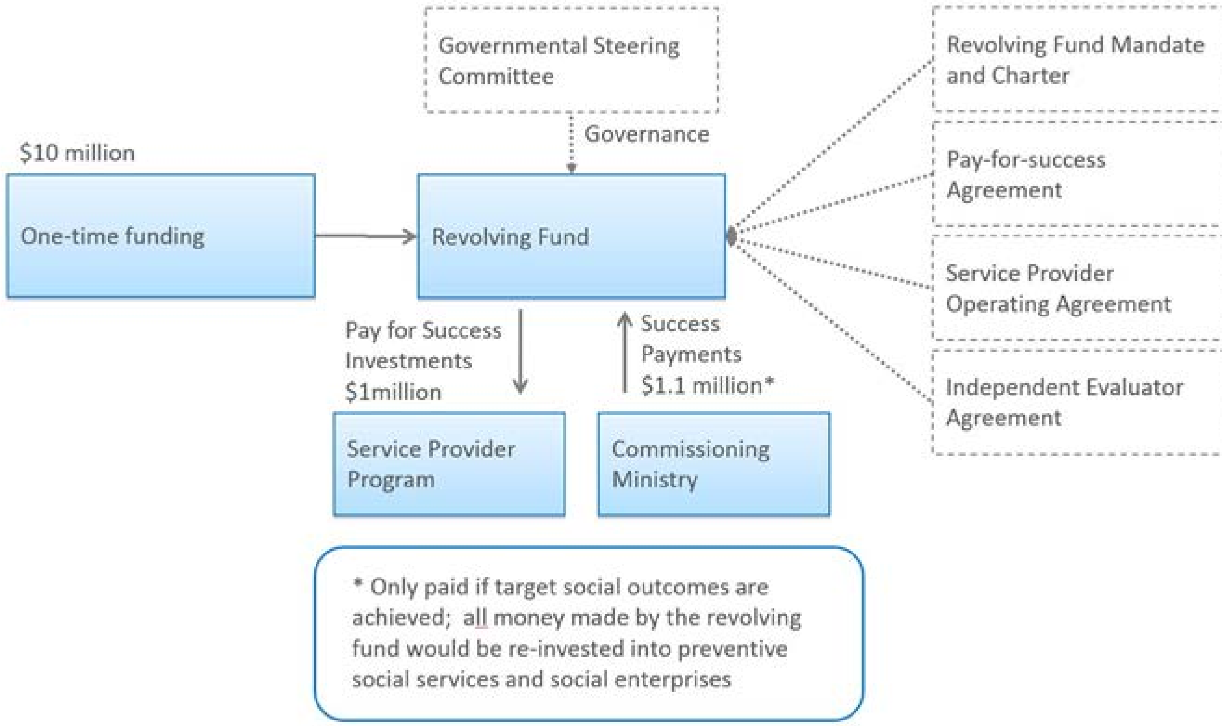
Illustrative Revolving Fund Cash Flow

Thousands of CAD

	Assumptions	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Initial commitment	50,000										
Beginning balance		50,000	40,700	32,600	25,700	20,000	15,500	12,200	10,100	9,200	9,500
Cash used for investing	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000
Cash used for management	1%	500	500	500	500	500	500	500	500	500	500
Cash return on investment (after tax)	12%	1,200	2,400	3,600	4,800	6,000	7,200	8,400	9,600	10,800	12,000
Cash at end of period	50,000	40,700	32,600	25,700	20,000	15,500	12,200	10,100	9,200	9,500	11,000
Cash invested	0	10,000	20,000	30,000	40,000	50,000	60,000	70,000	80,000	90,000	100,000

In reality, investments will vary, with some investments creating cash flow opportunities much earlier, and returns varying with success. Over time, such a fund could create a more diverse portfolio of interventions that specifically accommodate more innovation.

Example fund flow in a revolving fund



Implementation

There are three critical keys to implementation:

- **Independence**
  Issues of investment in social services are easily politicized, and therefore the fund would need independence by being more autonomous. There needs to be some degree of separation so that the civil service professionals managing the fund can focus on financing the most promising interventions.

- **Location**
  The Special Purpose Office (Operating Unit) should be centrally located, as to overcome the wrong-pocket challenges identified earlier. The office should invest in the expertise of non-profits and social enterprises for its initiatives.

- **Focus**
  To start, the office should take a narrow focus on areas of activity where there is already strength and experience, as well as existing political salience. The sectors that were prioritized included:

    - High-risk recidivism and rehabilitation
    - Employment and labour market attachment