

Success Begins with a Feasibility Study

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Pay for Success (PFS), a form of social impact financing, is receiving international attention as a way to pay for scaling up high-return interventions, ranging from prisoner rehabilitation to infant health. It is attractive because risk of failure is shifted from taxpayers to the private sector; if programs don't work, government doesn't pay. Government pays for success by rebating a large portion of the savings from programs that work to private investors in those programs. If there are no savings, that is if interventions do not reduce government costs, there is nothing to rebate to investors.

In this article, I review contracting and time-to-completion considerations with particular attention to feasibility studies, the critical first stage of establishing a social impact finance program.

Conduct Feasibility Research

The first step in any social investment program is a feasibility study. This study establishes whether the intervention can generate government savings large enough to repay investors with high confidence. In many respects, a feasibility study is to a social investment asset what a home appraisal is to a mortgage. Every mortgage is secured by a specific residence, at a specific address, in a clearly identified neighborhood. Every social investment asset (whether a bond, bank loan, or preferred stock) is secured by a specific intervention provided by specific providers to a clearly identified population.

Conducting a sound feasibility study is far more difficult than generally understood. The challenges were evident in a recent feasibility study in a city in one of the seven counties of Northern Virginia. To fully appreciate the results, keep in mind that Northern Virginia is the highest-income region of the state and one of the wealthiest regions in the United States.²

Leaders of a prominent pre-K program for low-income children wanted to know if the program might be a candidate for expansion financed by social impact principles. They embarked

1 ReadyNation is dedicated to helping establish strong state coalitions of business leaders who support effective early childhood investment. Establishing and managing PFS enterprises are particularly promising ways for business leaders to work with philanthropy and government to improve child school readiness and life success prospects. To enable business, philanthropy and government to help more children faster, ReadyNation is working closely with early health and early education social investment pioneers in Utah, South Carolina, Virginia and other states; aiding the preparation of reports on the data and methodologies required to conduct sound initial feasibility studies and final savings certifications; and facilitating drafting generic versions of the contracts needed to establish and manage early childhood social impact finance programs. ReadyNation's work in early childhood social impact finance is at "Social Impact Finance Working Groups," available at <http://www.readynation.org/SIB/>.

2 US Census Bureau, available at www.census.gov.

on a pioneering evaluation of the program's role in reducing public school costs. The evaluation was done with the active help and assistance of the county's public school system. The evaluation involved tracking the graduates of the pre-K program over four years and comparing them with similarly situated low-income children who did not attend a pre-K program.

The findings should be kept in mind for anyone considering using social impact finance to pay for scaling up early childhood programs. On the surface the results showed the pre-K program graduates had far fewer instances of special-education, grade-retention and English language learner costs than the non-pre-K children. Deeper analysis, however, revealed that the data and sample sizes prevented the researchers from concluding that the lower costs were solely the result of the pre-K program. The data were incomplete especially with respect to child socioeconomic factors and exposure to prenatal to age 5 intervention services, and sample sizes of pre-K graduates declined quickly, probably as a result of residential mobility. In other words, despite county's wealth and commitment to education, the data were insufficient to do a feasibility study of whether this particular high quality pre-K program was solely responsible for the reduction in public school costs. As a consequence, scaling up this program using social impact finance techniques will likely not be possible until data acquisition improves.

To assess a pre-K program's impact on special-education placement, grade-retention, and English language learner (ELL) costs, the county's public school system must significantly upgrade its information gathering and management capability. Drawing on these findings, pre-K programs in other areas of northern Virginia are working with school districts to improve the information available on families and their children prenatal to age 5. Efforts throughout Virginia will be made easier by Virginia's new statewide longitudinal education data (SLED) system, which will gather early childhood and K-12 information for each child and maintain it in secure unified manner to monitor student progress while protecting privacy and confidentiality.³

To realize the cost benefits of social impact finance programs, the SLED systems of Virginia and other states will need to acquire and maintain information on each child's exposure to early childhood programs, ranging from parent training to maternal health; prenatal care; birth to age 5 health, nutrition, care, and education; disability amelioration; and child abuse and neglect prevention and treatment. Because all of these programs affect a child's performance in elementary school, their effects need to be weighed in initial feasibility studies.

Identify Areas for High Returns: Early Childhood, For Example

Until recently people believed that applying social impact principles to early childhood investment would be impractical because the time frames for results were too long. High

3 Virginia was one of 20 states to receive a federal Longitudinal Data Systems Grant, funded through the American Recovery and Reinvestment Act (ARRA) of 2009. See Virginia Department of Education, Virginia's Longitudinal Data System, "2010 Longitudinal Data System Grant," available at www.doe.virginia.gov/info_management/longitudinal_data_system/vlds_grant/index.shtml.

returns on prekindergarten (pre-K) programs, for example, did not appear to emerge for more than a decade in reduced teenage crime.

Research in Louisiana, Pennsylvania, and Utah reversed that thinking, and confirmed earlier findings from the Perry Preschool Program, Abecedarian, and others of marked reductions in special education placement among low-income children who graduated from good pre-K programs.⁴ More recent research shows that the reductions in public school special-ed assignment, grade-retention, and English language learner costs are very likely to be high enough to cover the costs of providing quality pre-K programs. Because the cost savings are, for the most part, confirmed by the time children are in the third grade, the time frame is short enough to interest investors.⁵

The effects of prenatal counseling may prove to be even more fruitful. Prenatal counseling of at-risk mothers appears to reduce the rate of low-birth weight births.⁶ Because the cost of low birth-weight baby health care can be 10 times the cost of normal birth-weight care, the savings in state and federal health costs may be great enough to cover the cost of providing quality prenatal counseling. Most important, the savings are earned in just 12 months.

Establish Good Governance and Sound Contracts

The initial impetus for a social impact finance program can come from philanthropy, government, social investment bankers, business, or service providers. The central intermediary, sometimes called a Social Investment Enterprise (SIE), can be any of the prior entities or combinations of them.

There is no inherent weakness in government-centered programs, but there may be more flexibility and entrepreneurial energy in programs initiated by private, regional philanthropic and business leaders and social investment bankers. The creativity and speed with which private entities are able to act can reduce the amount of time it takes to set up programs and thereby increase their number and variety. This ultimately helps more people in less time. In addition, if social impact assets are to ever achieve wide investor acceptance,

4 Center for Child Development, “LA 4 Longitudinal Report” (Lafayette, LA: Center for Child Development, University of Louisiana, 2007), available at www.louisianaschools.net/ide/uploads/11515.pdf; S. Bagnato, J. Salway, and H. Suen, “Pre-K Counts in Pennsylvania for Youngsters’ Early School Success: Authentic Outcomes for an Innovative Prevention and Promotion Initiative,” (Pittsburgh: Heinz Foundation and Early Childhood Partnerships, 2009), available at www.heinz.org/UserFiles/Library/SPECS%20for%20PKC%202009%20Final%20Research%20Report%20113009.pdf; J. Dubno and L. Dolce, “A Sustainable Financing Model for High Quality Preschool for At-Risk Children.” Paper presented by Voices for Utah Children & Early Learning Ventures to the Boston National Business Leader Summit on Early Childhood Investment, 2010, available at www.partnershipforsuccess.org/uploads/20110713_SustainableFinancingModelPresentationtoPAESNationalBusinessLeaderSummitBostonJuly222011.pdf.

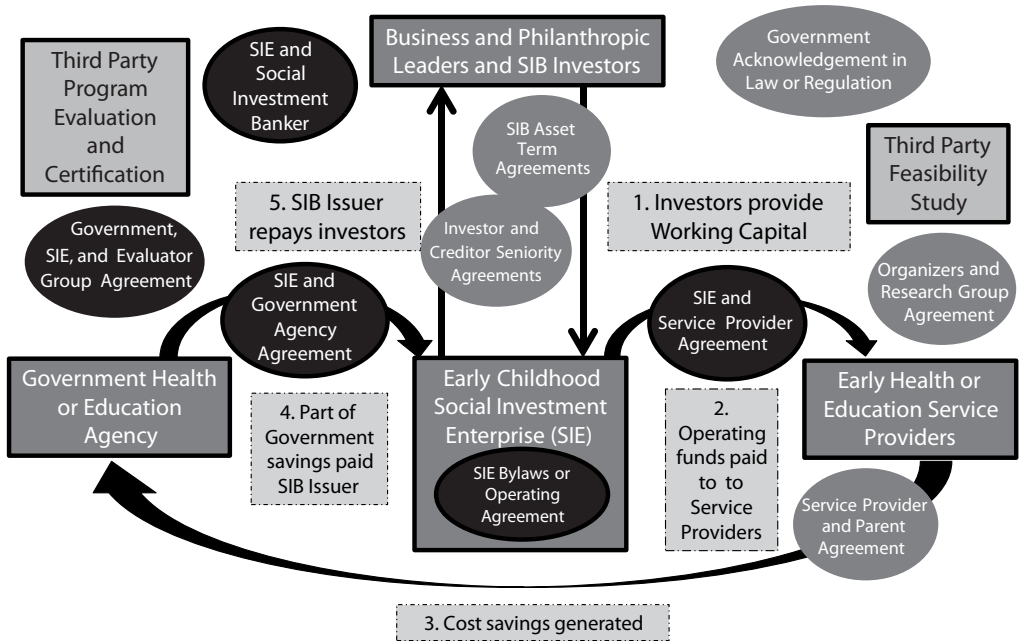
5 Robert Dugger and Robert Litan, “Early Childhood “Pay-For-Success” Social Impact Finance: A PKSE Bond Example to Increase School Readiness and Reduce Special Education Costs” (Kauffman Foundation/Ready Nation Working Group on Early Childhood Finance Innovation, April 2012), available at www.readynation.org/uploads/db_files/Kauffman-ReadyNation%20PKSE%20Report%2012041922.pdf.

6 Emmanuel A. Anum, Sheldon M. Retchin, and Jerome F. Strauss, “Medicaid and Preterm Birth and Low Birth Weight: The Last Two Decades,” *Journal of Women’s Health*, 19(3)(March 2010): 443–451, available at www.ncbi.nlm.nih.gov/pmc/articles/PMC2867587/.

business-sector understanding and support will be needed.

In any fully developed social investment program, there are at least 10 areas of contractual agreement. The five most important are shown as the black ovals in Figure 1. They are: the (1) SIE’s internal bylaws or operating agreement, (2) contracts between the SIE and a social investment banker, (3) contracts between the SIE and the government, (4) contracts between the SIE and service providers, and (5) contracts among the SIE, government, and third-party evaluator and savings certifier.

Figure 1. Example PFS Structure



Note: flow of funds represented by arrows and needed contract agreements by ovals

Adopt Government Savings Certification

The final step in a social investment program is the third-party evaluation and savings certification. The certification study establishes whether the intervention resulted in government cost savings and certifies how large the savings were. The findings feed into the SIE’s contract with the government, which outlines how much of the savings must be paid to the SIE and authorizes the government agency to make the payment. Because feasibility and certification studies rely on the same data, if feasibility can be determined, certification is also possible. From the first step to the last, social investment finance depends on the feasibility study.

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