
Development of Social Investment in Regional Indicative Planning: Possibilities of “Social Bonds” in Public-Private Partnership

Vertakova Y.V.¹, Polyinin A.V.,² Golovina T.A.³

Abstract:

Today, the state alone can not provide the necessary level of socio-economic development, which makes it necessary to look for new economic and institutional tools to address the problem of "failures" of the market.

In the areas of public interest, the consolidation of the public and private sectors in the form of the social responsibility of business, the tool for which is public-private partnership, contributes to the solution of this task. As a way of overcoming the budget deficit, currently developed and developing countries of the world are considering a new form of public-private partnership – social bonds.

While this social investment tool is attractive to government agencies, it also resonates with investors who want to channel part of their assets to the public good.

In this connection, the study of the essence, mechanisms of functioning and development of new instruments of social investment - social bonds - becomes relevant.

The authors show the essence, current state, problems and prospects for the development of social bonds as forms of public-private partnership in developed and developing countries.

Keywords: *Social investment, social bonds, social projects, public-private partnerships.*

JEL Classification Codes: *B55, H54, L32, R58.*

¹Doctor of Science (Economics), Professor, Head of Department of Regional Economics and Management, Southwest State University, Kursk, Russian Federation, vertakova7@yandex.ru

²Doctor of Science (Economics), Professor of the Department of Management and Public Administration, Central Russian Institute of Management, Branch of RANEPa, Orel, Russian Federation, polyinin.andrei@yandex.ru

³Doctor of Science (Economics), Head of the Department of Management and Public Administration, Central Russian Institute of Management, Branch of RANEPa, Orel, Russian Federation, golovina_t78@mail.ru

1. Introduction

We live in an era of change affecting many different aspects of life. Technology, social structure, economic relations are changing. A paradigm shift is felt by many. In particular, the European youth, experiencing more and more difficulties with employment every year, or the middle class in the US, which has become much poorer over the past 30 years, despite the enormous growth of labor productivity in the country. Recently, politicians and public figures of many countries are thinking about how to turn the vector of economic development towards the society, which should be the ultimate beneficiary of all technological improvements and innovations. One of the results of the work being done today in this direction is the development of a new financial instrument - social bonds. For its successful functioning and development, scientifically based approaches to the selection of social projects, contractors, evaluation of economic and social effectiveness are necessary.

It is necessary at the state level to purposefully develop a new form of public-private partnership in the social sphere-social bonds, actively involve investors and non-state organizations in the social services sector, which will make a breakthrough in the development of this financing tool in the social sector, improve the quality of social services and solutions socially significant problems of regions (Vertakova, 2014; Shekhovtsov and Shchemlev, 2017; Shekhovtsov *et al.*, 2017).

2. Background

Since the second half of the 20th century, there has been a trend towards increasing interest on the part of company management towards social investment around the world. While the resources of traditional charity are limited by the finances of a single charitable fund, financial instruments used in the framework of social investments allow the attraction of various sources of resources located in the private capital markets (Vitfild, 2015).

To develop this process in Russia, it is necessary to strike a balance between social justice and the economic efficiency of business. To find this balance, first of all, it is necessary to understand the essence of social investment and its development in world practice. Moreover, the process of realizing this type of investment still needs refinement. So far, scientists and practitioners have not formed a unified opinion on the terminology of social bonds in the investment system. Representatives of the American science school use the category “Pay for Success Bond” or “PSB” (Kim, 2011). Scientists - economists of the European Union for the systemic characteristic of the social investment process operate with the term “Payment for results” or “PrB” (Ankhaer, 2010). Russian researchers use the concept of “Social bond” (Liebman, 2013).

Social bonds as an innovative instrument of investment in theory and practice are recognized as the most transparent form of public-private partnership that provides solutions to social problems. The innovative nature of this concept is the combination of two goals that the investor sets for himself: achieving social effect on the one hand, and obtaining financial returns, on the other. Currently, public-private partnership is the main tool for indicative planning.

The purpose of the research is to substantiate the nature, characteristics and characteristics of the innovative tool of social investment - social bonds, as well as determining the direction of its development in Russian regions. The research was conducted on materials characterizing the development of this concept both in the whole world and its spread in the Russian economy.

3. Methods

Financial practices associated with certain social norms have existed for a long time. The first independent social investment fund, the American Pioneer Fund, was established in 1928, and its investment criteria, shaped by the ideology of the "dry law", completely excluded investments in the production and distribution of alcohol and tobacco (Dear, 2016).

The well-known financier John Pierpont Morgan identified the social investment mechanism with investments aimed at creating a positive influence beyond financial returns (Harji, 2012; Pena-Miguel *et al.*, 2017).

Among the conceptual approaches related to socio-economic theories, the most consistent analysis of the problems of financing and management of social welfare programs is conducted within the framework of the New Governance Theory, which is founded by the scientific leader of the International Laboratory, Professor John Hopkins University and director of the Johns Hopkins Center for Civil Society Studies Lester Salamon. As early as 1981, investigating post-war social policy in the US, Lester Salamon drew attention to the phenomenon of large-scale interaction between the state and non-profit organizations in implementing social support measures and providing education and health services for a budget account using a whole arsenal of special mechanisms and instruments of public administration, providing practical implementation of this interaction (Stout, 2012). The theory was further developed and widely used in the analysis of the modern development of the social state in European countries.

At present, there is no common opinion on the nature of social investment in the economy. Thus, the head of the sociology department at the University of Heidelberg and the rector of the Hertie School of Governance Helmut Anheier in his scientific works reveals this category from two positions. In the broadest sense of the word, the professor considers investments in financial and non-financial resources as "social investments", and in a narrow, from his point of view, these are

money resources aimed at solving social problems and supporting economic entities that are engaged in socially-directed activities (Alexander, 2012).

The term "social bonds" was introduced by Geoff Mulgan, executive director of the Young Foundation (Esposito, 2013). The attitude to investing socially important problems through the innovative mechanism of social bonds in the scientific and social world remains controversial. So researchers at the Center for American Progress, the American Enterprise Institute, support this concept and consider it viable (Lytneva, 2017).

The Washington State University of Public Policy has developed a manual on the application of the analytical methodology CBA (Cost Benefit Analysis) to evaluate social results and determine the effectiveness of services funded under this model. The scheme of investment in infrastructure social projects is actively promoted by specialists of authoritative American organizations: The Harvard Social Impact Bond Lab, The James Irvine Foundation and The Corporation for National and Community Service.

At the same time, Clara Miller, president of The FB Heron Foundation in USA, believes that the desire of state structures to solve budget problems using social bond instruments exceeds the desire to provide real assistance to those in need: "At the same time, nobody stops the fact that transaction costs in the complex scheme of "payment for success" is too high. In addition, the transaction involves at least five subjects - the customer, the intermediary, the investor, the performer and the appraiser. And what happens if one of them leaves the game? "No one thinks about this" (Liebman, 2013).

These findings are agreed by the world's largest investor, entrepreneur Warren Buffett, and believes that the potential of these new social investment instruments is highly exaggerated (Plotnikov, 2012).

Moreover, European non-profit organizations believe that the mechanism of social bonds significantly hinders the implementation of socially significant programs. Representatives of the National Council of Voluntary Organizations (NCVO) note that charitable organizations, unlike entrepreneurial structures, are not prepared for significant risks, and do not have the capital that would be enough to function in the period between payments under a contract based on social bonds.

At the same time, the executive director of Social Finance Tracy Palandjian with such categorical conclusions does not agree. Her team actively promotes social bonds, clearly understanding that such a model is certainly not a panacea for all ills and due to its novelty can not be irrefutable (Salamon, 2014).

Thus, the problems of social investment are global and this is confirmed by the research of scientists - economists, practitioners of different continents and

countries. At the same time, the issues of the development of an innovative financial instrument - social bonds - are mainly considered non-systematically, as isolated practices.

4. Results and recommendations

Social bonds are an innovative tool for financing long-term positive social changes with a payment mechanism only if the social goals are achieved on the principles of public-private partnership. The essence of social bonds lies in their ability to combine the interests of all stakeholders to achieve common goals for the benefit of the poor and vulnerable segments of the population (Vertakova, 2012).

Social impact bonds involve the use of private capital and investment instruments to support socially oriented activities in both developed and developing countries. The majority of investors in such bonds are charitable organizations and philanthropists (Dear, 2016). According to the authors, the main distinguishing characteristics of social investment based on the technology of social bonds are:

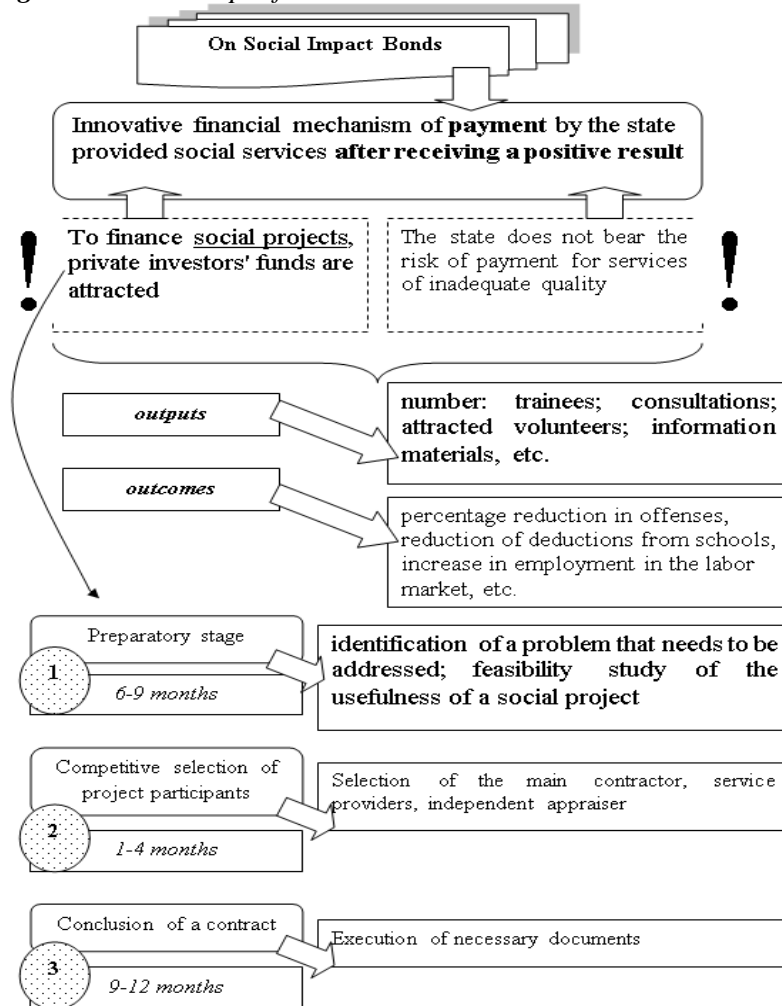
- funding is provided in advance, not when results are achieved;
- funded social projects should have a social and economic effect, providing service providers with greater flexibility in decision-making;
- unlike traditional bonds, this tool is designed to improve the quality of service delivery aimed at solving social problems.

If the social project is implemented successfully, the state returns the invested capital to investors and pays interest. The degree of "success" is determined by the results of the project evaluation on the basis of pre-agreed indicators (indicative planning). In case of failure, the investor loses his capital. The concept of social bonds is shown in Figure 1. Social bonds combine features of debt and equity: this investment tool has a fixed term of five to ten years, and also has a growth limit, but as an equity instrument, the level of profitability varies depending on the percentage of achievement of the goals. Compared to a typical debt instrument, investors bear a higher risk of losing the principal amount of the investment.

Moreover, these investments are not backed by solid assets or cash flows, and the results (the level of social significance) of investments are almost impossible to measure.

According to the authors, social bonds are best suited for use by charitable foundations, which have the opportunity to provide information on the constantly improving results of their programs with a clearly defined target audience. These results, in turn, should influence public savings that can be obtained within a relatively short period of time and which are significant enough to cover the cost of the program and show a reasonable return for investors. The scheme of the social bonds model functioning is shown in Figure 2.

Figure 1. The concept of social bonds⁴

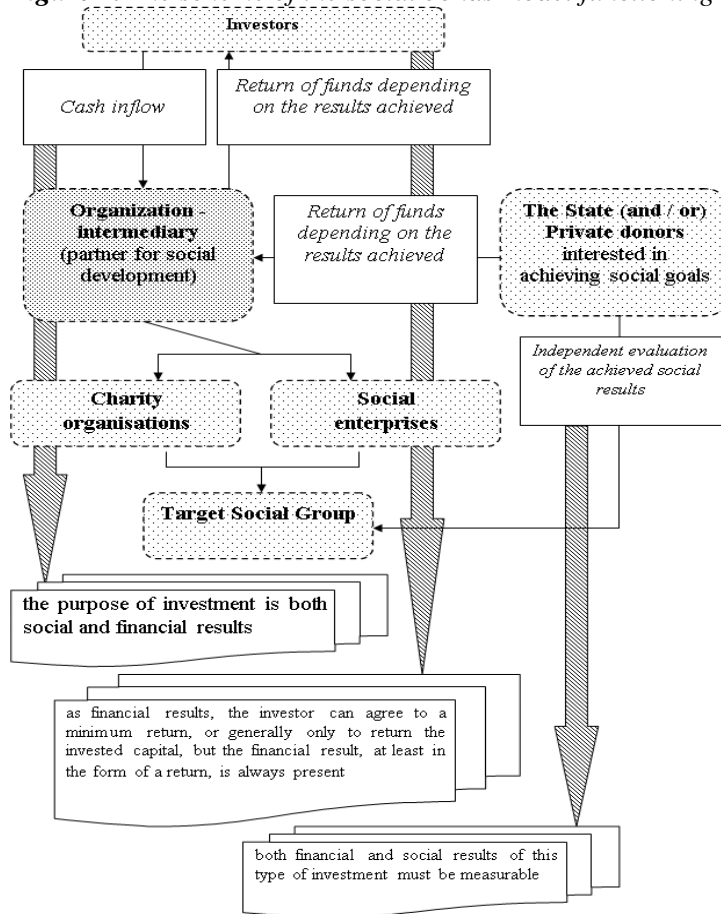


Currently, several types of social bonds are singled out:

- standard bonds, funds from which are sent for social purposes;
- social bonds tied to income;
- social bonds of project financing;
- social securitization bonds.

The development of social investment with the use of instruments of social bonds in the advanced economies is now passing the stage of market formation.

⁴ Compiled by the authors

Figure 2. The scheme of the social bonds model functioning⁵

In the period since 2012, the social bond market has quadrupled. Annual emissions increased from \$ 2.1 billion in 2016 to \$ 8.8 billion in 2017. Head of the debt capital markets of Citi Philip Brown points out that more than half (51%) of the volume of social bonds issued in the world was provided by European companies. China with Hong Kong accounted for the growth of the world market by 21%. This is the largest single market by volume growth. Very impressive and the data from Latin America - 8% of the world. In North America, the growth of this direction of social investment was 10%. As of 2017, more than 60 social bonds have been launched with a total cost of attracted capital of \$ 216 million, valid for 1 to 7 years and a yield of 1 to 13% (IBGD, 2018).

The very first American program of social bonds, aimed at reducing juvenile delinquency in New York (2012), did not lead to the expected result (Stout, 2012). Nevertheless, its investors and partners are analyzing the mistakes and continue to

⁵ Compiled by the authors

participate in new deals that provide for the return of capital and profit only if there is confirmed success. Currently, 10 social programs are being implemented in the United States, and more than 30 projects are being prepared for launch. The health sector is the key sector for implementing this investment format. Thus, Israel became the first country to issue social bonds for the prevention of diabetes. The research program will be launched in July 2018.

The investment-charity organization Social Finance Israel will issue the first 5,5 million dollars related to the prevention of diabetes for foreign and Israeli investors. This is an innovative scheme for financing medical research at the expense of private investors, according to which 2250 Israelis with risk of developing type 2 diabetes will be helped to change their lifestyle and diet (Stout, 2012).

The research of the current practice of using the instrument of social bonds to invest in socially significant projects allowed the authors to identify systemic problems that hamper the development of social investments and mechanisms for their implementation:

- lack of scientifically sound methodological approaches to the application of innovative instruments for financing social projects;
- lack of independent expertise for assessing social and economic outcomes;
- the lack of reliable and consistent criteria for assessing the effectiveness of social outcomes.

To solve the indicated problems and reduce the risk of ineffective application of this tool, it is advisable to consider the following proposals:

- to enable non-profit organizations to request from the government agencies participating in social investment detailed plans for ensuring sustainability and further development of successful programs;
- consider the possibility of assigning the status of "best practices of federal (regional) importance" to those models and practices of social investment that are suitable for replication on national (regional) scales;
- to ensure the priority of participation of non-profit organizations in such projects with the use of social bonds, which, as a prerequisite, require the collection and analysis of "evidence information" and guarantee financial stability to successful models;
- to improve the effectiveness of an independent evaluation of the results of social projects, it is necessary to develop and unify methodological recommendations that will ensure the systematic delivery of relevant data characterizing not only the final but also interim results of the programs, which will allow all stakeholders to evaluate the results for making operational decisions.

The authors of the research concluded that social bonds as a mechanism for financing the social sphere work well in wealthy countries (such as the United

Kingdom or the United States), and in the UK, social investment is promoted by the state, and in the United States, large entrepreneurial structures are the leader of this direction. In developing countries, the process of developing social investment is rather slow (a successful social project in India), which is due to the presence of a number of objective barriers, which include:

1. Difficulties related to the choice of priorities. The problems of developing countries are so vast and comprehensive that it is very difficult to determine the most important priority.
2. Numerous factors that adversely affect potential beneficiaries. In economically depressed communities, people need jobs, medical services, affordable housing, high-quality food, etc.
3. Lack of organizations that are able to participate in programs based on social bonds. In developing countries, social services are usually provided by small non-profit organizations that can not participate in large transactions, and do not attract the attention of private investors.
4. Limited financing of the social sphere. The government finances socially significant initiatives in an insignificant amount.
5. Lack of data. State authorities often do not have the initial data necessary for comparative analysis and evaluation of the effectiveness of programs using social bond instruments. And as for non-profit organizations, they lack the competencies and resources necessary to collect data and assess the effectiveness and quality of their own services.

To reduce risks and increase the attractiveness of social bonds for different stakeholders, it is advisable to adapt the experience of leading countries to the special conditions and needs of developing countries.

In particular, potential participants in social projects can agree on a phased payment for services to non-profit organizations based on the results of the evaluation of intermediate results (for example, in the first year 40%, in the second year 60%); encourage the implementation of "combined" programs (for example, combine educational activities with measures to improve the quality of nutrition), create investment funds to support different models of service delivery; and to strengthen relations with private investors who are able to strengthen initiatives with the help of "irrecoverable" funds and to draw the attention of the state to urgent social problems. For the development of social investment in Russia, according to the authors, there are a number of prerequisites:

- globalization and standardization;
- technologization;

- increase in the budget deficit at the country level;
- the desire of the state to increase the efficiency of spending money on the social sphere;
- awareness by large business of the need to create, in addition to consumer value, also a social value.

At the same time, factors that impede the development of social bonds in Russia include:

- disinterest of business structures in setting social tasks;
- lack of understanding of the importance of social tasks for strategic business development;
- lack of strategic domestic investors;
- lack of order from potential beneficiaries of social services;
- unwillingness to account for the effective use of invested funds and lack of necessary business skills.

At the same time, it should be noted that many elements necessary for the stable functioning of the system of social bonds in Russia already exist. Thus, social bonds can serve as a catalyst for new financing mechanisms, innovative business practices and models, and for improving public policies. These changes, in turn, can make it possible to resolve capital gaps on a significant scale. In this connection it is necessary:

- determine effective social projects based on the inventory of the best world practices of social investment;
- consider the possibility of creating development institutions in the social sphere (for example, on the basis of the Agency for Strategic Initiatives, which has a good base, a unique practice ground, and access to regional authorities);
- to work out the legal basis for the instrument of social bonds as a type of public-private partnership;
- create conditions for attracting large funds and private investors, in programs and projects of social investment.

Thus, given the limited resources and the slowdown in economic growth, the social bond instrument is of particular interest in the current situation, which, on the one hand, stimulates private sector funds to solve social problems, and on the other, increases the efficiency of social investments.

5. Conclusion

It is proved that the new form of public-private partnership – social bonds is a global trend and opens up great opportunities for solving structural social problems in the country. Establishing processes of interaction of all participants of social investment will allow them to unite potential opportunities, harmonize interests, reduce the level

of risk. The research determined that in order to "new horizons" of philanthropy become a reality, it is necessary to find not only investors, but also investment objects – promising projects, commercial or non-commercial, capable of performing social tasks and at the same time guaranteeing financial returns.

The state has a lot of experience in the development of the social environment, private investors have money for investment and great entrepreneurial experience. The combination of these two components allows us to open new opportunities for investing all investors. The result of the research is the conclusion that social bonds open up new opportunities for public-private partnership. It is necessary to find the formats for embedding an innovative social investment tool in existing regulatory frameworks or adapting legislative innovations. More work is needed at both the federal and regional levels in this direction.

Despite the existing diverse experience of using social bonds, which need to be studied, it is equally important to develop national solutions that take into account Russia's specifics and capabilities, which requires further development of both regulatory and methodological support.

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