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Public Private Collaborations for Social ImpactCreation

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INVESTING

Public Private Collaborations for Social Impact Creation

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Introduction

Impact Investing (II) is not "just" an investment category, or a trend. The concept of investing for impact without compromising financial returns can play a useful role to reconsider and reshape the role of business in society and the interplay between government and societal actors in creating social value, thus impact.

The interplay between state, market and society within their different goals has been the object of a rich, and ultimately intertwined, academic debate in the last thirty years. Corporate Social Responsibility studies (Carroll, 1979, 1991; Garriga & Melé, 2004), Stakeholder Theory (R. E. Freeman et al. 2010; R. E. Freeman 1984; Jensen 2010) and lately Shared Value approach (Porter & Kramer, 2011) have called for a greater accountability of the firm for the effects of its practices on the environment where it operates. Studies on social entrepreneurship (Austin, Stevenson, & Wei-Skillern, 2006; Dees, 1998; Peredo & McLean, 2006; Wallace, 1999; Weerawardena & Mort, 2006) have challenged non profit organizations to combine business rigour with their social mission. In public administration/management field the concepts of governance, networks and partnerships (McLaughlin, Osborne, & Ferlie, 2002; Metcalfe, 1993; Teisman & Klijn, 2002) are among the dominant topics.

Relations between public – private – non profit actors are becoming more and more tangled and nuanced and neither the private nor the public sector has the monopoly on the provision of social value, although governments play a special role (Bryson, Crosby, & Bloomberg, 2014). Therefore, we need to understand how their roles have been changed and are co-evoluting in the pursuit of social value.

Private firms and voluntary organizations, in particular, have to reframe their role's perception from that of, respectively, lobbyists and advocates for particular interests to become responsible partners in the production of innovative solutions for the society at large (Hartley, Sørensen, & Torfing, 2013). The public sector, characterized by curtailed budgets, high debt, administrative rigidity, should find the way to leverage the capacity and the capitals of the private sector to innovate and to increase the generation of social value.

Social value, in fact, is created (Kivleniece & Quelin, 2012) when hybrid mechanisms, based on a public-private-social collaboration, deliver new and appropriable benefits to the society for which it directly—as consumers— or indirectly—as taxpayers—is able and willing to pay.

In order to solve problems we are confronting with and make real impact, we have to change how business sees itself and how others see business (Porter, 2013). In other words, companies should be able to generate the so called shared value, which can be defined as policies and operating practices that enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities in which it operates (Porter & Kramer, 2006, 2011). The shared value model, that has become quite popular among consulting firms, allows overcoming the divide between standard and social enterprise, but reduces the role of government to a pure regulatory actor. In Porter et al. view, businesses that apply the shared value creation approach can do better in supporting social progress than governments and social sector organizations. Crane et al. (2014), have accused the authors of being unoriginal, as they have ignored the theories related to the role of businesses in society, synthetized by the four levels of corporate social responsibility - economic, legal, ethical and social (Carroll, 1991).

Furthermore, if businesses are going to make profit by generating social value, it is intuitive to ask who is going to foot the bill. As Bill Gates put it in a recent interview “There are a few things like new educational technology or better medicines or bootstrapping new charter schools, where you get into something that has got a non-zero return if things go well. You really have to be careful thinking you have your cake and eat it too”[1]. Even if through CSR, more or less strategic or traditional, and Impact Investing businesses can contribute to tackle social needs, the role of government continues to remain vital in certain domains, as noted by Gates, but it must be re-thought to make it more effective.

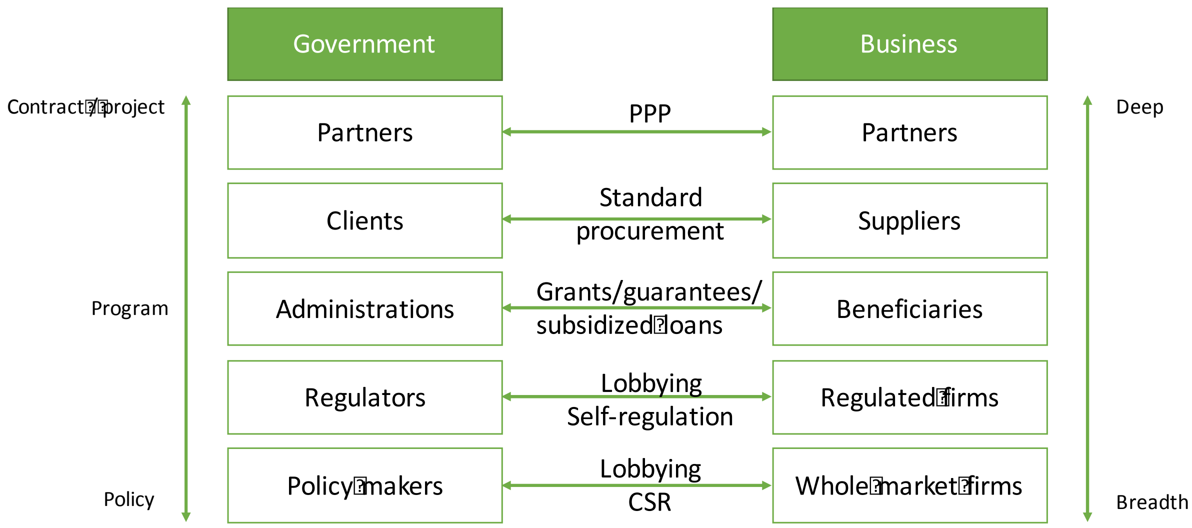
[1]Gates cautious on ‘impact investing’, published on Financial Times on the 30th of October 2015 http://www.ft.com/cms/s/0/c7f4efa2-7e7d-11e5-a1fe-567b37f80b64.html#axzz3wIHxgsc4

In this chapter we analyze the main relationships between businesses and governments and how they can be reframed to generate social impact.

Figure 1, adapted from (Vecchi, Caselli, & Corbetta, 2015), decodes the framework of public and private interactions. Interactions can take place at three levels: policy, program and contract level. These levels are characterized by different degrees of formalization and intensity.

At policy level, interaction is mostly relational, based on lobbying; at program level, they can take the form of grants or other incentives (tax shield, subsidized loans, guarantees) given by governments in order to stimulate companies to generate social innovation or to stimulate the market to create new social businesses in order to tackle certain social needs. At project level, these interactions take the shape of collaborations, which can be translated into procurement and Public Private Partnership (PPP)[2] contracts. The latter, which are discussed later, are promising for their capacity to generate social value.

Figure 1 business government relation spectrum



The chapter is structured as follows: the second paragraph discusses the evolving role of business in society. The third paragraph analyzes how this transition is carried out in practice, by mapping the instruments and organizational settings adopted by businesses. The third paragraph discusses why we need to make Public Private Collaborations evolve in order to generate the innovation necessary to increase social value generation.

2 PPPs are the contractual form of PPCs. In a PPP, a public authority and a private sector enter into a long-term contract, with the latter raising the finance required to design, build and operate new facilities. Latu sensu under a PPP the public sector puts in charge the private of operations and delivery so it can concentrates on the definition of policy, strategy and control.

1. Reassessing the role of business in society

In a traditional view, the state is in charge to foster public interest and make a society prosper and businesses create wealth, which also fuels the capacity of governments to tackle social needs, thanks to taxes they levy. Social actors, such as non profit organizations and foundations, can play next to governments and businesses to solve some social challenges, especially at local level, close to local communities. Businesses can also directly contribute to the social value creation through specific business models and philanthropic actions, which are becoming increasingly more and more relevant and popular.

With the aim to create wealth, business often creates, what economists call, externalities. Externalities represent costs or benefits that are not taken into account in the transaction between two parties, because of the imperfection of market. An externality may be negative, such as pollution, consumption of natural resources, inequality, or positive, such as employment, safety, health improvement, better quality of life, drinkable water, better environment, higher productivity. Businesses are often the cause of the negative externalities. However, by mobilizing financial, technological, and human resources, they are also the source of the solutions, along with governments and social organizations.

In contrast with neoclassical corporate theory, expressed by (Friedman, 1970)[3], corporate sustainability, has become a sort of "must have" for many companies, especially multinationals. Nevertheless corporate scandals hitting from time to time news headlines worldwide underline that the social value creation is still often disconnected from the competitive corporate strategy (Baron, 2001; Bhattacharyya, 2010; McElhaney, 2009; Porter & Kramer, 2006).

How is it possible, for example, that a company like Volkswagen (VW), ranked in the top ten most reputable global companies for its CSR in 2014 and 2013[4], was cheating on polluting emissions of its vehicles, becoming as one of the biggest corporate scandals ever? This case of misconduct is particularly striking because air pollution is certainly the most important negative impact produced by car companies. The fact that an industry leader, which prides itself for being socially responsible, acted deliberately to manipulate tests on emissions of its vehicles shows us the disconnect between CSR and business practices.

[3] "there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud"
[4] According to the Global CSR RepTrak 100 elaborated by the Reputation Institute

Rangan et al. (2015) underlines that the majority of companies interviewed in his research, despite being committed to CSR, are hampered by poor coordination and a lack of logic connecting their various programs. 87% of CSR programs the authors reviewed are still to be considered philanthropic initiatives or operational improvements, not real transformative business models.

On the contrary, through the philanthropic pillar of CSR or thanks to their personal wealth, companies, entrepreneurs and managers are channeling an enormous liquidity, which is playing a fundamental role to tackle social needs, especially in poor countries. In 2010, Gates and Buffett challenged fellow members of the ultra-rich club to give away at least half of their wealth. Since then, more than a hundred billionaires have signed the "Giving Pledge." If for many this becomes a social mission, it also raises critics about the real aim of these actions and concerns about the political influence they can get in the worldwide scenario, as the journalist J. Cassidy has underlined from the pages of the New Yorker, by commenting the decision of M. Zuckerberg to donate the Facebook's shares, or better to transfer them within a LLC (Limited Liability Corp) (Wharton, 2015).

Davis et al. (2016), who won a mention in a recent article of the Economist "Social saints, fiscal fiends", show that companies which do the most CSR also make the most strenuous efforts to avoid paying tax—and that those with a high CSR score also spend more lobbying on tax.

In a country with an enormous social divide like India, Corporate Philanthropy has become compulsory in 2014. Indian government introduced an obligation for all companies, with a certain level of sales and profit, to commit the 2% of net profits to CSR activities, such as supporting education and health access[5]. Whereas this can be seen as a hidden form of taxation, it may also be perceived as an admission of inability by the government, who is asking companies to run social program by themselves.

Beyond CSR and sustainability strategies, history has been marked by private sector advances and setbacks in provision of socially valuable services. British rail service provides a useful example. After the introduction of steam engine, at the end of XIX century, Britain saw a spurt of rail entrepreneurs seeking to take advantage from this new mean of transportation.

[5] Section 135 of the Companies Act provides the threshold limit for applicability of the CSR to a Company i.e. (a) net worth of the company to be Rs 500 crore or more; (b) turnover of the company to be Rs 1000 crore or more; (c) net profit of the company to be Rs 5 crore or more. Further as per the CSR Rules, the provisions of CSR are not only applicable to Indian companies, but also applicable to branch and project offices of a foreign company in India.

Investors piled in, pouring money into these new ventures. However, many of the new railroads never reached breakeven and the rail boom turned into bust, forcing state intervention. In 1921 the Railways Act was adopted and more then a hundred rail companies were merged into four. In 1948 the legislator intervened again and nationalised the remaining companies. British Railways was born. In 1994 the conservative government began to bring back railway service to the market. However, after a series of deadly train crashes between 1997 and 2002 and the collapse of Railtrack, the network operator, in 2002 the State intervened again and renationalised the network.

Was private experience at managing rail transportation only negative? Judging by the number of passengers and mileage the second wave of rail privatisation has also positive aspects. During Victorian age, private entrepreneurs created an extensive rail network and passengers almost doubled during the last 20 years increasing from 735 million in 1994/1995 to 1.65 billion in 2014/2015[6]. In comparison with continental Europe or China or Japan, which followed a centralised government-led path, however, the UK still lacks a high-speed train network and its infrastructure stock looks inadequate and old. In the British case the market has certainly contributed to create positive impact, but failed to create a financial return, thus triggering state intervention, and innovation.

2. Instruments and organizational arrangements for social value creation

As discussed in the previous paragraph, the shift from a paradigm where only non profit organizations and public agencies were considered committed at creating social value to a paradigm where impact creation is explicitly embedded also in for profit business models is non-linear and fraught with ambiguities. In this paragraph we attempt to map instruments and organizational settings used by corporations and individuals (philanthropists as well as citizens) for reaching social impact. In doing that, we distinguish between financial and non-financial instruments and traditional and innovative institutional settings; the latter imply a higher degree of integration of different perspectives (social, environmental, financial) and a greater cross-sectorial collaboration.

[6] Department for Transport and Office of Rail and Road (2015), Rail Trends Factsheet

The two following tables are rooted in UN Addis Ababa Action Agenda[7], which defines the framework for financing the UN post-2015 development agenda. The Addis Ababa Agenda is somewhat revolutionary because it makes an official shift from the traditional view of development, based on aid and cooperation, to a more holistic approach, by recognizing the importance of business and finance for development.

Table 1 lists financial and non-financial instruments – besides taxation - used by corporations for reaching social impact. Among non financial instruments, we find traditional tools like volunteering, co-production, and lobbying with all its forms (Slob & Weyzig, 2010). The last one is traditionally perceived as a way to influence legislation, also with industry standards, on issues that could have a direct impact on business/investment activities (labor, environmental rules etc.). Nowadays, as we recently saw at the COOP21 Paris Sustainable Innovation Forum, which laid out the new global agreement on carbon emission reduction after 2020, business is starting to get involved also on general social issues. Further, the UN Principles for Responsible Investment (PRI) initiative, sponsored by UNEP (United Nation Environmental Program) and the EU, in 2014 published a report calling for "*investor engagement in public policy*" as "essential for long-term investors." (Sullivan, Martindale, Robins, & Winch, 2014). However, in this context, Bill Gates underlined that "in our fear of allowing the relationship [between business and government] to go too far, we risk not allowing it to go far enough".[8]

Co-production refers to an arrangement where citizens, and/or their organizations, at least in part produce and finance, through regular long-term relationship with state agencies, their own services (Joshi & Moore, 2004; Pestoff, Osborne, & Brandsen, 2006). Traditionally this concept referred to some kind of empowerment and engagement of users/clients in the delivery of public services. Lately, together with the emergence of the governance theory, co-production became a core element not only of public service delivery, but also public service planning and design (Osborne & Strokosch, 2013) and nowadays it is considered as a new form of partnership between public sector and either commercial enterprises or civic organizations (Joshi & Moore, 2004).

[7] In particular figure IV, page 18/54, of the Report of the Intergovernmental Committee of Experts on Sustainable Development Financing, A/69/315
[8] MINT on line http://www.livemint.com/Opinion/oGo1cN0psp9jPHz5gqbkyM/Beyond-the-revolving-door.html

Regarding financial instruments, Addis Ababa Agenda points out that it is essential, to maximize synergies, to take advantage of complementarities, and build on an optimal interplay of all financing sources. The Agenda indicates the need for developing “blended finance instruments, which combines concessional public finance with non-concessional private finance and expertise from the public and private sector”. Socially neutral investments aim only at maximizing financial returns whereas concessionary investments (such as donations) are motivated only by the mission pursued without considering the financial performance (Brest & Born, 2013). In between there are the so-called program-related investments (such as venture philanthropy) that focus on the financial sustainability of the programs financed (Vecchi, Cusumano, & Brusoni, 2015). Among these instruments we find II, which can be applied not only to fund social businesses but also Public Private Partnership (PPP), which will be the object of paragraph 3 of this chapter.

Table 1 financial and non financial private instruments for reaching social impact

Non financial	Financial
• Volunteering • Co-creation / Co-production / Co-design • Lobbying • Codes of practice, Industry Standards	• Donations • Crowdfunding • Venture philanthropy • Impact investing • PPP • Socially Responsible Investments

The transition to a system where the distinction between profit and non profit sector, business and philanthropy is more nuanced, is also getting apparent when we look at the organizational settings (table 2, in which we also provide some emblematic examples) used to reach the social impact. Whereas wealthy people, such as successful entrepreneurs, usually establish family foundations (just think about Rockefeller or the Bill and Melinda Gates foundation), a new trend is emerging. The announcement of the Chan and Zuckerberg to create, as written, a LLC that is going to invest in services and products that can revolutionize target sectors (like education) marks a huge departure from the traditional approach. This follows the model chose by Pierrre Omydiar, eBay founder, and his wife, with the aim to invest like a normal venture capital fund, except that they target business ideas that can create a social impact.

Table 2 traditional and innovative organizational settings for reaching social impact

	Traditional		Innovative	
Families and individuals (high net worth individuals – HNWIs)	Foundation, Non profit organization	Rockefeller, Hewlett, Bill & Melinda Gates Foundations	Investment Company, Funds	Omydiar Network, Chan Zuckerberg Initiative
Companies (non financial)	Foundation	Vodafone, Novartis, Brunello Cuccinelli foundations	Strategic CSR	Unilever
	CSR department	The majority of firms	Corporate Venture Fund	Google Ventures
			Frugal innovation /reverse innovation	Vodafone m-pesa
Companies (financial instit.)	CSR department, Community Development Finance Institution (CDFI)	All major financial institutions, banking foundations, banking cooperatives	Dedicated structures and products	Banca Prossima, UBS, Citi group

Companies (for profit and non-financial) traditionally have followed two approaches: establishing a department dedicated to CSR or foundations. Both solutions, however, have been somewhat detached from their core business. Other corporations, such as Unilever, which launched in 2010 the Unilever Sustainable Living Plan and integrated environmental sustainability and societal impact in its vision, are making an effort to adopt a more strategically approach to CSR.

Another approach followed by corporations around the world is the so-called frugal and reverse innovation. Companies, which work or enter emerging markets, develop new products and strategies in order to meet local consumers demand, typically poor masses. Zeschky et al. (2014) identify three different strategies:

1) Cost innovation: same functionality at a lower cost;
2) Good-enough innovations: tailored functionality at a lower cost;
3) Frugal innovation: new functionality at a lower cost.

In the last case products or services are developed for specific applications in resource-constrained environments. One example is Vodafone m-pesa, a mobile phone-based money transfer, which also provides financing and microfinancing services. First developed in Kenya and Tanzania, the system provided access to financial services for the first time to those communities that were underserved by traditional banking channels. Vodafone is now expanding the service in other parts of the world and using it a source of competitive advantage, in what is called “reverse innovation”.

A less widespread approach is the one taken by Google – now Alphabet Inc. – to establish a corporate venture fund targeting also companies that aim at producing an impact. It can be considered a corporate impact investing approach and it departs from the practice to acquire stakes (or the whole company) in start-ups widely used in R&D intensive sectors like pharma. This approach is believed to reduce risks associated to new products development and be more effective than internal R&D department of big corporations. This is also beneficial for start-up entrepreneurs and their investors, since it provides them an exit. We may consider that this approach is producing per se a social impact: it fosters innovation and a faster adoption of new medicines, thanks to the distribution channels of already established companies. However, it lacks the intentionality of social value creation that characterize corporate impact investing.

Financial intermediaries are taking different approaches in the social value creation. In the US there is a long tradition of Community Development Financial Institutions (CDFI), since the Community Reinvestment Act was firstly enacted by Congress in 1977. The Community Reinvestment Act is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low-and moderate-income neighborhoods[9].

Some institutions are now setting up dedicated team, like Citi Group’s “Citi Inclusive Finance”, to develop new products for underserved communities, like microcredit. The biggest Italian lender, and among the first 10 bank groups in Europe, IntesaSanpaolo, made, instead, the decision to set up a dedicated bank for cooperatives, social enterprises and social innovation, Banca Prossima. Among its products, Banca Prossima launched Terzo Valore, a crowdfunding platform, which allows individual to make donations or loans to sustain social projects, which are also partially financed by the bank itself. The margins of the banking activity are used to feed a fund, which is used to provide a guarantee to individuals that invest in the pipeline of projects selected by the bank itself. Other institutions, such as UBS (see chapter 14), have developed a complete portfolio of social funding products.

[9] http://www.federalreserve.gov/communitydev/cra_about.htm

The limit and the need of public – private collaborations

The narrative that world's problems will be solved by clever businesses – without public intervention – is certainly a symptom of the widespread lack of trust in the political class and public institutions. According to Pew Research Center (2015), in 2014 only 19% of Americans trusted their government, down from 77% in 1958. The situation is slightly better in the European Union where in 2014, according to Eurobarometer, 31% of Europeans trusted the state. The paradox is that trust in private corporations is even lower and, despite public distrust of government, there is little public support for changing it (Kettl, 2015).

Compared to the Reagan and Thatcher era, when the imperative was rolling back the state and taming the leviathan, this time government is more ignored than reviled. Many companies believe that governments should reduce taxes, just leaving more resources into companies themselves, to be reinvested to generate innovation and employment and ultimately social development. The Economist (2016) argued that "They [companies] also need to recognize that there is a big difference between worrying that government is inefficient and pretending that it is irrelevant, and thus that contributing to its upkeep is unnecessary".

Social spending, in fact, is worth 22% of GDP on average across the OECD, private expenditure 3%, with the notable exception of the US where it accounts for 11% of GDP. According to Forbes, in 2015 there where 1,826 billionaires in the world with an aggregate net worth of $7.05 trillion. Assuming this sum was a foundation endowment releasing 5% each year, we would get $356 billion per year, which is slightly less than Italian public expenditure in health and pensions (around $400 billion per year). Considering that Italy represents 0.84% of world population, this sum would hardly meet global needs. Our example in based on a traditional view of philanthropy. If invested according to an impact investing approach (with an average annual return of 6% to be reinvested), the same $7.05 trillion will probably have a far greater reach – around $12,5 trillion in 10 years. Still inconsistent if compared to public budgets.

Regarding the argument of leaving more resources inside the companies instead of collecting taxes: if corporate taxation would be reduced to stimulate more investments, also for the society, probably these extra resources wouldn't be reinvested in social causes. Letting the private sector decide where and how channel resources for social purposes may be dangerous, because it would be done through a discretionary process. Some social needs may benefit more than other equally important, but less visible or fashionable. Finally, beyond philanthropy, there are some market failures that make even the more sophisticated impact business model inadequate to transform a public good into a tradable good.

Instead of a reduction of the government, we should, therefore, wish for more interaction between the public and the private sector, with the latter helping the former to reach the necessary innovation to generate more social impact. So far, partnerships have been used by governments across the world to outsource public services delivery to the private sector with the aim to reduce costs, increase management flexibility, leverage specialized expertise, decrease public monopoly inefficiencies and reach value for money (Van Slyke, 2003). Traditionally they have taken the form of arm's length transactions, in which buyer (government) and seller (private operator) act in their own best self-interests and, therefore, the public sector hasn't took the opportunity to explore all the possible relationships with the market actors (Bovaird, 2006).

Social problems, in diverse and complex societies such ours, requires innovative solutions generated by the contribution of several actors, with different perspectives (Hartley et al., 2013; Osborne, 2010). A more collaborative effort, even though a different approach to public-private collaborations (PPC) is required, help building social capital (Erridge & Greer, 2002) and to spur public innovation (Bommert, 2010; Eggers & Singh, 2009; Roberts & King, 1996). PPC can be a way also to attract more financial resources, thanks to the financial leverage generated by a better allocation of public funds.

One of the main barriers to generate innovation through collaboration is the inability of the public sector to take risks and to accept experimental failure (Potts, 2009), which are inherently at the basis of the innovation process. At the same time, also the private sector seems unable to take risks within transactions with the public sector and to generate social innovation.

Actually traditional PPCs around the world have experienced many problems, stemming from moral hazard, high transaction costs, frequent renegotiations, low value for money for the public sector. Scholars are often critical of the capacity of the public and private sector to develop PPCs based on mutual trust (Rosenau, 1999; Spackman, 2002); political authorities have also an incentive to change the rules of the game or claim a higher share of value, than foreseen initially, when the partnership deliver good outcomes (Kivleniece & Quelin, 2012). On private sector side, on the contrary, the maximisation of shareholder value tends to collide with public interest (Bloomfield, 2006).

The institutional and value-related differences between public and private players have required 'contractual enforcement', which remains a critical element due to the information asymmetry between public and private partners and the investment specificities (Parker & Hartley, 2003; Teisman & Klijn, 2002). Furthermore, when PPCs translate into long-term contractual arrangements, it is crucial to find the right balance between completeness and flexibility (Klein, 1998).

Taking from these challenges we may argue that public-private collaborations can't work. The problem, however it is not the collaboration, but the lack of it. Too often partnership arrangements are transformed into standard client-supplier relations (Teisman & Klijn, 2002). Koppenjan (2005) argues in favor of a 'logic of connection': partnership ought not to involve only the delivery but also the planning phase, connecting interactions with broader decision-making procedures in order to create trust. Koppenjan and Enserink (2009) notes that governments often are ill equipped and ill prepared to regulate their collaboration with private sector. We may argue that also the private sector too often lacks the skills and competencies to understand and manage the relation with government for the creation of social innovation.

In order to make these collaborations work we need a better alignment of public and private interests, leveraging respective differences and strenghts in order to pursue policy goals. Impact investing business models can be, therefore, the veichle to create new forms of PPCs, by overcoming the drawbacks of the traditional PPP, as described above.

Conclusions

Even if it may be "*tough to serve two masters*", as Warren Buffet[10] stated about taking into account not only financial performance but also social performance, in this scenario Impact Investing represents not only an investment approach to generate new private business models but also an approach to reconceive public-private collaborations to increase the social value generation.

As noted by Kivleniece & Quelin (2012) a deeper effort to understand the exact value creation mechanisms in public-private ties is still needed. Therefore, from now on it is important

[10] http://www.forbes.com/video/2886856992001/

that this new public and private relations evolve from being just a casual date to a relationship and ultimately to a marriage contract, which can be replicated and scaled.

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