THE ROCKEFELLER FOUNDATION: 
INNOVATIONS IN SOCIAL FINANCE

We only have about $200 million a year that we give in grants, and we have big aspirations and big ideas... Since 2005, if you include not just private capital but also capital from governments, we've leveraged $25 billion for resilience and $77 billion for impact investing from that annual dispersal. So we're always thinking about innovative finance mechanisms that add leverage.1

—Dr. Judith Rodin, President, The Rockefeller Foundation

When Dr. Judith Rodin became president of The Rockefeller Foundation in 2005, she identified a need to re-equip and re-organize the foundation to meet the challenges she saw emerging in an increasingly complex world. The foundation aligned diverse interventions, from helping cities prepare for climate change-related weather events and other challenges to improving health systems and reducing food waste.

However, Rodin also recognized that for philanthropy to make meaningful progress in solving the world’s biggest problems, it could not act alone. Certainly, philanthropic funds were significant and growing, reaching an estimated $373.25 billion in 2015 according to the Giving USA report, the highest total in the report’s 60-year history.2 However, these funds, even when combined with government financing and development aid, made up only a fraction of what was needed to address the world’s biggest problems (see Exhibit 1).

Rodin and her colleagues recognized that new financial products could be developed that would appeal to investors so that global capital markets could help fill this funding gap. The goal for

1 Interview with Dr. Judith Rodin, president, The Rockefeller Foundation, April 4, 2016. Subsequent unattributed quotes of Judith Rodin in this case are from this interview.

the foundation was not only to identify new financial products that could tackle social and environmental problems, but also to facilitate a process of innovation that would change the way capital could be mobilized for social impact. This led to the foundation’s role in catalyzing the field of impact investing.

A key element in the development of the foundation’s work on innovative, mission-driven finance was its commitment to support the development of social impact bonds (SIBs). Also known as pay-for-success or pay-for-performance contracts, SIBs created a new way of raising funds from private investors to pay for evidence-based interventions designed to solve social or environmental problems (see Exhibit 2). Initial investors would put up the capital to pay for the full cost of the intervention, as any philanthropist or donor might do. But underpinning SIBs were “outcome funders”—governments, international donors, or companies—who committed to pay those initial investors’ financial returns depending on whether the initiative or program achieved its goals. These returns came, in many cases, from the cost savings delivered to the outcome funder.

While great excitement surrounded the launch of the first SIBs, not all succeeded in meeting their goals. Nevertheless, the development of this new funding mechanism demonstrated that global capital markets—if equipped with the right investment tools and products—could provide previously untapped funding to take on some of the world’s most urgent and intractable problems.

AN EVOLVING APPROACH TO INNOVATION

The roots of innovation at The Rockefeller Foundation date back to its earliest years. Since its founding in 1913, the foundation frequently sought out new philanthropic approaches. “At the time, they called it ‘scientific philanthropy’ but really they were defining innovation,” said Rodin. “They were testing different solutions, taking risks with new ideas, adapting to changing dynamics, and supporting and scaling proven interventions.”

Rodin identified three different types of innovation that the foundation had pursued since its inception:

- **Funding the innovators**: The foundation provided funding and other resources—from offering fellowships to funding research on best practices—to the individuals working on world-changing social and environmental interventions. “Throughout our 100-year history, the type of innovation may have shifted, but the focus has always been on backing brains,” said Rodin. “We wanted to identify the innovators and the kinds of resources to give them so that they could flourish and have the space to innovate.” As of 2016, the foundation’s fellows and grantees had been awarded 24 Nobel Prizes.

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3 While the public and philanthropic sectors are the most common funders of SIBs, companies can also be funders. One example was the Mozambique Malaria Performance Bond, which aimed to address the funding gap for malaria interventions—and secured a $1.5 million commitment from the restaurant chain Nandos.

4 “Awards & Honors,” The Rockefeller University website; [http://www.rockefeller.edu/about/awards/nobel/#sidebar](http://www.rockefeller.edu/about/awards/nobel/#sidebar) (August 14, 2016).
Catalyzing movements: The foundation provided support for developments that could be transformative. “Whether creating a movement called public health, which settled into a 100-year field, or a movement called the Green Revolution, which fed 1 billion people, these were groundbreaking, innovative, and paradigm shifting,” said Rodin.

Leveraging strategic partners: Going beyond individual grants, the foundation deployed funding, expertise, and influence in partnerships with government, nonprofits, and the private sector in ways that allowed it to achieve more than the foundation could through grant making alone.\(^5\)

In 1919, for example, the foundation provided support for the National Research Council—a U.S. nonprofit institution advancing the pursuit of science, engineering, and medicine—to establish fellowships in physics and chemistry. The same year, it established a Division of Medical Education, which provided grants to medical schools in places such as North and South America, Western Europe, Southeast Asia, and the South Pacific. The grants were intended to increase the resources available to these schools to allow them to improve their teaching and research.\(^6\)

During the 20\(^{th}\) century, The Rockefeller Foundation was responsible for founding the modern field of public health, supporting urban sustainability (including funding the work of Jane Jacobs, the writer and activist who pioneered community-based approaches to urban planning). It also catalyzed the Green Revolution, a set of research and development initiatives that dramatically increased global agricultural production between the 1930s and the 1960s.

For Rodin, these examples modeled the continuous pursuit of innovation at the foundation, each using all three pillars she identified. These pillars, funding the innovators, catalyzing movements, and leveraging strategic partners, would also drive the foundation’s work in innovative finance.

**BUILDING THE TOOLS TO ACCELERATE INNOVATION**

While Rodin saw her efforts to promote innovation as a continuation of the foundation’s work, she recognized that changes needed to be made in order to increase its ability to innovate. “As we thought about innovation and what it could enable, we felt we had to be a different kind of organization with different kinds of people,” explained Rodin.

The first response was to start hiring experts who came from fields beyond philanthropy, global development, and academia, the three pools from which the foundation had traditionally sourced its human capital. In 2006, the foundation started to widen its recruitment net to bring in people from political life, experts with backgrounds in strategy, and professionals whose careers were grounded in innovation.

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At the same time as the foundation was expanding the diversity of backgrounds of its staff, it moved from a traditional siloed model of fixed programs to a flexible initiative-based approach. “We felt that problems of the hefty nature that we were trying to tackle didn’t land on the ground in convenient packages corresponding to The Rockefeller Foundation program areas,” explained Rodin. “That’s given us tremendous capacity to be both nimble and innovative as an organization because we’re not stuck in programmatic structures,” she added.

**IMPACTING INVESTING AND THE BIRTH OF INNOVATIVE FINANCE**

In 2007, at its Bellagio Conference Center in Italy, The Rockefeller Foundation brought together a group of entrepreneurs, philanthropists, and investors to discuss ways in which private capital could be put to work for social and environmental good. At this meeting, the term “impact investing” was coined to describe the broad range of investments that deliver social and environmental as well as financial returns. After a second meeting in 2008, the foundation’s Board of Trustees approved $38 million for use in the new impact investing initiative, which was established so that grants, program-related investments (PRIs), and non-grant activities could be used to help build an impact investing field.

Impact investment could take a wide range of forms. While it could include simple investments, managed individually or through specialist funds, the impact-investing field had expanded to include everything from bilateral loan agreements and private debt instruments to deposits, guarantees, private equity, and real assets (such as real estate, gold, or oil). For example, green bonds, which were developed in 2008 by the World Bank, allowed investors to put their money into projects designed to tackle the causes and effects of climate change, while generating a financial return.

The investment terms and structures of these financing mechanisms could be tailored to serve specific social functions or might resemble those in the mainstream investment world. Some might deliver market-rate returns; others were designed to deliver below-market returns but could also generate increased social or environmental impact.

In 2007, The Rockefeller Foundation began investing heavily in the development of the impact investing field and the infrastructure needed to support it. For example, it incubated the Global Impact Investing Network (GIIN), a nonprofit organization focused on increasing the scale and effectiveness of impact investing. GIIN did this by building critical infrastructure, including the Impact Reporting & Investment Standards (IRIS), a global reporting standard for measuring and communicating social impact, and ImpactBase, an online database of impact investment funds and products designed for investors.

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8 Program-related investments (PRIs) are investments foundations make to further the foundation’s social mission while also generating a financial return (often, although not always, a below-market return) that goes back into its programs or into other PRIs.
9 A bilateral loan agreement is one in which a borrower receives the complete loan from one lender (rather than in a syndicated loan agreement where the funding, and thus the risk, is spread across numerous lenders).
“We realized that there were lots of disparate efforts happening but we needed to help the field coalesce and build the infrastructure,” said Zia Khan, vice president for initiatives and strategy.10 “So we invested considerably in the infrastructure for impact investing, in supporting research and intermediary organizations, in making some of the first investments and, later, in supporting some of the policy work.”

SOCIAL IMPACT BONDS

Among the financing mechanisms that emerged under the broader umbrella of impact investing were social impact bonds.

What Are Social Impact Bonds?

While the term “social impact bond” suggested a bond, SIBs in fact were bonds only in the sense that they were a contract between an “outcome funder”—a government agency, an international donor, or, in some cases, a corporation—and investors, who supplied the initial capital to organizations providing social services. The outcome funder would then pay the investors back depending on how these services achieved the outcomes agreed upon in the initial contract. For this reason SIBs often were referred to as pay-for-performance contracts.

In a typical SIB, a local authority or government department identified an intervention that had proven successful in addressing a social problem such as prison recidivism, poor educational performance, or homelessness. The government agency then entered into a contractual agreement with an investor, a group of investors, or a financial institution such as a bank, which could raise funds from investors. Once the money had been raised, the government agency used it to pay for the intervention, which service providers with a proven track record of success would then execute.

The contract with investors set out the goals of the intervention, established points in time at which, if the goals had been met (according to assessment by independent evaluators), investors would be paid. Savings accrued in different ways. In the case of prison recidivism, for example, the cost of re-incarcerating prisoners would be calculated and the savings would accrue from a fall in recidivism. In the case of early childhood education, cost savings would be generated when fewer students fell behind, resulting in lower spending on remedial education.

Reducing Prison Recidivism in Peterborough, U.K.

The first social impact bond was developed in the U.K. to finance a pilot intervention called One Service that was designed to reduce prison recidivism at HMP Peterborough, a prison in the eastern British city of Peterborough. Since 2007, the U.K. government had been seeking new ways to pay for social programs. At the time, Social Finance—a nonprofit created in 2007 to develop a social investment market in the U.K.—started to adopt a new financing structure. This structure—a “contingent revenue bond”—enabled philanthropic funders to repay private

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10 Interview with Zia Khan, vice president for initiatives and strategy, The Rockefeller Foundation, April 4, 2016. Subsequent unattributed quotes of Zia Khan in this case are from this interview.
developers for projects in the developing world, if those projects demonstrated that they had generated positive social impact.\footnote{11}{Gabriel Kasper and Justin Marcoux, “Case Studies in Funding Innovation,” Deloitte Consulting LLP at the Monitor Institute, 2015, http://www2.deloitte.com/content/dam/Deloitte/de/Documents/Innovation/Funding-Innovation.pdf (August 20, 2016).}

Based on this principle, a SIB was developed, raising £5 million—with The Rockefeller Foundation as one of the major investors—to pay for a group of advisors to train and mentor short-sentence inmates (prisoners with custodial sentences of less than a year) before they left prison. The mentoring and training, which included providing job training and connecting the prisoners with services, had been proven to result in lower re-offense rates\footnote{12}{Ministry of Justice assessment paper, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/217392/peterborough-social-impact-bond-assessment.pdf (February 24, 2017).} than the average. At the time, about 60 percent of the adults on short-term sentences typically re-offended within 12 months of being released.\footnote{13}{U.K. Cabinet Office, Centre for Social Impact Bonds, April 2013, http://data.gov.uk/sib_knowledge_box/ministry-justice-offenders-released-peterborough-prison (February 24, 2017).}


In August 2014, the first results of the pilot were announced. According to the evaluation report, the program reduced reconviction rates among the first cohort of 1,000 ex-prisoners by 8.4 percent compared to the national average.\footnote{16}{“First Official Results Demonstrate Positive Outcomes at Peterborough,” Social Finance post, August 7, 2014, https://socialfinanceusblog.wordpress.com/2014/08/07/first-official-results-demonstrate-positive-outcomes-at-peterborough-3/ (August 20, 2016).}
Officials adopted intervention measures and rolled them out across the country’s prisons—a social change success. However, a change in government policy required the early termination of the Peterborough Social Impact Bond and meant that the third cohort was cancelled.17

**Reducing Prison Recidivism in New York State**

In 2013, another SIB was launched to reduce prison recidivism, this time in New York State. Foundations—including The Rockefeller Foundation—and private investors provided $13.5 million to pay for the training and employment of formerly incarcerated people.18 Through the project, the Center for Employment Opportunities, a New York-based nonprofit, targeted 2,000 individuals who were at high risk of re-offending after release from prison. The intervention provided these individuals with intensive employment training and work placement for a period of four years in Rochester and New York City.

Before investors could be paid, the project needed to reduce recidivism by at least 8 percent and/or the employment level among former convicts had to be raised by at least 5 percentage points. If the project achieved all performance measures, the public sector would achieve $7.8 million in savings.

To measure the program’s performance, the state of New York entered into a partnership with Chesapeake Research Associates, an independent assessor. Chesapeake Research Associates did not measure the performance but instead validated the measurement performed by the New York State Department of Corrections and Community Supervision Research Department.

Social Finance Inc., the U.S. arm of U.K.-based Social Finance, acted as the intermediary organization bringing the partners together, structuring the investment deal and supporting the effort to raise the capital. Social Finance Inc. and Bank of America Merrill Lynch partnered to raise $13.5 million from about 45 investors. Social Finance Inc. was able to direct a $1.3 million grant from The Rockefeller Foundation as a first-loss guarantee (providing financial cover against loss).

As of 2016, operational implementation was on track, including the key measure of enrollment and program engagement. However, because outcomes (and payments) were based on a three-year impact study, no results were to be available until the evaluation was complete and investor payments were made, something expected to occur in September 2017.

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Promoting Early Childhood Learning in Utah

At the Clinton Global Initiative America conference in June 2013, J.B. Pritzker, a venture capitalist, entrepreneur, and philanthropist, announced the launch of a multimillion-dollar investment initiative designed to make high-quality early education programs available to low-income children in the United States.

Pritzker believed that early learning helped reduce social and economic inequality by equipping students to advance through their schooling to higher education, enabling them to enter the workforce and succeed in their careers. For Pritzker, who as president of the J.B. & M.K. Pritzker Family Foundation made grants in support of research and programs targeting children from poor families, the SIB presented a new way of using private investment to increase the impact of government spending on education.

To structure the deal, Pritzker worked with Imprint Capital, a specialist impact investment advisor (acquired by Goldman Sachs in 2015). He took a subordinate position of $2.4 million to act as the catalyst for an investment by Goldman Sachs, resulting in a total investment of $7 million to be spent on placing high-needs children into high-performing preschools in Salt Lake City and Park City, Utah.19 Returns to the investors were to be based on the cost savings made as fewer students failed and more progressed through their schooling without needing special education.20

The project demonstrated positive results. Of 110 four-year-olds who had previously been identified as likely to need special education in grade school, only one went on to use special education services in kindergarten. Because fewer children required special education and remedial services, school districts and government entities saved $281,550 in the 2013-2014 school year.21 The results triggered the first payment to investors for any SIB in the United States, with investors receiving a payment equal to 95 percent of these savings annually per the terms of the SIB agreement.22

FROM SOCIAL FINANCE TO OUTCOMES-BASED FUNDING

The Rockefeller Foundation became a key supporter of SIBs in their early days, deploying $10 million over a three-year period. “We started looking at feasibility studies and holding convenings to try to get various players on the same page and that turned into a full-blown

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19 By taking a subordinate position an investor accepts a higher level of risk and a smaller share of any financial returns in order to attract commercially-focused capital that otherwise would not be invested.
strategy,” explained Kippy Joseph, associate director for innovation.23 “We invested in creating an ecosystem that would allow social impact bonds to be tested in the U.S.”

For the foundation, it was important to intervene while SIBs were beginning to attract investor interest in order to prevent badly structured deals from stifling the market’s growth. “We developed a strategy based on mitigating risks,” said Joseph. She was particularly concerned by the risks presented by poorly run pilot projects and an overreliance on traditional capital pools and PRIs.

The foundation used its funding for SIBs in several ways. Part of this involved creating and disseminating information and funding experts to write policy briefings. It also funded intermediaries. For example, in 2009, it started funding U.K.-based Social Finance. And in 2011, it made a grant of $500,000 to Social Finance to help introduce SIBs in the United States. It also provided anchor investments in SIBs that paved the way for other investors to join. In the Peterborough SIB, for example, it did this by using PRIs. And in 2013, it supported the New York recidivism SIB with a first-loss guarantee, which reduced the risk for and helped attract impact investors to the deal.24 “All of this was to create a robust environment in which SIBs could be appropriately tested,” said Joseph.

Tracy Palandjian, CEO and cofounder of Boston-based Social Finance Inc., stressed the importance of The Rockefeller Foundation’s role as an investor in early deals such as the state of New York’s recidivism SIB. “Their participation by providing that first loss-of-credit enhancement [or first loss guarantee] was hugely significant for the development of that deal,” she said.25 The foundation felt that putting its brand and public support behind SIBs was indispensable to investors and service-providers alike.

For the foundation, three aspects of the new funding mechanism were of interest, explained Antony Bugg-Levine, who as managing director at The Rockefeller Foundation from 2007 to 2011 designed and led the foundation’s initiative on impact investing.26 “There was the whole angle of making governments more evidence-based and focused on preventative services. And there was the angle of helping nonprofit organizations get the money they needed,” he said.27

However, it was the third element of SIBs that was of most interest to The Rockefeller Foundation, explained Bugg-Levine, who by 2016 was chief executive of the New York-based Nonprofit Finance Fund. “It was the idea that this could be an instrument that helps put for-

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23 Interview with Kippy Joseph, associate director for innovation, The Rockefeller Foundation, May 18, 2015.
24 First loss guarantee is a policy to ensure that a particular investor covers any losses, up to a predetermined point. This is a risk mitigation strategy that firms like Social Finance UK have used to incentivize other investors to view the terms of a SIB more favorably. If an investment loses money, the first loss guarantee stipulates that the initial money lost must come from that investor.
25 Interview with Tracy Palandjian, CEO and cofounder of Social Finance (US), March 25, 2016. Subsequent unattributed quotes of Tracy Palandjian in this case are from this interview.
27 Interview with Anthony Bugg-Levine, chief executive of the Nonprofit Finance Fund, June 19, 2015. Subsequent unattributed quotes of Anthony Bugg-Levine in this case are from this interview.
profit investment capital to work for social goals. So we decided to make a set of grants to make that happen and it was in that context that we got into SIBs generally.”

By 2016, more than 60 SIBs had launched in 15 countries, raising more than $200 million in investment to address social challenges. All but one of the 22 projects posted results demonstrating positive outcomes for beneficiaries.28

Of the four SIBs that fully repaid investor capital, two also provided an additional return on investment:

- The New South Wales Child and Family Welfare (UnitingCare Burnside) project in Australia. As of June 2015, investors in this project had received an 8.9 percent annual return based on the performance of the first two years of the project.
- The U.K.’s Department for Work and Pensions (DWP) Innovation Fund SIBs, Tomorrow’s People (UK) (No published data were available on the rate of return.)

The other two projects that fully repaid investor capital were ongoing (both of them were part of the U.K.’s DWP Innovation Fund). As of 2016, both were expected to provide returns beyond the initial investment.

While only four projects thus far had repaid investors in full with a return on their investment, Palandjian pointed out that the long-term nature of the deals meant that they needed more time before payouts could be made. “It’s hard to define success,” she said. “These financings are 5 to 10 years off, so nothing has completed its entire lifecycle.”

Another early SIB—used to fund the New York City Adolescent Behavioral Learning Experience (ABLE) Project for Incarcerated Youth on Rikers Island—did not meet its initial goals, nor was it able to make any payments to investors.29 However, Palandjian said that the Rikers Island project had demonstrated the importance of SIBs in allowing governments to fund innovation (and therefore take risks). “Rikers Island was a huge success,” she said. “Yes, it didn’t hit the target and, yes, the project was terminated—but that’s how the mechanism is intended to work. If we don’t hit the mark, taxpayers don’t have to pay for anything.”

When he first encountered SIBs while at The Rockefeller Foundation, Bugg-Levine recognized that this lack of risk for taxpayers was the real advantage of SIBs as a funding mechanism. “It was a way for investors to participate,” he said. “But what was really interesting was what it did to the politics of preventive services. Given how constrained budgets are for all governments, they don’t have money for everything and when things get cut, it’s hard to preserve political support for spending on, say, helping prisoners stay out of prison.”

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SIBs enabled innovative ideas to be tested at no cost to the taxpayer. For example, the success of the Peterborough pilot, even though it was terminated early, influenced a wider policy change with the launch of the U.K.’s Transforming Rehabilitation program, which extended rehabilitation services to offenders across the U.K. By creating savings that could be shared with investors, the SIB mechanism could harness private sector funding for social innovation. “The genius of it is what it does in shifting risk away from taxpayers and towards investors,” said Bugg-Levine.

However, he also stressed the importance of SIBs in creating a change in thinking towards outcomes-based funding and evidence-based policymaking. An example might be a homeless shelter, he said. Instead of paying a service provider an annual fee to house homeless people, the SIB structure could incentivize that service provider to reduce homelessness by paying a fee for each person transitioning out of the shelter.

Looking back, Bugg-Levine warned against the danger of focusing on SIBs merely as financial instruments. “There’s a danger in fixating on the narrow social impact bond because it’s so complex, the transaction costs are so high, and it’s so easy for deals to go awry,” he said. “But [SIBs] showed that there are these much wider opportunities to think more creatively about how we finance results and outcomes.”

THE FUTURE OF INNOVATIVE FINANCE

While The Rockefeller Foundation’s formal focus on SIBs ended, this experimental form of funding continued to be part of the institution’s broader exploration of innovative finance. “Once we had the SIB demonstration and were ready to exit the impact investing space as a field builder, we moved the rest of our work into the innovative finance space,” explained Rodin.

The foundation’s next innovative finance portfolio, called “Zero Gap,” worked to develop new financing mechanisms to mobilize large pools of private capital, by identifying and supporting innovations that have the potential to create outsized impact. Zero Gap continued to support early-stage financing solutions that, by deploying relatively small amounts of governmental funding, had the potential to tap into large-scale capital from institutional and retail investors. Innovative financing mechanisms under exploration in 2016 included:

- Developing a micro-levy financing model—placing small taxes on extractive industries to generate income to reinvest in the local economy—that would create a large and stable source of funding to combat chronic childhood malnutrition.
- In partnership with African Risk Capacity, an agency of the African Union, developing the Extreme Climate Facility, an African-led effort to access private capital to diversify and increase the amount of international funding available for climate change projects in Africa.  

• Funding the development of a forest resilience bond to channel institutional capital toward deforestation to both reduce severity and frequency of wildfires and increase the quality and quantity of water yields.31

By 2016, The Rockefeller Foundation was not alone in finding new ways to deploy its philanthropic capital. Rodin reflected on some of these changes:

There are lots of shifts in philanthropy. Some are thinking about how to use their balance sheet creatively. Some are taking more risk capital out of their endowments. Some are thinking about bulking up their PRI portfolios so that they can make a different set of investments than grant making alone could have done. Others are breaking down the barriers between grant making and investing and trying to use whatever source of capital is best. So we’re seeing a lot of experimenting and we’re going have a lot of field lessons over the next several years. But we like to think that we got all this started.

CASE QUESTIONS FOR STUDENTS

• How did the approach to innovation change at the foundation under Judith Rodin’s leadership—and in what ways was it a continuation of past traditions?
• What were the different strategies the foundation used to support the development of social impact bonds?
• Why did the foundation see the promotion of innovative finance as such an important part of its work?

Exhibit 1
Where Investment Capital Lives

Exhibit 2
Social Impact Bond Structure