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## ON THE FIRST ISSUE OF THE EUROPEAN JOURNAL OF PUBLIC PROCUREMENT MARKETS

Launching a new scientific journal requires a word of explanation on its *raison d'être* and objectives and in this case both are quite simple and clear to share with our new readers.

Modern economies have evolved from the paradigm of Industrial Society, commonly accepted until the fifties, to a Market-based Society which is now served by the conspicuous innovations of the Digital age. The traditional field of Economics on Industrial Economics has been progressively paralleled by the study of the most important markets, such as Food and Beverages, Transportation, Commodities such as Cotton or Cocoa, ICT, Security, Insurance, Banking, Tourism, Education or Health.

Nowadays, public markets are one of the most relevant *loci* of exchange, as Governments expenditure is steadily increasing and a higher percentage of it is allocated to the acquisition of goods, services and public works, the so called “public procurement”, which accounts for more than 18% of the European Union GDP.

Public markets are not just important in economic value. The diversity of public authorities implies that the public sector ends up acquiring virtually any good, service or construction, affecting the dynamics of those markets, also because of the social, environmental and employment relevant impact, as it is well known since the classical studies of Keynes or Baumol.

All of the above implies that any contract of public procurement has always a twofold objective: fulfilling the direct needs of the public contracting authority but also generating externalities that must be aligned to the public policies to be pursued at the national and European Union level (e. g. the EU 2020 Agenda). Obviously, this latter objective gains higher importance during hard times due to financial crises or the postponing of public objectives as it has been the case of Europe since the crisis of 2008 and the increase of internal tensions within EU. So, not surprisingly, the new EU Directives on Public Procurement - rather than on the coordination of processes for the acquisition of goods, services and works as it was the case for the previous Directives - are quite clear about their new scope, the functioning of public markets, and their objectives, aligning public procurement with the EU2020 roadmap.

To analyze critically and empirically these new challenges it is by now obvious one needs the contribution of scholars from a wide range of disciplines – among them Economics, Public and Competition Law, Public Management, ICT, Decision and Social Sciences. To develop such an interdisciplinary approach, together with the understanding and the improvement of the functioning of public markets, this journal is launched. Obviously, several existing journals in relevant areas such as Public Law or Public Economics can give useful contributions to such challenges, but the EUROPEAN JOURNAL OF PUBLIC PROCUREMENT MARKETS is the very first European and interdisciplinary journal embracing the wide range of disciplines and issues that have to be considered to achieve the presented objectives.

We believe that the focus and the merit of the papers selected for this first issue, after careful revision, are a good illustration of the nature of this new journal.

Enjoy the reading and consider the JOURNAL for the publication of your future procurement research!

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# The Amagasaki Pilot Social Impact Bond in Japan -Participation of SMEs in Public Markets-

Shinji Hosomi

## Abstract

Social Impact Bond (SIBs) attracts massive attention recently not only by major enterprises, but by SMEs in Japan to solve the social problems. This paper analyzes the first SIBs case on youth employment support in Amagasaki, Japan as well as the first SIBs case in Augsburg, Germany. Further, it considers the entry of SMEs that are familiar with local fields and circumstances to realize public-private partnerships and examine the possibility of their participating into the SIBs in Japan. SIBs invite the process improvement of the public procurement. Across SIBs, participation of SMEs in solving social problems conforms to the growth strategy of the Japanese government, and as a result to contribute the process improvement of public procurement.

## Keywords

Social Impact Bonds (SIBs); Youth unemployment; SMEs; Amagasaki; Augsburg, Public procurement

## 1. Introduction - Social tasks common to advanced countries

In Japan, the employment environment for youth has deteriorated since the late 1990s, and the reports on NEET and withdrawal have increased significantly. According to the data released by the Cabinet Office<sup>1</sup> in June 2017<sup>i</sup>, there are 770,000 unemployed in 15-39 years old, which is 2.3% of the population in this range. The economic downturn in the Japanese economy is said to be “Lost 20 years”, incurred a style of irregular labor, which led to a rapid increase in temporary workers. Further, new graduate students who dropped out of job hunting couldn’t get on the rail of society successfully, which resulted in one of the causes of increasing temporary labor force as well. Although the employment environment has been recovering in accordance with improving economic situation over the past few years, regular graduates who were unable to ride on the rails are still in a higher range. So far, Japanese government has taken various employment support, few of which led to the satisfying result of declining the number of young unemployed. In other words, a new unemployed are born every year. In general, withdrawal has been considered as a phenomenon peculiar to Japan, while according to newspaper<sup>2</sup>, similar phenomena have been reported overseas for example in Italy, isolating from the society. In the severe financial situation, the central and local government is seeking support for living reconstruction by early intervention. It is considered effective for private enterprises having good level of knowledge to support in the early stage. Collaboration based on the framework of public-private partnership has been planned, and SMEs familiar with the real circumstances of the region are likely to be able to participate in the public market as the key players of SIBs.

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<sup>1</sup> Cabinet Office, Government of Japan, accessed at [http://www8.cao.go.jp/youth/whitepaper/h29honpen/pdf/b1\\_03\\_02\\_01.pdf](http://www8.cao.go.jp/youth/whitepaper/h29honpen/pdf/b1_03_02_01.pdf) (20 Dec 2017)

<sup>2</sup> Yomiuri Shimbun newspaper dated 31<sup>st</sup> August 2017, World in depth, Increasing Hikikomori (withdrawal) in Italy

## **2. Social Impact Bond**

### **2.1**

SIBs is a kind of payment by results (PbR) typed public contract model. It is a form of partnership involving public and private entities (governments, investors, procurement organizations, NPOs, social enterprises, intermediately). In the definition of OECD, SIBs is a type of PPP, and social services are supplied by PbR scheme, where government, foundation, companies are joined as procurement players.

### **2.2**

Why can SIBs contribute to solve youth unemployment problems? It may be able to explore a part of cause by the social problem solution approached under government control exclusively in the past. A government project might end up regardless of the effectiveness of the outcome. Even the high project costs are incurred, continuation is guaranteed. Further, compensation for the project is paid to the activity itself by the party, not to the expected outcome. By adopting performance oriented approach to improve the unemployment problem, there is some expectation that improvement of activity would be aimed at better outcome. To solve the unemployment problem of young people, it is considered significantly to introduce and learn from the business management method.

### **2.3**

There are three types of contract forms. The first one is a direct contract type, between the government and the service provider. The second one is a SPV contract type between government and investor owned SPV, and then the SPV is a two-tier contract with a service provider. The third one is an intermediately contract type. Contract between government and intermediately, and plus the intermediately contracts with the service provider. (Bridge Impact + 2014: 20-23)

Regarding the contract type, if the target value would not be achieved, the investors might lose everything they spent including the principal. It is a high risk type. The other is the type that a mid-time outcome (output quantity) is set up and is paid for the achievement step by step.

## **3. SIB case in Japan**

### **3.1 Background**

In 2015, the pilot project was implemented to support young people with withdrawal of welfare households in Amagasaki, Japan for employment support. Due to severe financial situation by local authority, this project was programmed supporting by Nippon foundation. Amagasaki city was ranked the 4th worst welfare recipient nationwide, according to the data by the Ministry of Health, Labor and Welfare. It is in the urgent issue to reduce the expenditure. Amagasaki, located between Osaka and Kobe, has been playing an important role of the reconstruction and prosperity after the World War II. The Hanshin (Osaka-Kobe) industrial area was formed in the Osaka gulf, where the heavy chemical industry cluster has been built in Amagasaki. In the period of high economic growth era in Japan, they faced a shortage of labor force and implemented measures such as free nighttime school for promoting domestic immigration from the rural area in the other region. As a result, Amagasaki became a big capacity of immigrants from western Japan. In 1974, the population of the city exceeded 550,000, growing to the 12<sup>th</sup> scale in the whole country. However, due to subsequent shift of Japanese industrial structure and withdrawal from factories, the population has continued to decline, and as of December 2017, it is 451,095, decreased by 100 thousand from the peak, with ranking the 37<sup>th</sup> in Japan. What is more serious thing nowadays is the fact that the people on welfare are the worst 4<sup>th</sup> place, as mentioned. Workers who lost the jobs due to the withdrawal of

the factory cannot reconstruct their living. They become a day-to-day living and have no alternatives other than to receive welfare from the municipal.



Figure 1: Location of Amagasaki

### 3.2 SIB contents

A SIBs project has been launched to increase employment with implementing a visit support program targeting young people in living welfare households. The Nippon Foundation provided the fund, and the city selected the target person with the caseworkers. The NPO "Training Net" was appointed to the approach as the service provider. As a project evaluation advisor, Musashi University in Tokyo was assigned to review the process and results. The scheme was supposed to improve employment of 6 employees and 4 possible employees out of 200 candidates. The cost reduction effect was expected at 13 million yen<sup>3</sup>, assessing the benefits resulting from the reduction in welfare expenses and income tax payment, while the total project cost was set at 13 million yen, almost the same amount. One year after the program, the results of the project were far from satisfying.

Why did it fail? Firstly, there were only 20 people to be approached for visit support, only 1/10 of the population. In the first stage of listing the target, the city staff had no appropriate data, and it was necessary for them to provide the data arrangement. Then, the caseworkers were slow in submitting the list, because it took time to sort out the target who accepts the visit support. Each caseworker has different view angle individually so that it was difficult to make judgement on who should get the specific support. With various factors i.e. material preparation, differences in caseworker's judgment and etc., the initial activity were slow decisively, and as a result, only 20 people were listed finally. In addition, it took time consuming to agree and execute processes such as support process, information and budget control.

### 3.3

Regarding the process of public procurement, the Nippon Foundation was responsible for the role of investors as this project is positioned as social experiment to penetrate SIBs into Japan. Also, the contract type was executed in a high risk type without taking measures such as setting an intermediate outcome. Investors have played the role of the Nippon Foundation as well, who is the famous philanthropy organization over half century. In this project SMEs are not involved. On the other hand, there are many SMEs in the area who seek the social contribution. The issue is that lack of guideline in terms of fund management as to where and how to invest. There is the good traditional culture in Japan that a lot of fundraising is to be gathered once the purpose is clearly shown. In that respect, it can be said that recognition of SIB's and contribution to solving social problems is important for SIBs.

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<sup>3</sup> Social Impact Bond Pilot case (Oct 2016) issued by Japan fundraising association, accessed at <https://www.nippon-foundation.or.jp/news/articles/2016/img/63/4.pdf> (22 Dec 2017)

### 3.4 Setting outcome

The fact that the number of visit support target decreased from 200 anticipated to 20 was a painful disadvantage to achieve the target. It is obvious from the case of Amagasaki that we made benchmark numerical values exceeding costs related to implementation in benefit calculation. Concerning the expenditure, the benefit is raised to 13,268,548 yen against the total project cost of 13,000,000 yen. In order to calculate the benefit, achievement targets of 6 workers and improvement of work possibilities of 4 people are set. The outcome goal is considered to be the benefit calculation estimating the total project cost. If the benefit target is less than expenditure, it does not meet the real purpose of SIBs. While the benefit target greatly exceeds target value, it means that the target value may be set too high, to be difficult for reimbursement. It is necessary for the stakeholder to draw up the appropriate target amount based on the purpose and difficulty of the project, proficiency of the service provider, etc. while examining the outcome goal in the future and at total project cost.

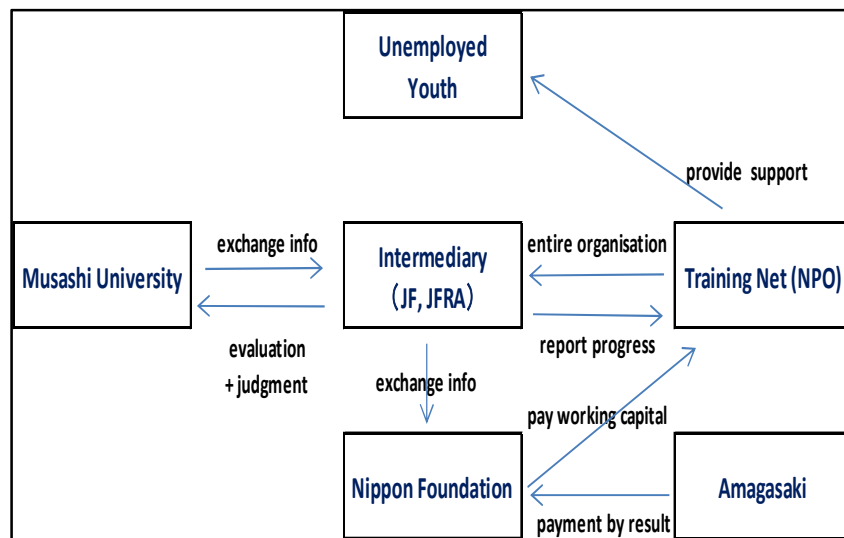


Figure 2: Amagasaki's SIB's stakeholder relationship chart.

(Source: Constructed by author, referring to <http://www.nippon-foundation.or.jp>)

### 3.5 Chapter Summary

The Amagasaki case is the purpose of accumulating knowledge as a pilot for the future model. Regarding outcomes, the target figures were not reached during the pilot period. However, after evaluating the usefulness of the initiative, the city decided to continue the project by own budget after the SIBs period ended. Although it did not achieve the numerical target as a pilot case, it is considered to be connected at the next stage. This suggests that SIBs will be applied to public procurement in the future. Another possibility is the role of social enterprises as investors. Further, if the attractiveness as an investment market increases, the possibility of fund investment is sufficiently considered even for SMEs. This is nothing other than SMEs participating in public procurement activities. Hence the advocacy activities to raise this momentum are important.

## 4. A case of SIB of Augsburg, Germany

In October 2013, as the first project of the Continental Europe, SIBs of youth employment support was constructed in Augsburg, Germany. Augsburg is an industrial city located 80 km northwest of Munich, with a population of ca.260, 000 and the third largest population in Bavaria. Curiously,



Amagasaki and Augsburg signed a partnership city agreement in 1959<sup>4</sup>, because of the connections between Rudolph Diesel, inventor of diesel engine and YANMAR Diesel of Japanese Company. Mr. Diesel's father came from Augsburg, and factory of YANMAR Diesel was built in Amagasaki. It is the first partnership city agreement between Japan and Germany, which has already 59 year history since then.

Augsburg's SIBs was set as a target for unemployed young people under 25 years old to work for 20 or more people in the city, including practical training, to work in the city for over 9 months, and to join the social insurance. Four NPO were participated as the service providers. Although the investment amount is not disclosed, the redemption interest rate is set to ca. 3%.<sup>5</sup>

Augsburg showed 21 people out of 100 achieved goals, the project was successfully completed, and the investment amount agreed upon was redeemed. In addition, the four investors made another social project with the return utilized with the Augsburg case, which was wise spending of funds.

The result in Augsburg was contrary to that in Amagasaki. What is the difference between the outcomes of these two cities? One reason is that the target setting and the length of the project. Amagasaki's case seems to be more challenging because they try to reach for the withdrawal (“Hikikomori” in Japanese word) among unemployed people. On the other hand, in Augsburg case they approached unemployed people who are not engaged in job hunting. The level of difficulty might be different. In addition, Amagasaki project ran only one year for the implementation period, while Augsburg project ran two years three months. It is obvious that the difference of the period affected the actual outcome.

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<sup>4</sup> Augsburg accessed at <http://www.augsburg.de/buergerservice-rathaus/rathaus/internationales/partnerstaedte> (20 October 2017)

<sup>5</sup> Juvat accessed at [http://www.benckiser-stiftung.org/content/5-blog/75-ziele-erreicht-der-erste-deutsche-social-impact-bond-ist-abgeschlossen/overview\\_finalization\\_SIB\\_germany\\_en.pdf](http://www.benckiser-stiftung.org/content/5-blog/75-ziele-erreicht-der-erste-deutsche-social-impact-bond-ist-abgeschlossen/overview_finalization_SIB_germany_en.pdf) (latest connection 20 October 2017)

Incidentally, there are multiple investors and evaluators as subjects, but the fact is that the second SIBs is not programmed yet in Germany. As an important subject in public procurement innovation including establishment of SIBs, issues of human resource development and benefits attributable to municipalities are raised. As a result, municipalities do not get motivated by the mechanism in which benefits are brought to the central government beyond the municipality. It is quite important to undertake the resolution in order to promote public procurement by SIBs.

Place	Amagasaki, Japan Population ca. 450,000, budget pa \$ 285 mil.	Augusburg, Germany Population ca 260,000, budget pa \$ 98 mil.
Timeline	07/2015 - 06/2016 (1 year)	9/2013 – 12/2015 (2 year 3 months)
Investment	ca. \$ 110,000	ca. \$ 330,000
Target group	Unemployed adolescents in Amagasaki under the age of 15 - 39 years old with household on warefare	Unemployed adolescents in the Augsburg region under the age of 25 years old
Outcome founder	Japan foundation on behalf of Amagasaki	Bavarian state Ministry of Labour and Social Affairs and Family and Integration
Service provider	Sodateage net (means training net)	1. programs over the last two years before being in touch with the project 2. Education Management Augusburg 3. Child and Youth Services Hochzoll 4. Joblinge
Intermediary	Japan foundation / Japan fundrasing	Juvat
Invester	Japan foundation	1. BHF-BANK Foundation 2. BonVenture (a social venture capital fund) 3. BMW Foundation Herbert Quandt 4. Eberhard von Kuenheim Foundation - the Foundation of BMW AG
Evaluation / Monitor	Musashi University	1. Dr. Mohren & Partner(low office) 2. Faculty of Economic and Social Sciences at the University of Hamburg
Target	6 of 200 candidtes target start working, and another 4 working to be	20 members of the target group - into an apprenticeship or gainful employment (in both cases subject to social insurance) - for more than 9 months - in the city or district of Augsbug, or the district of Aichach-Friedberg
Return to investot	not setting	max. 3%
Result	Not achieved	Achieved and return for investor

Figure 3: SIB comparison with Amagasaki and Augsbug (JUVAT)

## 5. Participation of SMEs in public procurement

SIBs is a public procurement mechanism with public utility of solving social problems. It is possible to join the scheme for the private sector as investors from the viewpoint of CSR. If SIB is viewed as the financial product, it requires some more argument to forecast the risk of the investment. Measures to attract investment by appealing “social aspects” contribute to the solution of the fundraising.

SMEs who know the region well have a significance of existence as SIBs players. Especially service providers familiar with local circumstances are able to participate as players to solve social problems. Regional financial institutions (e.g. regional bank) can form a bond and be at the forefront of fundraising. As an implementing player, local NPOs with skills of visiting support can enter the framework as a service provider. Comparing Amagasaki and Augsburg cases, the difference of success and failure was said to be the target setting and the length of period, furthermore the service provider in Amagasaki was alone, and Augsburg had four NPOs. In addition, the evaluators also have multiple in Augsburg. A variety of methods and perspectives are born by multiple stakeholders' efforts, and there is a high possibility that best practices would be exchanged. The expected effect of collective impact among stakeholders may come out. It is highly significant that Japanese SMEs enters into the public procurement market, such as NPOs and local financial institutions. SIBs is likely to become a gateway to the public procurement market in Japan.

There are two possibilities to be considered participating SIBs by SMEs. One is the public procurement by the social enterprises. The number of Social enterprises in Japan count ca. 200,000, among which NPO accounts for 1/4. Although it confronts various social problems, the source of the activity often relies on donations and subsidies, and weakness of fund procurement aspect has been pointed out for a long time. If the way of financial resources is secured through participation of SIBs, activities of these SMEs are expected to expand massively based on the stability of the financial base. Another possibility is the role of social enterprises as investors. If the attractiveness of investment market increases, then the possibility of fund investment for SIBs is sufficiently considered even by SMEs. Last but not least, the advocacy activities to mention about the public innovation by SMEs' participation into SIBs are significantly important.

## 6. Final remarks

Regarding the process improvement of public procurement, SIBs is categorized as private outsourcing project, although the municipality pays fee to the service provider according to the outcome and evaluation, the mechanism that the compensation increases or decreases with its evaluation is new in the public procurement field. If the outcome is poor, the compensation would decrease and the investment yield will also decrease, so service providers will have discipline for improvement. This “discipline” is the source of driving force. The method started in Europe will brought to Japan, but first of all, in order to take root in the private consignment mechanism linked with outcome, a broad framework is developed by forming with public and private sectors as well as forming in which SMEs can participate. Especially in Japan, there are so many SMEs, with 3.81 million companies<sup>103</sup>, accounting for 99.7% of the total. In addition, when measured by added value of manufacturing industry, SMEs account for 142 trillion yen<sup>104</sup>, accounting for 51.2% of the total. Apart from the macro figures, for example, having a look at the convenience stores opening with 24/7 service, they are nowadays the security infrastructure in the region, with over 56,000 stores nationwide. There are a lot of opportunities for small companies to be active in various scenes. Utilization of diverse entities is also a pillar of growth strategies by Japanese government. In the

<sup>103</sup> The small and medium enterprise agency accessed at [http://www.chusho.meti.go.jp/sme\\_english/index.html](http://www.chusho.meti.go.jp/sme_english/index.html) (latest connection 25 February 2018)

<sup>104</sup> 142 trillion yen = ca. 1.09 trillion Euro

field of public procurement, the author would like to conclude the participation of SMEs in the new public framework called SIBs is further required and activated.

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