Promoting *Spirited* Nonprofit Management Summer 2013 $14.95

The Nonprofit Quarterly

New Gatekeepers of Philanthropy

Sargeant on Donor Retention

Miller on "Enterprise Capital"

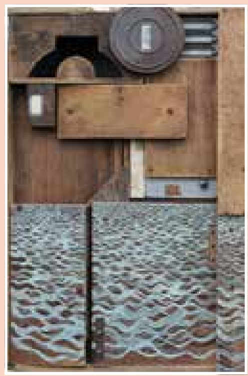
Scanlon on Strategic Philanthropy

Volume 20, Issue 2

THE Nonprofit QUARTERLY

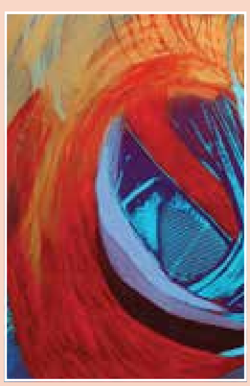
Summer 2013

Features



Page 6

Page 12

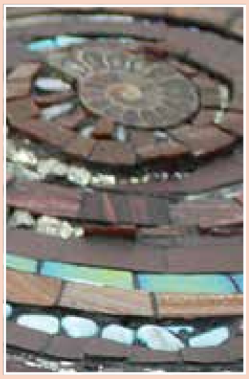


Page 30

Special Section

COVER DESIGN BY KATE CANFIELD

COVER ART: "NEW FOUND LAND" BY CATHY DREW / WWW.CATHYDREW.COM.AU IMAGE © PETER RICHWELL FINE ART; INQUIRIES PETERRICHWELL@GMAIL.COM



Page 50

Page 74

Features continued . . .

The Nonprofit Quarterly

www.npqmag.org

The *Nonprofit Quarterly* is published by Nonprofit Information Networking Association, 112 Water St., Ste. 400, Boston, MA 02109; 617-227-4624.

ISSN 1934-6050

Nonprofit Information Networking Association

Ruth McCambridge, Executive Director

THE Nonprofit QUARTERLY

Editor in Chief
Ruth McCambridge

National Correspondent
Rick Cohen

Senior Managing Editor
Cassandra Heliczer

Contributing Editors
Kate Barr, Jeanne Bell, Jon Pratt, Lissette Rodriguez

Online Editor
Jason Schneiderman

Web and Communications Associate
Aine Creedon

Graphic Design
Kate Canfield

Production
Matt Mayerchak

Administrative Coordinator/Customer Service
Megan Sampson

Copy Editor
Elizabeth Smith

Proofreader
James Carroll

Interns
Laura Auketayeva, Julia Miller

Advertising Sales
617-227-4624, advertising@npqmag.org

Subscriptions: Order by telephone (617-227-4624), fax (617-227-5270), e-mail (subscriptions@npqmag.org), or online (www.nonprofitquarterly.org). A one-year subscription (4 issues) is $49. A single issue is $14.95.

Welcome

Dear readers,

This edition of the *Nonprofit Quarterly* has been fascinating to patch together, because there is so much that is still a moving target where the new landscape of philanthropy is concerned. We almost feel like we should label this Part I—soon to be followed by a Part II—because although we have covered some major new philanthropic developments in a fairly thorough way, there are at least that many more that need to be explored.

So let me, for a moment, discuss the title of this edition: "New Gatekeepers of Philanthropy." Why are we discussing philanthropy in terms of "gatekeepers?"

Quite simply, the entry points and requirements for being funded are shifting in any number of ways. As one example, we are moving away from having a number of combined funds developed from pooled donations in our communities, and returning to an approach that has us more often in direct (albeit sometimes digital) contact with individual givers. And our task is to get a designation directly from them about who and what is to be supported/funded. This then requires that we are on our games in acquiring and sustaining strong multiple relationships with potential givers, even while they are being exposed to ever more opportunities to involve themselves and give away their charitable dollars. This backs into some other organizational requirements, like the ability to engage volunteers as ambassadors and to create a community of activists around what we do and a living out of a brand that embodies integrity and effectiveness.

This would require us to be responsible to the multitudes.

In that context, we have an article in this edition on the growing importance of donor loyalty and the practices associated with it. We also have a discussion on how to get the attention of self-made business people through financial advisors, and a thorough discussion of the fast-growing phenomenon of donor-advised funds.

But on the other side of the spectrum, many large foundations have no such "market" to which they need to be responsible. Some very large, iconic foundations have boards whose members you can count on one hand—with fingers left over. Set against that background is an article protesting the tendency of many foundations, under the rubric of strategic philanthropy, to narrow their grantmaking to reflect a very particular strategy. This, the author says, shuts down the interactive learning between the foundation and the field, starves grassroots action, and stifles creativity.

In short, we have nonprofits that are becoming increasingly driven by their markets and philanthropy that increasingly is not—except by conscious choice. Again, there is much more to do to provide a close to complete scan of this changing field, but we hope that what we present here resonates and informs.

The Nonprofit Ethicist

by Woods Bowman

It is a bad idea for an active member and volunteer to position him- or herself as paid consultant to a struggling organization. If you are connected to an organization in flux and want to help, join a committee to hire a disinterested consultant. As the Ethicist rhetorically asks, "You wouldn't consider being your spouse's therapist, would you?"

Dear Nonprofit Ethicist,

Can you advise me about the legal and ethical implications of the following? A member of the board of directors at a nonprofit agency serving foster and adoptive children and families is applying for an ED position. This board member is closely linked to the agency, being both a daughter of the founders (the organization was founded forty years ago) and a board member (for more than three years now, and very active on the board). I am wondering if there are mandates that prevent this from taking place, and, if so, what they are. If the board member were to resign from her board position, would it be a different situation? It seems there is a conflict of interest here, but if she were to leave the board at this time, is there?

Doubtful

Dear Doubtful,

It's a conflict, all right. The problem is not cured by the candidate's recusing herself from the discussion and the vote. A voting majority of a board is necessary to select an executive director. If Ms. Founder's Daughter loses, she will blame every member for her loss, which will poison the air in the boardroom for a long time. If she is confident that she is the best candidate for the job, she should resign her board position. Then, should she lose, she and the board can reunite by mutual consent if they are still friends.

The Ethicist will go one step further. It is not a good idea for her to be a candidate under any circumstances. Arguably, the most important job of a board is to hire and fire (if necessary) an executive director. This function is compromised when a board chooses one of its own for the top job. Additionally, after the fact, things are more likely to go haywire under an executive director who was a former board member and scion of the agency's founder, because the board might be unwilling to exercise independent judgment.

Dear Nonprofit Ethicist,

I've recently started my own business as a nonprofit consultant, and I'm in a bit of a conundrum. I'm an active member of a church congregation that founded a nonprofit organization two years ago, filed as a separate 501(c). I served as a volunteer for this nonprofit for about six months (January–June 2012), so I'm very familiar with the plethora of fundraising and marketing challenges it faces—thus making it a great prospect for me for new business.

However, I'm unclear on the ethics of approaching a group of people that I know fairly well in one arena (as church member and former skilled volunteer) to pitch a paid gig.

Complicating the situation is the fact that the board is a bit dysfunctional, the executive director is not well suited to a management position (it's a counseling center, and her primary training is in counseling, not nonprofit business), and the nonprofit is struggling to find firm financial footing.

The classic irony in our field is that all of these issues make this NPO the perfect candidate for consultant/outside assistance. Having said that, am I *viewed as enough of an "outsider" to offer assistance—for pay? Do you have any suggestions for transitioning such relationships?*

Thank you,

Confounded Consultant

Dear Confounded,

This is a very bad idea. You wouldn't consider being your spouse's therapist, would you?

If you are bound and determined to do it, you should follow the IRS guidelines for dealing with conflicts of interest that involve trading with insiders. Be sure everyone who has a vote knows of your deep roots in the church. And advise them to consider whether they could find a more advantageous arrangement with another consultant who does not have a similar conflict of interest. If an alternative is not "reasonably possible," be advised that in such a situation a majority of the 501(c)'s disinterested board members must determine whether such a proposal is in the organization's best interest, whether it is for the organization's own benefit, and whether it is fair and reasonable. And, of course, you should not be present during the deliberations and voting, and the board should make the decision by recorded vote.

The relationship between consultants and the organizations they work with can be fraught from time to time. Apparently, a really beneficial, transformative consulting relationship is often marked by resistance from the organization. Why create such a situation at your community of worship? Get on a committee to hire a good, disinterested consultant, if you think the organization needs one so badly. I repeat: it is a bad idea—steer clear.

Dear Nonprofit Ethicist,

I am the head of a health-and-nutrition-focused community that sees about eight hundred thousand visitors a month. While we are not a nonprofit organization, we offer the vast majority of our information as well as our entire nutrition program for free on our website. The first step of our healthy eating program is getting rid of all the processed, junky snack-type stuff in one's kitchen. People often ask us what they should do with it. We tell them either (a) throw it out, or (b) donate it to a local homeless shelter. Is it ethically defensible to give a homeless shelter foods that we believe are like poison to one's health and quality of life? On the other hand, is it ethically defensible to throw away perfectly edible food-like products rather than giving them to people who might otherwise starve?

We Are What We Eat

Dear We Are What We Eat,

NPQ has become embroiled in a number of discussions about the idea of restricting people's food choices on the basis of their being poor—as in banning the purchase of sugared foods with food stamps. We know from experience that food controversies are intense. How about just giving no advice, except, "Get it out of your house—*now*—if you know what's good for you." By the way, I like your phrase "edible food-*like* products."

Woods Bowman is a professor of public service management at DePaul University, in Chicago, Illinois.

To comment on this article, write to us at feedback@npqmag.org. Order reprints from http://store.nonprofitquarterly.org, using code 200201.

Ask the Ethicist about Your Conundrum

Write to the Ethicist about your organization's ethical quandary at feedback@npqmag.org.

Philanthropy–
Not Even the Same Stream Once

by Ruth McCambridge

Philanthropy is undergoing major shifts, and many of the larger ones seem to fall under the category of disintermediation. Will this trend necessitate a closer relationship between donor and grantee? Time will tell. But, as the author proposes, "It is important to know one thing in all this—nothing will stay as it is today, and, as giving changes, we must change also.

The *Nonprofit Quarterly* is going to press with this issue on the changing landscape of philanthropy immediately after the 2013 Giving USA report was released. The report confirms that the much-touted recovery from the recession that began in 2008 is only very slowly being felt in charitable giving. Putting this in perspective, in 2008, philanthropy was at its highest level ever, but the dive it took was precipitous, at about 15 percent in 2008 and 2009 combined—adjusted for inflation—and the climb back up may be so steep as to slow us nearly to a crawl.[1]

In short form, this is the slowest post-recession recovery of a giving level in recorded history.

Ruth McCambridge is the *Nonprofit Quarterly*'s editor in chief.

"SO MANY ENDINGS I" BY DAVID CASS / WWW.DAVIDCASS.CO.UK


U.S. ARMY
SC276A

At this rate, the recovery in charitable giving is likely destined to take at least twice what it has taken after previous recessions—approximately six to seven years—and that is, perhaps, being optimistic.

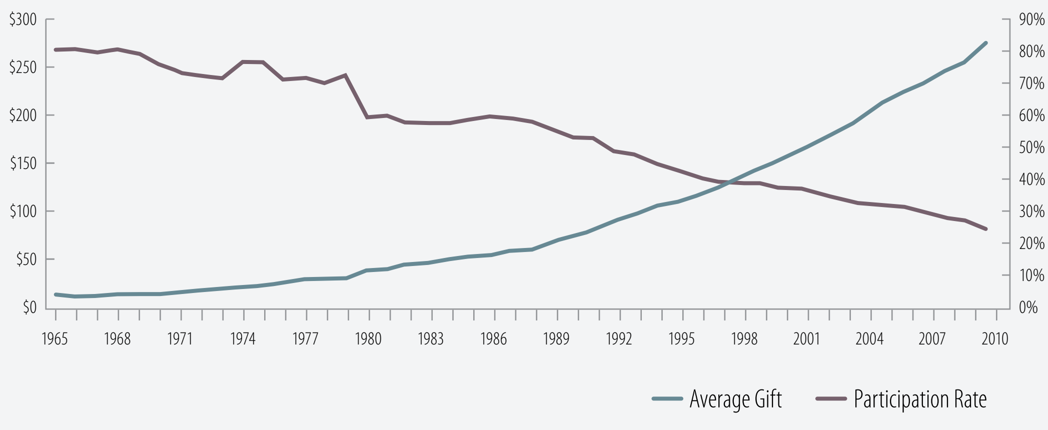


Figure 1: **Average Federal Employee Pledges**
Average Gift Amount vs. Participation Rate[2]

Losses felt in previous recessions have been regained within three years; we are already at four years and counting, and the really bad news is that the rate of growth appears to be slowing significantly. Most of the recovery in giving happened in 2010, when giving increased by 5 percent in inflation-adjusted dollars. In 2011, the increase was 1.25 percent, and in 2012 it was estimated at 1 percent. At this rate, the recovery in charitable giving is likely destined to take at least twice what it has taken after previous recessions—approximately six to seven years—and that is, perhaps, being optimistic.

But what should be just as important to fundraisers is the fact that philanthropy is not only coming back slowly but in different form. Some of the differences are hard to pin down because the targets are moving and there is a lack of readily available research that asks the right questions, but we feel fairly certain that there are serious shifts afoot.

As *NPQ* prepared to take on a mapping of changes in the philanthropic landscape, it recognized that this would be informed not only by changes that have occurred but also by the trajectories of that change. In other words, some trends are occurring quickly, almost like a tumble downhill, and others may remind us more of Sisyphus painstakingly pushing a rock up the side of a mountain.

Many of the more massive shifts in philanthropy that have occurred over the last twenty years might be grouped under the rubric "disintermediation" (the elimination of an intermediary), and the major force in charitable disintermediation is primarily, but not solely, the Internet.

Examples of Intermediaries

Examples of intermediaries in giving are the federated campaigns such as the United Way affiliates and community foundation general funds. These relatively recent examples of funding intermediaries would previously have acted as proxies for givers—receiving gifts and often making decisions on the donor's behalf out of a general fund. They were there to facilitate and direct giving, but more recently we see that those who may previously have given to a combined fund are making their gifts more directly, parking their gifts in some cases in charitable gift funds. This is a trend that began more than twenty years ago, as community foundations saw the numbers of their donor-advised funds growing and United Ways began to see an ever-greater proportion of gifts given as donor directed to a specific agency. Of course, donor-advised funds (DAFs) are still an intermediary of some kind, but although they are held or overseen by a foundation or charitable gift fund, grantmaking decisions are made by the donors.

The Internet facilitates direct giving by providing easy access to information about charities and ways to give online. Institutions such as GuideStar were developed to ensure that certain data were broadly available, and charities have become increasingly acclimated to the fact that their websites must be considered a major interchange between themselves and their publics. This may be eroding the traditional base of federated giving programs, and a series of interconnected effects will be felt by nonprofits.

Taking just one example, according to Giving USA, giving to so-called public benefit organizations was up, but within that category—which includes intermediaries like the United Way and the Combined Federal Campaign—are also a growing number of donor-advised funds handling an increasing number of philanthropic assets.

While we do not have the figures for the United Ways, the Combined Federal Campaign has been in a pretty steady decline since 2005, when it brought in $259.7 million; this year in inflation-adjusted dollars it brought in only $212.5 million. Additionally, there is a long-term trend toward far lower participation, which is to some extent obscured by larger gift sizes (see figure 1).

Because of the phenomenal growth of at least the largest of the commercial funds over the past year, and due to the fact that the payout at those funds is only an estimated 14 percent annually, we can assume that there is less moving through this field to nonprofits, which could actually use that money. Concurrently, since giving to foundations is down, we might suspect that people who may have previously given to foundations are now just placing their money in the DAFs—and that may be a good thing. Many foundations observe the 5 percent payout floor as a ceiling, but it appears to us that there must be no growth or negative growth in federated workplace campaigns, which pay out largely within the same year that money is raised.

Of course, another category of intermediaries is the welter of philanthropic and wealth advisors who help people of means figure out how to invest their assets in charities, whether direct donations, DAFs, or, if they have the wherewithal, their own foundations—or sometimes a combination of all of the above. To some extent, the disintermediation dynamic has impacted advisors themselves, as donors are reluctant to pay too high a premium for information that they can get at much lower cost from GuideStar or DAF managers.

Disintermediation Does Not Necessarily Mean Individualism

As tools and practices have changed, so have the expectations and habits in the big mix of individual givers. For some, the act of contributing is bound up with a collective act they are more intimately a part of. A good example of this was the crowdfunding effort to place an ad in the *New York Times* explaining the protests in Turkey. Not only did people give to a common cause, but they voted on the ad, too, choosing from a number of proposals. And, further, they will be voting on what to do with money that exceeded the need. These small and sometimes larger hubs of engagement and giving exemplify the times; they are at the very least the temporary embodiments of communities of purpose.

As tools and practices have changed, so have the expectations and habits in the big mix of individual givers.

And what about that transience? Our worlds have expanded through use of the Internet such that we can establish dynamic communities of purpose with people who are far-flung geographically. This creates a challenge for nonprofits to compete in terms of attracting and keeping the attention of those drawn to their work. Retention becomes more difficult—loyalty must be earned and preserved.

In a way, this is a return to form. We have always known that there is a connection between volunteering and giving, but in these situations the two are inextricably linked. Will this closeness of action and investment become more the norm?

In some cases, crowdfunding is even allowing people to bypass nonprofits altogether to help the individual. A recent article in the *Washington Post* highlighted the growing practice of people raising money over the Internet to defray personal medical costs. It opens with the story of one man with lung cancer who has decent insurance coverage, but, as co-payments and out-of-pocket costs mounted, the family turned to the Internet and their own network to eventually raise $56,800 from 325 friends and family members. The donations to his fund ranged from $10 to $2,000.

The above campaign was run on the site GiveForward, a for-profit that charged 7 percent

Some elements of philanthropy are immune to any democratic impulse and in fact may, according to some observers, be considered to promote anti-democratic practices.

for its services. GiveForward raised $225,000 for 359 campaigns in 2008, the year that it was launched, and as of this year it has grown to 15,000 campaigns raising $20 million. Other such sites include GoFundMe.com, YouCaring.com, FundRazr.com, and Indiegogo.com, raising money not just for medical costs but also for tuition, travel, disaster relief, pets' medical care, and funeral costs. Very often, those donating to such causes are family and friends of those needing help, but in the case of disaster relief we have seen the rise of such specific crowdfunded efforts as The One Fund Boston, an entity organized and seeded overnight, where corporate and individual gifts mixed to recompense victims of the Boston Marathon bombing for their injuries. Efforts like these have evolved quickly over the past few years, with lessons learned along the way.

These types of campaigns are interesting on any number of levels. Other crowdfunded efforts were organized alongside The One Fund Boston, including a campaign to replace the bullet-ridden boat in which one of the Boston Marathon bombers was captured. The proceeds of this were rejected by the boat owner because he did not think, in light of the losses experienced by others, that his boat was a priority. In a way, then, rather than being super-organized, these somewhat informal expressions of collective giving are perhaps more eloquent and might tell us something about the ways people are feeling and responding to the world around them.

Crowdfunding in philanthropy does not, of course, stand completely apart from crowdfunding of business endeavors, a trend that has taken hold quickly. We will see what its evolution brings.

Anti-Democratic Philanthropy—So What Is New?

But there is certainly a continuum still at play. Some elements of philanthropy are immune to any democratic impulse and in fact may, according to some observers, be considered to promote anti-democratic practices. This may be particularly evident where we see large-dollar philanthropists paying to play in resource-scarce public systems like education and health. In some cases, demonstrations are waged against the perception, if not the reality, of undue influence. In the case of the Bill and Melinda Gates Foundation, critics have noted that the foundation is often the biggest donor in the room, even in venues like the World Health Organization, and this influences what should be collective agendas forged by nation-states. The foundation then supplements this agenda setting with support of media to cover an area in which the foundation is interested, thus drawing what some consider to be unbalanced public attention to the foundation's strategy and goals.

In the United States, where there has been a lot of piling on of billionaire philanthropy in education (with questionable results), education historian Diane Ravitch feels it is "troubling" that the Gates, Broad, and Walton Family foundations, which are all large education funders, have similar agendas, because the combination of them can crowd out other voices and the truth about outcomes.

"They all support an agenda that is remarkably similar: privately managed charter schools; high-stakes testing; evaluating teachers by the test scores of their students; top-down, centralised decision-making by the federal government, the state government or the mayor; disregard for teacher experience or credentials or degrees," says Ravitch. ". . . In the past, our great philanthropies carried out demonstration projects in [the] hope of swaying government policy. Now government policy and foundation policy are intertwined, without any evidence to support its efficacy."[3]

In the growing arena of corporate philanthropy, there is yet another dimension of philanthropy as less than disinterested and democratic. Corporate giving is on the rise, but with much of it through in-kind giving of product and services, and much of it directed to the strategic priorities of the corporate givers themselves. Moreover, despite the numbers of corporations engaged in philanthropic giving, corporate giving is as concentrated at the top by large donors as private philanthropy is with the dominance of the likes of Gates and Ford. A small number of corporations account for the vast bulk of corporate giving. Corporations give, for sure, but they have agendas, whether it is pharmaceutical companies donating unneeded product or providing philanthropic gifts related to elements of national health insurance reform, or the big banks building community support after having been tagged with bringing down much of the economy, or big-box retailers like Walmart making contributions toward buying support for or diminishing opposition to their new stores.

It appears that much of institutionalized philanthropy is still struggling relatively uncreatively where transparency and accountability are concerned, but that is unsurprising given that it has no market that can react to it in a way that would visit consequences upon it. It is certainly not that there are no consequences for bad grantmaking decisions in philanthropy, but the consequences ripple out to community and grantees rather than to the grantmaking institution, which often merely needs to keep its mouth shut, wait out the distress, and perhaps change executives for all to be forgiven.

Sector Blurring and Era Shifting

New language has entered the scene, bringing new frames of reference, but it is unclear what will stick, what will fall away, and what will morph so significantly that it will be unrecognizable. For instance, the concept of social enterprise is still evolving significantly, and, in a way, it has ended up in a healthy relationship with the concept of business planning and the best uses of philanthropic capital and in a questionable relationship with cause marketing and hybrids. But all of that is not yet fully cooked. The blurring of sectoral boundaries and the emergence of sector agnosticism appear to be producing more high-dollar grantmaking to businesses and public-sector organizations. For instance, even when the journalism scene is moving toward the nonprofit sector and becoming more of a networked enterprise, the Ford Foundation is providing multimillion-dollar grants to major for-profit journalism outlets.

In general, philanthropy is a very complicated and changing space. There are threads of more traditional approaches woven in with new and more untethered forms of giving. It is important to know one thing in all of this—nothing will stay as it is today, and, as giving changes, we must change also. While the situation we are looking at here is complicated, *NPQ* believes that the essence of the change that likely needs to be made by nonprofits is somewhere in the realm of engagement or in the renewal of the closeness of relationship between the giver and receiver, or at least the giver and the cause.

It appears that much of institutionalized philanthropy is still struggling relatively uncreatively where transparency and accountability are concerned, but that is unsurprising given that it has no market that can react to it in a way that would visit consequences upon it.

Notes

1. Indiana University Lilly Family School of Philanthropy, *Giving USA 2013: The Annual Report on Philanthropy for the Year 2012* (Chicago, IL: Giving USA Foundation, 2013), www.givingusareports.org.
2. CFC-50 Commission, *Federal Advisory Committee Report on the Combined Federal Campaign* (Washington, DC: U.S. Office of Personnel Management, 2012), 2, www.opm.gov/combined-federal-campaign/cfc-50-commission/2012-report.pdf.
3. Shanaz Musafer, "Power of Policy-Making in the Hands of Philanthropists," BBC News Business, September 2, 2012, www.bbc.co.uk/news/business-19272108.

To comment on this article, write to us at feedback@npqmag.org. Order reprints from http://store.nonprofitquarterly.org, using code 200202.

Donor Retention:

What Do We Know & What Can We Do about It?

by Adrian Sargeant, PhD

Donor retention is key to a sustainable base of individual giving. What drives customers to stay, and what affects their behavior? This article outlines the actions nonprofits can take to improve donor loyalty.

In the twelve years since the first academic article on the topic of donor retention was published, the state of our knowledge has changed very little. Academic researchers continue to emphasize motives for giving rather than the determinants of switching or lapse, and even practitioner interest in the topic has been scant. The emphasis remains firmly on donor acquisition, with donor retention coming in a very poor second.

As a consequence, the sector continues to waste a substantial proportion of its annual fundraising spend. In 2001, a large-scale analysis of database records showed that even small improvements in the level of attrition can generate significantly larger improvements in the lifetime value of the fundraising database.[1] A 10 percent improvement in attrition can yield up to a 200 percent increase in projected value, as with lower attrition significantly more donors upgrade their giving, give in multiple ways, recommend others, and, ultimately, perhaps, pledge a planned gift to the organization. In this sense the behavior of "customers" and the value they generate appear to mirror that reported in the for-profit consumer sector, where similar patterns of value and behavior emerge. Indeed, the marketing literature is replete with references to the benefits that a focus on customer retention can bring, including:

- **The reduction of marketing expenditure.** It typically costs around five times as much to solicit a new customer as it does to do business with an existing one. Acquisition costs through direct forms of marketing are high. This is particularly the case in the context of fundraising, where it typically costs nonprofits two to three times more to recruit a donor than a donor will give by way of a first donation. It can take twelve to eighteen months before a donor relationship becomes profitable.

Adrian Sargeant, PhD, is the Robert P. Hartsook Professor of Fundraising at the Lilly Family School of Philanthropy at Indiana University.

"BURBULIATORIUS PURGATORIUS" BY FERNANDO JARAMILLO / WWW.FERNANDOJARAMILLO.COM

Given the scale of the opportunity, it seems timely to consider what we now know about the factors that drive donor retention. . . .

- **The opportunities that existing customers present for cross- and up-selling.** Existing customers can be cross-sold other product/service lines or upgraded to increase the value of their future purchases. In the fundraising context, existing donors can be persuaded to upgrade their giving, make additional donations, purchase from the trading catalogue, volunteer, leave a bequest, etc.
- **The additional feedback that customers are willing to supply as relationships grow stronger.** Continuing contact can enable organizations to improve the quality of the service they deliver.
- **The good word-of-mouth (or "word-of-mouse") advertising that successful relationships can generate.**

Despite the potential advantages that enhancing donor retention can bring, the opportunity remains largely untapped. In 1997, a report identified that a typical U.K. charity experiences an annual attrition rate of between 10 and 20 percent of all supporters who make more than one contribution.[2] More recently, my own work broke the aggregate retention figure down to examine both cash and sustaining donors, concluding that a typical charity will lose 50 percent of its cash (i.e., annual) donors between the first and second donation and up to 30 percent annually thereafter. With respect to regular or sustained giving, annual attrition rates of 20–30 percent are common. Recent data collected by the Association of Fundraising Professionals (AFP) suggests that the pattern of retention in the United States may be even lower than that in the United Kingdom, with attrition rates in initial cash giving being reported at a mean of 74 percent.[3]

Given the scale of the opportunity, it seems timely to consider what we now know about the factors that drive donor retention as well as what other lessons from the wider marketing literature nonprofits might take into account in the pursuit of a loyalty strategy. While there may have been little academic interest in donor retention per se, research into the determinants of customer retention has continued apace. Therefore, below I review both the marketing and the fundraising literature in order to determine the factors most likely to drive switching (to another nonprofit) and/or lapsing behaviors.

Key Drivers of Loyalty

In order to understand what drives customer loyalty, it is necessary first to understand the evaluations, attitudes, and intentions that affect behavior. Marketing literature regards *satisfaction*, *identification*, *trust*, and *commitment* to be the primary drivers. Also important are "triggers"—situational, influential, and reactional factors with the capacity to cause a review of giving behavior and, as a consequence, drive switching or lapsing. Finally, it is important to comprehend what I call "value determinants," and to focus on the key forms of utility that may be derived from the fundraising relationship. I believe this to be relevant, as some donors will consciously evaluate the service provided by a nonprofit and compare it to what could be achieved "in return" for their donation elsewhere. As will be explained further on, the benefit returned to the individual and the benefits delivered to beneficiaries are both at issue.

Satisfaction

Academics define customer satisfaction as a customer's overall evaluation of the performance of an offering to date.[4] It is now well established that satisfaction has a strong positive effect on loyalty intentions in a wide variety of product and service contexts. Satisfaction is viewed as the consequence of a comparison between expectations and overall evaluations of delivered service quality. In other words, people compare what they expected to get with what is actually delivered. They only experience satisfaction when their expectations are either met or surpassed. Recent work shows that the nature of the satisfaction-retention relationship can vary by such customer characteristics as demographics.[5] For some the issue of satisfaction with the quality of service received is a more important determinant of loyalty than for others.

These studies suggest that, in the context of fundraising, donor satisfaction with the quality of the service with which they are provided (as donors) would drive subsequent loyalty, but the strength of this impact may vary by the profile of the donors in question. The position for nonprofits, however, is further complicated by the agency role that they play, and it is probable that both donor service quality *and* the perceived quality of service delivered to the beneficiary group may be at issue, since it may be argued that donors are in fact purchasing both. Empirical work has so far failed to address this issue and the nature of these interrelationships.

In the first study to address donor satisfaction, I identified a positive correlation with loyalty, with those donors who indicated that they were "very satisfied" with the quality of service provided being twice as likely to offer a second or subsequent gift than those who described themselves as merely "satisfied." More recently, studies have confirmed this relationship, while in the latter simultaneously identifying a link between satisfaction and commitment to the organization.[6] Work by Roger Bennett similarly shows that there is a significant and positive relationship between satisfaction with the quality of relationship marketing activity (in this case, relationship fundraising) and the donor's future intentions and behavior, particularly the likely duration of the relationship and the levels of donation offered.[7]

Despite the weight of evidence that it is the single biggest driver of loyalty, few nonprofits actually measure and track levels of donor satisfaction over time. That said, a number of major charities are now measuring and tracking donor satisfaction, with a handful constructing supporter satisfaction indices that can be fed into their organizational reporting systems (e.g., a balanced scorecard). Managers are thus now being rewarded for changes in the level of aggregate satisfaction expressed. Given the foregoing analysis, this would seem a long-overdue practice.

Identification

Originally developed in social psychology and organizational behavior, the concept of identification is regarded as satisfying the need for social identity and self-definition. When a person identifies with an organization, he or she perceives a sense of connectedness with it and defines him- or herself in terms of the organization. As an example, someone might see him- or herself as a Greenpeace supporter, an environmental campaigner, or a "responsible person" when it comes to taking care of the environment. Unsurprisingly, studies have consistently shown that higher levels of identification lead to higher levels of loyalty to the organization and more supportive behaviors on the part of consumers. Researchers working in the domain of marketing have now shown that identification is a critical concept in driving loyalty in both membership[8] and non-membership contexts.[9]

Despite its utility, the concept of identification is little researched in the fundraising context. In particular, we understand very little about what drives identification between a donor and the charities he or she supports. Although he has not specifically employed the term, Paul Schervish has shed some light on the issue of donor identification, arguing that a basic connection to a cause (e.g., being a graduate of a school) is not enough in itself to prompt subsequent donations to that school, and that some degree of socialization is required. This, the author argues, is experienced through "communities of participation," and thus donors will be predisposed to give to causes connected in some way with these communities.[10] This reflects many of the themes developed in the psychology and sociology literatures, where the concept of "we-ness" is seen as a spur to caring.

Despite its utility, the concept of identification is little researched in the fundraising context. In particular, we understand very little about what drives identification between a donor and the charities he or she supports.

In an interesting twist, there is some evidence that emphasizing the development of identification may not always be an optimal strategy to pursue. Self-perception theory tells us that external triggers for giving, such as membership, or perceived membership, can cause a donor to discount any intrinsic motives they might have had, making it difficult to sustain that giving in the longer term—particularly when contact with that community comes to an end. Again, the need for further work to investigate the role of identification in fostering loyalty is clear.

A related strand of research has explored the issue of identification with a brand. As long ago as 1959, Sidney Levy noted that people buy things not only for what they do but also for what they mean. In electing to purchase brands with

Donors are drawn to [. . .] brands that are perceived as having a personality encompassing values congruent with their own, be they actual or aspired.

particular personalities, consumers can seek to convey representations of themselves and/or reinforce their self-image.[11] This may be particularly important in the context of giving, since research has indicated that giving carries important psychosocial meaning and that "fundraisers should recognize that the philanthropy opportunities they provide represent identity props or tools for their donors."[12] Donors are drawn to (and perhaps remain loyal to) brands that are perceived as having a personality encompassing values congruent with their own, be they actual or aspired. Similarly, Schervish has argued that philanthropy provides donors with the opportunity "to excavate their biographical history, or moral biography . . . and their anxieties and aspirations for the future."[13] The act of giving is therefore influenced by the individual's perceiving not only the brand's personality but also his or her own personality or self-conception, through the brand.

In 2006, I argued that in the voluntary sector context, brand personality is complex, and I identified three facets of charity personality shared by the sector as a whole.[14] In a study of nine thousand individual donors, I found that only perceptions of personality characteristics grouped under the dimensions of "emotional stimulation," "voice," "service," and "tradition" were capable of distinguishing between organizations. Interestingly, it is only these distinctive facets of personality that are linked to donor behavior, explaining a proportion of the variation in an individual's charitable pot that would be received by a given organization as opposed to being split among the other organizations they support. The facets of an organization's personality that have been linked to behavior are as follows:

- **Emotional stimulation.** Personality traits that have the ability to evoke an emotional response can be a source of differentiation. These might include such traits as "exciting," "heroic," "innovative," and "inspiring."
- **Voice.** Brands can also be differentiated on the basis of tone, as projected in the media. Is the organization perceived as "serious," "bold," "confrontational," "challenging," "impartial," "balanced," etc.?
- **Service.** The style or philosophy behind how an organization delivers its services can be an effective route to differentiation. Human service charities in particular might carve out a unique personality on the basis of such characteristics as "inclusive," "approachable," "dedicated," "compassionate," etc., in the way they deal with their service users.
- **Tradition.** Donors view some nonprofits as traditional, and may even regard giving as a duty, particularly during certain events or seasons. Who can deny the power of the Salvation Army kettles positioned outside shops across the United States around Christmastime?

In seeking to differentiate brand personality, it is important to remember that it is not appropriate to simply find different words to describe the organization. What is required is that the balance of the personality stand out from relevant local and national competitors for funds. These characteristics must also be perceived as desirable by donors and ideally have resonance with aspects of donors' own identity.

On balance, the literature on identification does suggest that nonprofits seeking to foster retention should think through the various identities that supporters might have, which the organization could seek to reinforce through fundraising and other communications. Aiding donors in fostering a favorable image of themselves, not merely because they are donors but also because of the values they aspire to or already possess, would be an effective strategy to adopt.

Trust

Successive studies have demonstrated trust's utility in driving customer retention—either directly or indirectly through satisfaction or commitment. Trust is built by the trusted party being seen to exercise good judgment, demonstrate role competence, adhere to a desired set of principles (e.g., a code of practice), and deliver high-quality service, possibly through high-quality interaction with front-line employees.

In the nonprofit context, Stephen Lee and I demonstrated that levels of trust drive giving behavior.[15] More recent work in the nonprofit context confirms the relationship between trust and commitment, although it also suggests that this relationship is in turn mediated by "non-material benefits." This is defined as "the belief that the nonprofit is making efficient use of its funds and having a positive impact on people for whom the funds were intended."[16] The model also stresses the significance of "shared values" and "communication," both of which have the capacity to build trust. In their classic article, Robert Morgan and Shelby Hunt conceptualized communication as having three dimensions—namely, frequency, relevance, and timeliness.[17] This was later extended by considering, in addition, informing, listening, and the quality of staff interactions.[18]

So, in the fundraising context, trust may be viewed as a driver of donor loyalty, and it, in turn, may be enhanced by:

1. Communicating the achieved impacts on the beneficiary group;
2. Honoring the promises—or rather, being seen to honor the promises—made to donors about how their money will be used;
3. Being seen to exhibit good judgment, and hence communicating the rationale for decisions made by the organization with respect to its overall direction and/or the services offered to beneficiaries;
4. Making clear the values the organization espouses—so, communicating not only the content of service provision to beneficiaries but also the style, manner, or ethos underpinning that delivery;
5. Ensuring that communications match donor expectations with respect to content, frequency, and quality;
6. Ensuring that the organization engages in two-way conversation, engaging donors in a dialogue about the service that they can expect as supporters of the organization and the service that will be delivered to beneficiaries; and
7. Ensuring that donor-facing members of staff are trained in customer service procedures and have the requisite knowledge and skills to deal with inquiries effectively, promptly, and courteously.

Commitment

Relationship-marketing literature suggests a further driver of customer loyalty—namely, relationship commitment, or a desire to maintain a relationship. What these definitions have in common is a sense of "stickiness" that keeps customers loyal to a brand or company even when satisfaction may be low.[19] It differs from satisfaction in that satisfaction is an amalgam of past experience, whereas commitment is a forward-looking construct.

What these definitions have in common is a sense of "stickiness" that keeps customers loyal to a brand or company even when satisfaction may be low.

It is now generally accepted that relationship commitment comprises two dimensions: an affective component (a strong and emotional attachment, i.e., "I really care about the future of this organization") and a component specific to relationship marketing called "calculative commitment" (simply, the intention to maintain a relationship that develops because of a conscious evaluation of the costs and benefits of doing so). In the for-profit context, this would normally include an evaluation of the costs of switching supplier. There are risks inherent in doing this because, for example, their performance might not live up to expectations, and individuals have to spend time learning how to use a new variant of the product or service.

The reader will appreciate that this latter construct is probably of less relevance to the fundraising context, where the costs of switching one's philanthropy are typically negligible. The notable exception here is the realm of planned giving, but the role of commitment in this context remains to be researched.

Indeed, only one study has specifically addressed the issue of donor commitment, and while the authors support a two-dimensional model, they replace the calculative component with what they term "passive commitment." In the study, a significant number of individuals "felt it was the right thing to do" to continue their support, "but had no real passion for either the nature of the cause or the work of the organization."[20] Indeed, some supporters, particularly regular givers (sustainers), were found to be continuing their giving only because they had not gotten around to canceling or had actually forgotten they were still giving.

In the fundraising context, organizations seeking to maximize retention will wish to evaluate the merits of participation in list swap programs.

These authors label the affective component of commitment as "active" commitment, which they define as a genuine passion for the future of the organization and the work it is trying to achieve. The literature suggests that this "active" commitment may be developed by enhancing trust, enhancing the number and quality of two-way interactions, and by the development of shared values. Other drivers include the concept of risk, which the authors define as the extent to which a donor believes that harm will accrue to the beneficiary group were they to withdraw or cancel their gift, and trust, in the sense of trusting the organization to have the impacts that it promised it would have on the beneficiary group or cause. Finally, the authors conclude that the extent to which individuals believe that they have deepened their knowledge of the organization through the communications they receive will also impact positively on commitment. The authors term this latter concept "learning," and argue that it serves to reinforce the importance of planning "donor journeys" rather than simply a series of "one-off" campaigns.

Triggers

There are also triggers that can cause customers to reevaluate their relationship with an organization. These can be defined as *situational*, *influential*, and *reactive*.

Situational triggers are events that occur in the customers' own lives and over which the service provider has no control. Factors such as the birth of a child, the death of a loved one, or an increase or decrease in income all have the potential to impact an individual's charitable giving. A change in financial circumstances was the most frequently cited reason in donor "exit polls" in the United States and the second-most cited factor in the United Kingdom (the leading factor being a desire to switch giving to another cause or organization).[21] More recently, a study of direct dialogue donors found that donors may lapse because of a change in financial circumstances, and that younger donors were particularly likely to lapse for this reason.[22] As a consequence, the authors advise charities engaged in recruiting donors to sustaining or regular gift programs to focus on individuals thirty years of age or older. Individuals under thirty exhibit lower levels of loyalty than their older counterparts.

Influential triggers are those derived from the competitive situation. In the giving context, it may be that a donor is won over by another organization, perhaps because it is perceived to be doing worthier work or because the package of benefits available to its donors/members is more attractive. As was noted above, many donors will switch their giving between organizations; a typical direct-mail donor now supports an average of six charities, with those who have been subject to a reciprocal or list swap program giving to an average of twelve.[23]

In the fundraising context, organizations seeking to maximize retention will wish to evaluate the merits of participation in list swap programs. Extant research indicates that lower-value donors (who are almost always the focus of such programs) can be just as likely to consider a bequest as other value segments in the database, and that once a list has been swapped, donors on that list will lose around 15 percent of their subsequent (annual giving) lifetime value. In deciding whether or not to participate in list swaps, it is therefore not as simple as comparing the immediate return on investment that accrues from the use of this technique as opposed to the use of traditional "cold" lists.

Reactive triggers are responses to the ways in which the organization interacts with the customer. In this sense, reactive triggers are more directly manageable than either of the other two categories, and as a consequence they have been the subject of a good deal more research.

To group our discussion, we will first look at those aspects of research that have considered the nature of solicitation itself, before moving on to consider issues pertaining to the acknowledgment of any gift.

Ken Burnett stresses the need to recognize individual donor motivation and to reflect such motives in fundraising communications.[24] While this may be difficult at the point of acquisition, it should thereafter be possible to focus on a particular donor's interests and concerns. It appears, however, as though many fundraising solicitations are product focused, in the sense that they focus on the organization's needs and are formulaic in approach. A recent study of fundraising solicitations identifies common arguments that revolve around the quality of the institution, the fact that an individual's gift matters, and the beneficiary needs that will be addressed. That is not a donor-centric approach (stressing what donors can achieve through their giving and, subsequent to the gift being made, praising them for having had that impact); talking only about how great the organization is, is a serious mistake.

Much of the creative approach will adjust to respond to changing motives over the duration of the relationship. In acquisition marketing creative, the portrayal of the beneficiary needs to be strong and emotive in order to make an immediate impact on a prospect donor and cut through the perceptual clutter of other charity appeals. In a bid to secure the all-important second and subsequent gifts, many organizations have developed welcome cycles, in which individuals receive a differentiated pattern of communication until the second or third gift is secured. Only then does the organization regard them as donors and enter them into the "standard" communications program. Organizations that have experimented with welcome cycles in the context of direct mail have found that they work best when they comprise a series of the best-performing "cold" recruitment packs that the organization has been able to produce.

Interesting work from the field of psychology has also identified that it may be appropriate to ask for different sums at different points in the relationship.[25] It appears that asking for too much initially can lead people to conclude that they have done their bit and ignore subsequent solicitations. It may be better to begin with requests for smaller sums and then build these up over time.[26] This is echoed in modern fundraising practice, where many U.K. charities, for example, solicit gifts of as little as six dollars per month and then work on developing the amounts over time. Such an approach works well, since a low-value ask eliminates many potential barriers to giving. When donors cannot post-rationalize their giving as a response to social or other pressures, they are significantly more likely to attribute their first donation to caring about the cause, and hence to continue their support.

Turning to the topic of post-gift communications, the issue of labeling has received the most research attention. The idea behind labeling is simple. If people can be induced to believe something new about themselves, then they may start behaving on the basis of that belief. In thanking donors for their gifts, organizations often append labels to the donor such as "kind," "generous," "helpful." Such labels elicit a greater motivation to help, and foster favorable attitudes on the part of the donor. The impact of labels will be particularly potent when there are concrete prior behaviors to be labeled and when the label stresses the uniqueness of the donor's behavior.[27] Repetitive labeling has been found to enhance efficacy,[28] and labels have been found to work best where the donor accepts the label,[29] emphasizing the need for the label to be credible and supplied by a credible source.

The idea behind labeling is simple. If people can be induced to believe something new about themselves, then they may start behaving on the basis of that belief.

The fundraising literature is also replete with references to the need for adequate donor recognition. Failure to provide adequate and appropriate recognition, it has been argued, will lead either to a lowering of future support or its complete termination. There is considerable empirical support for this proposition, indicating a link between the perception of adequate recognition and the level of gifts/lifetime value.[30] Where gifts are offered as part of the recognition process, they will be more effectual when the gift is clearly tied to the organization and its services. Generic gifts, obtainable from other nonprofits (or even for-profits), are significantly less effective in stimulating loyalty.

Value Determinants

Value determinants are components of the product or service that are considered to be critical from the customer's perspective, and where a poor evaluation of performance would lead to switching. We have already examined the issue of the service quality delivered to donors; here we are concerned with the utility that derives from the gift and the dimensions of the product or service itself that delivers utility.

Utility in the context of giving can take many forms. Two forms of utility are relevant here: personal, which may be further subdivided into tangible and emotional; and delivered (i.e., an evaluation of the impact a gift will have on the beneficiary group). Beginning with the former, it has long been argued that utility could take "material" form, and under this view donors will select charities to support on the basis of whether they have benefited from those charities in the past or believe that they will in the future. Individuals could, for example, give to those organizations that will do them political good and/or serve to enhance their career—perhaps through the networking opportunities that will be accorded. Donors may also evaluate potential recipient organizations against the extent to which their support will be visible or noticeable by others within their social group, thereby enhancing the donor's standing therein. Equally, in the membership context, members will evaluate the package of benefits received against the costs of renewal, stressing the need for ongoing research on the part of such organizations to ensure that the optimum "value for money" is maintained.

With respect to effectiveness, the degree to which the organization is seen to achieve its stated goals impacts gift-making decisions, the total amount donated, and the lifetime value of individual donors.

The prestige-based model suggests that utility arises from having the amount of a donation made publicly known.[31] Being seen to give may enhance a donor's social status or serve as a sign of wealth or reliability. A donor may wish to access a particular group, and thus desire to be defined by his or her philanthropic activity. Prestige is clearly about recognition and is therefore also relevant to the notion of feedback referred to earlier. To respond to the motive of prestige, charities can create gift categories and then publicly disclose donors who contribute to various categories. This type of motivation is typically more relevant to certain categories of nonprofits, such as educational and cultural organizations rather than national charities. It may also be more relevant when addressing younger givers, since for older adults esteem-enhancement motivations are negatively related to gift giving.[32]

It is now widely accepted, however, that utility can also derive from the emotions evoked by giving. Indeed, there is a well-established positive relationship between the degree of emotional utility afforded and gift-giving behavior. Emotional utility can take the form of a feel-good factor, or "warm glow," or it may derive from a family connection to the gift, such as the loss of a loved one to a particular condition or disease. Unsurprisingly, donors touched by a cause in this latter respect exhibit a high degree of loyalty.

Extant research also suggests that utility derives from the impact achieved with the beneficiary group. Individuals will also evaluate potential recipient organizations on the basis of the extent to which their performance is viewed as acceptable. Both efficiency and effectiveness are at issue. With respect to efficiency, donors appear to have a clear idea of what represents an acceptable percentage of income that may be applied to both administration and fundraising costs. They expect that the ratio between administration and fundraising costs and so-called charitable expenditure would be 20:80. It is interesting to note that, despite this expectation, most donors believe that the actual ratio is closer to 50:50. For example, recent research shows that respondents perceived that only 46 percent of the focal charities' expenditures reached beneficiaries, when in reality the average figure was 82 percent.[33] It has also been established that 60 percent was a significant threshold, with charities spending at least 60 percent of their donations on charitable programs achieving significantly higher levels of donation.[34]

With respect to effectiveness, the degree to which the organization is seen to achieve its stated goals impacts gift-making decisions, the total amount donated, and the lifetime value of individual donors. This is a view supported by a later study that found that perceived mismanagement by charity administrators and trustees can impact negatively on donations, although it remains unclear how donors actually draw such conclusions.[35] It has been shown that, to help individuals rate charity performance more accurately, charitable organizations simply need to provide relevant information in the public domain (for example, the number of people aided, the quality of outcomes achieved, etc.). Individuals appear to form holistic views about an organization's performance based on small pieces of relevant information. Providing a more complete picture appears unnecessary with most classes of donors.[36]

Conclusion

Overall, a brief review of the literature suggests a number of actions that nonprofits might take to improve donor loyalty:

1. They should begin by developing an understanding of the economics of loyalty, and thus identify for themselves the difference in the lifetime value of the fundraising database that would be garnered by achieving small improvements in the level of donor loyalty achieved (1 percent, 2 percent, 5 percent, etc.). This is essential if staff and board members are to understand the rationale for an enhanced focus on loyalty, and "buy in" to the process necessary for this to become a reality.
2. Perceptions of the quality of service offered to donors are the single biggest driver of loyalty in the fundraising context. Organizations should therefore take steps to measure the quality of service provided by their organization and improve on those areas where weakness is detected.
3. Organizations should think through and, ideally, conduct their own primary research program to understand why donors support their organization, or, more specifically, from which aspects of the organization's operations (or fundraising) individuals derive the most value. Value can then be engineered that directly reflects and satisfies donor motives for supporting the organization.
4. Allied to the above, nonprofits should consider how and under what circumstances they might contribute to a donor's sense of self-identity. Are there circumstances where a donor would be likely to start defining him- or herself, at least in part, through his or her support of the organization? Donors may, for example, derive value because they identify with aspects of an organization's brand or personality. These aspects may then be emphasized in communications.
5. Allied to the above, organizations should give greater thought to the labels they append to donors in their thank-yous and other communications. Donors can be persuaded to adopt an identity if it is fostered consistently over time and reinforced with credible messages from a credible source.
6. Nonprofits can seek to build donor commitment to their cause by considering each of the determinants we alluded to earlier. They can:
   - Clearly articulate their organization's values.
   - Make clear to donors the difference their support is or has been making and therefore the consequences to the beneficiary if they were to withdraw.
   - Consider the "journeys" that they will take supporters on through ongoing communications. This might be as simple as considering what "a year in the life" of each category of supporter might look like, or it may be more sophisticated, looking at how each segment of donors will be educated about the cause (and bought closer to it) over time.
   - Allied to the above, consider ways in which donors can be actively encouraged to interact with the organization. In the electronic environment, for example, this is relatively easy. Supporters can be asked to sign up for specific forms of communication, to offer recommendations or suggestions, to take part in research, to "ask the expert," to campaign on behalf of the organization, to "test" their knowledge in a quiz, etc. The more two-way interactions that are engendered, the higher the level of loyalty achieved will be.
7. Similarly, organizations should seek to foster trust by considering all of the antecedents alluded to earlier. An organization can:
   - Demonstrate to the donor that it has exhibited good judgment in its dealings with beneficiaries, its stewarding of organizational resources, and, where applicable, its approach to campaigning.
   - Stress that it adheres to appropriate standards of professional conduct. Ensure that all outward-facing members of staff receive appropriate training in customer service.
   - Design and instigate a complaints

Perceptions of the quality of service offered to donors are the single biggest driver of loyalty in the fundraising context.

procedure so that individuals who wish to can take issue with the quality of an organization's fundraising or approach.
- Communicate the achievements of the organization and, where possible, relate these to the contributions made by individuals or segments of supporters.
- Ensure that all promises made to donors are adhered to and, critically, *seen* to be adhered to.

8. Consider the development of regular or "sustained" giving programs. Levels of attrition are much lower than those achieved in traditional annual giving. Younger donors are also significantly more comfortable with regular giving than their older counterparts, so offering regular giving, particularly as an online option, will greatly reduce the level of attrition experienced.

Younger donors are also significantly more comfortable with regular giving than their older counterparts, so offering regular giving, particularly as an online option, will greatly reduce the level of attrition experienced.

9. Evaluate the continuation of activities that lower loyalty, such as list swap programs. Managers need to assess the impact on donor lifetime value rather than looking at the short-term attractiveness (i.e., return on investment) of such programs.
10. Consider the creation of donor welcome cycles. E-mail and mail versions of these cycles should be considered. Newly acquired donors should be exposed to a differentiated standard of care while their relationship with a nonprofit develops. The historically strongest recruitment messages would likely be the most effectual components of such cycles.
11. Finally, those organizations seeking to facilitate higher levels of loyalty would be advised to maintain regular contact with their donors, researching ongoing needs and preferences. As a consequence of this research database, segmentation can then be regularly reviewed and updated as necessary. It would also be helpful to conduct regular exit polling of lapsed supporters to identify the reasons that predominate for this behavior. Corrective action can then be taken where possible.

Notes

1. Adrian Sargeant, "Relationship Fundraising: How to Keep Donors Loyal," *Nonprofit Management and Leadership* 12, no. 2 (winter 2001): 177–92.

2. Simon McGrath, "Giving Donors Good Reason to Give Again," *International Journal of Nonprofit and Voluntary Sector Marketing* 2, no. 2 (May 1997): 125–35.

3. *Fundraising Effectiveness Survey Report* (Washington, DC: Association of Fundraising Professionals/The Urban Institute).

4. Michael D. Johnson and Claes Fornell, "A Framework for Comparing Customer Satisfaction across Individuals and Product Categories," *Journal of Economic Psychology* 12, no. 2 (June 1991): 267–86.

5. Vikas Mittal and Wagner A. Kamakura, "Satisfaction, Repurchase Intent, and Repurchase Behavior: Investigating the Moderating Effects of Customer Characteristics," *Journal of Marketing Research* 38 (February 2001): 131–42.

6. Sargeant, "Relationship Fundraising," 177–92; Sargeant and Lucy Woodliffe, "Building Donor Loyalty: The Antecedents and Role of Commitment in the Context of Charity Giving," *Journal of Nonprofit and Public Sector Marketing* 18, no. 2 (2007): 47–68.

7. Roger Bennett and Anna Barkensjo, "Causes and Consequences of Donor Perceptions of the Quality of the Relationship Marketing Activities of Charitable Organisations," *Journal of Targeting, Measurement and Analysis for Marketing* 13, no. 2 (January 2005): 122–39.

8. C. B. Bhattacharya, Hayagreeva Rao, and Mary Ann Glynn, "Understanding the Bond of Identification: An Investigation of Its Correlates among Art Museum Members," *Journal of Marketing* 59 (October 1995): 46–57.

9. Susanne G. Scott and Vicki R. Lane, "A Stakeholder Approach to Organizational Identity," *Academy of Management Review* 25, no. 1 (January 2000): 43–62; Bhattacharya and Sankar Sen, "Consumer–Company Identification: A Framework for Understanding Consumers' Relationships with Companies," *Journal of Marketing* 67 (April 2003): 76–88.

10. Paul G. Schervish, "Philanthropy as Moral Identity of Caritas," in *Taking Giving Seriously*, eds. Schervish et al (Indianapolis: The Center on Philanthropy at Indiana University, 1993); Schervish, "Inclination, Obligation, and Association: What We Know and What

We Need to Learn about Donor Motivation," in *Critical Issues in Fund Raising*, ed. Dwight F. Burlingame (Hoboken, NJ: John Wiley & Sons, 1997), 110–38.
11. Sidney J. Levy, "Symbols for Sale," *Harvard Business Review* 37, no. 4 (July-August 1959), 117–24.
12. Ida E. Berger and Brenda Gainer, "Jewish Identity, Social Capital and Giving," in *Advances in Consumer Research* 29, eds. Susan Broniarczyk and Kent Nakamoto (Valdosta, GA: Association for Consumer Research, 2002): 412.
13. Schervish, "The Material Horizons of Philanthropy: New Directions for Money and Motives," in *Understanding the Needs of Donors: The Supply Side of Charitable Giving*, New Directions for Philanthropic Fundraising 29, eds. Eugene R. Tempel and Dwight F. Burlingame (San Francisco: Jossey-Bass, 2001), 25.
14. Sargeant and John B. Ford, "The Power of Brands," *Stanford Social Innovation Review* 5, no. 1 (winter 2007): 41–47.
15. Sargeant and Stephen Lee, "Donor Trust and Relationship Commitment in the U.K. Charity Sector: The Impact on Behavior," *Nonprofit and Voluntary Sector Quarterly* 33, no. 2 (June 2004): 185–202.
16. Keith MacMillan, Kevin Money, Arthur Money, and Steve Downing, "Relationship Marketing in the Not-For-Profit Sector: An Extension and Application of the Commitment-Trust Theory," *Journal of Business Research* 58, no. 6 (June 2005): 810.
17. Robert M. Morgan and Shelby D. Hunt, "The Commitment-Trust Theory of Relationship Marketing," *Journal of Marketing* 58, no. 3 (July 1994): 20–38.
18. MacMillan, Money, Money, and Downing, "Relationship Marketing in the Not-For-Profit Sector," 806–18.
19. Sargeant and Woodliffe, "Building Donor Loyalty," 53.
20. John Maltby, Debbie Gorski, and Jonathan Ingram, *Sales and Marketing Software Handbook* (London: Pitman, 1991), 12.
21. Sargeant, "Relationship Fundraising," 177–92.
22. Sargeant and Elaine Jay, "Reasons for Lapse: The Case of Face-to-Face Donors," *International Journal of Nonprofit and Voluntary Sector Marketing* 9, no. 2 (May 2004): 171–82.
23. Sargeant and Jay, *Fundraising Management: Analysis, Planning and Practice* (London: Routledge, 2004), 78.
24. Ken Burnett, *Relationship Fundraising: A Donor-Based Approach to the Business of Raising Money*, 2nd ed., (San Francisco: Jossey-Bass, 2002), 98.
25. Richard L. Miller and Jerry Suls, "Helping, Self-Attribution, and the Size of an Initial Request," *Journal of Social Psychology*, 103, no. 2 (1977): 203–8.
26. Jonathan L. Freedman and Scott C. Fraser, "Compliance without Pressure: The Foot-in-the-Door Technique," *Journal of Personality and Social Psychology* 4, no. 2 (1966), 195–202.
27. William J. McGuire and Alice Padawer-Singer, "Trait Salience in the Spontaneous Self-Concept," *Journal of Personality and Social Psychology* 33, no. 6 (June 1976): 743–54.
28. Alice M. Tybout and Richard F. Yalch, "The Effect of Experience: A Matter of Salience?," *Journal of Consumer Research* 6, no. 4 (March 1980): 406–13.
29. Chris T. Allen, "Self-Perception Based Strategies for Stimulating Energy Conservation," *Journal of Consumer Research* 8, no. 4 (March 1982): 381–90.
30. Sargeant, "Relationship Fundraising," 177–92.
31. William T. Harbaugh, "What Do Donations Buy?: A Model of Philanthropy Based on Prestige and Warm Glow," *Journal of Public Economics* 67, no. 2 (February 1998): 269–84.
32. Anil Mathur, "Older Adults' Motivations for Gift Giving to Charitable Organizations: An Exchange Theory Perspective," *Psychology & Marketing* 13, no. 1 (January 1996): 107–23.
33. Bennett and Sharmila Savani, "Predicting the Accuracy of Public Perceptions of Charity Performance," *Journal of Targeting, Measurement and Analysis for Marketing* 11, no. 4 (May 2003): 326–42.
34. James W. Harvey and Kevin F. McCrohan, "Fundraising Costs: Societal Implications for Philanthropies and Their Supporters," *Business and Society* 27, no. 1 (spring 1988): 15–22.
35. Anne Lowrey Baily and Bruce Millar, "United Way: The Fallout after the Fall," *Chronicle of Philanthropy* 4, no. 10 (March 1992): 2–6.
36. Bennett and Savani, "Predicting the Accuracy of Public Perceptions of Charity Performance," 326–42.

This article was based in part on a review of the retention literature commissioned by the Association of Fundraising Professionals. Their generosity in sponsoring this work is gratefully acknowledged.

Notes *on the* Limitations *of* Strategic Philanthropy

by Thomas Scanlon

While there are benefits to strategic grantmaking, organizations should beware of taking the trend too far. As Scanlon concludes about the Public Welfare Foundation's adoption of a strictly strategic approach to philanthropy, "We threw the PWF baby—and many of its best qualities—out with the bathwater."

Editors' note: *The following, originally published on* NPQ*'s website on January 25, 2013, is an edited and abridged version of a memo, titled "Sweet Grapes," to the board of the Public Welfare Foundation. The memo was written by Thomas Scanlon, on the occasion of his leaving the board after forty years of service, including twelve years as board chair. According to its website, the Public Welfare Foundation "supports efforts to ensure fundamental rights and opportunities for people in need [and looks] for carefully defined points where [its] funds can make a difference in bringing about systemic changes that can improve the lives of countless people. The Foundation has an endowment of $450 million and, in its sixty-five-year history, has distributed nearly $500 million in grants to more than 4,500 organizations."*

Reclaiming Opportunistic Grantmaking as a Critical Part of Our Portfolio

Five years ago, the Public Welfare Foundation (PWF) made numerous changes in its governance and grantmaking that undercut many of the traditional qualities and values that have characterized PWF since its founding, in 1947. These qualities had gained for PWF a reputation as an innovator, open to opportunities, and supportive of new ideas as well as fledgling organizations that went on to play important roles in our society and the world.

But in 2007 we wiped the slate clean of many of the Foundation's traditions, values, and culture in a way that was, in my opinion, both unwarranted and unwise.

In 2007, we were told that we suffered, as many traditional foundations did, from "scatteration"—that is, too many projects in too many areas of interest. We were urged to focus on carefully defined programmatic objectives, and "to identify and frame problems and to determine whether systematic changes have been set in motion." Management called on us to set program objectives and ask potential grantees how to reach those objectives.

There was truth in this analysis. There had been mission creep over the years, and our funding was

Thomas Scanlon is the founder and president of Benchmarks, Inc., a consulting firm that has created and implemented social development programs in the U.S., Latin America, and China. He was among the first young Americans to serve overseas in the Peace Corps, about which he published an acclaimed book, *Waiting for the Snow*. Scanlon is a graduate of Notre Dame, and he holds a Master of Philosophy from the University of Toronto and a Master of Public Law and Government from Columbia University. He was the longest-serving board chair in the Public Welfare Foundation's history, and his tenure on the board included serving on nearly all of the Foundation's committees.

"DREAMING OF FLYING" BY ALEXANDER SENIN / WWW.STPHOTO.SMUGMUG.COM

“If too many donors seem to shut off openness and readiness to support ideas from outside our walls, we will cut off a source of creativity and undermine one rationale for our existence: being an R&D resource for the innovative ideas that spring from diverse populations.”

dispersed throughout too many program objectives. In the end, however, I think we went too far. We threw the PWF baby—and many of its best qualities—out with the bathwater.

Essentially, we embraced the new philanthropy: strategic philanthropy. To understand this trend, and some of the misgivings about it, I want to quote from some outside experts here. Stanley Katz, writing in the *Chronicle of Higher Education* earlier this year [2012], gave an apt description of this new thinking. He wrote:

> Foundations have tended to reduce the number of program areas in which they give funds, to be more precise and detailed in their program objectives, to restrict project time frames, to establish benchmarks for continued financing, to evaluate grantees in a more precise manner, and to form partnerships with grantees in managing their projects. Paul Brest, the very able president of the William and Flora Hewlett Foundation, has summarized the new position: “The fundamental tenets of strategic philanthropy are that funders and their grantees should have clear goals, strategies based on sound theories of change, and robust methods for assessing progress toward their goals.”[1]

There are certainly benefits to strategic grantmaking, and the present program of the Public Welfare Foundation illustrates them. We are identified with several unique funding niches as we work to reduce the number of persons incarcerated in our country, stop unnecessary detention of juveniles, and advance worker rights.

My own personal view is that we are overconcentrated in these areas and that we could have a real impact with grants that are fewer and smaller in size. Our advocacy of healthcare reform, for example, especially at the state level, was highly effective (and was considered the most effective by Grantmakers in Health), and yet it never crowded out the possibility of making grants to deal with other social problems or to assist new organizations or community groups.

The Foundation does allow for “Special Opportunities” in its program guidelines, but this does not open up the possibility for new initiatives as much as I would like. Our guidelines prohibit organizations from submitting “unsolicited” ideas. Criteria for use of these limited funds has become highly restricted and limited to the Foundation’s “mission”—that is, strategic objectives. I hope you support many more initiatives in the years ahead, and that many suggestions for new initiatives come, as was the case in the past, from board members themselves.

Susan Berresford, former president of the Ford Foundation, has pointed out some of the limitations of the strategic approach. She did this in an article in the *Chronicle of Philanthropy* and in a speech delivered at Duke University’s Fuqua School of Business, in 2007.[2] Among the pitfalls of strategic philanthropy that she saw were:

1. That it could “miniaturize ambitions” (i.e., settle for small, measurable, short-term results);
2. That it could create outsize expectations or an impatience for results; and
3. That it could turn applicants into contractors, who position their programs in ways to meet objectives set by foundations rather than pursue their own ideas and goals.

Most importantly, however, she pointed out that it could stifle creativity on the part of the grantees and the foundation:

> In the same spirit, I think we should be careful about too many foundations shifting the way they operate to designing and driving all the work they fund—again, the venture model. When I look back on my now forty years in philanthropy at Ford, I see that half of the results I am proudest of came from ideas we might describe as “hatched at the foundation.” But fully 50 percent came from ideas others brought to us because they needed money to make them happen and they took their chances with us. If too many donors seem to shut off openness and readiness to support ideas from outside our walls, we will cut off a source of creativity and undermine one rationale for our existence: being an R&D resource for the innovative ideas that spring from diverse populations.

Ms. Berresford contrasted the new or "strategic" philanthropy with the old. She concluded that the new/old effectiveness dichotomy should be abandoned. The "old" donors (I accept the sobriquet for the "old" PWF) were indeed interested in goals and results, and we should not say that they weren't. Too much emphasis on the "new approach," she stated, "has the capacity to damage our field. We should appreciate, rather than disparage, charity."

The adoption of a strictly strategic approach hampers what has been the most oft-cited and salient characteristic of PWF grantmaking: the responsiveness to new ideas put forth by new organizations. As I wrote in the introduction to *Seeking the Greatest Good*, my greatest satisfaction over the past forty years of being a director has been to hear from important institutions, time and time again, that we were the first or one of the first foundations ever to give them a grant.[3] Funding the first hospice in the United States and spreading the hospice movement around the United States was not something we planned to do; it came to us as an opportunity, and we seized upon it.

Over many years, the public reputation of PWF has largely been based on our ability to be "risk takers." I have used that term to describe us many times. On writing this memo, however, I began to think that "risk taker" was not the proper term. It did not take much of a risk, for example, to provide $2,000 to Sesame Street in its earliest days so that TV sets could be made available to low-income children. It was not much of a risk to be among the first to support Bob Greenstein at the Center on Budget and Policy Priorities, or John Adams at the National Resources Defense Council, or Joe Eldridge and Bill Brown at the Washington Office on Latin America. In retrospect, I believe that we were not so much risk takers as believers—believers in individuals, believers in a dream, believers in an idea whose time had come. We were, to use my favorite phrase, philanthropic opportunists. I urge you to give openness, responsiveness, and opportunism an equal place again on the scale of values that drive the grantmaking of the Public Welfare Foundation.

Restoring Direct Service and Empowerment of the Poor

For several decades, the key operating principles of the Foundation were a commitment to direct service, advocacy, and empowerment of the poor. In 2007, we walked away from two of these three key elements of our program.

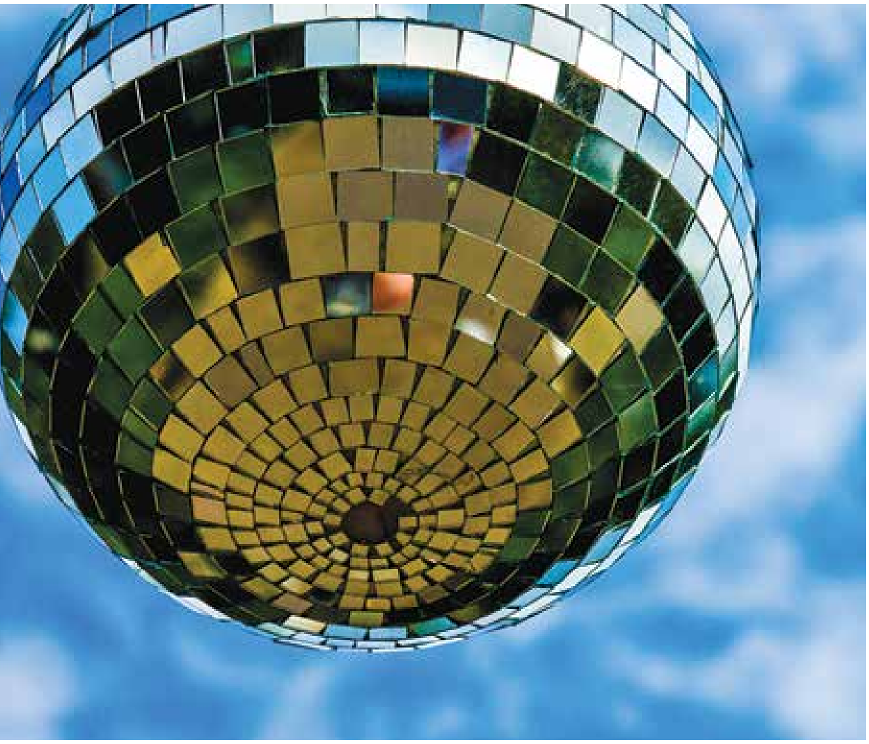
I cannot recall when the board explicitly ruled out support for direct service, and can find no mention of this decision in the strategic recommendations made in 2007 or in the guidelines that the board approved in subsequent years. Yet the description of the grant application process says that the Foundation does not fund direct services.

If anything, there has been renewed interest in direct service in some of the most important philanthropic institutions. Our new partner, the Kresge Foundation, which previously focused on building projects, has adopted a strategic approach but exclusively supports "organizations that provide critically needed assistance to individuals and families." Their rationale is that such programs "anchor us in the challenges and promising practices of day-to-day human service work."

To our founder, Charles Marsh, direct service was everything. It was epitomized by his creation of the agent system. The goal was to find people who would "distribute funds to needy people without their being compensated themselves." He wanted no paid staff, no bureaucracy, no middleman. Ten years after PWF was created, Marsh had eighty-nine agents spread throughout the world providing direct service to needy populations with practically no administrative or staff costs. This was about as direct as you could get. Foundation lore has it that Charles Marsh was the model for the television program "The Millionaire," which was so popular in the 1950s for highlighting anonymous gifts to individuals and families in dire need.

Over time, the Foundation realized that advocacy was also a critical tool in addressing poverty, but we should never let advocacy replace direct service in our scale of philanthropic values. Direct service organizations keep us in contact with the individuals whose problems our policy work is aimed at resolving. They can, in themselves, be

For several decades, the key operating principles of the Foundation were a commitment to direct service, advocacy, and empowerment of the poor. In 2007, we walked away from two of these three key elements of our program.



Through its community support efforts [. . .] PWF established a unique reputation for supporting grassroots efforts and community change. I continue to believe in this type of funding as a mainstay.

an important tool for community organizing and empowerment work. They bring the board and the staff to where "the rubber hits the road," and provide greater assurance that our time, effort, and resources have made a visible difference in the lives of individuals.

We have removed another key prop of the PWF funding platform: empowerment of the poor. This commitment entered into practically everything we did, even advocacy. Former PWF Executive Director Larry Kressley always made a distinction between "inside" and "outside" advocates, the insiders being those directly affected by the problem: the communities themselves. Nowhere was this more important or obvious than in our environmental justice work, where we enabled communities affected by pollution and contamination to become involved in advocating for change. When we launched the Fund for Washington's Children and Youth as part of our fiftieth anniversary celebration, in 1997 (a direct service project aimed at one of D.C.'s poorest communities, Ward 8, or Anacostia), we asked the communities themselves to establish the program criteria and to create an advisory council to help us decide on grants.

Through its community support efforts, carried out over decades, PWF established a unique reputation for supporting grassroots efforts and community change. I continue to believe in this type of funding as a mainstay.

Restoring a Global Vision

In 2007 the PWF board accepted—to my great regret—the argument that there was no place for us on the international scene, where the problems of poverty, illness, and deprivation are so much greater than in our own country.

Charles Marsh's philanthropic instincts and practices were first in evidence in Europe and the Caribbean. Our foundation's first projects were in Jamaica, small "Peace Corps"-type projects that brought improved water supply, vegetable gardens, and even gifts of wedding rings to couples to help them establish their legal rights. The international reach of Marsh's generosity spread rapidly. By 1953 the Foundation was supporting orphanages in France and Burma, and had agents in over twelve countries. Among them were Mother Teresa (yes, Mother Teresa) and Indira Gandhi, in India; Roald Dahl, in England; and Noël Coward, in Jamaica. Marsh's philanthropic interests clearly extended to whomever in the world he could find "in the greatest need."

In 2007 we were told, "the Public Welfare Foundation lacks the on-the-ground expertise to assess the competence and effectiveness of [international] applicants." In other words, we were told that we could not be "strategic" in international programs. The fact is that by being opportunistic and acting even without "on-the-ground expertise," the Foundation pioneered numerous international programs that had lasting and far-reaching effects. Here, I will recount several of them.

- PWF was one of the first foundations to support microenterprise. Microenterprise development plays an important role in the plans of all development agencies today as an exceptionally effective means of promoting economic growth and creating jobs. Our first grant, to Acción Internacional, who helped develop this tool, was in 1975 for a program in Brazil. We continued to support Acción with over $3 million until the early 1990s.

- PWF was among the first to make a grant to the National Resources Defense Council (NRDC). We did this in 1973. In the early 1990s, our support focused on the Atmospheric Protection Initiative, and supported NRDC's efforts to combat global climate change. We continued to provide NRDC with $250,000 a year for the next fifteen years in support of its climate change initiative.
- PWF became, in essence, the sustaining member of the Arms Control Association, starting in 1973. Its work was lonely but critical, especially in the 1980s, when our leaders were advocating massive military build-ups and placing MX missiles aboveground, on mobile platforms. We also provided core support for the Scoville Fellows Program for many years. The program continues to produce arms control experts today, a task that is as important now as it was then.
- In the last two decades, PWF supported two efforts in Africa that also demonstrated our ability to show leadership in international programs. We supported programs aimed at eradicating the practice of female genital mutilation (FGM) in Sudan, Somalia, the Gambia, Kenya, Guinea, and Egypt—and, shockingly, in New York City, as well. We also carried on a program to educate the citizens of South Africa and other African countries on HIV-AIDS prevention. Both of these programs are now components of massive international campaigns, but this was not the case when we started them. Actually, our efforts to repair the damage to women by FGM started as early as 1974, with multi-year support to the Hamlin Fistula Hospital in Addis Ababa, Ethiopia.
- In the 1970s and 1980s, we provided critical early funding to the Hesperian Foundation, which wrote and distributes the world-renowned book, *Where There Is No Doctor*. The book provides guidance on how to deal with serious injury and illnesses in remote places that lack medical facilities. Our grant enabled the foundation to create the first translation of the book into Spanish: *Donde No Hay Doctor*. Larry Kressley serves on the board of the Hesperian Foundation today. He told me that, were it not for PWF's help, "the Hesperian Foundation would not exist." The book has now been translated into 122 languages, and placed in the hands of over one billion individuals.
- Perhaps the greatest evidence that PWF can and has made a difference on the international scene comes from our experience with the Vietnam Veterans of America Foundation. In 1991, we awarded the Vietnam Veterans its first grant. It was for a direct service program in Cambodia to provide prosthetics to individuals who had lost limbs due to landmines. The Vietnam Veterans had a dual purpose that included efforts to ban the use of landmines as well as to eradicate those that already existed. We showed interest in this advocacy effort as well, and awarded them over $800,000 during the 1990s. In 1997, the foundation received the Nobel Peace Prize for co-founding and coordinating the Global Campaign to Ban Landmines.

Forgive me for the strong opinions and views expressed here. It's just that I know that foundations can and must change. Some of the changes we made in 2007 were for the good, but I want to urge you, in the strongest terms possible, to consider the values that have prevailed throughout the Foundation's history as your guide to its evolution into the future.

Forgive me for the strong opinions and views expressed here. It's just that I know that foundations can and must change [. . .] but I want to urge you, in the strongest terms possible, to consider the values that have prevailed throughout the Foundation's history as your guide to its evolution into the future.

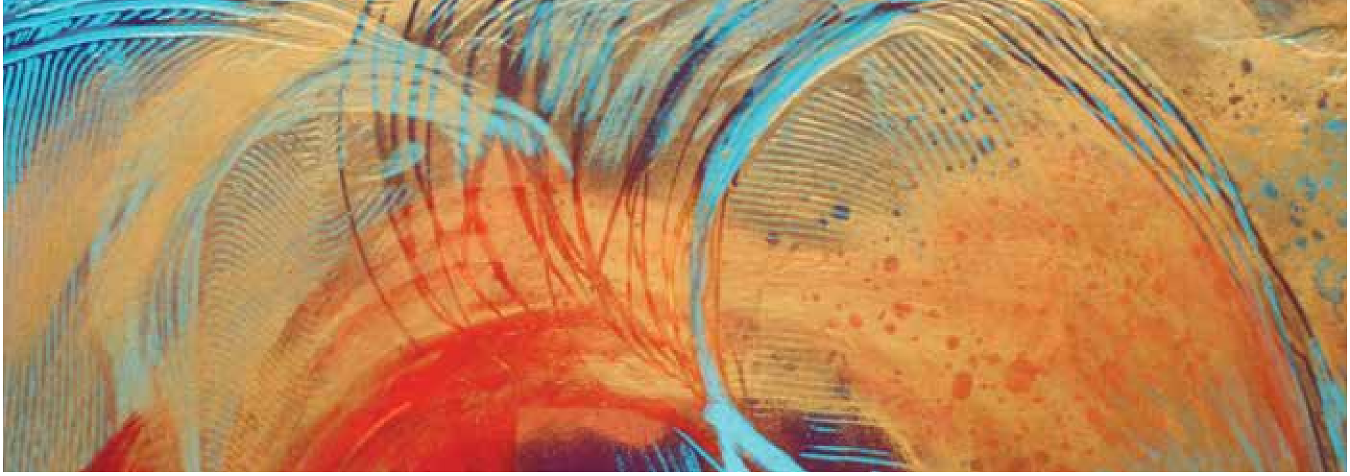
Notes

1. Stanley Katz, "Big Philanthropy's Role in Higher Education," The Chronicle Review, *The Chronicle of Higher Education*, March 25, 2012, www.chronicle.com/article/Big-Philanthropys-Role-in/131275/.
2. Susan Berresford, "What's the Problem with Strategic Philanthropy," *The Chronicle of Philanthropy*, October 3, 2010, www.philanthropy.com/article/What-s-the-Problem-With/124671/.
3. Peggy Dillon, *Seeking the Greatest Good: The Public Welfare Foundation* (Washington, DC: The Public Welfare Foundation, 2000).

Getting Serious about Philanthropic Capital

Editors' note: *For some years, the* Nonprofit Quarterly *has been tracking conversations about new philanthropic practices related to capital grants aimed at building organizations, but until just recently it sounded to us like a collection of practices instead of an emerging cohesive approach. In this group of articles, philanthropists and grantees describe in eerily similar terms what it takes to capitalize growth and transformative change in a nonprofit enterprise.*

"APPLE OF MY EYE" BY GRAY JACOBIK
WWW.GRAYJACOBIKARTIST.COM



Capital, Equity, and Looking at Nonprofits as Enterprises

by Clara Miller

Editors' note: NPQ *considers the practice described here to be a significant development in philanthropy.*

"Enterprise capital," the nonprofit equivalent of for-profit equity capital, is what fuels an organization's rise to the next level of performance. Here, the author outlines how these "equity-like" capital grants work.

The F. B. Heron Foundation is an investor—a capital investor—in enterprises where we see opportunity for mutually productive social and financial gain. As is the case with most foundations, our work includes nonprofits but is not exclusive to them: we invest across the spectrum of legal forms of organization, in public and private for-profits, governments, cooperatives, nonprofits, and hybrids. Our approach differs from that of most foundations in that *all* our investing is done to further our mission—the typical approach being that only grants to nonprofits are mission focused. We look for opportunities to make a positive difference through the power of finance and enterprise, skillfully deployed. Lately, we have been encouraged that a growing number of our foundation colleagues are finding ways to make the powerful combination of financial tools (debt, equity, grants, performance contracts, and more), enterprises (nonprofits, for-profits, and others), and program savvy work together to further their philanthropic agenda.

There is one particular need, however, that gets little attention, and it falls under the category of grants—and that is a nonprofit equivalent of for-profit equity capital, especially that subdivision of equity that focuses on mid-stage enterprise growth and change. While there exist some notable exceptions—the Edna McConnell Clark Foundation (EMCF), Omidyar Network, New Profit Inc., Venture Philanthropy Partners (VPP), and Nonprofit Finance Fund have done pioneering work in this area—both this kind of capital investing and the analysis, modeling, and structuring of a multi-party "grant deal" that gives the concept integrity are rare.

But this is not for lack of conversation about capital. In fact, for a while now I've been hearing

Clara Miller is president and director of the F. B. Heron Foundation, which helps people and communities help themselves out of poverty. Prior to assuming the F. B. Heron Foundation's presidency, Miller was president and CEO of Nonprofit Finance Fund, which she founded in 1984 and ran through 2010.

a lot of loose talk about capital in the nonprofit sector—loose, in the sense that we use the word "capital" interchangeably with words like "money," "income," "debt," and even "buildings." Hand-wringing about our sector-wide need for "capital"—or even "access to capital"—is invariably accompanied by vigorous head-nodding from all sides. "Lack of capital" is reflexively cited as the sector's final barrier to rapid scaling (of the nirvanic "hockey-stick trajectory" variety). And it has become axiomatic that unleashing untold trillions of dollars from the global capital markets (most of which are evidently panting for nonprofit action) will fix all manner of social ills.

But in our experience, "revenue," or "income," is far more fundamental to enterprise and mission success than capital—preferably reliable, repeatable net revenue. We're talking proceeds of government contracts, reimbursements by third-party payors, sales, net interest, tuition, bingo receipts, dues, ticket sales, annual appeal fundraising, investment earnings, and more. Without it, all bets are off: revenue pays for the operations that deliver goods and services day in and day out. Most businesses—including nonprofits—rely on revenue, not capital, to deliver every day. It's revenue, not capital, that we need to pay rent, salaries, the electric bill, and similar expenses—and without it, we don't have a sustainable business. Capital cannot make up for a permanent lack of net revenue.

So why the flap about capital?

The widely miscast and misunderstood "capital" (particularly "enterprise capital"), while less fundamental than revenue, cradles a growing star performer and takes it to the next level of performance. Lack of capital can sink an enterprise just as it seems to be taking off, even when revenue is pouring in the door.

Planning for, raising, and deploying equity-like capital in a nonprofit fulfills three needs that are universal for a growing or changing enterprise, regardless of tax status: 1) capital *investment*—separate and distinct from regular income, or revenue—when growth or change occurs; 2) the benefits of shared "ownership" and shared risk by a concerted, expanded group of investors and, potentially, supporters; and 3) the adoption of a protective rather than an exploitative role for these stakeholders (aka the equity holders ethic).[1]

Without equity-like behaviors and significant amounts of capital in the form of equity-like capital grants, significant long-term growth in nonprofits is painfully slow, often unsustainable, and frequently accompanied by a reduction in program effectiveness. With this capital, while risk is never absent, it is planned for, managed, and mitigated. The benefits go to the ultimate beneficiaries of the enterprise—where the greatest risk in the nonprofit sector resides—and the Shangri-La of sustainability is at last attainable (or at least understood by all parties, whether attainable or not).

Here's how it works in operation. When any enterprise starts up or grows, it needs both revenue and capital, and, as noted above, the former takes precedence. Beyond regular revenue, owners or managers need at least a bit of capital to set up (or expand, refresh, or improve) the facilities, processes, departments, skill sets, programs, cash reserves, and more that it takes to produce those goods and services in the first place. Capital investment can be as simple and small as a pitcher filled with lemonade, or as complicated and large as oil rigs and barges. And while the platforms built by capital are very different among enterprises, the cash from selling lemonade or selling oil is just the same. Cash is a little like air—everyone breathes the same air, billionaire or foundling, regardless of wealth, body size, planes owned, or trophies accumulated. And when there isn't enough air—or cash—the consequences are the same for all, great and small.

Entrepreneurs get capital to build that "platform" from a variety of sources: at the beginning it may be friends and family, or the well-known approach of "sweat equity" (unpaid labor) bolstered by personal credit cards. Founders of start-ups in both the nonprofit and the for-profit worlds typically use these methods, often combining them with profound resourcefulness.

Later on, when an organization grows, getting financing to build a larger production platform becomes more complicated, and the process of managing growth itself is challenging. At several stages of growth, the enterprise requires additional capital to expand the original setup to meet expanded demand, to make operations more

The widely miscast and misunderstood "capital" (particularly "enterprise capital"), while less fundamental than revenue, cradles a growing star performer and takes it to the next level of performance.

There is a period—sometimes relatively short, sometimes over years and years—when the enterprise needs to spend capital on expansion before the quantity and reliability of revenue make the enterprise profitable at an expanded or enhanced level of operation.

efficient, or to create new or improved product or program offerings (or all three!). There is a period—sometimes relatively short, sometimes over years and years—when the enterprise needs to spend capital on expansion before the quantity and reliability of revenue make the enterprise profitable at an expanded or enhanced level of operation. This is because growth typically occurs in a smooth curve, while capacity is built in increments that look more like stair steps, with the investment ideally coming in chunks before the growth (i.e., it's hard to hire one-quarter of a chief financial officer when you need a higher skill level in the finance area). In other words, the enterprise operates at a deficit for a period of time—often years—before it reaches sustainable operations again. If the deficit is temporary, capital investment funds that gap.

Most enterprises, in particular for-profits, use "retained earnings"—essentially savings from profitable operations—to fund growth, especially incremental growth. In the nonprofit world, retained earnings may be unavailable due to emaciated operating margins (i.e., no profits), and are generally frowned upon by funders (i.e., if you already have money, why are we funding you?). So when retained earnings aren't available, sometimes debt can bridge the financial gap, funding expansion of the platform before positive net revenue kicks in.

Debt is sometimes the answer. An enterprise with highly reliable revenue may borrow to pay for expansion ahead of revenue (think nursing homes with approved slots and the revenue that goes with them). But debt has its limits as a source of growth capital. "Reliable revenue" and "smooth growth" leave out many important organizations. Reliability of anything is scarce for organizations that are innovative. And in the nonprofit sector, those providing preventive services or doing advocacy outside an institutional setting have the risk factor of a predictably "sometimes" funding base. For them, the growth trajectory is too unsettled and the path is too obscure to use debt to finance growth, since most loans rely on a fixed schedule of payments over time.

When debt and sweat equity won't do it, where the principals simply lack needed skills, or where loans aren't appropriate for the level of operating uncertainty or scantiness of operating margins implied by growth, owners of many for-profit businesses sell ownership shares, called "equity," in their companies. Equity isn't repaid on a schedule, as is debt, but equity shares (representing ownership of a part of the company) can be sold for a profit by the investor when the company becomes profitable, grows, and the shares increase in value. The company's owners and managers invest the cash proceeds from selling these shares in an enhanced operating platform (capacity), ideally attracting more net revenue that produces more value for both the customers and themselves. Moreover, the larger group of investors/stakeholders takes on the role of assisting in the enterprise's success by helping to attract market share, expand business relationships, or provide coaching. Capital comes in social and intellectual, as well as financial, form. The interests of all owners are aligned: everyone wants growth—but healthy growth—so shares will increase in value over time. Equity holders want to protect the enterprise from overexploitation so it can survive and thrive.

This fund raise—or selling of more equity shares—may happen several times periodically over the life of an enterprise. Sometimes, business is so good that the private shareholders sell their shares to the public—through an initial public offering (IPO)—and the company becomes a "public company," but that's later!

Equity in this form is unavailable to nonprofits, in part because by law nobody can own or directly profit from a nonprofit enterprise, so technically there are no owners. Nonetheless, nonprofits' non-debt growth financing needs remain. Without access to some form of equity-like capital, nonprofits are pretty much sentenced to difficult, unhealthy, or slow growth. Beyond money, they lack supporters who take the protective role of the equity holder, even among board members. Everyone wants the nonprofit to do more, especially when opportunity knocks and additional revenue pours in, and the organization struggles with extreme pressure, given a too-small production capacity (think Disney's masterpiece, the cartoon *The Sorcerer's Apprentice*, where the

Sorcerer's broom enacts ever-increasing demand giving rise to out-of-control operations in the hands of an inadequate head count and skill set!). When intractable problems emerge in the face of success, it's confusing to many nonprofits and their supporters, who view increased revenue as growth, and think, "Mission accomplished—we're having more impact."

Sadly, the highest-performing and most promising organizations are the most vulnerable to severe growing pains, simply because they're opportunistic and successful, and find more and more ways to grow. Their success means they are the ones most likely to attract more revenue—restricted grants, a dizzying array of government contracts, project funding, an expanded list of willing individual givers. If it's like most revenue in the nonprofit world, it doesn't cover the fully loaded cost of operations, much less the cost of growth. And in the absence of equity capital to expand the systems and head count that can serve this heightened demand, retool systems to gain efficiency, and manage a more complex revenue mix, promising projects will not be sustainable, contracts will go unbilled and sometimes unfulfilled, and willing funders will languish unapproached and unstewarded—to name just a few sets of unintended consequences. What seemed like a slam dunk suddenly becomes a nightmare of cash-flow crises, abrupt resignations, internecine board-staff conflicts, and plummeting program results.

In the face of growth without enterprise capital, all enterprises—including, but not exclusively, nonprofits—use other means to "fund" capital needs in response to demand: overexploitation of human capital (i.e., long hours, stagnant pay, reduced benefits, more part-timers and unpaid interns); a slowing of bill payments, evidenced by higher payables and, sometimes, "evergreen" lines of credit; breathless and understaffed operations and poorly maintained facilities; and, worst of all, deteriorating program and product quality.

Enter a philanthropic form of equity, which we call "enterprise capital grants," and which we (and some of our colleagues named above)

When intractable problems emerge in the face of success, it's confusing to many nonprofits and their supporters, who view increased revenue as growth, and think, "Mission accomplished—we're having more impact."

Just as it does for its for-profit cousins, enterprise capital allows growing nonprofits to plan for and pay the inevitable deficits incurred on the way to reaching and maintaining an enhanced and durable level of operations.

consider the heart of our grantmaking. Just as in the for-profit world, these grants, ideally raised in a capital campaign–style concerted effort, acknowledge the need for the heightened amount of investment that accompanies program-focused revenue growth. Just as it does for its for-profit cousins, enterprise capital allows growing nonprofits to plan for and pay the inevitable deficits incurred on the way to reaching and maintaining an enhanced and durable level of operations. And, finally, providers of growth capital, along with the managers and boards of the organizations involved, together acknowledge that growth is risky and that they play a protective role—not only for the enterprise but also, and more importantly, for the ultimate risk takers: the beneficiaries and causes everyone hopes to serve.

While some funders instinctively understand the need for equity-like capital grants (small bits are often labeled "capacity building"), these grants frequently target only one part of operations—the computer system or staff training or board development. The reality is that a growing nonprofit needs relatively large amounts of capital to build an expanded operating platform. This more muscular platform, in turn, reliably attracts more net revenue—including but not confined to fundraising income—and eventually makes these and other expanded capacities part of ongoing operations. An occasional lucky grant for capacity building won't suffice.

The funders mentioned above—EMCF, Omidyar Network, New Profit, and VPP—have had experience providing these growth funds, in concerted campaigns, to individual promising organizations or to "anchors" of local neighborhoods. And while there's much more to learn (and they are the first to say so), we can see some lessons emerging.

Even if you aren't going to be a capital funder (and remember, revenue is more important, so being a good general-support funder is important too), identifying the warning signs of uncapitalized growth and making sure the growth of organizations that serve the people and causes you care about is fully capitalized is critical. Here are some ideas on ways for foundations and givers to proceed:

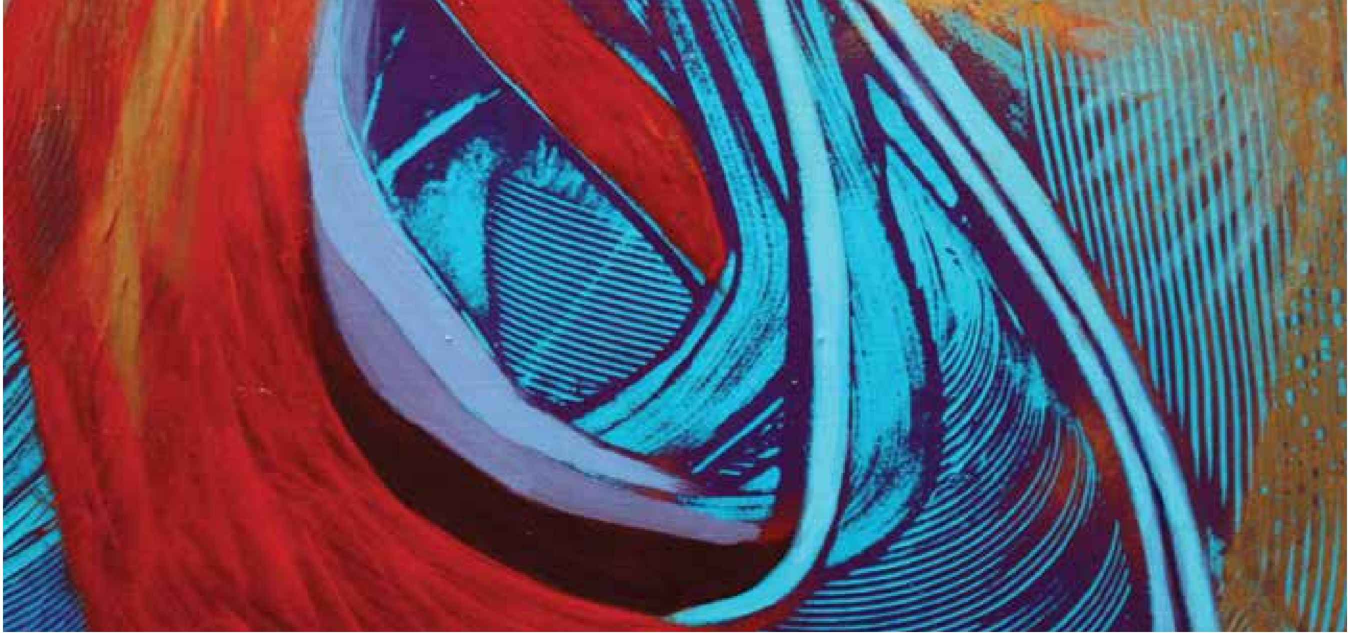
- **Make sure that growth and sustained change of any kind is capitalized fully.** Otherwise, continue to fund the great programs and services you love so much with regular revenue. Don't provide or use regular revenue to fund growth, unless it's retained earnings from net revenue (and if it is, congratulations!).
- **Make sure that any strategic plans you fund include a rigorous business section.** This must include a competitive analysis of the market; sources of revenue, with projections; and projections of increased operating costs, both structural and marginal, for an expanded organization. In my opinion, it is consulting malpractice to posit a "BHAG"-type strategy with no numbers.[2]
- **Require operating projections and regular financial reporting that separate operating revenue from capital investments on both the income and expense side.** Confusing regular revenue with capital—which is further complicated by "project grants," which are somewhere in the unhelpful middle—is at the heart of much confusion about finances and overly sunny expectations of growth and financial performance.
- **Remember that when revenue grows significantly, capital will be required.** This is counterintuitive: give or get *more*—not less—in the form of growth capital to organizations that you think are great and that are taking on growth. If they get more revenue from others but don't have capital to build the "factory" in order to execute well, then they need you more than ever. Don't stop revenue to give capital—they need both if they are going to grow.
- **Know your financial role, beyond deep program knowledge.** Are you a buyer (paying for program delivery) or a builder (building additional delivery capacity)? You can be both, but paying marginal prices for delivery of additional programming without building capacity to support it will simply shift the unfunded cost to others, or leave it unaddressed. It won't go away, and it will probably do harm to your favorite organizations and, most importantly, their beneficiaries.

- **Find buddies to fund capital campaigns with you for organizations you care about.** There is a reason that classic capital campaigns, most of which target only buildings or endowments, require a multi-party, multi-year fundraising effort. Few foundations make grants big enough, on average, to get a small or midsize organization up a three-to-five-year growth curve. Per the Foundation Center, average grant size for all subject categories was just shy of $166,000, and the median was $28,462. For human service organizations, this was even lower (and the lowest for any category): $86,433 average and $25,000 median.[3] The math is instructive: even the largest grant available from most foundations won't suffice. Midsize high performers will need in the tens of millions of investment capital to truly maintain quality and create sustainability as growth occurs.

Notes

1. See George M. Overholser, *Nonprofit Growth Capital: Defining, Measuring and Managing Growth Capital in Nonprofit Enterprises; Part One: Building Is Not Buying* (New York: Nonprofit Finance Fund, 2005), nonprofitfinancefund.org/files/docs/2010/BuildingIsNotBuying.pdf, for a clear and thoughtful description of the difference between the exploitative role of a buyer and the more protective role of the "builder" (i.e., equity investor) in enterprise finance, including its importance to funders of nonprofits. The author also wrote about this in "The Equity Capital Gap," *Stanford Social Innovation Review* (Summer 2008), www.ssireview.org/articles/entry/the_equity_capital_gap.
2. BHAG: Big Hairy Audacious Goal.
3. The Foundation Center's Statistical Information Service, "Average and Median Grant Amounts by Major Subject Categories, circa 2011" (New York: The Foundation Center, 2013), foundationcenter.org/findfunders/statistics/pdf/04_fund_sub/2011/avg_sub_11.pdf.

To comment on this article, write to us at feedback@npqmag.org. Order reprints from http://store.nonprofitquarterly.org, using code 200205.



Edna McConnell Clark Foundation's Growth Capital Aggregation Pilot: A Bold Philanthropic Innovation

by the editors

EMCF is known for its innovative philanthropic initiatives, and its pilot project, GCAP—emphasizing metrics and performance-based funding, among other capacity-building measures—is an interesting example, providing, as the article describes it, "a model for the development of evidence-based programming that may set standards and provide blueprints for other youth-serving organizations."

The Edna McConnell Clark Foundation (EMCF) is no business-as-usual foundation—nor is it the kind of philanthropic gadfly that chases fads and fashions. Rather, EMCF has brought a scientific and experimental kind of consistency to philanthropy in the field of youth development. In doing so, it has utilized many of the principles discussed in Clara Miller's article—an up-front investment based on a business plan, faith in the capacity of the organization to perform against the plan, creation of shared ownership among a group of investors, and multi-year funding of a size to limit the constant distractions of immediate fundraising.

Approximately fourteen years ago, EMCF began a process of changing its philanthropic focus and its methods. Where previously it had a number of active portfolios on criminal justice, health, and other ventures, over time, under the leadership of Mike Bailin and then Nancy Roob, it has become almost exclusively focused on youth-serving programs. But its bar for grantee performance became increasingly high. EMCF chose to fund what it saw as star or model programs with rigorous external evidence of effectiveness, and the screening processes it put applicants through were legendary. But, once in the pool, grantees could be assured of getting very close attention and a lot of assistance.

But EMCF took the scheme to an entirely different level with its $120 million Growth Capital Aggregation Pilot (GCAP), which was launched in 2007 and extended for five years. It was aimed at taking "to scale," or at least to broader scale, three programs that produced results and in which EMCF had faith. Only $39 million of the total comes from EMCF, but EMCF helped attract the rest of the funding, which is pooled, and it monitors the progress of grantees.

And since there are only three grantee organizations—Citizen Schools, Nurse-Family Partnership, and Youth Villages—this means that they received an average of $40 million. The pilot, according to a report by William P. Ryan and Barbara E. Taylor, was to help them expand their impact, improve their evaluation methodologies, and reach a sweet spot of sustainability by maximizing their "reliable-renewable sources" of revenue.

GCAP invests in the grantees' business plans, leaving them the freedom to spend their money as they see fit, as long as they make sufficient progress toward their goals. The investors rely on reporting systems that focus on that progress rather than on uses of money.[1]

The project is interesting on a number of levels. First, because it is massive in its investments in comparison to other aggregated capital efforts; second, because the investment was made just as the recession hit; and third, because its reporting lays out some of the growth-leveraging tactics used by all three organizations, the degree of difference in results, and the variables across the three organizations.

EMCF's Role

As the lead investor, the Edna McConnell Clark Foundation was also responsible for supporting and monitoring the grantees' progress and for providing quarterly reports to other investors. This also cut down on transaction time for the grantees, who did not have to report in various ways to multiple funders—this was described as "mindshare," or the time that grantees were afforded to focus on their strategic objectives. It also, according to the report, supported a bigger evaluation footprint than would have been possible if the reporting standards and mechanisms had been more diffuse.

On the downside, this central role also cut down on the face time that grantees had with all their funders. Overall, it was a focusing mechanism and time-saver, but some worried that it may have limited relationships that were important to their future prospects. This issue has been addressed more recently in EMCF's True North Fund, for which greater connections between co-investors and grantees are facilitated.

Record-Breaking Investments

Each of the three grantees was awarded a different sum:

- Citizen Schools received $30.3 million;
- Nurse-Family Partnership received $50 million; and
- Youth Villages received $40.6 million.

These are described as "big bets," even in the world of high-rolling philanthropy. The report's authors said that they had researched other aggregated grants programs and found around a dozen. Of those, like GCAP, focusing on a limited number of organizations, the average size of the investment was $3 million.

Sustainability in Growth Mode

Assuming that each of these programs will continue to grow and develop, each had to identify what was for them reliable and renewable funding. The definition of "reliable-renewable" varied by program. For Youth Villages, which is providing services in a field where funding is mandated, this meant figuring out the mechanisms

GCAP invests in the grantees' business plans, leaving them the freedom to spend their money as they see fit, as long as they make sufficient progress toward their goals. The investors rely on reporting systems that focus on that progress rather than on uses of money.

Propel*Next*: An Approach for Smaller Organizations

Editors' note: *Propel*Next *is one of the next generation of capitalization initiatives at the Edna McConnell Clark Foundation (EMCF). In this interview, Lissette Rodriguez, managing director of Propel*Next, *describes the EMCF approach with organizations in early stages of development.*

While the Edna McConnell Clark Foundation is committed to its strategy of supporting very large organizations with evaluated program models and business plans that ready them for growth on a national or regional basis, it also recognizes that much excellent work in youth development is done by smaller organizations, and is very local. Because it was clear that the hunger for solid performance measurement and building increased evidence is intense among many of these groups, EMCF, in 2012, began a new initiative aimed at helping propel these smaller youth-serving groups to the next stage of organizational sophistication. This initiative works with organizations with annual budgets of between $1.5 million and $10 million over a three-year period.

And increasing impact is the point, says Lissette Rodriguez, who was responsible for developing and now for implementing the program. What Propel*Next* does with its grantees is "grounded in leading with strong programming and helping them strategically use data to inform and to make meaning out of what's happening." But the approach includes a look at the organization as a whole.

"We approach [this capacity-building] work in a way that we hope will encourage our grantees to connect with what they were originally hoping to achieve. What was the ultimate aspiration? Is this program achieving that aspiration, and if not, what might I need to change?"

NPQ: *So Propel*Next *is not focused on growth necessarily?*

Lissette Rodriguez: Propel*Next* is all about depth and quality. Some of these organizations are going to grow locally, some regionally, and maybe even a few are looking at national expansion.

But, basically, this pilot is a response on the part of EMCF to get to organizations who are doing good work on the ground with promising programs, but who haven't had the wherewithal or the resources to develop their own performance-management capacity—let alone one day possibly be able to conduct any kind of external evaluation—because they hadn't done the internal work to prepare for that and needed the organizational capacity to do both to eventually grow and scale.

NPQ: *Can you sum up what Propel*Next *does, for those readers who may not know?*

LR: Our program is three years long. We are in the first eighteen-month phase, and right now we have a cohort of fifteen grantees. Each grantee gets a cash grant of up to $200,000 and one-on-one consulting support valued at about $150,000 to $200,000, as well. We also have a set of peer-learning activities to tackle common areas that grantees are struggling with as they sharpen their programs, like creating strong performance-management systems and creating the organizational infrastructure to support this work. We are adding an online platform to help to supplement the learning and keep people connected. Ultimately, our goal is to be responsive to the stage of development that each organization is in.

NPQ: *So you are using capital to increase impact but in a different way.*

LR: Yes, I think that people are beginning to play with depth as a scaling concept. Before an organization grows, how do you make sure that its programs have the depth needed to achieve impact? And how do we make sure that program evaluation is such a part of the organizational culture that it informs and guides the work on a daily basis? These are some of the questions we and the grantees are playing with as we do the work.

NPQ: *It sounds like you are in experimental mode.*

LR: We still have so many questions. We are only completing the first year of implementation. The project reminds me of that Rilke quote about living the questions patiently, because whatever data you get is generating additional questions. We have a design for Propel*Next* and we have a set of assumptions, but ultimately our grantees are helping us to test those assumptions.

I'll give you an example. For the second phase, which is the second eighteen months, we originally thought that we would help grantees do business planning. We are spending the first eighteen months helping grantees revisit their theory of change and program design and then helping them align metrics with that revised design. We initially believed that while that work would continue, they would also be in a position to do business planning in the second eighteen months.

NPQ: *That sounds rational.*

LR: It sounds very rational, but we know now that 1) the work takes much longer than we anticipated, and 2) it's not business planning that these grantees need now. Instead, they have to really look at what organizational structures need to be shored up so that what they've done programmatically is institutionalized.

So now we're working with grantees, having them give us suggestions for the design for Phase 2, and asking them what they need next. In the end, it is not our timetable to own. It is work we are doing together.

We must learn from and with our grantees to be effective and respectful funders in this realm. Our grantees have been incredibly successful in their own rights, and they are confident but not so overconfident as to prevent them from examining and deconstructing their own work. In that process they're going to make some changes—some of that they're going to get right and some of that they're not. But, in the context of raising money, how do people who've had a lot success in their communities talk about the fact that they're willing to rethink some of what they've done? This is a dilemma the foundation has to share with our grantees.

NPQ: *There must be a way to begin to talk about this idea of a constant testing of assumptions as being almost the ideal form of practice.*

LR: I think that that would be great. It would just open up such innovation and creativity to get us away from this need to produce slam dunks every single time—which, of course, we don't anyway. I think we all have to try to open up the space for continual learning a little bit.

to optimize their public funding. In contrast, for Citizen Schools, philanthropic dollars were considered to be most renewable, in part because of its high level of volunteer participation and in part specifically because it is not a candidate for high levels of public funding.

[S]ustainability for these grantees, and especially those that are publicly funded, lies in their ability in a performance-focused funding environment to prove that their models work better than others. . . .

The Nurse-Family Partnership, which is fee based through third-party payors, is working from an economies-of-scale model that requires the organization to expand its base of "customers" until the break-even point is reached. However, this, of course, is a model sensitive to the funding streams of the contracting agencies, and one of their major sources is Medicaid, which is now seriously in flux as a result of the U.S. Supreme Court's decision to strike down the portion of the Affordable Care Act that would have required states to expand Medicaid coverage. Still, the environment does give the organization plenty of room for expansion.

Thus, and obviously, sustainability for these grantees, and especially those that are publicly funded, lies in their ability in a performance-focused funding environment to prove that their models work better than others, and in their ability to negotiate political situations in every possible sense.

The Capacity-Building Measures Chosen by All Three Grantees

All three grantees chose to focus on a similar array of capacity-building measures:

- Evaluation. This was, as the report authors state, a natural focus, since EMCF screens its grantees for that native capacity, but it was also fortuitous in that the public and private funding environments emphasize metrics and performance-based funding.
- Leadership development—both on the senior team and at the state and local levels.
- Development of influence in public policy.

What Is the "Scale" Being Sought?

As Ryan and Taylor point out, there is no chance that any one of these organizations will expand to directly serve all of the youth in the United States in need of its services, nor is that EMCF's intention. It was estimated in their report that Youth Villages, for instance, in 2011 served 18,000 of 500,000 youth that may have needed such a service in the United States. Nurse-Family Partnership served 22,000 first-time mothers in 2011 against the 650,000 children eligible for their services born that year.

On the other hand, the robustness of the organizations, their access to great evaluation, and their political acumen and influence may afford the program models greater prominence in their fields. Additionally, the pilot provides a model for the development of evidenced-based programming that may set standards and provide blueprints for other youth-serving organizations.

Is this the right way for philanthropy to go? The *Nonprofit Quarterly* often worries about the "crowding out" effect that such enormous investments can have, promoting one model over others that may be emergent, innovative, or just plain ignored because they have not had the benefit of evaluation or a fully funded infrastructure.

EMCF has tried to address this challenge through its Propel*Next* initiative, which is open to developing youth-serving organizations driven to greater levels of impact (see sidebar).

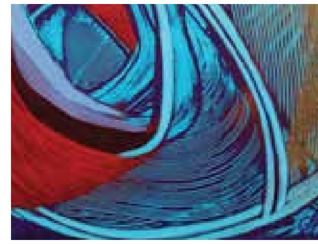
But no one can fault the Edna McConnell Clark Foundation for a lack of full commitment and rigorous attention to institution building among their grantees and in taking this big jump. As the authors point out, EMCF banked its reputation on the success of these grantees so that, ultimately, more young people will benefit from programs that can help them to achieve a healthy, productive adulthood.

Note

1. William P. Ryan and Barbara E. Taylor, *An Experiment in Scaling Impact: Assessing the Growth Capital Aggregation Pilot* (New York: The Edna McConnell Clark Foundation, 2012), 15, www.emcf.org/fileadmin/media/PDFs/GCAPReport_Final.pdf.

To comment on this article, write to us at feedback@npqmag.org. Order reprints from http://store.nonprofitquarterly.org, using code 200206.

An Interview with Nancy Roob*, President of the Edna McConnell Clark Foundation*



by the editors

Editors' note: *In the following interview, Nancy Roob, president of the Edna McConnell Clark Foundation, describes what it took to shift the foundation's approach to grantmaking—narrowing it to one field and many fewer grantees, but deepening its practice significantly.*

When EMCF narrowed its focus to fewer programs in order to deepen its investment, the strategy led to a greater impact on its field of focus—youth development. As Nancy Roob describes it, "What has been powerful about growth capital aggregation is that the grantees we're funding have been able to execute against their own theories of change."

NPQ: *Nancy, when you first joined the staff at the Edna McConnell Clark Foundation (EMCF), the foundation funded an array of five fields. How did you get from that to just youth development?*

Nancy Roob: That change occurred in the late 1990s under the leadership of Mike Bailin, my predecessor, and it came out of a process that the board went through. The board made a decision that, given our limited assets and the desire to know that our dollars were making an impact, we should focus on one substantive programmatic area in contrast to the five we had been in.

NPQ: *So how did this strategy of intensive capital investment in a relatively small number of organizations come about?*

NR: When we initiated this strategy over a decade ago, we had the same intention we have today—which is to find organizations that are making a transformational difference in the lives of the most disadvantaged young people, and to invest in their efforts to improve the quality of what they're doing and scale it up, so that significantly larger numbers of kids can be served and their lives can be dramatically improved.

We believe that one of the major constraints on nonprofits trying to expand what they're doing—or even just to operate at their normal capacity—is not having the resources they need in hand and up front before they launch their growth plans. So, typically they're chasing the dollars while they're trying to execute. One of our core principles from the beginning was that we would help organizations put together their business plans for three-to-five-year periods; we would provide multi-year investments against the performance metrics of these plans; and we would make these commitments up front. The metrics were clear, and we believed that if we helped our grantees put these great plans together—and EMCF made very large investments, which at the time were considered really big investments compared to those we *had* been making and to what was typical for the organizations receiving these grants—other funders would also support these plans.

Around seven years ago, however, we were finding that while grantees were eventually able to raise the money to fully fund their plans, it was a long, hard haul. They were going into year two and three of their plans still challenged with raising money while they were trying to execute. This made it really hard for them to succeed with their plans, and really hard for us as an investor to be confident that our investment approach was adding value. The one major exception during that period was Harlem Children's Zone (HCZ). At the outset, it was able to secure all the capital needed for its first growth plan, due to the leadership of board chair Stan Druckenmiller and of Geoffrey Canada. I'm not suggesting this was necessarily easy, but they did it and it made a difference—HCZ was able to execute their plan confidently and meet all their growth objectives much more rapidly.

We were very agnostic from the beginning about how investors' money could and should flow to grantees. What we wanted was for the money to flow to the grantees, and we didn't care how it flowed.

At that point we determined that we didn't know if we could completely fulfill the potential promise of our strategy if we weren't able to help more of our grantees secure growth capital up front in a more productive way. And that was when we launched the Growth Capital Aggregation Pilot, with three grantees: Citizen Schools, Nurse-Family Partnership, and Youth Villages. It was just a big idea and a guess at that point.

NPQ: *So how did you go about approaching other funders to get involved in this big plan?*

NR: Well, let me back up and say that, in addition to knowing that we needed to help grantees raise capital in a more productive manner, we felt that in some cases we weren't sizing the amount of capital they needed in a big enough way. Even though we thought we were making pretty large investments—and they were much bigger on average than most foundation grants to youth-serving organizations—they weren't big enough to get the job done.

NPQ: *Give me an idea of the size of the grants that were not big enough.*

NR: Our average might have been $5 million over three to five years. We could invest more ourselves, but we also knew we needed to help grantees make a better case for themselves so other funders might also invest.

Take, for example, Youth Villages. They developed a growth plan that showed where an infusion of $40 million in growth capital would leave them at the end of four or five years. They were able to demonstrate how with that growth capital they could reach a different level organizationally, where they would no longer be dependent on that growth capital, which would be replaced by ongoing and more renewable revenue streams—like government contracts that would then fund Youth Villages at that higher level.

The growth capital was designed to get them through a period of executing their plan. So, for instance, if they're going into new states, and they've got a stretch of time when they're trying to create the contracts they need to ensure that public dollars are going to be directed to their services in these states, they could use this growth capital as a bridge. But, at the end of the plan, essentially all of the money that had gone into that $40 million pot would be spent. It was important for our board to know that their commitment wasn't forever—that there was a way to invest strategically against a set of metrics and help an organization get from one level to the next. And we had an assumption that this was going to be really important to other investors, too.

Then we just rolled up our sleeves, basically, partnered with our grantees, and went out and talked with folks. Fundraising is purely a relationship-based endeavor, so we went to folks with whom we had relationships and who were interested in our work, and, most importantly, were interested in the work of Youth Villages and Nurse-Family Partnership and Citizen Schools, and their compelling growth plans.

We were very agnostic from the beginning about how investors' money could and should flow to grantees. What we wanted was for the money to flow to the grantees, and we didn't care how it flowed. We cared about a very simple set of things: that a plan had clear performance metrics and that all the money coming in was up front. So when we went to our board to recommend essentially tripling the size of our normal investments in these three grantees, we basically said to them, and to the grantees, "Okay, we know what our dollar amount will be, but the deal is not done until all of the money is raised." This was a very different way for us to do our business. We gave ourselves eighteen months to raise the money—that's what I told the board—and we raised it in nine. It was breathtaking—though I should add this happened before the economic downturn.

NPQ: *That's phenomenal. Were you surprised?*

NR: I was profoundly surprised in one way but not so surprised in another. We believed deeply that a better path for capitalizing nonprofits was needed, and we knew we and our grantees had a great roadmap to get there. But we had to take on a very unusual set of things to succeed, which made it an exciting and significant breakthrough.

NPQ: *In retrospect, what were the mistakes you learned the most from along the way? Or, what were the critical turning points (like the one you just mentioned)?*

NR: I think our biggest mistake was our very naïve assumption at the start that other investors were going to fund these plans because we were funding them, because the plans were great and the grantees really owned them, and because the performance metrics provided for accountability.

NPQ: *So you actually had to be involved in the fundraising? Is that what you're saying?*

NR: Well, it makes so much sense in hindsight. Today, many more nonprofits have business plans, but ten years ago that was not the case. It was very powerful and transformative for these nonprofits to have business plans and to have gone through the planning experience, and we were really compelled by them, but it was out of the norm. And we underestimated the challenge that funding in this new kind of way—investing in plans with performance metrics—would present to foundations and other philanthropists.

NPQ: *What other kinds of critical decisions changed the way you did something? You made a decision that you did not want to be deeply involved in decision making about those business plans, right?*

NR: We made a decision that the grantees absolutely have to own the plans. So we sit at the table and partner with the grantees while they're going through the planning process, but we're really clear from the beginning that their boards and their management teams have to own the plans. And I think, for the grantees for which we've aggregated capital, we've gotten that right for the most part. Another critical decision we made that could have been a big mistake was to be flexible about structure. We kept our eye on the bottom line, which was that all the money needed to come in up front at the same time, but we had a lot of iterations of how the money should come into the common effort, and we scratched them all.

We could have made a big mistake if we had overly prescribed this. We would have lost a lot of relationships with funders who were psyched to put their money in and happy to put it in up front, but wanted to do it in their own particular way. Being flexible and accommodating like this isn't the easiest thing to do when you're holding yourself accountable to your own board for a set of things, but our trustees were willing to support this, believing it was an experiment worth taking.

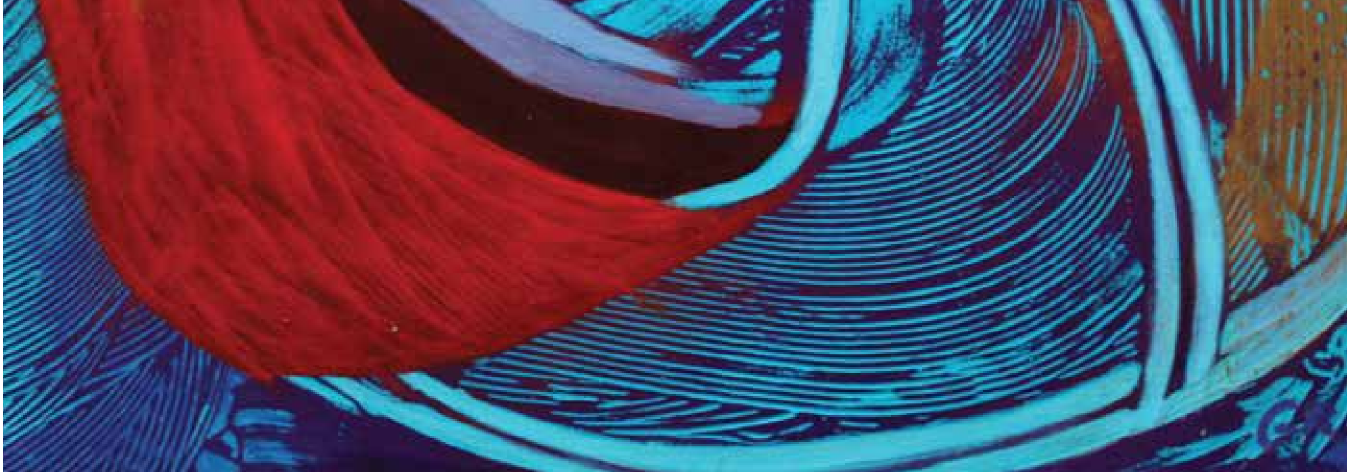
NPQ: *What are the points that you believe you have made through this experiment?*

NR: Some of it is really basic stuff, but fundamentally important. It's hard to help organizations secure up front the resources they need to deliver on performance, yet we've seen where this makes a huge difference. There's a correlation between having the resources you need in hand and getting the results. So I think there are two challenges. One is how money comes into nonprofit organizations. I think this basic principle of funding against performance metrics, funding in full and up front, and then holding organizations accountable for performance really works. The other is sizing investments appropriately to get the results you—and the grantee—want. I think underfunding is very prevalent in the sector. What has been powerful about growth capital aggregation is that the grantees we're funding have been able to execute against their own theories of change, and are not constantly getting pulled in ten different directions by ten different funders' interests.

I think underfunding is very prevalent in the sector. What has been powerful about growth capital aggregation is that the grantees we're funding have been able to execute against their own theories of change, and are not constantly getting pulled in ten different directions by ten different funders' interests.

As a result we've got real solutions that have the potential to dramatically change the life course of kids in this country. Youth Villages and Nurse-Family Partnership, for example, are serious solutions. And we wouldn't have them if they had been funded in ten different ways and couldn't get the money together to stay the course in executing theories of change on their own, based on their own deep expertise with young people and what it really takes to help them succeed.

To comment on this article, write to us at feedback@npqmag.org. Order reprints from http://store.nonprofitquarterly.org, using code 200207.



Second-Stage Growth: *How Major Grants Transformed Our Institutions*

by Rabbi Elie Kaunfer and Steven Lieberman, JD

There are many organizations that could benefit from large investments, but they will thrive or fail depending on access to second- and third-stage support.

Editors' note: *The previous three articles describe the practice of capital funding from the grantmaker's perspective; the following article describes it from an organization's point of view.*

How do start-ups move from infancy to the next stage? Quality programming, a strong brand, skilled leaders (lay and professional), and media presence are all critical. But an obvious, if sometimes overlooked, ingredient is major investment of philanthropic dollars. In the cases of two young educational organizations, Mechon Hadar and Yeshivat Chovevei Torah, major grants transformed and positioned them for second-stage growth. The question is, can these large investments become part of the Jewish philanthropic culture?

Mechon Hadar

Mechon Hadar was founded in 2006 to empower a generation of Jews to create and sustain vibrant, practicing, egalitarian communities of Torah learning, prayer, and service. In its first three years, Mechon Hadar's budget grew from $240,000 to $660,000. At that level of funding, Hadar was able to launch and grow a summer fellowship from eighteen students to forty students. But Mechon Hadar was programming only eight weeks of the year and had only two full-time staff. Although the budget had more than doubled, an infusion of major philanthropic dollars was required to take the leap to the next level and offer twelve months of programming.

For Mechon Hadar, that investment came in its fourth year, in the form of four multiyear grants: a three-year signature Covenant grant ($153,000), a three-year AVI CHAI Fellowship award ($225,000), a renewable $150,000 grant from the UJA-Federation of New York, and, most significantly, a five-year $1,375,000 challenge grant from the Jim Joseph Foundation. Until that point, Mechon

Rabbi Elie Kaunfer is co-founder and executive director of Mechon Hadar; **Steven Lieberman**, JD, is chairman of the board of Yeshivat Chovevei Torah Rabbinical School.

Hadar's largest grant had been a one-time $190,000 grant from the Jim Joseph Foundation. Although Hadar had been supported by more than twenty national foundations in its first three years, the average grant was $25,000. The next year, that average grant size doubled, and the overall budget grew to $1.2 million.

This increase in grant support was not a coordinated effort by foundations; rather, it was a fortuitous occurrence of increased investment that allowed Mechon Hadar to take a daring programmatic leap of faith: hire faculty and staff (including a development director) to work full time; open a year-round immersive learning program; and run multiple classes, seminars, and intensives during the ten months that had previously been unprogrammed. The organization transformed significantly in the space of twelve months, and its impact grew exponentially. Now its 350 alumni live in dozens of cities across the United States, Israel, and Europe, and, according to an independent evaluation conducted by Ukeles and Associates, Inc., have impacted forty thousand of their peers using the skills, confidence, and knowledge they gained at Mechon Hadar.

The matching grant from the Jim Joseph Foundation served as a major catalyst for Mechon Hadar to increase its individual donor base. Indeed, Mechon Hadar has managed to balance the relative investment of individual donors with institutional foundation support. While that balance used to be 70 percent foundations and 25 percent individuals (with 5 percent direct revenue), by last year that had shifted to 54 percent foundations and 39 percent individuals (with 7 percent direct revenue). But while the overall budget has increased every year, actual foundation investment decreased on a real (and not just relative) basis last year (see figure 1).

Mechon Hadar is now poised to make its next major programmatic leap. Having run its twelve-month program calendar since 2009, Mechon Hadar is now focusing on launching three centers (Jewish Leadership and Ideas; Jewish Law and Values; and Jewish Communal Music). These centers will extend well beyond the physical walls of Mechon Hadar's New York base, and greatly increase its impact. The question is, will the same fortuitous occurrence of funding that allowed Mechon Hadar to make its first quantum leap materialize to help move the organization to the next stage?

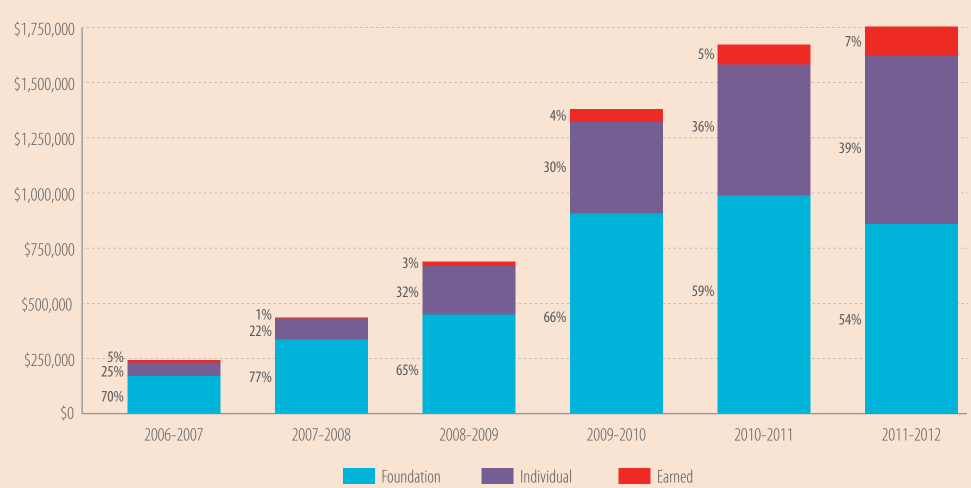
Mechon Hadar has managed to balance the relative investment of individual donors with institutional foundation support.

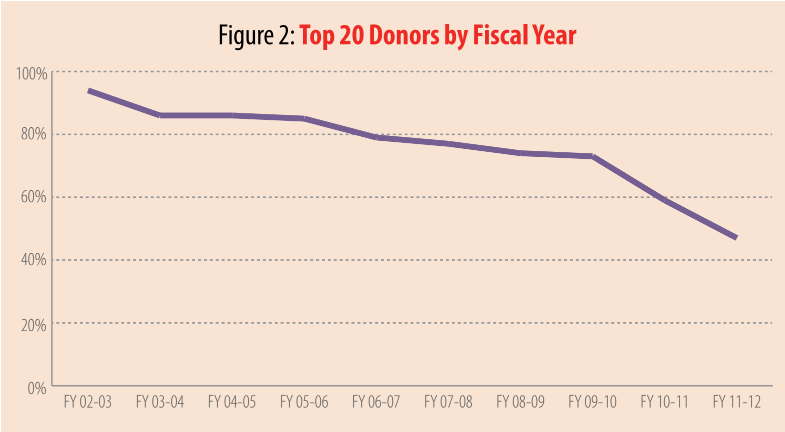
Yeshivat Chovevei Torah

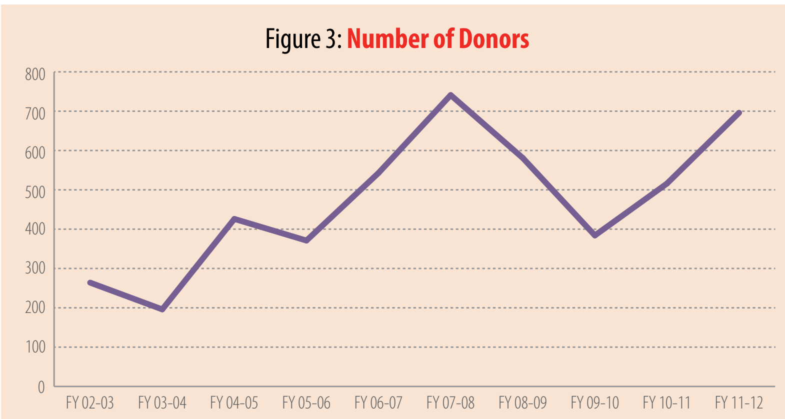
Yeshivat Chovevei Torah (YCT), the open Orthodox rabbinical school, is the realization of Rabbi Avi Weiss's dream to shape an orthodoxy that is open to the voices of others and driven by professionally trained rabbinic leaders. Since opening its doors, in 1999, YCT has graduated nearly one hundred rabbis from its intensive four-year program, grown its annual budget from $500,000

Figure 1: **Revenue Composition**

Earned Revenue and Individual Donations have increased as a percentage of overall revenue.







to $3.5 million, and raised $35 million in donations. YCT's alumni serve at the forefront of innovative congregations, inspire students in day schools and on college campuses, and lead organizations in the Jewish community's ecosystem of grassroots engagement efforts, such as Kevah and Uri L'Tzedek. (Kevah engages Jewish identity and builds community through the study of classical Jewish texts; Uri L'Tzedek is an Orthodox social justice organization guided by Torah values and dedicated to combating suffering and oppression.)

While angel donors were critical to YCT in its start-up phase, in the long term the financial model placed the yeshiva in a precarious position, threatening its sustainability and long-term viability.

Early support for YCT was offered by a close circle of friends and supporters who believed in Rabbi Weiss's vision. In the yeshiva's first years, the top twenty donors carried well over 85 percent of the institution's budget. As the yeshiva built its donor base, by 2007 support from these angel donors dropped to a rate nearing 70 percent of the yeshiva's overall fundraising (see figure 2).

While angel donors were critical to YCT in its start-up phase, in the long term the financial model placed the yeshiva in a precarious position, threatening its sustainability and long-term viability. Over time, founding donors tire, and reliance on a limited number of insecure revenue streams constrained the yeshiva's ability to expand programming and form long-term plans.

A similar analysis may be drawn from the number of individual donors giving to the yeshiva. The number of donors grew steadily in the yeshiva's early years, with the number of donors in 2007 nearly triple the number who had given in 2002. Such a growth pattern put YCT on the fast track to greater stability and sustainability. With the onset of the financial crisis in 2007, however, the number of donors dropped precipitously, forcing YCT to rely again on its base of angel donors (see figure 3).

In early 2011, the Jim Joseph Foundation awarded Yeshivat Chovevei Torah a five-year $3 million grant for organizational capacity building. As a cornerstone of this grant, $2.5 million was designated as a challenge grant, matching dollar-for-dollar donations from new donors, recaptured donors, and increased gifts. With the assistance of this gift, YCT was able to meet the challenge in slightly over two years and raise more than $1 million from 390 new donors; $0.3 million from 200 recaptured donors (those who had not given since FY 2008–09); and nearly $2 million in increased gifts from 195 current donors. Most profoundly, by building its base of support, the percentage of YCT's annual fundraising derived from the top twenty donors dropped significantly, to nearly 40 percent in 2011–12, and the number of donors rose again to pre-recession levels.

With angel donor support still critical to the yeshiva's operations, but at a more sustainable level, and the total number of donors on the rise, YCT is in a position to enter the next phase of its institutional journey. Catalyzed by support from the Jim Joseph Foundation and strengthened by a broad base of donor giving, in September 2012 YCT announced that Rabbi Avi Weiss would step down as president of the Yeshiva, and Rabbi Asher Lopatin would take up the reins of the institution. This leadership transition marks a new stage in YCT's institutional growth, and affords an opportunity to reflect on the past and develop new plans for the future.

Notwithstanding the broadened base of support, the leadership transition is not without financial challenges for YCT. Many of the angel donors who have sustained YCT for over a decade did so (at least initially) out of love for and devotion to Rabbi Weiss. Thus, in addition to a transition in leadership, the yeshiva is planning for the possibility of a transition in donors. Similarly, while YCT is extremely fortunate to have completed the five-year match in a little over two years, the timing is difficult, as it deprives Rabbi Lopatin of an important tool in attracting new donors. In planning for the transition, significant consideration was given to maintaining the support of existing donors while continuing to diversify and expand the institution's donor base.

* * *

The lessons here are clear: two start-ups that had proven themselves in their early years were prime candidates for relatively large investments. Both parlayed those dollars into a dramatic increase in programming, impact, and organizational sustainability. The percentage of individual donors versus overall funding is on the rise for both Mechon Hadar and YCT, leading to a more balanced funding portfolio.

We believe that there are many organizations that could benefit from large investment—some new start-ups looking to advance to the next stage, and others who have already made it to the next stage, like Mechon Hadar and YCT. These organizations will thrive or fail depending on whether they find second- and third-stage support. Jewish organizations need to find and share their visions of vitality and expansion. And Jewish funders need to be open to devoting more resources to looking for opportunities in which taking a chance on an organization with thoughtful plans for growth could yield big returns for that organization and the larger Jewish community. Equally as important, those organizations could become the agents through which foundations achieve their goals.

To comment on this article, write to us at feedback@npqmag.org. Order reprints from http://store.nonprofitquarterly.org, using code 200208.

The lessons here are clear: two start-ups that had proven themselves in their early years were prime candidates for relatively large investments. Both parlayed those dollars into a dramatic increase in programming, impact, and organizational sustainability.

Making Charitable Money Flow: Mixed Results with Donor-Advised Funds

by Rick Cohen

While critics of DAFs see them as a means of subterfuge, a closer look at the composition and behavior of DAFs and DAF managers reveals a more complex dynamic. With effective oversight and transparency, a more equitable approach to spend-out requirements, and a smarter approach to charitable giving, DAFs can be a great vehicle for the middle-income donor. But one thing is for sure: DAFs are a significant—and growing—part of philanthropy.

Why do donor-advised funds (DAFs), as an instrument of charitable or philanthropic giving, so often seem to stir up a hornet's nest of commentary and complaints? One would think that as the conveyer belts moving billions of dollars from charitable donors to charitable recipients, accomplished with a few cursor movements and a click, DAFs would be widely applauded for making charitable giving easier, faster, simpler.

In years past, criticism focused on the role of large financial institutions, such as Fidelity Investments, Vanguard, and Charles Schwab, among others, serving as the sponsors and managers of donor-advised funds. Being corporate players, their role in the donor-advised fund field was viewed—largely by their competitors in community foundations—as suspect. The fact that these corporate sponsors were earning little to nothing from their 501(c)(3) national DAF arms, that community foundations were themselves often tied quite closely to local banks and other corporations, and that the corporate DAFs were operating more cheaply and flexibly for smaller donors than community foundations, however, has worn down the theory of corporate taint. Now, the criticism leveled at DAFs is spotlighting not their corporate roots but rather their grantmaking practices.

Think of the managers of DAFs—whether the couple of dozen corporations in the game, the 750 community foundations (as of 2011) whose giving is largely dependent on the DAFs they control,[1] or the many other institutions (universities, hospitals, and other independent charities) that hold and manage DAFs—as gatekeepers to a large and rapidly increasing swath of philanthropy. DAFs

Rick Cohen is the *Nonprofit Quarterly*'s correspondent at large.

"THE EARTH SCRATCHES HERSELF" BY NATHALIE VIN / WWW.MOSAICWORLDS.COM

Are DAFs a "wink and a nod" for potential donors? Although the typical account size for a DAF at a community foundation is quite large [. . .] increasingly DAFs are a charitable donation instrument for middle-income investors with the impulse to give. . . .

already dominate the resources for giving by community foundations, and small private foundations are discovering that it is simpler and cheaper to operate as a DAF—with the likes of Fidelity Investments and Charles Schwab providing the institutional operating infrastructure—than to straggle along as a small grantmaker. Despite the popularity and growth of the national DAFs, critics continue to raise issues about the accountability of donor-advised funds.

The critics aren't fly-by-night naysayers but rather well-respected observers of the philanthropic scene. Boston College law professor Ray Madoff calls DAFs "problematic because they are based on deception." In comments submitted to the Internal Revenue Service, Madoff wrote, "The legal regime governing DAFs undermines the integrity of the tax system by implicating the government in a 'wink and a nod' system that encourages artifice over substance."[2] In Madoff's conception, the concern is that donors make irrevocable (fully charitably deductible) gifts to the 501(c)(3) sponsors, who then hold and administer the funds, "leav[ing] donors vulnerable to unscrupulous and insolvent sponsoring organizations that choose to exert their legal rights over the funds rather than their 'understanding' with the donor."[3]

One element of the "wink and nod," as seen by the National Committee for Responsive Philanthropy's Kevin Laskowski, is the dynamic of DAF distributions, or "payout." Laskowski notes, for example, that, in the aggregate, 126 large DAF managers had a payout rate of 22 percent of their $24.2 billion in assets; but a 2006 Department of Treasury study of more than 106,000 individual DAFs demonstrated that, while showing a mean payout of 9.3 percent, the DAFs had a median payout of 0.6 percent, half of the DAFs had a payout of less than 1 percent, and one-fourth had no payout at all during the study year.[4]

Are DAFs a "wink and a nod" for potential donors? Although the typical account size for a DAF at a community foundation is quite large (often five or six figures and, for some of the commercial sponsors, requiring a minimum investment of at least $25,000), increasingly DAFs are a charitable donation instrument for middle-income investors with the impulse to give—and many, such as the investor in the story below, are more and more finding DAFs an attractive vehicle for doing so.

The Middle-Income Donor

A few years ago, a DAF investor (who prefers to remain anonymous) and his wife had an equity investment, made up of mutual funds, with Fidelity Investments.[5] The investment had appreciated greatly, but the couple were informed by their financial advisor that at that time it had "gone as far as it was going to go." It wasn't a large investment—worth perhaps $17,000 if it were sold—and the capital gains hit would have been significant.

The Fidelity Charitable Gift Fund had lowered its minimum threshold for establishing a donor-advised fund, from $10,000 to $5,000 (subsequently matched by Schwab Charitable), and the couple were advised that if they donated the stock rather than selling it, they would avoid the capital gains hit. Because it was a Fidelity account, it was easy for them to transfer it to the gift fund. It was basically conducted online. As they put it, they "did it in about three or four clicks." The administrative cost? Fifty to sixty basis points, as they recall.[6]

The online ease in establishing the fund was matched by that of using it for making donations. For the couple, it was "our philanthropic checkbook." They used it to make donations "very much tied to things that we're committed to," including, in their case, a foundation that supported their local public library and another foundation that raised money for their public school. After four years, they had spent down their small DAF, but they decided to add additional funding to it. Interestingly, they pointed out that for them the attractiveness of a DAF was that, as moderately sized investors and charitable donors, they didn't need to pay for charitable advice. In their view, "ultra-high-net-worth individuals or families [as a result of] an IPO, or, most importantly, when a family business is sold, [when] there are some serious assets moving, these are the folks who are looking for new situations, looking for charitable advice." Those high-net-worth individuals might set up a DAF with a sponsor that caters to givers of a couple of million a year, but for middle-income givers, paying another fifty to one hundred basis points is a premium that, as small donors, they neither want nor need to pay.

A recently retired community foundation CEO confirmed the couple's DAF experience, explaining that "the typical Fidelity donor is using it more like a charitable checking account. People basically know where they want to give, and need a mechanism to do it. They don't see the added value of advice from a foundation." But they aren't quite the same as a checkbook. Linked to the donors' array of other financial assets—with charitable investments and income investments presented through an integrated online platform—DAFs are rather more contemplative and research oriented than your typical checkbook. On most DAF platforms, a donor can see his or her entire history of grantmaking, generate an analysis of the kinds of organizations supported, and move more money into DAFs from investments.

Figure 1: Overview of Donor-Advised Fund Market

	2010	2011
Assets under management	$31.85 billion	$37.43 billion
Total contributions	$8.71 billion	$9.64 billion
Total grant dollars	$6.78 billion	$7.70 billion
Total payout	17.6%	17.1%
Total # of DAF accounts	170,276	177,357
Average size of DAF account	$187,050	$211,067

Adapted by the author from "Table 1: 2012 Donor-Advised Fund Market Overview," *2012 Donor-Advised Fund Report* (National Philanthropic Trust, 2012)[9]

DAF Assets Skyrocket

Our donor couple in question are hardly alone in finding DAFs an increasingly attractive vehicle for charitable giving. As figures 1–3 (above and following page) demonstrate, donor-advised funds are a significant and growing part of charity and philanthropy. As of 2011, the National Philanthropic Trust tracked 652 DAF sponsors—including commercial funds and community foundations—managing a combined total of 177,357 DAF accounts, finding that they had, in aggregate, $37.43 billion in assets under management, received $9.64 billion in contributions, and distributed $7.7 billion in grant dollars for a total payout (grant dollars divided by assets under management and grant dollars) of 17.1 percent.[7]

Although DAF assets declined during the deepest part of the recent recession, they skyrocketed in 2010 and 2011, increasing by $10 billion in asset value over 2009. And, while the rate of DAF grant or payout growth wasn't quite as high as the growth in assets under management, they still increased from $6.26 billion in 2009 to $7.7 billion in 2011.[8]

On a cumulative basis, all DAFs add up to one massive foundation, with $37.43 billion in assets—slightly larger than the one largest individual foundation, the Bill and Melinda Gates Foundation, which in 2011 had assets of $34.6 billion. In comparison with the cumulative DAF grants payout of 17.1 percent, the Gates Foundation qualifying distributions (including permitted administrative costs) that year reached 11.44 percent, and its grants-only payout was 9.34 percent. For the top forty-nine foundations (including five community foundations) that reported assets under management, grants payout, and total payout, their cumulative grants payout was only 5.34 percent, and their total qualifying distributions, including PRIs (program-related investments), loans, and permitted administrative costs, were 6.37 percent. Removing the high-payout Gates Foundation from the list, the cumulative grants payout of the remaining forty-eight largest foundations drops to only 4.47 percent and their cumulative total distributions to 5.27 percent.[10]

Although DAF assets declined during the deepest part of the recent recession, they skyrocketed in 2010 and 2011, increasing by $10 billion in asset value over 2009.

Nonetheless, as Laskowski points out, that 17.1 percent is a cumulative payout for all DAFs.[11] By type of sponsor, single-issue DAFs had the highest cumulative payout rates and community foundations the lowest, but all were decidedly higher than the typical private foundation payout rate, which hovers around 5 percent (see figure 2, following page).

However, unlike institutional foundations whose 5 percent payout rates, for example, apply to their entire assets annually, a national sponsor's or a community foundation's donor-advised fund payout rate applies to the funds of dozens, hundreds, or in some cases thousands of donors, and, as a result, several DAFs with high payout rates could camouflage a DAF that pays out little or nothing over the years (see figure 3).

Figure 2: Payout Rate by DAF Sponsor Type (%)					
DAF Sponsor Type	**2007**	**2008**	**2009**	**2010**	**2011**
National Charities	17.0	19.3	20.0	18.8	17.8
Community Foundations	14.3	16.5	14.1	13.7	12.5
Single-Issue Sponsors	20.5	22.8	23.8	23.7	24.7

Adapted by the author from "Figure 12: Total Payout from Donor-Advised Funds by Charitable Sponsor Type," *2012 Donor-Advised Fund Report* (National Philanthropic Trust, 2012)[12]

Figure 3: Number of DAF Accounts by DAF Sponsor Type					
DAF Sponsor Type	**2007**	**2008**	**2009**	**2010**	**2011**
National Charities	71,580	82,720	86,410	91,720	95,580
Community Foundations	42,020	43,810	45,280	47,340	49,460
Single-Issue Sponsors	38,000	35,520	34,700	31,210	32,100

Adapted by the author from "Figure 8: Number of Donor-Advised Fund Accounts by Charitable Sponsor Type (Thousands)," *2012 Donor-Advised Fund Report* (National Philanthropic Trust, 2012)[13]

The challenge would be to determine the individual payout rates of individual DAFs and develop a median of the payout rates of tens of thousands of accounts. The commercial DAF sponsors, for one, report that, while operating as public charities and therefore not subject to a private-foundation-qualified distributions requirement, they encourage their donor-investors to maintain a reasonable payout rate and set up triggers if some accounts appear to be sitting on their assets.

The commercial DAF sponsors, for one, report that, while operating as public charities and therefore not subject to a private-foundation-qualified distributions requirement, they encourage their donor-investors to maintain a reasonable payout rate and set up triggers if some accounts appear to be sitting on their assets.

Contributions to the big three national DAF sponsors—Schwab, Fidelity, and Vanguard—were up 44 percent in 2012 compared to the previous year, according to Schwab Charitable's president and CEO, Kim Laughton.[14] In the fourth quarter alone, compared to a year before, charitable contributions tripled and new accounts doubled. According to Sarah Libbey at Fidelity, 2012 was a record year at the biggest of the national sponsors—$3.6 billion in incoming contributions, processing $1.6 billion in 428,000 grants to charities.[15] As Laughton noted, "a good chunk" of the increased 2012 activity was related to the fiscal cliff, as donors feared that Congress would reduce the excluded amount on estates for estate tax purposes and increase the capital gains rate.[16] The potential change in the estate tax—which didn't occur, when all was said and done—brought some donors into talking to financial planners and charitable advisors, conversations in which charitable giving undoubtedly arose as a discussion topic in light of the potential tax structure uncertainties.

To Laughton, the interesting dynamic is that the 2012 pace of setting up DAFs, at least in her experience at Schwab, didn't slow down in the first quarter of 2013, even though the fiscal cliff had, for the moment, been settled.

The DAF Payout Issue: What Is *Really* Going On?

Responding to the assertions of critics that the high payouts of DAF managers camouflage the low or no payouts of some specific funds, Libbey noted that Fidelity Charitable "has a formal policy that is stated in our circular about minimum grant activity, but we [also] make sure that we are tracking donors and callout campaigns [so] that if we see an inactive donor they're made aware of that status."[17] The specific language of the Fidelity minimum activity guidelines is as follows:[18]

> *Minimum Grant Activity*
>
> *Historically, Fidelity Charitable has made grants of more than 20% of average net total assets to charities each year. The formal grantmaking policy requires that minimum annual grants, on an overall basis, be greater than 5% of average net assets on a fiscal five-year rolling basis. If this requirement is not met in a fiscal year, Fidelity Charitable will ask for grant recommendations from Giving Accounts that have not had grant activity of at least 5% of the Giving Account's average net assets over the same five-year period. If Account Holders on these Giving Accounts do not make grant recommendations within 60 days, Fidelity Charitable will transfer the required amounts to the Trustees' Philanthropy Fund (described on page 28), from which the Trustees will make grants at their sole discretion.*
>
> *Minimum Giving Account Activity*
>
> *If a Giving Account is dormant for seven years (i.e., total grants distributed over that period are less than $250 with respect to a Giving Account), Fidelity Charitable will make every effort to contact the Account Holder to encourage him or her to satisfy this requirement by recommending*

that one or more grants be made totaling at least $250. If the Account Holder does not respond by recommending at least $250 in grants that are distributed from the Giving Account within a reasonable time, Fidelity Charitable will transfer the entire balance of the Giving Account to the Trustees' Philanthropy Fund.

The Trustees' Philanthropy Fund (TPF) is the Fidelity entity that receives control of DAF account assets when, for example, a donor dies and leaves no successor. Between 1991 and 2012, over two decades, the TPF made $13.4 million in grants; in 2012, the $1.5 million in TPF grants were mostly for disaster relief (40 percent), with the remaining going to charities involved in food banks and food distribution (25 percent), supporting children and families (21 percent), and supporting the philanthropic sector (14 percent). Only $1.7 million was granted out in 2011.[19] That isn't much money in the TPF, suggesting that Fidelity doesn't find itself absorbing too many dormant accounts that merit their transfer to the trustees, and the evidence needed to show something other than dormancy—$250—isn't an aggressive level of giving.

Remember that a donor who establishes a donor-advised fund at Fidelity, Schwab, or a local community foundation is making an irrevocable grant to the entity, receiving immediate charitable deduction tax benefits, but in theory is only able to recommend to Fidelity, Schwab, or that charitable foundation the grants that would be made from the account. However, as a Congressional Research Service (CRS) report from last year noted, "in practice [the donors] determine when and how the funds are distributed because sponsoring organizations typically follow their advice."[20] In other words, unless the donor wants to make a grant to an organization that isn't a qualified public charity or wants to do something otherwise untoward with the funds, the DAF sponsor is going to follow the DAF donor's "recommendations"—or else the donor will be looking for other account managers.

A 2011 Treasury Department study of over 180,000 donor-advised funds revealed that for DAF sponsors with only one or a very small number of DAFs, there was a significant program of payouts per account, presumably following the donors' directives. More than half of the DAFs in single-account DAF managers showed no payout in 2008 and that 70 percent had payouts lower than 5 percent. However, 87 percent of DAFs are held and managed by entities with one hundred or more accounts, and their payouts are much higher (see figure 4, following page).[21]

The large commercial funds and community foundations may be the most recognizable DAF sponsors, but they do not seem to be the ones that are laggard in their distributions. In the Treasury study described by the CRS report, 453 out of 1,828 DAF sponsoring organizations did not pay out any grants at all in 2008. Of the 453 no-payout sponsors, 334 managed only one or a very tiny number of DAFs. The payout rates, for the more typical DAF sponsors that managed one hundred or more accounts and for the commercial funds, were much higher. Eighty-seven percent of all DAF accounts are managed by sponsors with one hundred or more accounts, but only 3.6 percent of those individual DAF accounts showed a payout rate of less than 5 percent.[22]

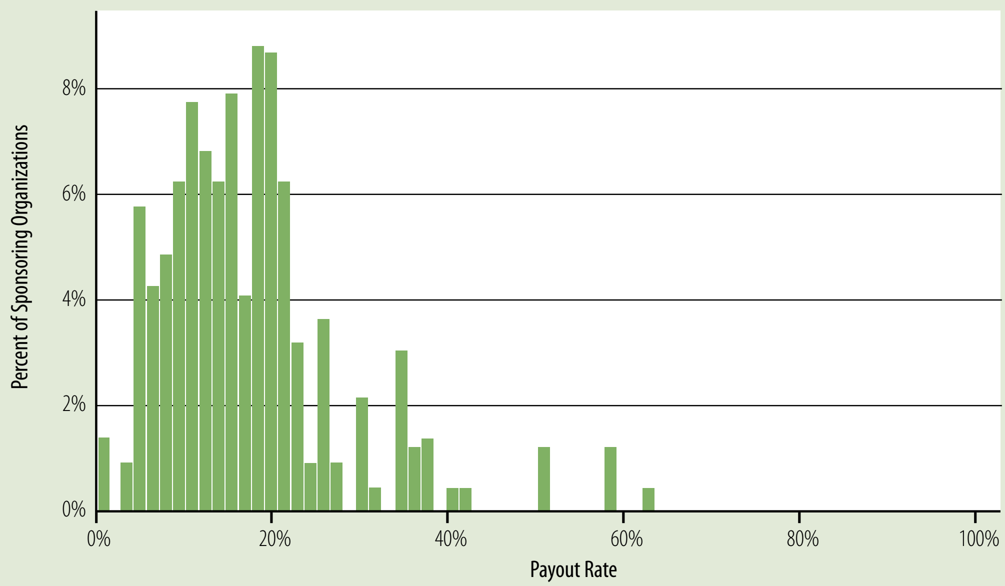
Do the big sponsors such as the commercials or the community foundations want the DAFs simply to sit so that they can earn management fees, or do they want the moneys to flow into accounts and out to charities?

Do the big sponsors such as the commercials or the community foundations want the DAFs simply to sit so that they can earn management fees, or do they want the moneys to flow into accounts and out to charities? Most financial advisors seem to believe in active capital investment strategies, rarely content with simply letting moneys sit. Libbey described the DAF management strategy, at least in her shop, as "financial services acumen applied to a planned giving vehicle." It would seem that the bigger managers—with multiple accounts—have an interest in getting moneys to flow, while the smaller sponsors may have something else in mind. While controlling a substantial portion of DAF assets, the commercial sponsors in the Treasury analysis represented only 31 out of the total of 1,828 DAF sponsoring organizations.

The critics of DAF payout rates cannot suggest that they are sanguine about foundation—much less private foundation—payout rates. If, in addition to the Bill and Melinda Gates Foundation, the five generally higher-payout community

That individual donor opening up a $5,000 DAF could be looked at as the next rung up from individual givers making scattered checkbook donations.

Figure 4: Payout Rate for Sponsoring Organizations Maintaining One Hundred or More DAF Accounts



Source: "Figure 3: Payout Rate for Sponsoring Organizations Maintaining One Hundred or More DAF Accounts, 2008," An Analysis of Charitable Giving and Donor-Advised Funds (Congressional Research Service, 2012)[23]

foundations in the list of the nation's forty-nine largest foundations are pulled out of the analysis, their cumulative payout (including PRIs, loans, and administrative costs plus grants) falls to 5.21 percent and their grants-only payout to 4.37 percent.[24] One idea suggested for donor-advised funds, since they get their full charitable deduction at the time of the irrevocable grant to the nonprofit sponsoring entity, is to require that the full DAF be spent out within, say, a ten-year period. Why wouldn't a similar, perhaps somewhat longer but still definable spend-out requirement be applicable for private foundations?

As described earlier, donors like the former foundation director who established his family's DAF at Fidelity are using the account like a charitable checkbook, except with a solid ability to look at giving trends and invest the assets with strategies fitting the donor's charitable objectives. There is more of a charitable immediacy to these middle-income donors using DAFs than there is to the large donors setting up accounts larger than $100,000, or even larger donors establishing their own private foundations. While in some cases donors who had small foundations have now shifted them into DAF structures, eliminating many of the administrative headaches of foundations and reducing their administrative costs, there are affluent donors who use both foundations and DAFs together—and private foundations for which part of their payout is actually grantmaking to nonprofit DAF-sponsoring entities.

If there is a grants payout rate to be imposed on donor-advised funds—especially as they gravitate into instruments accessible for more moderate-income investors, with initial setup thresholds of $5,000 and the ability to make grants as small as $100—it is hard to imagine that it shouldn't be accompanied by an increase in the mandatory payout of private foundations, whose grants payout often doesn't top 5 percent. If there is going to be a mandatory spend-out requirement placed on all DAFs, it would be hard to justify without a concomitant spend-out requirement for private foundations that certainly exhibit no greater celerity in their distributions.

That individual donor opening up a $5,000 DAF could be looked at as the next rung up from individual givers making scattered checkbook donations. With the proliferation of mutual funds as investment vehicles, many taxpayers have appreciated stocks and mutual funds to donate, an easier means of doing so than selling the fund and donating the cash. In 2010, hardly a banner

Figure 5: **Overview of Individual Noncash Charitable Contributions**				
Size of Adjusted Gross Income	**Returns**	**Donations**	**Donors' Cost (000s)**	**Fair Market Value (000s)**
All returns	131,882	290,166	$2,830,674	$17,769,514
Under $25,000	3,977	8,331	$70,318	$182,168
$25,000 under $50,000	5,309	6,468	$3,694	$22,384
$50,000 under $75,000	5,035	9,265	$13,761	$140,337
$75,000 under $100,000	12,929	22,501	$28,906	$97,125
$100,000 under $200,000	39,629	76,875	$133,945	$522,265
$200,000 under $500,000	32,046	71,182	$208,361	$983,433
$500,000 under $1,000,000	13,792	38,477	$206,062	$857,565
$1,000,000 under $1,500,000	6,182	16,521	$134,012	$709,274
$1,500,000 under $2,000,000	3,281	8,779	$78,230	$512,909
$2,000,000 under $5,000,000	5,519	16,678	$295,586	$1,613,720
$5,000,000 under $10,000,000	2,080	6,698	$433,018	$2,581,166
$10,000,000 or more	2,103	8,389	$1,224,781	$9,547,167

Source: "Table 1b: Individual Noncash Charitable Contributions: Returns with Donations of Corporate Stock, Mutual Funds, and Other Investments, Reported on Form 8283, by Size of Adjusted Gross Income, Tax Year 2010," "Individual Noncash Contributions, 2010," *Statistics of Income Bulletin*, (Internal Revenue Service, Winter 2013); also "Individual Noncash Charitable Contributions: All Returns with Donations, by Donation Types and Size of Adjusted Gross Income, Form 8283, Tax Year 2010," Internal Revenue Service.[25]

What seem to be amiss in the donor-advised fund dynamic are effective oversight and transparency.

year for charitable donations due to the continuing effects of the recession, well over one hundred thousand taxpayers took charitable deductions for the donations of noncash stock or mutual funds to charities (see figure 5).

This is the background from which the donor couple profiled in this story emerge, possessing an appreciated stock that would be better used as a charitable donation than sold, cashed out, a portion lost to the capital gains tax, and then donated.

In addition to noncash contributors, there are cash contributors in middle-income earning areas whose charitable interests might be better served by a one-stop shop for charitable donations such as a DAF at a community foundation or a commercial manager, having grown out of a more reactive check-writing mode of charity. The Internal Revenue Service statistics of income show that for tax itemizers, again in 2010, the numbers attest to significant appetite and capacity for not insubstantial cash giving (see figure 6, following page).

In 2010, itemizing taxpayers with incomes below $100,000 adjusted gross income were responsible for $49.5 billion in charitable cash giving. Charitable giving vehicles accessible to middle-income donors have a ready-made market in the charitable generosity of these itemizing taxpayers.

Conclusion

There are clearly some critics of donor-advised funds who see them as a subterfuge—a means of taking an immediate charitable deduction for a donation to a 501(c)(3) donor-advised fund manager, even though the funds are distributed to charities over a period of months or even years. There are critics who suggest that some donor-advised funds are simply warehoused capital, giving a maximum charitable deduction benefit to the donors while disbursing little to charities. Some even suggest that the high reported payout rates of donor-advised fund managers simply camouflage warehoused funds by aggregating all the funds they have under management—those that spend quickly with those that spend little or nothing. The statistics above and in this article's accompanying sidebar (see pages 61–63) show some of the composition and behavior of DAFs and DAF managers. What seem to be amiss in the donor-advised fund dynamic are effective oversight and transparency. If the problem of inactive accounts—possibly warehoused accounts—seems to be concentrated in DAF sponsors with

Are those entities with sluggish DAF accounts getting the audits they would seem to need to verify that there is a potentially foundation-like reason for their slow or absent payouts?

Figure 6: Itemized Deductions by Type and by Size of Adjusted Gross Income

	Total number of returns	Total number of returns with cash contributions	Amount of cash contributions ($000s)
All itemizing taxpayers by AGI	46,644,509	35,027,193	134,800,994
Under $5,000	419,841	193,652	290,962
$5,000 under $10,000	593,327	327,557	504,459
$10,000 under $15,000	911,539	522,182	870,577
$15,000 under $20,000	1,132,656	705,643	1,364,103
$20,000 under $25,000	1,269,230	755,863	1,352,457
$25,000 under $30,000	1,537,327	960,775	1,942,928
$30,000 under $35,000	1,699,403	1,070,771	2,090,122
$35,000 under $40,000	1,864,367	1,235,164	2,637,749
$40,000 under $45,000	1,973,819	1,317,716	2,718,132
$45,000 under $50,000	1,990,848	1,349,384	2,778,616
$50,000 under $55,000	1,950,152	1,351,653	3,140,595
$55,000 under $60,000	1,923,170	1,400,630	3,403,332
$60,000 under $75,000	5,507,988	4,055,804	9,878,708
$75,000 under $100,000	7,876,832	6,066,562	16,529,938
$100,000 under $200,000	11,873,957	9,979,411	34,187,327
$200,000 under $250,000	1,450,337	1,284,073	6,572,016
$250,000 under $500,000	1,866,973	1,697,107	12,860,201
$500,000 under $1,000,000	527,916	492,165	7,816,242
$1,000,000 under $1,500,000	123,984	116,735	3,242,287
$1,500,000 under $2,000,000	50,702	48,211	1,890,625
$2,000,000 under $5,000,000	71,694	68,575	4,838,844
$5,000,000 under $10,000,000	17,280	16,685	3,171,918
$10,000,000 or more	11,166	10,875	10,718,859

Source: "Table 3: Returns with Itemized Deductions: Itemized Deductions by Type and by Size of Adjusted Gross Income, Tax Year 2010" (Internal Revenue Service)[26]

a small number or only one DAF to manage, the issue seems to be one of IRS oversight. What are the bona fides of DAF sponsors whose track records involve sitting on a small number of DAFs? What kind of reporting is being asked of DAFs? Are those entities with sluggish DAF accounts getting the audits they would seem to need to verify that there is a potentially foundation-like reason for their slow or absent payouts?

In fact, as the CRS study notes, it appears that the IRS doesn't collect information on specific DAFs, relying (for the sake of expediency and workload) on consolidated reporting by DAF sponsors rather than examining the payouts of the over 180,000 individual DAF accounts. Without individual-level reporting on DAFs, it is virtually impossible for the IRS to know if there are valid charitable purposes being carried out by DAFs, camouflaged as they are by the consolidated reporting of DAF sponsors. As the CRS study suggests, "Useful information that could be provided by DAF sponsors could include the share of their DAF accounts that made no distributions, the share that made distributions of less than 5%, or a general distribution of accounts across different payout intervals."[27]

The problem with this scenario is probably not on the part of legitimate DAF sponsors or managers. Rather, the limitation is the IRS. Already, the tax-exempt division of the IRS, embattled and severely underfunded, is barely able to keep up with its regulatory oversight. Sidestepping the need to review individual DAF accounts, the IRS simplifies its task by reviewing what is probably a small subset of the 1,828 DAF sponsors rather than being compelled to dig into the sum and substance of 180,000 accounts or more. That a considerable number of private foundations get by with payout rates that slip below 5 percent—and if they are hit with excise taxes, the taxes count toward their qualified distributions—suggests that the challenge for enduring DAFs on the up and up, both in terms of charitable mission and charitable outlays, is in the oversight part of the equation.

From an operating charity's perspective, an equitable solution would be to place a spend-out requirement (say ten years) on DAFs that control $34 billion in assets, but also a spend-out requirement on private foundations that control the lion's share of the $646.1 billion in assets controlled by foundation grantmakers.[28] In reality, foundations won't even contemplate a higher mandatory payout rate—some even hint that it should be *lower* than 5 percent—much less a mandatory spend-out requirement.

In the absence of changing the payout thresholds and timelines, Congress can give the IRS the resources to enable it to monitor 1,800 DAF sponsors and their 180,000 DAF accounts (in addition to the other responsibilities of the tax exempt unit of the Service) so that it could do a modicum of effective oversight of the spending of individual DAFs. And the nonprofit industry of philanthropic gatekeepers, the financial advisors who provide advice to even middle-income people about putting their savings into mutual funds or planning for retirement, can become much smarter about the middle-income asset owners in their communities and encourage them to use their charitable giving smartly and energetically for charitable advancement. There's no reason for charitable giving—whether from a checkbook, a donor-advised fund, or a foundation endowment—to be lethargic.

From an operating charity's perspective, an equitable solution would be to place a spend-out requirement (say ten years) on DAFs that control $34 billion in assets, but also a spend-out requirement on private foundations that control the lion's share of the $646.1 billion in assets controlled by foundation grantmakers.

Notes

1. The Foundation Center's Statistical Information Service, "Number of Grantmaking Foundations, 1975 to 2011" (New York: The Foundation Center, 2013), www.foundationcenter.org/findfunders/statistics/pdf/02_found_growth/2011/03_11.pdf.
2. Kevin Laskowski, "Donor-Advised Funds 'Based on Deception,' Says Professor," *Keeping a Close Eye . . .*, June 5, 2012, blog.ncrp.org/2011/09/donor-advised-funds-based-on-deception.html.
3. Ibid.
4. Laskowski, "When It Comes to Donor-Advised Funds, the Median Is the Message," *Keeping a Close Eye . . .* NCRP's Blog, September 9, 2011, blog.ncrp.org/2012/06/when-it-comes-to-donor-advised-funds.html.
5. Mutual funds are a major component of U.S. stock market investments, comprising 28 percent of all corporate equity as of 2012. In the United States, 53.8 million households, or 44.4 percent of all U.S. households, own mutual funds. The median household income of mutual fund investors is approximately $80,000; their median household financial assets are $190,000. Statistics from Investment Company Institute, *2013 Investment Company Fact Book: A Review of Trends and Activities in the U.S. Investment Company Industry*, 53rd ed. (Washington, DC: Investment Company Institute, 2013), 90–91, www.icifactbook.org/pdf/2013_factbook.pdf.
6. A basis point is one hundredth of a percentage point, that is, 0.0001. One percent is 100 basis points. Fifty basis points is 0.0050, or 0.5 percent.
7. National Philanthropic Trust, "Market Overview," *2012 Donor-Advised Fund Report* (Jenkintown, PA: National Philanthropic Trust, 2012), www.nptrust.org/daf-report/market-overview.html.
8. Ibid., table 1.
9. Ibid.
10. The Foundation Center's Statistical Information Service, "50 Largest Foundations by Assets, 2011" (New York: The Foundation Center, 2013), www.foundationcenter.org/findfunders/statistics/pdf/11_topfdn_type/2011/top50_aa_all_11.pdf.
11. Laskowski, "When It Comes to Donor-Advised Funds, the Median Is the Message."
12. National Philanthropic Trust, "A Comparison of Sponsor Types," *2012 Donor-Advised Fund Report*, fig. 12, www.nptrust.org/daf-report/sponsor-type-comparison.html.
13. Ibid., fig. 8.
14. Kim Laughton, in an interview with the author, March 22, 2013.
15. Sarah Libbey, in an interview with the author, March 15, 2013.

16. Laughton, in an interview with the author.

17. Libbey, in an interview with the author.

18. Fidelity Charitable, *Fidelity Charitable Policy Guidelines: Program Circular*, last updated December 2012, 19, www.fidelitycharitable.org/docs/Giving-Account-Policy-Guidelines.pdf.

19. Fidelity Charitable, "Trustees' Philanthropy Fund," *2012 Annual Report*, accessed May 2013, www.fidelitycharitable.org/2012-annual-report/trustees-philanthropy-fund.shtml.

20. Molly F. Sherlock and Jane G. Gravelle, *An Analysis of Charitable Giving and Donor Advised Funds* (Washington, DC: Congressional Research Service, 2012), 6, www.fas.org/sgp/crs/misc/R42595.pdf.

21. Ibid., 17–18.

22. Ibid., 14.

23. Ibid., fig. 3, 18.

24. The five community foundations are: The Chicago Community Trust, The New York Community Trust, Tulsa Community Foundation, Silicon Valley Community Foundation, and the Marin Community Foundation.

25. Pearson Liddell and Janette Wilson, "Individual Noncash Contributions, 2010," *Statistics of Income Bulletin* (Winter 2013), table 1b, 76, www.irs.gov/pub/irs-soi/13innoncash10.pdf; Internal Revenue Service, "Table 1: Individual Noncash Charitable Contributions: All Returns with Donations, by Donation Types and Size of Adjusted Gross Income, Form 8283, Tax Year 2010," www.irs.gov/file_source/PUP/taxstats/indtaxstats/10in01cc.xls.

26. Internal Revenue Service, "Table 2.1: Returns with Itemized Deductions: Sources of Income, Adjustments, Itemized Deductions by Type, Exemptions, and Tax Items, by Size of Adjusted Gross Income, Tax Year 2010," www.irs.gov/file_source/PUP/taxstats/indtaxstats/10in21id.xls.

27. Sherlock and Gravelle, *An Analysis of Charitable Giving and Donor Advised Funds*, 24.

28. Steven Lawrence, *Foundation Growth and Giving Estimates* (New York: The Foundation Center, 2012), 2, www.foundationcenter.org/gainknowledge/research/pdf/fgge12.pdf.

To comment on this article, write to us at feedback@npqmag.org. Order reprints from http://store.nonprofitquarterly.org, using code 200209.

Scope of the DAF Market

The nonprofit complaint about donor-advised funds isn't really about their payout—though nonprofits would like to have DAFs, private foundations, and other grantmakers disburse their moneys faster and reach people in need now rather than waiting on some artificially determined payout rate. They want to know the people behind the DAFs lodged in commercial funds or community foundations, so that they can submit direct applications.

Unless the people behind DAFs want to be identified, their names are not disclosed, and technically nonprofits do not know which DAF accounts give to what nonprofits or causes (in the cases of entities such as Fidelity Charitable, the DAF managers increasingly report grant totals on their 990s—huge lists of disbursements, but without specific identification of the individual DAF accounts from which the grants are made).

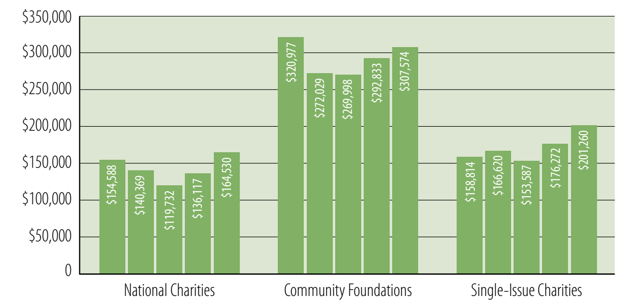
DAFs are instruments of individual giving (a donor's giving account or giving checkbook), except that, unlike the case with many donors, they're often larger: the average DAF size grew from $187,050 in 2010 to $211,067 in 2011.[1] While the focus is often on the big three (or more) commercial sponsors of DAFs, the largest average-size DAFs are those managed by community foundations, according to the research of the National Philanthropic Trust (see Figure 1 on page 62).

To most nonprofits, these are large charitable checking accounts, but ones that don't look for unsolicited grant applicants. While the community foundations have general grant pools, and the commercial funds often have trustee-managed giving vehicles capitalized by DAF funds—funds left by a donor who may have died without leaving an heir or specific instructions for the dissolution of his or her accounts—nonprofits don't really have an option of sending unsolicited proposals to Vanguard or Schwab, hoping for a grant. Increasingly, of course, all of philanthropy is headed in the direction of rejecting any and all unsolicited grant applications. The president of the Foundation Center, Bradford K. Smith, reports that 60 percent of independent, community, and corporate foundations do not accept unsolicited proposals, though perhaps the cold comfort of being able to see specific foundations' Form 990s is preferable to the anonymity of DAF account holders.[2]

Chafing at the lack of transparency behind DAF accounts, nonprofits sometimes feel hamstrung with respect to accessing these charitable resources. The reality for nonprofits is that they have to treat DAFs as one of the tools used by major individual donors. Few nonprofits in their online fundraising pitches with donation buttons on their websites pitch to DAF accounts and structure it so that DAF holders can make it easy for them to make donations through their DAFs. The commercial managers are trying to find ways of making nonprofits more visible to donors without penetrating their anonymity, for example, such as Fidelity Charitable's giving donors mobile apps with which they can make on-the-spot donations from their DAFs,[3] or the new DAF giving widget generated by Fidelity and Schwab for nonprofit websites.[4]

Apps and widgets aside, ultimately the challenge is for nonprofits to understand and reach major individual donors. At Fidelity Charitable, the range of potential donors—94,000 of them, with almost 58,000 accounts—is reflected in their account sizes, ranging from a few thousand to more than a million. Fidelity Charitable's recent profile of the giving of its DAF accounts is a very helpful instrument for understanding DAF donors that are likely to be more accessible to a broad range of nonprofits (Fidelity, like Schwab, has a minimum opening account threshold of only $5,000, and permits very small grants). The key characteristics for nonprofits to understand about Fidelity's DAF donors include the following:[6]

Figure 1: **Average Sizes of Donor-Advised Funds by Type of DAF Sponsor**



Source: Figure 13 from National Philanthropic Trust, "A Comparison of Sponsor Types," *2012 Donor-Advised Fund Report*[2]

- The average donor age at opening a Fidelity DAF is fifty-four; the average age of DAF account holders is sixty-two. It is understandable that people in their fifties typically open DAFs, as that is the age when people are thinking about charitable giving in a longer-term perspective, often with estate- or legacy-planning thoughts. Although donors will spend out of their accounts, they will also replenish them with new contributions. As a result, 40 percent of Fidelity DAF account holders have had accounts open for more than ten years.
- The states with the largest number of accounts (more than two thousand) are California, Florida, Illinois, Massachusetts, New Jersey, New York, and Texas. The ones with the smallest number, to no one's surprise who has any familiarity with the concept of the "philanthropic divide," are Alabama, Alaska, Arkansas, Delaware, Hawaii, Idaho, Louisiana, Mississippi, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oklahoma, South Dakota, Vermont, West Virginia, and Wyoming, each with between 25 and 250 Fidelity accounts.
- As one might expect, the donors to Fidelity accounts give most of their money as private or public securities—43 percent in publicly traded securities and 11 percent in nonpublic securities. These nonpublic S Corporation and C Corporation shares are very difficult for nonprofits to accept and monetize, but Fidelity and presumably the other commercial DAF sponsors have made this a growing part of their business plan.
- In an examination of DAFs that were established in 2007 or earlier, in order to look at long-term trends, the Fidelity research showed donors making more frequent grants the older the donor, but, in actuality, the difference in donation frequency only jumps after age forty, and the variations among age groups above that age is not very significant.
- In 2012, Fidelity DAFs made grants averaging $3,800, though $900 million in grants went out in sizes of $50,000 or more. Seventy-seven thousand charities received $1.6 billion from Fidelity DAFs in 2012, roughly one-fifth of the total DAF assets under management by the firm. Again, that doesn't mean that each DAF account disbursed 20 percent of its assets; some might have been higher or even spent out, camouflaging the low payouts of others. However, according to Amy Danforth, senior vice president of marketing and program development at Fidelity Charitable, Fidelity, like the other major national commercial DAF sponsors, has internal giving/activity guidelines, and regularly monitors accounts that look like they might be inactive. In its most recent review, only 1.4 percent of the accounts looked as though they were approaching inactivity (the highest percent in a year was 2.2), and after being contacted and prodded by Fidelity to start making grants, the inactive status accounts dropped to 0.2 percent. While scheduled grants—planned giving—are growing among Fidelity DAFs, so are unscheduled grants. In 2011, 75,000 out of 380,000 total DAF grants were scheduled grants; in 2012, 90,000 grants were scheduled or planned, but the total number of DAF grants had risen to 429,000.
- Unlike some other grantmaking institutions, a significant portion of DAF grants are unrestricted—42 percent in 2012 compared to 37 percent in 2008.
- Here's the information nonprofits want: what kinds of donations come from DAFs? The

Fidelity DAF grants break out as shown in figure 2. In terms of donor age, education is a higher priority for older donors, religion a much lower priority. Arts and culture and international affairs are of relatively equal interest to all age groups, with older donors more interested in human services.

- DAF donors are largely in-state donors, with 57 percent of Fidelity DAF grants going to charities in the donors' home states.

It might surprise people to realize that only 5 percent of Fidelity DAF donors request that their gifts be given anonymously, meaning that nonprofits receiving DAF grants generally know who they're benefiting from—much like their awareness of gifts from individual donors. There's the rub—and the challenge. Unless there is a change in charitable giving law that requires disclosure of individual giving (remember, even direct corporate philanthropy is not disclosed if the grants are not made through corporate foundations), DAF donors are much like other individual charitable donors: neither more nor less anonymous than the people a nonprofit might want to solicit for other charitable donations—other than the fact that they make their grants via a better online platform that generally links their charitable giving to their personal investments. The result is that nonprofits have to see DAF donors as people of some moderate to significant wealth, people who make both planned and unplanned grants, and give to a rather typical array of charitable interests. They sometimes make grants from their pockets, sometimes from their DAFs, and in a small number of cases they have both DAFs and foundations for providing charitable and philanthropic gifts. While a nonprofit might not be able to send an application to Fidelity or Vanguard in order for them to pitch to their thousands of DAF accounts, nonprofits can make themselves more accessible to DAFs through new technology, and more accessible to major individual donors, who in all likelihood are giving through DAFs instead of their checkbooks.

Figure 2: **Where Grants Go**

NTEE Category of Recipients	Fidelity DAF grants by percent of dollars	Fidelity DAF grants by percent of number of grants
Other	3	2
Environment and animals	3	5
International affairs	6	7
Arts and culture	7	7
Health	9	10
Human services	10	18
Society benefit	18	8
Religion	18	27
Education	26	16

Adapted by author from Fidelity Charitable, *Fidelity Charitable Giving Report 2013*, "Where Grants Go"[7]

Notes

1. National Philanthropic Trust, "Market Overview," *2012 Donor-Advised Fund Report* (Jenkintown, PA: National Philanthropic Trust, 2012), table 1, www.nptrust.org/daf-report/market-overview.html.

2. National Philanthropic Trust, "A Comparison of Sponsor Types," *2012 Donor-Advised Fund Report*, fig. 13, www.nptrust.org/daf-report/sponsor-type-comparison.html#figure13.

3. Bradford K. Smith, "Don't Call Us, We'll Call You," *Philantopic: A Blog of Opinion and Commentary from Philanthropy News Digest*, March 4, 2011, pndblog.typepad.com/pndblog/2011/03/dont-call-us-well-call-you.html.

4. Fidelity Charitable Gift Fund (2012), Fidelity Charitable [mobile application software], retrieved from itunes.apple.com/us/app/fidelity-charitable/id552407907?mt=8).

5. Aine Creedon, "Web App Will Help Nonprofits Tap into Donor-Advised Funds," *The Nonprofit Quarterly*, April 9, 2013, www.nonprofitquarterly.org/philanthropy/22105-web-app-will-help-nonprofits-tap-into-donor-advised-funds.html.

6. Fidelity Charitable, *Fidelity Charitable Giving Report 2013*, accessed July 23, 2013, 5–16, www.fidelitycharitable.org/docs/giving-report-2013.pdf.

7. Fidelity Charitable, *Fidelity Charitable Giving Report 2013*, accessed July 23, 2013, 13, www.fidelitycharitable.org/docs/giving-report-2013.pdf.

Collaborating with Advisors to the "Self-Made": A Fundraiser's Next Frontier

By Phil Cubeta, CLU, ChFC, MSFS, CAP

According to the author, advisors tend to see their role too narrowly, as money optimizers, and fundraisers tend to shy away from real "conversations of purpose" with donors. Cubeta encourages fundraisers to partner with advisors, as "[v]isionary and effective planning for large gifts in the context of a donor's ideals, overall wealth, and family situation is necessarily a team exercise."

Invocation

There is a Moment in each Day that Satan cannot find,
Nor can his Watch Fiends find it; but the Industrious find
This Moment & it multiply, & when it once is found
It renovates every Moment of the Day if rightly placed.

William Blake, "Milton"

Writing at the time of the American and French Revolutions, Blake, the prophetic poet, did not mean, by "Satan" and his "Watch Fiends," what we mean today; he meant the spirit of rationalism. He had seen England's common grazing land displaced by "dark Satanic mills." He foresaw us as imprisoned inside a large clock, which could, by an act of the moral imagination, become once again a town green where lambs graze.

A Personal Perspective

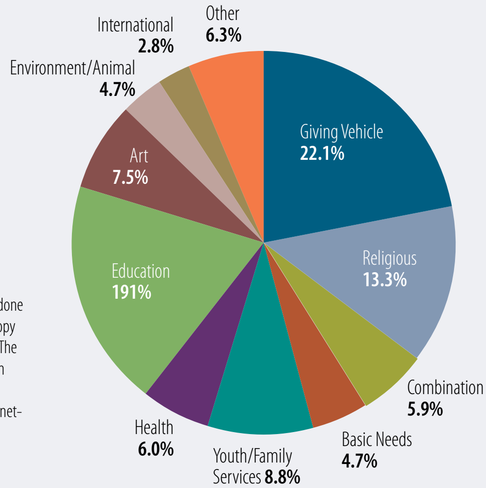
I once taught literature, then taught estate and financial planning to advisors, and now teach fundraisers and advisors how to collaborate to work with high-capacity donors. Whether it is metrics in fundraising (the art of the ask) or metrics in business (the art of the deal), I find that the failure point in gift planning is a failure of the moral imagination. That failure might be rectified if fundraisers stepped up from asking for money to helping donors achieve a better life through more imaginative, better-planned philanthropy.

Visionary and effective planning for large gifts in the context of a donor's ideals, overall wealth, and family situation is necessarily a team exercise. The wealthy potential donor already has advisors who call that donor a *client*. You will, as a nonprofit gift planner, have to work with or against advisors if you are to tap into the larger dollar. How advisors will respond to you depends on whether you have "control of the case." To gain control, your key strength is your willingness to engage in the conversation of purpose—one to which you are well suited and well positioned, working for an organization devoted to what is best in humanity. Properly conducted, that conversation of purpose, meaning, and community will drive and redirect the otherwise dry and often self-regarding planning processes that run their course daily in the offices of attorneys, CPAs, insurance professionals, investment advisors, and others who serve the wealthy. You can lift that conversation to a higher level, with a more inclusive view of what counts as winning in life for ourselves, our families, and our communities.

Phil Cubeta, CLU, ChFC, MSFS, CAP, is The Sallie B. and William B. Wallace Chair in Philanthropy at The American College of Financial Services.

"THE BURDEN OF FORMALITY" BY KEVIN SLOAN / WWW.KEVINSLOAN.COM

Where the Wealthy Give[1]



2009 Data cited in Bank of America Merrill Lynch study done with The Center on Philanthropy at the University of Indiana. "The 2011 Study of High Net Worth Women's Philanthropy." Data includes giving of both high-net-worth men and women.

Advisor-Driven Philanthropy as Money *into* Charitable Buckets

Consider the chart above showing giving by issue area. Much of it is what a fundraiser would expect. Now consider the largest slice, at 22 percent of the total. That is money not *to* a specific cause, but *into* charitable tools. It is a wealth transfer, deductible as allowed by law. But rather than going directly to a charity like your own, these funds go into a "bucket" from which grants or disbursements will, eventually, be made. The recipients of that biggest slice are foundations, donor-advised funds, charitable lead trusts, and charitable remainder trusts. Who funded that study? Bank of America Merrill Lynch. When encouraging financial advisors to discuss philanthropy with their clients, I say, "Look at that slice, my friends—that is money you can manage!" For nonprofits to access that money, to get it *from* charitable tools, they will often have to work with or against advisors who control the case and who have a financial stake in the outcome.

Nonprofits today get most of their gift dollars from a small pot of cash assets, while the largest pot—noncash assets—goes largely untouched.

Roughly 97 Percent of Gifts from 3–5 Percent of the Assets

Bryan Clontz heads Charitable Solutions, an organization that helps nonprofits, particularly community foundations, accept and process gifts of what are called "noncash assets." These include commercial and personal real estate, private business interests, tangible personal property, patents, mineral interests, timber, crops, and much else. According to a presentation Bryan made in 2012 to professional advisors on behalf of Community Foundation of South Jersey, "more than half of affluent investors' assets are held in noncash assets. Cash only represents 3–5 percent."[2] Yet, he says, gifts from noncash assets are estimated to be less than 3 percent of total giving. Exact data, Bryan would acknowledge, is hard to come by, but the point is clear: Nonprofits today get most of their gift dollars from a small pot of cash assets, while the largest pot—noncash assets—goes largely untouched. To activate these noncash assets for charitable purposes, the fundraiser must work with donor advisors who have expertise in this area.

The Closely Held Business Market

Daniel Daniels and David Leibell are tax attorneys who specialize in the closely held business market. In a 2011 workshop paper delivered to the Southern California Tax & Estate Planning Forum, "Estate Planning for the Family Business Owner," they acknowledge that scholarly data on the size and scope of closely held business is hard to find, but cite as indicative these findings from Family Firm Institute's Global Data Points:

> Approximately 90 percent of U.S. businesses are family firms, ranging in size from small mom and pop businesses to the likes of Walmart, Ford, Mars and Marriott. There are more than 17 million family businesses in the United States and they represent 64 percent of Gross Domestic Product and employ 62 percent of the U.S. work force.[3]

These business owners face significant challenges. As Daniels and Leibell note: "Only a little more than 30 percent of family businesses survive into the second generation, even though 80 percent would like to keep the business in the family. By the third generation, only 12 percent of family businesses are still viable, shrinking to 3 percent at the fourth generation and beyond."[4] These business owners are often deeply committed to their community. They are prime candidates to give back, but cannot do so at full capacity unless advisors are engaged to help liberate the closely held business wealth for charitable purposes.

How Generous Are These Closely Held Business Owners?

In *The Philanthropic Planning Companion*, citing a 2010 Fidelity Charitable Gift Fund survey, *Entrepreneurs & Philanthropy: Investing in the Future*, Brian M. Sagrestano and Robert E. Wahlers write, "Entrepreneurs are consistently more charitable than other high-net-worth individuals. Entrepreneurs are individuals for which 50 percent or more of their net worth comes from a family-owned business or start-up company. They are far more generous than those individuals who acquired wealth by inheritance, investment asset growth, or investment in real estate."[5]

The Fidelity study cited by Sagrestano and Wahlers found that 53 percent of entrepreneurs said charitable giving was a key part of their estate plan. Their motives include gratitude, empathy for others, and their having the resources and freedom to do it.[6]

What Is on the Successful Business Owner's Mind?

As baby boomer business owners consider transitioning their firms—either to employees, outside buyers, or family members—they ask larger life questions. To cite Dr. Lee Hausner and Douglas K. Freeman, *The Legacy Family: The Definitive Guide to Creating a Successful Multigenerational Family*, these are among the common issues:[7]

- What will I do with the rest of my life?
- Without the business, I am nothing.
- Without me, the business is nothing.
- Nobody can run it as well as I can.
- They may run it better than I did.
- I need some place to go every day.

Also on the owner's mind are questions like these:

- What will we get if we sell?
- How much do we need for ourselves?
- How much is enough, but not too much, for the heirs?
- How can we have an impact on our community?
- How can we reduce taxes in favor of heirs or charity?
- How can we pass on our values as well as our valuables?

Behind it all, as a generational soundtrack, you can almost hear Peggy Lee singing, "Is that all there is?" Is that all there is to being successful, building a company, having a family, selling the business in style—is that all there is? The answer has to be no. The business owner is looking for a second act after success, and is a perfect candidate for engagement with a local nonprofit.

Closely Held Business Wealth in Your Neighborhood

The successful business people I am describing are your neighbors. You may do business with them. You may have bought your car on their lot, you may eat in their restaurant, the food on your table may have been grown on their farm. They may service your air conditioner, or have built your home. One may own the strip mall where you pick up your dry cleaning. They may own the trucking company, the gas station, or the McDonald's franchise. Your last trip to the airport may have been in a cab from a fleet they own.

These are people who are rooted in the local community, often in a faith tradition. Some are from families who have lived there forever—born in the hospital like their parents before them and expecting to be buried in the same churchyard. Others are first- and second-generation immigrants from India, China, Cambodia, Mexico, Guatemala, or Vietnam, hoping to bring relatives here and put down roots. Asked the deeper questions, these families—who do not give big yet and who are not connected to community foundations or to the philanthropic networks—often express gratitude, obligation, and the need to make it come out whole by devoting their self-made wealth to leaving behind them a community worth living in for their children.

The successful business people I am describing are your neighbors. You may do business with them. You may have bought your car on their lot, you may eat in their restaurant, the food on your table may have been grown on their farm.

Your Role as a Fundraiser: Conversation Starters

Advisors often see their role narrowly, as helping clients with the mechanics of amassing, preserving, growing, and transferring wealth. They often see themselves as tax, legal, or financial strategists whose goal is to optimize money. Clients, however, are also human beings, not just "wealth holders." They are parents, citizens, potential donors, and civic leaders. Some may see themselves as on a journey whose end point is eternity. They need and want someone—perhaps you—to work with them to set direction, and to see their own life whole, as a narrative with purpose, dignity, and significance. Here are good questions you can ask:

- Where would you like to have an impact now, later, at death, and beyond death? On yourself and on your family, certainly. On your business, of course, and on your money. Is there anywhere else?
- Are there things you meant to do earlier in life, when you were starting out, that you have not yet done? How can you get back to that while you still have time?
- What principles will guide your legacy plan to date?[8]
- How wealthy do you want your children to be?[9]
- Where do you volunteer or serve on boards?
- What keeps you awake at night?[10]
- Do you believe you have a responsibility to society?[11]
- If your family had a crest, what would be the motto?[12]
- Has past giving reflected your hopes?[13]

Donor Narrative

These questions, or ones like them, when they register, elicit an often rambling and inconclusive self-narrative. The potential donor will begin to talk, often hesitantly, sometimes abashedly, and in leaping arcs of half-finished stories, about his or her life and what it means and where it tends. To literary ears, it sounds like a tale in search of what Frank Kermode called, "the sense of an ending." Psychologists tell us that "life review" is a life stage, setting in as we age, and is not optional. At a certain age, it becomes almost compulsive. We need our lives to come out even. Given enhanced life spans today, life review even at older ages can lead to new life—a new life as a giver and civic leader—so that the whole of life is redeemed or enhanced. By listening to the stories and connecting them to what your organization does, you can redeem the time by helping the donor achieve a purpose beyond money, a purpose that makes that life complete.

The potential donor will begin to talk, often hesitantly, sometimes abashedly, and in leaping arcs of half-finished stories, about his or her life and what it means and where it tends. To literary ears, it sounds like a tale in search of what Frank Kermode called, "the sense of an ending."

Stepping into the Conversation of Purpose

Having heard any number of excuses over the years from both advisors and fundraisers—ranging from "It's not my job"/"I'm not paid to do it" to "I don't know how"—I was in need of solace. I met with Rabbi Mordechai Liebling, teacher of theology and social justice organizing and of fundraising, and asked him if he and the rabbis he trains would risk these larger questions with donors. His answer came in one word: "No." He then said, "Phil, what you need to know is that as rabbis we have three roles. First, we are prophets." I protested that the questions about meaning are prophetic. "Yes," he said, "they are." "Second," he said, "rabbis are preachers." I protested that these questions about life and death are pastoral, to a fault. He agreed. Then he said, "Third, we are also employees of the temple." He was teaching me that these larger philosophical questions are terribly difficult to raise, even for someone with pastoral training.

Mordechai eventually came to The American College of Financial Services, where I teach, to role-play a fundraising interview on camera. He did a great job, but to me he sounded like a salesman. "But," I said, "Rabbi, you don't sound like a rabbi. That woman in front of you is going to die. Is this the best you can do?" His eyes flashed. He sat back down, and said: "Your last will and testament is your final teaching. What do you want it to say?" The hair rises on my neck each time I repeat those questions. That is the prophetic voice.

Each of us, rich or poor, as we plan our final affairs, deserves three heartbeats where those questions or others like them hang in the air. The spirit may enter. The spirit may not. But if a person—call that person a donor, call that person a client, call that person your neighbor—dies without such a question having been asked, what dream of a better life in a better world will be buried with him or her?

What gives you the right to ask larger questions of those with wealth, power, and influence? It is a matter of alignment. You have every right to ask others questions you have asked yourself, the ones that led to your own life course in service to an ideal. In the orbit of this "donor" or "client," you may well be the one person with the courage, or temerity, to lead from purpose. You may be their last chance to align plans and purpose before the books close forever.

Please lead. When you come to your highest-capacity donors, please lead from the best in yourself and from the mission of your organization, so that the best in us will live on for those who come after us. Who are you to do it? Who else will?

Who Works with Closely Held Business Owners?

Most small businesses are very small. But local successful businesses comprise a lucrative market for a cross-disciplinary cadre of professionals, including attorneys, CPAs, bankers, brokers, and insurance agents. Such professionals provide income and estate tax planning, groom businesses for sale, do business valuations for sales and charitable transfers, provide investments, or sell life insurance to provide liquidity for estate tax and business transfer purposes.

Among the Credentials Recognized in This Market

- Chartered Life Underwriter (CLU)
- Chartered Financial Consultant (ChFC)
- Masters of Science in Financial Services (MSFS)
- Chartered Advisor in Philanthropy (CAP)
- Chartered Financial Planner (CFP)
- Attorney (JD), particularly a Master of Laws in taxation (LLM)
- An attorney who is a Fellow of The American College of Trust and Estate Counsel (ACTEC)
- CPA specializing in business clients

Places to Network with Advisors

- Partnership for Philanthropic Planning (for more, see www.pppnet.org)
- Estate Planning Council

How to Connect through Your Own Networks

- Your board may well include advisors who are connected to this market.
- Your current donor list contains advisors.
- On your donor list are many donors who rely on advisors; ask them for referrals.
- You may want to form a gift-planning advisory group to engage advisors in your network, to elicit referrals from them, and to share ideas on how best to collaborate.

Notes

1. Indiana University Lilly Family School of Philanthropy, supported by Bank of America Merrill Lynch, *The 2011 Study of High Net Worth Women's Philanthropy and the Impact of Women's Giving Networks* (Indianapolis: Bank of America Philanthropic Solutions/The Center on Philanthropy at Indiana University, 2011), 8, newsroom.bankofamerica.com/files/press_kit/additional/Study_HNW_Womens_Philanthropy.pdf.
2. Bryan Clontz, "Creative Charitable Planning with Non-Cash Assets," April 3, 2012. In the presentation, Clontz cited a 2005 study by Spectrem Group and Realty Times. In fact, Bryan is speaking from his own extensive experience. For those who work in this market, it is quite clear from client balance sheets that the bulk of assets, particularly for self-made business owners, are rarely cash heavy. These owners invest in what made them rich in the first place—illiquid, closely held businesses, as well as land, collectibles, and other things that do not trade on an exchange.
3. Daniel Daniels and David Leibell, "Estate Planning for the Family Business Owner," a presentation to the Southern California Tax & Estate Planning Forum, October 26–29, 2011. They cite as their source Global Data Points, Family Firm Institute, Inc.
4. Ibid.
5. Brian M. Sagrestano and Robert E. Wahlers, *The Philanthropic Planning Companion: The Fundraisers' and Professional Advisors' Guide to Charitable Gift Planning* (Hoboken, NJ: John Wiley & Sons, 2012), 93.
6. Fidelity Charitable Gift Fund and Ernst & Young, *Entrepreneurs & Philanthropy: Investing in the Future*, 7, www.fidelitycharitable.org/about-us/news/11-12-2010.shtml.
7. Dr. Lee Hausner and Douglas K. Freeman, *The Legacy Family: The Definitive Guide to Creating a Successful Multigenerational Family* (New York: Palgrave Macmillan, 2009), 132.
8. Charles Collier, *Wealth in Families*, 3rd ed. (Cambridge, MA: Harvard University, 2012), adapted from questions on page 1.
9. Ibid., adapted from a question on page 5.
10. Joe Breiteneicher, head of The Philanthropic Initiative at the time, in a conversation with the author.
11. Collier, *Wealth in Families*, adapted from a question on page 5.
12. Breiteneicher, in a conversation with the author.
13. Tracy Gary, adapted from a question in her *Inspired Legacies*, 3rd ed. (San Francisco: Jossey-Bass, 2008), 53.

To comment on this article, write to us at feedback@npqmag.org. Order reprints from http://store.nonprofitquarterly.org, using code 200210.

Naomi Levine:
Insights from a Master of Fundraising

Interview by Ruth McCambridge

While allowing that there are new trends in philanthropy, the fundamentals remain the same: developing relationships, having a good product, knowing how to find the right donors, and having a board that is prepared to help in the effort.

A fundraiser for New York University and president of its George H. Heyman, Jr. Center for Philanthropy and Fundraising, Naomi Levine is credited with helping to save the university from bankruptcy. Levine, who just passed her ninetieth birthday, says that her mother always told her she was very smart. I would agree with her mother—and, indeed, with the many people who over the years have trusted Levine to fundraise for and from them. In the following interview, Levine says that much of being successful as a fundraiser is about building authentic relationships and just being interesting—and there is no hiding Levine's authenticity or vivid intellect.

Ruth McCambridge: *Naomi, you have helped raise more than $2 billion in contributions for New York University (NYU), which is a phenomenal accomplishment. I want to ask you a set of questions about what you see as having changed in the philanthropic landscape and in approaches to fundraising. But first, could you describe how you got into fundraising? When did that happen, and who helped you get in? You did not start out as a fundraiser. . . .*

Naomi Levine: No. I am a believer in John Lennon's line, "Life is what happens to you while you're busy making other plans." I'm a lawyer, and I had been at the American Jewish Congress overseeing a very important program in civil rights and civil liberties—an area in which I was and still am very interested. But after twenty-five years I realized I was fifty-five years of age, and if I didn't have any other experience that would be my only job. I had become executive director, the first woman to hold such a position in Jewish life; people made a big fuss about me, and I could have stayed there comfortably. But I felt it was time for a change, and I talked casually to a friend at lunch, and he knew the chairman of a search committee for a vice president for NYU. He gave my name to the president, John Sawhill, who called me. We had an interview, and for whatever reason, I got the job.

The job was senior vice president, and it covered many areas. It covered lobbying in Washington and Albany, which I had done. It covered press, public relations, special events, etc. Fundraising and development were one part of it. After a while, however, since NYU was close to

Ruth McCambridge is the *Nonprofit Quarterly*'s editor in chief.

"IT'S WARMER INSIDE" BY TIM HALLINAN / WWW.TIMHALLINAN.COM

The donors that I met with were very intelligent—as smart as me or smarter—and if I didn't come to them with something of value, they weren't going to fund it.

bankruptcy when I came in, in 1978, fundraising became my overwhelming responsibility.

So I got into fundraising so intensively by accident. But I was very fortunate. The president had brought in a new chairman of the board, Larry Tisch, and Larry made fundraising his priority. He also brought in George Heyman, a very respected leader in the world of finance, who became the chair of the trustee development committee. And they took me under their wing and taught me everything I know. Indeed, I organized the Heyman Center for Philanthropy and Fundraising to teach what Larry and George had taught me.

RM: *So you are ninety now, which means you've had thirty-five years of experience in the field. Can you talk a bit about what you have learned and the principles that guide your work?*

NL: Let me tell you my approach, because you started off the interview suggesting that there were new techniques and approaches that might change the face of philanthropy. I only agree with you halfheartedly, because I think that some of the basics in fundraising will be and are relatively the same over time. There are changes and there are new trends that we could talk about, but there are some fundamentals that I learned, and those have guided me in my fundraising and my teaching.

First of all—and this may have been often repeated, but for good reason—I believe that fundraising is developing relationships. You have to be able to get people to trust you and to like you, and to think that what you're coming to talk with them about is of interest to them and is something of importance that deserves support. The "program or project" is critical. You also have to be a relatively interesting person so they're prepared to develop a relationship with you. And when I say interesting , that means you must read—you must know what's happening in the world. When you sit down with someone and try to develop a relationship, you can't just say, Oh, Mrs. Jones, would you give me $100 million? That's not the way it works. It's a slow process. The quicker you ask, the less you get. Developing relationships and trust often takes a long time.

Second, as I said above, I believe that you have to have a good product. You can't sell *anything*—you have to sell something that's of value, that is going to make the world a little better, that's going to help solve a problem. The donors that I met with were very intelligent—as smart as me or smarter—and if I didn't come to them with something of value, they weren't going to fund it.

And then you have to be able to find somebody who will be interested in that project, and *that* requires some good research.

In addition, you asked me what I have learned. I learned that you can't do a fundraising job in an institution unless you have a board that is prepared to help you. Mr. Tisch was very strong on that issue. He felt that sitting on a board not only was an honor but also carried responsibilities—fiduciary, legal, financial, etc. You not only had to come to meetings, to review the budget, to participate—he felt you also had to a) give some money—it didn't have to be large, but you had to show your financial commitment; b) help get money; or c) if you could do neither a nor b, not serve on a board. I could look at your board and within an hour tell you whether you'll be here in five years or not.

So let me repeat: boards are critical. Fundraisers can't go out on their own and raise the money. Who did I know? Did I know all the affluent people in New York City? Obviously not. The board gave me names. They made suggestions. There's a principle in fundraising that "people give to people." They were not going to give to *me*; obviously, they were going to give to people with whom they had a relationship. Peers are important.

A board gives you such relationships. You must also have a competent and dedicated staff to help you.

RM: *What do you think are the worst mistakes people make when they're readying themselves to be fundraisers? What are the worst assumptions and the worst practices that you see out there?*

NL: Well, first of all, I believe that fundraising must be viewed as a very sophisticated profession. It breaks my heart when people don't recognize that. You know, they think, Oh, fundraising, it's selling cookies for the Girl Scouts. That's nonsense.

Today, if you're going to be a good fundraiser, you really should take courses in it and get educated, because it involves, for example, planned giving, technology, capital campaigns, etc., and you must have knowledge about the laws. You can get into serious trouble if you don't know the IRS rules on good governance. You have to know the federal laws. You have to know the state laws. And you must be sensitive to the ethical issues that arise in fundraising. So I believe that a mistake a person could make is wanting to go into fundraising without an education in fundraising.

For example, we give a course on the art of the ask. Now, I've been involved in a lot of asking, but I went to that course and, I must tell you, I learned something. And, in planned giving, I've learned a great deal that even as a lawyer I was not aware of before.

About the worst thing you could do is, out of ignorance, make ethical misjudgments or get involved in unethical behavior—even inadvertently. The worst thing you could do is to get a reputation that you're not an ethical person. Nobody wants to deal with a slick, unethical person. You can't lie. You can't misinterpret. You can't pressure. You have to obey the rules of privacy. All that matters. You don't learn about that unless you take courses. So I believe the worst thing a person could do is think that the field today is just selling cookies. It's far more difficult and sophisticated.

RM: *You have talked about a lot of things that are constant and abiding. Have you noticed anything significant that you think has changed?*

NL: Well, yes. There are new trends in philanthropy—something fundraisers today should understand. I read a report that indicated that, in the next ten or fifteen years, $40 trillion—*trillion*, not million—are going to be transferred from one generation to another, because a lot of people from this generation and the one before made an enormous amount of money.[1] And that money is being transferred, in many cases, to younger people. So the first trend to notice is that there will be younger people, in their late teens, twenties, and thirties, who will have a great deal of money.

Second, their interests are, according to this study, not exactly the same as those of their parents. Yes, they will give to some places that their parents gave, but their interests are in the environment, including animals. They're interested in civil rights, women's rights, gay rights. They're interested much more in international issues. They're interested in poverty and projects to make things better socially and economically for people in need. And, according to the study, they are not giving as much to, for example, hospitals and health institutions, maybe because they're young—they don't think about illness and dying. Also, they're not giving as much to religious institutions, and they're not giving as much to arts and culture. Perhaps in time this too will change.

So these new trends are one thing that you have to know about. A lot of money is going to be transferred. The people are going to be younger. Their interests are not the same.

[T]hese new trends are one thing that you have to know about. A lot of money is going to be transferred. The people are going to be younger. Their interests are not the same.

The report also states that these younger philanthropists want to see results, and they're using metrics and business systems to see what results their money is making. If they give, they want to see what happens with their money, and they want to make sure that they can watch it. Therefore, they don't like umbrella groups, like UJA-Federation of New York and United Way, because there the money goes in a pot and they don't know exactly how it is being used. And, also, they are a generation that will use technology far more than in the past. Now you have to know all about social media and how to use it in fundraising, and how you get your image across on the Internet. Technology is obviously increasingly important.

I started off by saying in the beginning of the interview that, yes, there are new trends and changes. But, on major gifts, I believe that the fundamentals will remain.

Note

1. Sharna Goldseker and Michael Moody, *Next Gen Donors: Respecting Legacy, Revolutionizing Philanthropy* (Grand Rapids, MI: Dorothy A. Johnson Center for Philanthropy and 21/64, 2013).

To comment on this article, write to us at feedback@npqmag.org. Order reprints from http://store.nonprofitquarterly.org, using code 200211.

Toward a Successful Internet-Enabled *Philanthropy Ecosystem*: *Part 1*

by Buzz Schmidt

In this article the author lays out his vision for a "philanthropic ecosystem"—dividing its principles into four component systems and explaining that, in order for the sector's online ventures to succeed, we must remove the "systemic barriers" existing in philanthropy that "limit the progress of innovative initiatives."

***Editors' note:** This is the first of two parts of this article, the second of which will appear in* NPQ*'s fall 2013 edition. The article started as a paper titled "Promoting Passion, Purpose, and Progress Online." It was first published online by* Alliance Magazine, *in February 2013.*

Over the past fifteen years, scores of American social entrepreneurs have tried but been largely frustrated in their efforts to promote more intelligent, proactive, and generous philanthropy via the Internet. For the most part, they have been unable to bring their databases, site traffic, and transaction activities to scale. The early Internet experience has been equally frustrating for managers of nonprofits. They are buffeted by numerous increasingly intense and generally conflicting demands for information. They receive inconsistent market signals from donors, both individuals and institutions, and watch the great bulk of online giving flow to causes that are hot, visual, and immediate instead of to those that are thoughtful, well managed, and persistent. Like the online philanthropy entrepreneurs, nonprofit leaders are frustrated by their own failure to exploit the transformative promise of the Internet.

While frustrating, this result was predictable. Our efforts to promote online philanthropy are stuck in a tangled web of ineffective and inconsistent practice that extends throughout the universe of philanthropy. We have sought, through our sophisticated tools and exhaustive data, to untangle a part of that web. Certainly there have been bright spots—modest untangling and change has occurred here and there. But the pace of that change has been painfully slow. This paper argues that change will continue to be hampered unless we invoke strategies to untangle the entire web—that is, remove impediments that inhibit progress throughout the entire philanthropy ecosystem, which is the aspirational name I use in this paper to describe the interconnected, information-driven, innovation-embracing philanthropic universe we must resolve to build together.

This paper revisits early initiatives to facilitate more generous and intelligent philanthropy, and

Buzz Schmidt is a visiting scholar at the Tuck School of Business, Dartmouth College. He is the founder of GuideStar and GuideStar International, the chair of the F. B. Heron Foundation, and a member of the boards of TechSoup Global and the Institute for Philanthropy.

"FREE FALL FISH" BY GAIL TROTH / WWW.GAILTROTH.CO.UK

[W]ithout a commitment to build this ecosystem together, the entrepreneurs and others who build and lead nonprofit organizations will continue to operate within a confusing and ineffective resource marketplace.

flags the causes of entrepreneurial frustration. It then discusses, in turn, the pertinent attributes and challenges facing each of four component systems of an inclusive philanthropy ecosystem: *the philanthropy knowledge system*; *the giving system*; *the nonprofit management and reporting system*; and *the nonprofit evaluation system*.[1] It concludes the discussion of each component system by identifying opportunities for social entrepreneurs to intervene productively. And, it highlights the systemic potentials of the philanthropic universe and the necessity for social entrepreneurs to pursue opportunities for coordinated or collective action across the ecosystem. Indeed, without a commitment to build this ecosystem together, the entrepreneurs and others who build and lead nonprofit organizations will continue to operate within a confusing and ineffective resource marketplace. And, most importantly, the people and planet served by these actors will be denied the benefits of a well-functioning philanthropy ecosystem.

The Drive to Make Giving Better: Early Initiatives Revisited

We haven't always sought to turn donors on to the rewards of smart, proactive philanthropy. We haven't always believed that we could elevate them to greater heights of discerning generosity by offering them immediate access to evaluative, fiscal, and programmatic information about nonprofits. Indeed, throughout its long history, American philanthropy has been very slow to move from its longstanding association with alma maters, churches, hospitals, and other local institutions—an association fortified by friends, family, pride, and proximity—to embrace the hundreds of thousands of distant, more cause-focused nonprofits that proliferate around the planet.

Community Chests and United Ways

Attracting the attention and allegiance of new donors has always been a difficult and expensive proposition for nonprofits that lack human ties to their targets. The most successful have deployed sophisticated marketing methods of messaging, direct mail, and friends-of-friends networking. Throughout the twentieth century, local Community Chests and their United Way offspring popped up to capture and rationalize donor interest in local social agencies. While still relying on tried-and-true direct mail and a network of workplace "arm twisting," United Ways have long researched local community need and purported to fund the most effective charitable responses. In this way they conduct, albeit not always cost-effectively, the evaluation and funds-sourcing functions for local charities that online intermediaries, as we will see, seek to do for nonprofits and causes throughout the world. But note that, despite their ubiquity and longevity, United Ways still process less than 2 percent of total giving.

The National Charities Information Bureau, Better Business Bureau, and American Institute of Philanthropy

Direct mail campaigns by national nonprofits seeking donations countrywide grew in prominence in the 1960s and 1970s. In response, state charity offices and national watchdog groups, principally the National Charities Information Bureau (NCIB), Better Business Bureau (BBB), and American Institute of Philanthropy (AIP), emerged to protect the public from fraudulent solicitors and inefficient charities. NCIB and BBB, each working with populations of roughly 350 nonprofits, identified those organizations that exceeded their standards and those that fell short. AIP offered letter grades for selected standards for the six hundred nonprofits it rated. The expressed purpose of these efforts was consumer protection, and the primary focus of analytical attention was nonprofit fundraising practice. The perverse upshot of the whole exercise has been a widely accepted, two-generations-long tradition of nonprofit evaluation based largely on the magnitude of fundraising and administration ratios.

The NCIB and BBB combined operations in 2003, revisited respective evaluative standards, and now offer a more holistic view of general fiduciary practice, as well as fundraising practice, in their reviews of 1,200 nonprofits.

GuideStar and Charity Navigator

GuideStar launched its comprehensive website in 1998, offering extensive financial and limited descriptive information, all self-reported and non-evaluative, on the hundreds of thousands of nonprofits that complete the Form 990. GuideStar assembles vast amounts of data from all American nonprofits, which helps donors and others to identify, compare, track, and connect with groups performing work that resonates with their own interests and values.

Charity Navigator, also seeking to take advantage of the data management and broad distributional functionality of the web, was founded in 2001 and has become the most highly trafficked website of the evaluative services. Using a relatively few financial data fields from the Forms 990 of 5,500 organizations, it applies star ratings for each of four indicators of the financial efficiency of organizations and three indicators of the financial capacity of organizations. Charity Navigator has sought lately to reorient its evaluative model to focus increasingly on organizational accountability and results, thereby diminishing its single-minded focus on simple financial calculations, an evaluative method now largely in disrepute.

The formation of Network for Good, originally a partnership of AOL, Yahoo!, Cisco Systems, GuideStar, and VolunteerMatch in 2000, provided a pivotal and instructive moment in this concentrated historical development. The question arose whether GuideStar should use its mountains of data to construct and display an evaluative framework, like the one eventually launched by Charity Navigator, but on a much larger scale. The principals at the time determined that GuideStar must remain a neutral aggregator of this largely self-reported information by charities. Beyond continuing to digitize the voluminous financial data resident in the Forms 990, they determined that GuideStar should strive to capture additional narrative information about the intentions, program activities, objectives, and accomplishments of all charities.

GuideStar's principals subscribed to the theory that a nonprofit's "worthiness" was largely a function of the values of the evaluator or other observer. Further, if it could assemble all the pertinent information about each organization and provide the robust mining and analytical tools, donors could theoretically do their own ranking and rating. GuideStar had confidence in the integrity of the do-it-yourself theory, but acknowledged that a donor public would likely seek the help of "expert" evaluators to help them identify the right organizations. It envisioned the ultimate emergence of a substantial network of evaluators, each bringing differing institutional perspectives, fundamental values, and subject and geographic expertise to proprietary evaluative models. It used the "movie critic" metaphor to explain its vision that one day millions of disparate donors would come to trust the judgment of one or more scores of evaluators to identify worthy nonprofits. In this conception, GuideStar would play a valuable role in supporting the emergence of this network of evaluators with data and Internet visibility.

Happily, new evaluation schemes seem to emerge regularly, and other new efforts that identify "excellent" giving opportunities (e.g., GlobalGiving) evaluate implicitly through their choices of programs to display, though they do not rank or rate nonprofits. Just as we have seen in every other walk of life, philanthropy has seen an explosion in information sites, Web 2.0 interaction sites, and now directly focused social network initiatives, such as scores of apps and thousands of custom pages grafting philanthropic services and nonprofit causes onto the Facebook platform. With these developments, perhaps we will go full circle, once more depending upon friends and virtual neighbors for the connections to social expression through philanthropy.

In 1999, Pete Mountanos promised that Charitableway would become the "Amazon of philanthropy." It was a little scary, but we believed him.

Progress to Date

So far, despite the churn, time has told a disappointing story. The amount and quality of philanthropic activity springing or gaining confidence from serious evaluative activity, at least that which can be adduced from web activity, is hardly in line with the expectations of the early Internet social entrepreneurs. In 1999, Pete Mountanos promised that Charitableway would become the "Amazon of philanthropy."[2] It was a little scary, but we believed him. While the hubris of subsequent initiatives has not matched that of this pioneer, our own founding expectations have rarely been fulfilled. Certainly the full value of online information services in supporting offline donations has not been studied adequately, but the contention that the web has revolutionized donor behavior, as it has virtually every other human transaction, is not remotely supported by the data.

The early frustrations have not inhibited efforts to use electronic technology and the web to rationalize and facilitate giving. But, like the wild philanthropic marketplace they seek to tame, these efforts are all over the map with respect to motive, method, and message. This uncoordinated entrepreneurial quality is at once the strength and continuing weakness of this movement. Operating independently, without a holistic view of the ecosystem they hope to improve, online initiatives today constitute little-heard noise in a vast forest of nonprofits.

Operating independently, without a holistic view of the ecosystem they hope to improve, online initiatives today constitute little-heard noise in a vast forest of nonprofits.

By no means does our sketchy early experience demand that we cease these efforts, but this will remain a tough road. In the larger economy, Internet information and transactional services succeed when they offer "consumers" a value proposition that builds upon current, self-interested decision processes. Like Amazon or E*Trade, our online philanthropy solutions also ask users to change to electronic transaction processes. But the success of these ventures also requires our users to switch from an affiliative, borderline-self-interested decision process to one that is more discerning, "other" centered, and cause related.

The institutional barriers to the success of online ventures do not end there. Lest we forget, another major operating challenge these initiatives face is the need to capture information about large numbers of nonprofits to feed proprietary databases. This requirement compels each service to ask nonprofit organizations to report differently and, at times, behave perversely, in reaction to our requests for information that are varied, conflicting, and often internally irrelevant.

The online philanthropy entrepreneurs could take comfort in the knowledge that they are not alone. Numerous systemic barriers to so-called rational behavior limit the progress of innovative initiatives in other areas of the philanthropy ecosystem, such as the promotion of "impact reporting," the sharing of grantee due diligence data, and the encouragement of best grantmaking practice by foundations. However, the continued failures of these initiatives bode poorly for our own. In practice, we need these types of initiatives, which lift the entire ecosystem, to succeed.

An Alternative Vision for the Philanthropy Ecosystem

We have not succeeded to date because we have not accounted for the complexities and contrary economies of philanthropy as it exists today. We are attempting to interject creative online methods into a philanthropy ecosystem that does not yet value, promote, and reinforce the importance of information, consistency, or effectiveness. If we continue to innovate without a sense of the whole and without assiduous attention to the major driving conditions, we will continue to spin our wheels.

But if we can step back and examine the methods, signals, and accountability of the entire philanthropy ecosystem, we will not only improve the prospects for the existing online intermediaries but also identify multiple additional opportunities for fruitful intervention. We will recognize that, far from a zero-sum shootout among the current group of online entrepreneurs, if we are to elevate philanthropy and nonprofit practice appreciably, many more savvy intermediary actors will likely be needed to innovate in what may yet become a vibrant, continuously improving philanthropy ecosystem. But first, we should attempt to reach agreement on a vision for an ecosystem that we intend to help build together. Here is my candidate for that vision:

> *The nonprofit sector will play an increasingly and recognizably effective role in our social economy and civil society. Its initiatives will continue to capture and offer institutional expression to the hopes, ideas, and energies of private citizens. But in the near future, supported by strategically coordinated information and transactional (mostly online) services, it will do so in ways that are at once more purposeful, coordinated, and accountable. Individual donors will seek out and support organizations that are doing work that they value.*

Institutional donors will be accountable, consistent, transparent, intentional, and demanding in their philanthropy. Communities will articulate common objectives and track collective progress. Nonprofits will report consistently about their own objectives and institutional progress. Resources will be directed to organizations that best meet society's evolving needs. Superior social and environmental progress will result and our liberal democracy will be strengthened.

Properly construed, these activities operate with a set of semi-discrete component systems that in turn are nested within an encompassing philanthropy ecosystem. Innovative but mutually reinforcing work by numerous intermediaries, existing and prospective, within and across the systems, will be needed if we expect to strengthen the entire ecosystem and advance social and environmental progress as a result.

To explain the workings, impediments, and opportunities of the philanthropy ecosystem more fully, I have divided its principal activities into the following four component systems, which are ostensibly discrete but ultimately interconnected:

1. **The philanthropy knowledge system.** The theoretical repository of pertinent social and environmental indicator data; government and corporate activities and policies; community objectives; and expert opinion about effective intervention methodologies that informs, constrains, and motivates nonprofits, donors, and intermediaries in the philanthropy ecosystem.
2. **The giving system.** The complex network of donors, trustees, institutional advisors, online transaction services, and formal philanthropic institutions that originate and/or manage over $300 billion in annual charitable gifts and grants.
3. **The nonprofit management and reporting system.** The process of objective setting, planning, performance tracking, and reporting that resides at the heart of every excellent nonprofit organization's management system.
4. **The nonprofit evaluation system.** The network of auditors, evaluators, accreditors, regulators, experts, information websites, journalists, friends, and others who seek to inform, influence, validate, and/or protect donors and their decisions.

In the sections that follow, I have attempted to depict each system's salient attributes, its interconnectedness with other systems, the bottlenecks and inefficiencies that impede its success, and the opportunities for tech-savvy social entrepreneurs to intervene and innovate.[3]

The Philanthropy Knowledge System

Donors, nonprofits, and intermediaries respond to what they hear and learn from the news, public opinion, policies of governments and corporations, studies of successful interventions, and explicit community objectives. The torrent of information that drives disparate behaviors of the actors in the philanthropy ecosystem is chaotic, and the signals these actors send and receive are inconsistent. If we expect to achieve our vision for a more intentional and connected philanthropy ecosystem, we must find better ways to access and assess this information and convert it into actionable knowledge. The following categories of information are particularly important and promising, and will comprise a robust philanthropy knowledge system to support the philanthropy ecosystem.

As we convert chaotic information into useful knowledge, it is critical to establish a common language and frame of reference. Today, we can access compelling data indicating the status of virtually every issue, which can support interventions at every level. The State of the USA, a nonprofit based in Washington that seeks to provide exhaustive indicator data with a toolbox of visualization tools, is one of dozens of compelling new services.

With excellent indicator data readily available, we should expect political leaders, communities, and private citizens to identify priority indicators to establish and track consistent objectives for progress for each priority indicator. If donors and

As we convert chaotic information into useful knowledge, it is critical to establish a common language and frame of reference.

nonprofits synchronize their objectives with those of their communities, we can expect information chaos to dissipate and collective action to emerge.

The marketplace of expert opinion is vast and uncoordinated. Foundations commission and fail to share proprietary studies about needs, data, and effective interventions. Nonprofits are asked sporadically to assess the impact of their own programs. Little is done with this information. There is a great need for a public repository of expert opinion about effective solutions and useful interventions.

Very often we think of the nonprofit sector as a closed system in which much of society's good work is performed. We acknowledge that government also performs much good work, though that assessment is continuously challenged. We seldom think about the role of business, beyond corporate social responsibility, with respect to its positive impact upon social or environmental objectives.

We have an excess of information swimming around, or more likely lying dormant, in the filing cabinets of foundations, government entities, nonprofits, and academics. Making the best of this information accessible and useful, turning it into knowledge that can power collective action and consistent provision of resources to effective nonprofit programs, is both a critical need and a tremendous opportunity for the Internet entrepreneur who wants to change the rules of the game. Without this common and virtual repository of knowledge, we cannot materially improve the effectiveness of the nonprofit sector.

Many, if not all, of the critical components of the knowledge system are already resident in specific online initiatives as well as in the nooks and crannies of the web.

What Is the Importance of the Knowledge System within the Philanthropy Ecosystem?

The knowledge system provides the context for the strategies and actions of each of the ecosystem's participants and predicates defensible so-called theories of change. A properly functioning knowledge system will offer greater clarity about the absolute and relative standing of each community's progress with respect to a broad range of social indicators (the metaphorical needles and dials); a formal statement of the priorities of each community (geographic or subject area), and objectives for these priorities; an inventory of successful intervention methods, and accompanying expert commentary to support effective program selection by nonprofits and funders alike; and a full record of government programs and business activities germane to each programmatic area.

What are the Bottlenecks or Impediments to Making This System Function Optimally?

The vastness of a well-functioning knowledge system is clearly daunting. Agreement over what is important or which language to use is elusive. The inclinations of both nonprofit managers and private foundations to "do their own thing," commission their own duplicative research, operate within narrow communities of practice, fail to share knowledge, and ignore the innovations of others are major barriers. Low data literacy in some quarters and the fast-rising belief that no one will agree on anything, worsened by our inane red/blue political "discourse," are certainly obstacles to consensus. Innovations in the giving and nonprofit management and reporting systems will be needed to compel the actors to build, respect, and make the most of the knowledge system.

What Are the Principal Opportunities for the Innovative Social Entrepreneur?

Many, if not all, of the critical components of the knowledge system are already resident in specific online initiatives as well as in the nooks and crannies of the web. The opportunities presented to the social entrepreneur are information design and online data aggregation. There are many public and private online sources of useful indicator data. The State of the USA already endeavors to assemble and display data in one easily accessible place, together with tools to help understand and visualize the data. The Results-Based Accountability™ program has developed tools to help communities (geographic and subject subsector) select priorities, establish objectives, and track progress using these types of indicator data. There are doubtless many other pertinent initiatives. From where I sit, the four opportunities listed below could compel policy-makers and enable their communities, donors, nonprofits, and other agents of progress to access common information, set common objectives, and employ the most effective strategies.

- **The expert source.** A well-indexed online catalogue (or set of subject-defined subsector catalogues) that would aggregate studies of conditions surrounding and causes for each indicator, evaluations of relevant current and past interventions and programs, and studies of untried prospective solutions.
- **The catalogue of social intervention.** Designed to complement the expert source, this online resource would catalogue the public, business, and nonprofit initiatives that have implications for each indicator and serve as a primary source of data for strategy development and partner selection.
- **Mash-up of The State of the USA and Results-Based Accountability™ services (or some similar combination).** This is an opportunity to give geographic and subject subsector communities a robust and convenient way to determine priorities, establish objectives for improvement, track progress, and publish all of the above (perhaps to the community objectives catalogue that follows).
- **The community objectives catalogue.** This online resource would combine and catalogue pertinent social progress indicators with objectives that had been established for every bona fide geographic and/or subject subsector community. They may conflict. Cohesion is a goal, not a prerequisite. The market of resource providers and practitioners ultimately decides. The catalogue enables that "transaction." In addition to objectives, the catalogue would display the current (and past) value for each indicator. Its purposes would be to focus donor and nonprofit attention on established objectives; encourage collective action; generate new programmatic initiatives that address the documented "sense of community intent"; compel communities to focus on collective objective setting; and encourage greater public data literacy and adoption of a common language for social progress.

The Giving System

The giving system, as described here, consists of *principals*—those individuals and trustees who have legal "ownership" of philanthropic assets—and *intermediary transaction services*, which offer decision, distribution, and accounting support and handle approximately 20 percent of $300 billion in annual giving.

Principals

These individuals have the ability, power, and ultimate responsibility to direct charitable resources effectively. They control donation decisions by giving directly, working through transaction services, or delegating their donation decisions and transactions to expert intermediaries.

Charitable gifts come from over 65 percent of American households. Their gifts totaled $251 billion in 2009, of which only 44 percent went to destinations other than local churches, private foundations, and alma maters—less than $78 billion was directed to disadvantaged people.[4] Individual donors seldom seek corroboration of the effectiveness of their contributions, their job being done when they give and claim a tax deduction. In a thriving philanthropy ecosystem, donors will take responsibility for their charitable gifts and demand performance from both nonprofits and intermediaries.

Advisors, typically the original donor to donor-advised funds, comprise an increasingly powerful segment of the donor population.[5] Technically, advisors "recommend" to the boards of the host institutions that they make gifts from each relevant fund. Practically, they call the shots on grants from over $27 billion currently sitting in such funds.[6] With few exceptions, original donors and their heirs can determine the disposition of charitable gifts from their "accounts" indefinitely.

The founding donor to charitable trusts and private foundations can choose to retain control (for him- or herself and his or her heirs) over charitable distributions. Practically, over time, family gives way to independent trustees and institutional fiduciaries. These trustees become legal owners, controlling vast sums in dedicated, generally long-term, charitable vehicles. Like individuals, they have the authority to direct charitable distributions; with respect to the largest funds, they effectively cede that power to professional grantmaking staff, an intermediary role in this construction.

In a thriving philanthropy ecosystem, donors will take responsibility for their charitable gifts and demand performance from both nonprofits and intermediaries.

Giving Transaction Intermediaries

Much of the country's giving is conducted through intermediaries that either execute a donor-directed or donor-advised gift or actually determine and execute gifts on behalf of donors. Six models of intermediary activity are explained below.

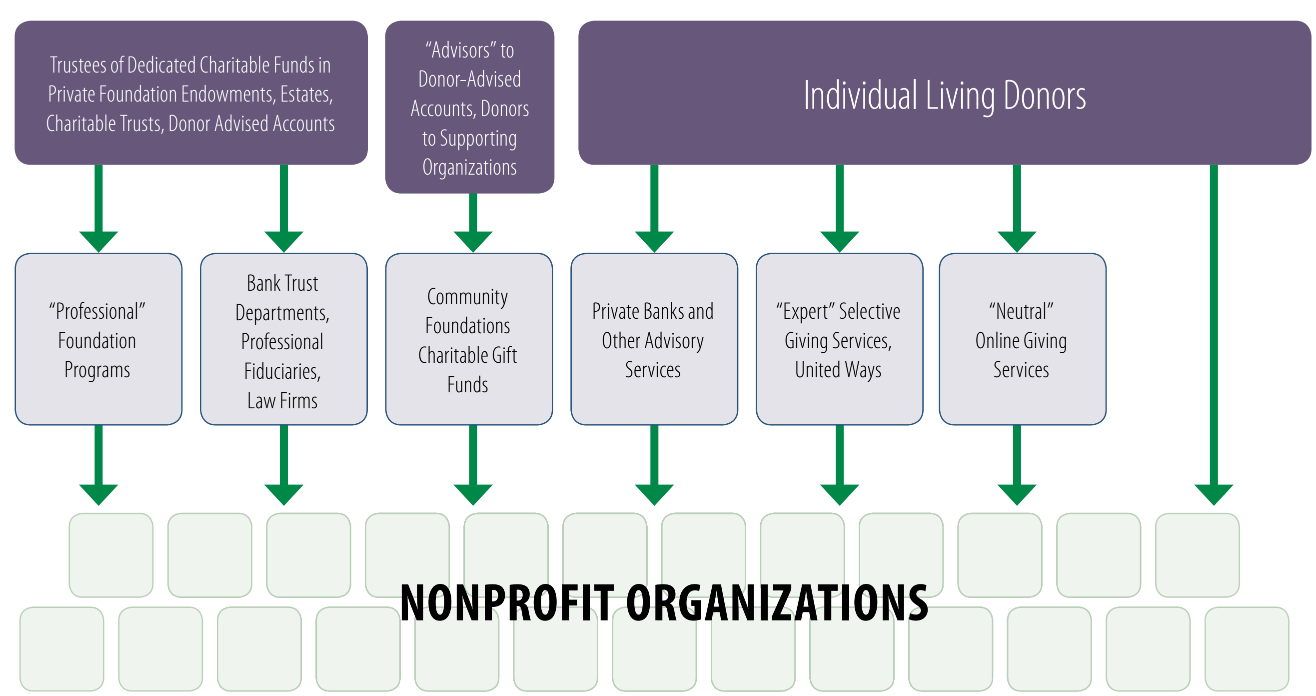
- **The neutral model.** This first, "neutral," model, used by JustGive and Network for Good, is the purest use of the web to facilitate proactive giving by donors. The more knowledgeable, sophisticated, and intentional donors become, the more these services can be integrated with personal accounting and planning services. The higher the quality of nonprofit reporting into such services, the greater the role and value of this model.
- **The expert model.** The second model, in which a donor gives through an intermediary, guided by experts, to nonprofits of the expert's selection is a century old. United Ways have long selected portfolios of "winner" local social agencies and distributed donor gifts accordingly. Services that aggregate interesting projects or worthy organizations (e.g., GlobalGiving and GiveWell), or use experts to rate organizations (e.g., Philanthropedia), allow donor choice, but only to a small number of preselected opportunities.
- **Advisory services.** An industry of formal donor advisory services, a third model, has emerged among private banks, family offices, accounting and law firms, and dedicated donor advisors, each of which seeks to differentiate its services to wealthy clients. The quality of such services varies broadly, but as other institutions enter the field and the industry matures, the potential for greater accountability and competence increases.
- **Community foundations.** This fourth model has tremendous potential to compel "advisors" to the accounts that comprise the bulk of community foundation assets to be more strategic and intentional. Community foundations have long wrestled with simultaneously serving donors and their own community objectives. The best look for ways to entice donor advisors to be partners in specific community initiatives. The huge charitable gift funds, established by mutual fund companies, make few attempts to promote pro-activity by advisors.
- **Trust departments and independent trust companies.** Hundreds of thousands of trusts, supporting organizations, and private foundations are effectively controlled by bank trust departments, independent trust companies, and law and accounting firms. In some examples of this fifth model, these institutions serve as trustee and staff. This expansive population of philanthropic institutions is hardly transparent and generally ignored in analysis of the nonprofit sector.
- **Professional foundation program staff.** Calling professional foundation program staff an "intermediary" in this construction is novel. This characterization, the sixth model, reflects the fact that private foundations, with their captive endowments and no need to report to external stakeholders, are largely immune to influence and oblivious to external, or even internal, accountability for the quality of their grantmaking and investment decisions. Professional grantmaking staff often call the shots for the putative owners: the trustees.

Figure 1 (above right) depicts the current movement of gifts and grants (green arrows) from donor principals (purple shades) directly to nonprofits at the bottom, as well as through relevant intermediaries (gray shades).

What Is the Importance of This System within the Philanthropy Ecosystem?

Nonprofit organizations often have opportunities to earn revenue through commercial or service activities and may be eligible for government payments for specific services. Nonetheless, philanthropic gifts and grants comprise the stock of capital that nonprofits use to support strategic evolution, new initiatives, and capacity development. The giving system comprises the philanthropy ecosystem's lifeblood of intentionality, innovation, and responsive capacity. The participants in this system, principals and transaction intermediaries, must take their role very seriously and send informed, faithful, and

Figure 1: **The Giving System**



consistent signals and resources to nonprofit organizations.

What Are the Bottlenecks or Impediments to Making This System Function Optimally?

Donor principals of all kinds are fundamentally unaccountable, which in turn compromises the accountability of the process of allocating philanthropic resources. In general, fulfillment of IRS requirements to realize a tax deduction by an individual or institution, or satisfaction of the statutory payout requirement by a private foundation, is the only auditable "bottom-line" reporting requirement that donor principals have to any external audience. One might expect compensating internal accountability within institutional philanthropies like foundations. However, program staff that effectively make most recommendations for foundation grant distributions recognize that their poor decisions will not impact the foundation fiscally. The same 5 percent of the endowment will be available to them to distribute the following year. As a consequence, foundations themselves have few, if any, effective mechanisms for either external or internal accountability. A philanthropy ecosystem that lacks an accountable resource allocation process is by definition suboptimal. *We cannot expect nonprofit organizations to function effectively if donor principals, particularly institutional donors who are looked to as powerful "experts," are fundamentally unaccountable.*

What Are the Principal Opportunities for the Innovative Social Entrepreneur?

There is no shortage of innovative giving-transaction strategies promoted by social entrepreneurs on the Internet, but these efforts will not be valued until donors recognize that they truly have "skin in the game," and that, as the allocators of financial resources to nonprofits, they must be accountable for their decisions. It is therefore critical for social entrepreneurs to focus on activities that promote accountability by donors, especially foundation trustees, and transactional institutions. Here are some opportunities:

Foundation practice watch. This initiative would evaluate the grantmaking processes of foundations on public websites. The Center for Effective Philanthropy (CEP) has developed

There is no shortage of innovative giving-transaction strategies promoted by social entrepreneurs on the Internet, but these efforts will not be valued until donors recognize that they truly have "skin in the game"....

[U]ntil foundation trustees become accountable externally for the activities and decisions of their institutions, we cannot expect the giving system to perform optimally

methodologies intended to help foundations understand and track grantee satisfaction with their own grantmaking. This is a good start, and CEP staff likely have many thoughts about how to make the foundation sector more effective and accountable through evaluation. However, CEP operates within the intellectual sphere and under the financial boot of the institutions it could evaluate. CEP and existing or new groups like it, such as the National Committee for Responsive Philanthropy, must be encouraged and independently funded to take on a more incisive role in foundation-practice evaluation. Also, existing or new entrepreneurial agencies should pursue the additional initiatives below.

A center for grantmaking impact. This initiative would evaluate foundation programs on their effectiveness, the quality of their reporting, and the congruence of their grantmaking strategies with community needs and goals, and report such findings on a public website. In a bid to encourage internal and external accountability in private foundations, the center would view trustees as a principal audience for this work product, encouraging them to demand more from program staff.

New intermediary grantmakers. If trustees of foundations remain dissatisfied with the conduct of their resident program staff, they should utilize the services of other grantmaking institutions to manage all or a portion of their annual grantmaking budgets. Social entrepreneurs could remake the grantmaking model to be more efficient, effective, and accountable, and sell that service to endowments and wealthy people. Such services would enable the necessary separation between endowments and grantmaking, and establish a degree of accountability unattainable in our dominant private foundation model.

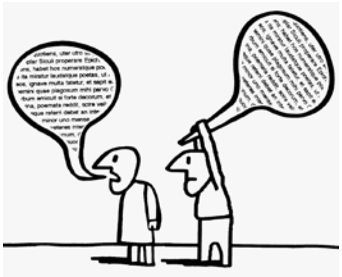
Foundation worthiness calculator. The strategies above would improve the internal accountability of foundations, but until foundation trustees become accountable externally for the activities and decisions of their institutions, we cannot expect the giving system to perform optimally. Today, accountability for trustees begins and ends with proper fiduciary conduct. A service that would not only reveal the effectiveness of the grantmaking program of a foundation but also report on each foundation's institutional strategy to *maximize the value of its capital* (e.g., more rapid payout, mission investment of endowment, collaborative grantmaking with other foundations, use of multiple grantmaking intermediaries, etc.) would have considerable, highly leverageable value for the entire philanthropy ecosystem.

Catalogue and evaluations of the donor-advised fund programs of community foundations and major charitable gift funds. This entire field would benefit if a new service were formed to review the value propositions offered by each of these transaction intermediaries. These intermediaries have the potential to become highly productive forces in the education of donors and the accountability of the giving system, but no external party is watching, evaluating, or reporting. A new evaluative service could assess the degree to which each intermediary provides its donor advisors consistent reporting by nonprofits, nonprofit performance tracking information, pertinent knowledge from the environmental knowledge system, and other support to become more intentional and discerning donors.

Notes

1. As this article presents just the first half of the paper, the nonprofit management and reporting system and the nonprofit evaluation system are not discussed here; they will be elaborated on in *NPQ*'s upcoming fall 2013 edition.
2. In an interview with the author.
3. See note 1, above.
4. The Center on Philanthropy at Indiana University, *Giving USA 2010: The Annual Report on Philanthropy for the Year 2009* (Chicago: Giving USA Foundation, 2010), 6–9.
5. Donor-advised funds are hosted and are technically owned by community foundations and charitable gift funds.
6. Ben Gose, "Charities Can Expect More Money to Flow from Donor-Advised Funds," *Chronicle of Philanthropy*, July 11, 2010.

To comment on this article, write to us at feedback@npqmag.org. Order reprints from http://store.nonprofitquarterly.org, using code 200212.



Dr. Conflict

by Mark Light, MBA, PhD

It's tough dealing with board differences, even when you have the power to influence the participants. So, when you don't have power, the challenges may seem insurmountable. Dr. Conflict outlines six steps for facilitating board members' working together when frictions arise.

Dear Dr. Conflict,

I am working as a consultant with a prestigious nonprofit board in Australasia, the members of which are politically appointed; as we have had a change of government (a shift to the right), we have a "half and half" board, with quite different values and worldviews. Over the years I have worked hard with the members to improve their boardroom culture and practice, adopt a bicultural approach to the work, and upskill themselves in community development so that they can take a more strategic approach to grantmaking and ultimately make more of a difference in their communities.

I have been asked to facilitate a board evaluation process, and the comments coming through from individuals reflect the reality in the boardroom: There is concern that factions are emerging, disappointment expressed from existing board members that what they have worked so hard for is being eroded, and an experience of increased conflict among members—all leading to decreased satisfaction in the board member experience. That members of the "right" faction are likely to be critical and dismissive of the value of the evaluation process itself makes the exercise all the more challenging.

The evaluation process is an opportunity that I would like to use to maximum effect. Any tips for assisting board members to work better together when fundamentally different worldviews and beliefs drive the differences about what is important?

Dealing with Differences

Dear Dealing with Differences,

It's tough enough to deal with differences when you have the power to influence the participants. But what if you don't have enough power? After all, power is the "potential ability to influence behavior, to change the course of events, to overcome resistance, and to get people to do things that they would not otherwise do," including helping board members work together when factions arise.[1] Thus, Dr. Conflict's first tip for you is to evaluate your ability to influence a successful evaluation.

There are a variety of sources of power, but they all fit into two categories—personal and positional power.[2] Because you are a consultant, you have very little positional power, but you do have personal influence. Board members obviously like you enough to confide in you, and respect your expertise enough to maintain a long-standing relationship.

Not having positional power isn't necessarily bad; effective leaders actually favor personal power to influence others.[3] The bad news is that personal power can fade rapidly if people dislike you or distrust your expertise. Accordingly, your ability to influence the outcome of the evaluation is contingent upon the breadth of your personal influence. This raises questions of whether your long tenure has biased your voice and whether you have developed enough personal trust with each of the members, especially the "right" faction, as you call it.

What worries Dr. Conflict is that you write with first-person knowledge about the "disappointment from existing board members," but you are subjective in saying "members of the 'right' faction are likely to be critical and dismissive." This suggests a bias against the right-faction members, perhaps because you don't have relationships with them. This is understandable and even inevitable given your long tenure as architect of the board development programs.

What should you do about your fractured influence? One alternative, painful as it may be, is to step aside. On the positive side, you could build your personal power significantly by shepherding the process of finding an independent evaluator. Another alternative is to reboot your brand with all of the board members, both sides of the "half and half."

Assuming a reboot, Dr. Conflict's second tip is to pump up your influence. This begins with being clear about the agenda, which in your case has a clear visionary texture: assist the board members "to work better together when fundamentally different worldviews and beliefs drive the differences about what is important."

The second step is a survey of the board members. There are a number of tools on the market, including BoardSource's highly regarded assessment tools.[4] Dr. Conflict uses a quick twenty-five-question survey that he developed from a study of effective teams.[5]

The survey will start people thinking about their interests and give you quantitative data that left-brainers need. It's also an icebreaker for step three: one-on-one interviews with each board member, preferably in person. This will help you to gain valuable information while building personal trust. Remember that many people "fail to get things done because they rely too much on reason and too little on relationships."[6]

Use the survey data to develop interview questions, but don't forget yours about emerging factions, increased conflict, and decreased satisfaction. Ask for suggestions about your agenda to help board members "work better together." Address the issue of the evaluation head-on by asking about its potential value. You're worried about the members of the right faction being "critical and dismissive," correct? See if you can gain insights into the causes and potential cures.

Step four is to map the political terrain by identifying the "players (who is in the game), power (how much clout each player is likely to exercise), and interests (what each player wants)."[7] Build the map with your agenda as the horizontal axis from "opposed" on one end to "for" on the other. The vertical axis is the amount of member power, from low to high. By mapping the members, you'll be able to quickly see the power players and where they stand on your agenda.

You'll also see whose help you need, including those opposed to your agenda and those for it. "The basic point is simple: as a manager, you need friends and allies to get things done. To sew up their support, you need to build coalitions."[8] As you look at your map and reflect upon those first visits, you may be pleasantly surprised to see that only a few board members require your focus.

Step five is to set second meetings with your most influential members. Perhaps one of those disappointed members should have lunch, go fishing, or play golf with a few of the right-half folks. Maybe you need to arrange some visits between external players and some of your members.

Step six is to bargain and negotiate agreements. During the second meetings— and third ones, if necessary—you need to help members reach agreement around differences. You have two choices of the types of agreement. First is a value claiming, where one party forces the other to agree. That does not appear to be a realistic possibility for you. Second is a value-creating, win-win agreement that is a must-do in your situation. Fisher, Ury, and Patton advise using their four steps of principled bargaining: separate the people from the problem; focus on interests, not positions; invent options for mutual gain; and insist on objective criteria.[9]

If you do as Dr. Conflict advises, you'll be strong on influence for a successful outcome: a board focused on important work and respecting the different worldviews and beliefs of its diverse members. Just one last tip: remember that doing important work doesn't require homogenizing differences and suppressing dissent. Indeed, persistent unanimity and harmony is as sure a sign of faltering governance as the opposite.

Notes

1. Jeffrey Pfeffer, *Managing with Power: Politics and Influence in Organizations* (Boston, MA: Harvard Business Press, 1992), 30.
2. See Bernard M. Bass, *Leadership, Psychology, and Organizational Behavior* (New York: Harper & Brothers, 1960).
3. Gary Yukl and Cecilia M. Falbe, "Importance of Different Power Sources in Downward and Lateral Relations," *Journal of Applied Psychology* 76, no. 3 (June 1991): 416–23.
4. "Assessments," BoardSource, accessed May 12, 2013, www.boardsource.org/eweb/dynamicpage.aspx?webcode=Assessments.
5. Mark Light, *Results Now for Nonprofits: Purpose, Strategy, Operations, and Governance* (Hoboken, NJ: John Wiley & Sons, 2011), 154–56. This survey is based on the study of effective teams in Carl E. Larson and Frank M. J. LaFasto, *Teamwork: What Must Go Right/What Can Go Wrong* (Newbury Park, CA: Sage Publications, 1989).
6. Lee G. Bolman and Terrence E. Deal, Reframing Organizations: Artistry, Choice, and Leadership, 4th ed. (San Francisco: Jossey-Bass, 2008), 218.
7. Ibid., 217.
8. Ibid., 220.
9. Roger Fisher, William L. Ury, and Bruce Patton, *Getting to Yes: Negotiating Agreement without Giving In*, 3rd ed. (New York: Penguin Books, 2011), 15.

Dr. Conflict is the pen name of Mark Light, MBA, PhD. In addition to his work with First Light Group (www.firstlightgroup.com), Light is executive in residence at DePaul University School of Public Service, where he teaches strategic management, human resource management, and ethical leadership. John Wiley & Sons published his most recent book—*Results Now*—in 2011.