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A Venture Worth Taking?

Sustaining 21st-Century Nonprofit Organizations Through Social Venture Philanthropy

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Venture philanthropy combines the principles of venture capital investment with traditional grant making. Although venture philanthropy currently represents only a small share of total giving, it has the potential to significantly change nonprofit agencies. Venture philanthropists demand greater accountability and involvement with their beneficiaries.

"If new wealth creates new philanthropy, then what does new philanthropy create?"

This was the question asked by Mario Morino, chairman of Venture Philanthropy Partners, and by Bill Shore, chairman of Community Wealth Ventures, in their 2004 book, *High-Engagement Philanthropy: A Bridge to a More Effective Social Sector*. They believe that ideally, the nonprofit sector should be about creating intense dialogues on how to use the precious new resources flowing out of social venture philanthropy to respond more effectively to the most basic of human needs. However, cautions Dennis Collins of the James Irvine Foundation, "As important as cognition is to the reduction of uncertainty, as central as clear thinking is to effective problem-solving, it is organized philanthropy's lack of imagination that reduces the power of its manifold good works. The reluctance or inability of foundations to 'swing for the fences' with unbridled passion, to fund the extraordinary, is discouraging." One hopes that foundations and high-net-worth donors will commit to long-term relationships with nonprofit organizations that do "good works," thereby enabling the power of human capital to help make a transformational difference in many of our social problems.

THE CASE FOR NEEDED CHANGE

Although foundations play a pivotal role in responding to the social challenges facing society, a sketch of the larger context within which foundations operate provides a stark new picture.

- In 2001, the top 1 percent of the U.S. population held 38 percent of all wealth; this figure is double that of 20 years ago. It is estimated that in 2001, America's wealthier individuals wasted $659 million by giving inefficiently. That money could have been kept by the donors or passed along to nonprofits. Instead, it went to government, mostly in the form of capital gains taxes.
- Out of the $240 billion given to charity in the United States in 2002, all foundations—and there are 60,000—distributed just under $30 billion. The 100 largest foundations in the United States provided $11 billion in grants.
- The United States is the wealthiest coun-

try in the history of the world, and yet, some 38 million people—12.4 percent of the population—live below the poverty line. An additional 6 million are classified as the working poor.

- The number of families living in poverty grew from 6.6 million in 2001 to 7 million in 2002, with 12.2 million children living in poverty.
- Hunger is an everyday issue for more than 13 million children in the United States today. It is estimated that it would take $5 billion a year to end hunger in America, the amount largely spent on updating the Food Stamp program.
- The transfer of wealth in the next 50 years could range from $41 trillion to $136 trillion. Charities could gain between $6 trillion to $25 trillion in that time period (Schervish, 2000).

Not only are there more rich people then ever before but also this wealth is not going away. The boom of the 1990s has produced a very large new group of mega-wealthy individuals and foundations. In 2000, it was estimated that more than 350,000 people led households that had a net worth of more than $10 million. This represents a 400 percent jump in the last decade alone.

Donors to charity are the providers of equity in the social sector, just as investors are in the for-profit markets. If the needs of the nonprofit sector were considered to form a capital market, it would be worth $500 billion. Of that amount, one-half, or $250 billion, was provided by all forms of philanthropy, and of this amount, three-quarters originated with individuals. Foundations financed $10 billion or just 2.5 percent of the nonprofit capital market.

THE CORPORATE CONTEXT

Human service organizations like Jewish Family Services agencies continually search for new funding streams to meet the ever-widening deficits in their core operating budgets. Recently, greater numbers of JFS agencies have had some success with corporate giving. But the corporate culture that is associated with the missions of nonprofit organizations has also underdone major changes. There is the growing trend of aligning philanthropic missions with business goals, so that corporate self-interest and altruism intersect. For corporations, giving to causes that help the bottom line is no longer optional. Between 2002 and 2003, "traditional" charitable philanthropy declined from nearly 60 percent to about 40 percent of corporate giving, whereas "strategic" giving increased 15 percent and "sponsorship-commercial" corporate giving doubled from under 10 percent to nearly 20 percent. Of 72 large companies surveyed by the Committee to Encourage Corporate Philanthropy (CECP), 51.5 percent identified their motivation for corporate giving as either providing a primary or strategic benefit to the company (Epstein, 2006). The strategic benefit to the company presents a new dynamic in an increasingly crowded philanthropic marketplace.

Many nonprofits are having trouble adapting to the change in the corporate giving culture. Businesses that are savvy about publicity and business-related causes are "leaving out groups that are doing critical work," says Steven Rochlin, director of research and policy development at Boston College's Center for Corporate Citizenship (Schervish, 2000). Not every nonprofit organization can make a business–oriented case for itself. However, in the new corporate giving culture, all nonprofits need to become more strategic, as well as more sophisticated about what they deliver (Epstein, 2006). This is why a partnership with established planning structures like UJA-Federation becomes more valuable and strategically important. The Federation system clearly understands cause marketing and positioning and works with corporations regularly as part of its mission to raise significant dollars on behalf of the agencies serving the needs of the Jewish and general community.

THE FOUNDATION CONTEXT

As the venture philanthropy mindset comes of age, some traditional foundations are finding that the social impacts they desire are not being realized. Foundation officers report a growing frustration that social problems persist and may even be worsening. In the age of shrinking government, foundations no longer can rely on government as a reliable partner for social initiatives. Shrinking public sector support and the changing landscape of the traditional private sector funding have led to increased competition for resources among the 1,140,000 independent sector organizations in the United States. As a result, foundations are being forced to consider the long-term issues of both organizational and program sustainability, as opposed to the more traditional role of seeding new ideas and developing "best practices."

A REVOLUTION IN PHILANTHROPY

The economic boom of the 1990s spawned a revolution in philanthropy. Charitable giving had been historically defined as "transactional philanthropy," a philosophy of giving that spread available resources as widely as possible, to as many agencies and organizations as possible. This type of philanthropy is usually expressed in a series of one-year grants that are predicated on being a "seed," with other resources expected to sustain the initiative or program or on achieving that which is the most visible and tangible. Unwittingly, these grant awards neglect to build up organizational infrastructure. Of more than 35,000 grants made in 1995 in the five states with the largest number of foundations, only 5.2 percent were for longer than one year (Letts, Ryan, & Grossman, 1997). Social venture philanthropy began as a response to this trend.

Launched in the late 1990s by the dot-.com craze and high-tech sector, this new movement within philanthropy provides an historic opportunity to have an impact on social problems in a way not achieved or envisioned up to now. However, social venture philanthropy is off to a modest start. According to the Wharton Business School, of the more than 50,000 charitable foundations in the United States, only 42 pure venture philanthropy foundations existed in 2003, making grants totaling $50 million, which represented less than 0.2 percent of all grants in the country that year (Gose, 2003).

Despite this modest beginning, the venture philanthropy movement is clearly growing. The recent explosion of hedge fund assets has already had a dramatic impact on nonprofit organizations. The amount of money that hedge funds manage has soared from $40 billion 15 years ago to $1 trillion today. At the end of 2004, there were 3,307 hedge funds, a 74 percent increase since 1999. In general, fund managers tend to be young and less wedded to a cause, making their involvement in nonprofit governance a natural target. Many of these new hedge fund managers are attracted to local organizations, where they feel they can have a real impact. They also work in tightly woven circles, creating a competition over who can be more virtuous. One fund manager becomes involved and pulls in his or her friends, who then strive to outgive one another, and the charity raises record amounts. Such organizations as the Robin Hood Foundation, Hedge Fund Cares, and 100 Women in Hedge Funds have flourished.

As a result of the growth in the hedge fund industry, many money managers are looking for investment ideas in the nonprofit world. "This group is focused on outcomes, and they want to be sure that when there are social problems we have a plan to deal with it," said Geoffrey Canada, executive director of the Harlem's Children Zone, in a 2005 *New York Times* article (Anderson, 2005). Because members of this new generation of philanthropists are less involved in traditional Jewish causes, the Jewish community has the challenge of competing for their philanthropic attention with more visible and nonsectarian causes that both Jews and non-Jews care about.

Even though venture philanthropy currently represents only a small share of total giving, it has the potential to significantly change the nonprofit capital market because of three reasons. First, it is being given by a new generation of young, self-made wealthy individuals who dislike traditional philanthropy. Second, the primary sources that provide funding in the nonprofit sector—government and community chests like the United Way—are evaporating. Third, there are emerging social enterprise sector/hybrid nonprofit/for profit organizations that run as revenue-generating businesses and also pursue a social mission. Venture philanthropists want their investments in nonprofit organizations to have a broad and significant impact, and they want to be able to measure that impact. They seek to obtain a greater return on their investment—be it social, financial, or both.

Application of Venture Philanthropy to Nonprofit Culture

Although the term "venture philanthropy" has several meanings, there is a consensus in the literature that it has eight common elements:

1. *A close relationship between the foundation and the grantee:* The relationship shifts from one of oversight to one of being a true partner. This creates an environment in which nonprofits can share their problems in a non-defensive manner and can discuss important management and programmatic issues in the open—issues that are typically hidden from most funders. One healthy byproduct of this new relationship is greater volunteerism from the donor, which fosters an emotional connection to the cause.
2. *Organizational focus:* Support is given to enhance the overall health of the organization, rather than a specific program or individual project. There is mutual interest in capacity building for the organization, focusing on management, leadership, governance, and problem solving.
3. *Length of relationship:* The relationship has a longer duration, as opposed to one year and out. It is not uncommon to have an 8- to 10-year relationship with the organization.
4. *Size of investment:* Instead of project-focused grants that address a small portion of the nonprofit's costs, venture philanthropy decreases the amount of grantees in order to increase the size of each grant so it can cover most of a nonprofit organization's operating budget. This type of grant encourages organizational development and capacity building.
5. *Risk management and accountability:* In contrast to funding only a portion of a program or a project, which reduces their risk, venture philanthropists may be willing to take the risk that some portion of their portfolio will not succeed. Foundations may may tie compensation for program officers to the performance of their grantees.
6. *Shared risk:* Venture philanthropy encourages innovation and new ideas, with a focus on what it takes to realize success.
7. *Performance measures:* Rather than accounting solely for the use of funding, venture philanthropy may demand higher standards of outcomes measurement, including a social return on investment (SROI). Some venture-oriented foundations employ a "balanced scorecard" approach that assesses finances, client satisfaction, internal organizational procedures, and overall organizational learning and growth. The nonprofits typically have many challenges with such an assessment, including how to answer the questions of "how much effort will it take?" and "is it worth it?"
8. *Exit strategies:* Instead of providing fixed-term grants that force nonprofits to apply and reapply for annual funding,

> venture philanthropy withdraws support only when the entity is able to sustain itself, has succeeded in its mission, or has been successful in engaging a new source of funding or the funding is no longer able to "add value."

Venture philanthropy can take many forms, including the following:

- *Investing in individual social innovators:* Organizations provide targeted financial and capacity-building support to individuals called "social entrepreneurs." These are people who address a critical social problem in a unique way.
- *Investing in social purpose enterprises:* Organizations provide capital, technical assistance, and access to other support networks to for-profit enterprises, owned and operated by nonprofit parent organizations to generate income and/or provide employment opportunities for marginalized constituencies (e.g., the homeless, physically handicapped, or mentally ill).
- *Investing in nonprofit organizational development:* Organizations provide financial and capacity-building support to nonprofits in an effort to bring to scale their successful activities.
- *Investing in helping foundations and corporations initiate venture philanthropy models in their giving*

Venture philanthropy seeks to combine the principles of venture capital investment with traditional grant making. It is a landmark opportunity to use the same venture tactics that succeeded with high-tech start-up companies to help nonprofit organizations. Since its inception a little more than a decade ago, social venture philanthropy has focused on building up organizational capacity, using multi-year grants, and developing a long-term relationship with organizations to improve program outcomes and, most importantly, organizational sustainability. The social venture philanthropy movement continues to evolve, attempting to forge a strong link between the private and nonprofit sectors. Its success requires a radically different relationship between the funder and the organizational beneficiary. Venture philanthropy partners may assume a seat on the board of the nonprofit organization and often have enormous influence over hiring, the development of a business plan, and how the product/service comes to fruition in the community.

In a pure venture capital arrangement, one that very few nonprofit organizations can implement, the philanthropist takes an active role in the start-up company, whose revenues will ultimately be directed to sustain the nonprofit organization. Then, the philanthropist may take an active leadership role in the nonprofit organization, which can be potentially threatening to the traditional donor leaders. Many critics of venture philanthropy continue to say, "The answer to every nonprofit problem is not a market solution." They feel that venture philanthropists are simply creating a new market, rather than serving one, and that in promoting an investment-like strategy, they are not recognizing the unique needs and culture of the nonprofit organization, which is not a business. The idea of a successful businessperson telling nonprofit executives how to run their shops more effectively, using business models of strategic planning and return on investment (ROI), can be problematic. Skeptics believe that the impact that social programs have on the community cannot be quantified like an investment that yields market shares or profit margins. The venture movement forces nonprofit organizations to reengineer themselves, which many organizations simply cannot do ("Venture Philanthropy," 2001).

Yet, a recent study by Letts and Ryan, two of the authors of the 1997 *Harvard Business Review* article that helped fuel the venture philanthropy movement, found that the majority of 116 charities that had worked with six so-called high-engagement grant makers considered the relationship "effective and satisfying."

CHALLENGES FACING TODAY'S NONPROFIT ORGANIZATIONS

Nonprofit organizations typically exist in a culture of chaos and are pulled between services, through which they carry out their mission, and overall sustainability. They have limited capacity, and modest outcomes typically characterize critical organizational elements, such as strategic planning, staffing, training, management, financing, and performance measurement (Morino Institute, 2000).

Many nonprofits struggle to provide essential human services that were once the role of government. Their work, which once supplemented government efforts, has now in many cases taken the place of government. A visibly successful nonprofit sees a market response, but it comes in the form of an increased demand for its services, often to a saturation point. There is not, however, a "capital market" response, which is necessary to increase their scale and impact.

Nonprofits are chronically undercapitalized, with charitable donation as a single source to fund an expanding array of organizational needs. They are risk-averse and often unaware of the broader range of financial tools that may be available. Because they are chronically undercapitalized, they rarely achieve their objectives, which in turn makes it less likely they will receive the resources they need, perpetuating a cycle of frustration.

Nonprofits agencies have been compassionate and committed service providers but inattentive institution–builders, focusing most of their energies and resources externally, rather than on building and supporting their own capacity (Morino Institute, 2000). Capacity building is a discrete skill, which is very different from the skills required to create a new organization or to deliver those services framed by the organization's mission. The relationship between programs and organizational capacity is one of competition, where each competes in a zero-sum struggle for limited resources. Money invested in organizations is considered "lost" to direct services.

Their inability to build strong and healthy organizations is what keeps the nonprofit sector from leveraging its assets and knowledge to improve and scale its most successful and effective organizations (Community Wealth Ventures, 2001). Nonprofits lack the ability to acquire facilities, stabilize or fortify the organization by acquiring technology, and develop new staff and systems. Less than 25 percent of foundations have paid staff, and most paid staff members are providing direct service and already are over-extended in the areas of management and grant oversight.

Nonprofits have difficulty sharing their "best practices" because their efforts have not been disseminated, adopted by others, or brought to scale. Nonprofits need new ways to fund and support their successes.

CHALLENGES FACING THE JFS NETWORK

As a cohort of 125 agencies within the larger nonprofit social service arena, JFS agencies understandably struggle with capacity building, under-capitalization, and an ever-growing clientele with chronic needs, which tugs at the finite resources available. Data from 1995 compiled by the Association of Jewish Family and Children's Services (AJFCA) show that 107 JFS agencies received $212,651,274 in operating revenue. This contrasts with a total of $157,696,940 received by 91 agencies in 1994. Of the funding received in 1995, 10 percent came from Jewish Federations, 6 percent came from United Ways, and client fees and third-party reimbursements accounted for 38 percent of the total revenue (Citron & Kurland, 1996/97). JFS dependence on government funding of core services has increased over the years to the point where government funding comprised 35 percent of the JFS's annual budgets a decade ago (Steinitz, 1995/96). This percentage will increase even more, as residential services for the developmentally disabled and chronically ill continue to grow.

If the JFS system hopes to capture the potential of philanthropic giving from new sources, it will need the expertise and focus of Jewish communal structures like the Federation system. By themselves, the JFS agencies do not possess the infrastructure and staffing to embark on the challenge of securing new gifts from the super-affluent. The need to have a mission-driven culture, to focus on service delivery, and to respond to unmet needs is daunting enough.

THE LARGER JEWISH COMMUNAL CONTEXT

Because of the many challenges it faces, the organized Jewish community has a major stake in re-engineering itself. Jewish Federations raised more than $2.25 billion in 2004, yet these donations came from only 30 percent of American Jews. American Jews are more inclined to give to non-Jewish causes, as one unintended consequence of their successful assimilation into American life. The National Jewish Population Survey found that almost half of Jews aged 55–64 gave to Jewish causes, but less than one-third of those aged 18–34 did so. One study of mega-giving during the period from 1995 to 2000 found that 865 gifts of over $10 million were given to various causes. Of these gifts, 22 percent came from Jews. Of these 188 mega-gifts, nearly half went to higher education, 21 percent to the arts, and only 6 percent to Jewish causes (Reinharz, 2005).

Not only are more Jews giving to other causes but also the donor base of the Federations is aging. Jewish adults aged 55–64 are almost twice as likely to give to Federations as those aged 35–44, a sign that the approach to fundraising that worked for Federations in their first 100 years is proving less effective among new generations of Jews (Cohen, 2004).

In the 1990s, the United Jewish Communities established the Trust for Jewish Philanthropy, which was designed to be the venture capital arm of the organization. This was to be the place where philanthropists could put their money into innovative, risk-taking projects that local Jewish Federations were reluctant to try. Despite efforts to attract major donors, the fund closed in 2003, and several projects that were seeded upon its inception are now funded independently of UJC. Some Jewish communal professionals point to the pragmatic realities of the UJC needing to reduce its overall administrative costs and see the closing of the fund as a response to this demand. Yet, the strategic planners within the Federation system clearly understood the need to have a place within the organized Jewish community in which innovative ideas could be tried.

Federations play an important role in the future success of venture philanthropy within the Jewish community because of their ability to enhance the organizational capacity of the many agencies they help support. Federations need to help agencies understand the venture philanthropy model in the areas of ideology, principles, models in use, steps to gain access, assessment, guidelines to present a good match, errors to avoid, and cautions and risks.

The UJA-Federation of New York has had some initial success in engaging younger donors, some from the venture capital world, who have identified with the impact and power of its work and have invested in targeted organizations that are beneficiaries of the UJA-Federation. Two initiatives piloted by the Jewish Leadership Forum of UJA-Federation of New York have demonstrated both the appeal of venture philanthropy for the next generation of leadership and venture philanthropy's ability to pull the next generation into the overall Federation system. *The Solelim Fund,* created in 1999, is made up of nine participating couples (18 individuals), each of whom contributes $50,000/year for 3 years. *Solelim* is now in its sixth year and third funding cycle, with a commitment confirmed for 3 more years. Since joining this venture philanthropy fund, all the *Solelim* members, most of whom were not previously donors to or involved in UJA-

Federation, have expanded their hands-on and philanthropic involvement with the UJA-Federation network of agencies and programs and the Jewish community at large.

Solelim has inspired a second venture philanthropy fund, *Bonim Atid*, consisting of six couples, and other funds are in the planning stages. UJA-Federation of New York also does extensive consulting with other Federations and organizations around the country and in Israel. The members of both venture philanthropy funds have found the experience of hands-on grant making intellectually challenging and gratifying. Moreover, it has given them significant respect for the depth and scope of mission of the Federation system and an appreciation for the knowledge and skills of Federation professionals.

More than 6 years ago, UJA-Federation of New York developed four Commissions, through which a donor can better understand how resources are directed to respond to crucial issues and problems. The Jewish Identity, Jewish Renewal, Network, and Jewish Identity Commissions not only make a compelling case for giving to a federated system as a core expression of collective responsibility but also attract younger philanthropists.

One of the great strengths of the federated system is its ability to provide tangible professional support and oversight to the local organizations and agencies that it helps fund. In New York, the Jewish Communal Network Commission has taken leadership in ensuring that human service organizations can adapt to the challenges that lie ahead in the nonprofit arena. This Commission's strategic goal is to maximize the assets of UJA-Federation's network of agencies while also achieving the Federation's mission. The Commission conducts organizational reviews of its beneficiary agencies, providing the framework for enhancing mission alignment, promoting excellence in management and governance, increasing accountability, and fulfilling Federation's fiduciary responsibility to their donors.

The Network Commission uses the Federation's significant resources to provide capacity-building services; for example, a management assistance program, professional training, and volunteer and leadership development. With one of UJA-Federation's goals being expanding services to the poor and elderly, the Federation's allocations, which are given to organizations for core operating support, are maximized by providing these value-added services, and the organizations themselves are better positioned to be the beneficiaries of venture dollars through UJA-Federation, which has high standards of performance, impact, and outcome measurement attached to venture giving.

New outcome research shows that families engaged in social venture philanthropy tend to give more to other forms of philanthropy as well. Some of these families have funds in a local community foundation and/or belong to another giving circle locally. Over time, these investors become more focused in their personal philanthropy. They write fewer checks, but for larger amounts. These funders increase their knowledge of community issues and of the general nonprofit culture, which leads them to become more involved in providing general operating support to organizations. Their participation on grant committees enables them to increase the quality of personal and family volunteering, with the combination of volunteering and philanthropy becoming core to their own personal identity (Guthrie, Preston, & Bernholz, 2001).

To capture the passions of these new venture philanthropists, the organized Jewish community needs to provide a more meaningful vehicle for donor education and experiential learning. Schervish (2000), in "The Spiritual Horizons of Philanthropy," highlights four characteristics of wealth holders that enhance their propensity toward philanthropy: "hyperagency," the enhanced capacity of wealthy people to establish or substantially control the conditions under which they or others give; feelings of gratitude; identification with the fate of others; and associational capital. These characteristics represent many of the value-added reasons for staying the organizational course and pursuing the challenge of implementing venture philanthropy within the Jewish community. By building a successful model that creates a new form of philanthropic experience, we foster significant relationships between donors and agencies that transcend money. A new generation of donors sees the dramatic impact their giving has—on the organizations they fund, the people they serve, and the clients they help.

CONCLUSION

Venture philanthropy is something more than a new and important source of funding. It can be a step up to the next organizational level, at which nonprofits make changes and take risks to reach new social outcomes. The nature of a new funder-grantee partnership within the venture prism will necessitate a more trusted partner who is intelligent, smart, and savvy, and together, they must be committed to making the partnership work for the sake of the people whose lives will be changed for the common good.

For faith-based nonprofits, there will also be hard questions about measuring the immeasurable elements of values and ethics. When is something worth doing because it is right, no matter what the cost? A potential danger of venture philanthropy's great promise is its use of inappropriate performance measures that may be punitive and not recognize current professional practices. Human service organizations need training and assistance in integrating the qualitative and quantitative methods of measuring social return on investment (SROI). Achieving this type of measurement may be expensive, complicated, and difficult to interpret. This is why the Federation system can become indispensable, providing these services as a condition of receiving an allocation.

The paradigm shift that venture philanthropy introduces is a shift away from *what* is being delivered to *how well run* is the organization. This will require a shift to becoming more bottom-line oriented, with greater accountability being placed on nonprofit managers and executives to be effective. Effectiveness will come to be associated more with a results orientation that will inevitably compete with the core values of the nonprofit organization.

Clearly, venture philanthropy is not for every organization. The nonprofit organization must ask whether innovation and reengineering are compatible with the programs and services it provides. The nonprofit must have the leadership and management to create the venture vision and the management orientation. How willing is the organization to allow the potential new generation of investor/ donors to have a major influence in hiring, decision making, and its internal affairs? Some organizations will decide that venture philanthropy moves them away from their mission and purpose, whereas for others, it will allow them to fulfill their core mission.

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