

Enlightened Investment or Excessive Intrusion?

By Neil Carlson

In 1980, Asian Neighborhood Design (AND), a nonprofit organization based in San Francisco, started a construction and development company. The plan was to use the business to create jobs and training opportunities for homeless people, and to use the profits to subsidize social services. The business limped along for two years, unable to attract enough money to start new projects or expand the business.

“As a nonprofit, we didn’t have any way of capitalizing the business to grow,” says Maurice Lim Miller, AND’s executive director.

When AND tried to grow the business by spinning it off as a for-profit enterprise, the company’s new board of directors eventually severed ties with AND’s training program, which it came to view as a drain on company resources. “The dilemma was that we really lost control of the business,” Lim Miller recalls. Seemingly unable to reconcile its nonprofit mission with the demands of a for-profit business, AND started a second enterprise in 1984—a cabinetmaking and woodworking business—and vowed to keep it under the aegis of the nonprofit organization, even if that meant reining in growth. For the next ten years or so, revenues hovered around \$750,000. But the real value was calculated in terms of services to the homeless, a population notoriously difficult to reach with conventional training programs.

In 1997 Jed Emerson, executive director of the Roberts Enterprise Development Fund (REDF), a private foundation based in San Francisco, approached Lim Miller with a new idea. REDF would donate the capital that AND needed to expand the business. Rather than wait for an annual report, however, Emerson wanted to develop a set of ongoing measures that would capture the social value of REDF’s philanthropic investment: How much money was REDF saving the government in social services by providing training and jobs for the homeless? By helping homeless drug addicts move off the street, what impact did the Fund have on the cost of policing in west Oakland? REDF’s bottom line was measured by the social return on investment: Since 1997, revenues have jumped to \$5 million, the number of jobs has grown from 12 to 60, and AND now provides work experience for more than 100 trainees per year.

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Thus began the first experiments with what has come to be called venture philanthropy. In the scant three years since REDF made its first investment, its portfolio has grown to 23 enterprises. Meanwhile, venture philanthropy has become a hot topic in philanthropic circles. It was featured prominently at the White House Conference on Philanthropy last November, and among the newly minted barons of technology, venture philanthropy is the shibboleth of enlightened giving. Since 1997, the Peninsula Community Foundation and the Community Foundation Silicon Valley, both among the ten largest community foundations in the country, have started venture funds. In 1998, Gib Meyers, a partner at the Mayfield Fund, a blue chip venture capital firm, founded the Entrepreneurs' Foundation. Technology corridors in Seattle, Boston, and New York have also given birth to venture philanthropy funds.

Yet venture philanthropy remains something of a Rorschach test. Depending on whom you ask, it is the future of philanthropy, a passing fad, good grantmaking, or misguided hubris. In light of its youth—REDF, just a few years old, is the senior venture philanthropic institution—all of these characterizations have a ring of truth. But venture philanthropy's resonance with the current economic zeitgeist, along with its enthusiastic following among the beneficiaries of that boom, guarantees that it will have a substantial impact on the future of the nonprofit sector. What exactly that impact will be is much less clear.

The Manifesto

In early 1997, Christine Letts, William Dyer, and Allen Grossman published an article in the Harvard Business Review that is widely held to be the venture philanthropy manifesto. "Virtuous Capital: What Foundations Can Learn From Venture Capital" criticized traditional foundations for investing in "program innovation" rather than nonprofit infrastructure and capacity building. Lacking adequate institutional support, nonprofits were often unable to carry out the very program activities for which foundations provided funding. As a consequence, the authors argued, most nonprofits spend too much time chasing parsimonious grants doled out at short intervals.

As a remedy, Letts et al urged foundations to borrow six strategies from venture capitalists: deploying risk management tools, creating performance measures, developing close relationships with their investments, investing

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more money, investing over longer periods, and developing an exit strategy. “The venture capital model,” they concluded, “can act as a starting point for foundations that want to help nonprofits develop the organizational capacity to sustain and expand successful programs.”

Like most manifestos, “Virtuous Capital” excelled in documenting the problem but left it up to the practitioners to implement solutions. For years, nonprofits had been complaining about foundations’ lack of general operating support. But in calling on foundations to develop intimate working relationships with their grantees, “Virtuous Capital” ruffled feathers throughout the nonprofit world. Even if one agreed with the argument that foundation funding practices could be more effective, was it appropriate to call upon foundations to become more deeply involved in the day-to-day activities of the nonprofits they support?

This question of foundation involvement has become the fulcrum of debate. Critics of venture philanthropy charge that it is fundamentally inappropriate for a foundation to be involved in its grantees’ operations. Bruce Sievers, executive director of the Walter and Elise Haas Fund in San Francisco, cautions that the venture philanthropy model could exacerbate power imbalances inherent in the funding relationship. “Part of the model as it’s presented is that the venture philanthropist does get very involved with the organization so they can bring in their expertise—which is great,” Sievers says. “But with that expertise comes an amount of control.” Quite simply, he argues, nonprofits should control their own programs and organizations. “To have a funder come in and reshape that organization, potentially in their image, simply because they are supplying the funds, is very problematic.”

Jed Emerson acknowledges the validity of such concerns, but argues that they misconstrue the nature of the relationship REDF seeks to develop with its grantees. The foundation’s \$1.2 million investment in AND sets REDF far apart from AND’s other donors. “We’re really shifting the relationship [between the foundation and grantee] to where someone is really investing in an organization, the players, the values,” Emerson says. By cultivating a close working relationship with AND’s staff and board—a relationship modeled on the ones venture capitalists cultivate with start-ups—REDF is positioned to react to problems and respond to short-term organizational needs.

“They had a concern that they wanted to be in a position to look over their investment,” Maurice Lim Miller says. “They wanted to be fully aware of

what was going on and to be able to have some impact, even if it wasn't final decision-making power." REDF and AND collaborated on the business plan and outcome measurements for social return on investment. REDF also works closely on the business's operations, meeting regularly with staff for progress updates and troubleshooting.

The Practice

As the relationship between the two parties evolved, the question of control became more than just a philosophical dilemma. Some members of AND's staff and board wondered if decisions were being made because of REDF or because the organization had decided on a particular course of action. This question assumes, of course, that REDF's influence was deleterious—a conclusion that Lim Miller is loath to make.

"There was a partnership that was formed," he says. "There were consensual agreements that were going on between us. It was a partnership, which means that they could and did have an influence." But, Lim Miller notes, REDF was amenable to negotiating a reasonable level of oversight and did not demand a seat on AND's board, as some venture philanthropists require of their grantees.

Lim Miller contrasts REDF oversight with the control that conventional foundations exert further upstream. "The counterpart to [REDF's control] would be what is happening with foundations as a whole. Large foundations that give any significant dollars are now putting their money out in 'initiatives' or RFPs. There is much less responsive grantmaking. Responsive grantmaking is when you can come up with a program, you send it in, and if they liked it, they funded you. Now foundations have consultants and policy-makers. Now they design an initiative and then ask you if you want to do their initiative. If you look at both models, there's down sides to both of them." Either way, Lim Miller adds, "we have to take care of our funders."

REDF's Emerson readily acknowledges venture philanthropy's shortcomings, but he insists that they can be overcome—or at least held in productive tension. "On the front end," Emerson concedes, "I didn't appreciate enough what it meant for a nonprofit to change the terms of the relationship with one of several donors, what that does to the organization. It's a much more complicated scenario than I understood." But, he adds, what distinguishes REDF from conventional foundations is its accountability to its nonprofit

partners. After REDF made its first round of investments, the foundation published a report on the practices and lessons learned—some of which were deeply critical of the foundation’s approach. “How many foundations publish things that indict the executive director’s approach?” Emerson asks. (REDF posts critical assessments of its funding model on its Web site, <http://www.redf.org>, and recently published new papers—one of which outlines the process by which REDF and three investment recipients decided to sever relationships.)

But that doesn’t mean that Emerson’s fellow venture philanthropists necessarily share his commitment to reflection and self-criticism. For all the talk about relationship-building and partnership, critics note a definite whiff of arrogance. “There is this implicit assumption that foundations don’t work in their present state,” says Gary Yates, executive director of the California Wellness Foundation. “I don’t know where that comes from.” There is plenty of evidence to the contrary, Yates says. “I think most foundations are really quite effective. The majority of grants achieve the impacts they are intended to achieve.”

Acknowledging that traditional foundations could benefit from venture philanthropy’s critique of strategic grantmaking, Yates questions whether venture philanthropists are really in a position to assess community needs. “It comes down to a question of who has a better knowledge of the needs of the community,” Yates says. “Is it the grantmakers or the nonprofits on the ground?”

So credit venture philanthropy with focusing on long-term funding and adequate capitalization, he says, but recognize that those tools can arguably be more effective when applied outside the venture philanthropy paradigm.

The Bandwagon

The merits of venture philanthropy’s critique aside, much of its cachet comes from its resonance with the technology elite. Around the same time that “Virtuous Capital” appeared in the Harvard Business Review, reports began circulating that the barons of the new Gilded Age weren’t nearly as generous as their forebears. In October 1999, Business Week reported that one-third of Silicon Valley households with incomes over \$100,000 gave less than \$1000 to charity in 1998. Against this backdrop, venture philanthropy provided a convenient explanation for the stingy ways of the newly wealthy.

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Qualitatively different from Carnegie and Rockefeller, the argument went, they wanted to do more than write a check. They wanted to get involved, to roll up their sleeves and “partner” with nonprofits. Most of all, they wanted results.

“It’s good to be warm and fuzzy” Winnie Chu, vice president of the Community Foundation Silicon Valley told the San Jose Mercury News. “But when talking to the business community, you have to be able to say what happened with the money.” And there’s no better way to know what’s happening with your money, reasoned venture philanthropists, than to jump in and work with that money yourself.

Throughout Silicon Valley, venture philanthropy is characterized by close organizational and personal ties to the area’s technology corporations. The Entrepreneurs’ Foundation, the Center for Venture Philanthropy (CVP), and Silicon Valley Social Ventures (SV2), all sprang from the hip of the Valley’s corporate community. All three are tied closely to the Peninsula Community Foundation and the Community Foundation Silicon Valley, their boards comprising a Who’s Who of the Valley’s corporate elite: Hewlett-Packard, Infoseek, the Mayfield Fund, Sequoia Capital, and a host of corporate advisors, consultants, and supporters.

Although the three organizations differ somewhat in their funding priorities and practices, all three seek in one way or another to boost individual philanthropy by involving people with business skills in the work of the nonprofits they choose to fund. “What we are trying to be is a forum for community donors to collaborate and catalyze societal change,” says Carol Welsh Gray, executive director of the Center for Venture Philanthropy. CVP allows individual donors to invest in venture funds targeted around the Center’s priority areas: education and asset development in the Valley’s low-income communities. Along with their checks, donors are expected to contribute their time and business acumen to CVP’s Investment Council. The Council, Gray explains, is comprised of “individual investors who want to do more than write a check. They would like to see a return on their dollars. They want to be engaged with these leaders, want to hear the day-to-day struggle.”

Despite the rhetoric of innovation and change, the investment portfolios of corporate venture philanthropists are hardly innovative—community economic development and education. Last year the Center for Venture Philanthropy launched “Assets for All,” a program to support individual

development accounts among the working poor in San Mateo and Santa Clara Counties. In November, the Entrepreneurs' Foundation invested \$325,000 in Partners for School Innovation, an after-school program for schools in low-income areas.

The Future

There's a saying in the Valley among young entrepreneurs looking for venture capital: "The best money is smart money." This axiom acknowledges that what matters most is an investor's ability to add value to the organization—through capital, experience, expertise, and business development. Although it is too early to judge whether or not this model of corporate venture philanthropy will achieve the results promised by its benefactors, critics wonder if these corporate patrons will be able to add significant value to the nonprofit organizations beyond their capital investments—particularly if the desire to promote citizenship and strengthen corporate culture overshadow nonprofits' needs.

Put another way, is it really going to be helpful to have donors with little or no nonprofit experience moonlighting for the organizations they fund? If AND had difficulties building a trusting relationship with REDF—which has a professional staff and solid expertise in the nonprofit sector—what happens when a small nonprofit feels obliged to accept the advice of a benefactor who contributes as little as two hours per month to the organization?

Talented entrepreneurs, facing a glutted venture capital market, can pick and choose their backers. But even the most talented nonprofit leaders lack that luxury.

Neil Carlson is Director of Communications at the National Committee for Responsive Philanthropy (NCRP). This article originally appeared in the Spring 2000 issue of Responsive Philanthropy. Copyright © 2000. Reprinted by permission. To subscribe to Responsive Philanthropy or for more information about NCRP initiatives and publications, including its new report on "Corporate Grantmaking for Racial/Ethnic Communities," visit the NCRP Web site at <http://www.ncrp.org>.