Slot Machines, Boat-Building and the Future of Philanthropy

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It's a great pleasure to be with you. I want to thank Virginia Hodgkinson and Georgetown University, and Eugene Wilson and the Ewing Marion Kauffman Foundation, for the honor of speaking with you today.

When Wally Nielsen was fully active in philanthropy I got to know him well. He was a commanding, perceptive observer. Having worked in it, he could talk from experience. He knew its strengths and its failings. He always tempered his writing with the highest ethical sensitivity.

Besides being friends, Wally and I had a special connection. You see, in his book, The Golden Donors, written in 1986, he had this to say about the foundation I work for [Surdna, which is the family's name, Andrus, spelled backward]:

> "Given the extraordinary generosity, vision and boldness of the donor - and the scale of its assets - it remains an underachiever. It awaits the force of strong, imaginative leadership to lift it from being a moderately good foundation to the status of an excellent one. If this happens someday, it will finally correct the impression that not the only thing backward about Surdna is the spelling of its name." [p. 318]

In 1989, when I was hired by Surdna, this critique was uppermost in the mind of the board. It wanted to professionalize and move decisively toward excellence. Five years later, in 1993, when John E. Andrus III, the wonderful Chair of Surdna (and grandson of its founder) retired, he quoted Wally's criticism at his retirement party. He added: "I can confidently and proudly say this situation no longer applies." There can be no doubt that Wally had a deep impact on the way our foundation has transformed itself and became a lot better.

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I also know a man named John Carr. John has the awesome job title of "Secretary of Social Development and World Peace" of the U.S. Catholic Conference. As he tells it, he was once at a convention at a large, urban hotel. He stepped onto the elevator, wearing his identification tag – name and title. At the next stop an elderly couple got on. The woman looked at his tag, and stared and stared at it. The elevator stopped and the couple turned to get off. As the doors were closing, she peeked back at him and said: "Can you please do a little better?"

Well, shouldn't we ask the same of philanthropy?

My thesis is this: Much of the way philanthropy does its business is dysfunctional. Sometimes it actually sabotages the best work in the field. Often it leaves a lot of hard feelings behind, too. Despite the good works of individual funders, overall, the system is broken.

There are ways to fix it -- or, rather, to transform it. To explain how, I want to use three points of reference; slot machines, boat-building and a "systems" point of view.

Think about modern American philanthropy: We're like gamblers playing the two-dollar slots in Vegas. We sit straight ahead, holding our little bucket of metal coins. Repeatedly, we drop in small change, hoping for a big payoff. We sit straight ahead, rarely pulling our eyes away from the spinning icons. We don't interact with the other players on our left or right. If we did, we wouldn't learn much anyhow – they're behaving in just the same way.

Essentially, we put large dreams on small coins. Even if we win a modest jackpot, we almost always feed the slots more than we win. We may be "up" for a while. But most likely we're down, and vaguely uneasy at the end of each cycle. "It just wasn't our day." Our exit strategy is the EXIT sign.

This edgy simile isn't entirely far-fetched. It highlights the fact that much of philanthropy, especially at the 100 largest foundations, with perhaps half the field's endowment, works in isolation, rarely sharing the task or the results. We make grants based on inadequate due diligence, partially relevant information, or simple intuition. After a grant is made we rarely share what we really know -- the "good the bad

and the ugly" -- with grantees or with our own colleagues. We are novices at cross-program, cross-sector collaboration and rarely buddy-up for mutual gain. In fact, there are no incentives in philanthropy to do that. Finally, we don't usually measure our successes, course-correct and learn intentionally.

Of course, not all foundations behave like this, at all times, with all grantees and colleagues. This is a description of the overall system* of philanthropy, and here are the system's "rules-of-the-road." They speak volumes about who we are.

Primarily, our work focuses on grantmaking. Grants are made on the basis of proposals. The submission requirements are sometimes over-detailed and arduous. The time it takes for funders to consider and disburse grants varies, from very quick to nearly endless. Communications from program staff, and even senior executives, may be unclear. Foundations (as well as individual givers and corporations), have different filing requirements, deadlines, time frames and grant sizes, so nonprofits have to do some really fancy footwork to get by. Every year they are compelled to cobble together their operating (and capital) budgets from numerous, quite unconnected, quite idiosyncratic sources of capital.

This makes raising capital highly labor-intensive. It bends nonprofit executives away from focusing on strategy and operations. We all know that, sometimes, in order to start new programs, or keep old ones alive, nonprofits "adjust" their programs and chase the scarce foundation dollar.

It is absolutely true that some individual funders communicate and relate to grantees better than others. But philanthropy's operating system is full of potholes, hidden curves and soft shoulders. What may appear rational to individual funders may, collectively, be nearly unworkable for grant-seekers. Further, philanthropy effectively throws nearly all responsibility onto the grant-seeker while retaining for itself the right to make and alter the rules. One social service executive recently bemoaned that he sometimes feels like Tom Hanks storming the beach in *Saving Private Ryan.*

For example, its commonly agreed that funders have been cutting back on general support grants. They increasingly tilt toward project support and let grantees absorb overhead costs. This approach makes nonprofits increasingly unstable by denying reimbursement for their core expenses. It has led to persistent, though often muted, protests by nonprofits. This pushback has made little difference in philanthropy -- it hasn't even generated sustained conversation.
Sometimes funders create their own approaches. They start entirely new institutions, in a deliberate attempt to change the playing field. Sometimes this is necessary. Yet it often has the effect of stoking mistrust, or fear, among grantees who may have come (at least partially) to rely on their support.

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OK. Let's assume the nonprofit is successful traversing the rules-of-the-road. It advances literacy or develops lots of job placements, or builds affordable housing or improves community safety. Even where success is achieved, more funding may still not result. Grantmaking can be so unpredictable.

For some funders, apparent success provides the opportunity to walk away and do something else. No reward here. For others, success leads to the reverse situation -- increased funding. At times, these funders, correctly or not, urge nonprofits to expand their programs, or to replicate them in other places. This push to "go to scale" is not regularly followed with ample capital to do the expanded job that

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* System - "An interrelated complex of elements that is coherently organized around some function or purpose. A system is more than the sum of its parts. It can exhibit self-preserving, adaptive, dynamic, goal-seeking and/or evolutionary behavior." From Sustainability Institute "Systemability: A workbook on Systems Thinking, Sustainability, and Funding," notes from a two-day workshop 1/12-13/01. A fine introduction to systems thinking is found in Peter Senge, et.al., The Fifth Discipline Fieldbook (New York, Doubleday, 1994), pp. 87-190.

funders encourage. When this happens, it exacerbates the undercapitalization of nonprofits and sometimes makes the nonprofit weaker, not stronger.

On the other hand, for some funders, it is failure which provides reason to continue funding. They think more money, time and effort would deliver the desired results. For still others, success or failure may be irrelevant. For unrelated reasons, they decide the time has come to alter their guidelines and head for the exit. As an added twist, and all too frequently, large grants from a big funder signal others to shy away; they conclude that the first foundation "owns" the program and are reluctant to take a second position.

A very successful grantee of Surdna's recently e-mailed me this:

> We are so 'scarcity constrained' that we typically tout whatever we are up to as The Cure for What Ails. We are worried that if we don't oversell our particular solution, then some other organization that does oversell will get the modicum of available support. And this is all such a slippery slope because nonprofits that oversell can't deliver...funders that have invested in what they believe to be a macro solution are disappointed by tiny incremental gains...clients/end users get partially served and fully frustrated...and the vicious cycle is perpetuated.*

In these funding decisions, the effectiveness of grantees seems to have little relevance. Peter Frumkin and Mark Kim of Harvard's Kennedy School of Government recently studied nonprofits, in many fields, over an 11-year period. They found that "nonprofits that position themselves as cost-efficient -- reporting low administrative to total expense ratios -- fared no better over time than less efficient appearing organizations in the market for individual, foundation, and corporate contributions."** The same conclusion has been reached by Jed Emerson, an economic development expert now senior advisor to the Hewlett Foundation. His pioneering studies of grantmaking and social investing are sharply critical of the foundation-grantee "dance."*** Outcomes, he says, are rarely important in the decision to fund, or re-up for another round.

Finally, numerous funders are unclear about what kinds of funds may be available. They may not be frank about whether they provide start-up funds, bridge funds, long-term support, or capacity-building grants. Sometimes there is little clear signaling about how much capital may be available and the decision may take many months to find out. So funders continually upend grantees' expectations. Often they come through with smaller-than-anticipated grants. Occasionally they give more than asked for. The result, system-wide, is the massive undercapitalization of nonprofits due to widespread fragmentation of effort, poorly targeted dollars, and inadequate communication bordering on secrecy.

While some might argue that this "let 1,000 flowers bloom" approach is inherently democratic, normal and typically American, I suggest it is autocratic, ineffective and willful -- and typically American. It certainly doesn't build toward Prof. Robert Putnam's definition of social capital: "Social networks and the norms of reciprocity and trustworthiness that arise from them."*

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We have just come off an era of enormous philanthropic expansion. Most philanthropies compiled very strong returns in the last decade,

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* Daniel Ben-Horin, President, Compumentor (1/26/01 e-mail)

** "Strategic Positioning and the Financing of Nonprofit Organizations," Working Paper #2 in the Hauser Center's series, Harvard University, 2000.

*** See Jed Emerson , esp., Social Purpose Enterprises and Venture Philanthropy in the New Millennium. 3 vols. The Roberts Enterprise Development Fund, San Francisco, CA 1999.

* Robert D. Putnam, Bowling Alone (New York, Simon and Schuster, 2000), p. 19.

some well into double-digits annually. Surdna's own endowment more than doubled and we gave out $250 million too. The '90s was philanthropy's chance to discuss the rules-of-the-road, experiment with new processes, improve communications, build relationships with grantees and find genuine common cause among funders. Yet the surge of money, old and newly-minted, doesn't seem to have fundamentally improved the way the system functions. Nor does it seem to have made service delivery more effective.

Why do we act this way? Surely a lot has to do with deeply rooted behavior patterns. This is the way it's always been done. Then there is the single-minded individualism of philanthropy, going all the way back to Rockefeller and Carnegie. Funders just don't see their work systemically, as part of a whole. For example, until recently we saw no need for a newspaper to cover philanthropy and after a buoyant decade, we still have only one. Serious research, as is daily journalism, still a rarity. Our trade association seems to scrupulously avoid taking up hard, key issues, like the estate tax. Only a small handful of funders make grants in the field of philanthropy and nonprofit organizations. Finally, in philanthropy there's no need to be externally accountable, and no sanction from the marketplace, so there's little incentive to improve.

It doesn't have to be this way. We can learn to collaborate among ourselves and with our grantees and, as they say, "leverage" one another.

One small ray of hope comes from "funding collaboratives." These are joint ventures among groups of like-minded philanthropies. The largest and most notable is the National Community Development Initiative (NCDI). More than a dozen foundations, banks, insurance companies and HUD participate. NCDI has been in operation for a decade. It has disbursed more than $250 million in grants and concessionary loans to CDCs in 23 cities (through the Local Initiatives Support Corporation and The Enterprise Foundation). Another effort is the Los Angeles Urban Funders Group. It began seven years ago and now embraces almost 30 funders and corporations. It has put more than $6 million into improving three local neighborhoods. Excellent work is now occurring in the broader environmental field, too, in sustainable forestry, climate change and toxics.

A related example is the Funders Network on Smart Growth and Liviable Communities. It uses information instead of grants to leverage impact. In a little over two years it has attracted 60 foundations of all sizes and dozens of nonprofit affiliates. It has created a truly comprehensive website, accessible to both funders and nonprofits, to share what they know. Its small secretariat champions group learning and sponsors cross-sectoral research. The research connects such disparate areas as aging, public health and educational access to smart growth practices.

At their best, collaboratives change the rules-of-the-road. They make grantmaking more predictable and supportive of grantees. They harmonize goals, processes and phasing. They offer the chance for a group of funders to proceed at the same time from an agreed upon and a common platform. This reduces the mystery of grantmaking. It adds regularity and consistency and sometimes a focus on outcomes. It brings funders and grantees into a more engaged, collegial relationship. The parts start to work adaptively, together.

As yet, there aren't many funding collaboratives and they tend to be seriously undercapitalized. They could be more effective, too. Seldom are they at the top of the agenda of most funders; everyone wants to play the slots with a little money and still get a big payoff. Large dreams follow small coins.

We should be more skeptical about the much discussed "venture philanthropy." While the arrangement is often claimed to be a partnership, focusing on organizational and financial improvement, we haven't yet seen enough of it to draw any conclusions. If this hybrid form of philanthropy invests its money well, strengthens institutions, incentivizes organizational performance with more money, and develops mutually helpful metrics, then it has much promise. Yet some investees may not be up to the task – and neither might the venture

philanthropists, particularly if they expect results too quickly. Further, their numbers seem to be diminishing rapidly. Stay tuned.

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If strong funding collaboratives can help to improve inter-foundation giving, what will improve the rules governing grantor/grantee relationships? Obviously, I am very concerned about this. I believe a "cultural" shift must occur in the system. Both funders and nonprofits need to consciously build social capital. We will never decisively improve the field of philanthropy until we learn to deal with each other more collegially and trustingly. Yes, power relationships will never entirely disappear. But they certainly can be altered. Here are three steps we need to take:

1. A Field of Shared Meaning:
First is to intentionally create what MIT systems theorist Peter Senge calls, a "field of shared meaning."[*] This begins with creating a reflective, safe environment, where funders and nonprofit executives can discuss their concerns over relationships, policies and strategies. Individual visions and styles can be affirmed, or altered. This will be hard to do -- as hard for nonprofits as for funders. Both would need to find common, honest, language and be willing to drop their protective armor.

Those with power should act first, possibly by joining with nonprofits to promulgate a "Code of Pretty Good Behavior" which can be mutually monitored and constantly upgraded. They could track, scrutinize and assess the grantmaking rules-of-the-road. They could trace what works and what doesn't, and even prepare an annual report card, a kind of Zagat's guide to the best and worst of the field.

2. Mapping the System:

[*] John O'Neil, "On Schools as Learning Organizations: A Conversation with Peter Senge," Educational Leadership, April 1995, p. 22

A second step, is mapping the programs and all the "money flows" in each field, like arts or education or human services, in specific geographical areas. The money flows would include corporate and government dollars too. This is seldom done,[**] causing redundant or ineffective grantmaking. An obvious case is in the field of educational reform in numerous cities. Here, more philanthropic and corporate money has been spent, less effectively and more idiosyncratically than any field I know of. Constantly mapping the system will tell us an awful lot about how the whole field interacts, changes and innovates. It will give a common baseline. We must compile these maps to help us to chart improved program and financing strategies and we must share widely the information we derive.

3. Co-creating Value:
Which brings me to my third proposal, "co-creating" value, as seen in the example of boat-building. Two business school professors at the University of Michigan recently wrote a very provocative paper.[*] They describe how manufacturers and customers work together with high trust and big results. They highlight the impressive story of innovation in boat-building that occurs, of all places, in rural Kentucky.

Sumerset Houseboats, the world's largest houseboat manufacturer, engages in "co-creating value." What is co-created is not only the boat. That's the physical artifact. It is also a process, where boat buyers engage in continuous waves of interaction with the manufacturer. The two also build a relationship. The customer has access to the accumulated data of other buyers, as well as the company's resident experts. There is a level of transparency from beginning to end, from configuration to design, from manufacturing to testing. Engineers and

[**] A notable case of mapping is done annually by the Sierra Business Council. Some cities, like Jacksonville, Florida, have also perfected the mapping approach.

[*] C.K. Prahalad and Venkatram Ramaswamy, "The Value Creation Dilemma: New Building Blocks for the Experience Revolution," July 30, 2001, unpublished.

carpenters share what they know. All are involved in a continuous dialogue.

In the words of two professors, the old boat-building process is transformed. It moves from "own and extract value *from* the consumer" to "respect, dialogue and co-creation of value *with* the consumer." [Italics added.] The former power of the supplier is transformed to the greater power of the two together. They add, "Sumerset is an illustration of a system where the entire order-to-delivery process is transparent, accessible, invites dialogue, and offers opportunities to explicitly recognize risks. "[p.27]

Further, "There is a significant 'forgetting' element here. Managers must come to terms with the genetic code of their organizations and develop explicit strategies for moving the entire organization to the new ways in which values will be created." [p. 29].
If I wanted a houseboat you know who I'd buy from. The quality of the experience and of the final product would convince me, hands down. I'd not only get a great new boat -- I'd get a partner, helper and teacher, too. Sounds a lot like social capital to me.

Needless to say, in both boat-building and philanthropy co-creation of value isn't easy to accomplish. In fact, in our field it's not clear who is the supplier and who is the consumer. Are funders the sellers and nonprofits the buyers? Or do nonprofits sell and funders buy? That the lines are blurred in our field seems to suggest that co-creation of value is trickier to accomplish, but no less important to try.

There is a tremendous need here for sophisticated use of information technology. Quick feedback loops are necessary in order to course-correct. Knowledge becomes as important as money. There is a need to provide incentives for grantmakers to "forget" their old ways. They have to see the value in working jointly and respectfully with grantees to "build their boat together." The manufacturer and the consumer, the grantor and the grantee, have to recognize they are two inseparable sides of the same coin.

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So, look at it this way. Suppose we didn't use money as our primary vehicle for getting and measuring results. Suppose grants aren't just discrete transactions made in linear fashion, where if you meet the goals you get more money. That's a 19th century model: mechanistic, transactional and isolating.

Suppose a new model, more like a network. It has several operating characteristics. It is driven by information and knowledge, which is shared constantly and purposefully among grantees and foundations, by web, print, and constant personal connection. Relationships flourish. Mutual learning occurs. Technical assistance is constant. Metrics aid accountability, but they are determined jointly and shared jointly for mutual gain.

Under this model, the foundations' role needs to be re-imagined. Instead of funders, they become information resources, brokers (and givers) of money and relationships, ongoing learners and listeners and active promoters of success. They are enablers of improvement and resources to connect to. In fact, even when the stock market sinks, their larger repertoire can help moderate the damage brought on by reduced funding. The multiple roles funders fulfill will help them maintain the effort more effectively.

One consequence of this new concept of philanthropy would be to review the numbers of program staff and their talents. The role of the program officer shifts, as does the CEO's. Their knowledge of the field, their maturity and their ability to collaborate becomes easily as important as their ability to analyze grant proposals. This shift, in turn, could lead to a review of the costs of staff relative to administrative overhead. Under a more embracing concept of its work, more money might need to go for more staff, performing a more comprehensive, relationship-and-information-focused job.

Wll then, what could philanthropy be? I can imagine a system embracing ongoing, positive partnerships, among funders, among

nonprofits, and between them. They would work together under open, mutually agreed-upon and adaptable rules. The rules would be geared toward producing successful outcomes by sharing useful information, by learning together, by treating each other respectfully, by encouraging and using feedback, by leveraging resources from all the sectors. If we look inside ourselves and across the room I think we can discern this great opportunity and great challenge. In fact, in the wake of the terrorist action on September 11, we can also see that the world -- and philanthropy's role, no less -- will never be the same. At this moment of tremendous discontinuity, we will do ourselves a disservice if we neglect the opportunity to reform, or to transform, our philanthropic ways.

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In the older style of transactional philanthropy, the wheel is still turning but the gerbil is on its last legs. I deeply believe time has come to re-imagine our system of relationships and processes, and our goals, in order to move philanthropy to a more synergistic, creative and effective next phase. This is the task before us. None of us alone knows how to do it. But together, we can co-create our future.