



## If Pigs Had Wings: The Appeals and Limits of Venture Philanthropy

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First, let me say how delighted I am to participate in the Philanthropy Seminar Series honoring Wally Nielsen. It is a wonderful and timely idea to dedicate a series of discussions to contemporary issues in philanthropy, and it is especially fitting that the Center would be hosting discussions, named for Nielsen, not just on the nuts and bolts issues of management and efficacy, but rather on the broad conceptual and philosophical questions of the field. And I feel truly honored and quite humbled to be included in a list of speakers who are among those I most admire in the field.

A brief word about the title of my remarks: One thing I have learned over the course of the years is that a good title is worth a lot--Bob Putnam's "Bowling Alone" is a great example of this dictum--and since I have become known as the "flying pigs" guy since publishing the article with this title a few years ago, I thought I might follow Putnam's example and use it again. One advantage of a title like that is its ability to sum up an argument in the fewest words possible--in this case, about transposing frames of reference. But more about that later.

My one qualm about the title, however, (and the article itself) is its decidedly critical tone. I'm trying to avoid becoming known as a "nattering nabob of negativism" about venture philanthropy. So, despite the fact that I have often voiced a contrarian view in debates about this topic, I actually do have some positive things to say about venture philanthropy, both concerning its aspirations and the healthy challenges it poses to the field.

### **The "Venture Philanthropy" Model**

So much for the positives. Now to the topic at hand: Today I want to explore the assumptions and implications of venture philanthropy (VP)--its overall plausibility and four specific problems in its approach--and to address a deeper issue it poses about the nature of the relationship between philanthropy and civil society.

Let's start with a definition. Anyone reading the publications of the field, or even more the general press, must have a very confused idea of

what "venture philanthropy" is supposed to be. It is variously referred to as operating for-profit enterprises in a nonprofit setting, using commercial practices in nonprofits, social entrepreneurship, and, sometimes, any philanthropy at all practiced by 20-something dot-com millionaires. Since none of these descriptors tell us much, I want to employ a more specific definition that has its origins in one of the articles that started it all: "Virtuous Capital: What Foundations Can Learn from Venture Capitalists," by Chris Letts, William Ryan, and Allen Grossman, in the March 1997 *Harvard Business Review*.

The article argued that traditional philanthropy, which (according to the authors) has had lackluster performance, would benefit from the infusion of venture capital techniques: adopting performance measures, placing large bets on chosen organizations, working closely with them to produce results, and exiting at the appropriate time. At the center of this model is the concept of treating funding as an *investment* rather than as the traditional concept of a charitable *grant*, with corresponding expectations of return on investment, operating efficiencies, and management oversight that this shift requires. For the purposes of this lecture, let's use this as the definition of "venture philanthropy."

My first question is then, how intuitively plausible is the model? Are venture capital investors as unquestionably successful as they seem to be? True, in the go-go years of the late nineties, it seemed that Venture Capital (VC) could do no wrong. In the dazzle of the dot-coms, VC seemed to have a special magic that fueled the economic fireworks. Who can argue with 50 or 100% annual returns? In the sobering days that have followed, however, the picture has changed dramatically. The VCs left standing operate in a much more conservative way, exercising great selectivity and placing stringent (sometimes onerous) conditions on their investees.

But, beyond the boom and bust cycle, what about performance? Well, first it must be said that the entire industry is relatively young, born essentially in the mid-70s, when total VC investment was under \$100 million annually. There was dramatic growth in the 80s followed by a decline and then spectacular growth in the late 90s to over \$15 billion

annually before the last collapse. So everyone is still learning how this works. Second, venture capitalists themselves are fond of saying that of every 10 investments, there will be 4 abject failures, 4 walking wounded, and maybe, if you are lucky, 1 or 2 real hits. Of course, in the financial world, the big hits make up for the dogs by returning huge profits, but we must ask whether this success rate is what we wish to emulate. Third is the question of the actual value added by the VCs. Although it is intuitively plausible that management skills, contacts, and technical resources brought to the table by VCs should increase the success prospects of the entrepreneurs in which they invest, I am aware of no study that documents numerically the real value added.

In sum, there are several reasons to ask, Is the VC model so self-evidently successful, even in its own realm of activity, that it *prima facie* demands to be transferred to the nonprofit sector? My answer is—not surprisingly—no. I think there is a need to explore both the actual historical experience of VC investing and, more importantly, the particular claims made for its relevance to the nonprofit sector.

#### Four Assumptions

This brings me to my second major point: What are the core operating principles of the VC model, and how well do they apply to the world of nonprofits? I want to suggest that there are four fundamental assumptions of venture capitalism that become deeply problematic when transferred to philanthropy:

The first is the issue of the bottom line. In business there is a single, and elegantly simple test of success: Do you make money or not? But what is the equivalent of the bottom line in the nonprofit world? I would suggest there is none, or, perhaps more accurately, there are many. Nonprofit activity has a complex and intangible range of aims that often elude simple classification and measurement. Consider the panoply of goals of dance companies, youth development programs, bioethics institutes, advocacy groups, character education organizations, cultural identity programs, and even, I would add, academic centers dedicated to the advancement of learning in the nonprofit sector. Not

only are the goals among these enterprises highly diverse and incommensurable, but their internal goals are frequently incommensurable as well.

For example, let us take an attempt to apply metric comparisons to the multiple aims of an international teacher exchange program that simultaneously seeks to: increase appreciation and understanding of other cultures, expand pedagogical horizons, broaden student perspectives through teachers' experiences, build lasting friendships, and provide participants with a sense of renewal. Yes, questionnaires can be devised to survey teachers' responses, but we know that a single "aha!" experience two years after the program has ended may outweigh all other factors in terms of its real effect. Or, think of an organization dedicated to the creation and performance of new music; What are the measurable success criteria here? Number of positive reviews? Number of performances? Level of audience satisfaction? Audience numbers? Earned income? What may be most important is the transformative impact of the organization's work on the field of modern composition, and that is a highly subjective judgment call.

Imagine a little visual comparison of the VC and the philanthropic donor: For the VC, on the left (input) side is a bag of money. In the middle of the picture are representations of a range of activities and tools through which the money is put to work, and on the right (output) side is a bigger bag of money. For the philanthropic donor, on the left side also stands a bag of money, followed by representations of various activities and tools. But on the right side is...what? Certainly not a bag of money, rather a range of ends that the organization is seeking to achieve.

One solution that has been offered to this problem is the concept of the "double bottom line"—on this view, nonprofits operate with two bottom lines, one financial and the other social. But, while this sounds good, it really doesn't take us any farther than the previous argument, because the financial bottom line is not the point of the activity (with the one exception of nonprofits that are about creating small business enterprises), but it is just a means—albeit a critical means—to its

success. And the so-called “social bottom line” takes us right back into the conundrum, described above, of applying metrics to social goals.

A related attempt to develop a measure of “Social Return on Investment” (SROI) I would suggest is similarly flawed. SROI is defined in one descriptive publication by the Roberts Enterprise Development Fund (REDF) as a vehicle to “quantify and monetize social value creation.” The formula to calculate this rate of return is the sum of “Enterprise Value” (the financial return from the enterprise) plus the “Social Purpose Value” (future monetizable public cost savings and new taxes generated by individuals while employed in the social purpose enterprise) divided by the investment in the enterprise. In other words, the calculated return is a function of projected public cost savings. As described, SROI applies to a very limited range of nonprofit activity—small social purpose businesses—and some of the cost savings are quite speculative. The publication also notes that: “REDF recognizes that social purpose enterprises create other types of value which are difficult to monetize, occur after the employee has left the enterprise, or accrue to family members of the employee.” We are back in the realm of the intangible.

Champions of venture philanthropy chide “traditional philanthropy” (by which is meant everything that is not venture philanthropy) for failing to apply rigorous measures of performance to their work, both their own and of that their grantees. While I do think it is healthy for the field to push itself to become as rigorous as possible in specifying the results it seeks to accomplish and quantifying them wherever feasible, the current mania for measurable performance outcomes can be counterproductive or sometimes just plain silly. An example of counterproductivity is the wave of teaching-to-the-test now sweeping the public schools that seems inevitably to result from an exaggerated emphasis on standardized testing. A wonderful description of the point at which an outcomes fixation reaches the level of absurdity appears in a delightful recent essay, “Generosity Without Measurement,” by Ira Cutler, former Director of Planning at the Annie Casey Foundation. As Cutler observes, the current hyper-emphasis on measurable outcomes is producing, “a system in which we now cannot

admit that evidence is scant and shaky and have to continue pumping up expectations about not only our successes but about our ability to measure success. There are folks out there from prestigious scientific think tanks telling people that \$1 spent on this or that program will produce \$7.11 in savings. Not about \$7, not \$7.10, but \$7.11. Surely this is foolishness.”

Apart from the problem of multiple variables and multiple inputs, which make cause and effect calculations next to impossible purely from a purely mathematical standpoint, there is the more fundamental problem of what the philosopher Albert North Whitehead called, the “fallacy of misplaced concreteness.” I will return to this later in the discussion of civil society.

The second problematic assumption of VP is the idea of “going to scale.” Based on the analogue of gaining market share for businesses, VP theorists commend their selected nonprofits to seek ways of growing their enterprises to scale, based on the logic that if you are successful in social problem solving, you can create greater efficiencies and maximize impact by expanding your operation to regional, national, or even international scope. Clearly this is true with some nonprofits, like the Sierra Club or the Red Cross (or maybe not with the Red Cross), based on economies of scale, national visibility, and the power that comes with control over major resources.

But the vast majority of nonprofits come into being to meet highly differentiated social needs or particular visions. They are designed to fill niches not satisfied through other mechanisms of society. Actually, we have a word to describe “going to scale” in the social arena: it is called “government.” This is how we try to apply large-scale resources to public needs, albeit incurring attendant problems of bureaucracy and immobility along the way. Indeed, in the argot of the nonprofit studies field, nonprofit organizations emerge precisely to address those needs that lie outside the interests or desires of the “median voter.” This particularism lies at the heart of the exciting, nimble, creative, localized, and sometime wacky pluralism of the nonprofit world.

There is a further problem with the recommendation to go to scale in the nonprofit arena. In contrast to the Darwinian world of business, nonprofits typically do not seek to build market share at one another's expense. This difference was highlighted to me recently by a question asked by a successful businessperson seeking advice about philanthropy: "Remind me, in the nonprofit world, do we crush the competition?" This is not to deny that competition exists among nonprofit organizations, just to say that it is not a central operating principle of our field.

The third issue I want to address is that of control. In a typical VC investment, the investor assumes an ownership role and thereby becomes actively engaged in the management of the enterprise, often taking a board seat, weighing in on hiring/firing decisions, using contacts to secure other investors, and steering company policy. Based on this model, venture philanthropists are encouraged to become "highly engaged" in the organizations to which they allocate their funds, using their personal involvement as well as their funds to advance the work of the nonprofits.

Such involvement can certainly benefit the chosen organizations, but it also raises sensitive issues of power and control. There is a significant difference between an owner and a donor: the former has an obligation (and a legal right) to seek to pursue the common goal of all involved—maximizing return on investment. The latter enters into a much different relationship with the "investee" organization—he or she is typically one of many sources of support for an enterprise that has a pre-established mission (unless the donor created the organization) that is the product of the vision of a founder, board of trustees, and sometimes a group of members. Nevertheless, the power balance in such an organization can be easily skewed by a single large donor, especially if the donor wants to exercise active influence. This poses a problem for nonprofit governance: the key to the special role of nonprofits in civil society is their ability to direct energy toward self-chosen ends, avoiding control by either the market or the state. An overly intrusive donor/investor can threaten this independence. I will just make this claim for now and return to this point in the discussion

of civil society in a minute.

At first this issue may not seem all that important; after all, what nonprofit would not welcome a supportive and engaged new donor? However, it turns out to be the single most troublesome factor for nonprofits who have been venture philanthropy recipients. To its credit, the REDF conducted a careful analysis of three investment "failures," that is, organizations that dropped out of their venture philanthropy portfolio in the late 90s. The single theme that characterizes all three cases is the problematic working relationship between the REDF and the organization—including different understandings of mission, disagreements on decision-making processes, and poor communication. These findings are consistent with my own informal conversations with other nonprofits who have participated in venture philanthropy experiments. Control is crucial.

The final problematic assumption is the idea of an exit strategy. In venture capitalism, the return to the investor typically occurs at the time of a successful public buyout, typically three to seven years. At this point the VC investors cash their checks and either buy their yachts or put their gains into new ventures (or both).

What is the analogue in the nonprofit world? Lacking any equivalent to a public buy-out, venture philanthropists sometimes suggest financial self-sufficiency as a goal to trigger the end of an investment cycle. But this is a dubious goal, because there are in fact only three streams of possible revenue for nonprofits: contributed, earned, or government. In the face of clear limits on the latter two sources (because of the non-commercial nature of nonprofits and severe current constraints on government funding), this leaves contributed income. Although growth in contributions by individual donors is always possible, one suspects that an important part of the search for VP replacement income will involve other foundations. I have had direct experience with the consequences of the exit of VP funding in the form of requests to our Fund, and it does not seem to provide any new solutions to the problem of nonprofit sustainability.

Actually, it may just be too soon to ascertain what a VP exit really means. The entire history of venture philanthropy as described here covers about half a decade. Since the investment period described by VP practitioners is in the five to seven year range, we may come to know more about this in the next several years.

### **Venture Philanthropy and Civil Society**

So far I have argued that important differing conditions in the for-profit and nonprofit worlds make the transfer of venture capital techniques to philanthropy highly problematic. But there is a deeper question at stake here. It is not just a matter of what techniques we adopt to do our work but understanding what our work is. This raises the most fundamental question of the purpose of nonprofit sector activity, or as I would prefer to state the issue, it is about the nature of civil society and our role in it.

Let me digress a minute. I want to throw in here a bit of history and bit of philosophy. In a lecture with “pigs” in the title, you probably didn’t expect this, but I hope you will indulge me. You will see where this is all going shortly.

As I have been recently working on a book on philanthropy and civil society--following my own academic roots in political theory--I have been increasingly drawn into examination of the historical origins of civil society. It turns out that there was an incredibly fecund period in European history—roughly in the 16<sup>th</sup> and 17<sup>th</sup> centuries—when seven defining elements (my argument seeks to make the case that they are the seven *essential* elements) converged in that small but remarkable country, the Netherlands, into the earliest modern form of civil society. Three of these were institutional: the rule of law, a system of free expression, and a set of independent voluntary associations; and three were normative: individual rights, toleration, and the pursuit of the common good. One element, philanthropy, had both institutional and normative dimensions.

Although “civil society” remains one of those concepts that resists a universally agreed upon definition, contemporary theorists, like Michael Walzer, Ralf Dahrendorf, Adam Seligman, Jean Cohen and Andrew Arato, Ernest Gellner, Jean Bethke Elshtain, Brian O’Connell, William Galston, and John Keane, among many others, consistently refer to some subset of these seven characteristics in their analyses of the constitution and role of civil society. Assuming that something like this mixture of civil society institutions and values came to form the platform of modern liberal democracy and continues to this day to shape the conceptual framework for what we now call the third sector, what does it mean for how we understand our work?

It means, in part, that the “lifeworld” (a very descriptive phrase used by the German philosopher Juergen Habermas and others before him) that we inhabit when we are acting in civil society is very different from those of other spheres of life: the family, economy or state. Each of these lifeworlds has its own set of goals, expectations, norms, and incentives. In the economic world, we think and act as producers, consumers, and investors; in the political world, we play the roles of voters, lawmakers, and public administrators.

In the world of civil society, we become community members, volunteers, and civic actors. What particularly characterizes this world is pluralism, diverse social goals, and a creative tension between individual interests and the commons. It is the sphere in which privatized visions of the public good play out in interaction with one another to shape the social agenda. Participating in civil society involves an odd mix of public and private, social problem-solving and individual expression. A phrase that captures it particularly well, I think, is Bob Payton’s description (referring specifically to philanthropy) of “voluntary action for the public good.”

All of this is to say that participation in civil society represents not just a tool for solving social problems (although it is that too), but rather a way of engaging in the world. This way of engaging carries with it a set of values, interests, behaviors, and even a language. This is why the diverse value commitments, processes, operating styles, and modes of

participation of nonprofit organizations are central to their existence and not just incidental to some other over-arching goal to which they are “really” directed.

We have now arrived at the central point around which I have been circling. Civil society provides an alternative to the ways in which economic and political frameworks structure our world. It is a vital alternative, because it allows for a realm of free socially connected action in the public realm. But it is vulnerable to encroachment by both the market and the state. The success and power of either of those other spheres can begin to overwhelm the rather fragile construction of civil society. Habermas describes this as the “colonization of the life-world.”

A recent book by Charles Lindblom, *The Market System*, brilliantly describes the virtues and limits of the market and its power to dominate other spheres of life. Lindblom observes that, the market, “can coordinate human behavior or activity with a range and precision beyond that of any other system, institution, or social process. But it is a harsh and often cruel coordinator...It achieves extraordinary efficiency because it permits participants to make precise and calculated choices. But it is grossly inefficient because of the choices it has closed off. “ And later, discussing its impact on the democratic process, he warns that, “Market elite persuasion is so persistent and relentless, so widespread, and so inventive in its appeals that one must ask how much room it leaves in the mind for thinking about other things—or thinking at all rather than simply reacting...” Lindblom’s concern here is that market forces and market thinking can come to dominate dimensions of life beyond its natural limits, with negative consequences for the rest of society.

One consequence of this tendency toward market expansionism is “sector-blurring.” Ed Skloot and others have insightfully described the contemporary trend of fuzzing the lines between for-profit, governmental, and nonprofit sectors. Businesses are beginning to expand aggressively into areas like welfare reform services and K-12 education that were previously the almost exclusive domain of

nonprofits and government. Government is increasingly relying on out-sourcing to both nonprofits and for-profits. Ed’s message is: Like it or not, get ready: It’s happening. I agree that it is happening, but I am not quite as sanguine as some about its effects. Nonprofits may be drawn though competition into emulating business practices that distort their missions. Sector-blurring, therefore, may pose a serious challenge to the nonprofit sector, calling more for a border patrol than a welcome wagon—with the urgent requirement for all of us to gain increasing clarity about what makes the nonprofit mission distinctive.

The role of language is vital here. Language plays a crucial role not only in articulating, but in structuring our worlds—in a sense, as philosophers have told us, the world comes into being and is constantly being reshaped through language. These days the metaphors of the market are riding high (maybe a little less this year than last)—“return on investment,” “branding,” “deal flow,” “burn rate,” “value chain,” “niche marketing,” “alignment” (of strategy with outcomes), “growing the business,” and “harvesting” (the investment)—to name a few. Sound familiar? As these words become assimilated into the life of nonprofits, they begin to change, subtly and not so subtly, the way we view our work. The model of investment, production, and consumption comes to characterize our activity, replacing the model of voluntary commitment, participation, and social vision conveyed by the language of civil society.

So what does all of this have to do with venture philanthropy? A lot, it turns out. Let’s return to the four assumptions of venture capitalism that I initially raised as problematic in their application to philanthropy. All four, considered in the context of social agenda-setting as described above, seek to redefine the frame of reference of civil society:

- 1) The search for an equivalent concept in the nonprofit world to the bottom-line in business—what I would describe as trying to find a proxy for profit—seeks to reshape civil society’s pursuit of multi-valent, self-defined, highly differentiated ends into a single, flat plane of analysis. This is not to say that it is useless to look for ways in which

results can be carefully assessed, only to note how limited and limiting an over-emphasis on narrow performance indicators can be.

2) The drive to “go to scale” potentially conflicts with the pluralistic, responsive character of civil society. While some efficiencies may be generated by large-scale service delivery systems, they almost inevitably lose a sense of local guidance and committed participation that accompanies it. A recent example I have observed in my own work is a decision by an organization that develops urban parks to decentralize and, in effect, “de-scale” its efforts in order to delegate more power and responsibility to local communities.

3) The injunction for donors to adopt the perspective of investors and become highly engaged with their investees, can, if generalized, transform the transactional relationship between funders and nonprofits. Because nonprofit organizations can be highly dependent on major funders, the potential for inordinate influence by high-level donors (investors) is great. Ideally, civil society provides a sphere in which diverse social strata can meet and participate on equal terms—a kind of democratic ideal—mutually shaping organizational visions. The introduction of an active funder-investor to this process may change its character in a way that skews agenda-setting for the organization in the direction of the investor.

4) Finally, framing the endpoint of a funding cycle as the “exit strategy” for an investment carries with it a fairly strong implication of moving the organization toward a more commercialized support structure. This brings the nonprofit closer to the influence of market forces and, by definition, away from those of civil society. While such a transition may be quite appropriate for a small number of nonprofits, such as social purpose businesses, it is likely to distort the mission of others.

Taken together, therefore, these four operating maxims of venture philanthropy define a vision of social practice potentially at odds with the core concepts of civil society. This is not to say their application to philanthropy is entirely negative. To the contrary, examining traditional philanthropic practice in light of VP principles promoting efficiency, effectiveness, and organizational strength can provide a healthy critical

perspective through which to hone the field’s goals, operating principles, and results. And there are positive ways the principles can sometimes be adapted into individual organizational circumstances.

Cumulatively, however, the four represent the leading edge of a trend in social thinking that poses a serious challenge to the autonomy of the nonprofit sector: the increasing encroachment of the market into the realm of civil society. This “marketization” process threatens to impose its own frame of reference, substituting the singular idea of return on investment for the rich pluralism of material, associative, aesthetic, and moral ends of civil society. While it is true that, if nonprofits had the resources, strategic objectives, and income-generating potential of large corporations, they might reach much higher levels of financial stability. But, as an old Montana friend of mine used to say, “If pigs had wings, they could fly.” Thankfully, neither of these events is either likely or desirable.