Impact of Venture Philanthropy on Foundations and Nonprofits in the U.S.

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(Abstract)
In this paper, the author tries to demonstrate that why the relationship between the foundations and the nonprofits has been so ineffective despite of giving huge amount of grants to the nonprofits for the social change. As a solution to this particular problem, the U.S. foundations conceive the venture philanthropy approach which is beneficial to both the foundations and the nonprofits. The concept and practice of the venture philanthropy derived originally from the venture capital investment to support new venture creations. Through a detailed case study of the innovative foundation coupled with the author’s substantial experience as a venture capitalist, this paper examines the various critical factors which the contemporary venture philanthropists are currently facing to enhance the development of social sector. In particular, the concept/practice of venture philanthropy has significantly promoted the importance of “management” and organizational development for the philanthropies and the nonprofits.

Key Words: Venture Philanthropy, Foundations, Nonprofits, Venture Capital, Social Sector

1. Introduction
Philanthropy is potentially society’s most innovative form of capital, but it is not always deployed effectively. Compared to policy-makers and business investors, philanthropists assume more risk, maintain a long-term focus and support less popular ideas. They actually provided the seed funding for many of the important social changes in the history of the U.S. They financed abolitionists, suffragettes, labor organizers, citizens’ rights groups, hospital builders and schools for the disabled—often long before the work was understood or publicity-validated. However, philanthropy was historically viewed through the lens of charity and often practiced in an unsystematic, even in capricious way (Bornstein & Davis 2010).

The term venture philanthropy could
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be traced back as far as the 1960s in the U.S. Its first recorded use was in 1969, when it was mentioned during a congressional hearing by a representative of old philanthropist, John D. Rockefeller III, grandson of the Rockefeller Foundation founder. What he meant by venture philanthropy was an adventurous and risk-taking approach to funding unpopular social causes (Bishop & Green 2008). However, it was only during the 1990s that the term gained popularity and stimulated academia and practitioners’ discussions on new forms of highly engaged grant making by foundations. In particular, in the mid-1990s and early-2000s a more narrowly focused form of venture philanthropy emerged, reflecting the techniques of Silicon Valley’s venture capitalists. The leading exponent of this kind of venture philanthropy is generally reckoned to be Paul Brainerd, the cofounder of Aldus, a pioneer of desktop publishing, who started Social Venture Partners in 1997\(^1\). Another exponent is Mario Morino, an early software millionaire, who launched Venture Philanthropy Partner in 2000\(^2\). They were widely admired for their ability to turn quickly a bright idea into a successful business\(^3\).

Another innovative approach to venture philanthropy also emerged in Silicon Valley by aiming to show newly wealthy high-tech entrepreneurs how they could be effective philanthropists. The Silicon Valley Social Venture Fund, launched in 1998 known as SV2 was a notable example of this sort of venture philanthropy\(^4\).

Outside the U.S., considerable interests in venture philanthropy began to develop in the UK. While there were several historical examples of venture philanthropy-like activity, it was not until 2002 that the UK’s first venture philanthropy organization, Impetus Trust, was launched\(^5\). The founder of the organization was Stephen Dawson, one of Britain’s first Silicon Valley-style venture capitalists\(^6\). In continental Europe, there has been a slow, but steady arousal of interest in venture philanthropy models. It was only in the last five to six years that new organizations/models of venture philanthropy had been created. However, noteworthy is that the European Venture Philanthropy Association (EVPA) was formed in 2004, which has been the primary vehicle to encourage the development of venture philanthropy model/organization throughout Europe\(^7\). Furthermore, a sister network of EVPA, Asia Venture Philanthropy Network (AVPN) was set up in Singapore in 2011 by one of the founders of EVPA\(^8\).

As far as academic interests/developments in venture philanthropy in the U.S. are concerned, the following two notable papers in Harvard Business Review (HBR) must be definitely reviewed. The publication of “Virtuous Capital: What Foundations Can Learn from Venture Capitalists” in HBR (Letts, C., Ryan, W. and Grossman A. 1997) was heralded as the starting point of venture philanthropy movement. Indeed, this work was the first written articulation of defining principles of venture philanthropy model. More accurately, it challenged foundations to employ concept/tools from venture capital to invest in the organizational rather than the programmatic needs of nonprofits. As mentioned earlier, venture philanthropy became exciting concept during a unique historical moment—one in which significant new wealth was being
created among successful entrepreneurs in the high-tech field. Such wealth coupled with the “can do” spirit and the exuberance of the new economy led such entrepreneurs to believe that they could use their business know-how and newly acquired wealth to create positive social impact (James & Marshall 2006).

Subsequently, the article “Philanthropy’s New Agenda: Creating Value” in HBR (Porter, M.E. and Kramer M.R. 1999) also challenged foundations to create greater value and to act as more than a passive conduit for transferring finance from private sources to nonprofits.

In line with those enlightened movements on philanthropy, existing foundations have been considering how to change some of their practices in order to assist better the social sector and how to align their grant-makings/investments with their social mission.

2. Research Question

In the U.S. foundations and nonprofits have been working diligently on behalf of its society’s needy. However, at the same time it could be said that their progress has been slow and various social problems have persisted. How can they learn to be more effective with their limited resources?

As mentioned earlier in Introduction of this paper, an influential HBR article by Letts/Ryan/Grossman successfully described the critical points of historical relationship between foundations and nonprofits. It was also contributable to describing significant ideas/hints by demonstrating concepts and tools of venture capital investments. Their focal points in the article could be summarized in the following ways (Letts, Ryan & Grossman 1997):

(1) Foundations have been making large grants to nonprofits in the hope of meeting a wide range of society’s most pressing and vital needs. Although these large sums of money have been put to work, many staffs in the nonprofit field have been reporting a growing frustration that their programs’ goals were not being achieved. In other words, many social programs of nonprofits have begun with high hopes and great promise, only to end up with limited impact and uncertain prospects.

(2) Forces beyond the control of either foundations or nonprofits account for some of problems. A notable example of them would be a scaling-back of funding for social services by federal/local governments. Furthermore, despite their best efforts many leaders of nonprofits are finding that social problems persist and may even be worsening. But part of the difficulty needs to be traced back to the relationship between foundations and nonprofits.

(3) Traditionally, foundations make grants based on their assessment of the potential efficacy of programs proposed by nonprofits. Although that approach creates an incentive for nonprofits to devise innovative programs, it does not encourage them to spend time assessing the strengths, goals and needs of their own organizations. Thus they often lack the organizational resources to carry out the programs that they have so carefully designed and tested. Foundations need
to find new ways to make grants that not only fund programs but also build up organizational capabilities that nonprofits need for delivering and sustaining quality.

In fact, many foundations have been aware of the problem and been trying new approaches: they have been experimenting with new models of financing that are better structured than past approaches to meet the needs of nonprofits. In particular, some foundations have been studying venture capital firms and their techniques for guiding their portfolio companies. Their idea makes sense: foundations and venture capital firms face similar challenges such as ① selecting the most worthy recipients of funding, ② relying on young organizations to implement ideas, and ③ being accountable to the third party whose funds they are investing.

In line with the awareness of problems and new approach by some prominent foundations as well as valuable focal points discussed in the HBR article, the author would like to clarify in this paper whether venture capital firms (venture capitalists) could significantly offer a helpful benchmark to solve the ineffective relationship between foundations and nonprofits. Through all in this paper, the author believes that his experience as a venture capitalist in Japan and partly in the U.S. over more than ten years forms the basis for insight into various practices in the venture capital fields (Fukuda 2000).

3. Research Methodology

(1) In order to answer the research question, the author chose the case study approach as a research methodology. Because the case study would be appropriate for research particularly in new issue areas where the focus is on understanding why a contemporary set practices emerges in the philanthropic field; the case study could be also appropriate for detailed analysis of specific focal points. Thus, The Robert Enterprise Development Fund (REDF) was chosen as the case study in this paper and examined carefully in the following section 5. The reason why author chose REDF as the case study is that it is one of the pioneers of using the venture philanthropy approach in the philanthropic field. REDF was influenced so strongly by the concepts/techniques of venture capital in the early 1990s that it actually became a venture philanthropy foundation.

(2) As for conducting case study research on REDF, author has analyzed; ① interviews with the REDF’s program director/officers in 2007 and in 2011 in San Francisco in the U.S. ② broke down the REDF’s annual statements for 1996, 1999/2000, and 2002; ③ analyzed descriptions in independent philanthropy publications. Drawing from these interviews, documents, research materials and surveys, author recognized the bundle of practices that make up venture philanthropy. Such specific bundle of practices has been gradually understood in the philanthropic field:

① Focus on organizational capacity-building
Highly engaged relationships with grantees (nonprofits)
Use of performance measures
Increased length of relationship
Increased amounts of funding with tailored financing

Based on the interviews, research materials and surveys above-mentioned, the author picked up the three time periods to examine the points, from which to evaluate the relationship between foundations and nonprofits. The first period, the year 1996, marked the time just before venture philanthropy burst in the U.S. onto the nonprofits sector. The second period, 1999-2000, was the height of venture philanthropy’s popularity. Shortly thereafter, crash of high-tech bubbles and the subsequent downfall of a number of venture philanthropy organizations took place. The third period, 2002, marked the onset of venture philanthropy’s current phase; it is slightly humbled but focused and resolved to prove that it can be practiced on a large scale.


1) Motivation

Venture philanthropy organizations usually position themselves as complementary to other forms of funding available to nonprofit organizations. However, they do view the venture philanthropy model as particularly appropriate for organizations undergoing rapid growth and development. Venture philanthropy organizations recognize that many nonprofit organizations lack the internal capacity, particularly the appropriate business skills and growth capital to grow significantly the scale of their social missions, to reach new markets or to be competitive when bidding for government contracts. The “capital market” for social innovations is not as efficient or diverse as it is for developing fully corporations. Venture philanthropy brings in funding solutions and helps to make the capital market more efficient, especially for rapidly growing nonprofit organizations. It could be summarized that venture philanthropy is best described not as a blueprint, but rather as a movement that is evolving a set of practices stemming originally from venture capital.

At present, venture philanthropy is still an emerging player in the social sector with the fundamental challenge of offering new solutions to the promotion and encouragement of entrepreneurship and innovation. In order to achieve this, the philanthropy organizations must address a number of enabling issues as follows:

1) Communicating and marketing what venture philanthropy organizations do within social sector to multiple audiences including nonprofit organizations, statutory agencies and other types of social sector funders.
2) Developing a range of financial instruments and advisory services that meet the needs of nonprofit organizations.
3) Measuring the performance and social impact of nonprofit organizations (See Figure 1).
4) Collaborating with and learning from complementary capital providers such as private equity and venture capital firms.
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2) Approach

Venture philanthropy provides a blend of performance-based development finance and non-financial support as professional services to nonprofits – helping them to expand their social impact. This is a high-engagement/partnership approach similar to the practices of venture capital in building the commercial value of new ventures (See Figure 2 and Figure 3).

Donors: Mainly foundations, Venture Capital/Private Equity firms, high net-worth individuals (many from Venture Capital/Private Equity sector or business entrepreneurs) and corporations.

Donors expect mainly a social return on "investment" (SROI)\(^6\)

Figure 1

The Impact Value Chain

<table>
<thead>
<tr>
<th>INPUTS →</th>
<th>ACTIVITIES →</th>
<th>OUTPUTS</th>
<th>→ OUTCOMES →</th>
<th>GOAL ALIGNMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>What you put in</td>
<td>What you do</td>
<td>Results that are measured</td>
<td>Collection of all results</td>
<td>How well outcomes align with intended goals</td>
</tr>
</tbody>
</table>

What would have happened anyway

= IMPACT

Source: The Rockefeller Foundation / The Goldman Sachs Foundation, Social Impact Assessment, P18, March 2003, New York City

Figure 2

Landscape of Capital Market

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Figure 3

Players in the Venture Philanthropy

Donors

Financing

VP (Venture Philanthropy) Organization

Financing
Non-financial support

Social return
Financial return recycled

Nonprofits (Investees)

Source: Establishing a Venture Philanthropy Organization in Europe (2010) EVPA Knowledge Centre

VP organization: Mostly set up as foundation funds or a structure that incorporates both. VP organizations provide tailored financing and non-financial support to the target nonprofits and expect a social return on investment. Any financial return is usually recycled into new investments.

Nonprofits: Small to medium-sized nonprofits at a critical stage in their development. They have some of the following characteristics:
- Strong growth potential
- Possibility to become financially sustainable
- Business models that can be replicated on a large scale to archive greater social impact
- Management that is receptive to hand-on

3) Characteristics

As described in the previous section, the characteristics of the bundle of practices making up venture philanthropy could be understood in the philanthropic field in the following way.

① Focus on organizational capacity-building

Venture philanthropists focus on building the operational capacity and long-term viability of the nonprofits rather than funding individual projects or programs of them. Therefore, they recognize the importance of funding core, operating costs to help these nonprofits achieve greater social impact and operational efficiency.

② Highly engaged relationship with nonprofits

Venture philanthropists have a close hands-on relationship with the nonprofits they support, driving innovative and scalable models of social change. Some may take board seats at these organizations and all are more intimately involved at strategic and operational levels than in many other forms of philanthropy.

③ Use of performance measures

Venture philanthropy is performance-based, placing emphasis on good business planning, measurable outcomes, achievement of milestones and high level of financial accountability/management competence.

④ Increased length of relationships

Venture philanthropist provide substantial and sustained financial support to a limited number of organizations. Support typically lasts three to five years, but timescales may be longer as venture philanthropy in the U.S. develops (Letts, Ryan & Grossman 2003). The venture philanthropist’s objectives include help-
ing the organization to become financially self-sustaining by the end of the funding period.

⑤ Increased amounts of funding with tailored financing

As in venture capital, venture philanthropists take an investment approach to determine the most appropriate financing for each organization. Depending on their own missions and the ventures they choose to support, venture philanthropists can operate across the spectrum of investment returns. Some offer non-returnable grants, thus accept a purely social return. While others use loan, mezzanine or quasi-equity finance, thus blending risk-adjusted financial and social returns (John 2006).

5. Case-study of Robert Enterprise Development Fund (REDF)

1) Background

The Robert Enterprise Development Fund (REDF) was launched in January 1997 as the successor fund to the Homeless Economic Development Fund (HEDF), which existed from 1990-1996. REDF was designed to implement the successful investment and management strategies HEDF had developed to support nonprofit-run (social-purpose) organizations. With seven years (1990-1996) of “research and development stage” and six years (1997-2002) of “implementing stage” what is now called venture philanthropy, REDF has experimented with many approaches to engaged grant-making, made many mistakes and learned a lot of lessons while helping a portfolio of nonprofit organizations grow and succeed along the way.

2) Profiles

The following REDF profile’s information and data consisting (1)-(5) was mostly obtained from the annual survey by Venture Philanthropy Partners, Venture Philanthropy 2002 (pp96-99) conducted by Venture Philanthropy Partners.

(1) Fund Description and Structure

Date of fund incorporation: 1997
Date of first grant: 1997
Fund mission:

The mission of REDF is to raise the standards of living and integrity in the nonprofit/philanthropic communities nationwide through development of innovative approaches to critical social issues. REDF pursues this mission by leveraging strategic partnerships that enable it to act as a catalyst for change through the application of business skills and practice.

• Implementing a venture capital approach to philanthropy by building the capacity of nonprofit organizations to deliver and sustain quality services to achieve their social mission.
• Bringing a portfolio of nonprofit organizations to definitive growth and market sustainability to provide transitional and permanent employment opportunities for very low-income/homeless individuals.
• Engaging the nonprofit and philanthropic field in dialogue through publishing, providing resources on the website participating in public forums and serving as a convener of interested players.

(2) Fund Management and Staffing

Lead executive: Melinda Tuan, Managing Director

Melinda Tuan co-founded REDF
with George Roberts and Jed Emerson, serving first as Associate Director from 1997 to 1999, then Managing Director from 2000 to 2003. During her tenure, REDF became known for its rigorous performance measurement practices providing the effectiveness of nonprofit organizations in creating lasting positive change in the lives of low-income/homeless individuals.

Full-time equivalent staff: Seven (as of October 2002)

(3) Grant Selection, Assistance and Engagement

Focus for grants: REDF grants focus on nonprofit organizations that are running social-purpose enterprises to provide transitional and permanent employment for very low-income/homeless individuals in the San Francisco Bay Area in the U.S.

Process for identifying grant recipients: REDF finds appropriate organizations through networking with funding colleagues, existing social-purpose enterprises, the community and other sources.

Criteria used to assess investment choices:
- Fit with REDF mission and goals
- Social-purpose-enterprise fit with nonprofit organization’s mission and goals
- Business impact (solid business plans and strong operating systems)
- Social Impact
- Ability of organization to benefit from REDF support

Anticipated length of relationship:
REDF’s investments/grants are designed as long-term relationships based on the business plan of social-purpose enterprise.

Exit phase planning process:
In case in which a social-purpose enterprise is expected to generate significant amounts of net income over time, REDF may exit that particular funding relationship, assuming that a enterprise can self-finance its continued growth and expansion.

Grant size range:
For the REDF 2001 portfolio, each organization receives on average $200,000-$300,000 each year, renewable based on the enterprise’s needs over the length of the funding relationship.

Amount of staff time per grant recipient per year: 400 hours

(4) Outcomes

Success measures for each investment/grant:
- Social Return on Investment (SROI) measures cost-savings to society and change in individuals’ lives as a result of social enterprise employment.
- Developed by REDF, Ongoing Assessment of Social Impact (OASIS) is a comprehensive, organization-wide management information system that provides timely, accurate information about the social impacts of an organization. Because of its customization for each organization, OASIS helps REDF
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Figure 4

**REDF’s Social Impact Assessment Efforts Address Four Perspectives**

**REDF Approaches to Measuring Impact**

<table>
<thead>
<tr>
<th>Measurement</th>
<th>INDIVIDUAL (enterprise employee)</th>
<th>ENTERPRISE (program)</th>
<th>ORGANIZATION</th>
<th>SOCIETY / COMMUNITY</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Demographics</td>
<td>Demographics</td>
<td>OASIS</td>
<td>SROI</td>
</tr>
<tr>
<td></td>
<td>Social outcomes</td>
<td>Social outcomes</td>
<td></td>
<td>Cost/benefits analysis</td>
</tr>
<tr>
<td></td>
<td>Stories</td>
<td>Financial results</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Desired Outcomes</td>
<td>Individual improved lives</td>
<td>Group of improved lives</td>
<td>Healthier, more effective organizations</td>
<td>Improved society</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>Dollar impact on community</td>
</tr>
<tr>
<td></td>
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<td></td>
<td></td>
<td>Cost-effective strategies</td>
</tr>
</tbody>
</table>

Source: The Rockefeller Foundation / The Goldman Sachs Foundation (March 26, 2003), Social Impact Assessment, P7, New York City

portfolio makes better decisions by giving them (See Figure 4).

Funding sources

(5) Funding sources

Investor/Donor involvement with recipients

The individual investor/donor meets regularly with REDF management to discuss how the portfolio is doing and annually or semiannually with REDF portfolio members.

Fund’s acceptance of private equity: No

3) REDF’s Challenge of Organizational Change toward Venture Philanthropy

(1) The Stages of Change

There are various ways to understand and analyze a process of organizational change, particularly as reflected in such a creative and complex developments as REDF. In this paper the author chose a practical framework presented by Michael Heifetz (Heifetz 1996). The reason is that his framework seems to be the most relevant and useful one for understanding the stages of change experienced by REDF which is a hybrid of for-profit and non-profit philosophies. However, the stages identified by Peter Drucker are just specific to nonprofit organizations and rather similar to Heifetz’s and include: Stage 1 Exploring the Environment; Stage 2 Synthesizing the Learning; Stage 3 Integrating the Learning; Stage 4 Internalizing the Learning and Creating Ownership; Stage 5 Applying the New Learning; Stage 6 Reflecting and Checking; Stage 7 Disseminating.

Regardless of which framework chosen, the most important point is that REDF engages in processes committed to ongoing organizational learning. Peter Drucker once observed that it is essential to learn from the process of change in order to be a successful innovator. Michael Heifetz presented a seven-stage process for effectively creating change in organizations. His framework for change and seven stages he enunciates are derived from extensive research and experience.
in analyzing organizational development in both business and government\(^{22}\).

Heifetz’s seven stages are as follows:

- **Stage 1** Choosing the Target
- **Stage 2** Setting Goals
- **Stage 3** Initiating Action
- **Stage 4** Making Connections
- **Stage 5** Re-Balancing to Accommodate the Change
- **Stage 6** Consolidating the Learning
- **Stage 7** Moving to the Next Cycle

Application of his seven-stage process into REDF’s case would be as follows.

In 1997 as the successor fund to HEDF, REDF chose its next target (Stage 1) by focusing on social purpose enterprise development and by choosing to implement a venture philanthropy approach to its funding. In establishing its investee portfolio, REDF set explicit goals for itself and worded with each investee to set its own business-specific goals (Stage 2). During the first year of REDF implementation, action was initiated (Stage 3). This action reflected the major components of venture capital practice:

1. Core financial investments were made in each organization,
2. Regular venture committee meetings were held,
3. Business assistance was provided,
4. Additional capital and business networking opportunities were made available,
5. Management information system was established\(^{23}\).

The REDF process appraisal\(^{24}\) was undertaken during the fourth stage of Heifetz’s seven-stage process, “Making Connections”. Examples of actions that were typically part of the fourth stage of change include ensuring everyone understands how the new approach affects them and scrutinizing the results of the initial change process to determine if the benefits of the change were real. The process appraisal was intended to provide formal feedback to all REDF stakeholders regarding the effectiveness of venture philanthropy approach and offer possible guidance to make refinements. It was also intended to lead Heifetz’s Stage 5 and Stage 6, “Re-Balancing to Accommodate change” and “Consolidating the Learning”.

(2) Implementing Venture Capital Approach to Philanthropy

The REDF approach to venture capital practice involves investments in a portfolio of San Francisco Bay Area nonprofit organizations. These investee organizations benefit from the components shown in the following \(1 - 8\)\(^{25}\). In particular, those components have played a critical role of raising the standards of excellence and integrity in the nonprofits engaged by REDF. The detailed analysis would be described in the following 3) Strategic Shifts.

1. Core Investments

The core financial support received by each organization in the portfolio comes in the form of an annual capacity-building grant ranging between $100,000 and $125,000. This grant enables the nonprofit to hire an enterprise manager and to invest in the human capital required to develop and oversee the execution of a business strategy as articulated in their 3-5 year business plan.

2. Capital Investments

REDF provides additional financing as dictated by each enterprise’s business plan and augments that financ-
ing with other charitable investments provided by individuals, corporations, and foundations interested in supporting the enterprise development goals.

3 Business Analyst

REDF partnered with Keystone Community Ventures, a local technical assistance organization specializing in nonprofit business development to assist the manager and Venture Committee in running the enterprises. The business analyst is involved in analyzing the strategic position of the business, critiquing the venture’s business plan, evaluating the financial statements (both actual and pro-forma) and providing an objective evaluation of the business. The business analyst directly assists management in conducting the analysis and assists also the managers in developing their own skill set in order to assure that knowledge transfer occurs and the future capacity of the organization to effectively manage the venture is developed.

4 Venture Committees

The Venture Committee consists of representatives from REDF, the nonprofit executive director, the enterprise manager and a Board member from the investee organization if necessary. The committee meets monthly to review financial and operational performance to identify areas of concern and to help ensure that these concerns are addressed in accordance with the enterprise’s business plan.

5 Farber Interns/Fellows

In partnership with The Phalarope Foundation and Students for Responsible Business, REDF established the Farber Interns and Fellows programs to leverage the talent of business school students in support of investee organizations.

6 Partners-for-Profit

Partners-for-Profit (PFP) was created to address the enterprises’ need for direct market access. The initiative was a focused working group of Bay Area business leaders representing a variety of industries. PFP provides REDF investees with more practical level of analysis and assistance. In addition to providing advice and guidance to investees, PFP members assist in connecting enterprise managers to professional networks within their industries and target markets. PFP also provides opportunities for the hands-on involvement of business people interested in making a meaningful and direct contribution to the process of social purpose enterprise creation and expansion.

7 Access to Technology

REDF equipped each enterprise with the basic hardware/software necessary to gain access to the web and communicate via e-mail. It partnered with a nonprofit computer consulting firm to build a private website for the REDF portfolio organization.

8 Outcome Measurement

In partnership with its investees, REDF developed and launched a web-based information system called WebTrack which was custom-designed using standard business MIS tools. It contracted with BTW Consultants to work with the enterprise managers in
developing indices of operational and social outcome against which future performance can be measured. WebTrack enabled enterprise managers and REDF to track monthly performance on both economic and social terms for the duration of the five-year initiative. REDF also creates the framework for analyzing the Social Return on Investment (SROI) on each enterprise and the REDF portfolio as a whole. Each of these components of the REDF venture philanthropy practice evolved over time and it is still seeking to improve the support it provides to its portfolio of nonprofit organizations. There are many ways in which each of these components relates to standard venture capital practice.

While there are clearly many similarities between venture capital practice and REDF’s venture philanthropy approach, there are also significant differences that should be highlighted as in the following categories.

1. **Risk Management**

Most venture capitalists ideally look to build a portfolio to minimize their risk and maximize their total return on investment. Although venture capitalists certainly end up backing many risky investments, they are clearly not looking to fund business that have a high likelihood of failure. By contrast, REDF’s approach is risky and limits financial returns. The purpose of the REDF portfolio enterprises is to employ individuals that private sector companies have already fired or would never hire. Businesses with jobs appropriate for people having little or problematic work experience are often in industries with low profit margins. REDF expects that at any given time, 70% of the enterprises in the portfolio would be profitable, while remaining 30% would be unprofitable at greater rates than planned. REDF’s approach to venture capital is also different in that REDF invests in nonprofit organizations with the capacity and capability to run social purpose enterprises that may be at different stages of development across many industry sectors. By contrast, the typical venture capital firm invests in a portfolio of companies at similar stages of development in a limited number of industries. For example, in 1999 the REDF portfolio consist of 23 different businesses in a range of industries from furniture manufacturing to retail and food services. These businesses are at various stages of development, ranging from start-ups to more mature businesses (more than 10 years). This necessarily increases the complexity of managing such a portfolio and requires a different skill set on the side of REDF’s management.

2. **Amount of Funding**

REDF supports a majority of the social purpose enterprises’ financial needs for start-up and ongoing operations; however, the social purpose enterprise is usually just one program of an entire agency whose funding needs far exceed that of enterprise. This makes for an tension in REDF’s work; similar to what would happen if a venture
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capitalist only funded one division of an existing company by the exclusion of other divisions.

As a summary of discussions so far, the author would like to provide the following chart (See Table 1), which making the comparisons among the traditional foundations such as Rockefeller and Carnegie Foundation, venture capital and REDF approach across relevant areas of practice. The fourth column provides examples of how REDF is applying a venture capital approach in each of these areas.

Table 1

<table>
<thead>
<tr>
<th>Relevant Practice</th>
<th>Foundations</th>
<th>Venture Capital</th>
<th>REDF Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organizational Capacity Building</td>
<td>Funding primarily for programs not personnel, infrastructure, overhead</td>
<td>Funding to build capacity to successfully execute business plan</td>
<td>Funding for organizational capacity: human capital, overhead, capital requirements, technology, etc.</td>
</tr>
<tr>
<td>Terms of Engagement</td>
<td>Arm's length, Large portfolios, Oversight</td>
<td>Joined at the hip, Small portfolios, Partnership</td>
<td>Input into management of enterprises through venture committee structure Small portfolio</td>
</tr>
<tr>
<td>Performance Measures</td>
<td>Funder: reward is in grant-making NPO: reward is in outcome</td>
<td>Clearly defined rewards (ROI) and risks for all</td>
<td>Social Return on Investment analysis (SROI)</td>
</tr>
<tr>
<td>Length of Relationship</td>
<td>1-3 years Arbitrary</td>
<td>5-7 years Linked to success</td>
<td>Minimum five-year horizon for Initiative</td>
</tr>
<tr>
<td>Risk Management</td>
<td>Low risk for foundation High risk for nonprofit organization Funds themselves not at risk (must be spent)</td>
<td>High degree of shared risk Funds are lost when projects fail</td>
<td>High managerial risk management through Business Analyst, Farber Interns/Fellows, Enterprise and Organizational risk management through portfolio diversification</td>
</tr>
<tr>
<td>Amount of Funding</td>
<td>Partial commitment provides small part of total needed capital. NPO management must continue fundraising independently.</td>
<td>Substantial commitment to provide significant capital and to help raise additional current and follow-on capital</td>
<td>Significant Core and Capital Investments Support in fundraising efforts through networking on enterprises' behalf</td>
</tr>
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4) Strategic Shifts and Future Challenges

We have now seen how REDF progressively moved through each level in its process of executing a venture philanthropy approach as indicated previously by Michael Heifetz’s seven stages of organizational change. At the same time, we can also observe the specific strategic shifts that REDF underwent as its structure evolved from a classic philanthropy model to a venture philanthropy model (See Table 2). More specifically, over the period of 1996 to 2002, REDF developed similar practices used in venture capital: focus on organizational capacity building, high engagement with grantees, use of performance measure, increased length of relationship, increased amount of funding and articulated risk orientation/exit strategies.

REDF’s challenges remain to be addressed and its success is not guaranteed by any means. It actually faces a crossroads: REDF could have maintained the defense of a foundations process that worked, but is not achieving its full potential. It could open up the process itself to examination and transformation. By having done so, it will be stronger, more effective and re-committed to moving forward to engage the future challenges in the philanthropy.

Table 2

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6. Research Implications and Conclusions

A lot of discussions on a venture philanthropy in the U.S. have been done, from its heralded beginning to the troubled times it fell on after the high-tech bubble and to its current state of affairs. However, a venture philanthropy accounts for only 0.2 percent of total US $ amount given in 2001\textsuperscript{[20]}, we have to ask the question “Why all the fuss on a venture philanthropy?” To answer this question the author has been making some research on this particular field, and has tentatively concluded that the attention given to a venture philanthropy might be attributed not to its actual results in practice, but to its creative impact on the philanthropic sector at large. The author also found that a venture philanthropy has influenced the practices within traditional foundations and more importantly developed a strategic shift across the philanthropic sector.

Furthermore, as a problem in philanthropy in the U.S., both foundations and nonprofits have acknowledged that the lack of standard principles/practices or a shar-
ing of best practices. As a head of prominent philanthropy organization once noted, Good Work Project 2002\textsuperscript{31}) also indicated that “Philanthropy is amazingly fractured… it is a fractured cottage industry… and it is still as random as it was 100 years ago”. Researchers on a venture philanthropy have argued that this problem stems from the philanthropic sector’s resistance to using the knowledge/skill contained in the management discipline. In 1974, P.F. Drucker stated that the service institution does not differ much from a business enterprise in any area other than its specific mission and it faces very similar challenges to make work productive and the workers achieving (Drucker 1974). However, the nonprofit sector has never brought in to the concept of management – because it has always viewed management theory as a tool of business rather than a tool of organizations. As an innovative contributor to nonprofit organizations, P.F. Drucker also observed of charitable organizations: they are not so much mismanaged as non-managed… they believe that spending money produces results. Their strength is that they have a clear focus. Their weakness is that they do not define results (Thomasen and Balda 2002).

However, for probably the first time in the last 100 years, many major philanthropic organizations have been attempting to achieve social ends by using the organizational tools that have served wealth-creation entities (Brower 2001). The author in this paper tries to examine that this shift has been partly fueled by the ideas and practices of venture philanthropy. As analyzed in the case of REDF, it is difficult to ignore the correlation between the rise of objective-based thinking and the rise of venture philanthropy from 1996 to 2002. It could be said that venture philanthropy at a minimum provided a base for the ongoing discussions on the importance of using management tools and establishing standardized good practices for the philanthropic sector.

It should also be noted that the author agree with the recent arguments that the individual pieces of venture philanthropy practice are really nothing new to philanthropy (Eisenberg 1999). Business moguls in the times of Rockefeller and Carnegie tried to bring business ideas to the philanthropic sector, which led to Carnegie’s famous statement that “it is easier to make money than it is to give it away\textsuperscript{32}). However, we can say that the venture philanthropists of today actually bring a different framework than the business moguls of the past, because the formers’ private sector ideas are grounded not just in business but also in management—a discipline of knowledge that did not exist in Rockefeller’s and Carnegie’s time.

Finally the author believes that a venture philanthropy is acting as a conduit between nonprofit organizations and the wealth of knowledge that resides in the management discipline—an impact that may promote the nonprofit sector to achieve social results which have never been seen before.
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Notes

4) SV2 was founded by Laura Arrillaga-Andreessen, a second-generation philanthropist; her father is one of the largest donors to Stanford University, having earned a fortune from owning much of the land in Silicon Valley, http://www.ssireview.org
7) Interviewed with Beate Truck, Managing Director, European Venture Philanthropy Association (EVPA) in Brussels, Belgium in September 2011 and http://www.evpa.eu.com
9) For the appropriateness of the case study as research methodology the author refers to Kodama, M. “Managing Organizational Boundaries: New Organizational Architecture through Teams of Boundaries, Information Science Studies No 20, pp12-13, Institute of Information Science, College of Commerce, Nihon University, 2011
10) Interviewed with Cynthia Gair, Portfolio Director, in August, 2007 and with Carla I. Javits, President in January, 2011, REDF. Both interviews were conducted at their office in San Francisco, California.
11) In addition to those annual statements, Investor Perspective Volume 1, Volume 2 and Volume 3 were provided as a kind of internal information of REDF’s activities/developments of venture philanthropy approach.
12) Venture Philanthropy Partner’s annual survey of organizations involved in venture philanthropy and high-engagement grant-making. These surveys were conducted in 2000, 2001 and 2002 for the improvement of effectiveness in the field. Venture Philanthropy Partners is a nonprofit social-investment organization that was created by the Morino Institute in partnership with Community Wealth Ventures.
13) Same interview with 7)
14) Philanthropy emerged initially as the transfer of cash or other assets in the form of grant. However, at present venture philanthropy funding instruments are broadly similar to those used in the commercial sphere. The available funding instruments for venture philanthropy organizations covers such financial spectrum; guarantee, loan, mezzanine-finance, equity and grant.
15) Major advisory services provided by philanthropy organizations to nonprofits generally include strategy consulting, marketing/communications, information technology, fund-raising strategy.
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financial management and accounting/legal service, human resources management, etc.

16) The Social Return on Investment (SROI) analysis was developed by REDF in 1996 for making grants to a portfolio of nonprofit agencies. SROI places a dollar value on ventures in the portfolio with social as well as market objectives, combining tools for cost-benefit analysis (used by economists) and tools of financial analysis. SROI has also been used by other organizations in a modified form.


19) REDF, http://www.redf.org/about-redf, particularly for their professional careers of M. Tuan and J. Emerson; enormous contribution for developments of venture philanthropy in the U.S.

20) same as for 16)

21) According to a brochure An Information OASIS redf (2002) prepared by REDF, “in partnership with several other funders, REDF launched the Ongoing Assessment of Social Impacts (OASIS) project in 1999 for the purpose of building customized, comprehensive, social management information system (MIS) within nonprofit organizations. REDF also reported that it was excited to follow the lead of four of their portfolio nonprofit organizations – Rubicon Programs, DVE, Inc., Golden Gate Community, Inc and Juma Ventures – in creating OASIS.

22) web@leading-change.com/Heifetz Halle Consulting Group

23) same as for 18)


25) same as for the above, pp4-6

26) The author acknowledges that such PFP activities based on the hands-on involvement of business people for the social purpose enterprises could be understood as “Pro Bono Publico” which means For Good Public.

27) same as for 16)


29) Please see the above case on REDF, pp11-19 for more detailed discussion of REDF’s venture capital approach in each of these practice areas.

30) According to a survey Venture Philanthropy 2002 (p10) by Venture Philanthropy Partners/ Community Wealth Ventures, venture philanthropy grants totaled $50 million in 2001, making up only 0.2% of all foundation grants.
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32) John D. Rockefeller founded the Rockefeller Foundation in 1913 with $35 million and Andrew Carnegie established the Carnegie Corporation of New York in 1911 with $125 million.

References

Schwab Foundation for Social Entrepreneurship (2011). The Social Investment Manual pp28-51. This manual is the first of its kind providing nonprofits a comprehensive guidebook on how to develop relationships with foundations. It was created with the research support of Technical University of Munich (TUM)

(要旨)

本稿で筆者は先ず、米国においてより良い市民社会の変革・構築へ向けて数多くの助成財団よりNPOに提供された多額の資金が、両者の関係が有効でないため十分に生かされていない
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経緯を指摘する。有効な関係作りの打開策として、ここ10数年来米国では助成財団が、ベンチャーフィランソロピーという新しい助成/投資の形態を生み出し、両者の有効な関係づくりに寄与している。ベンチャーフィランソロピーの基本的な考え方・実務は実は、ベンチャー企業への投資するベンチャーキャピタルの手法から多くの示唆を得ている。本稿の目的は、筆者の長年のベンチャーキャピタル投資の実務経験から得られた知見を活用しつつ、米国の革新的な助成財団の事例を詳細に分析することでベンチャーフィランソロピーが両者の良好な関係作りとソーシャルセクターの活性化に貢献してきたことを明らかにすることである。とりわけ筆者は、同事例がベンチャーフィランソロピーの助成財団とNPOの双方に、“マネジメント”と組織的展開の重要性を促したことも指摘している。