Impact on Economic/Operating Models in Organized Philanthropy

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IMPACT ON ECONOMIC/OPERATING MODELS IN ORGANIZED PHILANTHROPY:

Community Foundations

By Don Taylor

Community Foundations models have existed in much of the same paradigm since they began in 1915, nearly 100 years ago. That paradigm contains assumptions that no longer hold true as the world around them has changed. Unprecedented market conditions, new methods of philanthropic expression, an expanding definition of "community", a more mobile next generation—all have changed the environment for the community foundations and their relevancy. This work attempts to take a look at some of the pressures affecting economic and operating models of community foundations and suggests some options for changes to both.

Introduction

Community foundations have previously enjoyed a renaissance over the past 25 years--in the United States and around the world. By every measure, the field has expanded dramatically since the 1980's. Coinciding with a tax credit to incent permanent endowment, the State of Iowa, for example, currently has a community foundation in every county and receives regular distributions from the gaming industry. Internationally, work continues with the National Council of Foundations to introduce the community foundation model in other countries.

With the sudden and unexpected end of the stock market boom, however—first in 2003 and now more recently and more substantially in 2008—the climate for community foundations has shifted dramatically. Other external forces—demographic changes, regulation and accountability requirements, the emergence of commercial donor advised funds and changes in relationships between sectors—might presume the need for reinvention of both the economic and operating models.

Most urgent, many community foundations have seen their assets shrink by as much as one-third. Operating budgets for these organizations, based on fees to charitable assets under management, have shrunk in equal proportion. Cost structures and operating practices that were highly effective during the heyday of growth, no longer seem as viable. Each struggles to balance its budget through short-term compromises and stop-gap measures and have been forced to think about how to diversify revenue.

It is this 'perfect storm' that I believe creates an urgent need to examine existing notions of the business model for revision and/or re-invention. As early as 2005, in the introduction to their work On the Brink of New Promise—The Future of U.S. Community Foundations,[1] Bernholz, Fulton, and Kasper state:

> "U.S. community foundations have entered a pivotal new era. The generation ahead, from 2005 to 2025, will be marked by dynamic change…every individual community foundation—and the field as a whole—will face new choices. The path ahead is full of promise. Unfortunately, that promise will not be easily realized."

Background—Operating Model

Operating models of community foundations have traditionally been shaped by fees on products offered by this form of organized philanthropy. Prior to 1915, banks managed funds on behalf of wealthy families. Feeling less equipped to distribute charitable assets on behalf of these families, the community foundation was born—first in Cleveland in 1914. As the result of a banking industry 'convention'—community foundations began to spring up across the country albeit slowly. Minneapolis was among the first, established in 1915.

Currently and much like a bank, administrative fees are charged to permanent unrestricted assets, field of interest funds, scholarship programs, donor-advised funds, etc. and support the operation and, to a large extent, the mission for which the community foundation is organized. New community foundations are typically funded with seed capital from larger philanthropic sources—private foundations, individual donors, etc. Others without charitable capital have annual fund programs to build their operating revenue and support for programs until permanent endowment can be developed. Most work to build a portfolio of donor advised funds where families engage together in responsive philanthropy.

Most community foundations have built their fee structures on a trailing average of asset fund balances, usually expressed as basis points on a 3-5 year trailing asset average. Formerly, the premise was that operating budgets were "safe" from market fluctuations that might cause huge variances in market cycles. Recently, many saw erosion of up to 40% of their asset base. Previously, this model performed reasonably well in a solid and growing market combined with new assets through development strategies. Hedges against inflation (2-3% annually) plus

[1] Lucy Bernholz, Katherine Fulton, and Gabriel Kasper. On the Brink of New Promise—The Future of U.S. Community Foundations. (2005) Blueprint Research and Design, Inc. and Monitor Company Group, LLP, p.2.

spending policy on permanent assets (4-5%) remained reasonably consistent with market performances to incur further asset growth. The significant erosion of assets from market conditions and use of the trailing average creates significant problems for the operating budget for at least the next six years—even ***if*** market performance steadily improves.

The Perfect Storm—the Economy is Only One Factor

There are a number of new realities in the community foundation industry; some as a result of the economic downturn and other longer-term "trends" that are of particular importance to the notion of building a more sustainable operating model for community foundations.

- In a perfect world of steady and increased market performance, many community foundations built infrastructure and cost structures that are not affordable in the current economy. This includes staffing levels, in-house programs, investment in technology, etc. that all require sustained support. Some of these expenses are contained in important commitments to the community. Many have become fixed costs—and a challenge to operating budgets.
- The social consequences of a downturn in the market are substantial to most communities. Factors like unemployment, housing foreclosures, need for food and energy assistance place greater demand on existing charitable resources. For most, a majority of the community foundation assets come from donor advised funds. As a responsive community of philanthropists many donor advised funds (without enforceable spending policies) begin spending down resources in their funds to meet community needs. Combined with fewer gifts by donors to these same funds (less appreciated assets to contribute) creates a continued erosion of assets under management and--fewer fees to sustain operations.
- Highly visible national and international philanthropists are outspoken about wanting to demonstrate social change with their charitable capital during their lifetimes. Their collective voices have begun to influence fund holders' opinion about the validity of permanent endowment. Fund holders, with the ability to spend from principal and interest from the assets they advise, have begun to shorten their definition of "legacy" to include only their lifetimes or "spend downs" shortly after. Community foundations were founded on the fundamental notion of permanent endowment and intergenerational equity in giving—for the permanent good and welfare of the community they are organized to support. This change in philanthropic strategy threatens the existing operating model.
- The globalization of markets and the advent of an extremely mobile workforce challenge the definition of "community" and giving strategy for high net worth corporate leaders and their families. "Home-grown" corporate leaders are disappearing. Previously, these have been fund holders and trustees with strict allegiance to the welfare of a community that a) helped build their business; b) provided a high quality of life for a lifetime of company employees; and c) helped raise and nurture their families. "Community" can

now be defined by 2-3 different communities a CEO may live in while building his/her career. That challenges volunteer leadership models for community foundations that were important to the visibility and credibility of its mission, its products and its operations. It also lessens their personal financial commitment to building charitable assets on behalf of the community.

- A second generation of advisors to funds (created by their parents for community philanthropy and legacy) are highly mobile. Research is finding that their responsibility to advise from charitable assets diminishes as they begin to build their work lives and personal lives in other communities across the country and internationally. Parents who see and understand this phenomenon are disappointed that their children don't demonstrate interest for the community for which the fund was created. Some decide to spend down fund assets originally intended to be permanently endowed assets on behalf of the community.
- We are in an era of expanded regulation. In particular, Senator Charles Grassley (R-Iowa) leads a coalition of reformers looking at the nonprofit sector and opportunities afforded to both tax exempt organizations and those who contribute to them. In particular, reformers are looking at the tax benefits afforded to those able to amass charitable capital without requirements for distribution for public good. Permanent charitable capital and, especially donor advised funds—the mainstay of most community foundation operations—are under close scrutiny as a candidate for reform.

Building a New Operating Model— Begin by Understanding Costs

The dilemmas that community foundations face are not short-term in nature. The environment has changed profoundly over time on many dimensions including those previously mentioned. In addition, increased competition for donor advised funds, changing donor behavior, asset mix, pricing models and community expectations has demonstrated a need to better understand underlying costs in economic models. Rapid expansion in the "good years" concealed many structural budget problems, just as the painful contraction of the last 18 months has exaggerated them.

Community foundations have begun to better understand the costs of each of the many products and services they provide and in a way that allows them to allocate resources accordingly.[2] While a better methodology to understand cost structure exists, organizations are forced to balance the results with the realities of their charitable missions. Like most business enterprises, some products subsidize other products. More often in philanthropy, all are considered essential to mission.

In the course of analyzing cost study data among peer community foundations, one observes that for any problem that surfaced with any particular product, at least one foundation has already found a solution. Unfortunately understanding "peer" community foundations and

[2] Foundation Strategies Group, Strengthening Community Foundations: Redefining the Opportunities, October 2003.

their costs is complex. Each usually has a slightly different financial model and may operate in a community that may look substantially different from its comparative peers. Some community foundations, for example, may be the only organized philanthropy and solely organized by geography. Others have sister community foundations all in the same community that may be defined by geography, faith and/or gender. What is fortunate—is that many have begun to do a more thorough examination to better understand product mix, pricing and demand.

Reinventing the Community Foundation Model—Opportunities for Long-Term Relevancy

At a recent meeting of the management team in my organization, the CEO asked the question: "What would happen if our community foundation ceased to exist?" I believe it's the right—and also the first question to ask if we consider how we might "reinvent" how we do our work on behalf of the community and its citizens.

The following are considerations for how we might do our work differently and how the restructuring of work might influence our operating and economic models.

Opportunity I: Re-Focus Unrestricted Resources: Greater Community Change While Covering Full Costs

As mentioned, community foundations structure their work and operations quite differently from each other. Some, like the Rhode Island Community Foundation, exist only to create permanent charitable capital—ultimately for issues that they determine are important to the State. Others, like the Kansas City Community Foundation, create charitable capital through donor advised funds structured to support the operations of community nonprofits. Without a strategy to create permanent endowment, they don't set funding priorities for the community—donor advisors do that through their own giving. Still other community foundations have a combination of products that includes both donor advised funds and permanent funds. Rather than focus unrestricted revenue (from permanent charitable capital) on the community priorities its trustees might choose, they focus on program support to nonprofits in all areas of education, the arts, social services, etc., for the vitality and quality of life for all its residents.

The Minneapolis Foundation has a varied product line, but focuses much of its unrestricted charitable capital on efforts that create systemic change—change to public policy and/or advocacy on behalf of a community issue that leverages other resources and influences policy to do so. In its recent strategic planning effort (2009-2015) and in recognition of the need to focus limited resources, the Foundation's board of trustees defined for itself three community roles—leader, partner, and grant maker.

> LEADER—One of the most significant and traditional roles of a community foundation is to "lift up, build awareness" or "convene" around prominent community issues that deserve attention and could benefit from greater public support. (Resource needed:

Significant staff leadership and "enough" financial resources that demonstrate a serious leadership role.)

PARTNER—other community efforts may require building coalitions with other funding sources and policy makers to influence public opinion in order to create the right "space" to build a well informed policy. (Resource needed: Less staff leadership; some dollars just to be at the decision making table.)

GRANTMAKER—a more traditional role for community foundations, this resource allocation (dollars and sometimes technical expertise) is for strategies around community issues that are being addressed by its nonprofit partners. (Resource needed: significant dedicated staff time for competitive grant making, significant unrestricted resource to fund trustee/staff identified strategies)

Adding complexity to the reality of limited resources for these roles, The Minneapolis Foundation (and most other community foundations) has struggled to understand its outcome metrics. Where might the Foundation get the greatest ROI for its charitable dollar? Understanding how funding to one particular strategy has "moved the needle" is difficult; knowing that multiple funders may have contributed to multiple strategies trying to achieve the same outcome. What might one claim as ***their*** outcome for ***their*** charitable dollar? It's a critical measure to understand if the strategy deserves or requires additional resource because of its success.

Community foundations have traditionally enjoyed a certain "bully pulpit" that gives them permission to take a stand on community issues in a non-partisan way. Additionally, they often enjoy significant cachet that adds credibility to the message they are trying to elevate. It's my thought that the "bully pulpit" and cachet combination, along with demonstrated expertise in an issue area, is likely to create better outcomes more quickly.

I would like to assert that reinventing the operating model for our organization might mean dedicating more of our unrestricted resources to the Leader and Partner roles in our community and less to competitive grant making. Resources in those areas can affect the greatest change and return on investment for the community.

How does that help the operating model? Currently, we don't account for the expensive staff time in our operating budget--required in the leader/partner roles. Rather, we account only for the financial commitment we make to each strategy in order to be at the table. By re-allocating more of our grant making dollars to cover the most expensive staff time in a particular strategy, we cover our true cost of doing business in this area. Internal grant making to cover costs is a new way of funding meaningful and important work.

***Opportunity Two*:** Asset Development vs. Fundraising Role: It Costs Money to Raise Money

Community Foundations increasingly have become engaged in project "fundraising," a strategy that differs significantly from its traditional role in building permanent charitable capital (assets) for the eventual support of its unrestricted charitable mission. Fundraising bolsters the

amount of immediate charitable capital available for the foundation's defined roles, especially in a declining market. Target markets for additional resources are other organized philanthropy partners. They might include local and national private foundations, corporate foundations, local family foundations and donor advised fund holders.

The Boston Foundation, for example, runs an annual fundraising program that raises over a $1 million annually to support its community leadership activities. Minneapolis has fundraising targets for each of its competitive grant making strategies and next year will include a fund to support its activities in community leadership.

Raising money costs money. National standards for cost-to-raise-a-dollar vary significantly by methodology from major gift fundraising (the least) to special events (the most expensive). Community foundations are loathe to consider these nontraditional costs that use asset development staff for the purpose of fundraising. Assessing a cost to raise a dollar "fee" to fundraised assets might be another way to consider diversifying revenue and realizing true costs of doing business.

Opportunity Three: Add Fee-Based Value to the Commercial Sector's Donor Advised Fund Products

Fidelity Investments launched its Charitable Gift Fund in 1991. Since inception the fund has grown to $3 billion in assets and attracted like products built by its financial competitors. These low cost, high volume providers created considerable competition for charitable capital previously given to community foundations. Never intending to become experts in philanthropy, Fidelity used this strategy to retain assets under management and to round out its compendium of services to its clients. Relationships with clients through this product offering are purely transactional, offering accessible technology to its consumers for their responsive philanthropy.

What's missing is the value that community foundations can add to make responsive philanthropy more effective. Because we are close to the community, we have significant information about issues in the community. We can give advice about nonprofits in the community who do good work around various community issues and we can connect philanthropists with similar interests to each other to learn their effective grant making strategies. Information, advice and connections are something that community foundations could, collectively, package and sell to its low cost competitors for a fee. Not every client wants the "value add" but those who are engaged in significant philanthropy through their commercial funds, might be willing to pay for it.

Opportunity Four: What If?

Community Foundations have historically defined success by the amount of assets under management. I'd suggest that it's the wrong metric. Early in my life, my parents taught me the value of money and what it could do—for me and for others. They also quickly taught me that

if it wasn't in my check book or savings account, I couldn't spend it. I had to find other ways to find the outcome I wanted.

What if community foundations described their success—not by the amount of assets they held under management—but by the outcomes they created with what they had. Accordingly, understanding the costs associated with producing those outcomes would shape how it spent its resources toward the same—always understanding that the critical needs of any community will never be accomplished through philanthropy alone.

What's Next?

This essay identified some significant challenges to an existing paradigm in the work of community foundations. Those challenges affect both the way a community foundation operates its programs and how it funds it activity. The essay also suggests some beginning strategy about how to change both.

The future holds many things we cannot predict. A new generation of philanthropy is likely to create new surprises as influential as the introduction of the commercial donor advised fund was to this generation. Gaining better understanding of the impact a community foundation wants to make, how to measure it, the true cost of doing its business and building a more diversified economic model to fund it-- is critical to its future success.

About GHC Conversations

Annually, Gary Hubbell Consulting convenes and hosts a small hand-picked group of social sector professionals from throughout North America for three days of intense dialogue and critical thinking. We strive to create a thought-provoking, mind-opening, and stimulating conversation about philanthropy, organizational leadership, and the sector as a whole. This deep exploration of the nature and challenges of the philanthropic environment is intended to engage, inform, and inspire senior leaders to be catalysts for change in their own organizations and communities of influence. With each GHC Conversation, we seek to establish the seeds of a continuing and enriching network that nourishes us as individuals and helps each of us change how we converse, inspire, and seek new dimensions of philanthropy. This essay is one contributed for *Conversation 2010*.

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Don Taylor is a nationally recognized development professional. He is the vice president of development and client services for The Minneapolis Foundation, one of the nation's oldest and largest community foundations. The Foundation manages $710 million in assets, administers more than 950 charitable funds, and distributes approximately $36 million in grants each year. Prior to joining the Minneapolis Foundation, Don had a distinguished 12 year career as vice president and chief development officer of The Courage Center (Minneapolis). He completed a $17.5 million capital campaign and oversaw a $2.4 million vehicle gift program and a volunteer program with 2,500 volunteers. In past positions, Don helped secure funding for the University of Minnesota's Carlson School of Management and developed an alumni relations program, the annual fund, and a capital campaign program for the University of St. Thomas, School of Divinity.

He is the former chair and current board member of AFP (Association of Fundraising Professionals) US Foundation, and was awarded the 2005 "Professional Fundraiser" of the year by the AFP/Minnesota Chapter. Taylor received his B.A from the College of St. Theresa, Winona, Minnesota and an MBA from The University of St. Thomas, St. Paul, MN.

This is Don's first *GHC Conversation*.