CHAPTER 3

Navigating the Philanthropic Labyrinth

In the Social Entrepreneurship Framework laid out in the previous chapter, mobilizing resources to pursue the opportunity stands out as the primordial challenge. This is an especially daunting task in the social sector because the philanthropic marketplace abounds with imperfections that greatly complicate the mobilization of resources. In this chapter, we will begin by presenting a profile of the sources of philanthropic funds. We shall then turn to some of the recent innovations in the philanthropic capital marketplace that have emerged, in part in response to weaknesses in the traditional philanthropic marketplace. The case studies at the end of the chapter portray some of these newer approaches.

THE SOURCES OF PHILANTHROPIC FUNDING

The best documentation of the philanthropic marketplace in the United States is compiled annually in *Giving USA* by Indiana University's Center on Philanthropy and published by the Giving USA Foundation, AAFRC Trust for Philanthropy. Accordingly, the statistics indicated below are drawn from that source unless otherwise indicated.

Some of the salient features of the marketplace are the following:

- ***The pie is growing.*** In inflation-adjusted terms, total giving has grown from $5.4 billion in 1954 to $248.5 billion in 2004. In only 10 of the past 40 years did total giving decline. There is not great volatility in total giving, with the biggest annual decline being –5.4%, the largest increase 14.5%, and the average +2.8%.

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• ***However, as goes the economy, so goes the giving.*** The more money there is in their pockets and the more confidence they have in the economy, the more people and institutions give.[1] Individual giving as a percentage of personal income has fluctuated between 1.5% and 2.2%. Similarly, as a share of GDP, total individual and institutional giving since 1954 has ranged from 1.5% to 2.3%, moving up and down as the economy surges and recedes. For example, between 1973 and 1975, giving fell each year as the country slid into recession, and between 1996 and 2000, donations boomed as the stock market soared to record heights—and when the market crashed, giving fell into another three years of retrenchment. Thus, the entrepreneur's fund-raising task will vary in difficulty depending in part on the robustness of the economy.

• ***Individual donors are the principal capital providers.*** In 1964, they supplied 82.3% of total giving, slipping to 75.6% 40 years later: $187.9 billion in 2004. The vast majority of households in the United States give—between 70% and 80% of the population. The wealthy do not dominate this market: Fifty-nine percent of all giving comes from families earning less than $100,000 annually. But the rich do give mega gifts: The top 60 donors in 2004 gave $6.5 billion, and over 500 philanthropists made individual gifts in excess of $1 million. Bequests from individual estates account for another 8% of giving.

• ***Foundations are the major institutional givers.*** They accounted for 11.6% of 2004 giving, or $28.8 billion. In 1964, they provided only 6.1% of the giving pie, but over the past decade, they have more than doubled their giving and increased their share from 8.5% to 11.6%. Additionally, they have proliferated in number: from 21,877 in 1975 to 66,398 in 2003.[2] In the peak year 2000, on average, 17 new foundations were being formed every day. There are many more funding doors for entrepreneurs to knock on, and the foundations come in many different forms and sizes: In 2003, the nearly 59,000 independent foundations (of which 30,662 were family foundations) represented 88.8% of all foundations and accounted for 75.4% of foundation giving; corporate foundations were 3.8% of the total and provided 11.4%; community foundations were 1.1% and supplied 8.4%; operating foundations constituted 6.3% and represented 8.8% of foundation giving.[3] In addition to grants, many foundations offer program-related loans at submarket interest rates to nonprofits ($165 million in 2003). The amount foundations give is significantly tied to the value of their assets, causing variability with fluctuations in the stock markets in which those assets are invested. Between 1995 and 1999, foundations' assets grew in real terms an average of 15.3% per year, then slowed to 4.8% in 2000 and declined 6.5% and 8.3% the following two years, respectively. Foundation grants followed a similar pattern but with an approximate two-year lag and with the percentage changes being more

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moderate. Grantees' satisfaction with foundations is most dependent on the nature of the interaction: fairness, responsiveness, and comfort.[4]

• ***Businesses are smaller but significant givers, and they give more than cash.*** Corporate donations (from their foundations and from their other sources) accounted for 4.8% ($12 billion) of total 2004 giving, and around half of this comes in the form of in-kind goods or services rather than cash. Corporate giving in absolute inflation-adjusted terms has nearly tripled over the past four decades, but it fluctuates with profit levels and has a lag of about a year; annual giving amounts to about 1.1% of pretax profits.[5] Wal-Mart was the largest cash contributor ($170 million) in 2004, and Merck was the largest overall (cash and in-kind) contributor ($843 million) in 2003. However, businesses of all sizes contribute. Small social enterprises can match up with smaller, local businesses, not just giant corporations. Furthermore, businesses are also resource providers beyond their philanthropic giving. Many business interactions with nonprofits come out of the marketing and commercial sides and fall into the category of nonprofits' earned income activities, which are discussed in the next chapter.

THE USES OF PHILANTHROPIC FUNDING

Having looked at the supply side of the philanthropic marketplace, we flag some of the highlights on the demand side. Who gets how much in the social enterprise arena?

• ***Religion gets most, but all sectors are getting more.*** Religious organizations captured 35.5% of total 2004 giving. Just under half of all individual giving goes to religion; per capita annual giving to religion rose from $194 in 1964 to $300 in 2004. The remaining $100 billion of individual giving is still by far the major source for other sectors, all of which have experienced annual increases.

Giving is increasing faster than nonprofits are increasing. There has been explosive growth in the number of nonprofits being created by social entrepreneurs as was indicated in our opening chapter. From about 500,000 in 1954, the sector has expanded to around 1,400,000 in 2004. However, the philanthropic capital market has grown even faster, such that the average amount received per nonprofit has risen from $75,000 to $180,000. There are many more competitors chasing the philanthropic capital, but there are also more dollars to be captured.

Some sectors dominate the market, but smaller sectors are growing faster. If we remove donations to religious organizations from the capital supply, then

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the top three market share leaders are education (29.5%), health (19.1%), and human services (16.%), followed in the middle by arts, culture, and humanities (12.2%) and public–society benefit (11.3%).[6] The smallest slices of the charitable pie go to the environment (6.6%) and international affairs (4.6%). However, it is interesting to note that in terms of average annual growth rates, the ranking is almost the inverse: International is growing at 10.0%, environment 5.4%, public–society 5.2%, arts 4.7%, human services 1.5%, health 2.6%, and education 3.2%. Behind these multidecade averages there are also different dynamics. Human services appears to be the most starved sector with the lowest growth and also declines in 2002–2004. International has the greatest volatility, ranging from annual increases of 36.5% and declines of 8.8%. This may reflect the impact of natural or man-made disasters that trigger large-scale giving to meet the acute needs of emergencies. For example, following the December 26, 2004, tsunami disaster, of the more than $13.5 billion that was donated or pledged worldwide for emergency relief and reconstruction, 41% ($5.5 billion) came from private sources. The vast majority of these private donations came from the general public.[7]

Each sector faces different donor profiles, preferences, and practices. For example, in 2003, corporate foundations placed their top priority (27.8%) on education, especially K–12. Public–society benefits followed (25.5%), but this significantly reflects giving to the United Way as part of the long-standing practice of employee workplace giving. International, environment, and health were not targeted areas. Independent and community foundations placed their highest priorities on education (24.1%) and health (21.2%), followed by public–society and human services, both at around 15%. Family foundations represent about half of the foundation universe in numbers and aggregate giving. While they also placed their highest priority on education, they were less likely to give to health, public–society, or human services. The 1,000 or so small foundations tend to give in their local community, and their grants average about $10,000. The social entrepreneur needs to identify and tailor the fund-raising approach to these varying preferences.

The big nonprofits get most, but the smaller ones are growing faster. There are significant advantages that accrue to well-established, large nonprofits. Among these are long track records, high credibility, greater visibility, and larger fund-raising staffs. For example, the largest 30 environmental organizations capture 40% of the total giving to 10,000 environmental nonprofits. However, budding social entrepreneurs should not be totally intimidated by the big guys. Smaller nonprofits are speeding along the philanthropic highway. The average growth rate in 2004 over 2003 for small nonprofits (revenues under $1 million) was 8.31%, far outpacing the large nonprofits' (revenues above $20 million) 3.76%. Small organizations in human services and international,

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however, suffered declines of a little over 3%. Excluding these sectors would raise the small nonprofit growth rate to 13%. The smaller and start-up organizations have higher reliance on individual rather than institutional donors.

SOCIAL VENTURE PHILANTHROPY

During the late 1990s, a new entrant to the philanthropic marketplace emerged that has been referred to variously as social venture philanthropy, social venture capital, and high-engagement philanthropy. In part, this emerged as a response to what were deemed as some of the limitations of traditional sources of and approaches to philanthropy, both from foundations and individuals.[8] Funding from the traditional sources was generally on a short-term annual basis, obtained from many different donors with varying grant application and reporting requirements, restricted to programs or direct service rather than to strengthen organizational capacity, and very scarce for scaling up. Social enterprises cannot grow without increasing the funds invested in enabling the operation to function at higher and generally more complex levels. Getting bigger requires more cash for management functions and direct services. Growth can be fatal to an organization if it fails to also increase the cash flow. Creating the appropriate capital structure for each type of operation—with the right mix of assets and liabilities—is essential to sustainability.[9] Yet navigating this fragmented and demanding marketplace to get more funds, particularly unrestricted, is very time-consuming and costly. Executive directors of nonprofits have to spend inordinate amounts of time (up to 50% of their time is not unusual) in the capital-raising function compared to their corporate counterparts. The cost of funds mobilization for nonprofits is estimated at around 18% versus around 3% for businesses.[10]

As a way to overcome some of these problems, the idea emerged of utilizing the approach employed by venture capitalists in launching new businesses. In this venture philanthropy model, the donors engage more deeply with the recipient nonprofit organization. The relationship is seen as multiyear and ongoing. The capital disbursement is viewed more as an investment rather than a grant. There is a focus on strengthening the capability of the nonprofit to deliver on its mission more effectively. These social investors provide more than money. They deploy their other valuable assets such as skills, contacts, and credibility and allocate significant time and personal involvement to the nonprofit. Frequently, this engagement focuses on strategic planning and mobilizing resources that will enable the nonprofit to move to the next level of growth. These attributes can create a distinct relationship and dynamic between the social investor and the nonprofit compared with traditional donors. The deeper and longer commitment leads to more honest and transparent communications.

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Rather than having to try to tailor program design to the specific interests of traditional donors, which can cause the nonprofit to lose focus and deviate from its strategy, or attempt to hide problem areas for fear of losing funding, the social investor and the nonprofit partner can concentrate their energies on jointly overcoming barriers that arise. This does not mean that the relationship is less demanding. In many ways, it is more demanding for both sides; the investor has to give more along many dimensions and the nonprofit has to respond to higher performance expectations. Nonetheless, it can be more efficient in that the amount of time previously channeled to fund-raising gets reallocated to enhancing the management of the organization.

While there are many attractive features of social venture philanthropy, it is still in its infancy. As of 2002, about 42 venture philanthropy organizations had emerged in the United States with a total capitalization of about $400 million.[11] On average, these organizations were disbursing investments of about $50,000 per year, with about seven investing over $1 million annually. All were providing nonmonetary assistance, the value of which often exceeded the cash grants. The financing was for 4- to 7-year periods, frequently beginning with a 1-year planning grant.

One of the pioneers in this movement was Social Venture Partners. This organization was started in Seattle by entrepreneur Paul Brainerd, who had invented the Pagemaker software program and was the founder of the Aldus Corporation that was later sold to Adobe. Brainerd was interested in engaging in philanthropy but was not satisfied by the traditional approach. He was captivated by the idea of deploying some of the techniques of private venture capital with which he was quite familiar. In good social entrepreneurship form, he mobilized like-minded friends and created an organization in which each member (partner) would ante up $5,000 annually for a three-year period, and this aggregated total would be the capital fund that the partnership would use to invest in screened nonprofits. By 2003, the Seattle undertaking had been replicated in 23 other cities in the United States and Canada, engaging 1,500 social venture partners. The concept aims not only to mobilize capital but also to educate young professionals about high-engagement philanthropy with the goal that they will subsequently invest higher resource levels. Various giving circles that are more focused on particular causes or groups have also emerged. Examples of such affinity groups are the Global Fund for Women, Funders' Collaborative for Strong Latino Communities, and the San Francisco Bay Area Quality Childcare Initiative.[12] Scanning for such targeted funders should be top priority for social entrepreneurs because matching mission to donor interest is key to triggering investment.

New Profit, Inc. (NPI) provides another nonprofit social venture philanthropy model. It raised around $10 million in an evergreen fund from a small number of individual donors. With this capital base it has identified nonprofits

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that had successfully demonstrated their basic concepts and wanted to undertake replication and significant growth. A multiyear investment was made in each organization, and intensive management advisory services were provided, including serving on their investees' boards of directors. New Profit created a strategic alliance with the Monitor Company Group, a leading management consulting firm, which allocated consultants to work alongside NPI's professional staff in strengthening the clients' strategies and performance measurement systems and in expanding operations.

One of NPI's portfolio nonprofit organizations was Citizen's Schools, an after-school education program. President and Cofounder Eric Swartz had the following comment about the experience of working with New Profit and the Edna McConnell Clark Foundation, a traditional foundation that shifted its strategy and operations toward a venture philanthropy approach:

> Venture philanthropy has worked for us—big time. The clarity of our vision, tightness of our action plan, and power of our evaluation metrics are demonstrably greater than two years ago—and greater than they would have been without NPI and EMCF. In 18 months, we've more than doubled in size while improving quality and starting to replicate nationally. We're serving twice as many children and serving them better. Most importantly, we're building the capacity to continue to grow, improve, and creatively impact the field. Our venture partners trained us to use tools like the Balanced Scorecard (BSC) and introduced us to—and in several cases paid for—experts in the fields of evaluation, board development, technology, and business planning. They also provided me with an executive coach. In general, they motivated us to tighten up our strategic plan several turns more than we otherwise would have. They provided $3.75 million toward a $25 million, four-year growth plan—less than 20% of the total but vitally important to our momentum and ultimate success.[13]

Another pioneer in this field is Venture Philanthropy Partners (VPP), which was created in 2000 and mobilized $30 million from 30 technology and business leaders to create The Children's Learning Fund. This fund is targeted toward increasing the capacity of nonprofits in the Washington, D.C., area to serve the developmental and educational needs of children from low-income families. The fund provides cash investments and management assistance drawn from its network. VPP has also been a promoter of the very concept of high-engagement philanthropy, fostering ongoing research and learning about how to strengthen the philanthropic capital markets.[14]

Recently, many other successful businesspeople have made sizable allocations of their wealth to social investing, Bill Gates being the most prominent

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with the creation of the world's largest foundation and Warren Buffet's donation to the Gates Foundation as the largest charitable gift ever. The Bill and Melinda Gates Foundation stands out for its problem-solving focus. It selects a small number of critical and tenacious societal problems and then makes major, long-term investments aimed at achieving significant breakthroughs. Central to this approach is continual learning and adaptations based on ongoing findings, which is akin to what often happens in commercial venture capital. Such problems generally require multiple sets of distinctive competencies and resources and thereby call forth interorganizational collaborations. For example, the Gates Foundation partnered with the pharmaceutical company Merck and the government of Botswana to attack the AIDS epidemic ravaging that country. These lead investors attracted other partners from the United Nations, business, and philanthropic communities to create a coalition developing a multifaceted systemic solution that might also serve as a learning site for other countries' efforts.[15]

The venture philanthropy approach is also taking hold in other countries. For example, the Bridges Community Ventures and the U.K. Social Investment Taskforce are channeling venture capital into poor communities in England.

Many long-standing foundations continue to innovate in their approaches, with some having had impressive examples of venture philanthropy initiatives long before the term was invented. For example, the Ford Foundation played a key entrepreneurial role in creating and supporting the Local Initiatives Support Coalition (LISC), a national community development financial intermediary that became one of the pioneers in invigorating the national network of community development corporations (CDC) and community development financial intermediaries (CDFI). The efforts of LISC and The Enterprise Foundation, among others, led to the creation of a low-income housing tax credit that propelled the low-income housing market and movement. Although these actors in the social capital market face many challenges stemming from the consolidation and penetration of the larger financial services industry, the approximately 365 certified CDFIs have $4.6 billion in assets deployed about half in housing and half in other community investments.[16]

Major foundations are also increasingly utilizing their capital base differently. Over 300 foundations made around $300 million in Program Related Investments (PRIs) to nonprofits. These loans are made at below-market interest rates and are considered as part of the foundations' 5% of assets disbursement rate required by the Internal Revenue Service. This provides a new form of longer-term capital for nonprofits. A small number of foundations have opted to spend down their endowments rather than maintain operations in perpetuity. Other major foundations have made fundamental shifts in their strategies to have a more focused and deeper engagement with their clients.[17]

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Although Social Venture Philanthropy represents only a small fraction of the philanthropic capital market, it will continue to grow and evolve, and its practices will continue to influence the approaches of the larger traditional funding sources.

FINANCIAL CAPITAL MARKETS

The commercial capital markets have also begun to intersect with the social capital markets. Various funds and financial institutions have begun to offer investment opportunities to individuals and institutions that want their resources to both generate social good and provide them with an economic return. ShoreBank Corporation, a Chicago-based commercial bank, pioneered this approach in the 1970s with an explicitly dual economic and social goal. More recent entrants include Triodos Bank of Belgium and a variety of socially responsible investing mutual funds such as Calvert Group that screen companies based on their ethical, environmental, and social practices. Various new commercial venture capital firms, such as Generation Investment Management and Medley partners, are explicitly incorporating social and environmental criteria into their screening of companies because they deem those as enhancing the sustainability of the enterprises, thereby making them more attractive financial investments.

Partnering between philanthropic and commercial lenders to mobilize greater funds for social enterprises is also increasing. The Ford Foundation provided the community development nonprofit Self-Help with a grant of $50 million as a guarantee for mortgage loans. This enabled the group to parlay that into a $2 billion, five-year financing operation with Fannie Mae and 22 private lenders to enable home ownership for around 30,000 low-income families.[18]

Deutsche Bank mobilized $60 million from 25 other for-profit and nonprofit investors to create the Global Commercial Microfinance Consortium. This entity deposits cash as loan collateral in a bank that in turn issues a standby letter of credit to a local commercial bank. The letter-of-credit bank pays interest on the collateral deposit as well as a fee for the guarantee. The commercial bank also pays the letter-of-credit bank a fee for the guarantee, and then provides local currency loans to microfinance institutions double in amount of the letter of credit, thereby leveraging the original collateral guarantee.[19] *Compartamos* started out as an NGO doing microfinance lending in Mexico as part of the ACCION International network. It converted into a for-profit regulated financial intermediary and was able to raise 150 million pesos (about $15 million) through placements of notes with private investors. Subsequently, it raised another 500 million pesos with a public offering with a partial guarantee from the World Bank's International Finance Corporation.[20]

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ePHILANTHROPY

Another addition to the philanthropic arena was ushered in by the Internet boom of the 1990s. There are two sides of ePhilanthropy. The first is the Web-based social enterprises (WEBSEs) that exist in their entirety as Internet entities, be they dot.coms or dot.orgs. These entities proliferated in many forms: online giving directories, charity shopping malls, online charity auctions, click-to-donate sites, workplace giving systems, online donor-advised funds, alumni portals, nonprofit information hubs, and volunteer clearinghouses. As with their commercial sector counterparts, when the Internet bubble burst, the WEBSEs experienced a serious shakeout. Table 3.1 reveals that the population of these WEBSEs shrunk from 158 to 96, with only volunteer clearinghouses growing.

Table 3.1 Transactional WEBSE Shakeout

Transactional Enterprises	*2001–2006 % Change*
Charity Shopping Malls	–59
Click to Donate	–59
Online Auctions	–58
Alumni Portals	–50
Workplace Giving	–33
Online Giving Directions	–29
Nonprofit Information Hubs	–20
Online Donor-Advised Funds	–11
Volunteer Clearinghouses	+14

Numbers: 158 (2001) to 96 (2006).

In addition to the foregoing transactional WEBSEs, a group of support WEBSEs emerged to provide Web-based fund-raising and other services to operating nonprofit organizations. These too experienced a shakeout, as shown in Table 3.2.

These entities aim to integrate the Internet into the nonprofit sector and develop the capacity for online fund-raising within the nonprofit's operations.

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Table 3.2 Support WEBSE Shakeout

Support Enterprises	*2001–2006 % Change*
Application Service Providers	–50
Internet Infrastructure Support	–44
Software Providers	–28
Miscellaneous	–43

Numbers: 110 (2001) to 64 (2006).

Table 3.3 Giving Growth Rates

	2000–2001	*2001–2002*	*2002–2003*	*2003–2004*
Online Giving	22%	46%	63%	58%
Total Giving	0.6%	1.1%	1.3%	5.0%
Online Share	0.46%	0.67%	1.05%	1.60%

NOTE: Source of Total Giving Data: Giving USA 2005.

This is the other side of ePhilanthropy. While the sector lagged in its adoption of Web-based systems relative to the business world, the penetration was nearly universal in the larger nonprofits. Among the top 400 nonprofits, online giving entities rose from 50% in 2001 to 90% in 2005. While online giving is not yet 2% of total giving, its growth rates are explosive compared to total giving, as shown in Table 3.3. Total online giving is estimated to have reached $3 billion by 2004 (see Figure 3.1).

The potential for expanding online giving is significant. As can be seen from Figure 3.2, about 73% of the adult U.S. population uses the Internet regularly, and about 67% of the population donates, but only 7.7% donates online. Consequently, the opportunity is to expand this base of 16.6 million current online donors by getting increasing numbers of the 158 million online users to donate and of the 145 million donors to do so online. There are significant incentives for nonprofits to move in this direction because there is evidence that online givers make larger donations than offline donors.[21] Furthermore, the cost

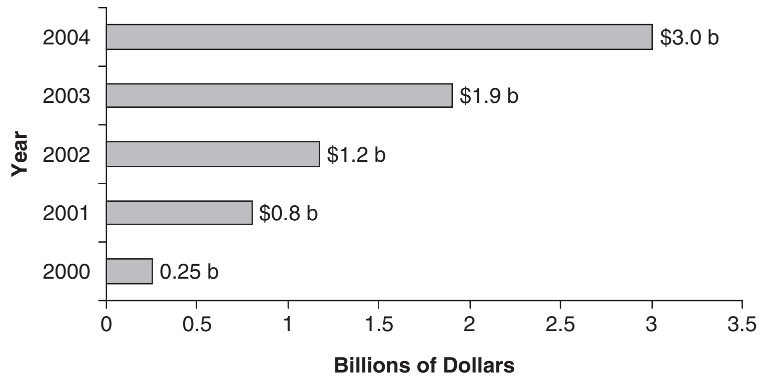

Figure 3.1 Annual Expansion in Online Giving

SOURCE: Used with permission of NPT Publishing Group.

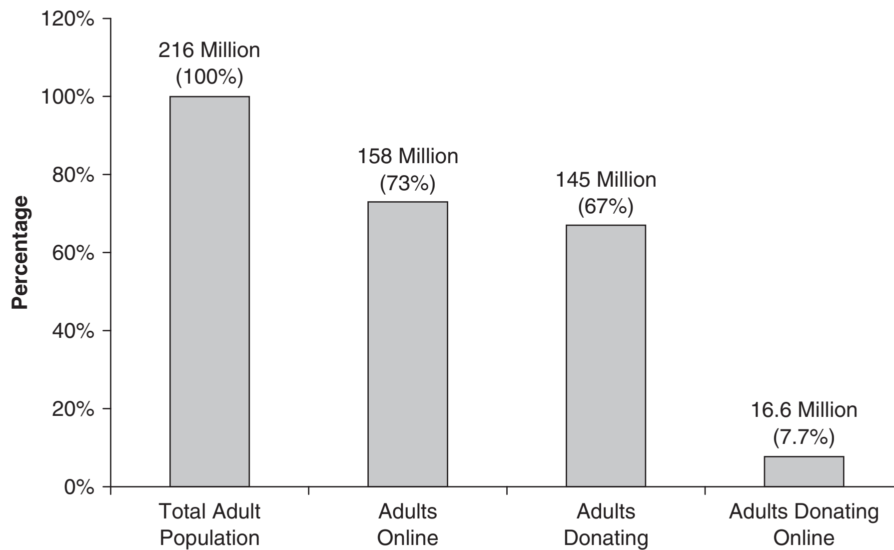

Figure 3.2 2004 ePhilanthropy Donations

SOURCE: Adapted from U.S. Census Bureau, *Current Population Reports*. From *Statistical Abstract of the United States* (2002); Giving USA Foundation (2006); www.pewinternet.org; Mary Malden, "Internet Penetration and Impact" (April 26, 2006); Kintera and Luth (June 2005), "Nonprofit Trend Report"; www.Kintera.com

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of reaching a potential donor online is only about 20% of the cost of direct mail or telemarketing. Currently, ePhilanthropy giving growth tracks the growth in eCommerce. As the consuming public continues to incorporate online shopping into their consumption behavior, it is likely that it will also be accompanied by increased online giving. Furthermore, when time is of the essence, donors increasingly turn to the Web. The share of giving done online rose from 11% after 9/11, to 25% after the Asian tsunami, to 50% after Hurricane Katrina. Donors consistently give more in response to highly publicized and emotionally evoking disasters, and the more they do this successfully online, the more they are likely to do so for nonemergency giving. Online givers give to all sectors, with religion dominating as it also does with offline individual giving.

Online giving is mobilizing increasing funds, with the average raised per nonprofit as surveyed by the *Chronicle of Philanthropy* rising from about $175,000 in 2000 to almost $1 million in 2004. While online giving still represents a small share of most nonprofits' total receipts, many are pursuing this new channel aggressively. Mercy Corps generated 35% of its giving online, United Way of Atlanta 15%, Heifer International 13%, and the American Lung Association 12%. National Multiple Sclerosis increased its online donation from $10 million in 2003 to $16.5 million in 2004, and the American Heart Association–Dallas jumped from $6 million in 2003 to $10 million in 2004.

What is also important to note is that 60% of donors check out the organization's Web site before making a donation, whether it is on- or offline. This reveals what is perhaps the real importance of the Internet: It opens up a powerful new avenue for nonprofits to relate to their constituencies. We offer the following observations as guidance for social entrepreneurs utilizing the Internet.

1. CONNECTIVITY: The Internet transcends space and time and creates connection opportunities; this is its transformative effect.
2. CONVENIENCE: It has the potential to radically reduce transaction barriers and costs, but this potential is realized only if the nonprofit makes its site highly user-friendly.
3. CAUSE: This is the motivational engine that attracts the donor; Web site technology can present the cause in captivating Technicolor™ form and beauty.
4. CONTENT: You have to have substance behind the sizzle, and that requires a dynamic ongoing knowledge and story production process.
5. CREDIBILITY: Trust is the nonprofit's key intangible asset, but for online givers, this requires security, privacy, and transparency built into the site's system.

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6. CONVERSION: This is the great power—converting the interested into the engaged, the e-mail newsletter reader into the donor, the donor into the advocate.
7. COMMUNITY: Durable conversion comes when the constituents feel they are a significant and engaged member of a group that has a common purpose and shared values, and this requires a site that enables two-way dialogue and multiple opportunities for interaction and contribution.
8. COMMITMENT: To obtain committed donors via the Internet, the non-profit must be committed to continually investing in its Internet presence.
9. CORE CAPABILITIES: This means that the Web should be viewed not as an administrative tool but as a strategically central capacity and mind-set.

MOBILIZING PEOPLE

As was emphasized in our Social Entrepreneurship Framework, the social entrepreneur must mobilize not only financial resources but also human capital. Beyond paid staff, volunteers play a vital part in the operations of social enterprises. In the United States in 2004, an estimated 109 million people (56% of all adults) provided 20 billion hours of volunteer labor valued at $225 billion.[22] In mobilizing people, social entrepreneurs should focus on four dimensions: role, recruiting, alignment, and managing of volunteers.

- ***Role:*** An important starting point is to establish clarity about where volunteers fit into the enterprise's value model. This requires an identification of the value added by volunteers. They are not a cost-free asset, so their benefits need to exceed the costs of acquiring and using them. While it is tempting to think of volunteers simply as a cheap labor source, they are usually much more. One way to sort out the benefits is to ask yourself: *Would I want them even if the organization had the funds to replace the volunteers with hired employees, and if so, why?* A healthy approach is to view volunteers as an integral part of the organization's human resources, rather than as a sideline activity.

- ***Recruiting:*** Just as a smart marketer thinks of distinct client segments for an organization's goods and services, so too should one segment potential sources of volunteers. For example, one can segment by age group, occupation, or institution. The Senior Corps of Retired Executives (SCORE) taps into the volunteer pool of more elder professionals interested in continuing to apply their management and technical skills in nonprofit organizations postretirement. Jumpstart recruits student volunteers to serve as mentors to disadvantaged preschoolers to

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prepare them to succeed when they enter school. For the United States as a whole, 59% of all teenagers volunteer.[23] Corporations have become a significant source of volunteers for many different nonprofit operations. Junior Achievement's model of providing in-school education about business depends critically on its corporate volunteers as teachers. In 2005, it mobilized 213,000 volunteers to work in 287,000 classes at 68,000 sites reaching over 7 million students. Many major corporations support community volunteering activities by their employees. Timberland, the leading boot company, provides its employees with up to 40 hours of paid time for community service of their choice. Of course, there are many other sources of volunteers. Over 400 communities in the United States and Canada have centers to facilitate the connection of interested volunteers and nonprofit organizations. As noted in the previous section, online volunteer clearinghouses were the only WEBSEs experiencing growth. Volunteermatch.org has made 2.5 million referrals. Networkforgood.org, founded by AOL, Cisco Systems, and Yahoo!, also includes opportunities for online volunteering. Regardless of the source, it is more powerful to approach recruiting as providing an opportunity rather than asking for a favor.

- ***Alignment:*** The contribution and engagement of volunteers will be greater when their assigned activities are aligned with their interests, skills, and time. People volunteer for a multitude of different reasons, so identifying their interests as part of the recruiting process is an important data point in the subsequent task of job design and assignment. Volunteers enrich the social enterprise's capability mix with the skills they bring, so matching specific organizational needs to those distinctive competencies will help maximize the value added of the volunteers, which in turn increases their motivation. It is also necessary to tailor the task to the time availability of the volunteer, both the absolute amount and the scheduling, so that they are compatible with the constraints imposed by the volunteers' other obligations.

- ***Managing:*** Volunteers should be managed as an integral part of the organization's personnel management system. It is more appropriate to view this as contracting individuals for designated jobs with specified responsibilities rather than bringing in volunteers. Nonetheless, because of their unpaid status, it is common for volunteers or paid staff to consider and treat each other as different. This can be counterproductive, so it is important to set forth very clear expectations up front and to execute performance accountability for the assigned responsibilities. Supervisory relationships, decision-making authority, and evaluation processes all need to be clearly delineated. While volunteers are not paid, they do require compensation in the form of psychological income. One should think through how this will be "paid" as carefully as one does for the organization's monetary compensation system. Fundamentally, one is

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valuing the volunteer's contribution through recognition and expression of appreciation. These can be both informal and formal, both private and public. But beyond issuing sincere thanks, it is probably most meaningful when one can attribute results to effort so that it is clear how that volunteer made a difference.

AT THE HEART OF IT ALL: THE VALUE PROPOSITION

The common central element critical to tapping any of the sources in the philanthropic capital market is the social entrepreneur's value proposition posited to the potential suppliers of funds, people, or other critical resources. Value creation is at the heart of the Social Entrepreneurship Framework that we presented in Chapter 2. It is the core motivator of the social entrepreneur and key to attracting most donors.

To construct the value proposition, the social entrepreneur needs to be able to set forth the organization's theory of change. Potential supporters want to know how their resources will be put to work to make a difference. One must delineate with clarity how the mobilization of various resources by the social enterprise can be deployed so as to bring about changes in the conditions that are causing the targeted problem such that it will be reduced or eliminated. This can be thought of as a logic model with resource inputs being transformed into activities that produce outputs that generate the desired outcomes. To be convincing, it has to be understandable, believable, and measurable. The measurability of outcomes is often surrounded with complexities, and these will be addressed more fully in Chapter 7. The goal is to demonstrate the "social return" that justifies supporters' investments and reveals mission attainment.

The foregoing stresses the analytical dimensions of the value proposition, but donors are also powerfully motivated by emotional dimensions. The social entrepreneur needs to capture hearts and minds. One way to accomplish this is to aim at creating empathy and sympathy for afflicted groups or issues. The hard data on the seriousness of a problem or the progress in alleviating it take on more meaning when connected with the human element through pictures and stories. It can be quite powerful if donors can interact directly with the groups being served. Most often this is not feasible, so one needs to have great skill in communicating and portraying the individuals being benefited. The Internet can be a powerful vehicle for doing this because of its multimedia formats and because it can transcend distance barriers and create communication linkages for donors with staff and clients in the field.

Resources are generally more forthcoming the more one can meet the supporters' motivations. This task is complicated because motivations are personal rather than standardized. While some will be interested in hard outcomes, others will be moved by human plight, yet others will be driven by their values,

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and some will be seeking social recognition, or some combination of all the above and others. Alignment can be elusive due to its heterogeneity. Just as businesses do consumer research, one should try to gather as much information as is feasible on supporters' orientation, but motivational understanding will be difficult to pin down with accuracy. This complication can be addressed in part by making one's case along many different dimensions, so that different donors can be reached across a motivational spectrum. This multifaceted approach also creates reinforcing arguments that make the whole case even more convincing.

One final cautionary note: The pressures facing chronically cash-starved nonprofits create an ever present temptation to adjust or invent programs to fit donors' interests. This carries with it the risk of diverting resources away from the mission or losing focus and diluting efforts by spreading resources across an ever broadening set of activities. Although the added cash may help meet short-term exigencies, mission drift and focus dilution will almost always come back to erode effectiveness.

CASE STUDIES

One important player in the philanthropic capital markets is the community foundation. These entities mobilize donations from the community and then invest them in projects aimed at bettering the community. As such, they are an intermediate financial institution. One of the leaders has been the Peninsula Community Foundation in the Silicon Valley area. After leading PCF through a period of tremendous growth, its president, Sterling Speirn, was faced with the prospect of a decline in the foundation's asset base for the first time in the foundation's history. In addition, the fact that commercial financial service companies had made significant inroads in the market for administering donor-advised funds (DAF) in recent years, an area that had been a key source for growth for community foundations for the past few decades, compelled Speirn to evaluate PCF's positioning in the market and to consider potential collaboration opportunities with these companies. Fidelity Investments had emerged as the major DAF competitor since it created its Fidelity Charitable Gift Fund in 1991, facilitating donations by its existing commercial clients. By 2005, it had 36,000 donors and had made $5.5 billion in grants to nonprofits.[24] In studying the PCF case, consider the following questions:

1. What are the key factors that enabled PCF to achieve its accomplishments to date?
2. How well do PCF's DAF services compare with other DAF options available to donors?

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In the venture philanthropy arena, one of the early organizations to emerge was the New Schools Venture Fund. John Doerr, a partner in the venture capital firm Kleiner Perkins Caufield & Byers, decided in 1999 to apply his venture capital experience to philanthropy. His particular interest and frustration was with public education. He created the New Schools Venture Fund, led by CEO Kim Smith, as a venture philanthropy vehicle to enable higher performance in the organizations they would fund. The case highlights ways in which the private sector venture capital model can be applied to the work of foundations. The following questions can guide your examination of the case.

1. How does Kim Smith balance the realities of the nonprofit sector with the elements of venture capital and the expectations of the 18 New School Partners?
2. How may the criteria for funding developed by New Schools be objectively applied to a nonprofit organization?
3. To what extent do venture capital methods apply to social enterprise?

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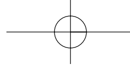

Case Study

Case Study 3.1

Peninsula Community Foundation

James E. Austin

Jane Wei-Skillern

Alison Berkley Wagonfeld

We are here to help realize and help shape the philanthropic dreams of individuals and organizations on the Peninsula and in Silicon Valley. Our customer is the community. We will serve the community and all who seek to improve and enhance it.

—Sterling Speirn, president of the Peninsula Community Foundation, "Grassroots and Treetops," 2002

It was January 2003 and Sterling Speirn, president of the Peninsula Community Foundation (PCF), had just been debriefed on the contract details for Merrill Lynch's new donor-advised fund. His team had been talking with Merrill for the past few months about Merrill's plan to partner with community foundations around the country. Speirn was interested to see how the Merrill partnership was going to unfold, as the financial firm was pursuing an innovative approach to the growing market for donor-advised funds.[2] Rather than pursuing Fidelity's strategy of replicating some of the key functions that had traditionally been performed by local community foundations, Merrill was seeking to partner with community foundations to leverage their collective knowledge about charitable giving, community needs, and local nonprofits. After months of discussions, Merrill was now looking for a solid commitment from PCF to be part of its network. Speirn was aware that this

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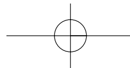

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partnership would require a substantial investment from PCF in terms of time, money, and forgone opportunities. He was still unsure if this was the best path for PCF, but it was time to make a decision. Merrill was expecting a final answer by the end of the week.

This option to partner with Merrill came at an interesting time for Speirn and his team, as PCF's business was at a critical inflection point. During the economic boom of the late 1990s, PCF's assets had more than tripled, from $150 million in 1996 to nearly half a billion dollars by year-end 2001. This growth had been fueled by the widespread adoption of donor-advised funds, on the one hand, and the meteoric rise of the public equity markets, on the other. But now, in the wake of the capital market correction that began in March 2000, and with a field of powerful new competitors in the donor-advised fund business, future asset growth at PCF was far from certain. Indeed, PCF's assets contracted in 2002 for the first time in its nearly 40-year history. This trend concerned Speirn, in part because PCF derived its operating budget from fees charged on assets under management. Beyond the issue of fees, the recessionary climate increased the number of local nonprofits seeking grants from PCF, and the team wanted to support as many as it could.

PCF had worked closely and collaboratively with financial institutions for many years. In fact, firms such as Merrill and Goldman Sachs were a vital aspect of PCF's channel sales strategy, by which new donors were cultivated with targeted outreach to financial advisors, private bankers, estate-planning attorneys, and other professionals. However, the proposed partnership with Merrill appeared to be different, presenting unique issues that needed to be carefully examined. As Speirn and his team worked on their strategic plan, they thought about all the challenges and opportunities that lay ahead. Speirn predicted that PCF would look very different in 10 years, and that transformation might well depend in large part on the strategic decisions to be taken now.

COMMUNITY FOUNDATIONS

The first community foundation was started in 1914 in Cleveland, Ohio, in order to create economies of scale by pooling the funds of various individuals who wanted to allocate money for charitable purposes. Several banks invested the assets, while a community board oversaw the grants. Other regions set up similar foundations, and throughout the rest of the 20th century, the number of foundations and the assets under management continued to grow. By 2003, there were over 600 community foundations, responsible for over $30 billion in assets.[3] In 2002, they disbursed grants of $2.4 billion, representing 8% of the grants made by all types of foundations. Community foundations were public charities [501(c)(3) organizations], and as such, they were regulated by the Internal Revenue Service (IRS) on a national level and by attorneys general at the state level. Beyond legal regulations, community foundations had developed and published standards for voluntary adoption.

Nearly all community foundations focused on a designated geographical area within a specific state and played an important role in helping to fund and support nonprofit

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organizations that offered key community services in that designated area. Traditionally, most community foundation assets were obtained through gifts to a foundation's endowment, and each foundation had its own rules governing how endowment gifts were granted to nonprofits. Many endowment donors trusted community foundations to grant money in the manner that the foundation thought was most beneficial; however, other donors gave endowment gifts with restrictions (e.g., nonprofits focused on education). Endowment gifts were tax deductible at the time of the gift, and donors relied on the community foundation to do the due diligence and monitoring associated with grantmaking to specific community organizations.

By the mid-1970s, some community foundations started offering donor-advised funds (DAFs)—vehicles that allowed donors to have greater influence over how their charitable dollars would be allocated. A DAF allowed donors to establish their own accounts within a larger foundation and make specific requests as to how dollars in that account would be distributed. The advice provided by the donor had to be nonbinding (i.e., the community foundation had the right to deny a request), but most requests were accepted.

DAFs were seen as a great alternative or addition to contributing to a foundation's endowment, starting a private foundation, or sending out individual checks to each charity. One advantage was that a donor could receive an immediate tax deduction when donating money to a DAF and then request that the money be gifted to specific charities over the following years. A second advantage was that the basis for the tax deduction was calculated at the asset's fair market value—a major benefit for gifts in the form of appreciated stock or real estate. For example, if a donor had $100,000 of stock that was purchased several years ago for $30,000, the donor could donate all $100,000 to a DAF and receive a tax write-off that year for the $100,000, up to 30% of his adjusted gross income (AGI).[4] Furthermore, the donor would not be required to pay capital gains taxes for the $70,000 profit from the sale of the stock. After making the onetime gift, the donor could then give $20,000 a year to various specified charities for each of the next five years.[5] In addition, the foundations that managed the donor-advised funds took care of issuing the individual checks and doing the paperwork. A third advantage—at least for donor-advised funds at community foundations—was that donors could use the foundation to learn about local community needs.

Donor-advised funds were also perceived as an alternative to private and independent foundations. A private foundation required a separate board of directors and extensive oversight responsibilities. Private foundations were also required to disburse at least 5% of their assets to nonprofits each year in order to retain their tax exemption, while DAFs had no minimum distribution requirements. Furthermore, donors were entitled to deduct their securities gifts to private foundations up to 20% of AGI and 30% of AGI for cash. For all of these reasons, a growing number of community foundations began offering donor-advised funds to complement their endowment funds. This trend contributed to the financial growth in community foundations—assets across all U.S. community foundations grew more than 1,000% from 1981 to 2001.

Most community foundations supported their operations by taking fees representing 0.5%–2.0% of assets under management.

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(Fees typically varied with the size and nature of a fund account.) Each foundation could choose how it wanted to invest its assets—some managed money on their own, and others outsourced this function to professional investment firms. Certain regions had only one community foundation (e.g., Boston), while other areas supported several. The San Francisco Bay Area was unique in that it had six community foundations. Although each covered a different set of counties, there was still some overlap. (See **Exhibit 3.1.1** for data covering the Bay Area community foundations.)

BACKGROUND AND HISTORY OF PCF

The Peninsula Community Foundation was founded in 1964 by Theodore and Frances Lilienthal. From 1974 to 1990, it was led by Executive Director Bill Somerville. Somerville was known for his creative approach to working with local nonprofits—he stressed the importance of establishing meaningful programs to help the community. Until 1989, the foundation had grown steadily from $400,000 in assets to $14 million. Many things changed in 1989 when an anonymous donor gave $25 million to PCF's endowment fund, propelling the foundation into one of the 25 largest community foundations in the country.

Shortly after receiving this gift, Somerville hired Speirn, whom he had known for several years, to help manage how the money would be granted to local nonprofits. Speirn had received his bachelor's degree from Stanford University and then went on to pursue a degree in law. He later decided to get a business degree as well, and in 1984, he started an MBA program at U.C. Berkeley. It was during a career night at school that he met Somerville. As Speirn recalled, "I remember hearing Bill speak and thinking 'that is what I want to do.' I introduced myself to him and asked if I could work as an intern at PCF during my second year at school. I believed that I had finally found the dream career." When Speirn left U.C. Berkeley, he took a job with Apple Computer as the manager of its national program for awarding grants to nonprofits. He enjoyed this position, but it ended abruptly in 1990 when Apple eliminated the division in an effort to cut costs. To Speirn's good fortune, the timing coincided with PCF's receipt of the $25 million gift. Somerville needed additional resources to help award grants, and he hired Speirn to be the program officer at PCF. However, shortly after Speirn started, Somerville decided to leave to start a new foundation. Within 15 months, Speirn was appointed to the position of president of PCF.

Speirn spent the next several years developing a plan for growing the foundation and made several changes to the seven-person team. (See **Exhibit 3.1.2** for management biographies.) In 1993, Speirn had the opportunity to attend the annual meeting for the top 25 community foundations in the country.[6] Speirn recalled: "I felt like the runt of the litter at the meeting, but it was a great learning experience. I sat there and absorbed everything I could. By the time I left, I had reached the conclusion that it would be hard to attract big endowment gifts if nobody knows you. I was convinced that donor-advised funds were going to play a major role in our growth."

In 1993, nearly all of PCF's assets were part of the endowment. Some gifts were

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Community Foundation—County or Counties Covered:

San Francisco Foundation—San Francisco, Alameda, Contra Costa, Marin, San Mateo

Peninsula Community Foundation—San Mateo and Santa Clara

Community Foundation Silicon Valley—Santa Clara and San Mateo

East Bay Community Foundation—Alameda and Contra Costa

Marin Community Foundation—Marin

Sonoma County Community Foundation—Sonoma

Bay Area Statistics (2000 Census):

County	*Population*	*Median Household Income*
Alameda	1,443,741	$55,946
Contra Costa	948,816	$63,675
Marin	247,289	$71,306
Napa	124,279	$51,738
San Francisco	776,733	$55,221
San Mateo	707,161	$70,819
Santa Clara	1,682,585	$74,335
Solano	394,542	$54,099

Exhibit 3.1.1 Map of Bay Area Community Foundations

SOURCE: www.bayareacensus.ca.gov/bayarea.htm, accessed May 29, 2003.

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Sterling Speirn, President Speirn joined PCF in 1990 and has since launched the Center for Venture Philanthropy; cofounded the Peninsula Partnership for Children, Youth, and Families; and led PCF as it has grown from $44 million to more than $470 million in total assets. Prior to starting at PCF, Speirn worked at Apple Computer where he led the company's national computer grants program for nearly four years. He holds a degree in political science from Stanford and a law degree from the University of Michigan. He also attended the MBA program at U.C. Berkeley. Speirn is chairman of the statewide League of California Community Foundations, serves on the Board of Directors of the American Leadership Forum of Silicon Valley and the Northern California Grantmakers, and is on the Board of Advisors of Pacific Community Ventures and the Entrepreneurs' Foundation.

Vera Bennett, Vice President, Finance and Administration Bennett is responsible for overseeing all foundation investments and for managing internal operations, accounting, and information systems. Prior to her 13-year tenure at PCF, Bennett spent a decade as the finance officer for Kainos, a facility for developmentally disabled adults in Redwood City, California. She received her B.S. in business administration with an emphasis in accounting from the College of Notre Dame in Belmont, California.

Ellen Clear, Vice President, Community Programs Clear is responsible for the foundation's community grantmaking to local nonprofit organizations. Prior to joining PCF in 1995, Clear worked with nonprofit agencies in San Francisco, Cambridge, Massachusetts, and Washington, D.C.; as a financial analyst for an investment bank in San Francisco; and as a newspaper reporter in Raleigh, North Carolina. Clear holds a master's in public policy from Harvard and a B.A. in political economy from U.C. Berkeley.

Ash McNeely, Vice President, Philanthropic Services McNeely is responsible for the planning and implementation of the foundation's business development, donor services, and communication strategies. Prior to her work with the foundation, she served for eight years in development and marketing roles in Bay Area theater companies. She has also held external relations positions at San Francisco State and U.C. Berkeley. McNeely received an MBA in nonprofit management from Golden Gate University and graduated Phi Beta Kappa from Vassar College.

Terence Mulligan, Director of Outreach, Philanthropic Services Mulligan joined the foundation staff in the summer of 2001. He is responsible for outreach to the professional advisor community. Prior to joining the foundation, he held a variety of customer-facing roles in both the public and private sectors, focusing on strategy and business development. Mulligan graduated summa cum laude with a B.A. in economics from U.C. Berkeley and holds an MBA from the Harvard Business School.

Exhibit 3.1.2 PCF Management Biographies

SOURCE: Adapted from the PCF Web site, May 2003.

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restricted to certain fields of interest, but for the most part, PCF had the authority to make grants as it deemed appropriate. Speirn explained, "Most community foundations grew up thinking that the primary goal was to get a big endowment and put together a process for giving it away." Speirn, on the other hand, believed that people should have the option "to give to PCF or through PCF." He continued, "We are here to put money to work today and in the future."

Speirn was pleased that his board supported these goals and encouraged him to grow the organization. In keeping with Somerville's strategy, Speirn wanted PCF to continue being creative and venturesome with the same spirit that had led PCF to describe its work as "venture philanthropy" in its 1985 annual report. (Venture philanthropy referred to applying certain practices of venture capital to the nonprofit community, such as investing the cash and expertise needed to build the capacity for high performance.) Speirn instituted a strong service ethic in the organization—he believed that PCF existed to serve the donors and nonprofits in the community. He hired people who "loved to talk with others about their philanthropic dreams." Speirn wanted PCF to be known for its cohesive organization and willingness to take risks. By 2002, the seven-person team had grown to 50 people focused on raising money, making grants, overseeing the finances, and managing special initiatives. The board continued playing an active role, serving on five different committees. (See **Exhibit 3.1.3** for a list of board members.)

In the late 1990s, PCF had expanded on its commitment to venture philanthropy and set up a special "Center for Venture Philanthropy." The center worked with local donors to incubate new philanthropic programs and sponsored chartered bus tours (venture vans) to highlight social issues in the community. Speirn also teamed with various organizations in San Mateo County to develop a special series of programs targeting young children in the region. Speirn believed that PCF enjoyed a unique position as the hub between people wanting to give money and nonprofits looking to get money. He prided himself on PCF's ability to work effectively with both groups.

PCF Grants

From 2000 to 2002, PCF granted between $62 million and $65 million each year to nonprofits. This was about twice the amount it had granted each year in 1998 and 1999, respectively. Approximately 80% of the grants were from DAFs, with the remainder coming from the endowment and other funds such as special-interest funds.[7] In 2002, 55% of DAF grants were directed to nonprofits in the community served by PCF (Santa Clara and San Mateo Counties), while approximately 30% went out of state. (See **Exhibit 3.1.4**.) In order to recommend a grant, donors with advised funds at PCF had the option of using the Internet, fax, or mail to send in their recommendations. PCF used a third-party technology supplier to provide its Internet capabilities, and approximately 40%–60% of donors used the Web service (PCF Connect) to manage their fund accounts.

PCF had developed eight portfolios representing the areas in which it donated the majority of the annual grants from its

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Patricia Bresee	***Linda R. Meier***
Retired Commissioner Superior Court of San Mateo Elected 1997	Community Volunteer Atherton Elected 1997
John H. Clinton, Jr.	***Karen V. H. Olson***
Retired Publisher Elected 1996	Independent Travel Consultant Bungey Travel, Palo Alto Appointed by President of Mills College, 1994
Bernadine Chuck Fong, Ph.D.	***Nancy J. Pedot***
President Foothill College, Los Altos Hills Elected 1999	Business Advisor/Consultant San Francisco Elected 1999
Susan Ford	***Jennifer Raiser***
President Sand Hill Foundation, Menlo Park Elected 1996	President Raiser Senior Services, San Mateo Elected 2001
Nylda Gemple, R.D./L.D.	***William L. Schwartz, M.D.***
Retired Public Health Administrator Hillsborough Elected 2001	Retired Internist, San Mateo Clinical Professor of Medicine, UCSF Samaritan House Medical Clinic Volunteer Elected 2000
Umang Gupta	***Donald H. Seiler, C.P.A.***
Chairman and CEO Keynote Systems, San Mateo Elected 2003	Founding Partner Seiler & Company, LLP, Redwood City Elected 1995
Charles “Chip” Huggins	***Warren E. “Ned” Spieker, Jr.***
President and CEO Joseph Schmidt Confections, San Francisco Elected 1999	Partner Spieker Partners, Menlo Park Elected 1999
Rick Jones	***Jane H. Williams***
Director E. Richard Jones Family Foundation San Mateo Elected 2002	President Sand Hill Advisors, Palo Alto Elected 2001
Olivia G. Martinez, Ed.D.	
Vice President, Institutional Development Canada College, Redwood City Trustee, Sequoia Union High School District Elected 1995	

Exhibit 3.1.3 PCF Board of Directors

SOURCE: PCF.

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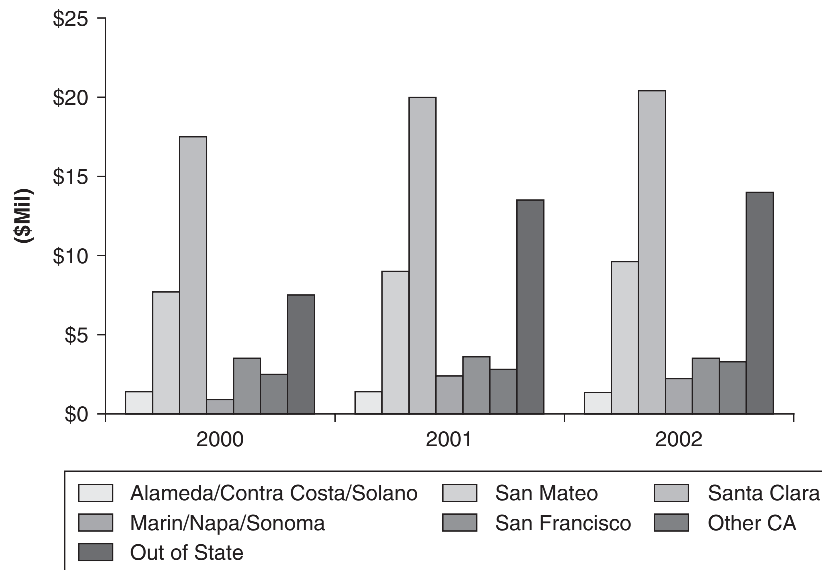

Exhibit 3.1.4 Geographical Distribution of Donor-Advised Grants at PCF

SOURCE: PCF.

endowment. These included First Five Years, In School & Out of School, Supporting Families, Health & Wellness, Strengthening Nonprofits, Community Building, Arts & Culture, and Environment. (See **Exhibit 3.1.5** for a detailed description of each category.) Nonprofits in each of these categories applied for grants, and the board helped choose the recipients of the larger endowment gifts. In 2002, PCF granted approximately $7 million to local nonprofits from its endowment fund.

PCF also assembled narratives describing causes that its staff found particularly worthwhile and shared these with donors interested in hearing about local philanthropic opportunities. PCF's Community Programs and Philanthropic Services departments together offered a program called Synergy Connection that enabled PCF to offer tangible and timely ideas to donors in a consistent manner. (See **Exhibit 3.1.6** for an example of a synergy listing.) As Ellen Clear, PCF's vice president of community programs, explained, "We believe that we can play an effective role of 'matchmaker' between donors who want to hear about opportunities and local nonprofits that are looking for donations for a specific need." In response to a charitable interest survey that PCF sent to its donors

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The First Five Years This portfolio supports early childhood programs that promote positive child development by maximizing healthy physical and emotional development of infants and young children; nurturing a young child's love of reading and learning; and investing in quality child care, including professional development for child care workers and increasing the supply of child care for low-income families.

In and Out of School The In School & Out of School Portfolio invests in programs that promote educational achievement and positive personal development in school-age children and youth, particularly those in low-income families. This portfolio supports a broad range of "in-school" strategies aimed at increasing schools' capacities to foster students' academic success. These include interventions that provide extra support and targeted instruction for students who need it, teacher professional development, and programs that encourage family participation in school. This portfolio also supports "out-of-school" strategies that provide homework assistance and academic support, enrichment activities, and programs that address working parents' need for safe, supervised activities outside of school.

Building Community The Community Building Portfolio represents a spectrum of different funding strategies to support community building efforts: "street philanthropy" (being streetwise, able to react quickly and close to the pulse of community issues and organizations), civic engagement (building residents' involvement and connectedness to one another and their community institutions), and a comprehensive systems approach (impacting root causes of problems and influencing an entire service delivery system). Much of the work in this portfolio is supported by a series of private and public partnerships—some that catalyze relationships, others that bridge social networks, and all that strengthen communities.

Supporting Families The Supporting Families Portfolio seeks to strengthen the human services safety net for low-income families and to help families of all kinds exercise their rights, fulfill their responsibilities, and realize their full economic and social potential. Our grantmaking supports nonprofit organizations that help low-income and disadvantaged children and adults meet basic needs for food, clothing, and emergency and permanent housing. The portfolio also targets organizations that address family violence, promote expanded opportunity for people with disabilities, and serve adults seeking to improve their economic prospects through literacy and employment development.

Strengthening Nonprofits The Strengthening Nonprofits Portfolio supports the visions and infrastructures of nonprofit organizations in our community. The goal is to help exemplary programs continue to thrive within healthy organizations and to promote a stimulating nonprofit environment where exciting ideas can easily develop. This portfolio makes selected grants to foster leadership through staff and board development, strengthen organizations' fund-raising and development programs, support capital campaigns, build the capacity of organizations to improve or expand their services and operations, and build the capacity of the sector as a whole.

Health & Wellness The Health & Wellness Portfolio promotes a healthy community and strengthens the health-care safety net for uninsured and underserved people. The foundation works in partnership with community-based organizations that target the health needs of diverse populations and geographic areas as well as public agencies that protect public health and ensure the availability of care for all. This portfolio supports strategies that prevent illness and promote health, enhance access to health services, initiate or strengthen services that promote recovery from illness and substance abuse, and involve community members in addressing local health needs.

Exhibit 3.1.5 *(Continued)*

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Arts & Culture The Arts & Culture Portfolio offers opportunities to artists and communities whose works we might not otherwise see and hear. We seek to increase artistic expression through support of individual artists, arts organizations, and arts programs for children and youth. Strategies supported by this portfolio include increasing the creation and performance of art forms reflecting the diversity of our community; supporting programs that offer children and youth experiences in the arts, both as participants and as audience members; and assisting organizations seeking to increase the venues for art exhibition and performances on the peninsula.

Environment San Mateo and Santa Clara Counties have developed amid diverse ecosystems of biological richness including a marine coast, bay wetlands, fertile agricultural lands, and Pacific-temperate rain forests. The Environment Portfolio seeks to foster greater awareness of, access to, and stewardship of the natural treasures that grace the peninsula and Silicon Valley.

Exhibit 3.1.5 Overview of PCF Portfolios

SOURCE: Adapted from PCF published materials.

in 2002, 32% of donors said they were interested in learning more about donor opportunities. PCF's recommendations generated $2.9 million of donations from DAFs in 2002—approximately 6% of all DAF grants at PCF that year. Speirn explained, "While this may seem low relative to all DAF donations, it increased our targeted local grantmaking by 40% to 45%. It had the same effect as adding $60 million to our endowment."

Clear managed a team of 11 staff, who were entirely focused on knowing all about the hundreds of nonprofits in the community. (See **Exhibit 3.1.7** for a PCF organizational chart.) Prior to recommending a nonprofit or approving a grant, Clear's team assessed the organization's management and program structure and reviewed its financials. Her team also compared nonprofits in various fields in order to determine which were being run the most effectively. Clear believed that "PCF was in the unique position of knowing more about all the local nonprofits and all the needs of this community than any other organization. This is one of the benefits for donors who give money to us." It was this local knowledge that supported the synergy program and differentiated PCF from its commercial competitors. In a survey of PCF donors conducted in 2001, 72% of fund holders said they had recommended PCF to others. As Mike Spence, former dean of the Stanford Graduate School of Business, said, "PCF makes it easy to see what opportunities are worthwhile." Susan Packard Orr, a PCF donor and the chairman of the David and Lucile Packard Foundation, reinforced this sentiment: "I enjoy working with PCF because I know the depth of experience they bring to the table. There are few community foundations in the country that have pioneered as many initiatives and partnerships."

PCF Financials and Business Model

As of December 31, 2002, PCF had 583 fund accounts totaling $448 million of assets under management, making it the 16thlargest community foundation in the country in terms of assets. Of the total assets, approximately $275 million (378 fund accounts) represented DAFs, $101

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Synergy Connection:

Community Education Center

Type of Request: General operating support

Organization Mission/Background

The Community Education Center (CEC) offers a quality preschool experience in English and Spanish for low-income children in the Fair Oaks community adjacent to Redwood City. CEC was founded in 1964 by parents affiliated with the Carlmont Parents' Cooperative Nursery School in Belmont who recognized the need for a nursery school to serve the Spanish-speaking community. The goal of the half-day program is to provide each child with a sound foundation that will encourage future success in school and in life.

Project Description/Needs Statement

CEC can serve 96 children at two sites in morning and afternoon sessions that last three hours. Children ages 3 years and 9 months to 5 years are eligible to attend, and priority is given to those children who will enroll in kindergarten the following school year. The majority of the children come from monolingual Spanish-speaking families. Children participate in a variety of meaningful activities designed to help them develop abstract thinking, social skills, and an understanding of other cultures.

Although CEC has been in operation for nearly four decades, several things have occurred in recent years to cause its financial situation to change dramatically. CEC qualifies as a state-funded preschool, but the state reimbursement rate is far too low to adequately finance CEC's operations, particularly given the cost of operating on the peninsula. The United Way had provided core operating support of $30,000 until five years ago and then, when its funding priorities changed, began reducing its contribution until it ceased completely two years ago. CEC's executive director was seriously ill during the 2000–2001 fiscal year and was not able to keep enrollment at capacity. This current school year, CEC has operated without an executive director in an effort to reduce costs. Two members of the board of directors have worked intensely and effectively with the program coordinator to keep the school running smoothly, and all of the eight board members have been actively fund-raising.

Community Impact

CEC is well integrated into the Fair Oaks community, and parents trust the program and find the idea of sending their young children to school less intimidating. Parents are encouraged to become involved in their child's education and give their child a head start in school that will last a lifetime. Parents must volunteer in the classroom each month, and parent education courses are offered each month. CEC board members and administrators estimate that while more than 90% of the children entering the program do not speak English, more than 75% understand and speak English upon graduation. Younger children often repeat the program a second year.

Budget/Specific Request From PCF

The Community Education Center must raise $22,000 to finance its program through June 2002. Board members are actively seeking foundation support and individual donors to help the program regain financial stability. A contribution of $4,000 pays the cost of enrollment for one child for the school year.

Exhibit 3.1.6 Sample Synergy Listing

SOURCE: PCF.

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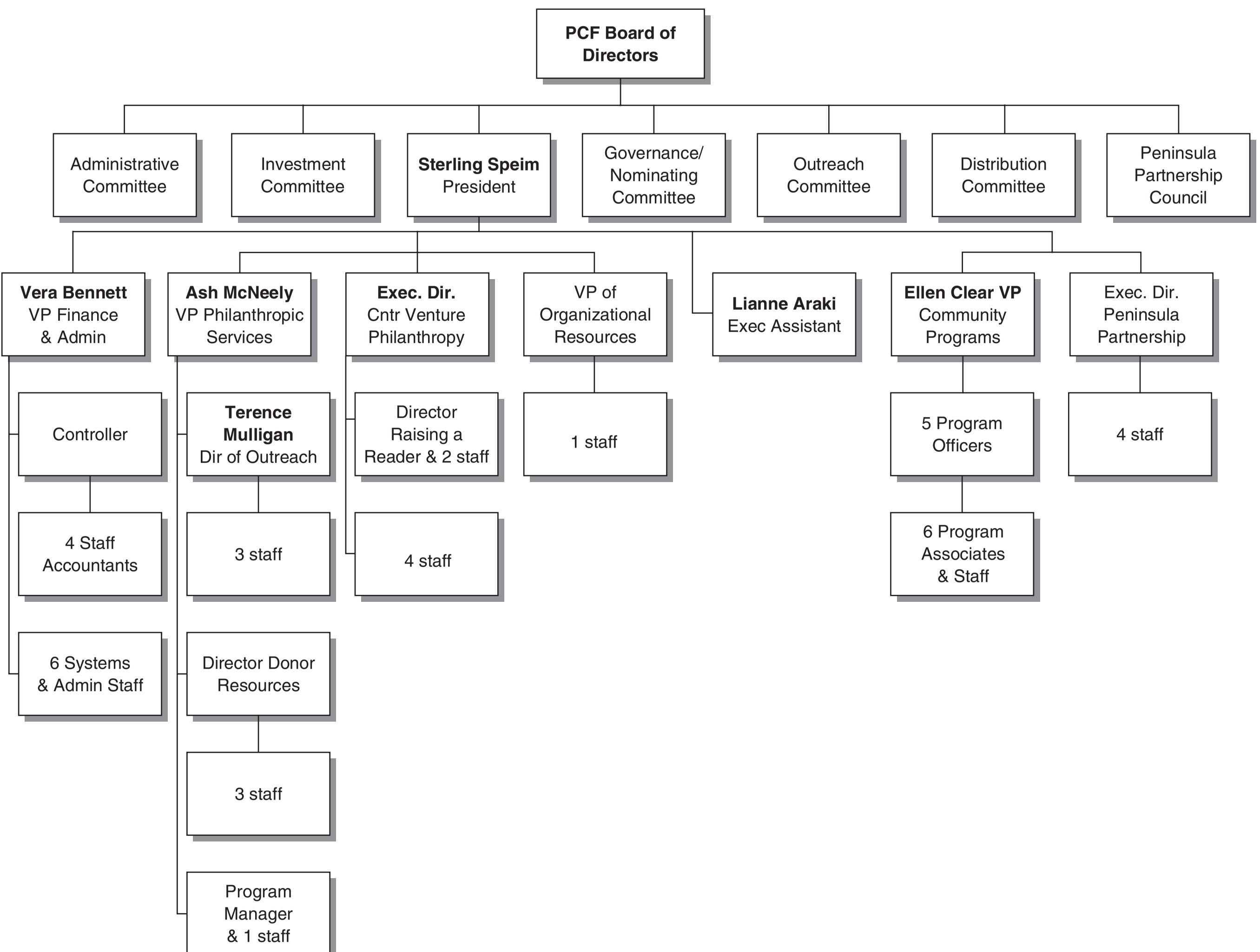

Exhibit 3.1.7 PCF Organizational Chart

SOURCE: Adapted from organizational chart provided by PCF.

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million represented the endowment, and the remainder was split among other smaller funds such as special-interest funds, scholarships, and charitable remainder trusts. (See **Exhibit 3.1.8** for assets by fund type from 1992 to 2002.) Gifts to PCF peaked in 2000 with $231 million coming in, $217 million of which was allocated to DAFs. (See **Exhibit 3.1.9**.) In 2000, about half of the incoming donations to PCF were from new donors establishing 130 new fund accounts and half from previous donors. PCF's minimum requirement to open a DAF was $5,000.

Between January 1, 2000, and December 31, 2001, PCF received 237 donor-advised fund gifts over $50,000. Of these, 48 (20%)

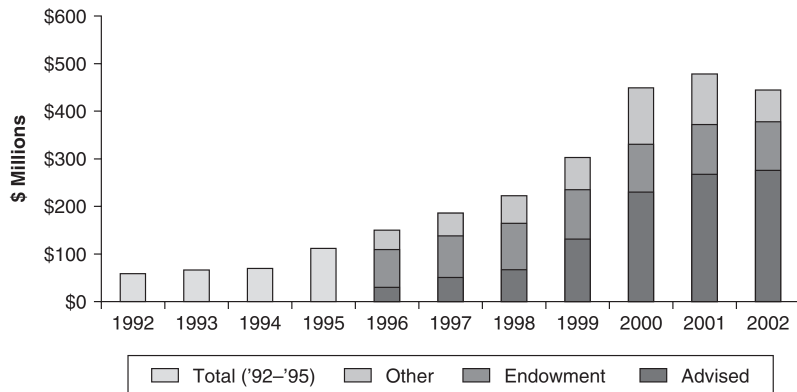


Exhibit 3.1.8 PCF Assets by Fund Type (1992–2002)

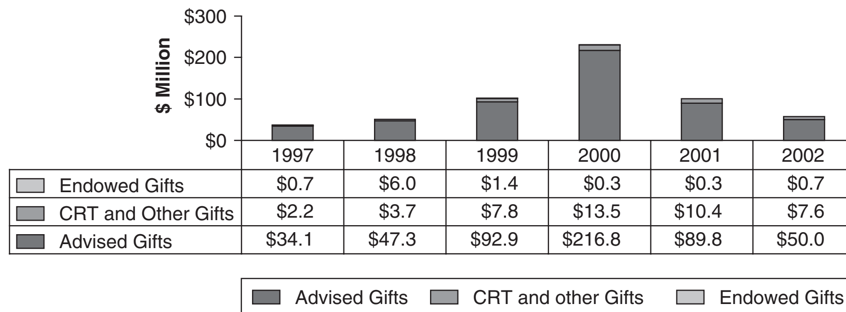
SOURCE: Adapted from information provided by PCF.

NOTES: Fund Type Definitions:

Other: Includes special-interest funds, charitable remainder trusts (CRTs).

Endowment: Represents money donated to PCF's primary endowment and available for general grant purposes.

Advised: Represents PCF's donor-advised funds.



	1997	1998	1999	2000	2001	2002
Endowed Gifts	$0.7	$6.0	$1.4	$0.3	$0.3	$0.7
CRT and Other Gifts	$2.2	$3.7	$7.8	$13.5	$10.4	$7.6
Advised Gifts	$34.1	$47.3	$92.9	$216.8	$89.8	$50.0

Exhibit 3.1.9 Gifts to PCF by Type of Fund (1997–2002)

SOURCE: Data provided by PCF.

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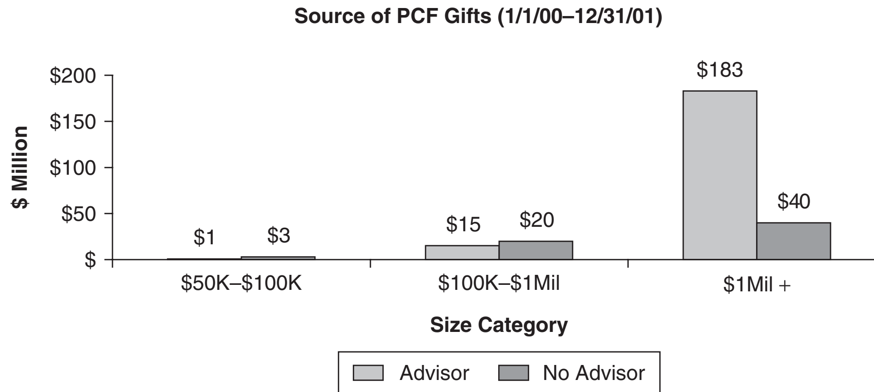

Exhibit 3.1.10 Source and Value of PCF Gifts by Advisor (January 2000–December 2001)

SOURCE: Data provided by PCF.

NOTE: Advisors include estate-planning attorneys, wealth-management advisors, accountants, financial planners, and trust officers.

represented 85% of the total dollar value. PCF found that 82% of its donors who set up fund accounts over $1 million were referred by advisors such as estate-planning attorneys, wealth-management advisors, accountants, financial planners, and trust officers. (See **Exhibit 3.1.10**.) These advisors were collectively seen as a critical channel to reach new donors. In 2001, PCF had hired Terence Mulligan (HBS '96) as the director of outreach to develop relationships with local professional advisors from firms such as Merrill Lynch, Goldman Sachs, and the region's many law and CPA firms. One of his goals was to highlight the services that PCF could provide to high-net-worth families. This was an important means of finding new donors, as PCF did little in the way of advertising. Speirn believed that Bay Area donors often chose a particular community foundation based on the quality of local services provided and the foundation's reputation. PCF did some direct mail and public relations targeted at affluent families in the region, but word of mouth also played an important role in building PCF's presence in the community.

In connection with gifting assets to PCF, donors were able to recommend how they wanted the money invested. The foundation offered four portfolio choices: cash, fixed income, equities, and a balanced "socially responsible" portfolio.[8] Within each category, PCF selected a pool of three to five mutual funds from different investment firms. For example, the fixed-income pool consisted of the Vanguard Short-Term Corporate Fund Admiral Shares, the Merrill Lynch Corporate Intermediate Term Fund, and the PIMCO Total Return Institutional Fund. The funds in each of the pools were selected based on fund managers, performance records, and expense ratios. Speirn commented, "Until the mid-1990s, donor-advised funds were pooled with our endowment funds and collectively managed by investment managers hired by the foundation. But after the stock market downturn in

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1993 and 1994, we decided to separate our endowment funds from our donor-advised funds and to offer donors a wider choice in selecting and mixing investment strategies for their funds."

PCF assessed annual fees ranging from 0.5%–2.0% to cover the costs associated with providing its services. Fees were charged monthly based on the fund balance at the end of the month. The tiered fees were as follows:

Donor-Advised Funds	
On the first $3 million	1.0%
On the next $3 million–$10 million	0.75%
Funds in excess of $10 million	0.5%
Other	
Special-investment funds	1.0%
Agency funds	0.5%
Scholarship funds	2.0%
Field-of-interest funds	1.0%–2.0%
Unrestricted endowment funds	2.0%

According to Mulligan, fees for scholarship funds, field-of-interest funds, and unrestricted endowment funds tended to be higher because PCF needed to do more research and due diligence in order to make grants. In addition, the competition in the market for donor-advised funds forced PCF to keep its fees down.

Most contributions to PCF were in the form of cash or appreciated stock. However, PCF was willing to accept less "liquid" assets such as real estate, privately held securities, and partnership interests. For all gifts, PCF converted the assets to cash as soon as possible and donors were able to deduct the fair market value. PCF required that all assets be kept in the PCF investment pools (described above) unless a donor was interested in opening a fund account over $5 million. In that case, the donor was entitled to choose an alternative investment option or to keep the funds where they had been to date with the approval and oversight of PCF's investment committee. (In either scenario, the donor still paid fees to PCF based on the sliding fee schedule.) For example, if a $5 million-plus donor had been referred by Goldman Sachs and already had money invested with Goldman, that donor could keep its money with Goldman's asset management team and pay $37,500 (0.75%) each year to PCF for its work in distributing the money to charities.

In 2002, PCF earned a total of $5.2 million in fees. Of these fees, about half came from donor-advised funds. The foundation managed its expenses to its revenues and tried to finish each year with a small amount of "excess revenue." (See **Exhibit 3.1.11** for PCF's 2002 and 2003 operating budgets.) As Vera Bennett, vice president of finance and administration, explained, "We are not in a position to raise our fees, so we have to be cost-conscious."

In 2003, PCF was hoping to start charging fees to nondonors who wanted to tap into PCF's extensive knowledge about philanthropy in the Bay Area. As Clear described, "We have found that some of the smaller family foundations that do not have funds with PCF are interested in paying us for our expertise regarding local nonprofits. We're not sure how big an opportunity this is, but we are starting to make this service available." This was one of the areas that PCF was starting to explore in connection with its strategic plan.

Peninsula Community Foundation
Summary of 2003 Operating Budget

Revenues	2003	2002	$ Change	% Change
Cash Carryover (Estimated 2002 Surplus)	$ 186,617	$ 95,500	$ 91,117	95.4%
Administrative Fees from Funds	$ 5,164,940	$ 5,159,992	$ 4,948	0.1%
Fees & Events-External	$ 69,800	$ 127,000	$ (57,200)	–45.0%
Interest	$ 76,000	$ 420,000	$ (344,000)	–81.9%
Contributions/Grants	$ 121,827	$ 151,050	$ (29,223)	–19.3%
Total Revenues	**$ 5,619,184**	**$ 5,953,542**	**$ (334,358)**	**–5.6%**
Expenses				
Personnel	$ 3,800,261	$ 3,783,527	$ 16,734	0.4%
Travel & Professional Development	$ 72,713	$ 121,921	$ (49,208)	–40.4%
Association Memberships	$ 4,250	$ 39,000	$ (34,750)	–89.1%
Leases & Insurance	$ 576,776	$ 640,528	$ (63,752)	–10.0%
Office Expenses	$ 390,776	$ 316,460	$ 74,272	23.5%
Meetings & Cultivation	$ 30,117	$ 32,667	$ (2,550)	–7.8%
Audit & Accounting	$ 43,100	$ 37,750	$ 5,350	14.2%
Computer & Tech. Consultant	$ 148,363	$ 168,787	$ (20,425)	–12.1%
Outside Consultant	$ 147,038	$ 260,530	$ (113,492)	–43.6%
Legal Fees	$ 25,000	$ 13,500	$ 11,500	85.2%
Advertising	$ 33,800	$ 94,250	$ (60,450)	–64.1%
Special Events	$ 35,805	$ 133,950	$ (98,145)	–73.3%
Capitalized Equipment/Leasehold	$ 137,030	$ 163,440	$ (26,410)	–16.2%
Investment Consultant Fees	$ 103,500	$ 103,500	$ —	0.0%
Total Operating Budget	**$ 5,548,485**	**$ 5,909,810**	**$ (361,326)**	**–6.1%**
Budget Surplus/(Deficit)	$ 70,700			
Special Projects Budges:				
NonProfit Center	$ 104,489	$ 120,942	$ (16,453)	–13.6%
Peninsula Partnership	$ 564,462	$ 652,675	$ (88,213)	–13.5%
EPA Neighborhood Improvement Program	$ —	$ 214,845	$ (214,845)	–100.0%
Children's Rpt. Card	$ 151,381	$ 193,595	$ (42,214)	–21.8%
Venture Funds (RAR & AFA)	$ 1,440,835	$ 173,961	$ 1,266,874	728.3%
Raising a Reader Business Fund	$ 822,496	$ 729,603	$ 92,893	12.7%
Packard Environmental	$ 1,079,798	$ 155,032	$ 924,766	595.5%
Total Special Projects	**$ 4,163,459**	**$ 2,240,653**	**$ 1,922,806**	**86%**
Interfund Transactions: (Amount contributed to operating budget from Special Projects)				
Personnel Cost Reimbursed to General Oper.	$ 49,565			
Overhead Paid to General Operating	**$ 233,873**			
Interfund Grants (RAR)	**$ 374,851**			
Total Interfund Transactions	**$ 1,088,289**			
Total Budget	**$ 8,623,654**			

Exhibit 3.1.11 PCF Operating Budget

SOURCE: Data provided by PCF.

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U.S. MARKET FOR DONOR-ADVISED FUNDS

Since their inception in the 1970s, DAFs have become increasingly popular throughout the United States. In addition to community foundations, Jewish foundations were largely credited with increasing the availability of DAFs in the 1970s and 1980s. In 1992, Fidelity Investments was the first commercial/for-profit financial institution to offer its customers the advantages of contributing to a DAF. Other financial institutions followed Fidelity's lead, and by the end of 2002, there were 13 commercial investment companies that offered a significant DAF program.[8] In addition to the commercial investment companies and the community foundations, a number of religious organizations and universities started offering DAFs as well in order to build relations with their affinity groups. According to a survey conducted by *The Chronicle of Philanthropy,* assets held by a sample of the largest DAFs in the United States totaled $10.2 billion in 2002, a small drop from the $10.5 billion of assets in 2001.[9] (See **Exhibit 3.1.12** for 2001 and 2002 data for commercial funds and **Exhibit 3.1.13** for data from 1999 to 2002 for a broader set of the largest donor-advised funds.)

Commercial Investment Companies

Investment firms were eligible to offer DAFs as long as they established a nonprofit subsidiary and applied for 501(c)(3) status. Most investment companies did not purport to have in-depth knowledge about nonprofits throughout the United States; rather, they presented themselves as an effective tool for clients who already had a clear idea of their philanthropic-giving strategy. Customers could receive the tax advantages associated with gifting money through a DAF without moving their assets to another organization.

Fidelity Investments

Fidelity branded its offering under the name Fidelity's Charitable Gift Fund. Initially, Fidelity marketed its services primarily to its own customers, but it gradually grew more aggressive in its outreach. Speirn recalled a time in 1997 when one of his staff members came into the office with a letter from KQED, the Bay Area's local public broadcasting station, promoting Fidelity's Charitable Gift Fund. This was upsetting, as PCF had supported KQED with numerous grants over the years. Speirn felt that "Fidelity was buying its way into our community." In 1999, Fidelity had 16,458 fund accounts representing $1.7 billion. By December 2002, Fidelity had 31,002 fund accounts representing $2.4 billion of assets under management for its donor-advised funds. As Mulligan explained, "Fidelity's growth was unprecedented in the charitable-giving industry. Fidelity was the first organization to educate consumers about the market. They let people know that donor-advised funds were not only for the superrich—they communicated that 'you can have one too.'"

For clients who wanted to research charities, Fidelity offered links on its Web site to several resources. Ash McNeely, PCF's vice president for philanthropic services, believed that "Fidelity had a few people on its staff to

Organization	Assets			Amount Distributed to Charities			Number of Funds		
	2001	2002	Percent Change	2001	2002	Percent Change	2001	2002	Percent Change
Commercial Funds									
American Gift Fund (Newark, DE)	$ 5,960,591	$ 6,926,536	16%	$1,407,853	$ 1,269,930	–10%	134	138	3%
Calvert Social Investment Foundation (Bethesda, MD)	3,617,120	5,966,000	65	36,365	592,268	1,529	39	84	115
Fidelity Investments Charitable Gift Fund (Boston)	2,648,760,694	2,389,029,773	–10	735,914,318	750,975,802	2	27,601	30,112	9
Heartland Charitable Trust (Dubuque, IA)	4,734,285	4,652,612	–2	1,152,292	1,092,697	–5	102	102	0
Raymond James Charitable Endowment Fund (St. Petersburg, FL)	13,000,000	13,800,000	6	800,000	1,130,000	41	110	175	59
National Philanthropic Trust (Jenkintown, PA)	345,587,000	416,970,599	21	25,878,000	73,091,080	182	204	416	104
Oppenheimer Funds Legacy Program (Denver)	5,566,527	9,268,091	67	1,312,204	1,833,914	40	160	250	56
T. Rowe Price Program for Charitable Giving (Baltimore)	6,783,000	8,100,000	19	771,000	1,800,000	134	200	300	50
Renaissance Charitable Foundation (Indianapolis)	581,240	6,335,233	990	0	213,850	– ?	1	24	2,300
Schwab Fund for Charitable Giving (San Francisco)	139,513,683	200,080,456	43	43,035,392	52,731,810	23	3,369	4,451	32
SEI Giving Fund (Oaks, PA)	n/a	3,000,000	– ?	n/a	550,000	– ?	n/a	15	– ?
Vanguard Charitable Endowment Program (Malvern, PA)	291,412,593	383,041,593	31	45,051,829	64,813,601	44	2,099	2,750	31

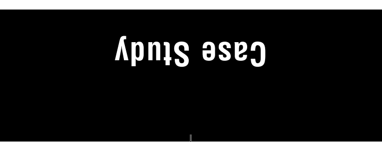
Exhibit 3.1.12 Sample of Top Commercial/Financial Organizations With Donor-Advised Funds (2001–2002)

SOURCE: "Donor Advised Funds: Assets, Awards and Accounts at a Sampling of Big Providers," *The Chronicle of Philanthropy*, May 15, 2003.

[AU: in the 4 blocks above with my "?" should there be a percentage there, or "n/a" ? or delete the minus sign?]

Organization	Assets 1999	Assets 2000	Assets 2001	Assets 2002	Assets % Change ('99–02)	Amount Distributed to Charities 1999	Amount Distributed to Charities 2000	Amount Distributed to Charities 2001	Amount Distributed to Charities 2002	Amount Distributed to Charities % Change ('99–02)	Number of Funds 1999	Number of Funds 2000	Number of Funds 2001	Number of Funds 2002	Number of Funds % Change ('99–02)
Fidelity Investments Charitable Gift Fund (Boston)	$1,700,000,000	$2,400,000,000	$2,648,760,694	$2,389,029,773	41%	$374,000,000	$574,000,000	$735,914,318	$750,975,802	101%	16,458	22,983	27,601	30,112	83%
Schwab Fund for Charitable Giving (San Francisco)[b]	n/a	72,000,000	139,513,683	200,080,456	n/a	n/a	14,000,000	43,035,392	52,731,3310	n/a	n/a	1,500	3,369	4,451	n/a
Vanguard Charitable Endowment Program (Malvern, PA)	72,175,612	171,446,300	291,412,593	383,041,593	431	6,734,488	19,458,793	45,051,829	64,813,601	862	550	1,268	2,099	2,750	400
Boston Foundation	174,266,076	230,393,325	219,961,935	183,547,620	5	17,573,902	27,631,291	26,545,510	24,593,026	40	406	438	464	516	27
California Community Foundation (Los Angeles)	116,248,000	154,400,000	170,044,000	167,597,000	44	80,399,000	30,311,000	32,300,000	47,607,000	–41	369	464	531	601	63
New York Community Trust	n/a	711,000,000	648,000,000	650,000,000	n/a	n/a	102,000,000	87,100,000	87,091,000	n/a	n/a	841	928	948	n/a
Marin Community Foundation (Novato, Calif.)	41,000,000	47,000,000	47,251,000	55,757,414	36	5,900,000	7,200,000	8,764,000	15,080,768	156	72	94	111	142	97
East Bay Community Foundation (Oakland, CA)	27,916,000	40,502,000	53,500,000	57,184,000	105	4,052,000	6,065,000	11,500,000	6,884,500	70	200	270	178	224	12
Community Foundation Silicon Valley (San Jose, CA)	136,000,000	171,000,000	241,000,000	208,000,000	53	18,000,000	27,000,000	35,000,000	41,000,000	128	121	178	148	252	108
Peninsula Community Foundation (San Mateo, CA)	121,010,842	217,850,082	256,194,363	264,523,912	119	26,942,453	37,090,891	40,166,862	52,641,711	95	248	343	362	377	52

Exhibit 3.1.13 *(Continued)*



	Assets					Amount Distributed to Charities					Number of Funds				
Organization	1999	2000	2001	2002	% Change ('99–02)	1999	2000	2001	2002	% Change ('99–02)	1999	2000	2001	2002	% Change ('99–02)
San Francisco Foundation	219,523, 463	233,288, 888	250,000, 000	n/a	n/a	41,380, 304	53,500, 839	50,000, 000	n/a	n/a	264	292	349	n/a	n/a
Sonoma County Community Foundation (Santa Rosa, CA)	n/a	8,489,700	11,156,766	17,716,026	n/a	n/a	2,157,009	3,792,5499	3,025,323	n/a	n/a	82	54	62	n/a
United Jewish Communities[c]	1,979,715, 000	2,203,000, 000	2,432,000, 000	n/a	n/a	388,000, 000	n/a	n/a	n/a	n/a	n/a	7,500	n/a	n/a	n/a
Jewish Community Federation of San Francisco, Peninsula, Marin & Sonoma Counties	n/a	n/a	200,085, 000	187,600, 000	n/a	n/a	n/a	39,800, 000	37,600, 000	n/a			672	713	n/a
Harvard University (Cambridge, MA)[d]	20,385,000	32,400,000	39,000,000	39,000,000	91	600,000	5,100,000	4,200,000	6,100,000	917	10	12	14	14	40
National Christian Charitable Foundation (Atlanta)	223,000, 000	350,000, 000	362,000, 000	350,000, 000	57	69,000, 000	80,000, 000	95,000, 000	103,288, 000	50	1,132	1,217	1,600	2,000	77
Tides Foundation (San Francisco)	122,000, 000	157,000, 000	155,900, 000	138,829, 231	14	28,000, 000	56,000, 000	76,300, 000	59,536, 000	113	275	275	300	314	14

Exhibit 3.1.13 Selected Organizations with Donor-Advised Funds (1999–2002)

SOURCE: Adapted from "Annual Donor-Advised Fund Survey," *The Chronicle of Philanthropy*, May 31, 2001; May 30, 2002; and May 15, 2003.

a. Fiscal years vary from June to December based on organization.

b. Data represent individual and corporate-advised funds.

c. In 2002, United Jewish Communities stopped reporting as a group.

d. Data represents estimates.

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answer questions about nonprofits, but these people were responsible for covering the entire United States. As a result, they couldn't possibly have in-depth knowledge about local charities throughout the country." Fidelity required a minimum $10,000 gift to open a fund account and charged its donors on a sliding scale between 0.25% (for accounts over $2.5 million) and 1% of total assets (up to $500,000) on an annual basis. Fidelity also charged money-management fees, so total fees ranged from 0.67% to 1.87% per year. Donors were required to choose among four investment pools (money market, interest income, equity income, and growth), and all investments were kept with Fidelity fund managers.

Fidelity granted $750 million to nonprofits in 2002, more than double the $374 million it granted in 1999. The majority of donors used a Web-based interface to recommend a grant. Fidelity took care of disbursing the money and doing the record keeping. Fidelity also provided a Web site for donors to review the investment performance of their funds. During the mid-1990s, Fidelity had invested in a significant technology solution to support its donor-advised offering. Fidelity's technology platform was so robust that the firm started managing the "back end" for several other financial institutions as well. Along these lines, Fidelity provided private-label services for institutions such as asset-management firms and universities that wanted to offer DAFs but lacked the resources or desire to develop the infrastructure. The private-label division operated under the brand National Charitable Services and was also a not-for-profit operation.

Merrill Lynch

Merrill started offering donor-advised funds in 1995, but it took a different approach than Fidelity. Merrill partnered with local community foundations across the country in order to provide more robust philanthropic services. Initially, Merrill teamed up with a group of 170 community foundations and planned to refer clients to foundations as long as the foundations allowed Merrill to continue managing the assets. According to Bennett, "The Merrill arrangement from the 1990s was complicated, and I don't think it really panned out as Merrill had hoped. Neither Merrill nor the community foundations had the infrastructure in place to achieve Merrill's vision." There was no standardization across the country, so fees varied significantly from one region to another. In addition, most of Merrill's financial advisors were not informed about the partnerships, and they had no incentive to refer clients.

In 2002, Merrill revamped this strategy and started looking for a smaller group of foundations with which to have a closer relationship. The new plan, called The Merrill Lynch Community Charitable Fund, would require each of the participating community foundations to build a technical interface to Merrill's account systems through a third-party vendor. Merrill planned to start with 10 to 15 foundations and increase its network of community foundations to 60 foundations in two years.[10] Mulligan explained, "By adopting this strategy, Merrill hoped to give its clients the best of what was out there—detailed information about nonprofit organizations, high levels of local service, and

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a choice of investment options wrapped up by Merrill." According to H. King McGlaughon Jr., former director of Merrill's Center for Philanthropy and Nonprofits, "Merrill will be the first to offer a uniform donor-advised program through community foundations nationally."[11] As of January 2003, Merrill planned to set the minimum investment level at $25,000.

Merrill informed PCF that donors could expect to pay fees of approximately 2.1%, 1% of which would go to Merrill while the other 1.1% would be divided among the local foundation and two different intermediaries helping with the interface between PCF and Merrill. Mulligan believed that "PCF would receive between 50 and 60 basis points of annual fees for each account. It was unclear, however, as to how much additional work would be entailed in providing services to Merrill's clients." For example, Merrill was expecting PCF to use customized donor correspondence as well as a customized Web site. In addition, PCF would need to manually synchronize all fund activity with its own database. These types of adjustments would cause additional work for PCF, while fees would be lower than those PCF received from its other DAF accounts.

Merrill planned to introduce its Community Charitable Fund in the spring of 2003 through a series of workshops for its 14,000 financial advisors across the country. If PCF signed the contract, McNeely and Mulligan would be invited to attend the workshop in San Francisco and make a short presentation about PCF's capabilities. Unlike the original plan in 1997, the new structure did provide some incentives to Merrill's financial advisors to refer clients to this new fund. According to McNeely, "Merrill was planning to position its donor-advised fund as another value-add that Merrill's investment advisors could present to their clients. Nobody had a clear sense as to how many clients would be interested." While Merrill was universally regarded as one of the leading brokerage firms in the United States, it was not perceived as a large fund manager such as Fidelity or Vanguard. It was unclear how this reputation would affect its ability to attract sizable new DAF accounts. Merrill estimated that the average fund size would be approximately $150,000, with a 20% annual distribution rate.

Other Commercial Investment Funds

In addition to Fidelity and Merrill, there were a number of other investment firms that started offering DAFs. Vanguard introduced its fund in 1999 and had $383 million in assets by the end of 2002. In 2002, it granted $64 million on behalf of its donors.[12] Vanguard differentiated itself by being a low-cost provider and charging lower fees than any other provider of DAFs. Charles Schwab began offering DAFs in 1999 and had $200 million in assets by the end of 2002.[13] Given that a high percentage of Schwab's customers were from the Bay Area, PCF believed that Schwab drew donors from the same region covered by PCF.

An increasing number of commercial investment firms were interested in working with private-label companies such as those provided by Fidelity and its National Charitable Services division. This division allowed Bear Stearns and Goldman Sachs to enter the market relatively quickly, although the fees to donors were 1%–2% higher than those charged by Fidelity to account for the involvement of both financial organizations. Another firm—National Philanthropic Trust—worked with a for-profit Internet company called GivingCapital to run

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donor-advised funds for American Express, JPMorgan Chase, Legg Mason Trust, and Morgan Stanley.[14]

Community Foundations

Community foundations continued to play an important role in the proliferation of DAFs. Out of the list of 84 organizations with substantial advised funds in 2002 published by *The Chronicle of Philanthropy,* 49 of them were community foundations. The largest of these in terms of DAF assets was New York Community Trust with $650 million of assets in 2002 from 948 fund accounts. The next largest was Communities Foundation of Texas (Dallas) with $284 million of assets from 428 fund accounts in 2002. PCF was the third largest among the community foundations in terms of assets in DAFs. The combined DAF assets of the five largest Bay Area foundations were approximately $850 million in 2002.[15] The average size of DAF fund accounts at community foundations was $318,000, as opposed to $89,000 at the commercial investment firms.[16] Speirn believed that some of this difference could be attributed to the transactional nature of the commercial fund clients—he had heard that many of Fidelity's donor-advised fund holders had set up accounts in order to make gifts primarily to universities and religious institutions in a tax-efficient manner. In contrast, families that set up accounts at community foundations tended to want more advice and counseling because they had more money to give away.

While many community foundations offered DAFs, most of the foundations were run differently than PCF. McNeely explained:

> Most community foundations focused the majority of their energy on the endowment, and DAFs were a small piece of the asset mix. Other community foundations also had fewer investment choices for their donors. They gave donors the impression that once money was given to the community foundation endowment, the donor was no longer involved. In contrast, PCF wants all its donors to feel like important customers, and it wants to be in the business of connecting them to community opportunities that match their philanthropic wishes.

McNeely wondered if these differences would become even more apparent as firms such as Merrill developed networks with multiple community foundations across the country.

Other Groups

In addition to investment firms and community foundations, religious groups and universities were the third major segment of DAF providers. The largest set of funds within this category was part of United Jewish Communities. As of December 2001, this set of organizations had $2.4 billion of assets.[17] The National Christian Charitable Foundation had $350 million from 2,000 fund accounts in 2002. By the end of 2002, a number of U.S. universities had started offering donor-advised funds to their alumni and affiliates. In 2002, Harvard University had $39 million of assets from just 14 fund accounts.[18] Universities often required that a large percentage of DAF contributions held with the university ultimately be donated to that institution, but as Mulligan explained, "Sophisticated development offices seemed able to attract some donors, particularly if those donors were not aware of other DAF

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options." Mulligan speculated that DAFs were becoming increasingly available, particularly through private-label options: "There are few barriers to entry in this market. Soon every insurance firm and local Rotary club will be offering donor-advised funds for their affinity groups."

PCF STRATEGIC OPTIONS

In light of the tremendous growth in donor-advised funds over the previous decade, Speirn believed that it was important for PCF to review its positioning in the market. PCF had grown accustomed to competing for donors with Fidelity and the other Bay Area community foundations, but as more organizations started offering DAFs, donors would have even more choices. PCF was optimistic, given that 4 million U.S. households had a net worth over $1 million and only a fraction of these already had DAFs or private foundations in place. In addition, analysts speculated that there would be a $41 trillion–$136 trillion intergenerational transfer of wealth during the next 50 years. A portion of this wealth was expected to be allocated to nonprofits, which could lead to growth for community foundations.[19] Nevertheless, PCF still needed to determine how it wanted to approach the market.

Competition

One option was for PCF to compete in all segments of the market with other institutions offering DAFs in the Bay Area. In this scenario, PCF would target everyone from young families hoping to give away $10,000 per year to retired CEOs looking to donate $2 million or more each year. PCF would continue to work with local professional advisors while also looking at broader marketing opportunities. To date, PCF had adopted the strategy of accepting any new donor with a minimum account of $5,000. Speirn explained, "At PCF, we have always believed in opening our doors to anyone that wants to be charitable—we do not say 'we don't want to work with this customer' because their giving goals are too small. We also see donor-advised funds as a gateway to a deeper relationship."

PCF could change its strategy and select one or two segments of the market in which to compete aggressively. For example, PCF could focus primarily on the wealthiest portion of the Bay Area population—the people who might be considering private family foundations as an alternative to a donor-advised fund. This group was likely to establish funds over $1 million and would be able to appreciate the breadth of philanthropic opportunities presented by PCF. In addition, this group might give a few large gifts rather than many small gifts—thereby reducing the workload on the staff at PCF. If PCF took a more segmented approach, it might choose to increase its minimum account size and develop new types of premium services.

Collaboration Opportunities

Speirn and his team were also considering establishing more collaborative relationships such as the potential relationship with Merrill. Speirn was pleased that the Merrill arrangement was designed to draw upon PCF's unique knowledge of Bay Area charities, but

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he wondered if this partnership would make it difficult for him to develop arrangements with other large commercial investment firms that already had sizable DAF assets. To date, Fidelity had not shown any interest in working with community foundations, but perhaps PCF could approach Fidelity with a proposed pilot project. Fidelity would not need any of the record-keeping services developed by PCF, but Fidelity's Bay Area clients could benefit from access to PCF's knowledgeable staff and list of synergy projects. Clear believed that "most Fidelity customers did not know what their local community foundation could offer in terms of grantmaking expertise and other services. Nearly all community foundations, including PCF, did not have advertising budgets to showcase their capabilities, so many Fidelity customers were unaware of other options." Schwab, with its headquarters in San Francisco, was also seen as a potential partner due to the high percentage of its clients in the Bay Area.

Speirn was aware that additional partnerships with financial institutions might further decouple what PCF had traditionally presented as a package, but he believed that "the situation was forcing us to examine our own core competencies and identify our marketable assets." McNeely commented:

> Some of the options we are reviewing take us away from a business model tied only to assets under management. While there are benefits to diversification, it is important that we don't forget about our endowment. In many ways, our endowment serves as our research and development center because we continuously review grant requests from local nonprofits who are seeking funding. Conducting due diligence for these requests helps us stay in touch with the nonprofits in our community year after year.

Members of the PCF management team also discussed various private-label arrangements for the DAF business. On one side of the spectrum, PCF could develop the infrastructure to offer private-label services to other companies along the lines of what Fidelity had done with its National Charitable Services division. Local banks or Rotary clubs could be interested in leveraging what PCF had built to date. This strategy would require hiring additional people with the IT skills needed to effectively integrate multiple organizations. At the other end of the spectrum, PCF was even considering reducing the activities it performed in-house and engaging one of the national private-label organizations to do some of the complicated back-office and record-keeping tasks. PCF had invested in the technology and manpower to ensure that donors got accurate statements, but it was expensive. Bennett elaborated, "We like to give our donors choice, but it is very difficult to manage all the accounts. We have money in 115 funds across 38 financial institutions. In order to reconcile all the financials, we have to allocate returns among every account. It takes a team of five people to ensure accuracy and monitor all the investments."

PCF was not alone in thinking that it might be best to partner with other organizations. According to an article published in a large Bay Area newspaper, Community Foundation Silicon Valley was thinking along the same lines. The article stated:

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"'When Fidelity launched its charitable fund, we went to Congress and the IRS. We tried to put them out of business,' recalled Peter Hero, president of Community Foundation Silicon Valley. 'In retrospect, we should have gone to them and collaborated.'"[20]

Other Options

Although donor-advised funds had become the largest part of PCF's asset mix, PCF also looked at the option of reducing focus on this competitive category. The foundation was aware that it was harder to attract endowment gifts, but once obtained, these gifts ensured a steady stream of management fees. To date, PCF had not undertaken a capital campaign, but that was a possibility for the future. McNeely also believed that board members had the potential to play a bigger role in attracting major endowment gifts. The management team was also reviewing records of the 1,200 independent or private foundations in the Bay Area and determining if some of them might be interested in tapping into the knowledge base at PCF. According to Mulligan, these foundations had assets of $10 billion in 2001 and were always looking for ways to give away money in a thoughtful manner.

On occasion, Speirn also wondered if it made sense to have six community foundations in such a small area. In 1995, the group had developed a "Statement of Principles for the Community Foundations in the Bay Area" that stated, "The Bay Area and its community foundations will benefit from *collaboration* in programming and *competition* in their donor services." (See **Exhibit 3.1.14** for the complete statement of principles.) Speirn believed that "although the six foundations were quite different in terms of focus and culture, they generally operated with collegiality and mutual respect."

CONCLUSION

As Speirn thought through all of the options available, he wondered just how much Americans valued the strong localized knowledge of community foundations. He questioned, "In an age in which people are less rooted and move frequently, what value do people place on having a strong community connection?" Speirn believed that deep, consistent relationships with donors and local nonprofits really made a difference. The success of the Center for Venture Philanthropy's first two social-venture funds (Assets for All Alliance and Raising a Reader) seemed to be perfect illustrations: The concepts were incubated with key nonprofit partners, and start-up funding had come entirely from people with donor-advised funds. Local families and private foundations later invested, and ultimately each initiative attracted federal funding and national attention.

The notion of venture philanthropy was based on working closely with a selected set of organizations for multiple years, and it was helpful to have philanthropists rooted in a community. PCF wanted its DAF donors to feel this same commitment to local nonprofits. Speirn believed, "In addition to funding programs, great community

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Preamble.

The nine counties bounding the San Francisco Bay are fortunate to be served by six respected community foundations. It is uncommon for an American metropolitan region to enjoy such abundant community foundation resources. This statement of principles reflects the dedication of the community foundations bounding the Bay to work in close association, and to affirm as paramount to all else they do the encouragement of Bay Area philanthropy and the augmentation of Bay Area nonprofit services.

1) Shared interests.
   Many of the community foundations have overlapping service areas and all have intersecting program interests. Their characteristics reflect the regional nature of each community foundation.
2) Collaboration and competition.
   The Bay Area and its community foundations will benefit from *collaboration* in programming and *competition* in their donor services.
3) Program.
   On the program side of their activities, the foundations should seek every opportunity to increase community benefits through collaboration.
4) Donor services.
   On the donor services side of their activities, the foundations should be guided by the following principle: advancement of the community foundation field is the prerequisite of and fundamental to the advancement of individual foundations.
5) Good practice.
   Accordingly, the health growth and community respect and regard for all Bay Area community foundations requires us to abide by four basic rules of good practice:
   - inform inquiring prospective donors about other community foundations serving the communities in which they reside or work;
   - assist inquiring prospective donors in examining a full range of their private and community foundation options before they choose an institution to serve them;
   - avoid judgments or comparisons of community foundations;
   - seek opportunities to engage in collaborative efforts designed to promote philanthropy through community foundations and when addressing donors, prospective donors, professional advisors to donors, and the general public.

Peter Hero,
Community Foundation of Santa Clara County ______________________________

Michael Howe,
East Bay Community Foundation ______________________________

Stephen Dobbs,
Marin Community Foundation ______________________________

Sterling Speirn,
Peninsula Community Foundation ______________________________

Robert Fisher,
The San Francisco Foundation ______________________________

Kay Marquet,
Sonoma County Community Foundation ______________________________

Exhibit 3.1.14 Statement of Principles for Community Foundations in the Bay Area

SOURCE: Provided by PCF, dated June 21, 1995.

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foundations help build organizational capacity within a nonprofit and are proactive with respect to launching and supporting new initiatives." This was done through money granted and time spent helping an organization understand how it could operate more effectively. Speirn and his team derived a great deal of satisfaction from watching donors observe the tangible benefit of their gifts. He enjoyed seeing donors increase their giving as they witnessed their impact. As he thought about the future direction of PCF, he wanted to ensure that the foundation did not lose the opportunity to help others realize their philanthropic dreams. McNeely elaborated, "At PCF we think about growth as more than bringing in money. It's also about giving it away and changing people's lives."

Speirn was concerned, however, about PCF's ongoing ability to increase its impact on the community. Unlike the commercial firms such as Fidelity, PCF perceived itself as both a provider of philanthropic services and a supporter of local community needs. He watched the financial services firms gather more fund accounts and wondered if the donor-advised funds would become nothing more than a commodity. He believed that "money managers have an incentive to keep money under management, not encourage it to be given away. In contrast, PCF measures itself by how much and how well the money is given away and the resulting impact on people's lives and our community." Speirn wondered if partnering with Merrill Lynch would just serve to strengthen the position that commercial investment firms had in the market. While PCF was interested in having access to Merrill accounts, the foundation did not want to be marginalized in the process. Speirn noted the irony of community foundations being started by a banker who wanted the community to help give money away, and now bankers were figuring out ways to pull money back into their accounts. Donor-advised funds had proved to be a "sticky" asset, and financial institutions were positioning themselves to capitalize on the projected growth in the industry. While it might be necessary to work with more financial institutions, PCF needed to figure out what it could carve out for itself. This was particularly true as the financial firms wanted to control both the relationships and the money.

Speirn had overseen a tremendous expansion period for PCF during his decade as president, and he wanted to make the next decade even better. There was a board meeting scheduled for the following week, and Speirn needed to provide his recommendation for the Merrill deal. He knew that his recommendation should also include the implications for PCF's larger future strategy.

NOTES

1. Donor-advised funds allow people to contribute assets (e.g., appreciated stock) at a tax-advantaged time and then request that charitable grants be made on the donor's behalf at a time of the donor's choosing. A more detailed explanation of donor-advised funds can be found on pp. 2–3 of this case.

2. Peter A. Dunn, "Should You Create a Donor Advised Fund Program," *The Journal of Gift Planning*, third quarter 2002, pp. 17–18.

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3. The 30% deduction represented the maximum deduction for securities. For cash donations, a donor could deduct up to 50% of AGI. (Any amount not deductible in the year the initial gift was made could be carried forward and used as a deduction in the five subsequent years.)

4. Any interest and/or capital gains/losses accrued over the five years are kept within the fund account, so the total amount available for donations at the end of the period would be $100,000 plus or minus the investment returns.

5. The annual Larger Community Foundations Meeting (sometimes referred to as the Peacock Meeting) was self-organized by the participating foundations. It was an opportunity for the board chairs and CEOs of the largest community foundations to get together and discuss strategy and best practices.

6. Special-interest funds allow donors to designate nonprofit grant recipients in a certain field of interest.

7. PCF defined "socially responsible" as a group of securities that have been screened using a standard avoidance list (e.g., tobacco) as well as for issues related to animal rights and international human rights.

8. "Donor-Advised Funds: Assets, Awards and Accounts at a Sampling of Big Providers," *The Chronicle of Philanthropy,* May 15, 2003.

9. Ibid.

10. Matt Ackerman, "Merrill Eyes Donor-Advised Fund for Charitable Giving," *Mutual Fund Market News,* March 10, 2003.

11. Ibid.

12. "Annual Donor-Advised Fund Survey," *The Chronicle of Philanthropy,* May 15, 2003.

13. Ibid.

14. Debra E. Blum, "Tailor Made for Charity," *The Chronicle of Philanthropy,* May 30, 2002, pp. 7–9.

15. Calculated from "Annual Donor-Advised Fund Survey," *The Chronicle of Philanthropy,* May 15, 2003.

16. Ibid.

17. "Annual Donor-Advised Fund Survey," *The Chronicle of Philanthropy,* May 30, 2002. (The United Jewish Communities started reporting separately for FY2002.)

18. "Annual Donor-Advised Fund Survey," *The Chronicle of Philanthropy,* May 15, 2003.

19. Terence Mulligan and Chris Nicholson, "The Community Foundation Value Proposition: An Introduction to Community Foundations and the Services They Provide to Estate Planners and Their Clients," *California Trusts and Estates Quarterly,* p. 27.

20. John Boudreau, "Philanthropy a Big Business Opportunity," *The San Jose Mercury News,* May 4, 2003, p. 5F.

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Case Study 3.2

New Schools Venture Fund

In December 1999, John Doerr—a partner with the venture capital firm Kleiner Perkins Caufield & Byers (KPCB) and a cofounder of the New Schools Venture Fund (New Schools)—reviewed a preliminary draft of New Schools' objectives for the year 2000. Doerr reflected on what New Schools—a $20 million nonprofit venture philanthropy fund started in 1998—had been able to achieve to date and what issues it faced going forward:

> In the past year and a half we've invested in a number of education entrepreneurs attacking the problems in our public education system with scalable programs. However, the goal with New Schools is to provide far more than money—we also take board positions, offer advice to our ventures, and connect educational entrepreneurs nationwide with each other. As we grow, it is important for us to think strategically about our network of supporters and donors to ensure we really add value to the ventures and make a difference in kids' lives.

New Schools (www.newschools.org) was one of the first funds focused on social entrepreneurs and "venture philanthropy." It borrowed the approach used in venture capital to invest in change in a specific philanthropic area. Social venture funds invested in high-potential entrepreneurial ventures that fit with the mission of the fund and provided ventures with strategic and operational guidance over the long term. Any returns generated by the investments were reinvested in the fund's ventures. New Schools' mission was to improve public kindergarten-through-twelfth-grade (K–12) education in the United States by (a) investing in entrepreneurial ventures targeting a vulnerability in the public education system and (b) creating a network of education entrepreneurs and New Economy leaders to both help New Schools' portfolio companies and build the field of education entrepreneurship as a whole. By late 1999, New Schools had made investments in five education ventures and had hosted a series of networking events, including a national conference for education entrepreneurs attended by 250 people.

New Schools' resources included 18 "partners"; among them were Doerr and

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cofounder Brook Byers—a fellow venture partner at KPCB—who contributed financial and/or intellectual capital to the organization. The group was comprised primarily of well-known venture capitalists and new-economy entrepreneurs, in addition to foundation leaders and educators. All of New Schools' partners were personally interested in the field of education and were committed to supporting entrepreneurs trying to create positive change within the public education system. The level of partner involvement in New Schools varied—some partners were very involved and had even accepted board positions within New Schools' portfolio companies; others were less actively involved but served as advisors on specific issues on an as-needed basis.

Kim Smith, president of New Schools, had prepared the organization's preliminary year 2000 objectives for New Schools' board of directors, which was comprised of Doerr, Byers, Smith, Dave Whorton—a former KPCB associate partner who had recently become CEO of Good Technologies—and Ted Mitchell, the president of Occidental College and former dean of UCLA's school of education. While Smith was pleased with New Schools' progress to date on the investment side, she felt that the organization needed to think more strategically about its approach to building its network of donors and supporters in order to both increase the level of support it provided to its portfolio companies and build the field of education entrepreneurship as a whole. Over the past year, Smith had seen that New Schools' portfolio companies needed more operational and strategic guidance than New Schools had the capacity to offer. Smith felt that in order to help each of its portfolio companies achieve its full potential, New Schools needed to do a better job of transferring the knowledge and experience of its partnership group to its education entrepreneur group.

One option was to expand New Schools' partnership group so that the organization had access to a larger pool of financial and intellectual resources. However, Smith believed that it was important to first develop a clear strategy for expanding the group, since there were many ways for partners to add value—they could contribute capital, investment advice, educational expertise, hands-on assistance for education entrepreneurs, board-level involvement in portfolio companies, and/or a broad network of contacts. Smith and her team had to decide which of these value-added services were most important since that would influence whom New Schools sought as partners. Another option was to partner with other organizations that could contribute support or specific expertise to education entrepreneurs. Smith knew that Doerr and Byers would be expecting her to have a recommendation on the most effective way of extending New Schools' network at their meeting the following week.

BACKGROUND ON NEW SCHOOLS

John Doerr first got involved with the issue of improving public education through a 1993 investment he spearheaded on behalf of KPCB in Lightspan Partnership Inc. (www .lightspan.com). Lightspan was a for-profit venture founded in 1993 that developed content and services for both K–8 schools and school districts, including curriculum materials, interactive software, and home-school connections using the latest tech-

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nology. As part of Doerr's due diligence on Lightspan, he visited a number of public schools with the company's cofounders. Doerr reflected on what he learned through this process:

> We visited dozens of public schools, in both upscale and poor areas. In both places I saw schools that worked and schools that didn't. In the cases where they weren't working, the problem was practically criminal. It soon became clear that the U.S. educational system was the most screwed-up part of the economy. In fact, one study showed that over 40% of fourth-grade students in the United States were reading below their grade level—an astonishing discovery.

While the Lightspan investment highlighted the problems with the public education system, the idea for the New Schools Venture Fund actually came about during a roundtable discussion on education hosted by U.S. Vice President Al Gore. Doerr recalls Gore asking the group—which included a number of Silicon Valley executives—"If you Silicon Valley types are so smart, why can't you do something to create new schools?" Doerr came back from the conference energized to use his venture capital experience and network in the new economy to do something—possibly start a venture fund dedicated to education entrepreneurs. As Doerr explained,

> I thought we ought to be able to take what venture capital has been able to do in the Internet or in biotechnology and apply it to education. I guess if you're a carpenter with a hammer, everything looks like a nail. So as a venture capitalist in awe of the power of entrepreneurs, their ideas, and their ability to create large-scale change, when you see a large unmet need like school improvement, you want to apply the same hammer to it.

A few months later, the idea began to take shape. At a conference at the Aspen Institute, Doerr and Steve Case, CEO of America Online, discussed the problems with public education, and Case posed the question of whether Doerr's venture capital approach—which had proven so successful in spawning entrepreneurship and innovation—could be applied to education reform. On the plane ride back, Doerr talked over the issue with Byers and the two decided to seriously pursue the idea of starting a fund, which would raise money from donors to invest in high-potential education-oriented entrepreneurial ventures. They quickly incorporated the idea into a nonprofit 501(c)(3) organization and tested interest in the concept by putting up a Web site under the domain name NewSchools.org.

At the same time, Doerr and Jim Barksdale, at the time the president and CEO of Netscape Communications Corporation (Netscape), cofounded the Technology Network (Tech Net)— the technology industry's bipartisan public policy network formed to build relationships between technology executives and political leaders. One of the first education-oriented initiatives with which TechNet became involved was to reform California's charter school legislation. With leadership from technology entrepreneur Reed Hastings, the group was successful in passing a bill through the California legislature in 1998 that raised the statewide cap on charter

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schools from 100 to 250 in 1999 and by an additional 100 per year thereafter. As Doerr explained:

> Influencing public policy can be a very high-leverage way to create change. We spent $4 million on the campaign to put our charter school initiative on the ballot before the legislature agreed to include it in a pending bill. If you think about that from a return standpoint, over a 10-year period we will have 1,000 new charter schools in the state of California, which will each receive on average $3 million in state funding per year. So that's a $3 billion per annum return on a $4 million initiative campaign—an outstanding return, worth the time, worth the money.

Excited about the impact that a committed network of professionals had achieved, Doerr and Byers began to assemble a core group of passionate supporters to serve as partners in New Schools. Doerr estimated that his role at New Schools accounted for 10% of his "professional" time.

Motivations for Partner Involvement

Brook Byers

Byers's interest in education traced back to his father-in-law, John Stremple, a former school superintendent who had spent his career working to improve public education and was an early New Schools partner. As Byers noted:

> What dictates a lot of philanthropic interests is being inspired by people you want to emulate. It really takes a one-on-one inspiration to develop a passion and motivate you. For me that personal inspiration came from my father-in-law, John Stremple, who for 17 years has taught me about the issues surrounding public education.

Byers estimated that he spent one day per month on New Schools business, which included attending New Schools' quarterly investment partner meetings

Reed Hastings

Hastings's involvement in education stemmed from a long-standing personal interest in the field dating back to his decision to become a high school math teacher with the Peace Corps in Swaziland, which is in southern Africa, after graduating from college. Hastings ultimately left the teaching profession and founded Pure Software, a company that made products to automate software development. After selling Pure Software in 1997 for $750 million, Hastings announced that he would begin a "new career in school reform." He was so committed that he enrolled in Stanford University's master's program in education in order to understand firsthand how the educational system worked. Hastings recalled the discussion with Mike Kirst, a professor in Stanford's program, that led to his decision to enroll:

> I met with Mike and said, "I really want to create some change in education and now I have the resources to do something meaningful. What should I do?" Mike's response was, "Well, you can either identify all the problems and work

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independently on solving them; then, after realizing that nothing has changed, you simply give up and go away. Or another approach would be to enroll in Stanford's master's program and understand the culture and theory behind education, because if you want to change what's here, you need to first understand the roots of the current model."

Hastings spent six months in the program before leaving school to spearhead the California charter schools initiative. As Hastings explained, "I thought, 'Here's my opportunity to really make a difference.'" Hastings believed that working to affect public policy was one of the highest-leverage mechanisms to create change in the educational system. It was through his work on the charter school initiative that Hastings learned of Doerr's involvement with New Schools. The idea immediately struck a chord with Hastings since he believed that his philanthropic involvement would be more effective and emotionally fulfilling if he were part of a group focused on issues that mattered to him. Hastings reflected:

> In my view, the fundamental problem with philanthropy is that people don't pool their expertise together. Everyone does their own fragmented thing, which means that everybody has to figure out how to be most effective on their own. Since there's very little accountability in philanthropy, it's hard to assess whether you're having an impact or not. As a result, there's a lot of hit-and-miss philanthropy out there and most people don't develop an institutional framework for learning how to do it better.
>
> Mid-tier philanthropists tend to get randomly "pinged"—reacting to various incoming requests for donations. Decisions are made based on what other people are doing or on what's politically correct. As a result, the process becomes far more reactive than strategic. That's why I liked the idea of getting involved with a small but organized group where I could really have an impact. I thought that we could learn together as a group and evolve our institutional knowledge. Plus, from an emotional standpoint, I thought it would be more enjoyable to share the philanthropic experience with a group of like-minded people.

Hastings estimated that he spent a day a month working on New Schools–related business, including attending investment partner meetings and serving as a board member for one of New Schools' portfolio companies.

Ted Mitchell

Ted Mitchell had built his career in the field of education, first as a professor at Stanford's Graduate School of Education, later as Dean of the School of Education at UCLA, and most recently as president of Occidental College. He was a recognized national expert in the area of education policy. Mitchell explained his interest in New Schools:

> I was attracted to New Schools for several reasons. The most important was that it represented some fresh voices in the school reform debate—fresh voices

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and fresh perspectives. Secondly, these people were serious, and although they were taking a new approach to changing education, they were genuinely interested in learning from people in the field, in knowing what sorts of things had worked and hadn't worked. Finally, and perhaps most importantly, I felt that New Schools and the distinctive strategy it represented had a chance to harness entrepreneurial energy in a way that most school reform efforts—and in fact most large bureaucracies—haven't been able to do.

Jim Barksdale

Barksdale's involvement in education reform also stemmed from a deep-seated personal interest. One of six boys raised in a highly literate household, Barksdale found himself unable to read by the end of second grade. However, working with a local tutor, Barksdale was able to overcome his reading problem and later excelled in school. After becoming CEO of Netscape and overseeing its highly successful IPO, Barksdale—a father of three—found himself in a position to give back to the community. After several discussions with his wife, Sally McDonnell Barksdale, the two committed themselves to improving education in his home state of Mississippi. The first initiative came in 1996 when Barksdale and his wife—both University of Mississippi graduates—donated $5.4 million to the University of Mississippi to establish the McDonnell-Barksdale Honors College, which offered college scholarships to top high school academic achievers. Barksdale also helped fund 12 scholarships for minority students applying to the university's medical school. In late 1999, Barksdale was contemplating his largest philanthropic effort to date—a $100 million donation to a literacy improvement program jointly developed by the state of Mississippi and the University of Mississippi. The donation would represent the largest ever to the field of literacy and one of the five largest gifts ever by a private individual or foundation to a public university. Barksdale reflected on how and why he got involved in New Schools in 1998:

> John [Doerr] and I had a series of passionate discussions about reforming the public education system and he told me what he was doing with the New Schools fund. Quite frankly I got excited because *he* was so excited about it. I viewed it as an opportunity for Sally and me to both learn and contribute. Our family foundation is dedicated to improving education in our home state of Mississippi, but there are lots of different ways of doing that. I saw New Schools as a way to broaden our minds about what has been successful in both the for-profit and nonprofit arenas. I also felt that by investing in the fund, we would be demonstrating our commitment to the problem, which I think is important since I believe we all learn by example.

DEVELOPING THE STRATEGY FOR THE NEW SCHOOLS VENTURE FUND

In late 1997, Doerr had a series of meetings with Dave Whorton—who shared Doerr's interest in improving education—to explore

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and further develop the idea. After working together to develop the basic principles for the fund, Whorton and Doerr realized they needed an entrepreneur who could further flesh out the idea. "The issue was important enough that it deserved more attention and resources than we could devote to it," said Whorton. He recruited Kim Smith, a second-year student at Stanford's Graduate School of Business, to develop a detailed strategic plan for New Schools. Smith—a founding member of Teach For America[1] and later, the founder of BAYAC AmeriCorps[2]—agreed to take on the project as an independent study with the support of Paul Romer, a Stanford Business School professor, in January 1998.

Smith spent the winter quarter working on a paper that defined various segments within the field of social entrepreneurship, including venture philanthropy. During the spring quarter, Smith worked with Whorton to outline a strawman strategy for how New Schools should operate—what its mission should be, in what areas it should invest, and what criteria it should use to evaluate potential investment opportunities. To develop the strategy, Smith helped organize a series of "whiteboard sessions" with the core team—Doerr, Byers, Whorton, and Mitchell—to brainstorm and discuss ideas. Smith reflected on the process:

> When I first started doing this project for John, Brook, and Dave, I thought I was trying to execute their vision. However, it quickly became clear to me that that was not how *they* saw it. They wanted someone who could flesh out their vision, ask them the right strategic questions, and propose various recommendations—an approach that comes from their experience in incubating companies. This was one of the first lessons I had to learn in working with them—they didn't just want an executor, they wanted an entrepreneur who would come up with new ideas and challenge them on theirs.

These "strategy sessions" in the spring of 1998 led to a number of important decisions regarding how to structure and position the New Schools Fund. Ted Mitchell, who participated in these early meetings, reflected on the thinking behind the fund:

> There were a couple of founding principles behind New Schools. First, we believed that the spirit and energy of entrepreneurship was missing from public education and yet could have tremendous potential for changing schools. Second, we felt that the new-economy approach of identifying areas for investing and then capitalizing on them in a rapid way through experimentation and redesign wasn't being done in education, but again could have enormous potential. We wanted to be sure that New Schools didn't become just another foundation, so it was extremely important to us that we stay linked to the intellectual discipline of the venture capital approach used in the new economy.

One of the first decisions the group made was to invest in both nonprofit and for-profit ventures. The issue was complex. On the one hand, for-profit ventures typically

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had vastly greater access to financial and human capital than nonprofits and therefore had a far better chance of scaling quickly. On the other hand, for-profit ventures frequently had a more difficult time gaining acceptance by educators, who were typically wary of any venture that tried to make money off of educating children. After debating the issue, New Schools decided that its overarching criterion was whether the venture was going to improve education. As a result, they were willing to invest in both nonprofit and for-profit ventures depending on which structure (nonprofit vs. for-profit) would enable them to best achieve their educational goals. Working with a combination of nonprofit and for-profit educational ventures would also allow New Schools to contribute important intellectual capital to the dialogue about whether children are better served by for profit, nonprofit, or public providers of education services.

Another decision that these sessions resolved was in which sectors of the educational field the fund would invest. Smith had initially recommended that the fund focus on *one* specific area in order to have significant impact and develop deep institutional knowledge in that area. Smith recommended that the fund focus on charter schools—an area she felt had the potential to have a major impact on students and the public school system as a whole by creating a sense of competition. However, after discussing the issue further, the team decided to broaden its focus beyond charter schools, but still use many of the criteria that made charter schools attractive to develop a framework for where the fund should invest. The team developed a framework that defined their target investment "sweet spot" as *scalable* ventures that had the potential to have a *direct* impact on student achievement. Given these criteria, a number of potential investment areas emerged, including charter school chains, comprehensive research-based curricula, and recruitment and training of teachers and managers. The group believed that other potential investment areas would emerge over time.

The group also developed a dual mission for New Schools—investing in scalable entrepreneurial ventures that would improve public K–12 education *and* creating a nationwide network that would connect education entrepreneurs to each other, leaders in the new economy, resources, and intellectual capital. The network would facilitate the sharing of information, ideas, and best practices and, thus, build the field of education entrepreneurship as a whole. This combined mission would help ensure that the fund leveraged its full potential for effecting innovation and change within the field of public education.

Finally, the team decided that the New Schools organization needed a leader that brought experience and expertise in both business and education. It was clear to Doerr, Byers, Whorton, and Mitchell that the best person for the position was Smith herself, even though she had always thought she would join a high-tech firm after graduating from Stanford. Byers reflected on what Smith brought to the table: "She had this amazing combination of an education background, urban and inner-city experience, a good heart for social good, a great analytical mind, a great network of contacts, and a

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proven ability to work with us and learn our approach." Kim accepted the offer to be president of New Schools in June, but she did not officially begin work until August 1998.

LAUNCHING THE NEW SCHOOLS FUND

When Smith joined in August, she set up shop in KPCB's offices to facilitate communication with Doerr, Byers, and Whorton and to learn KPCB's venture approach since New Schools intended to borrow heavily from it. During the first few months, Smith worked on building the New Schools internal organization, developing a perspective on whom the fund should target for investment partners, networking with educators and "edupreneurs," and continuing to develop New Schools' strategy and investment criteria.

As the New Schools organization grew, it was tempting to publicize the effort. However, instead of making a major public announcement about the formation of the fund, the group decided to keep a lower profile and let the results of the fund speak for themselves in the future. Smith explained:

> Our priority was to do a "proof of concept" before we began to get the word out about our efforts. As Brook often reminded us, in the end we would be defined by what we did, not what we said. We also wanted to save the publicity spotlight, in order to focus it on the education entrepreneurs themselves.

Doerr and Byers also pushed hard to start assessing investment opportunities quickly, since they believed that the process of determining whether or not to invest would force New Schools to develop and refine its investment criteria. Smith recalled:

> John and Brook are strong believers in the "learn by doing" model. I was ready to take time to conduct research in order to identify high-potential areas in which New Schools could invest, but after we developed the first version of our investment criteria, I remember John saying, "We can't figure this out in the abstract. We need to look at some real investment opportunities and meet with our investment partners. By getting specific, we will learn a lot about what our criteria should be."

New School Partners

The New School fund involved partners in three different ways. First, there were Investment Partners who attended New Schools' quarterly investment partner meetings (e.g., Byers, Dees, Doerr, Mitchell, Stremple). These people were invited for their expertise or were donors who wanted to be actively involved. Second, there were Limited Partners who chose to play a more passive role in the fund, supporting entrepreneurs primarily through their donations to the fund. Third, some additional members of the network served as special partners by serving on the board of New Schools' ventures.

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Early on, Smith recommended that New Schools increase the size of its investment partner group, by adding people with a passion for educational issues from a variety of backgrounds, including the venture capital community, entrepreneurs, educational leaders, and foundation leaders. Doerr and Smith encouraged a number of people to join New Schools, including John and Elaine Chambers (Cisco Systems), Jim Clark (Silicon Graphics, Netscape, and Healtheon), Steve Merrill (Benchmark Capital), Greg Dees (Stanford Graduate School of Business), Ann Bowers (Noyce Foundation), Doug MacKenzie (KPCB), Halsey and Deb Minor (CNET), Paul Lippe (Shine2000), Gilman Louie (In-Q-Tel), John Stremple (former school superintendent), Scott Cook and Signe Ostbey (Intuit), and Matt Glickman (BabyCenter).

Glickman—the founder of BabyCenter, which was sold to eToys in 1999—represented the type of partner who Smith believed could provide significant contributions to New Schools' portfolio companies. In addition to his work with Bain & Company and Intuit, Glickman had been the chief financial officer for Teach for America before going on to receive a dual master's degree in education and business from Stanford University. He was passionate and knowledgeable about educational issues, and he had experience in building a new-economy company. Glickman reflected on his decision to join New Schools:

> Philanthropy starts with identifying where you want to get involved, and for me, that was clearly in K–12 education. However, education is a huge field and I'm a big believer in being focused and going deep in a couple of areas. So I chose to get involved with two organizations: New Schools and Stanford's "I Have a Dream" program—a community-based program that "adopts" a third- or fourth-grade class and provides them with long-term mentorship and money for college. New Schools gives me the opportunity to be involved on a systemic, conceptual level in creating scalable solutions for problems with our educational system, whereas the "I Have a Dream" program gives me the opportunity to get involved in my local community and have a direct impact on the lives of a small group of people, which is extremely satisfying and important, even if it's not as scalable.

Developing Investment Criteria

The overarching goal of New Schools was to generate a high social return on its investments, as measured by the degree of educational impact on the "end consumer"—children themselves. As Doerr explained:

> We are interested in initiatives that help make an "information literate" kid—one who can read, manipulate symbols, write, speak, and think critically in a world where they will be bombarded with information. That's what it takes to be a full participant in the new economy.

A secondary goal for New Schools was to contribute to industry knowledge about the effectiveness of various entrepreneurial approaches in creating change in the educational system. For example, New Schools purposefully invested in both a nonprofit and

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for-profit charter school venture to develop empirical evidence about which approach was more effective in terms of ability to scale, access to capital, access to people, and impact educational outcomes for children.

With these overall investment goals, New Schools had developed a specific set of criteria to assess investments. These included:

1. Scalability: The venture must have the potential to affect thousands of students.
2. Sustainability: The venture must have a sound business model and a credible plan for raising additional capital in the future.
3. Passionate leadership: The venture must have leaders with expertise in education and business management who have the ability to execute the venture's vision.
4. Opportunity for New Schools to make a difference: There must be a specific reason why New Schools' involvement will make a significant difference in the venture's prospects.
5. Significant opportunity: The venture must have the potential to make significant improvements to public K–12 education.
6. Specifically, the venture must
   a. Target a real vulnerability in the system.
   b. Have measurable educational outcomes.
   c. Be designed to overcome systemic inertia.

Scalability was of utmost importance to New Schools. Smith explained:

> I've run local programs that are not scalable, and they can be quite effective and important in children's lives. But we need to change an enormous and ineffective system, and our donors' experience is with the venture capital model and an emphasis on taking ideas to scale. They understand that scale matters if you're really going to change a $350 billion system.

Doerr emphasized the importance of scale, too. Doerr observed:

> We know how to make any particular school work and ensure that any individual kid can read. But I've come to the view that the important problems in public education are problems of scale. How can we rapidly improve tens of thousands of schools for millions of kids?

New Schools also placed significant emphasis on the strength of the venture's management team, since that had a direct impact on its ability to scale. Mitchell explained:

> Early on, we made the decision to focus on the venture's management team and their ability to get things done, which is remarkably different from how most foundations deal with granting. Foundations are more likely to look at the leader to see if he or she has the right qualifications to get the project at hand done, not whether he

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> or she can make widespread change with it. At New Schools, we have been relentless in our focus on whether the management team as a whole has the strategic and execution capability to truly scale the idea.

Another criterion of particular importance to New Schools was the ability to measure results. During the due diligence process, partners at New Schools encouraged education entrepreneurs to show what results their initiative had achieved to date and pushed them to think hard about how results would be tracked and measured over time. While measurement approaches and methods were often difficult to agree on, New Schools forced education entrepreneurs to grapple with the problem upfront since the ability to measure results was so important to the long-term success and impact of the fund. Barksdale explained:

> Most people who give away serious money are looking for demonstrable results. Yet most philanthropic efforts and charities don't do a good job of measuring and communicating results. To the donor, it feels like your money just went down some hole—you think you did some good, but you don't really know.
>
> By emphasizing measurable results, New Schools has the opportunity to make a major difference. If New Schools can prove its approach works, then it will be able to raise future rounds of capital and "copy cat" funds will emerge, which will further contribute to innovative solutions.

As New Schools assessed investment opportunities in the fall and winter of 1999, it became clear that the investment criteria they had developed represented a high hurdle. One of the most common dilemmas New Schools faced was that innovative ideas didn't always come complete with a strong management team. Greg Dees reflected on the challenge New Schools faced working with nonprofit entrepreneurs:

> A fundamental question for New Schools is whether nonprofits can attract the capital and human resources needed to scale. They may have trouble attracting the human resources they need, because they cannot offer stock options and typically have pay scales below for-profit entities. Often the managers of nonprofits come from within the field and do not have a great deal of business experience or management training. They may be gifted managers, but we have to ask whether the nonprofit has a leadership team in place with the knowledge and skills to take them to scale. Of course, team issues arise with for-profits as well; it is just a more common issue on the nonprofit side.

One of New Schools' challenges was that since the field of education entrepreneurship was so new, there was a limited pool of experienced managers. In these situations, New Schools had to determine if they could either strengthen the existing management team through coaching or mentoring or recruit additional management team members to fill in for weaknesses.

Investment Process

The New Schools investment process was comprised of six separate steps, including:

1. Opportunity identification
2. Due diligence
3. Identification of a New Schools sponsor
4. Entrepreneur presentation to New Schools' investment partners committee
5. Follow-up due diligence
6. Investment decision and identification of a New Schools board member

Smith and her team were responsible for the initial screening of investment opportunities submitted to New Schools. She received business plans from a variety of sources, including her own broad network of education entrepreneurs, New Schools' investment partners, and other venture capital firms. Smith reviewed each plan to assess its fit with New Schools' investment criteria. If a plan met the criteria and Smith was personally intrigued by the concept, she would "recruit" a New Schools investment partner to sponsor the investment through the process. In some of the early deals, this was not necessary since one of New Schools' investment partners had brought the investment opportunity to the organization in the first place. The next step was to conduct due diligence on the opportunity, which included meeting the management team, conducting site visits, talking with industry sources, and evaluating the venture against other initiatives in the same area. New Schools had its own unique due diligence "check list" that Smith had developed based on research she had conducted on how other venture capital firms and foundations conducted due diligence.

Once an investment opportunity had successfully made it through the due diligence process, the next step was to invite the entrepreneur to present the concept at one of New Schools' quarterly investment meetings. While all members of New Schools' board of directors were in attendance at each of these meetings, the group of investment partners on hand sometimes varied. At the meetings, entrepreneurs would present their plan and then field questions from the group. New Schools' partners used these meetings to discuss and evaluate the level of risk involved in the venture. Byers explained:

> In both venture capital and venture philanthropy, you can't avoid risk, so you have to decide which risks you're willing to take. Then you direct management time and capital toward eliminating those risks, while at the same time making progress against the venture's overall goal. For example, in a start-up, the initial capital goes to eliminating the white-hot risk, which is usually, Can we develop the product and will it work? Once that risk has been eliminated, the venture can start using capital to scale its organization, but you don't do that simultaneously. Lining up priorities is a good discipline.
>
> The next question is whether there is a market for the product. For New Schools, this means, Will it be accepted

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> by the educational community and can it scale? Because at the end of the day, education gets down to a teacher teaching a student, so you have to gain acceptance at that level. There are a lot of good ideas out there that are just too complicated for schools to adopt.
>
> Even if the product works and gains acceptance, another question is, Will it always need philanthropic support to sustain itself, or is there a way for it to stand on its own? If it will depend on philanthropic support, who are the likely funding sources? Often entrepreneurs don't want to focus on this question, but we have to discuss it.

If the investment partners in the meeting supported the business plan and the management team, they would approve the investment contingent on any specific follow-up due diligence issues. Smith and her team would conduct the follow-up due diligence, which often entailed additional meetings with the management team or school administrators to answer questions raised in the New Schools investment meeting. If Smith and her team were comfortable with the answers to the follow-up questions, she would forward the investment opportunity to New Schools' board for their approval. While a majority vote was legally required, it typically turned out to be a unanimous decision.

New Schools also identified one of its own partners or an appropriate professional from their network of new-economy leaders to serve as a board member in the portfolio company on behalf of New Schools. While New Schools was willing to have someone other than one of its own investment partners represent New Schools on the board, that person had to understand and support New Schools' mission and had to understand New Schools' reasons for investing in the venture and its goals for the venture going forward. They also needed to offer expertise relevant to the venture's needs. Byers commented on New Schools' focus on board-level involvement:

> This is a signet of the venture capital model. To get a deal done in venture capital, several partners have to sponsor it and at least one has to offer to go on the board. Committing to a board seat injects discipline to the process. It avoids the practice of sprinkling money across multiple projects and simply hoping something happens.

New Schools Investments to Date

By December 1999, New Schools had invested in five education-related entrepreneurial ventures out of approximately 100 business plans received. Three investments—University Public Schools, LearnNow, and GreatSchools.net (GreatSchools)—fell into the category of offering parents "choice" in selecting public schools, through building charter schools or by providing parents with detailed information on public schools in their communities. The other two ventures—Success For All Foundation and Carnegie Learning Inc.—fell into the category of comprehensive research-based

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curricula for schools. Three of the five ventures were nonprofit entities, two were for-profits. The structure of New Schools' investments ranged from bridge loans to grants and equity investments. (See **Exhibit 3.2.1** for a brief description of each portfolio company.)

An Example of the New Schools Investment Process: University Public Schools

University Public Schools (UPS), a nonprofit charter school management organization, which planned to build clusters of elementary, middle, and high schools in ten California school districts, was New Schools' fourth investment. New Schools was introduced to Don Shalvey, the founder of UPS, through Reed Hastings, who had worked with Shalvey on the California charter school ballot initiative. Shalvey, a 34-year veteran of the public education system, had spearheaded the first charter school in California. After seeing the positive impact charter schools had on his own district, Shalvey became actively involved in trying to raise the statewide cap on charter schools. Following his work on that initiative, Shalvey teamed up with Hastings to found a nonprofit organization in November 1998 to build charter schools. To fund the organization, Shalvey turned to New Schools, in addition to state and federal grants, foundations, and individual gifts.

Shalvey's discussions with New Schools began in March 1999. New Schools' interest in UPS stemmed from UPS's plan to open 100 charter schools in California, which would enable them to test the hypothesis that when charter schools attract 10% or more of a district's students, they begin to serve as a major catalyst for non–charter school reform in their own and surrounding districts. Between March and September, Shalvey worked closely with New Schools to revise UPS's business plan to answer questions related to New Schools' investment criteria, talking with Smith and the New Schools organization several times a week. Specifically, New Schools sought changes in UPS's plan for building its management team, evaluating results, financing its growth, and raising future rounds of capital.

In terms of UPS's management team, New Schools made its funding contingent on three actions: first, that Shalvey devote himself full-time to UPS—which entailed resigning from his role as district superintendent and extracting himself from his other outside obligations—second, that UPS include two New Schools partners on its board, and third, that UPS expand its management team to include professionals from outside the educational sector who could contribute strong business expertise, particularly in the areas of finance and operations. Smith agreed to help UPS source qualified individuals by leveraging her own contacts and the New Schools network. In fact, in June 1999, UPS hired a consultant with a leading strategy consulting firm to be a senior manager at UPS, whom Smith had helped to recruit. Shalvey commented on the process:

> The New Schools people worried much less about the money and future funding than they did about building a strong management team that would include both educators and MBA types

- **GreatSchools** Founded by Bill Jackson, GreatSchools was a nonprofit organization that provided a comprehensive online guide to K–12 public schools in California. The guide rated schools on a consistent set of measures, including academic performance and quality of teaching, leadership, and learning environment. The mission of the venture was to leverage the Internet to help parents and the community choose, support, and improve K–12 public schools. GreatSchools planned to roll out its online guide to communities nationwide. Based on what they believed was a highly scalable business model and a strong management team, New Schools invested $100,000 in GreatSchools even though it did not exactly fit with New Schools' criteria of investing in ventures that would have a *direct* impact on students.
- **Success For All** Designed by Drs. Robert Slavin and Nancy Madden of Johns Hopkins University, Success For All was a nonprofit organization that was best known for developing a highly structured approach to teaching children how to read. Specifically, the program set aside 90 minutes of each school day for students to work on building their reading skills in ability-based groups. One of the distinctive aspects of Success For All was its "whole school" approach. In fact, 80% of the teachers had to vote to have the curriculum adopted by the school before Success For All was willing to implement the program. Started in 1986 as a single-district effort to prevent at-risk schoolchildren from falling behind during their first few years of school, Success For All was now the nation's largest comprehensive school reform organization with its program being implemented in 1,400 mostly high-poverty schools in the United States. The goal was to roll it out to 3,000 schools within three years. New Schools provided Success For All with a 5-year, $1 million low-interest loan.
- **LearnNow** Founded by Gene Wade and Jim Shelton, LearnNow was a for-profit education management organization that planned to create and manage a national network of charter schools focused on math, science, and technology, for sixth- to twelfth-grade students from urban communities. Conceived by five Harvard University Law School students, LearnNow was originally founded as a nonprofit. The founders realized that it would be very difficult to raise the capital needed to go to scale as a national nonprofit, so they created LearnNow as a for-profit. LearnNow's mission was to prepare students from poor and disadvantaged communities to become successful college students and knowledge workers. LearnNow planned to open its first four schools in the fall of 2000 and ramp up to approximately 50 schools serving 46,000 students by 2005. New Schools invested $1 million in LearnNow.
- **University Public Schools** Founded by Don Shalvey—a charter school advocate and public school superintendent—University Public Schools was a nonprofit charter school management organization that planned to build clusters of elementary, middle, and high schools in ten California school districts. University Public Schools' mission was to provide a high-quality educational alternative to students in California by focusing on attracting and retaining outstanding teachers, and in the process, serving as a catalyst for change in the surrounding public school districts. New Schools provided University Public Schools with a $500,000 grant and agreed to provide another $500,000 in convertible debt if the organization met specific performance targets.
- **Carnegie Learning** Started as a research project by Professor John Anderson at Carnegie Mellon University, Carnegie Learning was spun out as a separate for-profit venture in 1999 that developed a comprehensive approach to teaching algebra and geometry, which combined classroom instruction and a learning-by-doing approach with an artificial intelligence-based computerized tutor. The program included extensive teacher training, which emphasized the importance of interactive learning. Backed by 15 years of research, the Carnegie Learning approach had demonstrated impressive results across class and ethnic lines, and in 1999 it was selected as one of the top five K–12 math curricula by the U.S. Department of Education. New Schools invested $500,000 in Carnegie Learning's first round of funding.

Exhibit 3.2.1 New Schools' Portfolio Companies (in chronological order of investment)

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> who could help build the organization. That focus is very different than what is typically the case with foundation or government funders.

In terms of evaluation techniques, New Schools mandated that UPS develop a plan to be approved by New Schools for how the organization would measure its progress and its impact on students. As part of this effort, New Schools required that UPS hire an external evaluator to design and monitor measurements for student achievement. While UPS had initially considered bringing in an external evaluation firm to assist them, it was deemed too costly. However, New Schools placed such a strong emphasis on being able to measure results that the group increased the amount of capital they were willing to invest in UPS in order to fund an external evaluation effort. Shalvey explained New Schools' interest in measurement and evaluation:

> When Kim started asking questions about our plan for evaluating student outcomes during our first few meetings together, I started to think that New Schools might be taking a typical Silicon Valley/corporate perspective of wanting results immediately, which in education never works well. It took a lot of conversations for us to see that what New Schools really wanted was not immediate *results,* but rather immediate *data collection* on baseline variables that we would need in order to test our hypotheses over time. New Schools forced us to be much more thoughtful than we would have been if we had been applying for a federal grant.

On the marketing side, New Schools pushed UPS to think carefully about how it would "brand" itself. New Schools felt that it was important for UPS to define what had to be part of every UPS school, as a way to differentiate its schools from other education alternatives, but also as a way to inject some discipline into the process of defining the core elements that had to be in place in every school across the system. "The brand represents what every parent can expect when they go to a UPS school," said Smith. "Identifying the few core variables that are critical for educational and operational success is also crucial if an idea like this is to be scaleable. UPS could not create a customized school for every group of parents if they want to get to scale." Shalvey commented on the difference in New Schools' approach:

> Branding isn't something that public educators typically think about. The New Schools approach is to be much more forward and proactive with an edge of competitiveness and challenge. They tend to be much more evangelical and they like to focus on points of differentiation rather than similarities. That's really unheard of in the public school arena, where we tend to discuss how alike we are, because we don't want to alienate our colleagues at other schools.

Finally, in terms of development, New Schools pushed UPS to develop a two-year capital campaign plan that laid out their proposed funding sources for raising

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additional capital. Part of New Schools' motivation for this was to ensure that UPS was not going to be overly dependent on philanthropy in the future. New Schools also helped UPS bring in a former banker on a short-term volunteer basis to build a series of computer models that mapped out UPS's funding needs under a number of different growth and financing scenarios, specifically considering various debt strategies for facilities development.

After six months of discussions, New Schools committed to provide UPS with a $500,000 grant and another $500,000 if UPS met specific performance targets. (See **Exhibit 3.2.2** for UPS's performance targets.) While New Schools' due diligence process had been far more in-depth and lengthy than Shalvey had expected, he felt it had been well worth it in the long run. Shalvey commented:

> To be honest, the UPS team all wondered at different times whether we were being micromanaged by New Schools, because our interaction was so different than we were accustomed to when we applied for foundation or federal grants. Sometimes it felt like we were speaking two different languages, but the rigor of the process made for a stronger plan. New Schools really helped us integrate our mission, message, strategy, and budget. Every school district ought to write a business plan—which is vastly different than a grant—although you wouldn't want to have more than one New Schools–type partner! I can also say that out of hundreds of school board meetings I have been to, there have only been a handful that have been as mentally stimulating as UPS's first few board of directors meetings after our New Schools board members had joined.

Smith conceded that New Schools had high standards. However, as she explained: "Our decision to invest is a long-term commitment, and over time, New Schools will add value in many ways, including helping the venture scale and securing future funding, so we want to work things out at the front end to make sure we are all talking about building the same thing."

Fulfilling the Second Half of the New Schools' Mission

Since joining New Schools, Smith had also worked hard to spearhead initiatives that would help the organization fulfill the second half of its mission—to create a network that connected education entrepreneurs to each other, leaders in the "new economy," resources, and intellectual capital. Leveraging her network from Stanford Business School, and her days with Teach for America and BAYAC AmeriCorps, Smith's first step was to host a series of dinners at her own home for education entrepreneurs and other leaders in the education field. These dinners served as a medium for Smith to discuss the goals of New Schools and to learn about various entrepreneurial efforts in a variety of areas within the education arena.

Smith also spent a significant portion of her time meeting with education entrepreneurs, educators, and foundations to

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	1999		*2000*	
UPS MILESTONES 1999–2000 SCHOOL YEARS	*Q3*	*Q4*	*Q1*	*Q2*
People				
Hire CFO		♦		
Hire Director of Development		♦		
Don starts full-time as CEO			♦	
Fund-raising and financing				
Develop 2-year capital campaign plan to raise $25 million		♦		
Secure $2 million start-up financing for next 3 schools			♦	
School results				
Start 1999–2000 school year fully enrolled	♦			
Start 1999–2000 school year fully staffed	♦			
Hire external evaluator		♦		
Receive positive midyear reviews from parents			♦	
Exceed 95% student reenrollment rate of eligible students				♦
Show significant improvement in student achievement				♦
Retain 95% of staff performing at or above expectations				♦
Growth				
Secure charters for Stanislaus County and San Francisco			♦	
Identify and secure 1–2 sites in Oakland			♦	
Identify and secure 1–2 additional sites in Central Valley			♦	
Establish partnership with organization(s) for new Central Valley sites				♦
Hire 2nd principal for Oakland				♦
Hire principal(s) for Central Valley				♦

Exhibit 3.2.2 UPS's Performance Targets

SOURCE: New Schools Venture Fund.

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communicate New Schools' mission and to keep abreast of trends and developments in the educational sector. She also hosted a series of focus groups with educators and education entrepreneurs to discuss and generate feedback on New Schools' strategy—a mechanism Smith found to be highly valuable in helping her think through a number of issues.

In January 1999, Smith hired Lisa Daggs, a former Teach for America teacher who had gone on to earn her master's in business and education at Stanford University, to be New Schools' director of educational operations. One of Daggs's first projects was to manage a national conference for education entrepreneurs. The conference—the Summit for Leaders in Education Entrepreneurship, cosponsored by the Stanford Graduate Schools of Business and Education—was held on October 30, 1999, at Stanford University. Over 250 education and technology entrepreneurs, educators, policy makers, industry analysts, and donors attended the event, which was designed to bring these groups together and provide a forum for discussing how new-economy principles could be applied to educational ventures. Breakout sessions focused on issues relevant to education entrepreneurs, such as how to design a scalable venture and whether to incorporate as a nonprofit or for-profit venture. New Schools intended to host other national conferences focused on improving K–12 public education in the future.

EMERGING ISSUES

In December 1999, Doerr sat down at his desk to review the preliminary set of year 2000 objectives that Smith had prepared. Doerr concurred with Smith that the organization had made excellent progress toward its goal of investing in high-potential educational ventures over the past year and a half, and that now was the time for New Schools to shift its priorities to strategically building its network.

Smith felt that New Schools could and should do even more to add value to its portfolio companies. In fact, as Smith and her fellow New Schools partners had found, New Schools did not have the capacity to offer the level of hands-on support and expertise that its portfolio companies often needed. For example, New Schools' portfolio companies sometimes needed help with corporate strategy, managing growth, building their internal organization, and recruiting people. However, given the prominence of New Schools' existing partners, many were too busy in their jobs to commit more than half a day to one day a month to New Schools, which included attending the quarterly investment partner meetings. Smith knew that in order to provide the type of hands-on assistance needed by some of New Schools' portfolio companies, the organization needed to think more strategically about how it went about extending and managing its network.

Smith believed that one option was to expand New Schools' partner group. However, she felt that it was important to first develop a set of criteria for what New Schools needed from new partners at this stage of the fund's development. There were many ways for New Schools to add value to entrepreneurial ventures, including contributing financial capital, providing ongoing mentorship and guidance by

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taking a board seat in the venture, providing targeted advice in a specific functional area, offering educational expertise, and providing networking support. It was virtually impossible to find a partner who could contribute in *all* of these areas. In fact, New Schools had already experienced some of the trade-offs; often the partners who could offer significant capital or extensive new-economy management expertise had very little time to invest in providing hands-on support to New Schools' portfolio companies. Similarly, partners with deep educational experience often lacked experience in the business side of the new economy. However, one thing was clear to Smith—over the past year, she had seen that human *time* was the critical factor in determining how much value New Schools could add to the ventures in which it invested.

Smith believed that there was a group of young, motivated, passionate people that New Schools had yet to tap into. In fact, Smith's personal network included many of these young professionals (e.g., friends from her business school class, colleagues from her work in the nonprofit arena) who were in their late 20s or 30s and had developed a specific functional or industry expertise that could be valuable to New Schools. Some in this group were already successful entrepreneurs, while others were at an earlier stage in their career. Smith explained the idea further:

> Some of our partners already are sitting on six to eight boards, so we realized we just can't ask them to sit on multiple boards for New Schools. So that led us to explore our options. What if we brought in some younger professionals who each brought a particular expertise to the table? In some cases, they might even be experienced, talented, and interested enough to serve as board members on behalf of New Schools. In other cases, they could add value as a hands-on team, helping us with due diligence, or helping CEOs with specific problems they are facing. We're not sure what the answer is, but we sense that this is a good resource that we aren't tapping into. We think that if we invited them to get involved, they would be very enthusiastic and would want to make a difference. The question is, How do we structure their involvement so that we can maximize the experience for them and their value to education entrepreneurs?

The opportunity to learn from and interact with New Schools' prominent partner group was a compelling reason in and of itself for some young professionals to get involved with New Schools. However, Smith wanted to be sure that people were joining based on a true desire to improve education as well. One New Schools partner reflected on this dilemma:

> One of the problems that I see with the nonprofit and government sectors is that they ignore people's selfish motivations, instead of building off of them. The more you can align people's personal and organizational interests with their civic interests, the greater commitment you'll get. That said, New Schools does run the risk of having an adverse selection problem—people joining based on a belief that this is a great way to network with the

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> organization's prominent set of partners, rather than to contribute to the goals of the organization. The challenge for New Schools will be to keep the networking benefits a secondary focus.

Smith had asked Glickman, Whorton, and two other colleagues with technology and marketing backgrounds—who all fit the young professional age demographic—to help her identify 20 potential young professional candidates who could contribute one of four types of expertise she felt that New Schools needed: entrepreneurial leadership and operations, venture due diligence, branding, and technology expertise.

The young professional group could potentially offer energy, passion, new-economy knowledge, and, in some cases, financial capital to New Schools. However, the question again came down to whether they had the time to contribute to the organization, given their professional and personal obligations. That raised another possibility that Smith had considered of attracting recently retired executives with an interest in education. The advantage of this approach was that these individuals might have more time and experience to contribute; the question was whether they had relevant start-up or new-economy experience and whether they were interested in learning about the education half of the equation.

Smith believed that precedent had already been set for partners to play different roles within New Schools. This raised the question of whether New Schools should better clarify its own expectations about the role each partner would play. This could be accomplished either through New Schools' initial discussions with each partner or through the use of different partner "categories." Perhaps New Schools should develop an explicit agreement with each partner as part of the recruitment process, which outlined the type of value the partner was agreeing to contribute to the organization. Alternatively, New Schools could develop one or more partner categories for different types of contributions (e.g., financial, advisory). An analogy for this idea came from Silicon Valley where start-ups were increasingly making use of two boards—a board of directors made up of individuals who were very active with the company, had voting rights, and provided overall mentorship and a board of advisors made up of people who were less involved on a day-to-day basis, did not have a board vote, but served as on-hand advisors on specific issues. If New Schools decided to develop explicit categories of partners, Smith would have to think through who would be included in investment partner meetings and how New Schools would keep a larger group of partners feeling connected to the group and the goals of the organization.

Managing a larger group of partners brought up the issue of New Schools' internal infrastructure. New Schools had only three full-time staff members—Smith, Daggs, and Beth Sutkus—a recent Stanford graduate. As president of the organization, Smith was responsible for all internal and external issues related to New Schools. Daggs, New Schools' director of educational operations, split her time between conducting due diligence efforts for potential investment opportunities and building the New Schools network. Sutkus, New Schools' project manager, focused on New

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Schools' external communication efforts, including conferences and the organization's Web site. Responsibility for managing New Schools' network with its partners and with the external education entrepreneur community was shared among the group. Smith worried that adding additional partners might stretch the New Schools organization too thin. This represented even more of a concern since the New Schools board had all committed to ensuring that New Schools offer each partner a "high-engagement" way to get involved. Smith wondered what kind of team she would need to support a larger group of partners who sought high engagement.

Another idea for providing greater support to its portfolio companies was to develop partnerships with other organizations focused on serving educational ventures and/or nonprofits. While Smith hadn't compiled an exhaustive list of the types of organizations that might make sense, she had some early ideas, including consulting firms, executive search firms, education schools, and business schools. While this option clearly offered the advantage of having expertise "on call," Smith wondered whether it was important to develop this type of intellectual capital in-house rather than relying on external partners. By hiring more staff and developing these capabilities in-house, New Schools had the flexibility to share the knowledge developed with its other portfolio companies and with the education entrepreneur community as a whole. She also questioned whether this outsourcing approach would undermine the high-engagement approach for donors.

Smith knew that it was up to her to think through how to extend New Schools' network, since the board would expect her to come to the meeting the following week with a recommendation. Smith believed that the board would support a plan to expand New Schools' network since they had both seen firsthand the power of a strong network through their experience at KPCB and TechNet. While Smith had a series of ideas on the table, she knew there were probably many more she hadn't yet identified. She planned to spend the next few days brainstorming with her internal team, New Schools' partners, and friends to test her ideas and potentially develop additional ones. While Smith looked forward to the challenge of developing a recommendation, she knew that it would be a difficult problem to solve, and she felt fortunate to be able to tap into such experienced entrepreneurial leaders for support.

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NOTES

1. Teach for America was a national teacher corps that recruited, trained, and placed recent college graduates in teaching positions in underfinanced rural and urban districts with teacher shortages. As of 1999, Teach for America had helped bring over 5,000 new teachers into the profession.

2. BAYAC AmeriCorps was a consortium of 20 youth-serving nonprofit organizations dedicated to developing young leaders in education.