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commentary

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The Philanthropic Contract: Mutual Benefit for the Public Good

I want to talk this morning about an approach to grant making. Grant making is our central business, what all of us share whether we be staff, trustees or principals of foundations. We are also concerned about other matters, like governance, investment, management and our regulatory environment, but all of that is in service to our basic job, grant making.

If our eye is not on the grant making ball, we are looking in the wrong direction. Some foundations are not looking at the ball. They are concerned with things like managing or enhancing the asset base, satisfying the needs and interests of trustees or principals, or dealing with the many daily tasks of running an organization. In fact, one of the largest foundations in the country, a public foundation, is so distracted by these other things that it is having trouble disbursing its funds despite the rising needs in the community.

At The Maytree Foundation, we have a little mantra that the staff chants together every morning: "Keep your eye on the needs of the community." To us, this is our first rule of philanthropy and our greatest guide to good philanthropy. As a corollary, I would offer this observation: Philanthropy that keeps its eye on the needs of the donor is bound to fail eventually.

The investment paradigm

The particular approach I want to talk about this morning involves using the same approach in our businesses and in our philanthropy. At Maytree, we operate out of the same office as do our businesses, which are under the aegis of Avana Capital Corporation. I am the Chair and CEO of both Maytree and Avana. At Avana, we engage in a range of investments.

This speech was given to the Private Foundations Canada Conference in Toronto on June 1, 2001, by Alan Broadbent, Chair and CEO of Avana Capital Corporation and The Maytree Foundation and Chair of the Caledon Institute of Social Policy.

Some, like many investors and most foundations, are passive portfolio investments. Unlike most foundations, at Avana we also engage in venture capital, we take majority positions in operating businesses, and we actually provide management and management services to companies in which we invest.

I would prefer not to have to change hats when I move from Avana to Maytree business. So we have devised one approach to business at both places, where we think the philanthropy model borrows from business, and the business model borrows from philanthropy. It isn't perfect, but we think it works well enough.

So, how do you do philanthropy like you would business? The paradigm is investment. In both cases you are investing capital, for financial return or for social return.

Many of you are familiar with business investing. You ask yourself several key questions:

1. Is this a good business idea? That is, is there a significant customer base for the products or services to be produced? Can they be sold at a good enough price so we can make profits? Can we achieve some competitive advantage?

2. Is there a good strategy to achieve business success? From the strategy, is there a credible business plan?

3. Are the people in the business the ones who can make this successful?

A good business idea, the right strategy, and the people to make it work: These are the critical success factors.

What is the application of this to philanthropy? Let me try and restate those three questions:

1. Is this a product or service which is really needed in the community? Would it result in a significant improvement in the life of enough people? Can it be provided at a cost that makes sense? Does this approach to solving the problem offer some competitive advantage over other ways of doing it?

2. Is there a good strategy in place to achieve success? Has a good business plan been developed to implement that strategy?

3. Are the people running the organization capable of making this successful?

As you can see, these questions are virtually identical. There is one difference. In business, we can calculate return. We can subtract the costs from the revenues and say what the expected profit will be. In philanthropy, we have to describe what benefit will result differently.

That is not to say that the outcome is less clear, or less tangible. It is to say it is more difficult to describe. We tend to expend some effort in describing success at the outset. We view each grant that we make as a contract between the recipient and us. It is during the process of negotiating the terms of the contract that the definitions of success get articulated. What will success look like? Once we have been through that exercise, and the grant is made, we have a much better chance of recognizing whether or not we see success later on.

One thing we have working for us in business is well populated markets with a reasonably common language. The fact of having a great volume of activity in apparent markets is that it is easier to make comparisons. If I see a deal come across my desk to fund a company in new battery technology, for example, it is not very difficult in due diligence to find other such projects and to find competitive processes. Then I can do some useful comparison to discover if it is a good business idea, and if the financial structure makes sense. And I can find out a lot about whether the people behind the deal can deliver.

In philanthropy, where there is relatively less activity, or at least more fragmented activity, and no common language, the due diligence is a little more difficult. Where the marketplace is more dispersed, it is harder to find out if the idea is being tried elsewhere, or if there are competitive ideas. We have to work harder to find the networks from which we can glean such information. And often the people bringing the proposal may have never worked in that precise area before, or are attempting to make a transition to a different role, say from program staff to social entrepreneur.

That difficulty means two things: We have to work harder at due diligence; and we are exposed to greater risk. Not necessarily unacceptable risk, but less information results in greater risk.

Doing philanthropy with a business hat also offers some other points of view on things which have become popular in the funding world like matching funding and program funding. Lots of donors like matching funding, where they say to a charity that they'll meet half of a funding request if the charity can find the other half. They refer to this as "leveraging" their donations. I look at it as a way of under-capitalizing the enterprise, and under-capitalization may be the greatest contributor to business failure. In my view, the smarter donor makes sure that the charity is asking for enough money to actually get the job done. And many charities have become so attuned to lean times that they don't ask for adequate resources. There have been a number of grants we have made at Maytree where we have talked the applicant into a higher number, because we knew they would fail with the lower one. In some cases, matching may actually bring some new philanthropic money to the table. In most cases, it just diverts existing philanthropic money from one place to another.

It is similar with program funding, where the donor says they will not fund core costs, but only program costs. The presumption here is that the charity has its core costs covered, and the donor achieves greater "leverage" – that word again – by only funding the incremental costs of the new program. And the charities often fall into a trap by excluding any contribution of core resources from the program budgets, effectively discounting the incremental core costs. Is it smart business to invest this way, to risk instability at the core? As donors, as investors, we have to be sure the host is healthy before we begin to grow new elements. That means, particularly when governments are withdrawing as supporters of organizational cores, that we have to pay more attention to the capacity of the organization overall, at the heart of which is the core operation.

Both of these are cases where the donor's eye is on their own needs, not those of the recipient. It is about leveraging their own assets, not about building capacity in the agencies which deliver services to clients.

Is what I have been talking about the so-called Venture Philanthropy? I presume the term is borrowed from venture capital. In business, there are various ways to do venture capital. There isn't one model. The only basic description I know of venture capital is that it is high risk, high return. You recognize that of ten deals you do, many will fail, a few will struggle along, a few will be modest businesses, and only one or two will be what we call home runs. Those home runs need to give big returns, 30-40 percent, to account for the losses. I can only guess what the return analogy is in philanthropy.

The term Venture Philanthropy, though, usually refers to the style of engagement between the donor and recipient, and I want to say a few things about that. It refers to a style where the donor gets very active with the agency, as an investor might get involved in a company, working with management closely in the development of strategy and plan, and in some cases the running of the enterprise.

Arm's length

There is a concept beloved by financial community regulators called "arm's length." It concerns avoiding self dealing or other behaviour which treats other investors unfairly.

As I've said, we do venture capital investing in a variety of ways. In some cases, rare ones, we actually take over companies and provide management, select the board, and create the business strategies. We are the largest, and sometimes the only, investor in such cases. If there are other investors, we treat them exactly as we treat ourselves. But we are not at arm's length.

Our preferred way of venture investing, though, is to take smaller positions in companies we believe will be successful, and where there is a larger shareholder in control. In these cases we do not usually sit on the board, we never become part of management, and we never meddle in operating matters. We don't do this because we want to be able to divest of our interest opportunistically, and we want to rely on the people we think can deliver business success. We deliberately stay at arm's length.

When we started in philanthropy, we decided to take the same approach as we do in business. We identified one venture in which we wanted to be "the controlling shareholder" – the Caledon Institute of Social Policy – and I chair its board and am involved at board level in strategic and business decisions. I have an excellent CEO at Caledon in Ken Battle, and he develops the strategy for board approval, he runs the business, and I don't meddle in that.

For the rest of our philanthropy, we are very deliberate about being at arm's length. We do not sit on boards, we do not impose strategy or tactics, and we do not hire and fire managers. We do insist on good reporting, to aid our evaluations, and we like to talk to management to find out if they are on plan or if their approach has changed from our original understanding. But we do not get involved in management or developing strategy. We will, from time to time, fund an organization engaging in strategic work, or improving their managers, but only by funding the process, usually involving outside advisors. We will sometimes recommend such a process.

I took this approach for a simple reason. I want to decide whether to continue a grant based on what they have achieved, not on what I have influenced them to achieve. It is amazing how smart, interesting, and good looking you become when you have money to give out. The donor's voice is disproportionately powerful.

I saw a number of examples in the US where enthusiastic donors got side by side with managers in a charity and redesigned what the charity did. Two things tended to happen. The attention of the donor shifted, or the enthusiasm waned, and the charity was off course. Or the new direction didn't work, and the donor withdrew, blaming the managers. The charities were furious at being cut off because they thought they were just following instructions. Lose, lose.

Can arm's length be violated by so-called venture philanthropy? Probably, by donors who observe three things carefully:

- Be fully sensitive to the power differential, and put it on the table from the outset for all participants to deal with openly.
- If you are going to be involved inside the charity, be prepared to wear the results, good or bad.
- And be there for the long term. Change takes a long time. You have to stay.

The public policy dimension

Finally, I want to comment on the public policy dimension of philanthropy. State sanctioned philanthropy is not a right. The ability we have to create capital pools with tax concessions is conscious public policy. The government has said that these pools can be created and maintained as long as the proceeds are used for the charitable purposes endorsed by public policy, to a defined extent of at least 4.5 percent of assets, and the rest is used to increase the asset base when the capital has earned more than 4.5 percent.

Were there not to be such a public policy, these capital pools would be subject to the same taxation exposure as other capital pools. They would be less restricted as to their use, but taxed.

There are mixed views on what obligation to the public we have. Some foundations take the view that as long as they are complying with the basic rules, that is that they are giving away at least 4.5 percent of assets to registered charities each year, then it is nobody's business but their own. As such, they report publicly what grants they are making grudgingly, and are disinclined to engage in any public discussion about their granting.

Others, and I include The Maytree Foundation among them, think we have a basic responsibility to report our grants, and to be prepared to discuss them. While we don't think we need to adhere to the kinds of choices that governments make in their asset allocation, we feel that we need to be accountable to the public, at least to the extent that we expect governments to be accountable to us. The argument is that because we are creatures of public policy, we should provide the basic information about what we do so that the public can judge whether the policy is good. And if it is not, they could change it.

This is an important dimension in philanthropy, and it is in part what separates strategic and organized philanthropy, which is what foundation philanthropy is, from the acts of making personal donations. It is in the particular consideration of the public good, and the creation of a strategic response to it, that foundation philanthropy is based. It is the basis of Laidlaw's historic Children at Risk program, Kahannof's support of third sector infrastructure, McConnell's community economic development programs, and Muttart's youth challenge initiatives. And many more such programs in many other foundations.

We can look at the public good from many perspectives, and interpret it differently. That diversity of approach provides richness to foundation philanthropy in Canada. But it is through the lens of community, the expression of the public good, and our creative response to it, that good philanthropy comes. And for Maytree, it is through the discipline of the investment paradigm that we think we are best able to support the common good.

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