# OUT OF PHILANTHROPY'S FUNDING MAZE

## Roadmap #1: Strategic Co-Funding

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*Investing in Employment and Hope*

This is the first article in **REDF's "Stepping Out of the Maze" Series**, which has developed out of our concern for the funding environment in which nonprofits carrying out critical social change work must operate. The series of three articles explores ways that private sector financing practices, especially those in private equity and venture capital, can be adapted to improve practices in nonprofit funding. We are grateful to **The Aspen Institute's Nonprofit Sector and Philanthropy Program** for funding critical elements of this series.

**REDF** is a high-impact, hands-on, venture philanthropy and intermediary organization. We work with a portfolio of carefully selected nonprofits, providing money and business assistance to support the early stage social enterprises that intentionally employ those most disconnected from the workforce. Over the past decade, REDF-supported social enterprises have employed more than 3,300 people overcoming histories of incarceration, addiction, mental illness, homelessness, chronic poverty and joblessness. We build bridges between for-profit businesses, nonprofits, socially-focused capital markets, and government agencies to create more durable job opportunities and entry points to the workforce and we proactively share our insights and lessons with our publications and tools.

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# OVERVIEW

The types of funding available to nonprofit organizations and the processes for accessing funding are limited, restrictive, and confusing. Compared with for-profit firms' fundraising activities, nonprofits' search for funding is more idiosyncratic, circuitous, and expensive with more uncertain and impermanent results. This dysfunction continues to be a concern and an impediment to social mission supporters. We want our community initiatives to solve complex problems. But until we change the ways they access capital, we can't expect them to succeed. They require more money, more efficient money, and more stable money.

This article is the first in a series exploring the adaptability of several venture capital (VC) financing principles to foundation grantmaking. It builds on thinking and practice since the early 1990s: seminal work by Christine Letts, William Ryan, et al in their "Virtuous Capital: What Foundations Can Learn from Venture Capitalists,"[1] posited that venture capital approaches to investing might be usefully applied to philanthropic giving. Excitement, as well as some healthy skepticism, ensued, and fueled the development of venture philanthropy. VP's definition is fluid, but in general the term suggests an approach to philanthropic giving in which the donor is more, rather than less, engaged with grantees. Venture capital is considered the business model for this highly engaged funding approach. Examples of venture philanthropy organizations include Venture Philanthropy Partners, New Profit, Inc., REDF, and others. Examples of the value these organizations have brought to their "investments" are compelling.

However, this highly engaged approach to philanthropy is not a fit for most donors. Nor can grantees manage involvement with too many engaged funders at one time. Thus, although there has been a lot of buzz about venture philanthropy, a low proportion of the 70,000+ U.S. foundations have employed/implemented a venture philanthropy approach to their grantmaking.

Despite the venture capital model's very targeted and limited application to philanthropy, specific venture capital principles can be adapted broadly to foundations and to the philanthropic practices of motivated high net worth individuals. With this series we present key principles and practices for foundations and individual donors who want to increase the strategic impact of their grantmaking and to catalyze a more effective nonprofit capital market.

Article One looks at **Strategic Co-Funding**: how do venture capital investors and grantmaking foundations differ in their approaches to co-funding and how might the underlying principles of VC co-funding be adapted to foundation and individual giving? The article draws potential nonprofit capital market solutions from interviews with philanthropists, nonprofit experts, VC partners, and from a growing body of literature.

We focus on the funding dilemmas of a subset of nonprofits which does not include religious, higher education, hospital, or museum institutions. We exclude these organizations from our consideration because they share an advantage that others do not have: a built-in community of funders. Funding in these sectors is generally highly developed and stable. In contrast, nonprofits serving poor communities, or in some cases, environmental or educational causes, do not have built-in stakeholders able to ensure their funding stability so they must go outside their built-in stakeholders.[2]

What can nonprofit funders learn from their venture capital investor counterparts? We extrapolate the steps that charitable foundations and forward-thinking individual donors can take to adapt and incorporate these principles to improve the impact of their funding. The accompanying tool, "Considering Co-Funding," is designed to help readers assess the applicability of Strategic Co-Funding to their philanthropic giving.

1. Letts, C. W., Ryan, W., & Grossman, A. 1997. Virtuous Capital: What Foundations Can Learn from Venture Capitalists. Harvard Business Review (March-April 1997): 8.
2. Stepping Out of the Maze is a series of three articles co-funded by REDF and The Aspen Institute.

## Foundations and Individuals: Small Size, Large Impact Potential

Foundations in the U.S. provide a small proportion (12+%)[3] of all charitable giving but can have impact beyond their size when they fulfill their potential to be both flexible and strategic. Individual donors are widely dispersed and the majority of them give in relatively small amounts, but their giving is the critical source of over 75% of foundation and other charitable dollars. Large gifts from individuals, aggregated via some sort of intermediary organization, can be a powerful force. Both foundations and high net worth individuals can increase the impact of their dollars by co-funding strategically.

Unlike government funders of social mission activities, private and corporate foundations have a great deal of latitude in deciding what and how they fund. Unlike the diverse and dispersed universe of individual donor giving that is not coordinated via some sort of intermediary, foundations—the “organized philanthropy”[4] of individuals—have the ability to inform their funding by marshalling networks and resources and influencing policy. They can incorporate a broad and accurate view of needs, current developments and best practices to funding decisions and they have great potential to influence and attract new donors to the social missions they support. The relative autonomy foundations enjoy, together with the funds they manage, puts them in a unique position and gives them a serious responsibility: to do their grantmaking in a way that generates maximum impact.

Like foundation funding, U.S. venture capital investing is proportionally small—it constitutes just over 25% of U.S. private equity funding, and less than 1% of the overall capital market. But it has served a catalytic role in funding early-stage businesses and emerging technologies. VC investors stake their success on both getting early-stage businesses off the ground, and in helping them move to their next financing stages. It is this longer-term strategic role in mapping out and initiating a funding path that organized philanthropy can and should emulate.[5]

Foundation funding has fueled social sector innovation and filled critical emergency community needs. However, with some notable exceptions, the field has not developed an approach that supports long-term solutions to the long-term problems it seeks to address. As with other aspects of foundation grantmaking, co-funding is often short-term and project-focused. Foundation co-funding is in its infancy: collaboration efforts have resulted in productive funder networks and some coordination of resources but have rarely sought to or succeeded in attracting net new funds or long-term financing. Foundations can expand their impact by co-funding with each other and entities such as government agencies or high net worth individuals. However, in order to expand impact, this co-funding must be strategic: it must support clear and compelling problem solutions with the funding and time horizons that sustainable solutions require.

More aggregation of funds and funders is needed. Aggregation via co-funding that is based on clear goals, problem solution scale, and agreed-upon success measures is one route to more capital and an improved nonprofit capital market.

3. Bernholz, L. 2004. Creating Philanthropic Capital Markets: The Deliberate Evolution. Hoboken: John Wiley & Sons, Inc.
4. Ibid.
5. Global Insight. 2007. Venture Impact—The Economic Importance of Venture Capital Backed Companies. The National Venture Capital Association.

## Strategic Co-Funding: A Working Definition

We use the term "Strategic Co-Funding" to specify joint funding that has a particular set of goals aimed at solving a long-term problem. Strategic Co-Funding supports solutions to social problems in much the same way that venture capital-style money aggregation supports the development of a new company. Unlike much of current nonprofit funding, it is solution-focused, rather than project-focused and it is driven by the long-term strategy and overall needs of an initiative. More than a casual "contribute-if-you-want-to" pooling of dollars, it requires drive, strategic focus and long-term commitment.

Strategic Co-Funding not only operates with a view to the overall needs of an initiative, it expands its pool of donors and funds to achieve the initiative's agreed-upon outcomes.

A Strategic Co-Funding initiative is shaped by solution requirements, rather than funders' needs and limitations. It has

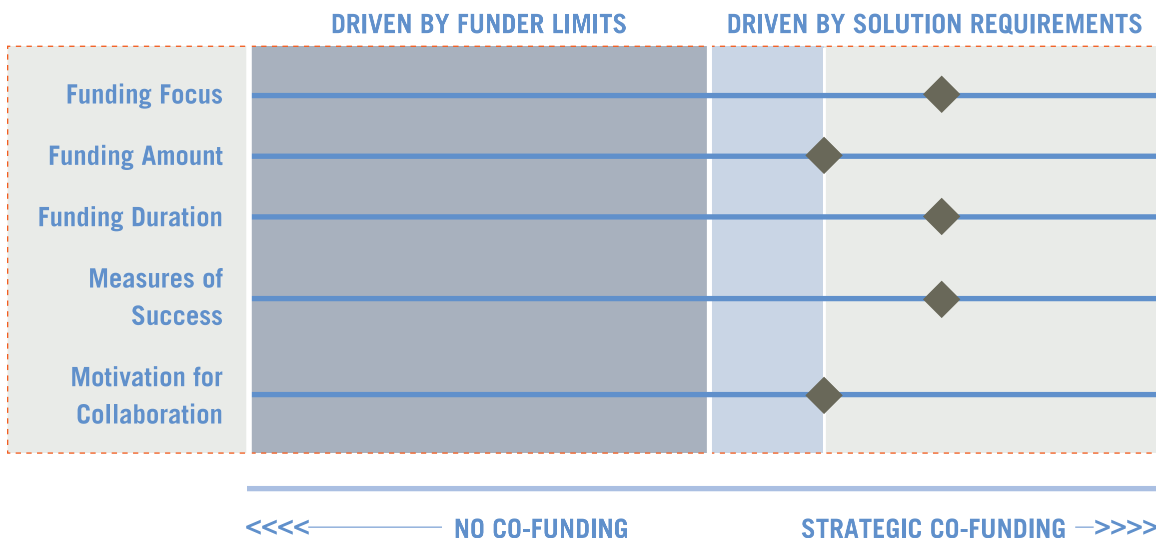
> a clearly articulated social mission goal

    > that has an accompanying funds-generating goal

        > which is based on analysis of the total funds and time required to achieve the social mission

            > and includes planning for funds required beyond what the co-funding group will provide.

### CHARACTERISTICS OF STRATEGIC CO-FUNDING




Not all joint funding needs to be Strategic Co-Funding. An example of appropriate project-driven co-funding might be a regional emergency fund that provides disaster relief and funds specific rebuilding projects. In contrast, when funders seek to solve a long-term problem, Strategic Co-Funding is called for. A group of funders aiming to improve the economic health of Latino communities, for example, would need to take a Strategic Co-Funding approach. The result might be a $100 million, 10-year plan for revitalizing 10 communities.

Individuals who lead or guide foundations and forward-thinking government agencies, as well as those who manage their own major giving, can spur the use of more Strategic Co-Funding in the coming years. This article and its accompanying tool are especially for them.

**Two Funding Stories**

**These examples of two contrasting entrepreneurial funding challenges are composites drawn from our research and conversations with venture capital and nonprofit leaders. Neither story is true, but both could be.**

Three years ago, Janet Schmidt started her solar energy company, **Solar-Jay**. She and her team have developed a unique product and a growing customer base. What they're doing works and it's time to expand. Janet contacts Fred Malcolm at Green Cap LLP, a venture capital firm known for its investments in early-stage, green-technology companies. Fred reads the Solar-Jay business plan, meets with Janet, and decides the business has great promise. He assesses the potential for a high-return acquisition of the firm and estimates that Solar-Jay may need twice the $5 million investment it seeks, to reach its profit targets. Since Green Cap can only commit to a $3 million investment, Fred calls up two friends who are partners at nearby VC firms. Three months later, after discussions, due diligence, and some business plan revisions, Green Cap and Solar-Jay agree on final terms for the investment. Fred joins the company's board, Solar-Jay receives its initial cash infusion, and expansion plans are set in motion.

A few miles away, Ed Baker runs **StepUp to Solar, Inc.**, a nonprofit that helps runaway teens stabilize their lives by engaging them in environmental education and jobs in the growing solar panel installation field. In the eight years since Ed founded the organization, the program has developed a good track record with the teens it serves and with community funders. It has demonstrated tangible, positive outcomes. Solar panels are catching on and more youth need jobs, so Ed and his board would like to expand. They calculate that it will take a one-time, $1 million upgrade of infrastructure plus an annual $300,000 increase in operating costs. Ed and his development manager start contacting potential funders. After six months—and 36 phone calls, 13 funding proposals, six meetings with commercial banks, 18 conversations with local and national foundations and city government departments—two foundations have committed to grants totaling $55,000. Proposals are on hold with two foundations that are undergoing strategy changes. Five foundations have rejected StepUp's proposal because the program is not new. A city department is eager to refer youth to StepUp's expanded program, but will not be able to fund the expansion unless it takes on a technical training focus. Ed calculates that in a best-case scenario, StepUp may receive $700,000 of the $1 million needed, but the expanded reporting requirements from these funding sources will add $50,000 to StepUp's annual operating costs, which no one appears ready to fund. Given these results, StepUp's board is uncertain about approving any expansion at all, but Ed and his team go back to the drawing board to calculate the costs of a reduced plan.

For-profit firms seeking development and growth capital have several known avenues to try, one of which—for businesses with particular profiles—is venture capital. VC firms raise and consolidate money from multiple investors and call it "co-investment" or "syndication," clearing the way for cash to flow easily from investors to emerging businesses. Nonprofit organizations poised for growth face a maze of possible funders, most of whom will fund, at best, very small pieces[6] of what is needed, for a very limited time.

Any serious discussion of nonprofit capital market deficiencies has to start with an acknowledgement that there is no obvious way out of this maze. Expanding social needs are being addressed by nonprofits with very limited funding options.[7] Grant seekers put extensive resources into navigating unclear and unpredictable restrictions. This fragmented funding landscape weakens the sector and ultimately limits impact, detracting from the very community efforts that the funds are meant to support.

Funding becomes more accessible when it is aligned in appropriate categories and funds can move more effectively when they are aggregated. By aligning and aggregating diverse capital sources via co-funding, philanthropists—both foundations and forward-thinking individuals—can lead the way to a more robust nonprofit capital market.

6 For an analysis of the ways in which the pieces are not just too small, but also of the wrong kind: "Overholser, G. M. 2005. Defining, Measuring and Managing Growth Capital in Nonprofit Enterprises, Part One: Building is not Buying, Nonprofit Growth Capital: 11: Nonprofit Finance Fund." The differentiation of growth and operations funding is explored further in William Foster's "Money to Grow On," Fall 2008, Social Innovation Review.

7 This article focuses on a subset of nonprofits that does not include religious, higher education, hospital, or museum institutions and their funding sources.

Start-up companies and nonprofit organizations are very different, but VC investors and philanthropic donors face some similar challenges. Often the organizations they fund have developed with big plans but limited budgets, lack of comparable efforts on which to base projections, and near-term goals that are hard to quantify.

## Venture Capital Investing: One Destination

Venture capital investing can be more art than science. Investors bring as much order as possible to the unpredictability of emerging businesses. VC firms typically focus on a specific life-stage and profile of growth potential. Some firms only invest in very early stage businesses; others specialize in more mature companies; most target specific ranges of investment need and projected return. Descriptions of these criteria are usually clear and accessible. Business plans are the coin of the realm—they serve as funding proposals, give a view of future plans, and cover standardized categories of information. Every entrepreneur seeking funding must have one.

VC firms seek out promising businesses, screen candidates by carefully assessing their potential for success, invest proportionally high amounts in relatively few companies, planning to exit the investment via sale or public offering in five to seven years.

VC investing has a clear goal: to generate returns of 40% or more for its investors. This central purpose is understood by all involved and it shapes each firm's investment targets: scale, industries, stage of business, and likely co-investors.[8] Consider how Labrador Ventures,[9] a San Francisco Bay Area firm, describes its focus: "Labrador invests in information services, applied materials science, software, messaging, and data communications." The firm's website goes on to summarize its investment criteria, its focus on seed-stage private companies, and the size of its initial and follow-on investments. It lists other firms that have co-invested with Labrador and gives guidelines for entrepreneurs considering whether to submit a business plan. This specificity allows Labrador to attract potential investments that meet some of its basic criteria for successful investing.

8 Gompers, P. & Lerner, J. 1999. The Venture Capital Cycle: Massachusetts Institute of Technology.
The importance of having a central goal has been highlighted by the failure of VC investing that didn't have one, including some corporate experiments with VC investing: "…it appears that the frequent dissolution of earlier corporate venture programs was due to three structural failings. First, these programs suffered from a lack of well-defined missions. Typically, they sought to accomplish a wide array of not necessarily compatible objectives, from providing a window on emerging technologies to generating attractive financial returns. The confusion over program objectives often led to dissatisfaction with the outcomes."

9 Labrador Ventures; http://www.labradorventures.com/; 18 Aug. 2008.

VC partners' compensation, as well as the ability to form subsequent funds, rides on the return their investments generate. This focus on returns leads to three underlying principles of VC investing. Investing decisions are driven by:

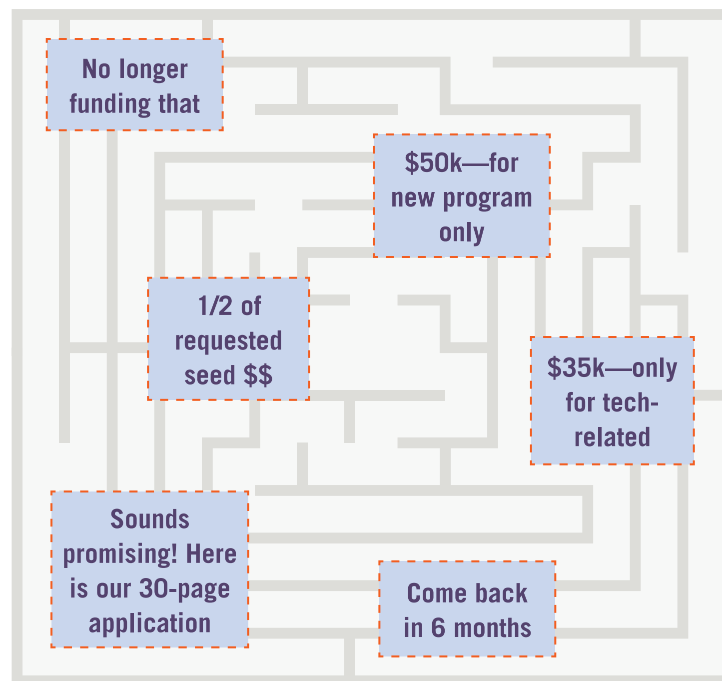
(1) One primary goal;
(2) Scale that will achieve the goal; and
(3) Clear measures of success.

The whole system works in an organic way. No venture capital partner needs this list of principles to stay on track because the principles naturally arise out of the drive for return.

## Nonprofit Funding: Myriad Destinations, Confusing Paths

In contrast, nonprofits' funding avenues are not clear or predictable.

### NONPROFITS' CIRCUITOUS PATHS TO FUNDING




*"I was involved with a couple of nonprofit organizations that had fantastic management, good results, a fair amount of financial discipline, and were ambitious. And if they had been for-profit businesses at a similar stage of development, they would have gone out and raised a multi-million-dollar, multi-year round of funding tied to their business plan. Instead, they were sending out scattershot proposals for relatively small amounts of money over short periods of time. In other words, there was no financial certainty in the system…It seemed to me to be a very ad hoc, inefficient, and restrictive way to grow an organization."*

*– Chuck Harris, SeaChange Capital Partners*[10]

10 Harris, C. 2007. Clinton Global Initiative - Q&A with Chuck Harris, SeaChange Capital Partners.

Nonprofit funding is characterized by many small grants going to many nonprofits; each funder creates its own unique funding categories, criteria, and processes, resulting in thousands of separate funding criteria and processes. While the number of grantmakers is large, typical dollars granted are small. Enormous resources go into navigating these twisting paths and blind alleys.

Unlike VC funding, foundation funding has no central goal that is specific enough to be meaningful across sectors. Nonprofits operate in arenas as divergent as healthcare and fine arts; they carry out many different social missions and their funding reflects this variety of goals. Philanthropy's general mandate, "make the world a better place," can be viewed and implemented in myriad ways, leading to grantmaking that is characterized by:

(1) Many goals;
(2) Lack of attention to the scale needed;
(3) Lack of explicit fundraising to meet scale requirements; and
(4) Idiosyncratic measures of success.

Like the organizations they fund, foundations have many goals. Different goals are often pursued within the same mission area, or within the same foundation. One foundation may aim to strengthen the healthcare, economic development, and fine arts in its community. Within healthcare, it may target improvement of prenatal care and development of programs for indigent elderly people. The goals can change unpredictably and sometimes they are not shared or even understood by their stakeholders, nor are they necessarily the same as the goals of grantees. One observer, speaking about the seemingly arbitrary nature of changes in foundation strategies and goals, noted that "changes in funding strategy are not the result of unhappiness about the impact of previous grantmaking."[11] Whether caused by funder insights, or changes in circumstances or direction, the effect on grant seekers is confusion and frustration.

Further complicating matters, each unique goal comes with its own unique definition of scale and success. The scale—the amount and duration and scope of a funding effort—to address lack of fine arts venues in a community is likely to be very different from the scale needed to change families' approach to prenatal care. Measures of success for each are necessarily different. Funders have been stymied by the impossibility of standardizing scale and success targets across mission areas and that has resulted in inconsistent target-setting. Sometimes foundations scrap goal-setting altogether.

11 Snibbe, A. C. 2006. Drowning in Data. Stanford Social Innovation Review.

## Venture Capital and Philanthropic Funding: Comparison of Underlying Principles

| | Venture Capital Investing | Philanthropic Funding[12] | Recommended Steps Toward Improved Grantmaking |
|---|---|---|---|
| **1. Goals** | Primary Goal: return on investment. This goal drives VC partners' decisions about potential investments, new industries, and management teams | Very diverse goals; often multiple and not prioritized; often unstated | **Agree on the Destination** |
| **2. Scale that will achieve goal; fund the *whole* plan** | Decisions based on analysis of scale potential and requirements for *whole* plan, including all activities, projects, resources, and time it will take to achieve the goal | Decisions often based on requirements for projects, rarely based on projections for a whole plan | **Pack for the *Whole* Trip** |
| | Specialization in high-uncertainty investments necessitates high returns[13] | Lack of clear focus leads to lack of clarity about required outcomes | |
| | Decision-making focus is on fit of whole plan (investor's outcome requirement fit with the investment potential and resource needs) | Focus is on funders' strategies, versus plan's outcomes and resource needs >>leads to short-term funding for long-term goals | |
| | Once VC commits to an investment, it usually takes on responsibility for raising necessary funding that it cannot supply: VC takes on fundraising for its investments | Capital needs beyond those provided by the funder are not considered: funders may want to know where the other funds are coming from but rarely help secure that funding. | |
| **3. Measures of Success** | VC's ultimate measure of success is linked directly to VC primary goal: return on investment | Success measures are often not articulated; or are generalities whose achievement is hard to pinpoint (e.g., "improve our community"); or are so specific, they are irrelevant to others | **Watch for Road Signs** |
| | Interim measures of progress toward the goal are set by the VC and investee. Some of these are standard business metrics, such as sales volume, others are set specifically for a particular investment | Tactical outcomes reporting is often required (e.g., how many people completed the program?), but links to primary goal achievement and ability to inform practice are rare | |

12 Although these characteristics appear to be predominant among organized philanthropies, they are not true of all 70,000+ foundations (~$470 billion in giving) and 70,000 donor advised funds (~$12 billion in giving); some organizations have taken major steps in better directions; Grantmakers for Effective Organization (GEO) is a good source of information about such steps.

13 Target returns must generally be 40% or higher; the level of return that VC firms have actually achieved has varied.

## MAKING A CASE FOR THE STRATEGIC CO-FUNDING TRIP

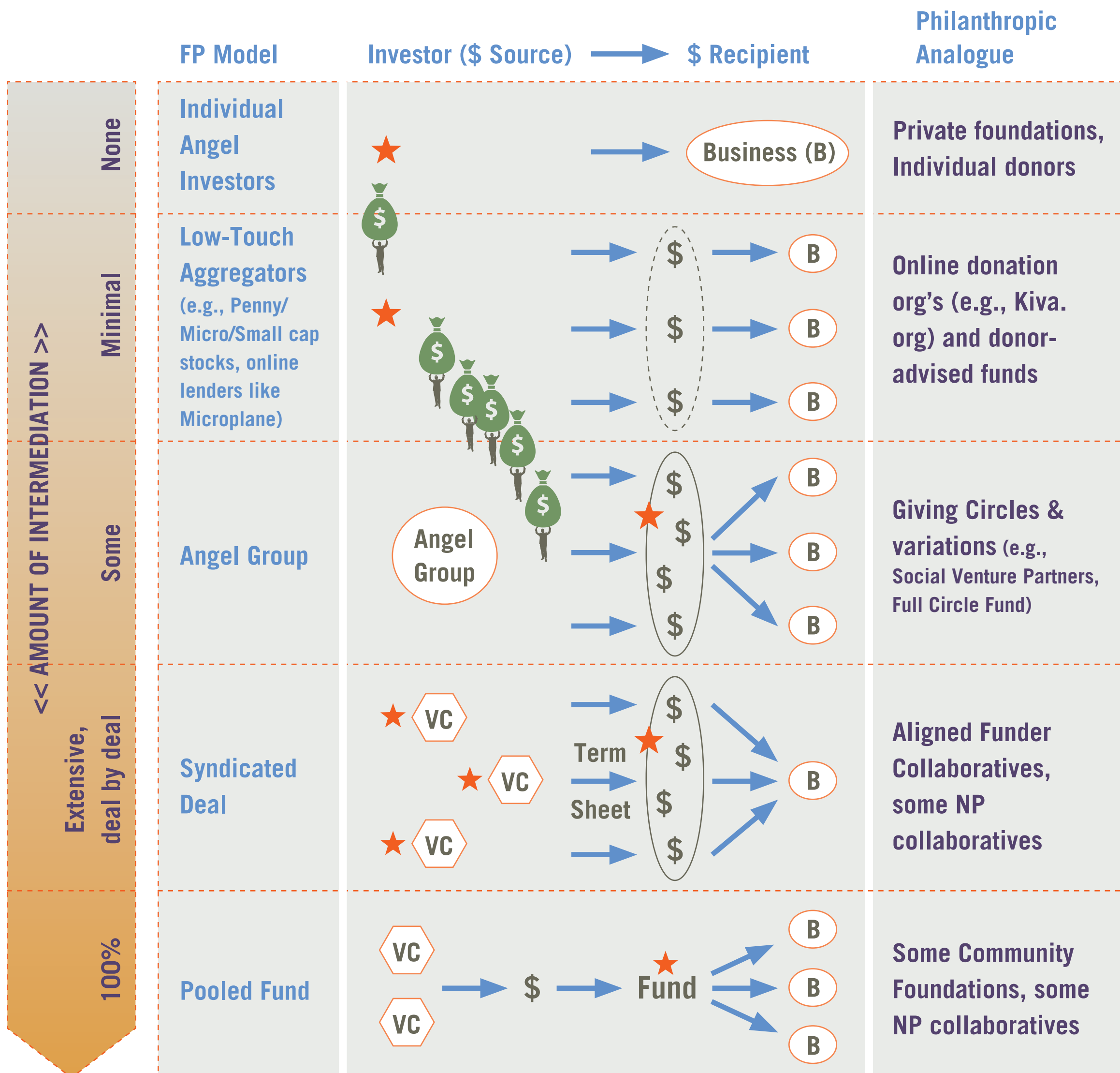
Strategic Co-Funding can help address two of the nonprofit capital market's primary problems: the need for more capital and the need for *more efficient* capital flows.

By articulating primary goals, determining the scale required to achieve the goals, and establishing appropriate success measures, funders can come together around initiatives that decrease nonprofit capital market fragmentation and duplication. A growing community of foundations is taking steps to increase the coordination and transparency of their grantmaking.[14]

Venture capital and VC-like co-investment can be done via a variety of forms, each form suited to particular investor goals. Though philanthropic co-funding is in an earlier stage of development, co-funding options and structures for nonprofit giving are evolving.

While structures for philanthropic co-funding are emerging, many of these structures continue to fund in short-term, limited-scope ways: the strategic routes discussed later in this article have yet to be fully developed.

### FOR-PROFIT MODELS AND THEIR PHILANTHROPIC ANALOGUES




14 See Grantmakers for Effective Organizations (GEO)'s website and publications for examples of recent improvements (http://www.geofunders.org/home.aspx).

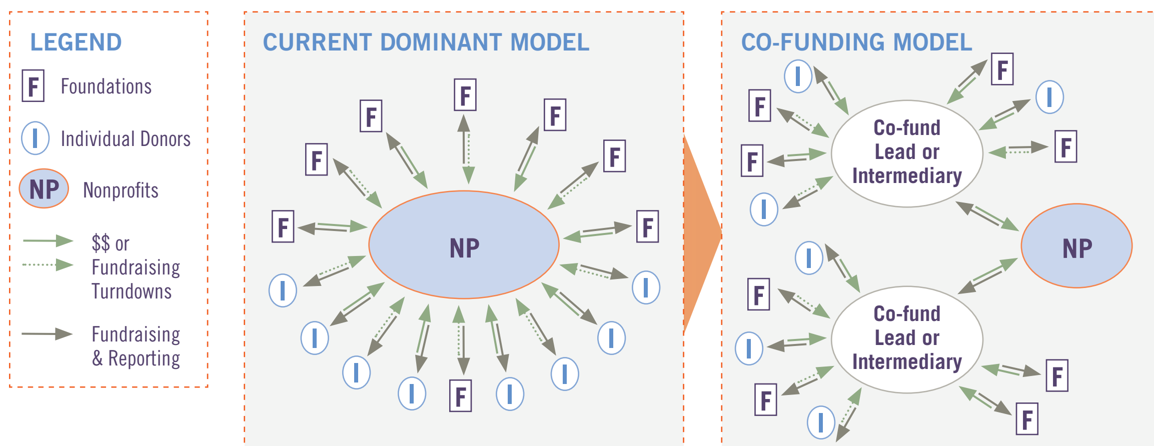
## *More* Money

Foundations and philanthropists can and should expand beyond grantmaking into fundraising for their causes. Money attracts money, and philanthropists are best positioned to expand donor pools because people like to put their money into pots that have already been "vetted" by others. Just as venture capital investors seek their peers' vetting of specific investments, philanthropists can influence each others' funding choices. Matching grant strategies, which work well to increase fundraising returns,[15] are an example of the effect that collegial influence can have. Philanthropists' calls for additional funds can be compelling. The Melville Trust, for example, a member of The Partnership to End Long-Term Homelessness (PELTH), plays an instrumental leadership role with its explicit fundraising: "The Trust is pledged to use its giving to leverage funds from other private or public sources in order to multiply the resources available to end homelessness and to promote collaboration between the many players with a stake in solving this devastating problem."[16]

## *More Efficient* Money

When money is aggregated via a co-funding group, fundraising and reporting can be reduced dramatically for "StepUp"-like nonprofit grantees.[17] Philanthropists, too, can be more efficient by decreasing due diligence and monitoring duplication while more effectively aligning funding, policy, and practice. One seasoned observer of workforce development efforts explained the need for a funds coordination role, "Most funding is tied to a federal, state, or local source and each source creates its own rules on eligibility, activities, and outcomes. There is little flexible funding available to fill gaps. Current funding streams run through multiple agencies; there is no flow of participants from one funding source to another, no aligning the various resources to make that happen…"[18]

### CO-FUNDING IMPACT ON NONPROFIT GRANTEES: LESSENS BURDENS ON NONPROFITS, INCREASES FUNDING




15 A recent study has confirmed the long-held belief that matching grants work. See, "Karlan, D. & List, J. A. 2007. Does Price Matter in Charitable Giving? Evidence from a Large-Scale Natural Field Experiment. American Economic Review, 97 (5): 1774-1793."

16 The Melville Charitable Trust; www.melvilletrust.org; 24 Mar. 2008.

17 Backer, T. E. 2001. Embracing Contradictions - Handling Innovation and Change in Uncertain Times, Helping Nonprofits Handle Innovation and Change: The Human Interaction Research Institute at 40. Faculty Center, UCLA: Human Interaction Research Institute.

18 Strong, E. Human Capital Initiatives, Corporation for A Skilled Workforce. Personal Interview. 2008.

## PICKING THE ROUTE: DIRECT OR ROUNDABOUT?

Strategic Co-Funding initiatives are built around clear financial targets: long-range funding requirements are identified and specific fundraising goals are set. Co-funding efforts that are not strategic take a much less direct and focused approach to money and to co-funders' financial commitments: financial goals and commitments are unclear; or they are driven by funder needs/capabilities rather than the requirements for success of the initiative; or specific funding goals are not set at all.

Venture capital achieves its goals of high return on investment with a strong focus on aggregating (and investing) funds. A majority of VC deals are completed via some co-investing.[19] Money is aggregated from multiple individuals and institutions into a pool (a "fund"), out of which subsequent investments are made. A minimum amount must be raised to cover the necessary infrastructure for a set period (e.g., 10 years) of investment, assistance, and monitoring. VC firms expect to proceed with a planned fund or an investment only if they have raised the required capital. Thus, VC investors are also fundraisers: they must bring in money to make money.

VC partners conduct active fundraising at two stages: first, when they are creating a fund, and then later, as part of their investment in specific companies. Generally, one VC firm takes a lead investor role in each investment, while many co-investors take a limited partner role, which holds little or no decision-making authority (as well as lower profit potential). Sometimes VCs will invite co-investors for specific expertise they bring, which can help the investment succeed. Others may be invited to co-invest on the basis of partners' personal relationships and trust.

Just as foundations' goals and practices are all over the map in comparison with venture capital's, philanthropy also lacks sector-wide clarity about co-funding, which is usually covered by a broader term: "collaboration." Co-funding is generally talked about as a positive force, something that grantmakers should do. And yet, a 2004 Urban Institute study found that even among foundations that agreed on the importance of collaboration, 41% had not participated in a formal co-funding arrangement in the previous two years.[20]

> ***"The need for aggregation and alignment has become both reality and rhetoric for one small corner of philanthropy: professional foundation staff. The reality can be seen in the proliferation of associations and alliances for information sharing and networking. The rhetoric can be seen in the lack of actual joint strategy and resource investment done by most foundations."***
>
> *- Lucy Bernholz*[21]

19 Note that, per comments from several seasoned venture capital partners, this may be changing as a result of recent large money inflows making co-investing less necessary for some firms.

20 Ostrower, F. 2004. Attitudes and Practices Concerning Effective Philanthropy: The Urban Institute Center on Nonprofits and Philanthropy.

21 Bernholz, L. 2004. Creating Philanthropic Capital Markets : The Deliberate Evolution. Hoboken: John Wiley & Sons, Inc.

In his 2005 study,[22] Robert Hughes, Chief Learning Officer at the Robert Wood Johnson Foundation, reported that collaboration between philanthropic organizations was on the rise. However, it is not clear that co-funding has increased, or that more net dollars are being generated by most of the funder collaboratives that have formed in recent years, though many collaboratives' non-financial activities have had good community network and policy results. Admittedly, generating dollars is not the only role for social mission co-funders. As Ralph Hamilton observed in his study of funder collaboratives, moving ideas and moving money are often related.

The National Fund for Workforce Solutions, formed in 2007, is an example of a co-funding initiative that is focused on funding targets that are complemented by non-financial goals. NFWS' ambitious financial targets are joined with plans to influence state and federal workforce development policy. A collaboration of national foundations,[23] together with the U.S. Department of Labor and regional workforce development funders and practitioners, it seeks to improve the way that workforce development services are funded and delivered nationally. It is too early to know how the money-raising and policy-influencing sides of the initiative will support each other, but the group's financial targets are clear.

In Hamilton's study of foundations, "collaboration" encompassed "the full continuum of inter-foundation relationships—from informal sharing of information and advice to much more complex and structured arrangements" and expanding the financial pie is not a focus for many funder collaboratives. Often, learning from each other is a central purpose. Some require that members contribute money, some don't, and most do not appear to position themselves with a strong focus on raising funds beyond the immediate participants' contributions. Given this, it is not surprising that funder collaboratives have had uneven fundraising results. Hamilton's study found that "respondents mentioned numerous instances in which an overall increase in resources to a field or problem never materialized, although other important goals were achieved."[24] Some funder collaboratives achieve impressive community coordination feats,[25] but it is difficult to determine whether, or to what extent, they have brought net new dollars to the causes they support.

John Weiler, Senior Program Officer at the F.B. Heron Foundation,[26] sees that co-funding has potential burden-reducing and burden-creating potential. Discussing the latter he says, "Sometimes the grantees are expected to drive a substantial learning agenda for an amount of funding that is not commensurate. In the most extreme cases, nonprofits may even feel that the collaborative is crowding out other direct funding that they might have received. It's important for foundations to consider carefully the grantees' likely perspective on the collaborative and keep the "net grant" concept in mind as funders consider the structure and goals of the collaborative."[27]

An overt focus on raising more and longer-term money is necessary for any co-funding group that wants to play a long-term strategic role in the life of its grantees.

22 Hughes, R. 2005. Philanthropies Working Together: Myths and Realities. In P. Patrizi & K. Sherwood & A. Spector (Eds.), Practice Matters: The Improving Philanthropy Project: 37: Foundation Center.

23 The National Fund for Workforce Solutions' national investors are Annie E. Casey Foundation, Ford Foundation, The Harry and Jeanette Weinberg Foundation, Hitachi Foundation, and the U.S. Department of Labor.

24 Hamilton, R. 2002. Moving Ideas and Money: Issues and Opportunities in Funder Funding Collaboration: 19. Chicago: Chapin Hall Center for Children at the University of Chicago.

25 Hopkins, E. M. 2005. Collaborative Philanthropies: What Groups of Foundations Can do that Individual Funders Cannot. Lanham: Lexington Books.

26 Weiler, J. The F.B. Heron Foundation. Personal Interview. 2008.

27 Ibid.

## FINDING A BETTER ROUTE

***"This is fiendishly complex—there are lots of players and nuances—but when it's done well, the results are so powerful and so concrete."***

*- Bob Hohler, the Melville Charitable Trust*

Grantmakers have an opportunity to build clear routes through the philanthropic funding maze by sharpening their focus on co-funding. Venture capital principles, along with lessons from successful foundation co-funding pioneers can lead to co-funding that forges a route to more, and more efficient funding.

Bob Hohler is a firm believer in co-funding's potential impact, having seen the power that it can bring to an initiative. He chairs the Executive Committee of The Partnership to End Long-Term Homelessness (PELTH), which was founded by a group of foundations and corporations in 2004. Together, the group's funders have contributed more than $36 million to the fight against long-term homelessness, while simultaneously aiming to attract $100 million from non-PELTH government and other funding sources for the intiatives it supports. Successful fundraising has been critical to PELTH's catalyzing role in improving public policy, building supportive housing, and encouraging the services needed to tackle homelessness.

Bob notes that if co-funding partners are in sync, raising the money is easy; what's complex is the coordination of a unified approach. In PELTH's arena, a mix of agendas—representing advocates, nonprofits, city governments, county governments, federal agencies, and others—must be considered in order to ensure that the funds do what they were intended to do.

Two longstanding co-funding initiatives demonstrate that philanthropists can build impressive funding paths by joining forces. Living Cities (also known as The National Community Development Initiative or NCDI), was started in 1991; the Partnership to End Long-Term Homelessness was started in 2004. Both have had the challenge and the benefit of an asset-based (real estate) strategy.

**Living Cities (National Community Development Initiative)**

Living Cities was launched in 1991 as the National Community Development Initiative (NCDI), an informal partnership of seven private philanthropic foundations and an insurance company that were all committed to urban revitalization and convinced that community development corporations (CDCs) could be an important vehicle to that end if provided with both technical support and sustained funding at scale.

**Over 15 years, it has invested more than $543 million in 23 cities. Its funding has helped build homes, stores, schools, daycare, healthcare, job training centers, and other community assets that exceed $15.9 billion.**

**The Partnership to End Long-Term Homelessness (PELTH)**

Launched in 2004, a collaboration of nine national foundations, nonprofit organizations, and financial institutions set out to galvanize leadership and dollars to bring an end to long-term homelessness in a decade. The Partnership to End Long-Term Homelessness has dedicated more than $37 million in grants and loans to the effort via its intermediaries, The Corporation for Supportive Housing (CSH) and the National Alliance to End Homelessness (NAEH).

**In its first five years, PELTH will have spurred the creation of 50,000 units of supportive housing, leveraged $1.7 billion in public financing, leveraged $500 million in public financing for services and operations, and established new programs to prevent long-term homelessness.**

Key factors that contributed to the success of these two philanthropy-led co-funding initiatives include:

- A central publicly stated goal that is specific and compelling
- A core group of funders that led the initiative, set the goals, made long-term commitments to it, and invited like-minded partners
- Targeted scale leading to very clear fundraising and technical assistance goals
- A focus on adding new money and long-term funding; minimum contribution requirements were established
- Intermediar(ies) to provide on-the-ground organization, coordination, and expertise on behalf of co-funding group

Two other examples of recent co-funding initiatives bear watching. Both are focused on generating funding for "growth stage" organizations:

• **The Edna McConnell Clark Foundation** has launched its Growth Capital Aggregation Pilot, a co-funding initiative to help three of its most successful grantees achieve their growth potential. Clark has articulated a specific and compelling goal, and is not shying away from clarity about its fundraising goal: to partner with other funders and raise the required up-front growth capital necessary to fuel the expansion, capacity building, and long-term financial sustainability of three high-performing, youth-serving organizations. Specific goals include: bringing $700 million in public funding to the targeted programs by 2012; fueling grantees' expansion of proven programs for low-income youth at an unprecedented rate and scale; and encouraging consequent shifts in public policy, in part because their leadership has been able to spend more time concentrating on quality and growth and less time raising funds.

Clark has been clear about its leadership of the initiative: "The Edna McConnell Clark Foundation launched the Growth Capital Aggregation Pilot to help some of its most successful grantees achieve their growth potential and become financially sustainable. EMCF's resources alone cannot provide all the necessary up-front growth capital grantees need, but we can do more, so we have launched a pilot to test a capital aggregation approach…"[28]

This comprehensive initiative includes long-term planning for the full range of challenges that its target organizations face. Nineteen other funders, including The Bill & Melinda Gates Foundation, Robert Wood Johnson Foundation, The W.K. Kellogg Foundation, and The Kresge Foundation, have become co-funders. Their approach may establish a new model for foundations taking a responsible role in the long-term success of grantees.

• **SeaChange Capital Partners**[29] is taking a different approach, forming a donors' network from which it will help selected nonprofits raise $100 million over a three-year period. It, too, has put fundraising at the center of its strategy, but seeks general commitments from co-funding partners prior to presenting them with specific funding opportunities.

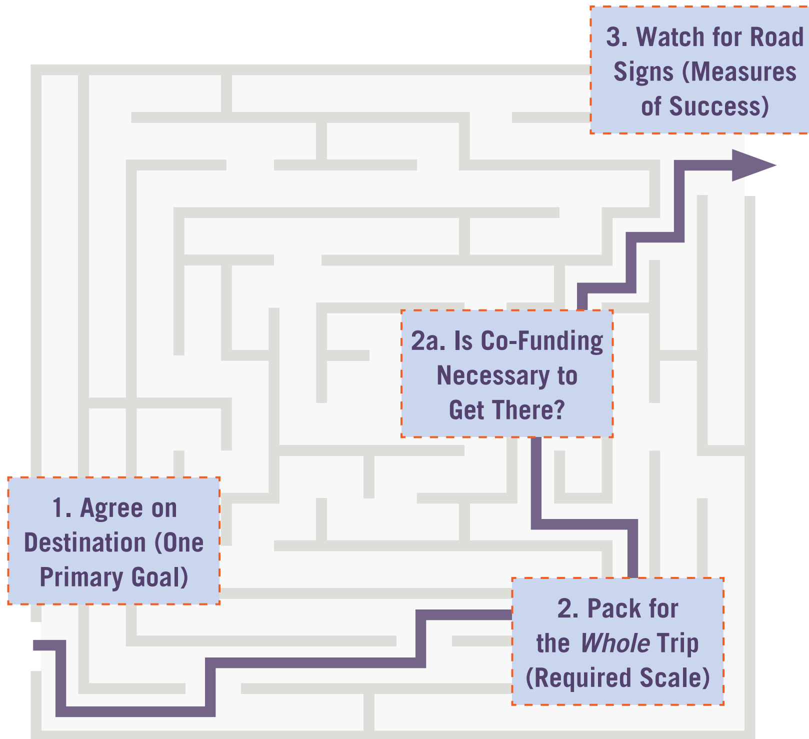
It joins innovative organizations like Social Venture Partners and Full Circle Fund that enlist a type of giving circle approach to coordinating the giving of multiple individuals. As Katherine Fulton and Andrew Blau point out, in The Future of Philanthropy, a growing number of intermediary organizations take on a brokering role, allowing individuals to "become much more strategic in your giving—to practice great philanthropy—without taking the time and expense to do the work by yourself."[30]

28 Edna McConnell Clark Foundation; Growth Capital Aggregation Pilot; http://www.emcf.org/how/growthcapitalpilot/index.htm; Mar. 24 2008.

29 SeaChange Capital Partners; www.seachangecap.org/; 24 Mar. 2008.

30 A giving circle is a group of donors who place their charitable dollars into a pooled fund and decide as a group which charities to support. See Fulton and Blau's "The Future of Philanthropy" for a discussion of other intermediary organizations useful for individuals.

## STRATEGIC CO-FUNDING: A ROUTE OUT OF THE MAZE




### 1. Agree on the Destination (One Primary Goal)

- **What is our goal?**
- **Is it broad enough to be compelling yet specific enough for action?**
- **Can we clearly convey the actions and outcomes we expect?**

When funders clarify where they are going and how they plan to get there, they are more likely to attract like-minded grantmakers and grantees. Having a clear, specific end goal paves the way for agreement on interim milestones.

Venture capital firms set clear investment guidelines (such as "invest in early-stage telecommunications firms"), making it straightforward to assemble investors with similar interests. Setting a clear goal for philanthropic co-funding is equally important, but much more complex. The nonprofit "sector" is really many sectors, with multiple social missions, so goals must be tailored to specific arenas. For example, many organizations seek to address poverty, but does an organization aim to eliminate poverty or to alleviate it? Will its reach be worldwide or regional? Will the funding be for job creation, food distribution, or housing? Philanthropists, too, have many choices and must point themselves in the direction that best targets the mission sectors, scale, and organization lifecycle stage that fits their aspirations and resources.

A good goal inspires, focuses, and leads to action. The Robin Hood Foundation is an example of a foundation that articulates a clear and compelling goal: "Robin Hood targets poverty in New York City by finding and funding the best and most effective programs and partnering with them to maximize results."[31] A clearly articulated goal is vital to attracting co-funding partners. Sizing a problem can also help mobilize supporters.

31 The Robin Hood Foundation; www.robinhood.org; 28 Mar. 2008.

The Partnership to End Long-Term Homelessness has successfully appealed to a wide variety of funders by articulating the ways in which its goal intersects with theirs: "Chronic homelessness is an issue that cuts across many funders' interests—from health and healthcare, mental illness, and child welfare to prisoner reentry, poverty, and community development. No single funder or provider can solve it alone, and we cannot solve it without the involvement of both the private and public sectors."[32]

## 2. Pack for the *Whole* Trip (Scale to Achieve the Goal)

- **What and how much impact do we seek?**
- **What is needed for the *whole* plan to succeed?**
- **What is our funding capacity? If it's not enough, can we co-fund?**

It is difficult to map out the future of a young company. Nonetheless, VC investors and entrepreneurs hash out a business plan that all can agree to. It is difficult to project the future of most nonprofits. Nonetheless, grantmakers and nonprofits must attempt to do so. All three questions, preferably in this sequence, must be answered to arrive at a credible plan for getting from here to the point at which the goal is achieved.

VC investors consider all the resources needed in a projected growth path, not just the resources needed for one project. The longer-term plan may entail staffing up, marketing, R&D, supplies, and facilities costs and it usually extends over years.[33] Why put $100,000 into developing a new line of business if the company is about to fail because of its cash flow? A VC would never specify that funds cannot be used to cover overhead when lack of staff or facilities would block the progress that leads to return for investors. Estimates of a plan's total investment and time needs, together with its potential returns, give investors the scale projections to determine whether this investment is a good fit. If it requires capital beyond one firm's capacity, co-investing may be in order.

In contrast, most nonprofit practitioners and funders have shied away from estimating the total resources required to accomplish their larger social goals, and instead have limited their view to specific projects, creating a funding environment that is predominantly project-oriented.[34] But a project, no matter how valuable, can fail if it is not supported by a viable organization. Long-term goals must be addressed with larger-scale planning and resources.

In addition, the resource needs of a co-funding initiative itself need to be projected and evaluated. Significant co-funding requires staffing and time, and sometimes it requires particular expertise. Are the co-funding group's fundraising targets set high enough? Will the money it brings in cover these additional costs with enough left over to make the effort worthwhile? Will the co-funding bring in net new money, or will it simply reroute existing funding? One self-admitted cynic assessed a funders' collaborative in her field as "just two more layers of overhead" and questioned whether anybody had done the math before starting it.

Some philanthropists have taken a courageous long view. The Los Angeles Urban Funders (LAUF), a 1990s-era consortium of 30 foundations that pooled funding focused on three low-income geographic areas, collectively mapped their diverse funding streams. They were able to gain a sense of the dollar sums of public and private resources, the duration of support, and the purposes assigned to each stream. From this birds-eye view, LAUF drew conclusions about what program areas were under-funded (or over-funded) and how they could fill the gaps.

32 Lavizzo-Mourey, R. Grantmakers In Health. Issue Focus Newsletter, 6 Mar. 2006.

33 Capital structure and needs are determined by strategy, business model, and business stage, not by mission area. For an important discussion of nonprofit capital structure issues, see "Miller, C. 2003. Hidden in Plain Sight: Understanding Nonprofit Capital Structure. The Nonprofit Quarterly: 1-3."

34 For an excellent discussion of this topic, see "Grantmakers for Effective Organizations. 2007. GEO Action Guide: General Operating Support. 11."

Individual funders were able to see their giving in the larger ecology of funding sources and determine how theirs could be spent most effectively.[35] In another approach to co-funding, in 2001 the Surdna Foundation and the Atlantic Philanthropies co-funded two of their grantees, VolunteerMatch and Philanthropic Research, Inc. (GuideStar), helping them develop a business and investment case. Their championing role and their matching grants attracted over $10 million in long-term funding.[36]

## 3. Watch for Road Signs (Measures of Success)

- **What have we set out to do; and**
- **How can we measure the success of our efforts?**
- **What milestones will tell us if we're on the right track?**
- **When should we reach our milestones?**

Venture capital investors look at various indicators to estimate whether, and at what pace, their long-term goals will be achieved. Near-term progress indicators must be identified for each investment since typical business metrics such as sales volume, profit margins, and inventory levels may or may not be the best indicators of performance in a business's early stages. Instead, the success of a product test or the acquisition of a licensing agreement may be better indicators of progress. Great weight is given to both quantitative and qualitative information. Leadership and managerial ability are always critically important, while being harder to quantify. Entrepreneurs and their boards (including VC investor representatives) decide ahead of time what progress indicators they need to track. All measures of success, whether quantitative or qualitative, whether interim or ultimate, are driven by the end goal.

The absence of useful standardized metrics to measure progress is a particular challenge of VC investing (because VC invests in early stage businesses and industries that often lack track records or comparison information). This does not stop VC investors from working with entrepreneurs to set and monitor appropriate milestones. Philanthropic co-funders can do the same, and some have. One promising and ambitious approach to codifying sector-specific measurement is Urban Institute's Outcomes Indicators Project,[37] which establishes core indicators for 14 categories of nonprofit organizations and suggests a common framework of outcome indicators for all nonprofit programs. This is a productive step toward a standardized approach to measuring diverse nonprofits' outcomes.

Some measurement standardization is needed to help nonprofits and their stakeholders understand what is working and what isn't. Nonprofits and foundations often shy away from codifying expectations and results into any sort of standardized form, citing the difficulty of comparing different sectors. However, standardization across multiple sectors and business models is not really necessary. As Craig Reigel, a Partner in Nonprofit Finance Fund's Capital Partners division, notes, "For-profit investors don't all look at the same set of metrics—why should nonprofit funders? The problem isn't having multiple markets and multiple metrics; actually the problems come when you try to look at it all as one market."[38] REDF aggregated funding from several foundations to support a "customized standardization" approach to measuring the success of a group of nonprofits with similar workforce development goals. Results from the initiative were useful for the nonprofits while simultaneously being meaningful to a broader audience.[39]

35 For a good source of information about past philanthropic collaboration efforts, see the previously cited article, "Hopkins, E. M. 2005. Collaborative Philanthropies: What Groups of Foundations Can Do that Individual Funders Cannot. Lanham: Lexington Books."

36 Stehle, V. 2007. Boom Time for Growth Capital? Grantmakers in the Arts Reader, 18(1).

37 The Urban Institute - Outcome Indicators Project; http://www.urban.org/center/cnp/projects/outcomeindicators.cfm; 1 May 2008.

38 Reigel, C. NFF Capital Partners at The Nonprofit Finance Fund. Personal Interview. 2008.

39 Twersky, F. & BTW Consultants. 2002. An Information OASIS: The Design and Implementation of Comprehensive and Customized Client Information and Tracking Systems: The Roberts Enterprise Development Fund.

The Clark Foundation-led Growth Capital Aggregation Pilot has set performance metrics that will be used by all funders in the group in assessing the progress of three different investee organizations.

If milestone-setting and outcomes measurement clearly reflect an initiative's overall goals and the links between near-term and long-term results, they help a co-funding group articulate expectations and observe progress. Clear and appropriate success measures can attract others with similar goals, and can prevent misunderstandings between co-funders.[40]

## Deciding the What, Who, and When

Past funder collaborative groups[41] have identified a number of success factors, including:

- **Clear and mutual values, goals, methods**
- **Honesty regarding foundation interests and decision-making authority**
- **Institutional willingness to negotiate and accommodate**
- **Sufficient time for working out logistics**
- **Willingness to commit resources**
- **Persistence throughout implementation**
- **Relationships, strength of personal bonds**
- **Clear and constant communication flow**

Before a foundation or individual identifies compatible co-funding partners and solidifies its role in a co-funding initiative, it must make the right decision as to whether to embark on Strategic Co-Funding or not, and then target the co-funding structure that best suits it.

Suppose Foundation Q wants to help its region's unemployed young people move into career-path jobs. Before setting co-funding targets, the foundation pays for a study of the youth it is interested in and of the regional economic situation. At least $30 million would be needed over a 10-year period to accomplish Q's goals. In addition to the dollars needed, the foundation learns that regional nonprofits providing training and job paths are predicted to have staffing and leadership shortages in the coming years, and that these organizations do not have the links to each other that would promote efficient regional activity.

Foundation leaders determine that while they can put substantial funding into this effort over a 10-year period, they cannot fund the whole initiative. In addition, they do not have in-house expertise to address the staffing and regional linkage issues.

Joining an existing co-funding group or starting a new one may be a good way for this foundation to accomplish its goals and deciding whether to co-fund is just the first of a series of critical decisions. Next come questions about goals, timeframes, and what co-funding structure and role will work best for the foundation. Answering these questions will put the organization on the right path to finding compatible co-funding partners.

40 Backer, T. E. 2004. Collaboration Approaches for Smaller Foundations: 13: Annie E. Casey Foundation.

41 These factors were compiled from the research / analysis projects of T.E. Backer, R. Hamilton, E.M. Hopkins, and R. Hughes, which have been referenced elsewhere in this article.

## WHICH CO-FUNDING STRUCTURE AND TYPE IS BEST FOR YOU?

| | | Strategic Co-Funding | | | |
|---|---|---|---|---|---|
| | | Aligned | | Pooled | |
| Characteristics | Collaboration | Lead | Participant | Lead | Participant |
| Learn from, network with other organizations | ✓ | ✓ | ✓ | ✓ | ✓ |
| Commit to long-term, solution-driven funding | | ✓ | ✓ | ✓ | ✓ |
| Maintain high level of control over funding process, metrics | ✓ | ✓ | | ✓ | |
| Minimize administrative efforts of coordinating multiple funding sources | | | | ✓ | ✓ |
| Minimize time and effort needed to participate in problem solution | | | ✓ | | ✓ |
| Co-fund a solution while still allowing each participant to maintain own process, metrics | | ✓ | ✓ | | |

In **aligned co-funding**, participating funders make a commitment to the same initiative, but each separately donates money directly to grantees to fund a portion of that initiative. Because the funds are never pooled, each organization retains more control over the destination and purpose of its funds; however, an aligned model requires more administrative effort to coordinate the grants of multiple donors toward a single initiative. Within an aligned co-funding group, there are two primary roles funding organizations can assume:

- The lead funder takes on a leadership role in handling funding commitments; due diligence and coordination are sometimes delegated to an intermediary organization;

- The participating funder takes on a more secondary role in funding the recipients of the initiative, but controls the implementation method and success metrics of the portion of the initiative that it chooses to fund.

Deciding how to co-fund can be as critical to an initiative's success as deciding whether to co-fund.

In **pooled co-funding**, each member funder donates money to a single pool of funds. Money from the pool is then used for various aspects of the initiative without distinguishing its original donor. Organizations in pooled co-funding relinquish more control over their funds, while creating a flexible pool that reduces the administrative efforts of coordinating multiple funding sources. Within a pooled co-funding group, there are two primary roles funding organizations can assume:

- The lead funder takes on a leadership role in deciding how to allocate the pooled funds, the implementation methods for the initiative, and the metrics that will be used to determine success; coordination is sometimes delegated to an intermediary organization;

- The participating funder contributes to the pool and may offer expertise and advice, but does not assume primary responsibility for initiative implementation and fund allocation.

## STRATEGIC CO-FUNDING: ARE WE THERE YET?

Foundations can bring more money, clarity, and success to the social issues that matter to them by pursuing co-funding opportunities in a strategic way. Venture capital's underlying principles suggest rules of the road for foundations and individuals interested in Strategic Co-Funding:

· Agree on a destination (set a clear goal);
· Pack for the whole trip (target scale that will achieve your goal);
· Watch for road signs (agree upon success measures).

In their 2005 assessment of trends in philanthropy, Katherine Fulton and Andrew Blau noted a convergence of funder motivation and innovation that bodes well for more Strategic Co-Funding and for nonprofit capital market improvements:

> ***"The good news about philanthropy today is that there are now so many others to travel with—both individuals and institutions. This was not true even a generation ago. The new critical mass that is possible in some regions and in some issue areas suggests many new ways of working today and in the future. That's why even a cursory look at the landscape reveals donors and funders attempting to "reorganize" philanthropy and its infrastructure around action—around their specific goals and purposes rather than around the institutional forms of the past or general interests they all share. They are not just forming partnerships; they are figuring out how to take a stand together or to pool funds, and they're creating new vehicles for doing so because they believe it will improve the results they seek in a time of growing complexity."***[42]

The geography of today's philanthropy is unlikely to change overnight but it is changing. Strategic Co-Funding can streamline philanthropy's circuitous paths, attract new funders and dollars, and lead to tomorrow's philanthropy.

**How will Strategic Co-Funding change the paths to capital for our example organization, and for the nonprofits it represents?**

Though runaway teenagers will probably still need help, the organizations they turn to, like our original example, StepUp to Solar, Inc., won't have to waste precious staff time on hunts through a maze of unclear and deadend funding options. In tomorrow's philanthropy, StepUp's new five-year plan will pave the way. The organization's local youth services intermediary will contribute guidance and information to the plan, and will take it to several appropriate funder groups. Seeing that StepUp is moving out of one longtime funder's early growth stage sweetspot, a replacement grant commitment will be lined up with a funding consortium that specializes in mature regional organizations. More debt may be appropriate at that point, so two local banks and the regional Community Development Financial Institution (CDFI) will be contacted. Two or three funder groups will express interest and will begin reviewing StepUp's plan. Three months later, the organization will have secured commitments for its next five years of youth services.

42 Fulton, K. & Blau, A. 2005. Cultivating Change in Philanthropy - A working paper on how to create a better future: 33: Monitor Company Group, LLP.

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**Quotes from interviews with**

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Julia Lopez, retired Senior Vice President of the Rockefeller Foundation

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