Prophets for non-profits?

Nicole Etchart and Lee Davis

'Venture philanthropy remains something of a Rorschach test. Depending on whom you ask, it is the future of philanthropy, a passing fad, good grantmaking, or misguided hubris,' writes Neil Carlson.[1] For us, the important thing about venture philanthropy is that it is a means, a particular approach to philanthropy, rather than an end in itself, and that this approach is engaging a new type of philanthropist and bringing new resources to the non-profit sector.

Guest editors for the venture philanthropy feature

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The topic of venture philanthropy has engaged donors, scholars and non-profit practitioners – believers and dissenters alike – in an important international debate. The story goes like this: a group of proselytizing heretics, armed with the mega-wealth of the new philanthropists, disavowed the doctrines of classical philanthropy and launched a venture philanthropy (VP) crusade. The missionaries were intent upon bringing salvation to the non-profit sector by injecting do-gooder organizations with wads of cash and words of innate wisdom dispersed via a philanthropic adaptation of the monotheistic practices of venture capitalism. The prophets offered a perfect combination of what non-profits had been crying out for: multi-year, tailored financing; professional coaching and assistance to build overall organizational capacity; access to networks of local business people and other 'investors'; a true partnership based on shared risk; clear performance benchmarks, etc. Alleluia! The philanthropic messiah had arrived! Articles appeared in leading business magazines; venture capitalists and successful entrepreneurs committed their names and chequebooks to establish VP funds. In fact, so many new funds popped up in the US (some started franchising) that a 'trade' annual report was published.[2] Expectations were high.

With all the hype about the virtues of venture philanthropy, it's no wonder there are so many disbelievers. The sceptics argue that it is promoting an investment-like strategy that fails to recognize the unique needs and culture of non-profits that sets them apart from for-profit businesses. They also question whether there is really anything 'new' about venture philanthropy. Isn't the field simply a re-packaging of existing 'engaged grantmaking' practices, or of the 'community venture capital' approach of bringing venture capital to marginalized communities? What really is the difference between venture philanthropy and 'social investment'?

But all the hype among both nay-sayers and apostles misses the point: there is simply a big demand for VP-type investment in the non-profit sector. There is a large unserved market of social enterprises that would benefit from the VP approach to financing and technical support. Herein lies the real opportunity, as Edward Skloot of the Surdna Foundation points out: *'If all these [VP] initiatives are the opening wedge of serious, deep commitment to a new kind of activist philanthropy, then I think we are on the right path and should be truly excited. For all the hype and arrogance, there is much good coming on-line. This is the promise of "venture philanthropy" …If I ran a non-profit, and I did for nine years, I'd jump at the chance to be a partner. To be someone's social investment.'* [3]

As the dust from the early crusade settles, what remain are the truly committed individuals, organizations and funds. Whether it's really 'new' or not, whether we like the name or not, whether we feel it is 'culturally appropriate' for all non-profits or not, the VP 'model' responds directly to fundamental flaws in the existing non-profit capital market. In particular, it:

- makes available an additional, unique philanthropic investment tool in an under-resourced non-profit marketplace;
- responds to fundamental needs of non-profits for general support – whether it be in the form of financial support, technical assistance/coaching or access to networks and contacts – to build organizational infrastructure;
- provides a point of entry to philanthropy for a group of potential philanthropists who otherwise feel estranged from the purely 'charitable' nature of 'classical' grantmaking.

Beyond North America and Western Europe?

Venture philanthropy is not limited to North America and Western Europe, however. It shows great promise in many developing countries and emerging democracies where local philanthropic giving is insufficient to meet local needs. While we must be wary about exporting yet another northern/western-born development 'fad' to the developing world, NESsT has been operating out of Central Europe since 1997 and Latin America since 1999 and has found the VP approach to be well suited to the needs of non-profits there. Our research and work with social enterprises found recurrent organizational, financial and capacity needs among non-profits in both regions,[4] and it was from these identified needs that the NESsT Venture Fund (NVF) model evolved (see p34). Launched in 2000, NVF 'invests' in a portfolio of social enterprises,[5] providing both financial and technical assistance to help the enterprises grow and, in turn, support the mission and financial sustainability of the non-profit parent organizations.

Over the last five years, NESsT has learned a great deal about applying a VP approach in Central Europe and Latin America – lessons that provide insight into applying the approach in other parts of the developing world.

A means to an end, not an end in itself

The objective of NESsT's work in Central Europe and Latin America has been less to 'prove' the model of venture philanthropy than to help local non-profits to diversify their financing through entrepreneurial activities – thereby helping to further their social change missions. The VP model is useful only in so far as it furthers this ultimate goal. The growing number of VP funds that have emerged in recent years apply the VP method to achieve different ends.

1 *Investing in individual social innovators*

Some venture philanthropists provide targeted financial and capacity-building support to individuals they refer to as 'social entrepreneurs' – ie individual leaders who address a critical social problem in a particularly unique or effective way.

2 *Investing in social enterprises*

Others apply VP approaches to provide capital and technical assistance to for-profit enterprises owned and operated by non-profit parent organizations to generate income and/or provide employment opportunities for marginalized constituencies (eg the homeless, physically/mentally handicapped).

3 *Investing in organizational development*

Still others apply VP approaches to provide financial and capacity-building support to non-profits in an effort to 'bring to scale' their successful activities.

NESsT's own 'ends' fit clearly with the second of those outlined above. However, all three share a similar means of reaching our different (albeit related) ends and believe that the VP model is very relevant to help address the leadership, financial and organizational needs of civil society organizations in the developing and developed worlds alike.

Measuring performance

Although all venture philanthropists may not have the same ends, there is a common investment approach and a common commitment to the importance of measuring progress towards achieving those various ends. Some venture philanthropists (groups 1 and 3) attempt to measure the increased social impact made by the social entrepreneurs or organizations they support. Others (group 2) attempt to measure both social and financial impact.

NESsT, for example, seeks to measure both the financial and the social impact resulting from our investments in our portfolio enterprises. However, the financial return involves the distribution of revenues from the portfolio enterprises to their parent non-profit organizations to support their mission-related work rather than a financial return to NESsT itself or our donors/investors. The social return we anticipate is increased mission impact as a result of the revenues the enterprises generate – as well as any direct social impact the enterprises themselves may make (eg increased employment opportunities for a marginalized group).

Venture philanthropy therefore has no single measure of success (ie it may seek a purely financial or purely social end or a combination of the two). Herein also lies the difference between venture philanthropy and what has come to be known as 'social investment'. The difference is primarily one of emphasis: the social investor, by definition, seeks a 'double bottom line', both a financial and a social return, whereas the venture philanthropist doesn't necessarily seek a financial return since the definition of venture philanthropy is more a question of means (ie 'engaged philanthropy') to a social end.

Defining venture philanthropy

NESsT defines venture philanthropy as an emerging field of 'engaged philanthropy' that combines the policies and practices of long-term investment and venture capital models with the principles and public benefit missions of the non-profit sector. VP strategies combine financial capital 'investments' with some form of additional capacity-building or technical assistance to the non-profits they support.

Some of the key distinguishing characteristics that define the VP approach include:

- Multi-year financing
- Tailored financing
- 'Engaged' relationship between investor and investee
- Organizational focus
- Shared risk
- Agreed benchmarks for success
- Exit strategy

1 See 'But is it Smart Money? Non-profits question the value of venture philanthropy' in *Responsive Philanthropy* (Washington DC, Spring 2000).

2 *Venture Philanthropy 2002* is the third 'annual report' on the field published by Venture Philanthropy Partners; see *Alliance*, p27.

3 See 'The Promise of Venture Philanthropy' (www.surdna.org/venture.html).

4 NESsT uses the term 'social enterprise' to refer to a number of entrepreneurial, self-financing strategies used by non-profits to generate income, including: membership dues, fees for services, product sales, use of 'hard' assets (eg rental of unutilized equipment or real estate) or 'soft' assets (eg licensing agreements, patents, copyrights), ancillary business ventures, and interest on savings or other investment dividends.

5 See eg *Profits for Non-Profits: An assessment of the challenges in NGO self-financing* (Budapest: NESsT, 1999) and *Get Ready, Get Set: Starting down the road to self-financing* (Santiago: NESsT, forthcoming 2002).

The true costs of investment in non-profits

Some critics of venture philanthropy point out that the model – in whatever variant – is highly resource-intensive. They are right. However, at NESsT we feel this is an indication not so much of an inefficiency in the VP model as of the general tendency in the philanthropic world to 'under-resource' non-profit endeavours. The VP model may not always be appropriate, but generally speaking the mentality of 'doing a lot with a little' is both an asset and a liability to the non-profit sector. Non-profits in the developing world have been the greatest victims of this mentality. Many local organizations have managed to implement their programmes by piecing together project grants from a variety of donors while stymieing the overall development of their organizations. The VP approach may support fewer organizations (at least initially) but it provides the support that many need to make the jump from an ad hoc project to a more stable organization with infrastructure and resources to sustain and/or grow their activities.

Redistributing the risk

For a variety of reasons, non-profits in the developing world are forced to be even more entrepreneurial than their developed world peers if they are to garner sufficient resources for their work.[6] The VP model provides a needed source of capital and organizational support to develop these activities in an otherwise hostile environment. NESsT has found that social enterprises (like most small businesses) require most assistance during the 'incubation' period of their development. It is during the planning and development phases that they are most vulnerable and at risk. For this reason, NVF focuses a great deal of attention on 'front-end' investments of both money and capacity-building assistance from the inception of the enterprise idea through to the point at which an enterprise becomes self-sufficient. Even before inviting social enterprises into our portfolio, NVF provides tailored coaching to help candidates develop feasibility studies for their enterprise ideas and 'venture planning grants' and training to help develop full business plans. This can help a non-profit avoid the risk of launching an unviable enterprise – and helps those who enter the portfolio with viable enterprise ideas to clarify their strategy and increase their likelihood of success in the face of the many unknowns that exist in emerging market economies.

Although venture philanthropy can help protect the philanthropic investments of donors against organizational or environmental risks, it is not a strategy for the risk-adverse. The needs of social enterprises and the challenges and risks they face do not necessarily correspond to the artificial timelines/deadlines of board meetings and calendar years applied by many grantmakers. One of the greatest assets of the VP approach is its flexibility and ability to offer financing and capacity-building support to social enterprises when (and how) they are really needed. The venture philanthropist thereby aims to 'share' the risk with the social enterprise. This assumption of shared risk – and of the corresponding shared success – is one of the things that distinguishes the relationship from that between a typical grantee and donor.

6 See Lee Davis, *The NGO-Business Hybrid* (Washington DC: NESsT and the Johns Hopkins School for Advanced International Studies, 1997) for cases of non-profit entrepreneurship in 13 countries, among them Azerbaijan, Brazil, the Dominican Republic, Jamaica and Romania.

Leveraging new local resources

NESsT has found the VP approach useful in reaching out and engaging a new type of philanthropist and thus leveraging new philanthropic resources – in-kind donations, pro bono services and financing – to support local non-profits. In Central Europe, for example, NESsT has already received commitments from local venture capitalists and other firms that have never been involved in philanthropy before. The philanthropic investment approach applied by NESsT helped them find a way of matching their professional skills and interests with their desire to become involved in the community. Building on these early successes, NESsT's initial goal is to raise at least a third of the direct capital investment in our portfolio from local philanthropic sources by 2003.

We have already succeeded in involving over 30 top local business leaders from the accounting/finance, legal, private equity and venture capital fields in our Business Advisory Network (BAN). Together, BAN provides the equivalent of more than $100,000 a year in pro bono advice and services to NESsT and our Central Europe portfolio. NESsT has found that this in-kind support from local corporate leaders is equally if not more important than the financial investment itself.

Locally based and 'engaged' philanthropy

By definition, venture philanthropy is 'engaged philanthropy' (as opposed to 'engaged grantmaking' since some venture philanthropists apply financial instruments, such as loans and loan guarantees, other than simply grants). Its success is fundamentally rooted in a close relationship, based on openness, trust and mutual accountability. In NESsT's experience, being locally based and building a local, sustainable circle of support around the portfolio is critical to long-term success. For this reason, NESsT Europe's supervisory board, Business Advisory Network and Investors Circle consists only of individuals from within the countries where we work, and all the staff that manage and work with our portfolio are based in Budapest and/or Santiago. This allows for easy and frequent personal interaction with portfolio members, donors/investors and business advisers. Often managed out of offices in North America and Western Europe, many international organizations working to build 'civil society' in developing countries lack a key ingredient of the VP recipe: the development of local relationships and trust between investors, advisers and portfolio.

Improving the long-term effectiveness of international philanthropy

The VP model can help provide an additional degree of assurance to donors – particularly to international donors supporting social enterprises in the developing world. While the local and engaged aspects of the VP model are critical, it is important to distinguish here between the role of the philanthropic donor and the VP fund (ie the organization managing these funds and working directly with local social enterprises). The added due diligence, capacity-building and financial support that the VP fund provides can help protect and multiply the impact of the financial support provided by international donors. International donors can enhance the long-term impact of their philanthropic giving by supporting local VP funds that provide support to their grantees and other social enterprises that they haven't the time, resources or expertise to provide themselves.

Furthermore, venture philanthropy can be an effective tool for easing the transition from dependence on foreign/international philanthropy. For better or worse, many international donors are leaving Central Europe and Latin America. Amidst all the talk of 'exit strategies', NESsT has found that the VP approach can be useful in helping local non-profits make the transition from dependence on international philanthropy to more diverse, local income sources. And while many international donors have already left Central Europe and Latin America (or are in the process of doing so), it is an opportune time to explore the VP model for countries where foreign aid still plays an important role in funding local civil society.

Promoting a culture of accountability and trust

In countries where corruption can still dominate the private and public sectors and foment continued distrust of the non-profit sector, ensuring accountability, ethical behaviour and transparency is especially critical. The VP model can help provide an additional degree of assurance to donors and policymakers in this respect as well. In the Czech Republic, for example, one local venture capitalist, who subsequently committed funds to a member of the NVF portfolio, recounted his inability to find reliable, trustworthy organizations to which he could make a charitable donation. The extensive due diligence and close relationship NESsT maintains with its portfolio thus provides an important assurance of accountability to potential local philanthropists. Furthermore, NESsT requires all portfolio members to sign up to and abide by the principles set out in its code of ethics for social enterprises.[7]

7 See *Commitment to Integrity: Guiding principles for non-profits entering the marketplace* (Santiago: NESsT, 2000).

Furthering local development

NESsT's approach to venture philanthropy (ie supporting the development of social enterprises) stimulates local community and economic development as well as furthering the development of the non-profit parent organization. This makes it particularly attractive to cash-strapped local and national governments, who can learn to see the non-profit sector as a creator of local wealth rather than simply a consumer of limited public and private charitable resources. Several of the social enterprises in the NVF portfolio have a dual mission of generating income for their organization and providing employment for their constituents (see case study of P-Centrum on p35). Enterprises like this can simultaneously further the mission and financial sustainability of the non-profit parent, stimulate local economic activity, provide employment, and reduce the burden of providing services for local and state governments.

Conclusion

The global debate on venture philanthropy is just beginning. While the field should be subject to the same rigorous examination as any other emerging field, it is important that donors and others should not too quickly dismiss a strategy that can potentially contribute to increasing the diversity of investment tools in the non-profit capital market and the flow of resources to civil society organizations. Venture capital was once the *avante garde* of the for-profit financial world – though never intended to replace mainstream investment banks – and is now an accepted financial instrument. So too will venture philanthropy join the mainstream of the non-profit capital market, calming both the nay-sayers and the apostles. @