4184_P-01.qxd 12/1/03 1:53 PM Page 19

CHAPTER 1

The Industry of Philanthropy

The sweat of industry would dry and die
But for the end it works to.[1]

—William Shakespeare, *Cymbeline*

Philanthropy—at its most basic—is the process of sharing private resources for public benefit. The activities it encompasses range from volunteering time to strategically investing endowed resources in socially responsible index funds to giving time and money together. All of these activities involve "putting something in" to make something better "come out." This can be expressed as an incredibly simple equation:

philanthropic inputs + existing conditions = better outcomes for others

This deliberate oversimplification is important in helping us locate the industrial elements of philanthropy. The equation in its entirety, including the final sum—"better outcomes"—captures both the public purpose of the industry and the extent to which philanthropy is part of its surroundings ("existing conditions"). Philanthropic actions are not about profit or outcomes for the giver, but are actions taken in pursuit of something for others. This public purpose distinguishes philanthropy from other industries and greatly influences the manner in which key components of the industry interact.

The industrial framework applies most specifically to the equation's "philanthropic inputs" variable. While the two most basic forms of input are time and money, applying the industrial lens allows us to see the magnitude

4184_P-01.qxd 12/1/03 1:53 PM Page 20

of the changing forms, functions, participants, activities, and scope of these inputs. Industries are defined as a set of companies that produce highly substitutable products or services. All financial vehicles for making tax-deductible contributions fall into the philanthropic industry, from charitable gift funds to independent foundations, private banks, corporate giving programs, and social donor networks. Each of these vehicles has a unique set of characteristics from the perspective of tax and estate planning, yet they are all firms or products for the purpose of giving away money. Understanding philanthropy as an industry is an effective aid in better seeing what it is uniquely capable of and what it stands no chance of accomplishing.

Applying an industrial framework to philanthropy is not a futuristic definitional trick, it simply recognizes the changes that have already occurred. The components of an industry, which are detailed as follows, now permeate philanthropy. The market and regulatory forces that shape this industry (and are discussed in Chapters 3 and 4) are profound. They will not disappear simply because many in the industry are uncomfortable with the language I use to describe them or because of some idealistic image of what the nonprofit sector should be.

Pointing out the industrial nature of philanthropy is both an act of accepting the real pressures of markets and regulation and positioning the industry to reclaim control of its future. There has long been a robust debate within nonprofits and philanthropy about what to call the work, some prefer “nonprofit,” others like “public benefit,” and the 1960s brought us the “independent sector,” by which to distinguish the work from government or business enterprises.[2] In contrast, this analysis shows philanthropy and nonprofits as dependent on the public and commercial spheres, especially when the guiding questions are about future directions.

This chapter outlines both the ways in which the industrial framework is useful and the limits of that framework. It also rounds out the conceptual work of the book by presenting components of evolutionary and systems theory that inform the argument.

Defining the Industry

The literature on business is rife with analyses, exhortations, and primers on industry characteristics, growth, and decline. Industries define themselves through trade associations, the government draws some defining lines

4184_P-01.qxd 12/1/03 1:53 PM Page 21

while investors determine others, and individual businesses are often active in more than one industry. The work of Michael Porter at Harvard University is particularly noteworthy in defining industries and helping us to see how the standard characteristics and pressures are relevant to philanthropy.[3] The six core elements of an industry are listed as follows and described in more detail in the following section:

- Capital for investment
- Firms, markets, and customers
- Products and services
- Competition and alliances
- Regulation and public policy
- Media attention and public awareness

Viewing philanthropy as an industry provides us with a conceptual framework to hold together these disparate pieces. By thinking of philanthropy as an industry, we can track the influence of capital growth, regulation, product differentiation, and markets. We need to push our imaginations beyond the commonly held vision of a purely commercial industry in order to understand the role that the human and social elements of philanthropy play on the overall shape and size of the endeavor. Lacking a common bottom line, philanthropic action is not as linear, predictable, or quantifiable as changes in the oil, biotechnology, or telecommunications industries.

The various elements of philanthropy are neatly defined by these six industry characteristics.

Capital for Investment

Philanthropy is experiencing an explosion of available capital. The financial resources dedicated to philanthropic action have increased multifold in the last decades, topping out at more than $240 billion in gifts and $476 billion in assets in 2001.[4] This growth is the primary reason that there is so much change in philanthropy. The opportunity to manage and/or advise these financial resources has attracted new types of firms to the market, caught the eye of regulators, excited the media, and created an entry-level for market participation that requires much less wealth than was previously feasible.

4184_P-01.qxd 12/1/03 1:53 PM Page 22

As more and more people attain a level of wealth at which managing their philanthropy is an option, they are seeking out a wide variety of giving products. They may choose to establish a donor-advised fund at either a commercial or nonprofit organization. They might partner with peers in creating a giving circle. They may simply increase their charitable giving as part of their overall budget and choose not to invest in a specific philanthropic product. They may simultaneously create a family foundation and become more active in their company's giving program. And, as we will see, many people will choose to use several of these giving products all at once. The growth in giving options—some of which look like products (donor-advised funds) and some of which look like firms (private foundations)—allows broader participation in the industry and encourages a new level of competition between products or firms.

While this growth in philanthropic participation is interesting, it is important to note that more people are purchasing philanthropic products and the actual value of their giving is increasing, but the percentage of individual wealth allocated to philanthropy has remained rather steady (ranging between 1.7 and 2.1 percent of personal income) over the last 30 years.[5] This narrow band of giving is surprising if viewed solely through the lens of the market. There has been no lack of effort to grow the market, as evidenced by the dramatic shifts in the types of firms actively involved in philanthropy and the customers and markets they seek to reach and expand.

The involvement of commercial firms offering charity-related products has drastically affected the role that competitive markets play in philanthropic decision making. As in most competitive markets, there are many players in philanthropy: individuals; financial service firms; private, community, and corporate foundations; giving circles; professional advisors (accountants, attorneys, and investment professionals); and estate planning and fundraising professionals. The various firms and products are simultaneously struggling to differentiate themselves and working together in alliances. They all offer a host of similar products, and several layers of regulation govern them as a single industry.

Firms, Markets, and Customers

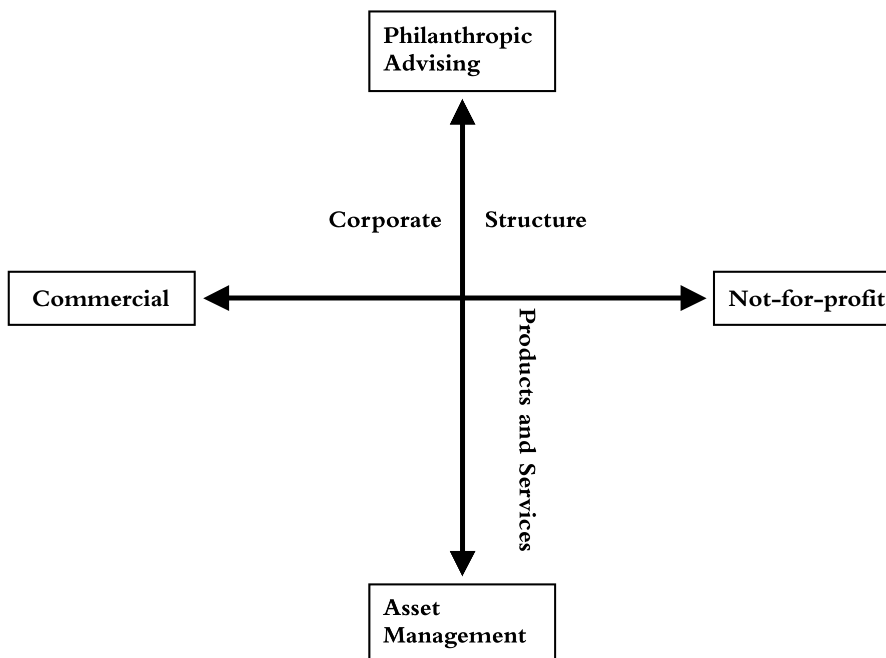
Firms in the philanthropic industry include all those who provide or advise charitable giving opportunities. Twenty years ago this would have included foundations, community foundations, community endowments, nonprofit

4184_P-01.qxd 12/1/03 1:53 PM Page 23

organizations with established donor services and planned giving opportunities, fundraising professionals, banks, and trusts. In 2002, the landscape of firms in the industry included the aforementioned list plus financial services firms, mutual fund companies, independent donor-advised funds, independent consulting firms, professional advisory services, and e-commerce companies that provide Internet technology to manage or assist in fundraising.

The marketplace has become increasingly crowded and diversified. The traditional customers for most of these firms have been individuals with high net worth. One result of the increased activity in the market is that customers with lower net worth are increasingly sought after as target customers, expanding the reach of the market. As the types of firms in the industry continue to diversify and new partnerships and alliances emerge, the old categories of foundation, commercial firm, and donor-advised fund decrease in their utility. As we look to the future, a new matrix for thinking about the firms presents itself, designed more around the services and products being offered than by the host institution selling them (see Exhibit 1.1).

EXHIBIT 1.1 KEY CHARACTERISTICS OF PHILANTHROPIC FIRMS—2003



All purveyors of philanthropic services can be categorized on the continuum in Exhibit 1.1. A key trend to track in the industry is where the majority of firms fit along the continuum at any given time. Fifty years ago, it is safe to say that most institutional philanthropy was managed through exclusively not-for-profit organizations (e.g., foundations, community foundations). Commercial banks were involved in the work to a small degree through their trust departments. These institutions provided a mix of advisory services and asset management services, and pricing was based on asset management fees.

Today, the mix has shifted dramatically. Commercial relationships are far more common, either through direct product sales from commercial banks (donor-advised funds) or partnerships between banks and foundations. Many firms that sell advisory services, absent any asset management component, are also visible on the landscape. As we think along these broad stripes of philanthropic firms, it becomes easier to focus on the mix of products and services available to the market, and we are less bound by traditional categorical breakdowns.

Products and Services

The two major products sold in the philanthropic industry are (1) tax-exempt structures for giving funds and (2) advice and research. The available asset management structures include direct gifts of cash or equities to a nonprofit organization, charitable trusts, private foundations, donor-advised funds, supporting organizations, and semi-restricted or unrestricted gifts to community foundations or endowments. Also available are several different annuities, trusts, and estate management tools.

On the advice and research side, the services offered include investment management advice, educational opportunities, reporting to regulatory bodies, grants management, advisory services regarding the structuring of philanthropic gifts, independent research and analysis on issues of concern, family wealth management, board training, peer learning opportunities, and management consulting. Sometimes these services are coupled with asset management products, and often they are sold independently.

Competition and Alliances

One of the most persistent mischaracterizations of this industry is that because it is largely not-for-profit it is also free of competition. As commer-

4184_P-01.qxd 12/1/03 1:53 PM Page 25

cial firms have entered the market for charitable giving options, the role of competition has become more obvious. Individual philanthropists have several options for managing their giving. From the standpoint of these donors, the options are in competition with each other. Donors are doing more comparison shopping across products and services. More and more frequently, donors are choosing several options and expecting to derive different benefits from each.[6]

Although community foundations and financial services firms are in competition for managing the assets of charitable individuals, there is also an increasing willingness to form alliances between foundations and other giving vehicles. Several financial services firms work with large numbers of community foundations.[7] Private foundations often work with community endowments. Alliances of private, corporate, and community foundations are nurturing several giving circles around the country. In some situations, private foundations are even turning to the commercial firms' donor-advised funds (and to community foundations) to help them meet payout requirements.[8]

These alliances have several drivers. Most important is the industry-wide recognition that asset management and advice are separate services, available from independent vendors, and that command different pricing structures. This encourages mixing and matching by both consumers and purveyors. Also at work is the recognition that no single philanthropic entity has the assets to achieve its goals alone. This awareness increases opportunities for partnership as philanthropic individuals find themselves choosing several vehicles at once and then seeking ways to make them work together.

Regulation and Public Policy

Philanthropy is a regulated industry. Federal, state, and municipal tax codes govern tax exemptions and regulate charitable giving. Secretaries of state, attorneys general, the Internal Revenue Service, and state departments of corporations oversee foundations and nonprofit organizations. Individual giving is subject to regulations regarding tax deductibility. For institutional giving, additional regulations require public reporting and influence the roles that tax-exempt organizations can play regarding political advocacy and lobbying.

The different firms competing in the philanthropic product market do not share the same interests vis-à-vis tax policy and regulation. This results

4184_P-01.qxd 12/1/03 1:53 PM Page 26

in conflicting activity on public policy regarding the oversight of the industry. For example, community foundations and private foundations have different opinions on the levying of an excise tax levy on private foundations. Community foundations and commercial financial service firms also have taken different stances on the regulation and oversight of donor-advised funds. The disparate preferences result in several subindustry appeals to regulators and limit the industry's ability to speak with one voice. In general, the industry has tended to be reactionary to public policy rather than proactive in working with regulators.

In his 2002 book, *Wealth and Democracy*, Kevin Phillips attempts a broad history of the relationship between money and politics. In looking over 300 years of government economic policy in the United States, he notes that, "Occasionally public policy tilted toward the lower and middle classes. . . . Most often, in the United States and elsewhere, these avenues and alleyways have been explored, every nook and cranny, for the benefit of the financial and business classes."[9] The preference for policies that help build wealth led to a "wealth gap" at the end of the twentieth century similar only to that experienced in 1929 before the Great Depression. Between 1977 and 1997, the percentage of all income held by the richest 5 percent of the U.S. population grew from 44.2 percent to 50.4 percent (i.e., 5 percent of the population makes more than half of all the money). At the same time, the poorest 5 percent saw their percentage of all income drop even further, from 5.7 percent to 5.2 percent.[10]

Media Attention and Public Awareness

General public awareness of philanthropy is on the rise. The economic boom of the late 1990s led many general-interest newspapers and magazines to profile individuals with high net worth and their philanthropy. In addition, foundations and individual givers have become more proactive in communicating with the public about their work. The competition for donors has led to broad advertising campaigns by commercial services firms and community foundations. Finally, the large-scale scandals that placed philanthropic and nonprofit entities in the news in the past have reappeared recently, and the attention to charitable giving and nonprofit decision making following the tragedies of September 11, 2001 has kept philanthropic issues in the headlines for more than two years.

4184_P-01.qxd 12/1/03 1:53 PM Page 27

The increase in advertising that has contributed to and accompanied the growth in donor-advised funds is part of the increased public awareness of philanthropy. From billboards in public transit stops to magazine advertisements to program support on National Public Radio, foundations are increasingly advertising their existence and their activities.[11] This goes hand-in-glove with the advertising done by commercial banks that offer philanthropic services. These ads tend to present the bank's or financial service firm's "one-stop" shop ability for all of an individual's wealth management needs, including estate and trust planning and philanthropic advising.

Heightened public awareness and media attention provides important context for considering the industry in the twenty-first century. Such attention may play out many ways. A greater general awareness may lead to infusions of funds into philanthropy that might not have otherwise occurred. At the same time scandals in philanthropy will play out before a larger audience, and changes in regulatory oversight will draw greater public attention.

The conceptual framework of an industry of philanthropy is a means to an end, not an end in itself. In Chapter 3, as we examine the major drivers of change, the framework allows us to pinpoint ourselves in the current landscape, fix our gaze on the horizon, and identify tangible actions foundations can take to spur movement toward a stronger nonprofit and philanthropic enterprise.

Mapping the Landscape of Philanthropic Capital

At the heart of understanding the philanthropic industry is the recognition that all philanthropic giving comes from individuals and is organized by individuals. Some people of great wealth never establish any kind of philanthropic organization, but they give millions of dollars from their checking account on an annual basis, asking for no guidance or input from anyone in their personal or professional circles. Other donors choose to affiliate themselves with as many peers as possible, and so may manage a much smaller annual philanthropic budget through participation in a giving circle, a community foundation donor-advised fund, sitting on their corporate giving committee, and serving as a board member on their family foundation. The dollar value of a person's giving is only loosely related to the number or types of philanthropic products that individual may use.

4184_P-01.qxd 12/1/03 1:53 PM Page 28

Recognizing that each philanthropic product is attached to an individual helps us to understand the degree and timing of influence that competition plays in the industry. The following example of Ricardo Jr. shows the sensitivity of different products to customer decisions. Ricardo is the fifty-five year old son of an immigrant father who founded a very successful packaged foods business. Before he died, Ricardo Sr. established a family foundation and named his three children as board members, along with several of his business associates. Ricardo Jr. serves on the board of the foundation, is active in the development campaigns at the university where he was an undergraduate and received his law degree, serves on the board of the local animal shelter, is active on his company's giving committee, and has donor-advised funds with his investment manager's bank, the local community foundation, and through an international community foundation sponsored by his church. He is also considering how to catalyze and inform his adult children's philanthropy.

In terms of his philanthropic assets, Ricardo represents the full spectrum of options. Every year he gives to his alma mater and to the animal shelter, although the amounts he gives fluctuate wildly from year to year. The giving that he oversees through his family foundation is much less volatile—because the budget was determined the previous year and the staff made deliberate efforts to maintain a certain level of giving. The donor-advised funds also rise and fall in size—some years Ricardo advises so much giving through these funds that he nearly depletes them, other times he focuses his own giving on building those funds rather than dispersing them. The new family foundation idea represents the largest possible new philanthropic purchase for Ricardo. He is deciding whether to endow a new entity, direct resources from the existing foundation to a new fund to be overseen by his children, direct his own estate to the existing foundation and bring his children onto that board, establish donor-advised funds for his children, or leave them the financial resources in his will and allow them to choose what to do.

Taken individually, the vehicles that now exist for managing philanthropic assets are discrete financial products. They include charitable remainder trusts, annuities, foundations, donor-advised funds, giving circle contributions, and direct gifts to nonprofit organizations. Yet each of these products is sold or provided by some sort of organization that seeks to manage the donor's philanthropic capital. In the example above, each of the philanthropic entities—from the family foundation to the animal shel-

4184_P-01.qxd 12/1/03 1:53 PM Page 29

ter to the community foundation to Ricardo's personal investment manager—has an interest in Ricardo picking their product to manage his resources. In this sense, they are all competitive products even though they range from free-standing organizations such as the foundation to legal subclauses, such as the estate planning options in Ricardo's will.

One way to look at this is to array the product options according to how prevalent they are. Recent research out of the Social Welfare Research Institute at Boston College along with IRS data and other survey findings can be aggregated into the following "topography" of philanthropic products. In the United States in 2002 there were:[12]

- 6,000,000 charitable bequests in wills
- 150,000 charitable trusts
- 70,000+ donor-advised funds (~$12b)
- 62,000+ foundations ($470 b+)
- 1.6 million nonprofits to which direct gifts can be made
- Charitable gift annuities and retained life estate (uncounted)

The most reliable industry metrics are those that count the most visible components of this complicated landscape. Thus we know that there are 62,000 foundations in the United States, more than 55,000 of which are structured as independent foundations, 600 are community foundations, 2,100 are corporate foundations, and 3,900 classify as operating foundations. These entities managed more than $476 billion in assets in 2002 and made more than $30 billion in grants.[13] The research also shows that almost half of all people who use one of these products actually use two or more.

These are impressive figures, yet they present an incomplete picture of the industry. All philanthropic giving in 2002 amounted to more than $240 billion, 76% of which was fueled by gifts from individuals. To further complicate efforts at tracking philanthropic capital, we know that bequests account for about 7.5% of all giving, or more than $18 billion in 2002.[14] Of the industry giving total, we know that some percentage of it is managed through the country's more than 70,000 donor-advised funds. It is striking to note that there are now more donor-advised funds than foundations, yet we don't have accurate values for either the assets or gifts from these funds.[15]

Nor can we equate individuals with small gifts and institutions with large ones. As Katherine Fulton and Andrew Blau of Global Business Network have pointed out, an integrated list of the 100 top givers that counted both

4184_P-01.qxd 12/1/03 1:53 PM Page 30

individuals and institutions would include 78 foundations and 22 individual donors. That is to say that these people gave more in that year than 1/5 of the nation's most active foundations.[16] The lines between individual and institutional philanthropy are blurring.

The landscape of philanthropic giving is littered with options, not all of which are easily identified and many of which are very small. Some of the players have been in existence for decades and are endowed in perpetuity, others are less than a year old and will be spent down and replenished each year according to the donor's interests. As products and firms in competition for donor assets, some of the players—particularly commercial entities and community foundations—are extremely sensitive to competitive pressures. For others, such as endowed foundations, the original purchase decision of the donor is the primary point at which the other options stand out as competing choices. The various products for philanthropic asset management are all subject to competitive market pressures, but they do not all experience it equally or at the same time. Exhibit 1.2 shows how the most common products array on a scale of competitive pressures.

A donor seeking to purchase asset management tools for her philanthropic capital must pick among these firms and products—and at this decision stage an endowed foundation is simply one of many product options. Frequently, donors will choose several of the options, including an independent foundation. Eventually that foundation may become home to more (or even all) of the donor's assets, or it may remain relatively small and operate in parallel with other funds, estate tools, or giving vehicles established by the donor. At this point, it starts to look less like a product in

EXHIBIT 1.2 SENSITIVITY TO COMPETITION FOR DIFFERENT PHILANTHROPIC FINANCIAL PRODUCTS

Product sensitivity to competition	High	• Independent foundation • Community foundation fund • Financial service firm account • Direct gift to nonprofit	• Community foundation fund • Financial service firm account • Direct gift to nonprofit
	Low		• Independent foundation
	Timeline of product purchase	**Initial purchase**	**Established**

4184_P-01.qxd 12/1/03 1:53 PM Page 31

the market and begins to act more like a firm, especially if it is one of the few foundations in the country to employ staff. Competition in philanthropy has uneven influences, acting as a much stronger force on some entities than on others.

Evolutionary Adaptations and the Limits of the Industrial Framework

> *Man's unique reward, however, is that while animals survive by adjusting themselves to their background, man survives by adjusting his background to himself.*[17]
>
> —Ayn Rand

The uneven responses to competition are just one example of how the industrial framework is not an exact fit for philanthropy. Some have compared philanthropy to an ecological system, whereas others prefer field of practice or sector. In some cases, the difference is purely semantic. Some simply do not want to be tainted by the market overtones that mark industries in general. I prefer to use what works from the industrial framework (which is a lot) and draw from other frameworks as necessary.

There are two other important frameworks: evolutionary theory and systems theory that will enhance the resolution with which we see how philanthropy works. I will highlight some key concepts of these two frameworks that help us to understand how philanthropy works and where it is going.

Evolutionary Aspects of Philanthropy

From Darwin to Gould, through anthropology, genetics, genomics, and zoology, our understanding of the natural changes that occur over time in animal and plant species is ever-changing. The recent mapping of the human genome has opened up a new world and called into question some old ideas. It also has rejuvenated theories and evidence that had once been discounted.[18]

Noting that nothing is static—even our understanding of evolution—is the first key contribution of evolutionary research. Second is the sense that change takes time. Third, research shows that our preference for a nice, linear story of progressive change that involves clear adaptation to overall

4184_P-01.qxd 12/1/03 1:53 PM Page 32

environmental stresses is too neat and clean. Change and evolution are messy. They occur sporadically.[19] Certain organisms (and organizations) change only in response to a new niche opportunity, not in line with some overarching predetermined plan. Opportunities for some are often death blows for others. The balance is important, and a diversity of types (e.g., species, organisms, organizations) is generally seen as critical to the health of the individual entities and the whole.

Without digressing into an exhaustive discussion of the state of evolutionary theory, these aspects of the work are indeed immediately applicable to understanding philanthropy:

- Organisms (organizations) adapt to their environment.
- Change is slow, messy, and uneven.
- Opportunities for some can be fatal to others.
- A diverse set of species (organizations) is critical to the health of the individuals and the whole environment.

Systems Theory

This question of the whole and its parts is where systems theory comes into play. Although a complex and ever-changing area of study, systems theory is essentially a means of looking at the interactions between and among organisms (or organizations) rather than looking at the individual entities. The theories have evolved and adapted through several academic disciplines, from math to philosophy, and are now usually viewed as inherently interdisciplinary ways of thinking about computers, communities, policies, or other phenomena. One of the key founders of the work, the biologist Ludwig von Bertelannfy, "emphasized that real systems are open to, and interact with, their environments, and that they can acquire qualitatively new properties through emergence, resulting in continual evolution."[20]

Systems theory helps us see how individual organizations can be shaped in very different ways by a shared set of environmental forces. The value of this approach is its emphasis on the interdependence of the whole and its pieces. It allows us to see how changing the philanthropic industry can assist individual organizations and how change at the organizational level

4184_P-01.qxd 12/1/03 1:53 PM Page 33

can influence industry progress as well. As analysis and research has applied systems theory to fields as far ranging as biological, environmental, organizational, economic, political, and urban systems, several key ideas have become standard. One of these is the idea that there are leverage points at which one can make a small change and have a large effect.[21]

The idea of leverage points has become almost endemic to institutional philanthropy. Grants are often made with either implicit or explicit expectations that, although the funds are small, if well placed they can spark change throughout the organization, the issue, or the system at hand. Grant funds are intended to leverage other funds and to be catalysts of change well beyond their own size. How to assess a system to identify these points, how to measure a grant's success at achieving such impact, and, most important, how to find the points of leverage for the philanthropic system are the harder questions.

In her analysis of how to find leverage points, Donella Meadows of The Sustainability Institute notes that two very common mistakes are made in this work. First, the leverage point is identified and agreed upon, but the wrong action is taken on it (it is pushed the wrong way to achieve the intended goals). The second mistake is that the wrong leverage point is identified. Leverage points, she argues, are counterintuitive.[22]

This would not be such a hindrance if we had good technology or methodology for identifying leverage points. Unfortunately, the science that has introduced leverage points is most robust when being applied retrospectively to data about known systems. It is less useful for analyzing emerging data or applying it to new systems to locate the points of leverage. In other words, systems theory and our understanding of leverage points are at their best when explaining what happened and why, rather than predicting what will happen.

From systems theory we can also draw several concepts to better inform our understanding of philanthropy. These include the following:

- The connections and interactions between entities matter in understanding the system.
- Leverage points are places where small shifts can have large ripple effects throughout a system.
- Leverage points are hard to predict and often counterintuitive.

4184_P-01.qxd 12/1/03 1:53 PM Page 34

The Exceptions Prove the Rule

Having drawn these lessons from evolutionary and systems theory, let us return to the industrial model. Perhaps the most compelling advantage of the industrial framework is that it affords us several comparison models, each of which sheds light on developments in philanthropy. Throughout this book I compare philanthropy to education, health care, the recording industry, movie studios, and financial services. Each sector offers important lessons from history that can inform our understanding of philanthropy's future.

I acknowledge that the industrial framework does not fit philanthropy perfectly. The role of competition, industry growth rates, and the lack of universal bottom-line standards are three characteristics of philanthropy where it is difficult to make the industrial model fit. As important, the human element of philanthropy, its contributions to the social good, and its relationship to the commercial and government sectors distinguish it from purely commercial fields. Some have warned me that to focus on philanthropy as an industry is to invite regulatory and legislative scrutiny and a resultant lack of special treatment. I agree with this point, although I believe the cause and effect are misplaced. Increased scrutiny is already being focused on philanthropy, and industrial standards are already being applied. Those in the industry who believe that philanthropy deserves special consideration because of its contributions to the social fabric of our nation had best find ways to document and account for those contributions, rather than bemoan the industrial analysis thereof.

Let us look quickly at the three exceptions to the industry model—competition, growth rates, and bottom-line standards. First, although many of the charitable fund providers are driven by profit motives, most are not. The short-term effect of the commercial players' entrance into the field has been to increase competition among noncommercial entities as well. The customer—the donor—is the same, and now faces two types of options, one commercial and one noncommercial (and several hybrids are also available). The first ripple of this competitive aspect hit community foundations; it has now expanded to other nonprofit philanthropic institutions, which must continually make their case to their donors.

There are many indicators of increased competition for donors. These include the growth in advertising, an increased (at least rhetorical) interest in demonstrating outcomes or return on investment, the development of

4184_P-01.qxd 12/1/03 1:53 PM Page 35

distinguishing, value-added services by entities previously focused on price-based competition, and the development of new alliances and hybrids between advisors and asset managers. The form that competition does not take, and that distinguishes philanthropy from purely commercial entities, is that it is rarely acknowledged. Philanthropic publications do not tout market share, and individual entities rarely go public with their efforts to woo donors from a competitor or to their services.

Second, the philanthropic industry does not grow and contract the way other industries do. Restaurants, shoe stores, booksellers, and drycleaners open and shut their doors according to their ability to generate a profit, but most foundations never go out of business. Some may lay off staff, they may suspend grant making, and they may move to cheaper offices, but the effect of an economic downturn is to reduce the size of the foundation; rarely does one go broke. In fact, the foundations most likely to go out of business are those that are deliberately designed to do so, they are known as "spend-down" foundations.

Endowed foundations are, of course, the minority of philanthropic actors. The amalgam of commercial and noncommercial participants is subject to a variety of factors influencing growth or decline, entry or barriers to entry in the business. Commercial firms clearly factor profitability of product into their decisions. It is possible that their charitable services, private banking, estate and trust management, and gift funds may each become so unprofitable as to cease to be offered; however, the motivation for many of these products is long-term customer relationships, and therefore profitability is not even a clear-cut demarcation for these firms.

Growth in philanthropy is greatly influenced by economic good times. The boom in personal income of the late 1990s led to more foundations being created and more donor-advised funds being opened. The bust, however, has not led to the folding of these institutions at anywhere near the same rate. Good times give birth to new philanthropic activity, and bad times slow the growth rate down. Both current regulatory structures and market forces over time have pushed philanthropic industry trends ever upward. In business terms, these factors would be analyzed as the "barriers to entry" for new products (low in philanthropy) and "exit rate" of firms (almost negligible in philanthropy).

Finally, the lack of industry-wide standards distinguishes philanthropy from other industries. This is partly a matter of the different metrics in use

4184_P-01.qxd 12/1/03 1:53 PM Page 36

by different players: Commercial players track profitability and long-term customer retention, whereas nonprofit entities focus less on profit, can sell services at cost, and focus more on societal impact. The industry is thus not uniformly concerned about market share or profit ratios.

The question of standards runs deeper than just metrics, however. Because of the independent, individualistic nature of philanthropy, there have been few associated efforts to set guidelines on ethical or fiscally prudent standards of behavior. Those that exist are largely self-referential and lack any power of enforcement. The best estimate regarding the percentage of foundations that join existing associations (and must thus meet their standards) is about 10 percent of existing foundations.[23] Government regulators are significantly understaffed when it comes to proactive investigation of charitable activities, and they must rely on whistleblowers or scandal to enforce basic fiduciary standards. There are nascent efforts at reporting performance metrics and developing standards of practice for managing philanthropic assets, but these are woefully basic given the industry's century-plus of operation.[24]

Although the industrial framework is not perfect, it helps us consider the effects of foreseeable future changes on philanthropy in ways that stand stronger than mere speculation. It also allows us to bring into one picture the rapidly changing and disparate elements of firms, products, services, customers, competition, and regulation.

In using the industry lens, we must maintain our understanding of philanthropy as more than a simple subset of financial services. Rather, the remarkably consistent rate of giving and its independence from resources and needs (supply and demand) highlight the very important noncommercial characteristics of philanthropy. Philanthropy is a human endeavor, influenced by pressures as diverse as moral compasses and tax brackets. It can be at once local and global, formal and highly personal, packaged into commodities and defined by human service, guided by religion and community, and subject to regulatory guidance and influence.

The Age of Commercial Charity

Philanthropy is similar to health care and education in terms of its development as an industry. Where once both of these services were provided mostly by the state or private charities, the twentieth century saw a rapid

4184_P-01.qxd 12/1/03 1:53 PM Page 37

privatization of these services in the United States. Health care in the United States is now a multibillion-dollar enterprise with a complex mix of public services, private commercial enterprises, and public benefit clinics. Education, which is constitutionally mandated as a state responsibility, has been provided through a mix of public and private entities since the nation's founding. For the most part, whether publicly or privately sponsored, education has been offered as a not-for-profit service. Recent decades have seen the rapid rise of commercial ventures in education at all levels from preschool to graduate programs.

The trajectory in these fields has not simply been one of privatization but also that of commercialization. In health care and education, the influence of commercial entities on charitable organizations and government providers cannot be denied. And so it is in philanthropy. Once upon a time, philanthropy was an informal activity of individuals or communities. The advent of the modern foundation at the dawn of the twentieth century began the age of institutional philanthropy. Now in the twenty-first century, the rise of donor-advised funds and the advance of for-profit firms and services mark the beginning of an age of commercial charity. There is no universal equation for the best relationship between the marketplace, government, and nonprofit providers—the challenge is making the mix work.[25] As the balance of players—commercial, nonprofit, and public—shifts, the public benefit sector presents a shocking new environment for philanthropic action.[26]

How do industries with robust mixes of commercial, private nonprofit, and public sector firms develop over time? Which characteristics first bleed into the others, and which fade away in the face of competition, lower prices, newer markets, or higher-paying customers? We have many situations where governments have turned to market tools to enforce public policy, such as in the sale of pollution credits and the auctioning of broadcast frequencies.[27] There is much to learn from these examples.

Consider the pressures on local governments as devolution continues to shift responsibility for services to cities from states and the federal government. Thus cities are attempting several new management techniques and service models to balance the available financing with the needs of their communities. More and more cities make ends meet by encouraging residents "to co-produce public services, such as through recycling and neighborhood watch programs."[28] At the same time, nonprofit contracts with

4184_P-01.qxd 12/1/03 1:53 PM Page 38

government have become the biggest source of revenue in some spheres, fundamentally shifting the provision of services from the public sector to the nonprofit and employing business systems for their purchase.[29]

We also have experienced decades of debate over how business practices can improve nonprofit operations. Markets, of course, rely on regulatory structure and publicly provided infrastructure. What can we expect to see as philanthropy continues on this developmental course from a cottage industry to a complex system of public and private, commercial and public benefit corporations?

The philanthropic industry includes both the "kitchen table family foundation" and the multibillion-dollar organization with hundreds of professional staff. Both are in the same business, just as the local bookstore is in the same line of work as Amazon.com. Readers are also free to go to their public library to pick up the latest fiction bestsellers. All three providers—e-commerce monster Amazon, small corner bookshops, and libraries—fit a niche in the system. The book industry also relies on publishers, editors, authors, magazine reviewers, distributors, and lecture series. As we consider the changing philanthropic marketplace, we will find ourselves looking not only at the individual firms, but also at the infrastructure that supports them, the secondary and tertiary vendors that sell to philanthropy, and the niches and networks that separate and bind them all together.

Philanthropy is a distinctive industry, set apart from others by its social mission and its elementally human focus. While the financial resources are only one element of the entire philanthropic equation and its final pursuit of public good, the changes surrounding the distribution and management of these assets can best be seen through an industrial lens. Efforts to improve the system as a whole will benefit from a deep analysis of the front end inputs in the system. The experiences of other industries will be instructive in imagining the future. The financial products and services of philanthropy are akin to other industries in that they are subject to both market pressures and regulatory structures.

It is these very products and services—the financial management tools and advisory services for philanthropic asset management—that are the core of new philanthropic capital markets. Just as commercial entities have choices in the types of financial backing they seek, so should nonprofit and civic groups be able to take advantage of a wide variety of capital products.

4184_P-01.qxd 12/1/03 1:53 PM Page 39

Donors, whose assets are the engine for these products and services, need to have clear, comparable choices, measures for success, and a conceptual and practical means of assessing the quality of their philanthropic asset allocations. We cannot move philanthropy forward without deliberately designing the system for providing financial resources.

4184_P-01.qxd 12/1/03 1:53 PM Page 40