Trusts & Trustees Advance Access published June 8, 2012

How foundations can achieve more with their money

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Abstract

Increasingly, funding activities of both foundations and private donors must meet demands for greater effectiveness. Therefore, new forms of funding and financing are being sought which promise to be more efficient and effective. Among those forms are investments in start-ups, the Cancer Support Accelerator model, and venture philanthropy.

Bill Gates is credited with the saying that giving money away requires the same effort as earning it ('What I discovered is that you've got to put in the same amount of work, and exercise the same degree of judgment, in giving money away as you do in making it.'). Indeed, times have changed. Conventional philanthropy was still relatively simple, and anyone wishing to do a good deed simply remitted money. Nowadays, this is often no longer enough. For one, in our complex and confusing world it has become more difficult to identify both the needs and the needy. Moreover, donors have to determine how to best meet the needs. After all, sending money is not the endpoint but rather the beginning. Donors want to know—and indeed, they should know—what is being done with their money. Thus, philanthropic activity increasingly moves away from a pure deed of donation to more ambitious forms; for example, donations may come with specific demands or may be subject to certain conditions. Grant agreements thus develop into service agreements with the unusual feature that the recipients of the donation do not have to provide a service to the donor. Accordingly, assessing the effect of the service—that is, the effect of the donation—becomes important in the donor's decision-making process regarding future donations.

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Demand for greater efficiency and effectiveness

In connection with the professionalization of the donation process particularly with a view to foundations, two criteria have become very important: efficiency and effectiveness. Effectiveness—that is, the assessment whether and to which extent the project supported by donations achieves its effect—is a variable that is difficult to define and measure.

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doi:10.1093/tandt/tts039

Unlike profit-oriented projects, not-for-profit projects lack the financial gain that could serve as a gauge. Nevertheless, the push towards finding a practicable method for measuring effectiveness continues.

In contrast to effectiveness, efficiency is a more clearly defined and measureable variable. Efficiency is calculated based on the ratio of donated funds used for funded projects to those used for administration and fundraising. According to ZEWO, the Swiss office for non-profit and fundraising organizations in Switzerland, efficiency is on average around 78 per cent for the organizations it has certified. In other words, of each 100 CHF donated, 78 CHF go directly into projects, and 22 CHF are used for the administration of the organization and for fundraising. Basically, efficiency should be as high as possible; however, it cannot be the goal of the administration to dismantle itself as a consequence of fund cutting. Here too the basic principle applies: as little as possible but as much as necessary. Regarding fundraising, newer organizations that must still establish their brand and market position often have higher fundraising costs compared with well-established organizations and particularly compared with those foundations whose ample funds allow them to dispense with fundraising activities. Nevertheless, all non-profit organizations must meet the demand of using every financial contribution to the greatest effect possible. While conventional donation activity, as mentioned, is based on the concept of simply giving money without aiming for a return on the assets, more innovative concepts aim to let foundations act more and more as investors.

Investment in start-ups

One option here is investment in the subsidized company. For example, a foundation wanting to contribute to the implementation of business ideas can demand to become a shareholder in the start-up firms, either right from the outset or upon reaching a certain donation amount. In this model, the subsidized company has no legal or moral obligation to repay the funds. If the start-up firm fails, the shares held by the foundation lose their value, and its financial position is as though it had never been involved at all. On the other hand, if the start-up firm becomes financially successful, the foundation will profit because the value of its shares will increase. The foundation can then sell these shares at a profit and recycle the proceeds into further donations. In this way, the same funds can be used several times and their impact multiplied. In other words, entrepreneurial principles are applied here to improve philanthropy.

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Cancer Support Accelerator

A related option to increase efficiency has been developed in connection with the fight against cancer. 'Cancer Support Accelerator' is the name of a model that is a PPP of a different kind, namely, a *philanthropy private equity partnership*. The fight against cancer serves as an example here, but the concept can also be used with other causes. The starting points are purely financially motivated private equity investments in private companies that focus exclusively on developing medications and other products against cancer. If these investments result in reflow of capital, these funds are then to be used entirely or in part for non-profit projects to fight cancer, for example, in cancer research, patient education, or prevention.

The private equity investors are thus also—at least potentially—donors. They invest by way of a cancer investment fund in companies whose cancer products are at the stage of clinical trials. While in firms listed on the stock exchange the money for the purchase of a share usually goes to a market participant—namely, the previous shareholder—in a private equity fund the money goes directly to the company, which uses it for developing its products. Here, success is determined by the profitability of the investments—the greater the potential of the cancer product, the higher the company's value when the development is finished or when it is sold. That is why it is important for investors to fund only the best and most promising companies. It is the fund manager's task to acquire expert knowledge and on that basis to evaluate companies that are developing innovative oncology products. Any resulting profits—ideally without the customary profit sharing deduction for the fund managers—are then allocated to a foundation designated by the investor, which is independent of the cancer investment fund but pursues related goals. There the funds will be used in accordance with the foundation's purpose a second time in the fight against cancer.

companies whose research shows the greatest likelihood of leading to marketable cancer medications. By funding these companies, the foundation is already fulfilling its purpose. If there is a return on the investment, that money can then be used again in accordance with the foundation's purpose. Here, too, the foundation's money serves its purpose more than once and thus increases the above-mentioned effectiveness.

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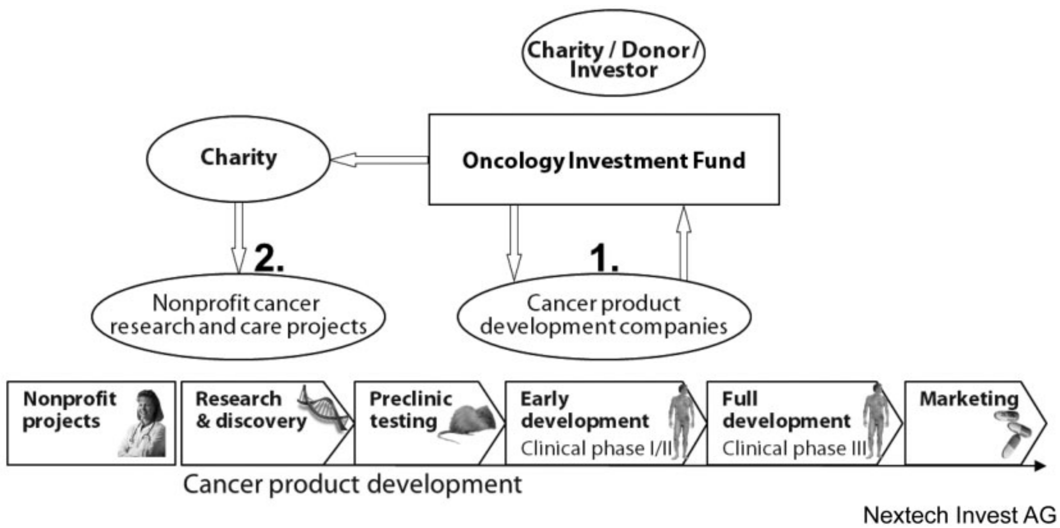

Any resulting profits are then allocated to a foundation designated by the investor, which is independent of the cancer investment fund but pursues related goals

In addition to investors who become donors, a foundation whose purpose is the fight against cancer can, of course, also invest in the cancer investment fund and profit from the reflow of capital. For the foundation the fund serves as a partner helping it to select from among countless market participants the ones with the greatest potential—that is, the

With this model the foundation's purpose is pursued in a twofold way. On the one hand, the development of cancer therapies is supported; though profit-oriented shareholders are already supporting this development, the foundation's donation accelerates the process. On the other hand, not-for-profit projects, such as basic cancer research, are also supported. Since this research is the basis for cancer therapies, what emerges is a closed circuit of funding for the fight against cancer. From the point of view of donors and foundations, it makes sense not to leave the entire potential profit for profit-oriented investors but rather to reclaim their share. That is, the principle of privatization of profits and socialization of the basic research which is necessary to achieve those profits and which is financed through government and foundation monies, is altered so that a part of the profits flows back into basic research.

From the point of view of the foundation, the Cancer Support Accelerator model means that a part of the donation process is delegated to external fund managers, and they in turn are responsible for identifying profitable companies. This process combines private and non-profit interests because both profit orientation and not-for-profit orientation in this respect pursue the same goal. Not-for-profit investors are also interested in achieving an attractive yield in this phase. The foundation council must have sufficient expertise to select appropriate funds and the appropriate fund managers who, perhaps in conjunction with a scientific advisory board, can understand and assess the global market—in this case, the rapidly developing oncology market and the rising demand for new and more effective cancer therapies and diagnoses. The delegation to the external fund manager is, of course, limited; the foundation retains the responsibility of closely monitoring the project.

Venture Philanthropy

Another philanthropic approach that is also based on the principles of venture capital and has become increasingly important in recent years is the 'venture philanthropy'. In this model investments are also made in new, vigorously growing organizations that will have as large a social impact as possible and are also designed to become profitable enterprises. For example, this may involve particularly economical and low-maintenance irrigation systems for subsistence farmers in developing countries. In contrast to venture capital investments aimed at maximizing profits, here smaller (or even negative) yields are accepted for the sake of the intended social impact. In contrast to the cancer support accelerator, venture philanthropy by itself is therefore limited to support projects suitable to a market approach. As in the Cancer Support Accelerator model, in venture philanthropy the reflow of capital can be allocated to a foundation and thus support additional projects for which a market approach would not be suitable. However, in this case donors must accept that the first use of their money is not based on profit maximization. Accordingly, less capital is available for the second use, that is, for the (pure) non-profit project. An additional difference is that due to the limited opportunities and options for venture philanthropy investments, venture philanthropy can hardly result in the above-mentioned recycling of funds in the fight against cancer. While in venture philanthropy the donor is from the outset both donor and investor, in the Cancer Support Accelerator model donors are initially only investors. Accordingly, this model is especially suitable in areas where non-profit projects, such as academic research, provide the groundwork that will later be used commercially in profit-oriented companies.

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Conclusion

From the point of view of foundation law, it must be pointed out that investments leading to an ownership position must be reported on the balance sheet as foundation assets. Nevertheless, these investments must be administered separately from the foundation's endowment fund because they do not fall under asset management but under funding. Care must be taken to have a clear contractual basis for these funding models, and in the case of tax-exempt foundations, the conditions for tax exemption must be preserved. The models described here are interesting innovations in funding from which 'non-profit' and 'profit' can benefit equally. Currently, hardly any other models exist that allow equally efficient use of donated and endowment funds in the funding segments suitable for them. However, they are only just beginning to be used, and their practical implementation will show whether these pioneering approaches achieve the lasting success they promise and whether they should be developed further. In any case, the entrepreneurial spirit motivating this innovative philanthropy deserves a warm welcome.