

PRESIDENT'S STATEMENT

In recent years, there has been much talk within the nonprofit sector about “strategic” or “effective” philanthropy, aimed at maximizing the social impact of foundation grants to nonprofit organizations. This talk takes place in the context of nonprofit organizations’ perennial and increasing concern that the large majority of philanthropic dollars are earmarked for particular projects – often designed by foundation staff with little or no consultation – rather than for general operating, or core, support. In 1994, only 16 percent of the grants budgets of large foundations provided general operating support, and by 2001 this had declined to 11 percent.¹ Many observers of the nonprofit sector argue that this trend seriously diminishes the efficacy and vitality of the organizations and the sector as a whole.²

Does the new interest in strategic philanthropy provide yet another reason, or rationalization, for not providing general operating support? Some foundations apparently believe that impact is best achieved and measured through grantor-initiated projects. Early in my tenure at the Hewlett Foundation, I spoke to an experienced evaluation officer at a foundation known for its ambitious projects, who flatly asserted that one cannot evaluate the impact of general support grants. If she is correct, then general operating support and strategic philanthropy are indeed in conflict – for strategic philanthropy depends on evaluation, feedback, and correction.

If only because almost 50 percent of the Hewlett Foundation’s grant dollars are designated for general operating support and because we think of ourselves as strategic and results-oriented, I was skeptical of the evaluation officer’s assertion. My skepticism has only grown with experience. Yes, the evaluation of projects is often simpler, and surely there are situations in which project support yields the greatest impact. For example, it is relatively easy to make and evaluate a grant to a museum to purchase a particular Rembrandt. Yet a strategic funder can often have the most significant and sustainable impact through general operating support grants – for example, maintaining the overall excellence of the museum’s collection and its accessibility to a diverse public. Moreover, a nonprofit organization that cannot cover its overhead expenses, of which project grants seldom pay their proportionate share, simply cannot sustain its operations.

This essay identifies the competing interests at stake in the funding of nonprofit organizations. It begins by categorizing the different kinds of support a funder may give an organization and by defining the concept of strategic philanthropy. It then articulates the legitimate interests of funders and grantees implicated by different kinds of support.

The essay concludes by proposing general principles for reconciling the potential competition between strategic philanthropy and general operating support. Although I do not believe that there is a single approach, resolution of the tensions often lies in what I shall call “negotiated general operating support,” based on a clear agreement and ongoing relationship between the funder and the grantee, and also in the willingness of project funders to bear overhead costs.

General Operating Support and Project Support

One can array the forms of funding for nonprofit organizations on a continuum, anchored at one end by totally unrestricted general operating support – for example, an expendable gift to Yale University to be used as its president pleases – and at the other by funding for projects designed by the funder – for example, a grant for a professor in Yale’s astrophysics department to identify asteroids heading toward the earth. There are many possible hybrids, but it suffices to describe two basic models of general operating support and two of project support.

General operating support

The least constrained form of general operating support is unrestricted support with “no strings attached” and minimal donor engagement. This is the support typically given by annual donors to colleges, symphony orchestras, museums, and membership organizations such as Mothers Against Drunk Driving, the National Rifle Association, and the National Abortion and Reproductive Rights Action League. Donors do not seek to influence the recipient’s actions directly, and they rely on general newsletters and annual reports to learn of the organization’s achievements.

By contrast, negotiated general operating support is based on an agreed-upon strategic plan with outcome objectives. Here, the funder engages in a due diligence process, which culminates in an agreement about what outcomes the organization plans to achieve, how it plans to achieve them, and how progress will be assessed and reported. With these

understandings in place, the funder's support goes to the organization's operations as a whole rather than to particular projects, and the organization has considerable autonomy in implementing the plan.³ For example, the Hewlett Foundation recently made a substantial general operating support grant to a performing arts organization. We expressed some concerns about the viability of the organization's business plan, which led to changes in the plan before the grant was made. However, our goal throughout the discussions was to support the organization's vision rather than impose our own.⁴

When given by foundations, either sort of general operating support typically consists of multiyear expendable grants, often with a reasonable likelihood of renewal.

Project support

While general operating support is an investment in the grantee's overall expertise, strategy, management, and judgment, project support is typically based on the organization's capacity to carry out specific activities. Here too there are two basic models, also with possible hybrids.

First, foundations and other organizations can support projects designed and autonomously implemented by the grantee. The paradigm is a medical, natural science, or social science research project designed by university faculty, who then shop it to foundations or government funders. For example, we recently made a grant to Princeton University for a professor to carry out an empirical study of the effects of affirmative action in higher education. And together with the Mellon Foundation, we are supporting the Massachusetts Institute of Technology's OpenCourseWare project, which makes course materials available free on the Internet.

Second, funders can initiate projects and seek organizations to carry them out. The paradigm is a funder initiative designed to achieve a particular result, such as protecting biological diversity in the Amazon. The funder designs a strategy that includes a number of component parts and assembles a portfolio of grantees to carry them out – for example, organizations doing scientific field research, indigenous groups trying to change regional policies and practices, and organizations advocating sustainable practices by multinational businesses. The funder may seek out particular grantees or issue a request for proposals. The funder thus serves as architect and general contractor, and the organizations as subcontractors.⁵

What is Strategic Philanthropy?

By strategic philanthropy, I simply mean philanthropy that is structured to be effective in achieving a donor's charitable goals, whatever they may be. The essence of strategic philanthropy is that (1) the funder specifies objectives and has a plausible (strategic) plan for marshaling its resources to achieve them; (2) the funder seeks grantee organizations that share its aims, and engages in due diligence to ensure that grantees have the capacity to achieve them; (3) the funder and its grantees articulate how they will ascertain if they are moving toward their shared objectives; and (4) they take reasonable steps to assess progress and evaluate outcomes.⁶

If there is a polar alternative to strategic philanthropy, it is a funder having a vague set of goals or preferences (for example, "protect the environment" or "help disadvantaged children"), waiting for organizations with interesting ideas or projects to come knocking, and making grants with little due diligence or agreed-upon objectives, strategies, and milestones. This is not usually the way to maximize impact. Achieving most social or environmental goals requires a coherent strategy that takes into account the scale of the problem, the ecology of nonprofit organizations working in the field, the funder's resources, and the roles of other funders.⁷

What Interests are Served by Different Modes of Support?

Strategic philanthropy, with its emphasis on planned and measured progress toward clearly articulated goals, is generally more suited to project support or negotiated general operating support than to general operating support with no strings attached. Does strategic philanthropy also favor project support over negotiated general operating support? Not necessarily, or even usually – though tensions with general operating support may arise. To understand the tensions and how they might be resolved, one must first ask what interests are served by the different modes of support. The following section outlines three clusters of interests held, respectively, by funders, grantee organizations,⁸ and funders and grantees together.

The Funders' Interests

Strategic focus. A strategically oriented funder endeavors to achieve particular outcomes. Sometimes, a grantee's mission will be optimally aligned with the funders'

goals. To the extent they diverge, however, general operating support blunts the funder's impact, and the funder may be more effective by making a series of coordinated project grants. For example, a funder focused on protecting biological diversity in the Amazon would not achieve this aim efficiently by providing general operating support to a multipurpose environmental organization. Even where the grantee and funder agree on outcomes, there may be sufficient disagreement about the strategies necessary to achieve them that the funder would deem general support ineffective.⁹

Accountability. A funder also has an interest in ensuring that grant funds are used effectively and for the agreed-upon purposes. Accountability entails at least that the organization report on its activities, outputs, and outcomes in a form satisfactory to the funder. Accountability is weakest with respect to general operating support when (1) there are no strings attached, (2) the organization's operations are not transparent, (3) outcomes are difficult to discern, and (4) the funder's only control is the organization's hope that the grant will be renewed. Accountability is greatly enhanced by the essentially contractual nature of negotiated general operating support, where the funder and organization agree on outcomes, strategies, measures of progress, and reporting requirements.¹⁰

Evaluation. When a project is well-defined in terms of objectives, activities, and indicators of progress, evaluating progress seems a fairly straightforward task. Although the evaluation of a general support grant is comparatively more complex, one should not exaggerate its difficulty. In effect, the grantor of general operating support assumes the grantee organization's mission as its own, and evaluates progress and the success of the grant essentially as the organization evaluates itself. This is the norm when the Hewlett Foundation makes general support grants to organizations ranging from Human Rights Watch to Planned Parenthood to the San Francisco Opera.

Making a difference. When one is the sole funder of a discrete project, one can take individual pride, shared only with the grantee, in its success. By contrast, funders providing general operating support often contribute only a small fraction of an organization's budget. A funder who contributes 3 percent of the budget of a large environmental organization may wonder just what difference the grant makes, and is unlikely to get the same ego gratification or publicity from the organization's success.

In this respect, providing general operating support is no different from any other activity or enterprise that depends on many people's contributions – for example, paying taxes or voting – where no individual makes a difference, but where the aggregate contributions are critical to the enterprise. The essential argument for such support is Kantian: If every potential funder acted on the belief that its contribution were not necessary, the enterprise would fail for want of funding. Most foundation executives who question the value of relatively small contributions to an organization's budget probably write personal checks to educational, cultural, and advocacy groups even though their contributions are even smaller drops in a bucket. The underlying principle, and the need for such philanthropy, are not different.

The Organizations' Interests

Autonomy. Grantee organizations value general operating support – the fewer strings attached, the better – because it allows them to operate autonomously, free from the funder's control. The grantee may have more expertise than the funder and may be able to carry out its mission most effectively with minimal interference. Advocacy organizations, universities, and think tanks may be particularly concerned about political interference from funders.

Coherence. A related organizational interest in general operating support is ensuring the coherence of the grantee's strategies and programs. A well-run organization will have developed its own strategic plan for solving the problems it addresses. A funder who approaches the organization with a particular project in mind is likely to have strategies that differ more or less from the organization's, calling for more or less different actions and allocations of resources. As the number of project-oriented funders increases, the organization's own strategic plans can get quite fragmented and distorted. An organization that depends heavily on project support must engage in fundraising that cobbles together grants of particular interest to funders while trying to maintain some semblance of a coherent plan.

Project support may thus contort the organization's fundraising and operations. Even negotiated general operating support may burden an organization if a number of different funders emphasize different strategies or require different sorts of information in different formats.

Sustainability. An organization's sustainability is compromised to the extent that foundations supporting particular projects do not cover overhead, or "indirect" costs for rent, electricity, back-office functions, and the like. Some foundations will not pay overhead at all, while others limit such payments to an amount, say 10 percent, that often comes nowhere close to covering the actual costs. So for \$1 of project funding, the organization must obtain additional unrestricted funds – anywhere from 25 cents to more than \$1 (for, say, a university's science or medical research project). Thus, a funder's ability to support particular projects depends on other funders providing general support. There is a problem of the commons here: It is in every funder's long-term interest to have viable organizations to carry out the projects of its choice, but any particular funder can usually avoid paying its fair share of what is needed to keep an organization viable.

Interests Shared by Funders and Organizations

Optimal deployment of expertise. Funders and organizations both may have considerable expertise in addressing the issues they tackle. The due diligence process involved in negotiated general operating support is a way for both parties' expertise to contribute to the outcome. This can also be true of project support if the funder is well-versed in the field and has taken account of the organization's particular capacities.

Flexible response. To the extent that an organization relies on project support, it cannot respond quickly or flexibly to changing needs. If the organization lacks discretionary funds, the sole responsibility for rapid responses falls on funders.

Advocacy. Although U.S. Internal Revenue Service regulations prohibit a foundation from earmarking any portion of a grant for lobbying, they permit nonprofits to do a certain amount of lobbying using funds provided from general operating support grants.¹¹ Thus, to the extent that direct or grassroots lobbying is an effective way to achieve the shared objectives of a funder and organization, general support is in both of their interests.

A robust nonprofit sector. Americans rely on nonprofit organizations to perform a wide range of functions in the realms of education, religion, social and health services, and culture; we also rely on nonprofit organizations as watchdogs of government and industry, and to engage in advocacy for every imaginable cause – and some that are nearly unimaginable. These organizations are woven into the institutional fabric of our

society. Though citizens and funders may disagree about the relative importance or desirability of particular organizations, much of society's well-being depends on the work of the nonprofit sector. Beyond the mission of any particular organization, there is value in a strong, vibrant, and pluralist "independent sector" – independent, that is, from government and business – and this interest demands organizational sustainability.¹²

A Proposed Approach to Reconciling the Interests

The real issue is not general operating support versus project support, but how best to accommodate the legitimate interests of funders and nonprofits, achieve the funder's philanthropic objectives and the grantee's mission, and maintain a vibrant nonprofit sector. I propose three general principles.

The first is simply that in designing strategies, funders should actively consult with others in the field, taking into account fieldwide knowledge and the opinions of nonprofit organizations. A strategy that is well-informed by research, consultation, and peer-review is far less likely to end up as a concoction of donor whim and presumption, and therefore less likely to introduce distortions into the work of good nonprofit organizations. Some of the potential tensions between general operating support and project support are reduced when the design of projects reflects the shared expertise of the funder, the organization, and the fields in which they operate.

Second, granting that there are many situations where funder and organizational interests only coalesce around particular projects, funders should nonetheless have a presumption in favor of negotiated general operating support. To be sure, the funder must sometimes tolerate "slippage" between its strategic focus and the organization's operations, and the organization will bear some loss of autonomy as well as the additional administrative costs of due diligence, evaluation, and reporting. But negotiated general operating support is not merely a way of splitting the difference. Agreement on a strategic plan and the evaluation process conduces to the organization's achievement of its own goals. Therefore, if done with appreciation of the organization's interests and capacities, negotiated general operating support strengthens the organization at the same time as it ensures accountability.¹³

Negotiated support should be designed to maximize the grantee's candor toward the grantor in the reporting phases of the grant. This entails, among other things, that the

grant include some leeway for changing circumstances, that assessment criteria be reasonable, and that the risks inevitable in almost any grant be mutually acknowledged.

Third, as mentioned above, project support pays for the direct costs of a project – for example, the salaries and travel expenses of the staff immediately involved in implementing the project – but typically covers only a small portion of indirect costs. Project support thus takes a “free ride” on others’ general support, which pays for overhead. Especially an organization that does not have a significant membership or alumni base may have to contort itself – and not always with full candor to donors – to accommodate diverse projects. Therefore, project support should presumptively include the organization’s indirect costs. A funder should get a realistic sense of an organization’s financial situation, and should stand ready to pay its full way.

This presumption requires funders to compromise at least their short-term interests, since funds spent on overhead could be channeled to other strategic projects. However, the presumption serves the social interest in sustaining a vibrant nonprofit sector, as well as the interests of the organizations themselves. It also compensates to some extent for the institutional costs (for example, in autonomy and flexibility) of not providing general operating support.

Is project support inevitably parasitic on general operating support, or can the two live in a symbiotic relationship? Consider a research university, where general operating support comes largely from tuition and alumni contributions (whether in the form of annual giving or endowments) and where research projects are funded by governments, the private sector, or foundations. On the one hand, to hold that the funding of research projects should pay all of its indirect costs would imply that alumni contributions should support only the university’s teaching mission and no part of its research. On the other hand, the financial reality is that universities could not afford to undertake certain projects without funders’ covering a significant proportion of indirect costs.¹⁴

Effective philanthropy requires a clear strategic direction. But just as surely, effective nonprofit organizations require the means and flexibility to carry out their own strategies. Earnest consultation and shared design can minimize the tension between these interests, and result in negotiated general support grants that achieve both philanthropic and organizational goals. Focused work will sometimes entail project-specific grants, but

these too should be designed with respect for the grantee's mission, personnel, and financial needs. In either case, it is essential that the funder and organization share a clear sense of their mutual goals and indicators of progress.

¹ Foundation Center Data 1996-2003, analyzed by the National Committee for Responsive Philanthropy. See Cohen, R. "Cutting to the Core," *Responsive Philanthropy* (fall 2002).

² See, for example, *Cutting to the Core*, which argues that the decline of general operating support threatens nonprofit organizations; Eisenberg, P. "The Case for General Support," *The Nonprofit Quarterly* (winter 1999), which maintains that general operating support is essential for strong and independent community-based organizations; and David, T. "Reflections on Sustainability," *California Wellness Foundation*, which explains the importance of general operating support to nonprofits' sustainability.

³ General operating support may, without losing its essential character, focus on a particular unit or department of a large organization rather than the organization as a whole. For example, a funder might provide general operating support to Stanford University's School of Humanities and Sciences, or to CARE's population work. Even with respect to a general support grant to the organization as a whole, the agreed-upon outcomes and evaluation may focus on a subset of the organization's activities.

⁴ So-called "venture" or "engaged" philanthropy is a more engaged form of negotiated general operating support, typically assisting relatively young and small organizations in increasing their scale – for example, the number of clients served. The venture philanthropist is often significantly involved in the organization's operations, through board membership, frequent consultations with the CEO, or other activities. The rationale for engagement is that the funder possesses business or organizational expertise not otherwise present in the organization. For discussions of venture philanthropy, see Letts, C. and Ryan, W. "Filling the Performance Gap," *Stanford Social Innovation Review*, (spring 2003); and Letts, C.; Ryan, W.; and Grossman, A. "Virtuous Capital: What Foundations Can Learn from Venture Capitalists," *Harvard Business Review* 97 (1997): 36-41. The present essay does not focus on venture philanthropy, but considers the more common form of negotiated general operating support provided to mature or stable organizations as well as to those poised for growth.

⁵ One might also characterize as "project support" grants aimed at improving an organization's capacity in, say, fundraising or database management. While such grants are intended to support the organization's achievement of its own goals, Pablo Eisenberg, founder of the National Committee for Responsive Philanthropy and a senior fellow at the Georgetown University Public Policy Institute, has cautioned that they may divert the organization's time and resources from its core needs. See *The Case for General Support*.

⁶ See Brest, P. "The Hewlett Foundation's Approach to Philanthropy," *2002 Annual Report*.

⁷ This is not to say that a strategically oriented funder need commit all of its resources to a set of tightly focused goals. On the contrary, a funder may sensibly reserve a certain amount of its grants budget for special opportunities. Even then, however, a strategically oriented funder will approach each special opportunity with clear objectives, strategic plans, and criteria for assessing progress and outcomes. For example, although it does not fit within guidelines of the Hewlett Foundation's environment program, when we were presented with the opportunity to restore thousands of acres of salt manufacturing ponds in San Francisco Bay to wetlands, we joined with three other foundations to help state and federal agencies purchase the ponds. The foundations worked together to negotiate a strategic plan for the restoration and are continuing to collaborate to assure that the plan is well-implemented. (This is also an example of an appropriate project-related grant, since the foundation has no reason to provide general support to either the U.S. Fish and Wildlife Service or the California Department of Fish and Game.)

⁸ For a comprehensive statement of organizational interests, see *Reflections on Sustainability* and *Cutting to the Core*.

⁹ Sometimes, a funder may wish to effect change in ways that existing organizations are not equipped or motivated to do, necessitating a strategic series of project-oriented grants or even the establishment of new organizations. Two historic examples from the postwar era are the Rockefeller and Ford Foundations' establishment of the international agricultural research centers that initiated the "Green Revolution," leading to increased food production in Latin America, India, the Philippines and other developing nations; and the effort by Ford and others to establish area studies programs in American universities. I am indebted to Kenneth Prewitt, professor of political science at Columbia University, for this point.

¹⁰ Accountability is a two-way street. In addition to owing the broader society results in its chosen area of work, a funder has obligations of respectful and candid dealings with applicants and grantee organizations. See Emerson, J.

“Mutual Accountability and the Wisdom of Frank Capra,” *Foundation News & Commentary* 42, no. 2 (March/April 2001). Both negotiated general operating support and project support offer the opportunity to build accountability into the agreement between the funder and organization, but neither assures it.

¹¹ Troyer, T. “Private Foundations and Influencing Legislation,” *Charitable Lobbying in the Public Interest* (http://www.clpi.org/lobbying_and_funding.html).

¹² See, for example, O’Connell, B. *Civil Society: The Underpinnings of American Democracy* (Boston: Tufts University, 1999), which describes the importance of the nonprofit sector to a democratic polity; and Prewitt, K. “The Importance of Foundations in an Open Society,” in *The Future of Foundations in an Open Society*, ed. Dieter Feddersen and Bertelsmann Foundation (Gutersloh, Germany: Bertelsmann Stiftung, 1999), which describes the nonprofit sector’s role in promoting polyarchy.

¹³ Funders providing negotiated general operating support should be aware that rigid requirements for proposal and reporting formats may subject an organization to responding to inconsistent demands by multiple funders. Therefore, a funder should take into account the size of its grant vis -à-vis those of other funders, and should consider collaborating with others on a common due diligence process, with one funder taking the lead.

¹⁴ Granting that cost accounting is more an art than a science, and that indirect cost negotiations between universities and federal government agencies reflect politics and power as well as rationality and fairness, funders of all types of organizations could learn from the guidelines resulting from those negotiations. For a criticism of certain caps and exclusions imposed by the government, see Bienenstock, A. “A Fair Deal for Federal Research at Universities,” *Issues in Science and Technology* (fall 2002).