GRANT MAKERS IN HEALTH

A Defining Moment for Health Philanthropy

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We are living in extraordinary times. The events of the past 18 months are familiar to anyone who has not been lost on a remote island in the Pacific, but it is worth briefly enumerating some of the "highlights." We are mired in a recession unprecedented in scale and scope since the Great Depression. Nationally, unemployment is at 10 percent, not including those who remain uncounted as having dropped out of the labor force. Waves of foreclosures are displacing millions who thought they had achieved the American Dream of home ownership. State and local governments are facing record deficits, with the largest states particularly hard hit. California alone is currently facing a budget deficit of $20 billion for the coming fiscal year, which is anticipated to result in another round of painful cuts to frontline health care providers.

And while the stock market had a terrific year in 2009, most nonprofit organizations are bracing for worse times yet to come. The Nonprofit Finance Fund's survey of 1,000 nonprofit leaders in the first quarter of 2009 revealed that 93 percent of organizations serving vulnerable populations had seen increased demand for their services (up over 87 percent in 2008). Only 12 percent of those surveyed expected to operate in the black in 2009; just 16 percent anticipated being able to cover their expenses in 2009-2010. To cope, 48 percent were freezing hiring and salaries, 41 percent were reducing staff or salaries, and 43 percent were dipping into reserve funds. In addition to decreased foundation and government funding, 49 percent had also experienced reduced individual donations.

> *The greatest danger in times of turbulence is not the turbulence; it is to act with yesterday's logic.*
>
> *– Peter Drucker*

But not all is bleak. To forestall a global financial meltdown and jumpstart the economy, we have witnessed the rapid commitment of hundreds of billions of dollars by the federal government to bail out banks and other major financial institutions, as well as additional billions in "stimulus" funds to preserve and create jobs across the country. Federally Qualified Health Centers, for example, have received substantial stimulus checks, with significant additional funding yet to come for health information technology and capital expansion. No matter what one's political persuasion, that is risk taking on a massive scale. There is no guarantee that it will work as hoped, but the potential consequences of inaction were simply too terrible to contemplate.

Meanwhile, after years of inertia and political stalemate, there has been growing recognition nationwide that reforming the health care system is an essential element of our long-term national economic recovery and industrial competitiveness. Even if partisan politics succeeds in derailing national health insurance reform (up in the air at this writing), that will leave it to the states to craft their own local solutions because inaction is not a viable option. There will be implications for every corner of the system, with much left to be done to significantly improve quality while "bending the cost curve." It will also be a major undertaking to simply help the American people understand how any new legislation – whether national or local – will affect them.

For most health foundations, whose missions tend to focus on issues of access and improving health outcomes, I contend that this is exactly the moment for which they were created. It is unlikely that anyone's strategic plan had 2010 pegged as *the* year for decisive action, but here we are anyway. The context for our work has been neither so dire nor so promising in the lifetimes of most of our organizations. The way we choose to act will define us for years to come.

HOW WILL WE RESPOND?

Will we rise to this historic challenge and act boldly and decisively even though (*or precisely because*) the risks are great?

Or will we choose to hunker down, cut our grantmaking, trim staff and operating expenses, and focus on regrowing our endowments? After all, is it not the fiduciary responsibility of staff and trustees to protect the assets of the foundation?

I would argue that the latter course of action seems prudent, proper, and reasonable only if you have been watching the news with the sound turned off. But I also predict that is the way many health foundations are likely to act. We like to think of ourselves as underwriters of innovation and catalysts for change, but it is moments like this that reveal just how risk averse we really are.

Foundations like to think of themselves as unique entities. We all smile in knowing agreement when someone quips "when you've seen one foundation, you've seen one foundation." But we are remarkably similar under the skin when it comes to the most important characteristic of all: how we define and approach the stewardship of our assets.

It has been fascinating to hear how frequently boxing metaphors have been employed to describe the toll that the stock market has taken on foundation assets. It is common to hear foundation staff use phrases like "we took a hit," "we got our heads handed to us," and "we took a beating." It is as if foundations had been engaged in a disastrous titanic cage match with the forces of chaos, and our only sensible course of action is now to withdraw to the temple of healing for restoration of our powers.

It is at times like this that nonprofits, who like to think of foundations as allies in their struggles, have learned not to count on their friends when they need them most. You can sense the frustration in their voices as they describe the strain their organizations and communities are experiencing, and we actually feel justified responding with our boxing metaphors so that they will understand that foundations are hurting as well.

Of course, there is a valid rationale for that response. The magnitude of government cuts (a reported $30 million for developmental services in Maryland alone) simply cannot be addressed by foundations. All of the health foundations in California could spend down all their assets this coming year, and we would still barely make a dent in our state's projected deficit.

But there is also an unchallenged (at least not openly challenged) assumption underlying that response that tacitly pleads our special status. Should not the priority be to preserve foundation assets for future needs rather than to squander them on the crisis du jour? Even if we cut back our travel and do not get raises, it is seen more as symbolism than real sacrifice. And let us be honest, we are buffered from the worst of what is happening. There is no point in apologizing or feeling guilty for a privileged status that is obvious to all. Instead, I would like to see health foundations respond by taking on some real risks to put ourselves on the line in ways that might tangibly, rather than symbolically, benefit our nonprofit allies in their time of greatest need.

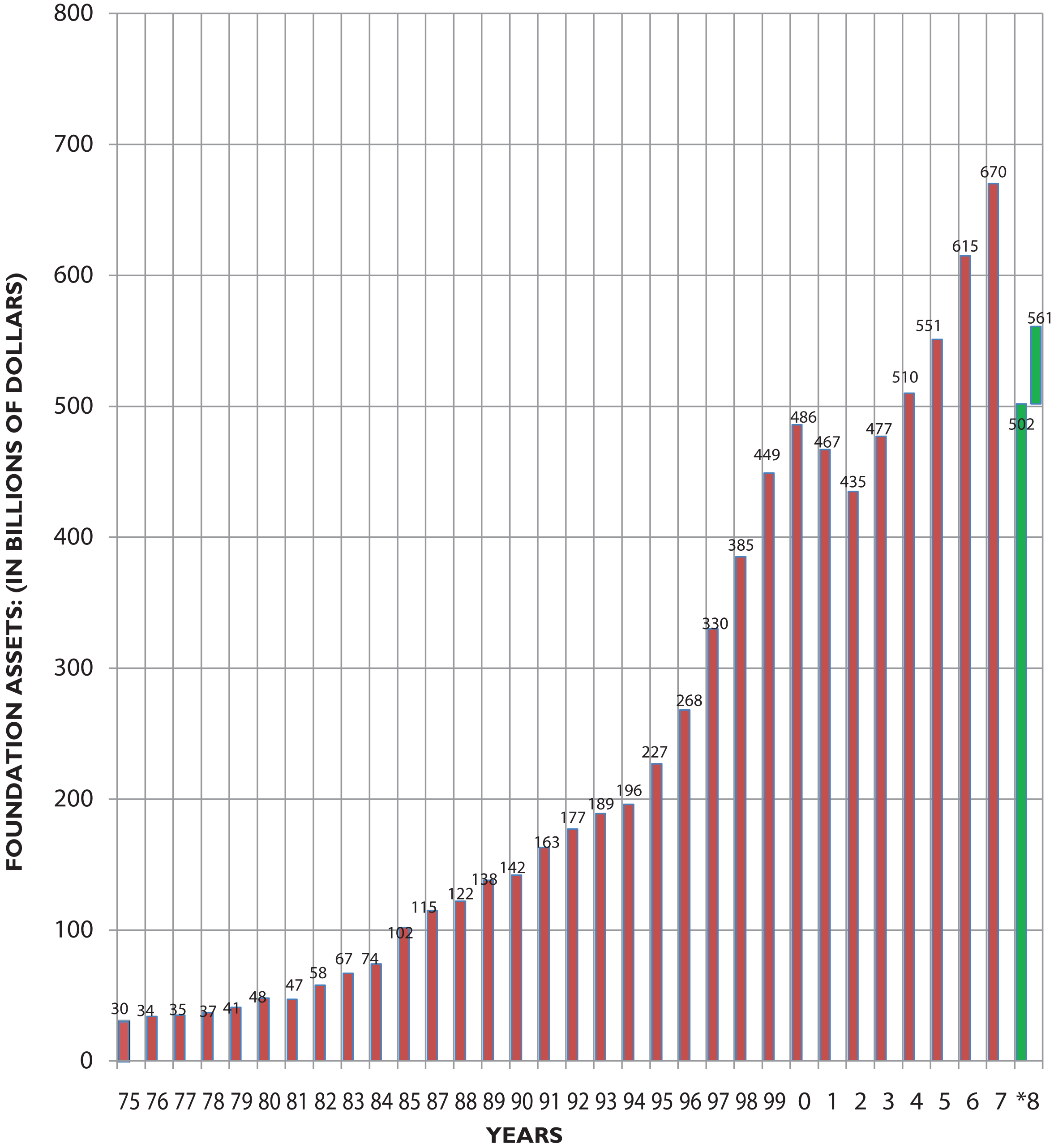
TAKING THE LONG VIEW

If there was ever evidence of the position of privilege that foundations occupy, it is that we could choose to put the narrow self-interest of our own financial replenishment ahead of the crisis in which nonprofits find themselves and the historic challenge this moment presents. Boards and their advisors rationalize such (in)action by the traditional stance that "we must take the long view and not be distracted by short-term events." I have sat through many discussions of long-term investment strategy over the years and am quite familiar with the argument (or should I say article of faith) that foundations must stick with a minimum 5 percent payout and not act rashly if they want to preserve their corpus in perpetuity. But I believe the time has come to challenge that thinking.

There is another way to take the long view, as illustrated in Figure 1. First, it is important to acknowledge the amazing growth in foundation assets that paralleled the great bull market of 1982-2000 (which witnessed an average annual return for the S&P 500 of 19.5 percent). Certainly there were some downturns along the way, notably in 1987 and when the tech bubble burst in 2001-2002, but the overall trend has been inexorably upward. Even with the significant market decline in 2007-2008, foundation assets are more than four times greater now than they were just 20 years ago. I do not have comparable figures for just health foundations, but given the number of new health foundations created since the 1980s, I would expect the assets devoted to health philanthropy to have shown an even greater percentage increase in magnitude.

FIGURE 1: FOUNDATION ASSETS 1975-2007

* *Source: Lawrence and Mukai 2008*



* *While final data is not yet available for 2008, The Commonwealth Fund provides two estimates of decreasing assets.*
* *2008 foundation estimates high and low projections.*

Perhaps that growth in assets has subtly altered our perspective in ways we do not even realize. It may be that instead of emboldening us, our relative wealth has actually made us even more risk averse. I had just accepted my first job in philanthropy shortly before the stock market crash in 1987. I had not yet reported for duty, and I nervously called my new boss to see if I still had a job. After all, the foundation's assets had just been diminished by 25 - 30 percent in the course of a couple of weeks. Surely that would affect their plans for the coming year. I cannot describe my relief when he told me, "We take the long view of these things. Sure, our assets are reduced on paper, but there's a still lot of work to be done, and we need you to help us do it." I wonder how many foundation CEOs would respond that way today?

Instead of fixating on how much they had "lost," foundations in those days looked back at the bleak stagflation years of the 1970s when their assets had barely appreciated for a decade. Their subsequent growth helped them put the events of 1987 in perspective. They used a different baseline for their calculation of the assets they felt they needed to preserve in order to do their work. As foundations have grown larger and larger, we seem to have adopted a "sliding" baseline more akin to a corporation's profit margin to gauge the adequacy of our assets. Viewed from the perspective of our colleagues of just 20 years ago, we have become financial institutions who have been stockpiling capital for an opportunity just like the one in which we find ourselves. Does our baseline keep moving up? Or do we look at our accumulated assets as providing a pool of dollars for risk taking at moments such as this?

EXAMINING FOUNDATION CULTURE

A true long-term perspective recognizes and acts on a historic moment such as this when it occurs. Before we can act, however, we need to confront our true feelings about risk. Most foundations do not think of themselves as risk averse. Indeed, we have historically justified our privileged tax status and minimal government regulation by arguing that we exist to stimulate creative solutions to social problems, that is to take risks that government cannot or will not take and at a scale at which most individual donors could not engage.

But if you talk with any randomly selected group of nonprofit executives "off the record," they quickly dispel the notion that most foundations are risk takers. In fact, they tend to use words like "stodgy," "overly bureaucratic," and "slow to act" to describe their foundation partners. That is unless we are talking about a project invented by the foundation itself. Then a different set of rules seems to apply.

What accounts for this disparity in perception? Foundations are circumscribed by a culture of their own creation that can provide a powerful distortion of reality as others see it. To paraphrase Marshall McLuhan's observation on the pervasive influence of culture, "The one thing fish know nothing about is water." Those of us who work in foundations swim in a very comfortable fishbowl that provides a clear but protected view of the world around us. The "water" in which we swim is rarely examined, at least by those of us who dwell in it. It is only when one of us has the opportunity (voluntarily or involuntarily) to jump outside the bowl that we can begin to objectively analyze its contents.

Periodic broadsides from critics of foundation practices typically bounce harmlessly off our bowls like foam Nerf pellets. Even significant challenges to foundation dogma like those represented by new "spend-down" donors may cause some significant ripples on the surface but ultimately few vibrations in the depths…or cracks in the glass.

I have been asked numerous times over the years about why foundations are the way they are, and I have also spent a good deal of time trying to reflect on that question with my colleagues. Others have written at length on this topic, but I would like to offer a couple of observations about foundation culture that I believe are pertinent to the challenge of stimulating more risk taking.

In my view, foundations have evolved an institutional culture that combines aspects of banks and universities (one might argue some of the less sanguine aspects of both). The similarities to banks are obvious and logical since some foundations actually had their origins as funds administered by bank trustees. Both institutions steward large amounts of money that others outside the organization are striving to access. Both have highly developed policies and procedures to minimize risk and maximize reward. And, at least until their misguided adventures in subprime lending were revealed in the recent financial crisis, banks were once viewed as the pinnacle of probity and prudent financial management. The common foundation terminology of "program officer, " "due diligence," and "docket" are all reminiscent of the role of "loan officer" and the process of loan approval in a financial institution.

Since many foundation presidents and staff have come from universities, they have also grafted onto banking culture a number of key cultural features of their institutions of origin. Chief among these is the now infamous "siloization" of the foundation by discipline and program area, akin to academic departments, with all the resultant competition for resources and attention…and lack of meaningful cross-silo communication and collaboration. Also central to academic culture is the refinement of written communications and the imperviousness to feedback from sources other than valued peers. Many foundations have implemented elaborate internal peer review processes to vet grant applications, and that requirement typically trumps any effort to move quickly on an opportunity. Foundations, like universities, are more likely to commission a study (or multiple studies) to inform their decisions rather than act in a way that might be perceived as precipitous.

There are also obviously positive cultural attributes that come from these institutional roots, such as commitment to high ethical and professional standards, thoroughness, and dedication to mission. But the culture that has evolved in the vast majority of foundations is also remarkably risk averse. While newcomers to the board or organization might notice it initially, it is amazing how quickly they can become socialized to the dominant culture. Of course, that has a lot to do with the kinds of people who are selected for positions on the board and staff. In my experience, those who have felt the most at odds with foundation institutional culture are people of color and others whose social class background is different from the upper-middle class values and style of the institution. These outsider-insiders can offer valuable insights into the self-limiting aspects of foundation culture, but that kind of feedback is rarely taken too seriously in my experience, despite most foundations' professed commitment to diversity.

THE SHADOW SIDE OF FOUNDATION CULTURE

There is also a darker side to serving as the steward of large sums of money. To borrow an analogy from J.R.R. Tolkien, it is almost as if a foundation CEO carries an invisible Ring of Power on a chain around her neck. It is a heavy but seductive burden, and even the pure of heart are not immune to its pull. Even though we are clear that it is not *our* money, the longer one bears the Ring, the power it exerts has an inexorable effect on one's thought processes. Over time, it is easy to become increasingly impervious to negative feedback and dismissive, perhaps even suspicious, of those who might question the Ring Bearer's judgment.

The influence wielded by investment committees of the board also reinforces the tendency to focus on *growing* the assets of the foundation. The competitive dynamic invoked by the desire to "beat the benchmarks" and "outperform our peers" subtly (and in some cases not so subtly) influences institutional policy to limit the dollars made available for grantmaking so as not to diminish the endowment. Particularly in times like these, when the book value of our investments has "taken a hit," there is a natural tendency to pull back and regrow what has been lost. If we equate power and prestige with the size of our assets, then the preservation of those assets becomes the priority…and helps reinforce a risk-averse corporate culture, at least on the program side. The power of the Ring has the ability to dull the senses to the larger charitable purposes of the organization and to blind us to opportunities such as the ones that now lie before us.

As John Craig, Jr., executive vice president and COO of The Commonwealth Fund, observes in his excellent essay on "New Financial Realities" (2008), even while foundations have taken a conservative approach to spending in their grantmaking, they have been taking increasing risks on the investment side.

> …Drawing on the success of such major university endowments as that of Harvard, Yale and Princeton, sizable foundations have successively dialed down the once-traditional 60:40 allocation between equities and fixed income: first to 70:30 (1980s), and then to 80:20 or lower (1990s). In doing this, they substituted riskier holdings like venture capital, real estate, emerging-markets equities, energy, commodities, private equity, and hedge funds for conventional stocks and bonds –

> in the end, leaving barebones fixed-income allocations to ensure liquidity and bolster returns in the event of deflation. This model worked well through the second quarter of 2008 but faltered in the fall 2008 market collapse….

Craig goes on to list several pertinent lessons for foundation investment policies, which I do not have the space to enumerate here, but I highly recommend reading the entire piece.

This may be truer of big foundations than smaller foundations, but I suspect that the tacit pressure to grow the endowment has similar proportional consequences, no matter what the scale of the organization. And, to be fair, many foundations have responded to the run-up of their assets in recent years by increasing their grantmaking. According to the Council on Foundations, the average giving rate for U.S. foundations in 2007 (excluding most intramural spending) was 6.4 percent. But it remains to be seen how many will maintain that rate of giving over the next few critical years.

SEIZING THE OPPORTUNITY

Just as savvy investors always see opportunity, even in a down market, this is an ideal time for health foundations to seize the opportunities that lie before them on the grantmaking side. This is not a time for excessive caution; it is a moment that calls for bold, countercyclical thinking. I am not suggesting that health foundations should suddenly back away from current grant commitments in order to engage in large-scale inappropriate risk taking. But this is a propitious time to question those aspects of our organizational cultures that cause us to be so slow moving and risk averse, even at such a critical moment.

We should all ask ourselves why the largest single grant for advocacy on health reform ($10 million to the Health Care for America Now coalition) was made by a foundation (The Atlantic Philanthropies) that until recently was not even a U.S. health funder. What helped them see a historic opportunity and act so decisively? They are in spend-down mode, and that certainly may make them more prone to take risks. But even foundations that are committed to existing in perpetuity can take inspiration from their courage.

Not many health foundations have the resources to make a $10 million grant, but there are actions that each can take to examine our heretofore unchallenged beliefs about risk taking. Some might be uncomfortable with these suggestions, but they are offered in the spirit of respect for this field and its potential. Here are eight ways in which health foundations might transcend their traditional aversion to risk and lead in this time of turbulence:

- **Initiate an institution-wide conversation about risk.** Given the privileged status foundations enjoy among nonprofit organizations, one could argue that it is not only our prerogative, but also our obligation to take risks, particularly at a time like this, to advance our mission. What is getting in our way? Have we been willing to take risks on the investment side that we have not given our program staff license to take as well? What is an appropriate level of risk for an organization of our size and scope? If you want to really take the next step, share those thoughts with your grantees and colleagues and ask for their honest feedback and suggestions.
- **Recalibrate your endowment baseline**. Rather than constantly increasing your institutional definition of perpetuity to match your appreciating portfolio, look instead at the assets your organization began with. Then ask, what is an appropriate baseline for your endowment that allows your program staff the latitude to propose bold and decisive actions at moments of historic opportunity? Take an enlightened perspective on "the long view" to not only allow for, but encourage, such risk taking when warranted. Promote a broadened view of fiduciary responsibility that looks not only at perpetuity, but also to creative and effective pursuit of mission as equally important charges for board and staff.
- **Increase your grantmaking this year.** Even if you are one of those foundations already exceeding 6 percent in your grantmaking, this is not the time to cut back. Indeed, there is no more important message you could send to the field than you are increasing your grantmaking in this time of economic crisis. Frontline nonprofits are facing tough times over the next few years as state and local government funds contract and caseloads expand. Foundations may not be able to fill the gap, but they can keep from adding to the problem.

- **Ease up on control of your grantees.** One of the most disturbing trends in recent years is the increase in highly prescriptive grant agreements, onerous paperwork requirements, and other efforts by foundations to exert more control over the work of their grantees. Some of these actions skirt the boundaries of illegality. But at this time in particular, an important way foundations can demonstrate support for the plight of their grantees is to cut back on reporting requirements and even offer to renegotiate active grants to give organizations more flexibility to meet their short-term survival needs. It also hardly needs repeating that the most valued funding by any nonprofit is unrestricted core operating support. In my experience, it is the raw material out of which extraordinary things are spun.
- **Make some big bets.** Every foundation is funding some extraordinary leaders and organizations that have the potential to really make a difference if they had more resources at their disposal and could devote less of their time to the minutiae of fundraising. What if every year we made a few large bets on groups like that rather than continuing our usual practice of funding them repeatedly for relatively modest projects? What kind of creativity could be unleashed? I would wager that it is exactly these kinds of risks – investing big in proven leaders and performers – that will take you further toward fulfillment of your mission than any precisely crafted grants program you could invent in-house.
- **Get serious about mission-related investing.** This is a prime area where the academic side of our culture gets expressed. How many studies and consultants have been commissioned to advise foundations on this topic? How many committees have studied and stewed about options for years without ever putting more than a token amount of the foundation's assets on the line to really test this seemingly common sense notion? If I were a trustee, I would be far more willing to risk a subpar return on an investment that is attempting to save or create jobs or promote the general health of the community in which I live. Why is it considered so risky to use the foundation's endowment to complement its grantmaking? Certainly the kinds of high-priced investment advisors who nudge foundations to invest in derivatives or real estate investment trusts would not recommend this course of action. It is not in their self-interest to do so. But is this not exactly the kind of risk that foundations *should* be taking with their endowments? From what I hear, some "socially responsible" investments actually did quite well in the most recent market downturn.
- **Invest in advocacy.** If there was one single strategy to effectively represent consumer interests in the current health reform maelstrom, it is through significant support for advocacy. Vast sums are being expended by special interests to shape the pending (and one could argue overly complex) federal legislation to their ends. By comparison, the voice of underserved communities is a relative whisper. Yet when appropriately mobilized, consumers can significantly influence the actions of policymakers at every level of government. In my view, every health funder should support advocacy as part of its portfolio. There is a new generation of politically active and astute young people who would love to do consumer advocacy as their life's work if they could only find a job that pays them to do so. Meanwhile, health advocacy organizations are typically undercapitalized and produce results far in excess of the funding they receive. For boards interested in "bang for the buck" and maximum leverage for their limited grant dollars, I can think of no wiser programmatic investment.
- **Share what you are learning and thinking.** This may seem oddly out of place in a list of suggestions for risk taking by foundations, but I could not resist including it. Too many health foundations devote very little staff time or money to learning from their work and sharing those lessons both internally and with the field. Yes, there is a risk that someone might point at an unsuccessful foundation-funded venture and call its judgment into question. But I would much rather take that kind of risk than pass up on important opportunities to capitalize on the practical knowledge being created daily by foundations and their grantees. It takes an intentional effort to prioritize learning and to have a thick enough skin to publicly share results even when they do not live up to our initial expectations. How else can we expect our field to advance?

This list could be longer, but it offers an ample set of opportunities for health foundations to expand their comfort zone and become a bit less risk averse. Most of all, it is important that foundations resist the temptation to pull their heads and legs back into their shells like giant tortoises until they have fully recouped their paper losses in the recent market turbulence. Any single one of these actions would be a valuable step in the direction of more appropriate risk taking; in combination they would demonstrate real leadership by health foundations at a time when it is most needed. As final words of encouragement, let me share these thoughts from two individuals who understood a bit about the importance of decisive action in turbulent times:

Now is the accepted time, not tomorrow,
not some more convenient season.
It is today that our best work can be done
and not some future day or future year…
– W.E.B. Du Bois

No matter how insignificant
what you do may seem,
it is important that you do it.
– Gandhi

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