HELPING NONPROFITS HANDLE INNOVATION AND CHANGE

The Human Interaction Research Institute at 40

Presentations from the 40th Anniversary Event Program

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Overview

This publication is the final product of a year-long celebration of the 40th anniversary of the nonprofit Human Interaction Research Institute (HIRI). The goal of this celebration was to contribute from HIRI's work to the nonprofit and funder communities in Los Angeles and nationwide, as well as to recognize this significant moment in the Institute's history.

Research and intervention concerning *nonprofit capacity building* has been one of the main themes of the Institute's work over the last ten years. Most of this work has concentrated on management, leadership (e.g., board development), communication and technology aspects of nonprofit organizations, and how these elements can be strengthened by foundations either through grantmaking or direct service. Less attention in HIRI's work has been given to the financial aspects of capacity building, because this is not a traditional area of the Institute's expertise.

Both to facilitate HIRI's own examinations of nonprofit capacity building, and to share some important new work from Harvard University with the Los Angeles community, a small conference was convened in December 2001, which concentrated on financial strategies for strengthening nonprofits. The conference keynote speaker was Professor Allen Grossman of Harvard University Business School, who has been exploring these themes in his research over the last several years - from the vantage point of performance measurement for nonprofits, as discussed in his groundbreaking book with Christine Letts and William Ryan, *High Performance Nonprofit Organizations* (Letts, Ryan & Grossman, 1999). His presentation, plus opening remarks by Institute President Dr. Thomas E. Backer, follow.

Other learning events offered to the Los Angeles community during the Institute's year-long celebration of its 40th anniversary were:

1 - A January 11 seminar on ***capacity building strategies for foundations in the arts***, sponsored by Los Angeles Arts Funders, a Southern California networking organization for foundations that fund in the arts and culture area

2 - A March 14 seminar on ***capacity building approaches for foundations in Los Angeles***, sponsored by the Southern California Association for Philanthropy, the Los Angeles area's Regional Association of Grantmakers

3 - A seminar on ***capacity building methods for nonprofit organizations based in the Long Beach area of Los Angeles***, sponsored by the Long Beach Community Services Development Corporation and the Long Beach Nonprofit Partnership

4 - A speech on ***capacity building strategies for nonprofits in the Los Angeles community***, given on October 26 as part of a larger conference for Los Angeles nonprofits hosted by Connect LA

5 - The November 1 Human Interaction Research Institute/California State University Northridge Community Action Workshop, ***Capacity Building for Social Sector Organizations in the San Fernando Valley*** (a follow-up report from this conference has since been issued, and a larger follow-up conference is planned for 2002).

Each of these events began with an overview of results from HIRI's recent national research study about foundation programs for nonprofit capacity building, which was sponsored by the John S. & James L. Knight Foundation (Backer, 2001). A discussion followed with the foundation or nonprofit organization representatives present about what these findings mean for the local community, and about how to organize and improve capacity building efforts in Southern California.

In January 2002, HIRI launched a new project, *Philanthropic Capacity Building Resources*, which is creating a national database of foundation grantmaking and direct service programs in nonprofit capacity building. This project also will include publication of an electronic newsletter, and offerings of training programs and seminars on capacity building. It is supported by the Knight, Kauffman, Meyer and Bruner Foundations. Discussions already have begun with the International Network on Strategic Philanthropy to promote international knowledge-sharing on this subject, and with several Los Angeles organizations about how resources generated by this project can be put to best use in Southern California - continuing HIRI's commitment to local service in its 41st year and beyond.

Embracing Contradictions - Handling Innovation and Change in Uncertain Times

Thomas E. Backer, PhD

In 1961, the late Edward Glaser and several colleagues created the Human Interaction Research Institute. Forty years later, the Institute's mission is the same - using behavioral sciences to help nonprofit organizations handle innovation and change. HIRI, has done pioneering work about dissemination of innovations, and about the evaluation of human service programs. Our projects cover the spectrum of systems change - finding what works, getting it used, and determining whether it works in a new setting.

In my 30 years with this organization, starting when I was a first-year graduate student in clinical psychology at UCLA, I have always been impressed by how cleanly HIRI reflects the wisdom of the great social psychologist, Kurt Lewin, who invented "action research" and said "nothing is so practical as a good theory." At HIRI, we use the tools of research to figure out how human interaction drives the processes of organizational change, and to apply what we learn to practical problem-solving, with a particular focus on the worlds of nonprofit health services and the arts.

We're privileged to have with us Professor Allen Grossman from Harvard University, whose work has transitioned from the corporate to the nonprofit sector. He will share with us his new research on financial elements of capacity building for nonprofit organizations, which he's presenting at this conference for the first time outside Harvard Business School! Nonprofit capacity building has become a major focus of HIRI's work in the last ten years, including the first national research on programs foundations fund or operate to strengthen the management, technology, operating and financial aspects of nonprofits - so they can better achieve their missions. In January 2002, we'll launch a national database of these programs as part of a project supported by four foundations.

A key finding from our research on capacity building is about the importance of putting services to strengthen nonprofits into the larger context of what else is happening in the life of the nonprofit organization, and of the community in which it does its work (Backer, 2001). The larger context is what I'd now like to focus on the context for nonprofit capacity building established by the great changes going on in the world today, including but not limited to the current downturn of the economy and the tragic events of September 11.

We're on a university campus that has done a splendid job of providing that larger context for its students and faculty. As many of you know, on September 12, UCLA Chancellor Carnesale challenged the faculty of this university to invent new courses for the Fall 2001 quarter, devoted to helping students understand and cope with the events of September 11. A large number of these courses were created, and are heavily enrolled in despite the fact that they were done too quickly to allow for academic credit. Many of the courses are intended to help students understand better the dramatic, often contradictory changes in the world and in their lives that have taken place recently.

I am convinced that one of the keys to surviving and thriving in the uncertain, troubled times we now live in is to do a better job of embracing the inherent contradictions in both man and nature. Walt Whitman spoke of this embrace in "The Leaves of Grass"

> *"Do I contradict myself?*
> *Very well then I contradict myself,*
> *(I am large. I contain multitudes.)"*

In truth, the universe has always been filled with contradictions - the reality of life and death being just one of them. But lately the magnitude of these contradictions has come into much closer focus.

And while there are many strategic, management-driven ways to respond to these changes in the world, one of the most important is in fact a *psychological* response - a re-framing, a figure-ground reversal that lets us see these events in a larger perspective - one that doesn't automatically search for ways of eliminating contradictions, but rather embraces them as a fundamental part of our existence. We must learn to live with the multitudes of life's contradictions if we are to respond to them effectively. But how do we do that?

Embracing contradictions first means giving up in the age-old Western, and especially American, quest to find simple answers to inherently complex problems. There are no clear paths now, no clear-cut answers, yet we must continue to act, and try to find a way to live with these complexities we can't solve in our traditional American "can-do" fashion.

Second, it means accepting that a basic principle of pharmacology applies to all the economic, social, political and military solutions we're struggling to implement in this brave new world - any intervention that has a powerful main effect also has powerful side effects. This doesn't mean not to act, but it does mean looking up front at how to manage these side effects, rather than assuming we can escape them.

Third, embracing contradictions means acknowledging that while the world has changed dramatically since September 11, in truth many of the sea changes in our lives were already well-underway before that date, and even before the current economic downturn.

Just to give a few examples: Postmodern science long ago proclaimed the end of certainty. Communism ended, and technology took a new leading role in everyday life. In 1987, Tom Peters in *Thriving on Chaos* talked about a paradigm shift - not just to a new set of rules, but to a world where the rules keep changing all the time. At about the same time, economic futurist Hazel Henderson said that the fundamental logic error of our times is "assuming anything will ever go back to the way it was." So all the new complexities are added onto many changes we already have been living with for some time. (Backer, 1997, 1998).

Fourth, embracing contradictions means accepting that much about the world *hasn't* changed - in particular, the complex, but predictable, human reactions to uncertainty and to the necessity for change, which haven't changed for thousands of year. As Herman Hupfeld's song so famously said in the film *Casablanca*, "A kiss is still a kiss, a sigh is still a sigh - the fundamental things apply as time goes by."

And it is this last contradiction that provides a bridge to how we can respond, and also to HIRI's particular work. When we ask about what the behavioral sciences contribute to help us in these times of great change, we immediately look to long established strategies for dealing with the human side of change:

- examining and overcoming fears and resistances
- building felt ownership and participation among key stakeholders in a community when change is being introduced
- using time-tested behavioral principles for building partnerships among groups in a community that need to work together to handle change
- building in effective stress management methods to handle the inevitable by-products of change.

In sum, using these approaches means understanding and applying the great principles of human behavior - for instance, that the best predictor of future behavior is past behavior. And that analyzing past behavior means looking at what didn't work as well as what did - or to use the phrase of the great spiritual philosopher Joseph Campbell, "dig where you stumble, that's where the treasure is."

Using these principles can help people and communities embrace the many contradictions now so much more apparent in the world - between democracy and security in the war on terrorism, between setting limits on fear despite some fear being appropriate, between using the tools of planning and recognizing that there are so many situations now when no planning can be done. And perhaps hardest of all psychologically, we must embrace the reality that in these days of horror also are great opportunities for growth and renewal, as we saw in the 1906 San Francisco earthquake, or in the aftermath of World War II. Behavioral sciences also can help with this last challenge, for example, through applying understanding of cognitive dissonance to help us work through our mental reactions to these contradictions.

Spirituality as well as psychology play an important part in this re-framing. As Ken Wilbur says so provocatively in his book *A Brief History of Everything*, postmodernism means that we are co-creators of our world, and that we can look to the ancient wisdom traditions for principles about how to respond to that realization. Management science plays a role, in strategic planning, in the scenario building of Peter Schwartz's *The Art of the Long View,* in Peter Drucker's view of demographic changes driving the new order of the world, as in his recent *Economist* article, "The Next Society," and in Peters and Waterman's principle from *In Search of Excellence* (does anybody still remember that one?) - that effective management involves "simultaneous loose-tight properties."

HIRI's work touches on all these elements, from a current national research study of partnerships in the arts, to our involvement in cultural participation consultant Jerry Yoshitomi's upcoming electronic book for arts management in the post 9/11 world, to a study of how services for post-traumatic stress syndrome can fit into substance abuse prevention programming throughout the U.S. For the coming years, we'll be devoting a good deal of our efforts to creating strategies for handling innovation and change that nonprofits can use in embracing contradictions - thus increasing the chances that nonprofit organizations can continue to contribute usefully to this changing world.

Philanthropic Social Capital Markets
Performance Driven Philanthropy

Allen Grossman

There is the assumption, sometimes explicit and other times implicit, that building organizational capacity in nonprofit organizations will contribute to organizational effectiveness or higher performance. For this paper, I am using the following definition for a high performance nonprofit organization: *A nonprofit organization that achieves its mission by continuously satisfying the changing needs of its clients in a cost-effective manner.*

Few would disagree that more money is needed to build, sustain, grow and improve nonprofit organizations. Directing more resources to this capacity building will help nonprofit organizations in their pursuit of high performance, yet it is well known that most grants are restricted to program support. But if high performance is to be achieved and sustained by nonprofit organizations, other structural dimensions of the nonprofit sector must be addressed as well.

Part of the reason for management's lack of focus on organizational performance may be attributable to endogenous characteristics of the nonprofit sector - such as cumbersome governance structures, scarcity of professionally trained managerial staff, vagueness of mission, etc. These organizational factors are certainly inhibitors to performance, but good leadership and more funds for capacity building can help overcome their impact. These factors, while important, are not the primary reasons why excellent organizational performance is so elusive in nonprofit organizations.

There is a more fundamental systemic reason: it has to do with *when capital is made available to nonprofit organizations and the terms and conditions of its distribution*. It is the absolute amount of capital, the stages at which it is available during organizational development and the conditions of its acquisition that all work together to create a powerful influence on nonprofit management behavior and organizational culture and, ultimately, on attaining high performance. This paper argues that philanthropy's influence on performance is far from neutral; it actually discourages management from pursuing performance as a primary objective.

The conversation must begin with an analysis of how and why the philanthropic capital markets, for the most part, fail to encourage high performance in nonprofit organizations. Ironically, nonprofit executive directors, in numerous interviews, consistently reported that excellent performance of a nonprofit organization is rarely systematically rewarded with an increased flow of philanthropic capital. In fact, an opposite situation prevails. As programs were proven effective and the nonprofit organizations developed plans to grow, foundations (even those currently funding their organizations) were less receptive to their requests for funding.

Luke O'Neill, founder and CEO of the nonprofit Shackleton School, described his situation in the following way, "The better the job my school does in educating its students, the better we all feel, but there is no clear correlation to increased donor support. In fact, most foundations tend to move away from funding the school as it becomes more established."

Nor is there a systematic reduction of philanthropic funds for mediocre performance. Examples abound of low performing nonprofit organizations that are kept afloat by sympathetic donors willing to contribute without objective data.

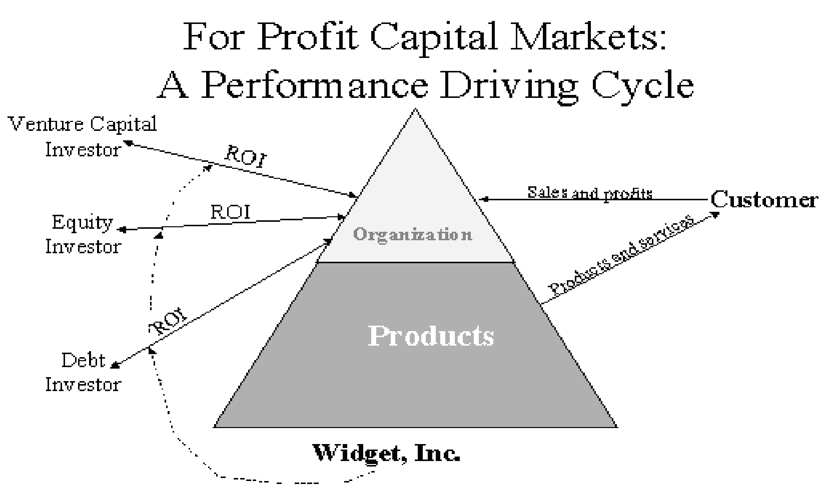
How and why is the current philanthropic system, which provides over $200 billion annually to U.S. nonprofit organizations, dissonant with encouraging high performance? What experiments for modifying existing philanthropic funding streams or creating new philanthropic social capital markets are being tried? What else might be done?

For-Profit Capital Markets - A Performance Driving Cycle

It is instructive to begin by looking at the impact that for-profit capital markets have on corporate managers as a baseline for discussion. The characteristics of the for-profit capital markets are:

- At most stages of an organization's evolution there are substantial and identifiable, informal or formal, capital markets. These markets provide capital for what investors deem to be an appropriate rate of return, and this information is widely available to interested parties.

- While imperfect, capital providers have fundamentally transparent and relatively uniform criteria for making investment decisions. (A notable exception is for start-up capital where criteria are more idiosyncratic.) This information is also widely available to other investors and to those seeking the capital.



The greater the corporation's ability to cost-effectively satisfy the customers' needs > Sales and profit > Availability of funds.

- Capital is usually provided for excellent organizational performance and withheld for its absence. This cause and effect continues over time-management's ongoing ability to cost-effectively satisfy customers' needs is a major determinant in its ability to systematically raise additional capital.

All the pieces of the for-profit capital markets work together to create a closed loop, self-reinforcing system or a *performance driving* cycle. The capital markets become important influences on management behavior and organizational priorities. Managers are encouraged to seek ever higher levels or organizational performance to ensure that the cycle repeats itself. Everyone in the sector knows the rules of the game, and understands that failure to perform well breaks the cycle - and has Darwinian consequences for both an organization and its management.

Philanthropic Capital Markets - A Chaotic Cycle

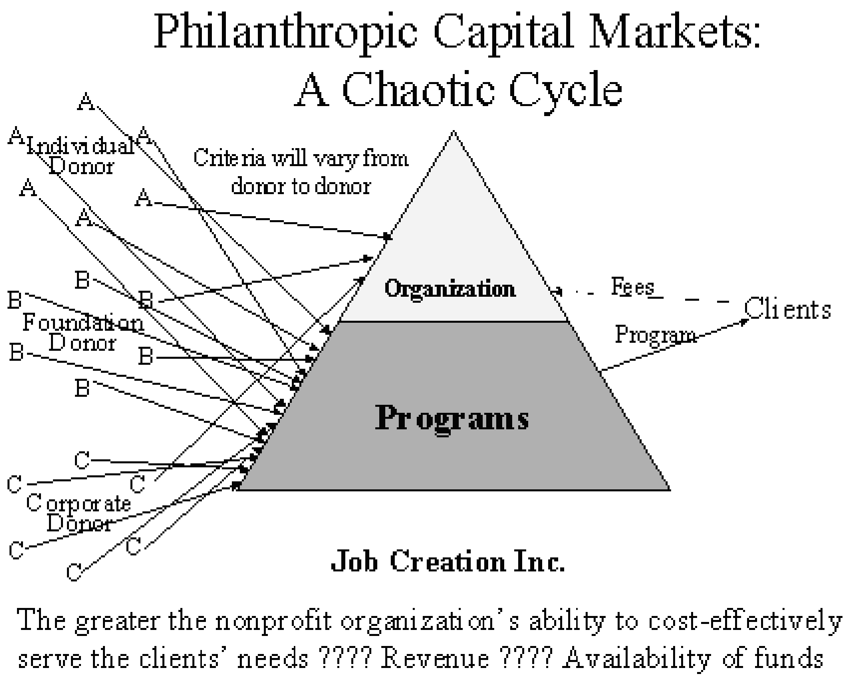
The picture of the nonprofit sector differs dramatically. The same components of the performance driving cycle exist - capital suppliers, capital, operating organizations and clients - but the way they work together creates a different set of dynamics. The philanthropic capital markets have three basic categories of donors - individuals, corporations and foundations - but within these categories are a large number of discrete actors moving in independent, highly personalized orbits. There are over one million independent nonprofit organizations trying to intersect with some sub-set of these capital sources (as well as with public or government services or funds which will not be discussed here). There are millions of clients served by nonprofit organizations, who often do not pay and rarely have formal feedback mechanisms to indicate their level of satisfaction with the quality of the service. The philanthropic capital market does have a distinct structure, but within that structure the components move in a fundamentally random fashion, creating something very different from a self-reinforcing system.

The following characteristics of the philanthropic capital markets prevail:

- The criteria for the allocation of philanthropic capital, from most sources, are idiosyncratic, often opaque, mostly ambiguous, and commonly based on personal relationships and reputation, rather than clearly promulgated objective data (Gronberg, Martell & Paarlberg, 2000).

- There are few identifiable sources of capital dedicated to each stage of a nonprofit organization's evolution, particularly for scaling-up and sustaining organizations. The length of the typical funding relationship is rarely geared to an organization's growth or operating requirements

- Donors, for the most part, operate and contribute independently of each other. Broad-based mechanisms to aggregate funds, as is the case with for-profit equity markets, are rare exceptions.



- The motivations that drive donors to contribute to a nonprofit organization vary from donor to donor. Donor motivation need not be, and mostly is not, linked in any systematic or understandable fashion to the specific needs of nonprofit organizations or the clients they serve.

- Metrics to evaluate organizational effectiveness have not been developed for most fields of nonprofit service delivery. If metrics do exist, they are not widely accepted by donors or by nonprofit organizations.

- There is no information system for measuring the effectiveness of philanthropic capital. Program evaluations conducted by foundations do not apply uniform criteria, even within the same field of activity, and are usually conducted retrospectively when the program is complete. The information generated is typically kept confidential, and is not intended to enhance the effectiveness of the foundation's grantmaking or of philanthropic markets.

Impact on Nonprofit Management Behavior and Priorities

While the for-profit capital markets encourage the pursuit of organizational performance, it is still a major challenge to build a corporate culture of high performance. The challenge is made more difficult for nonprofit organizations by the disorderliness and complexity of the philanthropic funding environment, which divert the focus of nonprofit managers away from organizational performance. Far from being benign, philanthropic markets have an insidious impact on getting and keeping high performance as a top priority for nonprofit managers, in at least five ways.

1 - Finite Management Time To be effective, nonprofit CEOs must spend a great deal of time understanding and dealing with the complexities of the philanthropic market. Numerous interviews revealed that most executive directors spend from 40% to 60% of their time, either directly or indirectly, raising money far more than their for-profit counterparts. The time absorbed to raise capital inevitably detracts from the available time needed for the never-ending leadership challenges of building organizational performance.

2 - Organizational Costs The acquisition costs of each dollar of capital in the nonprofit sector are considerable. Added to the cost of management time are the costs of building and maintaining complex infrastructures to identify, track and manage donors. Boards usually have to join in fund raising as well and are often distracted from the real business of governance. The resources dedicated to capital acquisition leave less for building performance capacity.

3 - Contradictory Forces on Management Nonprofit managers must serve two sets of customers--the client and the funder. Aside from the fact that criteria measuring satisfaction for either of these groups need not exist, when criteria do exist, they can be widely divergent. It is more the rule than the exception that nonprofit managers struggle to balance the clients' needs with the donors' needs. Added to this already complicated balancing act is the reality that there are often multiple donors for the same program, each of whom may have a differing set of needs to satisfy (Moore, 2000).

4 - Measurement Smoke Screen There is no question that it is difficult to develop meaningful measurement for much of the work conducted by nonprofit organizations. But, many managers and boards do not focus on this difficult measurement challenge because, in the main, they are not really rewarded to do so by philanthropic capital markets. However, they do suffer the consequences; the absence of objective performance measurement materially contributes to the randomness of the capital markets. How can markets be orderly, if there are no accepted standards to measure and compare absolute or relative organizational performance?

5 - Human Resource Shibboleth Without consistent external rewards and sanctions from the capital markets, is it reasonable to assume that nonprofit leaders will struggle against the grain to build a high performance organizational culture? Because a culture of performance does not exist, nonprofit management is not systematically pushed to measure employee performance; has fewer resources available for employee training or for creating dynamic employment opportunities; and generally utilizes a workforce that has little prior understanding of, or orientation to, organizational performance.

Leveling the Playing Field

How to change philanthropy's influence on nonprofit management behavior and organizational priorities is receiving some attention in the philanthropic community. Capital flows are being used by a relatively small number of philanthropic entities to explicitly encourage organizational performance, often with the for-profit venture capital model serving as a metaphor for experimentation (Letts, Ryan & Grossman, 1997, 1999). It is estimated that thirty-seven venture capital type philanthropic funds have been created or are about to be launched, including Entrepreneurs' Foundation, New Profits Inc. and the Roberts Enterprise Development Fund (Morino Institute, 2001).

A traditional foundation with assets of over $700 million, the Edna McConnell Clark Foundation has recently transformed its funding model to mirror many of the characteristics of venture philanthropy (Backer & Bare, 2002). While each foundation's approach to applying the for-profit venture capital model to philanthropy varies, some are now are establishing performance metrics for their "investments" and rewarding nonprofit performance with continued funding.

These are meaningful experiments, but the going is slow and the amounts distributed are, and will be in the foreseeable future, inconsequential as a percentage of annual philanthropy. If the current models distribute what they plan to over the next three years, they will give away, in aggregate, approximately $150 million, with Clark accounting for almost half the total. This will amount to .25% of the $625 billion estimated total giving in the U.S. over the same period. Nevertheless, these experiments have generated numerous heated conversations that often dwell on the appropriateness of using the venture capital metaphor to achieve social goals, rather than on the critical issue of the relationship between capital, management behavior and organizational performance (Sievers, 1997).

A few larger, more established foundations have re-oriented a portion of their grant making to reward performance. Disillusioned with the "entitlement mentality" of arts organizations and their failure to build high performing organizations after years of unrestricted funding, Pew Charitable Trusts created the *Philadelphia Cultural Leadership Program* in 1997. This program provides general support for three years exclusively to those arts organizations that score well on a homegrown set of objective performance metrics. The experiment has caused a great deal of public and grantee distress, but Pew is forging ahead with the program and is introducing modifications designed to improve communication, content and implementation. In the foundation world, there are few other examples of this kind of bold experimentation designed to drive nonprofit organizational performance.

Over the long term, these experiments may be too few and too late for sustaining a large number of service delivery nonprofit organizations. It is time to go beyond the discrete models and isolated foundation experiments. The emphasis and attention must become more expansive than individual experiments, and address the systemic restructuring of philanthropic social capital markets.

Who Should Lead Innovation?

Individual giving is diffused among countless individuals, is discretionary and is driven by a range of personal motivations. Because of growing interest in the venture capital model, and its comfortable conceptual alignment with many "newly wealthy" individuals, performance driven philanthropic experiments will likely continue. However, it is unlikely that this fragmented category of donors could lead a systematic approach to changing the philanthropic social capital markets. Corporate giving, while less fragmented, is similar enough to individual philanthropy that also makes it an unlikely category for leading broad-based sectoral change.

Endowed foundations are the most logical candidates for leading systemic change, and they have the human and financial resources to get the job done. The assets of America's 50,000 foundations are currently estimated to be over $448 billion, with more than $27 billion distributed in 2000 (Wilhelm, 2001). Additionally, it is argued that foundations have a fiduciary responsibility to the general public to perform at a high level because they receive considerable tax advantages (Kramer & Porter, 1999). It is also reasonable to assume that many of the professionals who staff foundations take their responsibility for effectiveness seriously. Striving for optimum grant making impact should be a moral and practical imperative.

Pushing the Envelope

Foundation Accountability - the First Step Foundations, as a financial sector, are unlike any other part of the U.S. economic or political system and are not, as a group or as individual organizations, formally accountable to any external constituency for their effectiveness. (Foundations are legally bound to maintain financial probity and distribute an average of 5% of their corpus annually.) There is no requirement, or any cultural orientation, to report to the public the results of individual grants or the effectiveness of multi-year grant making programs.

It is difficult to find an example of a foundation that keeps internal records tracking the success and failures of its grant making. Although organized boards may monitor the effectiveness of foundation giving, there is no uniform set of standards applied to activities, either within a foundation or across foundations, to determine success. The ability and will of boards to discharge oversight responsibilities, as with other nonprofit organizations, can and does vary considerably**.**

Meaningfully enhancing the effectiveness of giving inevitably requires a system of internal measurement, and a mechanism to drive individual performance and accountability within a foundation. This is a challenge for foundations, but very doable if there is the will. It would require a considerable reorganization in the way foundations conduct their business, and would necessitate changes in the way foundations collect and disseminate knowledge and compensate their professional grant makers.

It would be highly unusual for a group of professionals or organizations to voluntarily establish objective measures of individual and collective accountability and push for radical change, but this shift will be an essential element in enhancing organizational effectiveness in the nonprofit sector. Without a dynamic response to increased questioning of the effectiveness of the nonprofit sector, foundations do run the ultimate risk of increased scrutiny from the public, press and government. Legislation mandating standards for the effectiveness of foundation giving is an unattractive alternative for driving change.

Knowledge Creation and Information Sharing Formal and sustained dialogue around all aspects of systemic change is a good place to begin addressing the complexities of performance driven philanthropy. Forums should be created to bring together informed thinkers from the business, philanthropic, academic and nonprofit communities to analyze and understand performance driven philanthropy; and to design and propose changes to the system that foundations could then implement. These forums could be reconvened at regular intervals.

Based on research data collected at every stage of implementation, such groups would be perfectly positioned to evaluate the effectiveness of experiments and recommend modifications to enhance impact. An existing association, Independent Sector for example, or a new entity, could organize the forums, act as a clearinghouse for information, and promulgate information.

Individual Foundation Experiments A great many more foundations should undertake initiatives similar to the Pew Charitable Trusts' *Philadelphia Cultural Leadership Program* across a broad range of nonprofit industry categories. It would be beneficial for these foundations to coordinate their efforts, thereby allowing for a number of different approaches to performance driven philanthropy to be tried and evaluated simultaneously. A key element for rapidly spreading best practices would be a willingness of foundations to compare results and benchmark experiments against more conventional grant making approaches. The level of collaboration and transparency required for this kind of inter-foundation assessment is substantial, and would demand a significant commitment from participating foundations.

Creating Capital Pools A bolder approach to systemic change would be to create models of rational performance driven capital markets that replicate the desired characteristics of the for-profit markets described earlier in this paper.

Foundations of all sizes could agree to contribute to newly created common pools of capital, dedicated to nonprofit organizational support rather than to direct programmatic funding. Each pool could be used to fund a particular stage of a nonprofit organization's evolution from start-up, to scale-up to sustaining. As organizations pass through different growth phases, they would be eligible for funds from a different pool. The size of each pool would have to be substantial enough to fund organizations over a multi-year period, and thus keep the attention of nonprofit managers.

The distribution of funds from these pools would be based on publicly promulgated standards of organizational performance. While many in the sector wring their hands over the lack of consistent and meaningful metrics, there is almost no organized and systematic effort by most capital sources to address this challenge. The difficulty in developing meaningful metrics should motivate, not inhibit the allocation of adequate resources to study and develop measurement tools.

With transparency as the standard, each pool could be administered by a neutral entity; have the credibility of large foundation and public oversight; and disseminate its criteria for success. The desired result would be intensified competition, around outcomes and impact, among nonprofit organizations who deliver services in comparable areas, and who are at the same stage of organizational development.

If the results of the organizations funded by the pools are impressive and marketed well, these pools might, over time, attract substantial additional capital to performance driven pools, as they do in the for-profit sector. (Gompers & Lerner, 2000) . These pools could then be opened to all individual and corporate donors who wish to contribute.

It would be ideal for each pool to focus as narrowly as possible on a particular industry subsection, e.g., one for primary education, one for youth services. This could facilitate the development of metrics needed to compare organizational performance within a category of services. To promote buy-in at all levels, nonprofit organizations would work in partnership with academics and foundation representatives, to develop a process for creating, evaluating and modifying performance metrics. Performance measurement would become an incontrovertible component of a nonprofit manager's competition for funds and for the determination of effectiveness of pool managers distributing these funds. It is a fair bet that under these conditions, metrics that had increasing relevance and accuracy would evolve.

These pools would create benefits on a number of levels. They would:

- Encourage the development of new performance metrics for emerging and established nonprofits and accelerate the development of existing initiatives, such as Robert Kaplan's Balanced Scorecard approach to measuring nonprofit performance and the Roberts Foundation's pioneering work on measuring social return on investment (SROI).

- Broaden and refocus the dialogue in philanthropy away from the advantages and disadvantages of the venture capital model to a more basic question of how to create funding streams that support growth, sustainability and performance.

- Accelerate study of the relationship between organizational performance and enhanced social outcomes

- Introduce competition for funds among nonprofits around objective criteria, providing clear rewards for organizational excellence and encouraging under-performing nonprofits to improve or shut down.

- Create a performance-based meritocracy, inducing managers of nonprofits to focus on building high performance organizations and spend more time on service recipients.

- Create a more level playing field for nonprofits to compete with their for-profit counterparts.

- Enable the development of standards for success both within and across pools to measure the relative performance of grantmaking staff.

Risks of Experimenting with Systemic Change

Many in the foundation world hold the view that a primary role for their organizations is to encourage and test innovation. Experimenting with the way money is distributed and the management behavior it drives seems a worthwhile place to practice this role, and could be a lot less risky to all stakeholders than having foundations spend their resources over and over again on new program design and implementation.

Is there a significant downside risk in restructuring some portion of the philanthropic social capital markets to test the effectiveness of performance driven philanthropy? The short answer is, "No." The current reality is that most broad-based solutions to social problems have eluded the conventional and fragmented approaches to philanthropy. It is hard to imagine that experiments to change the system to a more performance driven and rational market would negatively impact the effectiveness of the current funding flows and could have dramatic upside potential.

Are there material risks associated with this type of funding experiment for nonprofit organizations? It is highly unlikely that taking time away from fund raising and making managers measure organizational performance will somehow move nonprofits away from their values. As long as organizational performance is coincident with the achievement of mission, then the benefits would far outweigh the risks. By aligning the needs of the client receiving the services with a funder's definition of success, performance driven philanthropy will move management away from worrying about serving two customers with different needs.

Could this refocusing on the client possibly create a risk that is more unacceptable then the conditions that exist in philanthropic markets today? If existing foundations do not respond to this challenge, it is the sustainability of nonprofit organizations, and the ultimate welfare of the clients and communities they serve and not the foundations, that are at risk.

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About the Human Interaction Research Institute

The Human Interaction Research Institute is a Los Angeles-based nonprofit center for research and intervention on ***innovation and change***. Its work centers on using ***behavioral sciences*** to address the complex human dynamics of change (such as how to meet people's fears and resistances about change; or their need to feel personally involved in change and rewarded for their participation).

Institute projects help nonprofit organizations, their funders, and the communities in which they operate, ***improve health and human services for vulnerable populations*** (such as *youth at risk for substance abuse,* or *people with severe mental illnesses),* and ***enhance nonprofit arts and culture programs.*** Objectives of these projects range from conducting research, to supporting systems change through technical assistance, to disseminating innovations or helping others to do so.

Since its founding in 1961, the Institute has undertaken more than 130 projects - ranging from an evaluation of youth violence prevention programs across the country, to a national research study of strategies for partnerships in the arts, to Capitol Hill hearings for Congressional staff on the needs of people with mental illness in the criminal justice system, to a national environmental scan of foundation-sponsored capacity-building programs for strengthening nonprofit organizations.

The products of these projects are disseminated in both print and electronic formats. The Institute's work is supported by Federal agencies, foundations, and the corporate sector.

Under the leadership of President Dr. Thomas Backer and a ten-member multi-disciplinary Board of Directors, the Institute's small staff of senior and junior researchers works in a "virtual office" environment - supported by a networked computer system. Core staff are based in several Southern and Northern California communities, in upstate New York, and in Washington, DC. Senior staff include distinguished university-based researchers in health communications, mental health and related fields.

The Institute has a long-standing tradition of community service, ranging from the individual efforts of its staff (some of whom are leaders in advocacy and support organizations such as the National Alliance for the Mentally Ill), to coordinating volunteer groups such as the Entertainment Industry Workplace AIDS Task Force, to hosting (with California State University Northridge) the first Los Angeles conference on AIDS in the workplace and a conference on nonprofit capacity building.

The Institute also coordinates a national learning community for the John S. & James L. Knight Foundation, supporting ten communities that are in various stages of developing arts marketing collaboratives. And it contributes to ongoing nonprofit capacity building work in a number of cities - including the Los Angeles area, with a series of community learning events tied to its recent 40^{th} anniversary year.

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