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# A Shock to the System

## Philanthropies are learning to cope and even prosper in a tough economy

**By ERIC SCHMUCKLER**

**T**he signs of distress in the world of philanthropy are no more vividly illustrated than at the David and Lucile Packard Foundation in Los Altos, Calif. At the height of the boom in the summer of 2000, its endowment -- consisting entirely of stock in Hewlett-Packard and its Agilent spinoff -- swelled to more than $15 billion; earlier this year, it tumbled to $3 billion and now hovers in the mid-fours. The foundation was forced to cut its grant-making last year from $450 million to $250 million. Its Western Lands conservation program, for example, went from 29 grants totaling $5.2 million to four grants valued at $675,000; organizations such as City CarShare, Malpai Borderlands Group and the Prairie Foundation were knocked off the list. In September, Packard announced funding would be reduced to $200 million next year and staff shrunk as much as 50%.

This bloodbath in Los Altos augurs an ominous trend for philanthropy, which had grown as fat and happy as the business world during the stock market's extraordinary run. Major donors, unable to live up to their commitments, have reduced funding or stretched out payments. Well-heeled benefactors, unnerved by 9/11, the threat of war and economic malaise, are cutting back on major gifts. Steadily appreciating stock, that most appealing and painless of donations, is a lot more scarce these days. Foundation endowments have lost billions in the market rout. Hard-pressed corporations are downscaling their giving. And the decline in and uncertainty about fundraising, combined with looming cuts in state and local government support, have pushed many nonprofit organizations to the edge of panic, preparing for layoffs and service cuts after this giving season.

"It's kind of a shock to the system," says Dot Ridings, president of the Council on Foundations. "The late '90s were hog heaven for us -- new programs, new ideas, experimentation flourished. Now market reverses have put a screeching halt to a lot of that."

One of the most visible signs of the slowdown is the legion of big-name donors forced to scale back their very public gifts. For example, high-tech investor and opera buff Alberto W. Vilar stiffed the New York Philharmonic. And the ever-voluble Ted Turner publicly complained that the drop in AOL Time Warner stock had put a crimp in his efforts to clean up the environment and promote world peace. His Turner Foundation isn't accepting any new proposals for 2003, and its $58 million in grants last year will be down sharply this year.

For every chastened celebrity donor to make the headlines, there are dozens more quietly wrestling with their commitments. Philanthropic circles in Atlanta are buzzing about whether Tom Dupree, who runs the struggling restaurant company Avado Brands, will come through with his $20 million pledge, due in two years, to the business school named for him at Georgia Tech. His company's shares have fallen 90%. "We've honored any pledge we've made and it's our full intention to make good on this one," says the Dupree Foundation's Scott Baldwin.

"Major donors have asked to have pledge commitments lengthened," reports Vance Peterson, president of the Council for the Advancement of Secondary Education. "It isn't that uncommon during an economic downturn. With a donor of that magnitude, it's a very close relationship, and it's possible to sit down and talk." Major donors, the $100,000-and-up kind, are skittish, he says. "They say, 'I'm with you, I want to support you, but I'm not comfortable making a commitment now.' This could be the first time in almost 30 years that giving to education was lower than the year before."

A similar drop in corporate giving is predicted by Dwight F. Burlingame, associate executive director of the Center on Philanthropy at Indiana University -- no surprise given the pressure on corporate profits. Last year corporate giving dropped almost 15% in real terms.

Almost all organizations have seen fundraising slow since the crash. "Giving is down significantly, 30% to 40%," says Bob Perkowitz, a trustee of the Sierra Club Foundation and founder of Cornerstone Brands, an upscale catalog company. "Small donations, under $1,000, are intact, but the big givers -- $50,000, $100,000, $1 million -- are the ones that cut back the most. I'm very happy if they give 70% of what they gave in the past."

Nonprofit organizations are being hit by a "triple whammy," as one foundation executive puts it. Budget crunches across the country are pushing government funding down, foundation and individual giving have been hammered by the market retreat, and corporate giving is tumbling. "Many nonprofits live from hand-to-mouth and they tell us they're suffering," says Albert Ruesga, a vice president at the Meyer Foundation in Washington. Some foundations are gearing up to give more than the minimum 5% of assets, even if it means dipping into principal, to help their supported organizations through tough times.

No place has been harder hit by the crash than the tech-centric Bay Area, home to scores of dot.com zillionaires who jumped headlong into philanthropy, intent on bringing their business acumen to bear on the world's problems. Consider Steve Kirsch, who sold Infoseek to Walt Disney at the top of the market. Kirsch put $70 million of the proceeds into a charitable fund at the Community Foundation of Silicon Valley, but kept the money heavily invested in tech stocks. The endowment is now worth $15 million. "It seemed like a good idea at the time," says Kirsch ruefully. "I was a genius until the crash."

Kirsch's interests -- environment, disease, world safety -- remain the same despite his foundation's reduced abilities. "It affects not the focus but the amounts and number of grants," he says. "We treat every year as a clean slate; we have X dollars and we evaluate what the needs are, rather than just do a 25% cut across the board. It's the same process we do every year, only the numbers are smaller." The fund, which had given away a healthy 10% of assets in the past, this year will distribute 30%.

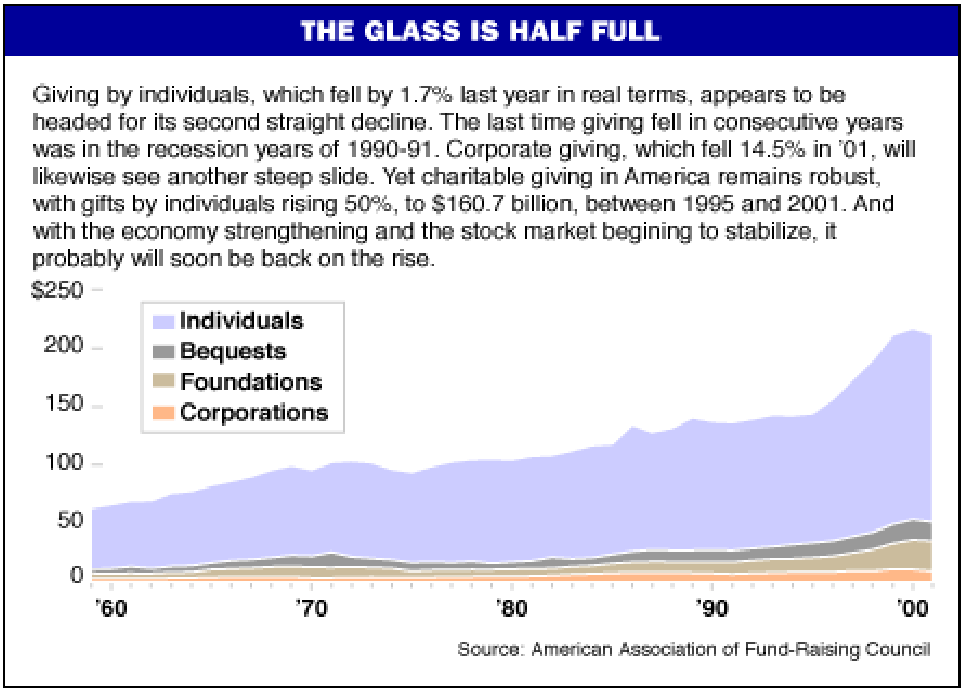
**And now, the good news**

With all the doom and gloom, it's hard to remember that only recently people spoke of a new Golden Age of philanthropy. A 1999 report by Boston College professors John J. Havens and Paul G. Schervish, "Millionaires and the Millennium," looked to the coming intergenerational transfer of wealth as a great boon for giving. The authors estimated a transfer, in current dollars, of $12 trillion to $18 trillion over the next 20 years, with a couple of trillion of that going to charitable bequests. Over 50 years, they projected a transfer between $41 trillion and $136 trillion and charitable bequests of $6 trillion to $25 trillion. Post-crash, the authors stand by their most conservative long-term scenario.

The low end of that range, $6 trillion, is still a lot of fresh money, however. And Schervish expects the wealth transfer also will boost gifts from living benefactors. That bodes well for the future of philanthropy in the U.S. Consider that since 1959, the earliest year for which there is consistent data, giving in the U.S. has totaled $5.1 trillion, in 2001 dollars, according to the American Association of Fundraising Counsel.

There is ample evidence that, despite the crash, the glass remains half-full. Total giving last year was an estimated $212 billion, according to the AAFRC, up just a hair from $211 billion the year before. Adjusted for inflation, that's a drop of 2.3%, which is consistent with other periods of recession such as 1973-74 and 1990-91 (see graph on page 34). "It isn't down very much considering you're talking about a recession all year, plus

9/11," says Prof. Schervish, who expects a similar decline in real terms in the giving totals for '02. Giving in America has long hovered around 2% of gross domestic product. By comparison, Britain gives 0.5% of GDP and Hong Kong 0.2%.




Nor is the news as bad as it might seem on the foundation front. While many foundations have taken a beating in the stock market, others are conservatively invested and widely diversified. The Packard Foundation's experience is highly unusual -- the Hewlett Foundation, for example, holds just a quarter of its assets in H-P stock. Indeed, giving by foundations rose 5% in '01, according to the Foundation Center; it "seems likely to be flat at best in '02," says research director Steve Lawrence.

One reason giving held up so well in the teeth of a market rout is that foundations make grants based on a three-year rolling average of assets. "We had '99 as an up year," he explains, "but we're running out of growth years, and it seems likely we'll see some decrease in foundation giving in '03." Even with looming declines, however, Lawrence points to a doubling of foundation giving since 1996.

Indeed, philanthropic enterprise grew significantly during the boom; there has been an almost 50% increase in giving in real terms since 1995. Much of that was driven by younger donors with a more activist style, who emphasized targeted giving, measurable outcomes, accountability and business-like practices. The question now is, how will nonprofits get through the current hard times?

Management guru Peter F. Drucker is a long-standing apostle of the need to improve the performance of nonprofits. And leaner times, in the for-profit world at least, historically have driven efficiency. But if the idea of presenting nonprofits in terms of results and customer satisfaction was gaining steam during the boom, driven by younger donors who wanted to ensure their contributions were used effectively, the trend is less so now. This message "is seen as less critical when times are tough," says Rob Johnston, president and chief executive of the Peter F. Drucker Foundation for Nonprofit Management. The irony, of course, is that "this kind of focus is just what's called for now," he says.

But here, too, there is hope. Johnston points to graduate schools that are offering courses in nonprofit management as "one indicator of a growing awareness and interest in the need for managerial and organizational effectiveness. The need to track results is clearly understood and people are developing ways to do that. I don't think this stuff is going to go away."

Certainly, the need is there.

Egged on by Wall Street and financial advisers, donors in recent years have set off a boom in private foundations, for example, creating nearly 10,000 new ones in 1999 and 2000 alone, an increase of 20%. "Business is good," says Linda Franciscovich, a managing director at U.S. Trust, which has created nearly two dozen family foundations in the past two years. Involving the kids is a heavy part of the pitch. "It's at the heart of what we do," she says. "It's important to provide children with the tools to be good board members and understand the responsibilities of wealth."

Yet private family foundations sometimes lead to philanthropic burnout. "I see too many cases where people set up family foundations and didn't know how much work it was and hate it and undo it," says Kathryn Miree, a nonprofit consultant in Birmingham, Ala., and author of "The Family Foundation Handbook." "It happens more than you think," she says.

In fact, the Community Foundation for Silicon Valley has rolled up a dozen private foundations over 18 months from donors who didn't want the administrative hassles anymore.

"People say, 'I want to concentrate on strategies for giving and not the paperwork,' " says Sterling Speirn, president of the Peninsula Community Foundation in San Mateo, Calif. "We're customer-friendly. You can still call it the Jones Family Fund and we'll desktop-publish stationery for you. Tell us how much or how little involvement you want, and you can tap into the deal flow that courses through our office every day."

Community foundations offer these services through donor-advised funds, which are the same sort of low-maintenance philanthropic checking accounts as the wildly successful Fidelity Charitable Gift Trust, which now has $2.1 billion in assets. The nation's top public grant-maker -- as opposed to the private Gates or Ford Foundations, which are internally funded -- Fidelity so far this year has received contributions of $308 million and made grants of $513 million. And the number of contributions is steady, suggesting that families have made giving to the fund a habit.

Meanwhile, with easy stock-market winnings much less abundant, nonprofits have had to get more creative about fundraising. Many are pursuing gifts of real estate, since housing prices remain sky-high. Miree is coaching charities to "ask about noncash assets that don't generate income: a vacation home, an insurance policy they bought in their twenties, undeveloped land, a collection of jewelry or art."

The Sierra Club has scrambled to offset a drop in its average major gift from $17,000 to $11,000. "We're willing to accept smaller grants," says chief advancement officer Rochelle McReynolds. "We're okay creating a grant proposal in the $10,000 range where before we were looking for $50,000. And we're teaming up with other groups as coalitions to get a piece of funding. We bring a different strength, a grass-roots piece, while, say, the Nature Conservancy is a land-buying organization. Donors like us working together."

One high-tech benefactor who reduced his funding of nature outings for inner-city youth has been working with a fundraiser, identifying potential donors to make up the shortfall. And McReynolds cannily hired three former dot.com-ers to beat the high-tech bushes. With these adjustments, she is close to reaching her revised budget goal for the year.

"Donors aren't going away," says Madeline Stein, a community volunteer in Palo Alto. She is a one-time schoolteacher and her husband Isaac is a former corporate lawyer who is now a biotech investor and chairman of Stanford's Board of Trustees. "These donors reached out to philanthropy during the robust economy," she says. "It became an important part of how they live their lives."

"I hope we're not losing the enthusiasm and volunteerism that developed among younger people," adds Isaac. "It's easy to lose the momentum that was built. My sense is that it will survive, but it will take more work by organizations to keep those people engaged." By all accounts, that is precisely the effort nonprofits are making to get through this down market and to better times.

## Patience, Please

One of the most invigorating developments of the stock-market boom was the emergence of venture philanthropy. This style of giving focuses on building the organizational strength of nonprofits through close, long-term relationships; it naturally appeals to the younger, more involved donors drawn to Peter Drucker's ideas about improving nonprofit management ("The Better Angels," Dec. 18, 2000). A sophisticated and time-consuming proposition for donors, venture philanthropy became highly fashionable back when venture capitalists all looked so smart.

Many in the philanthropic world assume the movement melted away along with those ephemeral dot.com fortunes, but it was merely the phrase that got thrown around by trend-seekers to the point of absurdity. "Yeah, all those people stood up and said, 'I'm a venture philanthropist!' and then lost all their money," sighs Paul Shoemaker, executive director of Social Venture Partners in Seattle. "Escaping the baggage of the term is tough as hell."

Venture philanthropy remains a vital, if tiny, movement. "Of the handful of groups, we're all still standing," reports Shoemaker, a former Microsoft executive. "Robin Hood, New Profit, Roberts Enterprise Development Fund, New Schools, Venture Philanthropy Partners, us -- everyone's very much there, doing the work." Social Venture Partners boasts two-dozen affiliates in the U.S. and Canada. Members donate $5,500 a year for two years; 70% also volunteer their time for organization-building. "This was a hypothesis five years ago," says Shoemaker, "and we need another five years to prove the model. It takes a lot of patience and self-examination on both sides, but we all have a handful of cases to show this stuff really works."

-- E.S.