

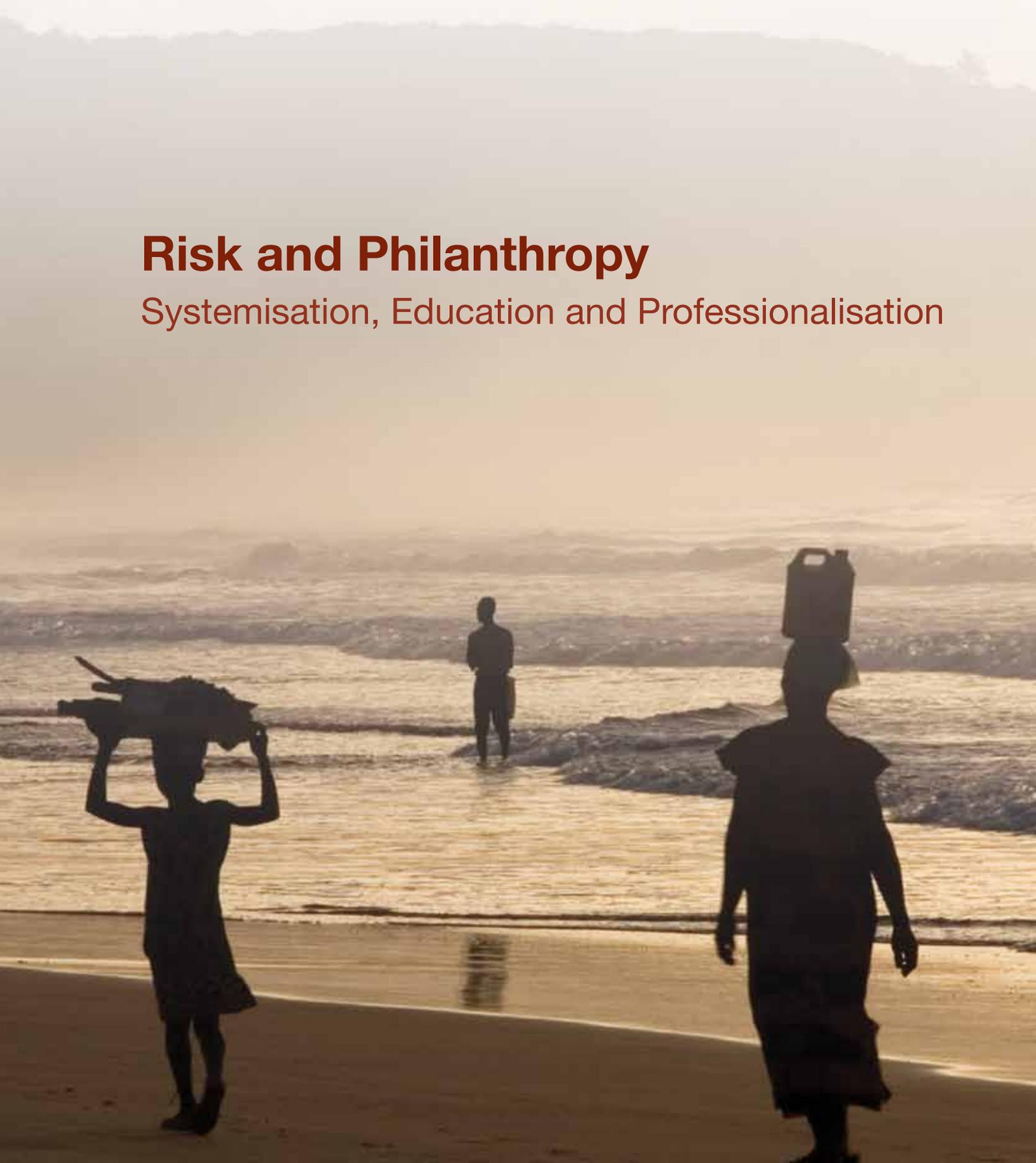


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# Risk and Philanthropy

Systemisation, Education and Professionalisation



October 2012

## About this paper

This paper was inspired by discussions at the Bellagio Summit which took place from 8-22 November 2011 and was organised by three partners:

- Institute of Development Studies (IDS) – [www.ids.ac.uk](http://www.ids.ac.uk)
- The Resource Alliance – [www.resource-alliance.org](http://www.resource-alliance.org)
- Rockefeller Foundation – [www.rockefellerfoundation.org](http://www.rockefellerfoundation.org)

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## Executive summary

This paper examines how risks in international development philanthropy are defined, assessed and managed. It reports the conclusions from a series of 27 interviews conducted with development philanthropists, philanthropic intermediaries, grantmakers from leading international foundations and sector academics in April 2012. It recommends ways through which risk that promotes innovation and expands opportunities might be optimised. Our findings will be of interest to philanthropists, grantmakers and those they seek to benefit.

Our interviewees were primarily concerned with impact risk (i.e. the risk of not achieving a specified impact goal with a given level of philanthropic investment). Our report begins by defining the two main risks that were found to comprise this overall impact risk, namely: strategic risk and operational risk. Strategic risk is most often mentioned as the critical risk and is defined as the risk of not having an accurate strategic perspective on the social problems at hand. Operational risk, by contrast, is defined as not having the right operational approach or plan to support sustainable impact. Other risks include financial risks, reputational risks, political risks and personal risks. These latter risks are all of concern because they increase strategic or operational risks.

We then explore how risks are assessed. We apply academic principles relating to anchoring (i.e. reference points based on prior experiences or contexts) and under-adjustment and Prospect Theory to the context of the philanthropic interventions our interviewees shared with us. We explain how risk perception is formed based on a philanthropist's past experience and the context of the risk assessment process. We discuss how philanthropists and philanthropic institutions use different decision rules depending on the categories of risks experienced and offer a range of recommendations for how risk taking might be facilitated.

We then examine the critical topic of risk management, examining both impact and operational risk. In respect of the former we focus on the identification of appropriate beneficiary groups, additional special interest groups that may need to be considered and the selection of appropriate processes through which change might be brought about. In respect of the latter we examine the selection of appropriate business models and the importance of developing a diversified risk profile, an organisational learning culture, adequate control mechanisms and trust on the part of both beneficiaries and funders.

The final section of the report draws together the thinking from previous sections and offers a series of recommendations, notably the need for the development of a professional support infrastructure that would expose new philanthropists to a body of knowledge designed to improve their chances of achieving sustainable impact. It could also facilitate the development of support networks to help philanthropists more accurately assess/manage risk and thereby optimise their decision-making.

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# 1.0 Introduction

In November 2011 a Summit on the Future of Philanthropy and Development in the Pursuit of Human Wellbeing took place at the Rockefeller Foundation Bellagio Center, bringing together participants from diverse fields and countries to explore ways to improve development outcomes through more effective collaboration across sectors. One of the major conclusions of the summit, was that philanthropy needs to become better at understanding the relationship between risk and opportunity, cognisant of the distinctive contribution that effective risk strategies can bring to innovation within the development eco-system. Democratic governments avoid risk with public money because of the discipline imposed by elections. Philanthropy, by contrast, has the potential to assume risk that promotes experimentation and innovation, and after successful interventions have been identified, the resources of the state can then be mobilised to bring them to scale.

Government is not the only sector that finds it difficult to take risk. Some of the new forms of social enterprise are similarly hampered. These businesses and their associated capital gravitate toward opportunities that offer the greatest promise of impact, but they must also seek markets with the potential to offer them a return. Social enterprise can certainly innovate and have a substantive impact on the communities it serves, but it sometimes can't take the kind of risks necessary to bring about systemic change. Philanthropy offers genuine potential to actively seek opportunity (with its associated risk) and seek out creative solutions to the most intractable development and social problems. Summit participants argued that in order to innovate, philanthropists need to be much more accepting of failure and recognise that to achieve large-scale change many of their resources may be wasted along the way. Occasional failure should be seen as the acceptable cost of innovation.

Unfortunately, there is evidence that philanthropists are not willing to take the risks they could with their philanthropy. A Bank of America study of philanthropy (2010) tells us that virtually no high value philanthropists want to take substantive risks with their philanthropic assets (a mere 3.8%). To compound the issue it seems that philanthropists are **more** risk averse with their philanthropic assets than they are with their personal financial assets. Some 26% are not willing to take any risks with their philanthropic assets, compared with only 10% who take a similar view of their other financial investments.

In the study that follows we seek to understand more about why so many individuals and foundations are currently risk averse with their philanthropy and how successful philanthropists and grantmakers conceptualise, assess and manage risk in the context of international development. Our goal is to offer a series of recommendations for how organisations such as the Resource Alliance and The Rockefeller Foundation can encourage and support philanthropists to think through and take more appropriate levels of risk in their giving.

To achieve this goal we conducted a total of 27 interviews. The majority, 22, consisted of one-to-two hour telephone interviews with philanthropists from Africa, Asia, Europe and North/South America. The sample also comprised a mix of different ages, genders and various types and levels of experience in philanthropy. These individuals conducting their philanthropy through a variety of structures, but primarily through Private and Family Foundations and Venture Philanthropy. We also conducted five interviews with personnel from large grantmaking foundations or philanthropic intermediaries. Each interview was digitally recorded, transcribed and subject to content analysis to identify the major themes. Interviews were semi-structured following a 'decoding the discipline' methodology (see Appendix 1) designed to focus on the factors influencing risk in specific giving scenarios identified by our interviewees (Pace and Middendorf, 2004). We focused on the tools, techniques and processes that each individual had adopted to manage their risks. For some, their approach to risk was easy to articulate, while for others their approach had become so internalised and habituated, that the interview process required them to deconstruct their thinking processes and reformulate how they approached each dimension of the focal decision.

We seek to understand the behaviour of both individual philanthropists and foundations working in the domain of international development. As will shortly become clear many of our findings appear equally applicable to both groups. Where there are differences they will be specifically highlighted in the text.

## 2.0 What do we mean by risk?

The primary risk articulated by our interviewees in international development philanthropy was the risk of failing to achieve impact appropriate to the level of the investment. The lower the probability is of achieving a given impact, the higher the risk. It became clear that there were two key components of this overall impact risk, namely strategic risk and operational risk.

We define strategic risk as ‘the risk of not having an accurate strategic perspective on the social problems at hand’. From our interviews there appear to be three dimensions to this risk that relate to how an intervention is defined, strategised, and measured. First, it is often difficult for philanthropists to articulate how they define impact (thus creating uncertainty) and in many of the examples we will introduce later, we will show how their definitions morphed substantively as they learned more about what was necessary in a given context. Box one provides some examples of how our philanthropists initially defined their impact. Second, it is often difficult for philanthropists to decide a priori how to design an effective social innovation system to achieve the desired impact and this design and strategy too might need to morph as the programme proceeds, creating further uncertainty. Finally, it can be difficult to establish meaningful metrics to measure success and/or to encourage those being funded to report on the impact achieved in a meaningful way. The lack of evidence or the provision of tangential or only partial evidence can also create ambiguity and uncertainty.

The second key risk articulated by our interviewees is the risk of not having the right operational approach to support sustainable impact. This is what we term operational risk. Box two provides some examples of the operational risks encountered by our philanthropists. High operational risk in international development philanthropy is caused primarily by the degree of innovation in the design of the intervention itself. The more philanthropists rely on pre-tested ideas and avenues commonly agreed to be effective, the lower the risk.

Other risks concerning philanthropists included financial risks, reputational risks, political/legal risks and personal risks. These other risks however were never described as the ‘core’, ‘fundamental’ or ‘most important’ risks that troubled them. In the majority of our cases, these other types of risks concerned philanthropists because they increased their strategic or operational risk. The reduction of these other risks was never mentioned as an end in itself.

In this report, we will summarise our learnings about how philanthropists in international development cope with strategic and operational risk, examining both the assessment of those risks and their management. We begin with risk assessment below.

### Box 1: Example definitions of impact employed by our interviewees:

- 1) Achieving the sustainability of local businesses in Africa
- 2) Improving the quality of life for retail workers in an Asian country
- 3) Increasing the number of orphans who attend universities in an Eastern European country
- 4) Achieving buy-in by local communities to invest in educational funds in an African country.

### Box 2: Example operational risks encountered by our interviewees:

- 1) Finding the right people to engage in small and medium sized sustainable business in Africa
- 2) Identifying the right business model to sustain an uplift in quality of life for retail workers in India after the intervention is complete
- 3) Sustaining the operation of a nonprofit in the face of unfavorable tax law changes, so that orphans can attend university in Russia
- 4) Implementing adequate record keeping procedures to facilitate leadership succession in an educational investment fund.

## 3.0 Risk assessment

### 3.1 Anchoring and under-adjustment

Before we present the results of our interviews, we will take a moment to review the relevant academic literature on risk and anchoring (reference points that might bias decisions when proper adjustments are not in place). Paul Slovic is one of the leading academic authorities on how people form perceptions and feelings of risk. He concluded after close to 50 years of research that: 'there is no such thing as...objective risk' and 'Risk is inherently subjective'. (Slovic 2000, pxxxvi) and a function of many different variables, notably the background and experiences of the individual. People take decisions in part about the risk they are prepared to tolerate by drawing on other life experiences, even if these are drawn from other contexts where the circumstances and rules of the game are very different.

To explain the mechanism that is at work here we will begin by explaining how one widely studied decision-making heuristic appears to influence most aspects of how philanthropists assess risk. This heuristic is termed anchoring and is one of the central principles in the domain now known as behavioural economics. It was first studied by Nobel Prize Laureates Amos Tversky and Daniel Kahneman in 1974.

In an experiment they found that people often make numerical judgments by anchoring on a given number and then adjusting for other things that they know. But on average, people under-adjust. In their original research, participants in a study were asked to estimate the percentage of African countries in the United Nations. The process adopted by the researchers was as follows. A random number between 0 and 100 was determined as a starting point by spinning a wheel of fortune in the subject's presence. Subjects were then instructed to indicate whether the percentage of African countries in the U.N. was higher or lower than the value on the wheel, and then to estimate the exact value of the percentage. Participants who were given higher numbers to start with gave higher estimates than those given low numbers. That is, they let irrelevant information influence their judgment.

Since this heuristic has been shown to influence all decision-making situations (Baron, 2000), it is no surprise that we also found our interviewees taking decisions in this way. They used different anchors or pre-existing and possibly irrelevant reference points to assess their philanthropy's strategic and/or operational risks. What is new from our research, however, is that this heuristic can be helpful or harmful to their risk assessment depending on the nature of such anchors, the specific context of the philanthropic decision-making and the extent to which they appropriately adjust. From our discussions it was clear that many of our participants had used anchors drawn from their experience in business and the public sector and thus, as it turned out, anchors that were wholly inappropriate to the practice of philanthropy. So how does this happen?

The first task that philanthropists and philanthropic institutions face when making decisions about how much risk to take in a given philanthropic engagement is to determine the magnitude of their risk.

Our data indicates that they consider the following factors:

- a) How easy or hard it might be to define success
- b) The extent to which there is agreement about how to measure that success
- c) How easy or hard it might be to conduct the relevant measurements
- d) The timescales over which the measurements must be conducted
- e) How risk-diverse their philanthropic portfolio might be
- f) The extent to which a given investment might fit with their philanthropic profile
- g) The size of the focal philanthropic investment
- h) Past experience working with the relevant community and/or stakeholders.

There are echoes of these points in the wider business risk and judgment and decision-making literature where it is well established that the more ambiguous the probability of success is, the more likely one is to perceive such endeavours as risky, the more risk-diversified one's portfolio is, the more likely one is to tolerate risk and the larger a particular investment is, the higher the risk it is perceived to carry. Nothing we have outlined above is therefore in any sense new.

Where we do gain new insight though, is in combining our knowledge of anchoring and under-adjustment with context specific knowledge about how philanthropists define strategic and operational risk. We can thus begin to answer questions such as how 'hard' is hard, how 'long' is long, how 'diverse' is comfortably diverse, and how 'big' is too big.

We found that our interviewees use their own previous experience to anchor their judgment about philanthropic risks, and they do so along the dimensions we mention above. For example, for someone who has been engaged in the world of venture capital in medical research, they will be used to making large investments over significant time horizons where the outcomes may not be known for many years and where the side effects of any new drugs may be hard to quantify. The likely outcomes from their philanthropy may be similarly hard to quantify, and they thus see the impact risk as moderate, but if the size of the investment is significantly smaller and the time horizon shorter than they are used to, they will be inclined to see less overall risk in their giving.

What this means is that people weigh their risk assessment more heavily on their past experience than they should and take less account of the 'real' risk in the context of their philanthropic decisions. For example, for a Venture Capital professional, when he decides to become a philanthropist he may engage in unnecessarily high risk philanthropy, simply because he is used to high risk, while an industrialist may engage in unnecessarily low risk philanthropy, because she is not comfortable with higher degrees of risk.

From this perspective, their past professional experience might become a foe not a friend in determining the optimal risk to take in their philanthropy.

To encourage individual philanthropists or grant officers to take optimal decisions in their giving they have to be encouraged to step out of their former mindset and to consider philanthropic decisions afresh. If an individual wishes to become a full time and thus 'professional' philanthropist (or grantmaker) a process of re-education must take place. Individuals need to be given new anchor points appropriate to the sector they will now be working in. This might be achieved through a process of formal education, but it can also be achieved informally through the establishment of networks that allow philanthropists and development professionals to share experiences and communicate norms. It was also clear from our interviews that many philanthropists utilise professional advisors to assist in giving decisions some of whom share a background in finance, rather than philanthropy. Where this is the case, they too should be encouraged to engage with a process of re-education. Their advice would be more meaningful as a consequence.

An alternative approach would be to encourage philanthropists and managers of philanthropic institutions to engage in a greater degree of reflection. The goal here isn't necessarily to change the anchor, rather to ensure that the individual adjusts correctly. Individuals need to be helped to realise how their (sometimes irrelevant) past experience influences their risk assessment in philanthropy, so they may adjust properly and arrive at a more mature assessment of the risk at hand.

A third potential approach would be to help philanthropists identify projects that have a better fit with the levels of risk they are comfortably used to taking. Philanthropists and philanthropic institutions can match themselves to the right causes, or the right causes can seek out the right supporters. The supporter can then be encouraged to take rational small steps out of their comfort zone. The idea is presented graphically in Figure 1.

If a supporter is comfortable with accurately adjusted risk assessment at level 1, in order for her to take up additional risk, the best way to encourage that is to find a project that is at level 2 and move her up the scale. She would be uncomfortable and may even refuse to invest directly in projects perceived as level 5. International development agencies need to have a greater awareness of the fact that funders from different professional backgrounds or with differing years of experience in philanthropy will be more or less risk tolerant and thus arrive at a different level in the model. It is a matter of matching the right level of risk in a project with the right level of risk tolerance.



**Figure 1: An incremental approach to the acceptance of risk**

A more nuanced approach is also possible, by teasing apart the various components of risk a given individual experiences. If their overall perception of risk is driven by doubts over whether an impact will be achieved in a focal community (impact risk) and a personal concern for the waste of their philanthropic dollars (i.e. financial risk) then the best strategy might be to lower the financial risk, keeping the budget well within the supporter's comfort zone and then stretch out the impact risk one step at a time, taking into account how comfortable they are at each stage.

## 3.2 Prospect theory

The major piece of research that gained professor Kahneman the Nobel Prize is the Prospect Theory he developed jointly with professor Tversky (1979). It consists of two parts, the Pi Function and the Value Function which collectively suggest that people prefer certainty to uncertainty. They would be more willing to support a project with certain yet small impact than a project with uncertain yet large impact. In making such decisions, philanthropists will compare two states of the world, either a world where their philanthropy occurs and a world where their philanthropy does not, or a world where their philanthropy supports one cause versus a world where their philanthropy supports another. We learned from our interviews that it is important to identify precisely what the alternatives are, for reasons we will outline below.

### 3.2.1 The Pi Function

The Pi Function tells us that people are most sensitive to changes in probability near the natural boundaries of 0 (impossible) and 1 (certain). Thus, a 0.1 increase in the probability of making a social impact has a greater impact on decisions when it changes the probability of making an impact from 0 to 0.1 (from impossibility to a slight chance of making an impact) or from achieving a definite impact to a slight chance of something going wrong (i.e. from 1.0 to 0.9). Consider the following philanthropic examples. In our first scenario a philanthropist believes there is a 70% chance of an organisation achieving a social impact without her help and an 80% chance if she offers it. She will be much less likely to offer her support than in a second scenario where there is a 10% chance of success with her help and none without it.

There was a sense in our interviews that many new philanthropists were taking decisions in the realm of 0.9 to 1.0 where with the proper metrics they could approach certainty in respect of the outcome they would achieve. In other words some philanthropists engage only when the outcome is certain.

The decision to take risks thus becomes a matter of framing. Non-profits could leverage the power of individual preference for certainty by dividing their portfolio up such that the success of specific programmes (or bundles of programmes) can be presented to approach certainty.

In the real world though, this is unlikely to be a frequently available option. In the context of international development there are few certainties and thus increasing the perceived probability of success from 0.9 to 1.0 is simply not an option. There may therefore be an opportunity to focus on the other end of the scale, where there is zero probability of achieving a social impact without a philanthropic involvement and a small chance of success with it (i.e. moving from 0 to 0.1). Again they may consider dividing their portfolio up such that specific programmes (or bundles of programmes) can be presented in this way.

To illustrate – one of our interviewees explained that each and every one of his programme ideas had been tried by other organisations before and met with failure. What attracted him was the ability to combine these ideas and have them executed in a single unified programme. In aggregate the risk was therefore substantial, but he believed that a multi-faceted approach might work. He was in a unique position to be able to try that approach and thus create something from nothing.

That is what ultimately drew him to the project. The Pi Function explains this behaviour and suggests that this philanthropist would have been less likely to invest if the previous interventions by other organisations had been met with mixed success.

We can develop the implications of Prospect Theory a little further by focusing on the role of the individual philanthropist, rather than the project per se. There may be scenarios where the project will only have impact if a particular philanthropist gets involved. In order to encourage risk-taking, it is important for the supporter to realise that this is the case and that there is a close to zero chance of the project happening without their specific support. Box 3 illustrates the idea. A similar rationale might be constructed in the case of a grantmaking foundation. It too may have contacts, influence or understanding that it can bring to bear on a project and its support might also be critical in attracting additional funding from other sources.

It may be rare that a philanthropist or a philanthropic institution would be willing to provide all the elements we list above, but some combination of the talent they bring to the table will undoubtedly be distinct. What excites us about this approach is that while such a tailored philanthropic engagement would be likely to increase the chances of support, it will also enhance the giving experience for the philanthropist or foundation.

**Box 3: Factors persuading a philanthropist to intervene**

	<b>Believable yet?</b>
1) A target amount (of funding)	No
2) A passion for a cause	No
3) A relevant set of social connections	Maybe
4) A contextualised understanding of the impact	Maybe
5) A set of skills, knowledge and competence relevant to reducing operational risk	Maybe
6) A set of skills, knowledge and competences relevant to achieving impact through defining strategy	Yes

### 3.2.2 The Value Function

The second reason it is important to make the alternatives explicit is because people value losses more than they do gains in their decision-making. In other words an objective gain or loss of equal magnitude are not treated equally, the loss receives a higher weighting and has a proportionally greater impact on the outcome of the decision.

To encourage successful risk assessment and management, the first step that philanthropists should take is therefore to explicitly articulate what will constitute gains and losses in terms of their resources. These resources may include financial, time, talent and/or network resources. An explicit consideration of these issues has the potential to greatly enhance decision-making since the philanthropists in our sample were typically very good at articulating potential losses, but they were rather less good at articulating all the potential gains.

In evaluating philanthropic impact, philanthropists and philanthropic institutions need to consider both the impact on society and the impact on themselves. All but a couple of our interviewees consciously considered social and systemic impact as a gain, since it is central to their philanthropic investment. Almost all interviewees were able to articulate it. They acknowledged that this articulation may not have been clear at the inception of a project but it was nevertheless something that they had made a conscious effort to do.

What was less obvious to some interviewees was that personal impact (i.e. impact on the individual) or institutional impact (i.e. impact on the philanthropic institution itself, for example in learning that applies to future work) can also be a gain. Most participants felt that personal gain was not why they entered philanthropy and they stopped their reflection at that point without necessarily asking themselves, if that were true, why they chose to be in philanthropy at all and what keeps them there.

#### Box 4: Solving problems in philanthropy is fun

'I am really good at problem solving. A lot of social problems are really difficult to solve, and no one has been able to solve them before. My philanthropy offers me the opportunity to stretch my problem-solving skills to a place where they have never been stretched before, and that is exciting and fun.'

As selfish as this reflection might seem, we recommend that philanthropists undertake it and articulate their personal gains. Our interviews revealed that those who had considered personal gains found much more depth and personal value in their philanthropy, typically reflecting on the meaning of their in life as articulated through their giving, the intellectual stimulation of trying to solve difficult and often intractable problems (see Box 4), and/or the sustained enjoyment derived from developing their competence to contribute to social change.

The process of reflection would be of equal value for institutional funders where it may be undertaken by the programme officer(s), the executive management team or the board. Interviews revealed that those who had explicitly considered institutional gains (perhaps in respect of development opportunities for the team) found that their future decision-making and team morale improved as a consequence. As obvious as these gains might sound, if philanthropists and institutional funders do not focus consciously on what their work achieves for them, potential losses can begin to outweigh their gains and they are less likely to be accepting of development risk.

There is also the issue of framing to consider. In a philanthropic transaction, an amount of money is transferred from the supporter's account directly to the recipient or the recipient organisation. There is nothing intrinsic to this transfer that is either a gain or a loss, so a supporter could view it as either. This transfer might be perceived as a gain when social impact is anticipated or achieved; and as a loss when a social impact is created inefficiently, or not at all. Equally, even where social impact is not achieved or may not be achieved, the eventual outcome could still be perceived as a gain if the supporter recognises the situation as an opportunity to learn. Those who enter philanthropy with a learning mindset or learning institutional culture are more accepting of risk.

Many participants in our study felt that one of the most important lessons they had learned on their philanthropic journey was the importance of gaining domain specific knowledge of the social problems they targeted and the need to gain higher competence in solving these problems. This higher competence could be derived from their experience in philanthropy, but it would more typically derive from understanding how to leverage their existing (perhaps business acquired) competences to tackle the social problem. During the initial learning stage, when there is a mismatch between the new philanthropist's knowledge and the complexities presented by development-oriented philanthropy, they experience a challenge to their sense of self-efficacy and can become disheartened with the difficulties of creating and sustaining social change. For some of our participants this feeling of powerlessness led to a growing desire to terminate their philanthropic involvement. As philanthropy in Africa, Asia and Latin America expands, the sector would greatly benefit by more rapidly and effectively providing new philanthropists with a greater sense of preparedness to engage in their new profession, assisting them to leverage their existing competencies, and speeding up their learning curve.

A further strategy would be to encourage individuals to see inaction as a loss. Pointing out what is being lost without a specific philanthropic intervention might sometimes be a more powerful way of engaging philanthropic risk taking than asking what is being gained with the same unit of help. During our interviews we asked participants what they would recommend saying to others to encourage them to engage in risk-taking in philanthropy. Participants saw themselves as problem solvers and/or entrepreneurs and felt that if they didn't use their skills in the pursuit of human wellbeing it would be a waste of their potential. Others, in their view, needed to be encouraged to see the magnitude of that loss. Instead of saying, 'why yes?' this way of thinking asks, 'why not?' Since the Value Function teaches us that people are loss averse, framing an individual's involvement in philanthropy as a gain is not as powerful a way of engaging them as framing their inaction as a loss.

The learning from this principle can of course be combined with the Pi Function we alluded to earlier. A philanthropist, in order to take up a higher risk, needs to understand that without the unique contribution they can offer, the building of a children's hospice is impossible and their talent for problem solving will be wasted, but that with the unique contribution they can bring, the children's hospice has just a chance of becoming a reality (see Box 5). This understanding is powerful because it utilises both loss aversion and the Pi Function from the perspectives of both what a society could lose without a project and what a philanthropist could lose by not offering their support.

Of course the real world may not be as neat as we present here. Rigorous, peer reviewed academic research to date has not studied general risk aversion, loss aversion and sensitivity phenomena in the philanthropic domain. We are therefore not in a position to point to a precise process through which an optimal level of risk perception (combining strategic and operational risk) might be determined. So the best advice we can offer for now is that philanthropists should be aware of how these general biases might play out when they consider strategic versus operational risks, so that they may move themselves up the scale to a point where they ask ‘why don’t I help?’

### 3.2.3 Different decision rules in different contexts

In addition to the foregoing, supporters can develop different decision rules for determining their risks in different contexts. For example, one interviewee told us: ‘When I make a business investment, I am concerned about the maximisation of financial returns in my investment. But when I make a philanthropic investment, all that I care about is that the non-profit organisation can make ends meet and build enough capacity to achieve its goals independently in the long run.’ So in the non-profit context philanthropists/ foundation officers do not seek to maximise financial returns, but look for a ‘tipping’ point, such that their impact may be independently sustainable even after their philanthropy ceases to exist.

#### Box 5: Factors changing a philanthropist’s mindset from ‘why take a risk to why not take a risk

	‘Only you I can help...’ Is it believable?	Why take a risk?/Why not take a risk?
1) A target amount (of funding)	No	Why yes?
2) A passion for a cause	No	Why yes?
3) A relevant set of social connections	Maybe	Why yes?
4) A contextualised understanding of the impact	Maybe	Why yes/not?
5) A set of skills, knowledge and competences relevant to reducing operational risk	Maybe	Why yes/not?
6) A set of skills, knowledge and competences relevant to achieving impact through defining strategy	Yes	Why yes/not?
7) It would be a waste if I don’t use my skills, knowledge, and competences to achieve impact I am passionate about		Why not?

There was broad agreement that philanthropy was different in this way, yet what seemed more problematic for our interviewees was unpacking the notion of a tipping point and thus what might constitute an appropriate level of investment and its associated level of risk. It seemed clear that supporters apply different decision-making criteria in their philanthropic decisions than they do in their business decisions when facing the same type of risk (i.e. financial risk in the example above) and that the criteria used in philanthropy are associated with a much higher degree of ambiguity.

The position is further complicated by the notion that there appeared to be different criteria applied when asking the question 'why should I support this project?' from 'why shouldn't I support this project?' One participant told us that 'I worked hard to earn my income, so I do not want it to be wasted,' but in the course of the conversation it became apparent that the avoidance of waste was rarely considered as a key criterion for saying yes to a project. Rather this appeared to be a major criterion in saying no. This was a theme repeated consistently in our interviews; philanthropists seemed to have two distinct sets of criteria. This dichotomy matters for two reasons; firstly that the value function tells us that philanthropists will pay a disproportionate amount of attention to the negative list and secondly, the negative list is often comprised of factors associated with a high degree of ambiguity e.g. what constitutes waste?

The judgment about what constitutes waste may again be determined through the principle of anchoring, but the difficulty for those new to philanthropy is that they frequently have nothing to anchor to as non-profits operate in a different way to either businesses or the public sector. About half of our interviewees mentioned administration costs as a cause for concern, yet administration in the non-profit context is inherently more complex than in business, making it inappropriate to anchor to that domain. Most of them are our interviewees with less than five years of experience in full-time philanthropy. The reasons for this complexity are well documented (see for example Sargeant 2010), but include:

- a) Non-profits have very diverse stakeholders and must build and maintain relationships with all/most of them
- b) Ownership is often diffuse and there is therefore no clear priority among the stakeholders
- c) Non-profits have more diverse sources of revenues than private businesses with each source requiring different management skills and strategies
- d) Non-profits adopt participatory methodologies and tools. Many organisations are democratic and inclusive, being driven by the often conflicting voices of their membership.

Supporters new to philanthropy are thus ill placed to take decisions on what constitutes management waste or inefficiency as their business or public sector anchors no longer apply. We therefore recommend that supporters be encouraged to consciously reflect on what they are anchoring against and the hidden incompatibilities of such anchoring. From the perspective of risk it would be better to avoid comparisons at all than to adopt those that are ill-suited to the task. As a consequence it may be helpful for, particularly new philanthropists or those new to philanthropic institutions, to be proactively and quickly educated about the realities of the development sector and thus be exposed to an appropriate set of anchors that might be adopted. This process of education could examine projects of particular types, taking place in different regions or involving different degrees of impact and operational risk.

The final learning that we would draw from academic research in this domain is that people have a low tolerance for ambiguity. This matters since when they are engaged in social innovation, where by definition pre-existing benchmarks are not available, they feel more comfortable utilising irrelevant numbers than having no numbers at all. This is a well-documented decision-making heuristic, but one that in this context would hamper social innovation. As one reflective participant put it: 'Comparing apples to oranges is not necessarily better than comparing apples to nothing.'

## 4.0 Managing strategic risk

In the previous section we examined academic theories and data from our interviews as they pertained to the topic of risk assessment. In this section we move on to consider how, having assessed a given risk, individuals and institutions proceed to manage it.

We were fortunate in being able to interview many philanthropists and managers from foundations who had been long term supporters of development initiatives. As they reflected on their personal journeys in philanthropy it became clear that to get to the point where strategic risk could be managed effectively, three broad (and inter-related) transitions needed to take place.

### **Accessible Outcomes → Systemic change:**

When many of our participants had first engaged in their philanthropy they were highly focused on achieving a specific impact with a specific group of individuals or on a narrowly defined problem. They had a clear idea of what needed to be done, but rather less idea of how it might best be accomplished. With the passage of time they became more focused on the processes that would need to be established to create more systemic impact. Only when the broad system of actors, organisations, and forces influencing their efforts was adequately understood, could the strategic risk be satisfactorily defined and managed.

**Fixed Strategy → Iterative Strategy:** A similar process of evolution seemed to occur with the conceptualisation of the nature of the impact an initiative would achieve. While philanthropists often set out with a clear articulation of what needed to be accomplished, this frequently morphed as they learned more about the development system, communicated with development actors, embedded themselves in the community and learned more about what was necessary for its wellbeing. As the nature of the required impact became clear, so too did the nature of the associated risk, making it much easier to manage.

### **Beneficiaries → System of Stakeholders:**

As we noted above, philanthropists were initially driven by the desire to improve the wellbeing of a beneficiary group. As their understanding of the circumstances of this group evolved, it often transpired that there were other actors or potentially interested parties who could impact the development process and either aid or detract from the outcomes achieved. As the actors in the development landscape became clearer, it was significantly easier to conceptualise and manage risk.

We develop each of these major themes below.

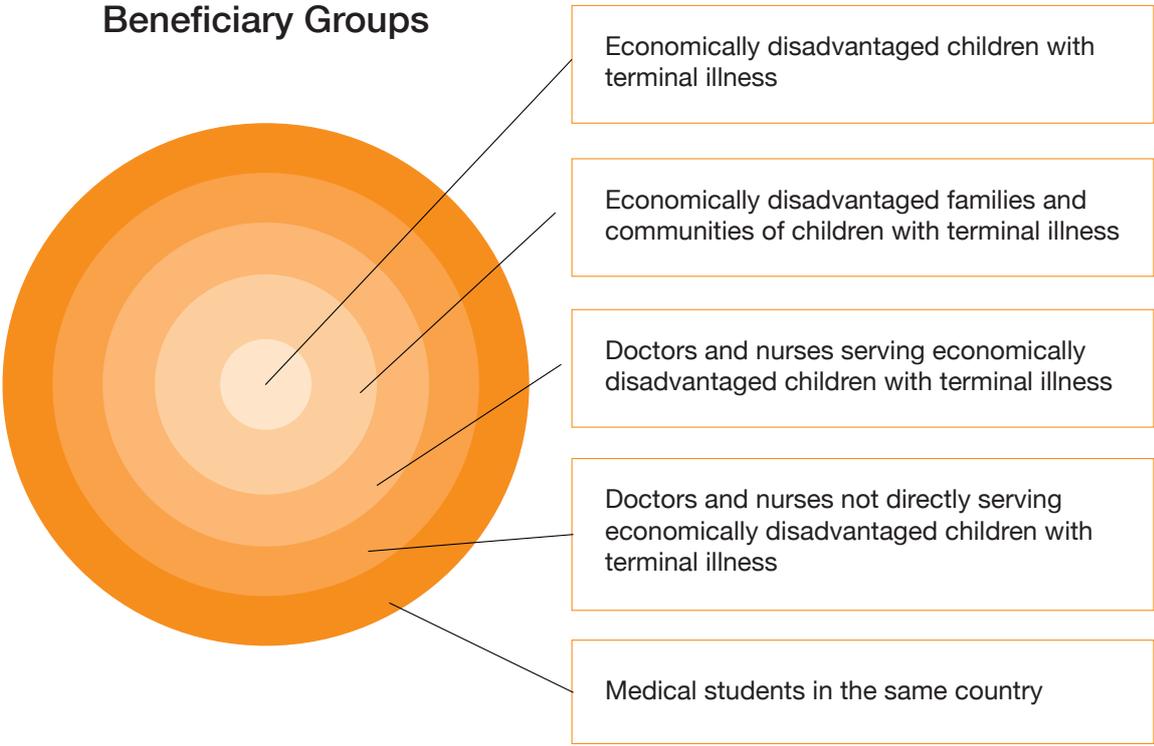
## 4.1 Accessible Outcomes → Systemic Change

Many of our participants felt that to successfully manage risk they needed to better understand the philanthropic landscape and move away from focusing on what they wanted to achieve to how best to achieve it. In a sense, they conducted a backward mapping of the process they needed to undertake in order to realise their intended impact on their beneficiaries. There was thus a shift in mindset away from 'delivering a positive outcome for easily identified beneficiaries' to 'creating a social innovation system to solve a social problem'. We provide an example below to illustrate how this transition occurs and then we will summarise why this transition is essential in successful risk management.

**Case one: Palliative care for economically disadvantaged and terminally ill children in Asia**

Consider the case of the opening of a hospice for children in South East Asia. The immediate and obvious beneficiaries are the economically disadvantaged children who are diagnosed with terminal diseases and their families and communities (see Figure 2). It is rather less obvious, though, that the doctors and nurses who will serve these patients will also be beneficiaries since unless they accept education in end-of-life care and change their philosophy of pain management, the impact on the children cannot be realised.

Another hidden beneficiary group is the doctors and nurses who do not currently serve these patients. As one group of medical professionals is educated, standards and norms of behaviour begin to be challenged, a process which if handled correctly can result in innovation being picked up and implemented more broadly. As others get to learn of what can be achieved a wider demand can be created to the point where end-of-life care is eventually included in the syllabi that a whole generation of new doctors will be exposed to. The last stage of this impact is then very likely to be achieved with government funding rather than private funds because of the now proven significance of the innovation for the society. The impact created by the opening of one hospice has thus been broadened into an innovation system that will revolutionise the state of end of life care in an entire country.



**Figure 2: The identification of additional beneficiary groups**

For this philanthropist the broadening of her perspective on who her beneficiaries were was a central part of her problem solving process. She found some aspects of the broadening process easier than others to realise and to integrate into her philanthropy. For example, the transition from terminally ill children to their families and communities is relative straightforward. In order for the children to receive pain management their parents needed to be told of the existence of such options. This was a significant shift since the focus in the local healthcare system was firmly on treatment, even when the likelihood of success had long since waned. Concurrent with this was the need to educate the communities from which these children were drawn, so that parents switching from curative treatments to regimes emphasising quality of life would not be criticised. A focus on pain management had to be deemed acceptable when treatment was no longer effective.

The transition from doctors and nurses actively caring for dying children to the wider supporting community, such as health volunteers and other NGOs was similarly unproblematic. When any one segment of the medical community became receptive to pain management techniques, they became powerful advocates for such treatments within their own community and thus influenced other professionals accordingly.

What had proved more difficult for this philanthropist stemmed from the recognition that doctors also needed to become the focus of her philanthropy. Doctors form a key audience because they guide parents in the selection of appropriate options for their child. Unfortunately, in the local culture there was no tradition of a focus on pain management, rather they preferred to continue treating the condition. Terminating treatment was perceived as akin to 'giving up' and was anathema to medical practitioners in this country.

Without a change in mindset the philanthropist realised that pain management would never become an option that was adequately promoted to parents. The focus of her philanthropy therefore had to morph to take account of the needs of this new beneficiary group and begin to break down barriers to the adoption of a wider range of treatment regimes. It will be instructive to examine in greater detail how this change was accomplished.

First, it was necessary for her to develop an understanding of how doctors work in this context. She worked closely with the medical teams to develop an intimate understanding of their mindset and the factors that influenced their decision-making. She was careful to build close working relationships with all the key players being careful not to impose the views of an outsider. As time went by she learned more about the local culture and how to raise her concerns more appropriately. She learned, for example, not to ask medical personnel directly what she was doing wrong, but rather to ask how she should be doing things differently.

With lines of communication now open, she also realised that the key to success lay in being willing to adopt their suggestions at all levels, right down to the seeming minutia of how she was using punctuation in her email. Only by carefully embedding herself in the local culture did she identify that to successfully change the mindset of the doctors, it was necessary to tap into the humanity of the nurses. In this case, she had to awaken the immense degree of sympathy the nurses had for the pain and suffering of the young children in their care and to appeal to their understanding of why it was necessary to change the way that care had been given. Because doctors rely heavily on nurses in getting the work done, the philanthropist was ultimately able to use the nurses' influence to convince the doctors of the need for change. Nurses could succeed where foreign experts, government officials and even well-meaning philanthropists had previously failed!

In this case the realisation that the broadening of the philanthropic effort was necessary was crucial. When a way was found to change the mindset of local doctors, work could begin on creating re-educational opportunities for them to reinforce the culture change and equip them with the skills and knowledge they would need to implement effective palliative care.

As a first step towards re-education – medical schools and nursing schools have indicated to her their interest in palliative care training. It is her hope that once local doctors are on board with the work, the national government will begin to recognise the value of the social innovation model and will be willing to provide financial support to integrate the concept of palliative care into medical school curricula so that the next generation of doctors can begin their practice with a different perspective on end of life clinical practice. Such an impact is well beyond what the philanthropist could have hoped for when she set out on this journey, but she made it possible by her flexibility in extending the concept of beneficiary group, and in doing so she transformed a barrier to success to an opportunity for even greater success.

There are a variety of wider inter-related lessons that may be drawn from this case:

- a) To realise that while thorough planning for impact is necessary, it is only natural that additional opportunities will reveal themselves during the implementation phase of that plan. Philanthropists must therefore be open to a re-definition of their impact risk as they advance their philanthropic involvement.
- b) It is necessary to move from the mindset of a 'target driven approach' to a 'learning driven approach', where targets can be adjusted as one learns more about the specifics of the local context and the various beneficiaries whose requirements need to be met.
- c) It is also necessary to move from a Top-Down process to a combination of Top-Down and Bottom-Up processes. Critical here is the development of an understanding of whose voices must be fed into the decision-making processes. In the example above, success was only achieved by listening to the advice of nurses and learning the subtleties of how to solicit that advice.

## 4.2 Fixed Strategy → Iterative Strategy

Most philanthropists share the vision that they want their philanthropy to have a real impact. A critical difficulty for many, however, lies in determining what the nature of that impact should be. Many of the individuals we interviewed noted that their definition of impact transformed over time as they began to learn more about the beneficiaries they should target and the needs of those often disparate groups. In this section we explore in more detail the nature of that transformation and the implications for risk.

### Case two: Palliative care in Asia

Palliative care is an extremely sensitive issue in Asia where many cultures experience difficulty in talking about death. In Chinese culture, for example, the belief that talking about death may bring bad luck and actually hasten its onset is prevalent. As a consequence elderly people do not want to talk about it and their children also find the topic difficult because they fear they may offend their parents. The government is similarly hampered because were it to raise the issue it could be perceived as being inconsiderate of the feelings of its people. The topic is, however, one that no-one can afford to ignore given the rapidly ageing populations that many governments are now responsible for. Some effort must be made to plan for the changing needs of these groups and societies should actively plan for the provision of any care that might be necessary so that there is sufficient availability and accessibility for proper end-of-life care when needed.

The philanthropist in this instance wanted people to talk about death, so that they might plan adequately for end of life care. He characterised his project as high risk because it takes considerable time to break down a taboo and shift the mindset of a nation. His foundation's approach to tackling the issue was framed in a campaign that comprised the following elements:

- 1) **Careful segmentation of the target audience:** It was decided to begin by targeting those most likely to be receptive to the message and thus change their behaviour. They targeted the young (under 50), better educated and English speaking population first, and then extended their focus progressively to important segments in the Chinese speaking population and then to minority language speakers.
- 2) **Large scale national media campaigns:** Whole page ads on the topic were placed in the most popular Sunday newspaper and high quality documentaries were filmed to promote a discussion of the options available for death and what death planning, palliative and elderly care could offer an Asian society.
- 3) **Successful audience engagement:** The team decided to make talking about death fun. They realised that the creation of a norm would be easier by the avoidance of a 'lecturing' or patronising tone. Instead they injected humour and a sense of fun into the process. Creativity was key and became a major driver of the initiative.

At the root of all these three steps was the development of a detailed understanding of the needs and thus sensitivities of each target audience before the campaign was developed. This understanding was used to mitigate risk by targeting the easiest segments of society first. Learning from attempts to communicate with the easier groups could then be applied to addressing the more difficult audiences for whom death was a more strongly felt taboo.

As the campaign was developed, it was clear who would be most likely to be influenced at each stage, the barriers that would need to be overcome in each case and the creative approaches that would be likely to be the most effective.

The wider implication from this case for development risk in general is that a segmented or staged approach to the achievement of impact might be warranted in some contexts. There may be merit in focusing on small but more achievable gains to develop individual and organisational learning and tackling more difficult forms of impact only when that initial learning has taken place. We also feel that while the approach we outline above was highly successful it is an example of well-established social marketing principles. We thus recommend that allowing other philanthropists to draw on this domain could be powerful in reducing risk. Social marketing is a well-established academic discipline which has at its core the notion of developing a focus on customers before engaging in a campaign for social innovation. The development of a greater understanding of human psychology, what works and what doesn't in creative approaches, etc could make it much easier for many philanthropists to conceptualise and manage risk.

### **Case three: The education of orphans in Eastern Europe**

In this case the philanthropist's beneficiaries were the orphans being enrolled in her educational programmes. She was initially focused on offering a greater proportion of orphans the opportunities they needed to prepare them to go on to attend university-level education. Initially she thus conceptualised her impact as an increase in the number of orphans participating successfully in higher education.

After a few years of operation, however, she came to the realisation that university education is often the last thing that many orphans want. They don't have the interest in that level of academic study and instead seek security, a stable profession and a safe place to live. As a consequence she changed her definition of the impact of her philanthropy. In addition to providing orphans with knowledge-based education geared towards university attendance, she adjusted her programmes to include professional training that would enable orphans to enter a skill-based profession (such as hairdressing).

If we look more closely at how risk can be construed in this situation, we find that at one level, risk could be defined as not achieving what the funder originally set out to achieve; alternatively, it could be defined as not achieving what the beneficiaries actually needed; or, it could be defined as a mismatch between the funders and beneficiaries in respect of expectations of what was needed. Since it takes effort from both the philanthropist and the orphans to create the kind of impact both parties desire it is this third form of risk that is potentially most detrimental to success. We therefore recommend that explicit comparisons of the beneficiaries' needs and the philanthropic objectives of the philanthropist be undertaken. This means moving beyond merely analysing the needs of beneficiaries per se, to a simultaneous consideration of the desires of the philanthropist, thereby permitting appropriate adjustments to be made to a shared goal.

In this case, the philanthropist recognised the misalignment and developed a tiered system where the foundation selects orphans to enrol in different types of programmes each year. Some ultimately enter programmes that prepare them for a vocational career, while others enter programmes to prepare them for the more academic demands of the university system.

To get to that point, however, the philanthropist works with specific groups of children to raise an awareness of the opportunities that higher education can offer and thus begins to work on changing the mindset of those who have great potential but who might never have considered it as an option. In this subtle way, the agendas of both the philanthropist and the children she serves are brought together. Her focus is no longer purely on education; it has shifted to focus on inculcating a change of mindset. That then becomes the desired impact – children making an informed choice as to what might be best for them.

What is common about case two and case three is that they have chosen what seems to be the most risky of all philanthropic impact: changing people's mindsets and their behaviours. The reason why they could successfully manage the risk posed to their philanthropy is that they reached a sufficiently deep understanding of what beneficiaries need, what they know, what they still need to know, and what the emotional, familial and cultural barriers might be for them to change their minds and ultimately their behaviour.

Achieving this level of impact maturity substantially reduces both strategic and operational risk.

### **4.3 Beneficiaries → System of Stakeholders**

Once philanthropists reach a system level of understanding of who their beneficiaries are and what they genuinely need, they can then focus on others who have the potential to influence the achievement of their impact or the reduction of their risks. In case one, local and national government was not one of the initial parties that concerned the philanthropist. However, once the nature of the impact became clear, it was identified that to bring the innovation to scale, significant engagement with government would be required. It is therefore important not only to consider other interested groups from the outset it is equally important to continue to keep the situation under review, adjusting the list as necessary, throughout the philanthropic process.

An awareness of wider groups that may be impacted by the innovation seemed particularly key where the philanthropist was dealing with socially sensitive issues and/or an established organisation's reputation was at stake. As one of our participants noted, even 'planting a tree is a political act'. On the basis of 25 interviews it is impossible to generate a comprehensive typology of third parties whose needs, attitudes, opinions and potential to influence would be worth monitoring, but the following emerged from our study:

- a) **Legal and regulatory bodies:** Local or district level law enforcement agencies who oversee the day-to-day operation of a philanthropic initiative, but also lawmakers at the highest possible level. Some interventions were ultimately only successful because of a change in attitude on the part of legislators and thus being cognisant of their attitudes and interests can reduce operational risk.

In order to establish this level of understanding, it is sometimes necessary to get to know key individuals from these organisations personally. Some of our interviewees managed the process of getting close to these groups by involving individuals in their project who were known to have ties to the relevant body. Our successful philanthropists were also quick to realise the limit of their influence so that they could anticipate and prepare for, the passage of any harmful regulations.

- b) **Commercial corporations and their lobbyists:** Our participants felt that while they had a good understanding from the outset of the corporate bodies who might be impacted by their intervention, it was not enough to simply identify them. It was also necessary to identify the lobbyists working for these corporations and to understand their methods of operation. Some of our participants had been caught off-guard by well-orchestrated communication campaigns whose purpose was to prevent or interfere with their work. They reported that they had initially thought that their programmes would be universally welcomed because of the benefit they would deliver to the community, only to find later that their activities had put them at odds with a powerful corporation. While some conflict can never be avoided, it can at least be planned for, particularly by building strategic alliances that act as a counter balance to that power.
- c) **Local civil society:** Important here is not only identifying relevant organisations and the nature of their influence, but also understanding their structural relationships with other bodies. Organisations and individuals capable of mobilising the community and instilling trust need to be identified, communicated with and potentially befriended. Our participants articulated the need to distinguish between opinion leaders with the capacity to lead the behaviour of others, from self-presented leaders who profess to speak for the community. The latter, while plausible, are not always as well placed as they may appear to help the philanthropist achieve their objectives.

This understanding again needs to be established early and continuously updated. It is important to establish channels of communication to elicit or hear their concerns, learn the role that they play in the community, how they serve community needs and what their comfort zone might be for collaboration. All this should be documented to preserve organisational learning as personnel come and go from the initiative.

d) **Local, national, regional and international media:** Risk can also be reduced by developing an awareness of the likely media interest in, and attitude towards, the philanthropic intervention. This knowledge too, needs to be as detailed as possible so that positive information may be strategically aired to the right audience and any negative publicity can be planned for, rather than simply responded to.

e) **International development bodies (e.g. INGOs):** It was interesting to note that many of our participants chose to serve (or had served) on the boards of local chapters of INGOs. This appeared to serve the dual purpose of 'learning the ropes' of the philanthropic world they intended to enter, but also to help forge alliances with those who might later be sympathetic to the work they were trying to accomplish. The learning and networks generated from such experiences were mentioned by many of our philanthropists as both valuable and nerve-calming when beginning their personal initiatives.

Overall, the philanthropists who found the management of the needs of these groups easier to accomplish were those who had existing social networks that encompassed their philanthropy. Philanthropists lacking those social networks appeared significantly less likely to tolerate risk. One way to systematically help philanthropists to take up more risk is thus to support them in identifying the right groups to reach out to (or take account of) and make the forging of key connections easier for them. The success of such initiatives will be a function of how targeted and specific they might be. Forums to discuss general development issues would not be effectual. Any intervention must be targeted to the very specific issues that a philanthropist is interested in and the very specific geographic regions where they are intending to operate.

We recommend that:

- a) Philanthropists be given access to case studies that illustrate how engagement with special interest groups can transform opportunities to create philanthropic impact. This will help sensitise philanthropists to the need to expend effort in identifying and reaching out to (or taking account of) each group to better manage their strategic risk.
- b) A network of philanthropists working in similar fields be established. This would permit the sharing of experiences and ideas of benefit to all, but it would be of particular value to those just entering the field. They could very quickly be apprised of relevant bodies to take account of and aided to form relevant networks. This would of itself make it easier to manage strategic risk, but extant research reveals an additional benefit. Individuals become more accepting of risk when they have the opportunity to discuss a given project with others (Stoner 1968).

## 5.0 Managing operational risk

In the previous section we focused primarily on the topic of strategic risk, examining the issues philanthropists typically face in defining and optimising that risk. In this section we move on to a more explicit consideration of operational risk and once again the issues that philanthropists must typically consider and manage. None of the operational risks we will describe, however, have been conceptualised, assessed or managed entirely in isolation from strategic risk by our interviewees. We will elaborate on why a differentiated conceptualisation and assessment of the two may sometimes be valuable and how the management of the two risks may be meaningfully combined.

Our interviews revealed seven primary issues of interest, namely:

- a) the selection of an appropriate business model
- b) the need to differentiate between strategic and operational risk
- c) the significance of a diversified risk portfolio
- d) mechanisms for sharing risk management
- e) the development of an organisational learning culture
- f) the role and development of trust and
- g) the creation and utilisation of a range of appropriate control mechanisms.

In the discussion that follows we discuss each in turn.

### 5.1 Selection of an appropriate business model

Key among the many decisions that must be taken will be the selection of either traditional philanthropy or the provision of social venture capital. The advantage of social venture capital over traditional philanthropy, according to our interviewees, lies in two areas, sustainability and scale.

One interviewee explained that he had been ‘pumping money’ into Africa for the best part of 50 years, but, as soon as his philanthropy stops, things immediately slip back to where they were. He felt that where a business option is available it can be a better route than philanthropy since it has the potential to motivate local participants to sustain themselves. Through the social venture capital model, the owners of local businesses are as motivated to make their enterprise a sustainable success as the social venture capitalist is to see the impact they can deliver. Once the motivation of local business owners is engaged and the business proves successful, social venture capital can then grow in scale, as others are motivated to get involved. An extensive consideration of the risk inherent in different types of social venture is beyond the scope of this text, but for readers who are interested, Appendix 1 contains a selection of relevant readings.

If a philanthropist decides that social venture capital is not the right approach, either to solve the issue at hand or for them as an individual, they need to decide between other philanthropic options. They can adopt the so called ‘write-a-check’ approach to their philanthropy or become a venture philanthropist who will engage more fully in the programme and monitor its progression over an extended period of time. Hybrids of the two approaches do of course exist, but they are beyond the scope of our discussion here. Key readings in venture philanthropy are provided in Appendix 2.

To decide on the optimum approach philanthropists need to conduct thorough research into the applicability of each business model, best practices in relation to each, and the culture and comfort level of their individual philanthropy. Even when the initial options have been explored with due diligence, there are still many factors that can later impact the implementation of strategy and call the selection of a specific business model into question. Thus one of the most important elements of risk management is a continuous monitoring of the efficacy and appropriateness of the model adopted.

It is certainly not news to philanthropists that these options exist but there has been surprisingly little research to compare the advantages and disadvantages of each in a meaningful level of detail. System level funding of research and the dissemination of results to the right communities could greatly increase risk taking and the success of risk management by informing the choice of business model. One valuable research question to address here would be – which model is more effective and efficient in achieving what kind of social impact in specific geographic and cultural development contexts?

## 5.2 Strategic versus operational risk

As the case below will demonstrate philanthropists must be clear about the difference between strategic and operational risk. Greater clarity is possible in respect of decision-making where they are considered separately and/or where the relationship between them is understood.

### Case four: A private foundation in Asia

This case concerns a private foundation in Asia whose objective is to help people in retail work improve their lives both at home and work.

They achieve this objective by developing and enhancing skills through relevant education and training, enhancing pride and respect, providing options for financial security and developing sustainable business solutions. The founder of the organisation has the philosophy that his life has comprised three stages: learning, leading and returning. After the successful completion of the earlier stages, he systematically planned his transition into the third stage of his life, for himself, his family and his business.

Before he started his foundation, he researched extensively the needs of the people that his organisation would serve and the best business and operational models that have been used by local and international NGOs serving similar needs. He designed a diversified financial strategy that would enable the foundation to sustain itself after the exhaustion of his personal wealth and he hand-picked the individuals to serve on his advisory board, his operational team, and his partner teams (comprising executives from related NGOs). Many of these individuals became involved because of the respect he had garnered personally through his success in business. He is now devoting his life to philanthropy and is comfortable considering the first three years of his engagement as an early stage experiment. He is content (and expecting) to adjust the course of his philanthropy as he learns more about what works and what doesn't.

In short, he is as prepared as any philanthropist could be in terms of his personal philosophy, his willingness to experiment, his family and business transition plans, and his plan for long term financial sustainability. None of this preparation, however, is sufficient to convince him that his philanthropy will create the desired social impact or that the impact will be sustainable after his savings are exhausted.

The reason for his discomfort we think is multi-faceted. First, he aims to create a highly complex social innovation system to increase the quality of life for a large population of relatively powerless individuals. Others have never attempted such a broad based innovation and thus any learning from the past is limited. Second, he is going through a re-learning experience in becoming a philanthropist and is thus participating in anchoring-and-adjustment on a daily basis with each decision. He is consciously modifying his assumptions about the impact that he aims to achieve and the nature of his beneficiary groups, what is needed, etc. As a consequence of this state of flux he has concerns over the real utility of his efforts.

A critical part of his discomfort stems from the conflation of operational and strategic risk. At this stage in the innovation cycle he is as yet unable to see any impact of his desired scale and is therefore unable to assess the appropriateness of the approach. This still gave rise to feelings of significant concern even though he had prepared in a practical sense in every way possible. We conclude that there may be a need to educate philanthropists in what to expect at various stages of the innovation cycle and thus to accept feelings of discomfort as perfectly normal in the early stages. They need to realise that at this stage in the innovation, operational and strategic risk are in effect combined and thus when the best operational strategy that one can possibly identify a priori has been implemented there is little else that can be done in anticipation of the early results. The proof of the concept and strategy only comes in time. The risk in this stage of the innovation cycle will quite naturally feel high. Managing the expectations of how individuals might feel at each stage in this cycle would therefore reduce emotional discomfort and make it more likely that the individual would persevere with a given course of action.

### 5.3 Diversification of the risk profile

Our interviewees also highlighted the need for philanthropists to actively consider the nature of their risk profile, in relation to both strategic and operational risk. Individuals with a wider range of activities were typically more accepting of risk. As previously, we use a case to illustrate.

#### **Case five: A family foundation in Asia**

At an institutional level, this foundation balances its philanthropic portfolio in such a way that it has a mix of high risk and low risk projects. The philanthropist refers to some of its projects as 'low-hanging fruit' where the outcome is easier to achieve within a short time horizon, is easier to sustain over an extended period and is perceived relatively positively by all the major special interest groups. Other projects do not necessarily meet all these criteria, but are chosen because of the potentially high impact they might offer.

These programmes also vary in terms of how many times and how successfully similar approaches have been tested by others in similar contexts before. For example, for some projects the foundation would need to invent a social innovation system, while for others it requires only a relatively established social impact system that has been thoroughly tested by others.

This philanthropist has many years of experience with managing risk in his philanthropy and is currently the president of his family's foundation. He attributes the historic success of their business model to his grandmother and the current operational success to the quality and efforts of his executive team. He jokes that he can afford to take substantive risks with his philanthropy, as he is only accountable to a small number of people who in his words 'cannot fire him, even if he does mess up'. This philanthropist therefore experiences little personal risk, although impact and operational risk is every bit as real to him.

We can employ agency theory to analyse the institutional and personal risks in this case and to articulate some general principles in risk management drawn from the design of his business model. Traditional agency theory developed in the business world suggests that owners who have a portfolio of shareholdings can afford to be risk-taking. They want managers to take risks because while some might fail, some can pay off spectacularly. Managers working in organisations, on the other hand, are risk averse. They manage only one business and don't want to lose their livelihoods. Similarly, philanthropists who have a broad portfolio of projects can afford to be risk-taking as they can spread the risk across their portfolio. Those with small or single portfolios, on the other hand will tend to act like managers – and not want to take risk. We thus recommend that individuals be encouraged to diversify their portfolios or perhaps work with others to share the risks involved in working on a particular issue. The idea is illustrated graphically in Figure 3.

		Number of philanthropists working on an issue	
		Small	Large
Philanthropists' portfolio	Concentrated	Cell A High risk for all parties	Cell B High risk for focal philanthropist, low risk for others
	Diverse	Cell C Low risk for focal philanthropist, high risk for others	Cell D Low risk for all parties

**Figure 3: Diffusion of risk**

Figure 3 contains no new thinking per se. The smaller the number of philanthropists working on an issue, the higher the risk is. The more concentrated one's philanthropic portfolio, the higher the risk is. The riskiest philanthropy lies in Cell A where an individual philanthropist concentrates on issues with only a few other actors in the field. What is new from our research, however, is insight surrounding the mechanism by which philanthropists might reduce their impact and operational risk in each of the four scenarios.

Regardless of how many others are supporting the same cause, if philanthropists can be encouraged to develop a diverse rather than a concentrated risk portfolio they would take more risks overall. This does not necessarily mean that a philanthropist cannot have a concentrated mission in their philanthropy. In this family foundation's case, for example, the mission is focused on the theme of radical philanthropy.

Where a philanthropist does have one concentrated cause that few others support (Cell A) we would encourage them to think of each component of their overall strategy separately when it comes to managing risk. It may indeed be the case that the uniqueness of the organisation's impact comes from the combined effect of all the components of its operation being successful, but this does not mean that the operational risk of the organisation must be managed holistically. There are real benefits that accrue from disentangling the various components of the operational strategy because in effect the philanthropist gains a portfolio.

Thinking in this way the he can then afford to take risk with one or more of the components of his approach thus increasing the operational risk in some areas, but reducing his impact risk overall.

When there are only few philanthropic organisations involved in each type of philanthropy, the risk is high. As a way of reducing risk, a philanthropist might team up with others to increase risk sharing. Others share in the project and the philanthropist can share in the projects of others. This transitions the philanthropic profile from Cell A to Cell D in Figure 2. Where this isn't an option, additional risk sharing could occur between the board, the president and the executive management team. This does not necessarily mean a split in responsibility, rather an agreement on what the risk comfort zone should be for the leadership team as a way of offering risk-bearing support. In the family foundation situation, risk sharing takes place among family members to reduce their individual perceptions of risk. We will explore other dynamics of this sharing mechanism in greater detail in our next case.

When all else fails, it is again important for philanthropists to frame their philanthropy in the context of potential gains, instead of losses. In doing so, they can persevere in their risk taking in the face of short-term setbacks. This is particularly important for a philanthropist engaged in the early stage of an innovation cycle. Several of our interviewees noted that they never felt insecure in their giving when they realised they could learn from their failures to potentially do a better job in the future. The key lay in establishing learning mechanisms so that the opportunities for learning were not lost. Documenting and disseminating this learning should be supported system-wide.

## 5.4 Shared risk management

Like-minded philanthropists coming together may achieve something beyond the reach of each of them working individually, because as one interviewee noted ‘group decision-making is often better than individual decision-making’. Not all groups can make better decisions than individuals, and a group cannot always make better decisions than each individual within a group, but on average groups achieve better results than individual group members and they achieve those results faster. (Lebiere 2012). Our interviewees noted that their groups could share both impact and operational risks. The discussion taking place within the group context helps each individual to analyse each philanthropic case from multiple perspectives and thus increases the likelihood that optimal approaches are considered. The discussion also reduces the anxiety for individuals and thus makes any risk-taking more comfortable.

A large literature exists on group decision-making, leadership dynamics, and collective action which might inform an understanding of shared management in philanthropy. Work in the specific domain of philanthropy is sadly lacking, however, and additional contextualised research would therefore be valuable.

The following case illustrates how shared a shared approach to risk management can offer genuine utility.

### Case six: An informal philanthropy network in Asia

This case concerns a group of six individuals all of whom have self-earned wealth. They decided to come together to put the money to good use and to have some fun along the way. The rules of the group are simple but strictly reinforced, each person may champion a cause that interests them, but all members of the group must agree on the cause that will ultimately be funded. While they may weigh in with their opinions, all members commit to expending effort to reach a unanimous decision. This may involve many hours of discussion or making a number of field visits to particular projects.

All members of this group have earned their wealth in different types of industry. All of them knew the organiser of the group but not necessarily each other at the beginning of the initiative. All members joined the group with their own preconceptions about how to do philanthropy. Half of the group has extensive experience in the philanthropic sector while the other half is new to it. As a consequence of this mix of both experienced and new philanthropists, a mentoring process occurs naturally within the group and becomes interestingly, a process where both parties would appear to benefit. New philanthropists benefit from the experience of their peers, while the more experienced members of the group benefit from being compelled to think through and articulate the key elements of strategy that have contributed to their past successes and failures. This latter process was perceived as contributing to their philanthropic maturity.

We believe that there may be merit in replicating aspects of this system for the general population of development philanthropists. Those new to the field could expedite the learning process by drawing on the experience of others, who would in turn benefit from the experience in becoming more reflective practitioners. But the gains for both groups would require a commitment of time. Mentoring and decision-making processes are usually too complex to be engaged in by telephone or email and thus commitment to face-to-face meetings would be critical to success. These decision-making processes may also require all members of the team to commit to field trips or site visits. We will elaborate later on how this peer system may become even more effective through the addition and integration of underpinning knowledge frameworks.

One of the key functions performed by leaders of such groups is to facilitate the transition between people's previous business experience and their new role in philanthropy. To achieve this it will be necessary to encourage reflection on the principles of 'anchoring and under adjustment' and 'prospect theory' that we referred to earlier in this report. The transition from business to philanthropy and the adaptations in thinking required are not only intellectually complex but also emotionally difficult. Group leaders can facilitate the intellectual transition and minimise the emotional difficulty that might otherwise be encountered working alone.

The last key outcome of this group process is to maximise the possibility of finding the most sustainable solutions for a given social problem. The example this philanthropist used is a project where they were looking to support a church. In order to make this project possible, all six of the group got into a plane and visited the site. The church was planning to secure funding to erect a new building on its land, so the easiest solution in that situation would have been for the six of them to come together and donate the requisite monies.

Their discussions prompted the group to consider a more systemic approach to the problem and they opted instead to provide funding for educational support to the church so that it could send two local church members to obtain the latest training in fundraising. In doing so they grew the long-term capacity of the church to fulfil its own mission. It is of course quite possible that one philanthropist working in isolation could have derived this solution, but with the additional expertise of their peers and the ensuing discussion, the likelihood of innovation in strategy development was greatly enhanced.

## 5.5 Organisational learning culture

We have highlighted many times in this report the critical nature of learning as a way for philanthropists to more effectively assess and manage risks in their giving. Learning in relation to the nature of the beneficiaries that should be addressed, learning as to the interventions actually required, learning about the risks perceived by focal communities and so forth. In this section we extend that debate to examine learning at the institutional level. As the next case will shortly demonstrate, institutional learning can also alleviate risk, but it can only occur where it is explicitly integrated into a non-profit's operational strategy and culture. Some of the largest foundations in our sample actively adopted this approach in their grantmaking process. In this case we will examine the establishment of an institutional culture of learning within a start-up non-profit organisation working in a post war environment.

### **Case seven: A post war advocacy group for philanthropy**

In this case a group of young people came together to discuss how to address education, health, social and political problems in their post-war society. Their different educational and working backgrounds provided them with the opportunity to uniquely contribute to the group and to learn from each other. Political reform in their country allowed them to consciously reflect on what impact their collective actions might make in a fast-changing environment. Learning thus became part of the outcome of their strategic planning process and each group member took ownership of it when it occurred. While this aided future decision-making it also added to their shared sense of ownership of the initiative because they had all shared in the creation of what was ultimately a successful innovation.

At one point the goals of this organisation were to raise an awareness of philanthropic activity and to have an open discussion with private businesses about philanthropy so that they could support non-profits to achieve financial independence from international institutions. Given the nature of the political environment, both goals were challenging and thus impact risk was perceived to be high.

The level of impact risk was also heightened because of confusion over the definition and role of philanthropy in their national culture. It turned out that the organisation needed to work with two schools of thought about what philanthropy should do. The first school believed that philanthropy (in the traditional model of charity) should only address immediate needs, while the second school felt that it should be more systematic in aspect and treat the root causes of a problem rather than just its symptoms. The organisation concluded early in its operation that it was of strategic importance to openly communicate with those taking both perspectives. They reasoned that they could not afford to take a stand on these issues and risk alienating certain aspects of society.

In order to acquire the capacity to effectively work with both perspectives, the organisation reinforced the learning culture that originated from the founding group members and talked to as many actors as possible in order to develop their understanding of the current knowledge and thus information needs of both groups. Actively seeking this information and monitoring shifts in attitudes was absolutely critical to their success. They therefore embedded their learning culture in their strategic plan for achieving their organisational goals. As an example, they expanded their original target of talking to 15 local businesses to over 100 as part of their annual strategising process.

The academic literature in organisational learning could inform how a learning culture might be embedded in development philanthropy. Additional research would be helpful to understand what kinds of institution might require particular forms of learning and how structural changes in the learning system adopted might facilitate the reduction of impact and operational risk.

## **5.6 The role and development of trust**

Our interviewees repeatedly touched on another theme discussed during the original Bellagio Summit and that is trust. They considered trust an important asset that has the potential to increase impact and reduce operational risk. There are many definitions, but trust is usually held to be: 'a generalised expectancy held by an individual that the word of another...can be relied on' (Rotter 1967, p651).

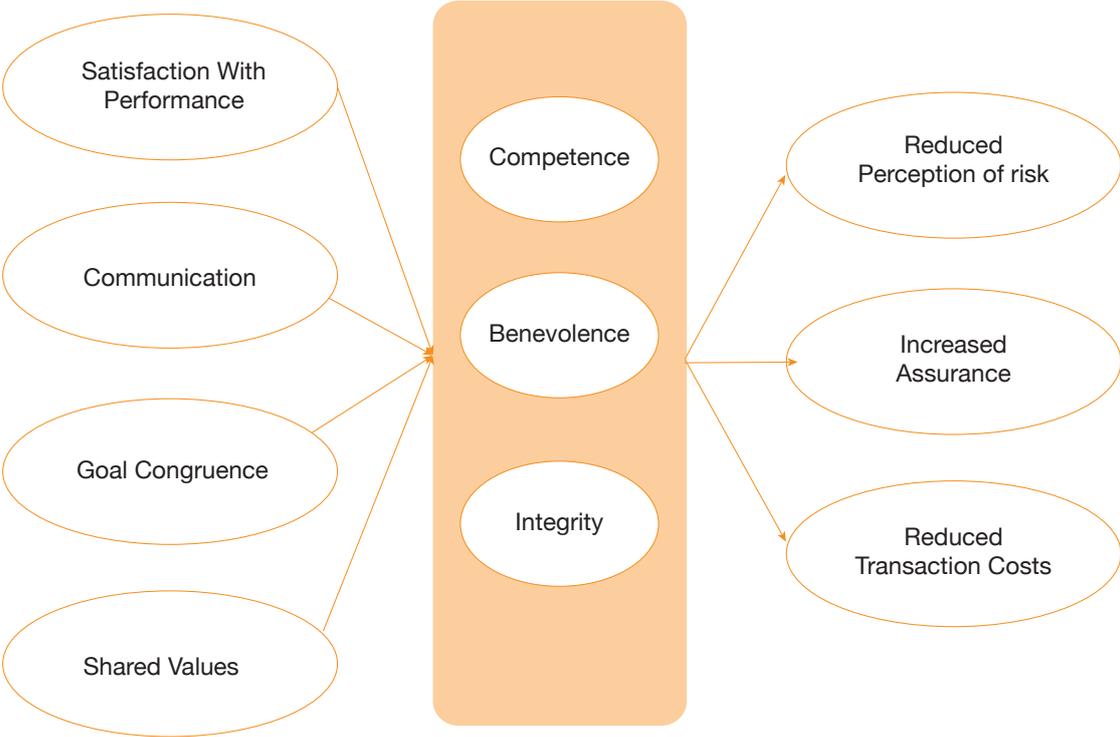
Two different categories of trust matter in the context of development philanthropy. First, there is the trust that philanthropists seek to gain of their beneficiary group. Success in garnering trust greatly increases the likelihood that communities will engage with the non-profit organisation and participate in its programmes. Potential beneficiaries develop greater assurance that a genuine change will result, see less risk in engaging in the project and are more enthusiastic about their engagement. Where trust is present, the impact risk is therefore substantially lower.

Second, there is the trust that non-profits want to build on the part of potential investors or donors. If the organisation is deemed worthy of trust it is significantly more likely to be able to generate the requisite funds needed from philanthropists, governments, or multilateral bodies to implement its programmes. In the presence of trust they perceive lower impact risk and develop increased confidence that sustainable change will result. Transaction costs are also lowered for them since the need for elaborate control mechanisms is reduced.

It was also clear from our interviews that trust was best regarded as a multi-dimensional construct as illustrated in Figure 4. When philanthropists used the term to describe their relationship with an organisation it was perceived as trustworthy when they believed that it

- a) had the competencies necessary to deliver impact,
- b) was primarily motivated by the need to do good, and
- c) that in achieving this good it would act in accordance with a congruent moral code or set of ethical principles.

**Development Trust**



**Figure 4: A multidimensional model of trust**

Interestingly, the same dimensions of trust were felt to be relevant for members of a community in their development of the trust in a sponsor organisation and in this context there are also two categories of trust that should concern us. The first is interpersonal trust which can exist between members of the communities benefitting from a social programme and individual members of the development team who are actively involved in its delivery. The second is a more general form of trust that communities have in the organisation as a whole. Both are highly significant in reducing impact and operational risk and both have similar antecedents that need to be actively addressed and managed. These are also depicted in Figure 4.

### **Case eight: An African community foundation**

During our interviews we discussed the case of an African community foundation. Trust building was an explicit part of its operational capacity building because it recognised that it was crucial to the success of its mission. This capacity building effort centres on earning the trust of the diverse group of communities in which the foundation and its programmes operate. Here the interviewee recognised early that to gain trust, the organisation would need to demonstrate tangible gains to those communities very early in the relationship. These gains, however, needed to have immediate relevance to the genuine needs of the communities and she therefore worked to open up avenues of communication to identify exactly what these might be and to align the goals of the foundation with the goals and values of the community. The establishment of good communication channels also made it possible to receive and process feedback about the progress of the initiative and to open a dialogue on the steps that might still be necessary. It also made it possible for her to see risk from the perspective of the community and to understand what difficulties people might face in engaging.

The academic literature on trust makes it clear that many of the same variables are equally relevant in the context of inter-personal trust. Trust is built where people are satisfied with the work of specific individuals and feel they can approach and communicate with them. It is also built where both parties appear to share the same goals and values (see for example, Moorman et al 1993, Ganesan 1994 or Doney and Cannon 1997). In this case the philanthropist expended considerable effort in identifying all the relevant parties in the community and developing a plan to foster trust with each. This included, for example, making sure that programme staff met key individuals, were on hand to meet and greet them when they visited a site and made arrangements to keep them in touch with progress thereafter.

We were struck in our interviews with how important trust was perceived to be in the development process. We were also struck by the fact that despite its importance many of our interviewees struggled with trust in the context of their relationship with potential non-profit partners and how best develop it. When pressed they would talk in terms of the importance of establishing and implementing accountability and control mechanisms, yet these are not mechanisms for the generation of trust per se, they are separate confidence based mechanisms necessary in the absence of trust. In our view successful risk management requires an amalgam of trust and confidence based measures, but philanthropists seem more focused on one than the other. They would be inclined to take greater risk were they to pay more explicit attention to fostering trust and thus many of the antecedents depicted in Figure 4.

## 5.7 The role of control

The final element of successful risk management highlighted in our interviews was the creation of appropriate control mechanisms. Controls were perceived to be important where there was little basis for trust, a strong desire to make the management accountable or when the interests of a diverse group of stakeholders required protection. Our final case illustrates the folly of giving inadequate consideration to control.

### **Case nine: A non-profit community centre in Europe**

Our last case focuses on a group of four businessmen who wanted to create a non-profit in an economically disadvantaged urban community. It was planned that the non-profit would convert a historical municipal building into a multi-functional community centre. The majority of the revenue for this project would come from operating a conference centre that would host events for other non-profits. From the outset it was established that an occupancy rate of 70-80% would be necessary to break-even. During the first three years of the Centre's operation the actual occupancy rate stood at around 20%. It has been in the red since its establishment and has survived only because of the willingness of a steady stream of individual philanthropists to continue investing in it despite seemingly high operational and strategic risks. How could this happen?

Each of the four founders of the non-profit had an average of twenty years' experience as successful local business owners or senior government employees. When they elicited funds for their non-profit, they had a strong record of personal success in their chosen domain, but they lacked evidence of a willingness to serve the public good. They leveraged their existing connections with regional government to secure a long lease of land and facilities at a one-off token price.

They also successfully leveraged their reputation to secure large grants from two distinguished national and international foundations. These two streams of income together made it possible for them to take a convincing case for support to a small number of individual donors to provide the necessary balance in order to start their venture. Despite the fact that substantive sums of money were involved, all the major funders failed to establish meaningful controls, relying solely on their trust in the individuals involved.

The national and international foundations only required the non-profit to provide information that they had met their programme objectives. These included a functional daycare and gym, accessible to the local community and employment opportunities for locals and especially local minorities. Although a sustainable revenue structure was part of the funder's requirement it was not subjected to robust, independent stress-testing. The same was true for regional government, since once the long lease was signed and a token price paid, it had very little interest in, or control over, how the non-profit might be kept sustainable. The individual philanthropists fared no better because of their reliance on trust, despite there being no evidence of a commitment to serve the public good (a key dimension of development trust in Figure 4). Their trust was driven only by flawed perceptions of competence drawn from another domain and from the obvious support for the enterprise from foundations and government.

The problems in this case were further compounded by the fact that the founders of the organisation became the executive officers of the charity heavily influencing the selection of the chairman of the board and other board members. As a result, the appointed chair was weak and the board largely ineffective, exerting very little control of its own over the executive team. As a consequence they were never held to account for their level of compensation, their flawed business objectives or the lack of sustainable impact in the community. Nor indeed were the executive held to account for their failure to implement firm proposals from investors regarding cost-cutting and other changes to the business plan.

The learning from this case is multi-faceted. First, philanthropists need to understand the precise roles played by other foundations and government agencies in the context of their work; in this case what the local government and other foundations had at stake and what they would expect as acceptable outcomes from the non-profit. If a major concern is not addressed such as how sustainable the business model might be following the completion of a grant, they need to exercise caution. In this case the support of local government and major foundations did nothing to reduce the impact or operational risks for the individual philanthropists. In fact, they worked against them in the following sense. The non-profit managed to convince their international and national funders that they had met the programme objectives for their grant. It then used this information to solicit new donors citing extant funding as evidence of the organisation's legitimacy and deflecting attention from the absence of a sustainable business model. The approach made it very difficult for new funders to adequately assess their level of risk. It therefore seems clear that control of philanthropic funds should not be released until successful, mutually-agreed business and operational plans are in place and on-going support should be contingent on successful adherence to these plans or appropriate adjustments to them.

Philanthropists must also consider the appropriateness of governance structures to local conditions. Neither this, nor the need to track performance against a given business plan are in any sense obvious. It also isn't clear how individuals should assess trust in this context. At least one of the dimensions highlighted in Figure 4 was lacking and the competence relied upon was drawn from completely different sectors. A greater degree of reflection on the part of the individual philanthropists would have specifically highlighted why a reliance on trust in this case was singularly inappropriate. All these issues could be potentially included in a formal body of knowledge for philanthropists, so that they might be better prepared for the practice of their philanthropy.

The case also highlights the fact that for a non-profit to be transparent is not in itself enough. The non-profit in this instance was perfectly open about its finances and the fact it was firmly in the red. Indeed, it merely leveraged this fact to its advantage in securing additional monies. Philanthropists therefore need to be clear about what they expect to be transparent. In this case the business model was opaque as was the nature of the impact on the local community.

The establishment of control mechanisms is something that established foundations have much more experience of and expertise in. However, it did not seem to us that their knowledge has been leveraged for the benefit of others working in development. This again highlights the need for a new system-wide learning structure and culture that could facilitate knowledge transfer.

## 6.0 Scaling up strategic and operational capacity

The theme of learning has been highlighted many times in this report, yet we were struck in our interviews of how few formal opportunities there appeared to be for our interviewees to learn either from each other's experiences or from academic frameworks or models that might aid them in the conceptualisation and management of risk. There were many common threads that emerged from our interviews, highlighting the potential utility that would be offered by an underpinning body of knowledge that could be offered to all new philanthropists or foundation officers setting out on their journey. While the challenge offered by attempts to solve the world's most intractable problems may have drawn many to our sector, it seems facile to suggest that every problem should be addressed afresh with no reference to existing learning or experiences. If as a community philanthropists are serious about wanting to tackle development problems then a way must be found to define relevant knowledge and ensure it is disseminated to all who might benefit from its application.

A new Association of Professional Philanthropists could map out key competencies for philanthropists, decide on the underpinning body of knowledge that would be required to support those competencies and identify the additional networks and support that might be helpful in assisting individuals to reach an appropriate level of competency. While practitioners must obviously take the lead, this professional infrastructure must not be developed by philanthropists or their advisors working in isolation. To be effective, academic input must also be sought to identify relevant theories and frameworks from a variety of different disciplines and to work to contextualise this knowledge to the domain of philanthropy. As many of our interviewees noted, knowledge from disciplines such as economics, psychology, sociology and marketing might be helpful but it must be adapted or translated in order to generate real value for them in their day-to-day operations.

In order to support this model, a professional body could also conduct its own research and actively build new theory in disciplines that could be of value to philanthropists. It could also conduct a periodic review of new work that could potentially offer value. In the current report we have already demonstrated the utility of prospect theory, anchoring and adjustment, and the broader literature on organisational learning and trust/confidence. Since we were focused quite narrowly on risk, it is possible to imagine a much wider body of knowledge that could potentially offer value for individuals working in or entering the field of philanthropy. New research with the potential to inform philanthropy is appearing on a regular basis and it deserves to be integrated.

An association might also offer training and educational opportunities. These opportunities might include the development of formal educational qualifications, but more likely could embrace certification or credentialing opportunities of relevance to philanthropists and foundation personnel directly involved in grantmaking.

We are aware that many organisations would currently lay claim to providing at least part of what we describe here. What is new about our proposal is the notion that development philanthropy should now be established as a profession in its own right, with the kind of dedicated support infrastructure and rigorous academic underpinning that is currently available to other categories of professional. To be successful, however, such an initiative must of course be owned and led by those actively involved in the endeavour and thus well placed to determine the needs of their peers.

## 7.0 Conclusions and recommendations

### 7.1 Categories of risk

Strategic and operational risk are the primary concerns of philanthropists engaged in international development. Together they are the primary components of impact risk. Other risks identified in our interviews were financial, reputational, political and personal risks. However, these were rarely considered as important and typically only became a concern because when they were perceived as increasing either strategic or operational risk.

### 7.2 Risk assessment

Individuals anchor their risk assessment in philanthropy on their past professional and personal experience. In becoming a professional philanthropist or grantmaker, they need to properly overcome the 'anchoring and under-adjustment' heuristic and adjust properly to the context of each giving decision. We have suggested three ways in which this might be accomplished; encouraging reflection on the fact that anchors exist, the provision of new anchors, and the selection of projects where one's existing anchors might be more appropriate. In the case of the latter solution, individuals can then be encouraged to take risks that are progressively outside of their comfort zone.

Donors have high sensitivity to probabilities close to impossibility and certainty. However, much of giving focuses on bringing a project with a high probability of success to certainty, instead of bringing an otherwise impossible project to a slight chance of success. We suggest that greater attention be played to the latter, with non-profits framing their need to take account of individual sensitivity to probability where the value is close to zero. Emphasising the unique contribution that a specific individual might make and tailoring the approach would increase risk taking.

Individuals are more sensitive to perceived losses than they are to perceived gains. This matters since they also expend significantly less cognitive effort in identifying their gains. To take more risk philanthropists need to be encouraged to reflect on why their philanthropy is intrinsically motivating to them and thus identifying all the gains it delivers. This conclusion is equally relevant to the domain of foundations, since there are benefits that can accrue to the institution from giving notably the learning, skill development and enhanced networks that may result. These gains too should be quantified to facilitate greater risk taking.

Individuals should also be persuaded to invest the time necessary to gain domain specific knowledge before participating in philanthropy. They need a fundamental understanding of how it might differ from others they have worked in and thus how they can adapt their previous knowledge, competencies and networks to greatest effect. Those taking this time will be better equipped to take decisions and tolerate a higher degree of risk.

There is a similar need to ensure that those new to philanthropy recognise their natural aversion to ambiguity. While it will be perfectly natural to seek out anchors to use in reducing that ambiguity, in the context of social innovation it will be highly unlikely that appropriate anchors will exist. Where this is the case it would be better to avoid comparisons completely than to take decisions based on inappropriate data.

### 7.3 Strategic risk management

Philanthropists and philanthropic organisations should be encouraged to engage in systems and stakeholder analysis in designing strategies for risk management. This moves beyond a narrow understanding of impact and strategy to include a broader consideration of all stakeholders and forces that will affect the implementation of a project. In so doing they will expedite the identification of other relevant actors whose needs should to be addressed to realise impact. Only when all stakeholders have been identified can strategic risk be satisfactorily defined and managed.

Philanthropists can also learn much from the field of social marketing and in particular from a shift in focus from a sales-oriented philanthropy to a market-oriented approach. Rather than sell ideas to communities, it is better to embed themselves or their organisation in those communities and take the time to learn about the genuine needs of the beneficiaries and any risks they might experience as a consequence of engagement with the initiative. When impact maturity is achieved it becomes much easier to manage the associated risks for both parties to the exchange.

Given that it takes time to develop a detailed understanding of the needs and sensitivities of beneficiary groups, it may be better to take a segmented approach to the achievement of impact, making small incremental gains that facilitate the learning necessary to target larger impact in the later stages of a project.

Managing strategic risk is also greatly facilitated by the development of an understanding of the other groups who can potentially influence impact. Philanthropists should therefore consider spending a significant portion of their time building personal and professional networks related to their philanthropic interest, so they can more accurately identify the relevant parties.

We also recommend that philanthropists be given access to case studies that illustrate how engagement with special interest groups can transform opportunities to create philanthropic impact. These cases could form part of the wider body of knowledge that we feel should now be packaged and made available to philanthropists and grantmakers.

A network of philanthropists working in similar fields should be established, to permit those new to the profession to learn from the experiences of others and to be supported in their decision-making. The ability to reach out and discuss with others would improve the quality of decision-making through the transfer of knowledge, but the process itself would also lower perceived risk as people are facilitated to share the issues that concern them.

## 7.4 Operational risk management

It is also important to distinguish between operational and strategic risks. The criteria used to assess and manage operational and strategic risk will vary from context to context and by the stage in the innovation cycle. We now understand a lot about how perceptions of these risks might be expected to change and therefore what would be a normal experience for a philanthropist. Preparing them for what to expect would lower the psychological distress that might otherwise be experienced and increase risk taking as a consequence.

Where possible, philanthropists and philanthropic organisations should be encouraged to develop a diversified risk portfolio. A more diversified risk portfolio permits greater acceptance of risk in an additional project. Where philanthropists must have a focus on one issue or cause supported by very few others, they should be encouraged to view each component of their strategy separately when it comes to managing operational risk. In this way they can afford to take risk in some aspects of their approach and reduce their overall impact risk as a consequence.

Mention has already been made of support networks that might be facilitated for philanthropists. They have a role to play too in the management of operational risk since mentors could greatly facilitate and expedite the learning process. While a significant investment of time would be required for both mentor and mentee, we have demonstrated that substantive benefits can result for both parties. Notable here is the opportunity for mentees to learn how to adapt their knowledge, competencies and networks to the new philanthropic environment.

While individuals can learn in this way, a further critical way of reducing risk was for their organisations to learn too. For operational risk to be managed successfully, a culture of learning should be supported through an organisation's strategy – i.e. learning is perceived as the vehicle through which impact will be achieved, rather than merely as a consequence of it. This learning needs to take place at the organisational level, but it would also benefit the sector as a whole if there were to be a mechanism for collating it and disseminating it to others who might benefit.

Philanthropists need to develop a strong understanding of the distinction between trust and confidence and understand the role that both can play in reducing operational risk. Interpersonal and organisational trust both play a role in reducing risk for parties to the exchange, lowering transaction costs as there is less need for reliance on formal control mechanisms. It is however, critical that philanthropists learn the nature of development trust and thus the circumstances under which trust will be appropriate.

In addition to building trust, rigorous control procedures should be developed to instil confidence on the part of philanthropists and beneficiaries that appropriate outcomes will be achieved. These control procedures should be designed and implemented in ways that reinforce rather than undermine trust. Such control mechanisms must be precisely aligned to impact, so the measurement provided is meaningful, timely and accurate. The management of operational risk is greatly facilitated where information is readily available and corrective actions can be taken as necessary.

To facilitate the development of appropriate control mechanisms we would also recommend that philanthropists new to development be appraised of the roles played by different categories of funder and thus the controls that each of these players will be likely to implement. In particular they should have a thorough grounding in the issue of sustainability and understand who has an interest in this and the controls that can be instigated to ensure it is delivered. The topic of governance and the strengths and weaknesses of models common to the focal region would also make a valuable addition to the philanthropic body of knowledge.

## 7.5 Philanthropy as a profession

It seems clear from the foregoing that a discrete body of knowledge now exists that may be valuable to philanthropists. We have highlighted the utility of extant risk theories and a working knowledge of how the non-profit sector might be different from business and the public sector. While many talented individuals can and do find their own way in philanthropy there are presently only limited mechanisms to allow them to learn from the experiences of others or to reflect on their personal approach to giving, using appropriate theories and frameworks. It seemed clear from our interviews that doing philanthropy well requires a distinct set of skills, knowledge, competencies and networks that may or may not overlap with what can be gained from the philanthropist's existing professional or personal experiences. To engage in an appropriate risk assessment and optimise philanthropic decision-making, individuals should be able to access a body of knowledge that would help them to do that well. The time may well have come for development philanthropy to be considered a profession, with its own curricula, professional association, credentials and support networks. Individuals exposed to the relevant thinking and body of knowledge will be much better placed to avoid the pitfalls of the past and to engage successfully with appropriate development risk.

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# Appendix 1

## Interview guide

The following interview guide was sent to participants in advance of their interview:

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The purpose of the interview is to explore how philanthropists conceptualise risk and the strategies they have employed in order to take and manage risk in their giving. We hope to identify the major barriers that philanthropists feel need to overcome in order to take risks and outline the processes through which different choices can be evaluated.

In preparation for the interview, we would like you think about how you conceptualise risk and one example in your philanthropy where:

- 1) You deliberately took a higher than normal level of risk. What concerns did you (or your team) have at the time about engaging in that level of risk and how did you overcome them?
- 2) You had to cope with a difficult consequence of having taken a risky decision. Perhaps a project failed to achieve its stated objectives, or there was an unintended consequence of success? We'll explore how you dealt with this consequence and its impact on your subsequent thinking.

We will begin our interview though, by learning more about the nature of your personal philanthropy. We'll then ask you to briefly describe one of the scenarios above and outline the risk(s) involved. We will then spend the majority of the time during our conversation exploring in detail how each scenario played out. In doing so, we will create a 'thinking map' of how you accomplished risk taking or successfully coped with the consequence of risk-taking.

It is possible that we will only have time to thoroughly analyse one philanthropic situation together depending on the complexity of the case. For this reason we'll give you the option of beginning with the scenario that you feel had the greatest impact on shaping your personal attitude to risk.

The interview will close with a short discussion of what you see as the role of risk in philanthropy and how you feel that philanthropists might be encouraged to take more risks with their giving.

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## Interview approach

We adopted an interview technique termed 'Decoding-The-Discipline' (Pace and Middendorf 2004). This approach assumes that people who are expert in their field become experts because they are extremely good at what they do (in most cases, solving problems). One consequence of being extremely good, however, is that the thinking process used to become an expert becomes so natural that individuals rarely need to think about how they do things or reflect on the major barriers that must be overcome in order to accomplish a goal. It just becomes second nature to them.

What this interview technique does is help us analyse philanthropists' thinking processes on a deeper level. The key during this kind of interview is for us to quickly get to a barrier that philanthropists need to overcome in order to achieve a goal. In most cases we got to this barrier during the first five minutes of our interview, by asking them what the biggest risk was that they had encountered in their philanthropy. Once we identified the barrier it was possible to probe their process to overcome it in significant detail. That then becomes the focus of the balance of the interview.

Since the barriers are a little different for everybody, the questions we ask are different for each person. At the end of all our interviews, we begin to see commonality in the barriers and as a result, we generate a list of standard issues to address in respect of risk and how to properly engage philanthropists in thinking through the level of risk they might be willing to take in their giving.

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### A practitioner's review

As someone who has been in the development field for over three decades, and received the whole range of funding – from straight grants to programme related investments (PRIs) in the form of soft loans; moving into the world of social enterprises, raising equity from social investors and then leveraging it with commercial debt from development finance institutions (DFIs) and regular banks – I have often had to deal with the issue of risk perceptions of philanthropists and investors. I have also had the opportunity to advise some of the biggest philanthropies in India and the US in formulating their programme strategies and have seen the issue from the other side. It is in this context that I read the above paper with great interest.

The paper begins by describing various kinds of risk – impact risk, operational risk, financial risk, reputational risk and personal risk, but folds the last three into the first two. Interestingly, the paper does not define risk anywhere, presumably because all of us have an intuitive definition. Nevertheless, I would like to begin by distinguishing between mere uncertainty, which may be disconcerting, and risk, where there is a financial loss in an adverse event.

Now, if a philanthropist in the first place was going to give away their money, what difference does it make to them if there is a loss? In this particular situation we can use the concept of impact risk – the philanthropist gives to make a difference to some human condition that they wish to improve. So if there is no impact or far less impact than expected, this creates an 'impact risk' – the money given away did not achieve the results for which it was given.

It would have been of great interest to me if the authors had also talked of 'attribution risk', as I have seen a number of philanthropic organisations concerned about this issue. By attribution risk, I mean that the impact of any philanthropic action is not adequately attributed to it. This can happen because a number of philanthropies, development agencies, such as the World Bank and the UNDP, as well as national governments etc may all be working on the same complex developmental issue simultaneously and it therefore becomes hard to attribute any specific improvement to any one of the actors. In a sense, this is the opposite of reputational risk, where a specific philanthropy's name gets embroiled in a controversy. Under attribution risk, the contribution of the philanthropy goes unknown or at least, unsung. Who, for example, will be able to claim the credit for the success of any one of the Millennium Development Goals, even if they are achieved?

The next section of the paper deals with risk assessment, where we are offered a theoretical framework – that of the Prospect Theory of Tversky and Kahnemann, for which they got the Nobel Prize in behavioural economics. There are several important building blocks of this theory:

- The first is the notion that all of us have a prior reference point (called anchor) for the value of any variable and that our assessments may be clouded by this bias or anchor. The philanthropist also has such biases and this affects his willingness to take risks.

- The second notion is one of the asymmetrical 'value function', whereby the extent of deprivation felt for a loss X is higher than the extent of fulfilment felt for the same amount of gain X. This makes everyone, including a philanthropist, more sensitive to losing (not making an impact) than to gaining (making an impact). This is what drives a great deal of philanthropic behaviour towards safe bets e.g. money spent on education and healthcare rarely goes to waste, although initially the lack of these represent state failure. However, one comes across scores of cases where philanthropists will finance schools and hospitals but not advocacy groups which wish to influence governments to spend more on education and health, and spend what it does already, more effectively. So even though I have believed in the power of policy advocacy for change, I have been able to raise money for it mainly along with 'programme delivery' funding. The naive philanthropist sees that the programme delivery will bring enough good marks, so that even if the advocacy does not work, the net effect would be positive. The astute philanthropist, on the other hand feels that the advocacy efforts of a programme implementing organisation will be more well-grounded and thus heeded.
- The third notion is that we tend to have a greater sensitivity to changes in probability in two zones – the zone of very high probability (90% or above) or the zone of a very low probability (0 to 10%), rather than to the zone of a more moderate probability (10-90%). The reason why a philanthropist would support a cause which has a high probability of success is easily understandable – it has a low chance of failure, and their giving would further enhance the chances of success. So 'risk averse' philanthropists would prefer this.

So how can we motivate philanthropists to contribute to causes with a very low probability of success? This is linked to the 'attribution' effect that I discussed earlier. If some philanthropists make a contribution to a cause which has a low probability of success, the chances are that hardly anyone else will be supporting it. In the event that the cause succeeds, it will be easily attributable to that sole philanthropist. Thus this zone would appeal to those philanthropists who are looking for a niche, and reducing their attribution risk. They don't have to be risk-takers to support causes with low probability of success. Does the quest for the AIDS vaccine fall under this category?

One of the issues that I have faced, quite honestly, is that the relatively new philanthropist often knows much less about the field in which I am working than I do, yet, one has to take into account his proclivities. These are not always tangential, but when they are, it can be a problem. Beyond a point, it is hard for a potential grantee to educate the funder. The paper is full of a number of practical suggestions to ensure that philanthropists learn and make adjustments in their anchors. A simpler way to present this concept from behavioural economics would have been to enable philanthropists to overcome their biases. Many of these they may have acquired in the course of their professional careers (e.g. stay away from governments), or in the early stage of their philanthropy (e.g. vow, microcredit is the answer to poverty). The authors make useful suggestions to make risk assessment more realistic including establishing links with a wider set of stakeholders in various sub-fields, establishing a peer-to-peer learning network, and building domain knowledge before giving.

The authors also suggest that one of the best ways to reduce impact risk is to help philanthropists develop an understanding of other stakeholders who can potentially influence impact. This is also a good way to reduce attribution anxiety and eventually build bridges for leveraging the inputs of any single philanthropist. In fact, as I argued in my paper on Scaling Up Social Innovation, philanthropists need to learn to build bridges with state institutions and market institutions, in order to scale up socially useful innovations. On reducing operational risk, the authors emphasise both good control systems but also more positively, establishing a culture of learning, in both the giving and the implementing organisations.

To me, however, the biggest risk in philanthropy is the ego of either the giver or the implementer. I have always maintained that the 'vertical' view of philanthropy, i.e. where the giver comes up with the strategy (may be using hired experts) and the funding, while the development worker/activist is just an implementer, and the people are just passive beneficiaries – is deeply flawed. The fact is that both the giver and the doer share a passion for a cause and have different resources to contribute to that cause. While funding is important, it would be naive to think that any outstanding development work resulted from just funding. It has also been driven by the vision, passion and the entrepreneurial talents of the development worker/activist. However, unless the community participates in the process pro-actively, neither can make any difference. So in conclusion, let us develop a 21st century view of philanthropy where we (philanthropists and development walas) co-create a commonly desired future with the community/ies we wish to serve.

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The Resource Alliance is an international charity headquartered in London whose mission is to be the global network for fundraising, resource mobilisation and philanthropy. We build skills, knowledge and promote excellence within civil society.

To help NGOs around the world increase their fundraising capabilities, we provide a range of services and resources, including conferences, international and regional Workshops, accredited in-depth courses in fundraising and communications, tailor-made training and mentoring, research, publications and eNewsletters, knowledge sharing via our website and award programmes in best practice. We organise and run the annual International Fundraising Congress (IFC), now in its 32nd year, which brings together fundraising professionals from around the world.

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The Rockefeller Foundation's mission to promote the wellbeing of people throughout the world has remained unchanged since its founding in 1913. Its vision is that this century will be one in which globalisation's benefits are more widely shared and its challenges are more easily weathered. To realise this vision, the Foundation seeks to achieve two fundamental goals in its work:

1. It seeks to build resilience that enhances individual, community and institutional capacity to survive, adapt, and grow in the face of acute crises and chronic stresses.
2. It seeks to promote growth with equity so that poor and vulnerable people have more access to opportunities that improve their lives.

In order to achieve these goals, the Foundation provides much of its support through time-bound initiatives that have defined objectives and strategies for impact.

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