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Survival of the Fittest?

Charities, foundations struggle over restructuring in sour economy

By Ben Gose

For years, many foundation leaders and nonprofit experts have argued that the nonprofit world is bloated and in bad need of consolidation.

The deep recession seems likely to fulfill that vision — even though few people are taking any joy from what will surely be a painful process.

Many charities have already sharply reduced their budgets, due to declines in donations, fees, endowment income, and state government support. But most experts believe the worst is yet to come, as foundations cut their grant making in the coming year to bring their distributions in line with the steep investment losses their endowments have suffered.

La Piana Associates, a consulting company in Emeryville, Calif., that specializes in such arrangements, is receiving three times as many calls for help with strategic restructuring as it did a year ago, and David La Piana, the company's president, believes the situation will worsen later this year.

"You'll see more financial pressure on nonprofits," Mr. La Piana says. "I expect to see the pace of consolidation only increase."

Winnowing the Field

The big question is whether the shrinking of the nonprofit world will happen in a rational way, with the best and most-needed organizations beating out other charities for money in what may turn into a Darwinian struggle for survival.

Paul C. Light, a professor of public service at New York University who predicts that more than 100,000 charities will fail in the next two years, says he fears that survival of the fittest is skewed to the wrong kind of fitness. Those charities with well-oiled fund-raising machines and either local or national visibility are likely to survive or even prosper, he argues, while some worthy charities with little name recognition or marketing clout will go under.

"There's general agreement, especially among funders inside government and in the philanthropic sector, that there are too many nonprofits and that some winnowing might

not be so bad," Mr. Light says. "But if the winnowing is done in a random, drive-by-shooting approach, we could end up losing a number of very good nonprofits that should survive."

Results Rarely Reported

In the past decade, foundations and other donors have increasingly tied their grants and gifts to third-party assessments of charity effectiveness. In theory, foundations could use that information to determine which strong charities to stand behind throughout the downturn — and which weak performers should be nudged toward mergers or a responsible shutdown.

But in reality, a very low percentage of charities possess any measurable information about their results or effectiveness — much less data that are compiled by an independent party. Charity Navigator, a watchdog group in Mahwah, N.J., recently sent out a survey seeking information about results to 110 organizations that had received the group's highest rating for financial health. Only 15 of the surveys were returned.

"For the sector as a whole, the idea of making impact and outcome measures widely known is in its infancy," says Paul Brest, president of the William and Flora Hewlett Foundation.

Mr. Brest, who shares the conviction that the United States has too many charities, says Hewlett and some other large foundations are in a strong position to make informed decisions about which of their grantees deserve continued support. Hewlett has for several years been strongly committed to measuring results achieved by its grantees.

Hewlett's endowment had dropped to roughly \$5.5-billion as of early March, down from \$9-billion at its peak, which means the foundation will probably cut its grant-making budget for the second consecutive year in 2010.

Mr. Brest says the foundation is likely to reduce the number of charities it supports so its money will be used to help the groups that it deems most critical remain strong and vibrant — even if the recession drags on for another three to five years.

"That doesn't mean that we will let everything else go, but it does mean that those groups become the center of our thinking," he says.

Wealthy donors and family foundations should adopt a similar concentrated approach, Mr. Brest says, even though they may have to rely more on "informed intuition" than results and measurements to determine which charities deserve their continued support. All donors and grant makers, he contends, should engage in the philanthropic equivalent of triage, and salvage more resources for the most-needed groups by ending support for charities that were "marginal" before the recession.

"Now they're submarginal," he says, "and putting money into them is just throwing money away."

Charity 'Stress Tests'

Mr. Light believes relying on the gut instinct of individual foundations to determine which charities survive would be too haphazard — and that worthy charities may fall through the cracks.

He would like to see the nation's biggest foundations band together to create a bridge-loan fund for charities — similar to the \$15-billion fund that Independent Sector, the national coalition of charities and foundations, unsuccessfully sought to have included in the recent federal-stimulus legislation. (Officials at Independent Sector say the organization is continuing to pursue the idea of a government fund.)

Mr. Light says the individual or committee put in charge of the foundation-led fund could do "stress tests" — similar to the tests the federal government is administering to banks — to identify high-achieving charities that deserve support and are likely to have the resources to repay the money when the recession ends.

But a number of foundation leaders — including Mr. Brest; Gara LaMarche, president of the Atlantic Philanthropies; and Richard L. Moyers, director of programs at the Eugene and Agnes E. Meyer Foundation — express little enthusiasm for the idea, saying that foundations should spend their money in a way that furthers their own goals and missions.

"I have a hard time seeing where money like that is going to come from," Mr. LaMarche says.

In communities around the country, however, foundations are collaborating to make sure key types of nonprofit groups or specific charities survive.

One of the largest collaborations among foundations is in Detroit, where the downturn in the automotive industry is hitting charities especially hard. The group — which includes the Skillman Foundation, the Kresge Foundation, the W.K. Kellogg Foundation, the John S. and James L. Knight Foundation, and the Community Foundation for Southeast Michigan, among others — is looking to make joint grants to strengthen, consolidate, or even help close some organizations, says Tonya Allen, vice president for programs at Skillman, which with \$435-million in assets is one of the city's wealthiest foundations.

"We're not just going to be supporting anybody who doesn't have enough money," Ms. Allen says. "We want to support people who understand that the ground has shifted under nonprofits."

Detroit, whose population has been halved since the 1950s, is full of vacant land and foreclosed homes. The foreclosures, coupled with the nation's financial crisis, have

crippled the city's community-development corporations, which focus on low-cost housing and economic development.

At least two of the roughly 30 neighborhood-based charities have closed already, and several others shut down for a spell in the past year before reopening.

The group of foundations is encouraging the neighborhood-based charities to consider merging to form regional organizations.

Prickly Relationships

But the Detroit experience illustrates that the relationship between foundations and charities, which can be prickly during the best of times, can become even testier when cash is tight and survival is on the line.

Maggie DeSantis is president of the Warren/Conner Development Coalition, a charity that has cut its budget by 50 percent and says it is owed \$300,000 by the City of Detroit. The charity is in negotiations with three other community-development corporations on the far east side of Detroit to form a regional corporation — exactly the kind of consolidation that the foundations have indicated they would like to see.

But Ms. DeSantis says she has not yet been able to find any foundations willing to provide a grant to pay for the technical assistance needed to carry out the proposed merger.

"It shouldn't be that difficult," Ms. DeSantis says. "If the funders want us to merge and restructure, the support should be out there to do it." (Ms. Allen says Skillman hasn't been approached about supporting the merger.)

Throughout the country, charities and foundations are in an awkward dance around the topic of restructuring. Charity leaders often worry that broaching the subject will demonstrate that they are in trouble, and it will jeopardize existing grants, while foundation officials may fear they are exerting too much influence over a charity if they bring up the topic.

Mr. LaMarche says Atlantic Philanthropies is just beginning to have discussions about restructuring with some of its grantees. He says Atlantic is aided by its grant-making approach — the foundation often provides large grants for general operating support over multiyear periods. "When you don't have charities on a short leash, and you're not doing project funding, you're in a better position to have a more trusting conversation about where a charity is going," he says.

Appealing to Donors

Charities, meanwhile, are aware of the growing interest in consolidation among foundations. In March, the Wellness Community and Gilda's Club, two national charities

that provide support for people touched by cancer, announced they were in formal conversations about a merger. Kim Thiboldeaux, president of the Wellness Community, says several foundations and philanthropists have invited her to apply for money since she contacted them about the merger.

"Funders are becoming much more discriminating about where they're putting their money," she says. "They're going to be looking for nonprofits that are thinking outside the box and looking at new ways of doing business. The donor community will respond to what we're doing."

Coming to Grips

Some foundation officials believe that most charities have not fully come to terms with the severity of this recession.

"It's really important that organizations understand what programs are generating revenue for the organization and what programs are costing them money," says Mr. Moyers of the Meyer foundation, in Washington. "As I watch executive directors dealing with the downturn, many of them are not taking steps to shore up their finances. They're hoping that things will somehow turn around and they won't have to. But if you put off difficult decisions for too long, you put the whole organization at risk — and you make yourself very unattractive as a merger candidate."

Some struggling charities have gotten the message. Strive DC, a Meyer foundation grantee that helps unemployed people in inner-city Washington develop the skills to get and keep a job, has faced financial challenges for years and shut down for two months in 2006. The problems continue — during a period in February, the charity only had enough money on hand to give employees 75 percent of their paychecks.

Christine Hart-Wright, the charity's executive director, says she is working on multiple fronts to find a solution. Compass, an organization that provides pro bono consulting by graduates of top business schools to charities in Washington, is working with Strive DC as it evaluates merger and restructuring options. Meanwhile, the Jovid Foundation, which is based in Washington and supports charities focused on poverty alleviation, is helping the charity explore the possibility of sharing administrative space with other nonprofit groups.

"We don't always want to be looking at survival," Ms. Hart-Wright says. "It's hard to think about your programs when that is all you're focused on."

Mr. La Piana, the consultant specializing in restructuring, says this is a time when charity boards need to step to the fore.

Chief executives are often reluctant to explore mergers and other options because they fear they will lose their own job. But boards concerned about sustaining at least part of a struggling charity's mission must act before the financial situation becomes too dire.

Closing the Doors

The Self Employment Loan Fund, an organization that helps minorities and women in the Phoenix area, had nearly run out of money early last year, as the organization was about to begin a search for a new permanent chief executive. After evaluating their options, the board and the interim CEO decided to abort the search and wind the lending program down. The board eventually agreed to turn over the charity's program to Arizona Women's Education and Employment, a stronger organization with a similar focus on women.

For Marie Sullivan, president of Arizona Women's Education and Employment, the combination marked the second time that she had expanded the organization's scope thanks to merger talks initiated by another charity's board.

"As the CEO, you become so invested in your own work, and all the blood, sweat, and tears, it's hard to think that it is going to change," Ms. Sullivan says. "The boards are the ones who have to lead the change."