Dealing with Risk in Philanthropy

Are German foundations missing an opportunity?
Foundations face a wide range of different risks. Reputational, legal, operational and opportunity risk are among them and the focus of this issue.

Research based on interviews with a dozen foundations revealed that the majority of foundations is not taking full advantage of their unique ability to take risk and thereby missing an opportunity.

Strategically including more risky bets in their portfolio would help foundations to become a more effective change-maker in the field of complex social problems.
In the quest to cure some of the most insidious diseases, researchers know that they will have to fail many times before they find a cure. With each failure however, they take one step forward towards achieving their goal. This is something well understood by foundations that fund research – they accept the fact that not all of their projects result in absolute success. But what about foundations outside of the scientific research field? How do they approach risk when devising their strategy and making funding decisions? Based on a dozen interviews with senior staff from German foundations, this issue of Beyond Philanthropy’s “Notes from the Field” explores this question.

While risk is a prominent issue in the private sector, an initial observation is that risk issues in the foundation sector are, for the most part, not thought about in a structured and explicit way. When risk and uncertainty are discussed, they are overwhelmingly associated with negative outcomes or project failure – the potential upside of risk is not something that is often thought about. Leaving aside financial risk, or the risk associated with managing an endowment, interviews suggested that foundations face four main risks in their operations. Each of these risks falls at a different point on the operational cycle of a foundation, which is shown in the figure below.
Reputational risk was overwhelmingly identified as the most important risk consideration in decision making. This preoccupation with reputation and a need to be seen “successful” can be explained by three related concerns. Firstly, for corporate foundations there is a strong association with the corporate brand and a reluctance to be seen to negatively impact this in any way. Secondly, any negative perceptions have an impact on the ability of a foundation to achieve leverage – it is difficult to influence decision making if the reputation of a foundation is not strong. Finally, a strong brand is crucial to gaining the respect of the public and legitimising the operations of a foundation.

Once a project is implemented, there is always the risk that goals envisioned are not met due to unforeseen problems being encountered. While thorough due diligence and planning processes ahead and during project implementation should mitigate operational risks, there is always a remaining risk that a project might fail. This in turn might explain why foundations tend to have a bias towards funding projects with a proven track record and tested solutions, as opposed to explorative projects with unconventional approaches to societal challenges. Given the preoccupation with its reputation, the hesitation to support riskier ventures is even more plausible from a foundation’s perspective, since project failures do not tend to reflect well on a foundation’s reputation.
Failing to change the game: opportunity risk

This raises important questions about the ability or willingness of foundations to grapple with truly complex problems to which solutions are unknown and outcomes are uncertain. This is a lost opportunity, as foundations, more so than the government or private sector, are uniquely positioned to take risk due to their institutional characteristics. In fact, the management of the previously mentioned risks – reputational risk in particular – might actually be a detriment to supporting high risk, high potential interventions that may have the ability to solve complex problems where existing approaches are simply not sufficient. This perhaps explains why the most crucial risk facing foundations is one that is not even widely recognised as a risk in the sector by the majority of the foundations interviewed. Opportunity risk, or the risk of not achieving maximum impact for spend, is not generally recognised as a risk at all. This means that the potential for taking calculated risks in pursuit of high impact outcomes is often missed.

Foundations’ unique position in society

- Only limited legal overview
- No electoral accountability
- Not subject to market forces or accountable to shareholders
- Ability to take long term perspective without fear of sanction

Foundations’ Risk Taking Abilities
Engaging smartly to change the game

Embracing risk and considering opportunity risk does not of course mean directing all of a foundation’s efforts into high risk activities. However a strategic portfolio approach that explicitly includes some high risk, high reward projects is a good way to incorporate projects that go beyond the known and that have the ability to be “game-changers”. Here the approach to managing innovation and risk used by companies such as Google provides some potential guidance: Google chairman Eric Schmidt suggests that 70% of management time should be spent on core business, 20% on projects related to the core business, and 10% on unrelated but high potential and innovative new businesses. And while for the moment we will not further look into the question of what actually constitutes the core business of a foundation and potential limitations of this approach for foundation sector, it can still serve as a useful point of reference.

Of course, incorporating risky bets into a strategy requires accepting that sometimes projects will fail, and seeing this as part of the learning process and not something to be avoided at all costs. In the international donor sector, instruments such as challenge funds, which are used to incentivise grantees to pursue innovative, socially valuable projects, generally accept a 20% failure rate as part of the cost of pursuing innovative projects – but also expect 30% of projects to exceed expectations.

At the end of the day, foundations need to take a hard look at themselves and ask what could be more beneficial for their legitimacy and reputation: a string of safe bets with certain, positive outcomes that incrementally benefit society? Or more risky, yet strategic and calculated bets, with a noticeably different risk-return profile, which hold the potential to substantially contribute to the development of game-changing social innovations solving society’s most complex challenges?

If you are also interested in learning more about and benefiting from strategic foundation risk management, please get in touch. At Beyond Philanthropy, we have worked in partnership with clients when taking risk in such fields as investigative journalism, supporting single parent households, unaccompanied minor refugees or eating disorders. Over the course of this work, we have supported our clients to design high-impact foundation strategies, including thematic sector analysis, project sourcing, due diligence and grant management, among others.
About Timothy: Timothy undertook this research as part of his Public Policy Masters thesis (Risk in the German Philanthropic Sector) with Prof. Johanna Mair at the Hertie School of Governance and Beyond Philanthropy as partner institution. Prior to coming to Hertie Timothy worked as a consultant in the donor and philanthropic space, where he designed, managed and evaluated large-scale programmes - including several foundations.

Beyond Philanthropy is a specialised consultancy which helps businesses, foundations and individuals to maximise the impact of their philanthropic and social investing activities. We support our clients with tailored services spanning strategy consulting, project management as well as research and analysis. With our team and network of experts, Beyond Philanthropy has successfully collaborated with more than 50 clients on projects in over 30 countries in areas such as children and youth, sustainable development and democracy and human rights. Beyond Philanthropy is a “social business”, and all profits earned are donated to the charitable Forum for Active Philanthropy. You can find more information about Beyond Philanthropy online at www.beyondphilanthropy.eu

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