Portfolio Philanthropy

How philanthropists can apply portfolio theory to make wiser social investments

by Randall Ottinger

In 2003, after a career in business, I began searching for the best ways to apply my time, money, and talents for the benefit of others. I quickly realized that I was not alone. Millions of baby boomers are poised to transfer trillions of dollars from their estates to their families and society. With the coaching of Christine Letts, an associate dean at Harvard's Kennedy School of Government, I began to interview a broad array of affluent people to find out how they manage their wealth and philanthropic activities.

I observed that for many people, philanthropy is quite random. They connect with a cause because someone asks them to be on the board, or invites them to a fundraiser, or takes them to visit a nonprofit organization. Rarely do they think strategically about how to invest in social causes.

I began to worry that the transfer of baby boomers' wealth might not only fall short of its potential, but also further fragment the nonprofit sector. If history is a guide, the influx of trillions of dollars is likely to lead to the creation of many more nonprofits.[1] With so many new nonprofits from which to choose, donors are likely to make even less focused, less strategic social investments.

There had to be a better way. As a businessperson, I find analogies between finance and philanthropy to be especially appealing and useful. I became interested in applying one of the most powerful concepts in finance – portfolio theory – to investing in the nonprofit sector.

Harry M. Markowitz received a Nobel Prize in 1990 for his formulation of modern portfolio theory, which he originally presented in 1952 in the *Journal of Finance*. According to the theory, investors should select securities on the basis of overall risks and rewards of the entire group of investments, rather than choosing securities that individually have attractive risks and rewards. Investors who manage some of the largest endowments in the world, such as those of Yale, Harvard, Stanford, and Princeton universities, indeed demonstrate that the greatest predictor of financial returns for an endowment is not any single investment, but the overall portfolio of investments and how they work together to create value over time.

In contrast, most philanthropists track and support individual nonprofit organizations. Although tracking and supporting individual nonprofits is important, constructing a balanced portfolio of programs that attack the many different fronts of social problems is also wise. Grants made to a carefully selected collection of nonprofit organizations that are encouraged to work together will have more impact than investments in nonprofits working on their own.

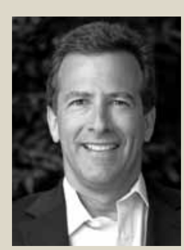
Philanthropy has successfully borrowed other concepts from finance, such as venture philanthropy's borrowings from venture capital. So too should foundations adopt portfolio practices.

A Different Approach

The cornerstones of portfolio theory are asset allocation, which defines where to invest; correlation, which describes how major asset classes perform relative to each other; and pooling, which means collecting investments from a variety of sources. The objective of the portfolio approach is to build a collection of investments in asset classes that complement each other by performing differently during various economic climates.

The Prostate Cancer Foundation (PCF) is one of the best examples of a foundation that applies portfolio

RANDALL OTTINGER *is a philanthropic adviser, author, and co-chairman of the Ottinger Foundation. He spent more than 20 years as an executive in high-tech companies in Washington, D.C., Boston, and Seattle before founding LMR Advisors, a philanthropic consulting firm. He has recently completed writing the book* Beyond Success: Building a Personal, Financial, and Philanthropic Legacy, *which McGraw-Hill will publish this fall.*



theory to social investing. Founded by Michael Milken, the famous junk bond financier, the PCF allocates its charitable grants only after careful research of the entire issue area; ensures that its investments work together to fill gaps in the field; and pools donor assets for scale and leverage in the area of prostate cancer.

Asset allocation. Universities such as Harvard and Yale take great pains to research the investment landscape before selecting individual investments. The PCF likewise first researched the area of prostate cancer before choosing its grantmaking strategy. From its research on stakeholders and the flow of funds into prostate cancer, the foundation learned that of the $100 billion spent on cancer in the United States in 1993, only about $2 billion went to finding a cure. The rest was spent on treatment for those who had developed the disease. Milken asked: "Is there an example, anywhere in private industry, where a company would spend 50 times as much to deal with the consequences of a problem as it would to solve the problem? It doesn't make sense." Accordingly, the PCF decided to allocate more donor funds to research.[2]

Correlation. Portfolio theory recognizes that individual investments can complement each other by performing differently over time within a portfolio. In philanthropy, social investments can complement each other by filling gaps. The PCF does this in two ways.

First, the foundation appoints top researchers to decide where the money goes so that there is an unbiased allocation of grant money to the highest and best uses, minimizing duplication and helping ensure that grants complement other investments in the larger prostate cancer portfolio. Second, the PCF requires that its grantees publish and speak about their findings in annual prostate cancer conferences and forums that the PCF sponsors. These conferences convene major prostate cancer industry players and raise the knowledge base of the entire industry. The sharing of information and convening of stakeholders help to advance the field.

The greatest predictor of financial returns for an endowment is not any single investment, but the overall portfolio of investments and how they work together to create value over time.

Pooling donor assets. Major endowments do not manage assets from just one university endowment fund, but instead aggregate funds from thousands of individual schools, departments, and university program areas. In a similar fashion, the PCF as a public foundation aggregates funding from many individual donors and allocates these pooled funds to selected grantees. By pooling grant money, the PCF has a larger voice, is able to exert greater leverage over the distribution of those dollars, and can encourage government funding.

Trillion-Dollar Social Impact

During the PCF's 10 years of involvement in prostate cancer research, there was a 24 percent drop in per capita death rates.[3] This dramatic decline outpaced drops in other forms of cancer. Although the PCF cannot claim all the credit for the drop, the foundation definitely contributed to advances in treatment. From 1993 to 2003, the PCF raised more than $230 million in private donations for prostate cancer research. Since 1996, total funding from the Department of Defense grew to $395 million, and government research dollars increased by a factor of 20 to $500 million.

Today, portfolio philanthropy is in its early adopter phase. Already signs of portfolio philanthropy can be seen in some public-private partnerships and donor collaboratives, such as the PCF, the Tides Foundation, and Social Venture Partners. Yet only a few foundations implement this approach. Others can borrow a page from the PCF's playbook by mapping the strategies and key stakeholders within the issue area they care about before investing, by allocating dollars strategically to fill gaps in the overall funding of an issue area, and by pooling donors through donor collaboratives or other methods.

With trillions of dollars likely to transfer to the civil sector over the coming decades, portfolio theory can play an important role in guiding philanthropists in making high-impact issue area investments. □

1 AFP eWire. "Fundraising Costs: Size, Age Matter." 18 July 2003; and AFP eWire. "Fundraising Competition Increases as U.S. Charities Number 800,000." 24 January 2005.
2 Cora Daniels. "The Man Who Changed Medicine." *Fortune*, 29 November 2004.
3 Ibid.