EXAMINING THE NONPROFIT CAPITAL MARKET:
The integrated challenges of performance measurement, growth, and sustainability

Fall, 2008

Meeting time: Thursdays, 6:00 – 9:00 PM
Location: NYU Stern, KMC5-75
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BACKGROUND AND DESCRIPTION

A nonprofit capital market, in theory, should work in a relatively straightforward way: funding should flow to the best organizations achieving the greatest impact; these organizations should attract investment adequate to support their growth so that their services reach those who need them; and as long as they continue to be effective, especially relative to others addressing the same issue, these organizations should continue to receive funding to maintain their valuable activities. Almost all observers acknowledge, however, that the systems and institutional practices through which nonprofits garner resources to deliver positive social impact are dysfunctional. Too many resources are wasted in the fund-seeking and grant-making processes; funding does not necessarily follow quality and information about performance is difficult to come by. In short: high transaction costs, allocation unevenly driven by value, and highly imperfect information.

This course will examine the integrated challenges inherent in making the nonprofit capital market more rational and efficient.¹

First, performance measurement. All agree with the premise that the strongest performing organizations achieving the biggest impact per dollar spent should be rewarded with funding. But how to define "impact?" Measuring the results of any single organization with any level of certainty is itself a challenge, and one that few nonprofits can afford to undertake in a scientific way. (Few mentoring organizations, for example, attempt longitudinal studies with control groups that account for changes in

¹ Note that this course does not examine in depth other aspects of the broader “social capital markets,” such as the market for double or triple bottom-line enterprises (e.g., organizations that seek to sustain themselves through earned income while achieving a social or environmental objective), nor the ways that for-profit market forces can be harnessed in new ways (e.g., micro-loans to the poor) but is focused instead on the environment for organizations that envision philanthropic support to be their main source of funding.
family, school, peer or other influences.) Comparing organizations to one another can be even more problematic, especially in many fields where outcomes are not readily measurable, or where strategies are intentionally long-term.

Second, growth. Leaders of well-respected nonprofits with proven track records regularly receive a frustrating message from funders: because they are successful, they must no longer "need" funding as much as other, less well-known organizations. Even when they can overcome this objection, it remains difficult for nonprofits to raise unrestricted money that they can use to bolster their infrastructure to support expansion. Nonprofits often face the difficult task of increasing their size while managing quality without the benefit of dedicated growth capital.

Third, sustainability. Every nonprofit engages in an annual ritual of raising its operating budget, from dozens of separate grants, each with its own application processes, requirements, and limited time periods. As a nonprofit gets big, it confronts the task of raising ever more money. This can be particularly daunting for organizations that attract funders to support increased services and then need to find new donors once their expansion is complete. There is no guarantee that delivering quality services reliably will attract support at levels required to sustain ongoing activities.

And yet, in the face of these challenges, there are established practices, experiments and new thinking that share the stated aim of delivering funds efficiently to high performing organizations and helping them extend their services. There is increased focus on metrics against which nonprofits can benchmark their results, and in turn, organizations are adopting more sophisticated management techniques to gauge their own progress. New fundraising strategies focused on raising "equity" capital are gaining traction; funders are beginning to address their own contributions to inefficient practices; new intermediary organizations modeled on investment institutions are emerging to facilitate the allocation of dollars to nonprofit organizations; and, there is a rising interest in the potential of government to partner in new ways with social entrepreneurs so that public resources can be coupled with accountability for demonstrable results at a truly large scale.

Objectives

The course is designed to help students: understand how the nonprofit market operates currently; confront the conceptual and practical challenges which make the development of a more rational market less straightforward than might be assumed at first blush; and, consider and critique emerging practices that seek to improve the nonprofit marketplace. Practitioners are integrated into the teaching of the course to a significant degree, giving students the opportunity to engage with leaders whose perspective stems from their day-to-day experience with the concrete and theoretical challenges of the nonprofit market.
Course Content and Structure

The course includes three areas: (1) broad issues of performance measurement, growth, and sustainability; (2) the mechanics of the market at start-up, mezzanine, and scale, and (3) cross-cutting market players and topics.

Each class session is divided into two sections. For the first 90 minutes, a roundtable of invited guests, moderated by the professor, will discuss the topic of the week. After a mid-class break, students will react to the readings and moderated discussion with reference to the themes and topics of prior weeks.

Student Responsibilities & Grading

Students are responsible for two single-class assignments, ongoing participation, and one writing project.

(1) Single-class assignment: roundtable preparation. Each week, a different student team will prepare questions and discussion points to guide the moderated panel of invited guests. Students on the team have responsibility for researching the guests’ backgrounds and organizations, doing the reading in advance, and developing questions to elicit interesting, informative, and thought-provoking discussion content.

(2) Single-class assignment: reaction. A separate student team will kick-off class discussion following the moderated panel by reacting to the panelists’ comments and placing the panelists’ discussion in the context of the weekly reading and course content to that point. For example, what was compelling, troublesome, unclear, reminiscent of other conversations and readings? How does what we heard relate and fit into the ongoing themes of the class, or challenge them?

(3) Class Participation. Students will be expected to attend all classes and contribute to classroom discussion. Quality of contribution to the discussion is more important than quantity, though all students are expected to be active participants.

(4) Writing project. Students will be responsible for completing a main writing project of no more than 12 pages of narrative, with allowances for appendices of charts, tools, diagrams, etc. Students can choose one of the following options for their project:

a. identify a social problem and recommend a strategy for solving it that navigates the conceptual challenges addressed in the course (for example, recommend a funding strategy to address childhood obesity, including the organizations you would fund and why, and how you would gauge the success of your strategy);

b. suggest how a market framework can be used in contexts where commentators suggest they are inapplicable (for example, considering how metrics and benchmarks might be applied to gauge a longterm civil rights organizing effort) – or why a market framework is inappropriate where it dominates (for example, arguing that the “cost of raising capital” should not be considered meaningful in the nonprofit sector);

c. propose a new institution to help solve a key issue(s) slowing the development of a rational nonprofit capital market, taking as inspiration models that we will examine during the
semester (for example, develop a concept for an online exchange to support educational organizations);

d. examine in depth the strengths and weaknesses one of the institutions or genre of institutions seeking to improve the nonprofit capital market (for example, compare the relative merits of different foundation approaches);

e. apply lessons from the course to existing organizations in a consulting engagement (for example, developing a robust performance management dashboard for a client nonprofit to facilitate its tracking and reporting of operating achievements and outcomes); or,

f. design a project of your choosing, with permission from the instructor.

Grades are based on the following:

- Single-class assignment: preparation – 20%
- Single-class assignment: reaction – 20%
- Class participation – 20%
- Writing project – 40%

CLASS ASSIGNMENTS

Class 1: Introduction and Overview
September 18, 2008

The first class will review the broad themes of the course and why our focus will be on performance measurement, growth and sustainability as central areas of inquiry.

To consider:

- Why hasn’t a more robust nonprofit capital market emerged by now?
- What might be different – positive and negative – if the nonprofit environment more closely resembled the private capital markets?
- Is there a fundamental problem with applying market analogies and systems to nonprofits, which arise in response to market failure?
- Are we as far from a rational market as the authors suggest? Are they missing anything?

Readings:


Optional background reading (appropriate at any point during the semester):

- For those seeking an introduction to nonprofit concepts covered in class: Emerson, J., “The US Nonprofit Capital Market: An Introductory Overview of Developmental Stages, Investors and
Funding Instruments,” REDF, 1999. Includes an overview of many of the “challenges of the nonprofit capital market” (pp. 207 – 214) that we’ll cover during the semester.

- **For those interested in a broad review of literature on nonprofit / social capital markets:** Emerson, J., and Spitzer, J., “From Fragmentation to Function: Critical concepts and writings on social capital markets’ structure, operation, and innovation,” Skoll Centre for Social Entrepreneurship, 2007. Includes a brief summary of “mainstream capital markets concepts and framework” (pp. 8 – 13) for those seeking a primer.

### Conflict for Professor – No class – September 25, 2008

### Class 2: Performance Measurement
October 2, 2008

Performance measurement includes two main strands: 1) identifying the social impact that an organization delivers, and 2) assessing the quality of an organization’s internal operations. When observers discuss whether or not an organization is effective, these two strands sometimes get conflated. We’ll examine both and their relation to a capital market, including the evolving use of evaluation within the sector and the increasing attention to the importance of organizational capacity.

To consider:

- What role should evaluation play in a robust capital market, taking into account the complexity of social change dynamics and the cost of scientific studies?
- What are the best indicators of internal capacity? How much weight should these indicators carry in funding decisions?
- How should we judge the appropriate balance between efficient operations and having adequate internal capacity?

Readings:


### Roundtable Guests:
[TBD]

### Break – No class October 9, 2008
The nonprofit landscape is largely made up of small (under $1 million budget) organizations. We’ll look at the factors that constrain organizational growth, as well as some solutions being proposed to enhance the size of successful nonprofits.

To consider:
- Are there non-financial differences between the for-profit and nonprofit sectors that influence whether or not growth occurs? What are they?
- What should be the factors in determining when growth is a good thing, from a manager’s point of view? A funder’s?
- Is it possible to generalize about the relationship between quality and size? Between breadth and depth?

Readings:

Roundtable Guests:
[TBD]

The leaders of nonprofits spend much of their time raising money to sustain their operations, continually replacing time-limited funding with new philanthropic sources. We’ll review the common critiques of how capital gets raised in the nonprofit sector and discuss implications of the sustainability challenge, and whether attempts to rationalize the fundraising process are likely to significantly alter the ways that nonprofit executives manage their organizations or their time.

To consider:
- Why is the practice of funding specific projects for a set number of years so dominant in philanthropic practice? Will an increased emphasis on measurable outcomes, usually a stated element of an improved nonprofit market, influence this practice? How and why?
- Performance is only one factor considered by donors when they decide to fund a nonprofit – what are others? How do these alternative considerations influence the nonprofit marketplace?

Readings:

Roundtable Guests:
[TBD]

Class 5: Mechanics of the market: Start-up & early growth
October 30, 2008

We’ll turn from a discussion of broad concepts to how the issues of performance measurement, growth and sustainability play out in practice for organizations at various life-stages. This week, we look at the start-up and early growth stages.

To consider:
• Is too much attention given to start-ups in the discussion of social entrepreneurship?
• How should early stage organizations think about performance? What degree of accountability is appropriate for new groups?
• What criteria should funders use in deciding whether to support organizations with no track record?
• What set of questions should those considering starting new organizations ask themselves?

Readings:
• Blue Ridge Foundation New York, “What We Look For”

Roundtable Guests:
[TBD]

Class 6: Mechanics of the market: Mezzanine & scale
November 6, 2008

Continuing our examination of how the existing capital markets are experienced at different stages, this week we look at organizations in high growth mode and those operating at a large scale.

To consider:
• What qualifies as “scale” in the nonprofit sector?
• What should influence whether an organization expands locally or to other geographic areas?
• Assuming a nonprofit raises growth capital to expand, what are the elements of a strong strategy for it to sustain its new, increased size?

Readings:
• Kalafatas, J., “Approaches to Scaling Social Impact,” Center for the Advancement of Social Entrepreneurship, Duke Fuqua School of Business.
• SeaChange Capital Partners, “General Criteria for Future Grantees”
• New Profit, Inc., “Statement of Interest in Consideration for the New Profit Portfolio”

Roundtable Guests:
[TBD]

Class 7: Determining relative effectiveness
November 13, 2008

One basic idea inherent in the market concept is that donors should choose the best nonprofits so that high performing groups can thrive and lesser organizations will wither. But the actual practice of determining whether one nonprofit is “better” than another often requires analysis on multiple dimensions: is the problem that the organization addresses (e.g., domestic violence) more important than an alternative problem; is the approach being taken to address it better than alternatives (e.g., offering legal advice v. providing shelter v. advocating for new laws); can the results of organizations pursuing similar activities be cleanly compared and traced back to organizational performance; are the metrics to gauge success appropriate or capable of analysis in the short term; are results tied to the depth of programs and their attendant costs…to name just a few. We’ll grapple with these questions, and consider two differing perspectives: one view, that a level of standardization is required so that like organizations can be compared for relative impact, and the other, that organizations are best evaluated against the goals and criteria they set for themselves.

To consider:
• What resonates for you about nonprofits reporting against standard metrics? What troubles you? And what resonates and troubles you about nonprofits selecting their own performance criteria?
• What practical challenges do you foresee in a push for standard metrics? How can these be overcome?
• Is it generally possible in the current environment to determine whether one nonprofit is better than another? What evidence is most compelling? Most common?

Readings:

Roundtable Guests:
[TBD]

Class 8: Funder Accountability
November 20, 2008

How, in the nonprofit market, should funders determine their “social returns”? If it’s hard to compare service providers, it can be an exercise in futility to judge the relative impact of funders who provide only a piece of any provider’s budget (and without the right perspective, such an exercise can result in a strategy that ill-serves grantees). Yet few would argue against the need for more funders to hold themselves accountable for performance. We’ll examine some of the issues involved in gauging donor effectiveness and how practitioners are approaching the challenge.

To consider:
• How important is it for funders to understand the impact of their individual contributions? What approach to doing so makes the most sense?
• How can we evaluate the job performance of foundation managers? How might the difficulty of doing so shape the way that philanthropy works?
• What should go into an informed opinion about whether a grantmaker is any good?

Readings:
• LaMarche, G., “Philanthropy can be made to measure,” Financial Times, April 19, 2008.

Roundtable Guests:
[TBD]

Break – No class November 27, 2008
Class 9: The Role of Government  
December 4, 2008

Any discussion of social change at scale must include the role of government – the number of people touched by services funded by government, and the amount of its related expenditures, dwarf the combined total of private efforts. We’ll focus our inquiry on the role that the U.S. government in fostering a healthier nonprofit market and supporting individual organizations at scale.

To consider:
- What do you think of the policy suggestions in the readings? Which have the most promise? The least?
- Will the combination of services with themes of “accountability,” “performance,” etc. give the proposed ideas broad political appeal, or will support depend on partisan perspective?
- Are there any special considerations that ought to accompany the use of public money? How should these affect organizations funded by government?

Readings:

Roundtable Guests:  
[TBD]

Class 10: New Market Infrastructure  
December 11, 2008

More intermediaries, tools and proposed institutions are emerging to fill roles within a capital market: analysts, research firms, financial instruments, even online exchanges. We’ll look at some of this new market infrastructure and discuss influential trends that might shape the nonprofit field in the coming years.

To consider:
- What are the most important pieces, currently missing, to improve the nonprofit capital market? What will it take to bring these to fruition?
- Which of the organizations and ideas in this week’s reading do you think have the greatest likelihood of taking hold? The least?

Readings:
Most nonprofit practitioners are generally enthusiastic about a more rational and efficient capital market for nonprofits, even if there are clear conceptual and practical challenges to its realization. Advancing nonprofit practices with only a market framework as a guide carries its own risk, however. In this class we’ll discuss how the market framework might exclude social change strategies, including those that have been extraordinarily effective, and we’ll try to assess what unintended consequences might accompany a robust marketplace.

Readings:

Roundtable Guests:
[TBD]