Executive Vice President's Report

Assessing a Foundation's Performance

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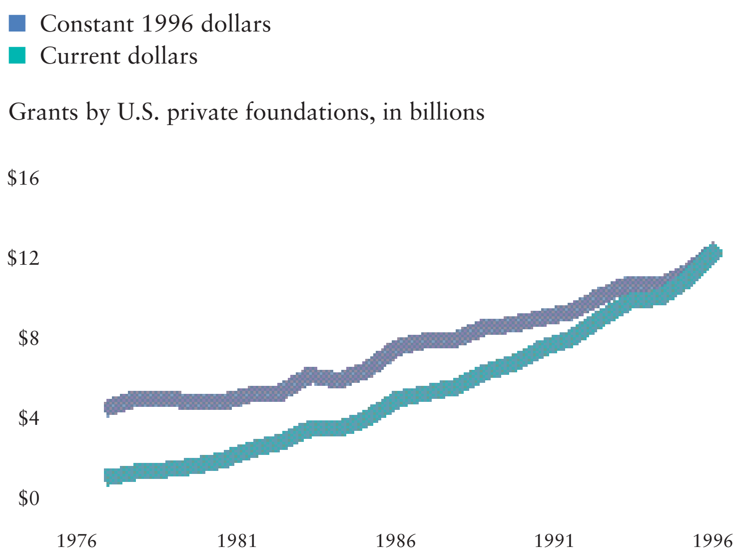
Nonprofit organizations play a major social, cultural, and economic role in American life, and in recent years have assumed increasing responsibility for maintaining society's safety net in an era of constrained government budgets. At the same time, periodic failures—even scandals—involving nonprofit management have drawn attention to the need for stronger internal mechanisms to assure the accountability and performance of these organizations. A growing body of literature is beginning to describe the challenges of managing and monitoring nonprofit organizations, and several research centers are now cultivating the very young field of nonprofit management. Nonprofit boards and managers, as well as government contractors and regulators, are increasingly alert to issues of accountability and performance.

Commentary by prominent researchers and practitioners indicates that performance assessment in nonprofit organizations is still in its infancy. Although true of the nonprofit sector as a whole, this is doubly true of private foundations, where serious inquiries into overall performance, or even fundamental good management, have been noticeably scarce.

The reasons for this shortcoming are well known. Most foundations operate under broad charter mandates and pursue social objectives for which accomplishments are not easily measured or are difficult to trace directly to a particular source. Valuing their flexibility, some foundations fear that performance assessment will hobble their ability to undertake unusual projects. Foundations are governed mainly by volunteer boards, whose members bring varying levels of commitment to the organization. Many foundations are very small in terms of assets, and even large foundations may have small staffs or no paid staff at all. Plus, the enormous diversity of foundations regarding mission, focus, grantmaking style, and size makes it difficult to generalize about performance standards, Between 1976 and 1996, grants made by private foundations in the United States grew from $1.94 billion to $13.84 billion. In constant 1996 dollars, the growth was from $5.53 billion to $13.84 billion.



Source: Calculated from data provided by the Foundation Center.

especially in light of a pervasive sense that customary management norms do not apply in this sector.

The risks arising from this situation are compounded by private foundations' exemption from the external forces that encourage accountability within other nonprofit, government, or for-profit entities: competition for funds from donors or contractors, operation under the scrutiny of client constituencies, public elections, attention from the media, and the need to make a profit and survive in a competitive marketplace. Recognition of the absence of these forces accounts in large part for the federal regulations that apply specifically to private foundations—regulations that appear to be generally effective in discouraging serious financial abuses.

Yet absence of widespread wrongdoing is no assurance that private foundations are realizing their potential or justifying their uniquely privileged position in American society. As Lloyd N. Morrisett, former president of the John Markle Foundation, wrote recently, "If a foundation is to make a difference, particularly if making a difference means something more than giving away money to worthy causes, the foundation must add value to justify its expenses and overhead."[1] He goes on to note, however, that the standard for adding value is not easy to assess.

A review of the most important current literature reinforces Morrisett's view but points toward a set of disciplines and tools that could build an organizational culture conducive to producing results and adding value. First, a set of necessary conditions must be present if a foundation is to function at a high level of effectiveness. With those in place, a foundation seeking to maximize its performance can look to other indicators—or vital signs—in the areas of governance, leadership and staffing, operations, evaluation, and endowment management. For The Commonwealth Fund, the guidelines that emerge confirm the foundation's long-term commitment to assessing the value of its work and seeking continuing improvements.

[1] Lloyd N. Morrisett, *Reflections on 28 Years*, The Markle Foundation, 1998.

Necessary Conditions for Foundation Success

High-performing foundations share four general characteristics: a clear mission; an ability to focus; a program of well-defined, specific strategies; and a solid intellectual grounding in its field of interest. These interlocking elements need to be established firmly within an organization, regularly assessed, and periodically reshaped or renewed.

There is broad agreement that, although most donors wisely establish a mandate broad enough to assure a foundation's adaptability over time, a specific and clearly stated mission is essential for sustained performance. According to Peter Drucker, the mission must be articulated in operational terms; otherwise, it is merely a statement of good intentions and provides no yardstick for assessing accomplishments. The mission also demands periodic reexamination and occasional refocusing as a result of changes in society, the economy, other institutions working in the field, or shifts in the comparative strengths of the organization.[2]

Within the guidelines of the foundation's mission, focus on a particular area is also agreed to be essential, given the resource limitations that apply to any foundation. The admonitions against trying to be all things to all people are numerous, as are warnings that excessive opportunism leads to dilution of effort and failure to stay the long-term course. John Evans, M.D., has stated the case with considerable cogency: "The result of too much program diversification is unsatisfactory. Too little money is spread over too many problems, and the foundation does not develop a depth of experience in any one area. More importantly, however, too great a diffusion of the potential intellectual leadership of the foundation means that it is almost impossible for the leadership to be at the cutting edge of any field. Foundations, like other institutions, should know that the chances of success are greatest when there is a sharp focus for their work."[3]

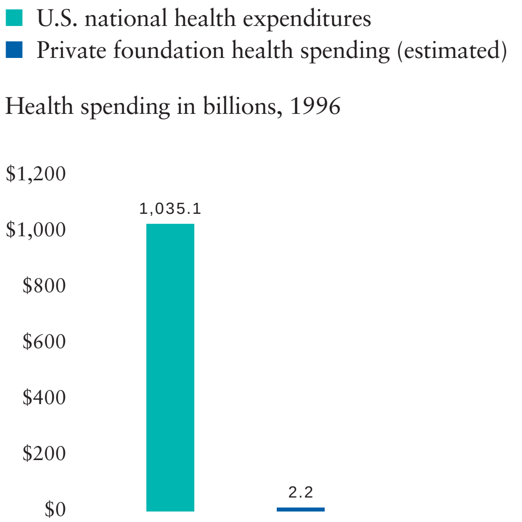
A well-defined program strategy is also regarded as a necessary condition for foundation performance. As Drucker states, "strategy converts an institution's mission and objectives into performance."[4] Denis J. Prager delineates aspects of strategy that require attention by any foundation, whatever its size or program focus: a clear concept of how to bring about change; a plan for developing and deploying all the resources at the foundation's disposal (including money but also capacities for convening, leadership, technical assistance, and education); the timing and duration of programs; external advice and participation by leaders in the field; and appropriate,

[2] Peter F. Drucker, *Managing the Non-Profit Organization*, HarperCollins, 1990.

[3] John Evans, M.D., *The Commonwealth Fund Board of Directors Retreat Briefing Materials*, 1995.

[4] Drucker, *Managing the Non-Profit Organization*, p. 99.

Private foundations account for less than one-quarter of one percent of national health expenditures. Therefore, they must target their contributions carefully to have much effect.



Source: Calculated from data provided by the Health Care Financing Administration and the Foundation Center.

well-integrated communications activities. Prager also argues that no strategy is likely to be successful if it is not grounded in a thorough knowledge of the field—a further necessary condition for successful foundation performance.[5]

Tell-tale signs of weakness in these key areas include confusion among outsiders about the foundation's mission and programs; a decline in the demand for long-standing programs, with grant proposals weakening over time; routine refunding of projects, with few questions of performance raised; rare development of new programs; almost exclusive focus on foundation processes, with little attention to project or program outcomes; programs appearing to be off the mark and out of tune with the times; programs failing to meet objectives; and, overall, a diminished reputation for the foundation.[6] Any of these signals indicates a need for reassessment by the foundation's board of directors and chief executive.

Vital Signs for Foundation Governance

The central role of the board of directors in assuring foundation performance has been eloquently stated by Morrisett: "No organization can in the long run be of higher quality than its board. The board chooses the management. The board, in the example set by the integrity, professional accomplishments, and wisdom of its members, creates a standard for its staff. . . . The board frames the working environment for the Foundation."[7]

Drucker elaborates that the board is the guardian of the mission, exists to ensure that the foundation has competent management and effective leadership, and is responsible for appraising the performance of the organization. More specifically, the board's responsibilities consist of exercising fiduciary responsibility; rewarding and motivating management; serving as a sounding board and bringing new ideas to the table; assisting in areas of special experience; disseminating word of what the foundation is accomplishing; assessing its own performance; and assuring succession and renewal through a recruitment and nomination process structured to maintain high-quality membership.[8]

5 Denis J. Prager, *Raising the Value of Philanthropy*, Strategic Consulting Services, draft report, August 10, 1998.

6 This list and others throughout this essay were stimulated by checklists of potential danger signs suggested by Laura Colin Klein and Paul Connolly, *Getting Back in Shape: Guidelines for Improving the Fitness of Established Nonprofit Organizations*, Conservation Company, 1998.

7 Morrisett, *Reflections on 28 Years*.

8 Brian O'Connell, *The Board Members Book*, Foundation Center, 1985.

After safeguarding the foundation's mission and overall health, selecting the right person to serve as chief executive officer is the single most important task of the board. The chief executive invariably takes the organization into his or her own area of strength; thus, in recruiting for the position, a board should determine the most important major area for development and the most fruitful direction for the organization over the next decade or so. Difficulties arise when the CEO's skills and experience diverge significantly from those needed to carry out the wishes of the board, or, obviously, when there is fundamental disagreement about direction. The CEO selection process is therefore a vital one and provides an important opportunity to reexamine mission and strategy.

If a strong, well-functioning board is a positive indicator of success, by the same token a weak board raises the risk of failure. Signs of weakness include disengagement from and shortcomings in exercising fiscal responsibility; domination by a small group brooking no inquiry; weakening quality of membership over time; and meetings that focus on ritualistic processes to the neglect of "learning exercises" (to use Prager's term), such as assimilating feedback, examining new knowledge, and discussing strategy and performance.

As observed by William G. Bowen, "trustees of foundations have more opportunity to affect institutional performance than do the directors of any other set of entities in either the for-profit or non-profit sector."[9] Given the central role that boards play in a foundation's life, periodic checkups of the board's health are likely to be beneficial to the foundation's performance. If serious weaknesses are found, the checkup can be used to help develop improvements but is also a signal for scrutinizing program performance more intently.

A board of directors should make time to consider its own functioning and its interactions with foundation staff—a goal not always easily accomplished, given competing demands for the time and attention of the group. In practical terms, however, a board may wrestle with precisely these issues when making decisions about recruiting new members, changing the order of business in meetings, or revising the format in which staff report on work supported by the foundation. For example, the Fund's board has taken steps to ensure a high level of engagement by establishing explicit personal and professional criteria for board membership and a wide-ranging meeting format for discussing policy issues.

[9] William G. Bowen, *Inside the Board Room: Governance by Directors and Trustees*, 1994, pp. 11–12.

Vital Signs for Leadership and Staffing

The chief executive officer of a foundation—whether a compensated executive or a board member serving voluntarily—needs particular characteristics to carry out the responsibilities of the office. The CEO must be skilled at articulating the vision that guides the foundation and must also be able to motivate and persuade others to accomplish the foundation's goals. An ability to capitalize on his or her own strengths and manage weaknesses (usually through delegation) is crucial, as is a capacity for recognizing strengths in others and encouraging them to use those strengths. A foundation's leader must be ethical, in fact and in public perception. Personally, the job also demands organization, discipline, and a high energy level.[10]

In staffed foundations, performance is heavily contingent on the ability of the CEO to recruit the right people, motivate them, and provide them with timely feedback on performance. As Drucker observes, people decisions are the ultimate determinant of performance. People work for a foundation because they believe in its cause: therefore, management's responsibility is "organizing the work so everyone feels essential to a goal they believe in."[11]

To build an effective staff, a foundation's leadership needs to make a habit of establishing ambitious objectives, focusing on strengths, and reviewing performance. Drucker and others endorse self-assessment, with management feedback: staff (including the CEO) should be encouraged to ask how they can best contribute to the goals of the foundation and what steps they and their colleagues can take to achieve that contribution. The Fund, like other nonprofit organizations, has found this approach to be highly productive and is seeking ways to base annual staff assessments on specific, performance-oriented goals.

Foundations that do not conduct annual assessments of CEO and staff performance are missing important opportunities to consider overall foundation performance, maximize their human resources, and identify early signs of failure. Those that do should be alert for clues that the CEO is burned out, an ineffective leader, or unable to think creatively about the foundation's mission or approach; that programs are operating as fiefdoms; that morale is low, with top performers leaving and poor performers remaining entrenched; that communication is poor among staff members and with the board; and that staff members are engaged in turf battles, unwilling to speak out on critical problems, or disconnected from important decision making.

[10] Robert Andringa and Ted Engstrom, *Nonprofit Board Answer Book: Practical Guidelines for Board Members and Chief Executives*, National Center for Nonprofit Boards, 1998.

[11] Drucker, *Managing the Non-Profit Organization*, p. 190.

Vital Signs for Operations

A foundation's processes and systems—program planning, proposal review, grant approval, monitoring, and communications—can also greatly affect its performance. Prager calls attention to the tension within foundations between the imperative to develop, prepare, propose to the board, and award grants and the need to nurture, monitor, and assess ongoing projects and communicate results. Characterizing this as the competition between "production" and "learning" aspects of grantmaking, he describes the "tyranny of the grant cycle" and cautions against allowing due diligence processes to become the exclusive focus of board and staff activities.

The Fund attempts to reconcile these tensions by focusing on five-year strategic plans, annual program plans, expert vetting of grants proposed to the board, evaluations of key projects, qualitative reviews (described in more detail below) of numerous grants and all major programs, and a publications and communications program designed to reap and disseminate the harvest of funded projects. This approach has helped streamline the traditional grantmaking process, motivate staff to pay at least equal attention to outcomes as to the making of grants, and promote board judgments on strategy and performance.

Much can be inferred about a foundation's likely effectiveness by looking at the robustness of its processes and systems. A checklist in this area should include the following questions: Have well-developed systems deteriorated into red tape or fallen into disuse? Is the foundation slow to modify systems and adapt new technologies? Is it "customer friendly" to applicants? Does it maintain mechanisms that keep the door open for fresh ideas and talent? Does it have a systematic approach for examining grant results?

Vital Signs for Program Evaluation

However helpful it may be to look at foundation fundamentals, governance, staffing, and systems as indicators of performance, one question remains for both foundation insiders and observers: What difference do the foundation's grants and programs—and the foundation as a whole—make in society?

The field of program evaluation is highly developed, and a substantial number of foundations attempt from time to time to assess the degree to which the activities they support are having the impacts intended.[12] As noted by virtually all foundation observers, however, assessments tend to focus narrowly on the success or failure of individual grants or programs, never on overall performance. Indeed, nothing in the literature or collective experience

[12] *Evaluation for Foundations: Concepts, Cases, Guidelines, and Resources*, Council on Foundations, 1993.

raises great hope that a foundation's overall performance will ever be definitively assessed.

What is equally clear, however, is that keeping the issue of performance constantly on the table is in itself beneficial. Further, a variety of evaluative activities—carried out over a period of time—can help create an environment that fosters learning and improvement. Rebutting the view that useful project and program evaluations require enormous sums of money, The Commonwealth Fund, the Robert Wood Johnson Foundation, and a few other foundations have implemented systems for producing qualitative completed grant and program reviews that provide continuing feedback on accomplishments and lessons learned.

In the Fund's system, key grants in major programs are reviewed upon completion by a consultant working closely with the appropriate program officer and grantee. The consultant examines the grantee's reports and other deliverables and typically interviews the grantee. The assessment considers the adequacy of the original strategy, budget, and timetable; factors that contributed to the project's achievements and shortcomings; and the immediate and potential lasting impact of the work. Fund executive and program staff meet to discuss the consultant's draft report, which is also reviewed by the grantee before being finalized. These reports are the building blocks for interim and completed program reviews. The latter are carried out by an independent consultant with experience appropriate to the task and involve review of program materials and interviews with project directors, Fund staff, and informed observers of the program. Members of the Fund's program monitoring committee—an external team of experts in the Fund's fields—provide significant input on completed program reviews. Completed grant and program reports are a focal part of board discussions.[13]

In addition to undertaking formal program evaluations when appropriate and maintaining feedback reporting systems, the Fund also uses board retreats, external advisory committees, and periodic surveys of major audiences—such as grantees, policy and media audiences, or professional and community constituencies—to review the effectiveness of its operations.

The Fund's experience suggests that program evaluation can genuinely contribute to overall performance. Guidelines include remaining knowledgeable about evaluation methodology; tailoring the evaluation to the project; choosing projects that justify the resources devoted to evaluation; using a variety of methods and approaches; and maintaining a long-term view in assessing impact. Most important, staff and directors must recognize that the prime function of evaluation is to improve, not to prove—a posture that encourages the cooperation of grantees and promotes objectivity all around.[14]

[13] Dennis F. Beatrice, Cindy Parks Thomas, and Brian Biles, "Grant Making with an Impact: The Picker/Commonwealth Patient-Centered Care Program," *Health Affairs*, vol. 17, no. 1, 1998.

[14] Robert Matthews Johnson, in *Evaluation for Foundations*, pp. 252 ff.

Vital Signs for Endowment Management

Unlike most other areas of foundation assessment, the literature on endowment management is well developed. Indeed, it would be reasonable to assume—given the wealth of existing knowledge, the importance of endowment income, and the fact that investment performance is the single aspect of foundation activity that can be measured with certainty—that all foundations would have established strong systems for managing their money effectively and monitoring their relative performance. Surprisingly, this is not the case.

Despite major advances over the last 20 years, many foundations show shortcomings in endowment management. For example, a foundation may know how well individual managers are doing but never combine manager returns to see overall returns on investment; fail to search for managers beyond those known to a few board members; neglect to examine the effects of market trends on the allocation of the endowment among asset classes; or maintain expenditure rates and asset class allocations inconsistent with a stated policy of preserving the purchasing power of the endowment over the long term.

This is not to say that a foundation doing all the "right" things will invariably avoid mistakes in managing its endowment or produce superior returns. Yet chronically poor endowment management practices and prolonged deteriorating investment performance may indicate fundamental problems that extend to a foundation's overall performance.

The Common Principle: A Spirit of Inquiry

As observed by Prager, "a major implication of the independence, diversity, and decentralization of the field of philanthropy is that, while it may be possible and useful to develop common frameworks and guidelines for the field, each foundation will have to develop standards, performance criteria, and assessment strategies that best suit its particular situation."[15] As a general principle, however, the foundations with the best track records have at least one thing in common: a spirit of inquiry at the core of the institutional culture.

Overall performance assessment should be regarded by virtually every foundation as a continuing objective, beneficial to its own effectiveness and to the long-term value of the foundation sector as a whole. Formal program evaluations and grant reviews may appear to be beyond the ken of smaller foundations, but all foundations can test for the "necessary conditions" and "vital signs" outlined above. These tests are likely to reveal creative ways to evaluate programs and shed beneficial light on the ultimate questions for every foundation: Has our work added value? Have our investments made a difference?

15 Prager, *Raising the Value of Philanthropy*, p. 3.