ETHICS AND FINANCE

The Idea of Venture Philanthropy

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This paper deals with the combination of Venture Capital and Philanthropy, creating a new concept: Venture Philanthropy. Philanthropy has a long history and has been redefined many times in an evolutionary process. Philanthropic initiatives, private or corporate, are considered fair in a sense of a subsequent giving back after previous success. Philanthropy offers an enormous social and economic impact if it is done in a strategic and efficient way. Venture Capital is said to be an efficient method in aspiring companies, markets and projects. The potential of a purposeful combination of these activities has not yet been fully realised. We argue that it is possible to unite philanthropic intentions and instruments of venture capitalism, leading to a win-win situation.

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1. History of Philanthropy

Philanthropy etymologically consists of the words 'philos', which means friend or love in the sense of caring or hospitality, and 'ánthropos', meaning human being or humanity, which together implies a broader sense of thinking and acting in a humane manner. Philanthropy has a long history: first mentioned in Ancient Greece, redefined and reinvented by Kant, Schopenhauer and at last in the 20th century. We are going to follow the term through its history.

Already in Ancient Greece the meaning of philanthropy changed many times, depending on who used it. In general, it was characterised as a term used for the acting of gods, kings and judges and their benevolent nobleness towards the poor and weak. Furthermore, it asserted that our nature and behaviour in life was educational and we could make ourselves more humane through self-development and a more positive kind of thinking. While Homer spoke about a generally kind attitude, Isokrates drew a distinction between the barbarian and the Athenian. Only the Athenians were educated and communicated in a proper language, and as these were conditions for philanthropy, only the Athenians had a sense of philanthropy. In the chapter about friendship in Aristotle's Nicomachean Ethics, we find philanthropy as the natural friendship between humans. Especially Plutarch dealt with the idea of Philanthropy as the top virtue, while he had a broad understanding of philanthropic approaches. They included politeness, democratically-minded ideas and a humane treatment of animals. After Plutarch's intensive use, philanthropy cannot be found over the following centuries until the Romans translated the word into the related "humanitas".

It was mentioned again in the 18th century in a philosophical background, for example in Kant's Metaphysics of Morals (1797) as maxime of benevolence (cf. Gründer and Riiter 1989), which means that a philanthropist feels pleasure considering other people, both far away and close by, in good health. Besides Kant, other philosophers who used the term, for example, Basedow, often mixed philanthropy with altruism and declared it to be a leading definition in describing human nature. This development reached its climax in the foundation of a Philanthropic School by Basedow in 1744 and in a pedagogic movement called "Philanthropism". Following Kant, Schopenhauer defined the "love of humanity" as one of his "cardinal virtues" from which every other virtue could be reduced. It was in the 18th century as well that the notion of philanthropy changed its context from the philosophical point of view to an economic one and could be found within the work of one man, known as the "capitalist" himself – Adam Smith. Hardly anyone links Smith to charitable giving, but besides his famous theory about the self-interested butcher, brewer and baker, in his work The Theory of Moral Sentiments (1759) we find the following quote:

> "How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it" (Smith 1759: 11).

Smith demonstrates that we are moved by altruistic sentiments, which he calls benevolence, and refers to benevolence as a universal element that makes us human. Although these sentiments are limited, optional and focused on our surroundings, the idea of philanthropic giving back could already be seen in the work of Smith. While Smith published his work in Europe, a big group of donators mostly businessmen emerged in the United States. Here, philanthropy was connected with humanitarianism and was generally associated with "doing good", closer connected to what we call "charity" today. Over the following decades and especially at the end of the 19th century, a more systematic approach to the question of how to improve social conditions was developed by private donors. This was the era of individuals and families such as Rockefeller or Carnegie, who earned their wealth in the steel, oil, railroad or automobile industries and who were known for their philanthropic engagement as well. Carnegie, who established several foundations, illustrates his opinion:

> "The Question then arose, What should these do with their surplus wealth? and the "Gospel of Wealth" contended that surplus wealth should be considered as a sacred trust, to be administered during the lives of its owners, by them as trustees, for the best good of the community in which and from which it had been acquired" (Carnegie 1889: 684).

He also writes "the man who dies rich, dies disgraced" (ibid: 684). Along with Carnegie, wealthy benefactors such as John D. Rockefeller set up some of the nation's first grant-making philanthropies, meaning organisations that donate monetary revenues to non-profit activities. While of course these activities are honourable, they clearly differ from philanthropy, as the notion was defined in Ancient Greece or even today. The motive which stands behind rich donors like Carnegie and

Rockefeller and their engagement for a better society is more or less the legitimation of their success afterwards. During their years of success, it was not part of their business model to engage in philanthropy, but they did so afterwards to give some of their earnings back to society. In the United States, this was part of the predominant picture concerning philanthropy, and remained so for quite a long time. Until the last quarter of the 20th century, philanthropy was not regarded as a field of systematic endeavour within the business environment. The American model of philanthropy was followed by a period of increased activities of the government in the early 20th century and during World War I.

Nevertheless, since 1980, more and more firms, managers and professors have started again to develop concepts of how to combine business strategies with ethical and social goals. Remarkable at this point is the work of Michael E. Porter and Mark R. Kramer, who have developed concepts dealing with Corporate Social Responsibility and Philanthropy over the last ten to 15 years. Several research centres and institutions which focus on the non-profit sector initially emerged in the United States, but over the last two decades, business ethics, strategic investment and corporate philanthropy have experienced a fast and still growing improvement and awareness in Europe. This is why it is no longer an outstanding quality of a business to engage in the social sector or donate parts of its profit, but is more or less a precondition for commercial success to develop a green or social strategy in order to be seen as an honourable and successful company in the consumer's eyes and in the public opinion.

This creates a question: Why and how can philanthropy play an important part in the business environment and what distinguishes philanthropy from other social engagement?

2. Profile of Philanthropy

To define philanthropy first of all, it is important to distinguish between redistribution or giving back and the creation of new opportunities and welfare. The meaning of redistribution is closer to the meaning of charity and associated with donation. Everybody can make a charitable donation and literally give some of his earned money to people who suffer from illnesses, who live in poor conditions or who happened to be a disaster victim. Meanwhile, philanthropy is more about investing money and ideas that create opportunities and more wealth through the social sector or new business ideas and concepts. It includes the concept of voluntary giving by an individual or group to improve the common good and is most of all an important resource for the non-profit sector.

Furthermore, we have to draw another distinction: the distinction between private and corporate philanthropy. Private philanthropy describes the willing contribution of resources - including money, volunteer hours, knowledge or connections – by a single person or a family, with the intent of addressing the needs and issues of individuals, groups or society as a whole. The purpose, of course, is to improve current social conditions wherever they seem the most urgent from the point of the private philanthropist's view. Often private philanthropists are so-called High-Net-Worth Individuals (HNWI) who are wealthy enough to realise their own projects or ideas. Thereby this is one reason why private philanthropy is an interesting way of donating money: it is possible to find a fitting project for everybody's individual concern, and a private philanthropist can literally be part of a developing idea, if this is wanted. Even though when we have a look at the volume of donations in Germany in 2008, which was about €26bn, with an annual increase of 3.5% over the last 10 years (cf. McKinsey & Company 2008), it shows us that there is huge potential and substantial willingness to create social impact.

On the other hand, there is corporate philanthropy, which is similar to individual philanthropy except for the fact that donations, profits or resources are given by a corporation, not an individual. Corporate philanthropy is always done through a corporation directly or a corporation's own non-profit entity, and it is usually done without the expectations of a direct corporate benefit. Unfortunately, in some cases, corporate philanthropy is not as efficient as it could be regarding its cost-benefit ratio. The engagement of most of the firms is unfocused and uncoordinated and therefore potential is not used. As Porter and Kramer outline the problem:

> "The majority of corporate contribution programs are diffuse and unfocused. Most consist of numerous small cash donations given to aid local civic causes or provide general operating support to universities and national charities in the hope of generating goodwill among employees, customers, and the local community. Rather than being tied well-thought-out social or business objectives, the contributions often reflect the personal beliefs and values of executives or employees" (Porter/Kramer 2002: 6).

Furthermore, Porter and Kramer describe that philanthropy is often misused for purposes like public relations or advertising to support a company's reputation. Strategic and intelligent philanthropy should be able to create social impact and end in itself and should not be part of a company's image campaign (cf. ibid: 5).

This raises one question: why are successful companies, which possess a lot of money because of their efficient and strategic behaviour, not able to donate their money and resources in a way so that they can have the most efficient impact? This question weighs even greater when we consider that there could be a win-win situation for both the corporation and society in general. Following Porter and Kramer's concept of the so-called "context-focused philanthropy" (ibid: 7) in order to achieve social and economic gains is a step in the right direction. With context-focused philanthropy, the efficiency problem can be addressed, as the corporation focuses on its immediate context and business environment and on social needs that affect the corporation. In accordance with Porter and Kramer's theory, "the more a social improvement relates to a company's business, the more it leads to economic benefit as well" (ibid: 7).

While Porter and Kramer's context-focused philanthropy is one good idea of how to solve the efficiency and the reputation problem, other concepts are imaginable as well. On the following pages we will have a closer look at another concept, the concept of Venture Philanthropy (VP).

3. Venture Philanthropy

Venture Philanthropy, which integrates modern financial methodology with philanthropic goals, could solve the problem of ordinary philanthropic projects not usually being efficient regarding a cost-benefit ratio. To understand how, we have to overcome the actual separation between philanthropic behaviour and economic instruments. If philanthropy is applied in business areas, it is either a direct donation for corporate reputation or expenditure for strategic purposes. A broader understanding of what philanthropy is and what possibilities are there to apply its concept in investment enables us to employ additional instruments in order to achieve higher efficiency, which again could lead to higher gains in the corporate, public and private sector. The integration of the aspects of efficiency and social or non-profit projects encourages the application of entrepreneurial approaches in managing these philanthropic enterprises. The old idea of philanthropy as unrelated to economic benefits and measurability seems to be out-dated due to the rising field of social impact measurement. Finally, due to the fact that most of these engagements are done monetarily and are often built from zero, venture capitalism seems to be an adequate instrument for realising these goals.

First mentioned in 1960 by John D. Rockefeller III, the term "Venture Philanthropy" (VP) describes a concept which meets the requirements of providing philanthropic projects, for example social enterprises, efficiently with capital by applying venture capital methods (cf. Alberg-Seberich and Wolf 2011: 288). If we want to use this approach, we have to re-adjust our perspective and regard philanthropic actors as kind of investors. Additionally, we have to understand how it is possible to achieve philanthropic goals through return-orientated projects. In comparison to classical venture capital projects, socially-motivated investments have different objectives. Nonetheless, financial returns can still be taken into consideration if the philanthropist prefers to do so, for example because he wants to use the rents for other projects later on. This is different from pure donations. By aiming to realise the two goals of social and financial returns, this intention is called the double-bottom-line approach (cf. Bernandez 2009: 18). Within this hybrid purpose, the mixture of an individually defined blend between financial and social returns has a wide range of possible adjustments. The project-specific differentiation of criteria is referred to as the respective blended return. Through this combination of different objectives, some trade-offs between the financial and social aims naturally arise, and with these, there are also new challenges of the measurement and comparison of figures. Although there does not necessarily have to be a conflict of objectives, it is imaginable that the social goals foster the financial ones and vice versa, which would allow for the achievement of a greater overall value than without such an reciprocal relation (cf. Achleitner et al. 2011: 269 ff.).

Venture Philanthropy also solves the fundamental problem that most current social engagement is backward-oriented. This means that most people who donate money for good purposes do so as a result of their own economic success as a justification. While it is possible to make Venture Philanthropy investments as a consequence of economic success, the direction of the Venture Philanthropy process itself however is aimed forward. A Venture Philanthropist provides capital to promising originating projects and not to existing non-profit organisations. We have to overcome the view that philanthropy is just about giving back. It is more the idea of assuming risks to provide social benefits within a certain project with the prospect of getting these risks refunded. The notion of investments already contains the aspect of future orientation. In this context, it is about assuming responsibility for future generations through professional methodology. The advantage of this approach is that the professional knowledge of investors helps to select more worthwhile investment projects in terms of economic success than if the evaluation had been carried out by pure philanthropists. Owing to the hybrid character of Venture Philanthropic objectives, there is also the necessity of estimating the social effects of the particular projects, leading to the subject of social impact measurement.[1] The core issue of each VP project is the balancing of financial and social aims. The possible range within such projects is wide, from purely non-profit donating to extensive profit maximisation, whereas these two extreme tails of the scale are excluded by definition (cf. Alberg-Seberich and Wolf 2011: 290).

In the literature and in the peripheral areas of financial services industry, we can find a few models of applied Venture Philanthropy. There is, for example, the Private Equity Foundation in London, which focuses mainly on funding ventures supporting socially-disadvantaged young people. The foundation employs a four-stage screening process to ensure the identification of projects with high effectiveness in their work, good management practices and last but not least, the aim that the capital is invested efficiently (cf. Private Equity Foundation 2012). LGT Venture Philanthropy, a philanthropic subsidiary of the Liechtenstein LGT group, employs similar models (cf. LGT 2012). There has to be no explicit financial return on the investment but the proof that it is used effectively and efficiently. They place more emphasis on the philanthropic aspect within the spectrum of social and financial returns. The Social Venture Fund declares to aim at increasing its equity by searching for highly innovative and socially or ecologically relevant projects which have a balanced proportion between financial and social returns (cf. Social Venture Fund 2012). Thus, the main difference in VP financing compared to classic philanthropy is that there is a repayment of capital. But we cannot define whether one of both possibilities should be preferable. If money is provided, the possible social impact can be maximised but even if a financial return is required, the capital can be reinvested and hereby lead to further social impacts. It is therefore simply a question of the definition of objectives. If we want to analyse the characteristics of VP, we should focus on the differences compared to classical investments and ordinary philanthropy rather than comparing different approaches within VP concepts.

1 See in this volume Jakob/Krull 2015.

4. *Advantages and Challenges*

What is the competitive advantage of Venture Philanthropy? The crucial point is: Professional investors are able to allocate capital to its most efficient use instead of spreading it according to purely philanthropic considerations. This means it is possible to realise much more social impact with the same amount of money, which implies that investors and philanthropists can also maximise their individual blended returns unlike classical giving back. In this context, a distinction between VP and Socially Responsible Investing (SRI) approaches also has to be made. SRI is a screening method for selecting portfolios in accordance with ethical parameters, such as excluding armaments industries (cf. DB Climate Change Advisors 2012). The difference is that VP projects contain the idea of taking risk in order to realise goals that aim high. In a SRI frame, the investor puts his capital in existing enterprises and can withdraw it every day whereas a Venture Philanthropist is committed over a longer period to only one or two nascent projects; respectively, a social venture fund is committed to few projects in the long term and will not disinvest at short notice.

In this commitment, there are advantages and restrictions for Venture Philanthropy. In the classic view of philanthropy, there is no need for continuing engagement or proved achievements of objectives. The restrictions of a lower availability of the money invested lead to necessary measures, which make VP a more complex method than social investing on the stock market. There are essentially three main differences that make the VP approach more laborious and which lead to more efficient social and financial results as well. The first one is an extensive ex-ante screening and due diligence process, targeted at clearly defined objectives. The second aspect is the possibility of individually defining the aspired blended return of social and financial goals the investor wants to achieve. The third one is the measurement of and reporting on the realisation of these goals.

There seem to be three alternatives for Venture Philanthropy to be applied in matters of the sources of capital. Following corporate philanthropy, successful enterprises could put effort into building up social enterprises and hereby reach similar strategic effects as with CSR methods but additionally receiving financial returns. The advantage of this Corporate Venture Philanthropy (CVP) would be that experienced corporations could also make some managerial skills available to the venture projects. But CVP runs into danger due to the lack of legitimacy if it is not strictly focused on strategic objectives for the company from a shareholder value point of view. Even by employing the stakeholder approach, a VP project should at least benefit some close stakeholders of the respective company and not uninvolved parties. If we consider private philanthropy, it is basically the same concept but without problems of legitimacy due to the qualities of private wealth. In Private Venture Philanthropy (PVP), it is, however, even more important to the investor to be able to fund projects which perfectly meet his expectations and to get extensive reporting on how his or her social enterprise develops. Lastly, the third kind of venture philanthropic approaches would be a hybrid as well as a collective one. For example, the Social Venture Fund provides Bundled Venture Philanthropy (BVP) for corporate and private social investors to participate in. But principally, it would be also possible for some corporate or private investors to join together individually to fund a social project. The challenge in this case is the coordination of similar social objectives of different investors; as a result, either there is strict pre-selection or the handling of such funds becomes very complicated. This leads to the point that at least for Private and Bundled Venture Philanthropy, it seems to be useful to have independent agencies providing services in VP in order to lower transaction costs. These intermediaries should be able to screen possible projects for certain social and financial criteria, register them in databases, execute monitoring and establish communication between investors and the social entrepreneurs. Established banks and equity funds with expertise in evaluating venture projects seem to be appropriate for this but they could be reliant on specialised consulting firms in matters of evaluation, social start-up ideas and social impact measurement.

The VP concept also faces limitations. The most operational restrictions nowadays are the lack of social measurement professionalism and the absence of consistent standards. If the idea of conditional giving is pursued too extensively, the risk of competition within VP could force inefficient projects out of the market so they would remain unfunded. But this argument only refers to such projects and VP investors which aspire to gain financial returns, not to cost-impact considerations, for instance from the Private Equity Foundation. Through its hybrid character, the price mechanisms of competition only take place if the social impacts are comparable. Without extremely similar social output, two projects could hardly be compared and if so, an allocation of capital to the more efficient projects seems desirable. This demonstrates the individual possibilities to design VP projects – even more individual than Venture Capital projects because there is more than the financial return to calculate. This may be a disadvantage with respect to transparency of markets, but to us, it seems that VP is rather an instrument for the optimisation of identifying and funding ideas with social value added.

To conclude, we do not see VP as a replacement of all “old philanthropy” up to now. Furthermore, it is a constantly rising and developing supplement for broad areas within private and corporate philanthropy, providing tools for selection of effective projects. It will hopefully catalyse the segment of philanthropy towards more measurability and help to fill the gap between investors and philanthropists in order to realise more social impact with higher efficiency and therefore also higher financial returns.

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