

Strategy Matters

ANTHONY KNERR & ASSOCIATES

PROSPERING IN A NEW AGE

Suggestions for Nonprofits in Difficult Economic Times

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ANTHONY KNERR & ASSOCIATES

We assist leading nonprofit institutions in the United States and Europe in solving complex strategic challenges. Established in 1990, the firm serves organizations across the nonprofit spectrum, including universities and colleges, cultural institutions, medical organizations, human service agencies, foundations and volunteer organizations.

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PROSPERING IN A NEW AGE

Suggestions for Nonprofits in Difficult Economic Times

As many commentators have observed, we are presently living through a period of significant transformational change, a paradigm shift the full dimensions of which are not yet evident. There can be no doubt that we are in the midst of historic upheaval and change, with the world seemingly more unruly, complicated and uncertain than ever.

The fresh shocks and major upheavals around the globe in just the last year have ranged from the Arab Spring to the Japanese tsunami, financial turbulence in the Euro zone to stubbornly high unemployment and a growing budget deficit in the United States, street riots in London to citizen outrage in China. Even the weather seems to be out of kilter.

Fundamental Forces at Play: *The root causes of these and other seismic events are not yet clear, but several fundamental forces appear to be at play:*

- Information technology is continuing its disruptive course, even more violently than only several years ago. Innovations such as tablets, cloud computing, wireless connectivity, smart phones, equipment miniaturization and robotics are fundamentally accelerating the flow and distribution of information, exponentially increasing productivity and radically changing whole industries. More disruption is surely on its way over the next decade.
- At the same time, social media is upending communications, work processes and traditional organizational structures. Facebook, Twitter, LinkedIn and Google+, among others, are empowering citizen discontent, enabling everyone to know about almost anything anywhere and reformulating institutional and individual relationships. Suddenly, it seems, the globe has gone from being highly connected to hyper-connected. As a consequence, traditional authority figures – be they governments, large organizations or “experts,” to suggest a few – are less tolerated, recognized or revered; participatory action and individual engagement is in the forefront.

- Globalization continues unabated, creating unparalleled opportunities in much of the world and for the well-educated everywhere. At the same time, new forms of risk and disturbance – hacking and other compromises of electronic security and liquidity crises, among them – are appearing. Sovereign governments are grappling with massive capital flows, immigration, currency fluctuations and realignment of geopolitical interests.
- Recent excess borrowing and leverage in the United States and other developed countries are radically curtailing discretionary action by government, placing financial institutions under new scrutiny and causing economic difficulties for many institutions, organizations and individuals.

While the full impact and implications of these factors are not yet clear, it is certain that yesterday’s world is gone, forever. We have moved into a new era, with its own dynamics, character and rhythm.

Implications for Nonprofit Organizations: *These fundamental forces present three significant implications for nonprofit organizations.*



1. Budgetary pressures will continue to be intense for the foreseeable future.

Like many organizations, nonprofits are now faced with a period of general relative financial scarcity after an unusual era of seemingly boundless funding.

- It will take considerable time in the United States and Europe for governments, financial institutions and individuals to deleverage their balance sheets and normalize their net asset levels and discretionary funding. The deleveraging process is likely to be slow, painful and wrenching, particularly in the short run.
- In the face of extremely tight budgets, all levels of government – federal, state and local – will increasingly cut support for the nonprofit sector, in part because truly discretionary governmental funding is limited. Presently uncontrolled entitlements and other obligations limit funding options, and it is politically easier to cut education, arts, culture and other so-called “soft” parts of governmental budgets. In addition, strongly-held ideological positions are increasingly influencing public policy in some regions of the country.

This new era of constrained resources will require major shifts in organizational outlook, clarity and focus.

- By the same token, capital markets are fluctuating more radically and rapidly than in the recent past, a reflection of uncertainty and lack of confidence, the impact of an increasingly frictionless global financial marketplace, and changing geopolitical circumstances and interests. As a consequence, there is continued lack of confidence in the economic and financial future of the United States and Europe, which is making many individuals and foundations more cautious with respect to spending, at the same time that the market continues to generate unparalleled financial returns for others.
- Pricing options are becoming more restricted in some sectors of the nonprofit world, in view of historically low rates of inflation, stubbornly high unemployment and constraints on personal discretionary spending. Thus, for instance, tuition in higher

education and fees for services elsewhere in the sector have probably reached points of inelasticity; rate increases no longer offer significant opportunities to offset reductions in public funding and mitigate the impact of other budgetary pressures.

This new era of constrained resources – whether absolute or relative – will require major shifts in organizational outlook, clarity and focus for all nonprofits. For some, it may mean drastic modification of mission, realignment of programs and services and, possibly, retrenchment. For others, affiliation and/or merger with more financially robust organizations may be the best solution.

2. While the fundraising environment may be more challenging, it still offers remarkable opportunities.

The perplexing paradox confronting all nonprofits during this time of unsettling change is that while resources will generally continue to be highly constrained, the opportunities to attract sizable new funding are unparalleled.

- The role of the nonprofit sector is getting more, not less important, as government support shrinks, the dislocations of the global economy become more prevalent, and there is growing recognition that major public problems cannot be solved by government alone, but rather through public-private partnerships. In spite of much of the current rhetoric, there appears to be growing recognition of the essential and growing role that nonprofits play today. Higher education is ever more important, because only the well-trained will have significant jobs in the developed world. Arts and culture are ever more critical to interpret the significance of change and disruption, and provide essential values to guide individuals through an unruly world. Social services will increasingly be provided by the nonprofit sector as government offers less direct provision of services and relies upon services provided through networks of nonprofits.
- There is an emerging recognition of the importance of philanthropy by many high net worth individuals and selectively by major corporations. The recent initiative to encourage high net worth individuals in the U.S. and abroad to commit at least 50% of their net worth to philanthropy is gaining traction as more such



individuals are making pledges to do so. The extensive media coverage of major philanthropic commitments is an important manifestation of a significant change in social attitudes and interest in philanthropy. The continued strengthening of U.S. philanthropy over the past several years in spite of the recent Great Recession is broadly encouraging.

- An extraordinary amount of funding is still looking for a philanthropic home in spite of the recent capital market turbulence. Total intergenerational wealth transfer is currently estimated at between \$25 and \$35 trillion, which, while down from the estimated high point, is still unprecedented in size. The top 1% of the country now controls an estimated 42% of total wealth in the U.S. One consequence is that a cohort of individuals is able to make remarkable gifts, as witnessed by the number of eight-, nine-, and ten-figure commitments in the past few years. Total corporate giving in New York City in 2010 grew 13% above the prior year. The portfolios of many individuals and foundations have grown rapidly over the last several years.

- Some thoughtful philanthropists are making truly significant gifts to nonprofits in order to strengthen institutional balance sheets during this period of economic complexity; others are doing so because they are concerned about actual and possible radical cutbacks in government support; still others are eager to support bold and clear aspirations of favored institutions.

An extraordinary amount of funding is still looking for a philanthropic home.

Two of our clients are mounting major new fundraising campaigns only shortly after successfully completing their largest development efforts to date. Both new efforts are seeking far larger major commitments tied to clearly-expressed strategic aspirations. Another client has changed its business model, replacing sizable cutbacks in public funding with new private giving, while simultaneously refocusing its programs and reducing its total operating budget. And another client has substantially sharpened its mission and program focus,

with the result that it is broadening its client base, expanding its global footprint and clarifying its financial architecture.

3. It is critical for nonprofits to understand their present business model while thinking strategically about their best future.

All nonprofits need to ensure they have solid, sophisticated analytic understanding of their present business model. Doing so requires the use of rolling long-term financial plans, an understanding of the source and purpose of every funding stream, and an awareness of net margins for all major program components, including allocation of overhead. A regular review of these factors will allow institutions to re-engineer resource allocation, increase productivity and strengthen efficiency, while ensuring their programs and services truly enable them to fulfill their stated missions. This new era requires strong, thoughtful and imaginative financial leadership at both the board and executive levels. The failure to provide such leadership will leave the organization at the mercy of external financial forces.

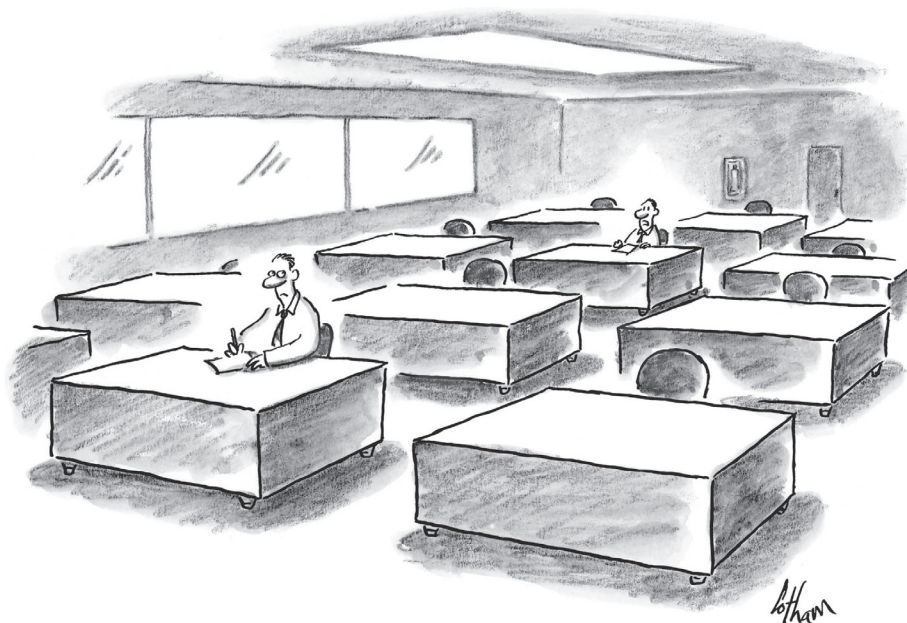
By the same token, every nonprofit needs to be continuously thinking strategically – to have a clear understanding of its present positioning; a cogent and bold vision; and a small set of major ideas about where it wishes (and intends) to be in the next five or ten years. Such strategic thinking may be realized through

a formal strategic planning process; it may be captured in a solid strategic plan. But without thinking – and acting – strategically, an organization cedes its future and well-being to others, which is never a good idea, even in the best of circumstances.

Strong, collaborative and engaged leadership is likewise critical for nonprofits to successfully navigate the current difficult and uncertain economic environment. Such leadership by the board, CEO and key internal leaders will bring a clear analytical understanding of the organization's business model and ensure a strong culture of thinking and acting strategically throughout the organization. It will also communicate clearly and regularly with all constituents, internal and external, and expect high performance by everyone associated with the organization. And effective leadership will likewise ensure strong accountability and regular measurement of the impact of all programs, services and the supporting infrastructure.

On the other hand, the need for and importance of the nonprofit sector are significant and only likely to grow over the coming years. The wise nonprofit will look beyond current pressures, challenges and financial constraints to take strategic advantage of the new opportunities and possibilities present in the rapidly evolving global world.

– Anthony Knerr, Managing Director



"I still say we're stretched dangerously thin."

THE NEW TECH-BASED PHILANTHROPY

Eight Things You Need to Know about the New Donor Culture

Not so long ago, most major U.S. foundations fit the image of the giant East Coast foundation, rooted in fortunes made by titans of the manufacturing and extractive industries. For decades, the Ford, Carnegie and Rockefeller foundations carried out sweeping programs on a scale that rivaled those of governments. Many public reforms and institutions were buoyed by their efforts, including public broadcasting, public libraries and the Green Revolution.

But in recent years that primacy has been challenged by a host of new foundations, rooted in the digital communications and technology sector, which are rewriting the rules of American philanthropy. They don't always march in lockstep or speak with one voice, but they are generating a new philanthropic culture nonetheless.

Here are eight ways in which the new tech philanthropies are making their mark:

1. Tech-based donors represent the fastest-growing sector in U.S. philanthropy today.

This claim could be based on the Bill & Melinda Gates Foundation alone. Founded in 1994 with an endowment of \$94 million in Microsoft stock, it immediately experienced dramatic growth. This was further galvanized by Warren Buffett's 2006 contribution of the equivalent to \$30 billion, which was to be paid out over a number of years.

The Foundation Center's list of last available audited statements (as of July 2011) places the Gates Foundation's assets at nearly \$34 billion at the end of 2009 (see chart below). This is more than the assets of the three next largest U.S. foundations listed (Ford, J. Paul Getty and Robert Wood Johnson) – *combined*.

Tech-based philanthropy displays a strong affinity for science and technology.

In recent years Gates has been joined by a number of other donors from the tech community, among them eBay's Pierre and Pam Omidyar, founders of the Omidyar Network; eBay's Jeffrey Skoll, founder of the Skoll Foundation, and the Google philanthropic arm known as google.org. Not only are these organizations built on vast new fortunes, their assets are also often neutral or even counter-cyclical compared to traditional foundations' portfolios.

2. They are generating new organizational cultures.

Institutions tend to mirror the dominant administrative cultures of their origins, and foundations are no different. The new tech-based philanthropies, rooted in start-up culture, tend to be distrustful of big bureaucracy and admiring of innovation.

The Gates Foundation began in Seattle with a bare-bones staff that had to be doubled in 2006 when

Foundation Rank	Assets	As of fiscal year end date
1. Bill & Melinda Gates Foundation (WA)	\$33,912,320,600	12/31/2009
2. Ford Foundation (NY)	\$10,881,598,073	9/30/2010
3. J. Paul Getty Trust (CA)	\$9,584,879,219	6/30/2010
4. The Robert Wood Johnson Foundation (NJ)	\$8,490,415,783	12/31/2009

Source: Foundation Center



the Warren Buffett contribution arrived. The Omidyar Network dispensed with traditional titles to indicate its idiosyncratic approach to the funding process. (This decision included the word “foundation.” One of the network’s alternate labels is “philanthropic investment firm.”) Omidyar programs are shaped by individuals whose titles include “principal” and “managing partner.” The network collaborates with “partners” rather than funding grantees. The Omidyar Network is also pioneering the use of social investment, by investing in for-profit companies for the sake of social impact, at times acquiring equity in the process.

3. They promote a global perspective.

The Ford Foundation and the Rockefeller Foundation were deeply involved with the architecture of the Marshall Plan that rescued Europe from the ashes of World War II. Now the Gates Foundation and its counterparts are taking a close look at the developing world, and at Africa and India in particular.

The Gates Foundation’s three program areas are global health, global development (with a special focus on Africa and India) and U.S. programs (with a primary focus on education). The Omidyar Network’s portfolio includes many projects in India and Africa. Google’s philanthropy has experimented with a number of different approaches, among them pro bono tech projects and public health initiatives in Africa. Some of these global initiatives include surprising new approaches, such as Jeff Skoll’s Participant Media, which finances films to advance public education on critical global issues. Participant’s most recent project is *Contagion*, a feature film that

portrays the world in the grip of a rapid-fire pandemic.

The project features a public education website, and its advisors included public health expert Dr. Larry Brilliant, formerly the head of Google’s philanthropy and currently president of the Skoll Global Threats Fund.

4. They’re still in motion.

There are older technology-based foundations, such as the David and Lucile Packard Foundation (founded in 1964) and the William and Flora Hewlett Foundation (founded in 1967). These foundations have been around long enough to define their portfolios and their institutional approaches and bear a stronger resemblance to traditional East Coast foundations. But their younger cousins are far from set in their ways. The Case Foundation was founded in 1997 by the former CEO of AOL, Steve Case, and his wife Jean. Google was launched as a project in 1996, and its philanthropic arm google.org debuted in 2004.

Many new foundations favor a “venture capital” approach in which new projects are seeded with the expectation that some will fail, and successful models will proceed to the next level of support.

5. They believe in “social entrepreneurship.”

Digital media celebrates a culture of grassroots participation, so it’s no surprise that many of their foundation portfolios feature projects in micro-finance, anti-censorship and public participation in good governance. The Case Foundation has experimented with the “Make It Your Own Awards,” in which individuals are invited to suggest “citizen-centered” solutions to their community problems and compete for \$25,000 grants to implement them – chosen by a public online voting process.

The John S. and James L. Knight Foundation is based in Miami with origins in the newspaper industry, but it has moved decisively into the spheres of digital media and tech-based philanthropy. Knight has not only pioneered online public competitions for digital media grants, it has also forged new approaches to collaboration among philanthropies with shared goals.

6. Their funding interests often reflect their core businesses.

It's only natural that foundations that arose from the digital revolution would take a strong interest in innovators in the field. The Omidyar Network and Google have recently made major grants to the Wikimedia Foundation, the nonprofit organization that supports Wikipedia, as well as to Global Voices, an international blogging community, and its academic birthplace, the Berkman Center at Harvard. Tech-based philanthropy also displays a strong affinity for other areas of science and technology, especially medical science and public health. The Gates Foundation has undertaken massive public health campaigns involving vaccinations, malaria eradication and nutrition in the developing world; the Omidyar Network and google.org have also made important contributions to global public health campaigns.

7. Individual and institutional philanthropy are both significant.

Sometimes they are carried out simultaneously. Pierre Omidyar's wife Pam was a co-founder of the Omidyar Network and also founded two other philanthropic enterprises, Humanity United and HopeLabs. A new generation of individual philanthropists is emerging from the tech sector, and they are not all American. New Indian philanthropists include Dr. Abraham George, a technology entrepreneur who created the George Foundation to promote projects in health, education and poverty alleviation.

8. They're West Coast-oriented.

This point is less obvious than it may seem. For decades, much U.S. foundation activity was concentrated in the Northeast Corridor, running from Washington through New York to Boston. This route involved heavy traffic with the federal government, New York media and cultural institutions and northeastern universities. The new corridor involves Los Angeles, San Francisco and Seattle. (It is noteworthy that while the Case Foundation is based in Washington, D.C. and the Gates Foundation has an office there, none of the new tech-based foundations mentioned in this article maintains an office in New York.)

Foundations that arose from the digital revolution take a strong interest in innovators in the field.

The relative influence of the West Coast donor community may be growing, but there have also been signs of increased consultation and collaboration among the various donors. Ideally, the surge of the tech-based donor activity can usher in a new age of American philanthropy, combining the energy of the new institutions with the experience of traditional foundations, to offer the world a much-needed array of innovative solutions.

— Anne Nelson, Senior Consultant

An online version of this piece was published in PBS MediaShift



*"Things were done very differently on the farm
when I was your age, Kenny."*

STRATEGIC FINANCE FOR HIGHER EDUCATION

Understanding Academic Program Costs and Contributions

Unlike institutions of higher education, hospitals and health clinics have long understood the financial contributions of their various functional units: which paid for themselves, which required support, and which generated revenue above costs that could be used to subsidize other functions. Savvy college and university leaders do know that understanding the costs, revenues and financial “contributions” of their various academic and non-academic units is central to ensuring the financial health of their institutions. Yet most colleges and universities lack the data and financial-modeling capabilities to generate good information about their program costs and contributions.

This can be partly traced to the political environment in which colleges and universities operate. Some on campus may fear that knowing this information might lead institutions to cut programs that don’t generate revenues to cover their costs. Others may believe this information is not relevant to mission-driven institutions. However, our clients have found that, in fact, such information allows institutions to *protect* important programs that may not cover their own costs by taking steps to generate additional revenue from programs that produce revenue above their costs.

In other words, having solid program cost and contribution information allows these institutions to create financially sustainable enrollment and academic-program strategies that are consonant with their institutions’ missions rather than simply cutting costs.

While such information will not end campus debate over how resources should be allocated, it helps facilitate an informed discussion by presenting essential financial facts. As Daniel Patrick Moynihan famously said, “Everyone is entitled to his own opinion, not his own facts.”

Margin analysis is a tool we have used with our higher education clients to create this baseline of financial facts – the actual costs and revenues relating to



each academic activity. Having seen the thoughtful debate this knowledge facilitates among diverse campus constituencies, we believe it is relevant and useful to institutions of higher education in general, and by extension, to all nonprofit organizations, with certain obvious differences with respect to specific categories of income and expense and organizational unit.

What is Margin Analysis?

Margin analysis establishes on a highly granular basis the specific revenues and expenses attributable to each academic and non-academic department, degree program or other activity of an institution – by student, faculty member, class, department, college/school, or campus. Indeed, it can conceivably be applied to almost any category of expenses within a given institution.

The specificity of these data is typically an eye-opener for faculty, academic and financial officers and trustees. Such information not only helps identify promising program opportunities or under-tapped student demand, but promotes constructive discussion about resource reallocation. It can also demonstrate to sometimes restive creditors, rating agencies and insurers that the institution has a firm grasp of its financial facts.

Most importantly, when combined with other internal and external data about the institution, margin analysis can be a building block for sound enrollment strategies, academic planning and especially for strategic planning to articulate goals and initiatives to achieve the institution’s vision.

From the Bottom Up

College and university leaders are generally most interested in program costs and contributions at the

department, school and institution-wide levels. Margin analysis begins at the level of the individual classroom – the revenue and expenses attributable to every single class. The initial step is the collection of revenue information: tuition and financial aid data for each student.

When these are aggregated, one obtains, for each class offered: total revenue produced; average financial aid discount rate; and the total net revenue produced by the class. These data are then “rolled up” to generate detailed reports covering every aspect of the institution – from the micro (course, faculty member, student), to mid-level (department), to the macro (degree program, school, campus).

The specificity of these data is typically an eye-opener for faculty, academic and financial officers and trustees.

To understand “margin,” however – how much the class contributes financially – it is important to understand the direct expenses associated with it. By examining compensation and workload data, each instructor’s cost can be applied to his or her classes and subtracted from the total net tuition revenue for each class to arrive at the class margin.

A View of the Whole Institution

This class-level analysis is the foundation for margin analysis at all other levels of the institution – department, program, school and the entire institution. Net tuition and instructional costs obtained at the class level are rolled up to the departments offering the classes, and departmental administrative expenses (e.g., portion of instructor compensation allocated to administrative duties, office expenses, etc.) are added.

Department revenue and expenses are then aggregated to the school and then the institutional level, and the administrative expenses associated with each level (e.g., the deans’ and the president’s offices) are included. The table below provides a hypothetical example of the results of margin analysis at the school level based on the courses offered by each school (as opposed to the students enrolled in each school’s degree programs).

School Margins by Courses Offered

Overall, the data generated by the margin analysis facilitate comparisons of departments within and across the individual schools of the institution to highlight the effect on department margins of different approaches to pedagogy, levels of faculty compensation, desired student-faculty ratios and similar factors. The analyses may also be used to reveal the financial impact of students who are degree candidates in one school of the university taking classes in another, an issue of importance at many institutions.

Margin Analysis in Planning

Margin analysis can be used in myriad ways to inform academic planning, enrollment strategy and overall institution-wide strategic planning. To illustrate some of the rich potential of margin analysis, consider a few of its potential implications for enrollment strategy at a hypothetical institution.

Margin analysis presents a snapshot of an institution’s performance at a point in time; however, it can also be adjusted to demonstrate pro-forma results of running all programs at full capacity. One reason for doing this is to compare schools and departments on an “apples-to-apples” basis and to consider their potential to generate additional net tuition revenue by adding more students where room exists. For example, our hypothetical School of Arts & Sciences, at full capacity, has a contribution

School Margins by Courses Offered

School	Gross Tuition & Fees	Institutional Aid	Net Tuition	Discount Rate	Instructional Cost	Class Level Margin	Administrative Costs	School Level Margin
Arts & Sciences	\$43,106,487	\$13,170,687	\$29,935,800	30.6%	\$7,894,355	73.6%	\$1,740,864	67.8%
Business	\$27,556,836	\$5,742,933	\$21,813,903	20.8%	\$5,468,773	74.9%	\$4,368,052	54.9%
Education	\$5,055,626	\$640,097	\$4,415,529	12.7%	\$2,191,640	50.4%	\$818,531	31.8%
Public Health	\$5,562,182	\$1,307,690	\$4,254,492	23.5%	\$1,884,246	55.7%	\$576,835	42.2%
Total	\$81,281,131	\$20,861,407	\$60,419,724	25.7%	\$17,439,014	71.1%	\$7,504,282	58.7%



margin significantly higher than that of other schools and, therefore, the greatest potential to contribute additional net tuition revenue to the institution as a whole. This might suggest a strategy of increasing enrollment in Arts & Sciences; that is, recruiting more heavily for students who will fill seats in classes offered by Arts & Sciences departments.

However, looking at the underlying data, the provost might determine that the largest number of seats in Arts & Sciences classes is filled with students enrolled in the university's School of Business who are completing core academic requirements, and that a low rate of tuition discounting among business students contributes significantly to the high contribution margin of Arts & Sciences classes. But, imagine further that the School of Business has significant constraints on enrollment growth as a result of accreditation regulations or infrastructure limitations. Given such a situation – no additional Business School students could be added to Arts & Sciences classes – the university would need to look at alternative sources of students: could Arts & Sciences fill its classes with more of its own students (i.e., students who are degree candidates in Arts & Sciences) or those enrolled in other schools of the institution?

How Our Clients Have Benefitted from Margin Analysis

One of our clients realized that their approach to enrollment management was incomplete. The university understood how to use financial aid and admissions yield data to recruit and enroll the students it most desired: those who would maximize the overall academic ability of the student body and be retained through graduation. However, it did not understand the full financial effect of recruiting such students – the different margin contributions, say, of students recruited and enrolled in one program as opposed to another.

By adding margin analysis to their consideration of financial aid and admissions yield data, the provost and deans were able to restructure student recruitment to not only attract the most desirable students, but to do so in the most financially sustainable way for the whole institution. That is, the university came closer to the optimal balance among the number of students, academic ability and true net revenue – “true net revenue” here referring to that accruing from not only the net tuition revenue generated from the students, but also from the overall institutional margin contribution resulting from the particular configuration of students, in terms of their chosen degree programs and probable course selections, enrolled by the institution.

Margin analysis presents a snapshot of an institution's performance at a point in time.

Another client used margin analysis to rationalize resource allocation between its professional schools and its core arts and sciences school, which was teaching many students from the professional schools but not receiving appropriate financial reimbursement for those students. It also discovered that enrollments in several programs recognized widely for their quality and distinctiveness could be carefully increased to respond to student interest and demand while generating highly attractive net margins. In addition, their margin analysis substantially increased classroom utilization and thereby improved the institution's overall financial performance.

These are only a few ways in which margin analysis can stimulate an institution's thinking about enrollment management, financial planning and overall institutional strategy. The versatility of margin analysis helps campus leaders test hypotheses about costs and revenues at all levels of their institutions and thereby generate enrollment and academic program strategies to maintain academic and financial health. Moreover, margin analysis helps a university establish a stronger institutional culture of data-driven management and decision making – a discipline that will serve institutions well as their environments become increasingly competitive and resource-constrained.

– John Braunstein, Senior Consultant

– Adam Boyd, Director, Goldin Associates, LLC

NOTABLE BOOKS

In each issue, we identify and briefly describe a small number of books that are insightful about consequential matters and offer new ways of thinking strategically about the nonprofit world.

The Innovative University: Changing the DNA of Higher Education from the Inside Out

By Clayton Christensen and Henry Eyring

Jossey-Bass: 2011, 512 pp.

When Derek Bok was president of Harvard University, he used to talk about what makes an institution great. In higher education, he said, it was not necessarily endowment balances, publication rates or other numerical data that rankers like to collect. There were many schools that he considered exemplary successes that would never become well-known based on such statistical criteria. Rather, Bok said, what makes an institution great is a shared sense of identity and purpose.

In their new book, *The Innovative University*, Clayton Christensen and Henry Eyring devote most of their attention to two great institutions: Harvard University and Brigham Young University-Idaho (BYUI), formerly known as Ricks College. Eighteen of their twenty-four chapters compare and contrast these schools. They eventually draw general conclusions about “the Innovative University” that are thoroughly grounded in what they have to say about their two case studies.

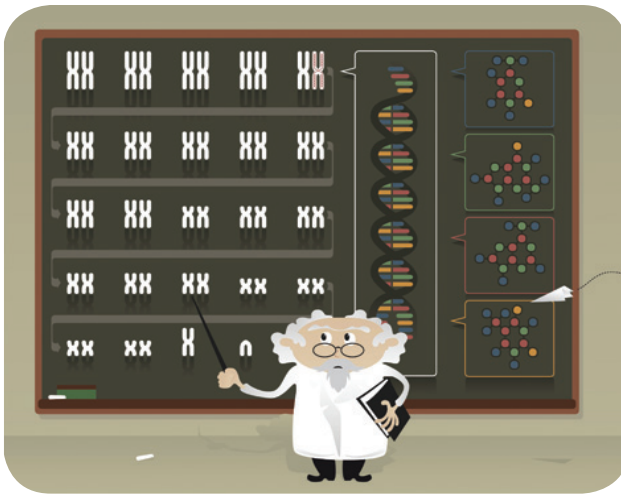
You may not think Harvard and BYUI have so much to do with one another, but this book will convince you otherwise. Their stories are actually intertwined in all sorts of ways, both important and unimportant. Author Henry J. Eyring, an administrator at BYUI, is the son of BYUI’s former president, Henry B. Eyring, who earned both his Masters and Ph.D. in Business Administration at Harvard. Clayton Christensen, now a professor at the Harvard Business School, was an undergraduate at BYU, though at the main campus in Utah rather than in Idaho. And Christensen’s former dean at Harvard, Kim Clark, left the Business School in 2005 to become president of BYUI. Clark also brought two other Harvard Business School faculty with him there, Steve Wainwright and Clark Gilbert.

The point is that, through many connections, the two authors are very familiar with both BYUI and Harvard – or at least with the Harvard Business School. It is less obvious that they have much intimate knowledge of Harvard College, or, indeed of trends and research concerning undergraduate education worldwide other than at BYUI. There are some sidebars that reference other schools, mainly in Utah, as well as other studies, mainly by McKinsey, Milken or Innosight. But the book concentrates almost entirely on what many people know about Harvard and what not so many people have known about BYUI.

This strategy is sometimes enlightening. The authors emphasize, for example, that Harvard began as a Puritan college and that BYUI began as a school, then became a junior college and is now a four-year university sponsored by the Church of Jesus Christ of Latter Day Saints. But sometimes the parallels really seem like a stretch. The long and selective histories they recount are laced with too many transitions of the form, “Meanwhile, back at Harvard, similar developments were taking place...” One almost gets the impression that these were the only two schools on earth and that, for more than a century, they were constantly thinking of little besides one another.

But the authors’ descriptions of each school seem accurate enough. In fact, most chapters helpfully provide tables that highlight certain defining characteristics of each institution at various points in their development. They refer to these contrasting traits – such as open admissions versus selective admissions or moral educational priorities versus liberal educational priorities – as the institution’s “DNA.” This metaphor runs throughout the book, including double-stranded graphics that grace both covers, the title page and every sidebar.





Indeed, the very subtitle of the book is “Changing the DNA of Higher Education from the Inside Out.” The problem with this metaphor is that no one knows how to change his or her DNA. The book goes to great lengths to draw out two strands in the history of higher education to illustrate how one shows the way forward and the other is in trouble. But even the most sophisticated chart of our genetic makeup does not and cannot tell us what to do about it. The implicit diagnosis is, of course, that Harvard is threatened but BYUI has a bright future. And that is because Harvard’s DNA makes it vulnerable to what Christensen has become famous for calling “disruptive innovation.”

The process of “disruptive innovation,” as developed in Christensen’s other books, unfolds when old established firms selling traditional products cannot cope with how upstarts provide new and initially inferior substitutes to new and ultimately larger sets of consumers. Think of how cell phones have moved up-market to displace landlines, or how discount stores have moved up-market to displace full service retailers. The underlying message of this book is that profit-minded online educators are going to eat Harvard’s lunch, while BYUI and its ilk will not only survive but thrive.

The authors convincingly suggest that BYUI has done a remarkable job meeting its goals, and will continue to do so as it adapts technologies and sensibilities from for-profit and online educational providers. But just what are the goals of BYUI? The book never explicitly says, nor do the authors ever seriously consider how these may be different from Harvard’s. In other words, Christensen and Eyring never really talk about what

Derek Bok talked about, namely, the sense of shared identity and purpose that can make an institution great.

The contrast between Harvard and BYUI is most strikingly illustrated by the authors’ account of how and why Ricks College changed from a two-year institution to a four-year university named Brigham Young University-Idaho in 2000. The President of the Church of Jesus Christ of Latter Day Saints, Gordon Hinckley, held a teleconference from Salt Lake City on less than 24-hour notice during which, to the surprise of all but one or two people on campus, he simply announced the change in the institution’s name and status within the Church Educational System. That kind of governance is hardly consistent with Harvard’s sense of identity and purpose (or most other universities in the United States).

In fact, for a book that purports to be about change and innovation in higher education, *The Innovative University* strangely omits much discussion of academic governance, leadership, or decision-making, beyond potted portraits of particular presidents that put Charles Eliot and Abbott Lawrence Lowell of Harvard on a par with David Bednar and Henry Bennion Eyring of Ricks College.

***The underlying message of
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Key management issues always concern how certain tradeoffs get made. Howard Raiffa, the Harvard Business School professor with whom I taught, impressed upon me not only that leaders have to make tough tradeoffs but also that this can be done well only relative to explicit objectives. Is the mission of BYUI to prepare as many students as possible to go on Church missions around the world? Is the mission of Harvard to prepare elite students to go on secular missions in government, consulting firms and other research institutions? Are the objectives of either institution really so similar to those of communication service providers, retailers, and other commercial firms? These are caricatures, of course. But this otherwise insightful and intriguing book finally falls short of greatness because of the authors’ unwillingness to address how great institutions can differ in their sense of identity and purpose.

– Daniel Goroff, Senior Consultant

**The Upside of Irrationality:
The Unexpected Benefits of
Defying Logic at Work and at Home**
By Dan Ariely

HarperCollins Publishers: 2010, 334pp.

If we offered nonprofit CEOs and public policy officials the incentive of banker-sized bonuses, would it lead to a more vibrant, high-performing social sector? Wouldn't it be nice if one could easily mobilize organizations' constituencies behind the mission? Why is it that an appeal on behalf of an individual can garner nationwide support, while the more dire suffering of masses often elicits little action?

Questions of this sort confound social entrepreneurs, nonprofit leaders and business executives alike. Some surprising answers can be found through the exploration of human irrationality – which may have an upside, according to Dan Ariely's new book, a sequel to his earlier work, *Predictably Irrational*.

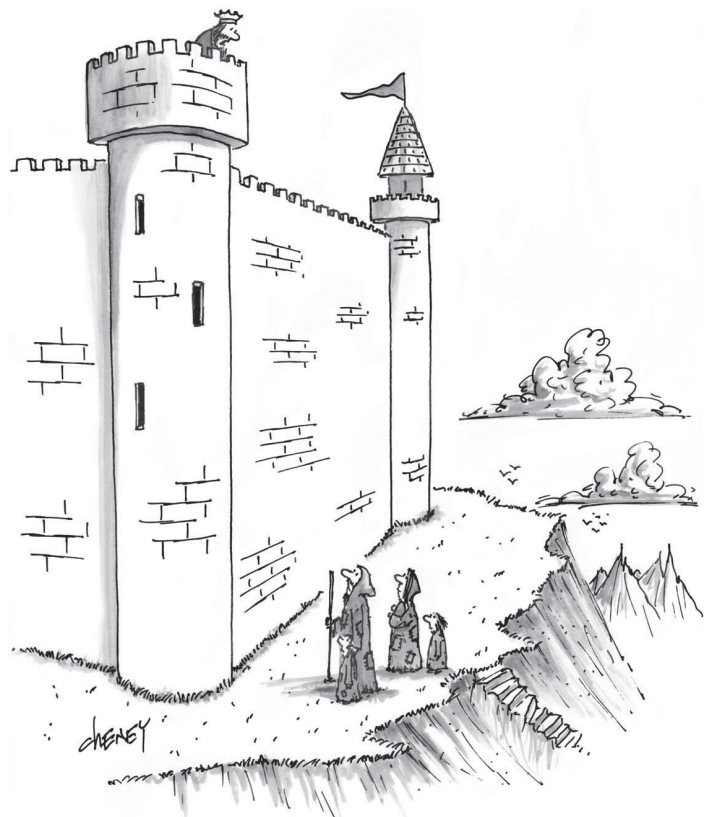
In *The Upside of Irrationality*, Dan Ariely, a professor at Duke, explores the puzzling question of why we consistently "overpay, underestimate, procrastinate and overvalue what we create," through the lens of behavioral economics, the vibrant new science bridging psychology and business. Presented with these human flaws, Ariely attempts to "figure out how we can get the most good and least bad out of ourselves" when making choices about money, work, relationships and, ultimately, happiness.

***Why does an appeal on
behalf of an individual
garner nationwide support,
while the suffering of masses
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Ariely's research is lodged in a sub-sector of economics that, until as recently as 15 years ago, was considered a marginal, exotic endeavor. Now behavioral economics can claim a Nobel Prize, a critical mass of empirical research and a history of upending the classical and neoclassical theories (based on the premise that people make rational, self-interested decisions that weigh costs against benefits and maximize value and profit for

themselves). The new approach allows practitioners and theorists to depict how actual human beings operate at an intersection of Adam Smith's "invisible hand" and the irrational, self-sabotaging mind. It's little wonder that books like Ariely's *Predictably Irrational* and its best-selling sequel, along with Malcolm Gladwell's *Outliers* and Steven Levitt's *Freakonomics*, are flying off the shelves.

Although he started out as a physics and mathematics major and later became a professor of marketing with no formal training in economics, Ariely is considered one of the leading behavioral economists. Drawing on the social research methods that made *Predictably Irrational* one of the most talked-about books of the past few years, Ariely's experiments reveal such idiosyncrasies as the "IKEA effect" (if you put effort into building something, pride and sentimental attachment are likely to make you overvalue your creation) and the "identifiable victim effect" (why we respond to one person's plight but not to the suffering of the masses). We also learn how identity and labor are intrinsically connected and how devaluation saps the meaning out



"Would it help if I trimmed my annual bonus?"

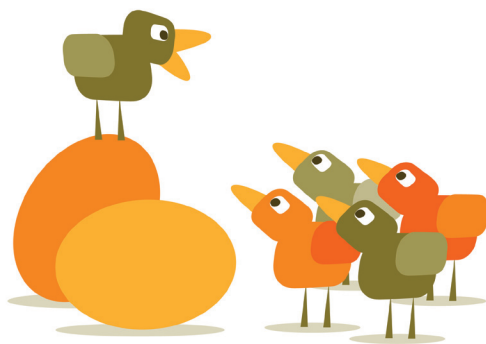
of work (people are hard-wired to seek meaningful ways to earn a living and spend their time). And insights on why outsized bonuses may actually reduce the quality of an executive's performance will allow to insert the helpful phrase "studies have shown" into arguments with one's banker friends.

The Upside of Irrationality is particularly relevant for the nonprofit sector. When scarce resources are allocated to serve the interest of critical social change, it is worthwhile knowing what drives people to choose long-term gain over instant gratification, break bad habits and feel ownership and pride for their actions.

Some specific lessons from the book:

1. Work performance and motivation

Consistent with the findings about market vs. social norms, salary alone will not motivate people to work, let alone risk their lives, for a cause; social norms, such as pride in one's profession and a sense of purpose, motivate people to do their best. In fact, money is very often the most expensive way to motivate people. "Social norms are not only cheaper, but often more effective as well." And while big CEO bonuses may not be an inherently nonprofit problem, the lessons are particularly applicable for the sector where monetary incentives are hardly the primary motivators.



2. Work climate and change

The tendency to fall in love with our creations (the "IKEA effect") can be applied to building ownership of change, planning processes and new policies.

3. Fundraising

The "identifiable victim effect" has direct implications for donor support and crafting effective fundraising campaigns, a well-illustrated point in the book.

Ariely's key concepts – adverse effects of over-motivation, decisions under the influence of emotions, innate desire for revenge, to cite a few – shed light on events as recent and dumbfounding as the debt crisis; the financial crisis of 2008 and the subsequent rage over the bail-out and CEO compensation; and the fear-induced dips in the stock market in 2011. (Somehow, the traditional economic notion that the market is self-correcting just doesn't seem to cut it.)

***We learn how identity and labor
are intrinsically connected
and how devaluation saps the
meaning out of work.***

Ariely does raise questions about the validity and reliability of experiments carried out, for the most part, in a university lab. Can we safely extrapolate his findings to the larger population? How would his theories apply to different personality types and other cultures with different collective psyches and social norms? There is also an ironic possibility that Ariely, the researcher, could be susceptible to the fallacy he describes: "We think we see with our eyes, but the reality is that we largely see with our brains. Our brain is a master at giving us what we expect to see." The jury is still out on this question, but putting it on the agenda through this book is of value in and of itself.

In the end, Ariely's new chronicle of human irrationality may seem simplistic to some, and replete with sometimes superfluous details of his autobiography. The upside? A front-row view into one's own irrational mind and a more nuanced understanding of the universality of the human experience linger long after the book is finished. And while some of the conclusions are obvious, Ariely's elegant synthesis and his thought-provoking, engaging style (sans academic jargon and bafflegab) make for a pleasurable read.

– Lana Atanazevich, Consultant

The Origin of Wealth: Evolution, Complexity, and the Radical Remaking of Economics

By Eric D. Beinhocker

Harvard Business Press: 2006, 527pp.

In *The Origin of Wealth*, Eric D. Beinhocker discredits neoclassical economic theory, calling it inadequate to explain the most important characteristics of the development and workings of the economy.

Beinhocker, the Executive Director of a new center supported by the Institute for New Economic Thinking at the London School of Economics and Political Science, believes that “traditional economics” attempts to describe an orderly, rational and predictive system which, save for periodic disruptions, tends to maintain a state of equilibrium. Thus “traditional economics” oversimplifies what Beinhocker posits is really an ever-evolving, highly dynamic, adaptive system which he calls “complexity economics.” The key to Beinhocker’s thesis is that the theory of evolution is applicable not just to our biological development, but to our economic, technological and social development as well. And, he explains, all of these evolutionary processes continuously interact as they each operate according to the principles of differentiation, selection, amplification and repetition.

***In today’s world no nonprofit
can be successful unless it
thinks of itself as a business.***

Competing ideas fight for primacy in the marketplace, with the winners moving the process forward until better or more advanced ideas take their place. In Beinhocker’s terminology, these are the “fit designs,” and all evolution is a “search algorithm” for them. Successful businesses are those that have created “fit designs,” but they cannot rest on their laurels because if they do, the evolutionary process will overtake them with something better. Economic evolution is marked by ever-increasing knowledge, which drives both the technological development of new inventions and products and the organizational methodologies that enhance productivity. (For an example of the latter, think of the impact of Henry Ford’s assembly line, which revolutionized manufacturing efficiency.)

Editor’s Note:

As the world experiences yet another stage of economic turmoil, we believe it is useful to revisit a 2006 book that explores the roots of the crisis.

Thus Beinhocker views evolution as a trial-and-error process moving from simplicity to complexity, rather than large periodic disruptions that interrupt the equilibrium of traditional theory and move economies forward, only to return them to a new level of equilibrium. For Beinhocker, change is constant, and it comes in much smaller pieces from many sources. His is bottom-up, not top-down thinking: economics is not an equilibrium-bound system. While there are many forces at work (and these can be technological, social or political), no one is really in charge, and that is why the evolutionary process is always dynamic, always adapting. Economic evolution is the product of what he calls “deductive tinkering,” the work of many people, businesses and institutions contributing to economic success and to moving the economy forward.



In *The Origin of Wealth*, Beinhocker takes the reader back thousands of years to the hunter-gatherers to describe the beginnings of economic activity: the production of tools and weapons which began to be traded and which themselves evolved into more sophisticated implements. Evolution in its various iterations is marked by continuous increases in knowledge over time. Thus, in the field of economics, he equates knowledge with wealth, and defines the origin of wealth as evolution.

Beinhocker draws upon the work of a large number of scientists, social scientists, economists both classical and modern, game theorists and others to make his case,



"Oh, that three billion dollars."

including the debunking of classical theory as well as to provide support for his theses. He builds his case carefully and convincingly, although his rejection of what he calls "traditional economics" is more unforgiving than it might be. After all, economic theory and thought have also evolved over time, and continue to do so.

In the last few sections of the book, Beinhocker addresses issues of "left" and "right" politics, multiculturalism in an increasingly linked global economy, the impact of poverty and inequality and other related social, political and cultural questions. He concludes that all of these affect economic evolution and are, in turn, influenced by it. In his view neither the left nor the right has the answers to the economic and social issues of today's world, and he offers some possible solutions that draw from both philosophies. Readers can decide for themselves whether or not they agree; however, keeping in mind that this book was published in 2006, it would be hard for anyone to argue that these issues have not intensified in the years since then. We need to find common ground soon, or risk even greater problems in the years ahead.

One part of the economy hardly mentioned in *The Origin of Wealth* is the nonprofit sector. One could argue that this is perfectly appropriate, given that wealth creation is not the goal of this part of our economy. Nonetheless, not only are nonprofits a significant part of the economy, particularly in the United States, but also, in

today's world no nonprofit can be successful unless it thinks of itself and manages itself as a business. (There are probably exceptions in the realm of small, volunteer organizations that provide individual services of one kind or another, but these are hardly a significant portion of the sector.)

The demand for nonprofits to obtain funding makes it incumbent upon them to be adaptable.

For readers willing to apply insights into how businesses adapt to and drive changes in the economy to

the world of the nonprofit sector, there is much to be gained from this book. One important lesson lies in understanding the impact of evolution on the ever-increasing complexity of the nonprofit arena, in terms of laws, rules and regulations. Thus, in addition to program delivery, nonprofits need to have sufficient infrastructure to be able to deal with these issues. In a world in which change is the order of the day, the demand for nonprofits to successfully obtain funding from whatever source – whether tuition, fees, government or philanthropy – makes it incumbent upon them to be adaptable, and in this context to be able to demonstrate the ability to generate and successfully execute viable business plans.

In developing business and strategic plans to achieve his notion of a "fit design," Beinhocker believes that the best plans are generated when leadership focuses on learning and on creating "prepared minds," combined with deep discussion, fact-gathering and analysis – prior to any decision making. Leaders should consider plans that make multiple bets on a variety of these options as a "portfolio of experiments" in order to minimize the risk of betting the entire plan on only one choice. While this might not work for all organizations, it surely offers food for thought for for-profit and nonprofit organizations alike.

– Stephen R. Reiner, Consultant

RECENT CLIENT ASSIGNMENTS

Baruch College (CUNY)

New York, NY

Preparation of a five-year strategic plan.

BBC World Service Trust

London, United Kingdom

Preparation of a strategic development plan for BBC World Service Trust in the United States.

Blithewold Mansion, Garden and Arboretum

Bristol, RI

Development of a new vision and evaluation and recommendations on organizational capacity-building, communications, branding, market audience and programming.

Cambridge University

Cambridge, United Kingdom

Strategic counsel on the University's £1 billion 800th Anniversary Campaign and on planning for the next Campaign.

Center for Curatorial Leadership

New York, NY

Strategic counsel on future directions and alternative business models.

Cold Spring Harbor Laboratory

Cold Spring Harbor, NY

Strategic analysis to ascertain the feasibility of the Laboratory's successfully mounting an unrestricted endowment campaign.

European University of St. Petersburg

St. Petersburg, Russia

Strategic counsel on mission and funding.

Fashion Institute of Technology

New York, NY

Development of metrics and goals for a "dashboard" to assess progress in achieving the objectives of FIT's strategic plan.

FRAME/French Regional American Museum Exchange

Los Angeles, CA & Paris, France

Strategic counsel.

Friends of the Hudson River Park

New York, NY

Assistance in developing a collaboration agreement with the Hudson River Park Trust.

Girl Scouts of the USA

New York, NY

Strategic counsel on planning a \$1 billion 100th Anniversary Campaign that joins GSUSA and 112 local Councils in a collaborative initiative.

Global Development Network

New Delhi, India

Review of global governance and counsel on strengthening the Washington, D.C. office.

Hunter College (CUNY)

New York, NY

Preparation of a five-year strategic plan and counsel on implementation.

Inwood House

New York, NY

Strategic and business planning.

Jerusalem Foundation, Inc. USA

New York, NY

Review of the governance of the U.S. Foundation and its role, responsibilities and relationship with the Jerusalem-based Foundation.

Long Island University

Brookville, NY

Review of organizational design and overall positioning of the University's four regional campuses.

Midori & Friends

New York, NY

Preparation of a five-year strategic business plan.

National Trust for Historic Preservation

Washington, DC

Preparation of a five-year strategic plan for Chesterwood, the summer residence and studio of Daniel Chester French in Stockbridge, MA, a National Trust Historic Site.

New York Academy of Sciences

New York, NY

Strategic counsel on identity and messaging.

North Carolina Agriculture and Technical State University

Greensboro, NC

Counsel on strategic planning.

Pace University

New York, NY

Strategic counsel on a range of issues.

Regional Plan Association

New York, NY

Assessment of the capability of successfully mounting a significant endowment campaign.

Rubik Studio

Budapest, Hungary

Planning, preparation and strategic partnership-building for an international touring exhibit of the Rubik's Cube.

Seamen's Church Institute

New York, NY

Preparation of a five-year strategic plan.

Wadsworth Atheneum Museum of Art

Hartford, CT

Preparation of a five-year strategic plan.

William Paterson University

Wayne, NJ

Preparation of a ten-year strategic plan.

Woodlawn Cemetery

Bronx, NY

Development of a strategic business plan.

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