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Foundations Don't Know What They're Risking

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Keywords: Risk, philanthropy, risk management, failure, innovation, maximizing impact, risk profile, risk tolerance

Sector

Key Points

- Critical gaps exist in philanthropy's definitions of and approach to risk management. This article describes the scope of the problem and a framework for philanthropists to adopt risk-management practices that better equip the sector to address the challenges of our time.
- In 2015, the Open Road Alliance surveyed hundreds of funders and grantees to explore questions about risk and contingency funding. The next year, Open Road partnered with Arabella Advisors for a qualitative analysis of existing foundation policies and procedures related to risk. The combined results suggest a need for contingency funding – and a lack among most funders and nonprofits of the basic structures, systems, and policies to address risk, which in turn leads to a breakdown in communication between funders and grantees.
- The world is unpredictable; no amount of planning can prevent disruption by unscripted events. This article, through quantitative and qualitative research coupled with illustrative case studies, highlights the importance of risk management and encourages its adoption throughout the philanthropic sector.

Introduction

We have all heard the clarion call for risk-taking in philanthropy. "To make a difference, family philanthropy must take more risk," argues a blog post from The Philanthropy Workshop (Lorenz, 2016). "Philanthropy is the go-to partner for risk," proclaims another, from the Rockefeller Foundation (Rodin, 2013). For its centennial celebration, the New York Foundation titled its main report *Taking Risks That Matter* (Barboza, 2009).

Philanthropists have long maintained that they are willing and able to take risks that neither the private sector nor government can. But how many risks do philanthropists really take? And how do they manage those risks?

These questions provided the focus for several qualitative and quantitative research projects pursued by the Open Road Alliance and Arabella Advisors over the past two years. The initial conclusions of this exploratory research are straightforward: Philanthropists talk a lot about taking risk, but they hardly do anything to define, assess, or manage it.

No industry standards exist for discussing, assessing, or planning for risk in philanthropy. Few grantmakers assess risk during the grant application process, and even fewer have processes in place to respond to anticipatable risks once a project is underway. The problem is not that philanthropists consciously seek to avoid risk; as noted above, funders are often explicitly described — and describe themselves — as risk-takers. The problem is this: Without appropriate structures in place, philanthropy's noble intention to take risks for the common good remains largely a noble intention. Without

Risk is the likelihood that an event will occur that will cause some type of undesirable effect. Risk events can occur anywhere, anytime. They may be predictable or not, controllable or not, and caused by internal or external variables.

taking steps to accurately identify, understand, and manage risk, philanthropy's ability to play the risk-taking role it has set for itself is severely limited. By the same token, foundations have a significant opportunity to increase the impact of their grantmaking by taking concrete steps to proactively identify and mitigate the risks that already impact their everyday work.

This article explores the findings of three research projects conducted to date on this topic — a literature scan, a survey, and a policy review. Both the individual and combined findings of these efforts point to a significant gap in practice for the sector. The article also highlights some notable bright spots, as well as collaborative efforts underway toward solutions and an initial set of baseline practices for philanthropic risk management.

A Definitional Challenge

One of the core challenges in talking about risk in philanthropy is the lack of a definitional framework or consensus about how to use key terms. The importance of such a framework becomes apparent when we consider the recent evolution in our sector of a clearer understanding of "impact." Prior to the turn of this century, the word "impact" in philanthropy meant little. Though funders large and small claimed it as their goal, there was no standard definition of the term and no best practices for measuring it.

While the notion of impact is still imprecise, a standard framework has emerged with regard to the differences between output, outcome, and impact (Stannard-Stockton, 2010). Meanwhile, the simultaneous use and study of impact metrics is leading to increased clarity about how to measure and track it (Hehenberger, Harling, & Scholten, 2013; Twersky, Nelson, & Ratcliffe, 2010). Without a common vocabulary and set of practices, the usefulness of the word "risk" today is as limited as the word "impact" was 15 years ago.

When speaking of risk, we propose a definitional framework based on the work of The Commons (2017), a task force convened in 2016 to develop adoptable and adaptable policies for addressing risk and implementing risk-management procedures throughout the grantmaking value chain:

- Risk is the likelihood that an event will occur that will cause some type of undesirable effect. Risk events can occur anywhere, anytime. They may be predictable or not, controllable or not, and caused by internal or external variables.
- Risk exists along a spectrum, and identical events may be deemed more or less "risky" by different parties depending on their perspectives. In other words, the same risk is often perceived and experienced differently by different people and organizations.
- While labeling something a risk implies the possibility of a negative effect, taking that risk can be a profoundly positive choice. Risk can lead to reward.

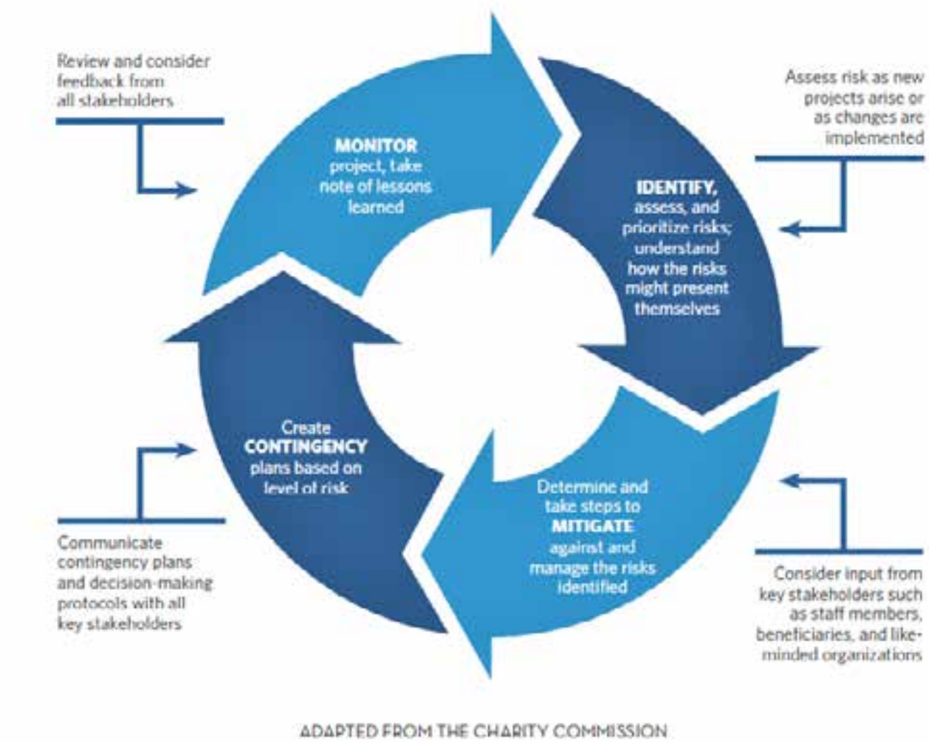
Risk Culture Versus Risk Management

Grappling effectively with the notion of risk also requires recognition of a core definitional distinction between "risk culture" and "risk management."

Risk culture refers to an organization's appetite or tolerance for taking risk. It is based in choice and, in a sense, is the "subjective" side of a discussion of risk. In contrast, risk management is a set of objective tools and practices concerned with avoiding disruptive events and/or reducing

Sector

FIGURE 1 The Risk-Assessment Cycle



their negative effects. These tools and practices are also known as risk mitigation and contingency planning. Risk management is necessary to deal with the unavoidable existence of risk, regardless of one's appetite or tolerance for it.

In grantmaking, risk management comprises a series of steps that funders and nonprofits can take to reduce either the likelihood of a risk event or the harmful consequences of that risk event, should it occur. Like monitoring and evaluation, risk management is, at its core, a continual learning process: it involves identifying risks, mitigating them, planning for contingencies related to them, and then monitoring and reassessing risks as projects move forward. (See Figure 1.)

What Is at Risk?

Also essential to any discussion of risk in philanthropy is answering the question, "What is at risk?" Indeed, one of the challenges to the existing discourse on risk is that different parties often talk past each other regarding the risks they are willing to bear. For example, an innovative project with no track record may seem very risky to a board of directors with fiduciary responsibilities, but less risky to the program officer who views the project as essential to achieving the desired impact. One party is concerned about the risk of wasting money; the other is concerned about the risk of failing to achieve impact. To maintain clear terminology, we recommend the following risk taxonomy specifically designed for the philanthropic sector (The Commons, 2017):

- *Financial risk.* Financial risk refers to the risk of losing money. Funders are generally sensitive to threats to the foundation's endowment or corpus, and place a high value on avoiding financial risk. However, proactive management of financial risk often does not extend to the management of programmatic dollars. This taxonomy encourages funders to equally consider their programmatic dollars as investments where the return is measured in impact. This perspective inspires impact-oriented questions, such as "How much money are we willing to risk to achieve the desired impact?" or "In what scenarios would we rather lose money than sacrifice impact?"

- *Reputational risk.* Reputational risk stems from events that could be seen as embarrassing a foundation or a threat to its brand. Funder appetite for reputational risk varies,

Risk in the Private Sector

In the for-profit world, the most basic investment equation is one that takes into account the proportionality of risk to reward. All investments carry risk, though the amount of risk per investment varies as much as the potential rates of return. As such, risk management as both a basic and a highly sophisticated practice is an integral and natural part of for-profit investing.

Aside from basic process structures, such as the risk-management cycle, many for-profit tools are not easily transferable to philanthropy. There are two primary reasons for this: First, most private-sector risk-management tools rely on the quantification of both risk and return, which is possible given that both the inputs and outputs are money. Since philanthropy's output comes in the form of impact, which cannot always be quantified, the algorithms that form the basis of actuarial tables and other standard practices around risk are not easily transferable. Second, the general theory of risk in the private sector is tied to the core assumption that risk is directly proportional to return — the greater the risk, the greater the potential reward. While this logic can apply in philanthropy, where innovation and learning is concerned, this axiom does not always apply to other standard philanthropic approaches.

For example, imagine two otherwise identical projects that work with homeless youth. One project focuses on a population of homeless youth with chronic substance abuse; the other does not. The project with subjects who have substance abuse problems is likely to be deemed riskier, but this does not mean that it will yield higher returns on impact than its counterpart. To illustrate this, let's apply the for-profit return-on-investment (ROI) model, where greater risk leads to greater return. In this scenario, one might expect that putting $100,000 into the riskier investment would have a higher possibility of failure — that's the risk part — but should also produce a higher return if successful, say 90 percent placement in long-term housing. The less risky investment of $100,000 would be more likely to succeed because it's lower risk, but therefore also at a lower ROI, such as only 70 percent placement in housing. Yet, experience and intuition suggest that the opposite is a more appropriate risk-return expectation. A project with the substance-abuse population should, perhaps, reasonably expect to have lower rates of housing placement (i.e., lower ROI) than its counterpart, despite the fact that it is deemed "higher-risk." In this case, higher risk equals lower returns when measured against dollar inputs.

On the other hand, when considering the added difficulty of placing a homeless youth with substance abuse in long-term housing, the impact of such an accomplishment could be valued higher than its counterpart. Put another way, when does placing an addicted youth in long-term housing represent more impact than placing a nonaddicted youth, because it was harder to do? These examples and questions illustrate just how difficult it is to transfer the linear risk-return equations from the for-profit world to the impact sector.

but those with a commitment to learning from failures and sharing those learnings tend to be more open to reputational risk.

- *Governance risk.* Governance risk refers to risks related to compliance with legal, tax, or good-governance practices, such as maintaining conflict-of-interest policies, and ensuring appropriate organizational structures. While crossing the law is a risk that should arguably always be avoided, other governance risks like investing in a young organization with an inexperienced board may be worth taking based on a foundation's risk tolerance.

- *Impact risk.* Also called execution or implementation risk, impact risk refers to that which may prevent a project from reaching its desired impact. This is the most critical area for philanthropy, as risks to impact are threats to our sector's raison d'etre. Impact risk exists at the grant and portfolio levels, as well as at the individual project and organizational levels. Evaluating and managing impact risk is the primary focus of our research and the resulting conclusions.

Literature Scan: How We Talk About Risk

In an effort to better understand and document the state of discourse related to risk management in philanthropy, in 2016 the Open Road Alliance commissioned the Foundation Center's IssueLab to do an independent scan of the sector's grey literature, asking, "How does philanthropy talk about risk?" The scan involved:

- a systematic search of IssueLab's own database;

- mined citations from a list of publications provided by the Open Road Alliance;

- the websites and blogs of funders whose grants included search terms related to risk;

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- literature about the sector from sector-specific publications, including *The Foundation Review, Stanford Social Innovation Review,* and *Nonprofit and Voluntary Sector Quarterly;* and

- the websites and blogs of philanthropy schools.

The scan focused on the past 15 years of literature and was limited to literature published in the United States. IssueLab identified 72 titles that matched the subject-matter criteria as well as criteria related to publishing date and geography. Using an open coding process, IssueLab tagged the content with terms that appeared in the reports themselves and then reviewed the terms for possible groupings or themes. After the resulting list of themes and categories was shared with Open Road and validated for relevancy, IssueLab staff recoded the resources in a browseable, searchable, and public collection[1] using three category groups and, within those categories, additional tags:

1. Types of risk (reputational risk, financial risk, impact risk);

[1]See full collection from Foundation Center Issue Lab at http://riskandphilanthropy.issuelab.org.

The scan revealed that, where they exist at all, practical materials on identifying and mitigating risk exist separately from the rhetoric about why philanthropy should take risks.

2. Perspectives on risk (risk and the role of philanthropy, risk and return, risk and compliance); and

3. Working with risk (learning from failure, funding innovation, assessing risk, mitigating risk, tolerating risk).

Of the 72 reports, case studies, blog posts, and conference proceedings in the collection, almost half (26) focus on "risk culture." These include such titles as "Risk and Return: Defining Your 'Comfort Zone'" (Rafferty, 1999); "The Role of Risk at the Heart of Philanthropy" (Cohen, 2013); and "What Makes a Foundation Embrace Big Risks?" (Proscio, 2014). Such articles speak in general terms of a foundation's "willingness to venture such large sums" (Proscio, 2014, para. 7), or a funder's need to "come to terms with the level of investment risk with which he or she will feel comfortable" (Rafferty, 1999, para. 72).

The second largest group of reports IssueLab found address risk through a social-investment frame, where topics like risk capital and the funding of innovation are given special attention and risk itself is understood in relation to return on financial investment. These resources include such titles as "Case Studies in Funding Innovation: A Few Wild and Crazy Ideas" (Kasper & Marcoux, 2015) and "When Nonprofits Become Market Innovators, Social Returns Are Exponential" (Seimens, 2016). Many of the articles chronicle big, successful investments in small startups, or profile funders who took a chance on new ideas. They are primarily retrospectives and often include conversations about impact investing itself as an innovative funding approach.

Only a handful of the reports identified by IssueLab address risk as a compliance issue, with most of these focusing on risk in a nonprofit or charity setting, rather than within foundations themselves.

IssueLab also found 21 resources that fell into the category of "mitigating risk." Some of the more notable resources in this grouping include a report from Resource Alliance (2012) and the Rockefeller Foundation on defining, assessing, and managing risks in international development efforts; an insightful look into risk management at the Commonwealth Fund (2008); and an older but still valuable guide from GrantCraft on how to respond to grants gone "astray" (Ryan, 2002).

The scan produced a much-needed aggregation of existing field resources. But more important than counts of the number of reports that fall within each of these thematic categories, overall the scan pointed to a gap in the literature between the discussion of why philanthropy should take risks and a discussion of how it could take them most effectively — a gap between "risk culture" discussions and "risk management" practices. The scan revealed that, where they exist at all, practical materials on identifying and mitigating risk exist separately from the rhetoric about why philanthropy should take risks. Public data sets or quantitative evaluations of risk were missing entirely.[2] In much of the existing discourse, risk rhetoric is decoupled from risk practice, and aside from case studies there is little evidence to back up authors' claims.

A Survey Story of Risk: Don't Ask, Don't Tell, Don't Prepare

Other efforts also indicate a paucity of risk-management tools and practices in philanthropy. In 2015, the Open Road Alliance conducted a 400-respondent survey designed to look at the frequency of need for contingency funding as

[2]The exception to this is Open Road's own 2015 survey on risk, discussed in the next section.

reported by both funders and grantees. This survey also compared funder and grantee perceptions of preparedness to adequately address contingency funding needs. The interview-based, 30-question survey included a random sample of 200 nonprofits[3] and 200 funders.[4]

Survey Methodology

Surveys were conducted via phone interview over a roughly 30-day period by Boston Research Technologies (BRT). To complete the study, BRT dialed 9,216 organizations and completed 400 interviews. The response rate is indeterminate, however: for the majority of the dialings, BRT did not make an actual contact (i.e., not a refusal). An average of three callbacks were required for survey completion, primarily to align scheduling. Callbacks continued the questionnaire with the same individual respondent. The average interview lasted 12 minutes to complete the survey.

All potential respondents were sent an electronic letter in advance from BRT explaining the purpose, objectives, and needs of the survey. All interview subjects held executive or key administrative-level positions as decision-makers within grantmaking processes. All answers were self-reported and held in anonymity and confidentiality.

The sample pool was limited to foundations based in the U.S., but there were no geographical quotas. An organization's size or assets were not factors in the sample pull. The sample was pulled from Hoovers by industry and job title.[5]

BRT also developed the research questionnaire and processed the data. The analytical method used was ANOVA (i.e., cross-tabulations). No multivariate analyses were performed.

Recognizing that the term "risk" is not well defined in the philanthropic sector, the Open Road Alliance and BRT looked at "unforeseen disruptive events" and a need for "contingency funding" as proxies for the presence of risk events.

Survey Design

Recognizing that the term "risk" is not well defined in the philanthropic sector, the Open Road Alliance and BRT looked at "unforeseen disruptive events" and a need for "contingency funding" as proxies for the presence of risk events. Contingency funding was defined in the survey as "requests for additional funding during the lifetime of the grant related to unforeseen disruptive events." The requests in question were specified to relate to "specific projects for which money had already been granted." Lastly, in this survey, "disruptive event" did not include catastrophic disruptions such as large-scale natural disasters or humanitarian crises.

With this framework in place, the survey was designed to explore the following questions about contingency funding:

- Frequency: How often do projects need contingency funding?
- Donor response: How often are projects granted additional contingency funds?

[3]Grantees are exclusively categorized as tax-exempt, charitable organizations with valid 501(c)(3) status. Survey respondents included nonprofits (grantees) implementing projects both domestically and internationally.

[4]The funder survey contained 29 questions; the grantee survey contained 32 questions. Each group answered questions tailored for its role as a funder or grantee.

[5]Industry (primary only): NAICS 813211 (grantmaking foundations), NAICS 813212 (voluntary health organizations), NAICS 813219 (other grantmaking and giving services), and NAICS 813410 (civic and social organizations); job function: president, chief operating officer, chief financial officer, senior vice president, vice president, chief executive officer, managing director, and executive director.

Most significantly for the purposes of this article, the survey highlighted a lack of robust risk-management practices, despite a clear need.

- Capacity: What policies and procedures are in place to deal with contingencies?
- Consequences: What are the consequences of unfunded requests for the project and for the funder-grantee relationship?

Survey Findings

The survey data were analyzed and published in January 2016, alongside the annotated questionnaires for both funder and nonprofit respondents.[6] The survey led to five key findings (Open Road Alliance, 2016):

1. Disruptions requiring additional funds (i.e., contingency funds) are common and expected.
2. It is not a common practice for funders or grantees to address the risk of such disruptions before they happen.
3. When contingency funds are needed, most funders do have the operational and financial capacity to respond. When asked, the majority of funders do approve additional requests.
4. Grantees are hesitant to communicate with funders about potential obstacles (i.e., risks).
5. Funders and grantees are often misaligned in their perceptions of the effect of their actions on the other. Specifically:
   - Grantees believe that asking for additional funds negatively affects the likelihood of being awarded future grants, while the vast majority of funders claim such requests have no effect on future decisions.
   - Funders incorrectly believe that if they deny a request for contingency funds, grantees will find an alternate source of funds.
   - Grantees report that when requests for contingency funds are denied, projects are much more likely to be delayed and somewhat more likely to be reduced in scope than funders believe; grantees report 16 percent of such projects are terminated, while funders estimate only 10 percent.
   - Funders believe that grantees are more comfortable talking about these issues with them than grantees report that they are.

Most significantly for the purposes of this article, the survey highlighted a lack of robust risk-management practices, despite a clear need. Specifically,

- Roughly one in five projects encounters unexpected challenges (i.e., risks realized) that require additional resources to bring projects in on time and with full impact.
- 76 percent of funders surveyed reported that they do not ask potential grantees about possible risks to the project during the application process. Grantees report that 87 percent of applications they complete do not ask for risk assessments.
- More than 60 percent of funders reported that they do have the operational and financial capacity to respond to risk, meaning that there is money as well as staff capacity available to handle an emergency or contingency request. However, only 17 percent reported they proactively set aside funds for emergencies or unexpected problems.

[6] Both funder and nonprofit raw data and annotated questionnaires are available at http://openroadalliance.org/resource/2015-survey-annotated-data.

- Only 35 percent of funders have policies in place to govern an emergency grantmaking process.

It is reasonable to think that ineffective communication may also be preventing more effective risk management. When asked if their grantees felt comfortable coming to them to ask for contingency funds, 77 percent of funders said yes, compared with only 60 percent of grantees. What's more, only 60 percent of grantees reported feeling comfortable discussing possible contingencies — i.e., risks — during the grant application process, and the comfort level dropped to 52 percent after an award was made. This decline in grantee comfort is somewhat puzzling, as logic and intuition suggest that trust and communication should increase after the award is made. However, this 8 percent drop suggests that in the eyes of nonprofits, it becomes riskier to talk about potential problems once the funding is secure. As the 2016 report notes:

> It is possible that once grantees have signed an agreement with a funder, they feel bound by the parameters of the grant and are thus unwilling to try to change an agreement, even if results are in jeopardy. This contrasts with the more ideal situation in which having signed an agreement, grantees acquire increased trust and confidence in their partners. (Open Road Alliance, 2016, p. 16)

Since all of the answers were self-reported, including those asking for quantitative percentages or amounts, the survey is best described as funder and grantees' perceptions of risk, and not necessarily an accurate count of "disruptive events" themselves. Before taking the survey approach, Open Road approached several foundations, nonprofits, and existing data centers, such as Guidestar and the Foundation Center, to see if there were existing data that could more objectively confirm the frequency and effect of "risk" on philanthropy. However, as was later illuminated by the Issue Lab literature scan, foundations do not routinely record or report on the actual risks they face, and 990 tax returns do not distinguish funds that were granted in response to a "disruptive event" or any other proxy for "risk realized."

Policy Review: A Qualitative Exploration of Available Tools for Risk Management

In addition to the survey and the literature scan, we also conducted a qualitative study of risk-management policies, tools, and frameworks in use by foundations and philanthropists across the country. In spring 2016, the Open Road Alliance and Arabella Advisors reached out to more than 100 foundations and nonprofits requesting that they share their risk policies, tools, and frameworks. Fifteen of these 100 sources replied, sharing 19 documents. While we do not know for certain why so few foundations replied, a limited response rate is consistent with the survey's findings that few foundations have written policies or tools to help manage risk in the daily course of their grantmaking.

In addition, our analysis of the documents we did receive revealed that most foundations tend to focus more on financial risk at the enterprise level than on impact risk at either the individual-grant or portfolio level. Tellingly, we did not receive a single document that squarely addresses the core components of risk management as outlined in the risk-management cycle above.

Despite the small sample size, we catalogued the documents we received, coding them according to document type (article, policy, or tool); type of risk (financial, impact, or both); and level of analysis (project/grant, organization/portfolio, or both). We found that:

- Five of the documents we received (26 percent) focused on impact risk, whereas 10 documents (53 percent) addressed financial risk. Four documents (21 percent) addressed both types of risk.

- Sixteen out of 19 exclusively addressed the individual grant or project level, while the other three addressed both the project/grant and portfolio levels. None of the documents we received focused on assessing risk exclusively at the portfolio level.

Too often, it seems, foundations are talking big about risk but failing to actively manage it — and then, in some cases, leaving their grantees to pay the actual costs.

Eight documents focused on financial risk at the organizational level (i.e. enterprise risk). These documents were formatted in one of two ways: One set of documents assessed risks to the foundation itself, such as damage to reputation, conflict of interest, fraud, and staff capacity; the other set focused on financial, reputational, and governance risks at the grantee level. Five of the grantee-focused documents were structured in the form of an active risk-assessment matrix or scorecard, to be completed by a foundation employee as part of the grant application's due diligence process. These matrices ask detailed questions about a grantee's financial and governance risks, such as:

- Does the audit opinion note any exception items?
- Do board members have strong program and financial skills relevant to the organization's work?
- How many months of operating budget does the grantee have in cash reserves?

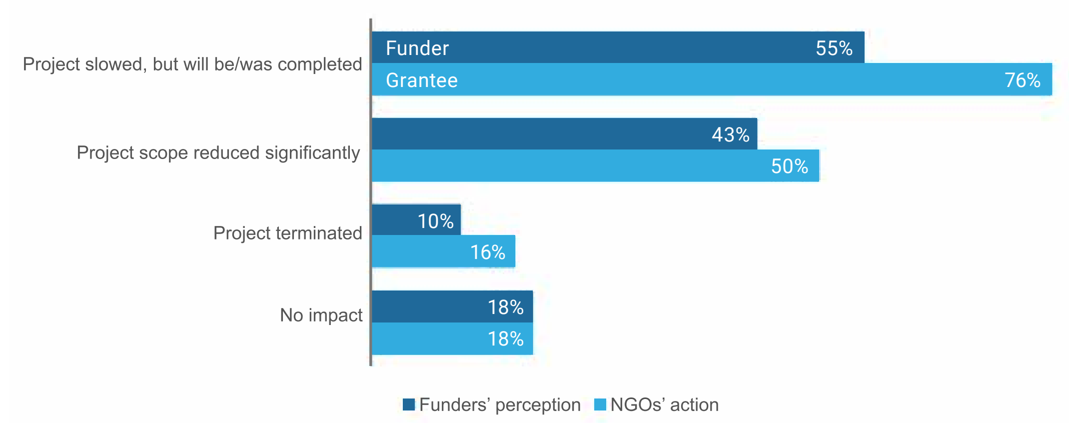
Only two foundations submitted documents that asked questions directly related to impact risk. These documents, which also took the form of matrices and checklists, asked questions like, "How likely is the strategy to have the desired impact?" and "How greatly is [successful impact] dependent on features of the environment that are out of the direct control of the team?"

Given the size of this data set, we can draw only limited conclusions. And, as noted above, we do not know for certain why so few foundations shared risk-management materials with us. That said, the teams at Open Road and Arabella have deep and wide experience across the philanthropic field, and we know that a similar attempt to gather resources on any number of topics in philanthropy — monitoring and evaluation, effective grants management, due diligence, foundation governance, and so on — would have produced a large set of documents filled with lessons learned, best practices, and useful tools. The fact that this inquiry produced so little in the way of similar documents is itself a salient point. Added to the findings of the survey and the literature scan, this leads us to conclude that the philanthropic sector lacks the shared tools it needs to adequately manage — as opposed to simply talk about — risk. If foundations have developed risk-management tools at all, most are not actively sharing them — and so there are few known best practices related to risk assessment, budgeting and contingency planning, risk-related decision-making, or effectively discussing risks with grantees and potential grantees.

The missed opportunity here is potentially huge. As noted above, one in five projects meets unexpected challenges (i.e. risks realized). When risks become realities and the resulting difficulties derail a project, the project's impact is negatively affected through a reduced scope, a slowed timeline, or a full termination. And our data suggest that funders may not even be fully aware of the problem: in the survey, 63 percent of funders reported believing that nonprofits have access to alternate funding sources when things go wrong, but only 35 percent of nonprofits report that they can actually find such alternate funding. (See Figure 2.) Rather than finding alternate funders, 44 percent of nonprofits cover contingency costs from their own operating or unrestricted funds,[7] which can hamper their capacity to achieve impact. Too often, it seems, foundations are talking big about risk but failing to actively

[7]It is important to note that when pulling from unrestricted funds, nonprofits are taking funds that had been allocated for other business operating or expansion purposes. This does not represent dipping into a reserve fund that is explicitly maintained for such purposes.

FIGURE 2 Question: When Contingency Funds Are Not Secured, What Happens to the Project?



manage it — and then, in some cases, leaving their grantees to pay the actual costs.

Bright Spots: Practices to Build On

For the most part, risk management is sorely lacking in our field. Still, there are a few bright spots across the sector, and our research uncovered several practices worth noting. We describe these in the brief case examples below.

Risk Management – Budget and Finance

At the Rockefeller Foundation, the board and staff have created a flexible contingency budget structure in two ways. First, every year the board authorizes the president to go above the annual budget by as much as 5 percent to ensure the success of the foundation's initiatives. This discretionary contingency fund allows the foundation to move quickly to support grantees and initiatives that may be facing unexpected obstacles. Second, Rockefeller's budgeting follows multiyear initiatives, rather than annual grant dockets. This is an uncommon practice, as most traditional grantmaking follows annual grant cycles, meaning that a foundation's board approves a 12-month grantmaking budget that typically must be spent — but not exceeded — within that 12-month period. Decisions follow accordingly, and foundation grantmaking coffers are therefore emptied (or fully allocated) at one fixed point during the year.

Many nonprofit initiatives, however, stretch far beyond a discrete 12-month grant cycle. Moreover, risks don't follow grant cycles; they may be realized at any point, including before or after a grant docket may be approved. As such, the typical annual grant-docket approach can hamstring foundations that allocate all of their funds in the second quarter, for example, and then have no budget left to deal with contingencies in the third or fourth quarters. In contrast, by working within a multiyear initiative-based strategy, Rockefeller's board also approves multiyear umbrella budgets, enabling its executive team and chief financial officer to manage the foundation's annual grantmaking more flexibly and adaptively. This enables the foundation staff to respond to unexpected needs and shift funds from one area to another as risks emerge or disappear. Smaller foundations have employed simpler contingency funds in a variety of ways, including setting aside a flat 10 percent in the annual 12-month budget for emergencies, creating a fast-acting executive committee that can make rapid decisions and release additional funds outside of the set grant cycle, or asking each grantee to budget for contingencies in their own grant applications.

Incorporating Risk Management Into RFPs and Due Diligence

Our research indicates that foundations are most likely to manage risk during the due diligence process. Some have even developed risk-management practices that are notable and potentially replicable. St. David's Foundation, based in Austin, Texas, developed a risk-assessment matrix, based on an open source tool created by the Knight Foundation, to track its grantees' operational and financial risks. (See Figure 3.) The matrix scores grantees on factors such as grant amount as a percentage of the grantee's annual budget, existence of other funding for the program, availability of recent audited financials and financial backup, board competence and stability, and staff expertise. After scoring grantees, St. David's categorizes them on a four-point scale as low risk, some risk, medium risk, or high risk. In addition to determining an overall level of risk, the matrix also identifies specific risk factors for each grantee. By assessing risks this way, the foundation helps minimize the possibility of surprises about the nonprofit's overall financial health and management capabilities, even as it works proactively to help grantees mitigate such risks in advance when possible. A tool of this sort is useful for donors who know their partners relatively well — St. David's Foundation typically attends at least one grantee board meeting per year.

The Rockefeller Foundation also conducts a preproposal risk assessment during the earliest stages of the application process, before significant time is spent by either the grantee or Rockefeller staff preparing a full grant application. The purpose of this assessment, which is evaluated by the president, general counsel, vice president of communications, and vice president of programs, is to ensure that the potential application is in line with Rockefeller's risk profile.

Notably, while they are innovators in philanthropic risk management, both Rockefeller and St. David's acknowledge that, for a variety of reasons, their systems are not optimal. At St. David's, the assessment focuses exclusively on the nonprofit as a whole and does not ask about potential risks to the specific proposed project. In other words, it addresses financial and governance risk, but leaves out questions related directly to impact risk. Neither Rockefeller nor St. David's shares or discusses the results of their risk assessments with the nonprofits in question, which may weaken the effectiveness of their risk-mitigation approach. The purpose of risk management is to identify and reduce risk; a risk assessment that is not followed by conversation may leave the funder with just a list of potential problems, rather than a path to solutions.

Incorporating Risk Management Into M&E Structures

At the Open Road Alliance, the recoverable grants team developed a risk scorecard that assesses individual grants across a range of roughly 30 preidentified impact-risk factors, including balance sheet strength, liquidity, management quality, operating methodologies, country risk, and regulatory risk. Categories are weighted according to Open Road's risk profile and preferences.

Based on qualitative and quantitative assessment, each recoverable grant is then assigned a "risk level category," which determines the extent of monitoring and reporting. For example, a project in the lowest risk category is asked to have only a 30-minute phone call with the portfolio manager once a quarter, whereas those in the highest risk category may be asked to submit monthly financials along with an in-person site visit every quarter. During these check-ins, risk levels are reassessed and scores are shared and discussed with grantees. Thus, over the lifetime of a grant, the reporting requirements could shift several times to reflect the current risk profile.

Creating a Toolkit for Risk Management

Despite the relative dearth of risk management in philanthropy today, several factors suggest that the field could identify and adopt a basic set of risk-management practices comparatively quickly. These include philanthropists' widely expressed desire to play an essential risk-taking role; the work being done by innovators such Knight, Rockefeller, and St. David's; and the existence of fully articulated risk-management practices in other fields.

FIGURE 3 Knight Foundation's Risk-Assessment Tool

Knight Foundation is currently piloting this form as a way to analyze project risk during the grants development process. Program staff must complete the form for all grants >$250,000 (and encouraged to use it as a due diligence exercise for smaller grants as well).

The weighting given to each response is still being tested - Knight recommends that any organization considering the adoption of risk assessment tools such as this should review the risk factors and consider adding, removing and/or adjusting the weighting of risk factors to meet the needs of their organization.

Factor	Score Weighting	Score	Staff Notes (optional)
Grant Amount: *What is the total value of the grant?*	<= $250,000 = 1 <= $500,000 = 2 <= $750,000 = 3 > $750,000 = 5		
Expenditure Responsibility: *Is it an expenditure responsibility grant?*	Expenditure responsibility = 5 Non-expenditure responsibility = 0		
Fiscal Agent: *Will a fiscal agent increase fiscal oversight?*	Using fiscal agent for added oversight = 0 Using fiscal agent due to capacity issues = 1		
Prior Experience with KF: *Has the grantee properly executed a previous Knight grant (performed project on time with no issues and fulfilled reporting requirements)?*	Proper execution of prior grant(s) = 0 No prior experience with KF = 2 Minor implementation issues in prior grant(s) = 3 Poor execution of prior grant(s) = 5		
Financial Collaboration: *Does project require close collaboration of multiple organizations carrying out interrelated activities funded by KF's grant?*	Sole organization = 0 Multiple organizations w/ executed MOU = 1 Multiple organizations w/o executed MOU = 2		
Project Budget: *Are costs clearly explained in the proposed budget narrative?*	Clear cost categories and explanations = 0 Undetailed budget categories = 2 Final budget does not equal grant amount = 3		
Sub-Granting: *Will grantee re-grant some or all of the funds?*	No sub-grants = 0 One sub-grant = 3 Two or more sub-grants = 4		
Grantee Support For-Profit Third Parties: *Will part or all of the grant funds be invested or loaned to for-profit third parties?*	Yes = 3 No = 0		
Relevant Experience: *Does grantee demonstrate experience managing projects of this type?*	Yes = 0 No = 2		
Start-up Organization: *Does the grant fund a new organization?*	Established organization = 0 Start-up organization = 3		
Domestic/International: *Does the grant project take place outside the U.S. or is managed by a foreign entity?*	Domestic = 0 International = 5		
Audited Financial Statements: *Does the grantee have audited financial statements less than one year old and did the audit opinion note any exception items?*	Audited financial statements with no exceptions = 0 Does not have audited financial statements = 2 Audited financial statements contain exceptions = 5		
Staff Risk: *Does grant implementation rely on 1-2 key personnel at the grantee?*	More than one person key to grant implementation = 0 One person, transition could be managed = 1 One person, transition would impact project = 2		
Accounting Practices: *Does the grantee have sufficient record keeping/ accounting capacity?*	Accounting staff/ general ledger system = 0 Lack of accounting personnel or practices = 3		
Board Oversight: Does the grantee have a board of directors?	Oversight by board = 0 No board/ limited involvement = 3		
Percent of Operating Budget: *What % of total operating budget does the grant represent?*	<= 5% = 0 <= 10% = 1 <= 25% = 2 > 25% = 3		
Project dependence on Knight Funds: *Is Knight the only funder for this project?*	Yes = 2 No = 0		
Cash Reserve: *How many months of operating budget does grantee have in cash reserves?*	<= 2 months = 3 <= 3 months = 2 <= 4 months = 1 > 5 months = 0		
Other Funding Sources: *Does the grant require grantee to raise matching funds to support the project?*	Other funding sources have committed = 0 Other funding required is pending/unsecured = 3		
	TOTAL SCORE	???	

Total Score	GEM type
0-6	No GEM Needed
7-14	Category A
15-25	Category B
26+	Category C

To this end, in 2016 the founder of the Open Road Alliance and the president of the Rockefeller Foundation co-convened The Commons, a group of 25 leaders from across the philanthropic sector, to discuss practical methods for assessing and planning for risk.

The Commons is a geographically diverse group of practitioners that includes institutional and family foundations, law firms specializing in philanthropic governance and tax issues, financial advisors, and nonprofits of varying sizes and missions. Through a six-month

Though often not thought of in policy terms, funders can do much to foster an atmosphere encouraging nonprofits to be transparent about possible risks to impact by enabling their program officers to exercise greater discretion.

consensus-driven process, and with the support of Arabella Advisors, the group developed a set of 10 user-friendly risk-management tools[8] for funders that are applicable across the philanthropic sector and address issues that face funders of all levels of size and type. The tools cover the following topics:

Risk Culture

- How to Talk About — and Determine — Your Appetite for Risk
- How to Create a Risk Profile Statement
- How to Incorporate Your Risk Profile Into Your Organizational Culture

Risk Management

- How to Set Aside Contingency Funding
- How to Build Contingency Protocols
- How to Incorporate Risk Management Into Governance Practices
- How to Incorporate Risk Management Into RFPs and Grant Application Forms
- How to Incorporate Risk Management Into Monitoring and Evaluation
- How to Implement Nonfinancial Risk-Mitigation Strategies
- How to Build Effective Funder-Grantee Relationships

While the majority of these tools focus on structural and perhaps unilateral actions that foundations can take with respect to their budgets, application process, governance, and internal protocols, a key finding from The Commons was that such "paper-based" solutions are not independently sufficient for effective risk management. As the survey findings showed, the first challenge to risk management is the lack of open and transparent communication between funders and grantees about potential challenges and risks. Funders cannot help with problems they do not know exist — and our research suggests that nonprofits will not share their challenges unless the funders ask. To this end, The Commons believes that ensuring transparent, honest, and effective communication between funder and grantee is both the hardest and highest form of risk management.

Though often not thought of in policy terms, funders can do much to foster an atmosphere encouraging nonprofits to be transparent about possible risks to impact by enabling their program officers to exercise greater discretion. While recognizing that not all will be applicable to every funder, recommendations[9] that allow program officers to tailor their actions to the grantee's needs include:

- Provide unrestricted funding so grantees can adapt quickly and efficiently to evolving on-the-ground needs.
- Execute multiyear grants to generate a longer-term relationship with grantees and provide them with space to plan, implement, and adapt, as well as time to develop the trust necessary to speak openly about potential risk.

[8]The full suite of tools in detail can be viewed and downloaded at http://openroadalliance.org/resource/toolkit.

[9]Drawn from "How to Build Effective Funder-Grantee Relationships," available at http://openroadalliance.org/resource/toolkit.

- Communicate about shifts in your risk profile or trustees' interests.

- Accept grant applications on a rolling basis, which allows grantees to seek funding when they need it most.

- Streamline the application process for repeat/long-term grantees and right-size the forms and requests you make of applicants depending on the risk level at hand (e.g., for low-risk grants or repeat grantees, consider shortened applications and reporting forms).

- Set aside funding explicitly for learning grants[10] and communicate openly about your grantmaking methods and range of grant sizes.

- Proactively take steps to understand the daily realities and challenges of nonprofit work. Encourage staff to get involved with a nonprofit organization outside of their role as a funder. Experiencing "the other side" builds empathy and may better position funders to have open conversations about risk with grantees.

Many of these suggestions to increase funder flexibility are certainly nothing new in the conversation about grantee-centric and partner-based approaches to philanthropy.[11] However, the key consensus of The Commons was recognizing that such behaviors are not merely nice practices for building relationships, but necessary practices for comprehensive, effective risk management.

Conclusion

The consequence of this conversation about risk management is important for two reasons. First, despite our best intentions as philanthropists, we will never be able to choose wisely among different opportunities with different types of risk if we do not have the mechanisms to identify, monitor, and mitigate those risks in the first place. The word "risk" derives from the early Italian *risicare,* which means "to dare" (Bernstein, 1996). Understanding risk enables us to make decisions in a rational manner. Without it, we cannot begin to take smarter risks instead of safer bets.

Second, and more importantly, managing risk is directly tied to ensuring and maximizing impact. When risk is not identified or managed, otherwise viable projects may wind up being terminated or reduced in scope — and the real people who depend on these projects for health, education, and other basic services miss out. The potential impact lost is likely significant. Philanthropy is a $358 billion industry (Radde, 2015), and its failure to manage risk results in lower impact per dollar spent. Research shows that more than 60 percent of grant-funded projects that encounter obstacles are reduced in scope or terminated, in part due to a lack of risk-management practices (Open Road Alliance, 2016). That represents nearly $43 billion in grant dollars per year that could see lower or no impact than originally planned and that better risk-management practices could help deploy more effectively.

We now know that at least one in five philanthropic investments are at risk. In the coming years, our sector has a compelling opportunity to develop guidelines based on real evidence and shared expertise in order to make risk management a common philanthropic practice. With a few simple steps, funders can adopt policies and practices that bring risk to the forefront and allow for improved mitigation and management. By incorporating risk into the equation, we can maximize impact and help to realize the full potential of this new area in philanthropy.

Sector

[10]Learning grants, which may be more applicable to risk-taking funders, are grants that support innovative projects and therefore may have a higher risk of failure. Learning grants allow funders to experiment with and learn from new and different approaches to solving problems.

[11]For more on the conversation about grantee-centric philanthropy, see Peery Foundation, Grantmakers for Effective Organizations, the Whitman Institute, and others.

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