Organizing a Family Philanthropy

Norman A. Brown, PhD, Joel J. Orosz, PhD, Joseph Horak, PhD, and Greg M. Kuhn, EdD

The NewCo Construction Company, founded by Bill and Linda Newman, has been blessed with great success. Bill and Linda have cleared the important family business hurdle of assuring the successful succession of their business: Laura, their daughter, is the Chief Executive Officer, and Paul, their son, is the Chief Financial Officer. But, the very act of transferring ownership to their children has caused Bill and Linda, both in their 60's, to reflect on their family and family business success, and to think about the meaning of their lives that have intertwined with family, business and community activities. They realize that many people over the past 36 years were helpful in creating the growth and success of NewCo, and they now feel an urge to give back—to help others as they have been helped—especially, to assist others who have not been blessed with the kind of financial success they have. But Bill and Linda—as well as their children —have been so focused on growing NewCo they have had little time to think about 'philanthropy'. The Newmans' desire to act upon their generous philanthropic impulses, but simply do not know how, and they are even unsure of where to go for good advice to sort out all of their complicated personal and family-based concerns.

NewCo Construction Company and its founding family are experiencing a very common family owned business (FOB) problem: how to take the next step from successful business enterprise to effective philanthropic activity. The skills that served them well in building a profitable company may not serve them well in making a positive difference in society. Long-time advisors such as attorneys or accountants are often well prepared in the many intricacies of forming a corporate or a family foundation, but they generally struggle with assisting the 'founders' in accurately identifying the founders' values and personal purpose for forming the philanthropic entity. Many people who have built very successful FOBs, therefore, simply go ahead, and create philanthropic organizations that have not been well thought out; this usually leads to predictable and disastrous results. Other founders, intimidated by the task at hand, turn away from philanthropy altogether, a decision that is wise neither in terms of tax implications for the family, nor for society's well-being.

There are surely good reasons to be daunted as FOB owners contemplate organizing a family philanthropy. Waldemar Nielsen, the most perceptive chronicler of the achievements and foibles of foundations, has well documented horror stories of foundations created without a clear purpose, and families that split asunder over the management of poorly conceived philanthropic endowments.

The tales Nielsen tells of the dreadful performance of such foundations and their clumsy efforts to support nonprofits could be highly amusing if it weren't such a sad tale of lost opportunity. For example, Nielsen's recounting of the formative years of the John D. and Catherine T. MacArthur Foundation is a cautionary tale of the struggles between company and family, culminating in extensive litigation to resolve the disputes. The MacArthur Foundation, of course, eventually became a highly effective foundation. Its formative years, however were consumed by conflict and vitriolic relationships. The owners of successful and even exceptional FOBs, therefore, can be forgiven if they approach the entire subject of philanthropy with the utmost trepidation.

On the positive side, there are many other examples of FOBs that created highly effective and strategic family philanthropies that serve to unite current and future generations in their important work, and that have made a positive impact on the quality of life in their local

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communities and the world at large. The Nathan Cummings Foundation is one of many that could be mentioned as an illustration.

Among the most compelling reasons or incentives for forming a family philanthropy are:

- Celebrating the success of the family, the FOB, and the founders' values that made it possible;
- Creating a means for "giving back" (what economist Kenneth Boulding calls "serial reciprocity"; repaying the debts owed to past generations by putting future generations in your debt);
- Reducing the burdens of taxation;
- Improving the quality of life in one's community;
- Inventing a vehicle that can keep a family cohesive and involved with one another through a meaningful purpose;
- Establishing a social legacy for the family that complements its commercial legacy (in fact, foundations are likely to outlast most FOBs).

This is a compelling combination of incentives, indeed. It allows FOBs to "take a victory lap," to reduce their tax burden, to improve their communities, to repay old mentors, strengthen family ties, and secure a level of immortality for their families and their names. Taken as a package, this is very hard to beat.

It must be admitted, however, that as a package, this is also very hard to achieve. It is no easier to build a successful family philanthropy than it is to build a successful family business. In fact, it is harder to find advisors knowledgeable in building philanthropic vehicles than it is to find advisors knowledgeable in creating strong families or in building successful family businesses.

But in some ways, advisors are the least of the concerns. Philanthropy inevitably involves the founders' personal and business values, and creating a family philanthropy will inevitably bring those values to the fore. It is not at all unusual for family members engaged in building a successful FOB to sublimate sharp value differences in the interest of achieving business success. For example, Bill and Linda Newman are quite conservative and their daughter Laura is very liberal, but their political views have been shelved as they tackle business opportunities and problems in order to grow NewCo. Now, however, as they ponder the creation of a family philanthropy, their personal values quickly rise to the surface. Bill and Linda want to support their church and pro-life causes; Laura wants to support soup kitchens and pro-choice causes. The Newman's are not atypical in that far from bringing cohesion and common cause to the family, the family philanthropy often brings endless bickering and surfaces unresolved conflicts and anger. No wonder that many advisors—lawyers, accountants, and investment managers—are reluctant even to raise the issue of philanthropy with their high net worth clients.

Yet Bill, Linda, Laura, and Paul, their political differences notwithstanding, wish to form a family philanthropy. Where do they start? They may wish to first avoid the most common mistakes made by families embarking on this great adventure:

1. The biggest error, as noted by Nielsen, is to create a foundation without first clarifying the donors' values. If they don't clarify the founders' values at the onset, the pressure to give money away will then result in bickering and infighting among the philanthropy's trustees, which guarantees that its grants will be ineffective.

2. Appointing an inexperienced person to establish and/or run the philanthropy. There is a body of law that governs the creation and operation of philanthropic vehicles. There is a set of good practices connected to the operation of those vehicles. Calling upon an inexperienced person, whether a member of the family or not, to establish and/or run the philanthropic vehicle, is likely to lead to an ineffective philanthropy, legal troubles, and family conflict.

3. Many families wait until it is simply too late. Philanthropies created on the donor's deathbed are rarely created with clear values, and they can saddle the next generation with the burden of guessing about the donor's intentions and motives. It is far better to create a philanthropic entity early and to have the active involvement of the donor in that process.

4. Creating burdensome provisions is another common error. In a misguided attempt to keep families together, the donors sometimes drive them apart by making service to the philanthropic entity a burdensome experience. For example, mandating monthly board meetings for the philanthropic vehicle may become such a hassle in busy lives that it drives family members away from the philanthropy.

5. Another common error is to attempt to control everything. If the philanthropic vehicle is defined so narrowly that only the donor's pet causes can be supported, or, in the case of a living donor, if the donor runs it as a dictatorship, then there is very little incentive for other family members to contribute their time and their energy to this operation. After all, if everything is cut and dried, why waste one's time in making suggestions?

6. A final common mistake is to exclude younger generations. Far too often, younger family members are shut out from participation in the family philanthropy. Older generations often rationalize this by saying younger family members are not ready to take on philanthropic responsibilities. This rationalization is refuted by the experience of community foundations in the state of Michigan. Since 1988, as part of the Council of Michigan Foundations' Michigan Community Foundations' Youth Project, 86 Youth Advisory Councils have given thousands of youth as young as 12 opportunities to raise money and make grants. The Michigan experience proves that young people are capable of being superb grantmakers.

Bill, Linda, Laura, and Paul are determined to avoid these problems, and to create a family philanthropy that will be as effective as possible. They turned to the Horak & Kuhn Founders Legacy (HKFL) model for assistance. The H&K advisor suggested the first step for the family was to clarify its values and intentions in starting a family philanthropy. The donors need not have the same wishes and intentions, but all of these wishes and intentions must be made clear and explicit. Family philanthropies can make grants to any 501(c)(3) organization, which are those deemed charitable by the Internal Revenue Service—organizations that work in education, health, human services, arts and culture, religion, and the environment—and can support multiple types of organizations in order to accommodate a range of interests among the donors. In fact, family philanthropies can even be completely contradictory in their giving. For example, this family foundation could support Bill's pro-life organizations and Laura's pro-choice organizations.

In the H & K model, a family therapist conducts a comprehensive set of interviews and video tapes all of the family members, beginning with the founding generation. A thorough history is

obtained, which illuminates the central themes that have shaped the family members core values. The inherent conflicts are addressed openly and a resolution process is initiated. Next, a senior family business consultant interviews and video tapes the family members who are involved in the business as well as a select group of the FOB's key employees. As the history of the business is obtained, the core themes that illustrate the founders' key values are obtained from real-life business experiences and examples. Next, a philanthropy consultant interviews and video tapes the family to assist them in determining how they can create a philanthropic entity that reflects the family's values and that will have the desired impact on society. The HKFL process brings the family to an in-depth clarification of their values and how they were shaped as well as how to establish an effective philanthropic entity. While all of the tapes of the interviews are kept, a jointly (family and H&K) edited version is created which serves several functions including:

a) Allowing future generations to understand who the founding family members were and what their intentions were regarding philanthropy;
b) Providing the family, business and trust/estate attorneys with a clear picture of the intentions of the founders, and what philanthropic entity the family wants to create and to establish for posterity. (This process alone can save future generations from bitter conflicts and legal battles that sometimes derail even well established foundations);
c) Providing a video orientation for future foundation board members that will allow them to more fully understand who the founders were and what their values and intentions were in regard to the foundation.

The next step in the HKFL model involves asking the family to consider whether they favor a perpetual or a time-limited philanthropy. Both models have their strengths, but both involve tradeoffs. A perpetual foundation, as the name implies, is a resource forever, thus insuring the legacy of the donor family long after they are dead and even long after the FOB becomes defunct. But perpetuity is purchased at the price of a low minimum payout (or grantmaking) rate: a mere 5% of the net asset value every given year. Thus, while its cumulative impact can be great, a perpetual foundation can have only a limited impact in any given year.

Time-limited philanthropies, on the other hand, pay out at a much higher rate, so they can have a great impact quickly. For example, the Aaron Diamond Foundation, in the process of spending itself out of existence, supported research that discovered protease inhibitors, the main ingredients in the drug "cocktails" that have extended the lives of thousands of HIV/AIDS sufferers. But, the faster spending literally uses up the endowments of such philanthropies, which results in their extinction within ten to twenty years. Not only is there no lasting legacy of Aaron Diamond, for example, but there is now no Aaron Diamond Foundation around to support research on SARS, the next plague, or a response to bio-terror. There is no right or wrong answer to the question of perpetuity versus time limitation, but it is a decision the family must make thoughtfully.

The H & K advisors then lead the family into a discussion of what kind of philanthropic vehicle they would like to choose: a public charity, a donor-advised fund, a community foundation, a charitable gift fund, a corporate foundation, or a family foundation. These alternatives, too, all offer strengths and tradeoffs. By choosing a public charity as its vehicle, the family could create an organization like Mothers Against Drunk Driving that would have a broad base of support and potentially a great public impact. However it would be a public institution, which means they would have to raise public funds for its support forever, and the family could have only limited control over its actions. Creating a donor-advised fund has many attractions. Whether one does this in a

community foundation or a truly commercial gift fund like Fidelity Investments, the vexation of managing an organization is removed. The community foundation or the commercial gift fund manages the endowment, and cuts the checks to the charities the donor recommends. These funds can be endowed forever, and can bear the family's name forever. The downside of advised funds in community foundations is that the donor loses control: while the donor's advice on gifts is usually taken, it can be overruled by the community foundation's trustees. The downside of the commercial gift funds is that unlike community foundations, they have no experts on their staffs who can help the donors to give thoughtfully and with impact. A corporate foundation allows for close identification with the FOB, and also allows for excellent tax benefits in sharing the bounty during good years. However, endowing corporate foundations is difficult without taking too much money out of the FOB, and if un-endowed, the giving can shrink to literally zero during unprofitable years for the FOB. An endowed family foundation allows for total control of the assets and the associated grantmaking. However, it also does not create as favorable a tax benefit as the creation of a public charity or a donor-advised fund, and is much more difficult and expensive legally to create than a donor-advised fund. Again, there is no right or wrong answer to the choice of philanthropic vehicle; the decision made by the family will depend upon its needs, and the extent to which it wishes to become involved in the day-to-day management of the philanthropy. The HKFL model is a highly collaborative process that involves all trusted family business advisors in the process.

Once the vehicle is decided upon, the H & K advisors turn to the question of governance. Depending upon the vehicle, the board requirements are very different. If the vehicle chosen is a public charity, a board that is widely representative of the public must be chosen. If the vehicle is a donor-advised fund, the board function is fulfilled by the board of the community foundation or the commercial entity, so there is no need to set up a separate board of trustees for the philanthropy. If the vehicle is a corporate foundation, there can be a broad overlap between the foundation's board of trustees and the corporation's board of directors. If the vehicle chosen is a family foundation, there is considerable freedom about who sits on the board, but presumably most of the seats would be held by family members.

In the Newman's case, the question of governance seems to be a simple matter: there are four family members who founded the family foundation and they should comprise its board of trustees. This is one option, and it could be entirely adequate. Family foundation boards are usually enriched, however, by the inclusion of two or more active and knowledgeable outsiders. Outsiders can bring fresh perspectives, specific types of expertise, and often can be a buffering or moderating influence, helping to settle disputes and promote family stability. Often, these non-family family foundation trustees are trusted advisors or key employees of the FOB. No matter who they are, however, there is a need to have at least two in order to create a critical mass. If there is only one outside trustee, it is virtually a certainty that she or he will be completely intimidated by the family majority and unlikely to provide a strong outside voice.

It is usually sensible to bring the next generation to the board sooner, rather than later. While Laura and Paul both have children who are under ten, and thus too young to serve, organizations such as the Council of Michigan Foundations and Youth on Board have demonstrated that teenagers can effectively serve as full voting members of nonprofit and foundation boards. Many family foundations ease younger generations into full board membership by first offering them the opportunity to serve on youth boards. These youth boards are sometimes purely advisory, but a more effective way to manage them is to provide the youth boards with their own grantmaking budget, and then allow them to make grants unhindered. It is better to allow the youth board to

make an occasional mistake (from which they will assuredly learn) than to overrule their grants in a misguided effort to keep them from unpleasant outcomes. Including older children in this activity can also provide a highly valuable and structured financial learning opportunity. In any case, after reaching a certain age, members of the youth board are then promoted to the full board.

Finally, the H & K advisors consider the question of management. Here again, the type of vehicle chosen matters. If it is a public charity, it may be necessary to bring in an outsider skilled in managing such entities. If it is a donor-advised fund, the paid staff of the community foundation or of the commercial gift fund will be the managers. Corporate foundations are often managed by an employee of the corporation. Family foundations have considerable freedom in choosing their CEO. It may make sense, if the foundation is small enough; to have one of the founding family/trustees also serve as the CEO. If the family foundation is larger, however, it usually makes sense to have someone, whether a member of the family or not, to be the full-time, compensated CEO.

No matter whether the CEO is a family member or an outsider, unless she or he is a seasoned grantmaker, she or he will need help. The management of foundations—and the making of effective and high impact grants—is both an art and a science, with recognized standards of good practice. The H & K advisors recommend books like *The Insider's Guide to Grantmaking* and resources such as the Association of Small Foundations' "Foundation in a Box," and the Dorothy A. Johnson Center for Philanthropy and Nonprofit Leadership's *Nonprofit Good Practice Guide* (www.nonprofitbasics.org), all of which contain a wealth of information on all aspects of foundation management. The advisors also recommend basic training programs offered by the Council on Foundations, and advanced training programs offered by the Dorothy A. Johnson Center's *The Grantmaking School*. Excellence in grantmaking and foundation management is no accident: it comes through serious training.

The Founders and owners of NewCo engaged in the HKFL process, which helped clarify values from their personal life history and business experiences. They established a perpetual foundation that reflected these values would make an impact on society. In addition, they have a video record that clearly states what their values are, how they were shaped, and what their intentions regarding the foundation are. The attorneys have drafted the necessary legal documents based upon this video, which will help ensure that disputes in future generations can be settled by viewing the video as opposed to hiring attorneys to battle over their intentions. The Newmans have decided that their family foundation will focus on funding research related to families that own businesses, to help them learn how to become successful in their personal life, their family owned business, and in their philanthropic endeavors.

All four family members joined the board of the foundation, and they invited three outsiders to join, as well. One was a long-time employee of NewCo, another was the trusted accountant for the business, and the third was a close friend of the family. The trustees are considering the formation of a junior board as soon as possible, and decided to ask the youngest brother, John, to be the first CEO of the foundation. John has read *The Insider's Guide to Grantmaking*, is about to attend basic training for grantmakers through the Council on Foundations, and plans on attending *The Grantmaking School* soon. The NewCo family foundation is off to a great start, but this certainly does not guarantee future performance. However, it does mean that they have avoided some of the multitude of well-documented philanthropic problems that have caused family and business agony for many other startup foundations.

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Authors

Norman A. Brown is the President Emeritus of the W. K. Foundation, Chair of the Points of Light Foundation, and the Principal of Norman A. Brown and Associates Consulting Firm.

Joel J. Orosz is the former Program Director for Philanthropy and Volunteerism programming at the W. K. Kellogg Foundation and is the Distinguished Professor of Philanthropic Studies at the Dorothy A. Johnson Center for Philanthropy and Nonprofit Leadership at Grand Valley State University. He is also the Principal of Inside Philanthropy Consulting.

Joe Horak is cofounder of Horak & Kuhn, LLC Family Business Advisors and CEO of Horak Family and Psychological Services PC. He is the Chair of the Licensing Board for Marriage and Family Therapy in Michigan and an adjunct faculty in the Department of Counseling Psychology of Western Michigan University at the university's Grand Rapids, Michigan campus.

Greg M. Kuhn is cofounder of Horak & Kuhn, LLC Family Business Advisors and CEO of Comprehensive Evaluation Services.