Plan to Finance Philanthropy Shows the Power of a Simple Question

By ANDREW ROSS SORKIN


David Maxwell for The New York Times **FARSEEING** Lindsay Beck came up with an idea in business school of a stock market for nonprofits.

What if?

That's the way Lindsay Beck, a two-time cancer survivor and the founder of a successful charity, started thinking about how the world of finance and Wall Street could revolutionize the staid nonprofit industry.

Ms. Beck was a graduate student at the Wharton School of the University of Pennsylvania when she blurted out a question that had been consuming her: “Could there be a Nasdaq for not-for-profits?”

The idea — creating the equivalent of a profit-driven stock market for nonprofits — might seem counterintuitive at first. It was a “radical idea, and maybe I was naïve,” she acknowledged.

But for the last year, she has pursued the concept. It has gained enough traction that it has won her meetings with executives at Goldman Sachs, Deutsche Bank and members of the Obama administration. A team of lawyers at Morrison Foerster has been working to understand the tax implications and how to comply with Securities and Exchange Commission rules.

Ms. Beck’s idea is just an idea, a germ of a concept that could go nowhere. And it is early, very early. But it has the potential to upend an entire part of the global economy if it succeeds. By some estimates, if just 1 percent of the money in the portfolios of wealthy individuals in the United States was directed to nonprofits through new financial instruments like social impact bonds or Ms. Beck’s exchange, the nonprofit world would be sitting on $1 trillion.

Wall Street is littered with clever plans to use financial instruments to change behavior — carbon trading, for example. Some have changed the world, and others failed miserably. As Douglas Horton said: “Good ideas are a dime a dozen. Bad ones are free.”

Several ideas about using financial instruments and a for-profit approach in the world of nonprofits are now taking hold. This month, Goldman Sachs announced a $250 million social impact fund. Morgan Stanley plans to raise $10 billion over the next five years for what it calls its “investing with impact platform.”

In September, JPMorgan Chase teamed up with the Bill and Melinda Gates Foundation to start a $94 million investment fund to finance late-stage drugs, vaccines and tools to fight diseases like malaria, tuberculosis and H.I.V./AIDS.

Considering the black eye that Wall Street has suffered in the public consciousness, some of these efforts will probably be greeted with cynicism. That may very well be part of Wall Street’s motivation, but that hasn’t stopped the nonprofit sector from jumping at the chance to explore how to use these funds to raise money.

Ms. Beck’s idea is an outgrowth of her experiences. She started a nonprofit, Fertile Hope, which helped female cancer survivors with pregnancy. Later, it merged with Livestrong (before Lance Armstrong confessed to doping and left the foundation).

Afterward, she decided to get an M.B.A. She began examining how to make the nonprofit world more efficient at fund-raising and made it her independent study project. She says she has long believed that charitable money is often misallocated; some of the most effective organizations struggle to raise funds, while some of the least effective charities are allocated millions.

That got her thinking: An exchange, like a stock market, would make the success — or failure — of organizations more transparent, leading to more money in the best hands. On top of that, if donors thought about their charity as an investment, literally, it would transform the nonprofit sector.

“When you take off your charity hat and put on your investor hat, you behave very differently,” she said.

She has been inspired, in part, by several programs that Goldman Sachs developed to sell so-called social-impact bonds. A group led by Alicia Glen, a managing director at Goldman Sachs who is a former lawyer and a former assistant commissioner for housing finance for New York City, has developed a series of such bonds.

Ms. Beck’s vision for an exchange “is very creative and visionary but it may take a long time to come,” Ms. Glen said. She added that although it might be years, if not decades, before such an exchange could be viable, “It is a very laudable goal.”

Ms. Glen should know. She helped develop the financing program for the Citi Bike program, in which Goldman Sachs paid for the purchase of the bicycles and stations in exchange for a potential profit that was capped by the city. Such an arrangement helped provide money for a program that the city could not otherwise have afforded.

The company also created a $9.6 million loan for New York City for a program run by MDRC, a social services provider, aimed at preventing former Rikers Island inmates from ending up back in jail. The program has clear goals and benchmarks. Goldman will directly benefit only if the program works. If recidivism drops by 10 percent, Goldman will be repaid the full $9.6 million by the city. If recidivism decreases more than that, Goldman could a profit, capped at $2.1 million. However, Goldman would lose up to $2.4 million, if recidivism does not fall at least 10 percent.

Goldman has used its own money to finance the programs. But now, it and other firms are coming up with ways to turn these types of programs into investments for its clients. JPMorgan’s nearly $100 million fund works because the Gates Foundation is offering to pay to protect investors from the potential downside of investing in some risky new drugs and vaccines.

“At the outset of the investment, you are underwriting both sides of the ledger: the financial side and the social side,” Ms. Glen said of these new bond products.

Still, Ms. Beck says that to expand such a program broadly, an exchange needs to be created to allow investors to trade these instruments. That way, they could hold the most successful ones and dump the duds.

She says the current spate of “impact bonds” aren’t really bonds; it’s a misnomer. From a technical perspective, she said, “They are really just multiparty contracts with contingent payouts.”

She is developing ways to create a common system to develop social impact bonds that are, in her words, “real bonds.”

Of course, her idea may be ahead of its time. When she was researching her idea, she came across an article from 2006 about a plan to hold initial public offerings for nonprofits. Still, she asked, What if?