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The Competitive Advantage of Corporate Philanthropy

by Michael E. Porter and Mark R. Kramer

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The Competitive Advantage of Corporate Philanthropy

by Michael E. Porter and Mark R. Kramer

Corporate philanthropy is in decline. Charitable contributions by U.S. companies fell 14.5% in real dollars last year, and over the last 15 years, corporate giving as a percentage of profits has dropped by 50%. The reasons are not hard to understand. Executives increasingly see themselves in a no-win situation, caught between critics demanding ever higher levels of “corporate social responsibility” and investors applying relentless pressure to maximize short-term profits. Giving more does not satisfy the critics—the more companies donate, the more is expected of them. And executives find it hard, if not impossible, to justify charitable expenditures in terms of bottom-line benefit.

This dilemma has led many companies to seek to be more strategic in their philanthropy. But what passes for “strategic philanthropy” today is almost never truly strategic, and often it isn’t even particularly effective as philanthropy. Increasingly, philanthropy is used as a form of public relations or advertising, promoting a company’s image or brand through cause-related marketing or other high-profile spon-

sorships. Although it still represents only a small proportion of overall corporate charitable expenditures, U.S. corporate spending on cause-related marketing jumped from \$125 million in 1990 to an estimated \$828 million in 2002. Arts sponsorships are growing, too—they accounted for an additional \$589 million in 2001. While these campaigns do provide much-needed support to worthy causes, they are intended as much to increase company visibility and improve employee morale as to create social impact. Tobacco giant Philip Morris, for example, spent \$75 million on its charitable contributions in 1999 and then launched a \$100 million advertising campaign to publicize them. Not surprisingly, there are genuine doubts about whether such approaches actually work or just breed public cynicism about company motives. (See the sidebar “The Myth of Strategic Philanthropy.”)

Given the current haziness surrounding corporate philanthropy, this seems an appropriate time to revisit the most basic of questions: Should corporations engage in philan-

thropy at all? The economist Milton Friedman laid down the gauntlet decades ago, arguing in a 1970 *New York Times Magazine* article that the only “social responsibility of business” is to “increase its profits.” “The corporation,” he wrote in his book *Capitalism and Freedom*, “is an instrument of the stockholders who own it. If the corporation makes a contribution, it prevents the individual stockholder from himself deciding how he should dispose of his funds.” If charitable contributions are to be made, Friedman concluded, they should be made by individual stockholders—or, by extension, individual employees—and not by the corporation.

The way most corporate philanthropy is practiced today, Friedman is right. The majority of corporate contribution programs are diffuse and unfocused. Most consist of numerous small cash donations given to aid local civic causes or provide general operating support to universities and national charities in the hope of generating goodwill among employees, customers, and the local community. Rather than being tied to well-thought-out social or business objectives, the contributions often reflect the personal beliefs and values of executives or employees. Indeed, one of the most popular approaches—employee matching grants—explicitly leaves the choice of charity to the individual worker. Although aimed at enhancing morale, the same effect might be gained from an equal increase in wages that employees could then choose to donate to charity on a tax-deductible basis. It does indeed seem that many of the giving decisions companies make today would be better made by individuals donating their own money.

What about the programs that are at least superficially tied to business goals, such as cause-related marketing? Even the successful ones are hard to justify as charitable initiatives. Since all reasonable corporate expenditures are deductible, companies get no special tax advantage for spending on philanthropy as opposed to other corporate purposes. If cause-related marketing is good marketing, it is already deductible and does not benefit from being designated as charitable.

But does Friedman’s argument always hold? Underlying it are two implicit assumptions. The first is that social and economic objectives are separate and distinct, so that a corporation’s social spending comes at the expense of

its economic results. The second is the assumption that corporations, when they address social objectives, provide no greater benefit than is provided by individual donors.

These assumptions hold true when corporate contributions are unfocused and piecemeal, as is typically the case today. But there is another, more truly strategic way to think about philanthropy. Corporations can use their charitable efforts to improve their *competitive context*—the quality of the business environment in the location or locations where they operate. Using philanthropy to enhance context brings social and economic goals into alignment and improves a company’s long-term business prospects—thus contradicting Friedman’s first assumption. In addition, addressing context enables a company not only to give money but also to leverage its capabilities and relationships in support of charitable causes. That produces social benefits far exceeding those provided by individual donors, foundations, or even governments. Context-focused giving thus contradicts Friedman’s second assumption as well.

A handful of companies have begun to use context-focused philanthropy to achieve both social and economic gains. Cisco Systems, to take one example, has invested in an ambitious educational program—the Cisco Networking Academy—to train computer network administrators, thus alleviating a potential constraint on its growth while providing attractive job opportunities to high school graduates. By focusing on social needs that affect its corporate context and utilizing its unique attributes as a corporation to address them, Cisco has begun to demonstrate the unrealized potential of corporate philanthropy. Taking this new direction, however, requires fundamental changes in the way companies approach their contribution programs. Corporations need to rethink both *where* they focus their philanthropy and *how* they go about their giving.

Where to Focus

It is true that economic and social objectives have long been seen as distinct and often competing. But this is a false dichotomy; it represents an increasingly obsolete perspective in a world of open, knowledge-based competition. Companies do not function in isolation from the society around them. In fact, their ability to compete depends heavily on the circum-

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stances of the locations where they operate. Improving education, for example, is generally seen as a social issue, but the educational level of the local workforce substantially affects a company's potential competitiveness. The more a social improvement relates to a company's business, the more it leads to economic benefits as well. In establishing its Networking Academy, for example, Cisco focused not on the educational system overall, but on the training needed to produce network administrators—the particular kind of education that made the most difference to Cisco's competitive context. (For a more detailed look at that program, see the sidebar "The Cisco Networking Academy.")

In the long run, then, social and economic goals are not inherently conflicting but integrally connected. Competitiveness today depends on the productivity with which companies can use labor, capital, and natural resources to produce high-quality goods and services. Productivity depends on having workers who are educated, safe, healthy, decently housed,

and motivated by a sense of opportunity. Preserving the environment benefits not only society but companies too, because reducing pollution and waste can lead to a more productive use of resources and help produce goods that consumers value. Boosting social and economic conditions in developing countries can create more productive locations for a company's operations as well as new markets for its products. Indeed, we are learning that the most effective method of addressing many of the world's pressing problems is often to mobilize the corporate sector in ways that benefit both society and companies.

That does not mean that every corporate expenditure will bring a social benefit or that every social benefit will improve competitiveness. Most corporate expenditures produce benefits only for the business, and charitable contributions unrelated to the business generate only social benefits. It is only where corporate expenditures produce simultaneous social and economic gains that corporate philanthropy and shareholder interests converge, as illustrated in the exhibit "A Convergence of Interests." The highlighted area shows where corporate philanthropy has an important influence on a company's competitive context. It is here that philanthropy is truly strategic.

Competitive context has always been important to strategy. The availability of skilled and motivated employees; the efficiency of the local infrastructure, including roads and telecommunications; the size and sophistication of the local market; the extent of governmental regulations—such contextual variables have always influenced companies' ability to compete. But competitive context has become even more critical as the basis of competition has moved from cheap inputs to superior productivity. For one thing, modern knowledge- and technology-based competition hinges more and more on worker capabilities. For another, companies today depend more on local partnerships: They rely on outsourcing and collaboration with local suppliers and institutions rather than on vertical integration; they work more closely with customers; and they draw more on local universities and research institutes to conduct research and development. Finally, navigating increasingly complex local regulations and reducing approval times for new projects and products are becoming increasingly important to competition. As a

The Myth of Strategic Philanthropy

Few phrases are as overused and poorly defined as "strategic philanthropy." The term is used to cover virtually any kind of charitable activity that has some definable theme, goal, approach, or focus. In the corporate context, it generally means that there is some connection, however vague or tenuous, between the charitable contribution and the company's business. Often this connection is only semantic, enabling the company to rationalize its contributions in public reports and press releases. In fact, most corporate giving programs have nothing to do with a company's strategy. They are primarily aimed at generating goodwill and positive publicity and boosting employee morale.

Cause-related marketing, through which a company concentrates its giving on a single cause or admired organization, was one of the earliest practices cited as "strategic philanthropy," and it is a step above diffuse corporate contributions. At its most sophisticated, cause-

related marketing can improve the reputation of a company by linking its identity with the admired qualities of a chosen non-profit partner or a popular cause. Companies that sponsor the Olympics, for example, gain not only wide exposure but also an association with the pursuit of excellence. And by concentrating funding through a deliberate selection process, cause-related marketing has the potential to create more impact than unfocused giving would provide.

However, cause-related marketing falls far short of truly strategic philanthropy. Its emphasis remains on publicity rather than social impact. The desired benefit is enhanced goodwill, not improvement in a company's ability to compete. True strategic giving, by contrast, addresses important social and economic goals simultaneously, targeting areas of competitive context where the company and society both benefit because the firm brings unique assets and expertise.

The Cisco Networking Academy

Cisco Systems' Networking Academy exemplifies the powerful links that exist between a company's philanthropic strategy, its competitive context, and social benefits. Cisco, the leading producer of networking equipment and routers used to connect computers to the Internet, grew rapidly over the past decade. But as Internet use expanded, customers around the world encountered a chronic shortage of qualified network administrators, which became a limiting factor in Cisco's—and the entire IT industry's—continued growth. By one estimate, well over 1 million information technology jobs remained unfilled worldwide in the late 1990s. While Cisco was well aware of this constraint in its competitive context, it was only through philanthropy that the company found a way to address it.

The project began as a typical example of goodwill-based giving: Cisco contributed networking equipment to a high school near its headquarters, then expanded the program to other schools in the region. A Cisco engineer working with the schools realized, however, that the teachers and administrators lacked the training to manage the networks once they were installed. He and several other Cisco engineers volunteered to develop a program that would not only donate equipment but also train teachers how to build, design, and maintain computer networks. Students began attending these courses and were able to absorb the information successfully. As Cisco expanded the program, company executives began to realize that they could develop a Web-based distance-learning curriculum to train and certify secondary- and postsecondary-school students in network administration, a program that might have a much broader social and economic impact. The Networking Academy was born.

Because the social goal of the program was tightly linked to Cisco's specialized expertise, the company was able to create a high-quality curriculum rap-

idly and cost-effectively, creating far more social and economic value than if it had merely contributed cash and equipment to a worthy cause. At the suggestion of the U.S. Department of Education, the company began to target schools in "empowerment zones," designated by the federal government as among the most economically challenged communities in the country. The company also began to include community colleges and mid-career training in the program. More recently, it has worked with the United Nations to expand the effort to developing countries, where job opportunities are particularly scarce and networking skills particularly limited. Cisco has also organized a worldwide database of employment opportunities for academy graduates, creating a more efficient job market that benefits its cluster as well as the graduates and the regions in which they live.

Cisco has used its unique assets and expertise, along with its worldwide presence, to create a program that no other educational institution, government agency, foundation, or corporate donor could have designed as well or expanded as rapidly. And it has amplified the impact by signaling other corporations in its cluster. Other companies supplemented Cisco's contributions by donating or discounting products and services of their own, such as Internet access and computer hardware and software. Several leading technology companies also began to recognize the value of the global infrastructure Cisco had created, and, rather than create their own Web-based learning programs, they partnered with Cisco. Companies such as Sun Microsystems, Hewlett-Packard, Adobe Systems, and Panduit expanded the academy curriculum by sponsoring courses in programming, IT essentials, Web design, and cabling. Because the project was linked to Cisco's business, it could gain the support of other companies in its cluster and use their contributions effectively.

Although the program is only five years old, it now operates 9,900 academies in secondary schools, community colleges, and community-based organizations in all 50 states and in 147 countries. The social and economic value that has been created is enormous. Cisco estimates that it has invested a total of \$150 million since the program began. With that investment, it has brought the possibility of technology careers, and the technology itself, to men and women in some of the most economically depressed regions in the United States and around the world. More than 115,000 students have already graduated from the two-year program, and 263,000 students are currently enrolled, half of them outside the United States. The program continues to expand rapidly, with 50 to 100 new academies opening every week. Cisco estimates that 50% of academy graduates have found jobs in the IT industry, where the average salary for a network administrator in the United States is \$67,000. Over the span of their careers, the incremental earnings potential of those who have already joined the workforce may approach several billion dollars.

To be sure, the program has benefited many free riders—employers around the world who gain access to highly skilled academy graduates and even direct competitors. But as the market-leading provider of routers, Cisco stands to benefit the most from this improvement in the competitive context. Through actively engaging others, Cisco has not had to bear the full cost of the program. Not only has Cisco enlarged its market and strengthened its cluster, but it has increased the sophistication of its customers. Through these tangible improvements in competitive context, and not just by the act of giving, Cisco has attracted international recognition for this program, generating justified pride and enthusiasm among company employees, goodwill among its partners, and a reputation for leadership in philanthropy.

result of these trends, companies' success has become more tightly intertwined with local institutions and other contextual conditions. And the globalization of production and marketing means that context is often important for a company not just in its home market but in multiple countries.

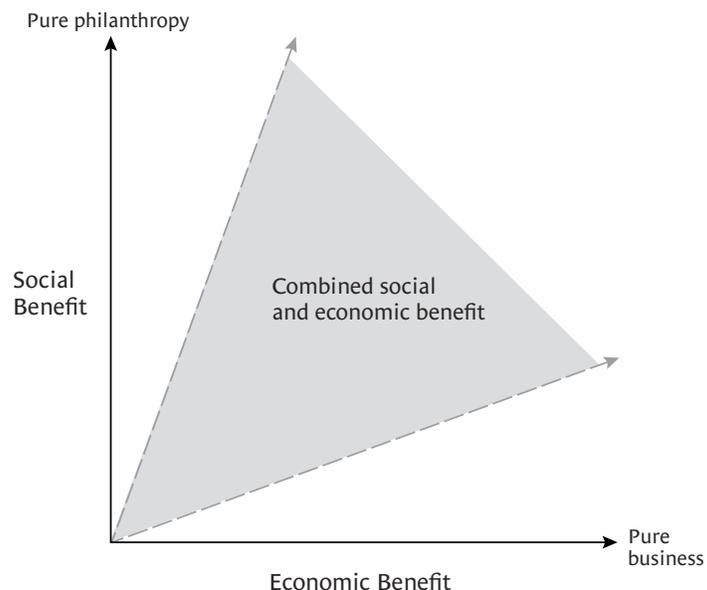
A company's competitive context consists of four interrelated elements of the local business environment that shape potential productivity: factor conditions, or the available inputs of production; demand conditions; the context for strategy and rivalry; and related and supporting industries. This framework is summarized in the exhibit "The Four Elements of Competitive Context" and described in detail in Michael E. Porter's *The Competitive Advantage of Nations*. Weakness in any part of this context can erode the competitiveness of a nation or region as a business location.

Some aspects of the business environment, such as road systems, corporate tax rates, and corporation laws, have effects that cut across all industries. These general conditions can be crucial to competitiveness in developing countries, and improving them through corporate philanthropy can bring enormous social gains to the world's poorest nations. But often just as decisive, if not more, are aspects of context that are specific to a particular *cluster*—a geographic concentration of interconnected com-

panies, suppliers, related industries, and specialized institutions in a particular field, such as high-performance cars in Germany or software in India. Clusters arise through the combined influence of all four elements of context. They are often prominent features of a region's economic landscape, and building them is essential to its development, allowing constituent firms to be more productive, making innovation easier, and fostering the formation of new businesses.

Philanthropic investments by members of a cluster, either individually or collectively, can have a powerful effect on the cluster's competitiveness and the performance of all of its constituent companies. Philanthropy can often be the most cost-effective way—and sometimes the only way—to improve competitive context. It enables companies to leverage not only their own resources but also the existing efforts and infrastructure of nonprofits and other institutions. Contributing to a university, for example, may be a far less expensive way to strengthen a local base of advanced skills in a company's field than developing training in-house. And philanthropy is amenable to collective corporate action, enabling costs to be spread over multiple companies. Finally, because of philanthropy's wide social benefits, companies are often able to forge partnerships with nonprofit organizations and governments that would be

A Convergence of Interests



wary of collaborating on efforts that solely benefited a particular company.

Influencing Competitive Context

By carefully analyzing the elements of competitive context, a company can identify the areas of overlap between social and economic value that will most enhance its own and its cluster's competitiveness. Consider each of the four elements of context and how companies have influenced them through philanthropy in ways that have improved their long-term economic prospects.

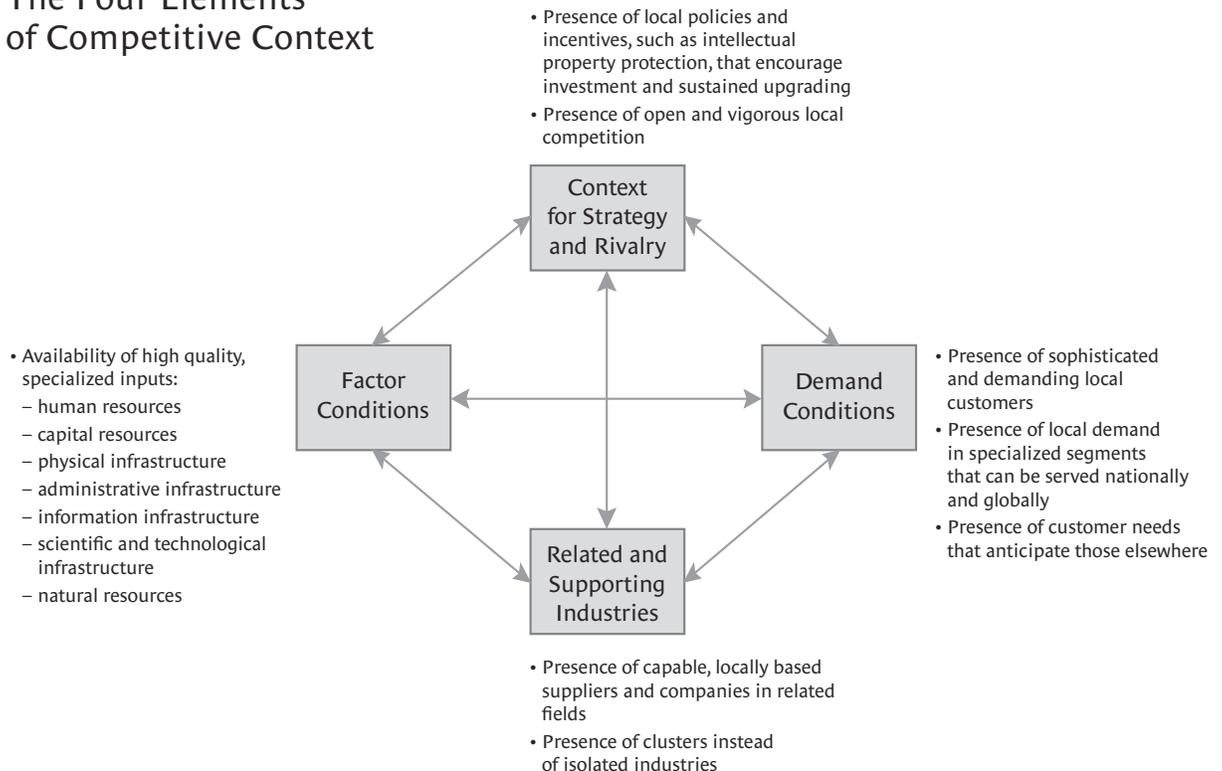
Factor Conditions. Achieving high levels of productivity depends on the presence of trained workers, high-quality scientific and technological institutions, adequate physical infrastructure, transparent and efficient administrative processes (such as company registration or permit requirements), and available natural resources. All are areas that philanthropy can influence.

Charitable giving can, for example, improve education and training. DreamWorks SKG, the film production company, recently created a program to train low-income students in Los

Angeles in skills needed to work in the entertainment industry. Each of the company's six divisions is working with the Los Angeles Community College District, local high schools, and after-school programs to create a specialized curriculum that combines classroom instruction with internships and mentoring. The social benefit is an improved educational system and better employment opportunities for low-income residents. The economic benefit is greater availability of specially trained graduates. Even though relatively few of them will join Dream-Works itself, the company also gains by strengthening the entertainment cluster it depends on.

Philanthropic initiatives can also improve the local quality of life, which benefits all citizens but is increasingly necessary to attract mobile employees with specialized talents. In 1996, SC Johnson, a manufacturer of cleaning and home-storage products, launched "Sustainable Racine," a project to make its home city in Wisconsin a better place to in which to live and work. In partnership with local organizations, government, and residents, the company created a community wide coali-

The Four Elements of Competitive Context



Philanthropy can often be the most cost-effective way for a company to improve its competitive context, enabling companies to leverage the efforts and infrastructure of nonprofits and other institutions.

tion focused on enhancing the local economy and the environment. One project, an agreement among four municipalities to coordinate water and sewer treatment, resulted in savings for residents and businesses while reducing pollution. Another project involved opening the community's first charter school, targeting at-risk students. Other efforts focused on economic revitalization: Commercial vacancy rates in downtown Racine have fallen from 46% to 18% as polluted sites have been reclaimed and jobs have returned for local residents.

Philanthropy can also improve inputs other than labor, through enhancements in, say, the quality of local research and development institutions, the effectiveness of administrative institutions such as the legal system, the quality of the physical infrastructure, or the sustainable development of natural resources. Exxon Mobil, for example, has devoted substantial resources to improving basic conditions such as roads and the rule of law in the developing countries where it operates.

Demand Conditions. Demand conditions in a nation or region include the size of the local market, the appropriateness of product standards, and the sophistication of local customers. Sophisticated local customers enhance the region's competitiveness by providing companies with insight into emerging customer needs and applying pressure for innovation. For example, the advanced state of medical practice in Boston has triggered a stream of innovation in Boston-based medical device companies.

Philanthropy can influence both the size and quality of the local market. The Cisco Networking Academy, for instance, improved demand conditions by helping customers obtain well-trained network administrators. In doing so, it increased the size of the market and the sophistication of users—and hence users' interest in more advanced solutions. Apple Computer has long donated computers to schools as a means of introducing its products to young people. This provides a clear social benefit to the schools while expanding Apple's potential market and turning students and teachers into more sophisticated purchasers. Safeco, an insurance and financial services firm, is working in partnership with nonprofits to expand affordable housing and enhance public safety. As home ownership and public safety increased in its

four test markets, insurance sales did too, in some cases by up to 40%.

Context for Strategy and Rivalry. The rules, incentives, and norms governing competition in a nation or region have a fundamental influence on productivity. Policies that encourage investment, protect intellectual property, open local markets to trade, break up or prevent the formation of cartels and monopolies, and reduce corruption make a location a more attractive place to do business.

Philanthropy can have a strong influence on creating a more productive and transparent environment for competition. For example, 26 U.S. corporations and 38 corporations from other countries have joined to support Transparency International in its work to disclose and deter corruption around the world. By measuring and focusing public attention on corruption, the organization helps to create an environment that rewards fair competition and enhances productivity. This benefits local citizens while providing sponsoring companies improved access to markets.

Another example is the International Corporate Governance Network (ICGN), a nonprofit organization formed by major institutional investors, including the College Retirement Equities Fund (TIAA-CREF) and the California Public Employees Retirement System, known as CalPERS, to promote improved standards of corporate governance and disclosure, especially in developing countries. ICGN encourages uniform global accounting standards and equitable shareholder voting procedures. Developing countries and their citizens benefit as improved governance and disclosure enhance local corporate practices, expose unscrupulous local competitors, and make regions more attractive for foreign investment. The institutional investors that support this project also gain better and fairer capital markets in which to invest.

Related and Supporting Industries. A company's productivity can be greatly enhanced by having high-quality supporting industries and services nearby. While outsourcing from distant suppliers is possible, it is not as efficient as using capable local suppliers of services, components, and machinery. Proximity enhances responsiveness, exchange of information, and innovation, in addition to lowering transportation and inventory costs.

Philanthropy can foster the development of

clusters and strengthen supporting industries. American Express, for example, depends on travel-related spending for a large share of its credit card and travel agency revenues. Hence, it is part of the travel cluster in each of the countries in which it operates, and it depends on the success of these clusters in improving the quality of tourism and attracting travelers. Since 1986, American Express has funded Travel and Tourism Academies in secondary schools, training students not for the credit card business, its core business, nor for its own travel services, but for careers in other travel agencies as well as airlines, hotels, and restaurants. The program, which includes teacher training, curriculum support, summer internships, and industry mentors, now operates in ten countries and more than 3,000 schools, with more than 120,000 students enrolled. It provides the major social benefits of improved educational and job opportunities for local citizens. Within the United States, 80% of students in the program go on to college, and 25% take jobs in the travel industry after graduation. The economic gains are also substantial, as local travel clusters become more competitive and better able to grow. That translates into important benefits for American Express.

The Free Rider Problem

When corporate philanthropy improves competitive context, other companies in the cluster or region, including direct competitors, often share the benefits. That raises an important question: Does the ability of other companies to be free riders negate the strategic value of context-focused philanthropy? The answer is *no*. The competitive benefits reaped by the donor company remain substantial, for five reasons:

- Improving context mainly benefits companies based in a given location. Not all competitors will be based in the same area, so the company will still gain an edge over the competition in general.
- Corporate philanthropy is ripe for collective activity. By sharing the costs with other companies in its cluster, including competitors, a company can greatly diminish the free rider problem.
- Leading companies will be best positioned to make substantial contributions and will in turn reap a major share of the benefits. Cisco, for example, with a leading market share in net-

working equipment, will benefit most from a larger, more rapidly growing market.

- Not all contextual advantages are of equal value to all competitors. The more tightly corporate philanthropy is aligned with a company's unique strategy—increasing skills, technology, or infrastructure on which the firm is especially reliant, say, or increasing demand within a specialized segment where the company is strongest—the more disproportionately the company will benefit through enhancing the context.

- The company that initiates corporate philanthropy in a particular area will often get disproportionate benefits because of the superior reputation and relationships it builds. In its campaign to fight malaria in African countries, for example, Exxon Mobil not only improves public health. It also improves the health of its workers and contractors and builds strong relationships with local governments and nonprofits, advancing its goal of becoming the preferred resource-development partner.

A good example of how a company can gain an edge even when its contributions also benefit competitors is provided by Grand Circle Travel. Grand Circle, the leading direct marketer of international travel for older Americans, has a strategy based on offering rich cultural and educational experiences for its customers. Since 1992, its corporate foundation has given more than \$12 million to historical preservation projects in locations that its customers like to visit, such as the Foundation of Friends of the Museum and Ruins of Ephesus in Turkey and the State Museum of Auschwitz-Birkenau in Poland. Other tours travel the same routes and so benefit from Grand Circle's donations. Through its philanthropy, however, Grand Circle has built close relationships with the organizations that maintain these sites and can provide its travelers with special opportunities to visit and learn about them. Grand Circle thus gains a unique competitive advantage that distinguishes it from other travel providers.

How to Contribute

Understanding the link between philanthropy and competitive context helps companies identify *where* they should focus their corporate giving. Understanding the ways in which philanthropy creates value highlights *how* they can achieve the greatest social and

economic impact through their contributions. As we will see, the where and the how are mutually reinforcing.

In “Philanthropy’s New Agenda: Creating Value” (HBR November–December 1999), we outlined four ways in which charitable foundations can create social value: selecting the best grantees, signaling other funders, improving the performance of grant recipients, and advancing knowledge and practice in the field. These efforts build on one another: Increasingly greater value is generated as a donor moves up the ladder from selecting the right grantees to advancing knowledge. (See the exhibit “Maximizing Philanthropy’s Value.”) The same principles apply to corporate giving, pointing the way to how corporate philanthropy can be most effective in enhancing competitive context. Focusing on the four principles also ensures that corporate donations have greater impact than donations of the same magnitude by individuals.

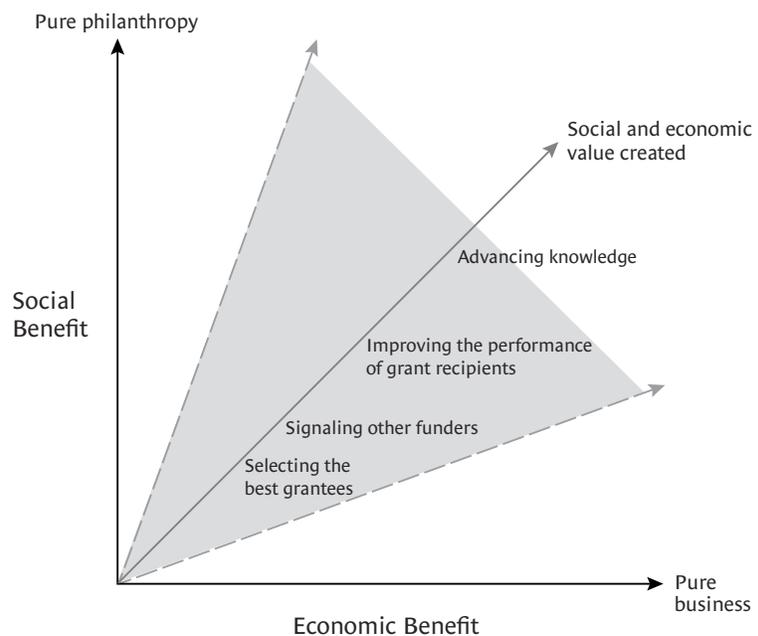
Selecting the Best Grantees. Most philanthropic activity involves giving money to other organizations that actually deliver the social benefits. The impact achieved by a donor, then, is largely determined by the effectiveness of the recipient. Selecting a more effective grantee or partner organization will lead to more social impact per dollar expended.

Selecting the most effective grantees in a given field is never easy. It may be obvious which nonprofit organizations raise the most money, have the greatest prestige, or manage the best development campaigns, but such factors may have little to do with how well the grantees use contributions. Extensive and disciplined research is usually required to select those recipients that will achieve the greatest social impact.

Individual donors rarely have the time or expertise to undertake such serious due diligence. Foundations are far more expert than individuals, but they have limited staff. Corporations, on the other hand, are well positioned to undertake such research if their philanthropy is connected to their business and they can tap into their internal capabilities, particularly the financial, managerial, and technical expertise of employees. Whether through their own operations or those of their suppliers and customers, corporations also often have a presence in many communities across a country or around the world. This can provide significant local knowledge and the ability to examine and compare the operation of nonprofits firsthand.

In some cases, a company can introduce and support a particularly effective nonprofit organization or program in many of the loca-

Maximizing Philanthropy’s Value



tions in which it operates. Grand Circle Travel, for example, uses its 15 overseas offices to identify historical preservation projects to fund. Fleet Boston Financial assembles teams of employees with diverse management and financial skills to examine the inner-city economic development organizations that its foundation supports. The teams visit each nonprofit, interview management, review policies and procedures, and report to the corporate foundation on whether support should be continued and, if so, where it should be directed. This level of attention and expertise is substantially greater than most individual donors, foundations, or even government agencies can muster.

Signaling Other Funders. A donor can publicize the most effective nonprofit organizations and promote them to other donors, attracting greater funding and thus creating a more effective allocation of overall philanthropic spending.

Corporations bring uniquely valuable assets to this task. First, their reputations often command respect, becoming imprimaturs of credibility for grantees. Second, they are often able to influence a vast network of entities in their cluster, including customers, suppliers, and other partners. This gives them far greater reach than individual donors or even most nonprofits and foundations. Third, they often have access to communication channels and expertise that can be used to disseminate information widely, swiftly, and persuasively to other donors.

Signaling other funders is especially important in corporate philanthropy because it mitigates the free rider problem. Collective social investment by participants in a cluster can improve the context for all players, while reducing the cost borne by each one. By leveraging its relationships and brand identity to initiate social projects that are also funded by others, a corporation improves the cost-benefit ratio. The Cisco Networking Academy draws support from numerous technology companies in Cisco's cluster as well as educational systems and governments throughout the world, all of which benefit from the graduates' success. American Express's Travel and Tourism Academies depend on the help of more than 750 travel cluster partners who bear part of the cost and reap part of the benefit. Different companies will bring different strengths to a

given philanthropic initiative. By tapping each company's distinctive expertise, the collective investment can be far more effective than a donation by any one company.

Improving the Performance of Grant Recipients. By improving the effectiveness of nonprofits, corporations create value for society, increasing the social impact achieved per dollar expended. While selecting the right grantee improves society's return on a single contribution, and signaling other funders improves the return on multiple contributions, improving grantee performance can increase the return on the grantee's total budget.

Unlike many other donors, corporations have the ability to work directly with nonprofits and other partners to help them become more effective. They bring unique assets and expertise that individuals and foundations lack, enabling them to provide a wide range of nonmonetary assistance that is less costly and more sophisticated than the services most grantees could purchase for themselves. And because they typically make long-term commitments to the communities in which they operate, corporations can work closely with local nonprofits over the extended periods of time needed for meaningful organizational improvement. By operating in multiple geographical areas, moreover, companies are able to facilitate the transfer of knowledge and operational improvements among non-profits in different regions or countries. Contextual issues within a particular industry or cluster will often be similar across different locations, increasing a company's ability to add and derive value in multiple regions.

By tying corporate philanthropy to its business and strategy, a company can create even greater social value in improving grantee performance than other donors. Its specialized assets and expertise, after all, will be most useful in addressing problems related to its particular field. DreamWorks' film production expertise helped it design the educational curriculum necessary to help inner-city students in Los Angeles get jobs in the entertainment industry. The Cisco Networking Academy utilized the special expertise of Cisco employees.

FleetBoston Financial took similar advantage of its corporate expertise in launching its Community Renaissance Initiative. Recognizing that its major markets were in older East Coast cities, Fleet decided to focus on inner-

city economic revitalization as perhaps the most important way to improve its context. Fleet combined its philanthropic contributions with its expertise in financial services, such as small business services, inner-city lending, home mortgages, and venture capital. The bank's foundation identified six communities where the bank had a presence, the economic need was great, and strong community-based organizations could be identified as reliable partners: Brooklyn and Buffalo, New York; Lawrence, Massachusetts; New Haven, Connecticut; and Camden and Jersey City, New Jersey. The foundation committed \$725,000 to each city, building a coalition of local community, business, and government organizations to work on a set of issues identified by the community as central to its revitalization. Bank personnel provided technical advice and small business financing packages to local companies as well as home mortgages and home-buyer education programs. The foundation also attracted \$6 million from private and municipal sources, greatly amplifying its own \$4.5 million investment.

Another example is America Online, which has unique capabilities in managing Internet access and content. Working closely with educators, AOL developed AOL@School, a free, easy-to-use, noncommercial site tailored by grade level to students, administrators, and teachers. This service improves the classroom experience for hundreds of thousands of students nationally by giving them access to enrichment and reference tools while providing lesson plans and reference materials for teachers. Through this program, AOL has been able to leverage its specialized expertise, more than just its donations, to assist in improving secondary school performance more rapidly and cost-effectively than could most other organizations. In the process, it has improved both the long-term demand for its services and the talent needed to provide them.

Advancing Knowledge and Practice. Innovation drives productivity in the nonprofit sector as well as in the commercial sector. The greatest advances come not from incremental improvements in efficiency but from new and better approaches. The most powerful way to create social value, therefore, is by developing new means to address social problems and putting them into widespread practice.

The expertise, research capacity, and reach

that companies bring to philanthropy can help nonprofits create new solutions that they could never afford to develop on their own. Since 1994, IBM has committed a total of \$70 million to its Reinventing Education program, which now reaches 65,000 teachers and 6 million students. Working in partnership with urban school districts, state education departments, and colleges of education, IBM researched and developed a Web-based platform to support new instructional practices and strategies. The new curriculum is intended to redefine how teachers master their profession; it bridges the gap between teacher preparation and the classroom experience by providing a common platform that is used in the teachers' college courses and also supports their first years of teaching. Neither the colleges of education nor the school districts had the expertise or financial resources to develop such a program on their own. An independent evaluation in 2001 found that teachers in the Reinventing Education program were registering substantial gains in student performance.

Pfizer developed a cost-effective treatment for the prevention of trachoma, the leading cause of preventable blindness in developing countries. In addition to donating the drugs, Pfizer worked with the Edna McConnell Clark Foundation and world health organizations to create the infrastructure needed to prescribe and distribute them to populations that previously had little access to health care, much less modern pharmaceuticals. Within one year, the incidence of trachoma was reduced by 50% among target populations in Morocco and Tanzania. The program has since expanded aggressively, adding the Bill & Melinda Gates Foundation and the British government as partners, with the aim of reaching 30 million people worldwide. In addition to providing an important social benefit, Pfizer has enhanced its own long-term business prospects by helping build the infrastructure required to expand its markets.

Just as important as the creation of new knowledge is its adoption in practice. The know-how of corporate leaders, their clout and connections, and their presence in communities around the world create powerful networks for the dissemination of new ideas for addressing social problems. Corporations can facilitate global knowledge transfer and coordinated multisite implementation of new

social initiatives with a proficiency that is unequaled by most other donors.

A Whole New Approach

When corporations support the right causes in the right ways—when they get the *where* and the *how* right—they set in motion a virtuous cycle. By focusing on the contextual conditions most important to their industries and strategies, companies ensure that their corporate capabilities will be particularly well suited to helping grantees create greater value. And by enhancing the value produced by philanthropic efforts in their fields, the companies gain a greater improvement in competitive context. Both the corporations and the causes they support reap important benefits.

Adopting a context-focused approach, however, goes against the grain of current philanthropic practice. Many companies actively distance their philanthropy from the business, believing this will lead to greater goodwill in local communities. While it is true that a growing number of companies aim to make their giving “strategic,” few have connected giving to areas that improve their long-term competitive potential. And even fewer systematically apply their distinctive strengths to maximize the social and economic value created by their philanthropy. Instead, companies are often distracted by the desire to publicize how much money and effort they are contributing in order to foster an image of social responsibility and caring. Avon Products, for example, recently mobilized its 400,000 independent sales representatives in a high-profile door-to-door campaign to raise more than \$32million to fund breast cancer prevention. Fighting breast cancer is a worthy cause and one that is very meaningful to Avon’s target market of female consumers. It is not, however, a material factor in Avon’s competitive context or an area in which Avon has any inherent expertise. As a result, Avon may have greatly augmented its own cash contribution through effective fund-raising—and generated favorable publicity—but it failed to realize the full potential of its philanthropy to create social and economic value. Avon has done much good, but it could do even better. As long as companies remain focused on the public relations benefit of their contributions instead of the impact achieved, they will sacrifice opportunities to create social value.

This does not mean that corporations can-

not also gain goodwill and enhance their reputations through philanthropy. But goodwill alone is not a sufficient motivation. Given public skepticism about the ethics of business—skepticism that has intensified in the wake of the string of corporate scandals this year—corporations that can demonstrate a significant impact on a social problem will gain more credibility than those that are merely big givers. The acid test of good corporate philanthropy is whether the desired social change is so beneficial to the company that the organization would pursue the change even if no one ever knew about it. Cisco, for example, has achieved wide recognition for its good works, but it would have had sufficient reason to develop the Networking Academy even if no goodwill had been created.

Moving to context-focused philanthropy will require a far more rigorous approach than is prevalent today. It will mean tightly integrating the management of philanthropy with other company activities. Rather than delegating philanthropy entirely to a public relations department or the staff of a corporate foundation, the CEO must lead the entire management team through a disciplined process to identify and implement a corporate giving strategy focused on improving context. Business units, in particular, must play central roles in identifying areas for contextual investments.

The new process would involve five steps:

Examine the competitive context in each of the company’s important geographic locations. Where could social investment improve the company’s or cluster’s competitive potential? What are the key constraints that limit productivity, innovation, growth, and competitiveness? A company should pay special attention to the particular constraints that have a disproportionate effect on its strategy relative to competitors; improvements in these areas of context will potentially reinforce competitive advantage. The more specifically a contextual initiative is defined, the more likely the company is to create value and achieve its objectives. A broad initiative such as Avon’s efforts to improve the health of all women will not necessarily deliver contextual benefits, even if it helps some employees or customers. And a tightly targeted objective does not necessarily diminish the scale of impact. Narrowly focused initiatives, like Pfizer’s trachoma program, IBM’s Reinventing Education, or Cisco’s

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There is no inherent contradiction between improving competitive context and making a sincere commitment to bettering society.

Networking Academy, can potentially benefit millions of people or strengthen the global market for an entire industry.

Review the existing philanthropic portfolio to see how it fits this new paradigm. Current programs will likely fall into three categories:

- Communal obligation: support of civic, welfare, and educational organizations, motivated by the company's desire to be a good citizen.
- Goodwill building: contributions to support causes favored by employees, customers, or community leaders, often necessitated by the quid pro quo of business and the desire to improve the company's relationships.
- Strategic giving: philanthropy focused on enhancing competitive context, as outlined here.

Most corporate giving falls into the first two categories. While a certain percentage of giving in these categories may be necessary and desirable, the goal is to shift, as much as possible, a company's philanthropy into the third category. As for cause-related marketing, it is marketing, not philanthropy, and it must stand on its own merits.

Assess existing and potential corporate giving initiatives against the four forms of value creation. How can the company leverage its assets and expertise to select the most effective grantees, signal other funders, improve grantees' performance, and advance knowledge and practice? Given its strategy, where can the company create the greatest value through giving in ways that no other company could match?

Seek opportunities for collective action within a cluster and with other partners. Collective action will often be more effective than a solo effort in addressing context and enhancing the value created, and it helps mitigate the free rider problem by distributing costs broadly. Few companies today work together to achieve social objectives. This may be the result of a general reluctance to work with competitors, but clusters encompass many related partners and industries that do not compete directly. More likely, the tendency to view philanthropy as a form of public relations leads companies to invent their own contributions campaigns, which are branded with their own identities and therefore discourage partners. Focusing on the social change to be achieved, rather than the publicity to be gained, will expand the potential for partnerships and collective action.

Once a company has identified opportunities to improve the competitive context and determined the ways in which it can contribute by adding unique value, the search for partners becomes straightforward: Who else stands to benefit from this change in competitive context? And who has complementary expertise or resources? Conversely, what philanthropic initiatives by others are worth joining? Where can the company be a good partner to others by contributing in ways that will enhance value?

Rigorously track and evaluate results. Monitoring achievements is essential to continually improving the philanthropic strategy and its implementation. As with any other corporate activity, consistent improvement over time brings the greatest value. The most successful programs will not be short-term campaigns but long-term commitments that continue to grow in scale and sophistication.

The context-focused approach to philanthropy is not simple. One size does not fit all. Companies will differ in their comfort levels and time horizons for philanthropic activity, and individual firms will make different choices about how to implement our ideas. Philanthropy will never become an exact science—it is inherently an act of judgment and faith in the pursuit of long-term goals. However, the perspective and tools presented here will help any company make its philanthropic activities far more effective.

Were this approach to be widely adopted, the pattern of corporate contributions would shift significantly. The overall level of contributions would likely increase, and the social and economic value created would go up even more sharply. Companies would be more confident about the value of their philanthropy and more committed to it. They would be able to communicate their philanthropic strategies more effectively to the communities in which they operate. Their choices of areas to support would be clearly understandable and would not seem unpredictable or idiosyncratic. Finally, there would be a better division of labor between corporate givers and other types of funders, with corporations tackling the areas where they are uniquely able to create value.

Charities too would benefit. They would see an increased and more predictable flow of corporate resources into the nonprofit sector. Just as important, they would develop close,

long-term corporate partnerships that would better apply the expertise and assets of the for-profit sector to achieve social objectives. Just as companies can build on the nonprofit infrastructure to achieve their objectives more cost-effectively, nonprofits can benefit from using the commercial infrastructure.

To some corporate leaders, this new approach might seem too self-serving. They might argue that philanthropy is purely a matter of conscience and should not be adulterated by business objectives. In some industries, particularly those like petrochemicals and pharmaceuticals that are prone to public controversy, this view is so entrenched that many companies establish independent charitable foundations and entirely segregate giving from the business. In doing so, however, they give up tremendous opportunities to create greater value for society and themselves. Context-focused philanthropy does not just address a company's self-interest, it benefits many through broad social change. If a company's philanthropy only involved its own interests, after all, it would not qualify as a charitable deduction, and it might

well threaten the company's reputation.

There is no inherent contradiction between improving competitive context and making a sincere commitment to bettering society. Indeed, as we've seen, the more closely a company's philanthropy is linked to its competitive context, the greater the company's contribution to society will be. Other areas, where the company neither creates added value nor derives benefit, should appropriately be left—as Friedman asserts—to individual donors following their own charitable impulses. If systematically pursued in a way that maximizes the value created, context-focused philanthropy can offer companies a new set of competitive tools that well justifies the investment of resources. At the same time, it can unlock a vastly more powerful way to make the world a better place.

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