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# The Multiple Effects of Entrepreneurship on Philanthropy, Society, and Education

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**Abstract.** Entrepreneurship has unexpected effects on philanthropy, society, and education. Entrepreneurs do not start out to become philanthropists but they often assume that role when a business becomes successful (*direct effect*). Entrepreneurs also enrich their associates and business investors, who also contribute to philanthropic wealth (*indirect effect*). The wealth of entrepreneurs and their associates is the main source of funding for private foundations, which often fund educational initiatives. There is a *feedback effect* from entrepreneurship. More entrepreneurship increases philanthropy, which in turn improves society and education. If this work also improves the business climate for entrepreneurship, there will be more entrepreneurs and wealth. Society and education also benefit from the taxes paid by wealthy entrepreneurs (*tax effect*). Even the consumption of wealthy entrepreneurs partially benefits society through jobs created and taxes paid (*consumption effect*). If an entrepreneur dies before spending all the accumulated wealth, the redistribution process starts over again with the heirs (*inheritance effect*). Finally, there is an *innovative effect*. Entrepreneurial thinking stimulates innovative ways of thinking about philanthropy and how to achieve the best results from the social and educational ventures it supports.

**Keywords:** entrepreneurs, wealth creation and distribution, philanthropy, foundations, taxation, consumption, inheritance, innovation, and education.

## 1. Introduction

In 2000, Bill Gates donated $5 billion to the Bill & Melinda Gates Foundation, which was almost half of the $11.1 billion given by the ten largest donors to private charities that year. In 2001, despite the downturn in the technology market, Gates added another $2 billion. This amount was the largest private donation that year and again almost half of the $4.6 billion given by the 10 largest donors to charities. At the end of 2001, the Gates' foundation had an endowment of about $24 billion, making it the nation's largest private foundation. The size of the endowment means that the Gates Foundation must give away about $3.3 million a day, or $1.25 billion per year, to comply with the federal law that it donate 5 percent of its assets on an annual basis.[1] The foundation plans to use these assets to support programs that improve global

1. The data in this paragraph were reported by Kessler (2002) and Houtz (2001).

health care and immunization, fund projects in the public schools, give educational scholarships to minority students, and update the technological resources of libraries.

What is remarkable is that when Bill Gates started Microsoft with Paul Allen in 1975, he never expected to become the world's biggest philanthropist. At that time his focus was on creating BASIC software for different types of computers such as Altair, Apple, Commodore, and Radio Shack. By 1979, the year the firm moved to Seattle, the company consisted of only 12 employees. The big break came in 1981 when Microsoft was invited to produce the MS-DOS system to run IBM PCs. Within seven years, the firm became the largest producer of computer software and had expanded its workforce to 20,000.[2] In 2001, although Microsoft ranked 72nd on the *Fortune* list of the largest 500 U.S. corporations, with revenues of $25.2 billion, it ranked second in its market capitalization at about $331.5 billion.[3] Bill Gates' stake in Microsoft stock gave him a net worth of $52.8 billion in 2001, making him the richest person in the world.[4]

The transition from struggling entrepreneur to super wealthy philanthropist is not a story that is unique to Bill Gates. The same story can be found in the biographical history of one of the foremost entrepreneurs of the late nineteenth century – Andrew Carnegie.[5] Carnegie was born in 1835 as the son of a poor Scottish weaver, who emigrated with his family to the United States in 1847. His hard work, self-education, and entrepreneurial insights led him into the bridge-making business when iron was the main type of material used for construction. He then incorporated the use of steel as the basic construction material with the 1864 introduction of the Bessemer process for transforming iron into steel. From that experience he figured out how to build steel plants that improved the production efficiency in that new industry and made his fortune. In 1901 he sold his company for $480 million to U.S. Steel, a company controlled by the wealth financier, J.P. Morgan.

After retiring in his sixties, Carnegie spent the remaining 18 years of his life giving his fortune away to support libraries and other projects.[6] The amount of wealth that Carnegie amassed over his lifetime was estimated to be about $475 million (about $4.9 billion in 2002 dollars).[7] He gave away more than $350 million and established an endowment of $125 million to create the nation's first philanthropic foundation, which is still in existence and bears his

2. For the source of this early history, see Hallett and Hallett (1997).
3. See *Fortune* (2002) for data on the largest corporations.
4. Kroll and Goldman (2002), p. 120.
5. The information on Carnegie that follows is largely obtained from Klepper and Gunther (1996), pp. 29-33, and Tedlow (2001), pp. 19-71.
6. The improvement of libraries was also the first philanthropic interest of Bill Gates.
7. The $475 million estimate is from Klepper and Gunther (1996, pp. 29-33) valued at Carnege's death in 1919. The 2002 estimate adjusts the $475 million for inflation based on the average Consumer Price Index and using the CPI calculator at http://www.bls.gov.

name. In his philanthropic work, Carnegie was following his principles for the social responsibility of the rich that he had set forth in his essay on "The Gospel of Wealth."[8] In this essay, he exhorted the wealthy to give away most of their fortune within their lifetime rather than wait until death to make the redistribution and also be actively involved in the philanthropic work: "surplus wealth should be considered as a sacred trust to be administered by those into whose hands it falls, during their lives, for the good of the community."[9]

The other classic example of the entrepreneur turned philanthropist of the late nineteenth century was John D. Rockefeller. In 1863, he started on the path to creating an empire in the oil refining business. Through a combination of management discipline, cost efficiency, and various business schemes, he expanded the reach of Standard Oil so that by 1880 it controlled 95 percent of the oil refining in the United States. Rockefeller's wealth accumulated with the rising monopoly power of Standard Oil and totaled about $1.4 billion over his life (about $17.5 billion in 2002 dollars). What is often forgotten is that Rockefeller basically retired from running Standard Oil in 1887, and devoted his full-time attention to philanthropic activities until his death in 1937. He also tithed ten percent of his income to the church throughout his life and donated half a billion dollars to various projects and causes. He left a legacy of almost half a billion dollars to his son, who also spent most of his life giving away money, as have the six offspring of John D., Jr.[10] The Rockefeller name, first synonymous with great wealth, is now equally recognized for its lasting and continuing contribution to philanthropy.

There are, of course, many other examples of generous entrepreneurs who made fortunes and gave large portions of them away, either during their lifetimes or at their deaths. George Soros, a Hungarian immigrant, made his estimated $6.9 billion fortune forming a hedge fund and taking risks as a hedge fund trader. He has donated over $2 billion to the development of open societies in Russia and central and eastern European nations.[11] Gordon Moore, the founder of Intel, has an estimated net worth of $6.1 billion as of March 2002. He and his wife reportedly donated or pledged a similar amount as Soros to education and scientific research projects. There are also many entrepreneurs with less substantial fortunes, who nonetheless give away a significant percentage of the wealth that they created as entrepreneurs.

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8. For the essay and details about it, see the Carnegie (1889/1992) chapter in an edited book on philanthropy and wealth by Burlingame (1992).
9. The quote is from Riley (1992), p. 68.
10. The data cited in this paragraph are from Klepper and Gunther, p. 7.
11. The data on net worth is from Kroll and Goldman (2002). The data on lifetime giving is reported in Albo (1999).

## 2. Direct and Indirect Effects

The above examples, and others too numerous to describe, illustrate how the amount of philanthropy in the United States is directly influenced by entrepreneurship and the wealth it creates. The capitalist system gives people the profit incentive to form businesses. If the start-up business is ultimately successful, which is by no means guaranteed in this profit and loss system, then the entrepreneur can accumulate wealth, often far beyond the initial expectations or forecasts at the beginning of the business. What is unexpected is that entrepreneurs do not go into business to start foundations or have social impact. They go into business to be their own boss, to put their skills and abilities to best use, to create a new product from a perceived opportunity, or for some other reason.[12] They do not start a business primarily because they can give their wealth to charities or to start a foundation that will redistribute their wealth for them. That philanthropic role, if the entrepreneur accepts it, comes as a consequence of business success, and gets thrust upon an entrepreneur as one possible answer to what to do with their abundance of riches.

What is forgotten in the media attention given to the entrepreneurial stars are the indirect effects of entrepreneurship on philanthropy. The amount of the wealth created by entrepreneurs such as Bill Gates, Warren Buffett, Larry Ellison, Sam Walton, Michael Dell, and Pierre Omidyar is significantly larger than their individual net worth.[13] There are business associates who helped the business grow during its start-up period or who invested in the business during its early development, and they also became rich along with the founder. For every entrepreneur who started a successful business and amassed a fortune, there are hundreds of other business associates and investors who become sufficiently wealthy from the work of the entrepreneur that they too have the choice of making significant philanthropic contributions. Entrepreneurship has a wealth-creating direct effect on the business founder and a wealth-creating indirect effect on major associates and investors enriched by the business. This indirect effect expands the pool of wealth far beyond that amassed by the business founder alone. These funds become the source for even more philanthropic activities in society.[14]

The strong connection between entrepreneurship and philanthropy is often unrecognized. Historians and other biographical writers primarily focus on the business practices and methods of the entrepreneur as the firm grows, while the philanthropic contribution of the entrepreneur is a secondary story because it

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12. For a list of such reasons, see Walstad and Kourilsky (1999), pp. 21, 28. For biographical sketches of the motivations for successful entrepreneurs, see Mariotti and Caslin (2000).
13. Although Buffett is often thought of only as an investor, his investment and management strategies in the development of Berkshire Hathaway are innovative and entrepreneurial (Miles, 2001).

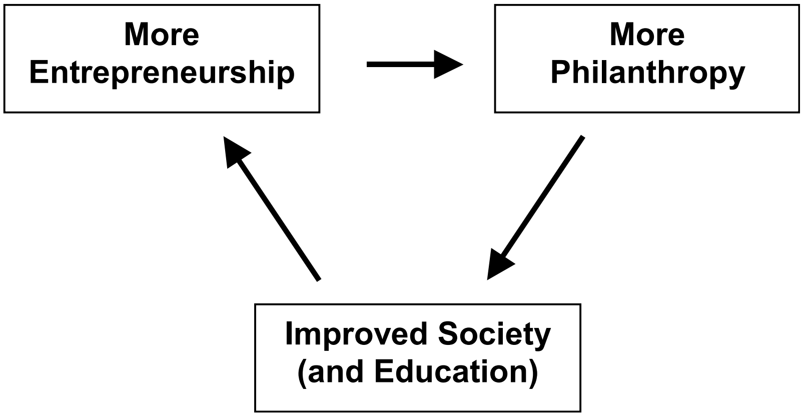
comes after the business has prospered.[15] What is often neglected in these histories and biographies is that successful entrepreneurship creates the unexpected opportunity for the entrepreneur to do something else with a life in addition to working in the business. It is this philanthropic opportunity that allows an entrepreneur to find an innovative way to improve society and build a reputation that is unrelated to the initial business success and might have a legacy that extends longer than the business.[16] Some entrepreneurs, such as Carnegie, accepted this philanthropic opportunity during their lifetimes; others, such as Sam Walton, preferred to focus on expanding their profit-making business and left the philanthropic opportunity to a foundation or family heirs after their deaths.

## 3. Feedback Effect

If philanthropy, and all it does to improve society is to be encouraged, then there needs to be more in entrepreneurship because it will create more philanthropy. The philanthropic work in turn should improve the society in which people live and work. This improvement in the society should enhance the educational system and the business climate and support for entrepreneurship. And if more entrepreneurship can be stimulated as society advances, there is a feedback effect from entrepreneurship that reinforces the process. Figure 1 below shows the connections:

14. Carnegie recognized the importance of surrounding himself with good associates, and did so with Charles M. Schwab and Henry Frick. He once remarked that his epitaph should read: "Here lies a man who was able to surround himself with men far cleverer than himself" (Klepper and Gunther, 1996, p. 31). It should not be surprising that along with Bill Gates on the *Forbes* list are Paul Allen and Steve Ballmer. Entrepreneurship creates wealth for the founders and their associates.
15. See commentary about historians by Johnson (1999). See commentary about the media by Saal (1997). For an example of biographies with minimal attention to the philanthropy of successful entrepreneurs, see Tedlow (2001).
16. An entrepreneur may decide to become a philanthropist for many reasons, such as an altruistic desire to give something back to people, perhaps to make amends for past business practices and improve public image, or because of tax incentives. The various motivations for the decision to become a philanthropist will vary by individual and is beyond the scope of this discussion, although it has been a topic of interest to historians, psychologists, and economists. For an economic analysis of the effects of tax changes on the philanthropy of the rich, see Slemrod (2000).

*Figure 1*: Feedback Connections




The major elements of this feedback loop can be seen in the U.S. economic experience since the industrialization of the mid-to-late 1880s. The United States has a long history of encouraging entrepreneurship, supporting economic freedom, and accepting technological change.[17] Given this business climate, entrepreneurship was able to flourish and great wealth was created. It should not be surprising that as the nation has become wealthier, the number of private charitable foundations grew from the one first started by Andrew Carnegie with $125 million in 1919 to over 50,000 foundations with an asset base of $449 billion in 1999.[18] Some of these foundations are large in asset size and others are small, but regardless of the size many private foundations in the United States are based on the donated wealth of entrepreneurs or their families. The not-for-profit sector thrives in the United States because entrepreneurs have been given an opportunity to thrive and prosper in this nation.[19] This entrepreneurship-to-philanthropy relationship is evident in the

17. For data on the positive business climate for entrepreneurship in the United States in comparison to other nations, see Reynolds, et al. (2001).
18. These 1999 data are the latest available from the Foundation Center. The assets, however, are not equally distributed across the foundations. Of the 50,000 foundations, there are only 206 with assets of more than $250 million. These foundations account for 53 percent of all foundation assets.
19. The importance of entrepreneurs to wealth creation should not be understated. It has been estimated that entrepreneurs account for 68 percent of the net worth held by the top 1 percent of households in the distribution of wealth in the United States (Hubbard, 2000, p. 456). For discussion of the taxes and its effects on the philanthropy of the wealthy, see Auten, Clotfelter, and Schmalbeck (2000).

names and industries associated with the most of the top 50 largest foundations in the United States, as shown in Table 1.

*Table 1:* Top 50 U.S. Foundations by Asset Size

| Rank | Name/(state) | Assets (in billion $) | Funding Source (Industry) |
|---|---|---|---|
| 1. | Bill & Melinda Gates Foundation (WA) | $ 21.1 | software |
| 2. | Lilly Endowment Inc. (IN) | 15.6 | pharmaceuticals |
| 3. | The Ford Foundation (NY) (1) | 14.7 | autos |
| 4. | J. Paul Getty Trust (CA) (2) | 10.9 | oil |
| 5. | The David and Lucile Packard Foundation (CA) | 9.8 | computers |
| 6. | The Robert Wood Johnson Foundation (NJ) | 8.8 | medical supplies |
| 7. | W. K. Kellogg Foundation (MI) (3) | 5.7 | cereal |
| 8. | The Andrew W. Mellon Foundation (NY) | 4.9 | banking |
| 9. | The Pew Charitable Trusts (PA) | 4.8 | oil |
| 10. | The Starr Foundation (NY) (4) | 4.5 | insurance |
| 11. | John D. and Catherine T. MacArthur Foundation (IL) | 4.5 | insurance |
| 12. | The William and Flora Hewlett Foundation (CA) | 3.9 | computers |
| 13. | The Rockefeller Foundation (NY) | 3.6 | oil |
| 14. | The California Endowment (CA) (5) | 3.5 | ——— |
| 15. | Robert W. Woodruff Foundation, Inc. (GA) | 3.1 | soft drink |
| 16. | The Annie E. Casey Foundation (MD) | 3.0 | parcel delivery |
| 17. | The Annenberg Foundation (PA) (6) | 2.9 | media |
| 18. | Charles Stewart Mott Foundation (MI) | 2.9 | autos |
| 19. | The Duke Endowment (NC) | 2.9 | tobacco |
| 20. | Casey Family Programs (WA) | 2.8 | parcel delivery |
| 21. | The Kresge Foundation (MI) | 2.8 | retail |
| 22. | John S. and James L. Knight Foundation (FL) | 2.2 | newspapers |
| 23. | The Freeman Foundation (NY) | 2.1 | ——— |
| 24. | The Harry and Jeanette Weinberg Foundation, Inc. (MD) (5) | 2.1 | ——— |
| 25. | Ewing Marion Kauffman Foundation (MO) (6) | 2.0 | pharmaceuticals |
| 26. | The McKnight Foundation (MN) | 2.0 | manufacturing |
| 27. | The New York Community Trust (NY) | 1.9 | ——— |
| 28. | Carnegie Corporation of New York (NY) (1) | 1.9 | steel |
| 29. | Richard King Mellon Foundation (PA) | 1.9 | banking |
| 30. | Robert R. McCormick Tribune Foundation (IL) | 1.9 | newspapers |
| 31. | Wallace-Readers Digest Funds (NY) | 1.6 | publishing |
| 32. | The Cleveland Foundation (OH) | 1.6 | ——— |
| 33. | Doris Duke Charitable Foundation (NY) | 1.6 | tobacco |
| 34. | W. M. Keck Foundation (CA) | 1.5 | oil |
| 35. | The James Irvine Foundation (CA) | 1.5 | ranch land |
| 36. | Houston Endowment Inc. (TX) | 1.5 | ——— |
| 37. | Alfred P. Sloan Foundation (NY) | 1.4 | autos |
| 38. | The Brown Foundation, Inc. (TX) (6) | 1.3 | construction |
| 39. | The Packard Humanities Institute (CA) | 1.3 | computer hardware |
| 40. | The Chicago Community Trust and Affiliates (IL) (1) | 1.3 | ——— |
| 41. | Donald W. Reynolds Foundation (NV) | 1.3 | media |
| 42. | The William Penn Foundation (PA) | 1.2 | ——— |
| 43. | Marin Community Foundation (CA) (6) | 1.2 | ——— |
| 44. | Freedom Forum, Inc. (VA) (4) | 1.1 | ——— |
| 45. | The Henry Luce Foundation, Inc. (NY) | 1.1 | publishing |
| 46. | The Anschutz Foundation (CO) (7) | 1.1 | gas, oil |
| 47. | The California Wellness Foundation (CA) | 1.0 | ——— |
| 48. | Howard Heinz Endowment (PA) | 1.0 | food products |
| 49. | The Joyce Foundation (IL) | 1.0 | lumber |
| 50. | Walton Family Foundation, Inc. (AR) | 1.0 | retailing |

*Source:* Asset data are reported at: http://www.foundationcenter.org/research/trends_analysis/top100assets.html. The data are for the fiscal year ending 12/31/00, unless indicated by the numbers following the foundation name: (1) [09/30/00]; (2) [06/30/00]; (3) [08/31/01]; (4) [12/31/99]; (5) [02/28/01]; (6) [06/30/01]; (7) [11/30/00]. The initial funding for the foundation by industry is based on author research.

### 3.1. Education and Assets

The education sector is a major beneficiary of the grant funding from foundations. Almost a quarter (24.4 percent) of the $11.6 billion in 1999 grants from foundations went to education. The education category was larger by a third to a half over other major grant categories such as health (17.2 percent), human services (16.2 percent) or arts and culture (13.4 percent).[20] Of the $2.8 billion given by foundations to education that year, well over half (62 percent) went to higher education, a quarter (25 percent) was spent on projects in elementary and secondary schools, and the remainder (13 percent) went to libraries or an assortment of educational services.[21]

Entrepreneurship indirectly influences education because it serves as the initial source of assets for many foundations, which in turn devote a major portion of their assets to grant-making at all levels of education.[22] This wealth also funds new initiatives in education. In higher education, for example, the Gates Foundation pledged $1 billion over 20 years for financial aid for minority students so that they can attend colleges and universities. At the pre-college level, Ted Forstmann and John Walton gave $100 million to establish a foundation to obtain matching funding for scholarships for low-income students to attend private schools. Solving problems in education will always be an appealing target for wealthy entrepreneurs.

There is a compound interest from entrepreneurship for education or any other area of philanthropic interest of a foundation started by an entrepreneur. By law, foundations must give five percent of their assets in grants each year. If, however, a foundation can earn more than five percent on the assets of the foundation, then it can slowly increase the asset base and this will allow the foundation to give more to education or other philanthropic concerns. Over time, prudent investing of the foundation assets has the potential to permit donations to projects in excess of the asset base left by the entrepreneurs or heirs. For illustration purposes, let's say a $1 billion foundation gives away $50 million a year (5 percent). Assume that the foundation is also able to earn $100 million on its assets (10 percent or around the long-term return on stock

20. The remaining categories were environment and animals (6.3 percent), international affairs (3 percent), science and technology (3.6 percent), social sciences (2.3 percent), religion (2.3 percent) and other (0.1 percent). The data are from the Foundation Center (1999).
21. The higher education estimate is based on combining grants for higher education (47 percent) and grants for graduate and professional education (15 percent). Foundation Center (2001).
22. It is not only foundations that give significantly to education. Wealthy individuals give a disproportionate share of their gifts to education. Auten, Clotfelter, and Schmalbeck (2000) obtained data on 90 individuals who gave $5 million or more in 1996. Higher education (non-medical portion) received 56 percent of the gifts. Successful entrepreneurs have a history of giving to education even if they never completed high school or college. See Tedlow (2001), pp. 431-433, for examples from Andrew Carnegie, George Eastman, Thomas Watson, and Bill Gates.

equities). At the end of the year the asset base of the foundation has increased from $1 billion to $1.05 billion, which means that next year the foundation can make $52.5 million in grants. If a similar process occurs over time, the foundation assets will significantly increase the philanthropic giving.

## 3.2. A Weak Link?

The most difficult connection to understand in the circular flow is not the one from entrepreneurship and philanthropy, or the obvious connection between philanthropy and an improved society, but the connection from an improved society to having more entrepreneurship. Here the link can be broken unless the improvements to society and education lead to changes in the business climate so it supports and encourages more entrepreneurship. Such immediate actions as improving the access to start-up capital for all entrepreneurs, and especially for women and minorities, will increase the number of entrepreneurs in all sectors and regions of the economy. It is also important to find ways to reduce the cost of government regulations and red tape so that they do not place an undue burden on smaller start-up businesses relative to larger corporations. Tax laws can be simplified to reduce the compliance cost, and tax rates can be cut to encourage more business investment. These policies are just a few of the ones proposed to enhance the business climate to help small businesses and stimulate more entrepreneurship.[23]

Our society also needs to give significantly more attention to entrepreneurship education at all ages. Too few youth and young adults receive an education that develops their entrepreneurial thinking and venturing capabilities. There is abundant evidence of strong interest in entrepreneurship among youth and young adults, but the current curriculum in both schools and colleges does not begin to prepare them with the basic knowledge and skills they need. This entrepreneurship education is important for both future entrepreneurs and others who do not become entrepreneurs. It will certainly expand the number of people who might start a business because they will have the initial preparation and encouragement they need to take the risk of becoming an entrepreneur. For other students, an education in entrepreneurship helps them learn to think in entrepreneurial terms, which can help them in whatever activities or careers they select during their lives. Perhaps most important, this type of education makes people generally more understanding and supportive of those who make a new venture successful, regardless of whether the enterprise is in the profit or non-profit sector.[24]

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23. See proposals from the National Federation of Independent Business (NFIB) which is available at: http://www.nfib.com.

## 4. Tax Effect: Education Benefit

Until this point, the working assumption was that the wealth the entrepreneur creates from a successful business was either used to establish a foundation or donated to a charitable cause of interest to the entrepreneur. This accounting, however, does not reveal the full story of what happens to wealth created from a successful business and how it can affect society and education. There is a tax effect from entrepreneurship that takes some of the wealth. The entrepreneur will be taxed at the local, state, and federal levels during a lifetime.[25] The earnings of the entrepreneur's corporation will also be taxed, generally at the state or federal level. If the entrepreneur dies without giving away all the wealth, then what remains will be taxed as part of the entrepreneur's estate. How much tax is paid by an entrepreneur while living and at death, or what amount of tax will be paid by the entrepreneur's corporation, will depend on complex tax laws and individual or business circumstances.

What then happens to the portion of the entrepreneur's wealth that is taxed is another complex story. The funds that flow into the coffers of the federal, state, or local government will be spent on government programs. At the state and local level, a good portion of the taxed income or wealth will wind up in the education sector. About 22 percent of the general expenditures of states are for education. Over 43 percent of the general expenditures for local government are for education. Taxes paid at the federal level will go primarily for pensions and income security, health, and national defense, but about 15 percent of the revenue transferred from the federal to state governments is for education.[26] To the extent that entrepreneurial income or wealth goes to pay taxes, education directly benefits from this transfer from private to public uses.

## 5. Consumption Effect: Taxes and Jobs

The consumption expenditures of successful entrepreneurs have a positive influence on society in several indirect ways. First, most consumption expenditures will be taxed either through sales taxes or property taxes. These taxes will become another source of revenue for government programs, especially at the state and local levels, a good portion of which goes for

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24. For further discussion and data on points made in this paragraph about how entrepreneurship education can contribute to entrepreneurship, see Walstad and Kourilsky (1999) and Kourilsky and Walstad (2000).
25. Another indirect effect from entrepreneurship would be the taxes paid by the entrepreneurs' employees, but this issue will not be considered here because the purpose is to track what happens to the entrepreneurs' wealth.
26. U.S. Census Bureau (2001, Table 224, p. 267 and Table 225, p. 268).

education funding.[27] Second, there are jobs created and supported by the consumption expenditures of the wealthy entrepreneurs. Although there can be a normative debate about whether these are the jobs that should be created in the economy, there is no need to argue about whether jobs are generated from this personal spending by wealthy entrepreneurs. The entrepreneur will spend some portion of disposable income (or accumulated wealth) for personal consumption on such items as food, clothing, housing, transportation, and an array of personal services. There is the mistaken belief that the wealthy spend all of their incomes on a high life style when surveys of the wealthy and other research indicate that it is often not the case. The problem is that the income and consumption relationship needs to be viewed in relative rather than in the absolute or dollar terms that gets the media attention. In economics, it has long been known that the average propensity to consume an income declines as incomes increase. This relationship means that high-income individuals (often the wealthy entrepreneurs) will save, on average, a higher proportion of their incomes compared with lower-income individuals. The high-income individuals are then able to use their savings to increase their net worth by investing in income-producing assets, a tendency that is especially present among struggling entrepreneurs seeking to "grow" their businesses.

## 6. Inheritance Effect: Accounting and Redistribution

Another avenue needs to be explored for a full accounting of what happens to the wealth created by the entrepreneurs. Some entrepreneurs may decide not to donate much of their wealth to charity or establish a private foundation to receive their funds either while they are living or at their death. They may instead decide to pass the bulk of their wealth to their family in the form of trust or other bequeathing arrangements. It may appear that in this case there are no societal effects from this portion of the wealth created by the entrepreneur. The conclusion, however, is not a valid one. The shifting of the entrepreneur's assets to other people only shifts the timing of when the wealth will be redistributed and when it will have its impact on society.[28]

There are many cases of entrepreneurs who gave most of their wealth to their family instead of directly to society, and yet that wealth is not lost to

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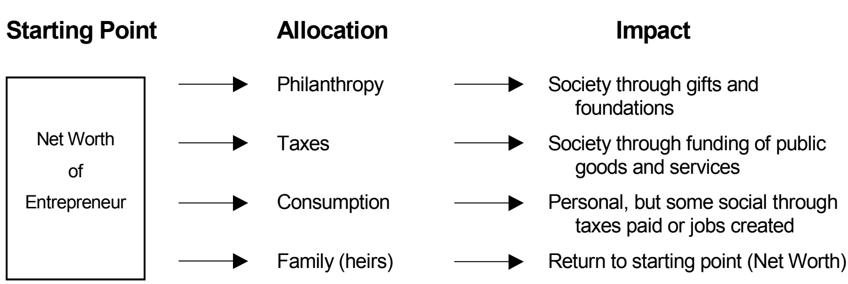
27. Stanley and Danko (1996, pp. 27-69) describe the frugality of the wealthy based on their surveys and interviews with the wealthy, many of whom were entrepreneurs.
28. Inheritances can have negative effects. Andrew Carnegie made the conjuncture that "parents who leave their children enormous wealth generally deaden their children's talents and energies and tempt them to lead less productive lives." Holtz-Eakin, Joulfaian, and Rosen (1993) found support for this conjecture. Larger inheritance led people to leave the labor force, and among those who stay, their incomes grow slower than others without inheritances, perhaps because they worked few hours or reduced their work effort.

society. It just remains unspent and is not yet redistributed. Consider the case of Sam Walton. He amassed a fortune estimated to be $22 billion in 1991, the year before he died, but had it divided into shares for his wife and four children. By 2002, the collective wealth of the five Walton heirs had grown to just over $100 billion, or about $20 billon each.[29] The family members will be redistributing some of that wealth through the Walton Family Foundation, which made a recent gift of $500 million to the University of Arkansas. The responsibility of redistributing the wealth and making sure that it has a meaningful impact on education or society was shifted from the original entrepreneur to the entrepreneur's family. The amount that the Waltons have to redistribute is so enormous that it will likely be shifted to the third or fourth generation of the Walton family, as was the case with the Rockefeller wealth in spite of the substantial philanthropic giving by John D. Rockefeller and John D. Rockefeller, Jr.

The major avenues for the redistribution of wealth are summarized in Figure 2. Perhaps the easiest way to think about the matter is to start with the net worth of the entrepreneur and ask what happens to the net worth of that individual over time. Some of that net worth is transferred to philanthropy through charitable gifts or through philanthropic foundations and is used to benefit society. Some net worth (or the income that generates it) is taxed. Those funds also benefit society by paying for public goods and services. Consumption expenditures either from income or accumulated wealth have some minor benefit for society because they provide more tax revenues and create jobs. Finally, a portion of the net worth that is amassed over time will be left to family members or other beneficiaries. For this group, the redistribution cycle starts over again because they face the same decisions as the initial entrepreneurs about wealth allocation or additions to net worth. All four avenues of wealth redistribution have an impact on the society.

*Figure 2:* Redistributing the Wealth of Successful Entrepreneurs




29. Kroll and Goldman (2002), p. 20.

## 7. Innovation Effect

One of the powerful outcomes from entrepreneurship is that it serves as the source of innovation in ways of conducting business that had not been tried before or been very effective in the past. Such an innovation effect can be seen in the approach to wealth redistribution via philanthropy. The most commonly used approach and the one with the longest history is for the donor to give a gift or grant directly to a worthy group or organization, be it a homeless shelter or a university. During the early part of the past century, with the growth of great entrepreneurial fortunes, the establishment of a philanthropic foundation became the popular means for redistributing great wealth. The entrepreneur's role in the leadership and management of these foundations could be active or passive depending on the founder's preferences and the timing of the major donations (during the life of the entrepreneur or after). The foundation would then solicit grant proposals that met the foundation's objectives and fund the project evaluated to be most worthy, be it funding for the local symphony or support for an after-school youth program. The grantee would then use the funding for the designated purpose, but there would not be active intervention by the foundation in management of the project. This approach to giving is considered to be the "traditional" type of philanthropy.

In the past decade, experiences with entrepreneurship in the high-tech sector led some newly minted millionaires and billionaires to rethink how they wanted to give away their wealth. What they conceived was a new and more entrepreneurial method for charitable giving called venture philanthropy. This approach involves applying the investing and management practices that venture capitalists use for start-up businesses to the allocation and management of charitable funding. The venture philanthropist would invest in those projects with clearly outlined business plans that would have the greatest social return. The venture philanthropists would be investing in "social" entrepreneurs, who would be responsible for delivering measurable results based on performance objectives or they would lose their funding. For their part, the venture philanthropists would help make the projects successful because they would contribute their skills and management expertise along with their funds. This transfer of expertise in funding and management would make the nonprofit sector more entrepreneurial and insure that the projects created social value.

Pierre Omidyar, the 34-year-old founder of E-bay, provides a good example of this new approach to philanthropy. He and his wife Pam were estimated to have a net worth of $4.6 billion as of March 2002. They plan to give away all but one percent of their wealth by 2020, but they want to make sure that it makes a difference to society. Hardy (2000) describes their mission as radical philanthropy: "Just as Webheads demolished old business models, Pierre and Pam Omidyar strive to demolish philanthropic models in favor of new ones that deliver on the very elusive goal of all grant givers, accountability" (p. 115). They established the Omidyar Foundation and it funds groups and organizations for longer periods than is the case for traditional charities. The conditions they require the philanthropic organizations to meet to receive funding are similar to what a venture capitalist would demand of a start-up firm. There must be a solid business plan, an important problem (opportunity) to be addressed, and the organization must meet accountability targets showing it having an impact by creating value for the community.[30]

Some of the enthusiasm for this new approach waned with the collapse of the high-tech sector because there is less available funding for these philanthropic initiatives. There are other significant reasons for the decline in enthusiasm for this new approach. Some of the wealthy entrepreneurs or foundation leaders who adopted this approach now realize that they did not have the sufficient foundation staff or time to provide the strategic management needed by the nonprofits. The nonprofits were also not always able to make the best use of the management expertise that was provided.

Of particular importance is that there is more realism about what can be accomplished through venture or even traditional philanthropy. Solving social problems and creating social value, whether in health care or education, is significantly more complicated and complex than solving business problems and creating market value. In this situation it is easy to oversell the benefits of the new philanthropic work and not be shown dramatic results. Perhaps indicative of this change in thinking about venture philanthropy was an industry report that was overly optimistic for its promise in 2000, the height of the tech bubble, but was equivocal in 2001: "It remains too early to demonstrate that venture philanthropy results in more effective outcomes or more powerful social change in ways that distinguish it from traditional philanthropy."[31]

The experiments in applying concepts and methods from entrepreneurship to make philanthropy more effective are far from over. Venture philanthropy and social entrepreneurship offer a new approach to charitable giving that in certain situations and contexts may prove to be more effective than other philanthropic approaches for addressing social or educational problems. This approach has sparked a re-thinking among wealthy entrepreneurs and

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30. This description of the Omidyars' approach to philanthropy is based on the story by Hardy (2000). The net worth estimated comes from Kroll and Goldman (2002). Another story of venture philanthropy can be found in Dowie (1999) who describes the activities of George Roberts of the KKR leveraged-buyout firm. Streisand (2001) provides another story of venture philanthropy.
31. The quote is from a commentary by Colvin (2001) in *Fortune* that is critical of the hype surrounding venture philanthropy. He also observes that "giving money effectively can be harder than making it" (p. 50).

traditional philanthropies of the best way to make the nonprofit sector more accountable and create more social value from philanthropy.

The entrepreneurial experiences in the U.S. economy over the past two decades produced a new model for thinking about how to make more efficient social use of the scarce resources available from philanthropy. Education will be a prime beneficiary of this innovative effect because of major public concern with improving the nation's schools, colleges, and universities. In entrepreneurship it only takes one or two successful models to radically alter an entire industry or ways of thinking about past practices. That possibility is present in education and with other social issues as experiments in philanthropy continue into the next decade.

## 8. Conclusion

Entrepreneurship has the power to transform society to a much greater extent than is commonly thought. Most people see that transformation only in terms of the new business innovations or products that come to market and alter what businesses produce and what consumers buy. What is often not recognized are the multiple effects of entrepreneurship on philanthropy, and in turn on society and education.

Without philanthropy, the major source of funding for societal or educational improvement would come exclusively from government funding. Philanthropy allows for a much wider range of ideas, choices, and programs to improve society compared with what is possible through government legislation and public budgeting. Philanthropy also achieves its objectives with more speed, flexibility, and targeting than is often possible through public decision-making or the control of government officials. The diversity in philanthropy enriches and expands opportunities to improve social life in much the same way as diversity in markets enriches and expands economic life.[32]

Each new generation of wealthy entrepreneurs will bring their innovative approaches to how best to redistribute their wealth so that it best benefits society. Andrew Carnegie considered those decisions and came up with innovative practices when he started to give away his wealth at the end of the nineteenth century. Some of the new wealthy entrepreneurs are re-thinking how to make effective use of their wealth to address the social and educational issues of the twenty-first century. The answers may be different over generations of entrepreneurs, but the powerful innovative effect of

32. For a discussion of the importance of diversity to economic life and markets, see Rosen (2002).

entrepreneurship on philanthropy, and the experiments it unleashes in society and education, will be ever-present and reinforcing.

Although entrepreneurship is often referred to as the "engine" of economic growth, it should also be considered the "engine" of philanthropy. An increase in the number of successful entrepreneurs means that there will be an increase in the available funding for philanthropic ventures. In this way, the profit-making activity of entrepreneurs that generates private wealth has direct and indirect benefits to society. Education, as a major focus of social concern, stands to gain from the philanthropic largess of entrepreneurs and the transfer of wealth that is expected to increase over the next few decades.

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