THE ANDREW W. MELLON FOUNDATION ORCHESTRA FORUM

A Journey Toward New Visions for Orchestras
2003-2008

A Report By The Elephant Task Force
April 2008

Contents

Introduction

In 1999, The Andrew W. Mellon Foundation established the Orchestra Forum as part of a ten-year initiative designed to further creative thinking and innovation among orchestras and related organizations. Forum meetings bring together musicians, managers, and trustees of participating orchestras with invited scholars and leaders from the performing arts, and sessions include blocks of time for ad hoc discussions focusing on participant-posed questions.

The so-called Elephant Task Force (ETF), a cross-constituent group of musicians, managers, and trustees, grew out of one such discussion in late spring 2003—a time when a significant number of orchestras were facing financial challenges. The economy was still reeling from the bursting of the stock market bubble and the direct aftereffects of 9/11, and national resources were being reallocated away from the arts. Orchestras, both major and regional, had reported significant financial deficits the prior season. All of the Forum orchestras admitted to projected deficits that year ranging from 5 to 15 percent of revenue.

From the outset, one key issue for the ETF was the question of whether fiscal problems were structural or cyclical. This question loomed large, for the organizational implications of it being one or the other are significant. A verdict in favor of cyclical would imply that the status quo is fundamentally sustainable, and the key financial challenge for orchestras would be to gain greater ability to withstand the inevitable ebbs and flows of the economy. A verdict that the problem was structural would carry with it far greater implications for the long-term management of the organization.

In March 2006, in response to the ETF's conclusion that there was a need for independent, third-party research this issue, the Mellon Foundation engaged Stanford University Economics Professor Robert Flanagan[1] to analyze the cyclical and structural influences on the economic performance of orchestras. Responding to the central question posed to him, Flanagan found that changes in the financial balances of orchestras reflect the influence of both general economic conditions (*i.e.*, cyclical effects or business conditions) and trend factors (structural factors unrelated to changing economic conditions over the business cycle). The ETF report makes use of only those portions of Flanagan's research dealing with the cyclical/structural questions.

Because orchestra finances cannot be addressed in a vacuum, the ETF in its multi-year investigation increasingly focused on four key, interrelated areas that affect orchestras' well-being:

[1] Konosuke Matsushita Professor of International Labor Economics and Policy Analysis at the Stanford Graduate School of Business

Community Relationships: The ability of the orchestra organization to connect meaningfully to its community and create true public value;

Internal Culture: The ability of orchestra constituents to work together in mutually supportive and cooperative ways;

Artistic Activities: The ability of the orchestra to deploy artistic resources broadly and effectively in service of the art form, the community, and individuals in the organization;

Financial Structure: The ability of the orchestra to match cash resources with expenditures either to maintain the status quo or to achieve financial viability or financial robustness.

What began as a response to fiscal exigency—coping with financial deficits—evolved over five years to a call for orchestras to create for themselves both a vision of a sustainable artistic endeavor and the innovations necessary to achieve that vision, recognizing that each orchestra's situation is unique and each orchestra has a specific place in its own community.

The ETF hopes that orchestras might reexamine the practice of focusing their energies on short-term coping strategies to address weak bottom lines. The ETF believes that traditional coping mechanisms (*e.g.*, unsustainable draws from endowments, underfunding pension obligations, reopening contracts to seek concessions, unrealistic budgeting) ultimately weaken rather than strengthen orchestras. Rather, orchestras may be better served, after carefully weighing costs and benefits, to find innovative and longer-term ways of addressing the inevitable challenges embedded in a changing environment.

In this report, the ETF poses a number of questions in the hope of stimulating exploration of these issues. The ETF hopes that people who care about the future of their orchestras will undertake the self-examination of their individual orchestra's circumstances, and use the ETF's work as stimulation for vigorous, cross-constituency internal debate, on their own terms, about the appropriate choices for their orchestra.

The Work

The four areas of attention cited above were developed into a set of vision statements as a result of the ETF's multi-year, cross-constituency journey. [2] The process of developing these statements involved years of polite disagreement and debate, through which the ETF built internal trust and mutual respect. Each vision statement is followed by a series of questions to stimulate thinking on the part of orchestras.

The vision statements focus on describing possible states of being, to be achieved at the local level in ways responsive to the particular circumstances of each orchestra. Some may indeed be the right questions for one or more orchestras; some may apply more generally to groups of orchestras in similar circumstances; others may miss the mark completely for some orchestras; and finally, there may be many omissions of good ideas that simply did not occur to the ETF members as they undertook this exercise.

Community Relationships

Viewed through the broadest possible lens, community relationships revolve around a fundamental economic transaction, a value proposition in which an organization provides sufficient service to its community in order to generate sufficient funding for the organization to function effectively. By virtue of the breadth, depth, and quality of service it provides to its community, how can an orchestra[3] energize a critical mass of its community to support it with enough sustainable intensity (in attendance, volunteer work, monetary gifts) that the orchestra garners the financial resources it needs in order to operate at its chosen scale and level?

The ETF believes that orchestras should continually strive to forge deeper and more interactive community relationships. Furthermore, it recognizes that there is no such thing as THE community; rather, each "community" is a collection of diverse communities.

A Vibrant Orchestra Might, in its Community Relationships…

1. See community engagement as the core mission …

- *What if an orchestra behaved as if it believed that artistic excellence and activities inside the traditional concert hall space were essential but incomplete parts of making itself indispensable to its community?*

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[2] These visions are not unfamiliar to observers of the orchestra field; variations on these themes form part of the League of American Orchestra's strategic plan, as well as ideas recently promulgated by a number of funders, including the Doris Duke Charitable Foundation and the Irvine Foundation. Indeed, at the outset of the Mellon Forum itself, Mellon Foundation Program Officer Catherine Wichterman (later Maciariello) recommended in a paper reprinted in the Foundation's 1998 Annual Report support for orchestras to "strengthen their core artistic values, reinforce core activities, and improve leadership within the organization. The Foundation is particularly interested in issues of artistic definition and identity, the role of musicians and composers, the integration of artistic and institutional planning, multi-year strategic programming, and the orchestra's relationship to its community."

[3] Throughout this section, "orchestra" refers to the entire orchestral association—musicians, trustees, and management.

- *What if an orchestra enthusiastically embraced community engagement as part of its mission, based on an understanding of its long-term strategic importance, and, motivated by enlightened self-interest, committed the requisite resources, time, and effort?*

2. **Be responsible first to the community—move from a delivery system to a service culture …**

   - *What if a community viewed its orchestra as the infrastructure of music in the community rather than exclusively as a provider of concerts, and allowed the unique capability of the individuals of the institution to be used to help the organization be more responsive to community needs?*

3. **Understand it's not always <u>just</u> about the music …**

   - *What if an orchestra viewed itself as a citizen in a community and functioned broadly through deep participation in civic events, through volunteerism, and through community leadership rather than merely acting as a beneficiary of that system?*

4. **Inspire people to make music …**

   - *What if an orchestra acted to cultivate people in its community who have active, meaningful lives in music and, for instance, sought out the amateurs, students, teachers, listeners who are not currently attending concerts?*

5. **Believe the community offers inspiration for artistic discovery and can stimulate innovation, adventure, creativity, and fun …**

   - *What if an orchestra moved beyond the role of conservator of a grand tradition to acting as the dynamic and catalytic advocate for music?*
   - *What if an orchestra preserved its commitment to artistic excellence while embracing the view that presentations, formats, locations can all change, as they have historically?*

Internal Culture

All organizations face time, resource, energy, and financial constraints. The internal culture of an orchestra can use the diverse talents and skills of its people to create greater effectiveness in delivering services to its community or can expend time, energy, and resources in ways that impede increasing its artistic and economic value.

The ETF focused on how individual orchestras might find approaches to bring all constituents together around common goals. The group speculated that the orchestra industry ultimately faces far greater threats from without—well-established societal patterns and trends that do not need further explanation here—than they do from within.

A Vibrant Orchestra Might, in its Internal Culture …

1. Embrace a philosophy of partnership and mutual responsibility …

- *What if the board, management, and musicians alike focused unfettered attention on an orchestra's collective best interests?*

2. Value and invest in personal and professional growth …

- *What if an orchestra made a steady investment over time in self-improvement and performance review—collectively and individually—in order to build a stronger and more productive organization?*
- *What if an orchestra nurtured the capabilities and creativity of musicians, trustees, and management to bring fresh ideas, energy, and perspective to their work in the orchestra?*
- *What if an orchestra developed the habit—and a culture—in which civil discourse about difficult organizational issues (whether staff or board performance or musician performance) were not only permissible but expected?*

3. Reinforce individuals' accomplishments and contributions to organizational health …

- *What if people across the organization were encouraged to know each other, understand each other's roles, and recognize the successes of their colleagues on a regular basis?*

4. Operate as a true partnership led by a managing partner …

- *What if an orchestra had an equal balance between leadership and partnership in its decision-making processes?*

Artistic Activities

Artistry is at the core of an orchestra, and is its most valuable and unique asset. The way in which artistic resources are employed carries major implications for an orchestra in its internal culture, community support, and financial health.

A Vibrant Orchestra Might, in its Artistic Activities…

1. Believe that responsibility for artistic growth and quality is shared throughout the organization and have imaginative and accountable artistic leadership …

- *What if everyone in an orchestra understood the necessity of artistic excellence as the most valuable asset and unique contribution to its community and worked together to achieve it?*

2. **Provide fulfillment and contribute to the artistic growth and development of everyone in the organization …**

    - *What if each member of the staff, each musician, and each trustee answered these questions every year: What new pieces did I learn over the past year? Am I a better musician/more thoughtful listener than I was a year ago? Did I add to the list of pieces I love? What did I learn to deepen my appreciation for pieces I already love?*
    - *What if patrons answered these questions: In what ways have I been stimulated by the live concert experience? Have I connected to a new conductor, guest artist, composer, piece of music, musician?*
    - *What if an orchestra cultivated the careers of distinctive specialists—conductors and soloists with a specific repertory, or composers?*
    - *What if an orchestra took a more active role in encouraging and rewarding creative activity among its players such as presenting master classes, creating chamber ensembles, composing, and conducting?*

3. **Invest in research and development …**

    - *What if an orchestra actively researched its audiences' tastes and evaluated its community's preferences?*
    - *What if an orchestra engaged meaningfully with composers, filmmakers, and other creators?*
    - *What if an orchestra actively sought to utilize the explosion of talent being produced by today's conservatories?*
    - *What if an orchestra engaged an animateur or an artistic adviser?*

4. **Produce and/or promote a broad range of significant artistic activity beyond the concert hall …**

    - *What if an orchestra supported non-orchestral artistic opportunities for its musicians and staff?*

Financial Structure

Financial deficits happen. Ultimately, orchestras need to be in financial balance over time, with sufficient cash flow to pay the bills. Continuing small deficits or a large unplanned deficit can produce insolvency and, in the worst case, demise of the institution. It is important to understand whether a deficit or series of deficits for any given orchestra occurs as the result of economic cycles, reflects structural/systemic realities, or is simply the result of unexpected external causes. Orchestras must evaluate how their community relationships, internal culture, and/or artistic activities can have an effect on development, marketing, expense structure, or managerial issues to prevent or eliminate long-term problems. It is also worth noting that unexpected deficits divert limited time and efforts away from core activities and into short-term crisis management.

A Vibrant Orchestral Organization Might, in its Financial Structure…

1. Be revenue driven rather than expense driven …

- *What if an orchestra deployed resources throughout the organization with the goal of building a far broader financial base in the community rather than relying on the commercial and philanthropic interests of the small percentage of the population that is able to attend concerts?*
- *What if musicians, music director, board, and management could articulate a shared vision for the short-term and long-term artistic goals and revenue goals of an orchestra, and could then work together to achieve those goals?*

2. Balance aspirations with proven financial capacities over time …

- *What if an orchestra set annual revenue goals and budgets with a realistic view toward its historical revenue capacities, and the economics of the geographic area it serves?*

3. Adopt a financial structure that smoothes out fluctuations caused by the economy…

- *What if an orchestra were able to act in a proactive manner relative to its place in the business cycle?*

4. Share risks and rewards …

- *What if board members, management and musicians agreed to share the risks and rewards of operating in a challenging financial and cultural sector?*

These are difficult, yet essential questions. The inter-relatedness of each of the four areas may be most powerfully felt in the nexus between internal culture and financial performance. However orchestras choose individually to approach these several challenges, it appeared to the ETF that a key challenge is that of learning to balance the urgency of near-term financial pressures with the importance of developing policies that will ensure the long-term durability of orchestras.

The Process

We now turn to the process by which the ETF arrived at these visions. This section is an outline history of the ETF's work since 2003. Our progress was not smooth and certainly not free of contention. Yet, over the years our "full and frank exchange of views" has led to a remarkably candid discussion of issues facing our field and a mutual respect for our differing opinions.

Elephant Task Force Origins and Activity

At an Open Space held at the Forum meeting at the Airlie Center in May 2003, a group of Forum musicians, board chairs, and executive directors addressed the question, "What are we going to do about the 'lousy' economy?" Over the next 18 months, 14 Forum members[4] met regularly to grapple with key questions about orchestra finances:

- How serious is the problem?
- What lies at the core of the problem?
- Is lack of money the cause of problems?
- Are there other causes of the money problems?
- What is the cause of persistent financial deficits?
- Is the problem a structural one or a cyclical one, *i.e.*, do orchestras incur deficits because of inherent imbalance between their revenues and expenses (reflecting internal and/or external influences), or are they incurred as a result of periodic fluctuations in the economy?
- Are there multiple "bottom lines" that add texture and complexity to the question?
- Could orchestras develop an analytical tool which might help them understand these issues in their own individual sets of circumstances?
- Could orchestras collectively agree on a few key indicators of financial health that might provide insight for individual orchestras in trying to understand their financial challenges?

From the outset, it was apparent that the ETF was dealing with extremely delicate issues, and the group vigorously endorsed the key idea that it would not engage in any pronouncements or "laying down of tablets" regarding fundamental truths about the nature of orchestra financial structure. Furthermore, the ETF did not seek to establish any kind of new national or regional standard for the financial structure or performance of orchestras. Rather, the group coalesced around the idea that hypothesizing about potential causes of financial imbalances and challenging themselves with tough questions about possible solutions would be a more constructive approach. In particular, the ETF sought to consider an orchestra institution's planning cycle in a long-term perspective, perhaps 30 years, to match the typical career commitment of its performing musicians. This was made much more challenging by the urgency of the financial issues facing our orchestras, as well as growing concerns about being able to continue to attract quality executive leaders and development directors to the field. It also attempted to emphasize the need for each orchestra to understand its own circumstances more thoroughly. As such, orchestras needed a new operating model embracing the systems concepts of "sustainability" and "self-regulation" previously discussed in the Forum, consistent with both fiscal and artistic success.

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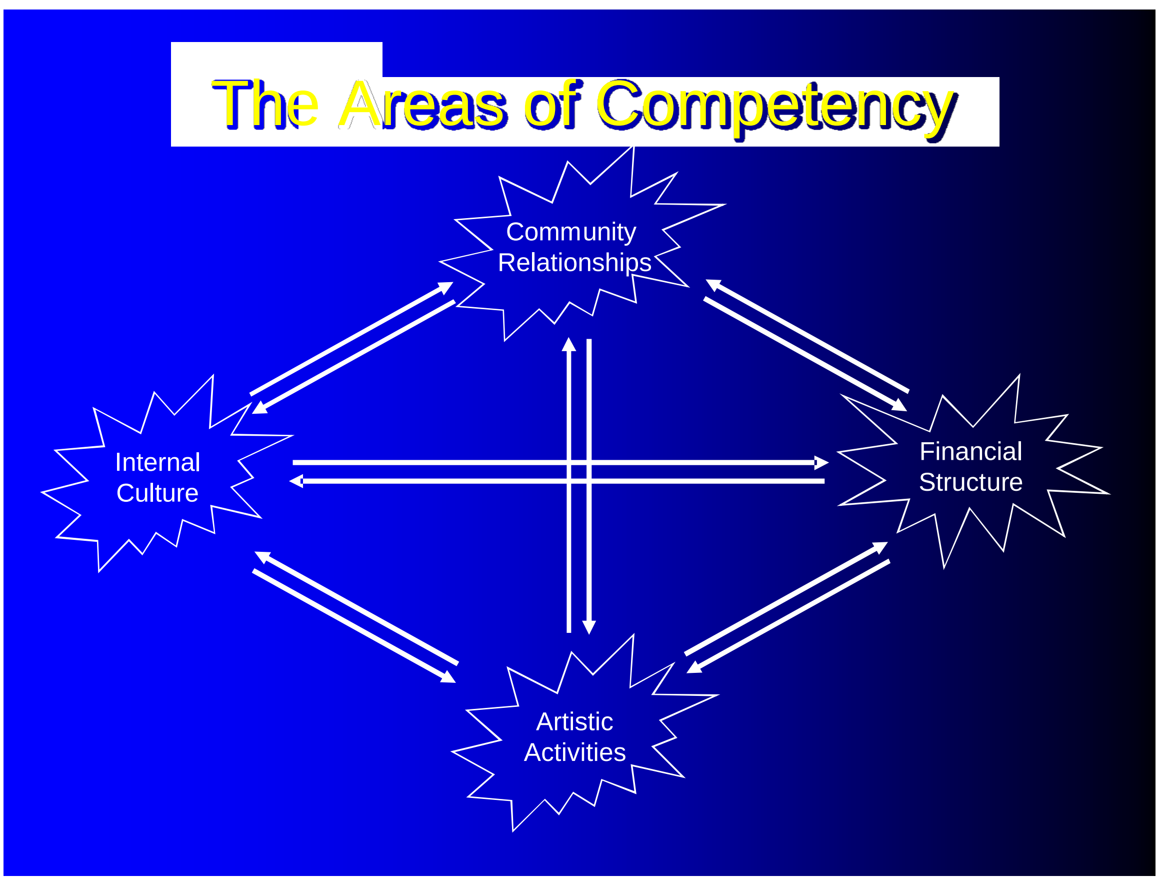
[4]Randy Adams, Saint Louis Symphony executive director, Penny Brill, Pittsburgh Symphony musician; Zan Brookshire, Seattle Symphony board; Bruce Coppock, Saint Paul Chamber Orchestra CEO; Gloria de Pasquale, Philadelphia Orchestra musician; Phil English, Baltimore Symphony board; Jamie Ireland, Cleveland Orchestra board; Sharon Litwin, Louisiana Philharmonic executive director; Hugh Long, Louisiana Philharmonic board; Henry Peyrebrune, Cleveland Orchestra musician; Brian Rood, Kansas City Symphony musician; Gary Smith, Saint Louis Symphony musician; Larry Tamburri, Pittsburgh Symphony CEO; Scott Wilson, Seattle Symphony musician. ETF meetings from November 2003 to May 2004 were facilitated by the consultants Paul Boulian and Fred Zenone.

The ETF did seek to develop a flexible financial modeling template, or perhaps to inspire individual orchestra organizations to develop one of their own.

Defining where orchestras were at the time as "Point A" and the new model as "Point B," the group suggested that, because the Forum, over its history, had forged relationships among its cross-constituent (musician, management, and board) members characterized by openness, collegiality, candor, and trust, there was a "safe" environment within which the Forum might consider the following project: (1) collect sufficient data from Forum orchestras to form a "critical mass" of understanding of the issues, (2) clearly define Point B with a scalable industry model, and (3) develop a map of the route from Point A to Point B including what funding would be required to travel the route.

Early in the process, the ETF members hypothesized that it was not possible to address orchestra finances in a vacuum, and that there were three additional interrelated areas—community relationships, internal culture, and artistic activities—that appeared to affect organization finances, and vice versa. At the time, the ETF called them deficits, but subsequently came to realize that they are best described as abilities or competencies. (Perhaps a lack of success in any one of these areas might be considered a deficit.)



Point A, Point B, and the Journey

The ETF struggled with a number of issues from defining Point A (where orchestras were at the time) to envisioning Point B (where they want to be) to supporting conclusions with facts and data rather than with intuition, “gut feel,” and belief.

Data, Definitions, and Debate

Defining the characteristics of Point A from an industry perspective proved difficult. Historical data readily available to the ETF was self-reported, generally by management. Some, especially the musicians of the ETF, had a strong preference for working from orchestras’ audited financial statements, so that data used was from an objectively verified third-party source. However, audited financial statements do not contain much of the detailed information needed for assessing Point A, such as attendance numbers or local market data. Also, orchestras’ fiscal years do not necessarily coincide with their seasons, nor are they uniform among orchestras. Orchestra Statistical Reports (OSRs) summarizing data reported to the League of American Orchestras (formerly American Symphony Orchestra League [the League]) were viewed with some skepticism because the reports are unaudited, and because of issues such as changes of the League’s data categories over time, inconsistencies in reporting by individual orchestras, and the possibility of false/faulty reporting.

The ETF decided to proceed using data based on audited statements and internal management data for a small sample of three orchestras from within the ETF membership. Only one of the three orchestras was able to supply the complete 20-year range of data that was sought by the ETF. Hence, the ETF was severely limited in being able to engage in meaningful statistical modeling and/or forecasting, and was unable to determine whether observations and learning from any particular market could be generalized to any other market(s).

Perhaps most important, there was substantial debate within the ETF on the question of whether fiscal problems were, in fact, structural, or, rather, cyclical. The ETF focus on the structural/cyclical causation dichotomy that motivated its seeking independent study of the matter requires some explanation of the ETF’s working definition of those terms.

The easier of the two is “cyclical.” The reference here is to “business cycles” and the economic experiences associated with expansions and recessions in the broader economy, with deficits reported during recessions and surpluses reported during expansions.

The second, more difficult term is “structural,” which has both static and dynamic components. The static component is generally described as the extent to which deficits accumulated during recessions are not fully offset by surpluses generated during expansions. A simple example of a severe structural deficit is a deficit that persists even when an organization is operating at full capacity, typically at the top of the business cycle. The dynamic component (which gives rise to the “systemic” label and is often also referred to by economists as “trend”) is how the static component changes through time.

One example of a trend factor is the productivity lag identified by Baumol and Bowen[5]: the performing arts, unlike other sectors of the economy, benefit little, in terms of productivity, from technological innovations; unit productivity does not rise as fast as the cost of talent; and thus performing organizations' costs almost always (and increasingly) exceed their earned income.

In the context of the ETF discussions, "structural deficits" were implicitly defined as the gap between all annual operating revenues and all annual operating expenses during "normal" times (the average across the business cycle), not masked by extraordinary circumstances such as the expansionary economy of the 1990s.

Historically, organizations find addressing cyclical issues, while not easy, easier than addressing structural issues. For cyclical matters, probably the most common prescription for weathering the full cycle is "saving" during good times for the coming rainy days. This may be an unrealistic goal for orchestras, and most nonprofit arts and culture organizations, since (1) it presumes that orchestras actually accrue surpluses during good times whereas many are unable to do so; (2) it presumes that strategically the best use of surplus funds is to build reserves rather than to advance, deepen, or expand mission or programs as soon as a surplus occurs.

Addressing structural matters is more challenging because it necessarily requires altering something basic about the organization or its functioning to offset the deficit, potentially a more threatening process than is "saving for a rainy day." Addressing a structural deficit should not be taken to mean, necessarily, cutting costs; rather addressing a structural deficit is about examining and rethinking an organization's underlying business model, which includes looking at the nature and composition of expenses, the interactions among expenses and revenues, and the relationship between these fiscal measures and the financial strategies that support and advance the organization's mission.

Support for the structural viewpoint was the logical appeal of the arguments made decades earlier by Baumol and Bowen: Labor costs for performing arts escalate in step with labor costs in other sectors of the economy but, unlike other sectors, are not mitigated by increases in productivity. The necessary consequence of this, it is argued, is that the prices at which performing arts services are sold must escalate faster than other goods and services, discouraging demand and leading to fiscal crisis. Countering this are observations (at least with respect to orchestras) that fiscal shortfalls simply occur in relationship to the low points in the business cycle of expansion and recession. The productivity issue identified by Baumol and Bowen has historically been offset by industry innovation and change: the introduction of touring, identifying organizational angels, the democratization of subscriptions, repackaging of concerts (radio/TV broadcasts, recording, podcasts...), tax advantages of not-for-profit status, expanded board sizes, developing alternative series such as pops or family concerts, moving into educational work with school systems, building endowments, having public fund drives, etc. It is important to note that the effect of any given innovation varies from institution to institution and over time; in fact, some of these strategies have not been "money

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[5] Baumol, William J. and Bowen, William G., *Performing Arts, The Economic Dilemma,* New York: Twentieth Century Fund (1966)

makers" (either in the short or long term) for some orchestras. As a consequence, there is an ongoing need for continuing innovation and adaptation in the field.

As noted above, the "cyclical versus structural" question loomed large over the entire ETF effort, for the organizational implications of orchestra finances being impacted primarily by one or the other are significant.

These two issues—reliability of data and the cyclical/structural debate—by virtue of the intensity of feelings on these issues outside the ETF, created pressures for the ETF to address just these matters. However, the ETF elected to proceed in a manner that circumvented those debates in the moment by generating findings based on the audited financial statements of one of the ETF orchestras (referred to as Orchestra "A"), showing its current financial condition and several years of detailed financial data. Using six key financial performance indicators:

- Total number of tickets sold;
- Percent of tickets sold on subscription vs. total tickets sold;
- Ticket price increases;
- Ratio of contributed revenue to total expense budget;
- Ratio of endowment size to total expense budget;
- Ratio of average expense increases to average annual revenue increases;

the ETF created three scenario projections of the financial condition of Orchestra "A" over five years: one based on historical trends for the prior five years, one a simulation of historical experience when the economy improves cyclically, and the third a simulation of historical "best-ever" single-year performances in each category, and sustained throughout the five-year projection period. All three scenarios resulted in unacceptably large accumulated deficits, ranging from 120% to 15% of estimated budget expense, respectively. While this led to a conclusion that Orchestra "A" faced a structural deficit situation, the ETF was unable to reach conclusions from this exercise about orchestra finances in general.

The ETF also explored a kind of evaluation system for determining the overall financial health of an orchestra, as well as early steps in thinking about the areas of concern. There was an understanding within the group that the work of the ETF was both incomplete and inconclusive, particularly with regard to identifying a model that would represent Point B, but that failure to share its findings might well create greater suspicion and controversy than the work itself. The time had come to begin the process of reporting its work.

Initial Reactions to the ETF 2004 Report

The ETF accordingly made interim presentations to the full Orchestra Forum in May 2004, the ICSOM Executive Board in June 2004 and to the League's Strategic Planning Group in autumn 2004. As expected, the report was seen as incomplete and methodologically flawed by some, irrelevant or unsurprising by others. Still others found it disturbing or possibly threatening. No one found it comforting.

Despite strong efforts emphasizing that the ETF's purpose – indeed its sole intent – was to stimulate independent thinking by asking probing questions, there can be no question that the work of the ETF was received with controversy within the field.[6] A nearly universal reaction, and one shared by all on the ETF, was the need for further independent research regarding the cyclical/structural question, using more sophisticated analytical techniques. The quality of the results of any analysis depends not only on its methodological soundness, but also on the quantity and quality of the data being analyzed. Data must be broad-based, credible, and reliable, in order to permit valid conclusions to be reached. In its initial work, the ETF did not have access to data from multiple orchestras, so was constrained in its ability to generalize from the specific.

Over the next year, ETF struggled to determine next steps given the skepticism it had encountered at its presentations. It considered a two-pronged process: (1) refining its modeling tool in order to have a few more orchestras enter their data; and (2) commissioning an independent researcher to (a) answer the "cyclical vs. structural" question and (b) to try to determine whether a helpful, predictive model could be created. At the same time, the ETF became aware that the League had begun a collaborative data project (CDP) with the AFM, ICSOM, and ROPA and was seeking consensus on what data it should be collecting and for what purpose. At the suggestion of the Mellon Foundation, in June 2005 a request for proposal was sent to the Stanford University Business School, one of whose professors, Robert Flanagan, expressed interest in reviewing League and ETF data. At a meeting in November 2005, Flanagan (1) gave the ETF and the League an analytical overview of the data he had received, (2) counseled collecting additional market data and other economic data, and (3) advised that in order to build a predictive model, orchestras must have a diversity of data in order to be able to test hypotheses and understand relationships and causality. Because the CDP would not be functional for at least a year or more, the decision was made to move forward with the ETF research project, and it was recognized that if Flanagan encountered challenges while analyzing the League data that this information could, in fact, be beneficial to the CDP process. In March 2006, Flanagan was commissioned by the Mellon Foundation on behalf of the ETF to conduct an analysis of the economic health of orchestras, with the objective of assessing the cyclical and structural influences on the economic health of orchestras. It was understood from the start of the project that developing a predictive model might not be feasible until data analyses discovered the determinants of economic outcomes for orchestras. In Flanagan's words, "it is not possible to predict behavior until you understand it." Ultimately, Flanagan did not create a predictive model, owing to time and data limitations.

[6] Regrettably, and against the policies and processes of the Forum, the management at one Forum orchestra referenced the ETF data during contract negotiations in an attempt to obtain a concessionary agreement, greatly upsetting the cross-constituent trust that had been established among the ETF constituencies. There also was a continued belief among some that deficits were principally a consequence of weak leadership and/or inadequate fundraising.

Cyclical vs. Structural: The Flanagan Report on "The Economic Environment of American Symphony Orchestras" (2007)

With data provided by the League, Flanagan had access to 17 years of continuous reporting for 32 orchestras, data for 13-16 of those years for 19 additional orchestras, and fewer years of data for another dozen orchestras, all of which were among the top 50[7] in budget size for some or all of the period 1987-2004. Given the data issues raised earlier, the question remained of whether the OSR data was of sufficient quality to give meaningful results. The large sample size and number of data points was more than sufficient to smooth out random variation, but questions remained about the reliability of the data, in that it was self-reported, about definitional changes through time in data categories, and about possible reporting inconsistencies across and within orchestras. Among the concerns expressed were questions about differing interpretations of survey items such as depreciation and revenue sharing and whether to include ancillary revenues such as food service or parking proceeds along with revenue earned from performance activity.

These concerns were both addressed and ameliorated by Flanagan's methodology. First, his analysis used the high-end of data aggregation. Differences of definition are not problematic when the subcategories have been combined into larger "buckets." Most subcategories blend together so that the data used does not depend on definitions or choices to place monies in one subcategory or another. Second, Flanagan uses the statistical technique of fixed effects analysis, which focuses on changes in variable values, not on the values themselves. This renders differences in reporting among orchestras irrelevant so long as each orchestra is consistent in its own reporting through time. Furthermore, when using this type of analysis, greater consistency in reporting within individual orchestras would only strengthen the conclusions. In order to sort out the question of cyclical vs. structural, Flanagan used the statistical tool known as multiple regression analysis. (Indeed, this is a classic application of the tool.) Quoting Flanagan:

> ...When multiple factors (such as cycle and trend in the present case) simultaneously influence particular outcomes (such as measures of the financial health of orchestras), the challenge is to determine the distinctive influence of each factor. Multiple regression analysis provides a statistical technique for meeting that challenge. Regression analysis isolates the distinctive influence of each factor on a measure of financial health after first holding constant the influence of all other factors included in the analysis.[8]

Flanagan submitted a first draft of his report to the Mellon Foundation in November 2006 but owing to transitions at the Foundation it was not reviewed by the ETF until meetings with him in May and July 2007 (at the latter, invited guests—including several non-Forum managers and board members as well as musician representatives from the AFM,

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[7] The orchestras in the sample represent over 70% percent of US orchestra revenues, and the orchestras range from full-time 52-week orchestras to per-service organizations. The vast majority of the orchestras represented in this sample are full-time orchestras with seasons ranging from approximately 34 to 52 weeks, while the majority of professional orchestras in the US are per-service orchestras.

[8] Flanagan, Robert J. "The Economic Environment of American Symphony Orchestras," (2007) pp 24-25.

ICSOM, and ROPA—provided reactions to a second draft). The greatest level of agreement among the responders to the two drafts was around the cyclical/structural question. Most agreed explicitly that Flanagan's analysis of the cyclical/structural question resolved that crucial issue for the first time to the satisfaction of the various interested parties.

As an independent researcher, Flanagan had collected additional economic data and explored questions beyond those originally posed by the ETF, but which he found to be of interest and which he thought could be of value in explaining the economic performance of orchestras. The ETF found most of Flanagan's conclusions to be thought-provoking, even if not advancing the ETF inquiry and even if not consistent with its observations of industry realities, and they inspired robust discussions at the two meetings.

Flanagan submitted the final version of his report, entitled "The Economic Environment of American Symphony Orchestras," to the Mellon Foundation in December 2007. In March 2008, he released the report publicly to the press and on the website:

http://www.gsb.stanford.edu/news/packages/pdf/Flanagan.pdf

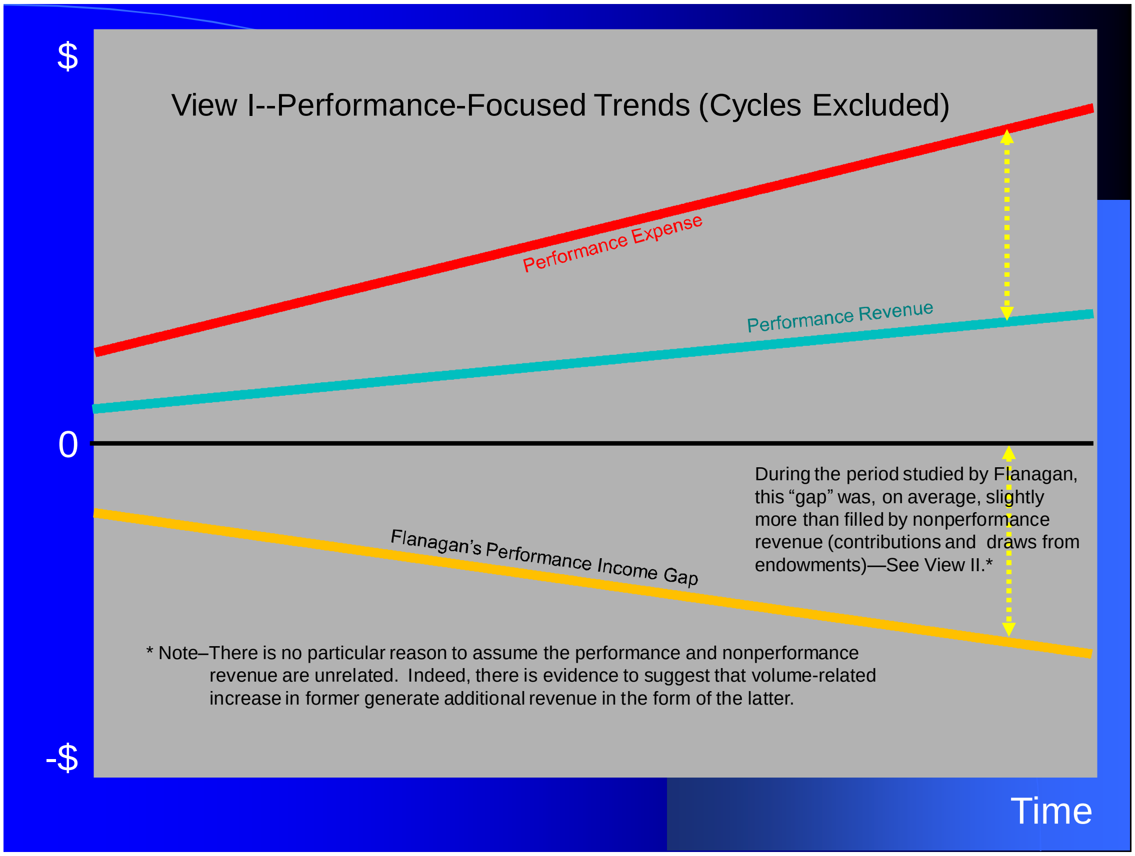
Coverage in the online press has converged primarily on the obvious and relatively uninteresting point of orchestral expenses exceeding revenues. Flanagan's principal conclusions are contained in his Executive Summary (reproduced as Appendix A to this document).

In October 2007, two months prior to the completion of the Mellon-funded report, Flanagan presented a paper at the Institute for Research on Labor and Employment at UC Berkeley. Entitled "Symphony Musicians and Symphony Orchestras,"[9] it attempted to trace the involvement of the AFM, ICSOM, and ROPA in American orchestras, the rise of the 52-week season in the 1960s, and the role of the collective bargaining agreement and work roles in the nonprofit environment of orchestras. It is cited here only because some readers mistakenly confused it with the report commissioned by Mellon. The ETF did not find the October paper useful for its inquiries and regrets any confusion its appearance may have created.

Is the problem cyclical or structural?

Responding to the central question posed to him, Flanagan observes as a preliminary matter that, independent of his regression analysis, across time for the orchestras included in his study, performance revenue (ticket sales, contracts, etc. generated directly by orchestra performances) does not cover performance expense (costs related to orchestra performances). Using terminology similar to Baumol and Bowen, he refers to this well-known phenomenon as the "performance income gap" (View I).

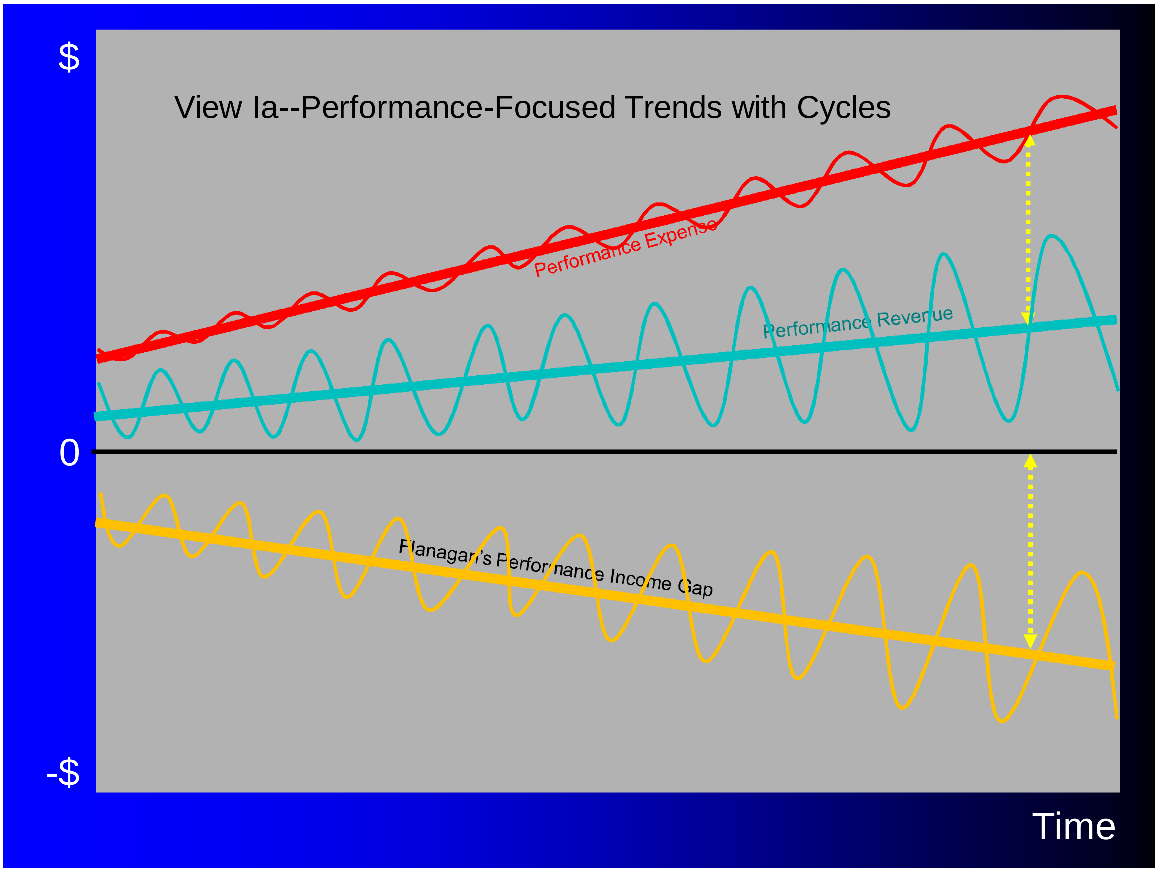
[9] A draft of the paper is posted on the Institute's website.
http://www.iir.berkeley.edu/events/fall07/symposium/index.html



Turning to the results of the regression analysis, Flanagan finds that changes in the financial balances of symphony orchestras reflect the influence of both general economic conditions (*i.e.*, cyclical effects or business conditions) and trend factors (structural)—such as the productivity lag identified by Baumol and Bowen[10] and/or changing consumer preferences for live performances and symphonic music—that are unrelated to changing economic conditions over the business cycle. Discriminating between the influence of cycles and trends is important because cyclical variations can obscure underlying trends, leading to misinterpretations of current financial developments (such as overly pessimistic views during cyclical downturns, or overly optimistic views during improving economic conditions)**.**

[10] Unlike other sectors of the economy, the performing arts benefit little, in terms of productivity, from technological innovations; unit productivity does not rise as fast as the cost of talent; and thus performing organizations' costs almost always (and increasingly) exceed their earned income.

First, Flanagan's regression results show that while real (adjusted for inflation) performance revenues are, to a high degree of statistical likelihood, cyclically sensitive (declining in recessions and increasing in expansions), performance expenses are far less so, showing no statistically significant change related to either recession or expansion. This means that the net of the two, the performance income gap, worsens in recessions and ameliorates in expansions (View 1a).



As noted earlier, if the business cycle alone was all that mattered, proper management of the results reported above would result in a balancing out over the full business cycle. But Flanagan's work reveals that, after controlling for the effects of the business cycle, there are significant trend effects that unfavorably affect the performance income gap.

Flanagan finds that, regardless of the ebbs and flows of the business cycle, real performance expenses grew over the 17 years of the study significantly faster, indeed three times faster, than performance revenues.

Essentially, (1) orchestra expenses continue to increase through time affected in only minor ways by the business cycle, while (2) performance income (a) varied with the economy (declining during recessions, increasing during expansions) while (b) showing only modest growth over the total cycle. What is the result? Each time business conditions improve, <u>from a perspective of looking only at performance revenue and expense</u>, orchestras find themselves in a slightly worse financial condition than they were prior to the economic downturn, and with a larger performance income gap to cover. In other words, even if orchestras were able to adjust successfully to the cyclical "weather," the long-run economic "climate," including the cost-productivity phenomenon described by Baumol, is producing ever-increasing performance deficits.

How can symphony orchestras address the weather?
Symphony orchestras cannot by themselves reverse economic cycles, but with sufficient advance warning those orchestras that are financially and operationally nimble may be able to take actions to mitigate the impact of cyclical changes. Flanagan points out that there are leading indicators of economic activity that provide advance warning of changes in business conditions. For almost 50 years, the Conference Board's Index of Leading Indicators (http://www.conference-board.org/economics/bci/) has, on average, predicted the onset of recessions about 11 months in advance and the onset of recoveries about seven months in advance. Leading indicators can provide the orchestra industry with information that assists forward planning to address the variations in the performance income gap and contributed support that accompany cyclical fluctuations. As stated earlier, although it is often difficult, mitigating the impact of cyclical factors on orchestras may require allocating some of the gains in good times to reserves to be used in bad times.

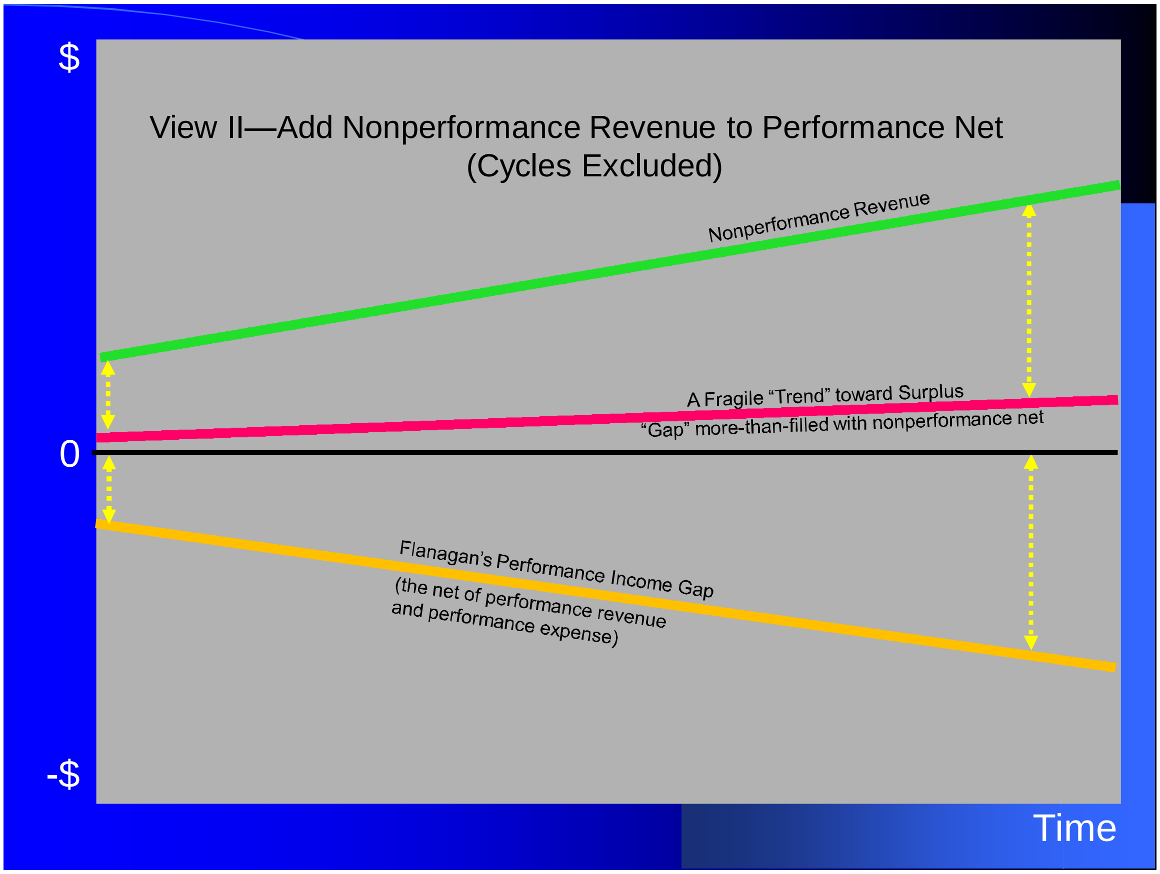
How have orchestras managed to stay afloat (dealt with the climate) over time given the worsening performance income gap?
Flanagan finds that the performance income gap has been addressed by a significant trend increase in nonperformance income (government support, private contributions, and investment returns net of their costs such as grant writing, other development expense, and investment management fees).

Each component of nonperformance income is, to the same high degree of statistical likelihood, also cyclically sensitive, meaning that less of the larger performance income gap is offset by nonperformance income during recessions and more of the smaller gap is offset during expansions (indeed, for some orchestras, more than offset during expansions).

After holding the business cycle effects constant, however, there was also a significant trend increase in nonperformance income, primarily in the form of private contributions and investment income over the period of the study that was a result of a combination growth of population, increase in per capita income, and additional development efforts.[11] The proportionality of the trend increase in private support among individuals, foundations, and business averaged 6:3:1. Over the period examined, the only area of nonperformance income showing a trend decline was government support.

When one combines the modest trend increase in performance revenue and sizable trend increase in nonperformance income, and sets it against the very sizable trend increase in performance expense and trend decrease in government support, there is a quantitatively small but statistically significant trend improvement in the overall financial balance of the average orchestra in the sample—what Flanagan calls a "gentle trend towards surplus"[12] (View II).

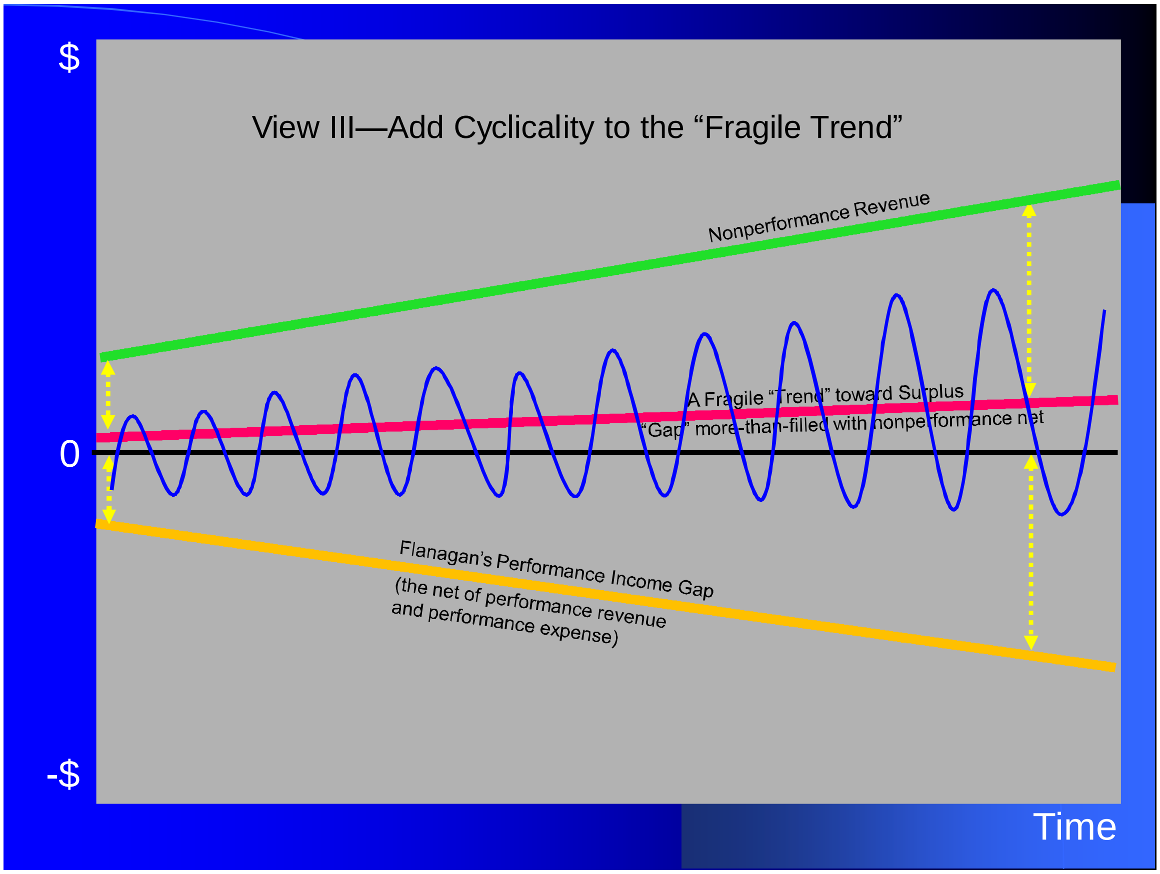
[11] It would take additional research to estimate how much of the trend resulted from each of these apparent influences.
[12] Flanagan (2007) op. cit. p. 31



However, Flanagan notes that in interpreting this trend on must consider the following: "(1) A trend towards surplus is different from a surplus. Most of the 63 orchestras continued to run an overall deficit at the end of the sample period. (2) To the extent that the trend toward surplus reflects excessive draws of investment income from endowments, it masks a serious long run financial challenge to orchestras …. (3) The effects of small adverse cyclical changes can overwhelm the positive trend."[13] For example, the financial consequences of a slightly more severe recession (a one-half of one percentage point increase in the unemployment rate) would completely counter the trend toward surplus in any year.

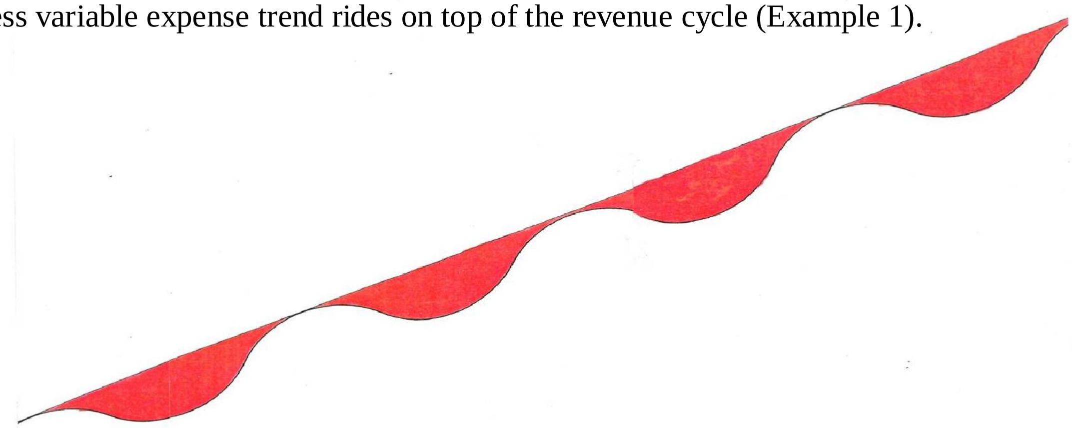
View III adds a theoretical cycle pattern on top of the "gentle trend."

[13] Ibid.



As depicted here, and consistent with Flanagan's concerns noted above, the magnitude of the tops and bottoms of the cycle may be large relative to the actual dollar amounts of the average result. Further, it is quite possible that the dynamics of individual orchestras do not center the cycle over the broad overall trend.

Understanding that there is a cycle associated with each of the trends depicted above, and that the magnitude of the variation across the cycle is different for each trend, the historical data suggests as noted that the fluctuations in revenue of all kinds is greater than the fluctuation in expenses. While deficits vary through time, they will accumulate though time if the orchestra can only reach balance at the top of the revenue cycle where the less variable expense trend rides on top of the revenue cycle (Example 1).

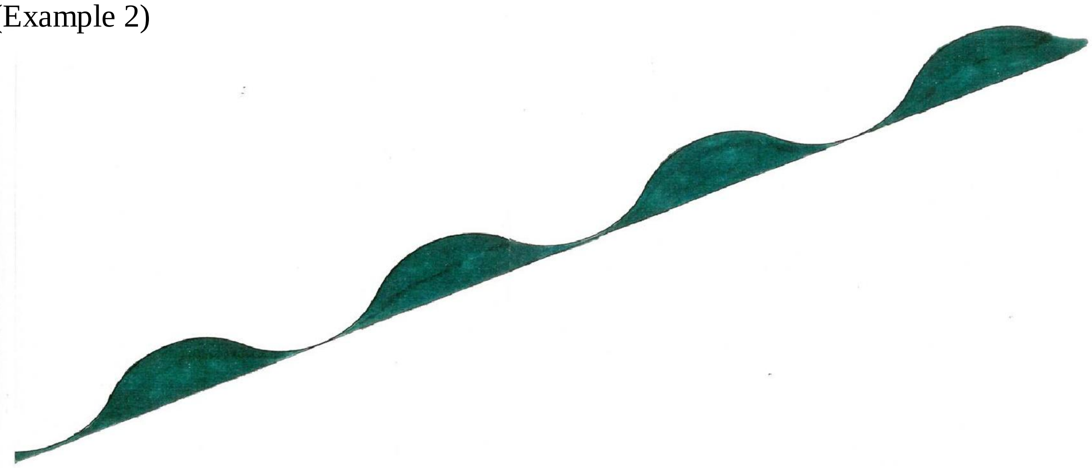


Example 1

The deficits that accumulate in Example 1, absent an adjustment to the steady increase in the expense line forces one or more responses: higher endowment draws to cover deficits; endowment transfers to cover accumulated deficits; internal or commercial borrowing to carry cash flow deficits; special deficit-elimination fundraising.

There are two other conceptual patterns that could occur over time:

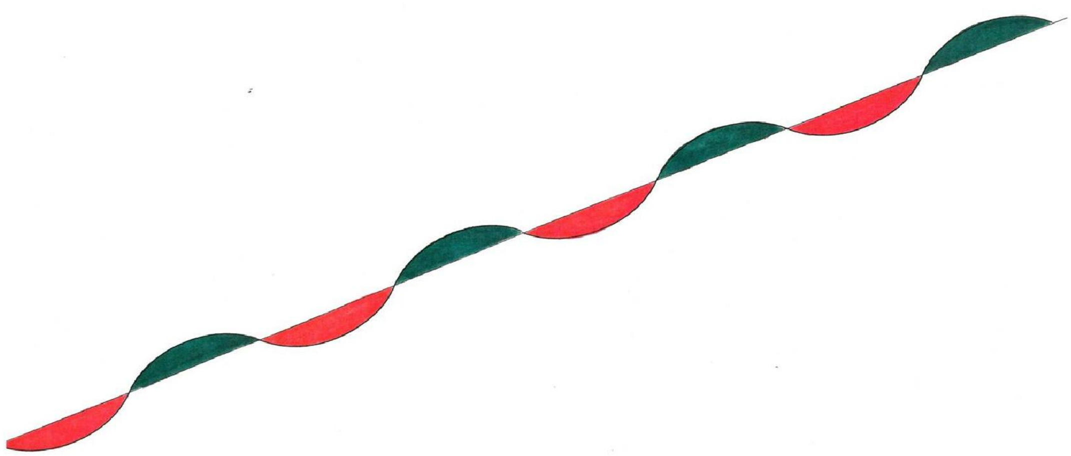
First, the inverse pattern of Example 1, where the expense trend runs along the bottom of the revenue cycle instead of the top, allowing the accumulation of surpluses. (Example 2)



Example 2

Were this pattern achievable, it might allow orchestras to make investments in artistic development, special projects, and research and development, and then take greater risks in their audience development, community engagement, and artistic endeavors.

The middle case is where the expense trend is within the revenue cycle (Example 3).



Example 3

In this example, assuming an orchestra has the ability to reserve surpluses achieved at the top of the revenue cycle to cover deficits that will occur at the bottom of the cycle, an orchestra could maintain relative continuity of operations over time, covering the trend increase of expenses across the business cycle.

What's Next? Unanswered Questions

The robust discussions carried on by the ETF internally and with Flanagan in response to the drafts of his report, as well as the responses the release of Flanagan's report has engendered, all suggest the thirst for additional knowledge about our field and the desire for additional tools with which to carry out further analysis. At this point in its journey the ETF recognizes that there are many questions about orchestras that beg for answers. These include issues about audience and attendance, programming, internal culture, musicians' careers, new revenue strategies, ticket pricing, contributed support, patron development, and endowment practices, among others.

Audience and Attendance

How well do we understand the composition of our audiences? What can we learn from US Census bureau data about the changing demographics of the college-educated population? To what extent are race, education, ethnic heritage, religion, individual study of music, or parental interest in classical music factors in the appreciation of Western classical music among an increasingly heterogeneous population? What drives or impedes conversion of listeners or practitioners of concert music into attendees?

What are household and individual attendance patterns? To what extent does the location of a concert affect attendance? What effect do run-out or neighborhood concerts have on these patterns? How far apart do concert venues need to be in order not to cannibalize existing audiences? To what extent do day of week and time of day affect attendance? What implications do these patterns have on marketing and fundraising policies?

What is the effect of substitute competitors and the larger culture change? How effectively are orchestras using the Internet to engage both existing and potential audiences? Are orchestras marketing effectively to both existing audiences and reaching new audiences? If not, how could they be more effective?

To what extent does programming affect audience size? What is the balance between leading and following taste? How does this fit with a "curatorial" mission? How effective are collaborative engagements with the wider cultural field: dancers, poets, actors, filmmakers, musicians from outside the classical music industry?

Internal Culture

What is the effect on the culture of the institution of such longitudinal factors as longevity of board leadership or executive directors, rate of turnover of music directors, and frequency and length of strikes? To what degree do these factors interrelate? To what extent does the internal culture of orchestras affect the pool of potential trustees and managers? There is perceived leadership deficit in the orchestra field—is this leadership deficit real? If so, where are talented past and potential leaders going and why?

What are the key factors driving organizational culture, whether acrimonious or harmonious? What role does governance play? Management? Musicians? Unions? How have organizational approaches varied over time? Are a more robust set of practices emerging? Are there best practices to be studied? Beyond the essential work that they do onstage, what do musicians consider "engagement in the intern al culture" of an institution to mean? How does this differ from orchestra to orchestra?

How do external factors from peer institutions in the orchestra field affect internal practices in an individual orchestra?

Musicians' Careers

How well does conservatory training serve the 21st-century musician? How well does the orchestra workplace serve the continued growth of musicians? Are there leadership principles and practices from the outside the orchestra world that would benefit principal players? How do professional musicians and music students determine career moves? How do age, stage of career, compensation, artistic reputation, cost of living, and audition format affect these decisions? What makes a musician choose one audition over another, given limited time and resources?

New Revenue Strategies

Is the concept of the performance income gap (the gap between performance expenses and box office/earned revenues) an accurate reflection of the business model? What is the relationship between ticket buyers/ticket sales and donors/contributions and would an alternate framework better reflect the drivers of the actual business model?[14] Is higher "earned" income an indicator of better fiscal health? What has been the effect of the valorization of earned income and the market on orchestras? Can orchestras learn from other revenue models from outside the orchestra industry (universities, public radio, museums, and membership organizations)? How might the field learn to encourage and celebrate the willingness of orchestras to experiment with other models?

Ticket Pricing

As various orchestras and other performing arts institutions undertake ticket pricing initiatives, what analytical research is taking place on churn, sustainability, and long-term effects of such efforts?

What is the relationship between ticket price/revenue and audience size? What is the relationship between audience size and donor base? What has been the long-term effect of steady increases in ticket prices on the demographics of audiences?

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[14] Coppock, Bruce, "Radical Revenue: A new business model challenges conventional industry thinking," *Symphony* (January 2008), 21-27

Contributed Support

Would it be possible for orchestras to develop a model for predicting realistic contributed revenue goals and potential donors on the basis of population, number of high-income households, and percentage of total non-profit contributed revenue in metropolitan statistical areas (MSAs) and to aggregate data in order to allow for comparisons with other orchestras?

To what extent do lapsed subscribers continue to be donors (either annual or as legacy gifts), and what to what extent do donations come from individuals who don't attend concerts themselves but recognize the civic importance of having a thriving orchestra in their communities? To what extent do perceptions of declining audiences affect the willingness of contributors to continue to support their orchestras? How has this changed over time? Are there discernable trends in individual giving between annual giving, project giving, and endowment giving, or does it vary according to community and circumstance?

Endowment

To what extent can prudent endowment draws help offset the performance income gap? How large would endowments need to be in order to cover existing gaps, and how rapidly would they have to grow to cover the trend in the performance income gap? To what extent have actual draws cannibalized orchestras' endowments? Is it possible to construct a predictive model that incorporates endowment draw needed, contributed revenue needed, and earned revenue needed for given endowment sizes, investment allocation, probable return, expense growth rate, etc.? What actions need to be taken to ensure that other revenue sources are sufficient so that only a prudent endowment draw rate is needed to balance the budget? Are orchestras with large endowments necessarily healthier than orchestras that lack them?

What has been the actual experience of orchestras' endowment performance over the past 20 years, incorporating actual endowment draws, additions to endowment (donor-specified and board-designated), transfers and investment returns (independent of additions)? For individual orchestras, what has been the growth rate of the endowment corpus, the growth rate for the endowment draw, and the growth rate for the proportion of expenses covered by the endowment draw? What is the average for the field (or similar orchestras)? What is the range of experience? What is the sensitivity of endowment values to general economic conditions, stock market, changes in tax policy, etc.? What is the sensitivity of endowment returns to the composition of the investment portfolios of orchestras?

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Answers to these questions and others may come from a combination of experiments by individual orchestras; pilot programs shared by a consortium of orchestras; regional, national, and international convenings; and research initiatives. Some may succeed. Others will be failures. The ETF does not presume to prescribe a specific research agenda for orchestras.

As the quality and availability of data quality improve, not only in the orchestra field but throughout the performing arts sector, it should also become increasingly possible to undertake cross-organization and cross-constituency investigations of the various issues, ideas, and challenges facing the orchestra field. It is the hope of the ETF that by posing the many questions in this report, a more fertile environment for conversation, research, and analysis may result, all in support of experimentation at orchestras that are crafting new business, financial, artistic, and community engagement models. Our collective goal is to bring about healthier and more sustainable American orchestras.

Bruce Coppock, Hugh Long, and Henry Peyrebrune

on behalf of
The Elephant Task Force
April 2008

APPENDIX A

Robert Flanagan's Executive Summary of "The Economic Environment of American Symphony Orchestras"

1. **What issues does the report address**? The Mellon Foundation requested a fact-finding study of (1) cyclical and trend developments in the economic health of the symphony orchestra industry and (2) influences on performance and nonperformance revenues and expenses of orchestras. The hope is that analyses of these influences will clarify decisions facing symphony orchestras and help individual symphonies to assess and project their own economic health.

2. **Which symphony orchestras are included in the analyses**? The main sample includes every symphony orchestra that was one of the largest 50 symphonies in the United States (based on budget size) for at least two years during the 1987/88 through the 2003/04 concert seasons (the period covered by the data). Each symphony that meets this requirement remains in the sample throughout the 17-year period, irrespective of its rank in other years. This approach produced a sample of 63 symphony orchestras (listed in Table A1) that includes some orchestras whose "economic health" either declined or improved over the period along with orchestras whose economic health was stable. The sample represents over 70 percent of orchestra revenues and expenditures in the United States and provides the raw material for most of the analyses in this report.

Some descriptions of basic industry trends use data from the 32 symphony orchestras that reported information in every year during 1987-2003 seasons (Sections III and VI).

3. **Where do the data come from**? The League of American Orchestras (formerly the American Symphony Orchestra League) provided data on the financial and operating characteristics of symphony orchestras. (Individual orchestras submit these data following a template established by the League.) Information on local market characteristics, such as population and per capita income, come from publicly available U.S. government data. Opera America provided data on the financial and operating characteristics of their members. In presenting the results of statistical analyses of large numbers of arts organizations, the report preserves the confidentiality of the data provided by individual organizations.

4. **How is the report structured**? Section II (particularly Exhibit I) explains the model of orchestra finances underlying the analyses. The economic challenges faced by symphony orchestras begin with the fact that their *performance revenues* from concerts, broadcasts and recordings do not cover their *performance expenses* for artistic personnel, concert production, marketing, and general administration. The resulting *performance income gap* has worsened over time and will worsen in the future.

Symphonies try to offset the performance income gap with *nonperformance income*, including contributions (from individuals, businesses, and foundations), government support, and investment income. The *annual financial balance* of a symphony indicates the extent to which nonperformance income has offset the performance income gap.

This report seeks to describe how the various elements of performance revenues, performance expenses, and nonperformance income and expenses are linked to three sets of potential influences: (1) Policy decisions of symphony orchestras, (2) characteristics of the local market, and (3) competition from other performing arts organizations.

5. **Broad developments**. The graphs in Section III show the main trends based on the 32 continuously reporting orchestras, whose presence throughout the period signals their superior economic health. Even this group of comparatively healthy orchestras has encountered significant economic challenges, including a worsening of the performance income gap (Graph 2), declining attendance per concert (for virtually all types of concerts) that limits performance revenue growth (Graph 1), and a tendency of performance expenses to grow more rapidly than other costs in the economy (Graph 3). This group of larger orchestras has also experienced changes in the distribution of performance revenues (Graph 6), performance expenses (Graph 7), growth of private contributed support (Graph 4), and a decline of government support (Graph 5).

The remaining sections of the report explore linkages between these economic developments and orchestra policies, market characteristics, and competition for attendance and contributed support from other performing arts organizations using the complete sample of 63 symphonies. The analytical results therefore reflect the experience of orchestras at varying degrees of economic health.

6. **Cycles and trends in revenues, expenses and contributions** (Section IV).
The financial health of symphony orchestras is sensitive to the general state of the economy. The burden of recessions on orchestras results as much from the decline in contributed support—particularly private contributions—as from cyclical change in the performance income gap. Recessions worsened the overall surplus/deficit position of the average symphony in this sample, while business expansions improve the overall financial balance.

Holding the influence of general economic conditions on symphony finances constant, upward trends in *private* contributed support and investment income offset both a long term decline in *government* support and the long-term deterioration in the performance income gap. As a result, there was a modest trend improvement in the overall surplus/deficit position of orchestras in the late 20th century.

7. **Concert attendance** (Section V). Annual concert attendance declines sharply in recessions and increases during economic expansions. After holding general economic conditions constant, annual attendance has increased as orchestras have added concerts to their schedules, but adding concerts yields smaller and smaller attendance gains. In fact, attendance *per concert* declined throughout 1990s and into the new century. Even if every concert were sold out, however, the vast majority of U.S. orchestras would not earn sufficient income to cover all performance expenses.

Once the number of concerts has been set, an orchestra's ticket pricing and marketing policies influence attendance per concert. Higher ticket prices discourage some attendance but raise performance revenues. Higher marketing expenditures increase attendance at regular season concerts. Only expenditures on mail and phone campaigns are significantly related to pops concert attendance. Incremental expenditures on all types of marketing activities are subject to diminishing returns—successively smaller gains in attendance per concert.

Location also influences attendance, which is positively related to an area's population (but is not significantly related to either the real per capita income or unemployment rate in an area). To a small degree, symphony and opera performances may compete for attendees: An increase in opera ticket prices raises symphony attendance (and conversely), with other influences held constant. This competitive effect is quantitatively small, however.

8. **Artistic Costs** (Section VI). Artistic costs constitute the major expense category of expense for orchestras but have declined as a percent of total costs. Most symphony musicians are unionized, and their salaries are set in collective bargaining agreements signed by both labor and management representatives. Between the 1987 and 2003 concert seasons, the minimum and average effective salaries of regular orchestra musicians increased more rapidly than consumer prices, the average wages and salaries of other unionized workers in the United States, and the average wages and salaries of nonunion workers. Payments to guest soloists and guest conductors have increased at about the same rate as the salaries of orchestra musicians.

9. **Public and Private Support** (Section VII). All symphony orchestras must rely on private philanthropy and government support to offset their performance income gap, but orchestras differ widely in the extent to which they rely on private contributions by individuals, businesses and foundations. Government support is invariably a less important source of funding than private philanthropy. The highly varied structure of nonperformance income for orchestras indicates that they do not follow a common model for achieving financial balance.

Philanthropic contributions to orchestras depend on the characteristics of their market areas, the development activities of the orchestras, and (to a small extent) the development activities of competing performing arts organizations. Orchestras in areas with higher per capita income receive more private contributions.

Orchestra ticket-pricing, concert programming, and fundraising policies also may influence the level of contributed support. Once the effects of an area's economic capacity are held constant, the effect of fundraising activities on contributed support appears more modest than sometimes claimed. For larger orchestras, there are indications that annual fundraising expenditures do not immediately pay for themselves.

There is some evidence of competition between different performing arts organizations for contributed support. Although the evidence is not ironclad, it appears that a small proportion of increased private contributions to operas comes at the expense of symphony orchestras in the same area, and vice versa. While, this competitive effect is small in the data for the late 20th century, it could lead to a mutual and mutually unproductive escalation of development and fundraising expenditures by all competing arts organizations.

10. **Endowment** (Section VIII). The returns on endowment experienced by individual symphony orchestras are highly dispersed even though they all have access to the same capital markets when they invest their endowments. Returns to endowment investments are cyclically sensitive (Exhibit 4). In the early 21st century, the endowment policies of most symphony orchestras permit annual draws from the endowment of 5-7 percent in nominal terms. The actual draws of some symphony orchestras appear to exceed this policy. Actual symphony orchestra endowments are not sufficiently large to cover performance deficits at prudent endowment draw rates (Exhibit 5). Endowment draw rates that would offset performance deficits in the short run are so high that they would cannibalize endowments to a point where it could sustain only smaller draws in the future.

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Robert J. Flanagan has written extensively on micro and macro issues in comparative labor economics and human resource management. His recent research interests include the effects of globalization on wages, nonwage working conditions, labor rights, and other global human resource management issues. Professor Flanagan is the Konosuke Matsushita Professor of International Labor Economics and Policy Analysis at the Stanford Graduate School of Business. He holds a BA in Economics from Yale University, and MA and PhD degrees in Economics from the University of California at Berkeley. Professor Flanagan has published 11 books and over 50 articles in professional journals on labor economics and human resource management. He has also served on the editorial boards of several professional journals.

His research interests have included the economics of discrimination, labor union behavior, and the impact of national incomes policies and collective bargaining institutions on wages, inflation, and other measures of macroeconomic performance. Most of his research focuses on the effects of international differences in labor market institutions and practices on employment outcomes. His most recent book analyzes the effects of globalization on working conditions and labor rights around the world. Currently, he is studying the role of competition between performing arts organizations on their financial balance.

Professor Flanagan teaches microeconomics and macroeconomics courses in the Sloan Program and an MBA elective on Human Resource Management in Global Organizations. He has also taught a variety of courses in labor economics, public sector economics, and labor relations during his career at the GSB. He has served as Associate Dean of the GSB and Director of the Public Management program.

APPENDIX B

The Orchestra Forum: A Brief Introduction

The Orchestra Forum forms an integral part of The Andrew W. Mellon Foundation's Orchestra Program, a ten-year initiative to bolster the internal capacity of orchestras in four areas identified as priorities by the field – leadership (artistic, managerial, and governance), the role of musicians, changing community expectations, and artistic identity and programming. The program provided direct grants to a select group of leading American orchestras.[15] The Orchestra Forum was designed to provide these orchestras with opportunities to:

- Share their insights into new and effective practices in a cross-constituent environment;
- Learn from each other and reinforce each other's experimentation;
- Further stimulate their own thinking by introducing them to creative leaders from other fields

Over the course of the initiative, approximately 120 musicians, 50 trustees, and 50 staff members from Forum orchestras attended meetings of the Full Forum. Many other orchestra constituents were exposed to Forum activities through on-site visits, orchestra exchanges, the New Strategies Lab, and other programs.

As leaders in the field, the representatives of each participating orchestra also enabled the Forum's secondary purpose: to identify and stimulate innovation in the field, and to provide guidance to the Mellon Foundation in the continuing development of its support for American orchestras.

[15] Participating orchestras: Baltimore Symphony, Cleveland Orchestra, Kansas City Symphony, Louisiana Philharmonic, New Jersey Symphony, New Mexico Symphony, Philadelphia Orchestra, Pittsburgh Symphony, Richmond Symphony, San Francisco Symphony, Seattle Symphony, Saint Louis Symphony, Orchestra of Saint Lukes', Saint Paul Chamber Orchestra, Toledo Symphony. Baltimore, Kansas City, and San Francisco did not remain in the program for the full ten years.