

**INCREASING THE CONTRIBUTION OF  
REVENUE-GENERATING ACTIVITIES TO THE  
SMITHSONIAN INSTITUTION MISSION**

**REPORT OF THE  
TASK FORCE ON SMITHSONIAN BUSINESS VENTURES**

**JANUARY 28, 2008**

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## INTRODUCTION

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In August 2007, Acting Secretary Cristián Samper established our Task Force to review the status of Smithsonian Business Ventures (SBV), recommend improvements to its structure and organization, and examine ways to maximize its financial and program-related contributions to the Institution. This report describes our review, and our recommendations to attain the substantial improvement to revenue-generation and mission enhancement performance that we have come to believe is achievable for these activities.

The Task Force was asked to consider four questions as part of its review:

1. What should be the role of revenue-generating activities within the Smithsonian Institution and how should they contribute to its mission?
2. Which business activities should be managed directly by the Smithsonian and which might be outsourced, if any?
3. What type of models for sharing business revenue with the units would promote and reward unit involvement in these activities?
4. What is the best way to manage these activities going forward? Should SBV continue to exist as a semi-autonomous unit or be fully integrated into the Smithsonian organizational structure?

We began our work by posing these questions to Smithsonian employees from across the Institution. What we heard from them provided a glimpse into how these activities have been conducted in the recent past, and as importantly, how they have been perceived to have been conducted. We learned that there is much to be proud of in these businesses, for example, an award-winning magazine, a profitable licensing effort, and a promising television venture. We also recognize the amount of effort that goes into producing these products and services, and the time and heart employees have dedicated to their success. But at the same time, these collective impressions painted a picture of an Institution unnecessarily divided against itself, a division that persists despite recently improved communication efforts, and in spite of the reality that most employees we talked to, inside and outside of SBV, are equally dedicated to the mission of the Institution and proud to be part of the Smithsonian. Since all members of the Smithsonian family have a role in ensuring the success of these activities, we hope that as they read and consider these recommendations they will approach them as we did this review: with an open mind and optimism that the challenges described herein can be overcome.

Finally, we suggest these changes with the knowledge that their implementation will be very challenging, and will take a substantial effort of many, over many months. We expect management to thoroughly consider their implications, and modify or reject suggestions that in practice they believe would not be effective. As that process unfolds, we welcome the opportunity to explain further our rationale and offer additional guidance if requested.

We are grateful for the time that Smithsonian employees from SBV, from the museums, and from elsewhere in the Institution have taken to prepare data and reports, answer our questions, and share their thoughts and suggestions. We are particularly grateful to Marsha Shaines, Deputy General Counsel, for legal advice, and to Pherabe Kolb, Senior Program Officer in the Office of the Under Secretary for Finance and Administration, for her outstanding staff support of the Task Force, and her perceptive and persistent assistance with this report's writing.

Finally, we offer our deepest condolences to the family of Richard Darman. Dick was an active, very effective contributor to the Task Force's work, and to the National Museum of American History, until his illness forced his hospitalization. We miss him very much.



Marshall Turner  
**SBV Task Force Chair**  
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**SBV Task Force Members**

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## THE ROLE OF REVENUE GENERATING ACTIVITIES AND THEIR IMPORTANCE TO THE SMITHSONIAN MISSION: PRINCIPLES AND CHARACTERISTICS

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**The first question asked of the Task Force was: “What should be the role of revenue-generating activities within the Smithsonian Institution and how should they contribute to its mission?”**

The Task Force believes that revenue generation through commercial activities is a desirable and important component of funding for the Smithsonian Institution, but only when conducted in consonance with the Institution’s mission and values.

As highly visible components of the Smithsonian experience, visitors expect these enterprises to add to the magic and wonder of their encounter with the Smithsonian—whether in person, or via media. They are part of the Smithsonian’s interaction between our nation and its people.

These commercial enterprises provide an essential source of unrestricted revenue for the Institution and should aspire to provide an extension of the Smithsonian experience. The best products and services symbolize and highlight the research, collections, exhibitions and educational endeavors for which the Smithsonian is so revered. The Smithsonian mission—*to increase and diffuse knowledge*—must be central to, or at least aligned with, any activities designed to generate revenue. **These assumptions form the basis of the following PRINCIPLES that should govern all Smithsonian revenue-generating enterprises:**

- Business activities should be consonant with the Institution’s status as a public trust and compatible with the Smithsonian’s reputation for integrity and quality.
- Business activities should provide an opportunity to significantly increase the financial resources of the Smithsonian Institution.
- When a connection to Smithsonian collections or programs is implied, it should be grounded in solid scholarship.
- Successful products, services and media content should strive to offer the public another means of learning from the Smithsonian in an enjoyable, meaningful and authentic way and encourage future visits to Smithsonian facilities, websites, and programs.
- Non-mission related activities, for example those offered for the convenience of the visitor, should be in keeping with the Institution’s reputation for quality. Therefore, commercial undertakings that are not primarily intended to further the Smithsonian mission must not undermine or harm the value of the Smithsonian name or the reputation of the Institution.
- The most successful products, services, and media content will enhance the value of the Smithsonian name.

These principles have been drawn from the sentiments and expectations expressed by all Smithsonian staff, including those at SBV, as well as the work of previous commissions and

committees discussing the Smithsonian. The Task Force recommends strongly that the leadership of the Smithsonian refine and adopt these principles, and that any current and future revenue generating activities be governed by them. Moreover, adherence to these principles should be the joint responsibility of all Smithsonian staff. Performance metrics associated with these principles should be evaluated with the same rigor as that accorded to financial goals.

We recommend that a “mission statement,” such as the one which appears below, be developed, committed to by the staff, displayed prominently and periodically reviewed:

**We engage in successful revenue generating activities that are compatible with the Smithsonian mission, values and reputation to support the Institution’s scholarship and programs. We aspire to offer authentic and high-quality products, media content and visitor services that augment the Smithsonian’s mission to increase and diffuse knowledge.**

#### DESIRABLE OPERATING CHARACTERISTICS OF REVENUE-GENERATING ENTERPRISES

Striving to fulfill these principles and maximize the revenue earned by these activities will be challenging. We believe that these principles lead to a set of characteristics that the commercial enterprises should exhibit in their operations.

The premise of these “characteristics” is the assumption that if revenue-generating activities are developed through **collaboration** with others at the Institution, their purpose and operation is **transparent**, their performance is measured and **accountable**, and they are conducted with **judgment** and **integrity** they are more likely to **align** with the Smithsonian mission. Past discussions of SBV that extended beyond simple financial performance often lacked the strong underlying context that a clear exposition of what is desirable and undesirable provides.

Such characteristics become powerful tools to describe an activity. They are needed to have informed discussions about operating performance, and to make decisions about the performance of leadership. Activities that have these characteristics can enhance adherence to the principles, improve financial performance, and result in more effective working relationships with the museums and other programmatic parts of the Smithsonian. We recommend that once these characteristics or a similar list have been discussed and agreed upon, they become important components of the criteria used for hiring, performance evaluation and compensation decisions of enterprise executives - - as well as for those museum and central staff executives with whom they interface.

#### *Collaboration*

Whether program related, or for revenue generation, the best opportunities to accomplish something interesting and/or significant at the Smithsonian involve collaborations with people who have other skills and other knowledge. Any structural changes to the way in which business activities are managed and operated will fail if this fundamental partnership is

not resurrected, valued and nurtured by the example and persistent drive of all the leadership's behavior. Throughout the Smithsonian, but especially in the commercial enterprises organization, leaders should be valued who demonstrate a collaborative style—actively seeking collaborative opportunities, and working toward more effective cultural integration.

The deep and diverse population that is the Smithsonian is one of the main reasons employees give for choosing to work here. Collaboration was sometimes not a characteristic of the commercial enterprise operations in the past. As noted in Appendix 4, the strained relationship between the Smithsonian's content experts and its business professionals was in large part responsible for the actual and perceived failures of SBV. This tension negatively affected working relationships and appreciation of each other's skills, and probably was detrimental to financial performance.

For example, there is no more important collaboration for enterprise success than that between a curator and the commercial enterprise employee tasked to create a new product based on an item from the collections. There are many good success stories of such collaboration in the Smithsonian. Yet the communication style of curators, scholars and educators differs markedly from that of merchandisers, financial planners and marketers, and in many cases, these differing styles have contributed to misunderstandings and resentments. The individualized jargon, pace and work style of these worlds can sometimes create unnecessary tensions. But these interactions should be as much a part of the fun and Smithsonian learning experience as collaboration between a biologist and an art historian. Senior leaders of all of these organizations should work together to find ways to improve the relationships between their staffs as a means of achieving the underlying goal of furthering the Smithsonian mission.

### Transparency

To the extent feasible, without impeding performance or compromising contractual obligations, the rationale for decision-making, the operational structure, and performance information about business activities should be clear and accessible to those internal Smithsonian stakeholders who need to understand it. (Later in the report, we recommend some processes and documents to organize this communication more efficiently.)

### Accountability

In an accountable culture, people desire and accept responsibility for performance of their roles, have control over the systems and other elements required for their accountable tasks, and have a clear understanding of the roles and responsibilities of others involved in common activities. Financial controls and governing policies are clear. The responsibility for key decisions, such as merchandising choices, pursuit of new business opportunities, and capital and facility investments should be clearly defined—for people inside and outside of the enterprises organization who can impact performance.

Metrics to measure performance should be associated with every enterprise activity, and be incorporated in every plan. Metrics should describe and measure mission furtherance as well as financial performance.

### *Judgment and Integrity*

People in leadership roles should demonstrate a “Smithsonian conscience,” that informs their decisions and actions. It is an amalgam of the taste, integrity, institutional knowledge and values that lie behind the name and reputation of the Institution. It is a characteristic that leads to confidence between two people working in different parts of the Institution. Successful commercial activities require frequent and quick decisions. While collaboration should inform major decisions, many smaller ones will have to be made without the benefit of additional consultation. In those instances, staff responsible for managing the day-to-day aspects of Smithsonian business activities will need to rely on their own judgment and integrity as the basis for their choices.

### *Alignment*

The revenue-generating activities should be aligned with the actions and interests of the Smithsonian as a whole—its museums, research facilities and commercial activities.

We hope for a day when all other parts of the Smithsonian view the enterprise organization as a competent, enthusiastic facilitator of their mission—and even eventually as a sought-after home to many of the small one-off commercial projects that populate the museums today.

These commercial enterprises are a service function to the Smithsonian, its “shareholder.” This is not to imply subservience, but a defined role as support to the Smithsonian mission. We believe more effective internal positioning of these commercial activities by the communications of Smithsonian leadership would emphasize this role as a supportive contributor, aligned with the goals of the rest of the Institution, and evaluated by how well they perform as a service to the Institution and its units. Later in the report, we have suggestions for how these enterprises can better develop and demonstrate a service mentality.

## ENTERPRISE-SPECIFIC CHANGES TO IMPROVE PERFORMANCE

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**Questions 2 of the Task Force mandate asks “Which business activities should be managed directly by the Smithsonian and which might be outsourced, if any?”**

The Task Force found the hardest question to answer was, “What is the real potential of the businesses that have composed SBV?” Performance of some important businesses has not met expectations, but what should realistic expectations be? Is significant growth possible, or should static, lower cost business models be adopted? If solid growth is a reasonable goal, what is the investment required? These are important questions to consider when asking whether certain activities should be managed by outside parties. In this section, we discuss a few points about each revenue generating business line separately. Since activities vary in purpose, size and operational structure, we have tried not to generalize across business lines but rather offer enterprise-specific suggestions.

We found good reasons for optimism about growth, particularly by seizing improvement opportunities for retail stores, and by finally making a serious effort to build comprehensive online and multi-platform retailing and publishing capability. The magazines and retail stores comprised 76% of the revenues, and nearly all of the net gain of SBV in FY 2007. (There are other profitable activities, but the net of all other activities is nearly zero). They also represent the most important growth (online publishing and retail) and performance improvement (retail stores) potential for the Smithsonian’s revenue-generating enterprises.

The Task Force did not engage in a thorough review of all the business lines of SBV. Our focus was on the business lines with the highest revenues, and those with the best potential for future growth.

### THE CHANGING EXTERNAL BUSINESS ENVIRONMENT

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A comprehensive description of the future opportunities of these enterprises is beyond our mandate. However, a few evolving aspects of the future competitive environment were important considerations for our strategic and structural recommendations:

- Web-based communication will continue to grow in relative importance, and will incorporate content-delivery from revenue-generating as well as mission-based activities. In order to make effective use of these technologies, relative to other mission-driven organizations, all parts of the Smithsonian must collaborate closely on a coordinated Smithsonian-wide on-line presence.
- Communication technology shifts are lowering the geographic barriers that have partially insulated the Smithsonian’s retail offerings from competing offerings of other museums. Via the web, many consumers now have easy access to the product offerings of many other museums. As a result, there are substantial

changes occurring in the nature and segmentation of the markets that SBV seeks to serve that will result in greatly increased competition.

- Advertisers will increasingly demand opportunities to place messages on several communications platforms simultaneously (for example, magazine plus web).

#### THE IMPORTANCE OF A STRONG ONLINE PRESENCE

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Online business is not a separate category or business line, but a customer communications path that should enhance each business line. Multi-platform placement of advertising is increasingly demanded by customers. It is a great opportunity for the retail stores, catalog, print magazines and magazine-associated websites to work together to enhance their offerings, especially with greater integration of content, merchandise, and underwriting/advertising. Online customers of many other organizations have come to expect easy movement between associated programmatic and revenue-generating sites—just as with the physical museum visit experience.

SBV's tentative start down the online road has been exceeded by several museum enterprise competitors. It is urgent that this be accelerated. Market share is rapidly being established in this new, largest-potential market for museum-based businesses, but the efforts of the Smithsonian, the nation's strongest museum brand, have been hampered by weak domain knowledge, low resource commitment, and lack of a Smithsonian-wide framework that describes the desired online relationships of museums, research centers, the central organization, and Smithsonian revenue-generating enterprises.

SBV's current web presence is mostly through the websites associated with its three publications (Smithsonian.com, AirSpaceMag.com, and goSmithsonian.com), Journeys, and the small retail website associated with the catalog. The potential for outreach and revenue generation via online offerings is not yet being exploited effectively. Nor are the SBV web activities and those of the rest of the Smithsonian constructively related to each other.

We do not underestimate the difficulty of the substantive and cultural challenges to creation of a pan-institutional web strategy for the Smithsonian, and recognize that new efforts are underway. Strong leadership from the Secretary and access to up-to-date domain expertise will be required to ensure this effort is conducted effectively. We see the development of this strategy as a great opportunity to enhance the Smithsonian mission, as well as to increase its financial support base. It will be a key near-term test of the Smithsonian's ability to build a needed capability through constructive collaboration between its substantive programs and its restructured and renewed revenue-generation organization.

## MAGAZINES

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The three magazines that SBV publishes reach a total audience of over 13 million people. They are the Smithsonian's largest source of business revenue, producing net gain of over \$11 million on total advertising and circulation revenue of over \$65 million in FY 2007. Each publication has also established a parallel online publication, and begun to offer multi-platform advertising. Increasingly, along with the rest of the world its business revenues will transition from print to electronic media.

The Task Force found no reason to consider outsourcing or other major changes to this activity, which though challenged by rapidly changing magazine industry dynamics is well run by its leadership team. They also have a clear, promising strategy for future growth.

### **Smithsonian Magazine**

With more than 2 million subscribers and over 7 million monthly readers, *Smithsonian* is a success story, recognized and respected inside and outside the Institution. Its newly invigorated presence on Smithsonian.com has grown recently, and also holds great potential for visibility and earnings through the web. The management team has adapted well to changing characteristics of its business. But we recognize the business vulnerability of the print magazine today, as costs escalate and reader's habits change—hence the urgency of our recommendation to invest in increased online capability, and to complete a comprehensive Smithsonian-wide Internet strategy as soon as possible.

As with the other SBV activities, connections to the programs of the Institution are weaker than most desire. *Smithsonian* magazine staff believes that the lack of any revenue sharing flow from magazines to museums inhibits museum staff motivation to work with the magazine on projects. Contention between Smithsonian-based scholars and commercial publication staff about what material constitutes appropriate content for association with the Smithsonian name, and whether the work of Smithsonian scholarship and programs should be highlighted more often in the magazine, are probably normal and permanent tensions. But more frequent interaction, especially when an article is about a core Smithsonian subject, and a few more joint projects as part of the generally more robust collaboration we are recommending for all enterprise activities would be welcomed.

### **goSmithsonian Visitor's Guide**

Over 3 million copies of *goSmithsonian* are distributed to visitors at the information desks at the Smithsonian museums and other facilities. It is also made available at more than 275 DC-area hotels, Congressional offices, other tourist locations and travel agencies nationwide. Its ability to lure visitors to Smithsonian venues, programs and websites is valuable. *goSmithsonian.com*, the online version of *goSmithsonian*, was launched in February, 2007, to provide end-to-end trip planning functionality for a global audience. However, the effort to create this publication, and its accompanying website, both of which replaced its precursor *MySmithsonian*, exposed a need for a better, more collaborative process to update content, and to gather all pertinent information from the Smithsonian's many components. Advertising sales are increasing for both print and online platforms.

### *Air and Space magazine*

Focused on flight, *Air and Space* serves a narrow category authoritatively. airSpacemag.com, the web version, was launched in 2007. With over 75% return visitors, it has an unusually sticky user base.

## RETAIL STORES

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Primarily located in museums, the Smithsonian's retail stores are an integral, even "crucial" part of the Smithsonian visit experience, according to the 2004 Smithsonian-wide Survey of Museum Visitors. They are also a vital source of funds for the Smithsonian mission. Retail operations (including the stores, theaters, food and beverage services, and kiosks) are the enterprise that contributes the most cash gain to Smithsonian programs and the trust—\$14.7 million net gain on \$58.7 million revenues in FY2007. The stores are a major contributor to that total with \$39.3 million in revenue and \$5.7 million in net gain in FY2007. Yet store revenue has remained essentially flat during the years since SBV began. Forecasts at the time of SBV's formation projected that revenues would nearly double in 5 years. The resulting low level of contribution to museum and Trust programs from these stores has been a large source of the disappointment with SBV as a whole.

Certainly visitor levels dropped post-9/11, and while two new museums opened (Udvar-Hazy and American Indian), a large one has closed temporarily (American History). But even in non-inflation adjusted dollars, revenue from stores in FY 2007 was only 5.6% higher than 7 years earlier at \$39.5 million.

Museum Directors and their staffs have been highly critical of the performance of the SBV retail stores located in their museums—both in terms of financial performance, and with the connections between the stores and the museum's scholarship. Most stores are not viewed as effective extensions of the visitor experience by museum directors. Most believe that a more differentiated merchandise selection tuned to their scholarship and visitor population would increase revenues and enhance the visitor experience. We agree this is likely. Largely left out of the thinking and decision-making on merchandising and stocking, and finding it difficult to analyze and understand the cost effectiveness of the SBV retail organization, most museum directors are convinced that they or an outside vendor could produce more income from their stores.

At the same time, many retail store employees feel isolated in the museums, not considered part of the museums by the museum leadership and staff. This separation is not likely to encourage good performance.

After our meetings with staff, stakeholders, and consultants gave us confidence that substantial improvement is possible, plus some understanding about the most promising elements of that improvement, we considered several **options** for how Smithsonian retail stores should be managed going forward:

1. Maintain the museum store operations under Smithsonian management, but make changes to improve performance, then periodically evaluate the results.
2. Contract with a third party to outsource the operations of all the stores, and reduce to a minimum the museum stores organization within the SI.
3. Dissolve the SBV stores structure, and return operation of the stores to their associated museums, with airport stores and the Castle's store managed centrally or outsourced.
4. Experiment with a mix of these options—e.g. outsource one or two large museum's stores, and keep the remainder under SI management

**We unanimously recommend the first option listed above—that retail stores should not be outsourced, but combined with related business lines in a new grouping under a new leadership position, provided access to good external advice, and encouraged to reinvigorate partnerships with museum staff.** The Task Force believes that improvement in financial performance similar to that offered by outsourcing proposers, and superior connection of the retail stores to the mission of the Smithsonian and its museums, with less accompanying risk, can be achieved. The opportunities to improve financial performance are clear and compelling. If they aren't achieved in a reasonable period of time, the other options will still exist.

The following evaluation of these four options describes our reasoning.

Option 1. Change aspects of retail merchandising to improve profitability of retail stores.

Prior to the formation of the Task Force, Smithsonian commissioned a study of its retail store operations by the Grayson Company (formerly Berglass-Grayson), a consulting firm specializing in retail stores. We have reviewed their work and met with them to discuss their conclusions and ideas. They also assisted a committee of Smithsonian staff, some of whom were members of the Task Force, to evaluate proposals received during an RFI process described below. While SBV Retail management disagrees with some of the Grayson report's descriptions of SBV retail performance, we agreed with the consultants' key recommendations to change and improve SBV's retail stores.

One weakness of the Grayson work, and of the Task Force's analysis, is the dearth of truly useful information about retail performance at comparable museums or other non-profit organizations. Grayson's comparables were mostly to commercial stores, some quite different in character from the Smithsonian's. We sought data for such metrics as revenue-per museum and store visitor, revenue per square foot, conversion rates of visitors to shoppers, price points, gross margin per purchase, revenue per purchase, contribution to overhead per square foot, merchandising metrics such as number of items and sales per item, and employee costs. But true comparables were difficult to find. The usefulness of museum industry surveys, for example, was largely limited to revenue-related and in-store salary statistics—not profits, overhead costs or merchandise performance. Upon examination, little of the information related to large metropolitan museums and the Smithsonian museums' particular visitor compositions. Much data is closely guarded by other institutions.

At the same time, the Smithsonian’s own internal statistics are deficient. Visitor statistics are considered unreliable. Income and cost numbers for individual museum businesses in the SBV financial statements have varied in calculation method over the years, only becoming consistent for year-to-year comparisons two years ago. Thus, even the all-important sales-per-visitor statistic is not yet a solid basis for precise comparison to others.

We did compare SBV retail stores to the several Smithsonian stores that are run by the Friends of the National Zoo, the Cooper-Hewitt, and the Freer-Sackler. When comparisons are made on a cash flow (EBITDA) basis, which excludes depreciation and other charges, the non-SBV stores performance is comparable to that achieved by that of SBV stores

We also received and reviewed data from several vendors who responded to the outsourcing Request For Information (“RFI”) process described later in this section. This also reinforced our impression that there are good achievable improvement opportunities, worth attacking now.

No metric has surfaced that upon examination showed unusual underperformance in relation to other museum stores. Rather, our recommendations reflect a belief that there is greater potential than realized so far. Five areas of improvement focus with high potential for better financial return are:

- Hire a leader for the restructured group of retail enterprises (see later section), with successful career experience that has emphasized merchandising;
- Improve merchandising—operations, product selection, skill levels of staff
- Improve sales training of store personnel;
- Improve the operating connections between museums and their stores, to assure that stores better reflect the ideas of the Director and the museum staff; and
- Change the formulas for revenue sharing between the museums and the central Smithsonian, to better align incentives and improve transparency.

### *Improve Merchandising*

One common consideration in the evaluation of each option is how best to improve the merchandising functions of the stores—the most compelling improvement opportunity identified by the retail consultants and other observers. We agree with the conclusion of the retail stores consultants—that the retail stores organization is short on merchandising knowledge and experience, while over-weighted with buying positions and managers whose strengths are in operations and buying.

We believe hiring an outstanding retail executive for the new position we recommend be established in a later section, who has both the merchandising strengths to lead the grouped retail enterprises, and the diplomatic skills to engage the museum curators and leadership effectively and enthusiastically, is important for success. An impresario whose performance record demonstrates great taste, sophistication, scientific and cultural interest, and the imagination and market knowledge needed to select the most appropriate new products for sale.

Better merchandising at the Smithsonian's retail stores would:

- Align more of the merchandise selection to the individual character of each museum—its taste, quality, visitor demographics and mission. (Ironically in light of complaints, the data shows that merchandise most closely related to the mission performs well at the Smithsonian, and at other museums nationwide.)
- Upgrade the merchandising metrics used to manage and communicate about retail performance, so all stakeholders can easily evaluate store performance.
- Improve inventory planning and control, and better integrate it with buying activities.
- Enable more effective working relationships between museum programs and retail sales.

If collaborative leadership styles characterize the head of retail and other senior positions, there should be no need for a defined process to bring the museum's voice into merchandise selection. But it is a good idea anyway. We recommend that the museum director or his/her designee be consulted about any merchandise to be sold in a museum store, and be given a veto over any item. We do not suggest that he/she select or decide merchandise for sale, but we do recommend that the new "Curator's Choice" idea be continued, so that each museum director has several feet of dedicated shelf space to assure that each has some representation of its research and exhibitions easily accessible to visitors.

Further, we recommend that if a museum director requests it, the store manager, or merchandise manager dedicated to the museum if there is one, dual-report, dotted line to the museum director, solid line to the retail leadership. While we do not recommend the museum director share direct supervision of the store manager, the most important consequence of the dotted line would be for the manager's performance evaluation criteria to include metrics important to the director that represents the store's service to the museum, that the museum director uses to evaluate performance as part of the manager's annual variable compensation and performance review.

We suggest that a small informal group of two or three experienced merchandisers, a "Retail Advisory Committee" could be of great benefit to the retail stores leadership as these changes are made, for assured access to knowledge of the best practices in all relevant areas.

We do not minimize the challenges that will face the team in the retail group and its parent organization. Significant changes in attitude on all sides will be essential. Contention and distrust must be replaced with cooperation, mutual understanding, respect, and openness. All of the problem areas must be addressed if the situation is to be turned around and store operations are to achieve the organizational benefits previously forecasted. Fixing only one or a few of these is not likely to produce the kind of improvement that the museum stores are capable of achieving in a relatively short period of time.

As discussed later in the report, a new revenue sharing arrangement that improves transparency and the alignment of motivations, so all participants pull in the same direction, will help the relationship.

## Option 2. Contract with a third party to outsource the operations of the stores.

The Smithsonian issued a Request for Information (RFI) in August 2007 to obtain information from vendors interested in operating the SBV retail stores. The objectives of the RFI process were to:

- Determine if there are any companies with technical prowess and financial scalability to take over full operation of SBV retail stores;
- Determine if these technically-able companies would provide better financial return to the Institution than SBV; and
- Provide this information and a recommendation to the SBV Task Force.

Seven companies submitted responses, and eight indicated they would respond to an RFP if one were issued in the future, and a ninth provided critiques based on its observations.

A multi-tiered process was used to evaluate the technical competence and financial characteristics of the submissions: the nine-member evaluation committee, made up of Smithsonian staff representing the central financial units as well as the museums and which included three members of the Task Force, reviewed and analyzed all material and developed its findings; the retail consultant (The Grayson Company) conducted an independent review; and informal input was provided by Ron Ruskin (retail expert on the SBV Board) and John Nolan (SBV Task Force member). Their findings and recommendations were unanimous.

The following minimum performance capabilities were considered essential for any company to receive consideration:

- A proven track record managing strong brand or mission-related businesses.
- The capability to design, develop, source and deliver mission-related and brand-consistent, quality product across multiple categories.
- Proven track record operating multiple retail outlets in stores that are similar to the Smithsonian's (museums, free standing stores, kiosks and at airports).
- Staff, structure, infrastructure and financial scalability to absorb all Smithsonian retail stores.

The information in the proposals, the report from the evaluation committee, and the report from the Grayson Company combined with the discussions noted above leads the Task Force to conclude that:

- There appear to be companies who are capable of taking on and running all of the Smithsonian retail operations at the museums and airports. There are certainly companies managing retail operations for other museums and cultural centers where the issue of a strong brand and mission relevance has been addressed.
- Excluding one of the respondents who appeared unlikely to be capable of taking on the challenge, the average revenue increase proposed by the other six firms in the first year of operation was approximately 20%.

- However only one respondent committed to a minimum guarantee payment, and not all respondents met the RFI's requirement for annual capital improvements of \$2.1 million. (One company proposed to make a \$16.5 million capital investment in the stores).
- Only two to four of the companies met all or most of the technical criteria (non-financial requirements related to merchandising and operations).
- For most of the respondents, acquisition of all of the Smithsonian retail operations would result in a very large increase in company size and/or scope. Of the firms that clearly had the capability to operate all of the stores, they did not offer financial returns significantly above what SBV is now earning. More ambitious returns were predicted by firms whose technical capability was considered not as strong. When analyzed closely, the RFI evaluation committee and the consultant concluded that none of the companies deemed most capable of taking on the large Smithsonian retail operation offered the Smithsonian the prospect of an increase in net profit that would justify a shift to outsource the retail operations.
- A pilot program that works with the existing SBV staff and infrastructure of one store to develop and demonstrate merchandising improvements is a promising suggestion of the retail consultants. They have offered to manage such a store themselves, as a consulting engagement. We recommend SBV leadership seriously consider this or a similar proposal as a way to get started with needed changes.

There are some solid reasons to consider outsourcing the management of the stores:

- The ability to hire retail leadership and to upgrade merchandising skills with required competitive compensation would be relieved of the uncertainties and limitations of the Smithsonian's policies.
- New parties could stimulate innovative approaches—including to the integration of commercial and mission goals—and a “fresh start” could lead to more positive interactions between museums and retail operators.
- Financial return to Smithsonian could potentially increase, especially if a minimum annual guarantee is mandated.
- Some Smithsonian capital could be freed up if the vendor assumes responsibility for store improvements and refurbishment.
- Significant amount of the day-to-day issues that burden the central Smithsonian's leadership and staff functions would be transferred to the outsourcer.
- Potentially customer service could improve.

However, the Task Force found the reasons not to outsource at this time more compelling, and agrees with the unanimous findings of the RFI evaluation committee that reviewed the proposals and the independent findings of the consultants. None of the proposers met all the technical and financial objectives with a high enough degree of certainty to outsource such an important element of the Smithsonian's support and mission. The reasons not to outsource include:

- The complexity and diversity of SI retail store assortments would challenge the capabilities of most potential outsource candidates.

- Loss of direct control over mission appropriateness or merchandise and marketing creates a risk.
- Even if processes and approvals were put in place, complex adjustments to financial incentives would also have to be added for the vendor. It would be more difficult to resolve the disagreements about the taste levels and mission-appropriateness of some products than it is now. In fact, external management could exacerbate the issues.
- Failure to achieve proposed revenue levels could occur because of contractor underestimation of challenges in dealing with museum staffs
- In excess of \$2 million in severance costs likely would be incurred by Smithsonian due to termination of store and other SBV personnel.
- Additional resources would be needed to administer and monitor retail store outsourcing.
- Addition of the outsource firm's own management structure to the communications path could add another layer of complexity to issues regarding retail issues.
- A portion of museum store profits would be retained for the vendor to meet its for-profit business goals
- If outsourcing fails to deliver an increased cash contribution to the museums and Trust, the cost and difficulty to recreate the in-house retail stores structure would be significant
- Outsourcing experts advised us that it is a good practice to make sure an operation is working as well as it can within an organization before deciding to outsource it. This improves the terms of a future relationship, and avoids giving the contractor the long term benefit of what appear to be obvious opportunities to greatly improve store performance in the near term.

Option 3. Dissolve the SBV stores structure, and return operation of the stores to their associated museums.

This option completely links the museum stores to the museums, with full accountability for performance resting on the museum director. We do not recommend this option because:

- We believe that real improvement in the financial performance of the retail stores requires large aggregation of sales activity to attract the quality of retail management needed—whether hired or outsourced.
- We believe that other mechanisms to restore the desired sense of “ownership” of the stores by the museums can be effective. Retail management should welcome the advice of those museum directors who are interested in participating actively in the operations of the stores in their facilities.
- We do not believe such stores would improve performance, because of the extra management time required at the museums, and the different levels of interest and expertise in retail on the part of individual museum executives.
- It would be more difficult to maintain good financial control, Smithsonian oversight, or realize the online platform opportunity for growth.

#### Option 4. Experiment with a mix of these options, e.g., by outsourcing one museum store.

Partial outsourcing may seem an attractive experiment. But the costs to dilute the approach to improving the performance of the stores would be high. Reducing the job's scale would make it more difficult to hire or retain the desired management talent for all levels of SBV and its retail component. If performance does improve significantly, the financial benefits would not reach the outsourced museum or the Trust. If it does not, the ability to seek the best overall outsourcing partner would be compromised.

## LICENSING

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The SBV Licensing Group has endeavored to, “manage and monetize the Smithsonian brand and content assets in businesses where we partner with third parties to sell Smithsonian branded products and services.” Our review suggested that these brand extension decisions routinely require the most careful application of Smithsonian judgment, and that additional emphasis should be placed on ensuring that these activities align with the Smithsonian’s mission and values. The “Strategic Advisory Committee” we recommend later in the report is one such step. We also recommend the licensing group design and use a clear mission statement that adds an emphasis on mission alignment to the statement of monetization goals, to help counter still-lingering impressions from the past that Smithsonian and SBV leadership is too-narrowly focused on its financial goals.

The royalties from licensed products, Smithsonian Networks, Smithsonian Books, and Smithsonian Student Travel were equal to 10% of SBV net gain in 2007. It is an important activity, with the potential for good future growth. It is also the source of many of the issues that have occupied SBV and Smithsonian leadership, and strained relations between SBV and other parts of the Smithsonian. While this activity has been effective as a business operation, it has sometimes exemplified the disconnection-from-the-broader-Smithsonian syndrome of SBV. The nature of licensing and its strategy is poorly understood by the broad base of Smithsonian employees. That information vacuum exacerbates concerns about whether appropriate uses are being made of the Smithsonian name. We were glad to see that “Improve collaboration and coordination between SBV, S.I. and licensees” has become a key strategic goal of the Licensing Group for this year.

When a museum’s collection is used to create specific licensee products, proceeds from licenses are shared with the relevant museum—70% of net gain to the museum, 30% to the central Smithsonian. Revenue from other licenses is all distributed to the central Smithsonian. In FY 2007, the amount of gain contributed to museums from licenses doubled from the prior year.

In the past, the reviews and processes in place as approval of licenses moved through the museums, SBV, the Deputy Secretary, and in some cases the Secretary, were not sufficiently robust to give the broader Smithsonian community the confidence that wise decisions about the use of the Smithsonian name were being made. (The SBV board was not tasked to review licenses). Nor were they rigorous enough to prevent a few arrangements that grated in the culture, or that have surfaced publicly after signing as surprises that needed

explanation in the resultant emotional and skeptical atmosphere. Later in this report, we recommend formation of a process and an informal “Strategic Advisory Committee” of respected Smithsonian staff members to vet uses of the Smithsonian name by SBV and other units. Some licenses need to remain confidential until the product appears, but the broad Smithsonian community needs to have the confidence that such decisions are being made comprehensively.

As we discuss later, we recommend the Smithsonian collaboratively re-calibrate the Institution’s policy for use of the Smithsonian name. We also recommend that the performance reviews of executives involved in licensing include components that evaluate how well, or not, the individual’s performance has enhanced the Smithsonian name, and how well it has exhibited the desirable operating characteristics for revenue-generating activity that were described at the beginning of this report.

### Product Development and Licensing

The fifty current licensees produce a wide variety of products, all claiming derivation or at least inspiration from Smithsonian collections and activities. Five of the licenses account for 75% of revenues. The oldest license, for jewelry, dates to the 1950’s.

Museum collections are researched for product ideas with the approval and involvement of the curator in an extensive process. However, this information does not always reach people within the museum, even museum directors, who feel they need such knowledge. Reliance on informal communications paths has led to surprises, misunderstandings, and in some cases regrets that a particular product has been licensed. Moreover, once a license begins the negotiation phase, the process is very different, and while curators may review mockups of products for accuracy, they may not be involved with discussions about marketing.

A written process to assure follow-through after a license is granted, to make sure the actual manufactured product meets Smithsonian expectations of “authority, authenticity and quality” also should be designed and described to the curatorial community.

We also observed that in some cases curators with ideas for commercial products based on their collection make one-time arrangements on their own, rather than involve SBV. They believe their cash proceeds will be higher without the weight of the SBV cost structure or feel their ideas are not taken seriously by SBV. It will be one of the best measures of future progress if trust evolves to the point that increasing numbers of new product ideas are brought to the licensing group by curators.

### Smithsonian Books

In 2005, after several years of financial losses, the Institution made the decision to close Smithsonian Institution Press and divide the publishing operations into two separate entities: Smithsonian Scholarly Press for academic publications and Smithsonian Books for trade publications. Smithsonian Books, managed by SBV, established a licensing arrangement with HarperCollins for the development, publication and worldwide distribution of co-branded books to bear the Smithsonian name. The agreement contains three components: (1) The Smithsonian licensed to HarperCollins the use of the Smithsonian Brand in conjunction with

a new book publishing initiative expected publish 100 titles in the first year (this target was met) and mutually agreed upon numbers of titles in subsequent years; (2) HarperCollins launched a Smithsonian-HarperCollins imprint to originate, develop, publish and sell approximately 25 new titles per year targeting the general adult trade market. (Smithsonian Authors who desire to publish a trade book using the Smithsonian trademark are required to present the concept or manuscript first to Smithsonian Books however there is no requirement that Smithsonian Authors publish here if the trademark is not to be used); and (3) HarperCollins would sell and distribute the commercially viable units in the backlist of titles remaining from Smithsonian Press.

The Task Force found general satisfaction with current arrangements, so did not spend a great deal of time reviewing the operations of Smithsonian Books. We did hear some concerns the about the reputational quality of some offerings, and some worry about how effectively the company works with Smithsonian staff on publishing projects. Currently, a committee of three SBV staff approves titles. Although HarperCollins is not required to publish Smithsonian material in the way that Smithsonian Networks is obligated to produce “mission critical” programs, a coordinated effort to encourage more Smithsonian authors to participate in the review of non-Smithsonian offerings should help to further the mission and increase the revenues generated by this enterprise.

### Smithsonian Networks

The process by which the Smithsonian entered into an agreement with Showtime Networks Inc., a division of CBS, to form Smithsonian Networks has been well-documented by now, by the Government Accountability Office (GAO) and others. It was a very confidential process that involved SBV, the Secretary, the Regents, the Deputy Secretary, and some Central Smithsonian staff functions extensively but few others. Had this agreement been better explained and justified to the internal and external stakeholders prior to and just after its announcement, the ensuing months of conflict and overstated concerns may not have transpired. In recent months, it appears that internal and external fears about access to collections have dissipated, and development and implementation of the processes noted below have addressed operational concerns.

Lessons were learned from that experience. We assume that any effort to form a major partnership with an outside organization that greatly expands the scope of such a revenue generating activity will now be conducted with as much transparency, fairness and collaboration as the business and contract negotiation process will allow.

The project is still in its early stages, operated by only two full time equivalent employees of SBV. Financial success is still not guaranteed, though the Task Force believes that the potential for the furtherance of the Smithsonian mission via television and other digital media is in place. The early revenues generated by this venture are providing some funds to cash-strapped programmatic units. A key factor for whether future financial contributions grow will be whether Networks programming obtains additional carriage on cable and satellite platforms.

Importantly, the internal processes developed to generate Smithsonian “mission critical” program ideas, review and approve the accuracy and reputational quality of all programming

(via the pan-Institutional Smithsonian Networks Review Committee), and streamline and monitor the access of Smithsonian Networks and third-party filmmakers to the collections and staff of the Institution seems to have been working. These processes have created a venue for collaboration, and sometimes healthy disagreement, about the content and operation of these activities. This dialog is essential to ensuring that the Smithsonian's commitment to the public is well-served by this endeavor. The Task Force believes this type of operational structure could serve as a model for other enterprises currently in existence or contemplated in the future.

### Smithsonian Student Travel

This is a licensed activity launched in 2006, targeted to middle and high school students. It produces only a small amount of net gain, and is operated at very low cost (one full time equivalent SBV employee). This relatively new license is a very visible promulgation of the Smithsonian name, spread over many types of affordable tours. The process developed to facilitate communication between SBV staff and Smithsonian educators (to ensure the alignment of these tours with the Smithsonian mission) seems promising. The Task Force is aware that some outside organizations have expressed concerns about how this licensing agreement was arranged. These comments can be considered when negotiating future licensing agreements. Later in the report we recommend establishment of an internal "Strategic Advisory Committee" to vet co-branding and other issues.

### Smithsonian Catalog

The catalog produced only \$863,000 in net contribution to overhead and \$101,000 in net profit on increasing revenues totaling \$29.3 million in FY 2007. (Though it also sold 19,500 memberships for *Smithsonian* magazine, whose members receive a 10% discount on catalog purchases.) It has been underperforming for the past two years, operating just above or below breakeven, and its cost structure has suffered from continuing increases in paper, postage and production costs. Competition from Internet-based companies and the catalogs and websites of other museums has increased. The aging customer demographic of Smithsonian catalog customers limits its future potential, in its current state. For the first time in 2007, internet media generated measurable revenues. Prior to that, the internet had not been a vehicle for catalog sales.

Many Smithsonian observers have expressed concern that some items for sale in the catalog are not up to the standards that should be associated with the Smithsonian name. We recommend that careful consideration be given to shifting the strategy of the catalog to part of a coordinated multi-channel retailing strategy that includes stores, online sales, and the catalog. For many other retailing organizations, the efforts of all three are synergistic. While there are few synergies today among the customer bases and products of the different platforms, that should not be true in the future.

Currently, the retail stores operation of SBV is located in the "retail" group while the catalog operation and SmithsonianStore.com is in the "member services" organization. As described later in this report, we recommend they all be grouped in a more comprehensive, restructured retail organization, under a single manager, to easily share products, merchandising processes and the online platform. An early task of the combined retail

leadership should be a review of the philosophy of the catalog and internet sales offerings to determine whether significant changes need to take place to assure consonance with the Smithsonian name.

### Theaters and Concessions

Located in Natural History, Air & Space, the Air & Space Planetarium, and Udvar-Hazy, the theaters generated a net contribution of approximately \$3.9 million on over \$11 million revenue in 2007 - - a 35% operating profit margin. Revenue from admissions has been relatively stable over the past several years. Due to the problems with the accuracy and year-to-year consistency of the attendance figures for each of the museums, no accurate analysis of conversion rates of visitors to theater goers can be completed. Action has been taken recently to rejuvenate the theaters and revenue by replacing underperforming films, introducing new programs and making use of theaters after hours for films (Hazy).

In 2007 concessions (ATM's, simulators, imaging, etc.) generated a net contribution of almost \$1 million.

While the Task Force admittedly spent little time analyzing theater and concession operations due to the other, larger issues we were asked to address, the information reviewed does not reveal a significant reason to outsource the operations of these activities.

### Smithsonian Journeys

Smithsonian Journeys are educational tours offered since 1970. For many years, they were managed by The Smithsonian Associates as a benefit of Smithsonian membership. We believe that the performance of Journeys has benefited from inclusion in SBV since 2005. SBV management believes Journeys can become marginally profitable, and its essentially breakeven performance is stable. But it does not contribute material net gain.

Some tours are led by Smithsonian staff. It is important that the choices of tour and operator are consistent with the attributes of the Smithsonian name, and we encourage more curator involvement as trip leaders and guides. SBV contracts with 30 tour operators who pay a commission on their revenue. We found no reasons to discuss additional outsourcing or other changes to this activity.

### Food Service

Outsourcing has worked in the case of food services, which are operated in the museums and Castle under contracts with Restaurant Associates and McDonald's. They are considered a necessary visitor service rather than a major profit opportunity. We heard some complaints about the lack of alignment between the service offered and the missions of the host museums, but these comments varied depending on venue, and at least one venue, the Mitsitam Café at NMAI, received praise. If there are outstanding issues about quality or reputational impact of food concessions, we urge SBV to review these issues with the vendors, in a conversation that includes the museums.

## REVENUE SHARING

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**Question 3 of the Task Force mandate asks “What type of models for sharing business revenue with the units would promote and reward unit involvement in these activities?”**

Revenue sharing is the process by which profits from revenue generating, SBV-managed business operations are shared in the Institution. Given the importance of this unrestricted revenue to the museums and to the Smithsonian overall, it is imperative that the manner in which these funds are shared is transparent, fair, and understandable. By all accounts, the current system for sharing revenue generated by museum-based businesses (e.g., stores, theaters, restaurants, and simulators) meets none of these standards. The Task Force recommends that the current patchwork of revenue sharing formulas that currently cover these businesses be replaced with a standardized approach that encourages cooperation and minimizes conflicts between the museums and the staff who operate their stores. Revenue sharing formulas for other activities, such as licensing and Smithsonian Networks, should remain the same for now but should perhaps be evaluated more closely in the future.

### **Concerns About Revenue Sharing**

During its review, the Task Force heard numerous complaints about revenue sharing. The complaints reflected a high degree of dissatisfaction with the amounts of income the museums are receiving from museum-based businesses. Although revenue sharing formulas are not set by SBV, the museums frustration about them is often directed at SBV, a situation that undermines the teamwork needed for a successful business partnership between the museum and the staff that operates its store. Moreover, the Task Force found the complexity and diversity of the existing of agreements —of which there are dozens as reflected in Appendix VI—to be bewildering. Some museum directors did not fully understand the formulas in use for their museums, and almost none were fully aware of the range of agreements in place across the Institution.

Revenue sharing is an emotional issue. The successful efforts to bring the Central Trust budget back into balance after 9/11 resulted in much of the Central Trust financial support for Mall museums being eliminated. As a consequence, Mall museums have become increasingly reliant on their museum retail revenue shares to sustain essential museum functions, such as, Director’s pay, fundraising, board support and program support. These areas are all under-funded and every nickel of museum revenue share can be put to excellent use.

By the same token, the portion of business profits retained by the Institution is also used for critical requirements, but those uses are not well-known or explained. The revenues allocated to the central trust are used to cover:

- losses that are incurred by businesses in smaller museums and the revenue shares paid to those museums;

- a share of the operating costs of programs that have not had strong Federal support, such as the Affiliations program and the Cooper-Hewitt Museum;
- a share of the cost of outreach programs, such as, Smithsonian Institution Traveling Exhibition Service and the Center for Folklife and Cultural Heritage;
- a share of central administration's salary costs for the Office of Human Resources, Office of Comptroller, Office of Contracting, Office of Planning Management and Budget, and the Office of the Chief Information Officer;
- a share of central development costs;
- and a share of the Secretary and Under Secretaries' salary and support costs.

Revenue sharing models currently in use redistribute income from revenue generating activities that require significant museum participation, such as stores, restaurants and theaters; product development and licensing (including publishing income,) Smithsonian Networks and Smithsonian Student Travel. Income from Smithsonian magazines, Smithsonian Journeys and the Smithsonian Catalogue has not been shared because there is little museum involvement in these activities. The product development and licensing revenue share formula provides 70% of any gains to the museum and 30% to the central trust. This model appears to be appropriately weighted toward the museum whose work and/or collection items are being licensed.). The Student Travel and Smithsonian Channel revenue sharing models are relatively new and while initially promising, more time should pass before an evaluation should be undertaken. The Task Force concentrated its review on the museum-based retail businesses (stores, theaters, concessions) and discusses a new proposal for this formula below.

As discussed elsewhere in this report, the Task Force believes that there are significant untapped revenue opportunities available through better use of the web. The Institution should develop fair and inclusive revenue sharing models early in the evolution of the web businesses to encourage the kind of teamwork and cooperation that will be necessary for the entire Institution to realize their potential value.

### **The Patchwork of Museum Retail Revenue Sharing Models Should Be Replaced With One Standard Formula**

The revenue sharing models for museum retail operations are many and varied. Up until the late 1990's, shares were generally computed as a percent of net revenues. For stores, the usual percentage was 5% and for third party operated restaurants, the usual percentage was 10% of the commission amount. Air and Space, American History, African Art, Postal and Hirshhorn stores currently receive 5% of the net revenue in their stores (i.e., they share at "gross"). In the late 90's, the revenue sharing model preference changed to a gain-sharing model. Under this bottom-line approach, business expenses are deducted before the share of gain is calculated. Generally, a 50/50 sharing model was employed. Variations of this model are used for Natural History, American Indian, and for the restaurant and theaters at Air and Space (i.e., they share at "net"). A table reflecting all of the revenue sharing models currently in use for these activities is included in the appendix to this document.

Most recently, at SBV's urging, the Institution switched back to a "gross" line or revenue-based model. The intent was to optimize teamwork by offering a tiered revenue sharing

model under which the museum's share percentage increases as revenue thresholds are passed. Each formula was to be negotiated between SBV and the museum. This approach is being used at the Donald W. Reynolds Center (DWRC), but has not been successful because the DWRC businesses have not been profitable.

The Task Force believes that the current patchwork of revenue sharing models for museum-based businesses in the Smithsonian is overly complex, confusing and difficult to administer. The various formulas or models are an accident of history. Each was thought to be the best model at a particular time, but there is no overarching logic to the models. As a result, there is little justification for differences in models from business to business or museum to museum. This makes communication on the subject difficult and common understanding and transparency impossible. The Task Force recommends that the Institution develop a revenue sharing model with a consistent logic that can be easily understood across the Institution; and substitute that model for the current collage of revenue sharing models. An effective revenue sharing model would align the interests of museums, the central staff, and the enterprises.

For simplicity, there should not be different formulas for different museum-based businesses (e.g., stores, theaters, restaurants, simulators, etc.). Rather, one model can be used to distribute the income from all businesses currently referred to as museum retail. Rationalizing and simplifying revenue sharing is essential to eliminating the mystery and misinformation that currently surrounds revenue sharing at the Smithsonian.

### **Revenue Sharing Options**

The Task Force considered the following sharing models:

1. Allocation Models
  - Distribute all income through an allocation process;
  - Cover debts, institutional requirements and distribute remainder based on revenue contribution;
2. Revenue "Gross" Models
  - Percent of revenue;
  - Percent of revenue that increases as revenue increases;
  - Hybrid wherein museums with debts, receive percent of net gain after debt service and everyone else receives percent of revenue;
3. Net Gain "Bottom Line" Models
  - Percent of net gain;
  - Percent of net gain with incentives for increased net gains;

#### *Allocation Models*

The models in number 1 above are simple, but funding Institutional needs first signals that "Center" needs are more important than museum needs. It also obscures the connection between the results in the store and what the associated museum receives. The Task Force believes these models are workable but will not reduce the controversy surrounding revenue sharing and will not properly incentivize teamwork to improve the businesses.

### Gross and Net Gain Models: Overview

The Task Force focused on various percent of revenue and percent of net gain models as listed in number 2 and 3 above. A sharing formula can be calculated either at the “top” (revenue line) or the “bottom” (net gain line). If calculated on revenue, it is, in many respects, similar to a lease payment for the space occupied by the businesses. This is an attractive approach to those who believe the museums have no control over the businesses’ costs. If calculated on gain, all costs of doing business are deducted before sharing occurs. This focuses the attention of the stakeholders on all aspects of the business both revenue and cost. The Institution’s future revenue sharing model should recognize and reward participation in and support of the Institution’s various businesses. The Task Force believes that in both revenue and gain sharing formulas, tiered models are better than flat percentage models because tiered models reward the museums for business growth.

### Gross Models

Percent of gross models are attractive because they focus museum attention on increasing visitor purchases. This is where museum staff can have their greatest effect. SBV has preferred this approach because they believe they currently spend too much time defending SBV costs, and because they believe this is used commonly when a third party “leases” space to operate a business in venues such as museums, tourist attractions, airports and shopping malls. However many museums currently operating under gross models continue to question costs, attempt to shift some costs such as maintenance and remodeling costs to stores, and disagreements persist. In addition without an incentive to take into consideration the profitability of a retail operation, museum directors have in some instances pushed space-usage or merchandise decisions that may increase revenue, but have adversely impacted the profitability of the retail enterprises in their buildings. Therefore the Task Force believes that gross formulas are not likely to encourage the kind of partnership between the museums and the retail staff that is needed to significantly improve the performance of the stores.

### Net Gain Models

Net gain models take all aspects of the business into account before shares are distributed. Several SI businesses were overbuilt for their level of business and will struggle for the foreseeable future to make a profit because of large depreciation costs associated with the build-out. This may be acceptable because the store is an extension of the visitor experience. However, the financial consequences and incentives should be clear so that the proper tradeoffs can be made between the visitor experience, beauty of the store and the financial implications of the decisions made. If museums receive income even when the store is unprofitable, the financial incentives are unlikely to be properly considered by all parties to the decisions pertaining to operating concept and construction.

As stated previously, net gain models deduct all expenses before gain shares are calculated. In the case of SBV stores, the major categories of expenses that have been deducted are: cost of goods sold, salaries and benefits of store workers, depreciation, divisional shared services, corporate shared services, and the SI administration fee. Cost of goods and salaries and benefits are the direct operating costs of the business in question. Depreciation is the

capital cost of the business spread over its useful life. Divisional shared services in the retail division are retail-related indirect costs such as merchandising, distribution, the salary of the head of retail, etc. These costs have been allocated to all retail businesses based on formulas that reflect benefit gained. Corporate shared services are indirect costs that benefit all SBV businesses. They include HR, accounting, IT, etc. These costs have been allocated using a variety of formulas intended to reflect the benefits received. For instance, the cost of SBV's HR function is spread based on number of Full Time Equivalents and the cost of SBV IT support is spread based on number of network connections. The SI administration fee is discussed more fully later in the report, and the Task Force recommends that it be eliminated from the revenue share calculation.

It is important to note that, contrary to rumor, the costs of the SBV CEO and CFO are not included in the SBV shared services. They are deducted after museum shares are calculated and only reduce the amount available to the central trust budget. It is also noteworthy that none of the salaries in shared services exceed \$200,000. The Grayson Company did comment that the allocated costs seemed high, but this was due more to total head count and not high salaries. In fact, the Grayson Company commented that retail management salaries were below industry levels.

### **Recommendation**

The model most likely to increase performance of the retail stores is one that encourages cooperation between museum and retail staff and focuses them both on the costs of operating this business. Therefore, after considerable discussion and debate, the Task Force recommends the Institution adopt a net gain formula with an incentive for improving performance. To minimize confusion and increase transparency, it should be standardized across all museums. In addition, the 12% administrative fee should not be charged against these revenues, no waivers should be granted for payment of overhead costs and the formula should be independent of the payment of museum debt obligations where possible.

The model most favored by the Task Force would share net gains on a 50/50 basis, but also include a business improvement incentive. When the current year net gain exceeds the rolling average of the prior three years by more than 5%; the museums would receive 75% of the increment above 5% of a prior three year average gain. This model reflects the Task Force's belief that museum actions were more likely to improve business results than actions taken by the "Center" (other than SBV) and should be rewarded with a greater share of the benefit of improved business performance. SBV does not need to be incentivized by revenue sharing because the bonus portion of their compensation system is based on the performance of the businesses.

One of the reasons the Task Force was drawn to a gain sharing model, as opposed to a gross model, was the desire for museums to receive a greater share of improved museum-based enterprise performance going forward. For example, the recommended gain sharing model allows NASM to receive \$698,323 for the budgeted improvement in net gain for the NASM businesses. If NASM was on a gross formula, such as 5% of the first \$3 million of revenue and an additional 1.5% for each succeeding increment of \$1 million of revenue, they would only receive \$220,946 for the improved performance.

Because the sizes of the businesses are so disparate, the Task Force could not find a standard model that shared at “gross” which adequately rewarded museums for improved performance. Any attempt to do so would require tailoring the model to individual museums and/or businesses. This would preclude the chance to simplify and clarify the sharing formulas, and forego all the advantages of improved understandings and communication.

In order to incentivize improvement in the retail operations that are not currently profitable, and to offer them a chance for a revenue share, the Task Force recommends that an approach similar to the 75% bonus be applied to improvement in these losing businesses. For instance, the museums could receive a payment equivalent to 75% of the amount that the current year loss is below the average of the prior three years’ loss. For example, the Postal Museum has lost an average of \$43,284 over the last two years (FY 2005 data is not available). Should the Postal Museum achieve a net gain of \$20,000 in FY 2008, they would receive a revenue share of \$47,643 in FY 2008. This share is 75% of the improvement from a negative \$43,284 to a positive \$20,000.

The following table uses SBV’s FY 2008 budget and the actuals for the last three years to model this approach:

<b>SBV Task Force-Proposed FY 2008 Revenue Shares</b>					
	Budgeted Rev Share Based on Current Formulas	Task Force Proposed Revenue Share			Change from Current Formulas
		Museum Share of Net Gain (50%)	Plus, Incentive Payment (75%) of Increment	Total Proposed FY 2008 Rev Share	
NMNH <sup>1/</sup>	2,096,741	1,829,332	448,146	2,277,479	180,738
NASM-Mall <sup>1/</sup>	3,403,329	3,813,155	698,323	4,511,478	1,108,149
NASM-Hazy <sup>1/2/</sup>	579,152	579,152	0	579,152	0
NMAI <sup>3/</sup>	459,220	305,513	0	305,513	(153,708)
NMAH <sup>4/</sup>	71,262	303,726	0	303,726	232,464
HMSG	38,921	10,557	2,774	13,331	(25,590)
DWRC	192,080	0	186,838	186,838	(5,242)
Renwick	18,780	0	6,461	6,461	(12,319)
Castle	33,368	45,110	0	45,110	11,742
NPM	19,385	0	21,849	21,849	2,464
NMAfA	32,803	0	25,480	25,480	(7,323)
<b>TOTAL</b>	<b>6,945,041</b>	<b>6,886,544</b>	<b>1,389,872</b>	<b>8,276,416</b>	<b>1,331,375</b>
Central Trust	8,036,245	8,094,741	(1,389,872)	6,704,869	(1,331,375)

<sup>1/</sup> For the purpose of this analysis, NMNH and NASM rev share amounts represent full amount earned, prior to repaying Westcourt debt and Hazy advance.

<sup>2/</sup> For the purpose of this analysis, NASM-Hazy budgeted rev share has been adjusted to reflect the portion of Hazy advance paid by the Museum.

<sup>3/</sup> Reduction in NMAI gain share between the budgeted and revised is the result of switching the Heye Center from revenue-based to gain-based calculation, and offsetting the projected Heye Center loss of \$162,000 against other Musuem net gain before calculating revenue share.

<sup>4/</sup> NMAH does not qualify for an incentive payment because it was not open in the prior year. It will qualify for incentive payments starting in Year 2, based on the preceeding year's net gain (like Reynolds Center), in Year 3 based on the two preceding years' net gains, and in Year 4 based on the 3-year net gain average.

### The Impact of the New Formula on Returns: Examples

The following examples are provided to illustrate application of the Task Force's proposal.

Revenue sharing today at the National Air and Space Museum NASM Main Store is 5 percent of revenue. In FY 2008, the Museum is budgeted to earn \$315,734 in revenue shares. Under the Task Force's proposed approach, the Museum would earn \$978,237, an increase of \$662,503. The retail performance data provided in the following table is used to calculate the current and proposed revenue shares.

NASM Main Store Operations				
	FY2005 Actual	FY 2006 Actual	FY 2007 Actual	FY 2008 Budget
Revenue	5,869,696	5,589,004	6,220,352	6,314,683
Net Gain/Loss	1,649,111	1,614,297	1,976,652	1,915,656
Revenue Share	293,485	279,450	311,018	315,734
FY 2005 to FY 2007 Avg Net Gain:				1,746,687
Avg Net Gain Inflated by 5%:				1,834,021
FY 2008 Budgeted Net Gain				1,915,656
FY 2008 increment above/(below) average				81,635

Task Force Proposed Revenue Share (Gain Based, plus 75% incentive)

Incentive: 75% of FY08 increment	61,226
50% of FY08 net gain, if incentive is <0	-
50% of avg net gain, if incentive is >0	<u>917,011</u>
Proposed Payment	978,237
Current Payment	<u>315,734</u>
Change to Museum	662,503

Changing the revenue sharing methodology at the NASM Lockheed Martin Theater produces an entirely different outcome. Current revenue sharing at the Theater is 66 percent of adjusted net gain. In FY 2008, the Museum is budgeted to earn \$1,635,282 in net gain sharing. Under the Task Force's proposed approach, the Museum would earn \$1,256,101, a decrease of \$379,181, even with the incentive payment.

NASM Lockheed Martin Theater				
	FY2005 Actual	FY 2006 Actual	FY 2007 Actual	FY 2008 Budget
Revenue	4,307,342	4,418,621	3,938,105	4,472,988
Net Gain/Loss	2,528,932	2,184,748	2,294,584	2,492,432
Revenue Share	1,640,672	1,431,280	1,496,622	1,635,282
FY 2005 to FY 2007 Avg Net Gain:				2,336,088
Avg Net Gain Inflated by 5%:				2,452,892
FY 2008 Budgeted Net Gain				2,492,432
FY 2008 increment above/(below) average				39,540

Task Force Proposed Revenue Share (Gain Based, plus 75% incentive)

Incentive: 75% of FY08 increment	29,655
50% of FY08 net gain, if incentive is <0	-
50% of avg net gain, if incentive is >0	<u>1,226,446</u>
Proposed Payment	1,256,101
Current Payment	<u>1,635,282</u>
Change to Museum	(379,181)

A final example at the National Museum of the American Indian (NMAI) shows a case where a retail operation does not qualify for the incentive payment. In this case, the Museum currently earns 50 percent of net gain from the NMAI Roanoke Store, a nearly comparable

model to the Task Force proposal. Under the Task Force's proposed approach, the Museum should earn the same revenue as before, since it does not qualify for the incentive payout. The slight drop of \$11,617 in revenue payment under the proposed approach reflects the change associated with eliminating the current net gain model adjustments for SI administrative fee and offsetting accounting rebates.

NMAI Roanoke Store				
	FY2005 Actual	FY 2006 Actual	FY 2007 Actual	FY 2008 Budget
Revenue	7,809,544	4,367,997	3,862,374	3,907,276
Net Gain/Loss	2,179,880	980,864	689,223	599,177
Revenue Share	1,076,630	492,295	344,473	311,205
FY 2005 to FY 2007 Avg Net Gain:				1,283,322
Avg Net Gain Inflated by 5%:				1,347,488
FY 2008 Budgeted Net Gain				599,177
FY 2008 increment above/(below) average				(748,311)

Task Force Proposed Revenue Share (Gain Based, plus 75% incentive)

Incentive: 75% of FY08 increment	-
50% of FY08 net gain, if incentive is <0	299,589
50% of avg net gain, if incentive is >0	-
Proposed Payment	299,589
Current Payment	311,205
Change to Museum	(11,617)

### **Importance of Clear and Structured Communication to the Museum-Retail Partnership**

The Task Force recognizes that the selection of net gain as the basis for revenue sharing places a stronger burden on financial communication of museum store performance. We are confident that sufficient transparency can be achieved to convey a clear understanding of direct and indirect costs, and that the museum and retail management will invest the time necessary for good understanding and collaborative problem solving. In an environment of greater transparency, this should recede as an issue.

Notably, SBV has already made improvements in this area. The establishment of monthly meetings with museum financial and management staff to compare and discuss monthly business performance against budget was a major step forward. The establishment of consistent and documented procedures to allocate all shared services, while controversial, was also an important step towards transparency. Similarly, a simplified gain sharing model will reduce confusion.

Ultimately, the success of this new sharing formula will rely on creating a regularized process for the discussion of business costs and decisions with revenue share recipients. Since a net gain sharing formula provides both the museums and the retail staff with an incentive to keep costs down, these discussions will increase in importance. However, they should not increase in frequency. Uncoordinated inquiry impedes performance and strains

relationships. Currently, an excessive amount of time is expended by SBV and the museums in reviewing and arguing over these individual costs. Instead, we recommend all museum directors and key members of their staffs should be invited to a regularly scheduled, perhaps quarterly, meeting at which costs issues can be collectively reviewed, questioned and understood. One standardized approach and a unified response to cost concerns will increase understanding of these issues across museums. Monthly meetings between museum directors and retail staff should continue, but could focus on improving gross results, discussing merchandise selection and presentation, and retail operations. On an annual basis, museums should be asked to participate to a greater degree in the building of the business budget, a process that will have the dual benefit of informing future decisions and enhancing the partnership.

Ensuring that these interactions are conducted in a spirit of collaboration will be the responsibility not only of the participants, but of the Secretary and the senior Smithsonian leadership. Therefore they too should be involved in these discussions where necessary to set the tone and resolve disputes. In addition, Smithsonian leadership should be more transparent in its descriptions about how funds put into the central trust are used to support important Smithsonian functions and programs. Clear, regular explanations to internal Smithsonian constituencies would be a helpful step.

### **Cost Sharing Considerations**

#### *SI Administrative Fee and Accounting Rebates*

Currently, an administrative fee expense and, in some cases, an offsetting accounting rebate is taken before gain-based shares are calculated. The administrative fee is a 12% charge assessed on the non-production expenses of the businesses. The intent of the fee, which was established in the years pre-dating the creation of SBV, was to recover the costs of central support (e.g. contracting, accounting, HR, budget, etc.) to the businesses. SBV-operated and non-SBV operated business activities are both required to pay this administrative fee. However, for the SBV-operated businesses, this charge is not well understood and has long been a source of friction. SBV now has its own specialized accounting, HR and contracting staff that perform a lot of those duties, and museums believe the charge is unfair because museum costs of monitoring and supporting the businesses are not similarly reimbursed. Therefore, the Task Force recommends that this 12% fee not be applied when calculating the museum retail revenues to be shared, despite the impact of this lost revenue to the central trust.

The Task Force could not find a rationale for the accounting rebate and so suggests it be abolished.

#### *Museum Costs to Support Museum-Based Businesses.*

The Task Force feels that, as a general rule, SBV businesses should be charged the full costs of their operation. However, it is not always clear in a partially federally funded museum environment what costs should be assigned to the businesses. There is a lack of clarity, and great variation in treatment of some cost categories among the museums, including re-lamping, utilities expense, guard services for extended museum hours, janitorial services,

design and construction cost sharing, costs of museum-mandated branding and graphics materials, museum employee training costs, carpet repair and replacement near cafes. These often have the same dysfunctional effects as the variation and complication of past revenue sharing formulas.

The stores, as an extension of the museum experience, should be held to the same standards of cleanliness and repair as the museums themselves, and some costs have more to do with visitor experience than retail operations. In addition, much of the support is provided by Federal employees whose salaries are covered whether they work in the stores or in other parts of the building. In addition, revenue shares and Central Trust allocations are, to some extent, also reimbursements for support of the businesses. Considering all of this, the Task Force believes that the costs of materials should be charged to the businesses when they are consumed by the business but non-SBV salary costs should not be charged to the businesses. For instance, if a museum store requires special lighting, the cost of replacement bulbs should be borne by the business, but the hourly costs of the museum's lampist should not be charged to the business.

The Task Force recommends that a complete list of cost sharing issues be developed, and a policy set for each one, and applied uniformly to all stores.

### **Debt Service Priority**

Natural History and the Udvar Hazy Center have substantial debt service requirements that are paid from their various businesses. Agreements are in place that stipulate payment procedures for these debt requirements. The Task Force is not suggesting that the agreements giving debt repayment first claim on income from the retail businesses in these museums be changed. However, the Task Force believes communication would be clearer if revenue shares were provided first, and then museums were billed separately for their debt repayment requirement. This would clearly show that the museum was receiving a revenue share. It would also clarify that the Central Trust is usually paying half the debt service from its revenue share. The Task Force recommends that Smithsonian establish such an arrangement, if all parties agree and appropriate administrative procedures can be developed.

## CHANGES TO HOW THE REVENUE-GENERATING ENTERPRISES OF THE SMITHSONIAN INSTITUTION ARE MANAGED: STRUCTURE, GOVERNANCE, PEOPLE AND PROCESSES

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**Question 4 of the Task Force mandate asks “What is the best way to manage these activities going forward? Should SBV continue to exist as a semi-autonomous unit or be fully integrated into the Smithsonian organizational structure?”**

To form our structure and governance recommendations, we drew from the preceding observations and recommendations about each individual revenue generating activity, in particular its characteristics, the key things it needs to do well, what it required from the other parts of SBV and the Smithsonian, and the patterns of its interactions with other parts of the Smithsonian as well as external constituencies and customers. For those conducted directly by SBV, we tested whether it could or should be outsourced to a non-Smithsonian entity, as described in the previous section. We also kept in mind the key opportunities to improve financial performance, and evolving aspects of the future competitive environment (discussed in a previous section) as context for our structure and governance recommendations. A list of the people and resources that the Task Force consulted during this process can be found in Appendix V.

The Task Force recognizes that some of the business activities within SBV have enjoyed growth and success in the last eight years. *Smithsonian* magazine, for example, has made a good financial contribution to the Institution while also enhancing the mission. In addition, it appears that all of the current business activities could make, or are already making, a substantial contribution to the Institution through their furtherance of the mission and/or their financial earnings.

Therefore, while the Task Force seriously considered the option of eliminating the centralized structure that governs these activities, and discussed whether they could be distributed among a number of Smithsonian units, or whether they could be outsourced in total or in part, in the end the Task Force believed none of those options were the best course of action. It became clear that the way in which revenue-generating activities were connected to the Smithsonian, whether integrated or separate, depended also on the way the revenue-generating activities were connected with each other. Part of the value of maintaining a centralized organization is the opportunity for synergy, and the opportunity for sufficient scale to attract the highest quality leadership.

These recommendations are not an endorsement of the status quo. Major internal restructuring, changes to the SBV’s business processes, and improvements to SBV’s interactions with the rest of the Smithsonian must be made before the financial performance, cultural, leadership and governance concerns described above can be solved—or the financial and mission-furthering performance of these revenue-generating activities improved. Structural changes are easy to mandate; the changes that must take place in the culture, operating processes and relationships recommended here will be very difficult. These changes must include: a clear understanding of the role these activities can and should

play within the Institution; changes to the leadership, structure, and interconnections among some of the businesses; more straightforward revenue-sharing agreements that align the incentives and interests of the parties; and careful leadership attention to the people and processes that connect these revenue-generating enterprises to the Smithsonian mission and culture.

Therefore, the Smithsonian should:

- Continue to group revenue-generating enterprises together;
- Organize the revenue-generating enterprises currently in SBV as a distinct (but not “separate”) operational unit;
- Re-name the organization “Smithsonian Enterprises” or something similar;
- Within the Enterprise organization, re-structure into three basic enterprise activities, plus staff functions; and
- Connect the Enterprise organization and people to the Smithsonian mission and culture through governance, accountability paths, and defined connective processes

#### CONTINUE TO GROUP REVENUE- GENERATING ENTERPRISES TOGETHER

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Immediately prior to the establishment of SBV, commercial activities were more integral parts of the Smithsonian dispersed among organizational units. The goal of the retail activities (museum stores, catalogue, product development and licensing, restaurants) and the magazine was to generate revenue. Other commercial activities (study tours, books) were operated as a part of a programmatic activity, with a goal of breaking even. A variety of relationships and processes evolved over time between these activities and their internal constituencies, so they and the rest of the Institution felt more connected. Today’s concerns about separation from the mission, and distrust, largely did not exist.

But most of these activities were underperforming to their perceived financial potential and cross-fertilization among them was not a priority. The Regents believed that by gathering them together in a large enough critical mass to attract focused, specially-qualified leadership and oversight, as well as greater relief from what the Commission on the Future of the Smithsonian called, “cumbersome government employment policies,” performance would improve. A description of the formation and history of SBV can be found in Appendix I.

The Task Force believes that the rationale for grouping revenue-generating activities under one umbrella organization is more valid now than ever, particularly as new opportunities emerge for collaboration across business lines on shared distribution and advertising platforms. While we seriously considered it, we do not believe that allowing individual programmatic or operational units to control commercial activities, such as the retail shops, would solve the current problems facing SBV. This belief is based on the observation that most units are not experts in commercial activity, none have the time or inclination to manage commercial activities full-time, and all could benefit from the efficiencies and synergies of collaboration. These enterprises require sufficient aggregation of activity to

provide an effective locus for attracting good leadership, develop specialized skills, and establish clear accountability for performance.

At this time, we do not recommend folding other Smithsonian revenue-generating activities that have not been part of SBV into the enterprise organization. These include non-SBV retail stores at the Cooper-Hewitt, the National Zoo and the Freer-Sackler Gallery, as well as Folkways Records, the Smithsonian Associates and other activities. These are not of a scale that would make a difference to the overall organization, and their addition would de-focus the enterprise group's leadership from the urgent requirements of its existing activities. Ideally, some of the stores and one-off licensing arrangements that have not been part of SBV in the past will ask to be administered by the Enterprise organization someday in the future, because that future organization will have created an expectation that financial contribution to the units would improve under their service mantle.

#### ORGANIZE THE REVENUE-GENERATING ENTERPRISES AS A DISTINCT OPERATIONAL UNIT

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When SBV was established, the outside consultants used by the Secretary and the Regents recommended that it be a separate company, wholly-owned by the Smithsonian, with its own fiduciary board of directors. The Regents chose to establish a separate organization within the Institution reporting to the Secretary. The Board of Directors was advisory, only accountable for a few actions delegated by the Secretary, and did not have the kind of true authority of a corporate board of directors. The Secretary delegated aspects of his supervisory role to others. SBV separateness from the substantive, mission-related activities of the Smithsonian was apparently encouraged by the Secretary. Not enough attention was given to the mechanisms, processes, and people needed to preserve or form important connections between SBV and the rest of the Smithsonian. The current structure and governance of SBV is described in more detail in Appendix II.

As has been described elsewhere in this report, the CEO of SBV was initially delegated broad authority by the Secretary, but over time oversight increased, operational stresses grew, and a confusing set of accountability paths evolved for several managerial tasks. In the end, it seems that SBV was neither separate, nor integrated. Neither “fish nor fowl,” it never obtained the advantages of true separation, while the formal and informal advantages of integration were sacrificed—largely by inattention to that issue. We believe that today's best solution is a discrete organization that is not legally separated from the greater institution—if it is appropriately integrated with the Smithsonian's leadership, culture, and governance processes. Separate the organization, but integrate the culture and people with the rest of the Smithsonian, and its mission. Much of the rest of this section will discuss how that should be done, and how it should differ from current structure, people and processes.

RE-NAME THE ORGANIZATION  
“SMITHSONIAN ENTERPRISES”

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Changing the name of a troubled organization is often a cliché recommendation, but we believe the use of “business” in the name has contributed to separation and misperception of SBV within the Institution. “Ventures” conveys some tentativeness, element of chance and risk. We suggest “enterprise” as the root word to describe these businesses, and have used it throughout this section of the report. We would call the organization “Smithsonian Enterprises,” but suggest that management build a list of other ideas, and then select one. (Perhaps *Smithsonian.com*, to place emphasis on the future platform.)

WITHIN THE ENTERPRISE  
ORGANIZATION, RE-ORGANIZE INTO  
THREE BASIC ACTIVITIES, PLUS STAFF  
FUNCTIONS

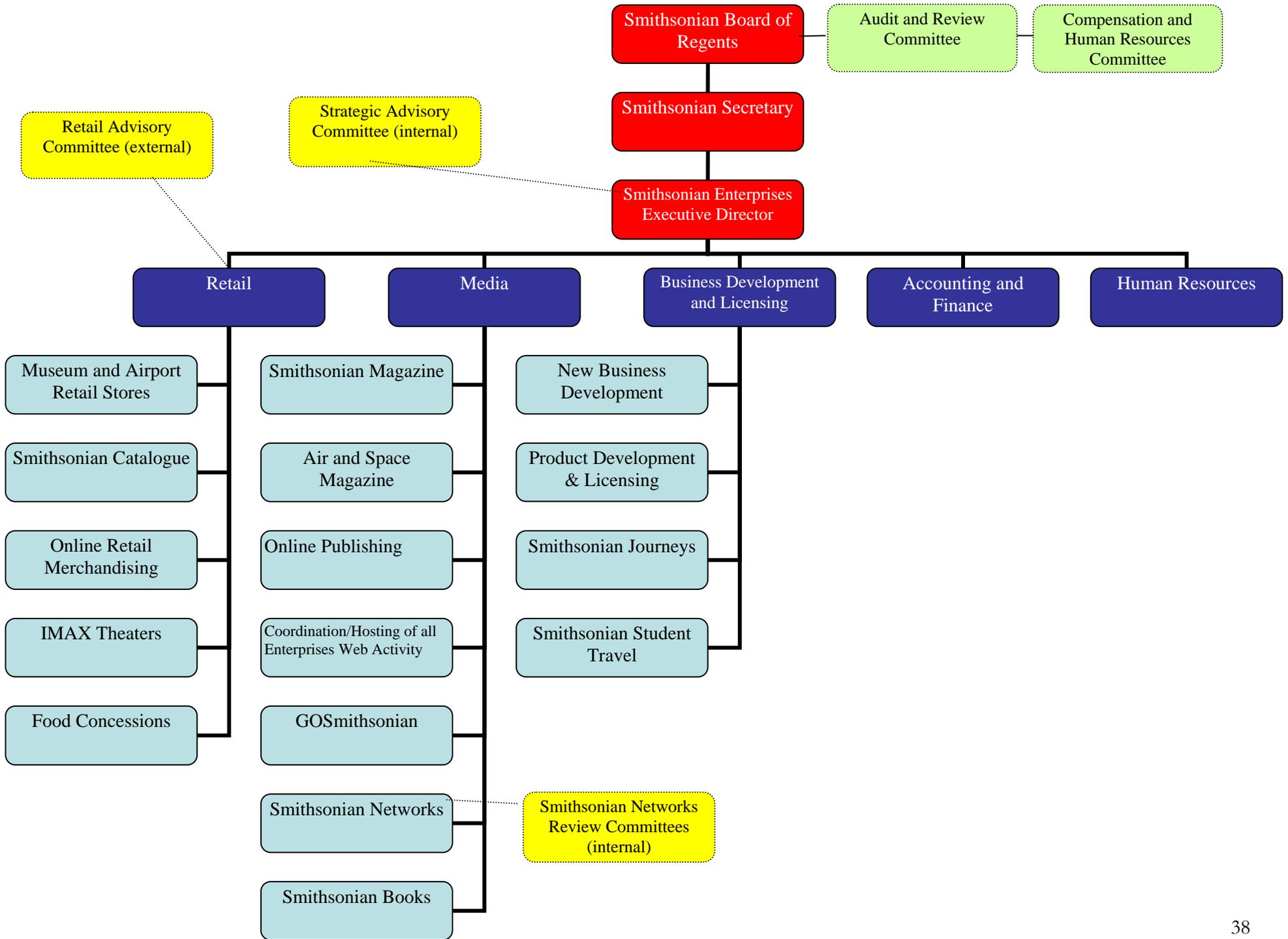
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We recommend the Secretary and Enterprise leadership examine the internal structure of Smithsonian Enterprises, to improve capability, costs and focus. At the top level, we believe the re-grouping described below, would:

- Improve performance;
- Reduce costs;
- Better distribute the total compensation costs of the most senior enterprise executives among fewer, but more clearly focused senior executive positions;
- Connect more effectively to the program activities of the Smithsonian;
- Enable more effective capture of the value available from future communications technology developments and the changing competitive environment;
- Focus Enterprises leadership attention on the two opportunities and changes with the highest potential to improve financial performance: retail merchandising; and on-line publishing with cross-platform advertising; and
- More effectively bring to bear better sophistication, taste, judgment, connection to the Smithsonian’s substantive culture, and a “sense of the Smithsonian” to crucial decisions regarding co-branding of products or services with the Smithsonian name, and merchandise selection for retail activities.

**New Organizational Structure for Smithsonian Enterprises**

The organizational chart on the next page describes our suggested new reporting and organizational structure for Smithsonian Enterprises.



These recommendations for internal re-structuring are meant to be broad-brush, only. We recommend that the leadership of each division conduct a thorough study of organizational structure reporting to him or her, to better synchronize the whole structure to the new strategies for seizing the best future growth opportunities.

## **Retail**

We recommend that all merchandise and museum-based enterprises be grouped in a new, larger “Retail” organization that encompasses:

- Museum and Airport Retail stores
- Smithsonian Catalog
- Online merchandise retailing
- IMAX Theaters
- Food/Concessions

As we have described in the previous section on retail stores, the change that possesses the highest near term potential for improving financial results from the Smithsonian’s retail stores is improvement of the merchandising functions. The need for good judgment, taste, imagination, understanding of the customer base, and marketing skill are shared key characteristics of good merchandising leadership—for all the activities that sell products. The information needed to do a good job of merchandise sourcing, the desirable skill set of the practitioners, and the diplomatic skills to collaborate well with the curatorial staff, are roughly the same for the three retail platforms: retail stores; catalog; and the retailing part of the web. The connection between merchandiser and museum management and curators is important to develop in depth over time. Buying processes are similar. The opportunity to build truly great capability of the leadership of these activities, and to better coordinate interactions with programmatic activities (and thus their acceptance and enthusiasm by the other parts of the Smithsonian) would be enhanced by combining them under one comprehensive leader.

## **Media**

We recommend these content presentation activities be grouped in a Media organization:

- Smithsonian Magazine
- Air and Space magazine
- goSmithsonian magazine
- Online publishing
- Web-based information about the Smithsonian (e.g. GoSmithsonian)
- Web communication and hosting for Smithsonian Enterprises as a whole, including as a service function to web retail activities
- Smithsonian Books
- Smithsonian Networks

All of these activities involve the sourcing and presentation of Smithsonian and non-Smithsonian content to external audiences. These activities require similar information from similar places inside the Smithsonian. The leadership of these activities must make similar judgments about good literary and visual quality, taste, timeliness, etc. Each of these activities share as key factors for their success: good content development; advertising sales to external parties; building good membership relationships; and effective external communication through media.

In addition, the leadership requirements and media and content skills of this group would be the closest match to those required to lead the content aspects of web operations for all the revenue-generating activities in Enterprises. Within Enterprises, we recommend that this organizational unit, whether based in NY or DC, coordinate the “look and feel” of web activities of all the enterprises, providing the communication format and logistical service functions to retailing’s on-line sales. They also have a major contribution to make to the pan-Smithsonian web strategy development that is now underway, and we urge the Institution to include and collaborate closely with Enterprises and its staff as the Smithsonian builds its role and capabilities in this area.

### **Business Development and Licensing**

We suggest the following activities be grouped in a division specializing in Business Development and Licensing:

- New business development
- Product development and licensing
- Smithsonian Student Travel
- Smithsonian Journeys

This grouping involves the decisions and contract negotiations for new business activities, including new licenses, and the operation of contracted relationships once they are established. New business and licensing activities require close interaction with museum staffs, and all the activities listed require the development and maintenance of relationships with external parties with whom the enterprises have contracted. Usually the negotiations, as well as the day-to-day monitoring and approvals, require a high quality of “Smithsonian judgment,” and alertness to deviations from expectations regarding use of the Smithsonian name.

The New Business Development component of this grouping includes licensing negotiations, but also includes new proposed joint ventures, re-negotiation (change) of major external relationships or contracts, and other kinds of deal-making. The skills required for these activities, as well as the nature of the required interactions with other parts of the Smithsonian, are often specialized. Sophistication and discretion are usually critical. We assume that a head of Enterprises, as well as the Secretary, his staff, and involved museum directors will have an active role in decisions to establish new businesses. The connection to the highest levels of judgment and the “Smithsonian judgment” is very important for good decisions and effective negotiations of this type. Therefore we encourage this division in

particular to communicate regularly with the Strategic Advisory Committee described later in this section.

The Task Force believes that the performance of Smithsonian Journeys has benefited from inclusion in SBV, and we believe that should continue. We have suggested it remain part of the Licensing operations because its key activity is managing thirty contractors, and maintaining close relationships with the external travel community.

### **Staff Functions**

We recommend that the remaining reports to the leader of Enterprises be as they are now—Human Resources and the Finance/Accounting/IT organization. It is important for an accountable manager to have control of the tools he needs for his organization’s task—including specialized data systems to operate the business. Similarly, the need for a local HR capability that is well versed in the issues of the enterprise organization and people is needed to assure clear accountability for the performance of Enterprises management.

The unique operational needs of revenue-generating activities require certain systems and skills that are not necessarily useful for other parts of the Smithsonian. The financial and technological requirements of operating businesses that buy and sell merchandise and advertising, and need to quickly and thoroughly analyze business trends and data, are best handled by staff and systems dedicated to that service. The specialized skill sets of the staff in these areas also require a different approach to recruiting and hiring. However, these functions should communicate and align with their counterparts in the greater Smithsonian when it would create efficiencies, encourage collaboration and ensure consistency in policy application.

### CONNECT THE ENTERPRISE ORGANIZATION AND PEOPLE TO THE SMITHSONIAN MISSION AND CULTURE THROUGH GOVERNANCE, ACCOUNTABILITY PATHS, AND DEFINED CONNECTIVE PROCESSES

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With the revenue-generating activities grouped together, in a distinct (not “separate”) organization, how should they connect to the other people and organizations of the Smithsonian Institution? Getting these connections right is the most important factor for curing past ills.

Some connections, such as lines of authority, or performance reports are easily defined. Other important ones will involve behaviors and processes that are less visible, easier to ignore in the heat of battle, or from past habits of separateness. It is not just a matter of the design and declaration of these connections, but the quality and consistency of their *operation* that will determine whether these recommended changes will successfully renew the revenue-generating enterprises. For that the burden will fall on the leaders of all parts of the Institution as well as of the enterprises. They must exemplify the behavioral changes, and continuing attention to the positive change that building these connections can produce.

It is important to select and define the interactions between the enterprise organization and the rest of the Smithsonian with great care. Too many connections will unduly slow the ability of Enterprises to operate effectively. An uncared selection of connections will confuse accountability, making recruiting and retaining outstanding leadership difficult. We are confident that the leadership of the Smithsonian can strike the right balance between encumbrance and separateness as it connects these activities with the broader Smithsonian.

#### THE BOARD OF REGENTS

We are aware of plans to change some aspects of the governance of the Smithsonian, and have endeavored to form recommendations consistent with the Regents' likely decisions on these issues. We also know that the Regents plan to shoulder increased responsibility to review, understand, and improve the future contribution of these enterprises to the mission of the Smithsonian. We support these changes, and have crafted our recommendations to be consistent with them.

We also recognize that the Regents have only a limited amount of time to devote to oversight of the enterprise activities. Therefore, Regent involvement should be focused on a few specific interactions. We recommend that the Regents or one of its committees:

- Annually review and approve the multi-year business plan of the enterprise organization;
- Receive a quarterly written report and in-person presentation from the head of Enterprises, and a copy of the Enterprise head's monthly written report to the Secretary—both written by and sent directly from the Enterprises leader;
- Review and approve the position description for the leader of the enterprises organization, and the specific person hired;
- Review the Secretary's performance evaluation of the head of Enterprises, and approve his or her actual compensation payments;
- Annually and prospectively approve the salaries and variable compensation formulas of the top two levels of enterprise management, and the compensation ranges associated with all Enterprise positions; and
- Periodically review and approve the system used to evaluate performance of senior Enterprise managers, including the quantitative and non-quantitative metrics used for measurement.

One way to enhance this oversight is to increase the Regents' understanding of these activities. To perform its oversight role effectively, the Board needs to build familiarity with the issues and people of these enterprises over time. For example, it could:

- Increase the size of the committee or sub-committee of the Board of Regents that focuses on Enterprises and add capability to handle increased oversight volume and expertise;
- Add off-board members with required expertise as voting members of some Regents committees; and/or

- Form an informal advisory committee to the Secretary, composed of some Regents to build a context about enterprise issues within the Regents, and some non-Regents with relevant business experience, to vet issues in advance of Secretary or Regent review, offer informal advice to the Secretary and the head of the enterprise organization as they face key decisions, and help them implement the many changes that will occur in these activities and their governance in the next year or so.

If the Compensation and Human Resources Committee oversees the compensation of Smithsonian Enterprises, and the Audit and Review Committee conducts financial oversight and business plan review, we do not believe it necessary for the Regents to establish a dedicated committee for other Smithsonian Enterprises issues.

### THE SECRETARY

We recommend that the head of Smithsonian Enterprises continue to report directly to the Secretary. The Secretary is the pivotal connection between the Enterprises and the other internal and external Smithsonian constituencies that must work effectively with them.

Moreover, the Secretary's attention and tone toward the Enterprises sets the example for others. The Secretary should signal value for the Enterprises and its staff, but not superiority or separateness. It will be the Secretary's instructions and related follow-through to direct reports, museum directors, and all employees that will drive the re-integration of these enterprises into the broader mission of the Smithsonian. An extreme change of many attitudes about the enterprise activity, organization and people is needed throughout the Smithsonian if growth and improved financial performance are to occur. This is likely to require direct action—frequent course-corrections, interventions in communications, and good example-setting in the first year. Only the Secretary can drive this effectively.

We recognize the heavy requirements on the Secretary's time. But we urge resistance to the impulse to delegate oversight or operation of these activities to others, including to a separate governing board (as described below). The better course is to have a competent and savvy Smithsonian Enterprises leader, along with sufficient reporting processes so problems and anomalies are exposed quickly. This will retain a clear chain of accountability from the Enterprises leader, to the Secretary, and to the Regents.

Similarly, we urge the Secretary to exercise care if additional committees or review steps beyond the ones suggested here are proposed for major Enterprise decisions that would lead to multiple reviews of important and potentially controversial Enterprise actions, through several levels and functional areas of the central Smithsonian organization. Recent Smithsonian history reinforces the notion that quantity of oversight does not improve the quality of oversight. Good oversight is NIFO-based—Noses In, Fingers Out. Instead of multiple approval loops, we suggest a few connective processes that are clear to all, visible to many, and short. They can be designed to minimize extraneous, authority-robbing, time-consuming connections—resulting in better and more timely decisions. “Integration” should not mean burdening each function in Enterprises with a set of existing central processes that have been designed for program activities, and accumulated over time.

Maximize common policies; but minimize the number of processes, committees, meetings, and reports that would divert time and focus from the key priorities and opportunities of the enterprises.

There are many examples of needed operational connections. For example, financial reporting flows directly between the SBV finance staff and the central Smithsonian staff, and press releases need to be approved by the central staff. Recently, the Smithsonian Chief Financial Officer has contributed to the SBV CEO's and SBV CFO's annual performance plan and performance appraisal, a process that has improved communication and increased accountability. This process could be replicated with other senior leaders of Smithsonian Enterprises to ensure their "shareholders," not just their superiors, are participants in their evaluations.

Decisions to use the Smithsonian name, and processes to fit the business plan of enterprises into the total Smithsonian budget must involve a comprehensive set of central staff. But central staffers do not need to be involved in the day-to-day decision making and minutia of each business.

#### THE ROLE OF A BOARD OF DIRECTORS OR ADVISORS

We recommend that the head of Smithsonian Enterprises report directly to the Secretary, and the Secretary directly to the Board of Regents, for all accountable responsibilities of his/her roles with respect to Enterprises. Further, we recommend that there be no subsidiary board of directors, or advisory board to which the Secretary or Board of Regents delegate some of their responsibilities.

SBV has an advisory board, to which some responsibilities were delegated by the Secretary, including compensation decisions for managers below the level of the CEO. The nature and structure of the SBV Board, while beneficial to the enterprises, CEO and Secretary, raised certain concerns for the Task Force:

- Because it was advisory, it could not relieve the Regents or Secretary of any accountability. Especially in times of stress, the board could not appropriately relieve the Secretary of his oversight responsibilities and time requirements.
- Because its focus was on SBV, the outside directors of SBV had limited day to day involvement with SBV activities and the activities and interactions with the broader Smithsonian. The outside directors' relationships were with SBV management and the primary relationships were with the CEO and Secretary. While the outside directors were aware of the inherent tensions between a profit-focused market compensated entity within a non-profit, mission driven entity, they were not aware of the full depth and breadth of concerns that existed within the broader Institution. Given that the Secretary was frequently in attendance at SBV Board meetings, and several senior SI staff members served on the SBV Board, we do not understand why the concerns and issues with the broader Institution were not more readily raised and addressed.
- The very existence of the SBV board may have contributed to the SBV's isolation and opacity. Knowledge of SBV was held to a small group that met

infrequently. The few board members who were Smithsonian employees were not tasked to discuss or explain aspects of SBV to the broader Smithsonian community. The “taste committee” was closed at about the same time the SBV board was started, but the SBV board was not tasked to be its replacement - - nothing but the decisions of the central hierarchy replaced it. We believe there are more efficient relationships or committees that can be formed to achieve needed knowledge and communication between enterprise activities and the other parts of the Smithsonian. This opinion is shared by the SBV board, which has recommended its cessation.

As discussed in the section on licensing, we recommend that before the final decisions on use of the Smithsonian name are made (including new license arrangements, whether initiated by Enterprises or some other unit of the Smithsonian), the Strategic Advisory Committee (recommended below) be consulted, as part of a process that brings comprehensive “Smithsonian judgment” to bear.

Certainly it is important to have formal and informal mechanisms to bring expertise and good advice to the leadership of the enterprises, as members of the SBV board did in the past. These enterprises need better access to such things as the best practices of their industries, to a better understanding of current technologies, and help with business planning. We suggest these be brought to bear informally, episodically as the need arises, targeted to specific tasks, such as retail merchandising, or as a group with which the enterprise head can discuss ideas—unmixed with governance, and only established at the request of enterprise management. We also suggest that among the many people who serve or have served as members of Smithsonian advisory boards, including the SBV board, are a few whose expertise would be of great value to the leaders of the enterprises.

#### ENTERPRISES LEADERSHIP

We recommend that the Secretary conduct a thorough, inclusive process to choose the next leader of the Smithsonian Enterprises. The Secretary should take the opportunity to involve many parts of the Smithsonian in a discussion of the position description and desirable characteristics of the person to be hired. This discussion will help build knowledge about the opportunities and operations of the enterprises, and result in greater support for the new head when he or she arrives, even if it is an internal candidate who is selected.

We urge the Secretary to think broadly about the desired background of this person. For example, consider people with strong museum or non-profit backgrounds who also had some experience hiring and managing people who conducted business activities during their careers. The most important characteristic is the ability to lead, both within and beyond the enterprises organization. The right leader must form and communicate a clear vision of how these activities contribute to the Smithsonian, and to select and inspire the rest of the enterprises management team.

The new leader of Enterprises will be a key link between the enterprises and the rest of the Smithsonian and will serve as the primary representative for revenue-generation activities to many external constituencies. He or she will make possible the synergies within the

enterprises, as well as between the enterprises and the programs, and will set a new tone for these activities, integrating mission and revenue-generation in his or her persona and style.

It may be possible to save costs and increase the scope of the key leaders, by combining the head of the enterprise organization's position with that of one of his or her reports.

We suggest that the ideal characteristics and demonstrated past performance of the leader, and all other senior Enterprises executives hired in the future, should include:

- A collaborative style;
- A solid record of management accomplishment in some field, not necessarily in business;
- Solid understanding of business cultures and practices.
- Curiosity and respect for scholarship and substance;
- Outstanding communication skills; ability to explain Enterprises, and the Smithsonian's purpose/vision/strategy to employees, partners and constituents.
- Ability to respond to public criticism.
- Entrepreneurial courage;
- Personal knowledge of one of the substantive subjects or areas of study of the Smithsonian; and
- A clear strategic vision of how Enterprises and its businesses can improve their financial contribution to Smithsonian programs, and enhance the reputation of the museums and the overall Smithsonian Institution.

We also suggest that the leader of the business enterprise organization be called the "Executive Director" or some other title selected by the Secretary, and ranked as a peer of the Undersecretaries. "Managing Director," or "President," are other suggestions. The title "CEO" seems unnecessarily jarring culturally, and probably contributed to the distant positioning of SBV within the Smithsonian. Nor was it really descriptive of this role, given its position within the Smithsonian's organization and accountability loops, and that it does not really report to a board of directors. Similarly, using a government title such as "Undersecretary" would be confusing to the vendors and other external constituencies of the enterprises.

#### ESTABLISH CONNECTIVE PROCESSES

An important change in the Smithsonian Institution's revenue-generating activities should be in the connective processes between the enterprises and the rest of the Institution. It appears that when SBV was established, it was felt that staffing, structure, and separation were enough. Important links were not designed carefully—even ignored in some cases. A few solid processes can form the connective tissue that makes the enterprises a more integral part of the Smithsonian. Important examples of processes with collaboration opportunities include:

- Setting priorities for the enterprise organization, and writing its business plan;
- Establishing new revenue-generating enterprises;

- Performance reporting;
- Decisions about the use of collection resources by partners and vendors;
- Decisions on the use of the Smithsonian name;
- Selecting museum store merchandise;
- Approving new licensing concepts, designs and marketing strategies;
- Approving exceptions to Smithsonian policies; and
- Approving proposed Smithsonian Channel programs for factual accuracy and consistency with the Smithsonian’s reputation.

We recommend that these processes should be few in number, but carefully designed, and re-designed periodically to improve them, to promote alignment, collaboration and transparency among the program and revenue-generating activities of the Smithsonian. Not only to improve the results from a process, but also to build the connections that will strengthen the enterprises’ support of the mission. Where such processes already exist, their steps should be communicated to all Smithsonian leaders so all are aware of how decisions are made.

Well-documented processes should define communications paths within museums and central staff as well as Enterprises, and should actually allow faster responses to new opportunities, as well as to any newly erupting internal and external queries. For example, communication failures that have contributed to hard feelings have often occurred within a museum: information from a briefing to museum directors is assumed to have been passed on to other key museum people who should have known about it; or a curator’s approval of a new license or product is assumed to have been communicated enough inside, to constitute the museum’s approval.

Where possible, the Secretary and enterprise leadership should seek opportunities for enterprise-related processes that include key people from other parts of the Smithsonian—even for their leadership. A good example of such a process, which seems to be working successfully, is the process to approve proposed Smithsonian Channel programs for factual accuracy and quality consistency with the Smithsonian’s reputation.

Success for Smithsonian Enterprises will depend to a large extent on the development of constructive relationships with curators, museum directors and others who directly manage collections and programs. Anyone involved in the decision-making flow needs the context that can only build from deep, prolonged exposure to its issues. There should be as few of them in the central organization, and as many of them in the museum organizations as possible.

It is important to collaboratively *synchronize* revenue-generating activities around the Institution, not *centralize* communication and processes.

### **Establishment of a “Strategic Advisory Committee”**

We recommend the Secretary create an informal “Strategic Advisory Committee” representing a broad spectrum of Smithsonian employees such as museum directors, scholars, curators, educators, collections managers, archivists and administrative staff, to

serve as a sounding board for the Secretary and the Enterprises leader for new ideas, to be consulted before co-branding or other uses are made of the Smithsonian name, and to advise regarding improving the connection and communication between Smithsonian Enterprises and the rest of the Institution.

The creation of a rotating group of Smithsonian staff to advise and comment on Smithsonian Enterprises will help integrate and align these activities with others at the Institution and will help avoid breakdowns in communication and judgment that have occurred in the past. Regular conversations about new product ideas, use of the Smithsonian name, marketing plans and operational challenges with a group of staff who are familiar with the collections, programs and facilities of the Institution will provide a venue for cooperation and mutual problem-solving. In particular this group will prove valuable in discussions about licensing activities which recently have caused concerns that may have been assuaged with better communication at the outset.

Although this is a function usually performed by a board working with a CEO, we do not recommend they be formed into a board, or become a formal step in any governance chain. Rather, consider this group as a “kitchen cabinet” of senior program people with extensive knowledge of the Smithsonian, whose judgment is highly respected by their colleagues. In the best of future circumstances, there will always be some tension in the Smithsonian between mission support and revenue generation. Preserving the proper balance will always be a key task of Smithsonian leaders and Smithsonian governance.

Threats to Smithsonian brand integrity, as well as internal impediments to effective operation of the enterprises could be raised for discussion in this group. So would other decisions to license the Smithsonian name - - whether by Enterprises or some other part of the Institution, such as a separate arrangement proposed by a curator or museum. The “Smithsonian conscience” would be expressed easily, among people who are knowledgeable about and committed to the success of the enterprises. New ideas could be vetted early, and quickly, in a way that does not scare off new initiatives and innovation. For example, a discussion of whether an exception to the competitive contracting process described in Regents’ governance recommendation 20 should be sought in a particular case.

### **A Collaborative Process Opportunity: The Business Plan**

The existence and use of a clear multi-year business plan that describes the environmental assumptions, strategies, investments, organization, budget and projected performance of the enterprises is a basic characteristic of good management. It is also a communication tool: if such a document had existed for SBV in recent months, the discussions about SBV would have been better informed on all sides with more facts and fewer pessimistic assumptions. The discipline of plan-writing exposes key analyses to scrutiny, aligns the parties accountable for performance, and communicates the strategy to those who need to know it.

We are not suggesting that the plan be written by a team whose composition is broader than Enterprises, but that suggestions should be gathered and options discussed with some broad Smithsonian constituencies. A good plan can be enriched by such suggestions, and tuned by necessary iterative communications with the Secretary’s financial staff—yet not bogged

down by detailed review and scrutiny from ancillary staff departments or inter-Smithsonian committees.

Careful attention should be given to selecting *metrics* used to describe desired performance, both financial and operational. Much of the frustration surrounding SBV has been characterized by widely differing assumptions about what constitutes good performance in relation to widely-used metrics—such as sales per visitor.

We have found less use of metrics, and sometimes even less curiosity about them than we are used to seeing in similar businesses. It has made competitive analysis of SBV and its alternative strategies very difficult—including for the Task Force. A big part of the problem has been very weak data on which to calculate some key metrics. Sales per visitor doesn't have much usefulness if no one has confidence in the basic visitor statistics (which are not controlled by SBV). And until improvements of the last couple of years, the SBV financial statements lacked consistency and transparency, and its numbers were not considered credible.

It is very important that the performance metrics include goals beyond the cash contributions to museums and the trust. Metrics should be developed that cover such things as the enterprises' maintenance of the quality and integrity of the Smithsonian name, service quality ratings by its constituencies (including museums and visitors), quality of internal communication, and other desired behaviors. These same metrics should also become components of the annual performance evaluations of enterprise management, and those evaluations should include input from stakeholders around the Institution where appropriate.

The resultant business plan should be approved by the Secretary and also by the Regents. It can include anything they would like to see in it, including the compensation strategy. Thus, it should serve as the primary prospective document for the Regents' governance of the enterprises.

### **Collaborative Process Example: Smithsonian On-Line Communications Strategy**

In a previous section we described the importance of a strong on-line presence to the future performance of Smithsonian Enterprises—and to the Smithsonian Institution. An effort has begun to form a comprehensive strategy for the relationships of all the Smithsonian's web sites and portals, as well as policies for their potential incorporation of underwriting credits. This is an urgent, important priority for the Institution, whose online capabilities have fallen behind some others'. Given the cultural dissonance that has marked some previous attempts (including the exclusion of SBV input to initial efforts), and the need to bring to bear on this project the wide variety of information, skills and knowledge that are dispersed through the Institution, including much in Smithsonian Enterprises, we can think of no better near-term opportunity to build and test a high-quality collaboration between Enterprises and the Institution's programs than the pan-Smithsonian web strategy project.

## IMPROVE COMMUNICATION

“Improve communication” is a nostrum that usually appears in documents like this one. But we don’t apologize, because in the SBV case poor communication has been a leadership failure that is a root cause of many past problems. The opaque years have had a devastating effect on attitudes toward SBV and its people that will take great time and skill to restore to constructiveness. Communication improvement will be a key factor to determine whether the ability of Smithsonian Enterprises to increase its financial support of the Smithsonian’s mission improves in the future.

The importance of the multi-year business plan as a communication tool has been described above. Similarly, excellent financial reporting for internal management control is an emerging skill of the Smithsonian that has contributed to better communication, and will add even more in the future. Improvement of the internal “financial language” for fact-based discussions builds trust over time.

We recommend an annual meeting be held by the enterprises organization with its museum and other program stakeholders, similar in tone to a shareholder meeting. We envision a direct, in-person presentation of the organization’s performance and plans, with opportunity for questioning, as quickly as possible after the close of the fiscal year.

### **Nomenclature**

We recommend that the leadership of the Smithsonian and the management of these revenue-generating activities examine the words that have been used in relation to these enterprises, and change some of the nomenclature in addition to the organization’s name. It could be less dissonant to the Smithsonian culture in some cases.

Conforming to a practice of some other institutions, we recommend replacing “profit” and “gain” with a term such as “contribution”—even on financial statements. For good communication, such words should appear as often as possible. For example, the bottom line on enterprise financial statements could be two lines: “contribution to museums”; and “contribution to the Trust.”

As has been mentioned with regard to the title of the enterprise organization’s leader, we recommend that the management re-think titles throughout the group, seeking opportunities to make them more consistent, descriptive and connective to the mission. For example, some ideas include “President of Museum Retail,” or “Smithsonian Publisher” for the head of the content group.

And when describing the enterprises, the less they are called a “separate” or “semi-autonomous” organization, the better.

### **Location**

Physical location is an important component of communication. SBV’s separateness from mission has been manifested physically as well. While separation has some advantages, this has inhibited development of the interstitial relationships that organizations need to

communicate well internally, and develop a strong social system. It also has undoubtedly made it more difficult for the types of knowledge that build judgment to transfer easily.

We recommend that the Secretary find opportunities to locate at least some Smithsonian Enterprises people in museum buildings—particularly for those individuals who are making merchandise judgments. If possible, exchange some Enterprises employees’ offices located in Capital Gallery with some activities currently located in a museum building. Occasional physical churn is good.

Certainly, key leaders of retail activities should be located in certain museums—close to the curators, stores, and most importantly—visitors. For example, if a dedicated merchandiser is assigned to each of the three largest museums, then locate that person there. As a service function to the museums, the enterprises have to be the ones to reach out, to move about, and to locate close to their customers.

### **Data Communication**

We recommend that Smithsonian Enterprises continue to manage its own data compilation and systems, and financial reporting that meets the needs of the central Smithsonian. The senior financial person in Enterprises should continue to dual-report to the Enterprises leader, and to a senior financial executive of the Smithsonian.

Enterprise leadership is accountable for the quality of its data, including its timeliness, so must have authority over its key systems. The enterprises have specialized data and systems needs that are closely tied to enterprise accountability. It should be the choice of accountable management whether and how much to integrate with Smithsonian-wide capabilities.

### COMPENSATION PRACTICES MUST BE CONSISTENT WITH DESIRED PERFORMANCE QUALITY

We recommend that the “pay for performance” characteristics of SBV compensation (described in more detail on Appendix II) be retained for Smithsonian Enterprises but modified to:

- Assure consistency with new Smithsonian unified compensation philosophy;
- Improve the alignment of performance metrics to desired outcomes; and
- Assure performance evaluations are conducted and documented according to policy.

The Smithsonian is currently implementing a unified compensation policy for federal and trust salaries. The Regents’ Compensation and Human Resources Committee is in the process of determining which Institutional trust-funded positions have Federal sector equivalents and will be paid consistent with those equivalents, and which will continue to have market-based compensation. The process leading to such decisions will result in the committee building knowledge and expertise about Enterprises compensation, and the committee will have studied and presumably approved the compensation parameters for each senior position in Enterprises. That work should not be duplicated in some other board or committee. Therefore, we recommend this be the only committee in the chain of

compensation governance for Smithsonian Enterprises, and recommend the following policies and practices with regard to its compensation practices:

- Salary and variable compensation (if any) ranges for all job levels of Enterprises should be approved by the Regents' compensation committee, upon the recommendation of the Secretary. Working within these ranges, compensation decisions can be made by Enterprises management for all but the most senior levels.
- The Regents' process to determine whether a comparable job description exists within the federal system for certain highly-compensated Smithsonian managers should apply to positions in Smithsonian Enterprises. The output of this process should be a job description and range of compensation for senior positions—with both fixed and variable components as applicable.
- We support a centralized locus of compensation leadership and expertise. The reviews by the Regents Compensation and Human Resources Committee, supported by Human Resources, will require access to market-based compensation data for these positions, and will be the future locus of oversight expertise on the compensation of more highly-compensated employees. Continuing to do this work in an enterprise advisory board or other board would be duplicative.
- For higher-level Enterprise managers during the next year or two, we recommend that variable compensation calculations place major emphasis on Smithsonian Enterprises' total net gain goals, less on revenues, and less on revenues of his or her scope area, to promote alignment with collaborative goals. Some refinements for individual performance may be appropriate, but aiming many reward systems and revenue-sharing formulas on the same metrics will help alignment.
- Compensation decisions also should be based in part on an executive's performance against non-financial metrics, such as the operational principles and characteristics described earlier in this report.
- For the higher-level managers, we recommend that their compensation, at the time of hire and at any subsequent adjustments, be recommended by the head of Enterprises, and approved by the Secretary, within ranges set by the Regents.
- For the head of Enterprises, we recommend that compensation at the time of hire and at any subsequent adjustments be approved by the compensation committee of the board of Regents, upon a recommendation by the Secretary.
- We agree with the Commission on the future of the Smithsonian, when they said in their 1994 report, *"a major role of the central [Smithsonian] administration should be to institute human resources management systems that serve the need to attract the highest caliber of professional staff in competition with private sector organizations."* And, *"Because of the small size of the Smithsonian compared to many federal agencies, its public-private nature, and its unique function within the federal system, it is a good testing ground for . . . new ideas."* (This language referred to attracting leaders of program activities, but applies as well to Enterprises.)

We believe the enterprises can attract and properly compensate the employees and leadership they need in the future. This is one reason we felt the Smithsonian does not have to revert to outsourcing museum store operations to a private vendor with more flexible personnel policies than the Smithsonian's. However, we believe compensation for some of the jobs will need to exceed the Federal cap—for both fixed and variable components.

Managing the transition to more consistent internal compensation in the Smithsonian, while preserving the differences that enhance the quality of some components of this complex organization will be a delicate task that will require the focused attention of all involved.

Variable compensation formulas should be re-designed to be more consistent with the multi-year goals of the enterprises, and tied more directly to the important desired outcomes. Some improvements have recently been made as a result of recommendations in the IG's report. Still, the level of sophistication of some performance systems can be improved further, to assure that performance can't be affected by such things as dysfunctional end-year pricing decisions, inventory purchases, etc.

Operating an organization where people work side-by-side with colleagues who are in somewhat different compensation systems is a major challenge of Smithsonian leadership. Minimizing the differences will help. Creating more opportunities for career movement between the enterprises and the programs would also help; compensation systems should not be barriers to such movement.

We recommend the local Human Resources function continue to be maintained within the enterprises organization, as it has in SBV. Changes to its role in executive compensation may change with the overall Smithsonian policies, but the need for a specialized capability, with the solid domain knowledge needed for recruitment and compensation of employees in the various enterprises is undiminished. Moreover, the HR function is a tool of the accountability of the head of Enterprises, and accountability would be diffused inappropriately if HR were removed.

### CONNECTING POLICIES

The original idea for SBV was to develop a distinct entrepreneurial business unit within the Smithsonian, staffed by people with business backgrounds. With a blank piece of paper to start, SBV was able to establish policies that fit their idea of standard business policies and practices. We believe they overdid differentiation. Some of these exceptions unnecessarily differentiated SBV from the rest of the Smithsonian, as we have all learned. But some are important to retain, to assure that the future enterprises have the operational flexibility and speed that is required by their markets and competition.

Approximately 113 Smithsonian policies are being examined by the Institution at this time as part of the response to the Board of Regents Governance Recommendation 20. We support this effort and recommend that differences in the policies followed by enterprise employees and those of the rest of the Smithsonian be minimized.

Yet we do know that some policies should be different at Enterprises for it to perform effectively. Such a list and its discussion should follow the compilation work and recommendations currently under way. One example is contracting: the first written policy for revenue-generating contracts is in the early writing stages. It will apply to the enterprises, as well as some program-related activities that generate revenues. It is expected to recognize that competitive bidding and non-exclusivity are desirable, but should not be an absolute requirement. It is not always practical for some projects. Effective processes and management review can assure the enterprise has researched the best partner or deal.

We agree with the spirit of the Board of Regents Governance Recommendations 20 and 25 which state respectively that “to promote accountability and ensure the public trust [business] operations will follow established Smithsonian policies, except in specific pre-approved circumstances when an exception is necessary to accomplish mission requirements,” and that “all Smithsonian contracting activities [should be] conducted with integrity, fairness, and openness and in a manner that will best achieve Smithsonian mission requirements.”

## CONCLUSION

As a group, the Task Force is excited by the prospect of major change at the former SBV. We have enjoyed the opportunity to understand it better. We are compelled by our new awareness of its potential greater contribution to the mission of the Smithsonian Institution by these revenue-generating enterprises, and look forward to observing the future progress of Smithsonian Enterprises and its staff.

## APPENDICES

## **APPENDIX I: History of Smithsonian Business Activities**

The Smithsonian Institution, like many nonprofit organizations, has long engaged in business activities to further the mission of the Institution. These varied revenue-generating endeavors help bring the research and collections of the Smithsonian to a broader audience, and generate valuable unrestricted revenues that can be used to support programs, exhibitions and scholarship.

Archival materials reveal that small business operations in the late nineteenth century, including a refreshment stand, a barbershop and a café, generated little if any revenue and were designed mostly for the convenience of the visitor.<sup>1</sup> Early forays into publishing, such as the *Smithsonian Contribution Series*, which was introduced by the Institution's first Secretary Joseph Henry in 1848, were initially distributed free of charge and were primarily designed to carry out the mission of "diffusion of knowledge." Publishing activities would continue for nearly a hundred more years before any net revenue was generated. Not until the 1960s, under Secretary S. Dillon Ripley, did business activities expand to encompass the variety of offerings that would be recognizable today. As visitors came to expect shops and restaurants inside museums, the Smithsonian complied, and the Institution began to depend on the revenues they generated.

In 1967, Ripley commissioned a review of museum shops. Among other observations, it said a museum shop should, "reflect the ideas and ideals of the Director and his staff." And that, "A museum shop cannot be divorced from the total museum picture." We strongly agree with those statements, and believe they should inform Smithsonian revenue generating activities, today.

The 1970s saw the growth of shops in nearly all Smithsonian museums, the establishment of *Smithsonian* magazine, the *Smithsonian Catalog*, and a constantly changing internal management structure to oversee these activities. In the 1980s, IMAX theaters and additional shops and licensing agreements joined the mix. By the 1990s, these activities were generating tens of millions in unrestricted revenues which became essential to support the Institution as it expanded and its federal appropriations began to decline.

### **Formation of Smithsonian Business Ventures**

In the late 1990s, the Smithsonian Secretary and the Board of Regents determined that the revenues generated by the Institution's existing business activities were not performing as well as their potential suggested. In January 1998, the Board of Regents created an ad hoc Committee on Business to consider options for how to better manage these activities and maximize their revenues. In May 1998, Mercer Management Consulting was engaged to assist the Committee "in a review of the strategic options available to grow the value of the

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<sup>1</sup> Historical references drawn from *History of Business Activities at SI*, Marsha Shaines, Deputy General Counsel, September 2007.

Institution's business ventures." The report<sup>2</sup> was presented to the Regents in September 1998 and contained the following findings and recommendations:

- The total profits generated from business activities had the potential to increase by \$35 million over the next five years through operational improvements and expansion into new business areas;
- The current organization and management of business activities (structure, leadership, skill-base of existing employees and compensation system) was insufficient to meet this potential; and
- The best way to achieve this potential was to create "an operationally and culturally distinct entity" with a separate governing board, an incentives-based compensation structure, and strong business leaders to manage these activities going forward.

When the Mercer report was presented to the Board of Regents at its September 14, 1998, meeting, then-Secretary Michael Heyman endorsed the suggested approach and emphasized that the new organization should be "profit-driven," and that its compensation system should be designed to attract employees from the business world and provide them with financial incentives to succeed.<sup>3</sup> As the structure for this new organization began to take shape, the Committee members echoed these sentiments but also noted that the Secretary and the Board of Regents should be held accountable for the actions of this entity in the context of the Smithsonian mission, to protect fairness in the marketplace and to safeguard the nonprofit status of the Institution.<sup>4</sup>

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<sup>2</sup> Mercer Management Consulting, "Smithsonian Business Ventures: Description of Opportunities and Organizational Recommendations," prepared for Ad Hoc Committee on Business, Smithsonian Board of Regents, September 14, 1998.

<sup>3</sup> Smithsonian Board of Regents Minutes, September 14, 1998, page 53-55.

<sup>4</sup> Report of the Regents Ad Hoc Committee on Business, January 25, 1999.

## **APPENDIX II: Current Structure and Governance of SBV**

### **SBV Board of Directors and SBV CEO**

During the winter of 1999, the Board of Regents appointed members to the SBV Board of Directors. Members of this board were intended to be “individuals with top management skills and experience, to provide advice and recommendations to the Board of Regents and Secretary concerning the operation of SBV.”<sup>5</sup> The SBV Board’s “core duty” was to “ensure that all appropriate plans and policies are in place to maximize the financial value of the assets under its stewardship to support the overall mission of the Institution and to evaluate the performance of the CEO.”<sup>6</sup> In addition, the Board’s purpose was to “provide advice, guidance, and recommendations to the Smithsonian Board of Regents, Secretary, and CEO of SBV concerning the operation of SBV, and provide general counsel on the performance and activities of SBV.”<sup>7</sup> The Board also was expected to endorse the annual budget, approve the capital investment plan, and make recommendations about compensation of SBV staff. In August 1999, Gary Beer<sup>8</sup> was appointed as the first CEO of SBV, a position that reports to the Secretary but which was required to consult with and seek the recommendations of the SBV Board.

### **SBV Compensation Philosophy**

In order for SBV to realize its financial goals, the Regents determined at SBV’s outset that its compensation structure must be competitive, market-based and performance driven. Therefore, its system of executive compensation<sup>9</sup> is designed to:

- Align the self-interests of senior executives with the goals of SBV;
- Attract and retain executives with the skills to accomplish SBV’s growth goals;
- Encourage the formulation of aggressive – but achievable – financial goals in annual budgets and multi-year growth plans;
- Encourage achievement of annual and long-term financial and operational goals; and
- Encourage actions that will improve the long-term growth of SBV’s businesses.

Unlike all of the federal and most of the trust salaries within the rest of the Institution, all of the salaries at SBV are based on market benchmarks. Base salaries are targeted at approximately the 50<sup>th</sup> percentile of the relevant external competitive set, and there are no automatic annual salary increases. Any salary adjustments are performance based, relevant to market conditions, and not dictated by any Institution-wide policies unless specifically directed by the Secretary. Additionally, the system relies heavily on monetary incentives which are awarded when annually established financial performance goals are met. Targets and incentives vary by business category but all are based on meeting established financial

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<sup>5</sup> Smithsonian Business Ventures Board of Directors Bylaws, “Preamble.”

<sup>6</sup> Smithsonian Business Ventures Board of Directors Bylaws, “Role of the SBV Board.”

<sup>7</sup> Smithsonian Business Ventures Board of Directors Bylaws, “Article I, Purpose and Function.”

<sup>8</sup> Mr. Beer was the former President and CEO of the Sundance Group, and co-founder of the Sundance Catalogue Company, the Sundance Channel and the Sundance Film Festival. He departed the Institution in August 2007.

<sup>9</sup> Smithsonian Business Ventures, Executive Compensation Philosophy, 2006.

goals. SBV management recommendations for the compensation of SBV executives, which are based on annual performance appraisals, are approved by the Compensation Committee of the SBV Board of Directors.

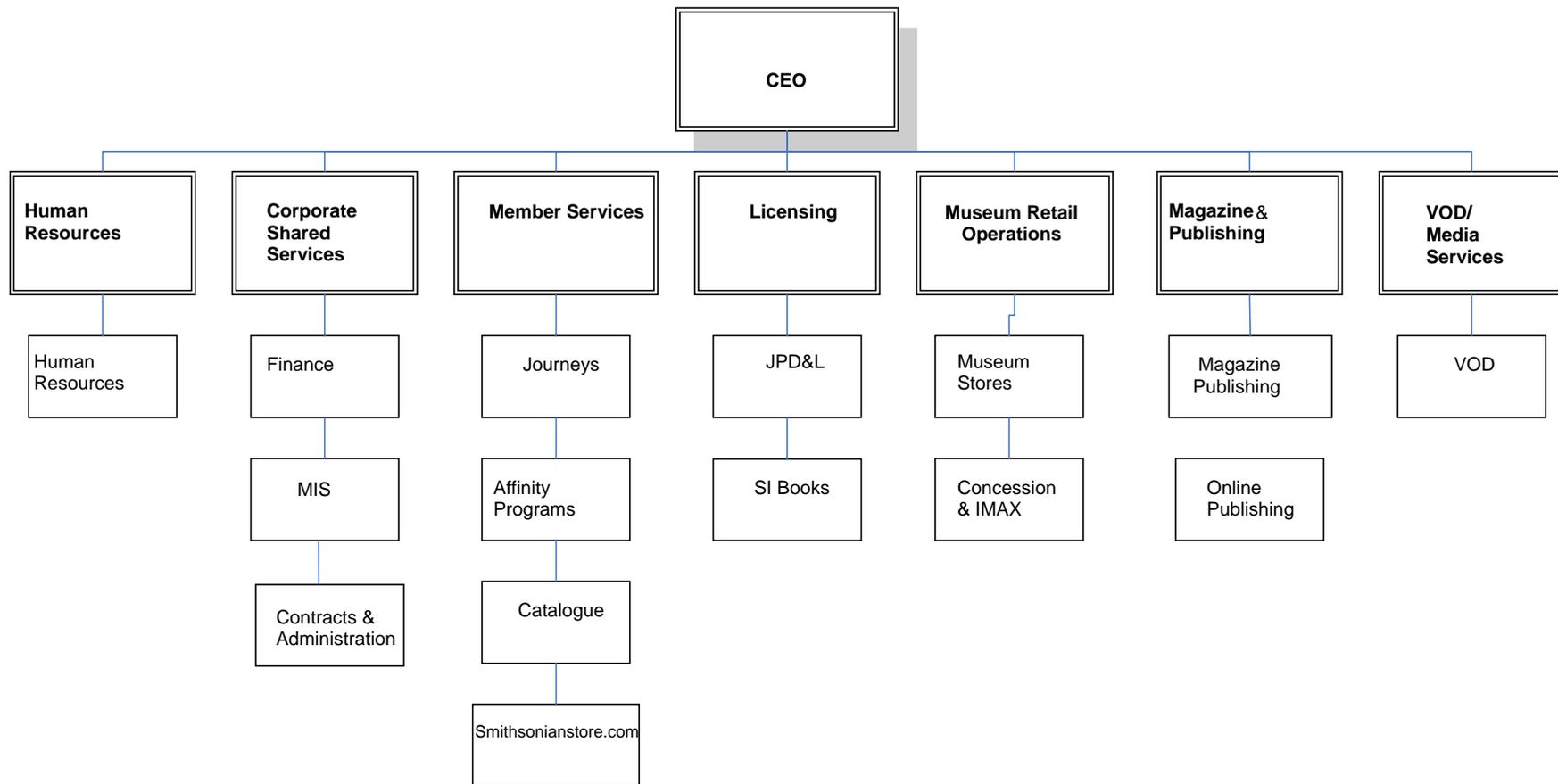
### **SBV Operational Structure**

The operational structure of SBV has evolved over time as it centralized control over most of the Institution's retail operations,<sup>10</sup> and entered into new businesses and licensing agreements. The current structure is illustrated in the chart on the next page:

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<sup>10</sup> Shops at the Freer-Sackler Galleries, the Cooper-Hewitt National Design Museum and the National Zoo are not operated by SBV.

# Smithsonian Business Ventures



### APPENDIX III: SBV Financial Performance

In Fiscal Year 2007, SBV generated \$166.4 million in revenues, producing a net gain of \$26.6 million which is returned to the Institution via the revenue sharing arrangements described in later sections of this report.

Since it was created, SBV has not achieved the hoped-for-gains in terms of increased dollars generated for the Institution. Prior to formation of SBV, the average net gain of Smithsonian business activities for the 3-year time period 1997 through 1999 was \$28 million in constant (1999) dollars. The average 3-year business activity net gain in constant dollars for the time period 2004 through 2006 was \$28.6 million, a modest 2 percent higher than before the creation of SBV. Certainly certain market conditions created unfavorable environments for SBV enterprises during much of their existence. As example, the *Smithsonian* magazine reached its apex in FY 1999, and soon thereafter the overall magazine industry entered the worst recession period in its history with market declines of 15-18 percent in both ad revenues and pages sold for monthly consumer magazines. Additionally, in the aftermath of the September 11<sup>th</sup> terrorist attacks, Smithsonian visitation plummeted dramatically. The average visitation during 1997 to 1999 was 30,255,000 compared to 22,260,000 during the 2004 to 2006 period. While there are questions about the accuracy of the visitor counts, a significant drop in annual visitation clearly did occur. Also, these numbers do not show that SBV absorbed a failed publishing operation, SI Press, and brought it to profitability during this period. Also noteworthy is that a major goal for SBV was to create what ultimately became Smithsonian Networks, an effort that proved time intensive and did not come to fruition until recently. While Smithsonian Networks could prove to be a very successful new business for the Smithsonian, recent SBV financial performance reflects only a small amount of contribution from its early stages.

The following table shows the slight business activity improvement since SBV was created.

	Nominal Net Gain	Constant Dollar Net Gain	3-Year Avg
FY 1997	\$27,854	\$28,912	\$28,054
FY 1998	\$23,564	\$24,084	
FY 1999 (Base Year)	\$31,166	\$31,166	
FY 2000	\$26,921	\$26,045	
FY 2001	\$21,920	\$20,620	
FY 2002	\$18,300	\$16,947	
FY 2003	\$21,633	\$19,588	
FY 2004	\$28,945	\$25,528	\$28,604
FY 2005	\$42,140	\$35,947	
FY 2006	\$29,450	\$24,337	
Change from 1997-1999 to 2004-2006 Average			+\$550 +1.96%

## **APPENDIX IV: OBSERVATIONS ON SBV**

The Task Force review yielded a considerable amount of information about how SBV has operated and performed, and about how it has been internally and externally perceived, over the last eight years. The Task Force recognizes there are strong opinions on all sides of the issues described below. From these opinions a number of themes emerged, in particular the main theme of this report—that **the cultural divide and communication gaps that have developed over the last eight years, and that persist today despite recent attempts to bridge them, is impeding the success of the Smithsonian’s revenue-generating activities.** Our intent is to make clear how even the most sweeping structural changes will be doomed to failure if these misunderstandings, broken relationships and inadequate connective processes are not first addressed.

*SBV’s Activities Provide an Essential Source of Unrestricted Revenue for the Smithsonian Institution, but Many Expected the Contribution to Be Greater.*

All Smithsonian staff agrees that the unrestricted revenue generated by SBV is absolutely essential to funding the operation of the Smithsonian and its units, and believe that revenue generating activities also should further the mission of the Institution. The erosion of base budgets across the Institution over the last ten years that has created staffing shortages (at the end of FY97, there were 6469 Smithsonian employees; at the end of FY07, there were only 5999 even though this same period saw the addition of several new museums and programs). Moreover, the successful efforts to bring the Central Trust budget back into balance after 9/11 resulted in most of the Central Trust financial support for Mall museums being eliminated. These factors have stretched individual unit budgets to the limit, heightening expectations for the performance of revenue generating activities and the unrestricted funding they can produce.

In Fiscal Year 2007, SBV generated \$166.4 million in revenues, producing a net gain of \$26.6 million which was returned to the Institution and shared between museum programs and the Central Trust via revenue sharing formulas. We found areas of very good performance within SBV, some enterprises with challenges that are being addressed, as well as underperforming enterprises. Prior to formation of SBV, the average net gain of Smithsonian business activities for the 3-year time period 1997 through 1999 was \$28 million in constant (1999) dollars. The average 3-year business activity net gain in constant dollars for the time period 2004 through 2006 was \$28.6 million, a mere 2 percent higher than before the creation of SBV. In fairness to SBV, performance certainly could have been worse in recent years due to post 9/11 international tension, reduced visitation, and a severe contraction of the magazine industry.

### *Communication and Culture*

Although recommended by the Mercer report and the Regents, the separation of SBV within the Institution, apart from many operational processes and previous relationships, was implemented in a way that has resulted in a cultural divide. It has contributed to suspicion and resentment between employees, and restricted opportunities for collaboration. This deliberate separation of SBV, combined with the management style of its former leadership, resulted in actual and perceived opacity of its operations and decision-making which

generated mistrust and misunderstanding. The Task Force acknowledges that recent leadership changes and reporting processes initiated by SBV have improved this situation. But comments from SBV and non-SBV staff reflect that the perception of a divide remains.

The emphasis on profitability goals, which was required by Smithsonian management and advanced by SBV leadership, at times has overshadowed the importance of these activities to the underlying mission of the Institution and left many Smithsonian staff with the perception that furtherance of the mission was not an important concern of SBV. In our conversations with SBV employees, they expressed a strong dedication to the mission, but they generally have felt isolated from the rest of the Institution because their role in advancing the mission has been de-emphasized, and their credibility with other Smithsonian staff has become strained, in many cases because of factors beyond their control.

In general, Smithsonian staff perceive SBV as dismissive of their ideas for new products and services or how to improve existing ones, and SBV staff perceives Smithsonian employees as not appreciative of the realities of operating a profitable business.

In sum, whether based on actual experience or perception, SBV's negative expectations about working with content experts—and the equally pessimistic views of curators and educators about working with SBV—have severely hampered this working partnership. This schism is exacerbated by a lack of clarity about how conflicts between SBV and museum directors should be resolved, which has caused confusion and created tensions. These circumstances have created a difficult relationship between SBV and the rest of the Institution. The resulting turmoil within SBV, combined with the current uncertainty about its future, has created significant retention and morale problems for its staff.

#### *Information, Reporting and Transparency*

As noted above, the relationship between SBV and other Smithsonian units has improved in recent months. Yet many staff expressed the opinion that they should have more information about SBV financial performance and costs than they see. The rationale behind major SBV decisions and Castle oversight of SBV was sometimes not shared beyond the Secretary with Smithsonian senior leadership and often not explained to Smithsonian staff. Smithsonian and SBV leadership jointly failed to recognize and adequately address these growing tensions thereby enabling a breakdown in the relationship between SBV and the rest of the Institution. There is simply a poor understanding of SBV's mission, strategy and performance throughout the Institution. And yet in some instances, SBV efforts at greater financial and operational transparency have been rebuffed by staff who are suspicious of the validity of the information.

### *Revenue Sharing Formulas Need Improvement*

SBV is not responsible for the agreements that determine how SBV net revenue from those enterprises that have a presence in the museum, or involve a collection-related license, is shared between the Castle and the museums. (The gains from other enterprises, such as the Smithsonian Magazine, all flow to the Central Trust). However, lack of transparency of these agreements and lack of consistency among them, and a belief that high SBV overhead costs reduced the revenue available to share has hampered cooperation between SBV and museum directors. In some instances, revenue sharing agreements have been coupled with museum debt issues, which has caused frustration and discouraged cooperation. Furthermore, the uses of the revenue allocated to the Smithsonian central trust are inadequately explained. In other instances, the absence of revenue sharing arrangements in certain business lines discourages content experts from collaborating with SBV. More recently established revenue sharing agreements, such as the one for work related to Smithsonian Networks, show promise because they are clear, equally applied to all units and at least so far, perceived as fair.

### *Smithsonian Supervision of SBV*

The Board of Regents involvement and awareness of SBV issues and interaction with the SBV Board has been limited during the last eight years, and the lack of business expertise among central Smithsonian financial staff also may have hampered oversight. In some instances, Smithsonian senior leadership could have been more helpful in mediating disputes between SBV and Smithsonian units.

The “Hub and Spoke” management style of the Smithsonian tends to run almost every issue through the central staff, including SBV issues. As a management system, there seems less unit-to-unit communication in the Smithsonian than usual elsewhere. This has the effect of increasing the isolation of an operating function like SBV that is grouped centrally with the staff functions, by restricting the channels of communication available to clear issues and build teamwork at operating levels. Roles relating to SBV issues have often not been well defined, well understood, or well aligned. It does not appear that SBV leadership was encouraged to build relationships among Smithsonian constituencies. Moreover, the SBV seems to have been tarred with the brush of being part of the last Secretary’s re-centralization strategy—and thus a proxy target for disagreement with that strategy on the part of museums.

### *Retail Operations Spark Disagreement, Have Great Room for Improvement*

The cultural divide between SBV and other Smithsonian staff is illustrated best by the widespread lack of confidence in SBV retail merchandising expertise that was expressed to the Task Force. Felt strongly among museum directors, this impression was reinforced by that of outside retail consultants and the Task Force’s analysis. Most directors, curators, and educators expressed the opinion that the merchandise in museum retail shops and in the catalog is of uneven quality and in some cases does not represent good scholarship. In addition, they believe some museum retail merchandise is of questionable taste and is inappropriate to sell. Many feel that merchandise selected by SBV is too similar to items found elsewhere and does not have a distinct “Smithsonian feel.” Most museum leaders

believe merchandise selection for museum stores often does not adequately reflect or capitalize on the individual identities of these venues and their collections and visitors. Some think food concessions are overpriced and over-emphasize low quality offerings, and that more venues should provide a high quality dining experience like the Mitsitam Café at NMAI.

Turnover in SBV's retail leadership over the last few years has hurt attempts to invigorate this business. Retail staff who deal regularly with museums believe they have tried to reflect the mission and the museums' preferences in their merchandise. Retail staff have at times felt pressured by the museums to make merchandising choices that were likely to be, and often were, unprofitable. They also believe that the major factor influencing store performance, visitation, is one over which they have no control. They are disappointed by the prevailing perception that they are not responsive to museum requests and that they do not care about the Smithsonian mission.

*The On-Line Platform: An Opportunity Needing Accelerated Attention*

The strategic and financial potential to use the Internet for revenue generating activities, including marketing across business activities, has not been effectively realized at SBV. SBV's start down the online road has been exceeded by some other museum retail competitors to the Smithsonian, primarily because (1) the Central Administration has felt the short-term net gain needs of the Institution have not allowed the initial investment necessary to fully capture the opportunity afforded by the Internet; and (2) lack of a Smithsonian-wide strategy and sense of urgency. To date, SBV has self-funded investments through budget cuts in the magazine and other areas. Market share is rapidly being established by competitors in this new, high-potential market for museum-based businesses, but the Smithsonian Institution's efforts have been hampered by weak domain knowledge, low resource commitment, and lack of a Smithsonian-wide strategy describing the desired online relationships of museums, research centers, the central organization, and the Smithsonian revenue-generating enterprises.

## **APPENDIX V: Task Force Methodology**

The Task Force attempted to conduct a “clean slate” review of SBV and its role within the Institution. Although each Task Force member brought distinct experiences and perspectives to this process, careful effort was made to identify biases where they existed, and to challenge everyone to take a fresh look at a situation with which several were already quite familiar. The Task Force had no pre-conceived notion of its recommendations before the review began, and based its ultimate recommendations on the fact-finding phase of the review, which was extensive, and its internal deliberations. Fact-finding tasks included the following:

### **Major Presentations and Informational Meetings:**

- Status of Regents Governance Recommendations as they relate to SBV
- History of Smithsonian business activities and SBV formation
- Operations and Revenues of SBV Businesses
  - Catalog, retail stores, Smithsonian Journeys, Smithsonian magazine, licensing, Smithsonian Networks
- Operations of SBV Shared Service Units
  - Finance and accounting, human resources, information technology
- Overview of SBV Compensation philosophy
- Overview and history of Revenue Sharing Agreements
- Roles and Responsibilities of the SBV Board
- Role of Smithsonian senior management in SBV oversight

### **Major Documents:**

- 1998 Mercer report and related documents on history of SBV
- Retail store “Request for Information” submissions and evaluations
- Phase I and II reports on SBV retail stores from Retail Consultant Berglass-Grayson
- 2006 Museum Store Association Report
- Smithsonian Board of Regents Governance Committee Report, June 2007
- Report of the Independent Review Committee, June 2007
- SBV Board of Directors letter to Acting Secretary, July 2007
- Smithsonian Inspector General Report on SBV Executive Compensation
- GAO Report on Smithsonian Networks contract

### **Stakeholders Consulted:**

- Smithsonian Board of Regents
- Smithsonian senior leadership
- SBV senior leadership and staff
- All Smithsonian directors
- Smithsonian Congress of Scholars
- Smithsonian Council of Education Directors
- All Smithsonian staff (via email request for input)
- Congressional staff from Smithsonian’s oversight and appropriations committees

External Individuals/Groups Consulted

- Retail consultants from The Grayson Group
- William Campbell, Discovery Networks
- Tate Museum
- British Museum
- Natural History Museum (Great Britain)
- Museum of Modern Art
- Golden Gate National Recreation Area
- National Gallery of Art

**APPENDIX VI: CURRENT SBV REVENUE SHARING AGREEMENTS**

Museum	Operating Unit	Calculation	Museum % Share	Central Trust Share	Treasurer Share	
Castle	Museum Store Operations	Total Revenue x Rate	5%	0%	0%	
	Castle Café	None	0%	100%	0%	
	Castle Staff Cafeteria	None	0%	100%	0%	
Hazy	Cart Operations	(Net Gain + Acct Alloc - Admin Fee) x Rate	0%	0%	100%	
	Main Operations	(Net Gain + Acct Alloc - Admin Fee) x Rate	0%	0%	100%	
	McDonalds	(Net Gain + Acct Alloc - Admin Fee) x Rate	0%	0%	100%	
	Other Operations	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
	Penny Machines	(Net Gain + Acct Alloc - Admin Fee) x Rate	0%	0%	100%	
	Simulators	(Net Gain + Acct Alloc - Admin Fee) x Rate	0%	0%	100%	
	Subway	(Net Gain + Acct Alloc - Admin Fee) x Rate	0%	0%	100%	
	Theater	(Net Gain + Acct Alloc - Admin Fee) x Rate	0%	0%	100%	
	Coffee Cart	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
Hirshhorn	Full Circle	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
	Main Store Operations	Total Revenue x Rate	5%	0%	0%	
	Other Operations	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
National Air & Space Museum	Basement Operations	Total Revenue x Rate	5%	0%	0%	
	Digital Photo	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
	Dog Tags Operations	Total Revenue x Rate	5%	0%	0%	
	Imaging	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
	Lockheed Mart	(Net Gain + Acct Alloc - Admin Fee) x Rate	67%	0%	0%	
	Main Operations	Total Revenue x Rate	5%	0%	0%	
	Mc Donald's	(Net Gain + Acct Alloc - Cost of Cap- Admin Fee) x Rate	25%	0%	0%	
	Mezzanine Operations	Total Revenue x Rate	5%	0%	0%	
	Other Operations	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
	Outdoor Carts	(Net Gain + Acct Alloc - Admin Fee) x Rate	25%	0%	0%	
	Penny Machines	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
	Planetarium	(Net Gain + Acct Alloc - Admin Fee) x Rate	67%	0%	0%	
	Planetarium Operations	Total Revenue x Rate	5%	0%	0%	
	Simulators	(Net Gain + Acct Alloc - Admin Fee) x Rate	0%	0%	50%	
	Staff Cafeteria	(Net Gain + Acct Alloc - Admin Fee) x Rate	0%	0%	0%	
	Theatre Kiosk Operation	Total Revenue x Rate	5%	0%	0%	
	Main Store Operations	Total Revenue x Rate	5%	0%	0%	
	Other Operations	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
	National Museum of African Art	AOTM Operations	(Operating Inc - Alloc Stores - Admin Fee) x Rate	50%	0%	0%
		Ice Cream Parlor	Total Revenue x Rate	10%	0%	0%
	National Museum of American History (prior to Museum closure)	Imaging	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%
Main Operations		Total Revenue x Rate	5%	0%	0%	
Main Street Cafe		Total Revenue x Rate	10%	0%	0%	
Mall Operations		Total Revenue x Rate	5%	0%	0%	
Music Operations		(Operating Inc - Alloc Stores - Admin Fee) x Rate	50%	0%	0%	
Other Operations		(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
Outdoor Carts		(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
Palm Court Coffee Bar		Total Revenue x Rate	10%	0%	0%	
Penny Machines		(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
POF Operations		(Operating Inc - Alloc Stores - Admin Fee) x Rate	50%	0%	0%	
Presidents Operations		(Operating Inc - Alloc Stores - Admin Fee) x Rate	50%	0%	0%	
Simulators		(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
Staff Cafeteria		(Net Gain + Acct Alloc - Admin Fee) x Rate	0%	100%	0%	
Subway		(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
Atrium Café		(Net Gain + Acct Alloc - Admin Fee) x Rate	0%	0%	100%	
Carts		(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
Coffee Kiosk		(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
Family Operations		see Westcourt Calc	0%	0%	0%	
Fossil Cafe		(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
Gallery Operations		see Westcourt Calc	0%	0%	0%	
Gelato Kiosk		(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
Gems Operations	(Operating Inc - Alloc Stores - Admin Fee) x Rate	50%	0%	0%		
Imaging	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%		
Jazz Café	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%		
Johnson Theater	(Net Gain + Acct Alloc - Admin Fee) x Rate	0%	0%	100%		
Mammals Operations	(Operating Inc - Alloc Stores - Admin Fee) x Rate	50%	0%	0%		
Other Operations	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%		
Penny Machines	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%		
Sims	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%		
Staff Cafeteria	(Net Gain + Acct Alloc - Admin Fee) x Rate	0%	0%	0%		
Summer Hrs	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%		
Tricerashop Operations	(Operating Inc - Alloc Stores - Admin Fee) x Rate	50%	0%	0%		
National Museum of the American Indian	Chesapeake Operations	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
	Other Operations	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
	Restaurant	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
	Roanoke Operations	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
National Museum of the American Indian	Gallery Operations	Total Revenue x Rate	5%	0%	0%	
	Museum Operations	Total Revenue x Rate	5%	0%	0%	
National Postal Museum	Other Operations	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
	Museum Store Operations	Total Revenue x Rate	5%	0%	0%	
	Other Operations	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
Renwick Gallery	Penny Machines	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
	Other Operations	(Net Gain + Acct Alloc - Admin Fee) x Rate	50%	0%	0%	
Donald W. Reynolds Center	Renwick Store Operations	Total Revenue x Rate	5%	0%	0%	
	Main Store Operations	Total Revenue x Variable Rate	12% min	0%	0%	
	Book Store	Total Revenue x Variable Rate	12% min	0%	0%	
	DWRC Portico Café	None (operation budgeted for net loss)	0%	100%	0%	
	Luce Center Restaurant	None (operation budgeted for net loss)	0%	100%	0%	
Courtyard Café	None (operation budgeted for net loss)	0%	100%	0%		