

What Americans Really Need to Know About Charities

... and how self-appointed watchdogs are muddying the waters.

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The economic crisis has put nonprofit organizations in a double bind. On the one hand, social-service organizations like food banks, rescue missions and health clinics have seen demand for their services skyrocket as unemployment rates rise and Americans see their savings, home values and retirement accounts plummet. Yet while demand for nonprofit services is rising, in a severe economic downturn it's harder than ever to raise dollars to pay for those services.

Since Americans at all levels are trying to make the most of every dollar, what should people know before choosing to give money to a charity?

Throughout the worldwide investment community, there is widespread agreement on the basic metrics that should be considered when potential investors are choosing where to place their hard-earned dollars. In evaluating a corporation, investors can assess leadership, revenue growth, price/earnings ratios and profit margins.

Evaluating charities isn't so straightforward. Besides looking at the financial information of the organization, charity evaluations must include the importance and effectiveness of the program the charity provides. Hence, it's difficult to establish metrics that can easily determine a charity's success. Even the self-described "charity watchdog" groups can't seem to agree on their own evaluation metrics.

For instance, the *American Institute of Philanthropy* only gives high ratings to charities that put at least 60 percent of their total spending toward programs. *Charity Navigator* only rates a nonprofit with "4 Stars" if more than 75 percent of its income goes toward program spending. The *Better Business Bureau's Wise Giving Alliance* demands that program spending be a minimum of 65 percent of total expenses.

This confusion would be laughable if the subject wasn't so serious. As a result of this simplistic dependence on an arbitrary ratio rather than a full examination of an organization's program effectiveness, well-known nonprofits like *Girls Scouts of the USA* are rated "A" by AIP but given only "two stars" by CN.

In their 2005 *Rating the Raters* report, the *National Council of Nonprofit Associations* and *National Human Services Assembly* found that, "some of the organizations that rate [charitable nonprofit

organizations] use their ratings as a critical component of their own revenue model (e.g., to generate membership/subscription fees, licensing fees, report fees, Web site advertisements), which leaves open to question whether they are motivated to inform donors or whether they are motivated by media attention that improves their revenue stream.”

Part of the problem lies in the fact that media attention fuels revenue for these groups, and negative assessments of charities garner the most media attention. This inherent conflict of interest might explain why their evaluations are anywhere between subjective and contradictory.

Whether these organizations are well-intentioned in their desire to evaluate charities or hamstrung by the inherent conflict of interest, they nonetheless are ineffective because they ignore the vital, yet complex area of program evaluation.

So, what's a donor to do?

The heart of the problem is that many self-appointed charity watchdog groups (and sometimes even the news media) are looking for a silver bullet: one statistic that is easy to calculate and can rate a charity as good or bad. As a result, they've become obsessed with the easiest ratio to calculate: the percents of revenue an organization spends on program, management and fundraising. Their simple reasoning is that the more a nonprofit spends on a program, the better it is.

While efficiency is indeed important, it pales in importance next to effectiveness. As Dan Pallotta wrote in a June 22 post titled “*Efficiency' Measures Miss the Point*” on his *Free the Nonprofits* blog at HarvardBusiness.org, “In 1995, *Physicians for Human Rights* had revenues of approximately \$1.3 million. They spent approximately \$750,000, or 58 percent of revenues, on program. Today that organization would fail all of the watchdog standards for ‘efficiency.’ It would be ineligible for a *BBB Wise Giving Alliance* seal of approval. The Nobel Peace Prize committee felt differently. *Physicians for Human Rights* won the Nobel Prize in 1997 for its work as a founding member of the *International Campaign to Ban Landmines*.”

Think about it. Who among us would ever invest a dollar of our retirement funds into a company that boasts to spend the least on management and marketing? No one. That company would soon be bankrupt. So why do the watchdogs want nonprofit organizations to disregard spending on skilled management and the most effective, growth-oriented fundraising programs? This spells disaster!

In reality, many of the most pressing causes of our day — poverty, literacy, AIDS research, homelessness, the environment — are best addressed not by big government and corporate America, but by nonprofit organizations. *Habitat for Humanity*; *ASPCA*; *Paralyzed Veterans of America*; *Catholic Charities*; *Salvation Army*; *American Red Cross*; *Nature Conservancy*; *St. Jude Children's Research Hospital*; *Operation Smile*; and your local rescue missions, food banks and health clinics each day make

the world a little better.

Because these issues are so vital, Americans should insist that the organizations that tackle them have the finest management and fundraising money can buy. Should we really scrimp on the leadership and marketing efforts of childhood cancer research and feeding hungry people? On the contrary — this is where we should invest even more money.

So, what's a nonprofit to do?

Ultimately, the watchdogs' current way of evaluating charities is woefully inadequate. Instead, there needs to be a more well-rounded way of assessing the success of nonprofit organizations. As Leslie Crutchfield and Heather McLeod Grant say in their book, "Forces for Good: The Six Practices of High-Impact Nonprofits," we need to look at the overall impact of a charity. To do this, I suggest organizations ask five probing questions about their own performances:

1. Are we having a significant impact? Are we effectively addressing an issue or cause that is important to the potential donor? Do we do what we say we will with donated dollars, and do we have methods in place to measure our impact? Do we build houses? Feed the hungry? Rescue animals? Assist veterans? Simply put, the single most important factor for a potential donor to consider is whether an organization actually does work the donor wishes to support.
2. Are we growing? Just as growth is one measure of the effectiveness of a corporation, so it is with a charity. Growth is often an indication of dynamism, vision, effective leadership and success.
3. Do we spend enough of our revenue on programs? A thriving charity should spend most of its revenue on the programs it purports to conduct because that's why donors give in the first place. But how much is the right amount? That depends on a number of factors including where the organization is in its life cycle (a new organization vs. a more mature charity vs. an organization in growth mode), what types of donations account for the bulk of revenue (e.g., small gifts, monthly pledges, large gifts, legacy gifts, gifts in kind) and what it needs to accomplish its objectives (e.g., hundreds of thousands of members to actually accomplish its advocacy goals).

A healthy, mid-size charity in a strong growth mode that has a diversified development model across direct response, major gifts, gifts in kind and foundation and government funds that designates 60 percent of its funds to program, could be far more effective than a charity that is not growing and depends only on one or two sources of revenue, yet puts 75 percent of its income to program.

4. Do we invest enough in management and marketing? Strong management and marketing contribute to the effectiveness, sustainability and long-term impact of a charity. Skimping on either management or fund development is short-sighted and ineffective.

5. Do we adhere to the highest ethical standards? Is there an independent board providing governance and oversight? Is there an outside financial auditor? Are there written ethical guidelines for management and staff? Is there public access to financial data?

By many measures, Americans are the most generous people on earth. These otherwise practical people regularly give away their hard-earned dollars to assist people who are less fortunate and to address social issues of importance.

For a charity to be entrusted with precious donor dollars, it should require far more than compliance with a simplistic formula. It calls for strong impact, growth, effective programs, sound management and marketing, and the highest ethics.

When a nonprofit organization can answer these questions in the affirmative, then it has earned the right to ask donors for their time, talent and treasure. And that gives them and other supporters the opportunity to do their part in making the world better, which makes each of us, everyone, all the richer.

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