Chapter 1

FROM ACCOUNTABILITY TO VALUE

Google the word "evaluation" and you'll get over a hundred million results in less than a minute.[1] There are hundreds of different approaches, and most are confoundingly complex. Indeed, measuring impact is the elusive holy grail of the nonprofit sector. And lately there seem to be a cavalcade of white knights hoping to save the sector. Journalists, bloggers, armchair evaluators, foundation CEOs, and self-styled philanthropic "analysts" pontificate solipsistically about logic models, theories of change, "Morningstar-like" rating services, sector-wide taxonomies, Zagat guides, and philanthropic "data management systems." It's all so audacious! Unfortunately, everyone seems to be blindly whacking away at the piñata of measurement without even knowing what's inside. And that's the bigger problem: it's not that we can't figure out the answer—it's that we're not really sure what we're asking for.

There's a lot at stake in getting this right. If we want to be able to *sell* our impact in the social capital market, we first have to *know* our impact. And in order to know our impact, and communicate it in some compelling way, we need to be able to quantify or measure it. This chapter explores the different drivers for measuring impact, explains the basic concepts, and introduces a simple framework that organizations can use to best capture and communicate their value.

Impact as Accountability

In the independent sector, our notions of impact are heavily influenced by individual donors, government, and foundations (those who support our work financially). There is of course an inherent mission-driven urge to improve our impact, but in my experience this is seldom the true driver of organizational desire to measure results. Case in point: I remember when I first started teaching classes for nonprofit executives at Northwestern University's Kellogg School of Management. It was 2004, and I had just released my first book, *Benchmarking for Nonprofits*. My first course was aptly titled "Benchmarking for Nonprofits: How to Measure and Improve Your Impact." I think maybe ten or twelve organizations signed up for the class; that was barely enough to keep it in the curriculum. The class went well, but the marketing team at Kellogg had a suggestion: "Why don't we change the name for the next offering?" They renamed it: "Performance Counts: How to Raise More Money by Demonstrating Results." Wouldn't you know, the class was packed!

How we think about measurement today is very much informed by the mentality of the independent sector, where donors consider themselves benefactors and nonprofits consider themselves the beneficiaries of largesse. This system of thinking has cultivated an "accountability" mind-set, wherein measurement is primarily used to account for financial resources and prove that donations were not misspent. Even when nonprofits seek to prove their effectiveness on a more rigorous basis, it is often to reassure donors that their dollars won't be wasted. According to the National Council of Nonprofits, "Two aspects of ethical practice have been most prominent in shaping the recognized 'best practices' of nonprofit organizations: accountability and transparency."[2] In a world of accountability, "best practices" are really just outstanding ways of proving that you're not bad. If the *best* we can do is not to be our worst, we may in fact have set the bar too low. This mentality is being driven by two forces: a heavily fortified legal regime and donor intent.

Over the years, a significant ethics and legal infrastructure has been created to guard against financial mismanagement, conflicts of interest, and tax code violations among nonprofits. An endless stream of high-profile scandals involving misappropriation of funds, fraud, and excessive compensation—most notably the one involving United Way in 1992—have only built up more legislative scar tissue. These developments have been a major factor in influencing the way we think about measurement today. Here are the major primogenitors of today's accountability regime:

- *IRS Form 990*. Form 990 is the Internal Revenue Service's primary tool for gathering information about tax-exempt organizations, for educating organizations about tax law requirements, and for promoting compliance with tax law.[3] It was primarily designed for monitoring and disclosure, not for setting performance standards for nonprofits. Form 990 has been the dominant source of information about nonprofits to date, serving up the majority of data made available to donors on such websites as Guidestar and Charity Navigator. The 990 does have a section (Part III) focused on "Service Efforts and Accomplishments" that requires organizations to list the accomplishments for their three largest (by expense) program services. Specifically, the IRS requires that organizations describe "program service accomplishments through specific measurements such as clients served, days of care provided, number of sessions or events held, or publications issued."[4] The 990 also requires "the activity's objective" both short-term and long-term.[5] This is the closest thing to any mandatory performance reporting for nonprofits, but this information has not been standardized in any way by the IRS, and most nonprofits report narrative data that is difficult to aggregate or analyze. The 990 also requires information about accountability and transparency, such as the composition of the board of directors, and answers to questions regarding conflict of interest policies, procedures for managing conflicts, a whistleblower protection policy, and a document retention policy.[6]

- *Sarbanes-Oxley Act of 2002*. One of the most influential laws affecting nonprofit accountability is the Sarbanes-Oxley Act of 2002, which was passed in the wake of the Enron scandal and created significant accountability requirements for publicly traded companies. Two of its provisions also applied to nonprofits: (1) a prohibition against destruction of documents that are tied to a criminal investigation, and (2) a prohibition of retaliation against whistleblowers. Though much of the Act is focused on public companies, many nonprofit boards have still benchmarked their accountability practices against the requirements of this Act as a precautionary measure.

- *The California legislature's passage of the Nonprofit Integrity Act*. In 2004, Governor Schwarzenegger approved the Nonprofit Integrity Act, which establishes certain accountability requirements for nonprofits operating in California. The Act requires audits for nonprofits above a certain size and mandatory board review of compensation for the CEO and CFO. It also regulates fundraising practices and prohibits various fraudulent or misleading fundraising practices.

In addition to these laws, many voluntary ethical codes and "accountability standards" have been promulgated. The Maryland Association of Nonprofit Organizations, for example, has created a set of fifty-five standards for nonprofits and a companion "Seal of Excellence" that organizations can apply for and license.

The standards are based on "fundamental values—such as honesty, integrity, fairness, respect, trust, compassion, responsibility, and accountability" and describe how nonprofits should act to be ethical and be accountable in their program operations, governance, human resources, financial management, and fundraising.[7]

Donor expectations further reinforce this accountability mentality. When it comes to measurement and data, most donors are primarily interested in this information to avoid making investments in "bad" charities, as opposed to informing their choices about which are the best ones. A recent survey (May 2010) by UK-based polling company YouGov reveals that over two-thirds of the British public (68 percent) would transfer their donations away from a charity if it were found to be performing badly. But only 18 percent claim they would feel more obliged to give to a charity they knew was performing well.[8] That pretty much sums it up.

In 2010, Hope Consulting completed a widely respected study called *Money for Good* in order to "understand US consumer preferences, behaviors, and demand for impact investment products and charitable giving opportunities."[9] The research focused on the largest segment of donors: those with household incomes over $80,000 (representing 75 percent of the charitable contributions from individuals) and focused specifically on high net-worth individuals, with incomes in excess of $300,000.[10] The findings support an accountability-type mind-set. Here's what they found:

- For better or for worse, Overhead Ratio is the number-one piece of information donors are looking for.
- In general, people are looking for comfort that their money will not be "wasted" (top three answers)
- Although donors say they care about nonprofit performance, very few actively donate to the highest-performing nonprofits, and very few spend any time looking into it.

- Donor comments:
  - "I look at what percentage of dollars actually goes to those being helped. I will look that up if it is easy to find."
  - "I look for 25 percent or lower admin costs."
  - "It's too hard to measure social impact."
  - "I'm not a mini-foundation; don't treat me like one."
- For the 35 percent of donors who do perform research, it is often to "validate" their choice of charity:
  - "I just want to make sure my charities 'hurdle the bar'; I don't care by how much."
  - "I just want to ensure that I'm not throwing my money away."
  - "I can't determine which is the 'best' nonprofit, but I can find out if a nonprofit is bad."
  - "We give to faith-based organizations if they are accredited by our church."
- Eighty-five percent of people say they do care about nonprofit performance, but only 3 percent make donations based on relative performance.
- Changing these donors behaviors will be challenging, due in large part to three critical barriers:
  - Donors don't give to "maximize impact" ("I give because it makes me feel good").
  - There is no "burning platform" to motivate change ("I don't research, but I am sure that the nonprofits to which I donate are doing a great job").
  - Donors are loyal. ("I give to the same organizations each year. Some metric won't change that.")

The lessons are pretty clear: the vast majority of philanthropic donors are *not* looking to make their giving decisions based on an organization's outcomes or performance. Most donors want to make sure nonprofits are well run and aimed at a problem they care about. The report concluded: "In general, people are looking for comfort that their money will not be 'wasted.'"

Most of the donor information and nonprofit watchdog sites are similarly inclined. They also reinforce the message to nonprofits that the way to communicate your impact to prospective funders is by demonstrating accountability. Following are some representative samples.

Charity Navigator

This organization calls itself "America's premier independent charity evaluator" and has analyzed the "financial health" of over 5,500 nonprofits. According to Charity Navigator, "We rate charities by evaluating two broad areas of financial health, their organizational efficiency and their organizational capacity."[11]

> • *Organizational efficiency*. Analyzing a charity's efficiency reveals how well it functions day to day. Charities that are efficient spend less money to raise more. Their fundraising efforts stay in line with the scope of the programs and services they provide. They keep administrative costs within reasonable limits. They devote the majority of their spending to the programs and services they exist to provide. Charity Navigator analyzes four performance categories of organizational efficiency: program expenses, administrative expenses, fundraising expenses, and fundraising efficiency.[12]
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> • *Organizational capacity*. We analyze a charity's capacity to determine how well it has sustained its programs and services over time, and whether it can continue to do so, even if it loses support or faces broad economic downturns. By doing so, we show givers how well that charity is positioned to pursue

long-term, systemic change. Charities that show consistent growth and maintain financial stability are more likely to last for years to come. They have the financial flexibility to plan strategically and pursue long-term objectives, rather than facing flurries of fundraising to meet payrolls and other short-term financial obligations. These charities can more ambitiously address our nation's challenges, envisioning and working toward long-term solutions. Charity Navigator analyzes three categories of organizational capacity: primary revenue growth, program expenses growth, and working capital ratio. We issue a score in each category, as well as a rating that combines a charity's performance in all three categories.[13]

The BBB Wise Giving Alliance

This intermediary evaluates 501(c)(3) organizations on four dimensions: how they govern, how they spend money, the truthfulness of their representations, and their willingness to disclose basic information. BBB rates nonprofits on the following four "accountability" standards:

- *Governance and oversight:* The governing board has the ultimate oversight authority for any charitable organization. This section of the standards seeks to ensure that the volunteer board is active, independent, and free of self-dealing.[14]

- *Measuring effectiveness:* An organization should regularly assess its effectiveness in achieving its mission. This section seeks to ensure that an organization has defined, measurable goals and objectives in place and a defined process in place to evaluate the success and impact of its program(s) in fulfilling the goals and objectives of the organization and that also identifies ways to address any deficiencies.[15]

- *Finances:* This section of the standards seeks to ensure that the charity spends its funds honestly, prudently, and in accordance with statements made in fundraising appeals.[16]

- *Fundraising and informational materials:* A fundraising appeal is often the only contact a donor has with a charity and may be the sole impetus for giving. This section of the standards seeks to ensure that a charity's representations to the public are accurate, complete, and respectful.[17]

All of this information may help a donor weed out bad apples, but it's unlikely to provide much information to help a donor decide whether a nonprofit is creating any significant social impact or which of many organizations is producing the best results.

Givewell

This donor ratings service purports to be more focused on effectiveness, claiming: "Unlike existing evaluators, which focus solely on financials, assessing administrative or fundraising costs, we focus on how well programs actually work—i.e., their effects on the people they serve."[18] Givewell uses four key criteria to help donors analyze and pick charities:

- Is there evidence that a charity's programs are effective?
- Are a charity's programs cost-effective?
- Can the charity productively use additional funds?
- Is the above information shared transparently?

Givewell's rigorous focus on evaluation certainly sets it apart from other donor sites, but its primary focus is accountability. Nonprofits are evaluated or measured not on their level of performance, but rather on absolute effectiveness (that is, whether it works *at all)* and on the organization's commitment to evaluation. Here is an excerpt from one of Givewell's analyses, this one pertaining to "developing world education":

> Our top recommendation in this cause is Pratham. Pratham has, in the past, shown a commitment to rigorous evaluation of its programming. This commitment does not by itself answer all the questions above, but to us it implies an organizational commitment to learning about what works and holding itself accountable. This charity has been closely involved with some of the studies discussed below and has completed a number of projects that have been evaluated by the Poverty Action Lab at M.I.T.[19]

The spotlight and focus on accountability from these nonprofit ratings websites puts pressure on nonprofits to think about their impact in a certain way: as a matter of compliance and donor risk aversion.

This accountability mentality is structurally reinforced through the ways in which donors give money. It helps to explain why so many foundations insist on "restricted" grants as opposed to letting nonprofits use funds for "general operating" purposes: general operating funds are harder to account for and could be construed to be "wasted" on overhead. (Grants to *general operating funds* can be used for any purpose the nonprofit wishes; *restricted grants* can be used only for the purpose designated by the grantmaker.) Accountability and risk management is usually behind another form of funding: grants commonly referred to as "challenge" grants (*we will give this much, but only if you raise this much first*). And accountability also explains the whole complex reporting regime in place for most government and foundation grants—few of which ever get read or used in any meaningful way.

All of these accountability drivers have created a due diligence "regime" that relegates measurement to the purpose of reassuring donors and proving that nonprofits are worthy of investment. In effect, measurement has become a kind of insurance policy for the donor. The current approach to measurement focuses on two primary questions:

1. *Did you do what you said you were going to do?* And did you use resources responsibly and account for them? This information is primarily designed to satisfy funder requirements and compliance reporting requirements.
2. *How can you prove that your program works?* And what type of research and evidence do you have to back this up? This information is primarily designed to establish credibility and trust with donors.

Measuring impact for accountability is particularly challenging for nonprofits because there are no common standards for what to measure. Beyond controlling risk (of losing money), it's often unclear what psychic benefit donors really want to know. What does it take to be "accountable" or to *prove* that you are "effective"? There are endless numbers of frameworks, methodologies, standards, calculations, rubrics, and measurement systems. As a result, nonprofits often end up mired in confusion or overcompensate by chasing their tails, measuring everything they can think of.

One reason donor interest in nonprofit performance data is so inchoate is that the primary value of a donor's gift—the psychic impact or "warm glow" of making the gift—is realized at the time the gift is made. Research supports this point: a ground-breaking study published in the journal *Science* found that when people made a decision to voluntarily donate money to charity, they experienced a burst of increased neural activity and heightened satisfaction in areas linked to reward processing at the moment of the decision.[20] The research described the effect as "associated with neural activation similar to that which comes from receiving money for oneself."[21] Because the primary intent of most donors is emotional, and the primary value of that psychic benefit is realized up front, any post-hoc data regarding a nonprofit's impact, although interesting, has no particular value or utility to donors.

This accountability approach to measurement has limited value to nonprofits in a social capital market, where stakeholders are less concerned about wasting money and more concerned about purchasing social outcomes that have value to them. Accountability is not the benchmark in the social capital market, it's just the price of entry. To succeed, nonprofits need to embrace a new approach to measurement, one that shifts the focus from compliance and accountability to value creation.

Impact as Value

The social capital market has created a different reason for nonprofits to measure impact: it's not about counting, it's about convincing. In this new market, nonprofits are motivated to measure their impact to demonstrate "value" created for existing stakeholders and to *influence* the resource allocation decisions of prospective stakeholders. Measuring impact in this way is about demonstrating that a nonprofit is making a meaningful contribution to outcomes—both social and economic—that stakeholders highly value. Measurement enables you to quantify and communicate the *degree* of value (such as outcomes) created by the work you are doing. If a particular stakeholder—a government agency or a corporation—*really* values the outcome, they're going to want to know how much impact was produced, not just that the strategy was proven "effective" by a researcher. As one veteran commodities trader put it when asked how markets are created: "Ambiguity is the enemy of markets."[22]

As we've seen, a donor who is giving for psychic benefit is concerned with questions like *Will the money be used to help people? Was it spent the way I wanted it to be spent? Was it used effectively or was it wasted?* These questions are all about the organization's accountability. On a very fundamental level, the donor wants to be reassured that he or she can feel good about giving the money to your organization. But in a social capital marketplace, a "value-driven" donor asks very different questions:

1. *What outcomes can your organization produce?* What are the outcomes you are hoping to influence or have a track record of achieving? In other words, to what end are you doing what you do? And how do those outcomes link to things that others care about or are willing to pay for? You may provide some evidence of your ability to produce these outcomes, either research or track record, but that is background information.
2. *How much change in that outcome can your organization create?* What is your contribution to that outcome? For example, if the outcome was increasing SNAP (Supplemental Nutrition Assistance Program) enrollment, how many people did you enroll? This may also involve demographic information (for example, who are you enrolling?) or cost data (what is the cost per person enrolled?).

In short, the purpose of measurement in the social capital market is to show not only that you are making "a difference" but also *what difference* you are making. To be sure, stakeholders in the social capital market are still rigorous and concerned about effectiveness. But the threshold for "proving" impact is not as high as in the accountability world: logic prevails in the absence of statistical evidence. For example, it doesn't really matter to a retailer whether the food bank in their area can prove that its programs were the *only* reason why more people are spending SNAP food stamps in their stores; it's enough to show that their efforts made a *substantial contribution* to the outcome of increasing SNAP enrollment in that area. Stakeholders in the social capital market have a direct, vested interest in creating certain outcomes. Accountability is built in: there is value only if results are produced. If so, it really doesn't matter *how* the results were produced: whether the organization conducted the program as it was originally designed; whether the organization spent all of their resources on computers, offices, or trips; or whether they were wholly or partially responsible for the outcome. The value is in the outcome, not the program design.

My goal in this chapter has been to help you understand the difference between being accountable and impact and to help you see why a traditional donor will primarily be concerned with *whether* you're making a difference, while a value-driven donor will want to know *how much* of a difference you made. To be sure, psychic benefit and social benefit are *both* valid reasons for investing in nonprofits. But nonprofits that want to tap into the vast resources of the social capital market will need to shift their focus from accountability to value. In the next chapter, you'll begin to see how measuring the right thing can help you do just that.