

# The End of Charity: How to Fix the Nonprofit Sector Through Effective Social Investing

David E. K. Hunter 25 September 2009

This article builds on three impolitic, unpleasant truths of which I have become persuaded over the course of my career working with and on behalf of nonprofit organizations.

*Unpleasant truth number 1:* While nonprofits work incredibly hard, with passion and dedication, and often in incredibly difficult circumstances to solve society's most intractable problems, there is virtually no credible evidence that most nonprofit organizations actually produce any social value.

*Unpleasant truth number 2:* Because so few nonprofits are willing to face this fact and ask themselves whether they are doing any good at all, or even as much good as they may be doing harm, we cannot rely on direct service nonprofits to fix themselves without a serious push.

*Unpleasant truth number 3:* In general, nonprofits do what their funders tell them to do. When funders make demands, more often than not the vision, mission, goals

and objectives of nonprofit organizations give way. As the saying goes, We are what we eat. . . . and most nonprofits are what their funders make them.

So, in the end, it will have to be the nonprofit sectors' funders (government, foundations, donors) who take the lead in building a strong, effective and efficient nonprofit sector — a sector that delivers what it promises, to those who need it most in order to have a decent shot at a productive, healthy, satisfying life.

This will be the end of charity — and the flourishing of effective social investing.

## **Evidence of a Broken Nonprofit Sector**

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Have I overstated the case? Is the nonprofit sector reliably producing social value — that is, changing the world for the better in targeted domains? That's why the sector was created in the first place: to meet public needs (Hall 2006).

## **Consider some examples.**

Many teen pregnancy prevention programs promote "abstinence only" and don't teach about contraception nor how to reduce risk in sexual behavior. But the fact is that "abstinence only" programs don't work: participating

teens start having sex as early as, have just as many sex partners as, have just as much sex as, and get pregnant out of wedlock just as often as other teens do. Worse, these programs actually do harm: when program participants do have sex, they are less likely to use condoms than are other teens, which exposes them to higher risks not only of pregnancy but also of contracting STDs — including HIV/AIDS (Maynard and Devaney, 1999).

Then there are the 21st Century Community Learning Centers, the nonprofit-run after-school programs intended to improve the academic performance of middle-schoolers attending under-resourced and underperforming schools. *All together, they get over a billion dollars a year to do so.* But a rigorous impact evaluation shows at best mixed results: limited academic impact (certainly not enough to improve these children's likelihood of succeeding in school) and an increased tendency toward negative behavior among participating elementary and middle school children (James-Burdumy, Dynarski, and Deke 2008).

Or how about D.A.R.E., a drug prevention program that was created in 1983 by then Los Angeles Police Chief Daryl Gates. D.A.R.E. is present in more than half of U.S. school districts, in all fifty states and thirteen foreign countries. It is typically delivered in schools by visiting police officers educating students about and presenting the dangers of drug use. But numerous studies have shown that D.A.R.E. doesn't work — it simply has no effect

on kids' drug use (Weiss, Murphy-Graham, and Birkeland 2005).

The list is endless:

- Scared Straight, an intervention that is intended to frighten kids who are heading for trouble out of becoming serious criminals by bringing them to prisons — but that can induce tendencies toward violence (Petrosino, Turpin-Petrosino, and Buehler 2003).
- Well intentioned but ineptly run mentoring programs where failed matches reinforce in youngsters a sense of their low worth and poor prospects.
- Homework support programs that don't go to the effort to find out directly from teachers what the homework assignments are and therefore can't really know if they are helping children do their homework better, or even know whether the kids hand in what they've done in the program.
- Programs intended to get people off welfare and into jobs that don't provide job-based coaching and support, even though it's known that job retention — not just getting a job — is the biggest challenge faced by the people they serve.
- Foster care programs that stop supporting kids when they "age out" of the system exactly when they need intensive support.
- Programs steering low-income people of color into higher education and counting each case of

matriculation as a job well done — when as many as 50% of these students drop out in the first two years and wind up doing no better than high school graduates with no college education at all.

These nonprofits and their supporters who believe in their value — government, foundations and donors alike — exhibit what Daniel Kahneman, winner of the 2002 Nobel Prize in economics, has called "delusional optimism" (cited in Bare 2005).

To ask a famous question: What is to be done?

## **Effective Social Investing**

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Like any investment activity, social investing involves putting resources to work in order to create something of value. Whereas investing in the commercial sector has financial objectives such as creating profits and shareholder value, social investing involves channeling resources — money, knowledge, support — toward nonprofits that measurably help to improve the lives and life prospects of the people who depend on their services and programs.

But social investing isn't monolithic. There is a continuum along which one can sort out various social investment approaches. So, for example, high-risk social investing involves channeling resources toward nonprofits that

show evidence that they are on the road toward being able to create such value for their intended beneficiaries reliably and sustainably, but need additional time and resources to build the capacities to do so. At the other end of the continuum, low-risk social investing means channeling resources exclusively to those nonprofits that already have a sustained track record of producing documented impacts. Clearly most social investors will operate somewhere in between.

I don't advocate for doctrinaire purity in social investing. I most emphatically do not believe that all social investing should be low risk. But I do advocate for clear thinking about what one is doing, why one is doing it and what one really is accomplishing.

Like commercial investing, social investing requires hard work up front and throughout the investment period. (This is yet another obstacle: in contrast to social investing, doing "charity" requires little work and provides great and immediate emotional rewards.)

While approaches differ, it is fair to say that social investing requires the following:<sup>1</sup>

- the use of *rigorous selection criteria* to choose nonprofit organizations to support,
- *structuring investments to strengthen organizations in which investments are made*<sup>2</sup> in order to enhance their ability to provide effective services reliably and

sustainably at high levels of quality,

- *tracking performance* and providing *non-financial supports*<sup>3</sup> as indicated, thus helping these agencies become more effective and efficient in helping the people they serve to measurably improve their lives and life prospects,
  - *diminishing transaction costs* to help these organizations stay focused on achieving their respective missions, and
  - helping nonprofits to *build reliable revenue streams* that will support them sustainably at the appropriate level of scale<sup>4</sup> — before terminating the investment.
1. ^Much of what follows is taken or adapted from the *Guide to Effective Social Investing*, which I co-authored with Steve Butz (2008).
  2. ^ In practice this typically involves several things such as making long (multi-year), relatively unrestricted investments that the organization can use in whatever ways it needs to in order to succeed against a series of ***pre-negotiated milestones*** — including such things as the ability to create a robust operating reserve, establish or build up its endowment, make capital and infrastructure improvements, and build essential organizational capacities such as an effective board, strong financial and human resource management, effective and efficient program management (with the use of

external evaluations when indicated), and organizational performance management. Continued investment should depend — at least to a significant degree — on the organization's ability to achieve its milestones.

3. ^ These are especially critical if it appears that the organization is experiencing unforeseen setbacks; this is not the time for an investor to cut and run (unless, for example, there was malfeasance or deception involved) – rather, it is the time to roll up one's sleeves and figure out how best to help bring things back on course to protect one's investment. This does not, however, imply uncritical acceptance of the organization's behavior; it could, for example, lead to tough conversations with the board of directors that might result in the replacement of an executive director.
4. ^ This will vary greatly from one social services organization to the next. Some are inextricably bound to the neighborhoods and communities in which they emerged and evolved, and their strategies may call for them to grow locally up to a certain point (which can be thought of in terms of "market penetration"). Others adopt strategies of aggressive regional and even national growth, through such means as replication, franchising, etc. There is no inherently right approach to scale. But it is fair to say that all approaches to scaling up pose enormous challenges to an organization's ability to maintain its quality and

ability to create social value — that is, good results for the people it serves. These matters should be looked at very carefully during the investor's due diligence selection process, and watched carefully throughout the investment period.

## **Investment Selection Criteria: An Engine for Radical Reform of the Nonprofit Sector**

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There is little mystery about what to look at when assessing organizations as prospective investment opportunities. While one might organize these categories in a variety of ways, inevitably they will include evaluating these organizational characteristics:

- leadership (board and executive),
- management (senior, mid-level and program),
- financial robustness,
- organizational depth, capacities and operational processes,
- infrastructure,
- strategic partners and other key stakeholders, and
- legal exposure.

These characteristics tell us whether a nonprofit is sound and running well, and something about its likely

sustainability — all legitimate investment concerns. *What they don't tell us is whether the organization is actually doing any good, actually helping improve people's lives and life prospects, actually creating social value.*

Consider the illustration that follows on below. Most social service nonprofits and their funders focus on the left side of the diagram. They want to know what the agency is doing and how many people it has served. They ask: How many meals were cooked and served in the soup kitchen, to how many people? How many middle schoolers attended the after-school program, and in what kinds of activities did they engage? How many newly released felons participated in the reentry program, and what curriculum does it use? How many unemployed people visited the job center and used the computers? How many job seekers took work readiness classes, and what skills were being taught? How many pregnant teenage mothers were served, and did they receive case management with or without wrap-around services?

These are the questions we ask when we look at the boxes on the left. And certainly, they are important questions. Doing all these things well does have some — albeit very limited — social value. But this limited social value is inherently short-lived. Once the meal is eaten and digested, what has changed? While of course it is necessary for children to have safe havens, is that enough to set them on course for successful living? Once the felon has finished his or her coursework, what difference

has this made? And if one finds a job but can't get it, or gets a job but can't keep it, or keeps a job but remains stuck in poverty, where is the benefit? And does it matter what kinds of case management services a pregnant teen receives if, as is so often the case, she will have a strong likelihood of abusing her baby, staying in poverty, abusing drugs? And if her baby is likely not to be as healthy as other children and not ready to make use of school when the time comes and soon languishes at the bottom of the class, what is the use of all that case management?

So, when we want to know about the social value produced by a nonprofit, we have to shift our focus to the right-hand side of the illustration. If we look at those boxes, a whole set of different questions arises. Who is receiving the meals in the soup kitchen, and what is it about their lives that needs to change? Are we linking them with services that can help them break out of their cycle of need, and how many people using those services actually reach self-sufficiency? Are the parents sending their children to the after-school program for anything more than to keep them safe? If so, what benefits do they expect their kids to get from participating, and what percent of these children actually do benefit as intended? Are felons in the reentry program changing their attitudes, habits and social networks? Are they getting and keeping jobs? And perhaps most to the point, are they breaking out of a criminal lifestyle and avoiding recidivism? And if so, what percentage? Are the unemployed people who are

using the job center and perhaps also taking work readiness classes getting jobs? Keeping their jobs? Moving up a career ladder to self-sufficiency? And what are the percentages who do? Are teenage parents avoiding drug use? Taking good care of their infants and young children? Not abusing them? Are the children healthy and thriving and ready for school when the time comes? Are the mothers finding daycare and employment and moving out of poverty? And again, what are the percentages?

In other words, we have to know what outcomes (measurable changes) a social service nonprofit actually is delivering to the people it serves. Put differently, what can program participants reasonably expect will improve about their lives or life prospects as a result of their participating in a nonprofit's programming?

And these are exactly the questions that social investors want answered. So social investors will add the following item to the selection criteria listed above:

- program or service value.

This is measured by looking at:

- Who, exactly, is the organization serving and what are their needs?
- How many and what percentage of the people they serve finish the programs or receive a large enough and long enough exposure to services so that they

can benefit?

- What empirical basis is there for believing that an organization's program(s) and service(s) are effective — that is, producing outcomes for the people they serve?
- What are those outcomes, what are the indicators used to assess them, and what is the rate of success for program participants in reaching them?

In my experience, the majority of nonprofits cannot answer these questions. Many don't even know with much reliability who they serve, how often and for how long. And as long as grantmaking was considered a form of charity, that really was okay (at least for fundraising — I would argue it was decidedly *not* okay for the people relying on these agencies to help them in essential ways). But in this new age of accountability, nonprofits that cannot answer these questions will find it harder and harder to attract funding from social investors. And social investors will increasingly represent the larger sources of revenues flowing into the nonprofit sector.

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The transition from charitable giving to intentional social investing has major implications, some of which admittedly are a cause for discomfort and concern to many people and organizations in the nonprofit sector.

Perhaps easiest for them to accept is the hope (and for some investors even the expectation, yet to be proven true) that social investing will promote the cultivation and growth of high-performing nonprofit social service organizations.

Less comfortable, doubtless, are the intended corollaries. Social investing, if widely adopted, will help channel funding streams that are directed by measurable performance rather than feel-good stories, habits of giving and rank sentimentality. And social investing has the potential (yet to be realized) to advance a selection process that either forces poor performers to evolve and improve, or weeds them out.

The bottom line is that social investing, if it succeeds, offers the potential to reduce the enormous cost to society of funding and sustaining organizations that are not high-performers and cannot justify their claims that they produce the social value promised in their mission statements. It means that scarce resources will be better spent, and people using social services will more likely benefit and achieve what they have been promised.

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