1 The Pressure to Perform

These are times that try the nonprofit soul. Hardly a day goes by without a news story about a nonprofit or philanthropic foundation gone wrong. Congress seems ready to put strict limits on how much nonprofits can spend on administration and fund-raising. State attorneys general continue to grind through a seemingly endless list of investigations. A deeply divided nonprofit sector remains mostly silent in its own defense. Not surprising, perhaps, public confidence has hit a contemporary low.

Even as nonprofits face unrelenting scrutiny, the so-called jobless recovery has yet to produce a surge in charitable giving. Federal, state, and local governments are cutting discretionary spending wherever they can. Philanthropic investment strategies are becoming more conservative as the federal government's budget deficit grows and interest rates begin to climb. And individual giving remains sluggish. Not surprising, again, nonprofits are doing everything possible to access new revenues but are finding little investment capital available.

At the same time, the nation wants more of virtually everything that nonprofits deliver, but with no administrative costs. The baby boomers are starting to retire, creating a wave of board and staff vacancies and producing intense competition over the next generation of employees both inside the nonprofit sector and against governments and private businesses. Nonprofit organizations are aging, too, with larger, older nonprofits becoming just as bureaucratic as the government agencies that fund them. To top it off, the nonprofit sector continues to add 3,000 to 4,000 new organizations every month, each one requiring at least some investment in organizational capacity, not to mention generating more competition for funding, staff, and board members.

The current crisis is unlike anything the nonprofit sector has ever faced. Watchdog groups are stronger and better staffed than ever. The media are better trained and more aggressive, too, and members of Congress and state officials are more engaged. The sector itself contains twice as many "targets" as it did just a decade ago, including the quasi-nonprofits created in the wake of campaign finance reform and the faith-based organizations that have emerged as potentially significant competitors for government support. In short, the past three years have created a "guilty-until-proven-innocent" climate that affects almost everything that matters to nonprofits: from raising money and managing volunteers to balancing the books and recruiting employees.

Defining the Crisis

Even a cursory sampling of guest editorials from the *Chronicle of Philanthropy* shows the range of opinion on addressing elements of this crisis. Claire Gaudiani argues for a "generosity revolution" built in part around a corporate tax credit designed to "enlarge the amount of money corporations learn to give and shareholders learn to accept as wise investments in the economy and society." Jeffrey Berry says nonprofits should stop hiding behind federal lobbying law as an "excuse for inaction," accept the fact that it is perfectly legal not only to lobby but to lobby extensively, and start giving "voice to those who can't speak for themselves." Lester Salamon urges the sector to confront the growing imbalance between "the nonprofit world's 'distinctiveness imperative,' that is, the things nonprofit groups do to remain distinct and thereby justify the special tax and other privileges they enjoy, and its 'survival imperative,' that is, the things these organizations must do to survive." William Schambra asks Congress to take on "big, elitist, bicoastal foundations" in search of a "more moderate, sober, humble philanthropy, no longer confident that it possesses a special capacity to shape public policy and more open to supporting citizen groups trying to design their own policies, however haltingly and unscientifically." Pablo Eisenberg urges Congress not to "squander its opportunity to clean up the nonprofit world," in part by increasing the Internal Revenue Service's enforcement budget by $250 million, of which at least $75 million would be earmarked for strengthening oversight by state attorneys general.[1]

Looking in the Mirror

There is much to embrace in these opinions and great hope that the sector's financial condition will improve once the recession ends, assuming that (1) the recession will ever end for nonprofits and that (2) private giving will somehow offset government cuts as budget deficits grow.[2] It is not clear, however, that increased funding, aggressive advocacy, and tougher enforcement will ease public worries about nonprofit performance.

More funding is unlikely to increase public confidence unless the sector can prove that nonprofits do a good job spending money wisely; more advocacy is unlikely to increase confidence unless the sector can make the case that nonprofits are doing a good job helping people, being fair in their decisions, and running their programs and services; and tougher oversight will not help unless the sector can address public concerns about nonprofit waste. Neither can the sector assert itself out of the current crisis by reminding Americans about all the good things it does. Many Americans no longer believe what the sector says on its own behalf, and few nationally recognized leaders are willing to stand up in its defense.

Absent strong objective evidence to the contrary and expanded investment in the organizational capacity to create it, public confidence is almost certain to continue its downward slide. According to an October 2003 telephone survey, only 14 percent of Americans said nonprofits did a very good job of spending money wisely, just 18 percent said the same about being fair in decisions, 21 percent about running programs and services, and 34 percent about helping people. As for stewardship, 60 percent of Americans said nonprofits wasted a great deal or a fair amount of money, while 46 percent said nonprofit leaders were paid too much, compared with just 8 percent who said they were paid too little.[3]

Bluntly put, Americans are not questioning *what* nonprofits do, but *how* nonprofits work. Asked to pick the largest problem facing the sector in October 2003, just 15 percent of Americans said nonprofits had the wrong programs for helping people, while 70 percent said nonprofits had the right programs but were simply inefficient. Put a different way, many Americans think the nonprofit sector has the right programs but that it often has the wrong organizations.

Discounting Reality

It is easy to discount these opinions as mere artifacts of negative press coverage. Yet, hard as it might be to accept, it is entirely possible that the public is more right than wrong about nonprofit performance. After all, millions of Americans are in the nonprofit sector every day, whether as donors, board members, employees, volunteers, or clients. In 2003 alone, roughly 100 million Americans volunteered, donated to, or worked in the nonprofit sector, and that does not include the millions more who went to the shelters, centers, theaters, museums, clinics, schools, marches, and campaigns organized by local organizations. If Americans can see the antiquated systems, executive pressure, employee burnout, constant scratching for dollars, leaky pipes, and broken windows, perhaps the nonprofit sector should see them, too.

Also hard as it might be to accept, former senator Bill Bradley (D-N.J.) and his McKinsey and Company colleagues could be right that the nonprofit sector has billions that it could put to better use through better management. "Imagine what an extra $100 billion a year could do for philanthropic and other nonprofit institutions," Bill Bradley, Paul Jansen, and Les Silverman write in the *Harvard Business Review*. "That's more than three times the annual giving of every charitable foundation in the United States. It's nearly twenty times the amount spent annually on Head Start. In fact, it's enough to give every high school graduate in the country a $40,000 scholarship."[4]

According to Bradley, Jansen, and Silverman, the vast majority of the sector's "$100 billion opportunity" resides in lowering the cost of raising and distributing funds, putting foundation assets to work faster, and improving the efficiency of program and administrative operations by "closing the gaps in performance between the more efficient nonprofits and the laggards." According to the estimates, benchmarking alone would help the bottom half of performers to reduce their service expenses 15 percent, which in turn would produce $55 billion that could be put to better use. Moreover, the savings would not stop there. "Our work with for-profits shows that even top performers can benefit from benchmarking individual functions because few organizations are at the peak level of performance across all of their activities. Thus any efficiency improvements among the top half of performers would further increase the savings.

The argument might be easier to accept if the estimates included the costs of implementation. It not only costs money to make money, it also costs money to save money. Equipping every nonprofit with the technology to raise funds on the Internet would cost billions, benchmarking would require both time and energy, not to mention occasional help from for-profit consulting firms such as McKinsey, strategic planning is both time-consuming and expensive, and McKinsey itself reports that mergers often underperform against expectations. Moreover, as Salamon argues in a scathing critique of the McKinsey analysis, "The McKinsey experts bring a combination of deep biases, serious misunderstandings, wild generalizations, half-truths, and sloppy reasoning to what charities need. In the process, they do a disservice to those who have dedicated their lives to improving the health and welfare of average Americans."[5]

As Salamon rightly argues, nonprofits are much better managed today than they were ten years ago. "This is no longer 'your grandfather's nonprofit sector' awaiting the arrival of the McKinsey geniuses to redeem it from sloth, but a resilient and competitive part of the American scene whose recent growth rate has exceeded that of the business world by 50 percent." Every survey I have conducted confirms Salamon's hunch about improvement: foundation executives believe it, as do scholars, consultants, and executive directors. And, as this book shows, nonprofits are doing a great deal to improve their performance every year.

However, as this book also shows, nonprofits are doing much of that work without any help. The vast majority of capacity building is self-funded and occurs with little or no contact with the outside world. Unlike the private sector, which spent more than $100 billion on consultants in 2003, nonprofits have little access to the kind of capital needed to update facilities and systems and often launch improvement efforts with limited planning and little objective data with which to measure success.

Thus, instead of arguing about where the McKinsey analysis is wrong, the nonprofit sector would be better off asking where it might be right. "We need to more deliberately create an expectation and demand among ourselves for measuring and improving our results on a regular basis," writes Alison Fine, director of a Washington-based evaluation firm called the Innovation Network. "We can continue squabbling among ourselves and allow others to prescribe what they think is best for us, weakening each other—and the sector—in the process. Or we can define the issues, frame the debate ourselves, and work collectively and with renewed vigor to establish what's truly important to our field, our organizations, and the people and communities we serve."[6]

Inside Opinions

If the nonprofit sector will not listen to the public or McKinsey, perhaps it will listen to Robert Egger, the sometimes caustic founder of the D.C. Central Kitchen and author of *Begging for Change*.[7] Some might discount the book for its dedication to punk rockers Joe Strummer and Joey Ramone, while others might wonder how a former nightclub owner found his way into nonprofit life. But none can doubt Egger's heart. He built the D.C. Central Kitchen from scratch as one of the first "food rescue" operations in the nation, took a brief leave of absence to help rescue the National Capital Area United Way from a Senate investigation, and remains one of the most visible figures in the antihunger movement.

More to the point of this book, Egger minces few words about the state of the nonprofit sector. Mega nonprofits such as the Salvation Army may have the dollars to invest in basic infrastructure, but most service agencies are constantly struggling to stay alive: "They struggle to hire and train employees. They're stuck between paying high salaries to their upper-level managers and offering respectable wages and benefits for lower-level employees. Many don't have the financial security to plan long-term goals. Some have to cobble together dozens and in some cases hundreds of different grants and subsidies to run their organizations, all of which have strings attached that in some way compromise the mission."

Egger overstates the level of nonprofit pay, which I believe significantly trails comparable government and private business jobs, and understates organizational mortality, which hovers well below government immortality, but above small-business turnover. However, I believe he is quite right about the sector's tolerance for bad behavior: "If our sector were subject to the same forces as the for-profit sector," he argues, "tens of thousands—maybe hundreds of thousands—of social service agencies would have merged, consolidated, or most likely gone out of business. Instead, they stay afloat because of lax IRS rules, an internal code of silence, and a public that hates to see an organization with a worthy cause go under, no matter how anemic it is."

Egger is also surely right about the need for further reform: "The only way to improve the nonprofit sector is for every constituency—the government, the private sector, the public, but most important, nonprofits themselves—to demand more and expect more from our nonprofits. We need to seek out and reward organizations that exemplify leadership, unity, responsibility, and accountability—and let go of those that can't or won't." He is also right about public confidence: "The recent downturn in public support for nonprofits isn't about the economy or 9/11. It's about skepticism. The public has had enough with pity and platitudes. Americans want a plan."

Those who do not believe this should talk to a nonprofit employee. As the next chapter shows, the nation's 12 million nonprofit employees are highly motivated, hard working, well led, and deeply committed, but they often serve in organizations that do not provide the resources they need to succeed. They are members of a first-rate work force often employed in second-rate organizations with third-rate equipment. Along with the chance to make miracles every day, nonprofit employees must tolerate high levels of stress and burnout, and many face persistent shortages of information, technology, training, and staff to do the job well. The nonprofit sector too often expects its work force to succeed in spite of organizational weaknesses that would collapse most businesses.

More to the point here, nonprofit employees have serious doubts about how their own organization works. Although they have much greater confidence in how their organization spends money, makes decisions, helps people, and runs programs and services than Americans in general, they report serious shortages in the basic resources needed both to achieve *and* to sustain high performance day after day. How can they sustain high performance when almost half say their organization only sometimes or rarely provides enough employees to do their job well? How can they sustain it when half describe their organization's hiring process as slow, or when a majority rate the quality of frontline employees as somewhat competent or less, and almost as many say the same of their board? How can they sustain it when 70 percent strongly or somewhat agree that it is easy to burn out in their job and that they always have too much work to do?

At least for now, the nonprofit sector survives because it has a self-exploiting work force: wind it up and it will do more with less until it just runs out. But at some point, the spring must break. As such, the current crisis is not at all about nonprofit hearts. Rather, it is about persistent organizational weaknesses that lead to the kinds of stories that invite public disquiet, media inquiry, congressional investigations, and demands for further regulation. Absent investments in nonprofit capacity, and the demonstrable gains in performance that such investments produce, the doubts will remain.

Plan of the Book

The challenge is to make a case for organizational investment at a time when nonprofits have little discretionary funding and must often choose between computers and kids, training and trees, salaries and seniors. Absent strong empirical evidence that capacity building actually produces the promised increase in capacity, which in turn produces the hoped-for increase in effectiveness, nonprofits pick the kids, trees, and seniors every time.

Chapter 2 provides the basic logic for this book by linking organizational capacity to discretionary giving and volunteering. The chapter starts by examining the nonprofit sector's capacity deficit and then argues that capacity affects organizational effectiveness, which shapes public confidence, which affects the willingness to contribute money and time to nonprofits other than one's own religious institution or alma mater. Although the statistical case is built on perceptions of capacity and effectiveness, the linkages between these key predictors of organizational performance are strong and clear nonetheless.

Chapter 3 examines the current state of capacity building by asking what nonprofits have done lately to improve organizational effectiveness. After examining the meager evidence on whether capacity building works, the chapter introduces the national survey of nonprofits that underpins the book. The chapter examines the recent history of organizational improvement among the 318 nonprofits that participated in the study. Although these nonprofits have been working hard to improve their organizational performance, the chapter shows that they have been doing at least some of that work without the full engagement of their boards and frontline staff and without adequate planning, funding, external contact, and objective measurement.

Chapter 4 takes the case for capacity building further by asking whether and how these improvement efforts changed the organizations in which they occurred. Simply asked, if capacity is important to effectiveness, does capacity building actually improve capacity? The chapter starts with basic questions about how to measure success in the absence of a hard bottom line against which to compare organizations before and after an improvement effort. It then examines a basket of possible measures that might be used as surrogates of success and proceeds to an analysis of why some of the efforts are judged as more successful than others. As the chapter concludes, it does not matter where the funding comes from, but it must be adequate.

Chapter 5 offers a brief inventory of advice for nonprofits on how to improve the odds of capacity-building success. Regardless of their age, size, or state of their budget, nonprofits that use evidence to track their capacity-building efforts, make more contact with the outside world, raise even a small amount of funding for their effort, and do advance planning are always more successful than their peers. The value of outside contact depends, in part, on the strength of the nonprofit infrastructure. It hardly makes sense to call on the consulting community, read a book or manual, or attend a training workshop if the consultants are weak, the books are dense, and the training is overpriced. The chapter concludes with a brief discussion of the urgent need to recruit the next generation of nonprofit employees. The sector is in a war for talent in a shrinking labor market but does not seem to know it.

Chapter 6 concludes the book by asking how nonprofits actually use capacity building to advance up a spiral of nonprofit excellence. Drawing on twenty-five case studies of high-performing nonprofits in Atlanta, Chicago, Indianapolis, Los Angeles, Minneapolis, New York City, San Diego, San Francisco, and Washington, the chapter argues that nonprofits move up and down a spiral that begins with organic questions about how the organization will make a difference, who does what, why it exists, and how it will know it is successful, if it is, and ends with reflective questions about legacy and renewal. As the chapter argues, there is nothing automatic about movement up the spiral—nonprofits move up and down the spiral as they confront crises and shocks, new opportunities and problems, leadership and board transitions, and the natural problems of growth and decline.

This is a research report, not a how-to book. It builds the case for organizational investment on hard evidence, not anecdote, and is based on five years and $2 million of data, including four major sources: (1) a 2001 random-sample survey of 1,140 nonprofit employees, (2) a 2003 random-sample survey of 770 Americans, (3) a 2003 random-sample survey of 318 nonprofits with annual budgets at or above $25,000, and (4) twenty-five case studies of high-performing nonprofits in the nine cities noted above. The book also draws on past surveys by the Center for Public Service of employees in federal government, business, and low-income-serving children, youth, and family agencies, a string of public opinion surveys on confidence in nonprofits, and my two earlier book-length studies of nonprofit effectiveness.[8] Much of this work was supported by the David and Lucile Packard Foundation, including the national survey of nonprofit capacity building that forms the backbone of this book.

Although many nonprofit executives and employees accept the case for capacity building, their donors and boards often underestimate the need for capacity building during hard times. Moreover, I have heard more than a few nonprofit executives describe technology, training, strategic planning, and so forth as luxuries of a kind. My hope is that a healthy blast of evidence will convince donors, boards, and even a few executive directors that building capacity is very much a necessity for sustainable effectiveness. Although at times the book may overwhelm readers with percentages, I believe it is time for a good old-fashioned overwhelming.

Conclusions

Some readers will argue that restoring public confidence is a slender rationale for investing in organizational capacity. Public opinion is notoriously unstable and easily influenced by the latest scandal, yet hard to change once it turns negative. Moreover, if Americans have not noticed the reengineering and reinventing that Salamon celebrates, how can anyone expect them to notice a new wave of capacity building?

A first answer is that confidence is both a leading and a lagging indicator of the changing market for scandal. Its decline creates a political market for negative coverage by the media, Congress, state attorneys general, and watchdog groups, which in turn creates further erosion. Just as declining trust in government has created a market for bureaucrat bashing and an unrelenting campaign against Washington and waste, declining confidence in nonprofits has created a climate for nonprofit bashing. It is a vicious cycle well worth stopping early.

The second answer is that declining confidence is a signpost of changing donor and volunteer attitudes. Donors and volunteers are demanding greater returns on their "investments" as their worries grow about nonprofit performance. Although one cannot say for sure that giving and volunteering will decline in absolute dollars and hours if confidence does not rebound, expectations most certainly have and will change. The donor choice movement began well before September 11, for example, but has accelerated since, in part because leading nonprofits such as the American Red Cross have been pressed to guarantee 100 percent pass-through on disaster relief.

A third answer is that confidence is a perfectly valid measure of organizational effectiveness, both for the sector as a whole and for individual nonprofits such as the Red Cross and United Way. Used in a basket of indicators that covers program and financial outcomes, confidence does reveal something about an organization's impact on its world. As we see shortly, public confidence in the Red Cross and United Way have improved over the past year due in large part to board development, new leadership, media relations, and strategic planning, all of which are forms of organizational capacity building. Although the gains have not affected confidence in the sector as a whole, they show that confidence can and does respond to organizational improvement.

Confidence is also an often-overlooked measure of regulatory outcomes, whether for the Internal Revenue Service, Congress, state attorneys general, inspectors general, or watchdog groups. In theory, increased regulatory activity should produce overall gains in nonprofit performance, whether through audits of individual nonprofits, adoption of best practices, or creation of what a federal inspector general has described as the "visible odium of deterrence."[9] In practice, however, most watchdogs prefer to be measured by their bite, meaning the number of audits and investigations opened, dollars recovered, indictments, and funds put to better use, rather than by public confidence. Nevertheless, it seems reasonable to hold watchdogs to some higher standard.

Finally, confidence clearly has some bearing on employee productivity and pride. At least in 2001, the vast majority of nonprofit employees said they felt proud to tell their friends and neighbors what they did for a living, and just under half said they were very satisfied with the public respect they received from their work. At least in 2001, nonprofit employees were also far more likely to trust their own organization to do the right thing than either federal government or business employees. But even in 2001, there were warning signs about the future: nearly a third of the nonprofit employees interviewed said that, all things considered, they would rather work in government or business, and half said they would receive the same amount of respect in a job outside the sector.

Unfortunately, there are no comparable trend data showing the corrosive effects on employee attitudes of declining confidence in the federal government. But there was a time when the public trusted the government to do the right thing, thought salaries were reasonable, perceived waste to be low, and trusted most agencies to spend money wisely, make fair decisions, help people, and run their programs and services efficiently. The nonprofit sector may well be at a similar moment today. Absent investment and self-regulation, the sector may someday soon find itself longing for the golden days when only 60 percent of Americans thought nonprofits wasted a great deal or a fair amount of money and when 14 percent thought nonprofits did a very good job spending money wisely.

I also believe that organizational investment is warranted even if improved effectiveness has no impact whatsoever on confidence. Indeed, the key link in the case for capacity building is not between organizational effectiveness and public confidence, but between organizational capacity and effectiveness. As this book shows, relatively small investments in capacity building can improve organizational capacity, which, in turn, can produce significant gains in output such as staff morale, management focus, public reputation, efficiency, and productivity, which, in turn, can produce significant gains in perceived management and program effectiveness. If those gains in organizational effectiveness produce gains in public confidence, all the better. But the case for capacity building is well made on the basis of organizational effectiveness alone.