



EVALUATING CHARITIES: WHY THE NUMBERS COUNT

Source: Charity Navigator

By Kyle Waide, Deputy Director

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In this era of online trading, e-commerce and virtual communities, numbers are everywhere. In seconds, you can find a whole army of scores, ratings and polls for stocks, bonds, mutual funds, cars, books, movies, restaurants, CD's, bath oils, and just about any product, company or politician you can think of. These numbers are derived from other numbers, also a few points-and-clicks away. You can find, for example, any publicly traded company's P/E, EPS, Beta, Market Cap, Moving Average (50- or 200-Day), Price/Book, Price/Cash Flow, and dozens more ratios and averages, as well as the company's quarterly or annual filings with the SEC, not to mention enough "off-line" investor newsletters, magazines and cable television shows to turn you into a walking stock screener.

Some would say we've gone a touch overboard with all these numbers. Beyond the frightening possibility that the day will come when we can't decide where to eat lunch without first consulting an average customer rating, this overabundance of data can be more confusing than clarifying. There are so many numbers issued by so many different experts that many have become meaningless. Indeed, too many ratings result from obvious conflicts of interest that individual consumers seem willing to ignore. (Witness the lack of objectivity among stock analysts during the dot.com boom and bust).

Are we more interested in ratings than products? Perhaps, but most of us would agree that the data craze is actually beneficial. Numbers help us navigate a crowded marketplace. They tend to be reliable and useful. They enable us to make informed decisions with our money. They protect us in most cases from catastrophic mistakes. (The case of Enron is a notable exception.)

Given this all-you-can-digest buffet of data, it seems impossible that all of us over-educated consumers would do anything without having data to guide us. And yet, up to now, the world of charities has remained relatively untouched by our quantitative demands. If you look up those charities you supported last year, are you able to learn if they're effective or efficient? Probably not. Givers have been willing to fork over hundreds of billions of dollars to charity while knowing next to nothing about the organizations we've written checks. How has this happened?

To begin with, it's inherently difficult to place a value on such services as feeding the hungry, healing the sick, or educating the underserved. As a result, the charity world simply lacks those easy-to-communicate, uniform bottom-line numbers that serve as barometers and guides in other areas of our lives, numbers such as quarterly earnings or win-loss records or even report cards. The bottom-line for a food bank may be how many meals it serves, while that same bottom-line says very little about a medical research institute. Although surveys show that givers want more data on charities, we have been willing to overlook the lack of a bottom-line and have continued to support worthy causes. (Individuals gave around \$150 billion to charity in the year 2000, more than ten times the \$10.8 billion that corporations gave.)

But an equally important explanation for this enormous blind spot in the number stream is that charities are uncomfortable with data analysis by outsiders. With no uniform bottom-line, the only data currently available for analyzing charities is financial information—how much a charity spends on fundraising and other overhead, what it pays its CEO, how large is its endowment. Non-profit leaders and fundraisers argue that widespread, publicly available analysis of this financial data is necessarily misleading. Such analysis allows and even encourages average prospective donors to compare charities in the same way that they compare stocks and radios and cars and houses and everything

EVALUATING CHARITIES: WHY THE NUMBERS COUNT

else. Non-profit leaders suggest that quick comparisons and evaluations of fundraising costs and endowments fail to capture the unique value of their organizations and the "human element" to their work. According to this view, every charity is uniquely valuable, evaluation of a charity is best left to the charity itself, and comparative analysis of financial data is like comparing apples to oranges. It does more harm than good.

This should neither surprise nor satisfy us. How many companies, politicians, authors, and eighth graders would like to tell us how good they are at what they do, instead of having us evaluate them? (By the way, boss, I'm your best employee.) Of course, you don't have to be a parent or an Enron shareholder to see the shortcomings in this system. Without comparing financial data, there's no way for us to know if an organization's fundraising practices are competitive with other organizations, if its revenues are keeping up with its expenses, or if it's about to go under. It's simply impossible to make a fully informed decision when the people seeking your money get to tell you why they deserve it. (I don't know about you, but I've never heard a charity admit that another organization deserves my check more.)

With hundreds of billions of dollars flowing through charities each year, we simply cannot perpetuate a system where it's impossible to access independent and objective data-driven evaluations of charities. But in the absence of a uniform bottom-line, what can numbers tell us about charities? Having analyzed more than 3000 financial statements for some 1100 charities, I can say that the numbers show me four important ways in which quantitative financial analysis can help improve our philanthropic marketplace.

First and most importantly, the numbers show that the majority of America's largest charities are fiscally responsible and financially healthy organizations. Three out of four of the charities examined by Charity Navigator spend less than 10% of their budget on fundraising costs, less than 15% on administration costs, and at least 75% on the programs and services they exist to provide. Nearly half have accumulated at least a year's worth of working capital to fall back on during economic downturns. The majority of them demonstrate healthy rates of growth both in increasing revenue and expanding their programs and services. Very few of us would be unsatisfied with a charity whose financial performance fits this profile.

Secondly, the numbers show that understanding the financial performance of charities is neither an art nor a mystery. The vast majority of charities perform in financially similar ways. While they don't pursue the same financial objectives as for-profit businesses, such as maximizing profits or shareholder value, charities do pursue the same general financial objectives as each other. Charities seek to maximize the resources they devote to their missions, to cut overhead costs, to develop more efficient ways to raise money, to increase revenue and expand services over time, and to maintain a healthy balance sheet that ensures their long-term future.

In addition to these shared objectives, similar charities face similar financial conditions. These conditions play a direct role in determining how charities perform financially. As conduits for giving to other charities, fundraising organizations (United Ways, Jewish Federations, for example) are required to limit their own overhead expenses; accordingly, they devote an average of 5.9% of their functional expenses to administration costs. Museums incur greater administration costs in maintaining and housing their collections and devote 21.8% of their expenses to meet these needs. Public broadcasting charities, which are required to use expensive air time to raise money, spend an average of \$0.24 to raise \$1.00. International relief and development charities can employ far less expensive fundraising strategies and spend only \$0.05 to raise \$1.00. Functioning primarily as non-cash businesses, the average food bank maintains only enough working capital to cover expenses for 1.4 months, while the average community foundation, which exists to manage assets and make grants to other charities, maintains more than eight years' worth of cash and securities.

That similar charities demonstrate similar financial goals and similar patterns of performance toward those goals shows that financial analysis can enhance our understanding of charities. The claim that all charities are unique and cannot be fairly compared to each other using financial data ignores these similarities. Financial analysis highlights them. This should tell us that financial analysis of charities is not misleading. It's not imprecise. It's not hocus-pocus.

EVALUATING CHARITIES: WHY THE NUMBERS COUNT

Indeed, financial analysis helps us evaluate charities more fairly and accurately. And it helps us make more informed decisions about which charities to support.

Third, the numbers show that even more scrutiny is needed, not less. One reason for this is that there is far too much flexibility in the way charities report their financial information. Financial analysis helps us identify where guidelines and regulations need to be enhanced and clarified.

A second justification for greater scrutiny is that we need to know more about how charities work now and how they can work better. More sophisticated tools for financial analysis will encourage innovation in all aspects of non-profit management. Charities will be certain to respond to a marketplace that shows them how they can perform more efficiently and demands that they do so.

A third justification for more scrutiny, not less, is that givers are being asked to sort through more charities than ever before, and they need more tools at their disposal to make informed choices. Large professional grant-makers (corporations and foundations) already require charities to set quantifiable goals and to report results. Non-profits respond openly to these large funders because so much is at stake. But unlike these large grant-makers, most individual givers don't have enough access to be this demanding. Just because you receive a nice letter inviting you to write a check for \$20, \$50, \$100, or some other amount, that doesn't mean the organization's president or development director is willing to visit you in your living room. Yet individuals still account for more than 75% of all giving in this country. If we want that giving to be effective, we must develop tools that enable these givers to make informed giving decisions.

Finally, the numbers show us that not all charities are equal. Most charities are fiscally responsible and financially health organizations. But 23% of the charities evaluated by Charity Navigator ran an annual deficit in their most recently completed fiscal year. Some 14% devoted less than 70% of their budgets to their programs and services, and 6% devote less than 60%. More than 26% have experienced a decline in their primary revenue over the past three fiscal years, more than 13% have contracted their programs, and 10% maintain less than a month of working capital.

America's largest charities are sophisticated organizations run by seasoned professionals who are already aware of how their financial performance affects their programmatic performance. The differences in the financial performance of similar charities cannot be chalked up to the unique circumstances they face. Some are more efficient than others. Some are more effectively managed than others. Some are more successful than others. Non-profit leaders know that these differences exist, and they know that financial analysis helps identify who's who.

The recognition that not all organizations are equal should encourage us to adopt a more sophisticated approach to giving. We can no longer expect charities to meet only a basic threshold of reliability. Million-dollar charities are too large and too important to receive pats on the back. If charities are to fulfill their true potential, if they are to help us overcome our greatest challenges, then we as givers must change how we evaluate and support them.

Utilizing financial analysis to evaluate charities will help us become better givers. It will help us identify charities with more cost-efficient and sustainable programs. At the same time, we must develop quantitative measures for assessing how effectively charities provide their programs. Knowing if two organizations require the same level of support to sustain programs of vastly different quality will help us identify those charities that are more likely to achieve lasting results.

Lastly, we must act on what we learn. Our charitable dollars will be used effectively only if we bring the same level of sophistication to supporting charities that we apply to our spending in other areas of our lives. This means that we support charities that show results. Whether it's as investors, shoppers, diners, or voters, Americans know how to use numbers to guide their decision-making. It's time we do the same as givers.