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Efficiency Measures Short-Change Individual Action

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by Dan Pallotta

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This is the fifth in a series on the failings of "efficiency" measures. Today: incremental vs. average effects.

The average percentage of a nonprofit's donations that goes to "the cause" may be dramatically different than the percentage of *your* donation that goes to the cause. "Efficiency" measures calculate an average for all donors, but an average effect is not the same as an incremental effect. Let's say a nonprofit had $1 million in revenues in 2008. It had $400,000 in administrative and fundraising costs and $600,000, or 60%, available for programs. We force the charity to tell individuals that 60% of donations went to the cause. This is misleading. If you gave $100,000 to an organization that was already sure to cover its $400,000 administrative and fundraising expense, then your $100,000 gift likely had a $100,000 impact on programs. If you didn't give it, they would have had $100,000 less for programs. 100% of your donation went to the cause.

The mandate that charities disclose averages stifles the motivation to donate. We compel the release of information that makes donors think their donation will have a much different effect than it actually might. The appeal to the new donor ought to be that every new dollar will have a one dollar effect on the cause (unless they have a fundraiser working on commission or the gift excites them to spend more on fundraising and administration). This is true even if, for example, the charity has added a new $100,000 expense in the form of an ad in the *New York Times* to attract new donors. That $100,000 will have to be covered by funds that would otherwise have gone to programs if it isn't covered by new donors, so each new dollar rescues a dollar's worth of program funds.

My company had an experience with this when we were under the ether of averages ourselves on a series of events for AIDS vaccine research. Participant numbers were very low which meant revenues would be low. Fixed costs were...well...fixed. So the average percentage of donations going to the cause (using extremely conservative accounting with no allocations to mission) was looking to be about 11%. In the interest of this dysfunctional ethic, we thought, "maybe we should tell everyone this so they feel we're being up-front." So we did. And no one wanted to donate anymore, so the 11% prediction became a self-fulfilling prophecy and we raised less for AIDS vaccine research. It would have been honest to say that 98% (after bank fees) of every new donation at that point would go to the cause. That would have increased donations and the money going to vaccine research, which was what everyone really wanted – and which would have been far more ethical if the ethic is based on the good that gets done. Instead we disclosed information that discouraged donations – and for what? So we could feel good about a bad ethic? Even if we didn't talk about incremental effects – even if we simply declined to disclose the average – we would have raised more for vaccine research, and had a higher average in the end to boot! It's a twisted ethic that orders you to disclose averages in the interest of lowering averages and hurting the cause.

An average is an abstraction. Incremental action is real. It's the only kind of action I can take. Why would I care that the average donation going to vaccine research is 11% if the percentage of mine that will go is 98? The "efficiency" measure runs on averages. It ignores incremental effects. That's fatal.

University of Indiana economist Richard Steineberg, who pioneered the distinction, wrote, "The average fundraising percentage contains little information of value to individual donors ... While society may care about the average return to donations, individuals can only control their increment to the donative pool...it is rational that they should care only about incremental returns from their individual donations.... Incremental returns do not depend on the average fundraising percentage."

To give you an idea of how little progress we have made, this wasn't written last week. Steinberg wrote this in 1989.

Dan Pallotta is an expert in nonprofit sector innovation and a pioneering social entrepreneur. He is the founder of Pallotta TeamWorks, which invented the multiday AIDSRides and Breast Cancer 3-Days. He is the president of Advertising for Humanity and the author of Charity Case: How The Nonprofit Community Can Stand Up For Itself and Really Change the World.

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