Why financial ratios aren't the way to evaluate nonprofit organizations

By Mal Warwick

The fundamental assumption underlying the claims of all the so-called "charity watchdogs" is that how much a nonprofit organization spends on fundraising is, independently of any other factor, an important indicator of its quality. (I use the word quality to bypass the question of efficiency vs. effectiveness, which is a separate and equally important matter.)

But, as anyone involved in raising money for nonprofits knows perfectly well, the proportion of an organization's revenue that is used to cover fundraising costs – the "fundraising ratio" in the jargon of the field – varies widely from one organization to another. And that's not just because nonprofits choose different strategies. The ratio is affected by many other factors such as the following:

1. *The popularity of the cause or issue.* If a nonprofit organization must depend on the generosity of just a few zealots rather than gifts from the general public, it's unlikely to match the fundraising performance of the American Red Cross or the Salvation Army.

2. *The organization's age.* Over time, an organization can establish a track record, build name recognition, and assemble a large list of loyal donors. These things are rarely possible in a nonprofit's first couple of years.

3. *Fundraising methods used.* The cost of a sumptuous lunch at even the most overpriced Manhattan eatery will be more than offset by a $10,000,000 endowment gift from a generous luncheon companion. But that $15 dinner you served to people paying $25 each didn't stack up quite so well. Neither did those 10,000 fund appeals you mailed at a cost of 50 cents apiece, yielding a grand total of $3,000 in gifts.

4. *How much money the organization raises.* Within limits, an institution that raises a great deal of money is likely to do it at a lower cost per dollar than a smaller nonprofit. Small organizations can't easily achieve economies of scale.

5. *The skills and experience of the development department.* A well-organized, professionally managed fundraising staff can reasonably be expected to raise money more efficiently than a startup operation or an institution with unseasoned fundraising staff.

6. *Competition.* If you have to spend thousands on advertising a celebrity golf tournament to get public attention on a weekend when three other charities have scheduled major events, you're suffering from what the business world calls "competition." Though some people in the nonprofit world are squeamish about that word, we are indeed in competition.

7. *The character of its constituency.* A community action agency serving poor people will have a tougher time raising money than the art museum in the same city. Most well-to-do folks may identify with the museum. Few will feel they have a stake in a community action agency unless they're involved as board members or volunteers.

8. *The charisma of its leader.* If your boss is Lance Armstrong or Oprah Winfrey, your organization has a big advantage in presenting itself to the public. Outstanding leaders sometimes attract support regardless of the specific character of their work. Many people welcome opportunities to identify with charismatic figures.

9. *The zeal of the fundraiser.* How many universities have gone "over the top" against all odds in extraordinarily ambitious capital campaigns because of the president's passionate commitment to reach the goal? How many churches and hospital wings have been built because of the grit and persistence of a single-minded campaign chair? The difference a dedicated leader can make is incalculable!

These are among the many reasons why the fundraising ratio may vary from one organization to another. And that's why I have little patience for the rigid, one-size-fits-all approach that some legislators, regulators, and charitable watchdogs want to bring to this question.

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