KIMETRICA WHITE PAPER

Defining What You Do Best: Rationalization for Non-Profits

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Ben Watkins,
Kimetrica LLC
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Kimetrica
P.O. Box 1327, Village Market 00621
Nairobi, Kenya
Tel: +254 (020) 201 8156

80 Garden Centre, Suite A-368
Broomfield, CO 80020
Tel: +1 303 997 0336

www.kimetrica.com

CONTENTS

1 INTRODUCTION

In any sphere of human activity, success requires focused effort and specialization. Socrates makes the point in Plato's Republic, written around 360 BCE. People and organizations should do more of what they do best, yet nonprofit organizations working in international development are often unfocused and unspecialized. Defining focus is the most crucial strategic set of decisions that an organization takes, but nonprofits face formidable incentives to lose focus. This paper argues that if organizations are interested in achieving high and measurable performance, they need to resist the temptation to drift and take deliberate and regular steps to focus and refocus.

Section 2 examines the extent of institutional drift in nonprofits and identifies some probable causes. Section 3 highlights the negative consequences of drift for measuring and improving performance. We outline the main steps toward rationalization in Section 4. Business rationalization is about resisting the urge to do everything and defining a narrow set of products and services. Having a narrow and relatively stable set of products and services allows organizations to measure performance and adjust their methods and processes based on performance information, as we describe in Section 5.

When organizations take on ambitious, complex and abstract goals, like reducing poverty, they are tempted to do everything it takes to achieve the desired results. Specialisation and rationalisation do not mean giving up on dreams of big impact, it means refocusing impact strategies around collaborative partnerships with other high performance but specialized organizations, as we discuss in Section 6.

2 WHAT IS INSTITUTIONAL DRIFT AND WHAT CAUSES IT?

Institutional drift or loss of focus is the tendency of nonprofit organizations to increase the scope of what they do, or claim to do, over time. It is an endemic tendency in the nonprofit sector. Specialisation is a deliberate decision to do x, y and z, and not to do a, b and c. Drift occurs when there is no obvious decision point and we just end up doing something organically.

The following statement could come from any one of thousands of nonprofits. We are not picking on Oxfam:

Around the globe, we work to find practical, innovative ways for people to lift themselves out of poverty and thrive. By supporting schools, to helping farmers sell their crops for a fair price, to improving access to people with HIV/AIDS to healthcare - our long-term development projects are transforming lives. We work with communities to tackle the causes of poverty by a combination of hands on know-how, financial investment and education. We give people a voice to speak out against the laws, actions and policies that keep them in poverty. This is how we create lasting change. [Accessed 05/27/2016 from https://www.oxfam.org/en/longtermdevelopment]

Unless an organisation is set up to do something specific, such as Médecins sans Frontières or the UN World Health Organisation, some drift is inevitable. Even within specialist organisations, drift occurs around the edges: health is, after all, a large and nebulous subject, and holistic management of health problems can involve doing just about everything.

Organic and unfocused growth happens in many organizations. The Washington Post has this to say about the Clinton Foundation:

"It was not designed as a master plan but rather has grown, one brainstorm at a time, in accordance with the ambitious, loyal, restless and often scattered nature of its primary namesake," the Post reporters write. "Many programs were sparked by chance encounters in Bill Clinton's life."

https://www.washingtonpost.com/politics/the-inside-story-of-how-the-clintons-built-a-2-billion-global-empire/2015/06/02/b6eab638-0957-11e5-a7ad-b430fc1d3f5c_story.html

To gain a sense of the extent of generalisation in international organisations, we selected the largest non-specialist international nonprofit organisations working in international development and relief. We also selected the largest non-specialized UN agencies and the main multilateral development banks. Organizational size was measured based on annual budgets.

From corporate web content searches, we tabulated data on who does (or claims to do) what from ten primary “sectors”. Where possible, we verified the “what we do?” lists with evidence of ongoing projects in that sector. Where the online data did not permit verification, we have placed a question mark.

Among some of the main players in international development, the level of generalisation is striking. In Table 1 below, we can see that the gaps are quite sparse. A similar analysis of the primary international donors shows the same pattern.

Table 1: What Top Development Nonprofits Do (and do not do)

ORGANIZATION	Sector									
	Health Care incl. HIV/ AIDS	Education	Governance, peace and security	Disaster Management / Relief	Agriculture	Environment and Climate Change	Financial Services, micro-finance	Small Business Development	Water and Sanitation	Social Protection*
UNDP	X	X	X	X	X	X	X	X	X	X
WFP	X	X		X	X	X	?	?		X
UNICEF	X	X	X	X					X	X
UNIFEM	X	X	X	X			?	?		
UNHCR	X	X	X	X	?	X	X	X	X	X
World Bank	X	X	X	X	X	X	X	X	X	X
African DB	X	X			X	X	X	X	X	
Asian DB	X	X			X	X	X	X	X	X
BRAC	X	X		X	X	X	X	X	X	X
World Vision	X	X		X	X	X	X	X	X	X
CRS	X	X	X	X	X		X		X	X
Oxfam	X	X	X	X	X	X	X	X	X	X
ACDI VOCA	X		X	X	X	X	X	X	X	X
Save the Children	X	X		X	X		X			X
Care International	X	X	X	X	X	X	X	X	X	X
IRD	X	X	X	X	X	X			X	
Mercy Corps	X	X	X	X	X	X	X	X	X	X
ICRC	X		X	X	X			?	X	X

* *Includes cash or food handouts excluding emergency distribution*

Some organizations have followed a gradual or unsteady path to generalisation. Oxfam, for example, has gone through several rounds of questioning, and at least two attempts at rationalization. However, the data illustrate a strong tendency away from specialisation, in organizations that are defined by what they want to achieve or who they want to help rather than by what they want to do.

We also reviewed the Forbes Fortune 500 list for 2015, which ranks global companies based on their annual revenue. The list also includes information on their areas of specialization. The contrast between the World's most successful companies and the largest international development organizations could not be greater.

Specialization in Top Companies

It is hard to find a single example of a top private company that provides services in more than two distinct sectors or industries. Not one of the World's most successful companies does. Ranked at 19 on the Fortune 500 list for 2015, EXOR produces cars and has a controlling stake in one soccer team. Nestle, ranked at 70, is perhaps the most diversified of the top 100 companies, but has been divesting some non-core companies recently. Procter and Gamble (100th) produce and distribute a range of consumer products and has also been rationalising products and cutting brands since 2014. Tata Motors (at 254 on the 500 list) is part of the famously diversified Tata Group empire, but each company has a separate governance structure and publishes independent accounts and tax returns. Very few of the World's successful companies are diversified at all.

Why should this be? Companies that lose specialization lose their comparative advantage, become less competitive, and risk going out of business.

Less evidence is available to explain the lack of specialisation in parts of the nonprofit sector. Clearly, motivations vary between organisations but we can isolate the five most likely influences. Let's start with the reasons that the organizations themselves give.

1. **Conceptual missions.** Explicitly, all the organizations listed are structured around big ideas such as poverty alleviation or reducing suffering. Within organizations that are founded to solve abstract problems, such as "poverty" or "hunger" or work with a specific group of people (women, children, the elderly, or refugees) rather than to do something specific, drift is the norm. If one's basic mission is to tackle an abstract problem the there is a fair chance that the solution will be non specific. It is what Peter Drucker (1992) called "a hero sandwich of good intentions". Clearly, reducing hunger entails a smorgasbord of strategies ranging from improving girls' education, to disaster response, better health care and improved household incomes. Therefore, a nonprofit might reason, we should do <u>all</u> these things if we want to reduce hunger.
2. **Opportunistic strategies**: When donor money is flush, and particularly when donor countries are keen to use NGOs as proxies for delivering development assistance (rather than investing in potentially disreputable governments) there is a strong institutional incentive to lose focus, as Edwards (1998) points out. For example, USAID routinely issues Requests for Proposals for implementation of large, multi-sector programmes and it is rarely convenient for NGOs to bid as part of a huge consortium. Revenue maximisation is achieved by learning the donor bidding and contract management processes and maximising scope. Edwards (op.cit) also makes the point that to manage donor funding risk,

it makes sense for NGOs to adapt to trends and fads in donor funding, rather than sticking to one sector that may go out of fashion.

3. **Glamour.** Defeating world hunger and tackling poverty are, on the face of it, far more appealing than being known as the world experts in digging low-cost pit latrines. Some extremely specialised work is also monotonous and unglamorous. Take, for example, is the Codex Alimentarius, which is one of the World's most important lists. It is nothing like saving babies, yet it helps ensure improving global food safety and that Governments do not use spurious food safety allegations to block trade.(http://www.fao.org/fao-who-codexalimentarius/about-codex/en/).

If these three considerations are a powerful force away from focus, nonprofits also lack the two primary forces that help private companies to start focused and stay focused.

4. **Regulation and other fixed cost barriers to entry**. For a private company, the costs of getting started in a new industry or product line must be recouped, so they will be reluctant to invest in a new product or service unless they are sure that it is viable. For a nonprofit, the start up costs are usually covered by donors, so the barriers to diversification are lower. Taxation also tends to be lower for NGOs and other regulatory barriers will depend on the country, but are generally more stringent for private companies than for nonprofits. International and national NGO regulation is generally weak. Bloodgood et al. (2014) provide a convincing explanation of what makes some countries more restrictive than others.
5. **The threat of competition** is the main reason why companies stay focused. Companies that compete in markets for services for which they do not have a comparative advantage will eventually lose market share to competitors, lose money, become less profitable and go out of business. In contrast, there is no inherent link between a nonprofit's survival threat and its ability to deliver efficient services. Fundraising prowess and ability to navigate the labyrinth of donor grant management guidelines are likely to be more important attributes for survival.

Corporations <u>must</u> control their inherent tendencies to drift, so they do.

3 CONSEQUENCES OF DRIFT FOR PERFORMANCE MANAGEMENT

Specialisation is intimately linked to efficiency. A nonprofit's short-term goal of maximising revenue may be best served by an opportunistic model, but if its long-term goal is to get the greatest possible impact per dollar spent, specialization is necessary. The consequences of drift for performance include:

- **Lack of institutional learning** about the industry and improvements in practice. If each project is a unique combination of this and that, how can we improve and genuinely learn lessons? "Economies of time" - becoming more efficient over time - cannot be exploited if we are constantly learning from scratch.
- **Failure to exploit economies of scale**. If there are economies of scale, these will be best exploited by doing one thing on a larger scale in a given location rather than doing many things on a small scale. Small may be beautiful, but its unit cost tends to be higher.
- **Lack of business process and cost model enhancement**. It takes time and experience to develop a robust business model for doing one thing well. Linked to the business model is a deep understanding of costs and risks, and the relationship between cost, quality and risk. How can we budget for a service that we do not fully understand?
- **Lack of specific performance metrics,** efficiency benchmarking and control systems. If the business model is constantly changing, we cannot develop metric systems for measuring and comparing performance over time. We cannot tell whether we are improving. What performance indicators can you select if you are not entirely clear what you do?
- **Lack of a career track for subject specialists**. Nonprofits often benefit from having highly motivated employees. They have a potential quality advantage and cost advantage in the sense that they can may be able to attract highly motivated individuals at below market rate. In a large unspecialised nonprofit, career growth will entail a gradual deskilling as people manage larger and more diverse portfolios. Top subject specialists will not be attracted to such a career path. Rather than attracting and retaining people who are leaders in their field, these organizations will be staffed by generalists, who are reasonable at doing a number of things.
- **Failure to develop networks**. In any country and sector, an organisation's ability to understand the sector and the market, and to identify key experts depends, to a large extent, on access to specialised networks. Building networks with specialised suppliers, with the right faculty in research institutions, with the key facilitators in government and with other service providers is critical for long term improvement in quality of service and cost efficiency.
- **Failure to deliver a model that can be handed over** to local (typically specialised) public institutions. Public institutions are, for the most part, specialised. Specific schools, health centres or agricultural research stations can be handed over to specific institutions to ensure that the long term benefits of the investment are realised. Community-driven "hero sandwich" projects cannot be handed over to public institutions.

4 REFOCUSING

How can organizations unlock the measurable performance gains from specialization? Becoming specialized requires a deliberate process of *product and service rationalization* (PSR) in nonprofits, as in any other organisation. In the private sector this is an extremely common and many large corporations have well defined guidelines and processes for doing it.

For private companies, specialization is based on *comparative advantage*. If you can deliver a cheaper or better product than your competitor you have an advantage. Companies focus their resources on what they are good at doing. If they consistently ignore comparative advantage, consumers will purchase from their competitors and they will, eventually, go out of business. Nonprofits do not face this basic survival risk, and so they can continue to be a "jack of all trades" indefinitely. In the absence of market discipline, nonprofits need to take continuous and deliberate steps to get focused and stay focused.

We have tried to synthesize the main steps from the wealth of materials available for private companies.

Step 1: Development of a decision-making process. Clearly, PSR is a major - perhaps the major - corporate strategic choice. Tactical choices on how to implement the rationalisation will be a key to achieving the strategic objective. PSR entails major tradeoffs and has immediate cost implications. We can anticipate differences of opinion, heated discussion, and, possibly, negotiation deadlocks. A highly inclusive and consultative approach will be impossibly lengthy and costly. It is probable that there are in-house proponents for all the current products and services, and they will see rationalisation as a turf threat. In contrast, a technical choice process with limited consultation and board-level decision-making will likely create some ill-feeling and passive resistance.

If conflict avoidance and staff goodwill are dominant considerations, the optimal strategy will be to drop nothing and the rationalization will never happen. It will be a political free-for-all. Ultimately, clear top-down decision-making will be required to adjudicate. Some employees will be disappointed to lose their pet projects. Some may be retrenched. Establishing clear decision structures and rules from the outset will minimise the overall friction.

Step 2: Listing all the current corporate products and services. It normally entails reading through project documents and logical frameworks, and departmental guidance as few organisations have a master list that describes what they actually deliver. This process may be more complicated than it sounds.

The same products and services may be defined in different ways or at different levels of detail. For example, if an organisation provides public health training and communications, "training in healthy living", "training in reproductive health", and "training in HIV/AIDS preventative behaviour" are described at increasing level of detail. Creating a manageable list will be about selecting an appropriate level. Overly general categories (like "training") are not specific enough.

If they are too specific ("training in adherence to ARV treatment protocols") then the corporate list will become extremely long and unmanageable.

Step 3: Definition of metrics. In the corporate sector, PSR is focused on the most profitable products and services, and this is reasonably straightforward to measure. Evidently, in the nonprofit context, we need a different set of metrics for comparative advantage that includes quality and potentially ethical standards of delivery. For most nonprofits comparative advantage is also competitive advantage, although as West and Posner (2013) point out, nonprofits may not like to admit that they are competing. The question is not so much "what do we do best?", but "what do we do better than other organisations working in the same space?".

The metrics used must be comparable across different products and services because they are used for ranking different options. Examples include:

- **Cost efficiency:** how we rate in terms of of our costs per unit delivered (e.g. patient treated, trainee trained, or borehole fixed) compared to industry norms?
- **Business model:** do we have a unique value proposition or particularly innovative and strong model for product / service delivery?
- **Internal capacity**: how do our specialized staff skills and competencies and corporate guidance compare with industry standards?
- **Quality standards:** how do we rate our ability to delivery high quality and compliant services?
- **Reputation:** how does our reputation for producing/providing this product or service compare with other organisations?
- **Demand or need:** How critical is the demand or need for the product/service among our core client group?

Step 4: Analysis of Comparative Advantage. Having established the basic criteria, the analysis itself will entail gathering information for each product or service against each criterion. This could be tricky because hard data on costs and delivery are likely to be lacking at this stage (they are only available after rationalisation). For example, very few organisations estimate delivery costs per unit of output. The analysis will often have to rely on qualitative ratings (i.e. how people rate performance on a 1 to 5 scale compared to the industry standard). Here problems of strategic bias arise. Insiders will tend to be more generous in their ratings than employees of external organisations or clients. They may also rate their "pet projects" more highly, irrespective of performance. An effective process is likely to poll opinion from both inside and outside. The irony of PSR is that the first time it is done it is unlikely that objective evidence will be available because it takes time and sustained focus to set up performance metric systems. Subsequent PSR processes will be easier!

Step 5: Ranking and prioritization. The next stage is to compile the data (probably in a spreadsheet) so that each product or service is scored against the criteria. An evidence-based procedure will then produce a full ranking. It probable that some products and services perform better against most or all criteria. These are the obvious "keepers". Some might perform poorly against all or most criteria, and these can be excluded. There may still be a substantial grey area of products and services that perform well against some criteria and poorly against others. It is much simpler for corporations to rank products and services, because profitability is the only criterion and it is easily measured! Filtering the “keepers” from the grey area is likely to involve extensive and probably heated discussion, with all the risks of special pleading and high transactions costs mentioned above. It is a good idea to fix a number of “keepers” and stick to it, to avoid a situation where all the “grey” products and services are retained because it is the path of least resistance.

Step 6: Simplification, strengthening and discontinuation. The ranking exercise will yield various categories of product and service:

- Keepers
- Probable keepers: invest in strengthening production and service delivery
- Probable droppers: pencil in for probable cancellation and set a date. Maintain existing commitments. Do not take on new commitments.
- Droppers: extract from existing commitments as painlessly as possible

In most organisations, these decisions will have to be ratified by the Board, and communicated to stakeholders.

It is always easier to say “yes” to opportunities than it is to say “no”. Given the tendency of nonprofit organisations (and others) to drift and accumulate complexity organically, the rationalisation process should be periodic, perhaps once every year or two.

For mature nonprofits the primary challenge is to rationalise. Of course, organisations may decide to add products and services. In which case, a similar and formal process of analysis of comparative advantage should be followed.

5 PRODUCT RATIONALIZATION AND PERFORMANCE INFORMATION

With a relatively short list of "core" products and services, an organization can start the process of business modelling, product rationalization and development of performance management and corporate M&E. Complex tangles of corporate outputs, outcomes and impacts make it extremely costly to build M&E systems and incur unsustainable recurrent information costs. Moreover, it is next to impossible to design a meaningful corporate M&E system if the fundamental goalposts (what the organisation actually does) keep changing. In contrast, specialization allows us to see trends over time. Lessons from one project may be transferred to another, because we are not starting from scratch every time.

With simplification comes the possibility of a huge strengthening including:

- **Efficiency measurement:** Business and cost modelling and benchmarking to establish minimum and maximum thresholds for delivering specific products and services. Tennant and Friend (2011) is an excellent guide. As a minimum, organisations should be able to estimate costs per unit of output for a specific product or service. For some products and services that can be valued in cash terms, more sophisticated calculations of "rate of return" or "return on investment" may be possible.
- **Quality and compliance:** Definition of product and service quality standards, metrics for assessing quality, and tests to establishing whether quality standards have been met. Serious private companies have "service level agreements", which are measurable commitments to provide services within specific standards to clients. Most nonprofits would benefit from a similar level of accountability to their clients.
- **Standardised Theories of Change** and impact pathway models based on a clear understanding how the organisation's products and services contribute in a measurable way to higher level outcomes and impacts. Specialised organisations should have models to predict attributable change in our corporate outcomes and impacts. For example, if we distribute improved seed to farmers, we should have reasonable predictions of the likely adoption rates, how far this will improve yields and by how much farm income and profitability will increase as a result of the higher yields.
- **Performance comparison.** With standardised products and services it is possible to define comparable corporate performance indicators that can be adopted on all projects that involve the same outputs. This is hugely beneficial as it permits comparison of performance across projects with similar products and services in different time periods or locations and the aggregation of results. If no two projects do quite the same thing, we cannot know where we are performing well and where there is a need to improve.

6 SPECIALISATION, COLLABORATION AND IMPACT

Specialisation does not mean losing sight of or ignoring the bigger picture. The international development industry has always endorsed multi-dimensional approaches, albeit with changing jargon ("integrated" → "synergistic" → "holistic" → "layered"). Understanding the broader context of how our activities contribute to a social goal gives value and meaning to our work. No one intervention will solve a complex and abstract problem like poverty, or promote "resilience". But this is not an argument for projects that include a "bit of everything" or for creating non-specialist organizations. It is an argument for better cooperation and coordination between NGOs, Governments and donors to ensure that the right people get the right combination of services.

It is difficult to accept that the work of one individual, project or organisation is part of a greater whole. Some organizations make improbable claims about the lives they have saved and the numbers of people that they have lifted out of poverty. Indeed the hubris and fallacy or "integrated", "holistic" or "layered" projects is to believe that because there may be synergy between education, health and agriculture, we can and should therefore do it all. Unsurprisingly, no evidence has been produced to support "layering" approaches, or to prove that the benefits of synergy. Part of the problem is that it is extremely difficult to detect the impact of interventions that involve giving people are given a little x, y and z in different sequences and amounts at different times.

How can organisations can be specialised and true to their impact mission? Stronger collaboration is almost always the answer. If the big impact (e.g. "reducing poverty") requires the delivery of everything from A to Z, this clearly does not mean that one organisation should deliver small amounts of A, B and C through to Z. For example, in a cooperative World, a nonprofit that is specialised in agriculture could ally with one specialised in microfinance to ensure that for a given geography or population both essential services are provided and that loan qualification conditions trigger access to input services under the agricultural project.

The chances of collaboration are greatly improved with specialisation, as nonprofits are less likely to be competing with one another for the same resources. An agricultural nonprofit providing improved seeds and extension advice could, for example, readily partner in the same area with a microfinance service provider to allow farmers to purchase inputs on credit. The moment the nonprofit has an in-house micro-finance team, reasons will be found why the local provider is not doing its job properly or costs more.

If the impact pathway analysis shows that for my service x to have an impact on poverty, it needs to be accompanied by another service y, then collaboration will make sense. As long as there is some broad agreement on mission and on service delivery standards, collaboration will tend to be far more likely to yield results. It will happen because organizations want it to happen and find ways to work together. It does not necessary mean that heavy coordination structures need to be established to force collaboration.

7 CONCLUDING REMARKS

Introducing performance management systems is a costly and lengthy process in the best of cases, but when organisations provide a complex range of products and services, costs and difficulties expand exponentially. To put it bluntly, if you are not entirely sure of what you are doing, you will have a hard time measuring whether you are doing it well. Business rationalisation and specifically PSR is therefore a first and fundamental step towards implementing performance management systems. Simplification and focusing on what an organisation does well is necessary for high performance and it is remarkable to see how few of the top commercial companies are diversified when compared to the largest nonprofits.

Organisational specialisation comes at a cost. There is a catch 22: without specialisation organisations do not have proper performance metrics and yet proper performance metrics are important for understanding what works and what does not work. Specialisation will require sacrifices. Some people will lose their pet projects. Others might lose their jobs, and managing the process will require formidable tactical skills and patience. But it is necessary for efficiency and for achieving lasting impact.

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