NGOs are increasingly put under a microscope regarding their financial data and accountability. As ratings of NGOs proliferate, an increasing number of funders look to business models to evaluate NGO efficiency and effectiveness, which tend to emphasize relative program spending instead of organizational impact. A few prominent observers of the NGO sector have challenged this shift, following Michael Edwards’ Just Another Emperor in which he warns against a growing influence of market principles in the not-for-profit sector. Based on a comprehensive interview study of international NGOs, we argue that the not-for-profit sector needs to raise its collective voice in developing an impact-driven understanding of their activities, or else succumb to the pitfalls of financially-oriented evaluation systems.

While self-appointed rating agencies defend the adoption of financial metrics as a mechanism for improving NGO effectiveness, the results of our study suggest a broad agreement among NGO leaders that rejects a single-minded focus on output defined as relative program spending. This study is one of the first to offer evidence based on a representative sample of U.S.-based international NGOs. The selection criteria of this study ensured the inclusion of NGOs across five major areas of activities (human rights, humanitarian relief, conflict resolution, sustainable development and environmental protection) as well as variation in size, efficiency and geographic location.

There are four major reasons to question the increasing use of financial metrics as a way of evaluating NGOs and increasing their effectiveness. First, such a business-driven framework equates the role of donors with shareholders and the role of NGO leaders with company executives. This view underestimates the importance of the mission and of other stakeholders in NGOs’ daily activities. In our study, NGO leaders felt accountable not only to their donors, but also to their boards, beneficiaries, partners, staff and organizational missions. Effectively translating the demands of local communities into fundable programs is a core goal of many NGOs and such programmatic success is poorly reflected in financial ratings focused solely on the ratio between program spending and other expenses. Increasing impact in a multi-stakeholder environment means effectively participat-

ing in an ongoing process of collective decision-making, rather than focusing on maximizing output only.

Second, the logic of financial metrics imposes a limited understanding of overhead costs on NGOs. Rating agencies and donors typically prefer a low overhead ratio while sometimes overlooking the actual impact of program spending. Since NGOs do not generate income by selling products, an excessive focus on overhead costs skirts the question of what kind of activities and programs are actually having an impact. The first question asked should not be if an organization maximizes program spending relative to its total budget, but what kind of impact its overall spending achieves. Even in the area of service delivery, where reduced unit costs and economies of scale can generate greater efficiency and extend the reach of aid, the diffusion of rights-based approaches has for some time now shifted attention toward developing long-term strategies of social transformation. Measuring impact is more difficult than measure-
Because charitable giving often tracks the economy and media attention to public issues, NGOs should adjust fundraising efforts from year to year in response to volatility in the donor environment.

ing program costs, but the former makes a lot more sense. Respondents in our study agreed. We asked NGO leaders how they defined the concept of effectiveness, and respondents overwhelmingly reported that being effective involved evaluation and achieving organizational goals. Managing financial resources was a distant third.

Third, it is not always prudent for an organization to spend 75 to 80 percent of its budget on programs. If an NGO is trying to maximize long-term sustainable impact, not just short-term program costs, then it makes sense to reallocate funds from programs to fundraising when donors are more generous and to reduce fundraising expenditures when donors are less forthcoming. Because charitable giving often tracks the economy and media attention to public issues, NGOs should adjust fundraising efforts from year to year in response to volatility in the donor environment. This, of course, should not be taken to either extreme, which suggests that building organizational endowments, or at least stabilization funds, offers a still vastly underutilized strategy for NGOs weathering turbulent financial cycles.

Finally, while a strong emphasis on program spending may be appropriate for larger and more mature organizations, it unfairly punishes smaller, growth-oriented organizations seeking to expand their capabilities. The focus on financial efficiency may limit the ability of NGOs to pursue growth strategies as a part of their efforts to create sustainable impact. As Alnoor Ebrahim explained in a November 2005 article in Monday Developments, “In instances of myopic accountability, where donor demands for information are satisfied at the expense of attention to longer-term processes of organizational learning, ‘too much’ accountability can hinder NGOs in achieving their missions.” The issue here is not just that too much time may be spent on satisfying reporting requirements, but that these demands shape how NGOs choose programs and define their missions. If NGOs are punished for investing in organizational growth, they are less likely to take on challenging causes and their long-term sustainability and learning will suffer.

Although most NGOs understand better than ever that sustainable impact requires long-term engagement based on building effective partnerships and coalitions, they have yet to find a common response to external pressures reducing effectiveness and impact to output measures. For individual organizations it may be rational to adapt to changing circumstances, but this may leave the sector weakened overall. Ironically, larger organizations with more resources to lead a collective response to those pressures are also likely to have the least incentives to do so because their economies of scale already secure favorable ratings on financial metrics. One solution to this dilemma is using umbrella organizations such as InterAction to develop a shared framework for defining impact related to qualitative goals such as local empowerment, capacity-building, and the effective exercise of rights claims. Without such an alternative system, individual and institutional donors will continue to flock to websites directing them to organizations with high relative program spending, but not necessarily a maximum of impact.

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