



'Mustaches for Kids': Charities Adopt Private Sector Models to Tap New Funds

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The marketplace for good works is growing and evolving. Are you looking to invest in Middle East peace? [LendforPeace.org](#) offers the opportunity to loan \$3,000 to a West Bank mother of six so she can buy more sheep and add meat to her dairy products business. Or you can support a refugee camp restaurateur who needs a \$1,000 loan to buy a refrigerator and rotisserie to expand her hummus and fava dip business to include meat and cold drinks.

If you are in the market for literacy, turn to [DonorsChoose.org](#), which offers dozens of opportunities to help teachers in high-poverty schools. You can buy phonics cards for inner city preschoolers in Pennsylvania or a vocabulary bingo game for third graders in Nevada.

In the wake of the global financial crisis, which hit charitable institutions hard, social enterprises are hastening their transition from the traditional donor model to rely more on market mechanisms long established in the private sector. In so doing, these organizations hope to not only survive the current recession, but create a foundation for long-term sustainability, according to Wharton faculty and executives at non-profit institutions.

In addition to specialized appeals online, charitable giving organizations are also searching for new metrics to determine their impact on the problems they have set out to alleviate.

Wharton professor of information and operations management [Kartik Hosanagar](#) says that non-profits exist because the traditional business goal of maximizing shareholder investments was not sufficient to address certain problems such as poverty or environmental degradation. Now, especially following the economic downturn, the sustainability of a traditional donor model is being questioned.

Increasing Sustainability

"The traditional non-profit model is supported by donations and that's great, but these things are highly cyclical," says Hosanagar. "With the recession, one needs to [ask], 'Is there a way to bring sustainability to this [non-profit] world?'"

New technology, including the Internet, is a key element in the changing models for social businesses. For example, maintaining a web presence allows non-profits to efficiently tap many individuals for small contributions or loans. In the aggregate, these new donors could become a powerful source of financing beyond large foundations and corporate donations that have been driving philanthropic causes, according to Hosanagar.

He notes an irony in the timing. As the current economic slump revealed the peril of excessive short-term thinking in the private sector, corporations are beginning to acknowledge the importance of other attributes, such as long-term reputational value. Meanwhile, the downturn has forced socially oriented institutions to look toward more businesslike solutions to help them avoid continued cyclicity and convince contributors that their dollars are being spent wisely.

"While some may call poverty or illiteracy 'social problems,' they also represent a market failure," Hosanagar says. "In this context, social businesses have a role to play and the recession only adds to this. If an organization is lean and sustainable, it will be more appealing [to funders]."

While government has been assigned a role regarding many public issues, Hosanagar argues that



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government should never be expected to cure all of society's ills. Even though excessive pro-market philosophy has fallen out of favor lately, markets are self-correcting over time and they can provide long-term, sustainable solutions, he notes. As a result, market-oriented ideas have attractive properties that could be adapted to social problems.

LendforPeace.org, founded by four University of Pennsylvania students -- two of them Jewish and two of them Palestinian -- is one example of this market-oriented approach. The guiding idea behind the organization is that economic development will lead to peace in the Middle East. To that end, the organization screens individual small businesses in the region and posts photos and short summaries of proposed projects on its web site. Individuals can then make small loans to the entrepreneurs.

Co-founder Sam Adelsberg says the idea of building sustainable businesses is critical to the organization because the region has grown overly dependent on traditional aid packages. The Palestinian people, he says, receive the highest per-capita level of aid in the world. "There is a cycle of dependency where they expect payment," according to Adelsberg.

Meanwhile, the model creates a marketplace of potential beneficiaries who, in effect, compete for donors. "What I think is more interesting than the traditional model is the constant engagement with the user ... to raise capital from the grassroots in a way that is low effort for the organization and low stress on the donor, and is associated directly with the action [the donor is] looking to fund," says David Fraga, another LendforPeace co-founder.

Wharton management professor [Keith Weigelt](#) says this type of microfinance model is gaining popularity. Indeed, small non-governmental organizations (NGOs) focused on microfinance are now facing more competition from for-profit lenders seeking to move into the potentially lucrative microfinance market. The for-profit institutions typically have a lower cost structure and can offer lower rates that would potentially crowd out non-profit lenders seeking to improve the community as well as offer a sustainable finance model.

"There's a real danger that the NGOs will be hurt and the mission will change," says Weigelt. "On the flip side, consumers might benefit because it will drive down the rates."

Weigelt adds that the gap between maximizing return in a for-profit model and the mission to do social good may be closing. Socially responsible investment funds have been in business for some time, he notes, offering slightly lower returns than competing funds. Research indicates, however, that investors are willing to accept returns that are between 2% and 4% lower than purely bottom-line driven, for-profit enterprises, if their investment is geared toward helping society.

On the operations side, DonorsChoose.org, which provides a platform for individual investments in specific classroom projects, has essentially outsourced the preparation of grant proposals to the teachers seeking funding. The teachers succeed -- or fail -- in the marketplace of what founder Charles Best calls "citizen philanthropists." Best founded DonorsChoose in 2000 when he was a social studies teacher in the Bronx. He and his teaching colleagues were frequently dipping into their own meager salaries to buy essential classroom supplies. They turned to Internet donations for help.

Best compares the DonorsChoose model to the open source software movement. "The idea is that if you turn to classroom teachers, who know their kids better than anyone else in the system, to design micro solutions for the very students they serve, they will come up with better targeted, smarter ideas than most top-down solutions designed by academics or administrators or government officials."

Cesar Bocanegra, executive vice president for operations at DonorsChoose, says the organization is also borrowing a model from Wikipedia to help with the presentation of projects. DonorsChoose asks the teachers who have been most successful in reaping donations to help rewrite or enhance the project descriptions submitted by other teachers hoping to get funding. The organization is also looking at marketing mechanisms to expand its donor base. For example, it partners in a one-month campaign called "mustaches for kids" in which donors can grow a mustache, post a picture of their new facial hair on the site, and ask friends and family to support them against rival mustache-growers by pledging donations. This idea draws young males, who typically have been absent from traditional charitable giving, into the process, says Bocanegra.

Smiles Earn More Than Tears

[Deborah Small](#), a Wharton marketing professor, is working with DonorsChoose to help understand how photographs can elicit additional donations. Her research has shown that while most charities try to present happy faces to encourage donors, sad faces are actually more effective. In a paper titled, "[The Face of Need: Facial Emotion Expression on Charity Advertisements](#)," co-authored with Wharton doctoral candidate Nicole Verrochi, the researchers note that Americans gave more than \$306 billion to 800,000-plus charitable organizations in 2007, roughly 2.2% of the U.S. GDP. According to [research by onPhilanthropy.com](#) based on Internal Revenue Service exemption data, large American non-profits spend at least \$7.6 billion per year on marketing.

Small says that while it might seem obvious that charities would appeal to donors with sad-looking victims, the opposite is the case. The researchers coded charity web sites that received high ratings and found happiness to be the most common facial expression (37.5%). In contrast, 8.3% of those highly rated sites depicted a person expressing sadness, 9.6% expressed neutral emotion, and the remaining images included at least two faces with unmatched expressions.

"When you see an image of a victim expressing sadness you feel their pain," says Small, who adds that research indicates emotion is contagious, and identification with a victim -- even on an unconscious level -- can inspire giving. "Even though this seems intuitive, charities aren't doing this," Small continues. "They think they need to portray a positive tone."

While new market-oriented approaches to generating funds are taking shape, philanthropic organizations are also searching for more business-like performance measures to determine how well they are meeting social needs. To develop a framework for this type of analysis, in 2006 a group of Wharton alumni established the [Center for High Impact Philanthropy](#), housed at the University of Pennsylvania's School of Social Policy & Practice. Katherina Rosqueta, executive director of the center, agrees that the current economic crisis has hit philanthropic organizations hard, at precisely the moment when they are most needed to help people struggling with unemployment and other problems brought on by the recession.

Now more than ever, she says, charitable organizations must be able to justify how they spend every cent. "In this painful environment there are a lot of needs. There are still people of means who want to help, but the point is to give them very concrete opportunities for their money."

Rosqueta says there are several reasons for the new emphasis on measures for the impact of giving. One is that a new generation of "hybrid leaders" -- people with experience in business as well as the non-profit world -- are recognizing that all sectors can contribute to social impact. At the same time, she says, new performance measures and metrics are developing in the social sector as well as the business world. A lot of wealth has been generated in recent years by people who are younger than donors were in the past and who gained their wealth as entrepreneurs, she adds. "Some of them want to apply what made them successful in business to a new area that is philanthropy."

Donors need to ask questions about the goals they hope to achieve, how they might measure success and how much change will cost. "These are pretty straightforward questions but are difficult for individual philanthropists to answer," Rosqueta notes. She also stresses the distinction between impact and sustainability. "In the for-profit or business sector, the more successful you are in delivering value to your customers, the more financially sustainable your business will be. You'll attract more customers and investors. But beneficiaries are not customers. In the philanthropic, non-profit sector, your impact is the public benefit you create."

She points to more students staying in school, or cleaner, water as examples of the kind of impact social enterprises hope to make. The new funding mechanisms, such as those used at DonorsChoose, may make it more efficient for charities to raise money and remain sustainable, but not necessarily more effective, Rosqueta points out. "We do have a philanthropic capital market. But it's inefficient and largely donor-driven, not impact-driven. Donor satisfaction and non-profit funding pitches are weak signals for impact."

Tools such as incentive pay or performance management metrics are being used increasingly in social enterprises, she notes, but given structural differences between the business and philanthropic sectors, "It's

not always an easy or effective translation."

Hosanagar says that while social organizations are turning increasingly toward market-oriented solutions, large donor-driven charities are not about to disappear. "The approaches are not exclusive. Clearly there is a role for the large foundation that donates millions of dollars. The large organizations have the funds to spend on marketing and to create awareness and fill in when a new issue that needs [large] resources arises, before other avenues are up and running."

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