

# Chapter 1

## The Nonprofit Marketplace

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### The Missing Hand of Adam Smith

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Charities deliver services to beneficiaries who often pay little or nothing. This contrasts with commercial customers who have to pay full value. To fund the difference, charities seek donations. However, donors do not always give based on the value that the charity delivers to the beneficiaries. Rather, they donate based on generosity, connections and the appeal of the fundraising campaign.

To bridge this structural disconnect between revenue and expenses, can the “invisible hand” of Adam Smith be replaced by the visible hand of the donor and the iron fist of governance and regulation?

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**M**arch to May 2003 was a remarkable but scary period in Singapore’s history. The unknown and deadly Severe Respiratory Syndrome (SARS) virus threatened the nation, but the government moved swiftly to contain the situation. Singapore’s success in doing so is now a textbook example of an effective national response for handling and arresting a potential pandemic.<sup>1</sup>

Amidst the fear and uncertainty of the damage the virus could wreak, the Courage Fund was launched by several organizations with the full backing of the government in April 2003.<sup>2</sup> The objective was to raise funds to provide relief to SARS victims and healthcare workers. The fund was so named to honor healthcare workers, in particular, those who died or suffered in the fight against the virus.<sup>3</sup>

SARS and the Courage Fund galvanized the nation. Donations poured in. Dr. Lim Suet Wun, Chairman of the Courage Fund's Working Committee remarked that he was pleasantly surprised, sometimes after the event, by the many spontaneous fundraising events that sprouted up around the country and which they had not been previously notified of.<sup>4</sup>

The Courage Fund collected more than S\$32 million (US\$21 million).<sup>5</sup> At that time, it was arguably the most breathtaking fundraising ever seen in Singapore in terms of the speed at which the money came in, the quantum raised and the broad base of people reached.

In the wake of its runaway success, the Courage Fund invited controversy. Did it raise more money than it really needed? Did it inadvertently divert funds from other more needy charities? What was the excess cash going to be used for? Should fundraising have stopped when it looked like the collections were more than enough for the Fund's needs? The organizers sought to answer these questions<sup>6</sup> and many of them are discussed later in the book.<sup>7</sup>

Beyond these immediate fundraising related questions, the phenomenon of the Courage Fund, in my view, highlights a more fundamental and structural issue in the nonprofit world—the dichotomy between revenue and expenses.

## **Commercial Reality**

In the commercial world, organizations are primarily driven by profits.<sup>8</sup> In the main, companies produce goods and services which they sell to their customers at prices that, hopefully, recover their costs and produce a tidy profit.

Companies live and die by their profits. Those that make losses will eventually close down, reducing supply in the market. If existing companies in a market space make too much profit, competitors will jump into the fray, thus increasing supply and bringing prices and profits down.

Adam Smith, the father of modern economics and the first proponent of *laissez-faire*, calls this the “invisible hand” that keeps the market in equilibrium. In the long term, the invisible hand continually moves the market towards this steady state, ensuring that there are just enough companies competing to make money, each making just sufficient profits (not too much and not too little) with goods and services priced at reasonable levels (not too high and not too low).

## **The Nonprofit Difference**

Charities are nonprofit organizations that also produce goods and services, but these are not delivered to customers. Rather, they are delivered to beneficiaries who often pay nothing or a nominal charge that is less than the actual cost of producing the goods and services.

To make up for the difference between the actual cost of goods and services produced and what can be recovered from their beneficiaries, charities rely on grants, donations and volunteer time from the government and the community.

However, the fundraising efforts may bear little relation to the nature and value of the goods and services delivered to the beneficiaries. The success of fundraising is often more dependent on connections, marketing and the appeal of various “feel good” or “heart-tugging” approaches.

Consider the popular fundraising shows on television. They tend to feature performances by personalities, stunts, lucky draws and audience responses to challenges. The shows’ content usually bears little relation to the charitable causes.

In Singapore, one of the most popular and successful fundraising events is the Ren Ci Charity Show. Since the first show, Venerable Shi MingYi,<sup>9</sup> the charismatic monk and then chief executive officer of Ren Ci Hospital and Medicare Center had consistently captured the imagination of television viewers by putting himself at risk. His stunts were the most anticipated part of the show and tended to generate the highest traffic of called-in donations. His abseiling down a 55-story building in 2003; immersion in 1,000 kilograms of ice for half an hour in 2004; balancing on a one-foot square plank on the roof of a building for two hours in 2005; walking across 20m-long, 15cm-wide parallel beams suspended 66 storeys above the ground in 2006; and pulling himself up 17 stories with a rope and pulley in 2007 helped raised over S\$35 million (US\$24 million) over the course of those five shows.

The Jerry Lewis MDA Telethon<sup>10</sup> held every Labor Day to benefit the Muscular Dystrophy Association of America is carried by 190 stations in America. In 2007, it raised more than US\$63 million. Since the start of the show in 1952, it has raised more than US\$1.4 billion. The success of the telethons lies, almost without question, in the pulling power of Jerry Lewis, the famous comedian and his celebrity guests, rather than the cause. However, the telethons have greatly helped to promote awareness and support of the cause of muscular dystrophy.

Global charity concerts like Band Aid, Live Aid and 8 Aid have been tremendously successful in raising funds for their respective causes. But it is well recognized that the donations were triggered more because of the singers and personalities on stage performing specific heart-warming favorites such as “We are the World,” rather than their adopted causes of famine in Ethiopia and world poverty.

Clinching the right benefactors or supporters can make a big difference in making ends meet. The Courage Fund had the benefit of full media and governmental backing and indeed, the entire country rooting for it. The Tent, a welfare shelter for troubled teenage girls struggled with fundraising until it found a benefactor who auctioned some of her treasured family memorabilia to support its cause.<sup>11</sup> The charity auction in 2003 raised over S\$2 million (US\$1.4 million). With its 2003 expenditure of S\$350,000 (US\$240,000), the Tent was then able to focus on long-term plans.

Of course, in the course of raising funds and in acknowledging the donors, the charity’s cause and beneficiaries are usually highlighted or at least mentioned. However, it is debatable whether the cause itself is the cause of donations, or if it is the cleverness of the campaign that makes people give.

Just check out any of the fundraising help materials. They are all oriented towards improving the “power of the ask,” many of which seem to have little to do with the actual causes or beneficiaries. For example, fundraisers.com’s list of the top ten fundraising tips<sup>12</sup> includes “use basic sales technique, chose the right incentive prize, motivate team work, reward the early bird” and so on. nfpSynergy’s most important idea to engage the modern donor is to simplify the complexities of life by offering “oven-ready, bite-size, fundraising niches.”<sup>13</sup>

A study in contrast would be the National Kidney Foundation (NKF) and the Kidney Dialysis Foundation (KDF) of Singapore. These two charities have essentially the same cause—their mainstay is kidney dialysis,

but their financial performances are dramatically different. The situation of both charities in 2002 is shown in Table 1.1.<sup>14</sup>

**Table 1.1** KDF versus NKF Fundraising Impact

	<b>KDF</b>	<b>NKF</b>
Funds raised for the year	\$1.0 million	\$46.6 million
Reserves at year end	\$0.18 million	\$130.34 million
No. of dialysis patients	174	2,200
Donations per patient	\$5,700	\$21,182
Reserves per patient	\$1,034	\$59,245
Note: All \$ amounts refer to US\$		

Clearly, NKF is the larger charity; it is also more established and better branded. While it does have other programs such as organ donation advocacy, preventive healthcare and clinical research, it is kidney dialysis that the public and donors recognize as its core competency and focus. Yet donors differentiate between the two organizations though they cover largely the same cause. So if it is not the cause, what is it? Well, it is the power of NKF's strategic and innovative fundraising approaches, controversial as they may have been.<sup>15</sup>

## **Market Failure?**

So, there can be little connection between what a nonprofit actually does and how successful it is at raising money to support its causes. There is no invisible hand of Adam Smith to ensure that a nonprofit raises just enough money to deliver an optimal level of services to its beneficiaries.

It is therefore possible to have over-funded nonprofit organizations with more money than they need, and which can end up being splurged on peripherals unrelated to the beneficiaries as in the case of the NKF<sup>16</sup> and other charities.

In a Canadian case, it was reported that most of the money raised did not go to the intended cause.<sup>17</sup> The Organ Donation and Transplant Association of Canada was set up in 2004 by a professional fundraiser to promote and raise funds for research into organ donation and transplant. It raised about US\$4 million in its first three years but only 10 percent of it went to transplant research. The bulk of the money was spent on telemarketing expenses to Xentel Incorporated, a commercial entity. The report pointed out conflicts of interest in the boards of Xentel and Organ Donation, misleading claims by telemarketers in their solicitations and Organ Donation taking credit for entire multimillion projects when it only contributed a small portion of the effort.

On the other hand, we have many cases of charities that are serving critical community needs which are unable to find funding to continue their work. Humanity & Golden Kids, a nonprofit center run by Cancerstory.com which offered complementary cancer treatments, closed because its funding ran out after it exhausted the capital donated by the founder.<sup>18</sup>

Not long ago, Amazing Kidz, another charitable organization serving over 100 families with children suffering from brain injuries, had to close after only two years because it continually struggled to raise sufficient funds for its operations.<sup>19</sup>

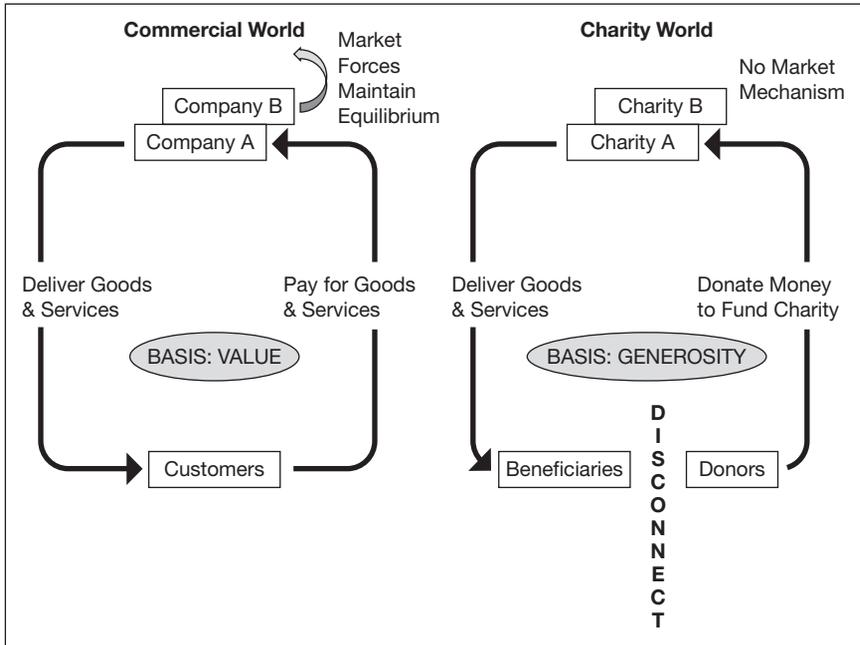
A recent analysis in the *Stanford Social Innovation Review* concluded that “there is little relationship between how much donors give and how many people need help.”<sup>20</sup> The author studied funding for sudden emergencies such as disasters versus funding for chronic health conditions. Private donors, for example, had spent about US\$1,839 for each person affected by Hurricane Katrina. In contrast, they had only given US\$10 for each person diagnosed with AIDS, or US\$3 for each person struck by malaria.

## **Bridging the Disconnect**

The structural differences between the commercial and the charity sector are illustrated in Figure 1.2.

In the charity world, there is a distinct disconnect between the value of services delivered and the source of funding for those services. In the commercial world, the function of aligning value and funding is performed by one party—the customer. With charities, the customer is replaced by two parties—the donor and the beneficiary.

Figure 1.2 Structural Disconnect



The beneficiary undertakes the function of consumption performed by the customer and the donor takes on the function of payment also performed by the customer. However, the donor has not made the payment on the basis of value as the customer would; rather, he does it for reasons other than value—you could say mainly generosity because that is how many of us choose to view it. Since the donor’s decision to pay is not necessarily based on how the charity performs its function, the loop is not closed. Hence, the disconnect.

With this structural disconnect between revenues and expenses in charities, the market forces that might otherwise ensure equilibrium in the charity marketplace are unable to work. Adam Smith’s hand is not just invisible, it is absent.

What is the solution? The first possible answer is to get the donor to do what the customer would do—pay on the basis of outcomes and value delivered to the beneficiaries. In charity parlance, this is called “informed giving.” It is asking donors to give on an informed basis, knowing what, why and how the charity is doing what it is supposed to do. In other words, replace the invisible hand of Adam Smith with the visible hand

of the donor. This subject of informed giving will be explored further in the next chapter.

Informed giving is not the complete solution since it is unlikely that there will be an absolute alignment of donors with the beneficiaries' interests. The fallback answer—derived from the commercial world—would be to back up the donors' visible hand with the iron fist of governance and regulations. However, there are significant differences between charity governance and governance in the commercial world. These will be discussed in greater detail in Chapter 3, "Who governs a nonprofit, really?"

Meanwhile, we may just have to accept that the nonprofit marketplace will never really be, or even trend towards, a "perfect marketplace" as Adam Smith envisaged in his laissez-faire economy.

## **Endnotes:**

Adapted from: "The missing hand of Adam Smith," *SALT*, March-April 2004; and "Charity: Donors should pay more heed to the cause," *The Straits Times*, April 8, 2004.

- 1 The story of the SARS outbreak is documented in Chua Mui Hoong, *A Defining Moment—How Singapore beat SARS* (Singapore Institute of Policy Studies, 2004).
- 2 [www.couragefund.com.sg](http://www.couragefund.com.sg). According to a Singapore Medical Association newsletter article ("Book Review of *A Defining Moment*," *SMA News*, December 2004, Vol. 36, No. 12), the Courage Fund was originally started by a couple of young medical officers, then adopted by the Singapore Medical Association and the Singapore Nurses Association, after which it was taken over by the two government-run health groups (the National Health Group and Singapore Health) and renamed The Courage Fund.
- 3 Andrea Tan, "Courage Fund for SARS victims," *The Business Times*, April 12, 2003.
- 4 "When is Enough, Enough?, Interview with Dr. Lee Suet Wun, Chairman of the Courage Fund Working Committee," *SALT*, January-February 2004.
- 5 All amounts are converted to US\$ in this book. Exchange rate used are: S\$1.45 = US\$1, £1 = US\$2.
- 6 "When is Enough, Enough?, Interview with Dr. Lee Suet Wun, Chairman of the Courage Fund Working Committee," *SALT*, January-February 2004.
- 7 Chapter 6, "The problem of plenty" deals with the questions raised here in relation to excesses from fundraising.
- 8 This creates a different set of issues which will be discussed in Chapter 8, "Is the business of business just business?"
- 9 In February 2008, Venerable Shi MingYi went on a leave of absence pending investigations by the Commercial Affairs Department into financial transactions made by Ren Ci Hospital under his watch. On July 15, 2008, Venerable MingYi was charged for forgery, misappropriation of funds and conspiracy to give false information to the Commissioner

of Charities. At time of publication of this book, the court case is pending. At the time of his arrest, Venerable Ming Yi stepped down from all his positions regarding charities. A new chief executive officer was appointed for the charity, Ren Ci Hospital. During the investigations, the charity lost its status as an Institution of Public Character (IPC), which allows it to issue tax exempt receipts to donors. When the investigations were over and after Venerable Ming Yi was charged, the IPC status was restored. However, thanks to its many years of successful fundraising, the hospital has S\$33.5 million (US\$23 million) in reserves—sufficient to last it six years.

- 10 [www.mda.org/telethon](http://www.mda.org/telethon)
- 11 [www.thetent.org.sg](http://www.thetent.org.sg); Wong Sher Maine, "Small charities fight for bite of the pie," *The Straits Times*, April 7, 2004.
- 12 [www.fundraisers.com/ideas/topten.html](http://www.fundraisers.com/ideas/topten.html)
- 13 Joe Saxton, Michele Madden, Chris Greenwood & Brian Garvey, *The 21<sup>st</sup> Century Donor*, nfpSynergy, September 2007), available at [www.nfpsynergy.net](http://www.nfpsynergy.net). nfpSynergy is a specialist research consultancy for not-for-profit organizations.
- 14 While I have put the figures into a tabular form for readability, these figures are as stated in the original article of the same name written for *SALT* magazine in March/April 2004. I have not updated them for a more recent year or for more accurate figures of 2002 that emerged in the NKF court case and KPMG investigation (the more accurate figures would make NKF look worse) given the change in the situation with NKF today and the significance of the original article in the NKF saga (see Chapter 19).
- 15 See Chapter 19, "NKF: The saga and its paradigms."
- 16 Ibid.
- 17 David Bruser, "Charity's ploy 'horrifying'," *The Toronto Star*, August 4, 2007 at [www.thestar.com/Investigation/article/243162](http://www.thestar.com/Investigation/article/243162); The charity's website is [www.organdonations.ca](http://www.organdonations.ca).
- 18 Wong Sher Maine, "Small charities fight for bite of the pie," *The Straits Times*, April 7, 2004; [www.cancerstory.com](http://www.cancerstory.com).
- 19 [www.amazingkidz.org](http://www.amazingkidz.org)
- 20 Keith Epstein, "Crisis Mentality," *Stanford Social Innovation Review*, Spring 2006.