SELECTED EXCERPT FROM *LEAP OF REASON*

LEAP OF REASON

MANAGING TO OUTCOMES

IN AN ERA OF SCARCITY

Introduction

by Lynn Taliento, Jonathan Law, and Laura Callanan

McKinsey & Company

The full book is available at leapofreason.org

A VENTURE PHILANTHROPY PARTNERS PUBLICATION

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Several years ago, Friendship Public Charter School, which manages ten schools in Baltimore and the Nation's Capital, developed some tools and processes for collecting data on students, teachers, and the schools as a whole. They built time into the academic calendar for reviewing the data and understanding their implications. And perhaps most important, the schools' leaders shared a deep commitment to using the data and the assessments to improve student outcomes.

With all of this in place—the data, the tools, the commitment—Friendship appeared to be a model nonprofit when it came to performance management. Yet Friendship's leaders realized they needed to improve. Because Friendship is accountable to many different stakeholders, they tracked an excess of metrics, overwhelming many staff members. The data they collected were not always explicitly linked to the outcomes they sought. Review processes for teachers and administrative staff were ad hoc rather than systematic. In short, Friendship had the foundations for performance management but lacked a coherent strategy for bringing it all together.

As you will read in more detail in the essays by Mario Morino (p. 1) and Friendship COO Patricia Brantley (p. 117), Friendship took the difficult steps necessary to build on its early experiences and create a world-class performance-management system. We were fortunate to partner with Friendship on this journey, and we were able to see firsthand—as we have with many other clients—the power that results from managing smartly against the right outcomes.

Today, Friendship is, by any measure, a high-performing organization. Its use of the performance-management system enables Friendship to make its already great teachers even better, helps principals do their jobs better, and provides board members with the information they need for more-effective oversight. All of which has had a discernible effect on Friendship's bottom line—helping students succeed.

It would be great if the story of Friendship were the norm; unfortunately, it's an outlier. Not many nonprofits manage to outcomes, and among those that do, few do it well. For that reason, *Leap of Reason* is an important contribution, and McKinsey is proud to partner with Venture Philanthropy Partners (VPP) to bring this volume to thousands of leaders who are predisposed to manage rigorously and effectively but can use a little encouragement and support.

The need for assessment and performance management seems obvious. So why doesn't every nonprofit define its goals, measure how it's doing, and manage accordingly? Not for lack of commitment to causes and communities. Not for lack of smarts. What seems to be missing is a combination of resolve to take on the hard work that change entails and, even more important, the appropriate resources to do so effectively. But as you will see throughout *Leap of Reason*, when leaders summon the resolve and resources, the results are worth the hard work.

Making Assessment Work

Through our work in the sector, we've identified five best practices for doing assessment well, doing it efficiently, and doing it sustainably. Given the alignment of our thinking and that of VPP, it should come as no surprise that all of these practices are fleshed out in greater detail in Mario's essay and the other essays that make up this important volume.

1. Hear the constituent voice. In order to get a complete picture of how and to what extent programs are delivering social impact, nonprofits must learn what the relevant constituents—the individuals and communities served by the program—have to say. Involving constituents in the design and implementation of an organization's ongoing assessment efforts, and in the interpretation of the results, helps ensure that a nonprofit is measuring what's relevant and valuable for them. And once the results are in, it's important to share the results with all stakeholders, as Patricia Brantley describes in her essay.

2. Assess to learn and do. Successful nonprofit organizations make learning the primary goal of their assessment. They begin by collecting as much information as they can about the target problem and the possible solutions. This way, they come to understand how their programs work and how they can work better. They also integrate assessment goals and results into all of their program decisions. In other words, assessment plans and program strategies are built hand in hand. Assessment is not just an academic review or an isolated exercise; it serves as a guide for the nonprofit's actions.

3. Apply rigor within reason. Understanding the true efficacy of a nonprofit also means periodically undertaking a more holistic program evaluation. Such evaluations complement the ongoing effort to manage to outcomes by verifying that regular results are in fact meaningful. When these evaluations are conducted, rigor is a desirable goal, but the most rigorous assessment approaches are not always feasible or appropriate. For example, randomized controlled trials are excellent when demonstrating the efficacy of a program prior to scaling. They are often less applicable, though, for new programs early in their life cycle.

Funders are notorious for requiring overly rigorous assessments. The result is a misallocation of resources and unnecessary headaches for the nonprofit. We've observed that the right level of rigor is the result of an open dialogue between nonprofits and their funders. By getting clarity on a program's strategic and assessment objectives, they can determine the level of rigor that's required.

4. Be practical—there's no need to do everything. Once nonprofits buy into the need to manage to outcomes, they sometimes fall into the trap of trying to measure everything. Developing a thoughtful, comprehensive assessment plan that is based on the right questions and crafted with funder participation avoids unnecessary burdens and expense. Moreover, many assessment tools already exist in the social sector. Successful nonprofits can tap into this trove and leverage such tools to great effect.

5. Create a learning culture. Robust assessment capabilities alone do not drive impact for nonprofits. From our experience, these capabilities must exist within a "learning culture" to derive the most value from assessment. Such a culture values honest appraisal, open dissent, and constructive feedback. It promotes intelligent risk-taking in pursuit of both insight and impact. It considers the relevant context of an assessment and makes difficult decisions based on evidence—even if that means ending a program.

Risks and Rewards

These practices can help nonprofits get assessment right. But to get assessment started, we must face up to a fundamental tension: The first time they conduct a rigorous assessment, nonprofits stand to lose as much as they might gain. Should their results provide evidence of significant impact, securing resources for their operations will be easier. However, poor results or—even worse—a misinterpretation of results could very well lead to lower levels of financial support, and even de-funding. At a minimum, stringent performance management will most likely mean changes in staff.

In short, the transition to outcomes-oriented management will almost certainly have some negative near-term implications for the organization. These changes, though, will just as certainly have a positive impact for the nonprofit in the long run as it becomes more effective in achieving its mission.

When done right, performance management is good value for the money. McKinsey has quantified the value of rigorous performance management in the private sector. Using data from our proprietary Organizational Performance Profile survey, involving more than 115,000 individuals in 231 organizations, we looked at whether strong organizational performance—including performance management—translates into financial results. The findings were clear: A company that measures in the top rather than the bottom quartile of organizational performance is more than twice as likely to attain above-average margins for its industry.

And then we went further, seeking to understand which specific attributes of organizational effectiveness were correlated with financial success. Once again, the findings were compelling. Robust performance management had the highest correlation with superior financial performance. Indeed, performance management beat out other important organizational attributes like innovation, capability, and environment. Companies with top-quartile performance in practices such as the consistent use of targets and metrics were 2.7 times as likely to financially outperform the median than those in the bottom quartile. Such data have convinced us that performance management is a no-brainer. It drives overwhelmingly positive results.

If the promise of such value for the money is not enough of a motivator, how else can nonprofits be convinced to adopt managing to outcomes? For starters, a sector-wide embrace of the learning mindset would help nonprofits and their funders make decisions in a positive, forward-thinking manner. For example, instead of simply de-funding an underperforming program based on a superficial understanding of results, a learning-centered approach would seek to understand the causes for failure and build upon that knowledge in future initiatives.

More radical steps could also compel nonprofits to embrace change. For instance, imagine an independent organization being created to certify whether nonprofits are adequately conducting assessments. Such a body would not be developing or conducting the actual assessment for nonprofits; this responsibility would remain with the organizations themselves. Instead, the certification agency would simply ensure that nonprofits are assessing themselves and publish its findings. For example, the body could determine whether the nonprofit has defined its outcomes and metrics that align with these outcomes, whether these outcomes and metrics are consistent with best practices in the relevant field, and whether the organization has at least basic systems for tracking these metrics over time. We raise this idea not necessarily to advocate for it but to push the thinking as to what might be possible.

Tailwinds for Assessment

Mission effectiveness will become an increasingly urgent issue in the decade ahead. To begin with, funders have come under immense fiscal pressures as a result of the deep recession we are only now emerging from. State governments across the nation are projecting budget gaps of $125 billion in 2012, according to the Center on Budget and Policy Priorities. Other sources of funding for nonprofits have also been declining: In 2009, donations to the nation's biggest charities dropped by 11 percent, according to an analysis by the *Chronicle of Philanthropy*. In such an environment, funders and donors will be forced to choose where and how to cut. They will undoubtedly demand more evidence of effectiveness from grantees as they make their difficult decisions.

Another trend is the emergence of impact investing. Investors who are actively seeking not only financial but also social or environmental returns want proof that their capital is delivering on all fronts. This trend is putting pressure on social enterprises both to show impact and to augment that impact in the future. Such pressure will certainly translate into spillover effects for the broader social sector.

These tailwinds suggest that assessment and managing to outcomes will become more widespread in the near future. Eventually, this discipline will become the norm. For all the rational fear of the inevitable challenges ahead, Mario's monograph and the accompanying essays in this volume should provide comfort that managing to outcomes is eminently doable. *Leap of Reason* also demonstrates that managing to outcomes is eminently *desirable*.

And not just for funders. For social sector leaders, the great benefit of managing to outcomes is that it gives them powerful new tools for learning over time, making better-informed decisions, and becoming more effective at what they are so passionate about doing. The greatest dividends of all of course accrue to the communities, the families, and the individuals with whom we work. They benefit from stronger schools, smarter clinics, and safer communities—all because of nonprofits' commitment to becoming better.