

WHY NONPROFITS MUST INNOVATE

SEVEN STEPS TO GET RESULTS

By Amy Hsuan, Adam Katz, Mark Freedman, and Brenda Thickett

MUCH HAS BEEN WRITTEN about how innovation drives growth and shareholder value in publicly traded companies. Apple and Google, which again took the top two spots on BCG's annual list of the world's most innovative companies, have also been the stock market leaders over the past ten years. But innovation is just as critical for nonprofits—especially as they face growing pressures to serve more people in need and to deliver measurable results.

Ongoing economic uncertainty has increased the hardship confronting many of the world's most vulnerable populations, and their needs have grown as a result. Because of rising numbers of refugees and displaced people, prolonged conflicts, natural disasters, epidemics, and other crises, the demand for humanitarian aid has increased. While humanitarian funding has grown—in fact, the nearly \$25 billion global budget for humanitarian aid in 2014 was the largest ever recorded—demand has grown even faster: that 2014 global budget met only 62% of humanitarian needs.

At the same time, governments are under pressure to reduce costs and do more with less. With less public funding available—and the need for social services growing—nonprofit organizations struggle to pick up the slack. Many nonprofits also face growing pressure from governments, philanthropic organizations, and individual donors to show quantifiable outcomes—a difficult task, given how long it can take to solve many of the problems that face the social sector.

Innovation is key to meeting these challenges. But not every nonprofit has the processes, capabilities, and leadership commitment needed to improve its operations and to compete for increasingly scarce philanthropic dollars. To identify the current best practices in the field, BCG conducted more than 25 in-depth interviews with innovation experts from a wide range of organizations in the social sector.

Our research revealed distinct differences between organizations that are innovating successfully and those that are struggling

to move forward. We've distilled our findings into the following seven guidelines.

Define a Shared Definition and Purpose

Innovation can mean many different things to different stakeholders. Organizations without a clear definition tend to dilute their focus and lack accountability for outcomes, hindering good results. By contrast, an unambiguous definition with a clearly articulated purpose helps create an innovation culture, organizational alignment, and ownership—becoming, in effect, a compass that ensures everyone is moving in the same direction. PATH, a global health organization, uses the following clear, simple definition: “Innovations are things that change the affordability, accessibility, or effectiveness of practices or tools used for treatment, prevention, and care.” PATH says that it “contributes to reducing morbidity and mortality among women, newborns, and children through innovations in vaccines, drugs, diagnostics, devices, and system and service interventions.”

Innovation efforts can be applied to programs, products or devices, partnerships, fundraising, marketing, and operating processes. Objectives can vary broadly. Some nonprofits innovate to reduce a competitive disadvantage and catch up to other organizations. Others innovate to achieve disruptive change that can lead to a long-term advantage in the field. A matrix can help your organization determine which types of innovation to pursue and which levels of impact to target. (See the exhibit, “Determine the Types of Innovation to Pursue and the Level of Impact Desired.”) All priorities should be integrated into the organization's overarching strategy.

Choose a Viable Organization Structure

Innovation can be centralized, decentralized, or something in between, and resource needs depend on the type of structure your organization chooses. The innovation departments and functions of the nonprofits we surveyed, had from 5 to 50

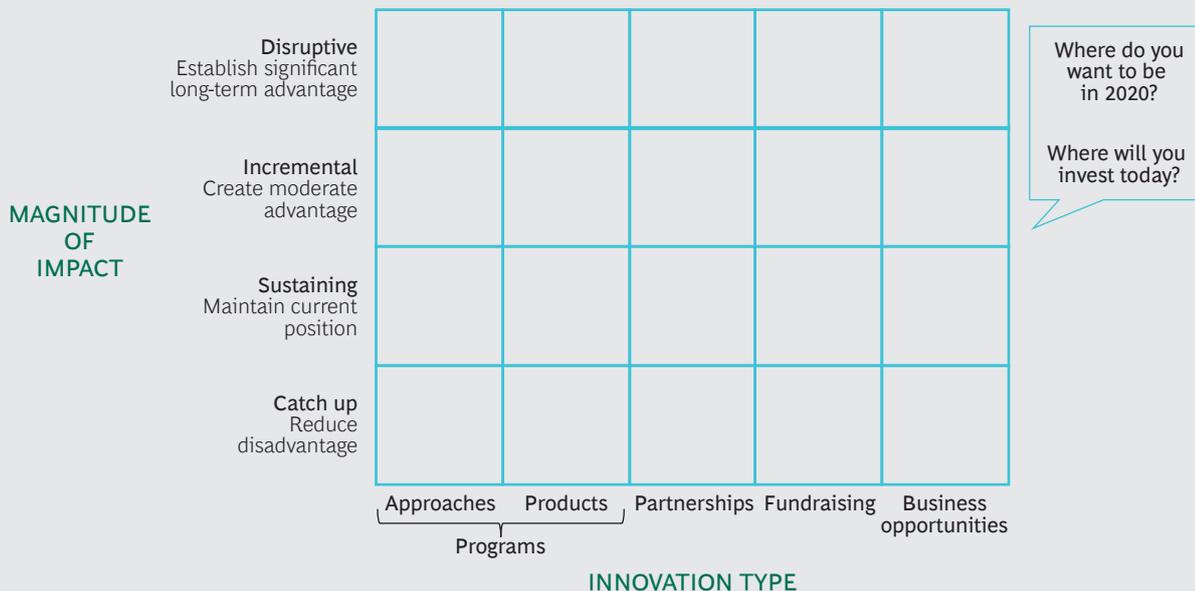
people. At one end of the spectrum is department-led innovation, a highly decentralized model that requires relatively few dedicated resources. In this model, program or country offices drive innovation, evaluate and develop ideas, and direct resources to innovation efforts. At Save the Children, staff members are in the process of becoming “innovation scouts.” In this role, staff will identify promising new opportunities and share best practices across the organization. Potential challenges to this model's success include insufficient support for the innovators, added complexity due to a lack of central coordination, and the need for new staff should current resources be stretched. To combat these challenges, Save the Children has committed funding in support of innovation and created a central coordination function.

A more centralized model is the “innovation accelerator,” which typically requires significant funding and a larger number of dedicated staff. More removed from the broader organization, this model can cause problems with cultural fit, but signals a true commitment to innovation and typically leads to more rapid results. The World Food Programme's innovation accelerator includes a sprint program that helps teams launch new products or prototypes in just three to four months and one-week “boot camps” that help teams focus on finding solutions to pressing problems.

An alternative is a hybrid model in which an innovation lab supports and facilitates—but does not own—innovation within the organization. An example of this third model is the US Global Development Lab at the US Agency for International Development (the Lab at USAID), which brings together diverse partners to discover, test, and scale breakthrough solutions aimed at ending poverty.

A fourth model—lab-owned innovation—is a highly coordinated approach that requires dedicated staff and funding. In this model, which is more common in the private sector (in the form of an R&D lab), the lab is the entire organization's primary source of innovation and holds most, if not all,

Determine the Types of Innovation to Pursue and the Level of Impact Desired



Source: BCG analysis.

of the people committed to innovation efforts.

Regardless of the chosen structure, we recommend starting with a pilot. Nonprofits using a more decentralized structure should begin working with one or two departments before expanding to the broader organization. Those with a more centralized structure should start small, with few resources, a limited budget, and a tight focus on one or two narrowly defined outcomes or objectives. It is unrealistic to expect perfection from day one. This is an iterative, evolving process, and conducting a pilot before scaling will help ensure a structure that delivers the optimal results.

Have an Effective Innovation Process

While innovation processes vary widely among nonprofits, the most successful innovators generally follow four critical steps: generate ideas, validate concepts, test and prove, and scale. Although new ideas are sourced both internally and externally, our respondents reported that many of the most promising ideas come not from headquarters but from the field and external partners, such as universities and the pri-

vate sector. Once ideas are validated on the basis of their viability, feasibility, and impact potential, they're piloted and data is collected to prove or disprove the likelihood of success. The innovation pipeline narrows as the most promising ideas advance. Only the most successful ideas get committed resources and are scaled. Although specifics such as timing, participants, and funding vary among organizations, this overall process is consistent among the best in class.

Consider Novel Funding Options

Innovation funding among the large nonprofits we surveyed, such as UNICEF and the Lab at USAID, ranges from less than \$2 million to more than \$5 million. Several raise funds specifically dedicated to innovation. For instance, Mercy Corps Social Venture Fund focused on investing in pioneering social-business approaches, and PATH received a grant from the Gates Foundation to develop innovative ideas that could lead to new global health initiatives. But there are two common misconceptions about how the social sector funds innovation. One is that successful innovation depends on a large pool of available

funding, and the other is that innovation funding must come from an organization's undesignated funding pool.

Although many organizations do have significant funds available for innovation, this is not a prerequisite. In fact, limited financial resources can help focus a nonprofit that wants to build its innovation capabilities and cultivate a “pilot, then scale” model.

Undesignated funds can be used for innovation, but they are just one possible source of funding. For instance, some nonprofits collaborate with the private sector in creative ways. UNICEF's Innovation Fund supports emerging startups in developing markets by providing seed funding to test open-source technology solutions that can improve the lives of children. The fund has received support from public and private partners. Jhpiego's partnership with the GE Foundation includes a \$1.6 million grant to develop low-cost life-saving health care technologies for women and children in developing countries.

Monitor and Evaluate Results

Rigorous tracking and measurement are critical to the success of innovation efforts, but our research showed that metrics and approaches vary. Overall, we noted a general trend and desire among the executives we surveyed to move toward metrics that measure outcomes and impact (such as dollars saved or increases in graduation rates), as opposed to the more traditional practice of measuring inputs and outputs (such as dollars spent or number of students served).

In health care, the disability-adjusted life year (DALY) metric is often the de facto standard for measuring the impact of disease and interventions. In essence, a DALY is one lost year of healthy life, and health interventions aim to decrease or avert DALYs. Population Services International (PSI), a global health organization whose mission is to improve the health of people in developing countries, sets DALY targets—in both absolute and dol-

lar terms—for all of its new and existing programs. Country directors are evaluated on year-to-year improvements in DALY metrics.

PATH also has a system for assessing the effectiveness of innovation efforts. The organization sets milestones and deadlines for each innovation and holds teams accountable for results. Then, PATH measures how innovations contribute to the achievement of national and global targets for reducing morbidity or mortality among women, newborns, and children.

The Mercy Corps Social Venture Fund has two criteria for funding: the business must have the potential to reach a minimum of 1 million people, and it must be financially sustainable within five years. The organization also customizes impact metrics for each investment.

Have a System for Sharing Knowledge

An effective knowledge management system can track projects in the pipeline and share best practices and insights across the organization. The nonprofits we surveyed had formal and informal systems in place.

UNICEF has a formal internal knowledge management platform that allows all staff to learn about internal innovation efforts. The organization asserts that “identifying, validating, and documenting innovations, lessons learned, and good practices are a necessary part of organizational learning.” Mercy Corps has a formal, technology-based knowledge management system that includes a digital library, weekly newsletter, grant tracker, and global metrics database.

Other innovation leaders in the nonprofit sector have informal practices that encourage knowledge sharing. An NGO based in Bangladesh, for example, holds monthly organization-wide innovation chats in which employees discuss the latest innovations, ideas, and lessons learned. At PSI, country leaders regularly describe their innovations to the rest of the organization at regional and global retreats.

Support Innovation with Appropriate Incentives and Rewards

Besides helping to create an innovation culture, the right incentives signal the importance of developing new, more effective ways of working and a willingness to take risks. Several organizations, including Save the Children, award spot bonuses for risk taking and innovative thinking. To cultivate a culture that embraces risk and accepts smart failure, Mercy Corps holds “fail fairs,” at which employees—including se-

nior leaders—relate stories of their personal and programmatic failures.

TAKEN TOGETHER, THESE seven guidelines for nonprofits can sharply improve the outcomes of innovation efforts—and the impact they deliver.

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