(Non?) Profits to the Rescue

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Abstract: Evidence strongly suggests that state-led humanitarian interventions are a failure. As an alternative, most point to civil society (non-government) to fill this void in providing relief. Left out of the discussion is the possibility that profit seeking firms can and often do provide additional humanitarian benefits. The purpose of this paper is twofold: 1) to illustrate the inability of non-governmental agencies to deliver adequate humanitarian relief, and 2) to highlight how profit-seeking businesses often find it in their best interest to provide humanitarian type assistance. Combining both findings, this paper concludes that the profit motive not only creates economic but also social value.

Keywords: NGOs, humanitarian assistance, entrepreneurship, social value, nonmarket participants

Introduction

What can be done to alleviate existing human suffering? Discussions involving humanitarian relief often assume that not only should we, the citizens of rich countries, help, but that we are capable of providing effective assistance. This mentality exists within academic circles, the development community, and the general populace. For example, Jeffrey Sachs, a Professor of Economics at Columbia University, states in *The End of Poverty* (2005) that we now possess the financial resources and know-how to end extreme poverty. These resources and knowledge are to be provided by Western governments. The Millennium Development Goals, the blueprint for government aid donors, takes Sachs' position as given. The only real constraint on achieving the Goals is political will and activism. The lead singer of U2, Bono, repeats these arguments when he encourages his fans to contact their respective political representatives in support of the use of government aid to end world suffering (Stossel 2006).[2]

A new book by Christopher Coyne (2013), *Doing Bad by Doing Good: Why Humanitarian Action Fails* calls this assumption into question. Coyne relies on an array of previous studies and presents new evidence suggesting that most state led humanitarian interventions are a failure. His theoretical framework highlights the perverse political incentives and knowledge constraints faced by those administering humanitarian assistance. These constraints contribute to the inability of government bureaucracies to alleviate suffering. The central focus of Coyne's analysis is *state led humanitarian action*. Coyne (2013: 13) defines humanitarian assistance as a "broader array of actions, such as the delivery of short-term emergency relief and long-term assistance intended for development purposes in order to alleviate existing human suffering and to protect vulnerable people from suffering in the future." The main players in administering humanitarian aid are domestic and foreign governments. It is this type of assistance that Coyne argues contributes to ongoing failures in humanitarian aid.

With evidence strongly suggesting that state led humanitarian interventions do not achieve their goals, civil society (i.e. non-government groups) is called upon as the alternative to fill the void in providing relief. As Coyne illustrates, government organizations dominate the provision of humanitarian relief; however, there are a tremendous number of other organizations delivering assistance that fall outside this scope. Coyne casually mentions the role of non-governmental organizations (NGOs) but argues that the line is becoming blurred between government and non-government agencies as many NGOs are supported, at least partially, from government funding. Thus, this implies that NGOs may also face many of the same hurdles as state led action. The first goal of this paper is to analyze non-state led humanitarian providers. I follow Coyne's definition of humanitarian assistance—any provision in providing assistance to alleviate human suffering including short term emergency relief to education and healthcare.

My analysis picks up where Coyne's leaves off. I extend his logic and apply it to non-government organizations (NGOs). When operating outside the market, an agency often lacks the necessary incentive alignment between provider and recipient. In addition, such organizations face a knowledge constraint where they do not actually know how to achieve their desired ends. Both incentive and knowledge problems exists as a function of operating outside the market. These constraints are faced not only by political agencies but *all* non-market organizations. As a result, NGOs with the intended goal of providing humanitarian assistance also must confront both incentive and knowledge constraints in order to alleviate suffering. Evidence is mounting (summarized below) that suggests many NGOs are failing at systematically providing effective poverty alleviation.

If both state led and non-state led (NGOs) action does not and cannot provide humanitarian relief, does this imply a hopeless situation? Coyne says no. He suggests focusing on empowering individual choice through fostering greater economic freedom. He calls for an institutional shift, a move toward freedom that allows for experimentation and discovery of what works for a specific time and place. A tremendous amount of evidence supports the argument that greater economic freedom leads to poverty reduction and increases in human welfare (see Hall and Lawson, 2014, for a review of this literature). This is a long-run perspective of what creates a foundation for rising out of poverty and thus making humanitarian assistance unnecessary. But this answer does not provide immediate relief to those who are currently in need.

The second goal of this paper is to illustrate that while we wait for economic freedom to take hold in places where it is currently lacking, for-profit firms may fill in the gap, providing humanitarian assistance in the short to medium run. As summarized in section 3 below, businesses often provide additional benefits outside the typical firm-employee relationship. These range from educational opportunities, disaster relief, financing opportunities as well as traditional charitable giving. Profit seeking firms can rely on the market feedback to tap into local needs in order to mitigate knowledge constraints. The provision of such assistance may be necessary in order for firms to achieve maximum profits, thus aligning incentives between the firm and recipients.

Coyne illustrates the failures from state led humanitarian assistance. Following his logic, I argue and present evidence suggesting that NGOs may suffer from the same crippling constraints. The reason why both government and non-government action fails is because both operate outside the market context. As an alternative to traditional providers of humanitarian action, I suggest looking to those operating within the market.

Why Not Non-Profits?

State led actors suffer from a variety of both knowledge and incentive constraints. This is well documented. The reason why government agents face these constraints is due to the channels through which assistance must be delivered—bureaucracy. NGOs also deliver their 'goods' through bureaucratic means. They exist to achieve their stated end, whether that is building schools, providing bed nets, or raising awareness on a specific issue. Many of the main arguments presented by Coyne to explain state led humanitarian action can be applied to explaining the constraints faced by NGOs. I rely on his theoretical arguments and apply it to NGOs before providing several case studies to illustrate such failures.

Resources are scarce. Choices must be made on how to allocate these scarce resources among competing humanitarian ends. As NGOs operate outside the market context, they also suffer from what Coyne calls the "planner's problem." The planner's problem is the inability of nonmarket participants to access relevant knowledge regarding how to allocate resources to their highest valued use. This solution only emerges within the discovery process of the market. This problem applies to resources that are devoted for long-term economic development purposes as well as the alleviation of short-term suffering. The question of how best to achieve the stated ends given scarce resources must still be dealt with whether the question is being asked by a well-meaning bureaucrat in a government agency or a non-government agency. In addition, agencies must also decide which humanitarian end they are going to pursue. These two issues are implicitly linked as agencies must often attempt to deal with issues that appear the most pressing first. But determining what is the most pressing is indirectly a function of how individuals value the use of society's resources. This valuation process is only revealed through market prices. However, NGOs are not explicitly relying on market mechanisms to determine their ends and how to best achieve these ends. This captures what Coyne refers to as knowledge constraints.

Incentives must also align in order for interventions to be successful. It is much easier to see the perverse political constraints that state based agencies face—public opinion, special interests and strategic interests, just to name a few. NGOs that are truly separate from government funding can avoid mainly of these perverse incentives, which is one of the main reasons why NGOs receive strong support as administers of humanitarian relief. However, incentive constraints must also be confronted by NGOs. Since decisions regarding which humanitarian goals to pursue and how to pursue them are not made within the market, NGOs rely on an incentive structure based on raising money either from private donors or from government support. Competition for resources amongst NGOs means convincing donors that a specific project is a worthy cause. This shift creates a set of incentives, possibly perverse, that may be divorced from the original goal of providing relief.

For example, NGOs, like government bureaucracies, also have an incentive to expand their budget and increase staff. The incentive to expand is somewhat independent from necessity to expand in order to better achieve the NGOs mission. Similarly, feedback and accountability is weaker outside the market. It is true that donors attempt to hold NGOs accountable; however, this link can be extremely strong or extremely weak depending on the number of donors and the task at hand. The weaker the link is, the looser the feedback loop will be, which sets up incentives for waste and resource misallocation. In the end, NGOs are ultimately answering to their donors as the ability to raise funds determines success. Countless examples have emerged to illustrate NGO failures resulting from both incentive and knowledge constraints. I recognize that there are positive examples of NGOs alleviating suffering. My point is not that no good can come from NGO work, but that systematic failure should not be surprising as theoretical arguments exists that predict such results. I highlight a few failures to illustrate this main point.

One of the greatest examples of NGO swindling and mismanagement of funds is Greg Mortenson's Central Asia Institute (CAI). In 1996, Mortenson co-founded CAI to reduce poverty in Pakistan and Afghanistan by promoting education for girls there. In 2007, he writes *Three Cups of Tea: One Man's Mission to Promote Peace…One School at a Time* describing his transition from mountain-climber to humanitarian. The book remained on the New York Times nonfiction bestsellers list for several years.

There is just one problem—turns out that much of what is described in the book is actually fictional, exaggerated truths of what CAI has accomplished. As of 2010, CAI reports that it had contributed to the building of over 171 schools, providing education to over 64,000 children. On the April 17, 2011 CBS News' 60 Minutes broadcast a report accusing Mortenson's claims as false. Specifically, CBS disputed the claims that Mortenson was captured by the Taliban in 1996 and that CAI had actually built as many schools as it claimed. CBS also found that many of the schools that had been built are now abandoned, not currently supported by CAI, or are being used for alternative uses such as grain storage. Also, allegations also surround the management of funds which include Mortenson using money intended for education to fund his travel and speaking engagements (see Kristoff 2011; Wright 2011; Stemle 2011; and Krekaeur 2011 for supporting evidence).

Another education example that received media attention is the failure of Madonna's NGO, Raising Malawi. In 2009, Madonna co-sponsored investments into building a school, Raising Malawi Academy for Girls. This was one of the NGO's major projects and was designed to provide education to girls. It is estimated that managers squandered $3.8 million, an entire year's worth of grant raising, on the school that will now never be built. The project has since been scrapped due to financial discrepancies and mismanagement of funds. The 120 acres of land that was taken out of productive agricultural use in order to build the school will now be the site of a national monument (Jacobs 2011; Mapondera and Smith 2012).

Another example comes from Médecins Sans Frontières (MSF), French Doctors without Borders. The account of this NGOs failure is told by Marilyn McHarg, MSF's Executive Director, on the website Admitting Failure. MSF's main duty is to provide humanitarian medical relief. McHarg states that the organization mainly focuses on treating those with infectious diseases as reflected in both management guidelines and their supply kits. In 2003, McHarg supervised MSF's intervention in Iraq. What she discovered is that most individuals needed treatment for non-communicable diseases. The team was prepared with malaria drugs and antibiotics. It was not equipped to deal with the problems at hand. In order to provide the relief these individuals needed, MSF had to change focus and find the medical supplies that were actually needed. McHarg remembers her frustration; frustration not just because the team was not prepared, but because this same situation was documented from a previous MSF experience in Kosovo. The failure was repeated again in Haiti in 2010.

The website this particular study is told on, Admitting Failure, exists solely as a platform for NGOs to admit their humanitarian failures. The mission of Admitting Failure is to bring together civil society organizations to share their stories as a way to avoid future disappointment. The website acknowledges that often groups do not discuss past failures in order to not scare off donors. However, the platform encourages an open dialogue so that NGOs can innovate and learn from previous mistakes. As it explicitly states, "Fear, embarrassment, and intolerance of failure drives our learning underground and hinders innovation. No more. Failure is strength. The most effective and innovative organizations are those that are willing to speak openly about their failures because **the only truly "bad" failure is one that's repeated."** The website does indeed have an open forum where those working in civil society can discuss the problems they face and the failures that are made. The problem is that these failures are repeated. Repeated within the same NGO, as with MSF, and repeated across different groups.

While this is tremendously disappointing, the results can be (at least partially) explained from our theory above. It is not surprising that we see the same failures repeated by the same agency and across different agencies. Nonmarket participants do not have the tight feedback loops necessary to gain relevant knowledge nor do they face the incentives to learn in order to not repeat the same mistakes.

Why Profits?

If NGOs face many of the same constraints (possibly not as severe) as state led humanitarian action, who will 'feed the children'? In other words, do we have other mechanisms that can alleviate human suffering? Porter and Kramer (2011) say yes we do—businesses. Profit seeking firms can and often do provide social benefits. In order to illustrate alternatives to government and non-government organizations, I briefly summarize Porter and Kramer's arguments and evidence below.

Porter and Kramer argue that businesses are too often cited as the problem of social ills, whether it is environmental, economic, or social. There is a perceived trade-off between social benefits and economic efficiency that has become entrenched in public policies. Government and public opinion worsens this view by attempting to address social flaws at the expenses of corporations.

> Neoclassical economics is partly to blame. As Porter and Kramer argue, "economists have legitimized the idea that to provide societal benefits, companies must temper their economic success. In neoclassical thinking, a requirement for social improvement—such as safety or hiring the disabled—imposes a constraint on the corporation. Adding a constraint to a firm that is already maximizing profits, says the theory, will inevitably raise costs and reduce those profits" (p: 4-5).

In addition, standard economics defines externalities as stemming from firms creating external, or social, costs that they do not bear. In order to correct these additional costs, additional taxes or regulations are created in order to internalize the costs. As a result, firms are aware that government will create such policies and therefore reshape their corporate strategies. This can provide disincentives for firms to internalize the external costs on their own leaving social and environmental issues out of profit maximizing strategies. This can lead to firms shifting from a long-run to a short-run perspective, maximizing profits in a more narrow view instead of incorporating all societal influences that determine long-run market success.

Porter and Kramer create a new concept in order to move beyond this narrow thinking.

> "The concept of shared value, in contrast, recognizes that societal needs, not just conventional economic needs, define markets. It also recognizes that social harms or weaknesses frequently create *internal* costs for firms—such as wasted energy or raw materials, costly accidents, and the need for remedial training to compensate for inadequacies in education. And addressing societal harms and constraints does not necessarily raise costs for firms, because they can innovate through using new technologies, operating methods, and management approaches—and as a result, increase their productivity and expand their markets" (p. 5).

Several large corporations, such as GE, Google, IBM, Intel, Johnson & Johnson, Nestlé, Unilever, and Wal-Mart, are already creating shared value. For example, Nespresso, part of Nestlé, combines an espresso machine with ground coffee capsules. One of the major challenges Nespresso faces is securing reliable specialized coffees. In order to do so, Nespresso works directly with small coffee producers across Africa and Latin America providing advice for growing, securing access to credit, and guaranteeing plant stock, fertilizers and pesticides. The company also created local quality checkpoint facilities, which meant that the company could pay a premium for higher quality coffee. Incentives were created for producers to increase quality production, which lead to an increase in grower's income.

Another example comes from Yara, a mineral fertilizer company building ports and roads in Mozambique and Tanzania. The lack of infrastructure was preventing access to fertilizers and farmers from transporting crops. Therefore, Yara helped build the roads.

Wal-Mart has created educational programs in Mexico, India and Brazil. These programs are designed to train potential employees, typically women, with valuable knowledge on commercial retail and leadership skills. These individuals retain these skills for life.

Finally, Wal-Mart also addressed humanitarian need through its response to Hurricane Katrina. As Horwitz (2009) summarizes, Wal-Mart's response was far superior to any government agencies attempting to provide relief. The company, within days, delivered truckload of supplies including prescription drugs. Horwitz cites private ownership and the price system as the reason why Wal-Mart outperformed state led action.

Porter and Kramer conclude that these business ventures are not guided by philanthropic incentives but by self-interest. When the institutional structure, which includes public policies and government regulation, shifts firm's incentives from short-run to a long-run perspective, the profit motive leads entrepreneurs to create social value.

Conclusion

Coyne's *Doing Bad by Doing Good* provides theoretical and empirical evidence that state led humanitarian interventions are a systematic failure. Using his framework, I extend his analysis to include non-government organizations. Evidence suggests that NGOs may not be able to deliver adequate humanitarian relief. All nonmarket participants, including NGOs, must confront knowledge and incentive constraints. As an alternative, profit-seeking firms may find it in their best interest to provide such humanitarian assistance as part of profit maximization.

My analysis supports the concluding remarks from Coyne. As a first move, we will better serve each other the sooner we recognize our own human limitations. Interventions by organizations into complex organizations lead to unintended consequences that cannot be predicted or avoided as we have limited knowledge regarding changes in individual behavior. As a result, the best of intentions that support humanitarian interventions can lead to more harm than good. Focusing on establishing an environment that supports economic freedom and shifts businesses from a short-run to a long-run strategy may provide more humanitarian relief than any well-meaning objectives.

Notes

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[2] Recently, Bono has come out in support of capitalism and markets as an important driver is solving global poverty (see, Olson 2012, for example).

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