Do We Have a Nonprofit Overhead Movement?

Opinions may differ as to what constitutes a movement—but when two different and influential groups hold noteworthy conferences on the same basic topic within three days of each other, you have to think something's up.

The conferences in question focused on nonprofit overhead and included a gathering in New York City led by members of the Green Group (an alliance of US environmental organizations, including the Sierra Club and Environment America) and Inside NGO, and a conference in Chicago organized by The Bridgespan Group and the Donors Forum.

Concerns about the sector's treatment of overhead—the much-maligned but critical types of indirect spending that enable delivery of programs, such as general management, information technology, performance measurement, and fundraising—fueled both convenings. And both sought to spur concrete actions—especially on the part of funders—that would address these major impediments to the effective growth and performance of the very organizations we are relying on to address society's toughest social challenges.

The discussions and debates were rich, passionate and well-informed. And as befits such early-stage gatherings, the participants made solid progress in the crucial first step of clarifying what the underlying issues really are. Pondering what I heard at both conferences, it's clear there are three distinct aspects to the overhead problem, each of which warrants dedicated attention.

The first part of the problem, which ratings gurus Ken Berger of Charity Navigator, Jacob Harold of Guidestar and Art Taylor of the BBB Wise Giving Alliance highlighted in their open letter last June, focuses on the tendency of many funders to use overhead figures (typically overhead costs as a percent of total costs) as an indicator of a program's or organization's effectiveness when selecting recipients. The result: significant funding inevitably goes to programs or organizations that have low overhead but may not be best positioned to produce high impact.

To be sure, it's very understandable why some funders resort to this suboptimal use of overhead rates in our data-starved sector. In stark contrast to most impact measures, overhead ratios are readily accessible, quantifiable, and comparable (at first blush) across organizations and domains. Further, overhead spending has intuitive relevance to common concerns of funders: High ratios or increasing overhead costs might just indicate bad things, such as excessive executive compensation, inefficiency, fraud, and inadequate scale. Meanwhile, low ratios or decreasing overhead costs might imply good things, such as rigorous cost management, high efficiency, and growing economies of scale.

To overcome the misconceptions without throwing the baby out with the bathwater, we should not aim to discredit scrutiny of overhead rates altogether, but rather situate overhead spending within a broader, better-informed context, one that acknowledges the benefits of the ratios while revealing their limitations.

Both conferences reinforced that the key to doing this is a keen focus on outcomes and impact. The activities and costs embodied in overhead are unquestionably important, but they are inputs toward intended social impact, not an end unto themselves. We know that overhead rates vary dramatically by organization, particularly across domains. What we don't readily know is how overhead rates and the underlying activities actually relate to an organization's ability to drive superior impact, especially considering the resources invested.

The second aspect of the overhead issue, highlighted in the Bridgespan article "The Nonprofit Starvation Cycle," focuses on the reluctance of many funders, once they've decided to make a grant, to pay the full cost of associated overhead in addition to program expenses. This reluctance, too, is understandable to the extent that funders have doubts about their ability to determine how well specific nonprofits are managing their overhead. Refusing to support these costs, however, or imposing arbitrary limitations not linked to reality, prevents even the most effective nonprofits from doing what they must to deliver great results and to improve over time.

The most consequential funder of them all, the US government, provided one very hopeful development in this regard, and one which was a major topic at the Chicago meeting. In late December, the Office of Management and Budget released a revised set of cost rules that should greatly improve the ability of nonprofits to get adequate reimbursement for overhead spending from federal grants and contracts.

Nevertheless, the irony is that determining what constitutes an appropriate level of overhead requires that nonprofits develop a better understanding of their true costs and which practices and programs generate the best results and why. In addition to diligence and brutal honesty on the part of the nonprofits, this in turn requires that funders support improved evaluation and performance measurement, which are themselves forms of overhead spending!

The third aspect involves recognition by nonprofits that they are equally critical to solutions. Yes, funders decide who gets money and what activities receive support. But the nonprofits are responsible for what actually creates social value: designing and implementing programs that can transform people's lives, tracking and applying data to optimize program performance, and literally serving those in need. Without organizations able to do these things well, all funders have is cash and bad options.

Yet all too often, nonprofits have not done all they can to optimize their performance including knowing the true costs of key functions. And even those that have and are able to produce strong results are not always effective advocates for their own needs and work. Still worse, they can be too ready to gratefully accept money from funders on terms they know do not enable them to sustain their performance, which only perpetuates the overhead problems.

Fortunately, there appears to be growing consensus for action across all aspects of the problem. Both of these conferences generated thoughtful and substantive observations and next steps, which gives hope that the stars are aligning, and funders, nonprofits, rating agencies, and other key intermediaries increasingly understand the problems and are motivated to find solutions. Does all of this constitute the lockstep march of a movement? While it's a bit early to tell, and there's a very long, winding road ahead, I unambiguously sense that a direction has been set and there will be no turning back.

Do you see signs for optimism—or pessimism—in the treatment of overhead in your own work?

Posted: 1/27/2014 12:40:10 PM by **Paul Carttar** | with 2 comments
Filed under: overhead, what, works

Comments

Molly Clark
It would be nice if the movement could include ways in which funders themselves drive up overhead costs of grantees through practices such as funding only certain line items and requiring reporting that reflects this. This is fake accountability, a huge unnecessary burden on nonprofit

management, and a lousy substitute for holding nonprofits accountable for outcomes. For heavens sake, what for profit investor would impose such restrictions and unnecessary process burdens?
1/29/2014 7:24:46 PM

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marjorie
Yes, there could be a movement! People across the industry have been talking about this for years and more so in the last five years as Funders seem to move further away from giving money to help support overhead costs. One of the downfalls of this lack of support is the difficulty non-profits have attracting and keeping talented staff; the chase for multiple small grants, requiring huge outcomes, to have additional resources to support overhead; and, the expansion of services into areas where they lack expertise. This is one of the issues Dan Pellota raised in his TED talk in early 2013.
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