

The Overhead Myth

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The Evolution of Efficiency Measures

- How did this happen??
- **SIMPLE EXPLANATION**
- The world has become addicted to simple explanations
- Richard Steinberg, Case Western Law Review 20 years ago wrote: “*the measure (cost of fundraising) has little to commend itself besides simplicity*”.

Evolution of Efficiency Measures (cont.)

- **Philanthropy is an emotional decision, not just financial**
- **No such thing as an average gift and one size does not fit all**

Nonprofit Overhead Cost Study

- 1999- 2004 Urban Institute, National Center for Charitable Statistics and Center on Philanthropy at Indiana University
- Study conducted in three phases included analysis of from IRS 990 Data of 250,000 charities of all types, 1,500 survey results & 9 in-depth case studies

A Few Key Findings

- Accurate Cost Reporting is a Challenge
- Large, Well Established Organizations (American Red Cross, YMCA, Salvation Army etc.) tend to have low fundraising costs
- Newly formed organizations tend to have higher fundraising costs
- Reliance on Direct Mail and other high cost types of fundraising yield higher fundraising costs
- “Contrary to popular ideas spending too little on infrastructure have more limited effectiveness than those that spend more reasonably”

Fast Forward to 2000 & Beyond

Uncharitable

- Written by Dan Pallotta in 2008
- Argues How Restraints on Nonprofits Undermine Their Potential
- Chapter 3, “*Stop Asking the Question*” is devoted to the dialogue about Cost of Fundraising
- Pallotta argues in this chapter that “*Efficiency Measures Miss the Point*”

Charting Impact

- Product Developed by the Better Business Bureau Wise Giving Alliance, Independent Sector and Guidestar helps charities measure impact.
(www.give.org, www.independentsector.org,
www.guidestar.org)
- Consider **Impact** in addition to other factors such as cost of fundraising and administrative expenses

Charity Watchdogs

- BBB Wise Giving Alliance (BBB WGA), Charity Navigator (CN), CharityWatch (CW), State Attorney Generals etc.
- Many differ in both Application & Calculation of overhead financial ratios

Standards vs. Ratings

- BBB WGA Uses “threshold” overhead financial ratios
- In contrast, Charity Navigator & CharityWatch use a rating scale (letters or stars) that reward charities with a higher rating for lower overhead costs
- Secretary of State for South Carolina, website advertises an Scrooges & Angels List of Charities
- BBB WGA Standard 8, Spend at least 65% of total expenses on program activities.
- BBB WGA Standard 9, Spend no more than 35% of contributions on fundraising

GAAP vs. Recalculated Numbers

- BBB WGA Standards Follow GAAP financial information
- In contrast, CharityWatch & Charity Navigator recalculate the charity's financial figures as follows:
 - Both Charity Navigator & CharityWatch reject joint allocation of costs and automatically place all joint costs in fundraising whether or not GAAP is being followed
 - In addition, CharityWatch omits all in-kind goods and services when calculating financial ratios even if the charity is following GAAP required practice for reporting these gifts and associated expenses.

BBB WGA believes it is inappropriate to evaluate a charity based solely on overhead ratios alone and believes that to determine a charity's accountability it is necessary to consider fundraising practices, governance, financial management and effectiveness issues.

Executive Compensation

- **Dan Pallotta suggests that charities should spend more on executive compensation and promotion and by doing so they will raise more money and solve more problems.**
- **The answer is somewhere in the middle**

Executive Compensation

- **Employees of Charities should be compensated appropriately based on market factors & charities should be open about how compensation is determined**
- **People Give for Many Different Reasons - Institutional Values are important**

BBB WGA, CharityWatch & Charity Navigator

- **Open Letter to Donors entitled, “The Overhead Myth”**
- **Attempt to Engage in A Public Dialogue**
- **Cost/Outcome A Better Approach**
 - **This approach incorporates all of the expenses a charity incurs to achieve a measurable result.**

Closing Thoughts

- Financial Ratios Do Not Tell the Whole Story
- One Size Does Not Fit All
- Stop Apologizing for Fundraising Costs & Explain
- Measure Impact & Effectiveness
- Tell Your Story

“Its time to stop obsessing about overhead and start focusing on progress. Change charity, and charity can change the world.” by Dan Pallotta

Resources

- Better Business Bureau Wise Giving Alliance www.give.org
- Charity Navigator www.charitynavigator.org
- CharityWatch www.charitywatch.org
- Independent Sector www.independentsector.org
- Association of Fundraising Professionals www.afpnet.org
- Secretary of State, South Carolina www.sc.sos.gov
- **Uncharitable, How Restraints on Nonprofits Undermine Their Potential** by Dan Pallotta by Tufts University Press, Medford Massachusetts, Published by University Press of New England, Hanover and London, 2008
- www.danpallotta.com

**Thank You.
Questions?**

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