

Overcoming the Overhead Myth

We've all heard it, and if we're being honest, many of us have even said it: "I don't want my donation to a nonprofit to support overhead. I want to support the cause." Countless posts on social media and stories on the news criticize large national nonprofit organizations for their CEO's salaries, leading readers to believe these groups are swindling donors. This mindset does not limit itself to large national groups, and it spills over into the way we manage our local nonprofits as well. Most donors feel they are serving as watchdogs, asking what percentage supports overhead or challenging a nonprofit who is making an investment in their organization.

Being mindful and aware of decisions made by nonprofits is important, as is being an informed donor. But is overhead the most important measure when it comes to evaluating the success or failure of a group?

Experts suggest it is not.

Dan Pallotta, author of *Uncharitable: How Restraints on Nonprofits Undermine Their Potential*, agrees. In his 2013 TED Talk, Pallotta states, "the things we've been taught about giving and charity and the nonprofit sector are actually undermining the causes we care about and our profound yearning to change the world."

The truth is, the problems nonprofits are working to solve are gigantic, adaptive challenges, and our organizations are small and sometimes defenseless against the enormity of those challenges. The current beliefs of donors, board members, and even nonprofit staff keep us from making real progress.

Pallotta contends the rules for the nonprofit sector and the rules for the rest of the economic world are different. He said the nonprofit sector is discriminated against in five areas.

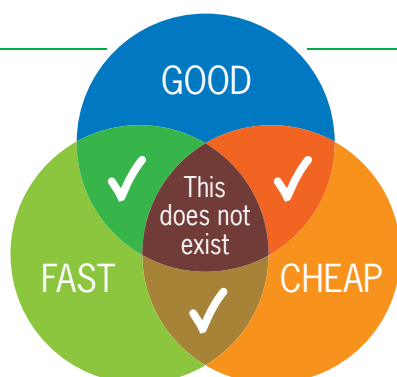
1. Compensation – In the business world, the more value you bring to your organization, the more money you make. In the nonprofit world, this is not the case. We don't like the idea that anyone could make very much money helping other people. This means the best and brightest talent leaves for the for-profit sector rather than staying in the nonprofit sector where they might be able to make a world of difference.

2. Advertising and Marketing – Coca-Cola spends just under \$3.5 billion a year in advertising and marketing. Years of making this investment has led to market dominance, and the return on their investment has been astronomical. However, we do not like charities to spend money on advertising. Donors don't seem to believe the investment could help produce more revenue to further their cause, even though the formula has worked in the for-profit sector for years.

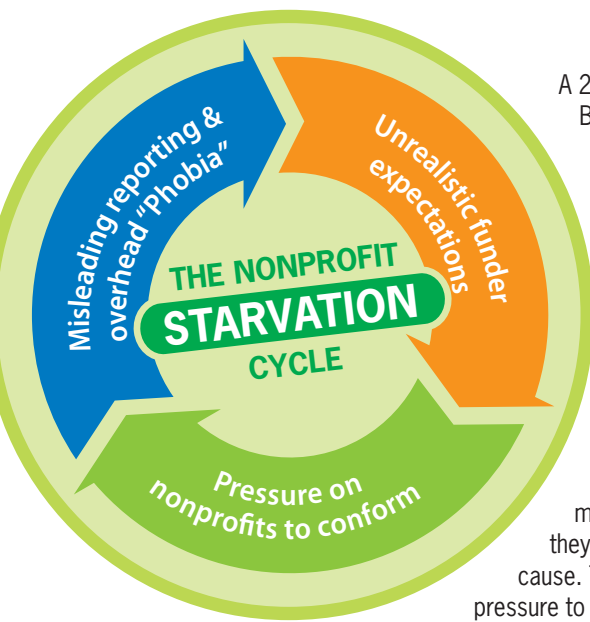
3. Taking risks in pursuit of new ideas for generating revenue – There is no great reward without great risk. When it comes to fundraising, most nonprofits feel they have to go with the smaller "sure bet" over taking a chance on something that could actually produce meaningful revenue for their organization. Very few nonprofits feel they can take the financial risk to invest in their large-scale fundraising endeavors, meaning fundraising activities stay stagnant, as does the revenue which could move the cause further.

4. Time – Pallotta says Amazon went six years before returning any profits to investors. People were patient and understood this investment was working to meet the long-term objective of market dominance. This practice is very rarely tolerated in the nonprofit sector. Pallotta says, "If a nonprofit organization ever had a dream of building magnificent scale that meant for six years no money was going to go to the needy—it was all going to be invested in building this scale—we would expect a crucifixion."

5. Profits to attract risk capital – Nonprofits are unable to return profits to investors, meaning that all risk capital goes to the for-profit sector.



In the business world, most people recognize you always have choices—good, fast, or cheap. It's rarely feasible to have all three. Good and fast is expensive. Good and cheap is slow. And fast and cheap is low quality. Because of the belief system that's been given to us, nonprofits are generally asked to stick with fast and cheap, resulting in lower quality and minimal impact on the cause.



A 2001 survey conducted by the Better Business Bureau reported that donors ranked overhead ratio and financial transparency higher than the success of the organization's programs when determining where to give. When donors place more value on low overhead than on what's actually being done to solve large social issues, it flips the priorities of the entire organization. This is the starting point for what researchers call **"The Nonprofit Starvation Cycle."**

The first phase is unrealistic donor expectations. In this phase, donors put more focus into how much money is being spent on overhead than they do in evaluating the work and its impact on the cause. The second part of the cycle is nonprofits feeling pressure to conform. Instead of challenging this way of thinking or defending their decisions, nonprofits feel it is more

important to please donors and end up adapting their thinking to match. This leads the staff to believe they can't justify investment, and it also leads to inaccurate reporting. When there is pressure to conform, this leads to the next phase in the cycle, misleading reporting and overhead "phobia."

Reno County is not immune to the "Nonprofit Starvation Cycle," but at Hutchinson Community Foundation, we believe that through concentrated effort and purposeful actions, we can move beyond the limitations the starvation cycle imposes and instead develop a culture where donors are asking nonprofits about their missions and whether or not their current infrastructure will allow them to fulfill those missions.

Focusing on outcomes measurements as the primary indicator of success may seem responsible, but taken alone, these measurements can actually prevent risk-taking and potential growth. Looking at nonprofit work through a more business-like lens and acknowledging that not all measures of success can be tied to quantitative outcomes allows donors to become catalysts in nonprofits' work to achieve bold, mission-driven goals. Within this type of culture, our nonprofits can become stronger and healthier, allowing them to make progress on the issues we, as a community, say we care about.

The Community Foundation has made a commitment to investing in organizations as they take the brave steps to clarify or grow their missions and build their capacity to meet those missions. We view overhead—investment in people, ideas, facilities, professional development, and marketing and communication—as absolutely necessary for growth and sustainability. Our commitment to this philosophy can be seen in many of the Fund for Hutchinson grants we've made.

For example, in 2014, Interfaith Housing Services, Inc. received the first year of a three-year \$15,000 per year grant to establish a central Projects Coordinator position to lead community efforts in addressing Hutchinson's housing needs by connecting organizations, programs, volunteers, and funding for critical repair and rehabilitation work. We partnered in funding this position with the United Way of Reno County, City of Hutchinson, and private donors to ensure that this collaborative effort would have the resources needed to be a conduit for change.

Advertising is an overhead cost that nonprofits often forego due to budget constraints, but just as in businesses, advertising can provide a boost that moves an organization further toward its goals and mission. TECH, Inc. was awarded a \$3,000 grant in 2015 for e-Cycle marketing and promotion to be used to advertise and encourage drop-offs at the new Reno County Landfill site. As a result of increased marketing, the e-Cycle program processed 267,429 pounds of e-waste in 2016, exceeding their goal of 100,000 pounds and showing a 156% increase over 2015. They were also able to increase the number of TECH clients working with e-Cycle from four to seven, creating nearly double the opportunities for people with disabilities.

Other recent grants have gone beyond programming and into increasing the capacity of local nonprofits. This includes a three-year \$10,000 per year grant to Stage 9 as capacity-building toward their new strategic vision and to strengthen and sustain the performing arts in Reno County and two grants totaling \$55,000 to Our Redeemer Lutheran Early Learning Center for construction costs to help create a sustainable business model. In these cases, a grant at the start of a strategic initiative to fill a need in the community and establish a stronger sense of sustainability means that the organizations have room to focus on their missions and not on funding infrastructure or salaries.

Real change will come when our community is able to reset our expectations as funders. We're inviting you, who are supporters of many nonprofit organizations and are valued donors of the Hutchinson Community Foundation, along with nonprofit board members and staff, to rethink the way you evaluate the work of our local organizations. We encourage you to consider the following ideas:

FOR DONORS:

Measure success by evaluating progress, not overhead

Give because you believe in the work, not because the overhead is low

Consider the for-profit rulebook and how applying it in the nonprofit world would make a difference

FOR BOARD MEMBERS:

Make the program report more important than the balance sheet

Allow staff the opportunity to dream big

Don't reward low overhead, reward progress and true successes for the cause

FOR NONPROFIT STAFF:

Be business-minded in decision-making and focus on impact, not price

Understand the true cost of operating, including pieces you've left out before like marketing, increased wages, and facility improvements

Engage board members in the conversation and help them communicate with donors

We've posted Dan Pallotta's TED Talk on our Facebook page and website. We encourage everyone to watch or rewatch the video and keep the discussion going with friends or family.

**Pallotta, D. (2013, March). Dan Pallotta: The way we think about charity is dead wrong [Video file]. Retrieved from www.ted.com/talks/dan_pallotta_the_way_we_think_about_charity_is_dead_wrong*

I am the Executive Director of the Cancer Council of Reno County. My job is to provide extra financial support to cancer patients and their families during their darkest times. I help people get the money they need to pay for all the extra expenses that come with having cancer. I keep records of the people we serve and make sure they're getting what they need to fight this terrible disease. I track and document all of our donations and organize fundraisers to help serve more people. Often when people donate to help people with cancer, they say they don't want their money to go to overhead costs like salaries. Without my job, there is no money to support people with cancer and no one to make sure support is given fairly. I am Sandy Woodson. I am dedicated to supporting people as they fight cancer. From providing vitally needed financial assistance to helping cancer victims find hope in their journey—I am overhead.



SANDY WOODSON



MITCH HIXSON

I am the Development Director for Hutchinson's Historic Fox Theatre. My job is to promote the Fox and bring in more money to keep operations going. I am exposing people to fine arts in our community by making sure the Fox provides diverse and high-quality live entertainment. My work also preserves a valued piece of Downtown Hutchinson. I meet with donors, plan fundraising events, and help provide strategic direction to the organization. Often when people donate to support the arts, they say they don't want their money to go to support overhead costs like salaries. They prefer the work is done by volunteers, which we use hundreds of at the Fox. Without the staff, we wouldn't be able to host the shows we do or make progress on some of our long-term goals. I am Mitch Hixson. I believe the arts can transform communities and that our historic treasures should be respected and preserved. From securing funding to keep our doors open to exposing more people to the amazing world of performing arts—I am overhead.

I am an Administrative Pastor at Our Father's House, serving as the director of the church's Abundant Life Community Childcare & Preschool. My job is to ensure parents can leave their children without worry in a safe, loving, high-quality childcare environment. I support our teaching staff by researching child development best practices, providing professional development opportunities, and offering spiritual encouragement for their important work. I collect data and write reports that keep us compliant with state and federal childcare regulations. I help to coordinate church volunteers for workdays that keep our facility looking fresh and functioning effectively. Often when people donate toward childcare centers, they don't want their money going toward administrative costs. Without my position, we would serve fewer families, and teachers would be forced to focus as much on paperwork as on children. I am Heather Faulkner. I am dedicated to providing an environment where children, their families, and staff all know they matter. From ensuring compliance for state and federal licensing to supporting staff as they teach and love those in our care—I am overhead.



HEATHER FAULKNER



JEFF THOMSON

I am the Projects Coordinator for Interfaith Housing Services, Inc. My job is to coordinate repair and rehabilitation projects on houses in our community, allowing people with moderate to low incomes to realize the comfort and security of a home. I work with the Department of Aging to identify cases where repairs and adaptive features would allow people to remain in their homes, and I work with the City's Brush Up Hutch program to refresh homes and build neighborhood pride. I lead efforts to flip donated houses, which are often purchased by folks who've completed our financial education program. I match volunteers to projects appropriate for their skills and collaborate with local contractors to ensure effective and economical project results. Often when people donate to housing programs, they say they don't want their money going toward overhead costs like salaries. Without my position, there is no one making connections with partnering agencies and volunteers to get projects off the ground or see them to completion. I am Jeff Thomson. I believe it's possible to lift a neighborhood one house at a time and a community one neighborhood at a time. From coordinating 13,000 hours of volunteer service to spark neighborhood and community pride to helping people age with dignity by remaining in their homes—I am overhead.

Underinvesting in overhead creates a range of negative outcomes which undermine quality and sustainability:

| Description of Underinvestment | Consequences |
|----------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> Limited staff for administrative roles (e.g. finance, development, operations) | <ul style="list-style-type: none"> Limited ability for organization to manage/monitor finance, development, etc. |
| <ul style="list-style-type: none"> Limited investment in staff training and development | <ul style="list-style-type: none"> Increased turnover among staff, particularly those looking for ongoing professional development Limited ability to continually enhance skills of employees Difficulty building senior team from within |
| <ul style="list-style-type: none"> Inexperienced staff for administrative roles | <ul style="list-style-type: none"> High turnover Poor work quality |
| <ul style="list-style-type: none"> Limited IT infrastructure | <ul style="list-style-type: none"> System crashes, downtime Loss of data/information, limited information-sharing |
| <ul style="list-style-type: none"> Outdated donation management systems | <ul style="list-style-type: none"> Inability to track donors and fundraising progress Limited ability to target fundraising |
| <ul style="list-style-type: none"> Low budget performance management systems | <ul style="list-style-type: none"> Limited ability to track beneficiary outcomes, particularly across sites Limited ability to easily generate reports for grantmakers |

**Mark A. Hager, Thomas Pollak, Kennard Wing, and Patrick M. Rooney, "Getting What We Pay For: Low Overhead Limits Nonprofit Effectiveness," Nonprofit Overhead Cost Project of the Center on Nonprofits and Philanthropy at the Urban Institute and the Center on Philanthropy at Indiana University, August 2004; case study interviews.*

The "Overhead Myth" persists despite evidence that investments on overhead facilitate better nonprofit performance:

Receiving general operation support played a major role in reducing burnout and stress among executive directors.
 –2006 *CompassPoint Services Study*

In 2011, the charities that GiveWell reviewed and recommended had higher overhead than the charities they reviewed and didn't recommend, 11.5% vs. 10.8%.
 –*Giving Evidence*

Organizations that build robust infrastructure—which includes sturdy information technology systems, financial systems, skills training, fundraising processes, and other essential overhead—are more likely to succeed than those that do not.
 –*The Nonprofit Starvation Cycle*



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