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Donors Can't Stop Believing That Nonprofits Pay Too Much Overhead

While many people in the industry have started to question the overhead myth, the people giving money still believe in it, resulting in strings-attached grants that might be holding back possible good.

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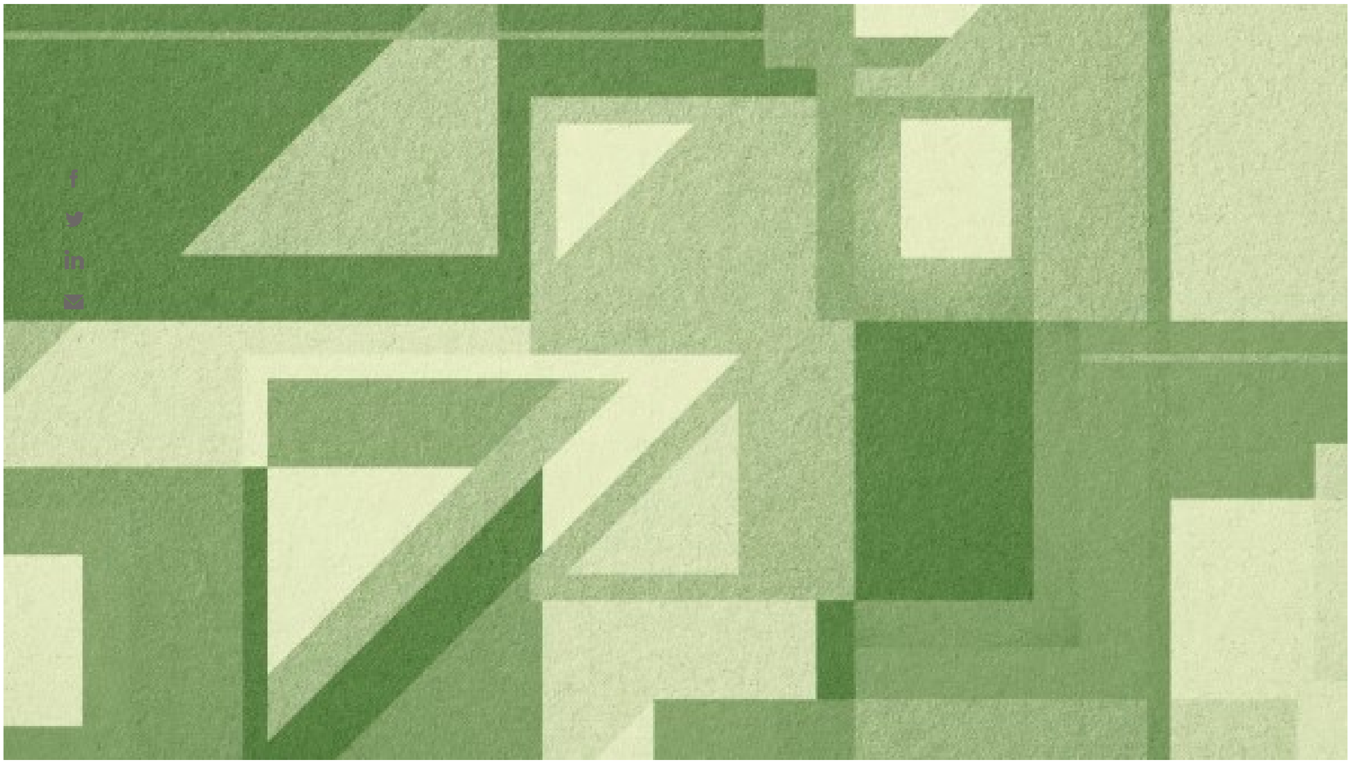
BY BEN PAYNTER

4 MINUTE READ

Do you consider yourself a fairly charitable person? If so, here's some bad news: Everything you think you know about what it financially takes to run a nonprofit is probably wrong. Because of that, you're probably hurting the groups whose missions you claim to support.

Those are the two uncomfortable takeaways from recent research first reported about by the *Chronicle of Philanthropy*. Grey Matter Research, a charity consultancy, and Opinions 4 Good, a philanthropic online market research firm, combined efforts to conduct a survey of 1,000 donors that shows most people still believe in the "overhead myth"; that's the industry term for the mistaken belief that groups keeping operational or indirect organizational costs low are somehow more effective at accomplishing their missions.

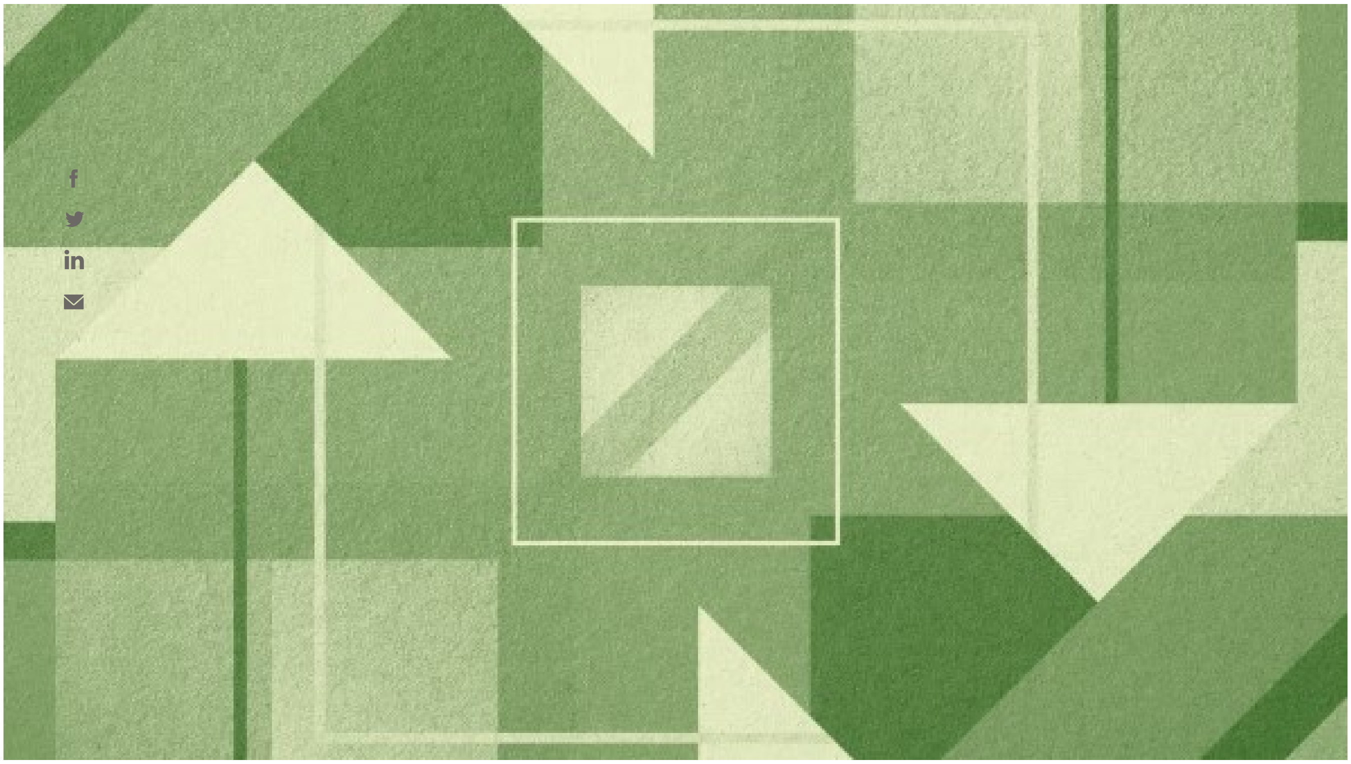


[Photo: RadomanDurkovic/iStock]

In truth, Bridgespan, a nonprofit consultancy, has argued previously that the sector should be embracing a transparent "Pay-What-It-Takes" model. Group costs can and should fluctuate within reason based on what type of remedy is being implemented (bioscience and tech-based interventions, for instance, tend to require lab space or hardware, not to mention advanced employee training, that might initially be pricey). The point is that oftentimes the overhead cost is worth it, especially if the money allows the group to be more successful and expand smartly.

Many nonprofits and charitable watchdogs understand that and have even lobbied for a wider awareness of it, but the public has been slow to catch on. As Grey Matter President Ron Sellers put it, charities continue to have "an unwarranted reputation problem" caused by a few public displays of greed that infected donors' worldviews. Case in point: the Wounded Warrior Project once collected $372 million a year and then spent 40% of that on employee indulgences.

That's lead to a jaded mentality among givers. "The typical person really knows next to nothing about what their favorite organization actually is spending on overhead," Sellers says. In fact, most estimate it's "significantly more than is reasonable." That mentality means would-be great groups may be getting judged by the wrong criteria, causing them to either miss out on funding or not expand in a way that raises their overhead ratios to avoid that scenario, even if it's not the most effective way to service their mission of actually helping people.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In the sector survey, dubbed “Elephant In The Room: Charitable Overhead Ratios And Donor Decisions,” researchers asked charitable contributors to state what they thought was an appropriate level for overhead and what they thought groups might really be spending. Turns out, donors expectations have gotten more stringent in recent years. Overall, 60% of respondents felt groups have been overspending.

When the last survey was done in 2012, respondents indicated that 22 cents per dollar was a reasonable allowance for overhead. In the recent study, they indicated that 19 cents is now more appropriate—a 14% drop in the overall allowance. (At that same time, upset donors estimated that today groups are more likely spending around 28% on these expenses.)

It’s hard to assign a fixed measure on what charities are actually spending, but Bridgespan has found that for successful businesses, the back-end number is more like 34%, and often double that for tech companies. In contrast many foundations cap this line item in grants at just 15%, which may be contributing to the perception problem.

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But there's irony in these complaints. Researchers asked respondents to name their favorite charity and what they thought it was spending overhead. Then, they went and looked up data on those groups. Half of all donors named organizations that were spending above the donor-imposed limit of what was supposedly responsible. At least a quarter of respondents actually favored groups spending at least twice that threshold. "What people say is important to them is not borne out by their actual activities," Sellers says.

Still, there's a real impact on charities that feel bound to address the perception problem. Sellers has seen at least one group fix its overhead ratio as low as 7% in an effort to attract donors. "The danger is that when you just have this arbitrary number that you set, or you just keep trying to squeeze it lower and lower and lower… you're cutting off funds that can be used for a whole lot of really important purposes like training staff and investing in infrastructure or systems that will help you be better at your job and better at serving your cause," he says. "It's really important that organizations don't pay so much attention to keeping that ratio down that they end up hurting themselves and therefore hurting their cause in the long run."

Part of the problem is that "overhead" is a nondescript word that many people don't understand. Sector experts have been trying with some success to make the entire concept sound sexier: "Shared costs" is one more positive alternative. But Sellers says nonprofits need to think more about how to telegraph their mission and how they judge success to donors so that no one feels like money is being wasted.

"A lot of nonprofits still really don't have a good way of measuring what their impact is and then of communicating those numbers," he says. "And that's one of the reasons the overhead ratio became so popular. It's a nice, clean, neat little pie chart. The problem is it tells about 1% of the story."

ABOUT THE AUTHOR

Ben Paynter is a senior writer at Fast Company covering social impact, the future of philanthropy, and innovative food companies. His work has appeared in Wired, Bloomberg Businessweek, and the New York Times, among other places. More

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