

THE **OVERHEAD** MYTH

To the Donors of America:

We write to correct a misconception about what matters when deciding which charity to support.

The percent of charity expenses that go to administrative and fundraising costs—commonly referred to as “overhead”—is a poor measure of a charity’s performance.

We ask you to pay attention to other factors of nonprofit performance: transparency, governance, leadership, and results. For years, each of our organizations has been working to increase the depth and breadth of the information we provide to donors in these areas so as to provide a much fuller picture of a charity’s performance.

That is not to say that overhead has no role in ensuring charity accountability. At the extremes the overhead ratio can offer insight: it can be a valid data point for rooting out fraud and poor financial management. In most cases, however, focusing on overhead without considering other critical dimensions of a charity’s financial and organizational performance does more damage than good.

In fact, many charities should spend more on overhead. Overhead costs include important investments charities make to improve their work: investments in training, planning, evaluation, and internal systems—as well as their efforts to raise money so they can operate their programs. These expenses allow a charity to sustain itself (the way a family has to pay the electric bill) or to improve itself (the way a family might invest in college tuition).

When we focus solely or predominantly on overhead, we can create what the *Stanford Social Innovation Review* has called “The Nonprofit Starvation Cycle.” We starve charities of the freedom they need to best serve the people and communities they are trying to serve.

If you don’t believe us—America’s three leading sources of information about charities, each used by millions of donors every year—see the back of this letter for research from other experts including Indiana University, the Urban Institute, the Bridgespan Group, and others that proves the point.

So when you are making your charitable giving decisions, please consider the whole picture. The people and communities served by charities don’t need low overhead, they need high performance.

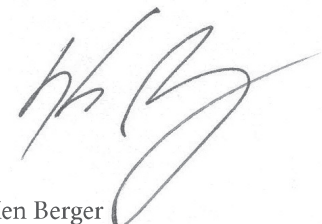
Thank you,



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Research shows that the overhead ratio is imprecise and inaccurate:

37%

37 percent of nonprofit organizations with private contributions of \$50,000 or more reported no fundraising or special event costs on their 2000 Internal Revenue Service (IRS) Form 990

13%

Nearly 13 percent of operating public charities reported spending nothing for management and general expenses.

(The Nonprofit Overhead Cost Study)

75-85%

Further scrutiny found that 75 percent to 85 percent of these organizations were incorrectly reporting the costs associated with grants.

But still, Americans over-emphasize the number and prioritize it over demonstrated success:

62%

62% of all Americans believe the typical charity spends more than it should on overhead.

(Giving Evidence)

A 2001 survey found that OVER HALF OF ADULT AMERICANS FELT THAT NONPROFIT ORGANIZATIONS SHOULD HAVE OVERHEAD RATES OF 20 PERCENT OR LESS; NEARLY FOUR IN FIVE FELT THAT OVERHEAD SHOULD BE HELD AT LESS THAN 30 PERCENT. In fact, those surveyed ranked overhead ratio and financial transparency to be more important attributes in determining their willingness to give to an organization than the demonstrated success of the organization's programs.

(BBB Wise Giving Alliance)

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

"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)

2,000

2006 CompassPoint Nonprofit Services study of nearly 2,000 nonprofit executives in eight metropolitan areas reveals that receiving general operating support played a major role in reducing burnout and stress among executive directors.

(Daring to Lead 2006: A National Study of Nonprofit Executive Leadership)

11.5% VS 10.8%

In 2011, the charities which GiveWell reviewed and recommended had higher overhead than the charities they review and didn't recommend, 11.5 percent versus 10.8 percent.

(Giving Evidence)

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/no 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"> Poor IT infrastructure 	<ul style="list-style-type: none"> System crashes, downtime Loss of data/information, limited information sharing
<ul style="list-style-type: none"> Poor 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"> Poor 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

Source: 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.

Primary Sources:

The Nonprofit Starvation Cycle

Stanford Social Innovation Review, Fall 2009

Getting What We Pay For: Low Overhead Limits Nonprofit Effectiveness

Center on Nonprofits and Philanthropy, Urban institute Center on Philanthropy, Indiana University

What We Know About Overhead Costs in the Nonprofit Sector

Center on Nonprofits and Philanthropy, Urban institute Center on Philanthropy, Indiana University

Nonprofit Overhead Costs: Breaking the Vicious Cycle of Misleading Reporting, Unrealistic Expectations, and Pressure to Conform

The Bridgespan Group, April 2008

Where'd My Money Go?

Americans Perceptions of the Financial Efficiency of Nonprofit Organizations
GreyMatter Research, 2008

Good Charities Spend More on Administration than Less Good Charities Spend

Giving Evidence, May 2013

Management and General Expenses: The Other Half of Overhead

The Nonprofit Quarterly, Spring 2003

The Worst Way to Judge a Charity

Los Angeles Times, April 2012

Ratio Discrimination in Charity Fundraising: The Inappropriate Use of Cost Ratios Has Harmful Side-Effects**

Voluntary Sector Review, March 2010 **Behind pay wall