
NonProfit Trends

Shaking the Foundation of the “Overhead Myth”

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As the not-for-profit sector moves toward greater transparency, organizations are facing a previously unknown level of scrutiny from the public, the government, and even from client communities.

As part of their operating and fiscal responsibility, not-for-profits, like all businesses, need to focus on their costs. – in order to both sustain themselves and improve their effectiveness in achieving their mission, they need to budget all available resources.

In a time when even for-profit corporations are struggling to keep pace with the constantly changing business landscape, not-for-profits' focus on keeping their overhead low can have a negative impact on an organization's ability to assist the people and communities they are dedicated to serving.

Government and donors continue to scrutinize what they perceive as high levels of overhead in a NFP as a sign of inefficiency and/or mismanagement. Although this can be an indicator of encroaching problems, an

effective support structure must be in place to run programs and to operate efficiently. As such, the excessive focus on overhead and other "non-programmatic" expenditures is often misguided and can distort the impact of the services delivered by an organization and their results.

It is important to highlight this issue because of the heightened level of external pressure on the not-for-profit community from sources including:

- New federal, state and city-level governmental guidelines on administrative and operating costs.
- A more competitive marketplace for delivery of services and a need to raise more revenue.
- Evidence of fraud and other improprieties by management in collusion with vendors and suppliers.

- Lack of appropriate governance by both management and Boards on vital operating and fiscal matters.

This new “Overhead Myth” – the idea that the only effective not-for-profit organization is one with a low overhead – is harmful because an organization must be evaluated based on its results, not on its “cost of doing business.”

The Overhead Myth is founded on a number of false perceptions:

- The NFP sector should pay lower salaries as “not a real business”
- Misleading reporting - controversial functional expense allocations
- Lack of widely accepted measurement standards
- Funders' unrealistic expectations of not-for-profit organizations

Noted NFP watch dogs Guidestar, Charity Navigator, and BBB Wise Giving Alliance, are collectively addressing this issue by providing more detailed information on each organization in order to help the public and other constituents evaluate its operating performance.

It is important to keep in mind that, when it comes to overhead rates, "one size does not fit all." Overhead is as different across sectors and organizations as their missions. Rates do not take into account essential activities to build infrastructures necessary to support the mission and ensure sustainability. Evidence suggests overhead investments facilitate better performance - those that build are more likely to succeed.

As more funding enters the sector, it has to be met with strong management and clear paths to the mission's success. The ultimate goal of an organization may be long-term, requiring exceptional resources to pursue. Effective short-term programming will justify ongoing, increased levels of support—in terms of staffing resources, funding, and management commitment to

the mission. The marathon of reaching a long-term goal can only be run effectively by a strong and dedicated management team and a focused board of trustees.

The importance of dedicated individuals has long been known to not-for-profit organizations, what is now gaining recognition is their role as the guardians of the increased capital entering the sector. The importance of skilled, dedicated staff will ultimately lead to better wages and improved working conditions as the industry continues to mature. And, as with any successful organization, not-for-profits must attract quality talent to drive success, which means maintaining competitive salaries and a functional work environment. Unfortunately, such improvements will not come easily, as evidenced by the government's efforts to keep not-for-profit executive compensation and necessary operating costs in check.

It takes greater diverse resources for a museum, or other cultural organization to put on its exhibits or programs than perhaps a social service or health related organization. It all depends on the criteria needed to achieve its mission.

This will be a continuing issue which requires much dialogue, communication and “lobbying” among all interested constituents. The not-for-profit sector long regarded as the “poor stepchild” of the commercial business world is more worthy than public perception has it and can only reach its required stature in the community by continuing to promote itself.

It’s a challenge, but it is an important one and it must be met.

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