The Bridgespan Group

The "Nonprofit Starvation Cycle"

What it is, why it matters, what to do about it

January 31, 2013

Boston Nonprofit Financial Managers

Collaborating to accelerate social impact

Does any of this sound familiar?

"No administrative fees means that all money goes to local charities."

- Ad for donation drive

"Our organization has remained lean, allocating nearly 90% of revenue to direct service programs..."

- Large multi-service organization in CA

"100% of your donation will go towards programs that help children; 0% will go to overhead."

- Large health services organization

What about this?

"The 10% figure is totally unrealistic…"

- Executive Director

"We're having to raise pools of general support to pay for our real overhead costs."

- Board Chair

"13% overhead doesn't nearly capture the reality of our administrative costs."

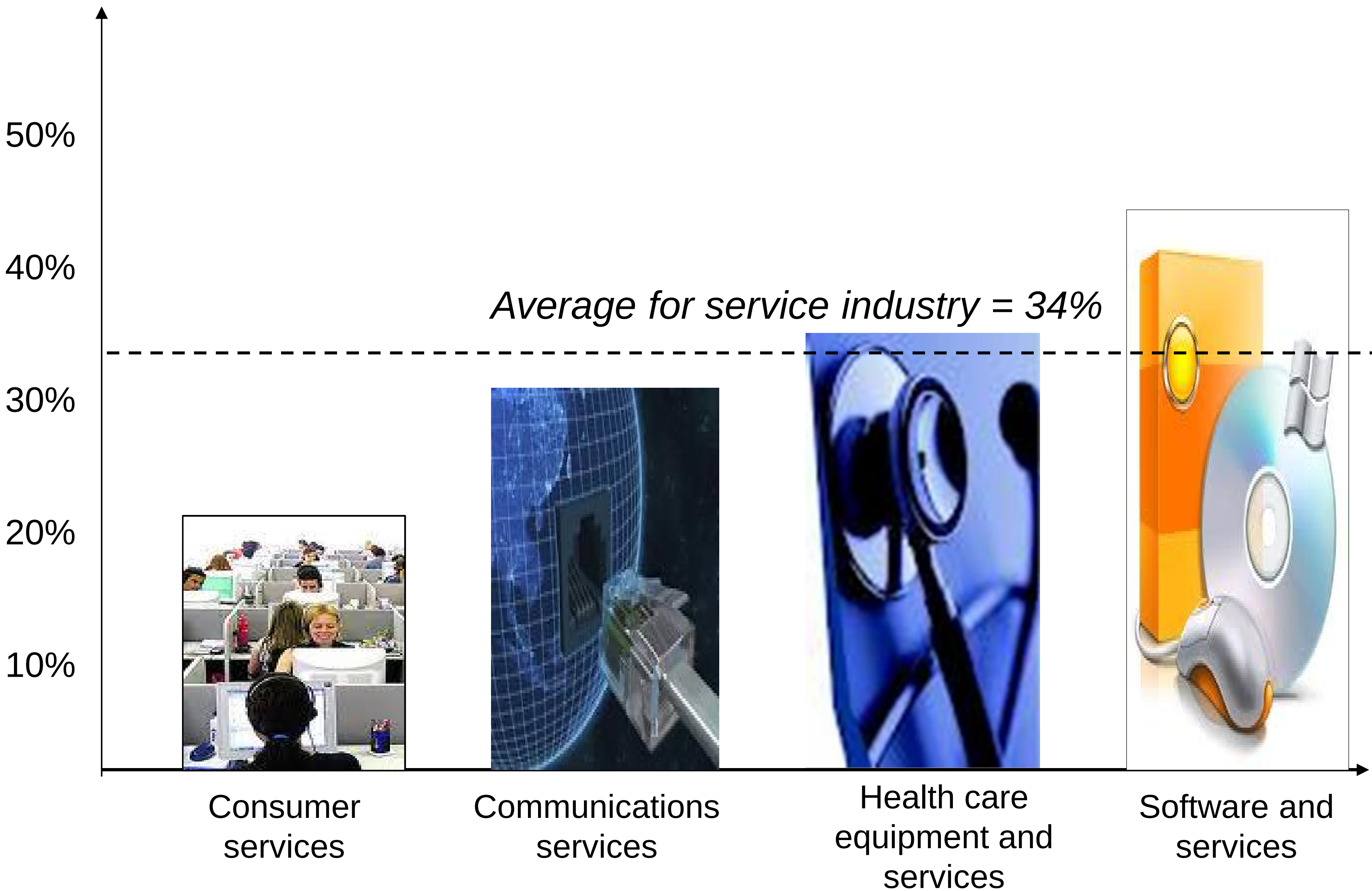
- Nonprofit COO

But Wait!

Adam E. Moreira, Wikimedia Commons Gallery

We don’t judge companies on their overhead

Sales, General & Administrative Expense as % of Total Sales



Source: Compustat; Standard & Poor’s Global Industry Classification Standard Structure

How does this play out for nonprofits?

“Ann Funder”

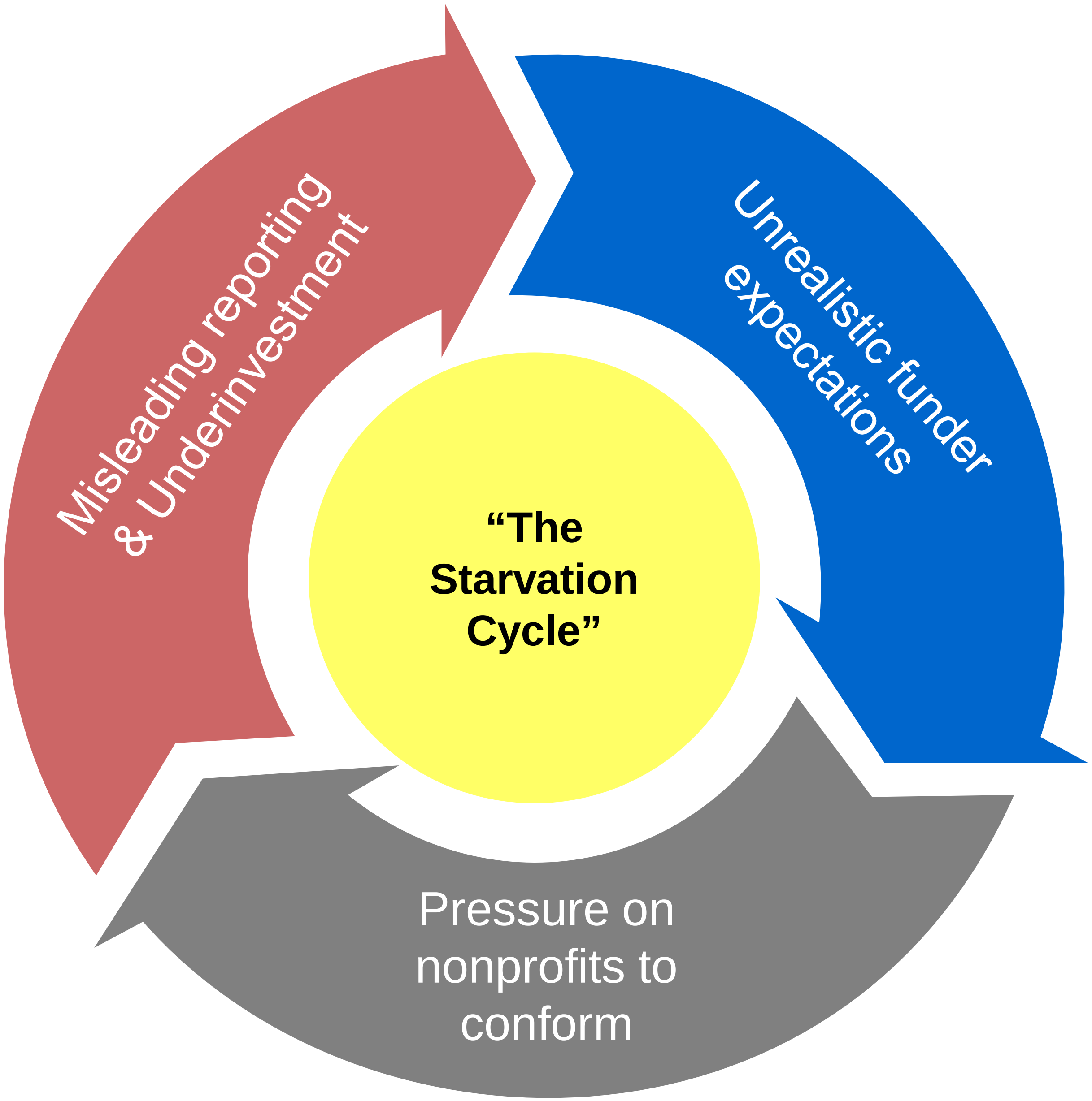
“Don Nonprofit”

*“**No more than 10%** of these funds can be used for non-program expenses.”*

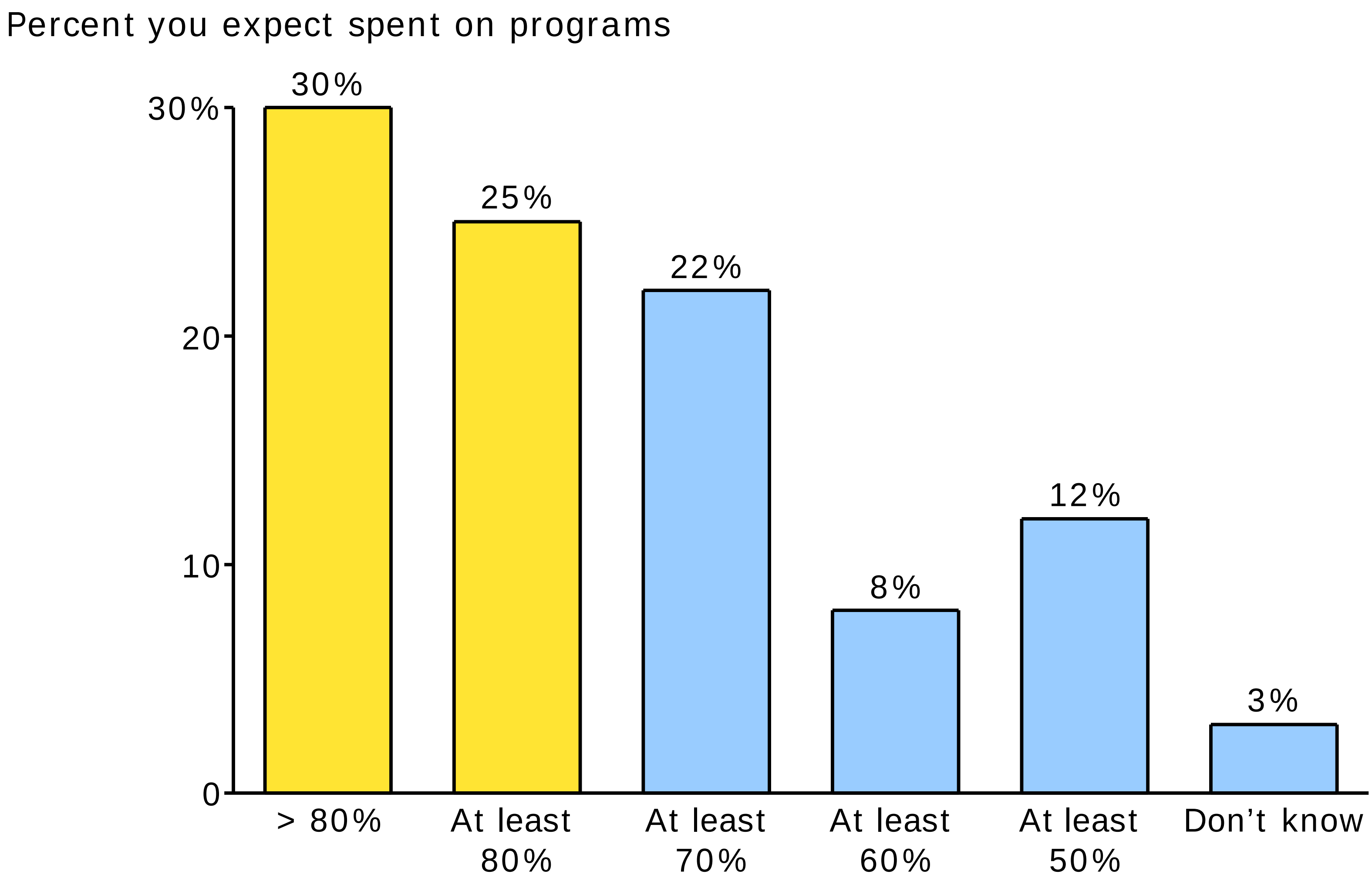
Pressure to conform →

Under-report + Under-invest

The Nonprofit Starvation Cycle

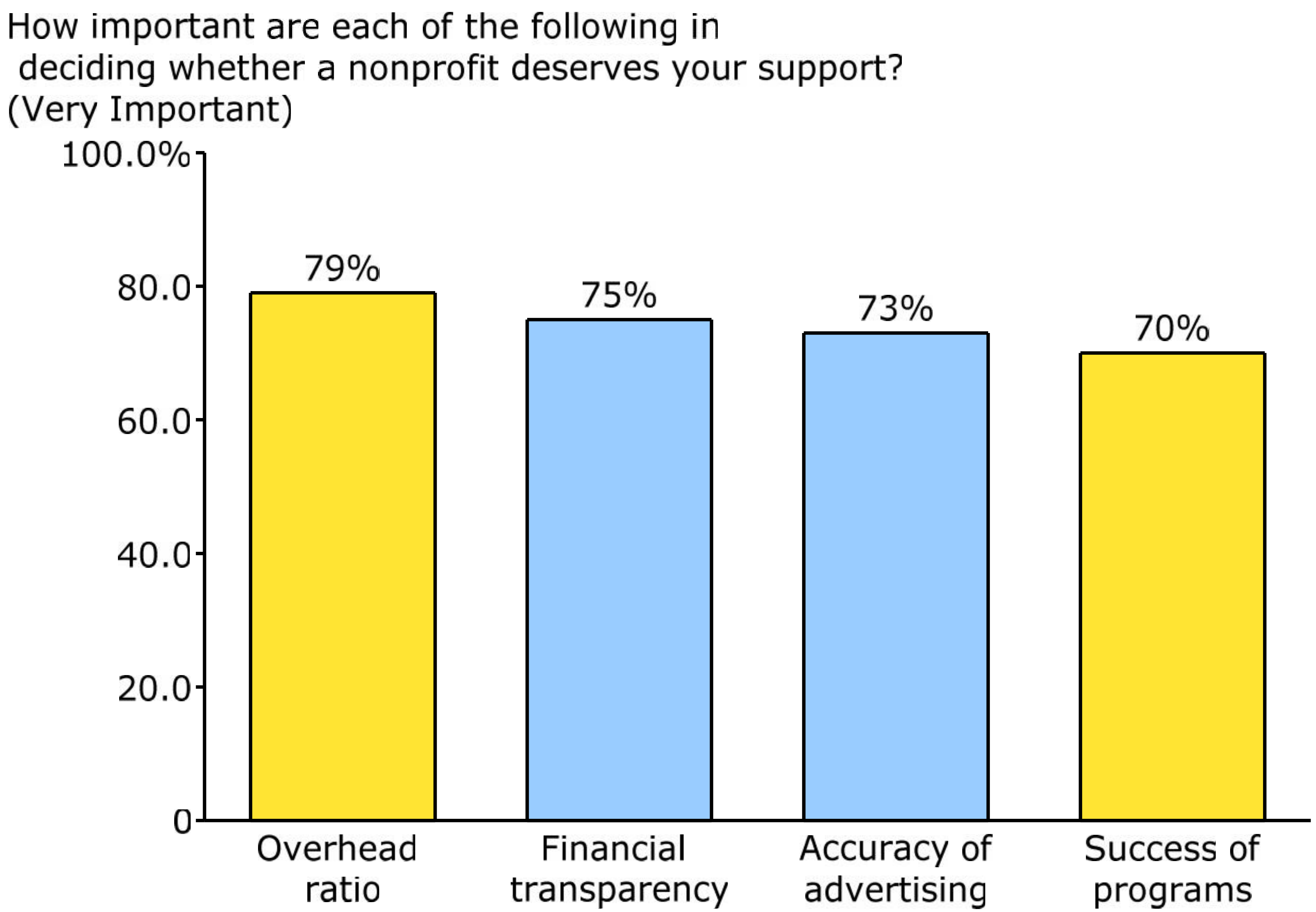


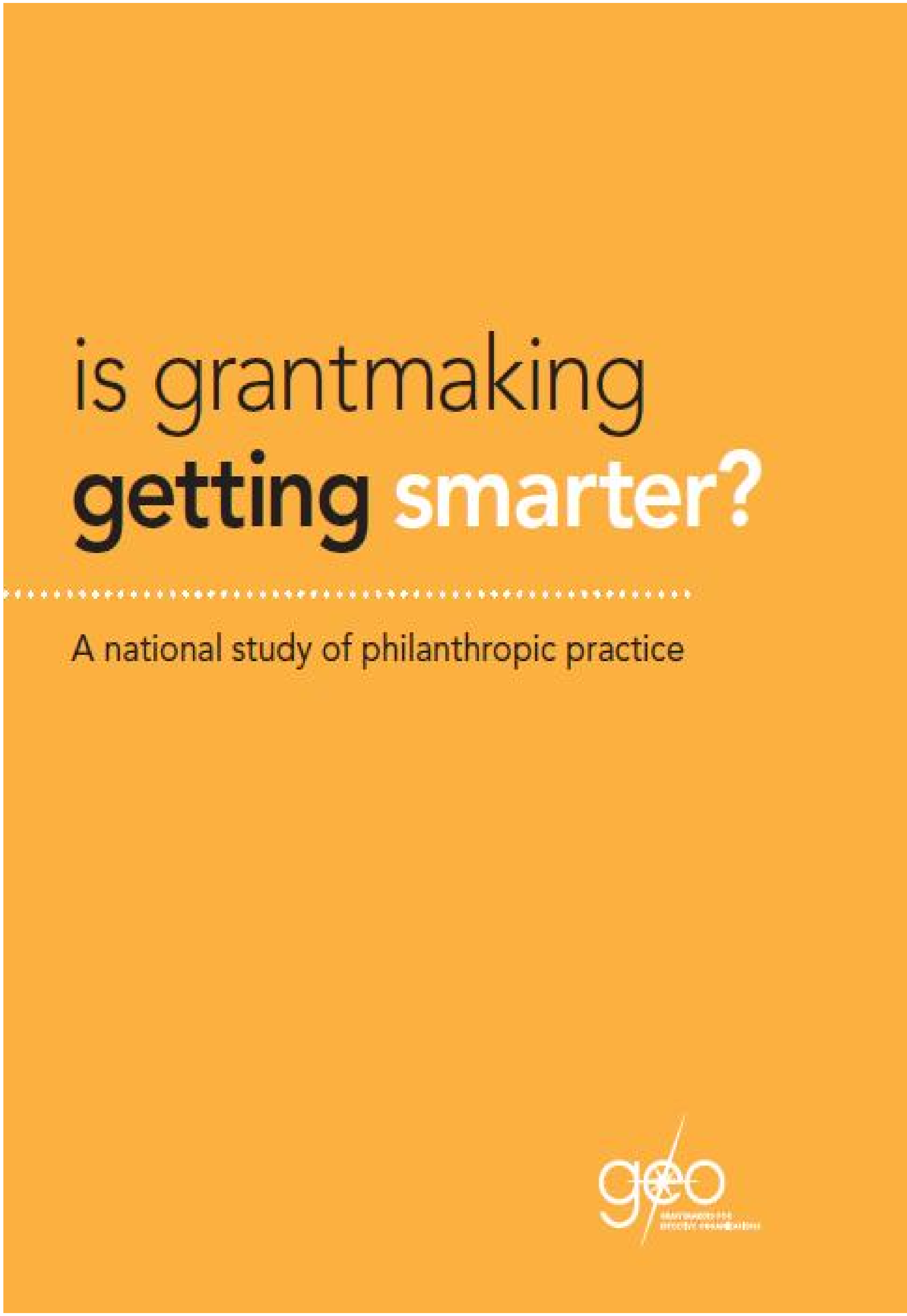
More than half of donors expect nonprofits to spend less than 20% on overhead



Source: BBB Wise Giving Alliance Donor Expectations Survey, 2001; case study interviews

Donors consider overhead rate *more important* than program effectiveness



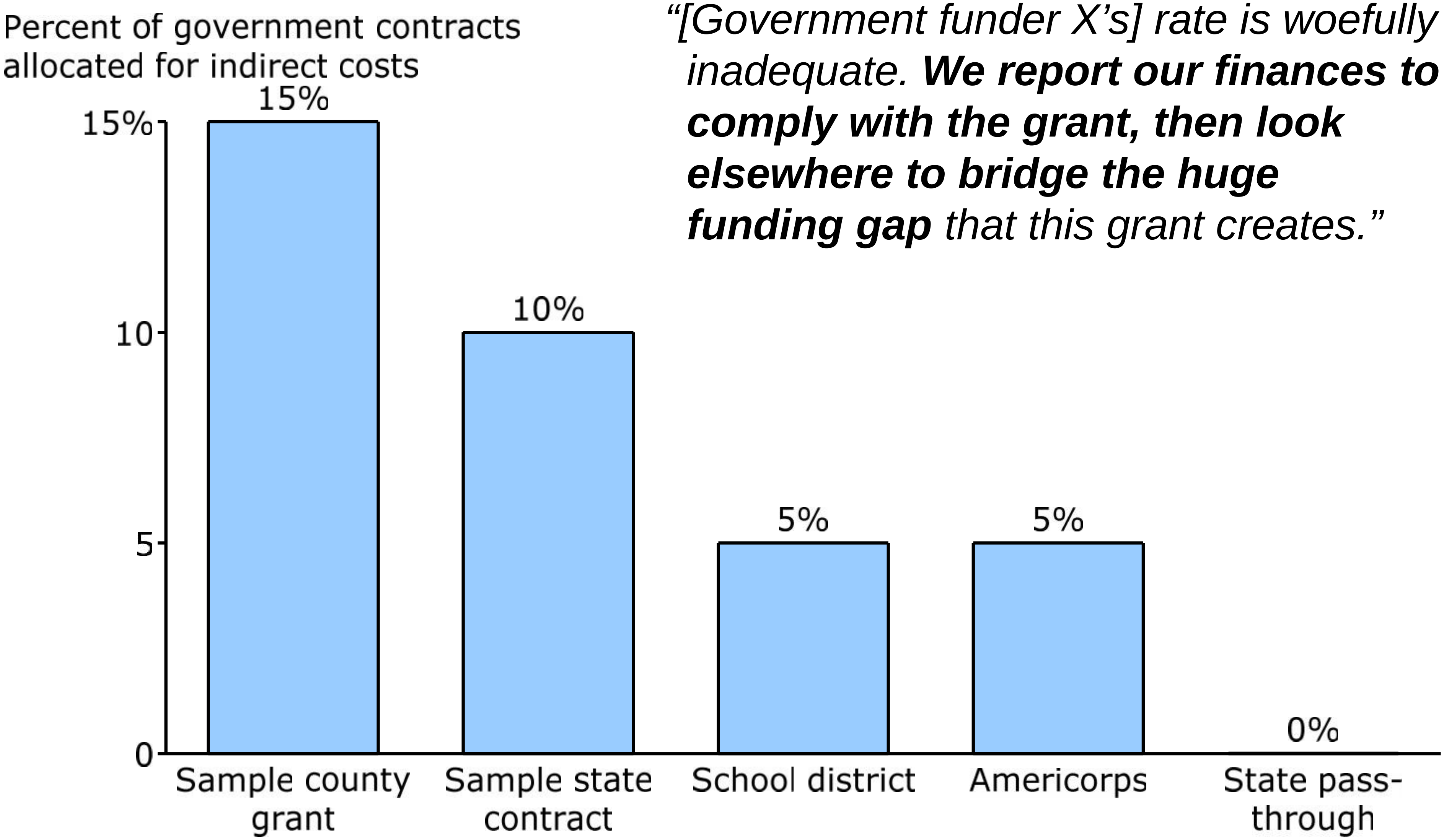

is grantmaking
getting smarter?

A national study of philanthropic practice

geo

80% of foundations said they did not include enough overhead to cover the cost of reporting.

Government contracts limit overhead

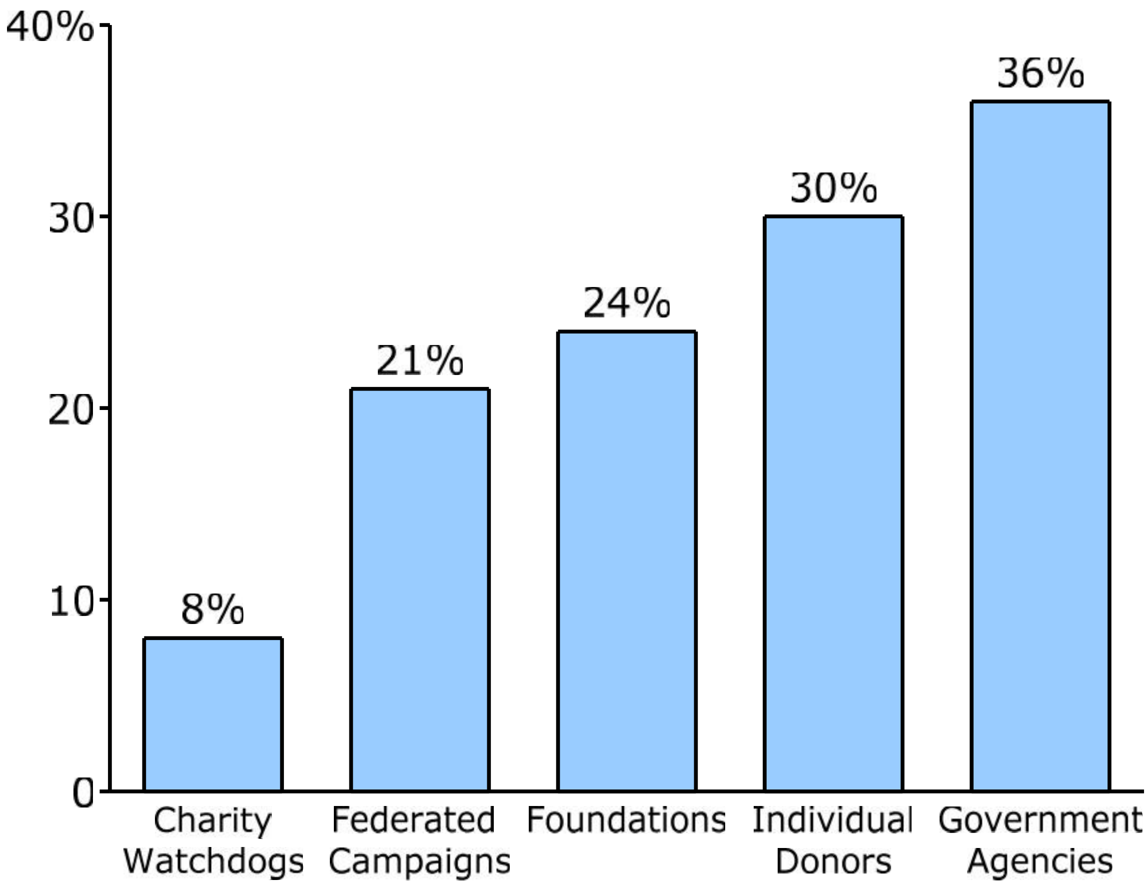


"[Government funder X's] rate is woefully inadequate. ***We report our finances to comply with the grant, then look elsewhere to bridge the huge funding gap*** *that this grant creates."*

Source: Case study interviews

Nonprofits feel pressure to limit overhead

"Do you feel pressures from ____ to limit overhead, fundraising or admin expenses?



*"**20% overhead is the industry norm.** It doesn't capture the way we think about and manage overhead…"*

*"We found that a **peer organization allocates 70% of their finance director's time to programs.** That's preposterous."*

Many nonprofits underreport true overhead

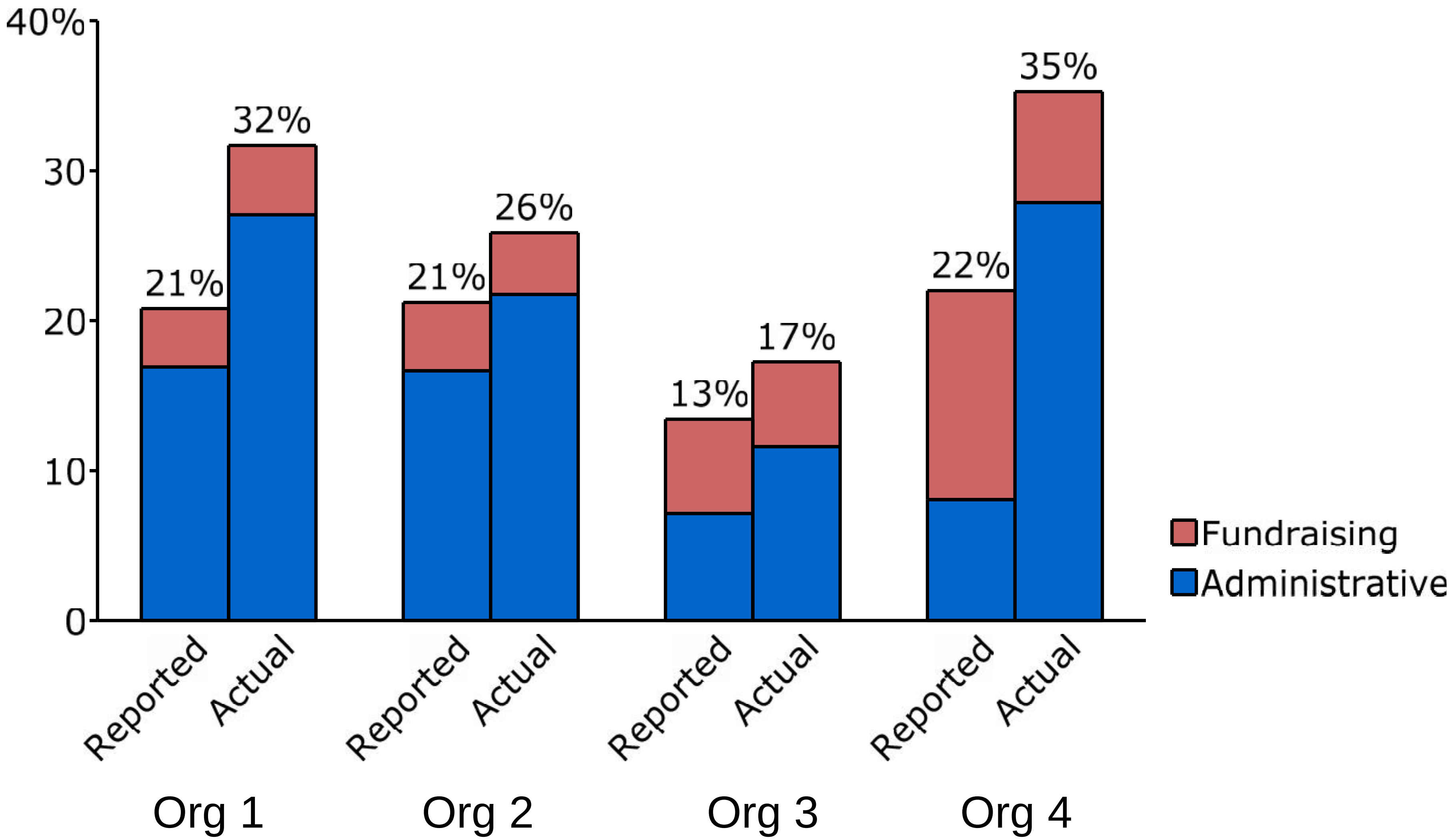
“Analysis of over 220,000 Forms 990 found widespread reporting that defies plausibility.”

37%

Percent of nonprofits reporting ZERO fundraising expenses on their IRS form 990

Actual overhead often differs from reported

Reported versus actual overhead, FY 2006

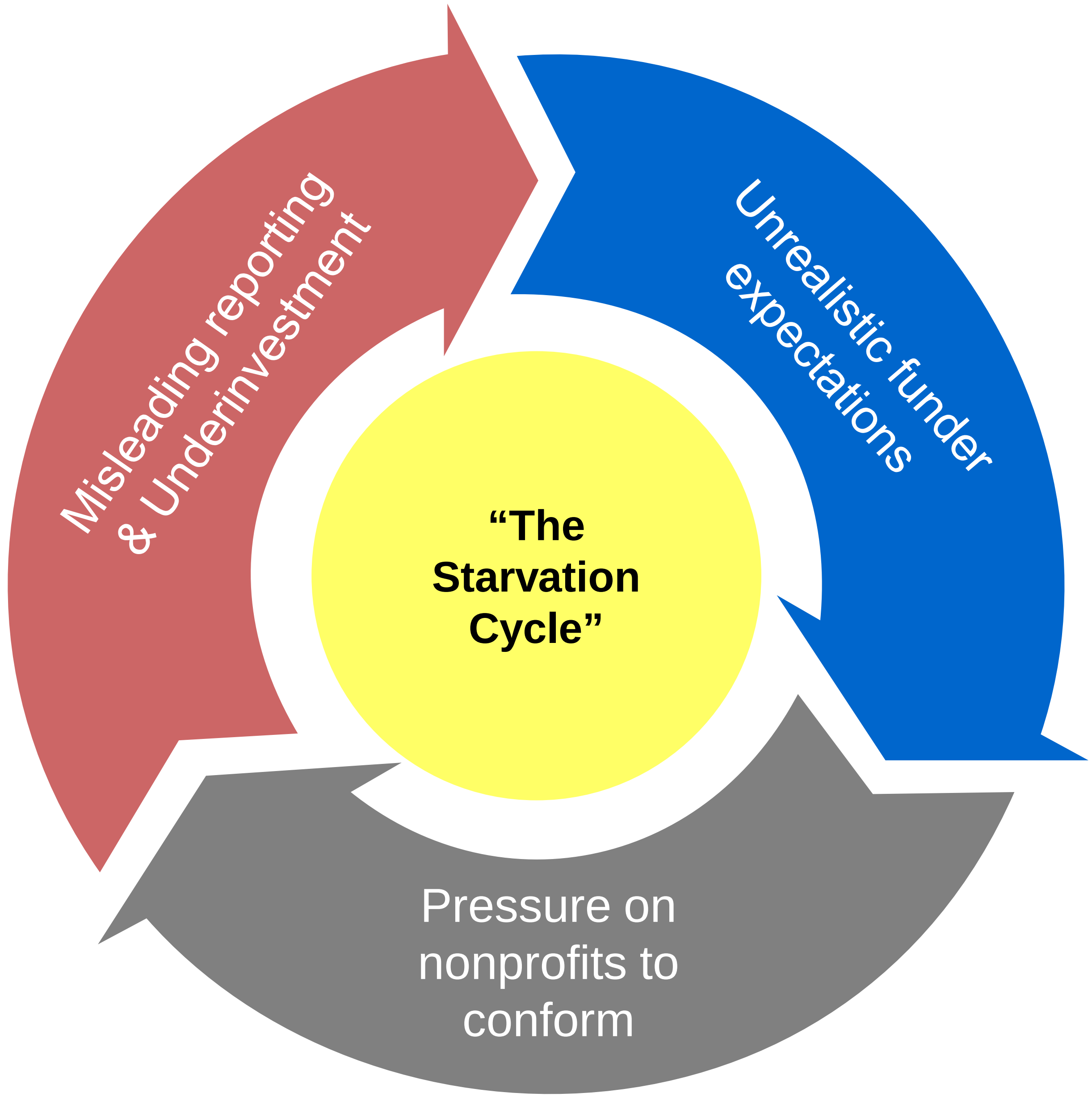


These differences aren’t surprising given:

- Lack of accountability and standards for nonprofit reporting
- Lack of infrastructure and systems
- Tacit “support” of misleading reporting by multiple players
- Lack of consequences for misreporting

Under-investment hampers impact

The Nonprofit Starvation Cycle



Where is your organization?

(A) Highlight us

We're able and willing to report on full costs

(B) Equip us

We're willing to report on full costs but not able

(C) Convince us

We're able to report on full costs but not willing

(D) Convert us

We're not able or willing to report on full costs

Framework courtesy of Grantmakers for Effective Organizations (GEO)

Nonprofit leaders, know thy costs

- It’s impossible to know if you are misreporting or under-investing without clarity on your true costs
- This **IS** about having clarity, within your management team, on where your money is going and what trade-offs you are making (explicitly or implicitly)
- This is **NOT** the same as reporting your functional “pie” on your 990 or in your annual report

Let’s start with an example

Average cost per youth for nonprofit X to serve ~1,100 youth

Contract price per youth by Dept of Juvenile Justice to serve 200 more youth

$3,200 → $3,400

At its most basic, this looks pretty good

Average cost per youth for nonprofit X to serve ~1,100 youth

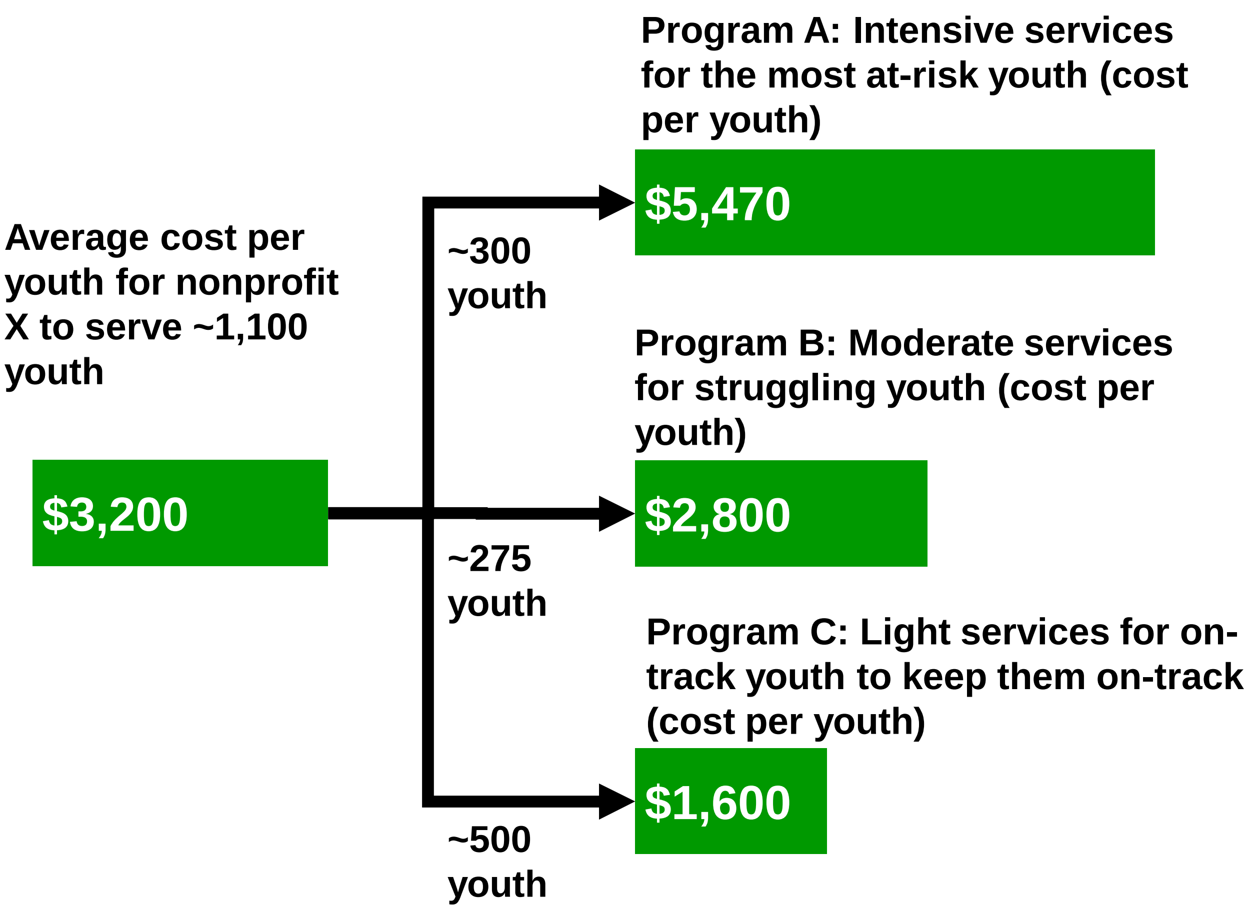
Contract price per youth by Dept of Juvenile Justice to serve 200 more youth

Surplus per youth

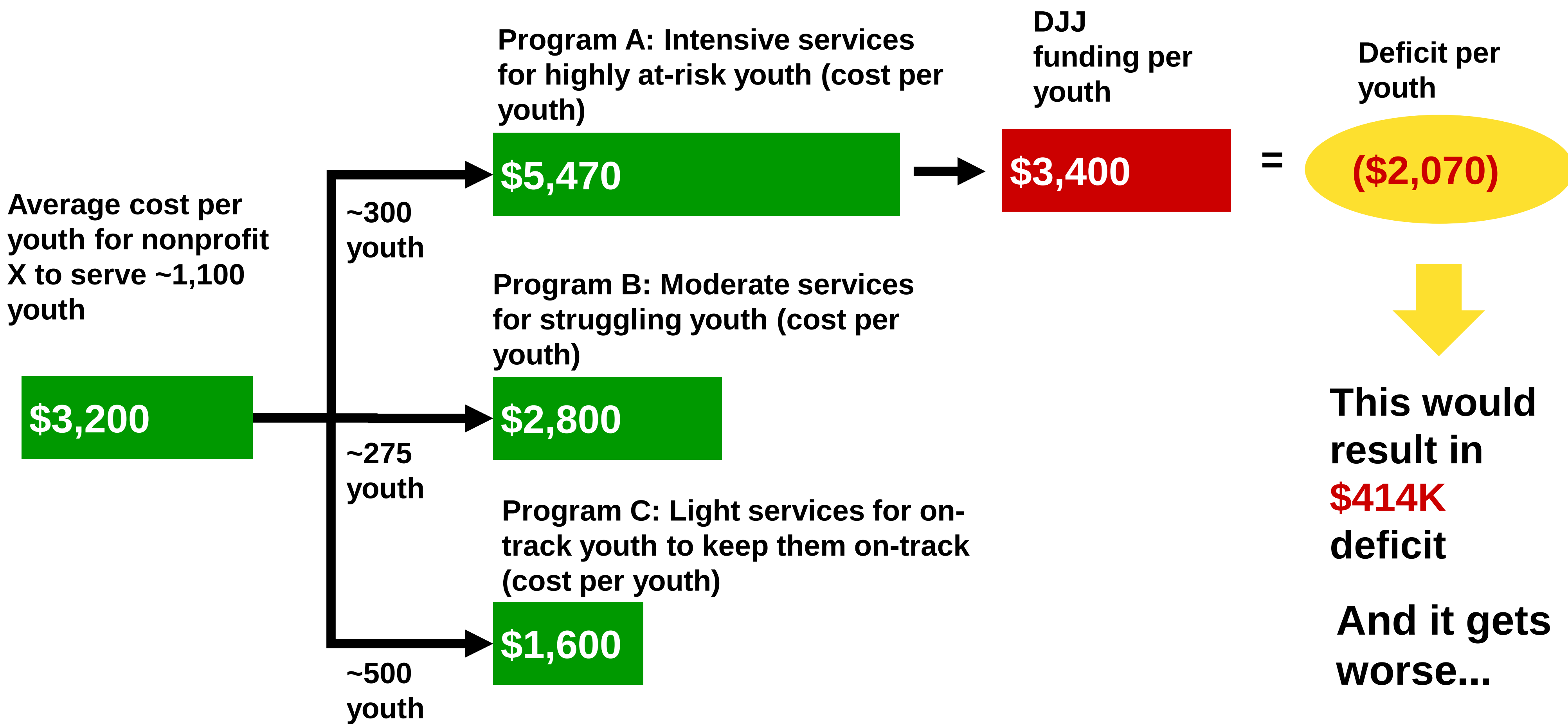
$3,200 → $3,400 = $200

Further analysis reveals different picture

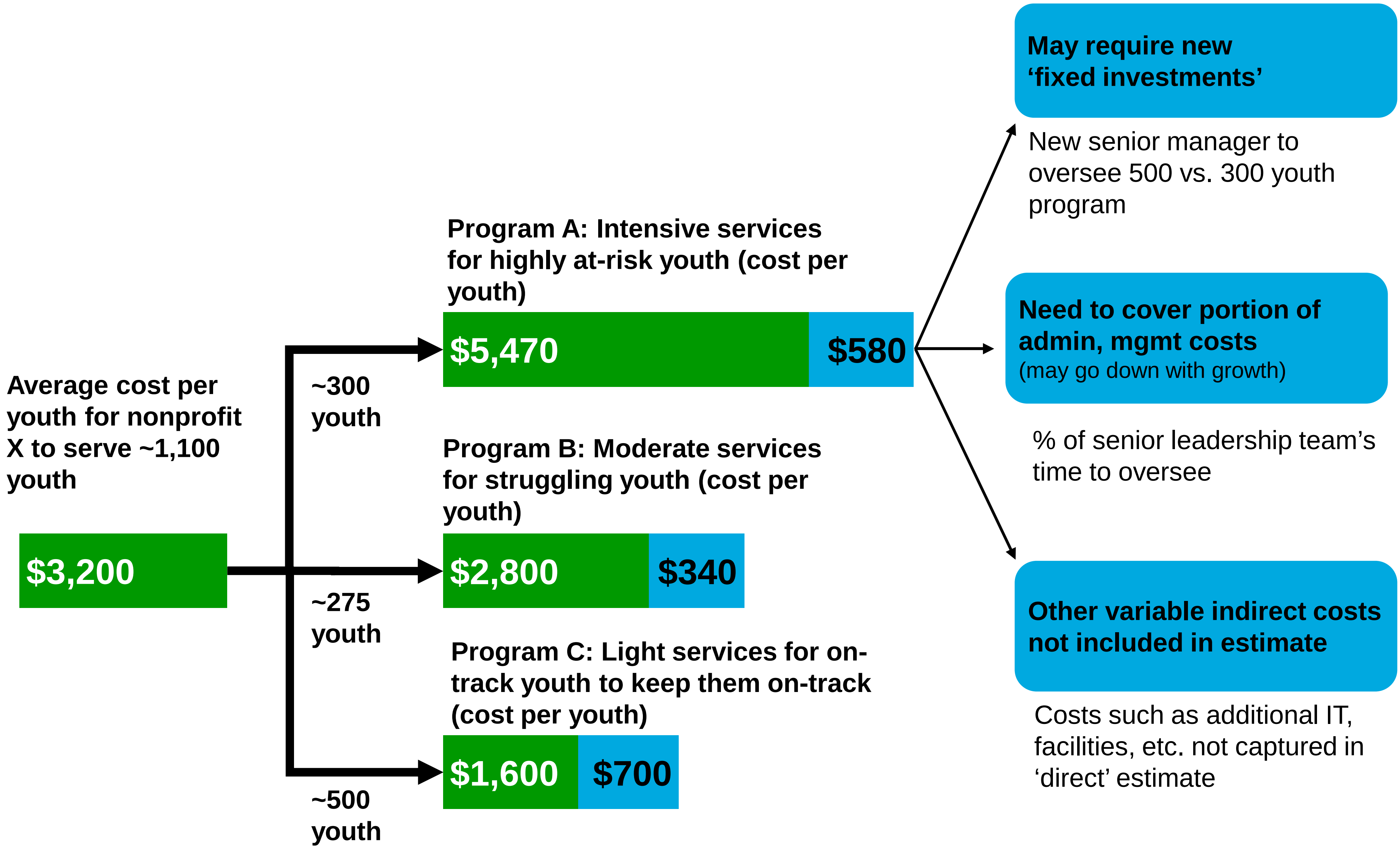
Nonprofit X serves youth with different intensities of service – and this impacts cost



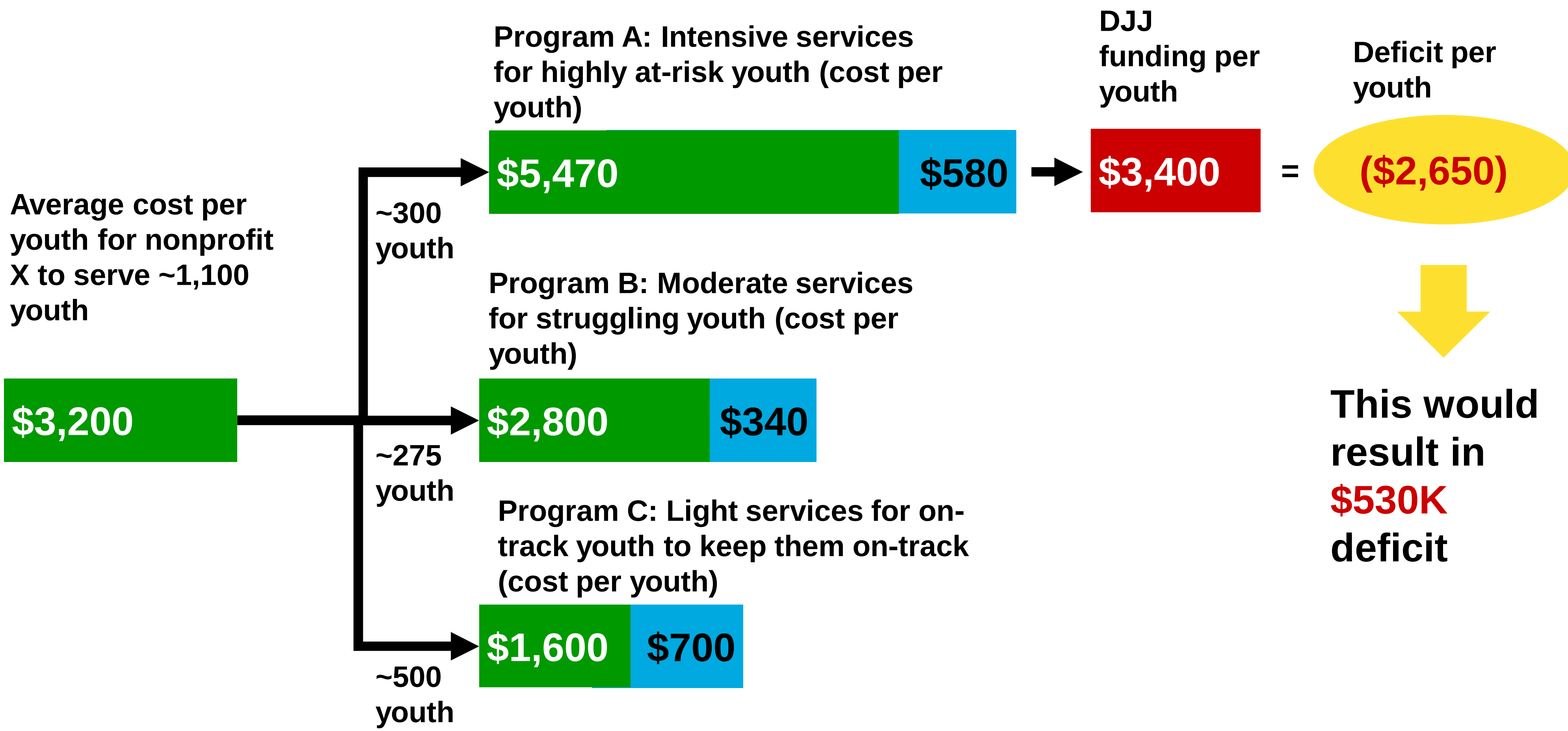
We learn that this contract is specifically for **intensive services** to youth most at-risk



These costs do not include **indirect costs** or **new fixed investments**



So it gets worse…



…Although it might get better (no promises)

Hypothetical – Contract requires 15:1 staff ratio; this nonprofit provides Program A at 10:1
(and staff represent 80% of direct costs)

Average cost per youth for nonprofit X to serve ~1,100 youth

$3,200

~300 youth

Program A: Intensive services for highly at-risk youth (cost per youth)

$2,917 **$580**

DJJ funding per youth

$3,400

=

Deficit per youth

($97)

This would result in $49K deficit

However – does this org believe it can achieve same results with higher ratio?

~275 youth

Program B: Moderate services for struggling youth (cost per youth)

$2,800 **$340**

~500 youth

Program C: Light services for on-track youth to keep them on-track (cost per youth)

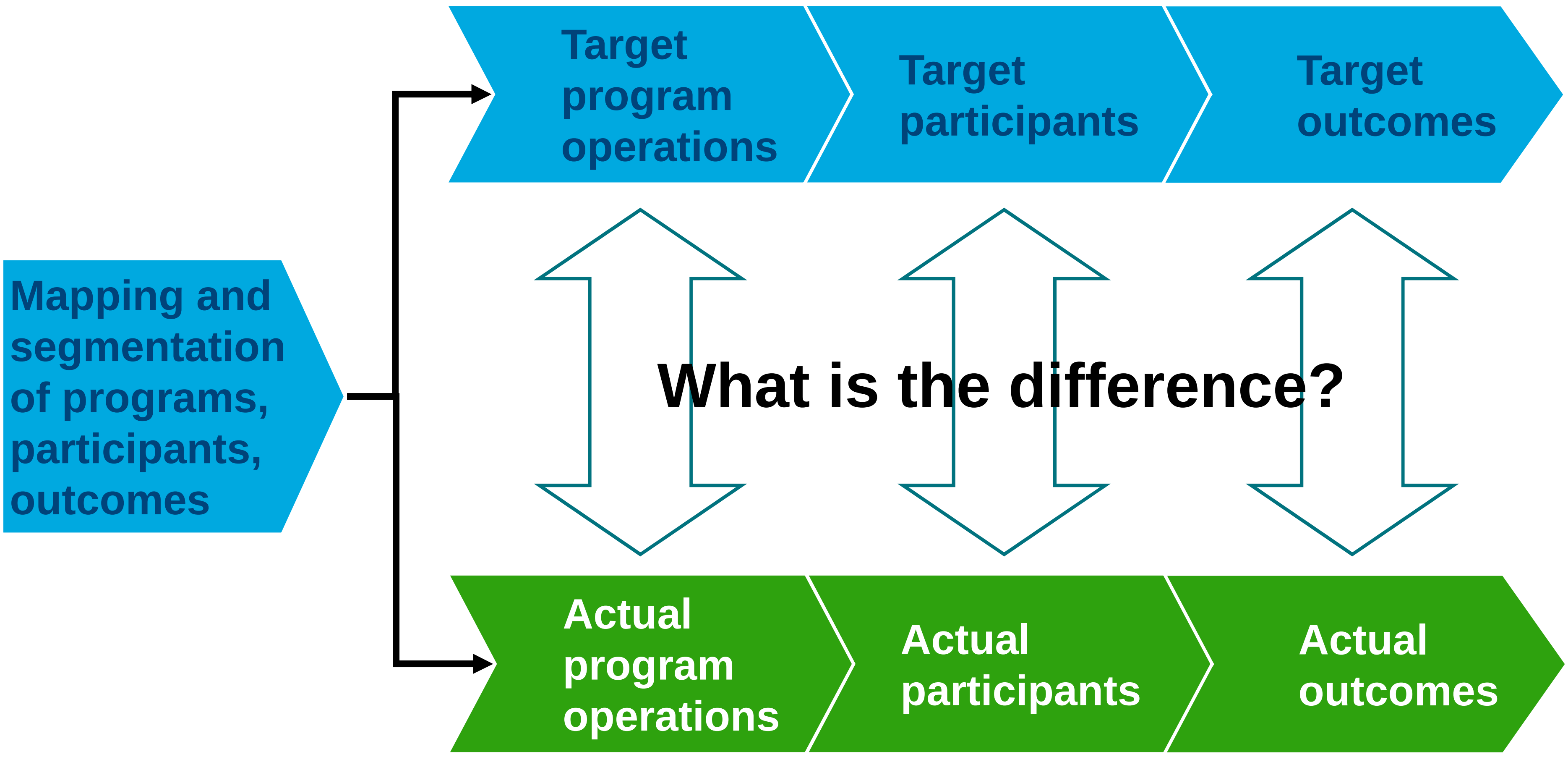
$1,600 **$700**

“True Costing” seeks to address these issues

	Functional analysis	True cost analysis
How are costs grouped?	• By **functional** area	• By **service offering**
Which costs assigned to programs?	• **Direct** costs of programs	• **Direct and indirect** costs • Focus on **key cost drivers**
Financial measure?	• **Gross contribution =** program revenue – program costs	• **Net contribution** = <ins>restricted</ins> program revenues – (direct + indirect program costs)

Begin by examining your programs, both in theory AND in practice

Your management's definition of programs <u>IN THEORY</u>



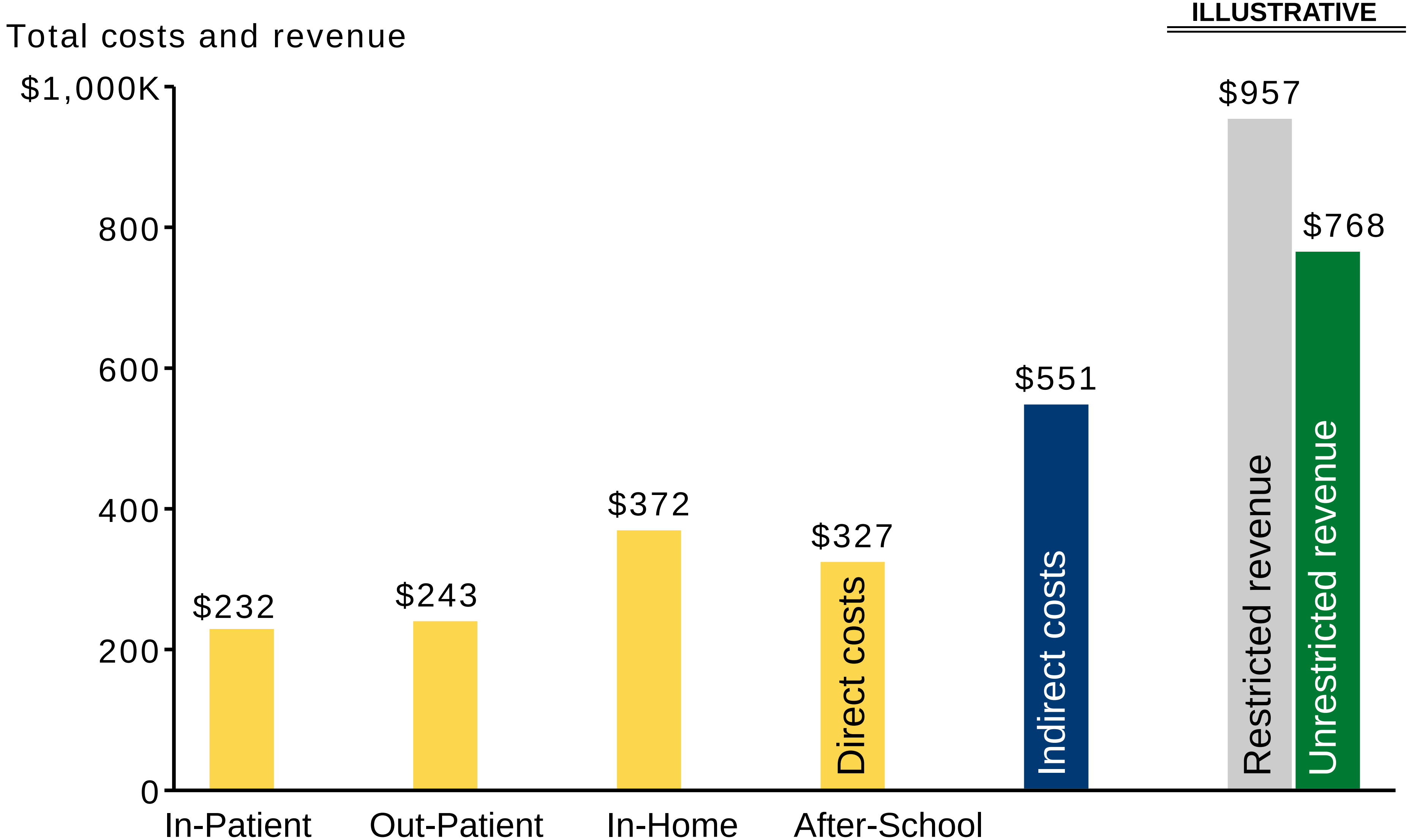
Analysis of actual program, participant, and performance <u>IN PRACTICE</u>, and impact on costs

This informs true cost by identifying (in principle and practice) key **cost drivers**

- **Various ratios of staff to participants**
  - – Case loads, class/program sizes
  - – Level of utilization of resources
- **Levels of 'dosage' of a service** (may contain three components)
  - – Duration of time service is delivered
  - – Frequency in which services are offered
  - – Intensity of effort per instance of services
- **Target number of participants served, and outcomes to achieve**
- **Where revenue comes from, what restrictions this places on who is served**

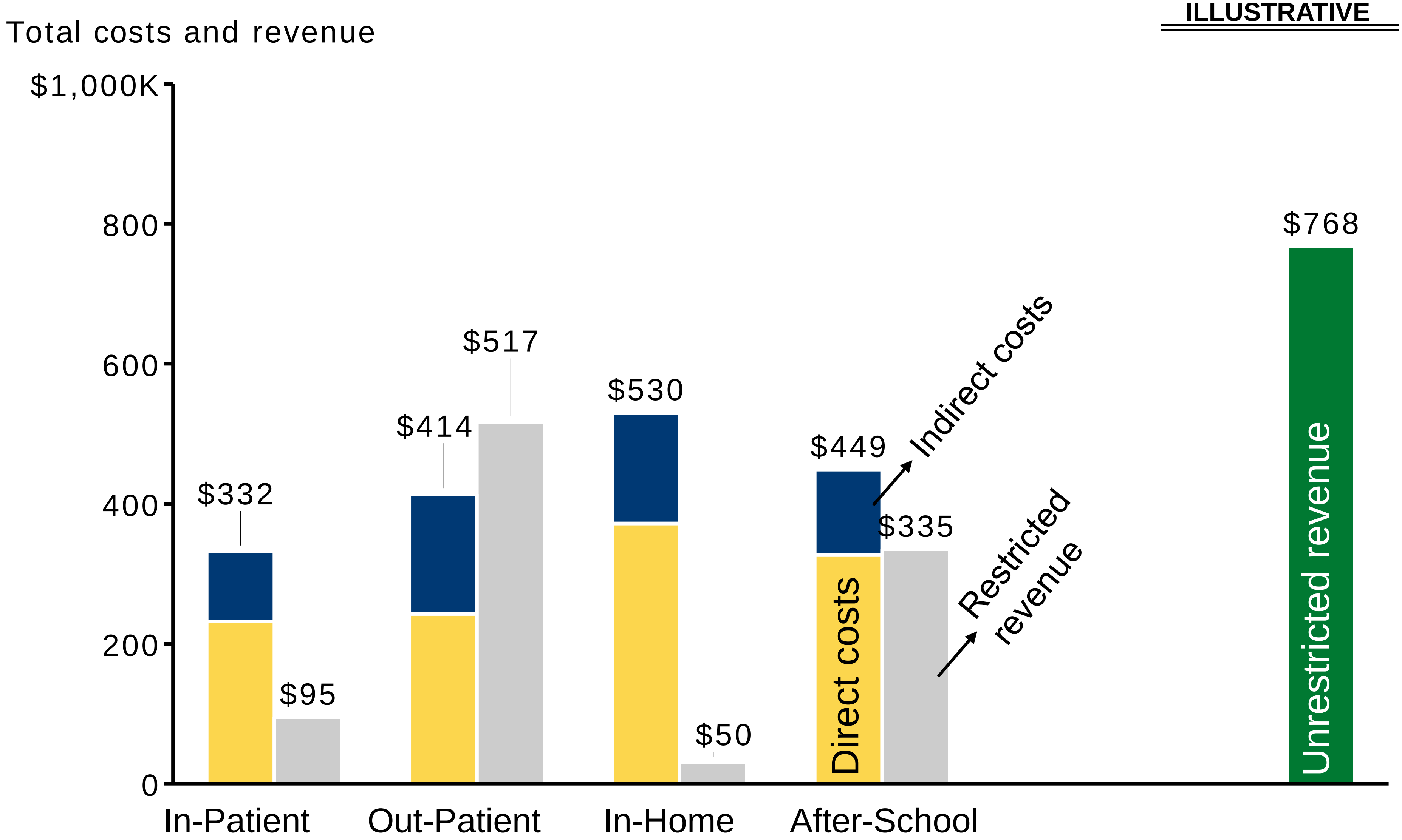
Bringing it all together: Here's what one nonprofit knew before true cost analysis...

ILLUSTRATIVE



…and here's what they learned

ILLUSTRATIVE



Ending the cycle: It starts with funders

- Shift to a focus on outcomes
- Be honest about what it takes to achieve outcomes
- Provide general operating support
- Pay a fair share of overhead when making program grants

Ending the cycle: Nonprofits also must act

- Share real overhead with the board
- Share real overhead with funders
- Ask “Where are we under-investing?"
- Educate donors on critical importance of overhead

Additional resources

For Funders

For Nonprofits

Nonprofit Cost Analysis: Introduction

Published Date: 2009-06-03

Author(s): Marta Garcia Abadia Johnny Lin

Introduction | FAQs | Links and Resources

Determine Purpose & Scope → Gather Financial Data → Allocate Direct Costs → Allocate Indirect Costs → Check Your Data → Apply This Knowledge

Why cost analysis?

Although nonprofits generally have a good understanding of their revenues, knowledge about costs can sometimes be less robust. This is particularly the case when it comes to the true, all-in costs of providing services, running programs, and otherwise operating the organization.

Questions?

Thank you!

To sign up for our newsletters, alerts,
Twitter posts, or RSS feeds, visit:

www.bridgespan.org/subscriptions

Amy.Markham@Bridgespan.org

The Bridgespan Group

Collaborating to accelerate social impact