

PAYING FOR OVERHEAD STUDY

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Overhead Costs: The Tension Between Nonprofits and Foundations

The Paying for Overhead study was undertaken to determine if foundations have a role in funding nonprofit organizations' overhead expenses and the effect foundations have (if any) on the condition of nonprofit organizations' infrastructure and finances.

Results from the study show nonprofit employees reiterating long-held beliefs about foundation support of overhead expenses. Nonprofit professionals believe that foundations prefer to pay for program expenses instead of overhead expenses.

However, responses received from participating foundations offer a challenge to those beliefs. Many foundations provide general operating grants or allow nonprofit organizations to request overhead funding within a program grant. Clearly, there is a disconnect between nonprofits and foundations concerning the assumptions about and practices of overhead funding. The intention of this report is to foster a better understanding of these issues between the two parties and to encourage a dialogue about the role of foundations in paying for overhead.

REQUESTING OVERHEAD SUPPORT

Of the 710 foundations that responded to the survey, a surprisingly large majority (69 percent) indicated they support nonprofits' overhead expenses, i.e., expenses that cover a nonprofit's rent, administrative staff, accounting systems, or strategic planning. Nearly half of the foundations reported that they provide grants for general operating support and almost one-third said they award unrestricted grants.

However, the survey also found that only 50 percent of educational and human service organizations requested overhead funding from foundations in the past three years. Of the 50 percent that requested support, 55 percent received some form of overhead funding. These results imply that many nonprofits are not seeking

overhead funding from foundations, either as a general operating support grant or as part of a program budget.

How We Defined "Overhead"

There are many terms—administrative and fundraising costs, general operating expenses, and indirect costs—that are used to describe overhead costs. For the purpose of this study, "overhead" refers to expenses such as rent, utilities, fundraising costs, technology, accounting costs, legal costs, and marketing costs.

Overhead Funding: The Disconnect

- The case studies and the Nonprofit Overhead Cost Study show that having adequate overhead is critical for effectiveness.
- Approximately half (53.4 percent) of these nonprofits said the reason they have inadequate funds to pay for overhead costs is because foundations want to support programs, not administrative expenses.
- Yet, more than two-thirds (69 percent) of responding foundations indicated they are willing to fund all types of nonprofit overhead expenses.
- Approximately half (49.2 percent) of foundations said they provide general operating grants.
- Still, 64.5 percent of foundations report they do not have a history of funding administrative costs.

FOUNDATIONS FUNDING OVERHEAD

Large foundations (those that grant more than \$6.5 million annually) and foundations that fund nonprofits locally were statistically more likely to fund nonprofits' overhead expenses than smaller foundations and foundations that fund nonprofits nationwide. Foundations between 10 and 55 years old, as well as community foundations, were less likely to fund overhead costs.

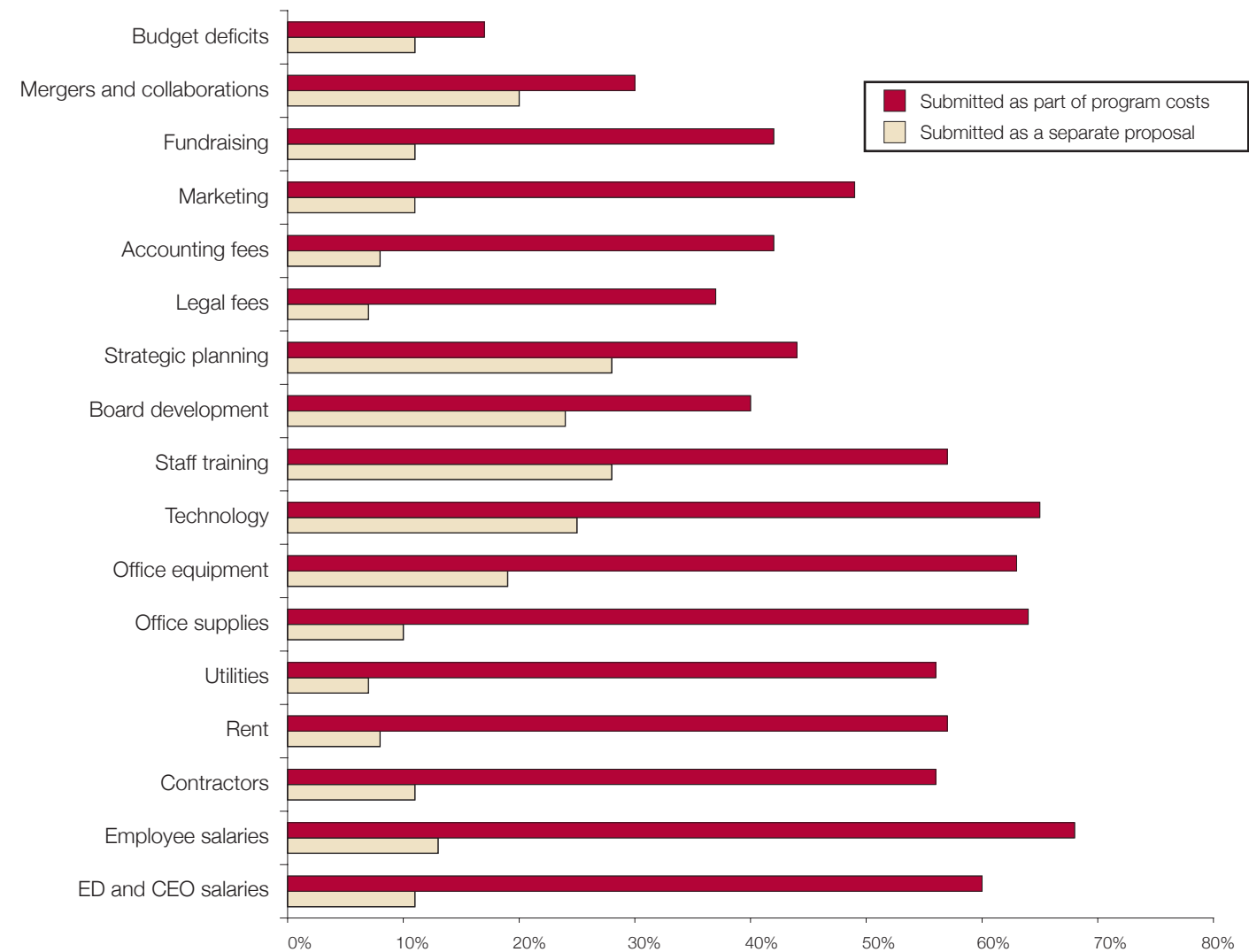
Table 1. How Much Foundations Permit Grantees to Request

	Overhead expenses as a percent of direct costs	Overhead expenses as a set dollar amount
Mean	15%	\$23,750
Median	15%	\$20,000
Mode	10%	\$5,000

The mean percentage of overhead expenses that foundations allowed grantees to request was 15 percent of direct costs. The mean amount that foundations provided for overhead expenses was \$23,750 per grant (see Table 1).

Foundations indicated they are much more likely to fund specific types of overhead expenses when expenses are submitted as part of a program budget than if expenses are submitted as a separate proposal (see Figure 1). When they receive overhead funding requests as part of a program budget, foundations are most likely to support employee salaries (68 percent), technology (65 percent), office supplies (64 percent), office equipment (63 percent), and executive director and CEO salaries (60 percent). When they receive separate proposals for overhead funding, foundations are most likely to support staff training (28 percent), strategic planning (28 percent), technology (25 percent), board development (24 percent), and mergers and collaborations (20 percent).

Figure 1. Types of Overhead Costs Foundations Fund: Separate Proposal vs. Part of Program Expenses



STATE OF OVERHEAD FUNDING

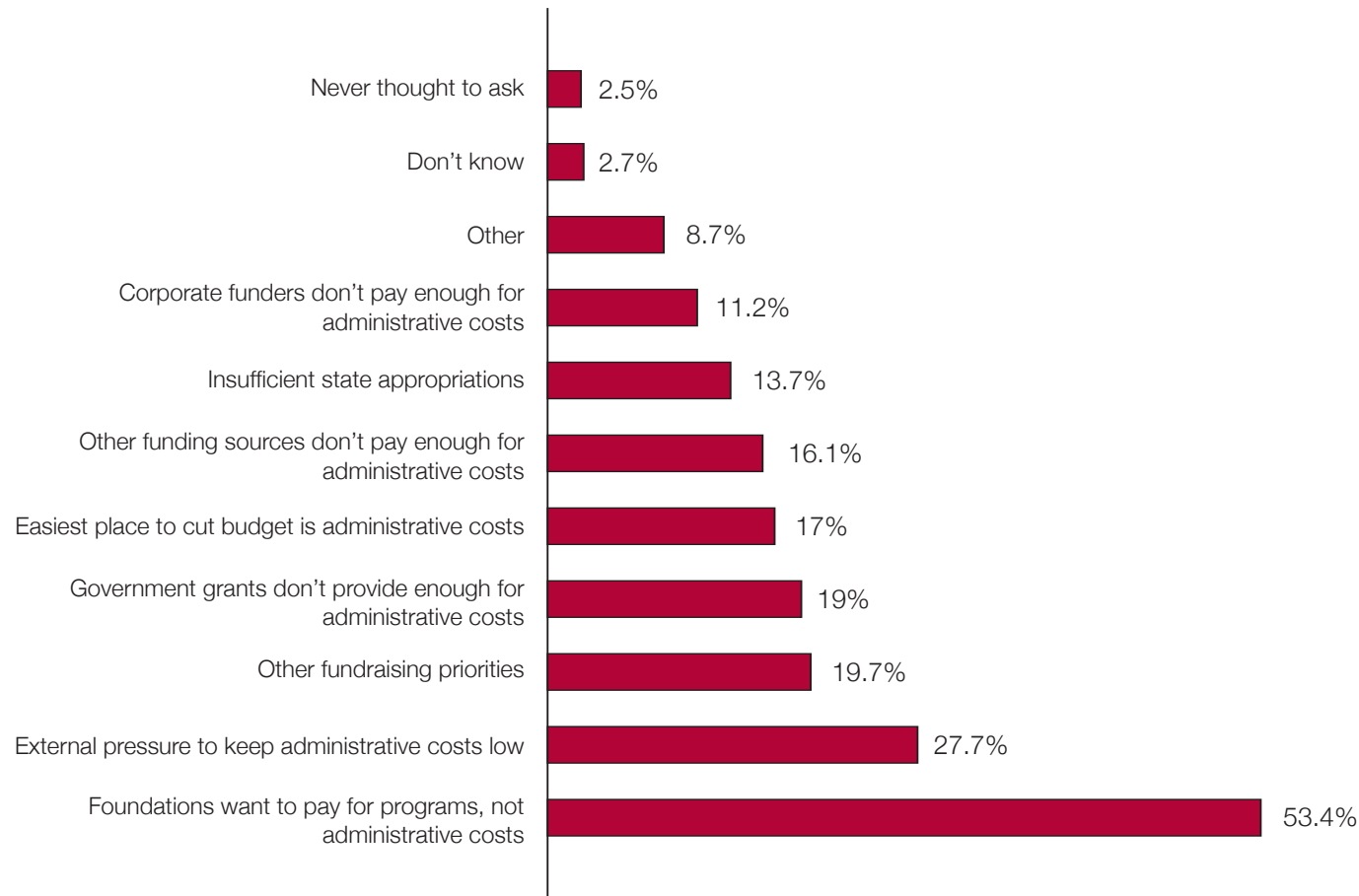
Of the 880 educational and human services organizations that responded to the survey, two-thirds (66.4 percent) reported inadequate funds for overhead expenses. More than half of that 66.4 percent said they lack sufficient overhead funding because foundations support programs instead of overhead expenses (see Figure 2).

One of the most statistically significant determinants of inadequate funding for overhead expenses was whether or not an organization received the majority of their charitable revenue from foundations. Seventeen percent of nonprofits indicated at least 41 percent of their charitable revenue comes from foundations. When organizations depend on foundation support for the majority of their budgets, they are more likely to be smaller organizations and statistically less likely to report adequate overhead funding. Likewise, large organizations were more likely than small ones to have adequate or more than adequate overhead funding, and their infrastructures were usually in good or excellent condition.

“Foundations want to fund new and innovative programs, not successful ones.”

—Executive director of a large human services organization located in the western United States

Figure 2. Reasons Nonprofits Give for Inadequate Overhead Funding



Among all types of overhead expenses, nonprofits reported that auditing and the qualifications of accounting personnel were much more likely to be good or excellent, while fundraising software and the pay rate of administrative staff were more likely to be poor or very poor (see Figure 3).

“We are probably
chronically
understaffed.”

—Executive director of a medium-sized
Midwestern human service organization

FOUNDATIONS’ ATTITUDES TOWARD OVERHEAD FUNDING

Most of the executive directors of the case studies indicated that the short-term nature of most foundation grants, as well as their focus on programming, limited their ability to rely on foundation funding in the long run. This opinion is supported by the survey, as 66.3 percent of foundations indicated they do not seek to provide long-term support of organizations and do not historically fund the same organizations from year to year (see Figure 4).

When asked about their general attitude toward funding overhead expenses of nonprofits, nearly half of foundations surveyed reported that overhead funding builds nonprofits’ capacity and helps to meet the needs of constituents (see Figure 4).

A TALE OF TWO ORGANIZATIONS

* The real names of these organizations were changed to protect confidentiality.

Youth Link* is a very small educational organization operating in the Midwest. Nearly two-thirds of Youth Link’s budget is supported by a single general operating grant from a local foundation. This unrestricted

Figure 3. Condition of Infrastructure of Nonprofits Reporting Insufficient Overhead Funding

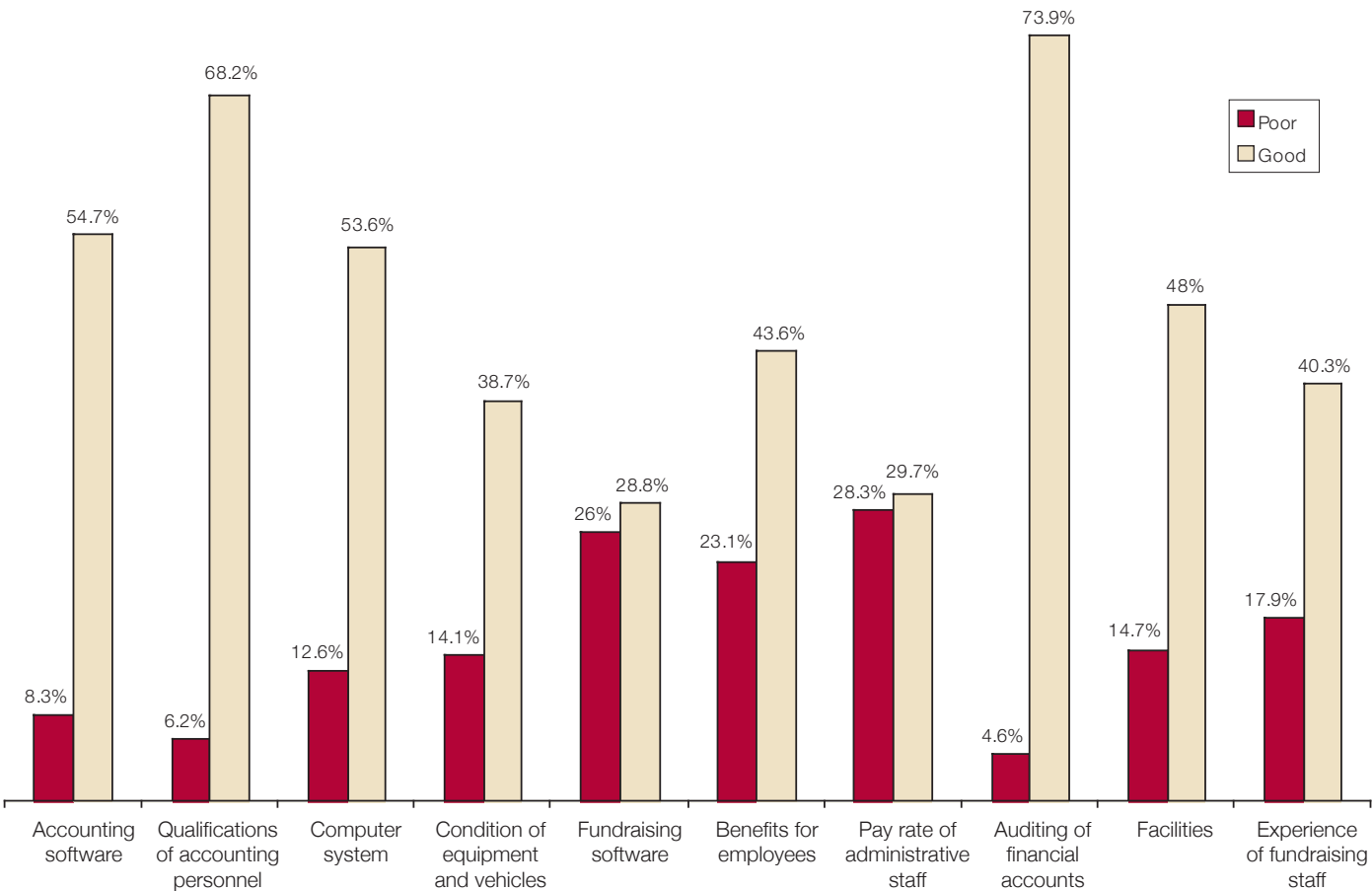
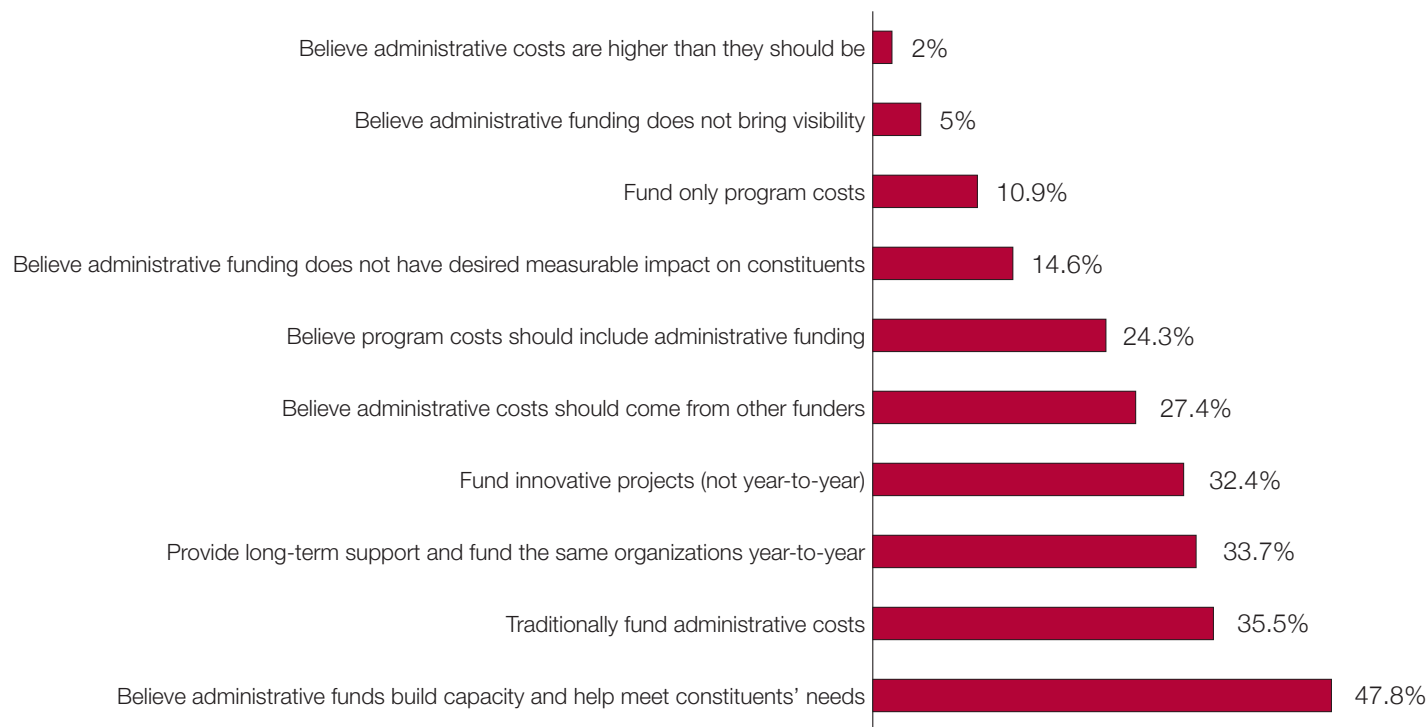


Figure 4. Foundations' View of Overhead Funding



foundation grant is coming to an end, most likely because the foundation does not want Youth Link to be solely dependent on them. The foundation money enabled Youth Link to increase the services it could provide in the short term. Youth Link now must seek long-term support to maintain its level of service. This organization provides an interesting case study. Although much of their funding is unrestricted, they spend very little on administrative or fundraising expenses, despite their low salaries and the poor condition of their roof and windows. In fact, when posed with a hypothetical situation of receiving 10 percent more income, the executive director said the organization would spend it on transportation to increase their services. The executive director's expectation is that by serving more youth they will be able to increase funding, which would allow them to spend more on overhead, for example, increasing their salaries by 3 percent.

Promoting Women,* a very small human services organization, has very diversified funding sources — 57 percent of their revenue is unrestricted. If in-kind donations that support their program are not considered, then approximately 90 percent of their revenue is unrestricted. Promoting Women's infrastructure is in good to excellent condition. But like many organizations, they are understaffed. Promoting Women's executive director commented that they are

probably always understaffed because they do not want to hire someone if they are unsure the organization has funding to maintain the position in the long term.

A foundation in Promoting Women's local area has provided them with a three-year capacity-building grant. This grant allowed Promoting Women, which has had a consistently dramatic growth rate, to begin a capital campaign. The capacity-building grant paid for consultants, fundraising software, and a full financial review, among other items. Promoting Women, which has run out of space in its current facility, is now raising \$500,000 for more space and more staff, so that the organization can reach more women. This organization was on a growth trajectory before the capacity-building grant, and the grant accelerated this process. It is important to note that Promoting Women has specifically sought out a diversified funding stream of corporate, individual, and special-event income because they feel foundations do not provide enough operating support, even for the programs they might support. However, without this capacity-building grant from a local funder, Promoting Women would be years away from affording their move and increasing their staffing to serve more women.

As shown in these case studies, foundation overhead funding has mixed results. Unrestricted funding for Youth Link caused their programming to increase, but

their infrastructure remains in poor condition. With the temporary unrestricted grant expiring, Youth Link is not likely, any time soon, to invest in their own infrastructure. A grant that paid for overhead expenses such as a financial review and fundraising software allowed Promoting Women, which already had a diversified funding base, to take its operations to the next level.

A MATTER OF POLICY

Only 18 percent of foundations have written policies about funding overhead costs. Of those with policies, fewer than 10 percent have analyzed their impact on the operations or programs of the nonprofits they support. Only 5 percent of foundations have changed their overhead funding policies (see Table 2).

Table 2. Percentage of Foundations with Grant-Making Policies

Have policy on funding administrative costs	17.8%
Have policy on operating grants	34.6%
Perform periodic review of policy	59.5%
Perform impact analyses	6.9%

Foundations were asked to select all that apply. Of those who answered, n = ~650.

WHY IS OVERHEAD IMPORTANT?

Results from the Nonprofit Overhead Cost Study suggest nonprofits’ organizational effectiveness may face serious consequences if nonprofits don’t spend adequate funds on overhead expenses. The study found that nonprofits with restricted funding, especially smaller ones, struggle with inadequate administrative and fundraising infrastructure. Inadequate infrastructure compromises organizational effectiveness (Hager et al, 2004). Common assumptions are that nonprofits do not spend additional money on overhead because foundation grant dollars restrict funding to only program costs or because nonprofits who report higher administrative expenses do not receive future funding from foundations. Investing in overhead is a sector-wide problem. Nonprofits’ inability to acquire sufficient overhead funding to maintain effective and ongoing operations is one of the serious weak factors in the nonprofit system (Wing et al, 2004).

The current research on overhead costs reflects long-standing tensions in the nonprofit sector. There is the perception that many foundations want to incubate new

Why Some Foundations Changed Their Policies

“We believe administrative costs can be the most effective grant. Not funding these costs is short-sighted and cripples the grantee.”

“We believe it’s important to ensure long-term support for initiatives and make multi-year grants that span three to five years.”

“We began increasing our proportion of general operating support grants and included unrestricted funding as a result of grant recipient feedback during a 2002 program assessment.”

“Over the past five years we have come to realize that what nonprofits actually need is help with operating costs. We have become more willing to support general operating costs as a result.”

“(Administrative costs are) often the most difficult to raise ... when we value what the organization accomplishes, supporting administrative costs is dollars well spent.”

“A few years ago we began the process of educating our board on the necessity of providing planning and organizational development grants.”

solutions, and they are concerned that providing long-term or general overhead support may harm nonprofits by creating dependence on foundation funding. There are also concerns that when overhead funding from foundations is insufficient or is only given briefly, this puts nonprofits at risk for inefficiency or reduced effectiveness. This presents crucial questions for everyone involved in civil society: Should the majority of foundation grants to the nonprofit sector support innovative programs, or overhead costs? If foundations were created for the sole purpose of supporting the nonprofit sector, why is it harmful for nonprofits to depend on them for general operating costs? Whose role is it to sustain the core operations of nonprofits in the long term?

METHOD AND DATA COLLECTION

This 28-month study was undertaken during 2006–2007 by researchers at the Center on Philanthropy at Indiana University. The study was undertaken in three parts.

Part one used a survey of foundations to access their payment of and attitude toward nonprofits’ overhead

costs. 3,595 foundations received a mailed survey. 710 responded, yielding a 20-percent response rate.

Part two examined results from a survey of educational and human services organizations' receipt and perceptions of overhead cost funding from foundations. This survey consisted of a stratified random sample of 6,000 educational and human service organizations, of which 880 responded—a 15.5-percent response rate.

Part three considered findings from a series of six case studies of educational and human services organizations across the United States, drawn from the National Center for Charitable Statistics.

MORE INFORMATION

For more information about this study, visit **www.philanthropy.iupui.edu** and select "Most Current Research," where you can download the full working paper. Or, contact Patrick Rooney or Heidi Frederick at the Center on Philanthropy at Indiana University at (317) 274-4200.

REFERENCES

Hager, M., Pollak, T., Wing, K., and Rooney, P.M. (2004). *Getting what we pay for: Low overhead limits nonprofit effectiveness*. Nonprofit Overhead Cost Project, 3. www.coststudy.org

Wing, K., Pollak, T., and Rooney, P. (2004). *Toward a theory of organizational fragility in the nonprofit sector. Overhead Cost Study Working Paper*. www.coststudy.org



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RESEARCH DEPARTMENT AT THE CENTER ON PHILANTHROPY AT INDIANA UNIVERSITY

The Center on Philanthropy's mission is to increase the understanding of philanthropy, to improve its practice, and to enhance participation in philanthropy. Research is at the core of all three. Through basic and applied research, the Center creates new knowledge that increases understanding of philanthropy and the nonprofit sector.

Recent examples of the Center's research capacity include:

- *Giving USA*, the industry standard, published by the Giving USA Foundation and researched and written by the Center, is the first and only annual, comprehensive look at who gives, how much they give, and to whom they give.
- The Center's signature research project, the Center on Philanthropy Panel Study (COPPS), is a mammoth undertaking that follows the volunteering and giving habits of 8,000 households over time and over generations.
- As consultant and evaluator, the Center identifies best practices and new challenges facing nonprofits, foundations, and corporations. Target Corporation funded a study of best practices and new ideas in corporate giving nationally, and the National Football League asked the Center to evaluate its NFL Youth Football Fund.
- Bank of America selected the Center to conduct its first ever scientific, random sample study of high net-worth households and their philanthropy.
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