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## **Executive Summary**

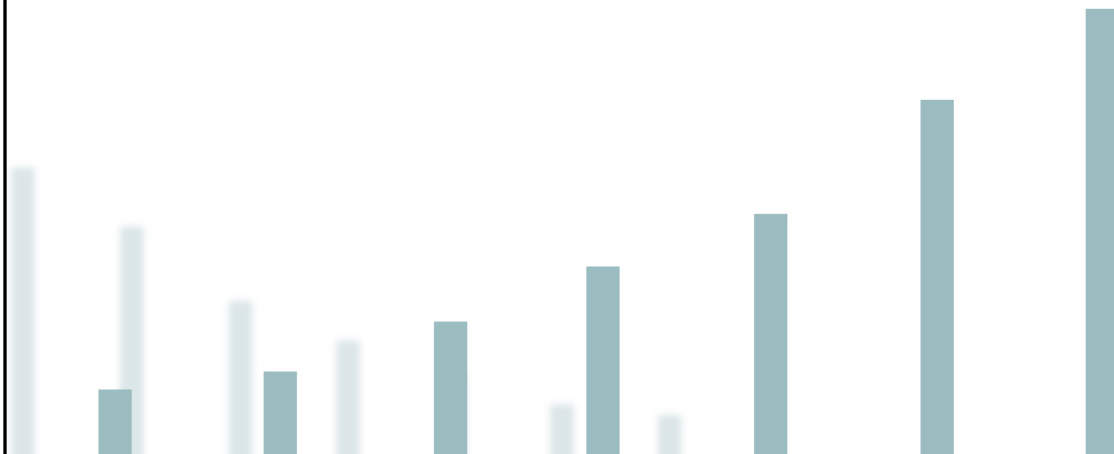
# **Nonprofit Overhead Costs**

Breaking the Vicious Cycle of Misleading Reporting,  
Unrealistic Expectations, and Pressure to Conform

*William Bedsworth*

*Ann Goggins Gregory*

*Don Howard*



## Executive Summary

How much does it cost to run a successful and sustainable nonprofit? No, *really*.

It's a badly kept secret that overhead costs in the nonprofit sector are most often much greater than what's visible in financial reports and fundraising literature. But misguided expectations and actions—on the part of funders and nonprofits alike—fuel a vicious cycle that keeps the pretense going.

This cycle persists despite its articulation in various studies—most notably the Nonprofit Overhead Cost Project, a study that was jointly performed by the Center on Nonprofits and Philanthropy at the Urban Institute and the Center on Philanthropy at Indiana University. Essentially, the situation has three drivers:

- *Misleading reporting*: The majority of nonprofits under-report overhead on tax forms and in fundraising materials.
- *Unrealistic expectations*: Donors tend to reward organizations with the “leanest” profiles. They also skew their funding towards programmatic activities.
- *Pressure to conform*: Nonprofit leaders feel pressure to conform to funders' expectations by spending as little as possible on overhead, and by reporting lower-than-actual overhead rates.

The cycle has grave consequences for an organization's ability to have impact. As unrealistic overhead expectations place increasing pressure on organizations to conform, executive directors and their boards can find themselves under-investing in infrastructure necessary to improve or even maintain service-delivery standards, particularly in the face of growth. In the short term, staff members struggle to “do more with less.” Ultimately, it's the beneficiaries who suffer.

To better understand the drivers of this vicious cycle, and to uncover possible ways for organizations and funders to break out of it, Bridgespan synthesized existing research on nonprofit overhead costs and conducted interviews with a range of nonprofit managers. We also examined four nationally-recognized youth-serving nonprofits in depth. These four organizations—each of which has a diversified

funding stream, including monies from government, foundation, and individual sources—have managed to expand their capacity in critical ways. Importantly, they have also laid the groundwork for supporting those changes over time, and for making future overhead investments. All four still underreport their “true” overhead costs. But they are closing the gap between what they report, what they really spend on overhead, and what they feel they need to spend in order to operate optimally and grow with confidence.

The lessons they have learned, coupled with Bridgespan’s experience working with foundations and with nonprofits developing business plans, suggest some steps that other organizations and their supporters can take to break the cycle.

Funders, for example, can take the following steps:

- Increasingly supporting organizations with general operating funds, when feasible. Doing so allows organizations to make the tradeoffs themselves between areas of investment.
- Committing to paying a greater share of administrative and fundraising costs in use-restricted grants.
- Fostering more open discussions about overhead and, in so doing, encouraging the development of a standard definition of the term. Dialogues about “real” overhead rates can help shift the focus to the real target—outcomes.

Nonprofit leaders can also start to break down the cycle by:

- Developing a strategy that explicitly recognizes infrastructure needs. Framing strategy discussions around goals and the investments needed to achieve them can be more effective than centering such conversations on costs.
- Communicating the logic for increased overhead investment throughout the organization, and to the board. A collective commitment from all levels of the organization, including senior staff and the board, is a powerful lever.
- Beginning to provide funders with better ways to measure performance than program ratios. A conversation about costs to achieve outcomes (and how investments in overhead can reduce those costs) can be much more meaningful.

*Sharing knowledge and insights from our work is a cornerstone of the Bridgespan Group's mission. This document, along with our full collection of case studies, articles, and newsletters, is available free of charge at [www.bridgespan.org](http://www.bridgespan.org). We also invite your feedback at [feedback@bridgespan.org](mailto:feedback@bridgespan.org).*