Intersections and Innovations

Change for Canada's Voluntary and Nonprofit Sector

The Muttart Foundation

ISBN: 978-1-897282-30-4

The Muttart Foundation

Acknowledgements

For far too long, Canada has lacked a comprehensive resource examining Canada's charitable sector. That has now ended.

The Muttart Foundation has spent many years focusing on building the capacity of charities in this country. The publication of this collection is another contribution to that effort. By understanding more about itself, the sector can continue to develop and find new ways to serve Canadians and those in need outside our nation.

The authors of these essays bring different perspectives on the role and inner workings of Canada's charities. Collectively, they bring an unprecedented insight into the work of organizations whose diversity is exceeded only by their desire to serve.

It is difficult to express adequate appreciation to Dr. Susan Phillips of Carleton University for her leadership of this project. She has been a source of encouragement, persuasion, cajoling and improving authors from across the country. Her efforts now bear fruit as we make this material available to students, academics, practitioners and others interested in the history and future of Canada's charities.

Amanda Mayer of the Lawson Foundation volunteered at the outset to be the administrative overlord of the project, keeping the editors and authors up to date and keeping track of various versions of articles. We are so grateful for her skills, her patience and her friendship.

None of this would have been possible, of course, without the work of authors, themselves academics and/or practitioners. They took time from their schedules to contribute to a resource we hope many will find valuable.

Lesley Fraser did an incredible job in editing the various chapters and ensuring consistency. And Don Myhre of P40 Communications has again brought his talent to the fore in providing an attractive design for a Muttart publication.

The work of all of these individuals has come together in this resource which we dedicate to all of those in, or interested in, Canada's charitable sector.

Malcolm Burrows, President

Bob Wyatt, Executive Director

The Muttart Foundation

The Muttart Foundation

This book may be cited as:

Phillips, Susan D. and Wyatt, Bob (Eds) (2021) *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Individual Chapter Citations

Chapter 1

Phillips, Susan D. and Wyatt, Bob (2021) Intersections and Innovations: Change in Canada's Voluntary and Nonprofit Sector. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Chapter 2

Lasby, David and Barr, Cathy (2021) State of the Sector and Public Opinion about the Sector. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Chapter 3

Marshall, Dominique (2021) Four Keys to Make Sense of Traditions in the Nonprofit Sector in Canada: Historical Contexts. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Chapter 4

Wyatt, Bob (2021) It Should Have Been So Simple: The Regulation of Charities in Canada. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Chapter 5

Chan, Kathryn and Vander Vies, Josh (2021) The Evolution of the Legal Meaning of Charity in Canada: Trends and Challenges. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Chapter 6

Manwaring, Susan and Kairys, Katrina (2021) Regulating Business Activity. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector*. Edmonton, AB, Canada: Muttart Foundation

Chapter 7

Phillips, Susan D., Dougherty, Christopher, and Barr, Cathy (2021) The Fine Balance of Nonprofit Sector Self-Regulation: Assessing Canada's Standards Program. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector*. Edmonton, AB, Canada: Muttart Foundation

Chapter 8

Charters, Owen (2021) Board Governance in Practice. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector*. Edmonton, AB, Canada: Muttart Foundation

Chapter 9

Grasse, Nathan and Lam, Marcus (2021) Financing Canadian Charities: The Conditional Benefits of Revenue Diversification. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector*. Edmonton, AB, Canada: Muttart Foundation

Chapter 10

Hale, Sharilyn (2021) Giving and Fundraising Trends. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector*. Edmonton, AB, Canada: Muttart Foundation

Chapter 11

Glogovac, Marina (2021) New Technologies and Fundraising. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector*. Edmonton, AB, Canada: Muttart Foundation

Chapter 12

Fontan, Jean-Marc and Pearson, Hilary (2021) Philanthropy in Canada: The Role and Impact of Private Foundations. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector*. Edmonton, AB, Canada: Muttart Foundation

Chapter 13

Khovrenkov, Iryna (2021) Canada's United Way Centraide as a Community Impact Funder: A Reinvention or a Failed Endeavour? In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector*. Edmonton, AB, Canada: Muttart Foundation

Chapter 14

Harji, Karim and Hebb, Tessa (2021) Impact Investing in Canada: Notes from the Field. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector*. Edmonton, AB, Canada: Muttart Foundation

Chapter 15

Raggo, Paloma (2021) Leadership in the Charitable Sector: A Canadian Approach? In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector*. Edmonton, AB, Canada: Muttart Foundation

Chapter 16

Fredette, Christopher (2021) Planning for Succession in the Interests of Leadership Diversity: An Avenue for Enhancing Organizational Diversity, Inclusion, and Equity. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector*. Edmonton, AB, Canada: Muttart Foundation

Chapter 17

Akingbola, Kunle and Toupin, Lynne (2021) Human Resource Management in the Canadian Nonprofit Sector. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector*. Edmonton, AB, Canada: Muttart Foundation

Chapter 18

Uppal, Pamela and Febria, Monina (2021) Decent Work in the Nonprofit Sector. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector*. Edmonton, AB, Canada: Muttart Foundation

Chapter 19

Thériault, Luc and Vaillancourt, Yves (2021) Working Conditions in the Nonprofit Sector and Paths to Improvement. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector*. Edmonton, AB, Canada: Muttart Foundation

Chapter 20

Russell, Allison, Speevak, Paula, and Handy, Femida (2021) Volunteering: Global Trends in a Canadian Context. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector*. Edmonton, AB, Canada: Muttart Foundation

Chapter 21

Shier, Micheal L. (2021) Social Innovation and the Nonprofit and Voluntary Sector in Canada. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector*. Edmonton, AB, Canada: Muttart Foundation

Chapter 22

McCort, Kevin and Phillips, Susan D. (2021) Community Foundations in Canada: Survive, or Thrive? (with apologies to lawn bowlers). In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Chapter 23

Murphy, Colette (2021) Community Wealth Building: A Canadian Philanthropist's Perspective. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Chapter 24

Doberstein, Carey (2021) Collaboration: When to Do It and How to Do It Right. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Chapter 25

Munshi, Shereen and Levi, Elisa (2021) Indigenous Peoples, Communities, and the Canadian Charitable Sector. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Chapter 26

Stauch, James, Glover, Cathy, and Stevens, Kelli (2021) The Business–Community Interface: From "Giving Back" to "Sharing Value." In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Chapter 27

Laforest, Rachel (2021) Transforming Health and Social Services Delivery Systems in Canada: Implications for Government–Nonprofit Relations. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Chapter 28

White, Deena (2021) Contentious Collaboration: Third Sector Service Delivery in Quebec. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Chapter 29

Levasseur, Karine (2021) Policy Capacity: Building the Bricks and Mortar for Voluntary Sector Involvement in the Public Policy Process. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Chapter 30

Houston, Sandy (2021) Evolving Relationships with Government: Building Policy Capacity. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Chapter 31

Northcott, Allan (2021) Reflections on Teaching Public Policy Advocacy Skills. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Chapter 32

Lauzière, Marcel (2021) A Lever for Change: How Foundations Can Support Public Policy Advocacy. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Chapter 33

Ruff, Kate (2021) Social and Environmental Impact Measurement. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Chapter 34

Lenczer, Michael, Bourns, Jesse, and Lauriault, Tracey (2021) Big Data Won't Save Us: Fixing the Impact Evaluation Crisis. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Chapter 35

Herriman, Margaret (2021) Social Media and Charities in Canada. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Chapter 36

Riseboro, Caroline (2021) The Overhead Myth: The Limitation of Using Overheads as a Measure of Charity Performance. In Susan D. Phillips and Bob Wyatt (Eds.), *Intersections and Innovations: Change for Canada's Voluntary and Nonprofit Sector.* Edmonton, AB, Canada: Muttart Foundation

Part III Innovation and Intersections

Community and Corporate Intersections

Intersections with Governments: Services and Policy Engagement

Measuring Impact and Communicating Success

The Muttart Foundation

Measuring Impact and Communicating Success

Chapter 36

The Overhead Myth: The Limitation of Using Overheads as a Measure of Charity Performance

Caroline Riseboro
Trillium Health Partners Foundation

Very few subjects in philanthropy are as contentious as charity "overheads." In simple terms, charity overhead can be defined as "the amount of total receipts spent on administration and fundraising, in contrast to the amount spent delivering services" (Hager, 2001). Donors' scrutiny of charity overhead stems from a desire to maximize the amount of their donations directed to the cause, rather than spent to cover operating or fundraising costs. Charities, in contrast, see such costs as necessary expenses – to generate future income, pay qualified staff, invest in technology, and ensure the future sustainability of their organizations.

Low charity overheads are often interpreted as a proxy for effectiveness and efficiency, and those charities with lower overhead rates are perceived as being better positioned to achieve their missions. As Caviola (2014: 304) explains, "The overhead ratio might appear important to many because it can seem to measure the efficiency of the organization: how much of my money will actually reach the destination?" Government regulators have adopted the notion of capping a charitable organization's overhead as a means of promoting charity effectiveness. As an example, in its fundraising guidance for charities, the Canada Revenue Agency (CRA) states that, while recognizing the necessity of incurring fundraising expenses, it expects charities to conduct fundraising within acceptable legal parameters. Those parameters include fundraising costs no higher than 35% of total revenues, and anything above this amount may trigger further examination (CRA, 2012).

The Canadian regulatory regime for charitable organizations is not exceptional; other jurisdictions have also imposed regulations that require charities to disclose financial information, including administrative and related costs (Phillips, 2013). And while regulating overhead may at first seem to make sense, it is important in judging the merits of such restrictions to understand the intent behind them. As Oonagh Breen (2016: 230) points out, "In designing any regulatory regime, the first concern must be the nature of the evil the regime seeks to redress." The intent behind most government regulation is to deter charities from the evils of ineffectiveness by ensuring that a sufficient percentage of donated dollars reaches the cause, with the expectation that this will have a positive effect on the charity's overall performance. However, empirical evidence suggests this focus on overhead ratios is not necessarily beneficial.

This chapter examines the effects of restrictions on overheads and fundraising costs, both formal and informal, as documented in the research literature. By "formal restrictions" I mean the regulations imposed by government bodies; "informal restrictions" refer to those created via the perceptions and preferences of donors and the general public.

Based on evidence that overhead regulations deter sufficient investment in infrastructure and result in financial misreporting by charities, I argue that the excessive focus on and the formal or informal capping of overheads has negative and damaging consequences for charities. The relevance of overhead rates as meaningful measures of charity effectiveness is questioned, given their inability to account for fundraising and subsector differences. Alternative methods of improving charities' performance are explored – ones that move away from restrictions on overhead but that nonetheless provide donors with relevant information to decide which organizations are worthy of their financial support.

Underinvestment in Critical Infrastructure

Various studies have shown that, in an effort to keep overhead ratios low and attract the interest of donors, charities underinvest in the critical infrastructure they require to be as effective as possible. Such infrastructure includes technology systems, staff training and development, competitive compensation, management processes to track and evaluate performance, and other essential operations. A persistent underinvestment in infrastructure undercuts charities' ability to best achieve their missions.

This destabilization has been coined the "nonprofit starvation cycle" (Hager, Pollock, Wing, & Rooney, 2004; Gregory & Howard, 2009; Lecy & Searing, 2015). In popularizing the concept, Gregory and Howard (2009) identify a three-step cycle of chronic underfunding that undermines charities' overall effectiveness. The first step begins with unrealistic expectations from funders (i.e. government, foundations, and individual donors) regarding the actual costs associated with running a productive nonprofit. These unrealistic expectations prompt the second step: nonprofits bow to the demands of their funders so as to secure much-needed financial support. In the third step, nonprofits lower their overhead ratios by spending too little on vital infrastructure while they underreport fundraising and administrative expenses.

There is strong evidence of systematic nonprofit starvation over time. For example, Gregory and Howard (2009) found that 56% of executive directors (EDs) reported plans to reduce their organizations' overhead expenses, even though it meant jeopardizing their ability to achieve their charitable missions. Nonprofits concerned about keeping their overhead levels low also hired unqualified staff because they were able to offer only below-market wages. Key positions were filled with junior people who lacked relevant training; once they acquired this training, they would often leave the charity for better-paying employment (Nonprofit Overhead Cost Project, 2004a). The Nonprofit Overhead Cost Project, which included a survey of more than 1,500 charities and a detailed review of tens of thousands of audited financial statements and American tax data, reports many instances of EDs preparing their organizations' financial statements themselves, even though they lacked the necessary skill and qualifications to do so, resulting in errors and inaccuracies (Wing et al., 2005: 3). Adequate support for technology infrastructure also suffers; one of the starkest examples comes from a suicide prevention hotline that could not update its phone system, leaving suicidal callers at risk of getting busy signals (Wing et al., 2005).

Funders often play an explicit role in dampening spending on infrastructure, particularly when they don't allow the recipient charities to designate sufficient funds to cover the costs associated with administering the grant; meanwhile, downward pressures on overhead force charities to pay uncompetitive salaries, resulting in a lack of leadership and expertise to deliver on their missions (Gregory & Howard, 2009: 51).

The decline in overhead spending is a long-term trend, as shown by Lecy and Searing in a study of US nonprofits from 1985 to 2007. The average reported overheads fell by almost three percentage points over this period – from 20.9% to 18.3%. The decline held across all subsectors and all sizes of organizations except the very small and very large. The deep cuts came from administrative expenses (wages of non-executive staff and professional fees), which were offset by an increase in fundraising expenses. This long-term trend has been confirmed in a study of nonprofits in Germany (Schubert & Boenigk, 2019), although there the decline was attributed to decreased fundraising and material expenditures rather than staff wages and was greater for nonprofits without government funding, which face greater pressures from a more competitive environment. Schubert and Boenigk (2019) found that declining overheads are more significant for large organizations, which they attribute to increased professionalization that makes large organizations more susceptible to external expectations, and that they skimp on material-related expenses as staff expenses rise.

In sum, research demonstrates that demands for low overhead result in charities sacrificing vital infrastructure investment in technology, staff development, and other critical operations even though doing so negatively affects their missions. If the original goal behind restricting overhead is to increase the impact of charities on their causes by directing as much of each donation as possible toward the program, a very different result is being achieved. Most disturbing is the fact that overhead restrictions, whether imposed by government regulation or the public's normative values, have had not just a negative effect – they have perpetuated a starvation cycle where nonprofits feel pressure to reduce overhead rates to the point of limiting their ability to deliver on their charitable mission.

Misreporting of Overhead

Critics of formal regulations on overhead argue that much of the reporting to government agencies by registered charities is inaccurate and inconsistent – although mainly unintentionally. Misrepresentation of overhead expenses makes government regulation irrelevant because inaccurate information eliminates any usefulness for donors in deciding where to best direct their charitable gifts. It also nullifies governments' ability to regulate effectively. Evidence would suggest that these critics are right in their assertions.

In assessing the financial reporting provided by charities, significant errors, both quantitative and qualitative, are found. The evidence demonstrates that many well-meaning Canadian charities have been both erratic and erroneous in their reporting of fundraising costs, often significantly underreporting their expenses (Ayer, Hall, & Vodarek, 2009; Phillips, 2013). Quantitative errors are frequently the result of a lack of financial acumen and expertise within the charity, coupled with multiple reporting requirements with no standard definition for reporting certain costs (Phillips, 2013). Other research has affirmed that errors in reporting are not the result of any intentional desire to misreport financial data, but as Wing and colleagues (2005) explain, many of these nonprofits do not have the necessary accounting or financial skills to effectively report their overhead costs. The Nonprofit Overhead Cost Project documented numerous quantitative inaccuracies in the data it analyzed from US-based charities' 990 forms (which most tax-exempt organizations are required to file with the IRS). It found that 37% of nonprofits with at least $50,000 in revenue reported zero fundraising costs, while 13% of them claimed zero management costs, suggesting widespread underreporting in administrative and fundraising costs, given the high likelihood that these statistics are inaccurate (Nonprofit Overhead Cost Project, 2004b). In addition to quantitative errors, qualitative errors were often the result of improper allocation of expenses. Salaries often represent the largest single cost, but many nonprofits did not report or attribute salary cost, versus overhead expenses, accurately in their financial statements, leading to imprecise reporting that skewed overhead results (Nonprofit Overhead Cost Project, 2004c). Reports from the UK suggest similar challenges. Sargeant (2009) argues that the latitude given to UK charities in how they report on overhead and fundraising costs in their Charity Commission filings leaves so much room for interpretation that any resulting data is neither usable nor relevant. The inaccuracy of the reporting is observed in Sargeant's survey of fundraising directors at the UK's 500 top charities, whereby 5% of them claim zero overhead expenses (2009: 338), clearly an impossibility.

While misreporting of overhead costs is often the result of a lack of accounting skills or inconsistent reporting standards, research also suggests that charities underreport their overhead expenses because of funders' unrealistic demands. There is evidence of charities underreporting fundraising and administrative expenses to perpetuate the appearance of falsely low costs so as to access funding or be more attractive in competitive funding scenarios (Gregory & Howard, 2009). Some charitable organizations were found to misrepresent overhead costs by claiming that 100% of donations were directed to the cause, but in the small print they reveal that the organization uses contributions from "founding supporters" to cover administration and fundraising costs (Gregory & Howard, 2009: 51).

The widespread inaccuracies and inconsistencies in overhead reporting reveal the limitations of those government policies that seek to regulate administrative and fundraising expenses.

Consistent patterns of overhead misreporting from Canada, the US, and the UK suggest that this trend is not confined to one nation's regulations, but rather point to a fundamental flaw with overhead regulation in general. If most charitable organizations lack the basic capacity to even report on whether they abided by the regulations, the regulations in effect become powerless in their ability to enforce compliance. If overhead restrictions perpetuate misreporting and underreporting because of pressures from funders and government, then policies that cap costs become immaterial, given that the guidelines do little to promote adherence.

Overhead Ratios Don't Allow Us to Compare Charities

Donors often use overhead (and specifically fundraising) ratios as a means of comparing different charities' efficiency and effectiveness as they assess how to best direct their philanthropic dollars. The premise for using ratios to evaluate charities "rests on the idea that, all things being equal, the donor would prefer that as much of his or her donation as possible be devoted to program spending, and not diverted to administrative or fundraising spending" (Tinkelman, 2006: 441). While donors may believe that they are making the best choice in donating their funds to the charity with the lower overhead ratio, studies have shown that such ratios are irrelevant in determining whether one is more efficient (the level of inputs used to produce outputs) or effective (achieving the intended results from the outputs).

A fundamental problem is that overhead measures are calculated as ratios – of administrative and fundraising to all program expenditures. This means that the ratio can be manipulated in several ways, making it a poor measure of actual efficiency. One way is to increase the denominator, which would decrease the ratio, for example by increasing program expenditures, or what are reported as program expenditures (Coupet & Berrett, 2019). Surely, the intent of the measure is not to create incentives to increase program expenses regardless of the impact of such spending; this would merely incentivize inefficiency. Indeed, Coupet and Berrett (2019) find that overhead ratios actually have a negative correlation with other standard measures of efficiency. Further, the ability to directly compare charities is compromised by the fact that not all charities use standardized accounting and reporting systems, making the data inconsistent (Van Iwaarden, 2009). The measure also ignores inputs other than financial and ignores any measurement of outputs or actual impacts, limiting its value as a test of effectiveness.

When we consider different fundraising strategies that charities may use to promote revenue and donor growth, additional problems emerge. These strategies may put upward pressure on overhead ratios by increasing the numerator but say very little as to whether a charity is more or less effective. One of the best illustrations of this is when a charity invests in fundraising to produce the highest net return in order to direct as much money as possible to the cause. Steinberg (1994: 14) illustrates this point with two scenarios of differing fundraising strategies:

> The first budget of $10,000 will produce $50,000 in donations and provide a 500 percent ratio return ($40,000 actual net return). The second budget of $100,000 will produce $200,000, a 200 percent ratio return ($100,000 actual net return). If a charity wished to maximize the rate of return on its fundraising investment, it would

choose the first budget: if it cared about maximizing the resources for providing charitable services, it would choose the second.

The first budget has an overhead rate of 20% and produces net “profits” of $40,000 to the cause; the second has an overhead rate of 50% and directs net profits of $100,000 to the cause. Charities with lower overhead rates do not necessarily put more funds toward their causes. Rather, it may be the contrary. Steinberg’s scenarios suggest lower fundraising overhead comes at a potential cost – the cost being fewer dollars in absolute terms directed to the charity’s mission. In fact, many nonprofits do not devote enough resources to fundraising at all levels to maximize revenues (Okten & Weisbrod, 2000: 271). Hence, direct comparison between charities with respect to their fundraising and overhead ratios tells us little about how many real donor-dollars are going to the cause, despite the public perception to the contrary.

A related issue is that overhead ratios are static – a snapshot at a fixed time. The usefulness of overhead as a means of comparing charities is challenged by how fluctuations in overhead and fundraising costs affect donors’ likelihood to increase or decrease their donations. Bowman (2006) concludes that overhead ratios are meaningless for comparing between charitable organizations. He did, nevertheless, find that changes in overhead are useful when analyzed at the individual charity level, but only longitudinally, over a period of time.

Donor acquisition often has high short-term costs but long-term payoffs, and when acquiring new donors, many charities will justify the upfront investment by using a long-term-donor-value metric. That is, they judge the initial acquisition investment against the value of the donor over time. For instance, it may cost $500 to acquire a donor in the first year, but the charity can be guaranteed a total of $2,000 from that donor over their lifetime with the organization. As Sargeant (2001) points out, in a long-term-donor model, acquisition costs are generally high and not necessarily offset by donation revenue in the short-term; rather, reasonable returns are generated over time, driven by an ongoing financial relationship between the donor and the charity. In long-term-donor-value models, fundraising overhead can be exceptionally high in a year where acquisition activity is abundant but much lower in years when a charity depends on the ongoing revenue of previously acquired donors. Such fluctuations in donor-acquisition costs and associated long-term revenue are not captured in overhead measurement, given that they are unable to account for future multiyear returns. As such, fundraising models that take longer-term investment approaches challenge the usefulness of comparing charities’ overhead ratios, given that these ratios cannot account for what is one of the underpinnings of good fundraising: taking a long-term approach to developing a financial relationship with donors.

Part of the challenge in using overhead as a proxy for effectiveness is that the public knows very little about the need for fundraising. Fundraising is what fuels most charities’ ability to deliver on their missions, but many donors do not understand or respect this (Impact Coalition, 2012: 2). Upward of 85% of donations to all charitable organizations are the result of a fundraising solicitation (Bekkers, 2011: 931), so when charities reduce their investments in fundraising to keep overheads low, the direct result is fewer dollars directed toward their missions and less security in ensuring their long-term financial viability. The public may not realize how central fundraising is to the health and sustainability of charitable organizations or that static overhead ratios reveal little about the complexity of fundraising strategies over time. The reality is that short-term investments for long-term revenue gain can drive up costs – and overhead ratios with them.

Subsector Influences Overhead

The approximately 86,000 charities in Canada represent a wide range of causes and are varied in their missions and operations. Yet overhead measures attempt to apply a universal metric without accounting for the distinctiveness of different types of charitable organizations and how these differences may affect costs.

The nature of the charitable mission may affect overhead levels. In a study of the top 500 charities in the UK, Sargeant (2009) finds a direct relationship between a charity's overhead and the nature of the cause it supports. For instance, education charities have lower overhead ratios when compared to other subsectors, which is consistent with earlier studies that suggest overhead ratios vary by subsector (Sargeant, 2009: 338). Because it could be easier to raise funds for commonplace health causes like cancer or diabetes versus a cause like mental illness (which continues to suffer from stigmatization), overhead levels between such health causes can vary dramatically. Cancer and diabetes charities could have lower overheads, as donors give readily to these causes, whereas a mental illness charity has a high overhead rate because of the stigma and donors' reluctance to support the cause. Hence, the variation in overhead could have little to do with the effectiveness of the charities and much to do with the nature of the charitable cause itself.

In addition to systematic variations in efficiencies of US nonprofits by subsector, Hager (2001) reports these vary by organizational size and age. In particular, Hager reports that smaller organizations were the least efficient in their fundraising costs, likely because of their inability to take advantage of economies of scale, and that overhead costs increase with organizational age. A study by Abzug (2013) comparing five nonprofit subsectors found significant variations in financial and overhead reporting between subsectors, indicating that meaningful comparisons should be done within subsectors.

With findings that consistently reveal that overhead levels fluctuate according to a charity's mission, size, and age, a one-size-fits-all approach to discerning where donors should direct their dollars and the value of formal or informal regulation of overheads seems inappropriate.

Alternatives to Overhead Ratios

While the assumption behind the focus on overhead ratios is that lower overheads indicate more efficient and effective charities, the evidence indicates that this assertion is incorrect. Overhead ratios are flawed measures for donors who want to maximize the impact of their donations and do not facilitate valid comparisons across charities, and regulation of overhead restrictions is not successful, raising the question as to what alternatives exist to effectively promote and assess charity efficacy. Four options merit consideration.

The first is to encourage donors, foundations, governments, and the public to adjust their assumptions and expectations about overhead ratios. We need to ease, or eliminate, unrealistic pressures on charities to keep their overhead rates as low as possible and instead encourage or require organizations to be transparent about the real costs required to operate a successful nonprofit. Rather than starving charities with very low permissible overheads, funders, including foundations and governments, would agree to pay a fair level of overhead costs. In addition, sector advocates argue that a public-education initiative is required to alert current and prospective donors to the limitations of overhead ratios as a reliable means of judging charity effectiveness (Pallotta, 2012; Impact Coalition, 2013). Currently, only 5% of people strongly agree that charities are justified in spending a portion of received donations on fundraising to guarantee future income (Impact Coalition, 2013: 4). Interpreted another way, this may suggest that 95% of people would agree that charities should invest no funds in fundraising. A more realistic understanding of what it takes to run a nonprofit is a starting point for ending the starvation cycle. Given the importance of public-sector funding for Canadian charities, the government could play a catalytic role if it were to ease or eliminate current overhead restrictions, thereby sending a powerful message to the general public about the need to find alternative means by which to judge charities' efficacy.

The second option promotes better measurement of the impact of charities on their missions. "While [overhead] can tell us a lot about a charity's inputs and outputs, it does not tell us much about what the charity's impact is" (Impact Coalition, 2012: 16). In the absence of meaningful information on how donor dollars are translated into impact, overhead is often used as a default indicator. Hence, the best way to modify the focus on overhead is to assist charities in reporting on their outcomes and impacts, or mandate that they must. Interestingly, this recommendation could also have a positive impact on many charities' bottom-line incomes, as research has demonstrated that when donors are presented with information about both overheads and outcomes, donations are higher to those charities perceived as more effective in achieving their outcomes. In an experimental study conducted by Caviola (2014), participants were presented with two fictitious charities: Charity A had an overhead rate of 60% and saved five lives, while Charity B had an overhead of 5% and saved two lives. When the charities were considered individually, participants said they would prefer to donate to Charity B, likely because of its low overhead rate. However, when both charities were presented simultaneously, significantly more participants were willing to donate to Charity A over B, suggesting that impact (in this case lives saved) was more important to donors than the overhead rates (Caviola, 2014: 306). This suggests that the use of overhead ratios does not need to be completely eliminated; rather, they could provide complementary, more contextualized information for donors and for regulators. The challenge, of course, is to develop meaningful indicators of impact across diverse charities to facilitate meaningful comparisons. The measures also require a degree of parsimony – readily understood – to enable ease of use.

A third option is a somewhat indirect means of addressing the problematic nature of overhead regulations. It encourages the charitable sector to develop collective capacity to address government restrictions on administrative costs, particularly given the importance of governments in financing and regulating charities. Governments' role in financing the charitable sector translates into significant power, which could dissuade many individual charities from speaking out against regulations or against contract and contribution requirements for fear of losing their funding. Dan Pallotta (2012) goes further to argue that charities need a legal-defence fund to protect themselves against unjust government policies that inadvertently and negatively impact them, including fundraising and overhead restrictions. While the idea of a stronger voice for the charitable sector with government policy-makers has value, and while it may address the formal regulations placed on charity overheads, it does not alter the informal regulations placed on charities through public pressure and the demands of donors to keep costs as low as possible.

A fourth route is strengthening self-regulation of the sector as a means of improving organizational practices and enhancing public trust that charities are well run (Phillips, 2012; 2013). In a survey of US donors, 72% say they would have greater trust in a charity's fundraising if the charity was accountable to an independent regulatory body (Impact Coalition, 2012: 7). With the launch of Imagine Canada's Standards Program in 2012, Canada has built one of the most rigorous voluntary accreditation systems for charities and nonprofits of any country, aimed at improving credibility and donor confidence. The central imperatives are to ensure that boards of directors exercise their oversight responsibilities and promote transparency. Administrative and fundraising costs are addressed through the requirements that no more is to be spent on administration and fundraising than is required for effective management and resource development and that all costs related to fundraising are accurately disclosed. The Standards Program also puts an onus on boards of directors to approve budgets and ensure there are processes in place to monitor organizations' performances in relation to annual budgets; review actual revenues and expenses against budgets at least twice a year; and review the cost-effectiveness of fundraising activities. To date, about 250 charities and nonprofits – large and small, across a number of subsectors – have been accredited.

While government regulation plays an important role in fraud prevention and basic financial transparency to ensure that charitable resources are spent on charitable purposes, it does little to advance organizations' learning and self-improvement. Thus, self-regulation is a valuable complement that provides a second tier focused on good governance and operational controls; working together, governments and nonprofits can form a more productive system of co-regulation (Phillips, 2012: 816). To address both the formal restrictions imposed by legal and regulatory means and the informal regulations imposed by the public, a likely combination of all four alternatives will be required.

Conclusion

More than ever, in an uncertain and rapidly changing environment, charities and nonprofits need robust infrastructure: to make productive use of technology, to be adaptive in resource development, to conduct R&D for innovation, and to be competitive in attracting talent. The evidence demonstrates the negative consequences of focusing excessively on overhead ratios and shows how doing so contributes to a starvation cycle that suspends critical infrastructure and growth investments that could improve charities' ability to deliver on their missions. Instead, charities bow to demands to keep costs as low as possible. This creates an incentive to manipulate ratios or under- or misreport financials, making it difficult for donors to distinguish impactful organizations from merely frugal ones. Because of their focus on a narrow annual cycle, overhead ratios provide limited information about fundraising investments that may increase costs and overhead ratios in the short-term but improve charity effectiveness over the long-term.

Alternative methods hold promise, particularly options that focus on impact reporting and self- or co-regulation. Impact reporting could provide donors with better information for making decisions as to which charitable organizations to support, while self- or co-regulation could build the confidence of government and the public in the charitable sector's ability to be accountable and transparent. Nevertheless, these options may not be effective alone and must be accompanied by initiatives that seek to change the public discourse on charity overhead ratios, challenging their ability to serve as a proxy for effectiveness. Such initiatives should include an honest and transparent dialogue about the real costs required to run a successful charity and a movement to create and finance a sector voice that can advocate against nonsensical or damaging government regulations with impunity.

Future research on overhead needs to move beyond the popular attempt to define a causal relationship between overhead rates and donations, and instead focus on more meaningful study that helps charities, government, and the public find viable options to replace overhead as the stand-in measurement for effectiveness. One thing is for sure: charity overhead will likely remain an issue of significant discussion and debate with both donors and government in the near future.

References

Abzug, R. & Webb, N. (2013) De-standardizing financial ratios: Again, one size does not fit all. Presentation at the Association for Research in Nonprofit and Voluntary Action, Hartford, Connecticut.

Ayer, S.M., Hall, M.H., & Vodarek, L. (2009) Perspectives on fundraising: What charities report to the Canada Revenue Agency. Toronto: Imagine Canada.

Bekkers, R. & Wiepking, P. (2011) A literature review of empirical studies of philanthropy: Eight mechanisms that drive charitable giving. *Nonprofit and Voluntary Sector Quarterly*, 40, 924–973.

Bowman, W. (2006) Should donors care about overhead costs? Do they care? *Nonprofit and Voluntary Sector Quarterly*, 35(2), 288–310.

Breen, O. (2016) Minding the pennies: Global trends in the regulation of charitable fundraising. In T. Jung, S.D. Phillips, & J. Harrow (Eds.), *The Routledge Companion to Philanthropy.* London: Routledge.

Canada Revenue Agency. (2012) Fundraising by registered charities. Retrieved from http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/fndrsng-eng.html

Caviola, L., Faulmuller, N., Everett, J.A.C., Savulescu, J., & Kahane, G. (2014) The evaluability bias in charitable giving: Saving administration costs or savings lives? *Judgment and Decision Making,* 9(4), 303–315.

Coupet, J. & Berrett, J.L. (2019) Toward a valid approach to nonprofit efficiency measurement. *Nonprofit Management & Leadership*, 29(3), 299–320.

Gregory, A.G. & Howard, D. (2009) The nonprofit starvation cycle. *Stanford Social Innovation Review*, Fall, 49–53.

Hager, M., Pollak, T., & Rooney, P.M. (2001) Variations in overhead and fundraising efficiency measure: The influence of size, age and subsector [Presentation]. Annual Conference of the Association for Research on Nonprofit Organizations and Voluntary Action, Miami.

Hager, M.A., Pollak, T., Wing, K., & Rooney, P.M. (2004) *Getting what we pay for: Low overhead limits nonprofit effectiveness* (Nonprofit Overhead Cost Project, Brief No. 3). Washington, DC: Urban Institute.

Hall, M.H., Barr, C.W., Easwaramoorthy, M., Sokolowski, S.W., & Salamon, L.M. (2005) *The Canadian nonprofit and voluntary sector in comparative perspective.* Baltimore: John Hopkins University Center for Civil Society Studies.

Lecy, J.D. & Searing, E.A.M. (2015) Anatomy of the nonprofit starvation cycle: An analysis of falling overhead ratios in the nonprofit sector. *Nonprofit and Voluntary Sector Quarterly*, 44(3), 539–563.

McNabb, D.E. (2012) *Research methods in public administration and non-profit management: Quantitative and qualitative approaches* (3rd ed.). Armonk, New York: ME Sharpe.

Nonprofit Overhead Cost Project. (2004a) Getting what we pay for: Low overhead limits nonprofit effectiveness. Center on Nonprofits and Philanthropy, Urban Institute, Indiana University, Brief 3.

Nonprofit Overhead Cost Project. (2004b) Lessons for boards from the Nonprofit Overhead Cost Project. Center on Nonprofits and Philanthropy, Urban Institute, Indiana University.

Nonprofit Overhead Cost Project. (2004c) The quality of financial reporting by nonprofits: Findings and implications. Center on Nonprofits and Philanthropy, Urban Institute, Indiana University, Brief 4.

Okten, C. & Weisbrod, B. (2000) Determinant of donations in private nonprofit markets. *Journal of Public Economics,* 75, 255–272.

Pallotta, D. (2012) Charities must battle myths about overhead. *Chronicle of Philanthropy*, 24(7).

Phillips, S.D. (2012) Canadian leapfrog: From regulating charitable fundraising to co-regulating good governance. *Voluntas*, 23, 808–829.

Phillips, S.D. (2013) Shining a light on charities or looking in the wrong place? Regulation-by-transparency in Canada. *Voluntas,* 24(3), 881–905.

Sargeant, A. (2001) Using donor lifetime value to inform fundraising strategy. *Nonprofit Management & Leadership*, 12(1), 25–38.

Sargeant, A., Lee, S., & Jay, E. (2009) Communicating the “realities” of charity costs: An institute of fundraising initiative. *Nonprofit and Voluntary Quarterly*, 38(2), 333–342.

Schubert, P. & Boenigk, S. (2019) The nonprofit starvation cycle: Empirical evidence from a German context. *Nonprofit and Voluntary Sector Quarterly*, 48(3), 467–491.

Steinberg, R. (1994) Economics and philanthropy: A marriage of necessity for nonprofit organizations. *New Directions for Philanthropic Fundraising: Financial Practices for Effective Fundraising,* 3, 7–25.

Tinkelman, D. (2006) The decision-usefulness of nonprofit fundraising ratios: Some contrary evidence. *The Journal of Accounting, Auditing and Finance*, 21, 441–462.

Van Iwaarden, J., Van der Wiele, T., Williams., R., & Moxham, C. (2009) Charities: How important is performance to donors? *International Journal of Quality & Reliability Management*, 26(1), 5–22.

Wing, K., Hager, M., Rooney, P.M., & Pollak, T. (2005) Paying for not paying for overhead. *Foundation News & Commentary*, 202, 466–512.

Biography

Caroline Riseboro, Trillium Health Partners Foundation

Caroline Riseboro is an award-winning nonprofit executive who currently serves as president & CEO at the Foundation of Trillium Health Partners – one of Canada's leading hospitals. During her 20-year career, she has led some of the country's top charitable organizations, including as president & CEO of Plan International Canada, where she transformed the organization from the seventh- to second-largest charity in the country. Caroline's accomplishments have been widely recognized: in 2019, she was named Canada's Most Admired CEO, and in 2017 and 2018, she was recognized as one of Canada's Top 100 Most Powerful Women. Caroline's policy interests include strengthening the ability of charitable organizations to deliver increased impact for Canadian society.