

Smashing the Overhead Myth: A Step Forward

10.24.19 | Linda J. Rosenthal, JD



It was just ten years ago, in 2009, when [Bridgespan's](#) Ann Goggins Gregory and Don Howard published their groundbreaking article, *The Nonprofit Starvation Cycle*, in the Stanford Social Innovation Review. Their premise: it takes money to achieve charitable purposes; nonprofits must spend enough in overhead to avert being in constant financial straits.

And it was only 6-½ years ago when activist Dan Pallotta first railed against the demonization of overhead in his famous [TED talk](#). He explained that “... the way we think about charity is dead wrong.” Nonprofits, he said, are praised for “how little they spend – not for what they get done.”

Soon after Mr. Pallotta’s TED Talk went viral, the editors of The Nonprofit Quarterly posted a [landmark letter](#), *The Overhead Myth* (June 17, 2013), from GuideStar, Charity Navigator and the Wise Giving Alliance “calling for an end to the obsession many have had with nonprofit overhead costs as a proxy for measuring effectiveness....” They explained that “the percent of charity expenses that go to administrative and fundraising costs—commonly referred to as ‘overhead’—is a poor measure of a charity’s performance” and that more attention should be paid “to other factors of nonprofit performance: transparency, governance, leadership, and results.”

Progress Against the Overhead Myth

Foundations are entrenched in their thinking and practices; it’s not surprising there’s been resistance. More to the point, they want to give money for the exciting programs that have been pitched to them: not for equipment or staff salaries or keeping the lights on at the organization’s headquarters. And it gives them “the most direct control over the funds.” Similarly, major donors want their money used for high-profile projects. Fundraisers (whose success and professional advancement are judged by their ability to snag the big bucks) are eager to accommodate these wishes. As a result, many contributions come with restrictions including that no money go to “indirect costs.”

There's been progress in changing funder thinking and practices, but it's been in fits and starts. At the beginning of this year, we asked: [*Are Funders Ready to Throw the Overhead Myth Overboard?*](#) (January 16, 2019). Researchers found that some "sophisticated donors and visionary funders are responding to the reasoned arguments that nonprofits desperately need financial support for their day-to-day operations and the build-up of a long-range, sustainable, structure of talent and assets." But surveys continued to show that the funding of general operating expenses remains at just 20-25% of all foundation giving. "[The good news is that number is starting to rise.](#)"

By March, we were happy to report additional progress in [*Ford Foundation, Others, Move to General Operating Support*](#) (March 13, 2019). "Now, we see the beginnings of a more enlightened era: Thought leaders, nonprofit organizations, and funders and donors recognize that adequate spending on general operating expenses – including reasonable pay for nonprofit executives and workers – creates the solid structure on which a nonprofit can grow, thrive, and fulfill its charitable mission." We cited examples including the Ballmer Group, the Chicago Community Trust, the Cummings Foundation and the Sobrato Family Foundation.

We also reported that "[back] in 2016, The Ford Foundation embarked on an important experiment and change of direction" to "give \$1 billion to social justice nonprofits, with all funds going to a [combination of general operating support and organizational strengthening.](#)" After the first two years of its five-year test period, "Ford's [BUILD initiative](#) is hitting its stride and starting to see results." Observers including Aaron Dorfman, president of the National Committee for Responsive Philanthropy, commented that Ford's change of direction – away from its usual practice of giving "mostly small, short-term, project-based grants" could be "hugely important." He added: "[When Ford does things, people pay attention.](#)"

Big Move Away From The Overhead Myth

What perhaps only insiders have known – until a big announcement on September 4, 2019 – is that Darren Walker, head of the Ford Foundation, has been [working with four other leading American foundations since 2016](#) to study and develop a plan to change the focus of charitable funding for the future. The goal: to move away from the old thinking that furthered the Overhead Myth and to fund grantees out of The Starvation Cycle and toward long-term financial sustainability.

The group that met secretly for over two years includes: The Ford Foundation (Darren Walker); The Open Society Foundations (Patrick Gaspard); The John T. and Catherine MacArthur Foundation (Julia Stasch, who has recently retired); The Hewlett Foundation (Larry Kramer); and The Packard Foundation (Carol Larson). These five foundations "[hold combined assets of \\$45.8 billion, or 5.3 percent of the assets held by all of the more than 86,200 foundations in the United States.](#)"

According to Maria Di Mento, writing for The Chronicle of Philanthropy in [*Five CEOs of Wealthy Foundations Pledge to Do More to Help Charities Pay Overhead*](#) (September 4, 2019), all of the five had – "unlike many other foundations, which don't provide overhead subsidies" – previously funded operating costs of grantees "but realized it wasn't enough."

Characterizing it as "[an unusual move,](#)" Ms. Di Mento explained that these collaborators "were embarking on a major campaign to encourage all other grant makers to join them to [help cover](#)

essential operating costs.

According to Ford's Darren Walker, the five leaders first got together in the fall of 2016 and have continued meeting "both in person and on conference calls to weigh the strengths and weaknesses of their foundations' different approaches to supporting grantees' administrative, overhead, and project costs." They learned that "many of the organizations they supported – including ... household-name organizations – face major deficits because of stingy policies that provide just a sliver of the money they need to operate and run projects."

Findings and New Directions

As part of the first phase, the CEOs selected Bridgespan – (of the original "Starvation Cycle" fame) – for consulting help and advice precisely because that organization "had been studying the persistent under funding of grantees for at least a decade." What has emerged so far is not a one-size-fits-all solution. There has been no consensus on a "common approach to helping nonprofits shoulder their overhead costs," according to Bridgespan partner, Michael Etzel. "The result was a menu of six grant-making approaches designed to be adaptable" to a variety of ways that funders and organizations can "work together yet provide enough standardization that the process will be transparent."

Conclusion

In later posts, we'll explore these six different approaches and how this important collaborative venture moves forward.

There is cautious optimism in the philanthropy community; it's "fundamentally good news that some of America's most powerful grant makers are focusing on fixing the problem of underfunding nonprofit overhead."

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