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# **STANFORD** SOCIAL INNOVATION *review*

## **Upfront**

### **Overhead Isn't Everything**

**How donors should think about nonprofit efficiency**

By Alana Conner Snibbe

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Stanford Social Innovation Review  
518 Memorial Way, Stanford, CA 94305-5015  
Ph: 650-725-5399. Fax: 650-723-0516  
Email: [info@ssireview.com](mailto:info@ssireview.com), [www.ssireview.com](http://www.ssireview.com)

# Overhead Isn't Everything

## *How donors should think about nonprofit efficiency*

Nonprofits that are linked to shady dealings often seem to have high overhead costs. For example, the veterans' assistance organization VietNow was spending only 3 percent of its revenue on programs in 2000 when its for-profit fundraiser, Telemarketing Associates, was charged with misleading the public about how much of their donations actually went to VietNow. And the James Beard Foundation was spending only \$29,000 of its \$4.7 million annual income on scholarships, the organization's primary mission, when its president was caught stealing thousands of dollars from the foundation.

Given high overhead's unsavory associations, should donors pay closer attention to it? Yes, but not the kind of attention they pay now, says Woods Bowman, a professor of public services management at DePaul University. In his study, published in the June 2006 issue of *Nonprofit and Voluntary Sector Quarterly*, Bowman recommends that donors pay less attention to the absolute ratio of overhead spending, and more attention to how that ratio changes over time.

Bowman suggests that donors first understand that overhead represents the price of giving to an organization. To buy \$1 worth of program, he explains, a donor has to give more than \$1 to cover the organization's administration and fundraising costs. The higher the overhead ratio – that is, the sum of the fundraising and administrative costs, divided by total revenue – the higher the price of giving.

"But like any price," Bowman points out, "you can't say a particular overhead ratio is high or low by itself," because different programs and fundraising tactics are more or less expensive to administer and support. Just as you shouldn't compare the price of water to the price of diamonds, he states, neither should you

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compare the overhead ratios of different organizations. Instead, you should compare an organization with itself over time, making sure that its overhead ratio goes down or, at least, does not go up.

Donors sometimes do this, Bowman's research shows. For three years, he tracked the charitable contributions of over 20,000 federal employees in the Chicago area. The employees made their donations through the Combined Federal Campaign (CFC), which allows federal employees to donate some of their paychecks to up to five local, national, and international charities.

The CFC lists 1,500 eligible chari-

ties in a donor guide that also gives additional information about each organization, including its overhead ratio.

Bowman found that when organizations' overhead

ratios fell, donors made more contributions to them. But this effect was very small, "and collectively other factors are much more important," he wrote.

Some foundations, nonprofits, and charity watchdog groups continue to tout overhead ratios as solid, stand-alone indicators of how efficient organizations are. Others handle the ratios with more caution. "Using overhead ratios as a sole benchmark can lead you to a false positive," says Bennett Weiner, chief operating officer of the Better Business Bureau Wise Giving Alliance. "A charity may have financial circumstances that look very good, but may have problems in governance and other areas." For this reason, Weiner suggests that donors should consider many different indicators in addition to overhead ratios before choosing which charity to support.

Bowman, in contrast, argues that the public should not use static overhead ratios at all. He notes that what was wrong with the Beard Foundation, VietNow, and others of their stripe was not their high overhead ratios, but their dishonest treatment of donors.

There are plenty of effective, efficient, and legitimate organizations that must spend more money on fundraising and administrative costs because they are new, have expensive programs (such as international services), or address unpopular causes. He concludes, "As a measure, the overhead ratio has intuitive appeal, but the more you look at it, the less appealing it really is." –A.C.S.