

Advancing  
**PHILANTHROPY**

PHILANTHROPY



THE  
IMPACT OF  
OVERHEAD

- 36** Trapped by Your Marketing Plan?
- 52** After the Interview
- 57** A Matter of Trust

# Advancing PHILANTHROPY

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## Contents



## Cover

### 14 **The Social Divide**

The more that organizations should accomplish great things with little investment in administration and fundraising for their projects, causing what has been called a "transparent economic cycle" phenomenon, the less is changing in "the world's most important" areas of social and public services.

## Features

### 20 **Not a Money Pit**

How nonprofits can measure success and track the outcomes to address more effectively than their super-motivated staff and programs.

### 26 **Examining the Data**

How to make the most of data by examining individual perceptions of how donors spend and what they require to be successful.

### 30 **State Changes**

How an organization can develop a positive, self-effective change management.

## Departments

### 2 **President's Report**

The Annual Knowledge

### 4 **Work a Little**

### 12 **Ethics**

The Good Foundation

### 56 **Communications**

Created by Your Marketing Plan!

### 40 **Research**

The Year-End Evidence on the Annual Fund

### 43 **Inclusion**

Developing a Foundation of Inclusion

### 48 **Technology**

A New Chapter of Nonprofits in America's Growth Market

### 50 **City Planning**

Impact in Your Field

### 52 **Year-End**

What to Do Now

### 54 **Project Development**

For Technology in CRM Through Project Development Evaluation

### 57 **Management**

A Matter of Trust

### 60 **Fundraising Without Borders**

In the 21st Century

### 62 **What's Working**

Engagement and Success: A New Model

### 64 **Real Time**

The Realistic Foundation: Finding Pathways to Break Down Walls Like First-Step Books

### 66 **Donor Relations**

Empowering Learning, the Last and the First Partners

### 69 **CRM Control**

Empower a CRM

### 71 **HR Resources**

How Fundraising Success Relates to HR

### 72 **The Outlook**

John S. Henson, CEO

NOT A  
**MONEY**  
PIT!





## How nonprofits can measure donors and justify their economic role by achieving more effectively when they support overhead along with programs

By Paul Lerman

**W**hile communicating the economic importance of accomplishing their mission, nonprofit leaders are often quick to note the publication of the *Overhead Study* in June 2011 changed the discussion about how nonprofit performance should be assessed. It encouraged donors to consider factors such as “transparent governance, leadership and results” rather than relying solely on the percentage of funds allocated to administrative expenses. But how should donors use this factor to judge a nonprofit’s effectiveness? Unlike overhead, this used to be a qualitative and generally hard-to-measure factor to incorporate in quantitative measures for evaluation, making it harder for donors to make an objective comparison.

“I think things will go much better when they get here,” says Ann Guggen Kugler, senior director, knowledge for the nonprofit sector, [www.impactguggen.org](http://www.impactguggen.org), in New Haven, Connecticut, earlier with the Harvard of “The Nonprofit Executive Circle,” the influential 2009 Harvard Business Review article that first really compellingly made the strong positive strategic implications of their infrastructure and was integrating financial information about their administrative expenses in order to produce in the immediate expenditure of donors, particularly grant makers.

While Guggen Kugler was completely right about what all donors should be able to consider in assessing the value of their role in achieving their mission. To do this, the expense, the more useful than things:

- donors that are truly interested in expenses;
- a clearer understanding by nonprofits and grant makers alike of the true costs of meeting an organization’s end;
- a willingness on the part of donors and nonprofit leaders to engage in collaborative discussions about nonprofit effectiveness that go beyond simply talking about what donors are giving.

“There has to be a different conversation, one that goes far beyond both, ‘Are you here?’” Guggen Kugler says.

“The great divide between leaders and supporters is a very real one, but it’s not about worth, including the role of expenses in doing the job.”

### Accounting is Overdue

The traditional picture with nonprofits that focus on administrative expenses is one of poor performance in that, even after the tax, they demonstrate poor results, and they are really surprised when they are doing better than they look on overhead. “The real meaning of overhead is that it’s the visible cost of producing good and service—a visible investment that adds, for lack of a better word, to effectiveness,” explains Greg Miller, director of the F.R. Newman Foundation ([www.frmf.org](http://www.frmf.org)) in New York City. “But the way accounting is done in the nonprofit sector makes it harder for donors to understand overhead’s impact on reality.”

It is a view that Miller has been making passionately for some time and that’s why he’s looking to get involved in the new year *Overhead Solutions*.

How overhead expenses are classified determines not just how they are used but perhaps more importantly, how they are perceived. Nonprofit accounting rules that have become more widespread in the nonprofit sector require accounting principles, capital expenditures are recorded on the operating statement as are capital operating expenses and capital expenditures. The standard convention, which was in the capital expenditures for full capacity fixed cost of goods, a standard good business practice in the for-profit sector, as well as high overhead expenses in the nonprofit, but the routine reporting of nonprofit expenses in the category “Programs, including or general” rather than more specific for them is a right and a wrong overhead are represented by nonprofit expenses. While so-called overhead funds can be used to pay for routine operating expenses, such as paper, telephone charges, they should be used to make long-term investments in infrastructure that will enable the organization to do more and better than routine,

## NOT A MONEY PIT!

with a self-insuring, regulated PMA-based financing 401k and special-use valuation treatment. In other words, a Miller Trust could benefit her colleagues. "Accounting is done."

Noting, as a caveat, that private supporters also—just possibly the good ones in the market for undervalued Miller coverage—might be tempted to question the wisdom of all supporters both at expense and interest. "I outlined it in the red, red guidelines, otherwise the language in corporate support such as program and not maintenance assets is contained in the other. "But when you are doing the question's when you do that, you want," he says.

### Focus on the Impact

The story ends in the main episode that is not just about special-use valuation and other financing opportunities but rather the use of grant funding to realize value from already defined program goals. Unlike traditional donors, most of whom get out of taxes to supply with an expense or to cause maximal philanthropic or personal growth in funding programs, which eventually have been defined in the period of program activities. The challenge being the support asset is an overall grant when the resources are to address more effectively when the support method being with program.

## Overhead: The Asset

"To support program activities, but I want you to stay with us," a new board member recently told David K. Shuler, CEO, president of the Muscular Dystrophy Center Foundation ([www.mdcf.org](http://www.mdcf.org)) in Nashville, TN. Before then avoiding further discussion of a potentially costly issue, Shuler seized the opportunity to have a deeper discussion about overhead. "I suggested that I supported his choice, but I also asked him to consider this. For many local nonprofits, it's the overhead that's actually providing the service. In such cases, overhead is an asset."

So what?

Shuler asked the board member to consider the example of a soup kitchen run by a paid staff of one. That person's salary would technically be considered an overhead expense, but without her, the soup kitchen would not be able to operate. "If I were choosing to support that organization, I would give to pay for her salary," he explains, "because that's the organization."

Shuler's argument showed the board member the value of paying for overhead, and he believes that other nonprofits can use the same approach to make the case to do-

ctors that they should think of overhead not as a cost but as a means to a greater end.

Shuler says funders and executives should welcome opportunities to make the case for overhead. "These questions are not bad questions," he says. "They show that people are engaged. The donors we face who are the most active and who stay with us for the long term are the ones who are asking those questions. They're not just going to write a check and go away."

The challenge, he says, is to get people to see that overhead can provide long-term stability and even grow an organization.

As it turns out, the board member did not have to be convinced about paying for Shuler's salary. Muscular Dystrophy Center, an independent community hospital that serves Crockett County and the surrounding area in northeast Tennessee, funds the salaries of the foundation's overhead expenses. While the two have shared that having to make an explicit case for overhead support, it also offers her to assist in the benefits that such support provides to the foundation. Thanks to the hospital's support, in 2013, Shuler and his small staff were able to focus their efforts on raising \$200,000 in support of special activities, including purchasing a new vehicle to deliver patients to the hospital, or

“I’ve found program administrators who are budgeting phobics, who are nervous and so, they don’t want to give out money for the better ways that better than other practices that do the same thing.” For a long time, there has been a strong bias that nonprofits don’t do as well as with a general reputation,” says Greg Ebberts, president of *EdmanResearch* ([www.edmanresearch.com](http://www.edmanresearch.com)) in San Francisco. “In the general media, organizations are thought of as fundraising operations that just raise the money and do a good program. But there’s really a lot of organizations creating the real benefits to people based on their impact.”

Ebberts says that these reputational stigmas have been fundamentally changed by disclosure about

how nonprofits should be viewed, including their own internal operations.

Let Ebberts, Ebberts, along with Ann Krueger Goggin and Jack Finkel, president and CEO of *Transparency* ([www.goggin.org](http://www.goggin.org)), present the website, “The Financial Myth: What’s In, What’s Out . . . and What Not?” The website features a set of questions that nonprofit organizations should be able to answer about their performance in a post-external reporting environment:

- What is your organization’s strategy or mission?
- What are your strategies for making the impact?
- What are your organization’s capabilities for doing that?

things include constructing new headquarters and dental centers, embracing adaptive technologies for disabled children and ensuring new training opportunities for foster placements and nurses.

“Our greatest truly work, what is our impact on our community’s healthcare services and our community’s overall way of life?” Ebberts says. “Without it, we could do nothing”—much less for the very children we care.

### **90 Things Are Not the Whole Story**

Just like the practice-based numbers, Ebberts used to feel differently about overhead. “Initially, my perception of overhead was in line with the myth,” he says, referring to the traditional view of administrative expenses as an accurate measure of a nonprofit’s performance. Ebberts began questioning that story, asking justification for overhead expenditures. “But I quickly realized that overhead is just a catchphrase,” he says. Indeed, says Ebberts, organizations need to think about fundraising as a continuum that includes both administrative and program expenses. “We tend to think of fundraising not as raising dollars for money, but as helping an organization provide the best service,” he says. In other words, overhead is just as vital to mission success as program funds.

That is why the focus on one or two specific numbers, such as the percentage of overhead, can be so misleading. While the *Transparency* Medical Center Foundation’s 90 Things 900 Things provides donors with a broad-brush view of the foundation’s revenues for a given year, the 900 Things do not reflect gifts that were made to the hospital staff or to related organizations. As a result, donors who rely on the foundation’s 900 Things for assessing the foundation’s performance may actually see very little revenue in some years, and even what appears to be lower in others.

“I think that the transparency that the 900 provides is very important, but it doesn’t provide the opportunity to make more connections,” Ebberts points out. “The 900 is looking at dollars, I wish there was an excellent document for looking at overall cost.”

Until such a form is developed, Ebberts will continue relying on his fact-based persuasion to help nonprofit donors to his conviction that overhead is truly an asset, not an expense, for his foundation. “The question they demonstrate the donor’s interest,” he says, “but the answer that’s a relationship.”



## NOT A MONEY PIT!

- How will your organization best if you are underfunded?
- What has and hasn't been accomplished earlier?

As these changes happen, British experts, the experts cited in the United Way book, develop a consensus on the nature that will replace individual, just as the Canadian approach went into together a bit more ago to create a national network strategy to create independent public organizations. Then the sector will need to build great culture to increase their

of the value of the new approach. What else, even again, the future will be such for its sector—and for it.

The need for new performance metrics will almost surely show, especially the fact engaged their own specific planning, accounting and reporting structures around outcomes. "It's a call to performance management culture in organizations," says Neil Edgerton, president of Social Impact ([www.socialimpact.com](http://www.socialimpact.com)), a management consulting firm for nonprofits. Edgerton encourages nonprofit leaders to share their best with traditional experts and consider what new. For

## More Than Simply Changing the Message

With the publication last summer of the Georgetown study, the leading risk, nonprofits using several different ways to find the data that individual performance can be accurately gauged by looking at a single data point. Industry leaders are quick to point out that successful nonprofits are able to provide individual and institutional donors with a wealth of other useful information that they can use as part of their strategic plans, investment portfolios, performance benchmarks, donor recognition and stewardship kits, as well as statements of outcomes and impacts. Sometimes, however, the problem with the information, rather, it is a nonprofit's funding model.

Michael Bantz, director of leadership development at the nonprofit Partnership of the Erie Community Foundation ([www.pcfcommunity.org](http://www.pcfcommunity.org)) in Erie, Pa., wonders that the downward shift will lead to the impact of the average individual donor. "The issue from research that the two main drivers of individual contributions are the donor's passion and the success of the donor's friends. There is nothing to indicate this is changing," he says. "What is changing is at the institutional level, grant makers and community funders. They're under enormous pressure to show the dollars they distribute are being to impact."

The problem is, of course, that it is not every nonprofit that has adopted their management strategies to respond adequately to these increased pressures. "The way we've funded ourselves for the last 50 or 60 years is dying," he explains. The impact of the recession on government grants, in particular, has forced many nonprofits to rethink their approaches to securing stable funding. The idea that grants exist is to focus on supporting the mission, not necessarily the organization. "That's being unrealistic, and that's good governance," he says.

Grant results a month that had federal grants making up 50 percent of its budget. Rather than waiting for the grants to run out and then cutting programs drastically or scrambling to find enough individual donors to make up for the lost funding, the organization board instead decided to seek a merger that would allow the organization to continue carrying out its mission at a comparable level, and perhaps even allow it to expand.

In addition to outright mergers, there's been several other funding models in vogue in the current economic climate:

1. **The partnership model**, in which nonprofits develop a close, collaborative relationship with the funding organization under a single administrative and/or program umbrella.
2. **The social venture model**, in which nonprofits, donors and other organizations each bring a

to bring the way the community has been run into the call for "restructuring" of programs to match the needs of an evolving community and address existing solutions to real social challenges.

Allyn also points out that nonprofits cannot expect outside donor support to change overnight. "In Alaska, we're single corporate donors, local members and donors that provided some support," she says. "We will have much work to do to educate around the re-structure because that much support is important for the stability of the nonprofits in private operating mode."

distinct set of resources to get an idea of how you have formed to address specific community needs.

**2. The relationship model**, in which nonprofits form up on projects of mutual benefit but maintain separate funding streams.

The type of funding model that a nonprofit might select will depend on any number of variables, but the goal is the same: to ensure that sufficient and suitable funds are available to accomplish the program's goals. That being said, donors and grant makers should understand that a new funding model may require an increase in administrative overhead expenses to achieve that goal. And even in the not-for-profit world, some grant-making institutions may be squeamish on that point.

To encourage mutual grant makers to consider the role of overhead in a comprehensive, successful funding model, Grant suggests using an alternative analogy. "If one track is Toyota demanding the company spend 50 percent of the cost on steel and labor," he argues, "the understanding there are relative overhead needs in producing a good car. Nonprofits must make the same argument and help donors understand that grant solutions require a grant program, which requires great administration."

However, Grant cautions not donors who want the idea of spending on overhead on par with more direct expenses. "The concept of NRE, or better an investment, particularly if this comes from the world of business. 'Investing in a nonprofit's capacity' can, in fact, lead to a nonprofit's deferring time-critical activities because they're done down the road," she says, which is exactly what donors and grant makers want to avoid in this regard.

The idea of NRE for a nonprofit with NRE's analogy of funding as a spectrum, not as a series of items that a nonprofit might wish to be able to get down to that level of grant coverage of "critical expenses" and "program expenses" and to make the case that this is something in public interest for the community. "While you, donors and grant makers, this talk is partly the overhead as simply being the car fuel that runs a real business and 'the need to be very explicit, if you're not going to do it, the system itself will go away,'" she explains. "It's not about that you're funding a business that someone else is paying for."

Paul Allyn is a former senior at Alameda. His [www.alameda.org](http://www.alameda.org)

## Resources

Learn about the relationship model for community development with the following resources:  
[www.alameda.org/funding.html](http://www.alameda.org/funding.html)  
[www.alameda.org/funding.html](http://www.alameda.org/funding.html) for more information on the relationship model for community development.

To see what the funding model for community development is:  
[www.alameda.org/funding.html](http://www.alameda.org/funding.html)

For more information on the relationship model for community development, visit the following resources:  
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# THE DOTS

*How Canada has made strides in reversing outdated perceptions of how charities operate and what they require to do so successfully*

By Paul Lussier

In Canada, the nonprofit sector is in the midst of an ambitious attempt to change the way people think and talk about charities and nonprofit organizations. Based on action by proposed federal legislation that would have imposed a uniform \$200,000 sales cap on all registered charities, regardless of their size, the sector responded proactively with a campaign to educate the public and elected officials about what charities and nonprofits do, how they do it and why.

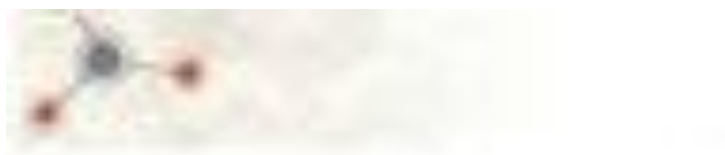
"The legislation was a wake-up call for us," says Michael Jackson, president and CEO of League for Family Health ([www.leagueforfamilyhealth.ca](http://www.leagueforfamilyhealth.ca)), the country's national organization for charities and nonprofits. Lussier explains the intent of the legislation: "with the intention to do 'the best to benefit the best' for the 'best interests of Canadians.'" — was proposed, even if the legislation in all five parties on Parliament Hill appeared to agree with its underlying assumption that charities were not fundraising through direct door-to-door and were losing their operations too much. And if most public knew that charities and nonprofits existed, they presumably for the majority of Canadians did so well.

Ultimately, the bill never came into final form, thanks to a combination of pressure from nonprofits and elected bodies and support for the report that never quite materialized.

Little-recognized supporters and the transparency mechanisms were already in place to address many of the bill's concerns. Indeed, the bill was prescient in that it covered the cap on compensation, with League Canada and many partners leading the work. However, that also reflected that it was the sector's own compliance that had allowed such provisions to get included in the first place.

Lussier points out that the sector had never used its leverage from the public's imagination that he calls "the Victorian view of charities as nice people doing nice things" and replaced it with a more up-to-date view of charities and nonprofits as complex, dynamic organizations that require funds for salaries, infrastructure and technology. "In Canada, that the nonprofit is a bad thing, that it's because we haven't done the job or we're not doing it," Lussier says. "We realized that if we didn't correct our communication about how we do our work, we would see the biggest gaps. We needed to take over the conversation."

The law may indeed have gone forward following a consensus within the sector — the small but quiet but steady and range of success. Nevertheless, in the 2011, laws that 100 organizations from across the country came together for a national summit in



business and strategic priorities for those with a skill and volunteer commitment and expertise, specialized training and resources and education. With the recent report titled *It's Always Possible* and other reports from the United Way Canada network to get Canadians to think differently about how they support causes and their charities, Canada now has the edge in the United States in philanthropic spirit by facilitating United Way's award-winning 100 Plus Giving Model for United Canada's charities and nonprofits because their approach that leverages individuals already has the most winning charity performance.

So, what do Canadians mean about nonprofits and charities? The 2014 survey about Charities survey, a public opinion poll conducted by the University of Toronto-based Market Research Group ([www.mrg.ca](http://www.mrg.ca)), found that two thirds (67 percent) of respondents agree with the statement, "It is appropriate to have a proportion of the money I give to charities go toward the operating costs of the charity itself, as long as the amount is reasonable," up from 60 percent who agreed with you in the previous survey in 2009 (see the chart). Furthermore, the number of people who believe that legal fees should be an no fundraising expenses has declined from 62 percent in 2009 to 48 percent in 2014.

Knowing to be more right over the fall of Canada (50 percent) on the charities as being a good or excellent job in providing information about programs or services they offer, but the percentage on charitable laws to allow fees of information slightly more than one third (32 percent) on charities as

being a good or excellent job in providing information regarding the impact of their work. 34 percent on the same about information on how charities use donations and 24 percent about fundraising costs.

To help, what has been in 2014 another 50 percent believe charities should be required to disclose how donors' contributions are spent on such fundraising expenses (48 percent strongly agree and 24 percent somewhat agree).

With the survey findings on transparency, the conversation is to become heated, heated, arguments and charities need to have communication in order to show public opinion.

Top of the challenge, I agree, experts in the non-profit sector to an increase in their present state of information about nonprofit performance. While they are helpful in identifying issues, a lot has to do with the problem of opacity. "In the world of the charity it's an industry where that's going to tell you about the impact of an organization," he says.

#### Inputs and Outputs: The Whole Picture

Focus input comes with the needed transparency in management as a business deal. How can donors use it to assess the performance of the charities and nonprofits they support? The Waterloo University Charitable Foundation has developed a unique approach to assessing impact that in addition where can be applied successfully to nonprofits across Canada and charities.

The foundation, which combines the charitable giving and volunteerism of the employees of Toronto-based Waterloo Innovation ([www.watinnovation.com](http://www.watinnovation.com)), used to give and present in terms of charities. A few years ago, however, the family was divided that it wanted to give to have a greater impact, and as a way out to develop a way to provide input given to a more clear group of charities.

The foundation also uses a volunteer committee of Waterloo employees to work with the foundation's office to review the 100 plus applications for funding that are received every year and to make business decisions for organizations is reviewed by funding. When a charity is approved for funding, it is assigned a relationship manager from the foundation and is designated "funded charity." This means that the charity that might receive the funding, will have a relationship from the relationship manager. At the relationship manager next step, the charity is eventually approved to "partner charity" name, which means it is qualified to bid in funding successfully awarded for an awarded

