The Civil Society War and the Popularization of the Fundraising Efficiency Ratio

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Quick Overview

Fundraising – Competition – Regulation

Community Chest (known today as the United Way) confronts leading voluntary health agencies (VHAs)

Opposing views on fundraising

Mean and nasty tactics

Legal activity

Lasting legacy

Value Proposition of Federated Drives

Community Chests and Councils

Community Chest does fundraising

Councils independent, assess social needs

Chest cost effectively funds needs Council identifies

Councils cannot fund themselves

Councils disappear no later than 1960s

Community Chest Goals

Monopolize workplace giving

Dominate social service giving

Dominate health advocacy giving

Allocate giving for social services & health advocacy

Agencies Supported by Community Chest

Boy Scouts and Girl Scouts

YMCA and YWCA

Boys and Girls Clubs

Salvation Army

How big were the organizations?

Estimated donations received, 1924-1948 (millions)

Community Chest	$2,332.1	7.10%
American Red Cross	$1,317.4	4.01%
United Jewish Appeal	$ 506.3	1.54%
American Lung Association	$ 197.8	0.60%
March of Dimes	$ 97.7	0.30%

Jenkins, E. C. (1950). *Philanthropy in America; an introduction to the practices and prospects of organizations supported by gifts and endowments, 1924-1948*. New York, Association Press.

What was the 7 Agencies Committee?

Largest Voluntary Health Agencies

- National organizations with many affiliates
- Need to inform and encourage affiliates to follow policy

Met ~bimonthly from 1948-1973+

Explicit purpose: stay out of federated fundraising

Counter adverse publicity

Members (current names):

American Cancer Society

American Heart Association

American Lung Association

Easter Seals

March of Dimes

Muscular Dystrophy Association

National Multiple Sclerosis Society

Why Maintain Independence?

- Entering federated drives resulted in reduced
  - Volunteers
  - Fundraising income
  - Public awareness of cause
- Brand building
  - Educate public about disease
  - Associate their organization with that disease
- Fundamentally Different Models for Raising Money
  - National organization funded through local efforts
  - Voluntary approach rather than workplace giving
  - Control over budget
  - Patient welfare & vagaries of disease incidence
  - Donors have a right to know to whom they donate

VHAs were serious about independence

- Returned money or checks that were accepted from federated drives by affiliates
- Progressive discipline for noncompliant affiliates
  - Personnel changes
  - Financial penalties
  - Disaffiliation and replacement

Pressuring VHAs to Join

Polite invitation to local drive

Invitation pressure at national level

Shut out of local media

Shut out of Main St. Business

Shut out of manufacturers

"Too many drives"

Public threats to agencies

Too Many Drives?

Slogan used to promote federated drives

Raise concern of excessive charitable solicitation

- Potential donors forced to say “no”
- Underline burnout of campaign volunteers

Only appears in 1920s and late 1940s-early 1950s

Coincident with growth spurts for Community Chest

“I gave at the office”

Dirty Tricks

Specify disease support in drive, not naming agency

Misinform donors about agencies in drive

Fund direct competitors

Create competing organizations

United Health Fund for disease (1963)

Promote rules conducive to their business model

Denial of permits

Charity rating manipulations

Competition Sponsored Nationally by Community Chest

March of Dimes

Easter Seals

American Cancer Society

Sister Elizabeth Kenny Foundation

3 Agencies for the Crippled or Handicapped

2 Agencies for Cancer

National Guidance from United Way

1949 *See that the community has a good solicitation ordinance as a protection against 'charity rackets' and that it is properly administered.*

1962 *Draw up and publicize a statement of approved and unapproved money-raising methods and a list of minimum standards for the conduct of benefits.*

Continue efforts to solve the problem of multiple health appeals and health program inefficiency caused by national policies against participation in United fundraising.

Why regulate fundraising?

Political concern: inform public about wrongdoers

Donor protection: competition and deception

Protect charities: fraudulent fundraisers

Protect charitable beneficiaries: advocacy

Maintain public trust

Retain assets in state

Revenue generation: fees from permits

>>>Promote a specific business model

From Irvin, R. A. (2005). "State Regulation of Nonprofit Organizations: Accountability Regardless of Outcome." Nonprofit and Voluntary Sector Quarterly **34**(2): 161-178.

Local Rules for Fundraising

- Delegation of home rule by states spurs regulation
  - Thousands of municipalities develop rules
- Permitting, registration, and fees
  - Restriction on solicitation methods
  - Limit fundraising expense as % of projected funds raised
  - Financial reports required
- United Way often named
  - Exempt from rules
  - Arbiter of permit disputes
- Differential enforcement

Emerging Problems with Local Rules

- Different permitting and reporting requirements between municipalities
  - Los Angeles County with 30 municipalities and 30 different fundraising permitting rules
  - Large organizations object to the level of detail required to file in many municipalities
- Different municipal and agency boundaries
  - Agencies consolidating to regional or state level
  - Desire regulations to do the same

Increase in Legal Restrictions

Local Solicitation Ordinances

- Thousands of Municipalities in Many States
- Some States Fully Delegate
- Rules Evolve with Court Decisions

State

- 12 States with Solicitation Laws in 1947
- 20 States with Solicitation Laws in 1957
- 31 States with Solicitation Laws in 1967
- 40 States with Solicitation Laws in 1977

Federal Proposals Never Get Traction

Legal Action

1937 Elkhorn, WI denies permit to March of Dimes

1950 Dayton, OH denies permit to Am. Cancer Soc.

1962 Park Ridge, IL: Am. Heart Assoc. sues, overturn 1928 law exempting United Way

1965 Elkhorn, WI denies permit to Am. Cancer Soc. and all other permit applicants

1967 Hamblen, TN denies all permits except United Way, sued by United Cerebral Palsy

1969 Fort Worth, TX denies permit to March of Dimes for excessive fundraising expenses

Content of State Laws

Typical requirements

- Registration/Permit
- Pay Fee or Post Bond
- Annual Report Submitted
- Written Contract with Professional Fund Raisers
- Authorization to Use Donor Identity in Promotions
- Records Available for Inspection

Professional Fundraisers Restricted More

VHAs banded together to draft model law

Calculating Fundraising Efficiency Ratio

$$\frac{\text{cost of funds raised}}{\text{funds raised}}$$

Permitting: prospective estimate

Rating: retrospective actual

Problems with Efficiency Ratio

Reflects average fundraising cost information

Overlooks critical cost variations:

- initiating new efforts
- marginal costs & unfunded programs
- fixed vs. variable cost projects
- different levels of competition
- different dependence on donations as % total income
- idiosyncratic events
- new donor acquisition vs. existing donor retention
- popular vs. unpopular causes
- young vs. mature charities

Problems promoted by Efficiency Ratio

Use low/unpaid fundraising personnel

Reduced risk-taking in solicitation & programming

Reduced acquisition of new donors

Leaving untapped money out of charity (Pallotta)

No focus on results, just internal management

Not effective at eliminating fraud

Misleading fundraising appeals & financial reporting

Steinberg, R. (1991) The economics of fundraising, in D. Burlingame and M. Hulse (eds) *Taking fund raising seriously*, San Francisco, CA: Jossey-Bass.

Steinberg, R., & Morris, D. (2010). Ratio discrimination in charity fundraising: The inappropriate use of cost ratios has harmful side-effects. *Voluntary Sector Review, 1*(1), 77-95.

Good Things Emerging from this Dispute

- Uniform accounting standards for charities
  - Spurred by Hamlin Commission report, published 1961
    - 3rd time Rockefeller Foundation pursued health agencies
  - National Health Council issues in 1964
    - 7 Agencies instrumental in the development
  - Adopted in 1963 by Multiple Sclerosis and Am. Lung
  - Other 7 Agencies Committee members follow by 1966
- Restriction on use of celebrity names in fundraising
- Protection of agency names and marks
  - Names, logos, taglines cannot be too close to other orgs

Other Uses of Financial Efficiency Ratios

Beyond ordinances and state laws

Embedded in rating agency calculations

Better Business Bureau closely connected to Community Chest

Complaints of BBB unfavorably manipulating reviews

Change reported financial figures of select VHAs

BBB Wise Giving Alliance | GuideStar | Charity Navigator

THE OVERHEAD MYTH

To the Donors of America:

We write to correct a misconception about what matters when deciding which charity to support.

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.

We ask you to pay attention to other factors of nonprofit performance: transparency, governance, leadership, and results. For years, each of our organizations has been working to increase the depth and breadth of the information we provide to donors in these areas so as to provide a much fuller picture of a charity's performance.

That is not to say that overhead has no role in ensuring charity accountability. At the extremes the overhead ratio can offer insight: it can be a valid data point for rooting out fraud and poor financial management. In most cases, however, focusing on overhead without considering other critical dimensions of a charity's financial and organizational performance does more damage than good.

In fact, many charities should spend more on overhead. Overhead costs include important investments charities make to improve their work: investments in training, planning, evaluation, and internal systems—as well as their efforts to raise money so they can operate their programs. These expenses allow a charity to sustain itself (the way a family has to pay the electric bill) or to improve itself (the way a family might invest in college tuition).

When we focus solely or predominantly on overhead, we can create what the *Stanford Social Innovation Review* has called "The Nonprofit Starvation Cycle." We starve charities of the freedom they need to best serve the people and communities they are trying to serve.

If you don't believe us—America's three leading sources of information about charities, each used by millions of donors every year—see the back of this letter for research from other experts including Indiana University, the Urban Institute, the Bridgespan Group, and others that proves the point.

So when you are making your charitable giving decisions, please consider the whole picture. The people and communities served by charities don't need low overhead, they need high performance.

Thank you,

Art Taylor
President & CEO,
BBB Wise Giving Alliance
overheadmyth.give.org

Jacob Harold
President & CEO,
GuideStar
overheadmyth.guidestar.org

Ken Berger
President & CEO,
Charity Navigator
www.charitynavigator.org/thebestandworstwaytopickacharity

Research shows that the overhead ratio is imprecise and inaccurate:

37%

37 percent of nonprofit organizations with private contributions of $50,000 or more reported no fundraising or special event costs on their 2000 Internal Revenue Service (IRS) Form 990

13%

Nearly 13 percent of operating public charities reported spending nothing for management and general expenses.

(The Nonprofit Overhead Cost Study)

75-85%

Further scrutiny found that 75 percent to 85 percent of these organizations were incorrectly reporting the costs associated with grants.

But still, Americans over-emphasize the number and prioritize it over demonstrated success:

62%

62% of all Americans believe the typical charity spends more than it should on overhead.

(Giving Evidence)

A 2001 survey found that OVER HALF OF ADULT AMERICANS FELT THAT NONPROFIT ORGANIZATIONS SHOULD HAVE OVERHEAD RATES OF 20 PERCENT OR LESS; NEARLY FOUR IN FIVE FELT THAT OVERHEAD SHOULD BE HELD AT LESS THAN 30 PERCENT. In fact, those surveyed ranked overhead ratio and financial transparency to be more important attributes in determining their willingness to give to an organization than the demonstrated success of the organization's programs. *(BBB Wise Giving Alliance)*

The "Overhead Myth" persists despite evidence that investments in overhead facilitate better nonprofit performance:

"ORGANIZATIONS THAT BUILD

robust infrastructure—which includes sturdy information technology systems, financial systems, skills training, fundraising processes, and other essential overhead—are more likely to succeed than those that do not."

(The Nonprofit Starvation Cycle)

2,000

2006 CompassPoint Nonprofit Services study of nearly 2,000 nonprofit executives in eight metropolitan areas reveals that receiving general operating support played a major role in reducing burnout and stress among executive directors.

(Daring to Lead 2006: A National Study of Nonprofit Executive Leadership)

11.5% VS 10.8%

In 2011, the charities which GiveWell reviewed and recommended had higher overhead than the charities they review and didn't recommend, 11.5 percent versus 10.8 percent.

(Giving Evidence)

Underinvesting in overhead creates a range of negative outcomes which undermine quality and sustainability:

Description of Underinvestment	Consequences
• Limited/no staff for administrative roles (e.g. finance, development, operations)	• Limited ability for organization to manage/monitor finance, development, etc.
• Limited investment in staff training and development	• Increased turnover among staff, particularly those looking for ongoing professional development • Limited ability to continually enhance skills of employees • Difficulty building senior team from within
• Inexperienced staff for administrative roles	• High turnover • Poor work quality
• Poor IT infrastructure	• System crashes, downtime • Loss of data/information, limited information sharing
• Poor donation management systems	• Inability to track donors and fundraising progress • Limited ability to target fundraising
• Poor performance management systems	• Limited ability to track beneficiary outcomes, particularly across sites • Limited ability to easily generate reports for grantmakers

Source: Mark A. Hager, Thomas Pollak, Kennard Wing, and Patrick M. Rooney, "Getting What We Pay For: Low Overhead Limits Nonprofit Effectiveness," Nonprofit Overhead Cost Project of the Center on Nonprofits and Philanthropy at the Urban Institute and the Center on Philanthropy at Indiana University, August 2004; case study interviews.

Primary Sources:

The Nonprofit Starvation Cycle
Stanford Social Innovation Review, Fall 2009

Getting What We Pay For: Low Overhead Limits Nonprofit Effectiveness
Center on Nonprofits and Philanthropy, Urban institute Center on Philanthropy, Indiana University

What We Know About Overhead Costs in the Nonprofit Sector
Center on Nonprofits and Philanthropy, Urban institute Center on Philanthropy, Indiana University

Nonprofit Overhead Costs: Breaking the Vicious Cycle of Misleading Reporting, Unrealistic Expectations, and Pressure to Conform
The Bridgespan Group, April 2008

Where'd My Money Go? Americans Perceptions of the Financial Efficiency of Nonprofit Organizations
GreyMatter Research, 2008

Good Charities Spend More on Administration than Less Good Charities Spend
Giving Evidence, May 2013

Management and General Expenses: The Other Half of Overhead
The Nonprofit Quarterly, Spring 2003

The Worst Way to Judge a Charity
Los Angeles Times, April 2012

Ratio Discrimination in Charity Fundraising: The Inappropriate Use of Cost Ratios Has Harmful Side-Effects**
Voluntary Sector Review, March 2010 **Behind pay wall

Logical extreme of financial manipulation

Fundraising is program, so $0 fundraising expense

- Federated fundraisers
- Community Foundations
- Commercially affiliated donor advised funds
- Health advocacy organizations
- Scholarship providers
- Gifts-in-kind procurement specialists

Separates resource procurement and operations

Leaves operational organizations vulnerable

Critical management decisions for charities

Cost of capital

Regulatory compliance creating usable information

Multipurpose efforts: public education & fundraising

Continually adding new donors