



# Countering the Overhead Myth through Evaluation

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Successful nonprofits need sustainable scalability to produce greater impact. Strategic spending in areas deemed “overhead” is critical in accomplishing this growth, but presents several challenges to organizational leadership. “Overhead” seems to be the proverbial dirty word within the nonprofit arena. But why?

The turn of the century saw the advent of the “Overhead Myth” defined as “the false conception that financial ratios are the sole indicator of nonprofit performance.”<sup>1</sup> The notion of evaluating nonprofits and charities based primarily on the amount of money spent on fixed overhead expenses compared to money spent directly on programming to facilitate change has some merit and makes sense. However, void of additional context and evaluation metrics, it is an extremely limited indicator and one that can easily inhibit growth by prohibiting organizations from spending strategically in areas that produce more effective results. Frugality is worshipped and viewed as morality in the development and aid sector whereas risk and growth are worshipped in for-profit businesses.

The Overhead Myth has largely been disproven, but the consequences and liability of limited nonprofit overhead has not been adequately remedied. **The main problem with the overhead myth is that it fails to factor efficiency and impact when comparing overhead.** A small stagnant organization with very restricted overhead appears superior and more reputable than an organization spending far more on development and infrastructure that is accomplishing infinitely more good.

To that end, there is a very different set of standards governing businesses and nonprofits – even while businesses are becoming more socially minded and nonprofits are becoming more businesslike. There are still plenty of strategies applauded on Wall Street that are incredibly frowned upon in the nonprofit sector. **This double standard was born out of the desire to increase accountability, but in reality, often leads to conservative stagnation in services provided.** Author and AIDS Ride Founder Dan Pallotta proclaimed that,

*“The nonprofit sector is starved for growth, risk, and idea capital.”<sup>2</sup>*

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<sup>1</sup> Source: <http://overheadmyth.com/>

<sup>2</sup> Source: [https://www.ted.com/talks/dan\\_pallotta\\_the\\_way\\_we\\_think\\_about\\_charity\\_is\\_dead\\_wrong?language=enft-545825](https://www.ted.com/talks/dan_pallotta_the_way_we_think_about_charity_is_dead_wrong?language=enft-545825)

Social problems that are massive in scale will require more robust for-profit type strategies and growth to translate to the nonprofit sector.

The largest obstacle to overcoming the myth of overhead is that donors inherently view money spent on overhead (staff, M&E systems, donor campaigns, marketing, etc.) as being in direct conflict to the change work being done – ie. money spent on overhead *should* be money spent on directly impacting beneficiaries. As a result, this view stunts the nonprofit’s growth in order to appease donors and grant standards.

Growth is required to address the major problems nonprofits and NGOs seek to alleviate globally and locally. The myth of overhead kills much of the innovation that will be required to end homelessness, hunger, illiteracy, and all other social problems nonprofits are fighting by prohibiting failure.

## How Do We Counter the Overhead Myth?

One of the most effective ways of countering the Overhead Myth is through the use of evaluation to quantify results, both successes and failures. **The nonprofit watchdogs (BBB Wise Giving Alliance, GuideStar, and Charity Navigator) that monitor organizational transparency and accountability have called to move toward an “Overhead Solution.”** Rather than limit the work of nonprofits, they

implore stakeholders to view overhead as the driver for growth in development work. Evaluation should play a crucial role in leveraging overhead solutions by maintaining accountability while also establishing an infrastructure for growth that preserves

Charity Navigator reported that total giving as a percentage of GDP has hovered around 2% from 1977 through 2017.<sup>3</sup> This stagnation indicates that nonprofits have struggled to increase their share in the marketplace. Furthermore, nonprofits are growing at drastically reduced rates compared to for-profits. A Bridgespan study revealed less than 150 nonprofits<sup>4</sup> have gone from founding to \$50 million in revenue within 40 years, while thousands upon thousands of businesses have done so. Such scaling is impossible without an increased understanding of how things are working and not working and the ability to strategically invest in the people and processes to better understand impact.

## Conclusion

Nonprofits are becoming more and more similar to for-profit businesses, but numerous pronounced differences still remain. There will always need to be measures in place to hold nonprofit organizations accountable for how they spend money. However, the idea that *money spent on overhead expenses is in direct opposition to money spent addressing the cause* is not only wrong, but

<sup>3</sup> Source: <https://www.charitynavigator.org/index.cfm?bay=content.view&cpid=42>

<sup>4</sup> Source: [https://ssir.org/articles/entry/how\\_nonprofits\\_get\\_really\\_big](https://ssir.org/articles/entry/how_nonprofits_get_really_big)

also quite harmful. Overhead expenses used efficiently and effectively can drive solutions to great humanitarian problems rather than inhibit them. Evaluation allows the impact of overhead expenditures to be more accurately understood and quantified. Metrics can show what is working and signify progress towards short- and long-term goals. Both failure and successes can help nonprofits learn and create the infrastructure and management to create greater change. Deciding how, when, and where to invest in evaluation capacity can be a daunting task, but it does not need to be -- nor will it happen overnight. M&E coaching and consulting can be a great starting point to determine initial steps to promote sustainable growth and build capacity in this critical area.



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