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Foundations Show Signs of Moving Beyond 'Overhead Myth'

By Drew Lindsay

Last year, several local foundations gave Atlanta Celebrates Photography a most unusual three-year grant. It was for $160,000, roughly half the small nonprofit's annual budget, and it came without strings.

In the grant's first year, the group used the money for less-than-glamorous essentials. It upgraded its computers, hired a part-time administrative assistant, and sent staff to training. It also worked with consultants to build a strategy for fiscal stability through expanded corporate support, foundation giving, and earned-income revenue.

Foundations typically don't pay for overhead costs, but two other Atlanta arts organizations received similar grants, part of a pilot by the Metropolitan Atlanta Arts Fund. Small as it is, the effort is one of several across the country that may signal a shift in the long, heated debate about overhead.

Nonprofits and charity experts say they are seeing changes in the attitudes of grant makers, with some foundations increasingly providing general operating grants — the type of flexible funding that charities seek most — and increasing funds targeted directly toward administrative expenses. At the same time, foundations and charities are working together to explore new grant-making practices that invest in the long-term financial health of nonprofits.

'Culture Work'

Many of the efforts to craft new financing approaches are young and have not yet produced dramatic change. "It's culture work, and culture change isn't easy," says Delia Coleman, vice president for strategy and policy at Forefront, an association of Illinois nonprofits, grant makers, public agencies, and related groups.

General operating support has nudged up only slightly in the past decade, according to a Foundation Center analysis of data from 2013, the latest year available. Yet advocates are cautiously optimistic that these new efforts will accelerate and encourage others to tackle the question: Just how much does it cost to do good?

"I do get a sense of movement among foundation leaders," says Antony Bugg-Levine, head of the Nonprofit Finance Fund. "It's starting to pick up momentum."

Individual donors and the general public continue to see overhead costs as the best measure of whether a nonprofit is doing its job, Mr. Bugg-Levine says. California lawmakers, for example, recently considered a measure that would require nonprofits to prominently display their administrative costs on websites and fundraising material.

Still, GuideStar CEO Jacob Harold points to a "profound shift in the conversation" among top leaders in the nonprofit community. He also sees a consensus among the chiefs of large foundations that "we need to care about results, and we need to care about an organization's health."

Hopeful Signs

Advocates note encouraging signs across the country:

- Grant makers such as the Weingart and James Irvine foundations in California, the Chicago Community Trust, and the Citi Foundation have increased general operating support. Ripples are still being felt from the Ford Foundation's decision last year to increase general operating support to 40 percent of its grant-making budget.
- Grantmakers in the Arts, a national network of private foundations and government agencies, has run more than two dozen workshops as part of an effort to persuade its 300 members to help grantees build financial strength. This effort, called the National Capitalization Project, marks the first time the association has made formal recommendations to its members, according to its president Janet Brown.
- In California, three grant-making associations with more than 600 members have come together under the umbrella Real Cost Project to develop new grant-making practices that identify and fund what nonprofits need to succeed in their mission. The California Wellness Foundation, for instance, is now funding some grantees' cash reserves as "a signal that we're invested in their long-term sustainability," says Fatima Angeles, the foundation's vice president of programs.

At the same time, California's state's association of nonprofits is campaigning to encourage members to negotiate with foundations and government agencies for "indirect," or administrative, costs.

- In Illinois, Forefront (formerly Donors Forum) is leading a similar education campaign among its members. It aims to train 50 or more charities this year to develop budget documents that reflect the full cost of their work. It also is lobbying to persuade at least six foundations to revamp their grant-making practices.
- Nonprofit consultancy the Bridgespan Group, whose 2009 research famously dubbed the nonprofit-financing system the "starvation cycle," will issue a study this week urging the development of benchmarks for indirect costs by type of nonprofit — measures that could guide foundations and organizations as they negotiate grants.

Jeri Eckhart Queenan, one of the report's authors, says the research reflects "a need to shift from talking about the problems to finding solutions."

Weakness Exposed

A number of events inspired these new efforts to move beyond the "overhead myth." Grant makers say they were moved to act after the Great Recession exposed financial weaknesses in many nonprofits. A 2009 survey of small nonprofits nationally showed that nearly a third did not have enough cash to cover more than a month's operations.

Another catalyst was a White House Office of Management and Budget decision in late 2014 to require states and localities to pay part of the indirect costs of federal grants that they pass through to nonprofits. In that decision, the federal government — the country's largest grant maker — effectively acknowledged the obligation to pay costs beyond direct programming. "That gave us a window in," says Nancy Berlin, policy director with CalNonprofits, the state association of nonprofits.

About the same time, GuideStar, Charity Navigator, and BBB Wise Giving Alliance published an open letter to nonprofits. They urged groups to identify their "true costs" and educate donors, foundations, and others about the "real cost of results."

Last year's decision by Ford, one of the country's most influential private foundations, perhaps did the most to change attitudes. "I think when we look back, we'll see that as a watershed event," says Heather Peeler, a vice president with Grantmakers for Effective Organizations.

At the start of this year, Ford doubled to 20 percent the proportion of each program grant earmarked for overhead.

Tricky Partnerships

California is home to much of the movement on "true costs." Through the Real Cost Project, foundations and nonprofits there are working together, whether in groups or one to one, to align grants with expenses.

Christina Garcia, a senior program officer at the James Irvine Foundation, describes a recent meeting with the chief financial officer for a grant applicant. Ms. Garcia asked questions about the program's full costs to make sure they were covered. The CFO "was speechless," she recalls. "She said, 'No funder has ever asked me this.' "

Don Howard, Irvine's president, says all his program officers are pursuing such conversations, often with good results. "Nonprofits are getting savvier about how to run their business, and they're better equipped to understand cost structure," says Mr. Howard, a co-author of the "Starvation Cycle" paper.

Grantor-grantee partnerships on costs are often tricky to negotiate, however. Traditionally, few nonprofits enjoy an open, candid relationship with grant makers, observers say. Because foundations hold the purse strings and the power, grant applicants often present a false front of financial strength and exclude administrative cost from funding requests.

Ford President Darren Walker, in a November 2015 letter announcing the foundation's boost in its coverage of administrative costs, said all of philanthropy is complicit "in this charade," with grant makers knowingly underfunding programs. He urged "more honest dialogue" about operating costs.

To spur such discussion, the Weingart Foundation and the California Community Foundation are funding a pilot project in which a dozen charities are analyzing their finances with consultants to determine the full cost of their programs. The foundations are also organizing sessions in which grant makers and the pilot groups discuss nonprofit needs.

Those conversations have put the two sides on common ground, says Fred Ali, Weingart's president, but frank, open dialogue will take time. "It's a process of building trust," he says. "Often nonprofits are afraid to say to a funder, 'We have limited cash on hand. We really don't have operating reserves.' "

CalNonprofits, meanwhile, is leading workshops and webinars to help charities calculate their overhead and develop the confidence to negotiate for full costs.

Ultimately, nonprofits are the key to finding solutions, says Ms. Angeles of the California Wellness Foundation, which is helping to fund the CalNonprofits effort. "Why should philanthropy always lead?" she says. "Nonprofits ought to lead this work. They're the ones doing the work. They know how much things cost."

How to Budget for Profit

Grantmakers in the Arts is leading the only nationwide effort aimed at revamping grant-making practices. It initially ran its Capitalization Project training only for its members but last year launched a new series for grantees.

Ms. Brown, the association's president, says arts organizations accustomed to operating on the margins or in debt often don't easily embrace the goal of building a budget surplus or healthy cash reserves.

"They need to budget for profit," she says. "You can't fund your way out of debt if you don't change the business model that got you there to begin with."

The Metropolitan Atlanta Arts Fund, which is part of the Community Foundation for Greater Atlanta, began its work to promote a "balance-sheet culture" in 2013. It was spurred to action by a survey of 40 small and mid-sized arts organizations, 78 percent of which reported having less than three months' worth of operating liquidity. "We knew that this was a financially fragile sector, but we didn't understand how fragile it was," says Lisa Cremin, the arts fund's director.

Atlanta Celebrates Photography and the two other grant winners received $540,000, money they are using to increase liquidity, beef up reserves, and test new revenue models. Each is also working with a consultant to study its business model and create long-range spending and revenue projections.

Atlanta Celebrates Photography is particularly interested in expanding its earned-income revenue. All its programs are free, but using the grant money, it's planning to put on an admission-fee event this fall featuring a marquee name in photography who might attract a broad audience.

The investment represents a risk for an organization that’s never run a major ticketed event. But with the grant as a safety net, failure is not as scary a prospect as it is for the traditional shoestring nonprofit, says Amy Miller, the photography group’s executive director.

"If we don’t hit our projections, that’s OK," she says. "And that’s a new feeling. We can just go back and figure out what should change."