Effective Economic Decision-making by Nonprofit Organizations

Dennis R. Young, editor;

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Excerpt from Chapter 5, "Fundraising Costs," by Joseph J. Cordes and Patrick M. Rooney

Regardless of whether one believes that reported fundraising expenses provide a complete picture of the resources that are devoted to fundraising by individual organizations, there is general agreement that it would be in the public interest to limit certain forms of "wasteful" expenditures on fundraising. Does increased competition among nonprofits for donations cause more resources to be invested in fundraising, resources that could instead be used to meet the needs of service recipients? What role, if any, should the government play in regulating the fundraising practices of individual nonprofits?

Competition, Coordination and the Social Return to Fundraising

From the perspective of the community, the question is not only whether fundraising activities are productive for individual nonprofits, but also whether total giving increases by more than the extra resources devoted to seeking donations. If it does, then increased spending on fundraising prompted by competition can actually have the beneficial effect of increasing the net amount of resources available for meeting social needs.

It is an open question, however, whether greater competition for donations among nonprofits significantly increases the amount of total giving or instead causes a largely fixed pool of charitable dollars to be redistributed among existing organizations. In the latter case, competition for dollars may create strong incentives for nonprofits to make expenditures for fundraising that, while rational for any individual organization, are wasteful in the aggregate.

Umbrella campaigns, such as the United Way, have traditionally been one means of reducing wasteful competition among nonprofits. But in many large urban areas, pressures to allow greater donor choice have had the effect of reviving such competition. Although it may be desirable in principle to reduce incentives for organizations to engage in socially wasteful competition, it is more challenging in practice to develop either new social institutions, or policies that limit such spending.

The social welfare aspects of fundraising are ultimately an empirical question, but one that has not received adequate attention. *Giving USA 2001,* the most recent iteration of the AAFRC Trust for Philanthropy's annual compendium of giving in the United States, estimates that giving in the United States totaled over $200 billion in 2000—more than doubling since 1990.

Yet, by several measures, relative giving has not increased in a meaningful way. First, total giving as a percentage of Gross Domestic Product (GDP) has hovered around two percent, but it has not exceeded 2.1% since 1970. Second, personal giving as a percentage of personal income has ranged between 1.6% and 1.9% since 1970. Third, corporate giving as a percentage of corporate pretax income has gone from as a low as 0.7% to as high as 2.1% since 1970, but it has been more than 1.6% only three times in the last thirty years.

The observed growth in absolute, but not in relative giving has taken place in the context of a rapidly growing number of nonprofits (67% increase in the past decade according to *Giving USA 2001*) and the growth in the development field as a profession (there are currently more than 25,000 members in AFP). Future research should address some possible explanations for these trends.

Perhaps increases in (relative) giving lag behind increases in investments in fundraising (see Schervish and Haven 2000). It may also be that part of the observed growth in professional fundraising staffs reflects a shift from unpaid volunteers to paid fundraising staff, as more women (who in the past formed the core of unpaid fundraising efforts) entered into the paid labor force (Duronio and Tempel 1997). Similarly, examining simple time trends does not tell much about what would have happened to relative giving if nonprofits had failed to increase investment in paid professionals.

The Role of Standards and Disclosure

Increasing the public accountability of nonprofit organizations for their fundraising practices might be seen as one way of limiting certain forms of socially inefficient fundraising activity. Both government regulators and private nonprofit watchdogs have called for greater disclosure, both of fundraising costs and fundraising practices. In the context of nonprofit organization management, the quest to improve uniformity of reporting by nonprofit organizations dates back to work conducted by Levis and New (1981), Greenfield (1996 and 1998), and Rooney (1999).

Within the accounting profession, new guidelines have been gradually adopted for nonprofit organization reporting (Financial Accounting Standards Board 1993). The allocation of joint costs for activities such as mailings that include both fundraising and program components have been addressed in several official publications (AICPA SOP 87-2 and SOP 98-2). However, the Form 990 instructions do not specifically require compliance with these standards. A useful question to consider is whether these guidelines result in consistent reporting on both financial statements and on the Form I990.

Another contentious issue is whether or not there should be one number for fundraising efficiency that is used as a benchmark nationally, or benchmarks that differ by subsector or by even more gradations (e.g., by subsector and size). Practitioners and scholars disagree on this point.

Some point out that such comparisons are difficult to make even among similar nonprofit organizations. It may be difficult, for example, to compare fundraising expenses among different types of theaters, not to mention the arts more generally, or the nonprofit sector as a whole. Other skeptics maintain that the cost of fundraising is a number without much meaning, and suggest that organizations be evaluated based on mission fulfillment.

Those who support making reasonable efforts to measure and report indexes of fundraising efficiency counter that the public and policy makers, especially corporation leaders, expect items to be quantified. Thus, it is in the interest of the nonprofit sector to devise measures of fundraising expense and fundraising efficiency that use consistent methodology, and that make an effort to address at least some of the main criticisms levied against reported financial ratios.

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Please contact the National Center on Nonprofit Enterprise at 703-993-4994 or ncne@nationalcne.org

Mailing Address:
3401 North Fairfax Drive, MS 3B1
Arlington, VA 22201
Fax: (703) 993-8215