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Overhead aversion: Do some types of overhead matter more than others?

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ABSTRACT

Overhead aversion is an issue of great importance to nonprofit organizations. On one hand, overhead (non-program expenses) is vital to the operational abilities of a nonprofit; on the other hand, there is evidence that donors dislike paying for overhead costs. In this paper, we use an experiment to study overhead from the perspective of donors. First, we replicate the prior finding establishing the existence of overhead aversion. Then we obtain new results by extending this line of research, examining whether donors have an aversion to specific types of overhead (specifically, salaries and fundraising). Our results suggest that donor behavior may be dependent on their outside option. If an overhead-free donation is readily available, then the average donor in our experiment (70–80% of subjects) prefers that charity to receive the donation. However, if donations are not overhead-free, most (approximately two-thirds of subjects) prefer the donation go toward fundraising efforts instead of salary-related expenditures.

1. Introduction

Various factors, such as rebate or matching programs (e.g., Eckel and Grossman, 2003) and third-party ratings (e.g., Yörük, 2016; Brown et al., 2017), have been shown to affect charitable giving decisions. A more recent literature argues that a charity's overhead expenditures can also play a prominent role in the donation decision. Specifically, some donors experience "overhead aversion" - a negative feeling donors have toward a charity's overhead costs.[1] This feeling could come from several sources (e.g., believing that only money going "directly to the cause" has an impact (Duncan, 2004), or that overhead spending is wasteful or inefficient), but the effect is the same – charities with higher overhead are less appealing to donors than those with lower overhead.

In this paper, we contribute to the growing literature on overhead aversion (Bowman, 2006; Meer, 2014; Caviola et al., 2014; Gneezy et al., 2014, hereafter GKG[2]). We make use of a series of experiments to determine whether specific types of overhead (specifically, salaries and fundraising) influence donations. This is, to our knowledge, the first experimental study to examine attitudes toward specific overhead costs. Our results suggest that donor behavior may be dependent on their outside option. If an overhead-free donation is readily available, then the average donor in our experiment prefers to direct a donation to that charity. This result and its strength are consistent, regardless of the overhead level (20% or 50%) and overhead type (general overhead, fundraising, and salaries). However, if donations are not overhead-free, they would prefer the donation go toward fundraising efforts rather than salary-related expenditures.

Related literature has argued that potential donors pay close attention to expenditure ratios as a means of inferring important information like how efficient a charity is (e.g., Frumkin and Kim, 2001; Caviola et al., 2014). Empirically, GKG (2014) demonstrated through a series of experiments that donation allocations decrease when overhead expenses (fundraising and administrative) increase, but this effect disappears when a third party covers overhead expenses. Caviola et al. (2014) have shown that there is a strong tendency to give money to charities with low overhead ratios, when such ratios are used as an evaluation tool.[3] Similarly, Bowman (2006) finds negative associations between positive changes in overhead ratios and the number of contributing donors (and the amounts contributed). In contrast,

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[1] In our study, we define "overhead" costs as all non-program expenses, including both fundraising and administrative costs. A non-exhaustive list of overhead costs would include in-house and third-party fundraising, salaries, training, rent, and insurance.

[2] GKG demonstrated experimentally that donations decrease when overhead expenses increase. We base our design off theirs while altering their instructions to make explicit to our subjects that the overhead costs are those of the charity, not of the experimenters.

[3] Caviola et al. (2014) also suggest alternative evaluating criteria such as the number of saved lives per dollar. However, they also make the argument that criteria like overhead ratios can be easily computed and compared across charities, which largely explains their popularity. Karlan and Woods (2017) also suggest that other measures of "effectiveness" could provide better information and persuade donors differently. Nevertheless, these measures are not always easily developed.

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Frumkin and Kim (2001) find no evidence that suggests that charities who spend less in the administrative category fared any better in the market for contributions than those who spend more. Meer (2014), using data from DonorsChoose.org (a platform that makes overhead expenditures salient to donors), finds that higher overhead costs decrease the likelihood that a program receives funding. Most of the literature, therefore, seems to suggest that the average donor wants her donation to be spent mostly (if not only) on program-related expenses. However, it is clear that nonprofit organizations must spend some resources maintaining their infrastructure to deliver their charitable services.

Survey evidence reports that the most commonly-researched information about charities by prospective donors relates to how their donation is going to be used (Hope Consulting, 2010).[4] The growth of charity watchdogs such as Charity Navigator further suggest donors do try to educate themselves before donating.[5] While the expenditure ratios may not be the best metric to make a donation decision (Rose-Ackerman, 1982; Steinberg 1986, 1989), they are easy to compute and comprehend (Tinkelman and Donabedian, 2007; Caviola et al., 2014). Therefore, we believe our results can inform nonprofit managers' decisions on how to appeal to donors and structure their organizational costs. GKG found that having seed donors pay for overhead costs is a successful fundraising tactic.[6] In practice, these seed funds are likely limited and unable to cover *all* of a charity's overhead expenditures. Our results suggest that donors are less willing to have their donation used for salary expenditures. Therefore, this (stronger) aversion to salary expenditures suggests those limited funds may be better targeted to cover a specific type of overhead, like salaries, and assuring donors that their donation would not be used for those purposes. This approach might be more feasible than finding donors to cover *all* overhead expenditures, and would help nonprofits raise funds from the general public and deliver services to their intended beneficiaries. Alternatively, our results also provide a first step to discovering whether certain overhead categories are more important than others to prospective donors, and how different overhead categories affect the donation decision. Knowing this information can help nonprofit managers to know what categories of overhead expenditures may need to be monitored closely to better appeal to donors and avoid drops in donations.

2. Methodology

In this section, we provide an overview of our experimental designs. To study the impact of overhead on donation decisions we run two experiments summarized in Table 1. Similar to GKG, our first design (the *"Across Charity"* experiment) asks subjects to choose one of two charities as the recipient of a $100 donation. We vary the level of overhead associated with donations to the treated charity between 0% (baseline), 20%, and 50%, while fixing the other charity's overhead at 0% across treatments. This implies that for a $100 donation (if the treated charity is selected), either $100, $80, or $50 goes to the treated charity's program expenses, and the remainder to that charity's overhead. We then extend GKG by attempting to identify whether *specific* types of overhead (salaries and fundraising expenses) have different effects on subjects' decisions, relative to both the (i) "fixed" charity, and (ii) "general overhead" (which includes both salaries and fundraising expenses).[7]

Table 1
Experimental designs and treatments.

"Across Charity" Design[1]	
Treatment	Description
Zero (baseline)	0% of the donation to T×V is allocated to overhead
50GEN	50% of the donation to T×V is allocated to General Overhead
50FUND	50% of the donation to T×V is allocated to Fundraising Expenses
50SAL	50% of the donation to T×V is allocated to Salary Expenses
20GEN	20% of the donation to T×V is allocated to General Overhead
20FUND	20% of the donation to T×V is allocated to Fundraising Expenses
20SAL	20% of the donation to T×V is allocated to Salary Expenses
"Within Charity" Design[2]	
Treatment	Description
20%	20% of the donation is allocated to a specific type of overhead by the donor
50%	50% of the donation is allocated to a specific type of overhead by the donor

[1] *CW is always the alternative in every treatment above. No overhead is associated with CW.*
[2] *We compare these decisions to a conjectural even split.*

Our treated charity is *Truth x Vision* (T×V), and our charity with zero overhead is *charity: water* (CW). These organizations were chosen because of their similar missions; they both aim to help communities in developing nations gain access to safe drinking water.[8] CW is well-known in the nonprofit community for their 100% donation policy. A sister organization, The Well, is funded by private donors and pays for all of CW's overhead costs. This allows CW to advertise to the public that 100% of public donations go entirely to programs, and enables us to truthfully inform subjects that this is how the donation would be used if CW was chosen.[9]

T×V agreed to partner with us and allocate any donations received as a result of this experiment as specified in our treatments.[10] This agreement allowed us to vary the level and type of overhead across treatments, without deceiving our subjects. Thus, if T×V was chosen to receive the donation, our agreement with T×V enabled us to earmark *our donations* and direct portions of that donation to specific expense categories.[11] A note indicating how the donation was to be allocated

[4] Hope Consulting (2010) reports that roughly a third of donors do research before giving. The report further states that "For better or for worse, Overhead Ratio is the #1 piece of information donors are looking for."

[5] For instance, in self-reported numbers (https://www.slideshare.net/CharityNav/charity-navigator-financial-measures-and-beyond, accessed June 1, 2017), Charity Navigator states they had 18,259 unique website visitors when it first launched its website in 2002. By 2005, the number of unique website visitors had grown to 1.2 million and in 2006, the number of unique visitors more than doubled to over 2.7 million. Currently, Charity Navigator advertises they have over 10 million annual visitors.

[6] GKG proposed convincing some donors to cover overhead costs, then advertise (to other donors) donations that are overhead-free. If different types of overhead have differing appeal to donors, this type of seed money could be used strategically.

[7] Treatment names refer to the overhead of the treated charity.

[8] For more information, visit www.truthxvision.org and www.charitywater.org.

[9] On their website, CW state "Private donors cover our operating costs so 100% of your donation will bring clean water to people in need." They further add that "[CW] depend on private donors, foundations and sponsors to cover everything from staff salaries to basic office systems to office rent and supplies. These donors are some of our most dedicated: their investment fuels our long-term mission, our ability to scale as an organization and our mission to continue using 100% of public donations for water projects." They also provide an auditor's validation of the 100% model. While the structure of CW and The Well was not mentioned to subjects, they could verify CW's overhead costs upon request.

[10] In Appendix B, we have provided the letter given to us the T×V's founder where he confirms his intent to allocate donations as specified.

[11] We did not (and cannot) change the way the charities allocate their spending, so we cannot change their underlying overhead ratios. Instead, subjects in the treatments with overhead were told that a portion of *our donation* was going to an overhead cost. Gneezy et al. (2014) found that, as the overhead of their variable charity increased, the proportion of subjects who chose their fixed zero-overhead charity increased. However, when their subjects were told a third party would cover the overhead costs, the proportion of subjects who chose their variable charity increased to the point it was not significantly different from the results of their zero overhead treatment. This result suggests that people do not care about the underlying overhead ratio of a charity. Rather, people care about the percentage of *their* donation that goes to overhead costs.