Rating Charity Overhead Rates:

The Limitation of Overhead to Determine Charity Performance

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Introduction

There are very few subjects related to philanthropic giving that generate as much contention as charity overhead. Donors' scrutiny of charity overhead stems from the desire to maximize the amount of their donation directed towards the cause rather than it being spent to cover operating or fundraising costs. Charities, in contrast, see overhead costs as critical expenses necessary to generate future income, pay qualified staff and ensure the future sustainability of their organizations. In defining charity overhead, "[it] can be thought of as the amount of total receipts spent on administration and fundraising, in contrast to the amount spent delivering services (Hager 2001)."

Low charity overhead is often interpreted as a proxy for effectiveness and efficiency, and those charities with lower overhead rates are perceived as being better positioned to achieve their mission. As Caviola explains, "The overhead ratio might appear important to many because it can seem to measure the efficiency of the organization: how much of my money will actually reach the destination (2014, 304)?" The notion of limiting or capping a charitable organizations' overhead has been adopted by government regulators as a means of promoting charity effectiveness. As an example, the Canadian Revenue Agency (CRA) in their issuance of fundraising guidance for registered charities contends that while they recognize the necessity of incurring fundraising expenses, it expects charities to conduct all fundraising within acceptable legal parameters. Those legal parameters include fundraising overhead rates no higher than 35% of total revenues and anything above this amount will trigger the likelihood of further examination and questioning by CRA[1].

The Canadian regulatory regime for charitable organizations is not exceptional given that numerous governments have imposed regulations on charities demanding the disclosure of financial information including their overhead costs (Phillips 2013). And while regulations on overhead may at first pass seem commonsensical, it is important in judging the merits of such restrictions to understand the intent behind them. As one scholar points out, "In designing any regulatory regime, the first concern must be the nature of the evil the regime seeks to redress (Breen forthcoming, 1)." The intent behind most government regulation is to deter charities from the evils of ineffectiveness by ensuring a sufficient percentage of donated dollars reaches the cause with the expectation that this will have a positive effect on the charity's overall performance. However, there is incongruous evidence as to whether such regulations produce constructive results on a charity's ability to achieve its mission; in fact, some research supports the notion that regulations impose unintentional negative consequences on charities.

This paper examines the effects of both formal and informal restrictions on overheads and fundraising costs as documented in the research and evidence. In reference to formal restrictions, this pertains to those regulations imposed by legal or government bodies. Informal restrictions refer to those imposed via the popular preference held by the public and donors. Based on an examination of how overhead regulations deter sufficient investment in key

[1] http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/fndrsng-eng.html

infrastructure and result in financial misreporting by charities, it is proposed that the capping of overhead rates has negative and damaging consequences on a charity's success. The relevance of overhead rates as meaningful measures of charity effectiveness is questioned given their inability to account for fundraising and subsector differences. Lastly, alternative options to increase charities' performance are explored - ones that move away from imposing overhead regulations but that nonetheless provide donors with relevant information to decide which charitable organizations are worthy of their financial support.

Underinvestment in Critical Infrastructure

In an effort to keep overhead ratios low and attract the interest of donors, studies have suggested that charities often underinvest in the critical infrastructure they require to be as effective as possible. Such infrastructure investments include technology systems, staff training and development, process efficiency and other essential operations. While a low overhead rate may satisfy public demand and serve as a substitutionary measure for efficacy, the evidence indicates that it perpetuates a persistent underinvestment in infrastructure which destabilizes the ability of charities to best achieve their intended mission.

This destabilization is well documented by Goggins in *The Nonprofit Starvation Cycle*. Goggins' (2009) research on charitable organizations' spending habits has led her to identify a three-step cycle of chronic underfunding that undermines the overall effectiveness of charities. The first step in the cycle begins with unrealistic expectations from funders (i.e. government, private individuals, foundations) in regards to the actual costs associated with running a productive nonprofit. The unrealistic expectations prompt the second step, where nonprofits bow to pressure to meet the demands of their funders so as to secure much-needed financial support. In the third and final step, nonprofits lower their overhead ratios by spending too little on vital infrastructure needs while they underreport fundraising and administrative expenses. Goggins' starvation theory is based on research developed in her examination of nonprofits and their associated funders. One study revealed how 56% of Executive Directors reported plans to reduce their organization's overhead expenses even though it meant jeopardizing their ability to achieve their charitable mission (Goggins 2009, 50). Another study identified how grant funders failed to allow the recipient charities to designate sufficient funds to cover the overhead costs associated with administering the grant, while ongoing downward pressures on overhead also forced charities to pay uncompetitive salaries, resulting in a significant lack of leadership and expertise to deliver on their mission (Goggins 2009, 51). Although the low overhead of the charities Goggins' examined may appease demands from donors and funders as a substitute measure efficacy, her findings support the idea that low overhead rates do little in the way of increasing a charity's effectiveness.

Goggins' findings are not unique as there are other documented instances of charitable organizations making inadequate investments in infrastructure due to the pressure of overhead regulations and public perception, and as a result, they all experienced some degree of reduction in their effectiveness. The *Nonprofit Overhead Cost Project*, which included a survey of more than 1500 charities and a detailed review of tens of thousands of audited financial statements and available United States Internal Revenue Service data, reports many instances of Executive Directors preparing their organization's financial statements themselves although they lacked the necessary skill and qualifications to do so, resulting in errors and inaccuracies (Wing 2005, 3). Other examples are given of where the lack of investment in technology infrastructure has caused strain on registered charities' ability to deliver on their mission; one of the starkest examples comes from a suicide prevention hotline that could not update its phone system, and as a result, suicidal callers were at risk of getting busy signals (Wing 200, 4). Nonprofits concerned about keeping their overhead levels low were also led to hire unqualified and unskilled staff due to their ability to offer only below-market wages. Key positions were filled with junior people lacking any relevant training and once they acquired this training, they would often leave the charity for better paying employment (Nonprofit Overhead Project 2004a).

Such examples demonstrate how demands for low overhead result in charities sacrificing vital infrastructure investment in technology, staff development and other critical operations even though it negatively impacts their mission. If the original goal behind overhead restrictions is to increase the impact of charities on their cause by directing the highest possible amount of each donation towards the program, the evidence suggests a very different result is achieved. Most disturbing is the fact that overhead restrictions - whether imposed by government regulation or by the public's normative values - have had not just a negative but have had the opposite effect. They have perpetuated a starvation cycle where nonprofits feel pressure to reduce overhead rates at the sacrifice of delivering more impact on their charitable cause.

Misreporting of Overhead

Critics of imposed charity regulations on overhead argue that much of the reporting by registered charities to government agencies is inaccurate and inconsistent, although mainly done unintentionally. They point out that the misrepresentation of overhead expenses makes regulations imposed by government irrelevant seeing as inaccurate information eliminates any usefulness for donors in deciding where to best direct their eleemosynary gifts. It also nullifies any ability of governments to regulate effectively. Evidence would suggest that these critics are right in their assertions.

In assessing the financial reporting provided by charities, rather significant errors are found of both a quantitative and qualitative nature. In looking at Canadian registered charities, the evidence established that many well-meaning organizations have been both erratic and erroneous in their reporting of fundraising costs, often significantly under-reporting their expenses (Phillips 2012, 818). Quantitative errors are frequently the result of a lack of financial acumen and expertise within the charity coupled with a multiplicity of reporting requirements with no standard definition for reporting certain costs (Phillips 2013). Other research has affirmed the notion that errors in reporting are not the result of any intentional desire to misreport financial data, but as Wing (2005) explains, many of these nonprofits do not have the accounting or financial skills required to effectively report their overhead costs. Numerous quantitative inaccuracies have been documented in the data analysed by the *Nonprofit Overhead Cost Project* from the Form 990 reporting of US-based charities. It found that 37% of nonprofits with at least $50,000 in revenue reporting zero fundraising costs, while 13% of them claimed zero management costs, suggesting widespread underreporting in administrative and fundraising costs given the high likelihood that these statistic s are false (Nonprofit Overhead Cost Project 2004b). In additional to quantitative errors, qualitative errors were often the result of improper functional allocation of expenses. Salary costs often represent the largest single costs, but many nonprofits did not report or attribute salary cost accurately to program vs. overhead expenses in their financial statements, leading to imprecise reporting which skewed overhead results (Nonprofit Overhead Cost Project 2004c). Reports from the United Kingdom (UK) suggest similar challenges. Sargeant (2009) criticizes the data from UK filings with the Charity Commission, and argues that the considerable latitude given to charities in how they report on overhead and fundraising costs can be interpreted so broadly that any data deriving for this reporting is neither usable nor relevant. The inaccuracy of the reporting is observed in Sargeant's survey of directors of fundraising at the 500 top charities in the UK whereby 5% of them claim zero overhead expenses (2009, 338). Given the impossibility of these organizations having zero overhead costs since there are obviously costs associated with running any organization, Sargeant argues that the financial reporting imposed by government looking to restrict overly high overhead costs is ineffective given it is rife with erroneous information.

While misreporting of charity overhead costs are often the result of a lack of accounting skill or inconsistent reporting standards, research also suggest that charities underreport their overhead expenses due to the unrealistic demands of funders. There is evidence of charities underreporting fundraising and administrative expenses so as to perpetuate the idea of falsely low costs in order to access funding or be more attractive in competitive funding scenarios (Goggins 2009). Some charitable organizations were found to misrepresent overhead costs by claiming 100% of donations were directed to the cause, meanwhile in the small print they reveal the organization uses contributions from "founding supporters" to cover administration and fundraising costs (Goggins 2009, 51).

The widespread inaccuracies and inconsistencies in overhead reporting reveal the limitations of those government policies seeking to regulate administrative and fundraising expenses. The research presented above shows consistent patterns in overhead misreporting from Canada, the US and the UK, suggesting this trend is not confined to one nation's regulations, but it likely points to a fundamental flaw with overhead regulations in general. If the majority of charitable organizations lack the basic capacity to even report on whether they abided by the regulations, the regulations in effect become powerless in their ability to enforce compliance. If overhead restrictions perpetuate misreporting and underreporting because of pressures from funders and government, then policies capping costs become immaterial given the guidelines are doing little to promote adherence. Given it is impossible to ensure enforcement of and compliance with the regulations if the very charities that government seeks to regulate provide imprecise information, the ability of the regulations to direct as much money as possible to the charitable cause is highly questionable.

Fundraising's Impact on Overhead Comparison

Donors often use overhead and fundraising ratios as a means for comparing different charities' effectiveness as they look how to best spend their philanthropic dollars. As one authors states, "The underlying idea of using ratios to evaluate charities rests on the idea that, all things being equal, the donor would prefer that as much of his or her donation as possible be devoted to program spending, and not diverted to administrative or fundraising spending (Tinkelman 2006, 441)." While donors may believe that they are making the superlative choice in donating their funds to the charity with the lower overhead ratio after comparing costs between similar organizations, studies have suggested that such ratios are irrelevant in comparing charities to determine which one is more effective than the other. In particular, different fundraising strategies that promote revenue and donor growth both put upwards pressure on overhead ratios, but speak very little to whether or not a charity is more or less effective.

There are factors that can inflate a charity's overhead ratio that have very little to do with its effectiveness. One of the best illustrations of this is when a charity invests in fundraising to produce the highest net return in order to direct as many funds as possible to the cause. An example provided by Steinberg proves this point:

> "The first budget of $10,000 will produce $50,000 in donations and provide a 500 percent ratio return ($40,000 actual net return). The second budget of $100,000 will produce $200,000, a 200 percent ratio return ($100,000 actual net return). If a charity wished to maximize the rate of return on its fundraising investment, it would choose the first budget: if it cared about maximizing the resources for providing charitable services, it would choose the second (1994, 14)."

In the scenario above, the first budget has an overhead rate of 20% and directs net profits of $40,000 to the cause. The second budget has an overhead rate of 50% and directs net profits of $100,000 to the cause. The mathematical examples above reveal that charities with lower overhead rates do not necessarily put more funds towards their cause. Rather, it may be the contrary. Steinberg's scenario suggests lower fundraising overhead comes at costs – the cost being less absolute dollars directed to the mission of the charity. In fact, many nonprofits do not devote enough resources to fundraising at all levels in order to maximize revenue (Okten 2000, 271). Hence, direct comparison between charities with respect to their overhead tells little about how many real donor-dollars are being directed to the cause despite the public perception to the contrary.

The usefulness of overhead as a measure of charity comparison is challenged by other evidence. Bowman (2006) looked at how fluctuation in overhead and fundraising costs affect donors' likelihood to increase or decrease their donations, and concludes from his study that overhead ratios are meaningless for comparing between charitable organizations. He did, nevertheless, find that changes in overhead where useful when analyzed at the individual charity level but only longitudinally and over time. Van Iwaarden (2009) found similar evidence supporting the fact that many of the criteria used to assess between different charities effectiveness were limited given charities did not have standard reporting systems.

Other flaws are revealed in using overhead rates to judge between different charities performance when higher volumes of donor acquisition are included in the mix. Donor acquisition often has high short-term costs but long-term payoff, and when acquiring new donors, many charities will justify the significant upfront investment by using a long-term-donor-value metric. That is, they judge the initial acquisition investment against the value of the donor over time. For instance, it may cost $500 to acquire a donor in year one, but the charity can be guaranteed a total of $2000 of revenue from that donor over his or her lifetime with the organization. As Sargeant (2001) points outs, in a long-term donor model, acquisition costs are generally high and are not necessarily off-set by donation revenue in the short-term; rather, reasonable returns are generated over time, driven by an ongoing financial relationship between the donor and the charity. In long-term-donor-value models, fundraising overhead can be exceptionally high in a year where acquisition activity is abundant, but much lower in years where a charity depends on the ongoing revenue of previously-acquired donors. Such fluctuations in donor acquisition costs and associated long-term revenue are not capture in overhead measurements given they provide limited information with an annual scope and are unable account for future, multi-year returns. As such, fundraising models that take longer-term investment approaches cast doubt on the useful of overhead ratios to compare between charities given these ratios cannot account for what is one of the underpinnings of good fundraising – taking a long-term approach to developing a financial relationship with donors.

Part of the challenge in using overhead as a proxy for effectiveness is that the public knows very little about the need for fundraising. Fundraising is what fuels most charities' ability to deliver on their mission but donors have very little understanding and respect for its necessity (Impact Coalition 2012, 2). While upwards of 85% of donations to all charitable organizations are the result of a fundraising solicitation (Bekkers 2011, 931), when charities bow to the pressure of reducing their fundraising investment as a means of keeping overhead low, the direct result is less dollar direct towards their mission and less security in ensuring the long-term, financial viability of their organization. While the public may not be fully apprised of how fundraising is central to the health and sustainability of charitable organizations, overhead ratios certainly do not account for the complexity of fundraising strategies, nor do they account for how short-term investments that produce long-term revenue gains for the organization put upward pressure on costs. Overhead rates do not provide directly comparative information for the public to the judge different charities' effectiveness, particularly when fundraising variances are placed into the equation.

Subsector Factors Influencing Overhead

There are over 80,000 charities in Canada and more than 1.2 million charities in the United States (McNabb 2013, 65). These charities represent a wide-range of causes and are varied in their mission and goal, and yet, overhead measurements attempt to apply a universal metric without accounting for the distinctiveness and uniqueness between charitable organizations and how those differences may impact costs. Because sub-sector variations are not taken into account in the calculation of overhead ratios their relevance is debatable. The application of using overhead as a means of comparison between charities is also dubious given the difference between causes is not captured in the financial calculation.

Evidence implies that the nature of the charitable cause or mission affects overhead levels. Sargeant (2009), in his study of the top 500 charities in the UK, suggests a direct relationship between a charity's overhead and the nature of the cause it supports. For instance, his research found that education charities had lower overhead ratios when compared to other sub-sectors, and Sargeant's points out that his findings are consistent with earlier studies that suggest overhead ratios are higher or lower depending on the cause central to the charity's mission (2009, 338). These findings are consistent with research from Hager (2001), who found that organizational characteristics of individual charities (cause, size and age) influence the efficiencies of the organizations. Hager (2001) discovered that smaller organizations were the least efficient in their fundraising costs, likely driven by their lack of ability to take advantage of efficiencies of scale. He also suggests that as age of the organization increases so does its overhead costs and that there continues to be variations in overhead costs between subsectors (i.e. health, environment, education). A study by Abzug (2013) comparing five nonprofit subsectors found significant variations in financial and overhead reporting between subsectors, which led him to conclude similarly that nonprofits should be compared with other organizations in their subsector if the comparison is to be meaningful and not at the aggregate level.

With the findings revealing that overhead levels fluctuate due to a charity's size, mission and/or age, a one-size-fits-all approach to cost regulation seems irrational. Of note is that fluctuations in overhead are directly related to the cause central to the charity's mission. For instance, because it could be less problematic to raise funds for common-place health causes like cancer or diabetes over a cause like mental illness (which continues to suffers from stigmatization), overhead levels between such health causes can vary dramatically. The cancer and diabetes charities could have lower overheads as donors are readily giving to these causes, whereas the mental illness charity has a high overhead rate because of the stigma and donors' reluctance to support the cause. Hence, the variation in overhead could have little to do with the effectiveness of the charities and much to do with the nature of the charitable cause itself. Illustrations such as these continue to cast doubt on the usefulness of an across-the-board approach to overheard ratios as a means of discerning where donors should direct their dollars.

Alternatives to Overhead Ratios

Governments use formal modes of regulation to limit and cap overhead and fundraising expenses for registered charities with the assumed intent of guaranteeing a sufficient percentage of all donations is directed towards the cause. Donors and funders use informal restrictions to do the same by wielding power with their financial contributions. In both cases, their goal is to promote maximum effectiveness within charitable organizations by safeguarding against frivolous spending and ensuring that the highest percentage of each donation is directed to the cause. The primary assumption of overhead costs is the lower the amount, the more effective the charity. However, the evidence and research would suggest that this assertion is incorrect. Rather than promote effectiveness, the regulations are deterring charities from making the critical infrastructure investments they need to thrive and better deliver on their mission. The regulations cause many charities to misreport and underreport expenses in an effort to conform to the standards of low overhead. Even for donors looking to maximize the impact of their gift, the evidence suggests overhead ratios provide meaningless comparative information as they lack the ability to account for variances in fundraising investment, along with variations between charities such as their size, age and cause. While it is established that using overhead restrictions to regulate charities is not successful, and that overhead comparison between charities is a flawed methodology for donors who aim to maximize the impact of their donation, this begs the question as to what alternatives exist to effectively promote charity efficacy. The following analysis reviews the merits of four alternate options by analyzing their potential to promote effectiveness for charitable organizations.

The first alternative to using overhead as the superlative and often singular measurement of charity effectiveness is one where publics, donors, funders and government adjust their expectations about overhead ratios. Unrealistic pressures placed on charities to keep their overhead rates as low as possible are eased if not eliminated, and a discussion is sparked where charitable organizations can be transparent about the real costs required to operate a successful nonprofit. Goggins' suggests that private foundations and governments should take the lead in adjusting their expectations given the enormous power they hold over charities (2009, 52). Rather than starving the charity, funders, including governments, would agree to pay their fair share of overhead costs. Goggins' argument holds weight, particularly in relation to the leadership role of government, given that in countries such as Canada the government provides 51% of all nonprofit income (Hall 2005, 15). Along similar lines, sector advocates argue that a public education initiative is required to alert current and prospective donors to the limitations of overhead ratios as a reliable means of judging charity effectiveness (Pallotta 2012; Impact Coalition 2013). This concept also holds promise given donor perceptions are so far-removed from the realities of what it costs to run a successful nonprofit.

For instance, only 5% of people strongly agree that charities are justified in investing a portion of received donations on fundraising to guarantee future income (Impact Coalition 2013, 4). Interpreted another way, this may suggest that 95% of people would agree that charities should invest no funds in fundraising. As aforementioned, with 85% of donations driven by fundraising activity (Bekkers 2011, 931), a zero investment in fundraising would essentially result in the dissolution of many charitable organizations. While there is validity in educating average donors on the limitations of overhead, the leadership role of government is of particular note. Government can likely play a catalytic role if they were to ease or eliminate their current overhead restrictions, thereby sending a powerful message to the general public about the need to find alternative means by which to judge charity efficacy.

The second alternative encourages both charities and the public to shift away from overhead ratios as the proxy for effectiveness towards focusing on measuring the impact of the charity on its mission. As one expert point out, "While [overhead] can tell us a lot about a charity's inputs and outputs, it does not tell us much about what the charity's impact is (Impact Coalition 2012, 16)." Overhead is often used by the public and government to evaluate charitable organizations' efficiency in absence of any meaningful information on how donor dollars are translated into impact. In the vacuum of information regarding impact, it is fair to say many have defaulted erroneously to using overhead as its representation. Hence, the best way to modify the focus on overhead is to mandate that charities report on their impact and outcomes. Interestingly, this recommendation could also prove to have positive impact on many charities' bottom-line income as research has demonstrated that when donors are presented with both overhead and information about the charity's impact and outcomes, donations are higher to those charities perceived as more effective in achieving their outcomes. This was witnessed in a study by Caviola (2014) whereby subjects were presented with two fictitious charities. Charity A had an overhead rate of 60% and saved five lives, while Charity B had an overhead of 5% and saved two lives. When the charities were presented to subjects in isolation, preference was given to Charity B as more subjects were willing to donate to it over Charity A, likely because of its low overhead rate. However, when both charities were presented simultaneously to subjects, significantly more were willing to donate to Charity A over Charity B, suggesting that impact (in this case lives saved) was more important to donors than the overhead rates (Caviola 2014, 306). The Caviola study may also suggest that the utilization of impact and outcomes as an alternative to overhead ratios may not involve eliminating administrative and fundraising ratios altogether. Rather, there is the possibility of including both overhead and impact reporting as means by which donors can judge effectiveness. In relating this to a regulatory environment, this suggests governments could compliment overhead reporting with contextual information about the charity's impact. As a result, high overhead rates would no longer trigger a mandatory government review of the charity's costs if it was also able to deliver better outcomes through increased investment.

In assessing the alternative of using outcomes and impact rather than overhead as a measurement for charity efficiency, it is important to acknowledge two key challenges with this option. Firstly, there is the issue of common indicators. Currently, overhead ratios are perceived by the public as common indicators between differing charities even though the evidence discussed earlier documents their limitations in this area. In moving to a model where charities are judged for their impact and outcomes, there are very few metrics that can be applied to all charities. As one author explains, "In the nonprofit world, organizations are so diverse that they do not share a common indicator of program effectiveness (Goggins 2009, 52)." This poses a challenge for the public who are used to using overhead as a common metrics to judge between charities; under an outcome and impact reporting model, very few common metrics would exits. The second concern is that impact and outcome reporting lacks sufficient ease of evaluability in comparison to overhead ratios, which may result in hesitancy by the public to adopt them as measures for charity effectiveness. While Caviola's (2014) study did support the focus on outcomes and impact as an alternative means of measurement to overhead, the same study suggested that the ease of evaluation of overhead can bias the donors' likelihood of giving to an organization even though they are presented with compelling information on the impact of the charity on its mission. In the adoption of an alternative to measure charity efficacy via impact on mission, it is critical that donors are presented with the same ease of evaluability as is currently the case with the overhead ratio measurement; however, this may prove difficult.

A third alternative purports a somewhat indirect means of addressing the problematic nature of overhead regulations. It encourages the charitable sector to develop a stronger, collective advocacy capacity so as to address government restrictions on overhead spending, particularly given government's roles in both regulating and financing registered charities. With the US government being the largest provider of restricted contributions to US-based charities (Wing 2005, 9), while the Canadian government is the largest funder of nonprofit organizations in Canada (Hall 2005, 15), the suggestion of building the sector's voice with government policy-makers has merit. The role played by government in financing the charitable sector translates into significant power, which could dissuade many individual charities from speaking out against government regulations for fear of losing their funding. As a result, overhead critics suggest that charities require a legal-defense fund to protect themselves against unjust government policies such as fundraising restrictions (Pallotta 2012). A legal defense fund could provide charities with the ability to collectively advocate against policies that might inadvertently and negatively impact them. Pallotta (2012) points out that many other interest groups have legal defense funds to protect and advocate for their rights, including Lamda Legal who defends the legal rights of gays and lesbians, Maldef who advocates for Mexican Americans and the legal defense and education fund for the National Associate for the Advancement of Colored People (NAACP). While the idea of a stronger voice for the charitable sector with government policy-makers has value, and while it may address the formal regulations placed on charity overhead, it alone does not address the informal regulations placed on charities through public pressure and the popular demands of donors to keep costs as low as possible. Hence, while stronger collective advocacy may represent a viable option to address the limitation of overhead with government, it alone will be inadequate in its ability to comprehensively adjust the restrictions imposed by both government and the public.

The fourth and final alternative is the notion of self-regulation of the charitable sector. Likely one of the more promising options, Phillips (2012) explains that proponents of self-regulation prefer its approach over hardline government policy or regulation because of its bottom-up, consent-based and cost-effective nature while helping to build capacity, conversation and empowerment. Donors also support this alternative with 72% of adults agreeing they would have more trust in a charity's fundraising if the charity was accountable to an independent regulatory body (Impact Coalition 2012, 7). This would suggest charities should unhesitatingly opt into some form of self-regulation. Momentum in this alternative has been created by the recent advancement in self-regulation in Canada's charitable sector, most notably through the umbrella organization representing the nonprofit and charitable sector, Imagine Canada (Phillips 2012, 822). They re-launched a code of ethics for charities that articulated standards for donor policies, fundraising and financial management. This was followed by a more detailed certification process through a Standard Program focused on increased transparency and self-assessment (Phillips 2012, 823). Self-regulation alternatives, such as those developed by Imagine Canada, hold promise for the charitable sector as they encourage a move away from regulation imposed solely by government to an ideal where charities are more assertive in governing and regulating themselves. Under a self-regulation model, charities could replace misinformed and ineffective overhead restrictions with regulations that lead to more effective and meaningful methods of increased performance.

Alongside the self-regulation alternative, co-regulation has also been proposed as a viable option to sole government regulation. Co-regulation seeks to compliment the capacity-building benefits of self-regulation with the enforceability of government regulation should the charitable sector self-regulation fail (Breen forthcoming, 1). In making use of a dual system, co-regulation prompts government to focus on the more basic tiers such as fraud prevention and transparency while the charitable sector focuses on a second tier of good governance and operational controls (Phillips 2012, 816). While co-regulation merits further exploring, it does nothing to address the negative impact imposed by some of the current government restrictions on overhead and fundraising expenses discussed earlier. In fact, one could argue it imposes further reporting burdens on charities without providing them with the resources to respond appropriately. Hence, in order for the notion of self- or co-regulation to be successful, hardline government regulations around overhead cut-offs would still require easing or elimination.

The four alternatives explored each represent viable options to address current restrictions imposed by government regulatory regimes on charities and instigate changes in donors' current perceptions on overhead. Misguided government regulations on overhead can be addressed by promoting greater advocacy by the charitable sector in addition to giving it the ability to self- or co-regulate. Misguided donor opinions can be addressed by challenging the unrealistic expectations of how much it actually costs to run a successful nonprofit and by focusing on impact either in concert with or instead of overhead rates. It is important to note that none of the alternatives discussed would be successful as stand-alone solutions in addressing the current misguided use of overhead as a proxy for charity effectiveness. In order to address both the formal restrictions imposed by legal and regulatory means and the informal regulations imposed via popular preference held by the public, a likely combination of all four alternatives will be required.

Conclusion:

While overhead and fundraising restrictions may be a tool used by governments to regulate charity efficacy, they are limited in their ability to produce solely positive outcomes given the documented harm they impose on charities. The evidence demonstrates the negative consequences as charities suspend critical infrastructure and growth investments that could improve their ability to deliver on the mission, and instead, they bow to the demands to keep costs as low as possible. Widespread financial reporting inaccuracies and inconsistencies by charities make government enforcement of cost restrictions essentially ineffective. For donors who aim to have their donations to the most good, and as a result, direct their charitable dollars to those organizations with the lower overhead, this methodology is proven to be flawed given that overhead ratios do not account for subsector variations. Because of their focus on a narrow annual cycle, overhead ratios provide limited information to donors in relation to fundraising investments that may increase costs and overhead ratios in the short-term but do much to improve charity effectiveness over the long-term.

Alternatives to using overhead ratios hold promise, particularly options that focus on impact reporting and self- or co-regulation. Impact reporting could provide donors with improved and enhanced information for making decisions as to which charitable organizations to support, while self- or co-regulation could build the confidence of government and the public in the charitable sector's ability to be accountable and transparent. Nevertheless, these options may not be effective alone and need to be accompanied by initiatives that seek to change the public discourse on charity overhead, challenging its ability to serve as a proxy for effectiveness. Such initiatives should include an honest and transparent dialogue about the real costs required to run a successful charity, along with creating and financing a sector voice that can advocate against nonsensical or damaging government regulations with impunity.

Future research on overhead needs to move beyond the popular attempt to define a causal relationship between overhead rates and donations, and instead focus on more meaningful study that helps charities, government and the public look for viable options to replace overhead as the stand-in measurement for effectiveness. While more recent scholarship from authors such as Caviola (2014) has demonstrated promise in finding meaningful substitutes to overhead for donor-decision making, it will likely require more depth and breadth of research in this area before charities themselves are convinced that these new measurements will be as compelling as low overhead as a proxy for high effectiveness. One thing is for sure, charity overhead will likely continue to remain an issue of significant discussion and debate with both donors and government in the near future. Nevertheless, with overhead restrictions looking to redress the evils of charity ineffectiveness, the irony is not lost that overhead as the very measure of charity effectiveness is ineffective itself.

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