THE NONPROFIT TALENT RATIO

Final Report on a Pilot Study

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Introduction

The Talent Philanthropy Project seeks to address the human capital challenges of nonprofits and social change movements by increasing funder investments in talent and human resources systems at grantee organizations and the social sector.

While many studies have looked at nonprofit financial ratios including "program services ratio" (the ratio of program expenses to overhead expenses) and "fundraising ratio" (the ratio of money spent on fundraising to amount raised) our literature review revealed that no one has looked at the role "talent" plays in a nonprofits expenses. And the costs associated with recruiting, developing, retaining and retiring talent does not seem to be visible in tax filings, audits or other aggregated datasets. To rectify this significant gap in the field, this pilot study attempted to define a new "talent ratio:" the ratio of what organizations are spending on talent costs in comparison to overall expenses. For this initial pilot we defined "talent" in the following broad categories:

- Core Costs: essential employee costs such as salaries and benefits
- Development Costs: for staff professional development and performance-based incentives
- Infrastructure Costs: volunteer management, human resources departmental costs, etc.

In addition to looking at what nonprofits spend on talent, we attempted to obtain information on their funding streams for those costs – how much funding from talent is coming from foundation and other grantmaking sources, and how much is coming from individual donations, government, earned revenue, or other sources.

Pilot Study

As a first step in obtaining these numbers we developed a pilot study to look at the spending habits (and matching funding streams) of eight varied nonprofits from across the US. We identified these organizations by advertising through various networks and allowing organizations to self-select to participate in the study. From an initial interest of 18 organizations we narrowed the list to eight, attempting to vary the organizations as much as possible in terms of location, budget size, and sector. This is in no way a random sample but rather eight individual representations of organizations found in the nonprofit sector.

Participating Organizations

In order to obtain sensitive financial and funding information we have agreed to keep the identification of our participating organizations anonymous. Below is a demographic description of the eight participating organizations. Each organization provided actual expenses and related funding for their last fiscal year (usually 2012, but different organization have different fiscal years). All organizations are 501(c)(3) with one exception (see below) and are located in large cities including New York, Boston, Washington, DC, and Atlanta.

- Arts and culture institution with annual total expenses of $1,880.521 and 10 staff members.
- *C*ommunity development organization with annual total expenses of $388,763 and 8 staff members.
- *M*anagement and technical assistance organizations with annual total expenses of $739,027 and 4.8 staff members.
- Arts and culture organization with annual total expenses of $150,826 and 2 staff members.
- *C*ommunity development organization with annual total expenses of $19,388,109 and 105 staff members.
- Advocacy group with annual total expenses of $206,192 and 3 staff members. This is a new organization that had been working under a fiscal sponsorship of another nonprofit and so did not have its own 501(c)(3) filing status at the time of the research, but can still be classified in the same category as the other organizations.
- *C*ivic participation organization with annual total expenses of $260,301 and 5 staff members.
- *R*esearch institute with annual total expenses of $5,800,863 and 48 staff members.

Findings

Due to the small size of the pilot study it is not our intent to make generalizations about the nonprofit sector as a whole, but the study creates a new 'talent lens' through which to view nonprofit finances that is not accessible in tax filings, audits, or elsewhere. And it suggests possible trends and interesting variations that indicate a need for further study.

The Talent Ratio

The talent ratio (talent expenditures as % of total expenses) in the organizations we studied averages at 67.80% (unweighted based on budget size) – a significant majority of organizational costs. The ratio varied widely amongst the groups from 44.33% to 96.35% (a range of 52.02 percentage points).

These variations are likely due to type of organization and size. The organization with the smallest percentage was by far the largest organization in the study both in budget and staff size. It's likely that at such a large organization they have more equipment and property that would decrease the percentage of talent costs. Likewise the second smallest organization is an arts and culture organization (performing arts) that might have similar PPE costs for rehearsal and performance spaces. On the other side, the organization that had by far the highest percentage of talent costs is a research organization that would spend the vast majority of its cost on salaries for talented research staff.

The data becomes slightly more telling when the talent costs are broken out into different types. For the purposes of this study we have bundled talent expenses into three categories:

- **Core Talent Costs** including salaries, benefits, fees (for consultants), and stipends;
- **Staff Development Costs** for professional and leadership development; and
- **Infrastructure Costs** including board development, volunteer management, the cost of maintaining human resources functions, and anything else the organization would classify as "talent" costs but that did not fit into "core" or "development" costs.

The pilot study organizations spent between 71.98% and 99.68% of their total talent costs on Core expenses with an average (unweighted for budget size) of 88.66%. The range between these numbers was only 27.7 percentage points, implying there may be more of a trend in this data than the talent ratio itself, outlined above. The percentage of talent costs spent on Staff Development ranged from 0% to 10.77% (range of 10.77 percentage points) with an average of only 2.96% (unweighted for budget size).

Funding for Talent Costs

In looking at funding streams for talent development we looked specifically at the amount of funding that comes from grants for talent costs. In defining "grants" we included grants from foundations, corporations, and governments[1]. The range for the percentage of funding for talent costs across the eight participating organizations was substantial; from a minimum of 11.91% to a maximum of 100% (range of 88.09 percentage points) so in this case an average across the organization is not likely indicative of any trend in the sector.

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[1] The definition of government grants vs. government contracts is complicated. Depending on the organization's sector, funding from the government might be more likely to come in the form of "contracts" which could be fee for service, or grants (for example a grant from the National Endowment for the Arts). For simplicity's sake in this small pilot study we asked organizations to self-identify what they consider grants. In most cases all government funding was included in the grants category.

Allocation of Talent Expenses

The percentage of the funding allocated to different types of talent costs, however, was more telling. The percentage of grant funding for talent costs allocated to Core costs (salaries and benefits) ranged from 71.71% to 100% (range of 28.29 percentage points) with an average (unweighted for budget size) of 90.41%. Conversely, the range for talent funding allocated to Staff Development was 0% to 9.5% (9.5 percentage points) with an average of only 1.49% (unweighted for budget size). Taken together with the general trends of funding for talent costs, this shows that while grantmakers are funding for talent costs at significantly varied rates, when they are funding, they are focusing their grantmaking on essential costs such as salaries and benefits rather than professional and leadership development.[2]

Conclusions

From this pilot study, we can hypothesize that organizations spend a significant majority of their overall budgets on talent costs, but that the vast majority of those costs are allocated to the core costs of salaries and benefits, and only a minor portion is spent on staff development and human capital systems. The rates at which funders are investing in talent costs vary widely, but in general they appear to focus on funding core costs and not staff development or infrastructure costs.

This is not surprising if we put these numbers in the context of the division between "program" costs and "overhead" costs. Many salaries can be classified as program costs and there is widespread pressure in the sector to encourage nonprofit organizations to keep overhead costs low, and for funders to focus on funding programs rather than overhead costs.[3]

While this study does not offer a large dataset from which to draw conclusions, a February 2013 survey of 138 nonprofits in Michigan by Grand Valley State University[4] produced strikingly similar findings. They found that seventy-three percent of respondent organizations offer professional development training to their staff and 51 percent offer professional development to their board. These organizations allocate between 0.05 percent and 10 percent of their annual budgets for this purpose. On average, organizations devote approximately 2 percent of their annual budgets to professional development. These Michigan nonprofits identified the main deterrents to offering in-house professional development as cost (47%) and lack of relevant

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[2] The categorization of Core and Staff Development costs in the spending category vs the funding category are slightly different as we were not able to collect as detailed information on funding, so "core" only includes salaries and benefits and professional development is pulled only from the professional development category.
[3] Several organizations are working to change the negative connotations of "overhead" costs in the nonprofit and funding communities. See overheadmyth.com for further resources.
[4] Carpenter, H., Gregg, R., Clarke, A. (2013). *2013 Nonprofit Needs Assessment: A Profile of Michigan's Most Urgent Professional Development Needs.* Grand Rapids, MI: Johnson Center for Philanthropy, Grand Valley State University.

information (20%). They expressed challenges participating in external trainings primarily because of money (37%) and time (26%).

It is striking that both our small study and the larger Michigan sample found staff development budgets at roughly 0-10% of organizational budgets with an average at 2% or below.

Reactions from Organizations

While gathering the financial information from organizations we interviewed their staff to put their numbers in context. In general, the feedback from organizations supported the broad conclusions offered above. Organizations reported that their funders were generally interested in funding only programs and less interested in broader organizational or personal development. A number of the leaders we interviewed said they spent a significant portion of their time providing professional development for their staff members on an informal basis, but that that cost is not classifiable because it is not officially included in any program budgets, and so ends up as time spent on top of official job duties. One executive director specifically identified professional development for her staff as the reason she has to work above a 40-hour work week. She has to allocate her 40 hours to specific income streams and none of them cover professional development.

One interesting question we asked all interviews was what they would do with the money if funders increased their funding specifically for talent costs. Most gave one of two answers, either increase salaries and benefits further for staff, or invest that money in better organizational infrastructure, including staff development, to improve the organization's efficiency. While more money is not always an option, a number of organizations expressed a desire to have more flexibility even within their current level of funding.

Finally, the most common statement given by the interviewees is not directly related to talent costs, but is relevant to this study and how funders interact with their grantees. Almost all the leaders we interviewed said the wished their funders had a better understanding of the work they were doing and a more intimate relationship with the organization. It seems likely that if funders were more in touch with their grantees needs, they might better be able to meet their grantees talent funding needs.

Limitations of the Pilot Study

As mentioned above, a pilot study with a small sample of eight organizations cannot in any way lead to generalizations about the nonprofit sector as a whole. In order to test the hypotheses stated above, a larger study of randomly identified organizations needs to be done.

Another limitation of the study was the subject organizations' inability to obtain accurate financial information in the specific categories that we identified. Depending how organizations track their financials, some organizations were not able or willing (because of the significant time it would take) to identify specific accurate numbers within a given category. For example, a number of organizations stated that they had volunteers and did spend money on those volunteers, but they listed zero in the volunteer category because they had no way to know how much was spent specifically on volunteers, since they didn't have a line item in budgeting/expensing connected to volunteers. This problem is likely occurring, at varying levels, across all of our identified categories and therefore calls into question the accuracy of the ratios even at an individual organization level.

The problem of inaccurate data was even more apparent in determining funding streams for talent costs. Almost all the organizations in the pilot study said it was difficult or impossible for them to pull out specific funding amounts in different categories.

Recommendations for Further Research

Despite the limitations listed above, the possible trends identified across these eight organizations show that further, more comprehensive examination of these numbers is warranted. If indeed the hypotheses above are true, this could be crucial data for increasing the performance and impact of nonprofits and the grants provided by their funders.

The need for further study is also supported by the significant interest in this study. There was much more interest than expected and we were surprised by the time and effort organizations were willing to commit, because of the value they thought this research would bring. All of the organizational leaders we interviewed, as well as many we were unable to interview, expressed frustration that these issues had not been looked at more closely and a desire to continue to work with us on the project.

In future research, the issue of a small sample study could be alleviated by undertaking a larger study, done with a random sample of organizations across all budget sizes and nonprofit fields of work. Organizations could be examined not only in the aggregate, but also in categories based on budget and field of work to determine if there are different trends depending on the type of organization. In addition, the research could look closely at the difference between Core, Staff Development and Infrastructure costs and segregate that information further as well. The Core costs could be examined against existing data on salary levels in the sector. The Development numbers could be addressed together with research on the value of professional development to long-term organizational and personal success and sustainability. In addition it might be

interesting to look at allocations for Core, Development and Infrastructure costs as compared to similar expenditures in government and for-profit institutions.

Addressing the problem of inaccurate data would be more difficult. It would be possible to re-structure the study questions slightly to make the information more attainable, but that would also change the categories for which we are gathering data. The reality is that all organizations use their own accounting systems and it is difficult to retrospectively fit their numbers into our categories. To obtain the most accurate data, a yearlong study would enable participating organizations to report-out on a regular basis, in real time, what they are spending and the sources of funding in our talent categories . While this would be significantly more time intensive, it would provide more accurate data in the long run. The study could be simplified to identify only significant costs, for example salaries and benefits and professional development costs. A real time study of professional development costs might also allow organizations to track the opportunity costs of providing professional development in ways that are informal, under-funded or unfunded, unrecognized and underdeveloped.

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