

Outsourcing Back-Office Services in Small Nonprofits: Pitfalls and Possibilities

A Study Conducted by the Management Assistance Group
In Partnership with the Eugene and Agnes E. Meyer Foundation

Executive Summary

The current economic collapse has only intensified the ever-present need of executive directors of small and mid-sized nonprofits to find cost-effective ways to reduce overhead costs and meet their back-office needs. In many of these organizations, the executive director also serves as the chief financial officer, the human resources director, and the chief technology officer—managing important back-office functions with little formal training and very few resources.

Daring to Lead 2006, the widely circulated report on nonprofit executive directors produced by CompassPoint and the Meyer Foundation, cited limited management infrastructure and lack of administrative support as key contributors to executive director burnout and turnover—particularly for small and mid-sized community-based nonprofits. As a follow-up to *Daring to Lead*, the Meyer Foundation made a grant to the Management Assistance Group (MAG) to support a study to assess the back-office needs of Meyer grantees and to identify alternative approaches, such as outsourcing or shared services, that could relieve the pressures on executive directors and help organizations function more effectively.

The full 44-page study is available on the websites of the Meyer Foundation and MAG, and is based on a survey of Meyer grantees, interviews with 16 industry experts and a review of the literature on outsourcing and shared services in both the for-profit and nonprofit sectors. Among the highlights:

- **Outsourcing shows promise as a strategy for helping nonprofits improve their back office operations.** Outsourcing can offer nonprofits access to higher level professional skills than they can afford to hire on staff and can reduce the management and administrative workload of executive directors. However, current business models for outsourcing are often not well suited for serving organizations with annual budgets of less than \$3 million. These small and mid-sized organizations have significant unmet back-office needs that are just as complex as those of larger nonprofits.
- **Entrepreneurs and businesses that offer outsourced services have a significant opportunity to create new business models to serve more nonprofits.** The back-office needs of small and mid-sized nonprofits (the vast majority of nonprofits) are urgent and largely unmet. However, service providers should be realistic about price point and scope of services offered. The study suggests that most existing business models do not work for serving small to mid-sized groups, and that thoughtfully designed combinations of technology and innovative business models are required to dramatically reduce costs.
- **For those organizations most in need of better back-office services, outsourcing may not offer short-term cost savings, but can offer significant long-term benefits and savings.** Nonprofits that are spending very little to perform a function poorly won't save money by

transferring it to an outside firm. However, the long-term benefits and cost savings could be significant if outsourcing allows the executive director and other key staff can spend more time on program and strategy and they are less distracted by important work for which they have little time or training (or by the serious and sometimes costly consequences of neglecting back-office functions).

- **Executive directors need to develop the skills required for successful outsourcing.** In addition to cost, lack of knowledge about outsourcing, lack of time to research service providers, inexperience in writing good outsourcing contracts, and negative past experiences are significant barriers that prevent nonprofits from outsourcing back-office functions. Intermediary organizations, such as nonprofit associations and management support organizations, could address these barriers by creating basic reference material about outsourcing, offering training or peer support sessions, and facilitating a network of service providers that understand the needs of small to mid-sized organizations and are willing to design appropriate business models to serve them.
- **Grantmakers should proceed with caution as they encourage grantees to consider outsourcing.** Funders have limited knowledge of the nuts-and-bolts back office functions of their grantees and are not generally well positioned to select specific vendors. Grantees may feel obligated to use back-office services suggested or paid for by funders even if the fit is not right for their needs, and may be reluctant to offer critical feedback. Productive roles for grantmakers include listening carefully to grantees to identify common needs, engaging in continuous learning about new outsourcing service providers and business models, educating grantees, and facilitating conversations among grantees and outsourcing service providers.

The project included a survey of small and mid-sized grantees of the Meyer Foundation, interviews with key informants, and a literature review. The 16 interviewees included grantmakers, consultants, and a range of back-office service providers. Mark Leach, a senior consultant at MAG, led the project and reported its findings.

Grantee Survey Highlights

The online survey, which was completed by 89 of 177 recipients, asked executive directors of selected Meyer grantees how they currently handled key functions in finance and administration, human resources, communications, and technology, and how satisfied they were with how the function was handled. The survey also asked executive directors to identify their two most pressing back office needs, the barriers to meeting those needs, and the impact of leaving the need unaddressed. Among the major findings:

- Areas most in need of better solutions included human resources functions related to finding and keeping good staff, financial planning, and communications and marketing.
- Many organizations expressed great dissatisfaction with the state of their communications and marketing plans and saw this—along with the need for improved publications and marketing materials—as their most pressing need.

- Almost a third of respondents are dissatisfied with their lack of financial planning and say they don't have the capacity to raise more money to escape chronic problems with cash flow and episodic funding.
- Human resource functions are handled poorly or not at all in many of the respondents' organizations (especially in those with 5-20 employees), resulting in inefficiency, poor performance, burnout, and high staff turnover.
- A large percentage of respondents, particularly those leading small organizations, are performing back-office functions themselves, and most of them are dissatisfied with their own performance.
- For some functions (financial planning, human resources, marketing/communications, and IT), high levels of dissatisfaction are reported whether the function is performed by in-house paid staff, external consultants, or pro bono professionals.

The impacts of not finding better solutions to back-office needs include: inefficiency and burnout, high staff turnover, cash flow crises, loss of funding, missed opportunities for expansion and collaboration, diminished impact, and threats to growth and sustainability. At best, these are enormous distractions for leaders of small nonprofits. At worst, the lack of adequate back-office infrastructure reduces effectiveness at achieving mission and wastes human and financial capital.

Report Overview

The full report provides:

- Descriptions of the most pressing needs of small and mid-sized nonprofits, drawing on data from the Meyer grantee survey, other studies, and the expert interviews.
- The best reasons for outsourcing and better understanding of the barriers that prevent nonprofits from outsourcing back-office services, including the inability to find specialized skills at a reasonable cost, lack of time to find and contract with providers, and negative past experience.
- A disciplined analysis of several distinct business models, revealing why some back-office service providers can provide affordable and high quality services to nonprofits—and why those nonprofits most in need of better solutions (groups with annual budgets below \$3 million) are difficult to serve without innovative business models or some form of third-party subsidy.
- A framework for evaluating outsourced back-office services based on affordability, quality, scalability, demand, range of services, transaction costs, and cost of transition.
- Ideas for grantmakers, back-office service providers, nonprofit executives, and business entrepreneurs as they consider how to better meet the back-office needs of nonprofits.

To explore these issues further, download the full PDF report at:

www.meyerfoundation.org or www.ManagementAssistance.org