

LAPA News & Views

Winter 2008

Welcome to the Winter Edition of "LAPA News & Views," a quarterly newsletter from LAPA/Laurence A. Pagnoni & Associates, Inc., providing indispensable tips on nonprofit fundraising.

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***Plus:* AN INVITATION FROM LAURENCE : Panel concerning outsourcing in the nonprofit sector at Baruch College, School of Public Policy--February 21st**

A Personal Note from Laurence

The two articles featured in this newsletter also appear in the January 2008 issue of the New York NonProfit Press. I wanted to make sure that our loyal readers had an opportunity to read them and I hope they will be of some benefit to you. We suggest that you print this issue for easier reading because the subject is weighty and longer than usual.



My thanks go out to the New York NonProfit Press for giving me the opportunity to express my thoughts on the importance of outsourcing to the nonprofit community.

As a result of these articles I have been asked to lead a panel on outsourcing at Baruch College's School of Public Policy Administration. The panel will be held at Baruch on the evening of February 21, 2008 from 4:00pm - 6:00pm. To make a reservation or to receive more information,

please contact Mark Hogan at mark_hogan@baruch.cuny.edu. I hope to see you there.

- Laurence A. Pagnoni, President

PS. Our readers send wonderful emails responding to our newsletters. Thank you. I learn so much from your perspectives. Please keep the dialogue going! If you would, please forward a copy of this newsletter to a colleague who may find it of interest. Thanks.

NONPROFIT OUTSOURCING: A Vital Option

Thirteen years ago, as executive director of a human services organization, I was faced with two problems: I saw hired staff fail and realized that I needed a higher level of thinking than I could afford to bring inside the organization. A friend recommended an outside specialist. At first, it seemed unusual to be reaching outside of the organization. Then I realized that my bookkeeper was only on the premises for two days a week, and my direct mail service had never been on-site. My frame of reference suddenly changed, and I began to explore an option that many nonprofit organizations still do not explore or underutilize.

In fact, while preparing this article, I contacted the Hauser Center for Nonprofit Organizations at Harvard University, the Aspen Institute, and several other think tanks to inquire about the latest research on nonprofits and outsourcing, and found that it was almost entirely nonexistent!

Outsourcing is now a \$450 billion industry. It refers to the practice by which a company delegates certain in-house functions to a third party. In a fast-paced world, it is often used as a synonym for *offshoring*, which refers to the growing practice of American, Japanese, and European firms to outsource to third-world countries where wages are low, regulations are few, and the costs of doing business are substantially less.

Having become identified with offshoring, outsourcing may perhaps seem an unsavory practice, particularly to members of the helping professions who have a keen sense of social justice. “We don’t *outsource*,” the development director of a downtown youth services agency recently advised a consultant who sought an interview with her. Her tone was dismissive, as if she were being asked to support the death penalty or carry a concealed weapon.

One can even detect something of a “backlash” in the nonprofit world. Blackbaud, a leading software provider and consulting services for nonprofits, is also a major source of information about the nonprofit sector. Its recently released 2006 State of the Nonprofit Industry Survey opens a unique portal on various aspects of nonprofit operations including staffing. Seven hundred and eighty-five nonprofit professionals responded to the survey. Given a list of ten specific tasks ranging from accounting to grant writing, between 84% and 99% said that at their agencies the functions were performed in-house. Roughly a quarter of all respondents indicated that a full-time staff person had been hired to discharge each task. Half of all respondents said the tasks were part of a non-specialist’s job description.

Nonprofit executives, however, may want to consider assigning non-core functions to outside specialists, because overlooking this option may be to an organization’s increasing disadvantage. The first part of this article presents an overview of outsourcing and assesses its risks and benefits; the second installment looks at the outsourcing option most integral to nonprofit operations.

Outsourcing in Perspective

Outsourcing was an inevitable consequence of the growth of specialization. In the nineteenth century, companies not only turned raw material into finished products entirely on their own but also employed their own lawyers and designed and built their own buildings. As the world became more complex, specialists began to offer a depth of service that was not available in-house. In New York, for example, attorney Paul D. Cravath presided over a law firm that hired the brightest graduates of the best law schools and put them to work designing the most elegant financial blueprints. Fortune 500 corporations preferred the Cravath firm over an in-house legal staff because of the knowledge, skills, and genius with which Cravath and his successors became synonymous.

The information revolution gave traditional outsourcing a new impetus. Payrolls, communications, and document management rapidly became information transfer functions that were best left to professionals with specialized training. By 2000, more than half of all IT services in North America were being outsourced. The trend rapidly spread from big business to small and mid-sized businesses. Entrepreneurs across the financial spectrum realized that they could save time and money, and gain access to high-level talent by farming out all computer-related applications.

Information technology also enabled capital to flow more freely across national borders; the controversial practice of offshore manufacturing consequently became feasible. In a more recent wave of outsourcing, businesses have started to relegate their human resources, accounting, and marketing operations to specialized firms. The outsourcing experience of the for-profit world has not been entirely rosy. One lesson learned is that outsourcing is not a cure-all for corporate ills. An organization in disarray will not solve its internal problems by moving them off-site. Additionally, there may be hidden costs in outsourcing, particularly in the time and expenses involved in negotiating a satisfactory contract and in resolving the disputes and misunderstandings that may arise after the contract is signed.

The recent Blackwater controversies bedeviling military operations in Iraq show what happens when outsourcers are given inappropriate latitude and not enough partnership. Richard Phillips, co-founder of Out Sec Limited, an outsourced secretarial service, has wisely observed that “Outsourcing is like a marriage and must be worked on by both sides to be successful.” As in romance it pays to know who you are dealing with, and a commitment to a long-term relationship is usually the key to a successful coupling.

That said, for-profit outsourcing has been remarkably successful. Tasks are completed cheaper, quicker, and better by outside specialists. A higher level of technical expertise is available to the buyer, and in-house staff is free to undertake more productive and stimulating work. For these reasons, the trend is expected to continue and the use of off-site resources, whether offshore or down the road, will inevitably become the norm. As Thomas Friedman put it in *The World is Flat*, “The best companies outsource to win, not to shrink. They outsource to innovate faster and more cheaply in order to grow larger, gain market share, and hire more and different specialists—not to save money by firing more people.”

Outsourcing and Nonprofits

I have been a nonprofit professional for 22 years and am perplexed at the evident sluggishness of our sector to acknowledge this reality. Of the organizations represented by the 785 nonprofit professionals surveyed by Blackbaud, only 16% outsourced their Internet and Web management. Another 15% outsourced their data management and computing needs. The percentage that outsourced any other function was negligible. Meanwhile, outsourced human resource services such as HR XCEL are available to many nonprofits, and IBM Business Consulting Services is developing an off-site procurement operation that would enable smaller agencies to aggregate their buying power and obtain better prices.

In New York City, the FEGS Health and Human Services System of the Federation of Jewish Philanthropies, has created within the last decade a new platform of “shared services” to help nonprofits build infrastructure. Alfred P. Miller, who recently retired as CEO of FEGS, established four companies—HR Dynamics, ALLSector Technology, Staff Resources, and XBRM—providing, respectively, support services in HR, IT, staffing, and crisis management. More than one hundred nonprofits avail themselves of these services. Approximately 40% of the nonprofit clients of HR Dynamics and ALLSector entirely outsource in-house functions.

The “common market” approach to procurement functions has caught on elsewhere in New York. Both the Nonprofit Coordinating Committee and the Federation of Protestant Welfare Agencies broker discounts on purchases of member agencies as well as discounted professional services such as legal and management assistance. Like the European Economic Community, however, the member units have refrained from assigning any of their internal functions to the umbrella organization.

In the Big Apple, the FEGS experiment remains unique. “Nonprofits,” said Al Miller, “are at the beginning of the journey with outsourcing.”

Why are nonprofits shy of outright outsourcing? E.S. Savas, Presidential Professor of the School of Public Affairs at Baruch College offers several reasons. “One,” he says, “is ‘We’ve always done it this way. We’ve been doing it this way since the Dutch.’ Two, non-profit executives just aren’t thinking in terms of outsourcing. Three, there is a feeling that a favored staff member would lose a job, even though that person might be harming the organization. And four, there is a concern that they would lost control, even though governments that outsource have found that they actually gain control.” Savas has studied government outsourcing to nonprofits in eight major cities and is the author of *Privatization*, a seminal work on the subject. “Stephen Goldsmith, the former mayor of Indianapolis,” he adds, “outsourced some eighty functions including water plants, solid-waste—i.e., garbage—disposal, and street paving. He said, ‘I have more control over private contractors that I ever had over my own work force!’”

Mr. Goldsmith may or may not be exaggerating the difficulties of managing an entrenched municipal bureaucracy. His remark may nevertheless be taken as a reminder that outsourcers, as a rule, are intensely results-driven.

In-House or Off-Site?

The most shocking statistic in the Blackbaud survey, however, is that no more than 7% of the respondents said their agency outsourced any component of the area most critical to a nonprofit’s survival: fundraising. The second part of this article will focus entirely on outsourced fundraising options. To conclude this overview, here is a consensus of opinion gleaned from academics and practitioners on what executive directors and board members need to consider before they outsource anything.

First, you must know who you are and what your mission is, and be able to distinguish your support functions from your core competencies. Core competencies concern the *quality* of the services you provide—how food is delivered to your hungry clients, how housing is made available to those who are homeless. Any organizational task that is not central to your mission can be outsourced without detriment to the integrity of your agency.

Second, you should examine your assumptions about outsourcing and see if they hold up under scrutiny. Some nonprofit executives, for example, are prejudiced by one unsatisfactory experience with a consultant. They freeze-frame that experience and replay it in their memory, and stop themselves from hiring another consultant who might be capable of doing a fine job. Is dismissing someone for poor performance a barrier to hiring new staff? Why then should an experience with an inept consultant form a barrier to engaging another? Others assume that outsourcing is only an option for large, established agencies and not for small, emerging ones. Actually, it doesn’t matter where

you are on the projected growth curve of your organization. Outsourcing may be appropriate at any stage of organizational growth so long as it is cheaper and smarter than in-house staffing. It all depends on the dilemmas you are facing.

Third, you should be able to frankly assess what your problems are. If the same intractable dilemmas confront you year after year, it may be necessary to outsource a non-core function, such as fundraising, in order to advance further along the growth curve and arrive at a new and better set of problems. In this connection, proportionality is a good rule of thumb. Ideally, outsourcing should simplify matters. If the proposed solution is more complicated than the problem, it may not solve anything at all. Measure the time and costs involved in outsourcing against the comparative costs of your in-house administrative processes. Consider in addition the “opportunity costs” of failing to take advantage of a specialist’s knowledge and skill, and the “hidden costs” of relying on an in-house staff that lacks the know-how to navigate in critical waters. The smart alternative will be obvious.

Above all, executive directors and trustees should not hesitate to explore the option of nonprofit outsourcing. Nor should they be deterred by an emotional aversion to the subject. The strategic use of volunteers is a form of outsourcing. The IRS outsources the fiscal control of tax-exempt revenue to a board of directors. As Guy Clapperton, a columnist for *The Guardian* wrote, “If you have an accountant, if you use British Telecom or another supplier for your phone service, if you don’t have your own power generator, you’re outsourcing at least something. In these examples you’re doing traditional outsourcing—getting someone with the right skills in to do something you can’t.”

SMART OUTSOURCING: A Focus on Fundraising

As a young executive director newly hired at a middle-sized human service nonprofit, I was presented with a three-person development team: A director of communications who did not want to be involved in fundraising. A development assistant who managed the donor data base, prepared biographical profiles on donors, and coordinated special events. And an executive assistant who spent a quarter of his time on direct mail. The organization was about to hire a director of development and had identified three finalists, all good candidates. But I was worried.

I did not want the new development director to get bogged down with grant deadlines. I wanted the new hire to focus entirely on the lucrative area of major gifts solicitation. (The strategy worked out very well as we made up a \$187,000 deficit within four months and established the agency’s first reserve fund three months later.) So I decided to venture into unknown territory and outsource the grant-writing function. A few board members frowned: it was an additional expense. But I went a step further and secured a restricted grant from one of our most loyal supporters to underwrite the consultant’s fee.

I have always been an avid reader of the *Chronicle of Philanthropy*. Reading it as a freshman E.D., I realized that small and mid-sized organizations were grossly underperforming in raising funds. Specifically, they were—and are—failing to energetically apply advanced fundraising strategies in major gift solicitation, planned giving, and capital campaigns.

The reason became obvious to me when I began to see ads for major gifts officers in the *Chronicle* increase by a factor of five. Like law, fundraising has become an increasingly specialized field. Large nonprofits, of course, employ a corps of specialists to write grant proposals and direct mail appeals; identify, cultivate, and deepen relationships with major donors; obtain and manage relationships with corporate sponsors; and build endowment funds. Small and mid-size organizations, such as the one on my resume, usually hire one or two full-time staff members to discharge all fundraising functions. But the generalist is more of a liability than an asset in today’s economy. An intellectual property lawyer may not litigate, and on probate cases an expert on mergers and

acquisitions will defer to a specialist on trusts and estates. Similarly, a proficient grant writer may not be a skillful steward of major donors or be able to help an agency increase its endowments through planned giving.

Just as a for-profit business may lose money if its legal team cannot cope with the complexities and nuances of all relevant areas of law, so too may a nonprofit lose potential revenue if its development personnel are one- or, at best, two-dimensional players and critical areas of fundraising are not being effectively explored.

I was thinking seriously about these matters by the time I started my second executive directorship, this time at a health services agency. Our organization had to file an application for a *Certificate of Need* to obtain third-party Medicaid reimbursement, a documenting consisting of a couple of hundred pages. As no one on my staff was equipped to discharge this task, I outsourced the assignment to BTQ Financial, a NYC consulting firm. David Terrio, president of BTQ, became a trusted colleague. David is an apostle of the outsourcing model as a means of providing nonprofits with high-caliber administrative and financial services at an affordable price. I quickly saw the fundraising applications of that model.

Highly specialized outsourced fundraising services are multiplying in many areas of the country. The Dayton Foundation, a community foundation based in Ohio's Greater Miami Valley region, has established a Legacy Partnership Program for the outsourcing of planned giving for local charities. Outsourced planned giving options are exercised in other parts of the country through private consultants. Alternatively, many nonprofits have been turning to consulting firms that, like major law firms, offer the services of a cross-trained team. Such firms can assemble polished grant writers, proficient capital campaign managers, and experienced major donor and planned giving specialists, etc. in accordance with an agency's needs over the course of a multi-year contract. Since services are based on a defined scope of service, the retainer fee remains highly competitive.

Outsource fundraising counsel can also help scrape off the rust that nonprofits tend to accumulate in their fundraising machinery. As Richard N. Foster, a management consultant in the for-profit world, has shown in his book, *Creative Destruction*, organizations tend to become locked into certain mindsets that adversely affect their performance. Here, by way of illustration, are eight fundraising dilemmas which outsourcing can rectify by exposing outmoded beliefs, assumptions, and modes of operation. These examples derive from conversations with colleagues who are leading fundraisers and from twenty years of personal observation.

"We try new ways of increasing revenue, but keep getting the same results."

Outsourcing in this scenario functions as the intervening variable needed to make the changes you seek. The consultant's task is to re-organize the overall development strategy to allow for more lucrative activities. Approaches that are not bringing in a good return on the fundraising dollar will be identified and revised or deemphasized, and the development staff assisted in making the requisite shift to other tasks and priorities.

"I have a great staff, but they don't know how to close a major gift."

Your competitive edge has to be sharpened by acquiring advanced skills. The consultant can add value to your organization by working alongside your existing team, or the consultant can do the work, thereby adding greater capacity to your operations.

"The board keeps asking me why we aren't raising more money."

Do you know what it is costing you to raise a dollar? You may want to hire a fundraising consultant to audit your development program, determine your ROI (Return on Investment), and suggest what fundraising opportunities you may lack the expertise to pursue.

The development audit often starts with an analysis of your donor cultivation process, donor data, and revenue projections. It also appraises the extent to which your revenue sources are diversified and the role of the development department in assuring program outcomes. The process is relatively short, taking 30 to 90 days.

“I’ve got a great idea for a program, but”

Starting a new program should not be a total leap of faith for nonprofits. It is often prudent to call for a feasibility study. Feasibility studies clarify the assumptions underlying the proposed initiative and test those assumptions in a series of interviews with both donors and clients.

Feasibility studies can also assess your current fundraising program to see if the necessary foundation has been established for a major or capital campaign. In this connection, the development audit mentioned above can be an effective tool.

“I don’t know what I’d do if the government doesn’t renew our contract.”

As the collapse of communism, the rise of terrorism, and the advent of the internet have made clear, the world we live in is continually changing and reshaping itself. Funding sources change. A new generation of donors emerges with different interests and needs. The demand for services change. The AIDS epidemic, to cite one example, ceased being a death sentence and became a life sentence. Those afflicted with HIV are now living longer with the virus and requiring different kinds of support.

Strategic Planning, Operational Planning, or Results Management is often needed to better prepare for the fundraising future. Such planning may require intensive research from a fundraising specialist whose area of expertise aligns with your mission. An advanced level of planning would not only look at your agency but also analyze your competitors and document various best practices. Such planning almost always makes nonprofits more fundable.

“I know he’s not the right person, but I’m going to hire him anyway.”

You may want to take your time and not rush to replace a key member of your development staff. It is not unusual to spend six months in a search process for a senior development position.

During that time, you need not lose capacity. Outsourcing certain fundraising functions will keep the wheels spinning. Further, you can provide a new staff person with a proper transition period if the consultant overlaps with the new hire for the first 30 to 90 days on the job and smoothly transfers the details of your fundraising program.

“It’s becoming harder and harder to raise a dollar, and I’m getting burned out.”

The culture of most nonprofits is to expect a fast return from fundraising activity, which is a slow and painstaking process. That’s why it’s called *development*. The expectation of rapid results is a heavy burden for development professionals to bear and a major cause of burn-out. The best first-aid for development burn-out—and an even better preventive measure—is to enjoy the support of a coach, particularly one trained in the art of transferring development skills. Surveys show that senior executives who have coaches perform at higher levels. For this reason, for-profit companies, on average, budget \$13K annually for coaching each of their managers according to Vistage, Inc. who’s been in that business since 1957.

The two reasons most often given for not finding a coach are “I don’t have the time” and “I don’t have the money.” Yet those who experience coaching say, “It was the best thing I ever did.”

“Things are happening out there that are not on our radar screen.”

You may be trying to add a new dimension to your development program or invent something that has never been tried. Perhaps you have read Valerie Reuther's article, "Individual Donor Trends," in the Fall 2007 issue of *The Nonprofit Quarterly*, and are wondering how to reach "younger donors who] often look for some stellar project or individual to fund that will propel things forward." A consultant can explore areas of expansion and growth potential, and devise appeals to a new constituency.

Outsourcing basically means aligning the *right person* with the *right skill set* with the *right task*. For small and mid-sized agencies that understand the need to equip themselves with advanced techniques of fundraising, that person is more likely to be based outside of the agency than in-house.

AN INVITATION:

As a result of these articles I have been asked to take part in a panel on outsourcing for nonprofits sponsored by Baruch College's Program in Public Administration. The panel will be on February 21, 2008 from 4:00 pm to 6:00 pm. Admission is free. For more information and to RSVP, please contact Mark Hogan at mark_hogan@baruch.cuny.edu . I hope you can join us.

If you would like Laurence and/or one of LAPA's many associates to speak at your organization, please contact us, at 212-868-4800, ext. 0. Give us the topic, and we will customize the training for your particular needs.

Again, please feel free to forward this on to colleagues who you think might be interested in subscribing to LAPA's *News & Views*. Thank you.

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