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*Patrick Fine:* My name is Patrick Fine. I'm the Chief Executive Officer of FHI 360, and I'm here today with Jeri Eckhart Queenan, one of the preeminent voices on development effectiveness, and on management efficiency in the development community.

Jeri Eckhart Queenan is a partner at the Bridgespan Group. Before joining Bridgespan, she had a diverse career working in both the private, the public, and now the nonprofit sector, as Bridgespan is a nonprofit organization advising mission-driven leaders and organizations.

Jeri, we're very pleased to have you—

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—with us. Do you see any emerging trends with respect to how organizations are organizing themselves and managing their programs in order to deliver the most effective results?

*Jeri Eckhart Queenan:*

Thank you, Patrick. I am delighted to be here. I think we're living through some seismic shifts these days. So of course we're all aware that the bilateral aid funding is flat to declining, and we all expect that it will stay that way.

And that has caused quit a few of the international nonprofit NGOs to be thinking about what their funding models are, and what their operating models are.

And by operating model, I mean, "What is it we do, and how do we do it." For a very long time, many of us were in the business of executing projects that someone else funded us to do, and now organizations are asking themselves, "Is there additional—

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—value that I can add? Can we be a platform for scale? Scaling what works across a broad global network. Can we be local capacity builders?"

Can we play a roll as knowledge creators and knowledge providers?

International NGOs that have been around for 50 years have a treasure trove of experience and expertise on what works and what's already been tried that didn't work, and the world needs those organizations to mine that knowledge and share it. I think they're also seismic shifts in the demographics and in the geopolitical context. It used to be, 25 years ago, that most of the poor people were in poor countries. Now 70 percent of those in extreme poverty are in middle income countries. We also know that a tremendous amount of wealth is being created in those countries, and so we have emerging philanthropists—

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—coming forward in places like India and China and Brazil and Africa that are really changing the landscape of philanthropy, as well as the landscape of need.

Those two forces coming together is actually quite exciting. By 2050, there will be as many billionaires in India plus China as there are in the United States.

*Patrick Fine:*

I think that's an untapped area, at least with respect to how we in the U.S. have looked at financing development.

One of the issues that I struggle with has to do with insuring that we are adding value in a cost effective manner.

There's a perception that I often encounter about the private sector being simply—

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—more efficient and more cost effective than the nonprofit sector is.

Do you think it's possible to compare nonprofit organizations with for-profit organizations, in terms of their efficiency or cost effectiveness in achieving a set result?

*Jeri Eckhart Queenan:*

It's possible. It's quite difficult. We don't have the data in the nonprofit sector that we would all like to have about the outcomes we achieve and the cost of achieving those outcomes. And that's what we would need to do those comparisons easily.

In 2012/2013, I published an article called “Stop Starving Scale” where we actually went to great lengths to compare the financial costs – and the IT costs and some of the other indirect costs – of nonprofits with like-sized corporations.

And we found some interesting things.

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For example, we found that NGOs had 80 percent higher financial management expenses, but IT costs about half of their for-profit counterparts.

It’s very difficult for nonprofits to invest in the kind of capital systems that our for-profit colleagues take for granted.

My belief is that in the nonprofit sector, we have been trying to do as much as possible with as little as possible for a very long time.

*Patrick Fine:* It’s been a mantra. “Do more with less.”

*Jeri Eckhart Queenan:*

It’s not working. What we see is that nonprofits are systematically and chronically under-reimbursed for the full cost of the work they do, and as a result they are systematically and chronically unable to invest in the kinds of systems leadership training, professional development, et cetera, that we all know is the hallmark of an outstanding organization. We do the best we can, —

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— but I believe that it’s our system of financing nonprofits that’s broken and that needs to be fixed.

*Patrick Fine:* I worry about that, too. As we adopt new innovations, new technologies that allow for more effective ways of collecting information and analyzing information, new ways of reaching unserved or underserved populations with a whole variety of services. The true costs of doing that are not recognized. I don’t think we know how to price them. I don’t think the funders know how to price them. And because we don’t have good pricing models, those costs don’t get recognized.

I suspect that’s one of the reasons why the development community is behind in the application of new technologies. We don’t have any way to finance the kind of work required—

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— to take those products and adapt them to be fit for purpose.

*Jeri Eckhart Queenan:*

I think that is so right.

In the corporate world we have a concept called segmentation that we take for granted, and we understand that organizations in different segments have different cost structures, and therefore different pricing models. For example, a software developer might have indirect costs of 70 percent of revenues. A pharma company has indirect costs of 45 percent of revenues.

We understand that the cost structure reflects the business they're in, what they do, and how they do it. We don't have that in the nonprofit sector. We do actually have it, we just don't recognize it in our costing and pricing systems.

So Bridgespan has just done some work that shows that nonprofit biomedical research—

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—facilities have indirect costs that are 65 percent of their direct cost. International NGOs have indirect costs that may be 35/40/45 percent of their direct costs.

Those are indirect costs that drive value, that are essential for impact, that are required for innovation, and we need to move to a system of financing nonprofits that reflects that and that says, "Yes, FHI 360 is an organization that should be investing in technology. That is an indirect cost, and we're going to recognize that."

Why is it so difficult to see change, particularly in the way that funders look at how they manage their financing?

*Jeri Eckhart Queenan:*

I think there are a couple of reasons. One is, a lot of people don't understand that true indirect costs vary by type—

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— of business or organization legitimately. It's not a reflection of inefficiency at all. It's a reflection of the nature of the work that's being done.

There is a myth that overhead is a proxy for efficiency. Many people believe that, and they believe that overhead or indirect costs should be minimized. So we have a belief problem we have to change. Second, even people who would agree with you and me that indirect costs are greater than 15 percent, and they do vary would say,

“Well, I could pay full cost, but it won't solve the problem. The problem is bigger than me. Government has to be part of it.” That's the second problem.

*Patrick Fine:* Let me just add – from an international perspective, in addition to government, multilateral organizations like the UN, it puts—

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— a 12 percent cap on the indirect costs that it will cover.

Organizations like the Global Fund, which is a big financier in the health sector, has a 7 percent cap on indirect costs that it will finance. And then you have philanthropies that are market makers, like the Gates Foundation, which I think many in the philanthropic world look to as a leader in best practices as an organization to emulate, and they have a ceiling on indirect costs of 15 percent.

So sometimes there's an explicit expectation of cost sharing, or just a denial of the true costs of providing the services. Again, I come up against the question of why is there—

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— a lack of acceptance of the true cost of those activities?

*Jeri Eckhart Queenan:*

Let me ask you a question in return. Do you feel that those funders have good data on what the real costs are?

*Patrick Fine:*

I do. I think that organizations like ours and many of our peer organizations are completely transparent with our financial statements. If a funder wants to look at whatever level of detail of our financials, we'll provide it to them. So I don't think it's a data problem.

I think there is a legitimate concern about cost reasonableness. But when I look at established organizations in the development community, both in the U.S. in social service—

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— provision and international development, I see a very strong commitment, serious commitment, to the stewardship of the resources from funders.

So that's part of the reason I'm perplexed by the fact that we see the development of our organizations requiring greater investment in things like research, in iteration of activities, in new technologies, in systemic approaches that by their very nature are shared services, or shared investments in an organization's ability to add value, to deliver value, and to increase the value proposition to the funder.

Yet on the financial supply side, I haven't seen the response—

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— to these conditions that you have a trusted relationship with.

*Jeri Eckhart Queenan:*

I share your desire for a new system, and I am hopeful that we are at the cusp of something new, with some funders contemplating change. Having said that, I do see at least three reasons why it's hard. One is a lot of people do not understand the truth of cost structures. They believe that 15 percent ought to be enough.

I think that's just wrong. But that is a belief, and as you know, many nonprofits put out their pie chart on their website that says, "Our overhead is less than 8 percent," or something like that, which just reinforces that ill-conceived notion.

*Patrick Fine:* Can I just add something here before you get to 2 and 3?

*Jeri Eckhart Queenan:*

Yes.

*Patrick Fine:* That notion, that sense that 15 percent is a—

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—reasonable indirect cost rate without reference to types of activities or market segments, is one of the reasons why I asked you earlier, is it possible to compare efficiency between the nonprofit and the for-profit sector? Maybe I put outsized confidence in benchmarking, but I just wonder if we could do some benchmarking to commercial organizations that people accept as being well governed, well managed, taking their shareholders interest into account, and maximizing value for their shareholders, and you show that, hey, their overhead rate is 40 percent. Then you show a nonprofit that is also working at scale, working diversified across many countries, has a—

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—workforce of thousands of people, is working in dozens of legal environments, has the same kinds of pressures and demands that a large global enterprise faces – and make the case that if you want the nonprofit organization to be as efficient as the for-profit one, then you should expect it to be investing in the systems that bring that efficiency at the same rate as the commercial sector.

*Jeri Eckhart Queenan:*

I love this idea. I think you are right, that if we had true indirect cost by segment of nonprofit – so nonprofit biomedical research facilities, for example – we could find a comparable in the for-profit world – pharma R&D. Then say, “So what’s their indirect cost, and how does that compare to the nonprofits?” My hypothesis—

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—is that what we will find is a lot of commonality. We’ll see that actually most nonprofit biomedical research facilities – indirect cost rate between 65 and 85 percent.

And guess what? It’s not that different than their for-profit pharma colleagues. Because it has to do with the cost of facilities and the cost of the people and the nature of the data systems and the equipment.

We should be doing those comparisons by type of organization, and the kind of work that they’re doing, not by size– we often do it by size, right?

*Patrick Fine:*

Right. It’s probably by both, because there’s going to be a big difference in terms of the sorts of systems needed for an

organization that's managing a hundred people and working in one locality, versus one that's working –

*Jeri Eckhart Queenan:*

Forty thousand.

*Patrick Fine:*

Right – across 50 countries.

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But it also is by segment.

Like you say, if you're working in research, there's special costs. You have to pay attention to the safety of human subjects, if you're doing work that involves human subjects. So you've got a whole different additional set of shared costs that you have to take into account. Now you had two other points.

*Jeri Eckhart Queenan:*

So the second one is, if we put ourselves in the shoes of a funder, particularly a funder who has a large portfolio with many grantees or many social service organizations that they might fund as a government entity, you can imagine that there's tremendous variation in the true indirect costs of those grantees. So a flat-rate policy was a rule that was intended to simplify things. It turns out that it's wrong.

It's very wrong, —

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— so it leads to poor resource allocation.

But there's no simple substitute. If I'm a very large foundation, and I'm funding advocacy organizations and global networks and research facilities and charter schools and any number of other kinds of organizations, I now have a challenge. And my program officers and my grants managers really have a challenge. They're not necessarily organizational experts.

So this is where I think your approach of benchmarking becomes very powerful. Are there some guidelines, some benchmarks that we could use that would be much closer to the true indirect cost than a flat rate like 10 percent, 15 percent, 20? But we don't have that today. So that's the second barrier.

Then the third is the lack of knowledge of all the people—

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—who are involved in the process.

So very often in foundations and government agencies, you have individuals who are there because of their subject matter expertise. They're experts in education. They're experts in public health. They're not experts in organizational effectiveness and indirect costs and financing, et cetera. This becomes difficult.

So there's belief issues. There's a practice and policy issue. And then there's just practices and tools and trainings that we need to solve this problem.

*Patrick Fine:*

It strikes me, as we think about the role that international organizations have to play that part of the global agenda ought to be how we advance thinking on these issues of—

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—how to finance activities in the way that assures cost reasonableness, so you get value for money, but at the same time allows organizations to build the sorts of systems that will enable them to really deliver a strong value proposition to the communities that they're serving into – the funders whose funding they're using. So when we think about the innovation agenda, it's almost exclusively focused on technical innovation, and methodological innovation.

How do we reach communities with new financial products? How do we reach communities with new access to health care? How do we expand the quality of education? It would be really great if we could get a consensus—

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— amongst the international development community to include in that agenda a component that looks at the organizational effectiveness of the organizations that are carrying out that work.

*Jeri Eckhart Queenan:*

What you're articulating so powerfully is that in the international development community, we really need to invest in new technologies and in innovation, new ways of reaching people and

solving problems. That is a core capability for an international development organization. So we need to recognize that cost, and we need to make right investments.

*Patrick Fine:* We're actually fortunate, because we have our own foundation.

And the foundation was capitalized by two for-profit organizations that—

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—FHI 360 established.

They started both as nonprofits. Then they grew so large that we hived them off as for-profit organizations, and then eventually sold them, and used the funding to capitalize a foundation that supports us and provides us a little funding. Not very much, but a little funding that gives us some leeway to experiment, to do research, to invest in systems. But there are very few organizations that have that kind of flow of unrestricted funds available.

*Jeri Eckhart Queenan:*

I see three ways that nonprofit organizations are really able to drive and—

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— fund innovation. One, as you referred to, is to have projects that enable them to move into new frontiers, and they're funded to do that.

*Patrick Fine:* I think that's the prime one.

*Jeri Eckhart Queenan:*

Second is to build the strength of their own balance sheet, so that they have unrestricted capital that they can invest as they choose. That's very difficult to do.

*Patrick Fine:* Super hard.

*Jeri Eckhart Queenan:*

But strong balance sheets, resilient funding, is hugely powerful, because you can self-direct it. Then the third is the emergence, the glimmer, of some funders who are really thinking very differently about capacity.

The Ford Foundation is one that I would mention, where they announced a billion dollar investment in capacity building of critical nonprofit organizations. So this is not necessarily in the international development space, but it's an example—

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—of a large foundation that has said, “We recognize the importance of strengthening institutions. We recognize that these nonprofit institutions will exist long after our strategy. We need them to end extreme poverty, to reduce inequality, to end injustice.”

“And we can impact by helping them be strong. That means investing in their core capacities. That means making sure that they have resilient balance sheets. That means making sure that their full costs are reimbursed, their true costs are reimbursed.” That's a very progressive point of view that I've heard a few funders start to articulate.

*Patrick Fine:*

Not too long ago, I was on a panel with another leader of a nonprofit, who started his—

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— presentation by saying, “Our goal is to work ourselves out of a job, and if you provide us with some support now, then in a few years we won't be needed anymore. We'll have worked ourselves out of business.”

I hear that from many people.

Once it's fixed, it's fixed, and there's no further need for an organization to fix it – is in my view just a complete misunderstanding of the nature of reality, or the way the world works.

As the world changes, human development challenges become more complex often more sophisticated, and as human society evolves, so do the challenges of human development. So the notion that our work is short-term work, and that—

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— if we were really competent, if we were really able, then we wouldn't need to exist five years from now, is a misguided thought. But I think it is a thought that does inform many decision makers.

*Jeri Eckhart Queenan:*

I agree with you that this is a long game. That society's biggest problems have been with us for a very long time, and will remain with us for a very long time.

For me this is what argues for the necessary vitality and health of the international NGOs. These global networks. We need global institutions to solve global problems.

As Kofi Annan talks about – “Problems without passports.” We need more large global networks, and we've invested so much over 50 years in the creation of this infrastructure, that it's an enormous asset for humanity. The—

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—knowledge that's resident in your staff all around the world. The ability to scale. When we design a program that works in early literacy or maternal or child health, you can scale it across a network.

It would take decades to recreate that. So this is a huge asset for society and these organizations. We need to continually invest in their vitality and their health. It's imperative.

*Patrick Fine:*

I think that as the world becomes more interconnected, the ability of nations to work together becomes more and more important, and more and more critical to both economic prosperity and to security.

What a rich discussion we've had. Thank you so much for sharing your perspectives on these issues.

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*Jeri Eckhart Queenan:*

Thank you, Patrick. It's been a pleasure.

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