

2015

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Recommended Citation

Pope, Jennifer A.; Saigal, Ashima; and Key, Katherine E. (2015) "Outsourcing Trends in Small Nonprofit Organizations in West Michigan," *Seidman Business Review*. Vol. 21: Iss. 1, Article 5.
Available at: <https://scholarworks.gvsu.edu/sbr/vol21/iss1/5>

Outsourcing Trends in Small Nonprofit Organizations in West Michigan

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West Michigan has numerous small nonprofit organizations (NPOs) which fill a variety of gaps left by the government and for-profit organizations. These organizations often struggle to stay solvent and provide the services needed in the community. One way they could save some money is to outsource certain back-office or administrative functions, but they usually will keep those in-house for a variety of reasons. This paper briefly examines some of the reasons why NPOs have not embraced outsourcing with the same enthusiasm as for-profit organizations.

The outsourcing of back-office functions by NPOs is a recent development in the sector. Most research on outsourcing practices are focused on large or medium-sized businesses. However, most NPOs more accurately resemble a very small enterprise (VSE) and have annual revenues of less than \$500,000 (Independent Sector, 2013). Similar to NPOs, “in very small firms, owner-managers perform most business activities themselves, or directly supervise performance of these activities.” There are differences in the rationale behind small business and larger companies outsourcing practices. While larger companies can create a competitive advantage and lower cost through outsourcing, VSEs often outsource because they lack the skills in-house. This means that “when a VSE owner or operator is not skilled in handling an HRM (human resource management) activity, it is likely that it will be outsourced” (Barczyk, Husain, and Green, 2007, p.40). NPOs, however, conscious of the donor mentality that all of their money should go to the cause, will often “learn” the skill rather than outsource it.

Many small businesses, like their NPO counterparts, are running “on a fire fighter mentality: constantly putting out crises in the organization” (Barczyk et al. 2007, p.42). Barczyk et al. believe that VSEs (and small NPOs) might not be aware of the importance of strategic HRM and might not have the resources necessary to outsource HRM activities.” They will therefore take on that task even if less than optimally (Barczyk et al., 2007). Just like their for-profit counterparts in VSEs, a “large percentage of small nonprofit executives are performing many of these back-office functions themselves, and many or most of them are dissatisfied with their own performance.” (Meyer Foundation, 2009, p. 2)

According to the Meyer Foundation, “Small nonprofits already outsource many functions... although they may not think about it in this way” (2009, p 7). These organizations are more likely to rely on board members and other volunteers for their “outsourcing” rather than pay for the service in order to keep overhead costs low. Small nonprofits are also at a disadvantage in relation to overhead rates as compared with

larger nonprofits. Small and medium nonprofits tend to spend 20–25% on overhead while large organizations only spend 10% on overhead (Meyer Foundation, 2009). This higher ratio could lead to a drop in their rankings on charity watchdog sites, which could encourage donors to perceive them as less efficient than their larger counterparts. Since individual donors are responsible for about 75 percent of all moneys given to NPOs, NPOs take the potential impact of watchdog rankings seriously (Williams and Moxham, 2009), despite the uneven evidence that such sites have any significant influence on donor behavior. Li et al. (2012) found that the focus on these rankings encourages NPOs to change their financial practices at the expense of the mission of the organization.

For these reasons, nonprofits often misreport their overhead expenditures. NPOs realize that they will be “judged on how many of their total dollars they can put toward programs, and they know that donors want to believe that a minimum of their contributions is being used for administration and fundraising. So they find ways, some legitimate and some not, to represent as many of their expenses as programmatic expenses as they can” (Hager, 2003, p. 50). With this administrative overhead being buried into program costs, it becomes more challenging for a nonprofit to want to outsource, since they are unable to weed the administrative functions from the core activities. Thus, cost savings cannot be achieved because the “managerial incentive intensity becomes the primary motivation for outsourcing, as managerial efforts are focused on core competency maximization when undistracted by non-essential tasks” (Kakabadse and Kakabadse, 2000, p. 673). In other words, when the NPO administrators cannot separate non-mission-based tasks from mission-based ones, it is hard to achieve any real saving through outsourcing.

As part of a larger study, we interviewed ten small nonprofit organizations in West Michigan about their outsourcing practices. While these organizations were willing to outsource certain functions, they often did so only when they could get the service for free or at a sharply reduced cost (see Tables 1 and 2). Two areas that are more likely to be outsourced are payroll and bookkeeping, in part because of their complexity and the ability to easily and safely outsource them. As one West Michigan NPO stated: “It’s something we probably could handle in-house but not nearly as well. And we have an organization that... we’ve been with for over 10 years and who’s never raised their prices for us and it’s a real sweetheart deal and they do a professional job, keep up with all the logs changes everything.” Another local organization, that once did payroll themselves, realized that as the organization grew from five to 10 people it became more challenging to manage, but

“we still had a bookkeeper and the bookkeeper said oh this is silly we can do it ourselves. And then we grew more and it was taking her much longer to do it than the cost of farming it out.”

In our survey, information technology is a back-office function that was split between outsourcing and keeping the function in-house. The two West Michigan organizations that kept IT entirely in-house mentioned that they had a unique situation where their staff had the skills to do the IT work and if they “didn’t have [removed name] and her unique skill set, we would outsource all of it.” Both organizations were lucky to have such staff. The two that were blended were housed within a University or College environment and were able to use the resources available to them. Thus, it can be concluded that unless circumstances warrant, like having staff and external resources available for free, organizations will likely outsource their IT functions.

There is also loyalty to the companies with which the NPO staff are connected. Very few organizations are willing to move from their current IT provider to a new provider. Most of the organizations in our survey were “not unhappy so it would be a harder sell.” But, one organization, in particular, is looking to find a new company to provide their IT functions, because quality is an issue. “We discovered we were getting back-ups and so I had to go back to him three or four times to ask him to please follow up on this. And finally it’s resolved, but yeah it’s just, you know, the old adage ‘you get what you pay for’ is often true in many cases.”

However, other functions are more likely to be kept in-house because of the feeling of control and cost savings. Because local small NPOs are very concerned about cost savings, they were more likely to look for the cheapest alternative and sometimes found this to be an issue. One NPO that used to outsource its printing stated: “It was just disaster working with them. I mean we were not high on their priority list and we were like a month past our deadline getting our last newsletter out.”

Another organization found that they could control costs by owning their own copier and “can control the number of copies we make and thus reduce our in-house printing cost.” This director felt if they were tied to a company, they’d suddenly have less control over the cost of the copies. A different organization stated that they would rather take the time to learn the publishing software and design and print their own materials in order to save money.

A third option that West Michigan nonprofits use is board expertise or receiving in-kind donations for certain back-office functions. This is the typical approach for legal services for example. As you can see in Table 1, two of the organizations use board members for their legal service, and the three that outsource stated they use in-kind donations for legal services. None of the NPOs interviewed paid for regular legal services. Our study suggests that West Michigan NPOs still view outsourcing from either an absolute necessity viewpoint (“there is no way we can outsource this, so we have to do it ourselves”) or from a convenience viewpoint (“we have a staff or board member who can do this for free”). There does not seem, as of yet, to be a systematic approach to outsourcing among smaller NPOs. As Table 2 shows, the reasoning for deciding to outsource a back-office function is more about whether or not they can handle it in-house and not as much about the cost savings. It seems that they will outsource only when they recognize that there is no way for them to do the work in-house (due to lack of expertise/time or potential ramifications for getting it wrong). ■

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Table 1: Results for Interviews on how back-office functions are handled

How function is handled	Printing	IT	Payroll	Legal	Bookkeeping
Blended	2	2	0	1	2
In-house	3	3	0	2 (board)	3
Outsourced	3	5	8	3	3
Not Mentioned	2	0	2	4	2

Table 2: Deciding to Outsource

Staff Skills (in-house)	6
Cheaper (outsourced)	1
Cheaper (in-house)	1
Unknown	2