NONPROFIT OUTSOURCING: A Vital Option

First of Two Parts by Laurence A. Pagnoni

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 o*utsource*," 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.”

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