

The Importance of Benchmarking for Nonprofit Organizations

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Benchmarking is a critical tool for nonprofit organizations to assess their financial health, operational efficiency, and mission effectiveness in comparison to peers and industry standards. By measuring key performance indicators (KPIs) against sector norms or similar-sized organizations, nonprofits can identify strengths, uncover areas for improvement, and support data-driven decision-making. Benchmarking also enhances transparency and accountability to stakeholders such as donors, grantors, board members and regulators, and can inform strategic planning, budgeting, and fundraising efforts. Certain KPIs are essential to rating agencies and how they rate nonprofit organizations, which in turn can also influence fundraising efforts.

Benchmarking can seem overwhelming at first, but starting with a structured, focused approach will yield meaningful insights. First, define your objectives – what are you trying to achieve – and identify relevant peer organizations using any combination of organization size, subsector, geography, etc. Next, select your KPIs and begin collecting data – both your own financial information and that of your peer group, using publicly available Form 990s or other third party providers. Finally, analyze and compare each KPI across your selected peers. Use the insights gleaned to guide budgeting and planning, justify strategic decisions and communicate with your board, and when applicable, your funders.

Select Financial KPIs for Nonprofits:

1. **Program Efficiency Ratio** (*Formula: Program Expenses ÷ Total Expenses*) This measures the proportion of total expenses spent on mission-related programs. A higher ratio indicates that a greater share of resources is going directly toward the organization's charitable purpose, which is often viewed favorably by funders and evaluators.
2. **Operating Reserve Ratio** (*Formula: Unrestricted Net Assets ÷ Average Monthly Expenses*) This KPI assesses the organization's financial cushion and ability to sustain operations during periods of revenue shortfalls. Most best practices recommend maintaining at least 3–6 months of reserves.
3. **Fundraising Efficiency** (*Formula: Fundraising Expenses ÷ Contributions*) This reflects how much it costs the organization to raise each dollar of contributions. Lower ratios indicate more efficient fundraising efforts. However, this should be interpreted in context—start-up organizations or those making strategic investments may have temporarily higher costs.
4. **Administrative Cost Ratio** (*Formula: Management & General Expenses ÷ Total Expenses*) This KPI evaluates the proportion of expenses spent on administrative support. While lower ratios are often seen as desirable, it is important to ensure that administrative functions are not underfunded to the detriment of sustainability and compliance.
5. **Revenue Diversity Index** (*Formula: Calculated using a weighted mix of revenue sources (e.g., grants, donations, fees)*) A diversified revenue base reduces dependency on any single funding stream and increases financial resilience. Tracking this KPI helps nonprofits manage risk and adapt to changes in the funding environment.

Regular benchmarking of these KPIs helps nonprofit leaders and boards make informed decisions, demonstrate stewardship, and enhance long-term impact.

If you have any questions about how to begin benchmarking or would like help interpreting your organization's financial KPIs, please reach out to a member of your Nonprofit team.

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