Pay What It Takes

Report launch

24th March 2022

Funded by:

Context: We know that Australia's not-for-profits were financially vulnerable pre-pandemic and are unlikely to have structurally improved

Charities have thin margins…

35%
of charities made a loss in 2018, and a further

25%
had a surplus of under 5%[1]

…and limited reserves…

59%
of charities have net current assets on hand that cover less than six months of expenses[1]

…in an increasingly competitive environment

While funding has always been a factor for NFPs financial sustainability, competition for funds has become "a core issue impacting on long-term sustainability"[2]

1. SVA and CSI, "Will Australian charities be COVID-19 casualties or partners in recovery? A financial health check", 2020
2. M. S. Booth, "An Accountability Framework for the Financial Sustainability of Australian International Development Organisations," Queensland University of Technology, 2017.

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Context: Indirect costs, or ‘Overheads’ are a key driver of financial vulnerability over the long term, which continues to impact the US philanthropic sector

Indirect costs are costs that cannot be allocated to programs

Many US funders still look to minimise these costs when funding

This has had a devastating effect on the US NFP sector

We undertook this work to understand this issue: Does the way that Australian funders treat indirect costs make the sector more vulnerable?

To understand the Australian context, SVA and CSI have completed:

A literature review

9 case studies of NFP finances

Philanthropic interviews

Four key messages emerged from this report

1. Indirect costs should not be used to assess organisational efficiency, effectiveness, or fundability

2. The drivers of indirect cost underfunding are complex and deep-rooted

3. NFPs ‘true’ indirect costs often far exceed the amount they are funded

4. Underfunding of indirect costs leads to lower capability and effectiveness

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Indirect costs cannot and should not be used to assess charities, are not a measure of efficiency, and restricting funding of them may actively harm NFPs

Evidence suggests that indirect costs are either completely unrelated to charity efficiency, or they are positively associated with it.

Evidence suggests indirect costs are unrelated to charity efficiency or impact

- Research has shown that NFPs that spend less on indirect costs are **not more efficient nor more effective** than those who do not.[1]

Other evidence shows underspending on indirect costs is actively harmful

- Indeed, there is clear evidence that spending insufficient resources on indirect costs can impact overall NFP effectiveness[2].

1. Caviola, L. et al, "The evaluability bias in charitable giving: Saving administration costs or saving lives?" Judgm Decis Mak. 2014 Jul 1; 9(4): 303–316.
2. P. Rooney et al., "Paying for Overhead: A Study of the Impact of Foundations' Overhead Payment Policies on Educational and Human Service Organizations," p. 36, 2007.

How did this situation come about? The four key drivers of the Starvation Cycle

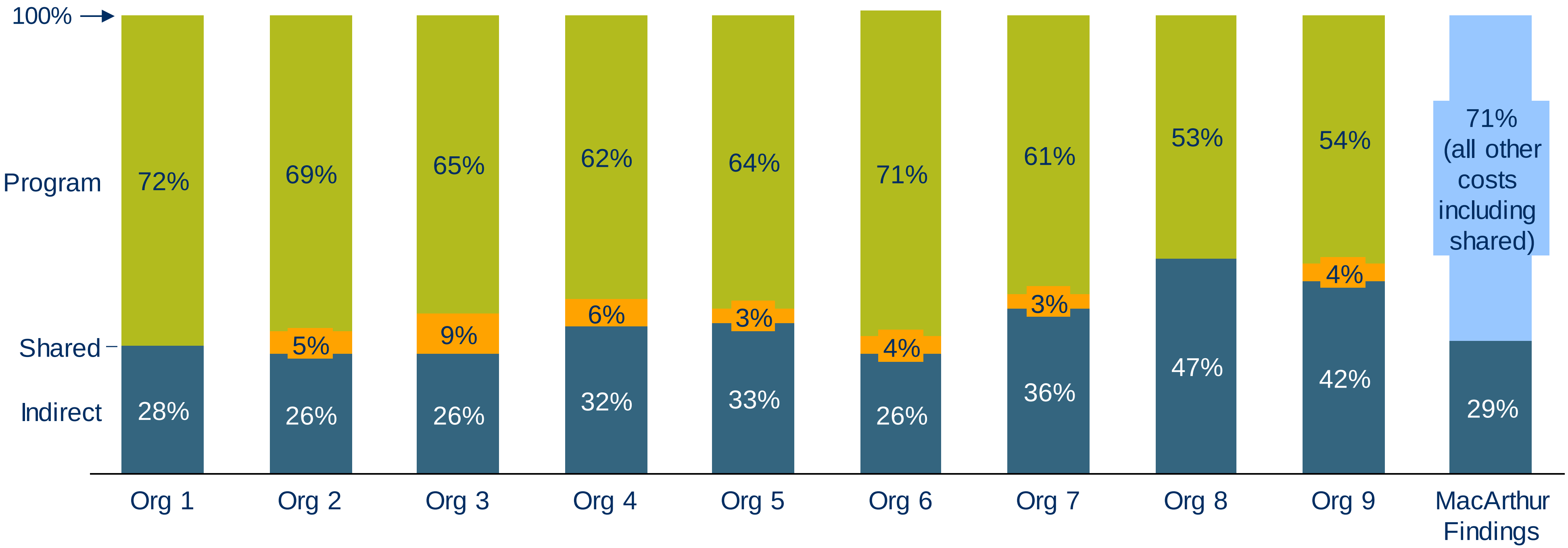
Financial vulnerability

Power dynamics

Relationships and trust

Measurement

The case studies suggest that the ‘true’ indirect costs of Australian NFPs vary substantially but are an average of 33%, a similar finding to a large study in the US



Expe-nditure	>$100m	~$20m	~$10m	~$10m	~$6m	~$1m	<$1m	<$500k	~$100k	
Sector	Develop-ment	Education	Family services	Legal	Children’s services	Arts	Disability	Com-munity Services	Com-munity Services	~130,000 US non-profits

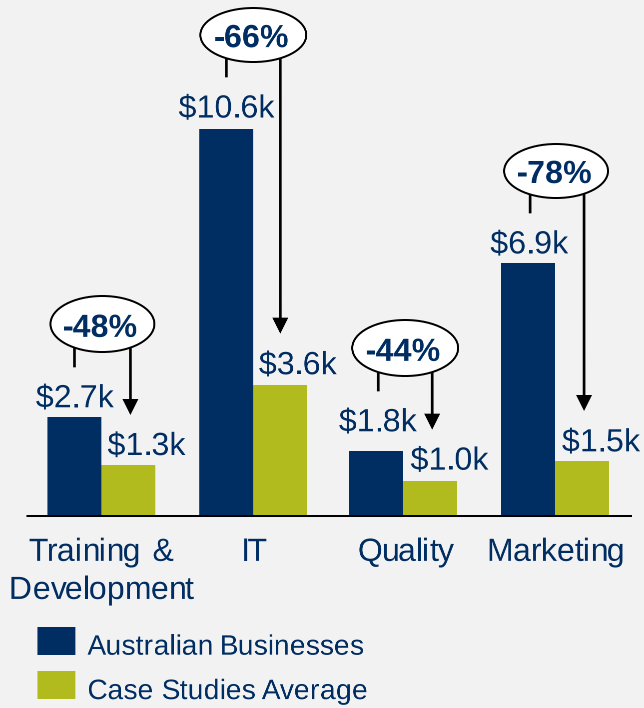
We found that NFPs underinvest in, and underreport, their indirect costs

Across the case studies, this issue was universal

100% of interviewed organisations said that their funding does not cover their true costs

100% of interviewed organisations said that they are underinvesting due to their funding circumstances

On average, the NFPs studied spent half the for-profit average in key indirect cost areas



Underreporting was a key theme from interviews

A number of organisations admitted to (intentionally or unintentionally) underreporting their indirect costs to funders in order to win funding.

There was general agreement that more than 20% indirect costs on a grant application started looking 'high'. Organisations would generally self-censor to stay at or under that level.

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NFPs believe that this underinvestment in indirect costs makes them less effective, as the research would suggest

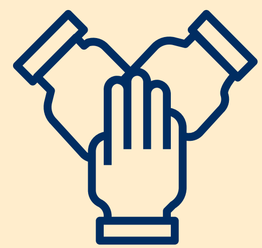
NFPs named a number of harmful effects from this underfunding of the full costs of programs, including:

Front line staff do more admin as they are a ‘program cost’

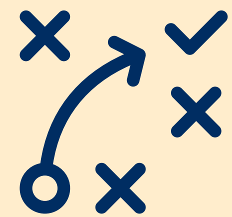
Higher staff attrition due to low investment in training and staff mental health

Spending significant time searching for funding to shore up their existing programs

Limited ability to collaborate due to limited resources and time



Reduced strategy development and strategic capacity



> “Funders want good financial systems and governance but aren’t willing to pay for it” – *Small NFP*

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Moving towards a better funding paradigm for the NFP sector will take time and actively engaging in addressing these issues

There are a number of key actions proposed to drive change:

1. Sector leaders are encouraged to support a range of activities and initiatives that educate charities, funders, government, the media and the general public about the issue

2. Build an evidence base around what full-cost funding can achieve to help shift the sector towards better practice

3. Building up a common language around overheads and indirect costs

4. Support peer-led change in philanthropic giving

5. Actively engaging in processes that build up trust between fundees and funders

6. There was also recognition that some NFPs need external support to improve things like their measurement capacity – especially for smaller organisations

There is not just one way to pay what it takes, but we've observed some key themes across organisations that do so

Ways to pay what it takes

- **Courageous leadership**
- **Build PWIT into strategy**
- **Create trust with grantees**
- **Be grantee led**
- **Learning mindset**

Example approaches:

The Myer Foundation and the Sidney Myer Fund
Focus: General operating grants

- Offers multi-year general operating grants – rarely funds projects
- General operating support built into the foundation strategy, two of the four strategic pillars
- Driven by sector need
- Trust built over many conversations
- Partly modelled on Ford and Barr Foundations in US

CAGES Foundation
Focus: Indigenous orgs

- Approach starts with aligning on common objectives
- Focus on expected outcomes
- Build trust through shared due diligence and long term relationships
- Partner led funding focus
- Costs shared for transparency but funds are flexible (8 line budget max)

Westpac Foundation
Focus: Social enterprise

- Funds the business, not the program
- Uses staff volunteers to deep-dive on applicant finance, risk and strategy – health check
- Aims to understand, and help organisations understand, their costs and cost structure.
- Produces a report on areas of weakness, funds work to shore up those weaknesses.