Are low overheads in charities the public's real concern, or does this miss the point?

Recent research by the Cass Centre for Charity Effectiveness (Cass CCE) has found that charities are in desperate need of better guidance when it comes to developing a sound infrastructure upon which to support their beneficiaries. Mark Salway shares how Cost Recovery, the new toolkit recently launched by the CCE, is vital in helping charities better understand their overheads.

Charities have the ambition and mission to create a better world for the poorest and most marginalised, be that providing food and shelter in emergencies, helping those with disabilities, or providing job opportunities. However, none of this can happen without a sound operational platform.

In the last two months, there have been two in-depth analyses of overheads in charities (so called 'core costs') published. The first, *to the Core*, is published by the think tank Charity Futures and draws on behavioural science to understand donors' and funders' psychology about why they are not funding charities in a sustainable way.

The second, is the lead article in Charity Finance's magazine and the theme for their first ever weekly set of events, celebrating the work of charity finance professionals. It highlights that overhead recovery is still a hot topic after twenty years of discussion, since Julia Unwin first raised the issue in 1999 in her report "Who Pays for Core Costs?". On the positive side, a sound infrastructure and secure funding enables charities to do the amazing work they do, changing people's lives. On the negative side, it identifies that a lack of knowledge in charity finance professionals and poor funding practice from donors and government is leading to charities chasing the money, and focusing on survival, rather than delivering the important work they exist for.

This follows on from the recent bi-annual Charity Commission survey (2018) which highlights that trust in charities has again dropped, off the back of recent scandals. Oxfam, Kids Company and unethical fundraising practices; these have stuck in the public psyche. It identifies the two biggest drivers of public trust as ensuring a reasonable portion of costs goes to the end cause [again focused on overhead levels] and ensuring that charities make a positive difference to the cause that they are working for.

All this discussion hides the real question. Rightly, what people want to know is that their money is being used towards the purpose it was intended and delivered as effectively as possible.

You wouldn't expect an airline to operate without overheads, so why is it so surprising that charities have them too? In the same way as British Airways should be judged by how good it is at flying planes, charities should really not be judged on their low overheads, but by the change they create in the World.

Our recent work at Cass Centre for Charity Effectiveness ('Cass CCE') has identified that charities fall into three clear groups:

- Roughly, 1/3 know their overheads and are good at recovering costs and negotiating with funders to cover these;
- 1/3 don't know their cost base or overhead levels, and therefore can't negotiate effectively; and
- 1/3 are on the journey but need some help in developing better skills and understanding.

Many are driven by 'heart' not 'head', and rely on goodwill and doing 'good' rather than costing and pricing their services effectively as any commercial organisation would. They bid over-optimistically for public service contracts at a level that doesn't always include a fair proportion of overheads, let alone the true cost of services. They simply don't think a funder or commissioner will pay full overhead costs, and rather than give details of how much they are subsidising the work, they often shape their bids to meet the envelope they believe donors will pay. They hide the real cost of doing business to the funder.

Secondly, many charities report costs in their audited reports and accounts which are different from those used in bids and tender submissions. Commissioners and funders rightly ask why these are different. Many charities pick and choose costs to go into bids.

To help improve practice, we have released a simple toolkit which should help charities to build this narrative with funders and give them confidence to argue for the true cost of delivery.

There is growing disquiet from the US and UK that charities are moving into a 'starvation cycle' with charities feeling pressure to continue cutting overhead costs and pressure to conform to funder demands. Levels of overheads are dropping to a place where many in the charity sector are struggling to survive and cannot scale up even if they wanted to (identified in reports from Bridgespan 2009, PwC 2016, NCVO 2017, Charity Futures 2018, among many similar reports).

Charities need infrastructure money to survive and thrive. Bridgespan (2009) highlights that charities spend around 10-20% on overheads and marketing, for example, far less than Banks (28%) and Healthcare (38%).

There is also a group of charities who are in competition with commercial organisations – for example around care contracts. Commercial organisations make a profit, while charities struggle to cover overheads. Can this be right?

On the opposite side, sit funders and commissioners. Funders and commissioners should really pay a fair price for services. This was the intent in the 2005 Compact between the Government and the charity sector, which has been re-committed in 2010, to funding 'appropriate and relevant overheads'. However, this is not always the case.

We should not fall into the trap of assuming that all funders want to fund charities and nonprofits on a sustainable basis. Instead, some aim to spread their money as widely as possible, relying on the goodwill of other donors and reserves to pay for the infrastructure.

All of this however misses not one, but two elephants in the room. Firstly, is the fact that charities create social impact and change for the poorest and most marginalised. Why do we use low overhead costs as a proxy for increased social impact? Secondly, is the fact that efficiency is the real story; how do we see if the charity offers value for money or not?

A Cass CCE report written with Barclays, *Charities in a dynamic world*, identified that efficiency is one of the six key concerns that charities have. Our view is that relatively little discussion takes place around this subject in charities, and there is relatively limited focus on this as a sector. This leads to throwing the spotlight back on overhead levels as a proxy for this argument. Charities should focus on efficiency if they want to win the argument that money spent with them is money well spent.

Similarly, we urge charities to start measuring and publishing some activity measures and the outcome of their work – engaging people with statistics and stories to show the value created. Otherwise the conversation falls back to money alone.

Currently, we are a sector being remembered for our low overheads and this is being driven by the charity marketing machine prizing low, or no, overheads. This is simply not right. Rather, we should tell the truth that a charity's work costs money. Effectively, someone has to pay.

If you would like to find out more about how the Cass Centre for Charity Effectiveness can help your organisation, please contact us using the following details.

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