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Communicating the "Realities" of Charity Costs

An Institute of Fundraising Initiative

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This article reports the background to a new initiative by the Institute of Fundraising in the United Kingdom to supply the public with information with respect to charity costs and in particular the costs of fundraising. The initiative is described, and the results of a recent benchmarking survey of the Top 500 Fundraising Charities that will be used to underpin it are reported. The mean cost of raising £1 was found to be £0.21.

Keywords: *fundraising; fund raising; development; nonprofit marketing; fundraising cost*

The fundraising environment in England and Wales has experienced a period of rapid change. Since the Cabinet Office report "Private Action, Public Benefit" was published in 2002, a number of critical developments have occurred that, considered together, will have a major impact on the way that organizations fundraise and report the performance of their fundraising in the coming years. Among its numerous recommendations, the report concluded that there "is a view that fundraising is under-regulated, and that there should be greater accountability" (Cabinet Office, 2002, p. 65). A number of initiatives have begun to address these concerns.

With respect to the former, the spring of 2007 saw the creation of a new self-regulatory body for fundraising, the Fundraising Standards Board. Members of the scheme must ensure that their fundraising adheres to the standards laid down in the Codes of Fundraising Practice, produced by the Institute of Fundraising, and also abide by the "Fundraising Promise" drafted by the board. This includes a commitment "to answer all reasonable questions about [their] fundraising activities and costs" (Fundraising Standards Board, 2007). At the time of writing, some 600 charities have joined the scheme.

With respect to the latter, the U.K. government invested heavily in the introduction of a Guidestar information service. The organization was provided with £2.9 million start-up capital from the U.K. Treasury and garnered a further £1.9 million from foundations. The site operates in a similar way to its U.S.-based counterpart and now provides online access to the published accounts of registered charities in the United Kingdom. There has, however, been considerable debate within the sector about whether the provision of accounting data to the public offers utility commensurate with this investment (Sargeant & Lee, 2003), particularly given that the Cabinet Office itself concluded that published accounts are “ill-suited to the public’s needs” (Cabinet Office, 2002, p. 63).

In an attempt to better address these needs, five of the United Kingdom’s largest charities jointly funded a public information initiative in 2004-2005. The Web site www.charityfacts.org was established to dispel many of the common myths about fundraising and to communicate a number of key messages to the public about the costs of the activity and what they should expect from their charities. The ImpACT Coalition (Improving Accountability, Clarity and Transparency) was also launched in 2005. As the name suggests, the aim of this coalition of nonprofits is to work collectively to enhance the public’s understanding of the sector and within that, the process of fundraising. Members of the coalition agree to be transparent about how much they invest in raising money and how this helps them to meet the needs of their beneficiaries (National Council for Voluntary Organisations, 2007). These two initiatives are now combined under the stewardship of the Institute of Fundraising.

Although both these initiatives are commendable, as we shall establish below, communicating data with respect to the cost of fundraising remains a difficult task. There are problems surrounding the use of published accounts for this purpose, and aggregate performance ratios based on this data tend toward the meaningless (Sargeant & Jay, 2004). In this article, we briefly review the nature of these difficulties and outline a new approach developed by the Institute of Fundraising. It is intended that the data this generates will underpin public information initiatives such as Charityfacts and the wider work of the ImpACT Coalition.

Do Reported Costs Matter?

Despite the media fascination with the issue (Cornforth, 2005), Steinberg (1986, 1991) famously argued that donors should not concern themselves with fundraising costs. Because reported figures typically represent only an average productivity figure (i.e., total fundraising cost divided by total contributions), he argued they can be highly misleading. According to Steinberg, donors should concern themselves with only the marginal productivity of the fundraising effort. The appropriate approach is thus “to determine whether the last dollar allocated to fundraising brings in $1, no more and no less” (D. R. Young & Steinberg, 1995, p. 88). Weisbrod and

Dominguez (1986) argued that this tends not to happen because donors perceive themselves as giving only a very insignificant fraction of the total contributions accruing to an organization. They therefore continue to equate the average and marginal fundraising expense per dollar solicited.

Whatever the reason for the public fascination with average performance, the evidence is clear that perceptions of these costs matter. Donors give more to organizations that allocate a greater proportion of their expenditure to programs as against fundraising and administration (Callen, 1994; Greenlee & Brown, 1999; Tinkelman, 1999; Weisbrod & Dominguez, 1986). Individuals appear to have a clear idea of what represents an acceptable "program ratio," and although they would wish the ratio between administration/fundraising costs and program expenditure to be 20:80, most donors believe that the actual ratio is closer to 50:50 (Warwick, 1994). Harvey and McCrohan (1988) found that 60% was a significant threshold, with charities spending at least this proportion of their donations on charitable programs achieving significantly higher levels of donation. It is also interesting to note that donors are significantly more likely to make a contribution when information about the program ratio accompanies a request for funds (Parsons, 2001). Bennett and Savani (2003) concluded that even small amounts of financial data assist in facilitating donations because the information "stimulates cognitive effort" to consider other aspects of an organization's performance.

Performance Ratios

Key ratios said to be of interest to donors are administration costs as a percentage of total expenditure (ACE) and fundraising costs as a percentage of total expenditure (Margolis, 2001; Tinkelman, 1999). As we noted above, it is also common practice to combine these two categories of cost and calculate a fundraising and administration costs as a percentage of total expenditure ratio. Although we concur that the fundraising and administration costs as a percentage of total expenditure and ACE ratios may be helpful, we follow Sargeant and Kaehler (1998) and Palmer and Randall (2002) and avoid the fundraising costs as a percentage of total expenditure ratio, relating fundraising costs instead to the income that they generate. The fundraising costs as a percentage of voluntary income ratio is preferred for this reason.

The news media and organizations such as the Directory of Social Change have based their calculation of such ratios on published accounts (Fitzherbert, 2002). This simplistic approach has been widely criticized because although charities in England must prepare these accounts in accordance with an accounting Statement of Recommended Practice (Charity Commission, 2007), considerable latitude remains with respect to the definition of various categories of costs (F. Young, 2001). Many of these decisions are entirely arbitrary, particularly those concerning joint costs. Some charities claim that when they raise funds they are also fulfilling their mission by educating the public about the nature of their cause. As a consequence, they take out a fixed percentage of the costs of fundraising and assign it to program expenditure. Other charities take the opposite view, arguing that fundraising benefits from the awareness generated from brand advertising and fundraising is therefore charged with a percentage of corporate communication expenditure (Hopkins, 1995). As a consequence, variations in reported performance of up to 30% have been reported between organizations on the basis of nothing but accounting conventions (Sargeant & Jay, 2004).

A further difficulty arises because public accounts are not prepared with the communication of fundraising performance data in mind. Relevant costs and revenues should include all the categories that the public would reasonably expect to see included (Sargeant & Lee, 2003), yet this is frequently not the case. The handling of legacies, trading income, and certain forms of government support are particularly gray areas.

Aggregate Benchmarking Study

In a bid to overcome these difficulties, the Institute of Fundraising and Henley Management College consulted on a methodology for the gathering of more meaningful data that could be reported to the general public. The goal was not to report data on individual organizations but rather to provide sector norms that could be used for the purposes of public education. In generating this data, the institute recognized the difficulties associated with using published accounts for this purpose, yet it also recognized that if data were to be gathered from a significant number of organizations, there would be a need to avoid the complexity of projects such as Fundratios (a subscription benchmarking service involving the completion of lengthy management accounting documentation).

As a consequence of the consultation, a draft questionnaire was developed and piloted with the directors of fundraising of the Top 500 charities. The final version was used to gather data in the spring of 2007. In responding to the questionnaire, recipients were asked to draw their data from their trial balances, not their published accounts for the period. In doing so, the goal was to avoid many of the reporting nuances alluded to above and to reflect (as far as possible) actual fundraising activity undertaken in the period rather than an interpretation of it. Detailed guidance notes for respondents were included in the questionnaire pack.

Respondents were asked to report all the income received from all of their fundraising activities (i.e., individuals, foundations, and corporations).

The questionnaire specified that this was to include

a. all income achieved from solicited and unsolicited donations (including legacies) and the monetary value of any gifts in kind;
b. all income received in the form of tax refunds from the Inland Revenue for gifts made in a tax-efficient manner (e.g., through gift-aid);

c. all income from grant-making trusts where the fundraising department was deemed responsible for the solicitation of the grant;
d. any income in the form of grant aid or payments for contracted services undertaken by the charity on behalf of central or local government, where the responsibility for raising this income is held within the fundraising function of the charity and the costs of doing so are allocated back to the fundraising division;
e. all fundraised income from companies (i.e., donations, gifts in kind, sponsorship income, income from corporate trust funds, and income raised through joint promotions and cause-related marketing)—where elements of income from companies were accounted for in an associated trading company for legal or tax purposes, respondents were asked to include the gross income from these; and
f. the gross income from sales made in charity shops—if the activity was undertaken through an associated trading company, respondents were again asked to allocate the income across from this source.

Similarly, respondents were asked to indicate the direct costs associated with their fundraising. This was also to include

a. any expenditure incurred in fundraising activities with individuals;
b. any expenditure incurred from receipt of unsolicited donations and gifts in kind;
c. any expenditure incurred in the promotion and administration of gifts made in a tax-efficient manner;
d. all fundraising expenditure associated with trust fundraising, where the fundraising department was deemed responsible for the solicitation of the grant;
e. all expenditure associated with securing grant aid or payments for contracted services undertaken by the charity on behalf of central or local government where the responsibility for raising this income was held in the fundraising division of the charity and the costs for so doing were allocated back to the fundraising division;
f. all expenditure associated with fundraising from companies (i.e., donations, gifts in kind, sponsorship income, income from corporate trust funds, and income raised through joint promotions and cause-related marketing)—where elements of expenditure associated with income from companies were accounted for in an associated trading company for legal or tax purposes, respondents were asked to include the relevant gross expenditure; and
g. the gross expenditure incurred in association with sales made in charity shops—if the activity was undertaken through an associated trading company, respondents were asked to allocate the expenditure across from this source.

In total, 120 replies were received, of which 5 were incomplete or unusable. Our analysis is therefore based on a usable response rate of 23%. This is much higher than would typically be the case for benchmarking studies, where response rates of 10% (or less) are not uncommon (Helgeson, Voss, & Terpening, 2002). The higher response rate was undoubtedly due to the backing of the institute.

Responses were obtained from organizations ranging in size, as measured by their total income in their past financial year, from £65,000 to £300 million (voluntary income ranged from £55,000 to £210 million). A comparison of the profile of respondents with the "size" profile of the sampling frame indicated that respondents were representative. No significant difference could be found.

Examining first the direct costs associated with fundraising activity, we relate these to the voluntary income they were able to generate (fundraising costs as a percentage of voluntary income). The mean cost per £1 raised was found to be £0.20 (standard deviation = 0.15), the median £0.16. When indirect costs are factored in, the mean cost of raising £1 rises to £0.21 (standard deviation = £0.16), the median £0.17. It is important to note that 61.5% of respondents indicated that there were no indirect costs associated with their fundraising activity. The inclusion of these costs where reported, therefore, has only a small impact on the aggregate pattern of performance reported. It is also important to note here that 5.2% of respondents claim to have zero costs of fundraising, including one organization citing voluntary income of £4.8 million. Because the distribution was found to be highly skewed, a log transformation of the data was performed prior to subsequent analysis.

Larger organizations might have been presumed to enjoy economies of scale in fundraising activities that would tend to lower the value of their fundraising costs as a percentage of voluntary income. Although this may indeed be the case looking beyond the Top 500 Fundraising Charities, we could find no evidence within this group of a size effect on fundraising costs as a percentage of voluntary income. Larger organizations appear to generate returns that are no better or worse than their smaller counterparts'.

However, variation in reported performance was found to exist between charities serving different categories of need (*F* ratio = 4.69, probability = .002). Post hoc tests confirmed that education charities generally fared better than other categories of cause in the sector, spending £5 on average less than other charities to raise £1 and confirming the findings of previous studies that have concluded there are significant "cause" effects in reported fundraising performance (see, for example, Hager, Pollak, & Rooney, 2001; Sargeant & Kaehler, 1998). It should be remembered, however, that our results preclude a more detailed analysis of this dimension as our sample size was small and it was therefore impossible to meaningfully explore many other categories of cause. The detail of our post hoc analysis of transformed data is reported in Table 1.

The questionnaire also gathered data with respect to administrative costs. Calculating the ACE ratio, we find that our respondents spent a mean of 4.13% of their total expenditure on administration (standard deviation = 6.19). The median expenditure was found to be 1.39%, lowered by a number of organizations that claimed no such costs.

Our empirical analysis confirms that there is an inverse relationship between ACE ratios and the size of charities. However, the relationship is not linear; the correlation coefficient between ACE ratios and total expenditures of the charities in the sample is a statistically insignificant –.115, whereas the correlation coefficient

Table 1
Post Hoc Analysis of Transformed Fundraising Costs as a Percentage of Voluntary Income (Tukey)

(I) Category	(J) Category	Mean Log Difference (I-J)	Standard Error	Significance
Education	Social welfare	–.505	.153	.011
	Health/care	–.523	.154	.009
	International aid	–.649	.153	.000
	Religious	–.513	.155	.011
	Physical disability	–.932	.231	.000

between ACE and the reciprocal of expenditure is highly significant at .331. After considerable experimentation with different functional forms, it was found that the following simple function achieved the best fit to the data. As an example, it indicates that for a charity with total expenditure of £1 million, one would expect an ACE ratio of 4.43:

$$ACE = 3.44 + \frac{995648}{Expenditure}.$$

A regression model with the reciprocal of total expenditure as the explanatory variable can explain 12% of the variation in ACE ratios.

The final ratio of interest is that of fundraising and administration costs to total expenditure. In this case, we find that our respondents were spending a mean of 18.5% of their total expenditure on fundraising/administration (standard deviation = 12.34). The median expenditure was found to be 14.90%. Because this distribution was also highly skewed, a log transformation was undertaken prior to further analysis. We found no evidence of any economy of scale or category effect in the fundraising and administration costs as a percentage of total expenditure ratio.

The Next Steps

It is intended that the results generated in this study will now be used to underpin the public information Web site www.charityfacts.org. As we noted above, the site will report only average costs. No data with respect to individual charities will be available to prevent the generation of charity league tables that could be highly misleading to donors. Although the figures above represent an improvement on those that might be derived from public accounts, the results may still not be used as the basis for comparison between organizations; they establish only broad norms of behavior. In its education message, Charityfacts will make it clear that the fundraising performance of particular organizations will still be driven by variables such as the form of fundraising undertaken, the split between donor recruitment and donor development activity, and the category of cause for which the fundraising is being conducted. With respect to the latter, our results have served to reinforce the work of previous studies, indicating that certain categories of nonprofits have significantly different levels of cost. Such variations say nothing about the quality of fundraising per se; they merely reflect the level of public interest and concern with a particular issue. They may also reflect the relative wealth of the "natural" supporter base.

The communication of sector averages with respect to performance is an issue that must be handled with care. We believe the fact that our data are drawn from a methodology specifically designed for the purpose rather than from published accounts will in itself help reinforce the message that the latter cannot be used for this purpose. As with any benchmarking project, critical decisions must always be taken with respect to the most appropriate level of detail to provide. The institute's view in this case was that sector averages were the most appropriate statistics to provide, accompanied by an explanation of why the performance of specific organizations might vary from these norms. The site will also provide data with respect to the performance of specific forms of fundraising, with an emphasis on those of the greatest public interest and concern. A separate research instrument will therefore be employed to gather data with respect to key direct marketing media such as direct mail and direct dialogue (i.e., on-the-street recruitment into regular giving). Data on other forms of fundraising will be made available to students and journalists, but in a separate section of the site to avoid inserting unnecessary complexity for the typical user. The initiative will continue to be promoted through the ImpACT Coalition and the Institute of Fundraising, and senior fundraisers wishing to comply with the new National Occupational Standards for Fundraising will now be required to link their organizations' Web sites to Charityfacts.

The results do, however, highlight a number of issues that give cause for concern. It seems unlikely that 61.5% of the United Kingdom's largest charities in reality have no indirect costs associated with their fundraising. Although the salaries of all fundraising personnel, including the director (if one exists) will be considered direct costs, there will undoubtedly be other senior staff in the organization who are not employed as fundraisers but whose role includes an element of fundraising activity or responsibility. The chief executive officer is a case in point, and some allowance should be made for his or her time if he or she engages in fundraising. Equally, it is difficult to believe that the fundraising function does not incur the usual administrative overhead: at a minimum, heating, lighting accommodation, and so forth. This is an issue that the accounting profession may wish to address through the Statement of Recommended Practice. Indeed, the Institute of Fundraising can also play its part here, as it currently insists that its members ought not to imply that their fundraising is conducted at zero cost. There may be a need to emphasize that this guidance should apply to both direct and indirect costs. In our view, transparency with respect to indirect costs would be unlikely to have a marked impact on the ratios reported in this article, but it could potentially have a very marked impact on the public trust as charities are seen to openly provide the finer detail of their actual costs.

Our results also indicate that a number of nonprofits that report voluntary income claim to have no costs of fundraising, including one with voluntary income of more than £4.8 million. Although this percentage is small, it is still to be regretted. There may therefore be a case for a further toughening of the Institute of Fundraising code of practice on accountability and transparency in fundraising and for the new fundraising regulator to form a view on this issue. The U.K. Workforce Hub may also have a role to play, as this is the body that now has responsibility for maintaining the National Occupational Standards for Trustees (i.e., board members). Inculcating a knowledge and understanding of the realities of fundraising cost among members of this group should be a priority, and facilitating accurate and transparent reporting could become a skill required of every trustee wishing to claim the label “competent.” The current iteration of these occupational standards requires only compliance with the law (U.K. Workforce Hub, 2006). If public trust and confidence in the sector is truly to be enhanced, we must move beyond this minimum requirement and look not to conceal or manipulate but to educate the public about the realities of our costs and to actively participate in initiatives that encourage this endeavor.

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