Submission to Charitable Fundraising Regulation Reform Discussion Paper

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Consultation Question 5.2 Should charities be required to report on the outcomes of any fundraising activities, including specific details relating to the amount of funds raised, any costs associated with raising those funds, and their remittance to the proposed charity? Are there any exceptions that should apply?

I see no argument for requiring reports on funds raised or the costs of raising funds, either for entities raising money from the public or for entities where the funds are raised privately The unintended but nonetheless negative consequences of reporting of the items in 5.2 will result in a lower level of funds raised than otherwise would be the case. This may sound contrary to what Treasury or the ACNC would expect of a non-profit director and PAF Trustee to propose but in this submission I will argue that reporting can safely be left to NFP boards and donors, without the need for reporting requirements. These are my views and not those of the organizations I have, or have had, affiliations with.

My argument is based on the following propositions:

1. Donors and boards of charities are seeing very little demand for the type of information proposed to be provided.
2. The economics of charitable fundraising are no different to the price and output decisions of the firm and can safely be left to directors to decide
3. If reporting obligations are put in place, we are likely to see a lower level of fundraising in aggregate than would be expected without the proposed reporting requirements.

Each of these arguments is set out in more detail.

There is little demand for fundraising reporting from outside charities

Fundraising consumes a lot of time of directors on charitable boards as one would expect. The cost of fundraising is typically a budget line item that is also monitored. However I cannot recall any AGM of a charitable board that I have chaired or attended where the question has been raised to provide more information on the outcomes of fundraising or the cost of fundraising. Nor have the trustees in our PAF raised questions that they wish to know more about the outcome of fundraising or its cost. I believe there is little demand for this information by members or donors, which raises the question of who is the reporting requirement aimed at. The questions members, donors and supporters ask of their charitable boards focus on issues like “ are you making a difference

to social disadvantage with your programs", "how is fundraising going in this climate" and "is there a business model that will allow the organization to be sustainable"?

Nonetheless there are calls for transparency in NFP reporting and there are even Transparency Awards. If the calls are loud enough we should expect to see responses from not for profits. My point is that they are not at a level that is necessitating response from charities who might lose funding, nor are they of concern to warrant a regulatory obligation.

Why is it then that the information in 5.2 isn't valued and in high demand? I think there are a couple of reasons. First we expect diligence from charitable boards about fundraising activities and costs of all kinds. The choice of fundraising approach selected by the board varies depending on the strategy and the organization's longevity. For example, older charities are more likely to seek bequest income and pursue major gifts, where the income generated is substantial in relation to costs of acquisition. Newer charities are more likely to mount campaigns via direct mail or organize events, where the income is more closely in line with costs to generate income. The result is we should expect and be comfortable with very different profiles of fundraising costs and outcomes, depending on the strategy and age of the organization. Second we know that comparing fundraising costs to income for different charities is like comparing apples and pears. What appear as cost items in some charities for rent, printing and advertising may not appear in other charities because of pro bono contributions from companies and supporters. Accounting standards don't provide for consistent reporting and the result will invariably be apples and pears comparisons.

If donors and members aren't seeking the information why then do Treasury and the ACNC believe it's worth reporting? If it is felt that high costs of fundraising is bad and needs to be made transparent I argue below that this is an erroneous conclusion and no basis for reporting on fundraising to a regulator.

The economics of fundraising can safely be left to charitable boards to decide

In microeconomics we are trained to expand output to the point where Marginal Revenue= Marginal Cost. A charitable organization is no different. The board finds it has a portfolio of fundraising approaches that have varying marginal revenue and marginal costs. I alluded to bequests in the paragraph above. Bequests often have high marginal revenue and low marginal costs to acquire the bequest (zero where the bequest is unsolicited). Major gifts above $100,000 have high marginal revenue and in most cases relatively low marginal costs. At the other end of the spectrum are programs like direct mail, major events like gala balls, running festivals and canvassing campaigns using 3rd parties, where the marginal revenue is lower and the marginal cost is higher. Charities should continue with programs up to the point where marginal revenue= marginal cost, as you would expect in a business firm.

Recently the *Daily Telegraph* ran an article featuring charities where the cost of fundraising to income was 50% and above. The metric was certainly being applied to indicate that it's bad behaviour. Not so. As an example take a charity that has two fundraising sources, that is, bequests and direct mail where each contributes 50% of funds raised. Assume that the fundraising costs of bequests are close to zero and the direct mail program only makes a dollar above its costs so we'll call it 100%. There is nothing bad or sinister about the charity but its fundraising cost to income is 50% with this fundraising program mix. If it doesn't have the benefit of fundraising sources like bequests or major gifts, fundraising cost to income is more likely to be closer to 80%. As a director of such a charity that's yielding a 20% net margin, any board ought to be happy with the result.

Charitable boards have a different metric in mind than fundraising cost to income. They look at net margin as a proxy for marginal cost and revenue and those with business backgrounds think in terms of fundraising return on investment. The various metrics are linked as follows:

Fundraising ROI = Net margin X Asset turnover

= Income-Fundraising cost/Income X Income/Investment

=(1- Fundraising cost/income) X Income/Investment

What the Fundraising ROI approach tells us is that a charity can have a very high fundraising cost to income and still generate very attractive fundraising ROI, whenever the income is greater than the incremental investment. For example, the Heart Foundation was quoted earlier in the year as having raised $48 million at a fundraising cost of $16 million. Using the equation it has net margin of 67%. Even if it took investment of $48 million to generate the funds raised (which it didn't) the asset turnover at 1 times yields a fundraising ROI of 67%. Charitable boards could hardly reject opportunities like this.

Fundraising ROI is calculated over time to reflect the fact that costs and investments are made in one time period while fundraising income may take several years to reach fruition. Campaigns for donor acquisition fit into this category. The costs are incurred up front and may take several years to be recouped with income form donors acquired. Similarly where organizations have a bequests officer and invite donors to modify their wills, there is a time delay between incurring costs in the current period and receiving income. I have found that charitable boards scrutinize these investments carefully and review carefully the assumptions underpinning fundraising programs with their actual experience.

The unintended consequences of reporting requirements will be reduced charitable fundraising

The impact of implementing reporting obligations as set out in 5.2 will impose additional costs on charities. Of that we can be sure. Of even greater concern is the likely reduction in charitable funding that will occur.

If reporting requirements enshrine fundraising cost to income as the performance metric for the charitable sector, I believe the unintended consequence is likely to be reduced charitable fundraising. In turn this will lead to underfunded opportunities to address social disadvantage in Australia, fund medical research and provide private funding to education and the environment.

Why might this occur? With the advent of reporting obligations, charitable boards would be obliged to look beyond fundraising and social impact to meeting the expectations for fundraising costs of the regulator. Rather than follow the logic of marginal revenue exceeding marginal cost for undertaking fundraising, charities would likely pull back to a target below 50%, a level that may satisfy the *Daily Telegraph* and keep a particular charity off the list of 'profligate spenders on fundraising'. Should this occur a substantial amount of fundraising will not be undertaken, the zone between 50% of fundraising cost to income and 100%. The end result can be expected to be a sharply reduced amount of charitable fundraising.

We should also expect to see a slowdown in the creation of PAFs and the increase in charitable income that flows from them. Recently I learnt that where individuals create a planned giving structure, such as a PAF, their annual giving increases four fold. If I have to choose between reporting individual tax donations to the ATO and to a regulator with a PAF I see a barrier emerging to creating new PAFs.

I don't assume the questions posed by the review to regulate charities are aimed at reducing charitable fundraising but that could well be the result. One could argue that in countries like the US groups like Charity Navigator provide such data and this has not led to reductions in fundraising. I see an important difference between private groups assembling data and reviewing fundraising costs and social impact, and the presence of a regulator imposing reporting obligations, especially with the unintended negative consequences that I have outlined above.