



TULIPWOOD ECONOMICS

Creating value through better public policy

***Measures in support of the not-for-profit sector***

***Indicators of Object 1(b) ACNC Act***

Final Report

6 December 2018

Tulipwood Economics

## Executive summary

Object (1)(b) of the *Australian Charities and Not-for-Profits Commission Act 2012* (the ACNC Act) is “to support and sustain a robust, vibrant, independent and innovative Australian not for profit sector”. The ACNC has sought advice on workable metrics, that would capture the objectives listed above, namely: *robust, vibrant, independent and innovative*, as applied to the not-for-profit (NFP) sector.<sup>1</sup> These metrics would be published annually. To the extent possible, the new information would be sought from the existing Annual Information Statement, to not increase the overall regulatory burden on charities and NFPs.

This report draws on a literature review to provide a range of workable measures to better understand how the NFP sector as a whole performs against the objects identified in the ACNC Act. These measures are intended to apply to the NFP sector, *rather* than to individual charities. It is not intended that these proposed measures evaluate the efficiency of individual charities in any way. Rather, the objective is to measure the health of the sector and how that health changes over time.

The following table summarises the proposed measures. Most measures proposed are already collected via the ACNC Annual Information Statement. However, some new questions may be required.

We have interpreted the object ‘vibrant’ as relating to the health of the NFP marketplace. The literature identifies several measures of vibrancy, including the rate of mergers and acquisitions, revenue growth, and the type of organisations operating in the marketplace by size and structure.

We have interpreted the object ‘robust’ as relating to organisational activity in terms of new registrations and revocations as well as a measure of average organisational longevity.

We have interpreted the object ‘independence’ as relating to the funding source. That is, what proportion of funding is derived by the government (taxpayer) or a major single benefactor.

We have interpreted the object ‘innovative’ as relating to the dynamism of the industry in terms of its ability to adapt and change and deal with external change. Here, we have proposed measures such as the rate of new sources of funding, new programs, how much collaboration is taking place between NFPs and the use of new technology platforms in the business.

Overall, in our view, these measures will add significant depth and perspective to the picture of the charities and NFP sector and promote continual improvement across the sector.

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<sup>1</sup> The ACNC only registers charities, however, much of the literature in the field relates to non-for-profits, as indeed does the ACNC legislation. For the purposes of the literature review the terms charities and not-for-profit are essentially synonymous.

**Table 1-1: Summary of proposed measures**

Object	Measure	Detail	New Activity Question required (Y/N)
Vibrant	Mergers	Report data by size of NFP	Yes
		Report data by industry sub-sector	
	Revenue growth	As above	No
	Distribution of size	Histogram chart or similar	No
	Range of organisational forms/vehicles	As above	No
Robust	Registrations	Report data by industry sub-sector and size	No
	Revocations	As above	No
	Net Registrations	As above	No
	Longevity	As above	No
Independent	Funding source	Government (taxpayer)	No
		Non-Government	
	Proportion of 'closely held' charities	By size and funding source	Possibly
	Proportion of 'highly-regulated' charities	As Above	No
Innovative	New sources of funding	By funding source and organisation type	Possibly
	Number of new Programs	As above	Possibly
	Collaboration with other NFPs or organisations	As above	Yes
	Uptake of IT and new technologies	As above	Yes
	Staff training/numbers of skilled staff	As above	Yes

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# 1. Introduction

Tulipwood Economics has been engaged by the ACNC to provide advice in relation to developing indicators of the objectives set out in Object 1(b) of the *Australian Charities and Not-for-Profits Commission Act 2012* (the ACNC Act).

Part 1 of *Division 15-5 Objects of this Act* is set out below, (Object 1(b) is highlighted):

## Division 15—Objects of this Act

### 15-5 Objects of this Act

- (1) The objects of this Act are:
  - (a) to maintain, protect and enhance public trust and confidence in the Australian not-for-profit sector; and
  - (b) to support and sustain a robust, vibrant, independent and innovative Australian not-for-profit sector; and**
  - (c) to promote the reduction of unnecessary regulatory obligations on the Australian not-for-profit sector.

## 1.1 Proposed scope of works

The ACNC Commissioner seeks advice on workable metrics, to be published annually, that would represent the objectives set out in 1(b) above. The Commission is to support and sustain a *robust, vibrant, independent, and innovative* NFP sector, but there are no agreed measures of these concepts. It is important to have agreed definitions and measures and, indeed, for the sector to be aware of these if these objectives are to be measured by the regulator.

These measures apply to the NFP sector, not to individual charities or not-for-profits. The measures should be drawn from readily recognised and tested measures in the for-profit or the not-for-profit academic or professional literature. The suggested measures should be simple, unambiguous, not burdensome to charities and, as far as possible, able to be collected through the ACNC Annual Information Statement.

## 1.2 Report outline

This report is structured as follows:

- In Section 2 we provide a brief overview of the NFP sector to inform the discussion.
- In Section 3, we undertake a literature review to better understand the types of issues that may be relevant in assessing the ‘performance’, broadly defined of the NFP sector.
- In Section 4 we draw on the previous discussion to propose several measures that are considered workable and tractable ways to follow not-for-profit performance against the objectives set out in 1(b).

## 2. NFP landscape

This section provides a brief overview of the Australian charities and non-for-profit sector, jointly referred to as the NFP sector in this report. The material is drawn from the Australian Charities Report 2016 and the ACNC Annual Report 2017-18 and is provided as background to later sections for readers not familiar with the sector.

### 2.1 Overview

The NFP sector is made up of a diverse range of entities. NFPs deliver services to their members, to their clients or to the community more broadly, such as welfare, education, sports, arts, worship, culture and emergency services. Some NFPs build or maintain community endowments such as biodiversity, cultural heritage and artistic creations. Some engage in educative, advocacy and political activities, while for others the focus is on activities that create fellowship. Many charities rely to a large extent on regular government (taxpayer) funding to deliver their services to the community.

Defined as a unique industry, the sector is large; comparable in size to the Australian transport sector, and larger than both the electricity, gas & water sector and the agriculture sector in terms of income and significantly larger in terms of paid employment. In summary, as at 2016:

- there were just over 50,000 economically significant NFPs (on the basis that they employ staff or access tax concessions), contributing just over \$100 billion to Australia's GDP, and accounting for around 10 per cent of total employment;<sup>2</sup>
- the registered charities sector generated \$142.8 billion in total revenue (of which, \$10.5 billion consisted of private donations) and \$137.1 billion in total expenses<sup>3</sup>;
- the sector consisted of 1.3 million paid staffers and 2.9 million (unpaid) volunteers; and
- the NFP sector held almost \$200 billion in total assets.

### 2.2 Size distribution

Table 2-1 below reports charity industry revenue, by size of charity. The distribution of charities by size is skewed towards smaller operations, with 40% of all registered charities reporting revenue of less than \$50,000 per year and only 160 charities report revenue above \$100 million per year. In contrast, while the large charities account for only 4% of all charities, together they account for 80% of total industry revenue. Median revenue for the very large charities (over \$100 million in revenue) is \$216.6 million per year.

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<sup>2</sup> GDP and employment estimates are calculated by Tulipwood Economics, based on Productivity Commission 2010 (Table 4.2).

<sup>3</sup> Australian Charities Report, 2016.

**Table 2-1. Australian Registered Charities sector - Total revenue by size of charity, 2016**

Size	Number	Mean (\$)	Median (\$)	Sum (\$)	% of total revenue
XS (<\$50k)	20,144	15,906	10,371	320,412,386	0.2
S (\$50k-<\$250k)	13,797	126,009	113,019	1,738,551,678	1.2
M (\$250k-<\$1m)	7,990	515,789	473,951	4,121,153,389	2.9
L (\$1m-<\$10m)	6,688	3,272,346	2,526,722	21,885,451,767	15.3
XL (\$10m-<\$100m)	1,888	25,256,562	18,960,821	47,684,388,756	33.4
XXL (>\$100m)	160	419,196,282	216,622,571	67,071,405,101	47.0
Total	50,667	2,818,824	113,525	142,821,363,077	100.0

Notes: All figures include estimated data for charities which had not provided financial reports, except medians which are based on reported data only. Excludes ORIC data.

Source: Powell et al (2017).

Table 2-2 below further illustrates the significant concentration of revenue in the largest charities. While the top 1% of all charities accounts for over one-half of total revenue, the bottom 50% of all charities only accounts for one-half of one percent of total revenue. The top 10% of all charities accounts for just under 90% of total revenue.

**Table 2-2. Revenue concentration, 2016**

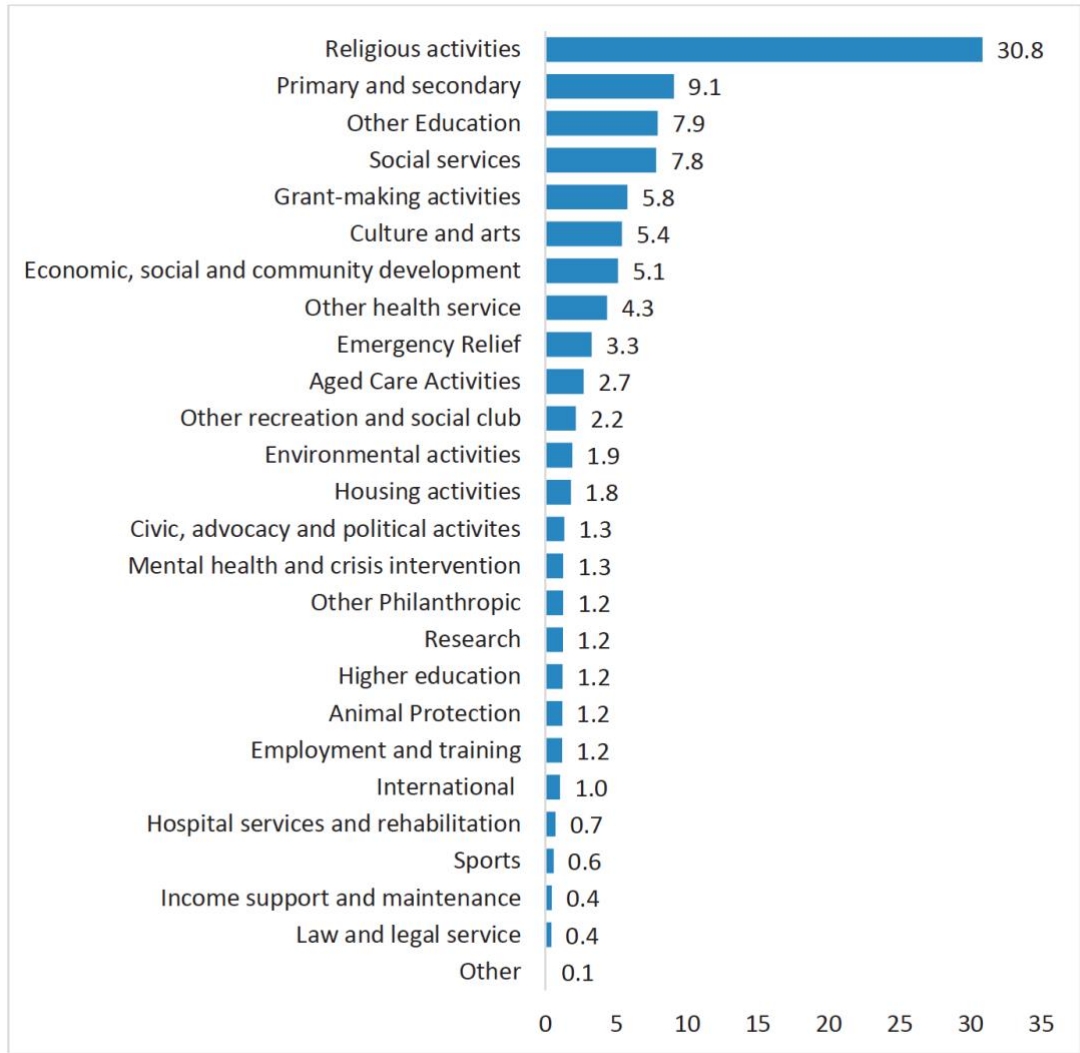
	Number	Percent of revenue	Mean revenue (\$)	Median revenue (\$)	Total revenue (\$)
Top 1% charities	401	54.9	168,074,471	74,090,226	67,397,863,009
Top 10% of charities	4,014	89.1	27,240,244	9,467,991	109,342,337,457
Top 20% of charities	8,027	95.7	14,633,121	3,636,619	117,460,060,052
Top 50% of charities	20,068	99.5	6,082,214	653,877	122,051,909,097
Bottom 50% of charities	20,068	0.5	31,082	19,790	623,757,519

Notes: based on reported revenue data only. Excludes ORIC data.

Source: Powell et al (2017).

Figure 2-1 provides an overview of the NFP sector by activity and shows that the focus of almost one-third of charities is religious activities. Charities focussed on education account for 17% of all charities. Social services (7.8%) and grant-making activities (5.8%) are also significant categories. Some more prominent charity sectors in the media and in public policy debate, such as related to environmental protection, political activity and mental health for example, are relatively small parts of the sector overall.

Figure 2-1. Charities by activity category (%), 2016



Notes: n=48,409. Information on main activity was unavailable for 2,258 charities. Excludes ORIC data. See also Figure A.16 and Figure A.17.

Source: Powell et al (2017).

## 3. Literature review

In this section we review the literature, as it relates to charities and not-for-profits more broadly to assess the relevance of the key terms highlighted in section 15-5(1)(b) the ACNC Act. Where relevant, we also draw on the commercial business literature.

### 3.1 Not-for-profits and charities

#### 3.1.1 Productivity Commission (2010)

In 2010, the Productivity Commission (PC, 2010) undertook a comprehensive review of the contribution of the NFP sector, including of its role in promoting productivity and social innovation. The following discussion summarises the main findings identified by the PC.

The PC also found that NFPs are diverse. Many operations are at the micro-scale, while some operations are very large, employing hundreds of people and engaging many volunteers. In some respects, NFPs and charities resemble conventional businesses. For example, NFPs combine 'inputs' to produce 'outputs'; but there are key differences, most notably a focus on their 'community purpose', rather than profits, but also production processes that tend to be more inclusive, participatory, quality focused and volunteer oriented. Figure 3-1 (below) classifies the main differences between the Business and Social sectors by many key issues.

**Figure 3-1. Major differences between the business and social sector**

<i>Issue</i>	<i>Business Sector</i>	<i>Social sector</i>
Accountability	Primarily responsible to stakeholders	Primarily responsible to constituents (e.g. disadvantaged children and their families) and myriad supporters or stakeholders
Defining and measuring success	Widely agreed-upon financial metrics of performance Money is both an input (a means to success) and an output (a measure of success)	Fewer widely agreed-upon metrics of performance Money is only an input, not an output Performance relative to mission, not financial returns, is the primary measure of success
Focus	Doing things right (efficiency) Competition to deliver the best products	Doing the right things (effectiveness <sup>a</sup> ) Collaboration to deliver the best outcomes
Leadership/ Governance	Governance structure and hierarchy relatively clear and straightforward Concentrated and clear executive power often substituted for leadership	Governance structures often have more components and inherent ambiguity More diffuse and less clear executive power with leadership more prevalent
Talent	Often have substantial resources to attract and retain talent Can more easily get the wrong people 'off the bus' for poor performance	Often lack the resources to acquire and retain talent Tenure systems and volunteer dynamics can complicate getting the wrong people 'off the bus'
Access to capital	Efficient capital markets that connect to the profit mechanism Results attract capital resources which in turn fuel greater results, and so on	No efficient capital markets to channel resources systematically to those who deliver the best results

<sup>a</sup> This refers to both effectiveness (did it work?), and to allocative efficiency (was it the right thing to do?).

Source: Collins (2005).

Source: Productivity Commission (2010)

### Efficiency and productivity

Different measures of efficiency – making the most of limited resources – are a key metric for evaluating NFPs, as they are for commercial businesses. In the context of NFPs, efficiency in production translates into cost-effectiveness in achieving the NFP's community purpose. NFPs are clearly less subject to commercial pressures to improve productivity (for instance, NFPs may be able to source additional revenue via taxpayer funds), and managers have weaker incentives to achieve financial targets.

At the same time, the PC notes that NFPs face some constraints in improving their productivity, including difficulties in accessing longer-term funding to invest in technology and training, a lack of support for evaluation and planning, prescriptive service contracting by government, and in some cases resistance to change by volunteers, members and clients. Similarly, NFPs' incentives to adopt innovative approaches is sometimes restricted by risk averse attitudes on the part of funders and boards, constraints on investment in knowledge and a reluctance to collaborate with other NFPs. These issues are material to finding appropriate indicators for sector-wide measures of robustness, vibrancy, independence and innovation.

In its report, the PC distinguishes between:

- efficiency in production – how well inputs are turned into outputs, or ‘did it work’; and
- efficiency in allocation – putting resources to the uses that deliver the best outcomes for the community, or ‘doing the right thing’.

The PC found that the drivers of efficiency in production in the NFP sector can differ:

- Many NFPs add value to the community through the way in which their activities are undertaken. The way in which NFPs are organised, engage people, make decisions, and go about delivering services is often itself of value. Yet, such participatory and inclusive processes can be time consuming and costly, and severely complicate measuring and valuing the ‘output’ of NFPs.
- NFP activities may generate benefits that go beyond the recipients of services and the direct impacts of their outcomes. For example, involving families and the local community in the delivery of disability services can generate broader community benefits (spillovers), such as greater understanding and acceptance of all people with disabilities thereby enhancing social inclusion. Smaller community-based bodies can play an important role in generating community connections and strengthening civil society.

Selecting which mix of activities delivers the greatest benefit to the community is a challenge; unlike in markets, prices do not serve as an allocation mechanism. Stakeholders, such as donors or members, play a role here, as does NFP management, but also the government, either directly (for instance, by using NFPs to deliver services and through grants) or indirectly through the taxation system.

In relation to the productivity of NFPs, the PC then concluded:

- Whether NFPs are fully productive, in the sense that they minimise the unit cost of producing an output, is very difficult to establish, given a lack of data and definitional issues. Quality is an important dimension of activities that delivers value to stakeholders, including intrinsic returns to management.
- Many (smaller) NFPs may not view productivity metrics as important. However, this is not the case for NFPs that rely on support from donors, or provide government funded services, where achievement of their mission is a central concern. Further, it might not be possible to meet future demand for services unless more cost-effective ways are found. Related to this, there is a push for greater accountability by NFPs. Business and other major donors increasingly want evidence of the effectiveness of the activities, and prefer NFPs that can provide robust business cases for the investments they seek.
- The size of NFPs and their ability to attract non-government funding can then be considered a broad indicator of the effectiveness and efficiency of NFPs. While smaller agencies may be better placed to meet certain social needs, larger organisations have some clear advantages:
  - scale is associated with reduced average costs (training, IT, office space);

- scale facilitates funding and increases an organisation's reach; and
- scale tends to be associated with improved utilisation of technology.

The PC found that the importance of scale points to a need for mergers and collaboration between NFPs. Over time, efficient production requires investments in skills, capital, planning, research and relationships that allow the 'best' (defined by quality as well as quantity) outputs for the level of inputs. Many NFPs would agree that they face constraints on increasing their production efficiency due to difficulties accessing finance and in freeing up resources to invest in training and enabling technologies such as management systems.

The PC also highlighted the potential for technology to reduce costs and improve effectiveness in the delivery of services, but also in advocacy, fundraising and other NFP activities. Participants suggested that there are two areas where common technology can play an important role — in client record management systems and in accounting and reporting. Yet, at the time of the inquiry (in 2010), the sector lagged on the adoption of ICT.

### Social innovation

Social issues or problems are described by the PC as multipart problems; solving these requires identifying the causes of the problem, including difficult social problems, and require multidisciplinary views from different stakeholders. While funding is important, so too is the commitment to work together across the whole social innovation process.

The PC found that the purpose-driven nature of activities should encourage NFPs to explore new approaches to achieving that purpose, often requiring collaborative approaches. Research collaboration, for instance with universities and research organisations, should be promoted. There needs to be a coordinating mechanism to bring interested parties together, with the ability to harness sufficient resources to collaborate on exploration, experimental and execution platforms.

### Funding

As of 2010, NFPs obtained funding from three broad types of sources — philanthropy, government and self-generated income. For economically significant NFPs, around 50 per cent of all income is self-generated, while 33 per cent comes from government. Demand will generally exceed supply, and many community-serving NFPs must ration their services in some way.

There are limits to what government is willing and able to fund, and public funding for innovation will generally be focused on innovation that is applicable at a jurisdiction level or addresses issues of broad public interest. For these reasons, and to help ensure their sustainability, NFPs must look beyond government for innovation funding. Member-serving NFPs face less of a funding constraint, but like community-serving NFPs, may face financing constraints which make it difficult to make investments such as in information systems, housing or training for staff. For many smaller NFPs, productivity and innovation are limited by poor access to finance for investment.

## Skills and the NFP workforce

The PC found that many areas of NFP activities are becoming ‘professionalised’, resulting in a shift to paid employment to attract qualified workers. In some sectors (community services), skill shortages are a sector-wide issue related to low wages and lack of career paths. NFP boards also need to develop their governance skills as their tasks have become more complex with delivery of government funded services and demands by donors, members and clients for greater accountability. The PC cites research suggesting that most NFP failures stem from inexperienced, weak or sympathetic supervisory groups.

NFPs in the community services sector identified many key workforce issues that influence their effectiveness, including:

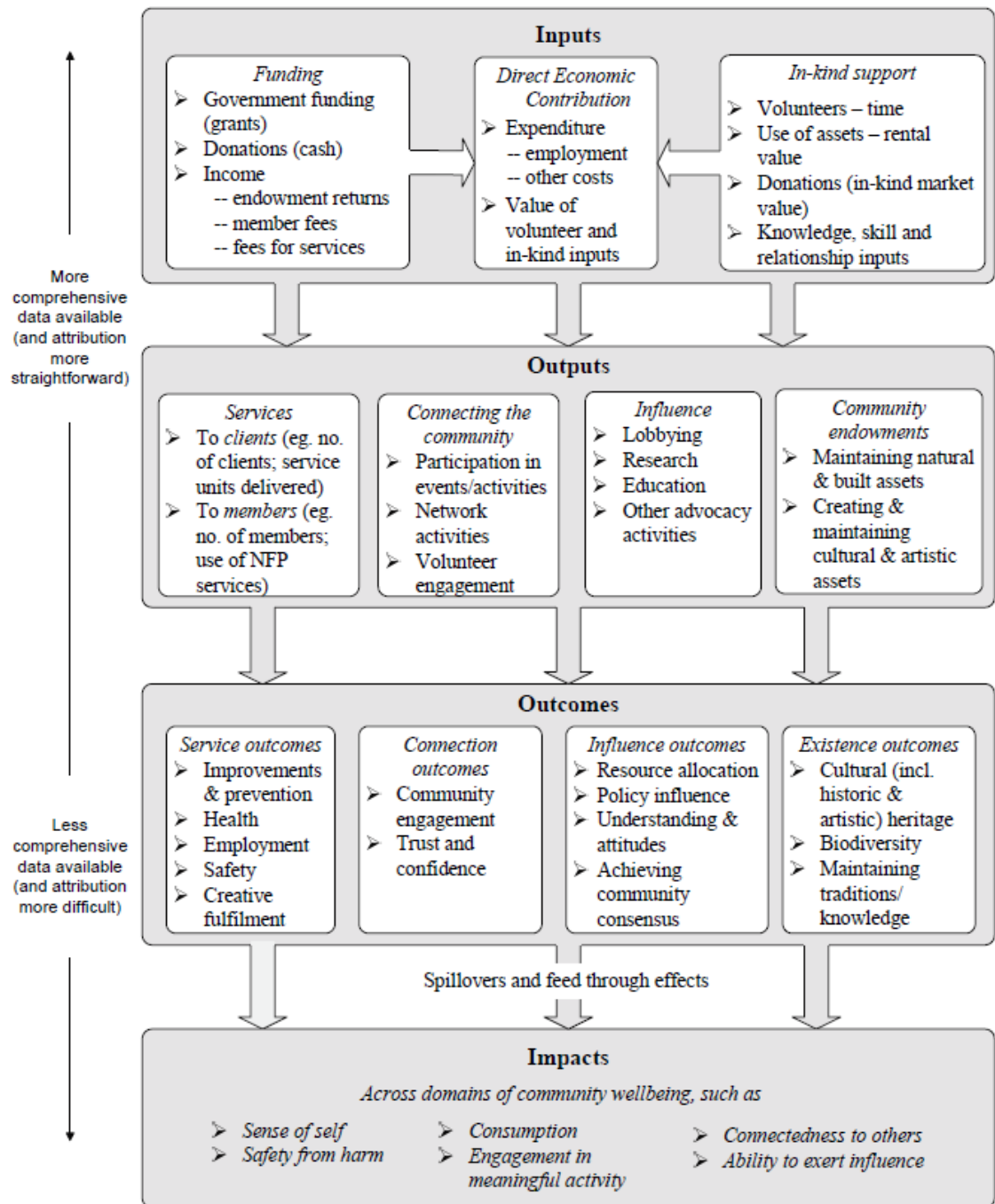
- the impact of professionalisation on costs of delivering services;
- difficulties attracting and retaining employees due to low wages;
- high levels of employee turnover within the sector; and
- a lack of career paths and training opportunities.

These difficulties are illustrated by the declining share of volunteers working in the NFP sector, high turnover and vacancy rates, a high share of part-time and casual workers, and a higher proportion approaching retirement age. There are concerns that the failure to engage appropriately qualified staff can have adverse effects on clients.

## Measurement framework

Overall, the PC proposes a measurement framework to guide the collection of data, evaluation approaches and reporting, and production of information about the sector (Figure 3-2).

Figure 3-2. A framework for measuring the contribution of the sector



Source: Productivity Commission (2010)

### 3.1.2 Performance measurement and NFPs

Campbell and Lambright (2016) use survey and interview data to investigate the motivations of funders and NFPs for collecting and analysing program-level performance information. There are differences in the two groups' respective motivations, reflecting each group's distinct interests and attention to different constituents:

- Funders collect performance information to learn whether their expectations for the resources they provided were met, as well as to gather planning information consistent with their mission.
- NFPs emphasised collecting performance information to enhance their responsiveness to clients and improve services.

There is a concern that the funder-driven emphasis on outcome measurement may be too short-term in focus, punitive in nature, and de-emphasises organisational learning. Also, given the number of stakeholders in the performance assessment process, coming to a consensus on a single measure of program performance is likely to be difficult if not impossible for most organisations.

Overall, current practices privilege the perspective of funders. For example, NFPs emphasised the importance of responsiveness to funders; yet funders did not consistently seek the kind of information NFPs valued. Funders required outcome information while NFPs valued information that told them about beneficiary experiences. A more effective performance measurement process would therefore involve collaboration and negotiation among multiple constituents in defining what constitutes performance and how to measure it.

### 3.1.3 Business-like NFPs

Maier et al. (2016) discuss the implications of NFPs becoming more business-like in their organisation and operation. They note that, since the 1980s, NFPs have undergone changes that have made them more like for-profit enterprises, as reflected in the following trends:

- a corporatisation in terms of governance structures;
- marketisation, in the sense of increasingly market-type relationships with stakeholders;
- consumerism, as reflected in the changed attitudes of beneficiaries, funders, or volunteers;
- market orientation (or marketing orientation) as reflected in the generation of, dissemination of, and responsiveness to intelligence about customers and competitors; and
- professionalisation, reflecting a more business-like approach in the selection of personnel, for instance by raising volunteers' qualification levels, employing more paid staff, and placing stronger emphasis on formal educational credentials.

The authors' survey suggests that the effects of more business-like NFPs are generally positive, although there are some exceptions:

- Organisational performance is positively related to market orientation, but not to commercialisation. These positive effects seem to be stronger if business-like approaches are implemented fully, and in NPOs that are already business-like.

- The effects of commercialisation on the ability to attract and retain qualified staff differ between activity fields. In human service NFPs, positive effects were found, while commercialising universities may suffer negative effects. Where attracting financial resources is concerned, the positive effects of market orientation are well documented.
- The effects on the fulfillment of societal functions are mixed. For NFPs that provide services, the evidence about mission drift is inconclusive. Some studies find that commercialisation does not lead to mission drift, that diversified funding may prevent mission drift, and that commercial activities may even promote mission attainment. Business-like approaches may lead to a drift away from community-building, and to some extent from advocacy, toward service delivery.
- The findings about the effects of client orientation of services vary. Quantitative studies suggest that market orientation improves client satisfaction. Yet, several qualitative studies suggest that ‘managerialisation’ has detrimental effects on service quality.
- Professionalization helps NFPs to become more proactive and heard by governments. At the same time, a dependency on government funding in ‘marketised’ and ‘managerialised’ exchange relationships may weaken advocacy in favour of service-delivery.

### 3.1.4 Accountability of NFPs

Dhanani and Connolly (2012) focus on the accountability of UK charities. The authors identify four key themes relating to the accountability of NFPs (Table 3-1). While they each emphasise slightly different constituency groups, collectively, they are concerned with the willingness to account and the preservation of public trust as embedded in the ethical model of stakeholder theory:

- strategic accountability is associated with an NFP’s core purpose;
- financial accountability is concerned with their financial outlook and the main trends and factors underlying their financial development;
- fiduciary accountability emphasises probity and compliance, and at an operational level, good governance and control, as well as with the professionalism with which organisations are run and the safeguarding of their funds, assets and future; and
- procedural accountability disclosures relate to internal organisational operations and are designed to confirm that management processes and procedures embody societal norms and beliefs.

**Table 3-1. Not-for-profit accountability: examples of disclosure items**

<i>Strategic accountability</i>	<i>Procedural accountability</i>
Aims and objectives	Ethical operational policies
Charitable activities, programs and projects	Investment
Performance and achievements	Trading
Program results/outcomes/impact	Fundraising
Program efficiency	Advocacy
Program effectiveness	Environmental
	Staff
	Volunteers
	Downward stakeholders
<i>Fiduciary accountability</i>	<i>Financial accountability</i>
Governance	Financial position/stability
Organizational structure and decision making	Income
Risk management	Expenditure
Trustee recruitment policies	Surplus/deficit levels
Financial policies	Trading activities
Investment	Performance of financial policies
Reserves	Investment
	Reserves
	Organizational efficiency
	Program spend
	Fundraising

Source: Dhanani and Connolly (2012)

The results of the study suggest that the annual report served as the formal accountability document while the voluntary annual review principally performed a publicity role. In addition, disclosures in both documents were not led by the ethical model of stakeholder theory. Management sought to respond to market expectations and, to some degree, the recommendations of the Charity Commission, rather than account proactively and disclosures were also cultivated to present a positive image.

### 3.1.5 NFP reform in Australia

Weinert's (2013) research is concerned with the scope and potential for reforming NFPs in Australia.

The author notes that mismanagement and opportunistic behaviour within NFPs occurs because of their amenable structures, which permit a small number of people to have the exclusive power to manage and control the organisation's affairs. This can be hidden from the membership base regardless of its size. Weinert finds that the promotion of regulations to achieve transparency, governance and accountability under the ACNC Act is limited to registration and the submission of an annual statement and that the federal government's reforms do not address the major issues that greatly affect the sector:

- managing risks and related parties' transactions;
- avoiding charity abuses;
- preserving the sector's independence; and
- protecting an entity's property.

‘Social inclusion’ policies involve governments seeking to share the responsibility of providing social and welfare services with NFPs. The main consequence for NFPs being enticed into a partnership with government is a phenomenon referred to as the ‘contract culture’: a shift in how not-for-profit organisations secure funding. Statutory funding involves the government ‘contracting out’, for a fee, to an NFP to provide services that were once directly provided by the government.

This new construct has given rise to numerous implications for many NFPs. For NFPs that are highly reliant on government contracts, a ‘quasi-market’ emerges where the government dictates this market’s operation. Funding is distributed within this market by the purchaser’s contract, which has created a contract culture, as well as a competitive tendering culture amongst NFPs. Under the government’s contract, an NFP must deliver services efficiently, and many report that this requirement brings pressures that the organisation did not experience before the development of contracts, and risks the sector’s diversity. Governments have an interest in ensuring that high standards are delivered, hence the delivery of services has become indistinguishable from how the government provides services. Overall, this has resulted in the sector becoming less diverse and less independent.

### 3.1.6 Market orientation and NFPs

Wood et al. (2000) undertake a statistical study to evaluate the effects of market orientation and organisational performance on 37 not-for-profit hospitals. The results suggest evidence of a positive association between market orientation and both the professional commitment of the senior management team and organisational entrepreneurship, and tend to validate the relationship between market orientation and hospital performance.

Market orientation is defined as the organisation-wide generation and dissemination of, and responsiveness to, market intelligence, comprising four distinct notions:

- gathering, monitoring, and analysing information pertaining to the current and future needs of customers;
- monitoring and analysing exogenous factors outside the industry that influence the current and future needs of customers (e.g., government regulations, technology, the general economy, and other environmental forces);
- monitoring and analysing competitive actions that influence the current and future needs of customers; and
- gathering and monitoring market through both formal and informal means.

The authors find that market orientation directly influences organisational performance. The degree of market orientation in turn depends on: the professional commitment of the senior management team; the professional education of the senior management team; the professional ethics of the senior management team; the extent of organisational entrepreneurship; perceptions of the presence and intensity of the competition; perceptions of competition as a threat; and the perception of demand as it relates to the organisation’s capacity to serve.

### 3.1.7 Performance measurement of NFPs

Macpherson (2001) comments on performance measurement in NFP and public sector organisations. The author argues that attention to human resources (HR) performance is more critical in NFPs where human costs (payroll, benefits, training and development) can account for more than 75% of overall costs, and whose human assets directly affect performance. Measurement of human resources performance fall into three broad areas:

- function measures include employment efficiency and effectiveness measures like turnover, cost per hire and grievance numbers;
- operational measures which track productivity and profitability per employee; and
- strategic measures are future-oriented (required vs current skill set, culture, environment, information utilisation, technology utilisation and demographics).

As a process matures, the indicators used to track its performance may also mature. For example, an organisation may decide that completing an action or delivering an outcome by a due date is an appropriate measure of performance.

### 3.1.8 Barriers to service evaluation

Bach-Mortensen and Montgomery (2018) survey the relevant literature to identify the barriers that may prevent NFPs from evaluating their activities in accordance with government or donor requirements.

The main barriers to undertaking (self-) evaluations are related to organisational capacity (resources) and capability (skills and knowledge). While NFPs are under growing pressure to evidence their performance to secure grants or contracts, they do not have the necessary support to undertake meaningful evaluations. The authors' findings are consistent with a reported tendency that many NFPs customise their evaluation procedures not to improve their service delivery, but to satisfy funding bodies and to meet the increased pressure of performance measurement.

The authors further found that not external barriers and facilitators are central for NFPs to undertake evaluation, but that organisational culture and management were also important. They cite a recent report by the Big Lottery Fund, which found that despite allowing its grantees to spend up to 10% of the allocated funding on self-evaluation, half of the surveyed NFPs only allocated between 1% and 5% of their budget to these activities. Additionally, there is little consensus among funders, practitioners and other stakeholders about what constitutes good practice, pointing to a lack of stakeholder collaboration and inclusion in defining and planning the evaluation requirement of NFPs.

### 3.1.9 Innovation and diversity

Gilmour and Milligan (2012) examine the growth of 'hybrid' NFP organisations that are active in social housing in Australia, encompassing traditional housing and welfare organisations that have adopted an entrepreneurial ethos, as well as an array of newer state, private or not-for-profit-sponsored special purpose vehicles (SPVs). The hybrid

diversity found in Australia can be explained partly through different policy contexts that operated at the time individual organisations were established and by the influence of varying policies at state government level, including a recent shift to private finance. In addition, the Australian Government has an explicit policy objective of professionalising the NFP housing sector through commercial disciplines and private sector partnerships.

The authors identify several emerging issues that are relevant to governments using hybrid organisations to deliver social housing policy:

- These organisations face challenges in balancing social and economic missions, there is a risk of them ‘becoming too attached to commercial motivations and losing touch with their social objectives’. There is an apparent split between the more traditional organisations, which retain a balanced social and economic mission, and SPVs with less grounded social missions and riskier business models.
- Some traditional and more novel organisations have relatively shallow community anchorage.
- Widespread diversity among Australian NFP housing organisations may moderate the speed at which the sector can grow. For example, organisational heterogeneity limits the ease of staff and knowledge transfers, and minimises economies of scale for professional service providers, lenders and tax-credit investors.
- The diversity of, and innovation by, housing providers of the last four years may be short-lived. Institutional factors such as the proposed introduction of national regulation will most likely encourage greater convergence in the modus operandi of different housing provider types. Unless more sustainable public policy settings and funding strategies emerge, the shelf life of high-risk not-for-profit business models may be short-lived.

### 3.1.10 Attitudes to financial reporting of NFPs

Palmer (2013) surveys the attitudes of Australian NFPs and interested bodies towards financial reporting in the Australian NFP sector, as reflected in the submissions to the Senate inquiry into the disclosure regimes for NFPs.

The author finds that:

- There is a widely held view that adequate disclosure and transparency are critical to the ongoing development and confidence of the sector and that these concepts could be improved across the sector.
- Financial reporting is one of the key ways in which disclosure and transparency are achieved and is also an area for improvement. There is a clear link between good financial reporting and securing funding from the public and government grants. However, non-financial information, such as effectiveness of programme outcomes, should also be considered when considering the transparency of the sector.
- Consistency in regulation – in relation to state-based regimes – is essential to ease the administrative burden and reduce the compliance costs NFP entities face, and improve stakeholder confidence in the NFP sector.

- The myriad legal forms of NFP entities contributes to the complexity and fragmentation in the sector and hinders accountability.
- NFPs considered that current accountability models are focused on a ‘for-profit’ definition, and that a specific accounting standard for the NFP sector is needed.

### 3.1.11 Motivation of NFP employees

De Cooman et al. (2011) examine differences in motivation-related concepts between employees in NFP and for-profit service organisations. They find that for-profit and NFP employees differed in certain work values and motivational types:

- NFPs and for-profit organisations offer very similar job contents, in terms of decision authority and autonomy or for skill utilisation or for work pressure. There is also no difference in financial security, and in work effort, although monetary remuneration is a more important motivator in for-profit organisations.
- NFP employees have significantly more client contact in delivering their services.
- Even after the impact of gender, age, seniority, contract type, and job content were controlled for, employees from both sectors differed significantly in the importance they attributed to the work values social service and career and leadership. NFP workers valued making a positive difference in people’s lives more than employees in the for-profit sector.
- Workers are less likely to receive promotions in NFP than in for-profit organisations, probably because NFPs are less hierarchical and because there are more older employees. For the third work value, financial security, no difference was found between the sectors.
- Employees in NFPs perceived a better fit between their work values and the organisational values than their counterparts.
- There is no difference in the extent of ‘intrinsic’ motivation (interesting and fun aspects of the job), but NFP were significantly more motivated by their appreciation of valued outcomes and outcomes that are personally important.

## 3.2 Relevant business literature

While NFPs differ in important respects from conventional businesses, there are nonetheless areas of overlap where relevant parallels can be drawn. The analysis of managerial models and tools developed in the management literature and practice stresses the importance of measurement as a process for assessing business performance. The following literature is necessarily brief but provides some relevant insights into key themes in the business literature.

### 3.2.1 Balanced scorecard

Sim and Koh (2001) discuss the concept of a ‘balanced scorecard’ as a tool for strategic performance measurement, a tool developed by Kaplan and Norton (1992) as an integrated model for measuring organisational business performance. This model

marked the development in managerial studies of performance measurement, highlighting that business excellence is:

- first, tied to four fundamental perspectives: an economic and financial perspective, a customer perspective, an internal process perspective, and a learning and innovation perspective; and
- second, to the integration of the measures into a unified framework.

The balanced scorecard framework is built around the premise that companies can no longer gain sustainable competitive advantage solely by developing tangible assets; intellectual capital is a critical success factor (Figure 3-3). Thus, a statistical analysis of 83 companies suggests that:

- innovative techniques and employee training are positively correlated to shorter product development time and quality, while quality is positively related to the customer perspective;
- employee training is positively related to delivery and customer performance, and lower manufacturing costs;
- innovative techniques are related to lower manufacturing costs, higher sales and greater market share; and
- a shorter product development time is related to lower manufacturing costs and a greater market share.

**Figure 3-3. Framework of the balanced scorecard for a manufacturing division**

Perspective	Goals	Performance measures
<b>Innovation and learning</b>	Be innovative and continually improve our manufacturing skills	Employee training (average across three indicators) (1) management devotion to quality improvement (2) quality related training provided to employees (3) Percent of employees who have quality as a major responsibility Innovative techniques (average across three indicators): (1) quality function deployment technique (2) Taguchi methods (3) continuous process improvement technique New product development time
<b>Internal business process</b>	To improve manufacturing efficiency	Quality performance (average across five indicators) (1) cost of scrap (2) units reworked (3) units of defect (4) warranty cost (5) sales returned Performance in manufacturing lead time
<b>Customer</b>	Delight the customers	Customer performance (average across three indicators) (1) customer perceived product durability and reliability (2) customer perceived overall product performance (3) customer complaints Delivery performance (1) Percent delivered to schedule
<b>Financial</b>	Reward shareholders by cutting costs and improving sales	Manufacturing costs Sales Market share

Source: Sim and Koh (2001, p22)

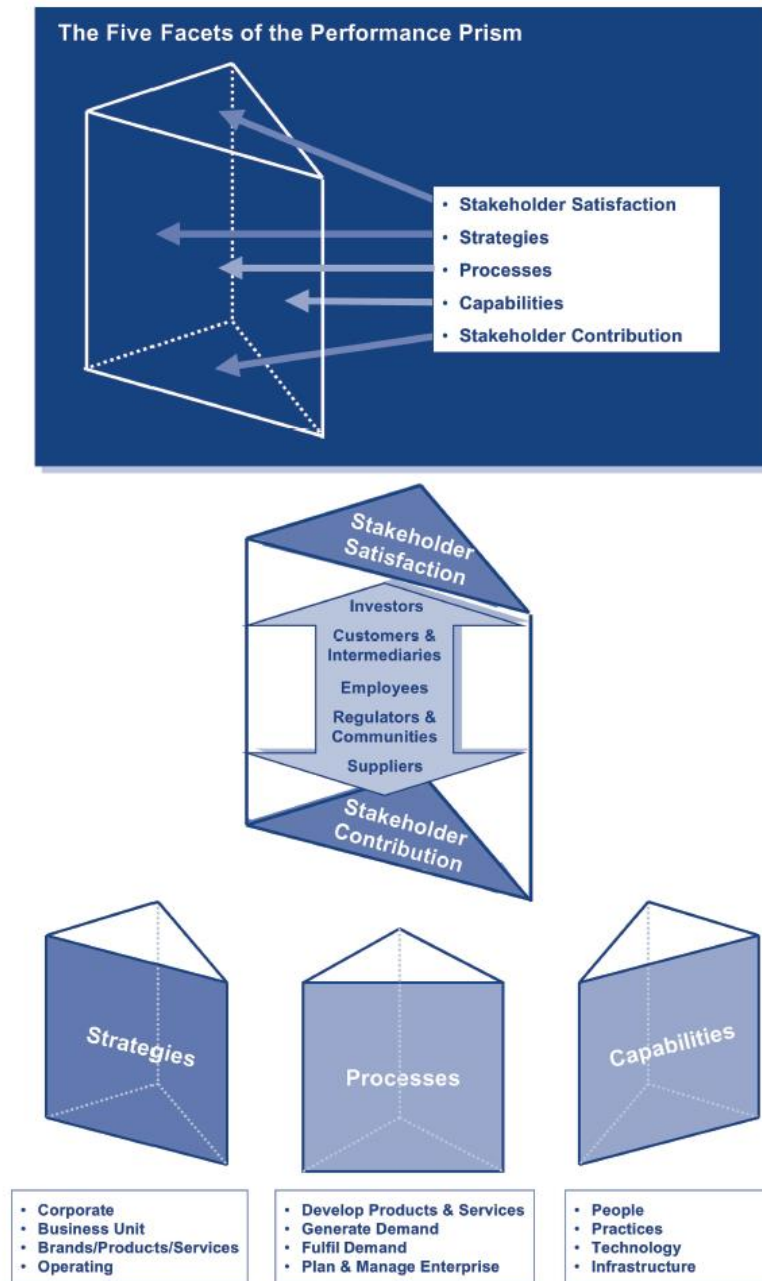
### 3.2.2 Performance prism

Neely et al. (2001) expand the balanced scorecard framework to incorporate stakeholders explicitly, making this approach more suitable for application to NFPs. The

authors' 'performance prism' consists of five interrelated facets, each with their associated questions (Figure 3-4):

- Stakeholders: Who are the important stakeholders in an organisation and what do they want and need? Here, stakeholders include shareholders and customers, but also employees, suppliers, alliance partners or intermediaries.
- Strategies: What are the strategies required to ensure the wants and needs of stakeholders are satisfied?
- Processes: What are the processes that need to be put in place to allow these strategies to be delivered? Such processes may include: developing new products and services, generating demand, fulfilling demand, and managing and planning the enterprise.
- Capabilities: Capabilities are the combination of people, practices, technology and infrastructure that together enable execution of the organisation's business processes now and in the future. What are the capabilities required to operate the identified processes?
- Stakeholder contribution: This symbiotic relationship between the organisation and the stakeholder is true for all classes of stakeholder whether we are talking about suppliers, customers, employees, alliances, investors, or the local community.

Figure 3-4. Five facets of the performance prism



Source: Neely et al. (2001, p.12)

The authors apply the performance prism framework to businesses, but also to an NFP - The London Youth NFP. This NFP's membership includes 460 youth clubs, groups and projects made up of 75,000 young people, as well as 5,000 adult leaders and committee members. They note that while charities do not have shareholders and do not seek to make a profit, but do have benefactors who donate funds and provide them with the financial income that enables them to do their good works. These benefactors expect to see their funding spent on projects that have tangible benefits, and they are unlikely to part with more cash unless they can see some evidence of money well spent. The prism framework was then applied to The London Youth NFP to assist the organisation in meeting its current and future challenges.

## 4. Proposed metrics

The Australian NFP sector is diverse across a range of indicators, including size, revenue, purpose and income source. The literature review additionally revealed a literature covering many aspects of the NFP sector, including productivity metrics, but also staff and volunteer attitudes, transparency, recent trends towards greater market orientation and commercialisation, as well as governance.

The objects identified in 1(b) of the ACNC Act can be categorised as follows:

- Robustness:
  - How responsive is the industry to environmental, social or economic ‘shocks’? Can the industry adapt to a new social ‘threat’, such as a greater emphasis on transparency and accountability?
  - Is the industry resilient over time?
- Vibrancy:
  - Is the industry changing over time and adapting effectively to new circumstances, for instance, are new entities or legal vehicles emerging to address identified needs?
- Independence:
  - How independent are NFPs from government funding?
  - To what extent do NFPs rely on a sole source of funding?
- Innovation:
  - Is the industry developing new products and services?
  - To what extent is new technology used to provide better products to clients and the community?

The literature review provides insights into potential metrics to measure the key terms identified in the legislation. In this regard, it is important to keep in mind that the objective is to find workable sector-wide metrics of robustness, vibrancy, independence and innovation, not firm-level efficiency or other firm-based performance metrics. The proposed metrics are compatible with the Annual Information Statement (AIS) or would require minor adjustments to the AIS to obtain the relevant information.

Based on the literature review, we propose the following metrics:

- An NFP sector that is vibrant is changing, and growing. Mergers may indicate that NFPs are joining forces to make the most of their respective ‘competitive advantage’. An NFP sector that is diverse, in terms of size or organisational forms, could also be interpreted as indicating that individual entities are focusing on how best to deliver services to their clients.
- An NFP sector that is robust would be expected to grow, in the sense that the number of new registrations is increasing, and decreasing numbers of registration.

The average longevity of entities may also offer an indication of the robustness of NFP initiatives.

- Independence can be interpreted to refer to both financial independence or regulatory independence, which may in turn support more innovative service models. The PC, for instance, noted that NFPs that are highly reliant on government funding may drift towards a ‘contract culture’. Relatedly, a high reliance on one or few sources of funding may suggest that an organisation is less robust to changes in external conditions than might otherwise be the case.
- In the literature review, innovation is associated with access to IT, staff skills, and more broadly, the flexibility to adopt changing service and organisational models, including by cooperating with other organisations (see Table 4-1 below).

**Table 4-1: Proposed summary metrics**

Object	Measure	Detail	New Activity Question required (Y/N)
Vibrant	Mergers	Report data by size of NFP Report data by industry sub-sector	Yes
	Revenue growth	As above	No
	Distribution of size	Histogram chart or similar	No
	Range of organisational forms/vehicles	As above	No
Robust	Registrations	Report data by industry sub-sector and size	No
	Revocations	As above	No
	Net Registrations	As above	No
	Longevity	As above	No
Independent	Funding source	Government (taxpayer) Non-Government	No
	Proportion of ‘closely held’ charities	By size and funding source	Possibly
	Proportion of ‘highly-regulated’ charities	As Above	No
Innovative	New sources of funding	By funding source and organisation type	Possibly
	Number of new Programs	As above	Possibly
	Collaboration with other NFPs or organisations	As above	Yes
	Uptake of IT and new technologies	As above	Yes
	Staff training/numbers of skilled staff	As above	Yes

These proposed measures, to the extent possible, should be derived from existing data sources, principally the AIS. Firstly, however, we recommend that these proposed measures be circulated to stakeholders for comment and further refinement.

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