COVID-19 policy snapshot

Partners in recovery: why charities need tailored support

Summary

Charities are a vital part of Australia's society and economy. They provide services that we all rely on, and employ around one in ten Australian workers.

Charities are working in challenging circumstances to help get us through the current crisis. They are losing revenue from multiple sources at the same time as they face increased demand for their services, and increased delivery costs. We will need charities even more as partners in recovery, but many charities are vulnerable themselves.

Charities face different financial, legal and operational constraints to commercial businesses, which will make it harder for them to rebound. Their financial position was precarious going into the crisis, with decreasing margins and limited reserves, due to their unique position as charities. Charity revenues don't recover from downturns the same way that business revenues do. And they can't easily access the resources they need to rebuild and transition to a new normal.

Charities need tailored support from government that recognises their unique situation if we are to preserve jobs and services. We cannot assume that business-oriented support will work for them. All charities that have been hit by the economic crisis need access to a 'ramp' not a 'cliff' for the end of JobKeeper, along with an integrated package of measures to tackle the structural challenges they face.

Partners in recovery: why charities need tailored support

As Governments consider their next round of support to alleviate the economic damage caused by the COVID-19 crisis and help companies bridge to the recovery, misconceptions about the financial structures underpinning Australian charities could leave many exposed if the policies are just designed for commercial entities.

Charities have some fundamental differences in financial structures compared to other organisations. Government policies for recovery, including changes to JobKeeper, will need to be adapted to support Australia's charities.

Australia's 54,000 charities employ 1.3 million people.[1] They contribute more than 8 per cent of Australia's GDP[2] - the equivalent of the entire construction industry, and more than the manufacturing industry.[3] Charities are critical to Australia's society and economy, and provide services that people, communities and government rely on.

Ensuring we have thriving charities will be critical to the future productivity and wellbeing of Australia. But as our previous report '*Will Australian charities be COVID-19 casualties or partners in recovery? A financial health check*' showed, many charities are struggling. They are losing revenue from multiple sources at the same time as they face increased demand for their services, and increased delivery costs.

Charities aren't in the same position as commercial businesses to bounce back as the health crisis recedes. Social distancing affects some of their activities, and the current situation in Victoria shows that some forms of distancing will likely be required for a long time. These impacts could reduce as restrictions ease, but the financial hit they are experiencing is significant. It is affecting their long-term viability, and will require a direct response.

The economic downturn compromises their financial viability precisely at a time when we will all need *more* from our charities to support us in the recovery. They will provide the social glue that helps our communities to rebuild and we need to continue to invest in them.

What makes charities so uniquely vulnerable? We identify three factors. Our analysis shows that:

- Their financial position was precarious going into the crisis, with decreasing margins and limited reserves, due to their unique position as charities
- Charity revenues don't recover from downturns the same way that business revenues do
- Charities can't easily access the resources they need to rebuild and transition to a new normal.

For each of these reasons, charities will need tailored support to survive and thrive in the coming years.

Charities were already in a uniquely precarious position

Charities have been operating on increasingly thin margins. As Figure 1 on the next page shows, their net income ratio fell to 6.3 per cent in 2018 from 8.7 per cent in 2017. On average, charities who employ people are even leaner – their 2018 aggregate net income ratio was only 4.9 per cent.[4] We expect that the situation in early 2020 would have become even worse for many charities, as

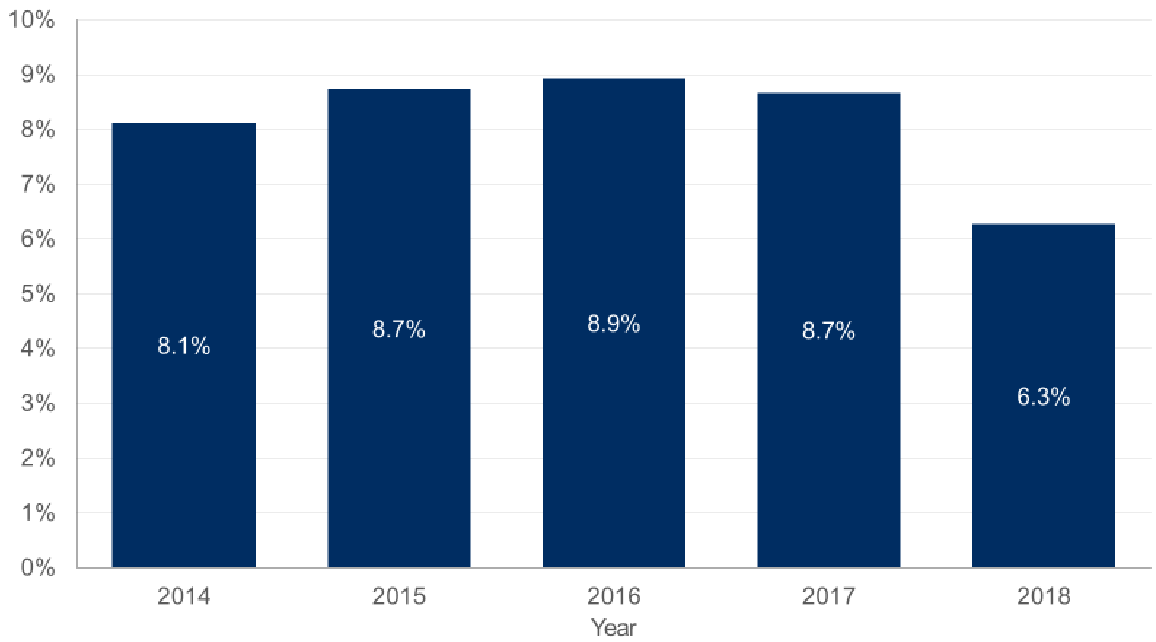
[1] ACNC (2020) *Australian Charities Report 2018*
[2] ACNC (2020); ABS (2019) *5206.0 Australian National Accounts: National Income, Expenditure and Product*, *Dec 2018*.
[3] Reserve Bank of Australia (2020) *Composition of the Australian Economy: Snapshot 8 July 2020.*
[4] SVA & CSI (2020) *Will Australia's charities be casualties or partners in recovery after COVID-19? A financial health check*..

charitable giving was diverted to support people and communities affected by the 2019-20 summer bushfires.

Before COVID-19, these thin margins were already having a real impact on the services that charities could provide. In a survey of the community sector in October 2019, only 5 per cent of staff said their service was completely able to meet demand, and one third of organisations had stopped delivering one of their services or programs due to financial constraints in the past year.[5]

Many charities also have limited resources available to tide them over in a crisis. Our previous analysis showed that a 20 per cent drop in income would lead one in six charities exhausting their liquid reserves within six months. If they are forced to close, or to shed jobs at a scale to match the income drop, we could see more than 200,000 jobs lost.

Figure 1: Aggregate net income ratio of Australia's charities, 2014-2018[6]



Charities are not in this position because they have been mismanaged. In fact, they have been pushed into 'running lean' by various forces for many years.[7] For example, it is generally understood that payments for at least some government-funded services, especially those delivered by competitive tender processes and similar market structures, don't fully cover the cost of delivering such services at the quality needed to achieve desired outcomes. Some philanthropists also resist fully funding expenses perceived as 'overhead', even when it is clear that such spending is necessary for charities to have the impact that donors seek.[8]

[5] Cortis, N. & Blaxland, M (2020) *The profile and pulse of the sector: Findings from the 2019 Australian Community Sector Survey*. ACOSS.
[6] ACNC (2020) and previous years. For consistency, we have re-calculated this figure from reported income and expenses data in the ACNC's *Australian Charities Report*, as the ACNC does not report an aggregate net income ratio every year. Aggregate net income ratio is calculated as ((total income – total expenses)/total income).
[7] See Cortis, N., Lee, I., Powell, A., Simnett, R. and Reeve, R. (2015) *Australian Charities Report 2014*. Centre for Social Impact and Social Policy Research Centre, UNSW.
[8] See Gregory A.G. & Howard D. (2009) 'The Non-profit Starvation Cycle'. *Stanford Social Innovation Review* and Eckhart-Queenan, J., Etzel, M and Prasad, S. (2016) 'Pay-what-it-takes Philanthropy'. *Stanford Social Innovation Review*.

For-profit businesses will quickly stop producing a product or service that doesn't cover its costs. But because charities believe in, and exist for, the public good that they provide, they may seek to continue to deliver high-quality services to those in need, even when they are not funded to do so.

In short, charities have had to be flexible in meeting the many pressures they face with minimised margins – but this has left them vulnerable in the face of a crisis.

Revenues won't recover the same way

Like many organisations, charities are suffering significant falls in many of their major revenue sources. They are seeing donations fall, and a loss of revenue from the sale of goods and services – ranging from op shop sales to tickets to events. Based on data available so far, we believe that it is reasonable to assume that on average charities could see a 20 per cent drop in their revenue for the duration of the crisis.[9] This will vary from charity to charity, but gives an estimate of the scale of the challenge that charities are facing.

History tells us that charity revenues will not bounce back quickly.[10] JBWere has estimated that total giving will fall by around 7.1 per cent in 2020 and a further 11.9 per cent in 2021.[11] This is a concern considering that at least 70 per cent of charities get some of their income from donations and bequests.[12] Charities also rely on governments for a large proportion of their revenue. If governments seek to reduce debt and rebalance budgets quickly, as they did following the Global Financial Crisis, charities are very likely to be affected.

Demand for charity services goes up in a crisis, at the same time revenue is falling. Unlike commercial businesses, demand for critical services run by charities – not just emergency services but lots of different early intervention services and points of community connection – goes up when our community faces challenges. They are counter-cyclical. And also, unlike commercial businesses, an increase in demand does not necessarily lead to an increase in revenue to meet that demand. Charity boards and staff will want to 'lean in' to meet increased demand, but they are left trying to do more with less, and will be trying to do that for some time. Past experience shows that unemployment takes much longer to fall in recovery than it took to rise during a recession, so we may see higher than usual rates of joblessness for many years.[13] Charities will face increased demand to support people over that time, at the same time that their revenues remain low.

Charities can't access resources to transition or rebuild

For many charities, the COVID-19 crisis is prompting a fundamental review of their business model to enable them to survive and thrive. This is not unique to charities – but their very nature means that most don't have access to the capital they need to transition or rebuild like a commercial business would.

Unlike businesses, charities can't raise equity from shareholders. Most aren't in a position to take on debt to help them smooth their income, adapt their business model or invest in rebuilding. Although on

[9] This estimate is based on available survey evidence detailed in our *Charities Financial Health Check* report, and the Commonwealth Government's threshold for JobKeeper eligibility for charities at 15% reduction in turnover.
[10] See PriceWaterhouseCoopers, Fundraising Institute Australia and the Centre for Social Impact (2009) *Managing in a downturn: the impact of economic downturn on not-for-profit organisations;* and The Centre for Corporate Public Affairs (2009) *Impact of the economic downturn on corporate community investment.*
[11] McLeod, J. (2020) *Where to from here? The outlook for philanthropy during COVID-19* JBWere.
[12] Powell, A., Cortis, N., Ramia, I. and Marjolin, A. (2017) *Australian Charities Report 2016.* Centre for Social Impact and Social Policy Research Centre, UNSW Australia.
[13] Daley, J., Wood, D., Coates, B., Duckett, S., Sonnemann, J., Terrill, M., Wood, T. and Griffiths, K. (2020). *The Recovery Book: What Australian governments should do now.* Grattan Institute.

paper some large charities appear to have a large asset base, many of their assets are necessary for them to pursue their purpose, such as a hospital for a health charity, or a campus for an educational institution and cannot be used as a source of funds. Even if this is not the case, liquidating assets in a downturn can leave the organisation's overall position in worse shape, if they are selling into a highly volatile property or equities market. Moreover, charities cannot easily take out loans against these assets, because their constrained and inflexible revenue streams can be unattractive propositions for lenders. Charity boards may also be understandably reluctant to take on the risk of debt due to the uncertainty of future revenue sources to repay these debts and the organisational risks and personal liabilities they may face.

Many charities will also be starting their transition from a with-COVID to a post-COVID world without the capacity and capabilities they need to rebuild successfully. As noted above, community expectations and funder requirements impose constraints on charities' spending. People expect that high proportions of their funding go towards 'front line' services, and many government and institutional funders resists paying for 'overhead'. A significant proportion of charity revenue is 'tied' to particular programs, so charities have less ability to balance short- and long-term needs. As a result, charities have little flexibility to invest in capability building, organisational and staff development, or investments in technology (e.g. only 43% of surveyed not-for-profits use cloud-based systems[14]). This has impeded the ability of charities to develop the capacity and capabilities they need to survive the crisis, and to transform to operate successfully in the post-COVID world.

What supports will work for charities?

As we showed in our *Charities Financial Health Check* report, charities face a looming 'October cliff' arising from the currently legislated end of JobKeeper, the end of the Coronavirus Supplement to JobSeeker and other payments, and overall government budget pressures. This combination of reduced revenue and increased demand has the potential to tip many vulnerable charities over the edge. If this happens, many jobs will be lost and services that the community relies on will no longer exist.

Many of the financial challenges charities are facing are a result of their nature as charities, and the factors that differentiate them from commercial organisations. To best support the charity sector to help Australia build back better from the crisis, government support needs to be tailored to their specific needs.

Supporting charities makes good economic sense. One in ten Australian workers are employed by charities, and compared to the workforce as a whole, they are disproportionately female, work part-time or casually, and are lower paid[15]. These are all groups that have been hit hard by the current economic crisis. Charities are also major employers in many areas where we expect growth in service demand in coming years, such as aged care, disability services, education and health.[16] Growing labour market demand in these sectors could be a major force for job creation for those who need it most, if charities are thriving. Failing charities would also likely lead to secondary economic impacts. With less service delivery capacity in industries like health, aged care and early learning, we could see additional workers leaving the paid labour force to fill the gap in services as unpaid carers.

Many of the supports that government has announced to date, or suggested as part of the next phase of recovery spending, will not help charities survive. For example, charities already have access to a

[14] Infoxchange (2019) *Digital technology in the not-for-profit sector.* Infoxchange.
[15] See YWCA, WomenOnBoards and ACOSS (2012) *Reflecting gender diversity: An analysis of gender diversity in the leadership of the community sector: Inaugural survey results*; AIGroup (2018) *Casual work and part-time work in Australia in 2018*; Australian Government (2019) *A statistical snapshot of women in the Australian workforce*. Department of Education, Skills and Employment.
[16] See Australian Government (2019) *Australian Jobs: Jobs by Industry* Department of Education, Skills and Employment

number of tax exemptions in recognition of the public good they generate, so tax cuts and concessions will not provide any further assistance. Some government assistance to date has been in the form of access to discounted loans which, as noted above, are not feasible for most charities.

Some support to date, such as the special conditions for charities accessing JobKeeper, has made a significant difference to many charities in the past few months. But government must create a ‘ramp’ not a ‘cliff’ for the end of JobKeeper. The Commonwealth should plan for a gradual transition from JobKeeper to provide ongoing support for charities where needed, and minimise negative effects on the broader Australian community. Charities need enough time to either recover their lost revenue, and/or to develop new operating models that are better suited to the new environment.

There has been some suggestion that the next round of government support, such as extensions to the JobKeeper wage subsidy beyond September, will be focused on industries being hit hardest by the crisis. Charities are not an ‘industry’ - they are a legal structure that can operate in any sector, and so an industry-by-industry approach will not effectively support them. Charities face common pressures and constraints that don’t apply to for-profit organisations, regardless of which industry they are in.

Government should not attempt to differentiate between charities by sector or category. They have all qualified as charities on the basis of their charitable purpose in line with current legislation – discriminating further is an arbitrary decision that will distort the principles underlying charity governance in Australia. In particular, a focus on supporting ‘emergency relief’ and similar charities will further distort a system that already underinvests in primary prevention relative to crisis intervention. Without ongoing support for charities working to prevent social dislocation, many will not be able to deliver the outcomes we rely on them for, and the costs will be enormous. For example, Australia spends $15.2 billion each year because children and young people experience serious issues that require crisis services.[17] We also know that poor educational performance and educational inequity directly affects long-term GDP growth. The fall in school performance between 2009-2015 in Australia was estimated to have cost us $118.6 billion, of which $20.3bn was due to the increase in inequality (students in the bottom fall more than those at the top).[18] Many of these costs are avoidable in future and a strong charities sector will play a significant role.

To avoid distorting the system further, we should treat charities on the basis of their financial position. The more helpful approaches being looked at by think tanks and policy analysts link JobKeeper eligibility to the improving financial health of the charity, so that supports are gradually removed as charities get back on their feet. Some examples worth considering include:

- A tapering of the overall rate of JobKeeper over time, including differentiated rates for part-time workers
- Gradually increasing the scale of the revenue drop required to qualify, with appropriate baseline comparison rates and more regular checks on eligibility.
- Options for how organisations can average revenue changes over several months even if there are more regular, rolling checks, to account for the uneven income of many charities.

Measures already in place – such as giving charities the option to exclude government revenue from JobKeeper calculations – are also going to continue to be very important to prevent revenue drops in one revenue stream from irreparably damaging the organisation as a whole.

[17] Teager, W., Fox, S. & Stafford, N. (2019) *How Australia can invest early and return more: A new look at the $15b cost and opportunity*. Early Intervention Foundation, The Front Project and CoLab at the Telethon Kids Institute.
[18] Hetherington, D. (2018) *What price the gap? Education and inequality in Australia*. Public Education Foundation.

In all these scenarios, a JobKeeper 'ramp' will not be enough on its own. Tackling the structural challenges that charities face will require an integrated package of measures, as recommended in our previous report:

We recommend 6 actions for government:

The end of JobKeeper should be a ramp, not a cliff

The Commonwealth should plan for a gradual transition from JobKeeper, including extensions in sectors facing long recovery times. This will provide ongoing support where needed, and minimise negative effects on the broader Australian community. Charities and other affected sectors need enough time to recover lost revenue, or develop new operating models.

Transition to a 'new normal' with a Charities Transformation Fund

Most charities do not have much financial margin or flexible funding, and so cannot invest in capacity building or transformation to prepare for the post-crisis world. Setting up a one-off, time limited, Charities Transformation Fund could help aid this transition without requiring ongoing government outlays.

Keep funding for services that reflects increased costs and demand

Service funding for charities should reflect the true cost of delivering services, and meeting increased demand, particularly given the sensitivity of the sector to changes in government funding. Funding should take changes to charity cost structures into account, including compliance, regulation and Fair Work Decisions on wage entitlements.

Retain JobSeeker at a higher level

Keeping JobSeeker at a higher level mitigates the increase in service demand on charities while stimulating the broader economy. Individuals on low incomes are more likely to spend the additional income, reinvesting in the economy rather than saving money. Immediate financial support has also been identified as the most pressing need for individuals approaching charities.

Simplify fundraising and philanthropy to encourage increased giving

Creating nationally consistent fundraising regulations would reduce the red tape burden on charities seeking to fundraise. There are also opportunities to provide better incentives for philanthropy to support the charity sector.

Support further research to help build back the charities sector

Understanding the financial viability and business models of charities and how this might be reshaped in the future to ensure charities don't just survive but are able to deliver the public good purpose for which they exist.

Social Ventures Australia (SVA) is a not-for-profit organisation that works with partners to alleviate disadvantage – towards an Australia where all people and communities thrive. We influence systems to deliver better social outcomes for people by learning about what works in communities, helping organisations be more effective, sharing our perspectives and advocating for change.

The Centre for Social Impact (CSI) is a national research and education centre dedicated to catalysing social change for a better world. CSI is built on the foundation of three of Australia's leading universities: UNSW Sydney, The University of Western Australia, and Swinburne University of Technology. Our research develops and brings together knowledge to understand current social challenges and opportunities; our postgraduate and undergraduate education develops social impact leaders; and we aim to catalyse change by drawing on these foundations and translating knowledge, creating leaders, developing usable resources, and reaching across traditional divides to facilitate collaborations.

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Social Ventures Australia and the Centre for Social Impact acknowledge Traditional Owners of Country throughout Australia. We pay our respects to Aboriginal and Torres Strait Islander Elders past, present, and emerging. We also accept the invitation in the Uluru Statement from the Heart to walk together with Aboriginal and Torres Strait Islander peoples in a movement of the Australian people for a better future.