It’s time to have a frank discussion about charities and their administrative and fundraising costs. Over the past decade, the increasing focus on a charity’s cost of doing business – and yes, charities are in the business of societal betterment – has forced the entire charitable sector to defend itself against a rash of naïve accusations.

While there is no doubt that a few bad apples have found their way into the sector, the fact remains that over 85,000 other charities are doing precisely the work that most of us admire: feeding the needy, housing the homeless, nursing the sick and educating the young. Why some choose to focus their energy on the rotten apples rather than the orchard of vibrant ones is, sadly, a product of our negative media culture.

Our charitable sector is perhaps our great country’s most valuable resource. It places human decency and kindness above all else. It is not surprising then that the charitable sector has reacted to the recent focus on its cost structure with politeness, diplomacy and tact. The sector has (correctly) pointed out that evaluating a charity’s fundraising cost ratio might very well reflect its fundraising efficiency but may have little correlation to a charity’s ability to achieve its mission (that is, its impact on societal betterment). The problem is that measuring a charity’s impact is difficult and subjective, while measuring fundraising efficiency is relatively simple. In the final analysis, however, impact is really the only thing that truly matters.

I’m not saying that the charitable sector is entirely off the hook. In fact, until now, the sector has been too willing to tolerate the use of fundraising and administrative costs as the only appropriate metrics, when it knows full well they are not. The sector needs to take a positive approach to marketing its impact, while promoting more appropriate metrics around societal betterment.

I work for an investment management company (although admittedly, I’m no investment expert). When portfolio managers analyze companies, they look at a variety of factors before they decide to invest. First, they crunch the numbers from absolutely every angle. Second, they look at other less tangible factors – the company’s management team, its products and services, etc. Third, they look at the company’s secular context – its competitors, the industry in which it operates and even broader local and global economic inputs. In other words, their analysis is not just a simple numerical one but one that incorporates broader judgment. (It should be noted that the numerical analysis itself is a comprehensive one and certainly doesn’t focus only on a single area of a company’s finances.)

For the sake of argument, let's say our investment analysts are evaluating three companies:

	Coal Mining Company	Furniture Manufacturer	Software Developer
Revenue*	$10,000,000	$5,000,000	$1,000,000
Production Costs	$2,500,000	$1,500,000	$300,000
Marketing Costs	$100,000	$200,000	$100,000
Administration Costs	$400,000	$300,000	$100,000
Total Costs	$3,000,000	$2,000,000	$500,000
Net Profit	$7,000,000	$3,000,000	$500,000
Cost Efficiency (Profit as a Percentage of Overall Revenue)	70%	60%	50%

*Note: It is recognized that these terms are not necessarily the ones used to describe the item in a company's financial statement

I presented this scenario to a few of our highly sophisticated portfolio managers and asked them which company they would select as an investment. Not surprisingly, they had a number of questions:

- Tell me a bit about the management teams and the quality of board governance and oversight at each company
- What are their revenue and profit trends? How did they do last year and in the years before that?
- What do the other numbers look like? What about the balance sheet?
- Are they diversified?
- How long have they been in business?
- What kind of furniture is being manufactured? What kind of software is being developed?
- Where are they doing business?

They had about 75 additional questions, some focusing on numbers, others focusing on more qualitative factors. At the end of the exercise, they told me they would invest in the company with the greatest promise. As one senior portfolio manager told me, "If I were looking at a company, I would be looking at the trend of that market and I would be focused on the potential for growth." So while the numbers are part of the analysis, they are understood in a broader context.

Let's take a similar analysis and extend it to charities.

	Women's Shelter	International Development Agency	Community College
Revenue	$1,000,000	$5,000,000	$50,000,000
Fundraising Costs	$50,000	$500,000	$2,500,000
Administration Costs	$100,000	$750,000	$15,000,000
Total Costs	$150,000	$1,250,000	$17,500,000
"Profit" – (Funds left to deliver programs and services)	$850,000	$3,750,000	$32,500,000
Cost Efficiency (Profit as a Percentage of Overall Revenue)	85%	75%	65%

I asked the same portfolio managers which charity would be more likely to attract their donation. They unanimously responded with a blank and befuddled stare. One asked me why he would donate to a community college when he never attended one. Another said he'd prefer to direct his donations within Canada rather than outside of the country. A third told me that she had volunteered at a shelter and would definitely choose it over the other two. There was no analysis – no focus on profit or efficiency. Their decision was a thoughtful one but it was based on personal values around philanthropy and volunteerism rather than on quantitative factors. The choice was a seemingly simple one – so I decided to make it more difficult.

	Women's Shelter A	Women's Shelter B	Women's Shelter C
Revenue	$1,000,000	$1,000,000	$1,000,000
Fundraising Costs	$50,000	$100,000	$200,000
Administration Costs	$100,000	$150,000	$100,000
Total Costs	$150,000	$250,000	$300,000
"Profit" – (Funds left to deliver programs and services)	$850,000	$750,000	$700,000
Cost Efficiency (Profit as a Percentage of Overall Revenue)	85%	75%	70%

As donors and media consumers, we've been led to believe that Shelter A is "better" than Shelter B, which in turn is better than Shelter C. But our sophisticated portfolio managers are quite astute even on matters relating to philanthropy. More questions arose when I asked them which charity would be their preference.

- What communities do they serve?
- Do they all serve only women or women and children?
- How do they help these women acclimatize back to the community and find supportive housing?
- Do they provide both short- and long-term support systems?
- They also asked other numerical questions, especially around how these numbers trended with previous year?

The focus on immediate fundraising and administrative costs virtually ignores answers to these important questions. If Shelter C is the only organization serving both women and children, shouldn't that be important? If Shelter B were the only one serving your community, wouldn't you choose that one over the others? Perhaps Shelter C wishes to purchase a newer, safer building, potentially increasing its fundraising costs. There are countless other potential variables, all of which speak louder than a narrow focus on fundraising and administrative costs. A pure focus on the sector's cost efficiency belittles the importance of charities and the work that they do.

Those that work closely with the charitable sector know that it doesn't stand on a soapbox and shout about the wonderful work it does. It just isn't the type. Instead, it does its job proudly and quietly, like your trusted colleague who always gets the job done quickly and properly with no

fanfare. Perhaps charities need to respond more vociferously to those who diminish their importance by focusing primarily on administration and fundraising costs. Until then, they will be forced to defend themselves from those who devalue the importance of the entire sector.