

# TO THE CORE

CHARITY  
FUTURES

THE  
BEHAVIOURAL  
INSIGHTS TEAM. ◆

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# INTRODUCTION *by Sir Stephen Bubb*

When I joined ACEVO in 2000 I quickly realised one of the major concerns of charity leaders was the failure of funders to adequately support the infrastructure of charities. And indeed charities themselves often failed to make grant applications that included core costs. I thought it was an issue that a sector leaders' body should be campaigning on – and we did.

Today, the issue of who pays for core costs remains central for many professional staff. Many funders persist in only paying project costs and this adds to the instability of the charity sector. No business could run effectively without proper infrastructure. And in the current climate of financial problems for many, a failure to support infrastructure is particularly damaging. As Gerry Salole, CEO of the European Foundation Centre recently commented:

**//** *Infrastructure is rather more like a skeleton than scaffolding. You need it all the time and, unlike scaffolding, you can't dispense with it.*

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This has been vividly demonstrated by the recent controversy over safeguarding. If charities are to have effective policies and monitoring on safeguarding then they need to spend money on charity infrastructure. Indeed Oxfam, as a result of the recent scandal, will now spend £1 million on improving their policies and procedures on safeguarding. Rightly so. Yet will funders support this spending or will they insist on only funding direct costs in the field? Donors want more oversight and accountability. But that carries a cost.

In 1998 ACEVO commissioned research, funded by the Joseph Rowntree Foundation, to analyse the challenges faced by charities in this culture. A joint working party was established which included representatives from government and funders. The report 'Who pays for core costs?' was published in August 1999 and quickly became a bestseller.

In 2001 I decided to re-publish this report along with an update. I wanted to see how much progress was being made on this crucial issue and this proved a decisive move. Many organisations supported the need for change and many funders began to review their practices. The National Lottery Charities Board took a lead and the government set up a working party. Crucially this established that government grants should recognise core costs.

So, you would think our job was done. So, why over 15 years later are we still talking about this issue?

At the time of our campaign, it was clear to me that there was another problem. Many charities were reluctant to include core costs as they thought they would not get funding. And many charities failed to understand what their core costs were which often led to them being unsustainable. So, ACEVO commissioned NPC to devise a core costs calculator. This tool is still available and used by charities because even if you cannot secure core costs you must have an idea of what that cost is!

We have certainly moved on from those days but recent austerity measures, cutbacks in local government and central government spending have again undermined the case for paying core costs.

We must also recognise that the public still do not fully understand the need for infrastructure support and many still demand that their donations go directly to the front line. So the battle for proper recognition of infrastructure funding continues.

Charity Futures, as a think tank, aims to support the sustainability of the charity sector and therefore sees the battle for core costs as a central plank of our work. But how do we promote the need for effective infrastructure to the public more generally? The rows over CEO pay illustrate that the public's desire to ensure money goes to the front line can conflict with developing essential infrastructure that supports effective charity.

So this report, commissioned from the Behavioural Insights Team, takes a fresh look at the problem and encourages funders and others to think differently about how to support sustainable charity.

As we said in our original report:

***The issue of core costs is not dead and will not die down.***

# BEHAVIOURAL SCIENCE AND THE SUSTAINABLE FUNDING OF CHARITIES

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# EXECUTIVE SUMMARY

Core costs, and how to fund them, are important issues for many charities, as donors and other funders seek to get the best 'bang for their buck' in a marketplace for social good where quantity and quality are very often hard to determine. We believe that to some extent, funders' behavioural biases - the facets of human psychology that lead us to make decisions that are not always economically rational - are driving their aversion to core costs.

The rise, over the last forty years, of behavioural science and its applied cousin behavioural insights, offer suggestions for how charities might, either individually or collectively, go about overcoming these biases.

**Table 1:** Key challenges and recommended solutions

Behavioural Insight	Challenge	Solution
Overhead aversion	Donors prefer when donations go directly to delivery.	Large funders and high net worth individuals (HNWIs) should cover core costs and thus allow smaller donors to give directly to cover delivery.
Evaluating impact	The sector views core costs as a proxy for impact.	Charities should seek to emphasise their impact per pound invested, including their core costs.  Funders should evaluate similar proposals in groups.
Identifiable beneficiaries	Donors and funders prefer to give to a cause when beneficiaries are identifiable.	Charities should communicate the average cost of delivery, rather than the marginal cost.  Charities should attach warm glow to core costs by including information on 'identifiable helpers': backroom staff who are integral to a charity's function.

<p>Loss aversion</p>	<p>Funders evaluate spending that covers core costs as a loss of delivery capacity.</p>	<p>Charities should communicate the average cost of delivery, rather than the marginal cost.</p> <p>Funders should evaluate similar proposals in groups.</p> <p>The sector should reframe core costs as a long term investment that facilitates innovation and development.</p>
<p>Race to the bottom</p>	<p>Charities feel that they must cut core costs to receive funding.</p>	<p>Sector leaders should set standards.</p> <p>Funders and charities should attach prestige to HNWI's who cover core costs.</p> <p>Funders could encourage charities to collaborate where appropriate.</p>
<p>Home bias</p>	<p>Charities do not merge when it may be economical because they exhibit a preference for their charity over similar others.</p>	<p>Funders should encourage charities to merge or collaborate where appropriate.</p> <p>Funders should encourage charities to share a common back office and core cost function in lieu of increased mergers.</p>

# INTRODUCTION

All charities have unavoidable core costs that are essential for them to survive and to continue to make a difference in people's lives.

There is substantial resistance from donors, and particularly large institutional funders such as governments, trusts and other funding bodies, to funding a charity's core costs. Anecdotally, it appears that these funders implicitly view costs that are core to the charity's existence, but not to its mission, as waste, and hence not eligible to be funded. This might be particularly the case where government funders face constrained budgets themselves and are under pressure, rightly, to achieve the best possible value for money.

In fact, core costs can be a generator of additional value - they may allow a charity to provide training to increase volunteer skills, develop its board, or hire a digital expert. These investments can help to foster long term improvements in functioning. The Comic Relief Core Strength fund found that the majority of applicants wanted to use their core cost funding for strategic projects.<sup>3</sup>

Dr Beth Breeze provided testimony to the House of Lords Select Committee on Charities that covering core costs in service delivery had "always been a problem historically", and that it was being exacerbated by the concept of the "golden pound": the notion that all money received by charities must go directly to beneficiaries "and not a penny is wasted on things like getting an

accountant to do your accounts properly or all the other things that you need to do."<sup>4</sup>

Organisations like GiveWell and Giving What We Can seek to provide potential donors with information on how to maximise the cost-effectiveness of their donations. However, their reach seems constrained to a specific type of donor who is particularly motivated by cost-effectiveness and evaluated impact.<sup>5</sup>

In their testimony for the House of Lords Select Committee on Charities, New Philanthropy Capital said that "funders and government need to consider how they can support organisations to be more effective in delivering their mission" because this funding is unlikely to come from individual donations.<sup>6</sup> Organisations which do fund core costs, perhaps to the exclusion of other types of funding, may perpetuate a market structure which is not conducive to an optimal allocation of scarce funds. By funding typically fairly small amounts of core costs, these institutions, although important, might prevent charities from merging and benefitting from economies of scale. This produces a market in which core costs are artificially high because each small charity must cover their own backroom operations.

There is some evidence that charities themselves are reluctant to ask for core funding from funders, potentially forcing themselves into a position where they receive funding with more spending

<sup>3</sup> Menzies, S., Kane, D., Lawson, M., & Barabhuiya, F. (2017) Comic Relief Core Strength Funding - Analysis. NCVO <https://www.scribd.com/document/342691095/Comic-Relief-Core-Strength-Fund-Analysis>

<sup>4</sup> "Stronger charities for a stronger society" <https://publications.parliament.uk/pa/ld201617/ldselect/ldchar/133/133.pdf>

<sup>5</sup> Karlan, D., & Wood, D. H. (2017). The effect of effectiveness: Donor response to aid effectiveness in a direct mail fundraising experiment. *Journal of Behavioral and Experimental Economics*, 66, 1-8.

<sup>6</sup> "Stronger charities for a stronger society" <https://publications.parliament.uk/pa/ld201617/ldselect/ldchar/133/133.pdf>

constraints than was initially needed.<sup>7</sup> Charities, driven by their missions, might choose to inefficiently allocate funding away from core costs and towards the delivery of their missions, even when this comes at the expense of the long term benefits of the organisation. Charities' missions, and in particular the passionate drive of their leaders and founders, might mean that charities are less likely to merge or to create a sector with lower fixed costs.

In this paper, we will consider what the lessons from behavioural science - the combination of behavioural economics and psychology - might teach us about some of the barriers to funding core costs and to achieving a more sustainable financial future for the sector. As well as identifying potential barriers which emerge from the academic literature in this area, we will suggest a series of interventions which might alleviate some of the barriers we identify.

We focus on challenges that we believe can be addressed using insights from the behavioural science literature. The changes that we propose should likely be complementary to, rather than a substitute for, wider changes within the sector. As such, this paper should not be viewed as an exhaustive account of all the reasons that contribute to the underfunding of charity costs. Structural factors such as the local and national political context, regulations, and changes in how funding is allocated by governments and councils

undoubtedly play a large role in how charities and funders respond to their environment and make decisions, but we do not consider them here.

## INTRODUCTION TO BEHAVIOURAL SCIENCE

Behavioural Science is a term used to describe several fields within social science that aim to understand and influence human behaviour, typically using empirical and analytical techniques rather than a reliance on theoretical insight. The two largest branches within behavioural science are behavioural economics and social psychology.

Both of these fields, and in particular behavioural economics, identify cognitive biases which lead people to behave in ways that are not predicted by the standard, canonical model of economics. Under the standard model, people are assumed to be "rational", acting as agents who maximise their utility (their personal satisfaction or happiness) based on their preferences (the extent to which they enjoy, or dislike things), and their constraints (how much time, money, or energy they have). These rational agents may or may not have perfect information (although they are often assumed to), whilst they do not make mistakes or experience regret - they always make the best decisions they can for themselves.

<sup>7</sup> Menzies, S., Kane, D., Lawson, M., & Barabhuiya, F. (2017) Comic Relief Core Strength Funding - Analysis. NCVO <https://www.scribd.com/document/342691095/Comic-Relief-Core-Strength-Fund-Analysis>



As any of us who have experienced everyday human life can attest, the reality can be very different. We are very often present-biased, for example, choosing the joy of ice cream now and avoiding the current pain of going to the gym, while implicitly accepting the long term future costs of being out of shape and overweight. We do not save for retirement, whilst we take out insurance on our bikes (suggesting to the economist that we are risk averse), simultaneously playing the lottery (suggesting that we are risk loving). We also view the same outcome, or the same amounts of money, very differently depending on our starting point.

## THE BEHAVIOURAL SCIENCE OF CHARITABLE GIVING

There are numerous published field experiments which show how small contextual changes can significantly change the likelihood that someone makes a donation to charity. Priming donor identity as prior donors - by reminding them of their previous donations in subsequent solicitations -, nudging people to give through their existing social networks, and inducing reciprocity in donors by giving small packets of sweets have all been shown to materially increase donations.<sup>8,9</sup>

As donation behaviour likely differs depending on individual motivations, understanding the drivers of donations is important.<sup>10</sup> People may give to

charities because they want to increase the output of the organisation (e.g., providing more voluntary drivers in a rural area). This motivation is reflected in organisations that translate donations into delivery outputs, for instance, when a charity tells you that your £20 contribution will fund 20 bed nets to fight malaria. Other theoretical reasons to give include the prospect of receiving in kind gifts like having a building named after you, or giving for reputational considerations. Donations may also alleviate a sense of guilt, or allow people to give back to society. James Andreoni has conducted substantial research into the “warm glow” people may experience from donating to charity - we may give in part because it makes us feel good about ourselves and the impact we can have.<sup>11</sup>

## CHALLENGES AND SOLUTIONS

In this section, we describe some of the main behavioural biases that can contribute to the suboptimal funding of charities, alongside evidence-based solutions. It is difficult to fully “debias” decision makers - we all have limited attention, cognitive capacity, and time and behavioural insights can clearly never completely fix this. As such, we focus on solving the core bias in a given decision environment.

<sup>8</sup> Kessler, J. B., & Milkman, K. L. (2016). Identity in Charitable Giving. *Management Science*.

<sup>9</sup> Behavioural Insights Team (2013) Applying behavioural insights to charitable giving. Cabinet Office

<sup>10</sup> Vesterlund, L. (2006). Why do people give. *The nonprofit sector: A research handbook*, 2, 168-190.

<sup>11</sup> Andreoni, J. (1990). Impure altruism and donations to public goods: A theory of warm-glow giving. *The economic journal*, 100(401), 464-477.

We also consider how the behaviour of charities themselves can influence the state of the market. Although the charitable sector is more collaborative and collegiate than the private sector, it must be acknowledged that charities are in some sense competing with each other for the marginal donor pound.

## OVERHEAD AVERSION

### Challenge

Overhead aversion refers to the reluctance of donors to cover core costs when donating to a charity.<sup>12</sup> Donors exhibit a preference for charities that spend a lower percentage of their income on core costs, and correlational studies suggest that there is a negative relationship between the amount spent on overheads and donation size.<sup>13</sup> That is, all else equal, donors typically prefer to give to charities that have lower core costs. Gneezy et al suggest that this may be because donors are using the size of overheads as a signal of charity effectiveness. Alternatively donors may implicitly feel that covering core costs does not maximise the impact of their donation or provide them with sufficient warm glow.

### Solution

For individual donors, one way to overcome aversion to overheads is to avoid them completely. Gneezy and coauthors worked with an education foundation to run a randomised controlled trial with four groups of 10,000 people who received donation solicitation letters. In the control group, participants were asked to donate \$20, \$50, or \$100 to an education project, which they were told cost \$20,000 to implement. In the 'seed' treatment group, participants were told that a private donor had provided \$10,000 in seed money for the programme. In the 'match' group, participants were told that a donor had provided a \$10,000 matching grant. In the 'overhead' condition, participants were told that a donor had provided \$10,000 to cover the costs associated with the project. Thus, the dollar amount provided by the external donor is the same in all three treatment conditions, but the way in which they are framed was different.

All of the three treatment conditions saw significantly higher donations compared to the control group, but the overhead frame significantly outperformed the other two treatments. Communicating with potential donors that a charity's overheads have been covered by another funding source increased donations by 65% (3.1 percentage points).

<sup>12</sup> Gneezy, U., Keenan, E. A., & Gneezy, A. (2014). Avoiding overhead aversion in charity. *Science*, 346(6209), 632-635.

<sup>13</sup> Tinkelman, D., & Mankaney, K. (2007). When is administrative efficiency associated with charitable donations?. *Nonprofit and Voluntary Sector Quarterly*, 36(1), 41-64.

Encouraging institutional donors to give a matching donation that covers costs would allow a charity to communicate to their donor base that their core costs are covered. This is attractive to the individual donor, as they can maximise their impact on delivery. Larger donors funding the core costs are also, by extension, buying more delivery with their money. For instance, while fundraising for hurricane relief, the American organising group MoveOn pledged to cover credit card expenses for donations “so that more of your gift will go directly to those who need it most”.<sup>14</sup> We note that there is a risk that this kind of an intervention serves to perpetuate the idea that core costs are to be avoided. However, there is no convincing research as of yet that individual donors can be persuaded to cover these costs.

## EVALUATING IMPACT

### Challenge

When making donation decisions, we consider that which we can easily evaluate to be more important.<sup>15</sup> As it is likely harder to evaluate a charity’s cost-effectiveness compared to the ratio of its spend on overheads to delivery, we expect donors to overweight these costs in their decisions.

Caviola et al conducted a lab experiment in which participants were either asked to evaluate information about Charity A and B together or to evaluate a single charity - A or B - in isolation. The

only way in which A and B differed was in their overhead ratio and their cost-effectiveness. Per \$1,000 donated, Charity A cost \$600 to implement, and saved five lives whereas Charity B cost \$50 to implement, and saved two lives. Thus, while cheaper to implement, Charity B saved fewer lives relative to Charity A. Participants who wanted to maximise impact should thus donate to Charity A when comparing the two charities.

In the two conditions where participants evaluated one charity in isolation, participants donated more on average to Charity B. In the condition where participants evaluated them in concert, they donated more to Charity A.

This is understandable; Charity B has low overhead costs and saves two lives. If that is all the information available, it seems to be very effective. Charity A spends 60% of its donations on overheads, which seems very high for five lives to be saved. It is only when comparing the effectiveness of the two charities to each other that the higher overheads of Charity A become less important - if they save an extra three lives per \$1,000, the extra costs seem worth it.

Gabaix and Laibson’s study of shrouded attributes finds that many goods have two components - transparent attributes, which can easily be seen by a consumer, and shrouded attributes, which cannot, or which are costly to access.<sup>16</sup> Where attributes are “shrouded”, people can make decisions that

<sup>14</sup> See <https://act.moveon.org/donate/hurricane-maria>

<sup>15</sup> Caviola, L., Faulmüller, N., Everett, J. A., Savulescu, J., & Kahane, G. (2014). The evaluability bias in charitable giving: Saving administration costs or saving lives?. *Judgment and decision making*, 9(4), 303.

<sup>16</sup> Gabaix, X., & Laibson, D. (2006). Shrouded attributes, consumer myopia, and information suppression in competitive markets. *The Quarterly Journal of Economics*, 121(2), 505-540.

are not optimal, because they can only make use of information that is transparent. Given that core costs are transparent, and are at least somewhat correlated with charity quality, we expect them to be focused on in the absence of an alternative.

If the percentage of a charity's expenses spent on delivering its core mission is interpreted as a proxy for charity effectiveness, charities with higher overheads will be evaluated as less effective and will receive fewer donations.

## Solution

The most obvious potential solution to the use of core costs as a metric for quality is for charities to invest in providing a better alternative. If attributes of a charity's quality that are currently shrouded were to become transparent, funders could make more informed decisions. A charity may have a very effective intervention that requires substantial backroom costs to deliver - this is still more impactful than an intervention which is not costly to deliver but is in fact ineffective.<sup>17</sup>

Evaluations can be done by conducting a randomised controlled trial (RCT). RCTs are considered to be the gold standard of intervention evaluation, and are used extensively in medicine, and to a growing extent in the evaluation of charities. In a randomised controlled trial, potential beneficiaries of a charity's work are assigned at random either to receive the support, or not to.

Because of the randomisation, any difference that is observed between the two groups at the end of the support period can be attributed to the effect of the charity's help. Given that charities are often constrained in how many people they can help, those that invest in generating a robust evidence base by contracting external evaluators would help funders to make truly informed decisions.

Funders should seek out and reward charities that provide information on cost effectiveness, and set up their decision making processes to facilitate effective comparisons. Bohnet et al find that gender bias in hiring decisions is significantly reduced when applications are evaluated together rather than individually.<sup>18</sup> As the research by Caviola et al suggests, evaluating applications jointly may help to reduce the focus on overhead costs and increase attention on cost-effectiveness, leading to better decisions. Funders should consider evaluating similar proposals in groups rather than in isolation, which would facilitate these clearer comparisons across projects.

## IDENTIFIABLE VICTIMS

### Challenge

The behavioural science literature suggests that donors have a strong preference for identifiable victims (for instance of famine or domestic violence) over 'statistical victims' (typically abstract summaries of need and impact).<sup>19</sup> We are more

<sup>17</sup> Caviola, L., Faulmüller, N., Everett, J. A., Savulescu, J., & Kahane, G. (2014). The evaluability bias in charitable giving: Saving administration costs or saving lives?. *Judgment and decision making*, 9(4), 303.

<sup>18</sup> Bazerman, M. H., Bohnet, I., & Van Geen, A. V. (2012). When Performance Trumps Gender Bias: Joint Versus Separate Evaluation (No. 8506867)

<sup>19</sup> Small, D. A., Loewenstein, G., & Slovic, P. (2007). Sympathy and callousness: The impact of deliberative thought on donations to identifiable and statistical victims. *Organizational Behavior and Human Decision Processes*, 102(2), 143-153.

likely to donate when given information about a single beneficiary than we are when given statistics which do not include personalised information. This is true even though theoretically we should assign the same value to a life whether an individual is identified or not. This effect persists even when potential donors are provided with information about the identifiable victim effect, and even results in a reduction in the overall amount of money raised.

## Solution

Charities could focus more on the benefit to individual recipients of their entire operation, including core costs. If charity marketing campaigns focus exclusively on the marginal cost of helping a recipient, it would be more appropriate to consider the average cost of that support. To use a simplified example, consider a charity that looks to provide free vaccinations in the developing world, and which tells its donors that the cost per vaccination is £7, an estimate that does not incorporate core costs. Communicating the average cost of a vaccination will inflate the stated 'price' of that help - to perhaps £9 - but will more accurately reflect the true cost of the charity's output. Reference points are important, and if donors move from a baseline of believing that £7 is the cost of providing support and later find out that the true cost is £9, this is likely to be more negatively received than had they initially believed it to be £9.

Similarly, there is a case for providing information on identifiable helpers. Much as the armed forces advertise by showing the full breadth of roles within their ranks, including administration and management, charities could help donors feel more supportive of core costs by explicitly showing the staff associated with these costs as a part of the process of helping. This idea would require further testing; a randomised controlled trial could examine the impact of providing information on identifiable helpers on the propensity to donate.

## LOSS AVERSION IN EVALUATING COSTS

### Challenge

Another factor that may influence the perception of core costs is how they are evaluated relative to delivery costs. An overarching concept in behavioural science is that of loss aversion, our tendency to weigh losses more heavily than we value equivalent gains. A famous example is the "Asian Disease Problem".<sup>20</sup> Individuals are presented with one of two scenarios regarding a disease that is expected to kill 600 people. In the first scenario, they must choose between programme A in which they can save 200 people for sure, or programme B which has a 33% chance of saving 600 people and a 66% chance of saving no one. Given this scenario, most people will choose programme A, which guarantees that 200 people are saved.

<sup>20</sup> Tversky, A., & Kahneman, D. (1981). The framing of decisions and the psychology of choice. *Science*, 211(4481), 453-458.

In the second scenario, people are asked to choose between programme A in which 400 people are guaranteed to die, or programme B, in which there is a 33% chance that no one will die, and a 66% chance that 600 people will die. With this framing, most people choose option B. However, the two options are identical: in both versions of programme A, 200 people are saved and 400 die. This body of research suggests that the way in which options are presented to us, and our desire to avoid losses, can influence our decisions.

Consider a charity that asks for £100,000 of funding for 10 ambulance drivers, which implies a cost of £10,000 per driver. If the charity disaggregates the core costs of £30,000 in their funding request, then it is easy to translate these costs into three drivers. This framing may prompt funders to interpret the core costs as a loss, and lead them to avoid incurring such psychic losses when they make funding decisions. In fact, the cost of the driver is not truly £10,000, as core costs are required to keep the service running.

Funders may evaluate core costs relative to the reduction of the delivery cost units with which they are associated for individual applications. They may also evaluate core costs across applications from multiple charities. If each application is evaluated on the basis of predicted impact, one way of measuring this is how many 'units' of delivery that can be funded (for example 10 drivers compared to 20 youth workers). This comparison would lead

funders to choose organisations that minimise their core costs in applications. Organisations that include core costs in their applications, or that have higher core costs, appear less effective in these comparisons, because it seems that they deliver a lower number of units for a given quantity of funding.

## Solution

The concept of evaluating similar proposals in groups, as outlined in the evaluability bias section, applies here too. It further follows that the metric against which applications are evaluated jointly should be chosen carefully. If funders ask for cost effectiveness evaluations but permit charities to exclude their core costs, this may further incentivise applicants to minimise these costs. If instead applicants are asked to include core costs in these estimates, funders can conduct a more realistic comparison.

Viewing core costs as something that reduces delivery provision instead of being central to it is a fallacy: if a charity cannot remain open, then the decision is not about funding more drivers, it is about whether there will be any drivers at all.<sup>21</sup> One way to reframe these decisions is to make salient the actual comparison that a funder (be they a government agency or local authority, a trust, or a member of the public) is making. For example, core costs could be framed in a way that makes the impact of their not being funded more salient,

<sup>21</sup> Of course, we recognise that this would have to be done in such a way that funders do not feel threatened that they will be responsible for closing a charity if they do not provide funding.

highlighting the loss - if core costs cannot be covered, no drivers or youth workers can be funded at all. Similarly, framing core costs as funding that drives innovation and marginal improvements for charities in the long term may mean that organisations are less likely to view them as a loss, and instead consider them as an investment.

## RACE TO THE BOTTOM

### Challenge

In many ways competition is a good thing - it keeps charities thinking about how to be innovative and efficient, in a way that might happen less in a more concentrated, less competitive space. However, there are risks associated with the intersection of market forces and pro-social behaviour.

Charities are, essentially, selling some measure of 'good' in the world in exchange for a given price. Although donors can typically give what they want, the amount of good that they are able to achieve - the number of children vaccinated, cats saved, research pounds spent on curing cancer - depends on the amount of money that they donate, in much the same way that although loaves of bread are a more discrete category than donations, the more money you spend, the more bread you get.

It is difficult to verify the quality of a charity. In competitive markets where the quality of goods is equal across the board, or where it cannot be

easily differentiated, players in that market have little choice but to compete on price. This set of incentives leads to a 'race for the bottom' for charities that feel that if they do not cut core costs, they will lose donors and grant funding.

In a competitive market for goods and services, this tendency to lower costs is likely a good thing. However, when consumers of a good (in this case, funders and donors) implicitly view the cost as an inverse measure of quality - which is the opposite of how things are perceived in a competitive market - a feedback loop could be created that risks the sustainability of the charities involved.

### Solution

Research has suggested that highlighting someone's identity as a prior donor increased the likelihood that they donate.<sup>22</sup> Kessler et al included prior donation amounts in solicitations for the American Red Cross and increased the probability of donations by 20%, from 6.3% in control condition to 7.6% in the treatment condition. Tapping into the identity of funders or HNWIs could help to reconfigure their role in the process. Considering core cost contributions as the purview of the sophisticated or intelligent donor could increase the likelihood that HNWIs or funders cover them. We have also discussed research that demonstrates that covering core costs in this manner can increase the amount of money a charity raises overall.

<sup>22</sup> Kessler, J. B., & Milkman, K. L. (2016). Identity in Charitable Giving. *Management Science*.

Charities, led by larger charities with more market power, could agree to a principle of not aggressively cutting core costs in order to take part in this race to the bottom. Umbrella bodies, like the IoF, and others, could conduct advertising and outreach outside of the sector and, for major funders, help to provide education and transparency about both the existence and level of core costs, and their importance to charities' successes. As sustainable charities require investment in core costs, communicating this message, perhaps using salient examples, could be worthwhile.<sup>23</sup>

## HOME BIAS

### Challenge

As we have mentioned above, core costs are not entirely unrelated to the quality or effectiveness of a charity. Core costs should be subject to constraints, and to the extent that two charities that perform a very similar function but have quite different core costs, this might be a legitimate cause for concern. A part of the concern is borne of the fact that the sector, while heavily concentrated in a small number of large charities, contains a very large number of quite small players that might be difficult to differentiate for outsiders. Insiders, meanwhile, might experience the 'home bias' phenomenon of preferring their own charity to another that is very similar or perhaps better.<sup>24</sup> Although home bias is likely to work alongside the

much more powerful desire by individuals to keep their current jobs and perhaps to avoid change, the bias may be impactful at the margin. This home bias can be compounded by factors that are shrouded to funders, but transparent to insiders, and that narrowly differentiate one charity from another.

### Solution

If rationalisation is not achievable in the short term, charities should collaborate to create and use a series of shared services to increase effectiveness and reduce core costs. As home bias combines an emotional attachment to things one has been involved in, as well as the superior information that one has about their own charity, it can lead to charities failing to merge efficiently. By overestimating the quality of their own charity, and by focusing on the salient (to them) differences between their charity and others, there might be reluctance to merge two charities together. In cases where mergers are unlikely because of these factors, charities could opt to share a common back office and core cost function, and retain a sense of their individual identity while increasing efficiency.

<sup>23</sup> Fiennes, C (2017) "Try not to judge a charity by its admin costs alone" <https://www.ft.com/content/17cbc96c-b5b6-11e7-8007-554f9eaa90ba>

<sup>24</sup> Wolf, H. C. (2000). Intranational home bias in trade. *The Review of Economics and Statistics*, 82(4), 555-563.



# CONCLUSION

Charity funding and sustainability is a complex area: funders rightly feel responsible for the money they control, and seek to minimise the likelihood that they select a charity that is wasteful and does not use resources wisely. We think that charities could be more efficient, particularly by merging where their functions are extremely similar, or by sharing backroom functions in a cost effective manner, to the extent that this is possible.

However, we believe that there are many reasons stemming from the behavioural science literature that contribute to the status quo as we see it. In the majority of these cases, funders' psychology, as well as the types of information that are salient and readily available to them, might steer them away from funding charities in a sustainable way, or may drive funding towards charities that are less effective.<sup>25</sup> Charities that are honest about their core costs may be at a disadvantage, and funders may truly believe that they are maximising impact by funding charities that appear to have no core costs.

There are a number of ways to change - and test - the framing or incentives for both charities and funders to improve the impact of the sector as a whole and ensure that effective charities can continue to deliver their services. Charities should consider altering how they describe their core costs, by providing average instead of fixed costs, using robust evaluation to communicate their impact per pound invested, and by showcasing

backroom staff who are integral to a charity's function. They could also seek commitments to cover core costs from HNWI and communicate this fact to their smaller donors.

Funders themselves should seek to augment the environment in which they make decisions, where possible evaluating similar proposals in groups, and using their role as a key player in the market to reward charities that provide evidence of their impact, and are candid regarding their core costs. They should also celebrate and highlight HNWI who give based on impact and evidence.

The question of the motivations and drivers of decisions by major funders (either HNWI or institutions), is much less researched than the behaviour of smaller (albeit more numerous) donors. There is therefore an urgent need for further high quality, empirical research into which, if any, of the behavioural biases we have outlined here apply to this group, and to test the effectiveness of interventions that could lead to better and more sustainable decisions by funders. In particular, given that donations or grants of substantial value require a more deliberative and considered decision than, for example, sponsoring a friend running the marathon, we should be optimistic. Through deliberation and institutional rules governing funding, many behavioural biases could be addressed to help charities obtain funding for their work.

<sup>25</sup> <https://giving-evidence.com/2013/05/02/admin-data/>







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