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Charities and Administration Costs

Good charities spend *more* on administration than less good charities spend

Caroline Fiennes

Giving Evidence

Enabling **giving** based on sound **evidence**

The popular idea that money spent by charities on administration is 'wasted' is wrong.

About Giving Evidence

Giving Evidence encourages and enables charitable *giving* based on sound *evidence*.

Through *consultancy*, Giving Evidence helps donors and charities in many countries to understand their impact and to raise it.

Through *campaigning*, thought-leadership and meta-research, we show what evidence is available and what remains needed, what it says, and where the quality and infrastructure of evidence need improving. We work on both *what to give to*, and also *how to give*. This latter is less studied, and includes understanding the relative effectiveness in various circumstances of restricted vs unrestricted, engaged vs hands-off, grants vs other instruments, large vs small grants.

Giving Evidence was founded by Caroline Fiennes, a former award-winning charity CEO, and author of *It Ain't What You Give*. Caroline has advised many donors of many types on many continents over many years. She speaks and writes extensively about these issues, e.g., on BBC TV, in the Stanford Social Innovation Review, Freakonomics, and the Daily Mail. She is on boards of The Cochrane Collaboration, Charity Navigator (the world's largest charity ratings agency) and the US Center for Effective Philanthropy.

About this research

This analysis by Giving Evidence is, to our knowledge, ***the first empirical data to be published about what administration costs indicate about charities' performance***. We published the data (on pages 3 and 4) in 2013, actually only as a press release; we now publish these data in a 'proper document', and add some explanation (on pages 5 and 6) as to why admin costs are no guide to a charity's effectiveness. The latter explanation is taken from *It Ain't What You Give, It's the Way That You Give It*, which discusses the admin cost fallacy in more detail.

The analysis on pages 3 and 4 here drew on a method developed by Dean Karlan of Yale University; Karlan discussed his findings on the Freakonomics blog[1] but didn't publish the data. (Disclosure: Karlan and Fiennes collaborate, e.g., in Stanford Social Innovation Review[2].) Giving Evidence re-created Karlan's analysis in 2013.

We are grateful to Gareth McKibben for his work on the analysis.

The data for this analysis is published at www.giving-evidence.com/admin-data

Introduction

Many people believe that charities waste money on 'administration', and hence that the best charities have low administration spend. This leads some charities – who should know better – to publicise their low admin costs, and to talk about the amount of their money which 'goes straight to the cause'.

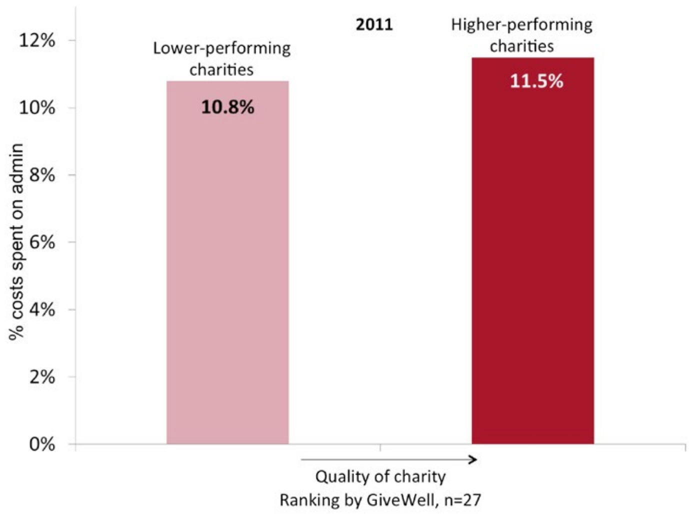
This is wrong. Analysis by Giving Evidence below shows that **high-performing charities spend *more* on administration costs than weaker ones do**. This analysis by Giving Evidence is the first empirical data to be published about what administration costs indicate about charities' performance.

The popular belief that high admin costs indicate poor performance is hence shown to be wrong. So it's unhelpful of Parliament's Public Accounts Committee[3] to be considering limiting charities' admin costs. It's unwise of donors such as Gina Miller[4] to suggest that admin costs be capped: the data indicate that such caps would nudge donors towards choosing weaker charities, at untold cost to their beneficiaries. It's time for this to change.

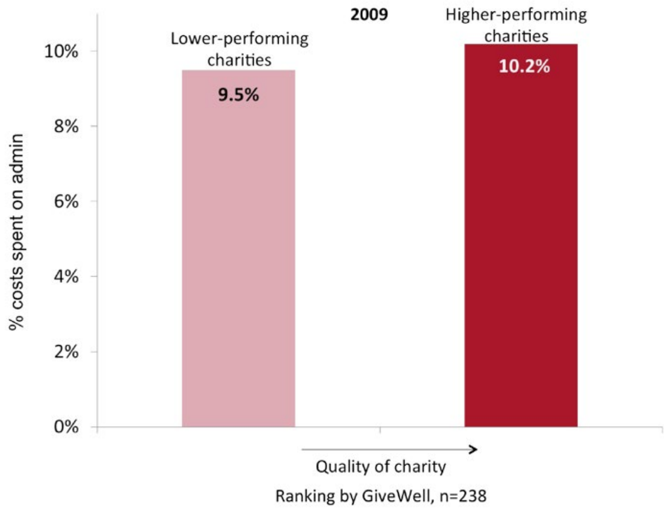
The analysis

Judging whether a charity is good is hard. Some of the most rigorous and detailed charity analysis is by GiveWell[5], a US non-profit run by former New York hedge fund analysts, whose analysis of the charities it reviews often runs to dozen of pages. GiveWell looks for various sensible indicators of quality, including: a strong documented track record of impact; highly cost-effective activities; a concrete need for more funds.

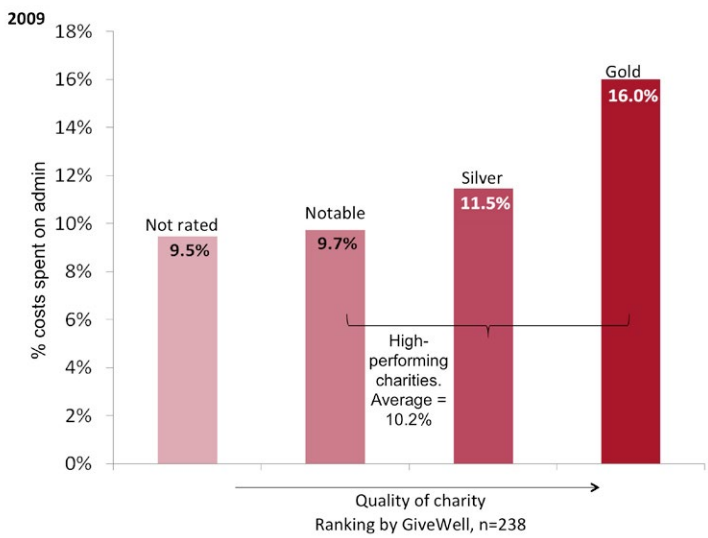
The charities which GiveWell reviewed in 2011 and recommended, on average spent 11.5% of their costs on administration. Charities which GiveWell reviewed and didn't feel confident recommending spent less on administration, only 10.8% on average.



This is no freak result. The same pattern was true in 2009:



In 2009, GiveWell had four levels of ranking, and the pattern is even more pronounced if we use those:



This implies that ***low admin costs do not signal that a charity is good. They signal the converse***.

Why might more effective charities spend more on administration than less effective ones do?

a) Case studies: false economies

Imagine a water charity which operates in several less developed countries to improve irrigation. If it's run well, it will have a system for recording what works and what doesn't in particular circumstances, and for sharing that learning between its various country offices. Now, should the costs of that system count as 'administration'? On one hand, the system isn't directly helping people: it probably involves databases and conference calls, rather than pipes and water. As a result, it may well be classified as 'administration' in a charity's accounts. However, the system will reduce the charity's costs and increase its effectiveness, and therefore certainly isn't waste. Aha – in this case, money spent on administration increases performance.

Let's consider finance costs. Perhaps the Finance Director purchases a better invoice-handling system. Same thing. That system should reduce work for finance staff by reducing processing times and/or mistakes, which frees up their time (and/or frees up money) to improve the quality and quantity of service to beneficiaries.

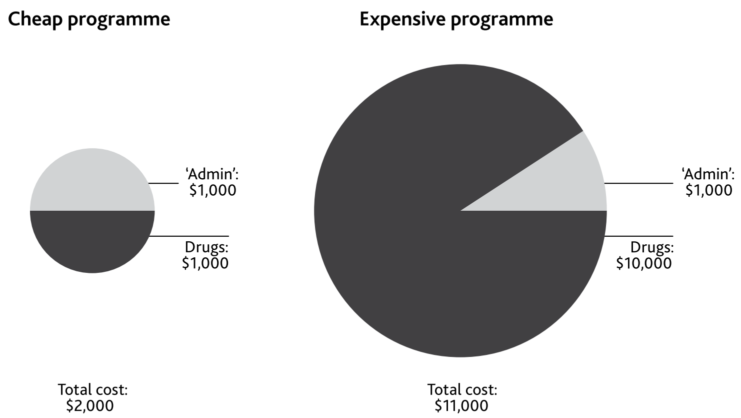
Let's take a real example. Chance UK provides mentors for primary school children who are at risk of developing anti-social behaviour and possibly being permanently excluded from school (formerly called 'being expelled'). The charity spent some money evaluating its work. It found that male mentors were best suited to children with behavioural difficulties, whereas children with emotional problems responded best to female mentors.[6] Again, the money spent on that evaluation would normally count as 'admin', but for the children receiving support which has improved because of that insight, it was money well spent.

b) The maths: What happens if you choose based on admin costs?

As well as discouraging learning and improvement in the way we've encountered, you might encourage pointlessly expensive work.

Suppose you are trying to improve child health in a less developed country by distributing drugs to reduce diarrhoea, which accounts for huge amounts of avoidable mortality. Suppose there are two types of drug: one costs £1 per child, the other costs £10 per child. You want to reach 1,000 children, so your expenditure on drugs will be either £1,000 or £10,000. Either programme will have costs associated with finding and dealing with 1,000 children and their families (for example, hiring and accommodating the team, and managing the finances). Let's put a figure of £1,000 on these 'admin' costs.

Programme A		Programme B	
Direct cost per child	£1	Direct cost per child	£10
Cost of treating 1,000 children	£1,000	Cost of treating 1,000 children	£10,000
Fixed 'admin' cost	£1,000	Fixed 'admin' cost	£1,000
Total programme cost	£2,000	Total programme cost	£11,000
Proportion of spending on 'admin': £1,000 ÷ £2,000 = 50%		Proportion of spending on 'admin': £1,000 ÷ £11,000 = 9%	



Judging by the 'admin' percentages, Programme A looks bad – but that's precisely because it's cost-effective! Looking at it another way, the question about admin percentage is useless because it doesn't ask 'percentage *of what*?'

A real-life illustration of exactly this is provided by the Disability Law Service, a charity which employs solicitors to give advice to disabled people. It found that by employing more secretaries, and thereby increasing its 'admin percentage', it could move administrative tasks away from the solicitors and hence serve more disabled people at lower overall cost[7].

The clear implication is that donors shouldn't favour charities with low administration costs. The empirical evidence provided here shows that they're likely to be low performers.

Reactions to these analyses

Michael Green, co-author of *Philanthrocapitalism: How Giving Can Save The World* says[8]: 'A bad charity with low administration costs is still a bad charity'.

Susan Hitch[9], trustee of various organisations including the Sigrid Rausing Foundation says: 'I'm often worried if a charity claims very low admin costs. Either they're fudging it to try to please a funder, which doesn't promise much of a relationship; or their admin really is rock bottom, in which case they're unlikely to be well run. You can't run an effective organisation with barely any core. Grants are usually more effective if the charity is spending a realistic amount on its core costs.'

Albert Einstein[10]: 'Not everything that counts can be counted. Not everything that can be counted counts.'

Detail and limitations of the analytical method

The admin percentages are from Charity Navigator for US-registered charities; where not available, from Guidestar; where not available from the Charity Commission; or lastly the charities' own filings. Where we couldn't find data on admin spend, the charity is excluded from the analysis.

The obvious limitation here is the sample size. We used all GiveWell's data up to the point in 2013 at which the analysis was done, which just does have a small sample. The fact that the pattern is the same for each of the three years implies a pattern.

Why do the admin percentages in both recommended and non-recommended charities increase from 2009-2011? We don't know. But we suspect that, as GiveWell has continued its search for the best charities, it's come across better and better charities: many which were recommended in 2009 have been superseded by organisations identified since then. This would be consistent with the finding from 2009 that good charities spend more on admin than less good ones: the charities recommended now outperform those recommended in 2009, and their high performance is a result of spending on understanding the problem they are trying to solve, and tracking and improving their performance, most of which would count as 'administration'.

How then *should* donors judge a charity's performance? Currently it's hard. In the UK, and most countries, there is no reliable 'ratings agency'. Charity Navigator in the US, the world's largest charity ratings agency, is moving towards a model which looks at many aspects of a charity's performance, including transparency and results. (Disclosure: Caroline Fiennes serves on its Advisory Board[11]).

Endnotes

1 Karlan, D. (2011) Why Ranking Charities by Administrative Expenses is a Bad Idea. [Online] http://freakonomics.com/2011/06/09/why-ranking-charities-by-administrative-expenses-is-a-bad-idea/ [Accessed: 14.12.15].
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3 Homer, L., Richardson, D., Shawcross, W., Younger, S. (2013) Uncorrected transcript of oral evidence. [Online] http://www.publications.parliament.uk/pa/cm201213/cmselect/cmpubac/uc1027-i/uc102701.htm [Accessed: 14.12.15].
4 Pudelek, J. (2013) Too many 'careerists' in the voluntary sector, says philanthropist. [Online] http://www.thirdsector.co.uk/careerists-voluntary-sector-says-philanthropist/finance/article/1173686 [Accessed: 14.12.15].
5 GiveWell. [Online] http://www.givewell.org/ [Accessed: 14.12.15].
6 'Chance UK': Brookes, M., 2009, *'Measuring impact, why it matters and why so many organisations need to sharpen up their performance'*, Speech at CharityComms seminar 'Measuring Impact, Communicating Results' www.philanthropycapital.org/downloads/pdf/CharityComms_why_measuring_impact_matters_FINAL.pdf
7 Copps, J., Vernon, B. (2010) 'the Disability Law Service'. *The Little Blue Book*: *NPC's guide to analysing charities, for charities and funders*. London: New Philanthropy Capital.
8 Green, M. (2012) Book Review: It Ain't What You Give, It's The Way That You Give It. [Online] http://www.theguardian.com/voluntary-sector-network/2012/mar/27/it-aint-what-you-give-book-review [Accessed 14.12.15].
9 Hitch, S. Quoted in *It Ain't What You Give*, Chapter 2.
10 Cameron, W.B. (1963) 'Not everything that counts'. *Informal Sociology: A Casual Introduction to Sociological Thinking.* Random House.
11 Fiennes, C. (2012) Why I'm delighted to join the advisory panel of Charity Navigator. [Online] http://giving-evidence.com/2012/12/11/charity-navigator/ [Accessed: 14.12.15].