# Mythical Realities: Challenging the Government/Nonprofit Nexus in Community Services Procurement[1]

Professor David Gilchrist[2]
& Ben Perks
Centre for Public Value
University of Western Australia, Australia

*The delivery of services and supports that fall under the heading of community services is one of the most important undertakings a community can pursue. Indeed, these services fulfill the social objectives of a nation and are the manifestation of our dreams and hopes for all. However, it is the vulnerable people at the heart of the system that are the shock absorbers for service failure. Often this failure is invisible and goes unobserved. Additionally, the myths built up surrounding the system—not just the nonprofits but the system—drive decision making and operational action that can drive service failure as an unintended consequence. This paper considers those hidden drivers of service failure and lays down a challenge to governments and sector providers in the context of building outcomes-based systems that support prioritisation and delivery in the context of a mature strategic horizon. It discusses the objective of dispelling the myths and building a true collaboration within the government/nonprofit nexus.*

---

[1] Paper presented at the King's Business School Outcomes-Based Contracts Workshop 2024, Bush House, London, May 30th to 31st 2024.
[2] Corresponding author: david.gilchrist@uwa.edu.au

## Introduction

The policy and program environment of the nonprofit human services sector has been veiled in myths that have distorted perceptions of its functioning, resources needs and social and economic contributions. Long held misconceptions of the sector have established and reinforced considerable biases among policy makers, government, sector leaders and the public which has, in turn, resulted in policy design and implementation strategies that undermine sector capacity rather than cultivate it. Amongst other things, these myths and biases impact both the broad vision of the sector (for instance, that the nonprofit sector is a fiscal sink) and the bases for procurement (for instance, that competition is a universally applicable and effective policy). These myths impact policy and practice by establishing biases that constrain the sector and prioritise short-term resourcing and programs rather than creating meaningful, evidence-based long-term social addressment of an array of wicked problems. Thus, they weaken the government/nonprofit nexus to the detriment of those who rely on services and supports to live their lives and the broader community, making genuine collaboration between the sectors toward a common outcome a significant challenge. Moreover, they have enabled a business as usual that prevents these myths from being adequately challenged.

Over time, the biases in policy design have produced an operating environment in which many nonprofit organisations: are not comprehensively funded for the services they deliver; experience suspicion from government and the public in relation to their capacity, experience and intentions; operate under a different set of rules to commercial businesses despite the constant rhetoric of market economics; and are expected to continuously do more with less as need for services, and their complexity, increase. Of course, the bigger problem is that of sustainability of the sector by way of the organisations operating in it while the consideration of sustainability itself is subject to a significant and impactful misreading when considered in relation to this sector.

Further, this situation imperils human services sustainability. In this regard, we are not concerned with individual organisations surviving, whether they are nonprofits, charities or for-profits, but, rather, whether the human services and supports will continue to be delivered at the right time, in the necessary quantity and at an adequate quality that best serves those in need and builds on a collective effort to solve the problem(s) at hand (Gilchrist & Perks, 2022). Clearly, this is a different perspective to that taken in the context of for-profit operations and market economics. But it is a perspective that is necessary if, for instance, service users are to be truly placed in the centre of the system. Importantly, the presence of these myths and the biases serve to reduce sustainability and remove service users from being central to the service delivery outcome—notwithstanding the continuous rhetoric from policymakers that the consumer should be at the centre of decision making.

In this paper, a selection of these myths, and the biases they cause, are compiled and evaluated by drawing on the latest literature to determine their substantiation and prevalence. Describing each myth, we link it to the biases observed in policy design, in addition to the practical consequences of the policies implemented. Through evaluating each myth, the scope of the problem and context surrounding each idea will become clear, as will the paradoxical and interconnected condition of the collection of myths and biases.

In canvasing the selection of myths we make two timely contributions to the nonprofit literature. Firstly, and to our knowledge, no other scholarly literature has compiled and evaluated a selection of myths impacting policy outcomes relevant to the human services sector. Similarly, the paper is the first to demonstrate the links from sector myths to the practical consequences and issues being observed at present. This extends the potential policy alternatives beyond the traditional empirical and evaluative approaches and urges policy makers and researchers to commit to introspection and critical engagement with the myths presented. Second, the paper provides a foundation for further research interrogating singular myths and their importance more closely. Establishing a research program that unpacks the power dynamics and social misconstructions at play here is a crucial supplementary action to developing an empirical evidence base that destabilises these myths in public and policy discourse. In short, while these myths prevail, the prospects for real step change for much better human services delivery is considerably restricted.

The next section details what myths and biases are in the context of the human services sector and presents the list of myths selected for evaluation. Next, each myth is discussed and placed in the context of the biases it informs, as well as the demonstrable consequences within the systemic and organisational operating environment. Then, we discuss some potential causes of the myths and consider as to why they continue to dominate nonprofit policy discourse. Lastly, four strategies are briefly presented that offer a starting point to dismantling these ideas and their often harmful consequences.

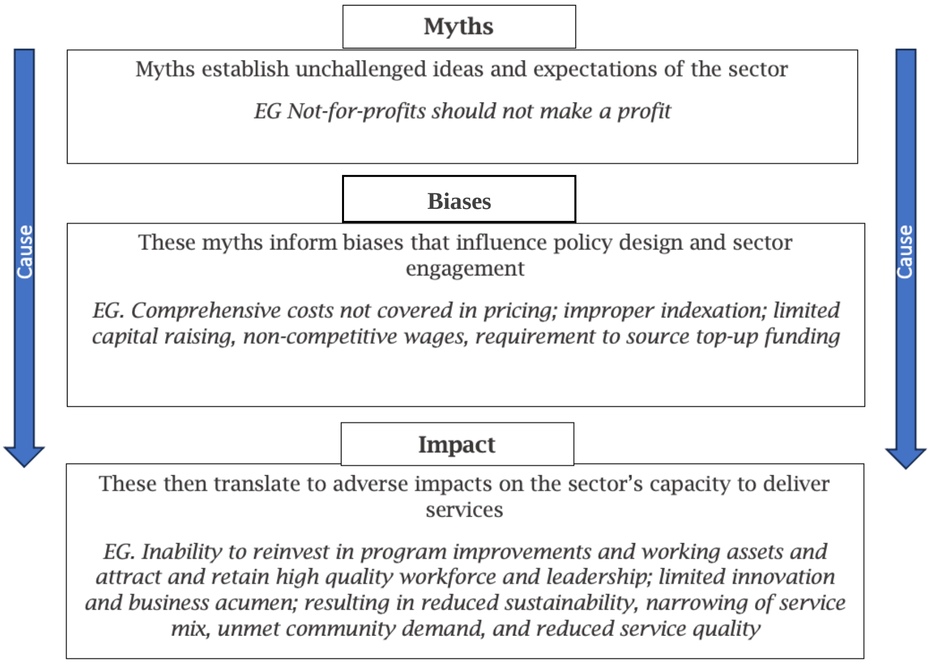
## What are myths and biases and why are they relevant?

Myths and bias in public policy (as elsewhere) are well-documented and can be recognised and distorted for all manner of purposes. In this paper, we are concerned with identifying myths relevant to the nonprofit human services sector, describing the bias those myths instigate and considering the impact that such behaviour has on policy and practice.

Often thought of as traditional stories that depict the particular origins of a place or tradition, myths constitute a set of symbols and language that are passed down generationally. Although they are most readily associated with supernatural beings and heroism—think of the Gods of Olympus—they are also present in less sensational aspects of our lives (Des Bouvrie, 2002).

Indeed, many myths exist in our understandings of how the world works, including in relation to the human services sector. These sector-specific myths concern our understanding of the operation and efficacy of nonprofit organisations. However, many such myths are not recognised and, if they are, are not rectified to the detriment of good policy and practice—this is especially the case in a sector like the nonprofit sector which has developed and changed significantly in the second half of the 20$^{th}$ century as state welfare provision grew post World War II—at least in most Anglophone countries—and then service delivery being reassigned to private organisations with the emergence of neoliberal economic policies from the 1980s (Gilchrist 2020). Importantly, the continuation of poor data sets, funding limitations and poor capacity in the area of program and service outcomes assessment mean that the myths and the biases caused are not undermined in a timely manner to the detriment of the human services sector and, most importantly, that of the service users.

Figure 1: The relationship between myths, biases and examples of poor impacts on human services and supports.




The creation of mythology is complex and varied. However, for the purposes of this discussion it is the issue that myths are communicated often uncritically between people or within institutions or in society that is most vital. Stories and the underpinning assumptions are disseminated and so thoroughly embedded in how we operate day-to-day that they become seemingly unchallengeable. These myths then drive the creation of policy bias (see figure 1 above).

Biases are inherent preferences that inform our individual thoughts, beliefs and actions. These are unconscious shortcuts people take to understand complex ideas and to supplement available information when making decisions. This includes the tendency to seek out information that confirms existing beliefs, generalising in relation to diverse groups or using a set of predetermined characteristics or attitudes that influence our perceptions (Hendriks, 2000). It is widely agreed that bias is an innate part of human thought and is present in some form in every decision we make. Much effort and importance are placed on becoming conscious of bias in thought processes and devising ways to minimise its negative effects. In the context of human services policy and practice, biases are significant problems as the label "human services" is really shorthand for a very complex and difficult range of services and supports responding to complex and often wicked problems. As such, the ability to discuss policy in this regard is impacted negatively by this complexity making the reduction of the discourse to a set of biased assumptions very easy.

In a very real sense, it is these underlying understandings that inform our thinking and interactions. In the case of the nonprofit human services sector, myths surrounding the operation, effectiveness and motivations of organisations have biased how: its policy makers devise relevant policy; governments administrate third sector matters; approaches taken in the measuring of outcomes and service quality; and how the public views nonprofits as well the expectations it places on the sector. These myths, and the biases they drive, impact the sustainability of the nonprofit human services industry negatively, despite there being no evidence or experience that supports these myths nor the biases they encourage.

## Myths and Biases in Focus

There are a number of myths and biases that exist in relation to the nonprofit human services sector, some are easier to discern than others, but all adversely impact the sustainability and trajectory of that sector. Like any social phenomena, they interact in complex and contextualised ways, informing and reinforcing each other at iterative stages. Table 1 below displays what we see as the dominant myths in the sector, as well as the resultant biases that inform policy and practice generally within human services sector.

**Table 1: Primary myths and biases in the human services sector**

| Myths |
|---|
| Nonprofits should not make a profit |
| Nonprofits should not pay competitive salaries to executives/appropriately reward leaders |
| Nonprofits are inefficient and non-innovative as compared to the commercial sector |
| All funds can and must be spent directly on programs for short-term return |
| The nonprofit sector is a fiscal sink: we should be looking for ways to reduce expenditure into this sector in all instances |
| **Biases** |
| Quasi-markets will elicit efficient and high-quality service delivery |
| Competition is required to correct motivation and improve efficiency |
| It is not necessary for governments to pay a price for services and supports that represents a profitable financial outcome for a nonprofit |
| Consumer Price and Wage Price indices appropriately capture cost changes in services |
| Contracting duration and particulars should not contribute to capacity-building and reserves |
| Contracting partial funding amounts that do not reflect comprehensive cost of services |
| Raising capital and filling expenditure gaps are necessary responsibilities of the organisation |
| Government is benevolent and supports sector rather than relying on service purchasing |
| Administration is automatically red tape and must be reduced; administration should not be funded |
| It is not necessary for nonprofits to hold a strong balance sheet |
| Misuse of metrics by government and philanthropic entities |
| Downplaying of economic contribution of the sector |
| The third sector being both distinct and comparable to other sectors |

## What does the literature say about these myths?

Due to the breadth of our argument, literature covering numerous topics was reviewed, albeit, limited to the major threads across each. For direction we selected articles that covered the themes related to the myths and explored whether the extant literature either directly engaged with the myths listed, established evidenced justifications for them or their consequences, or whether scholars make mention of the insufficient evidence perpetuating these myths or the policy design choices they inform. As such, the review acts as a scoping exercise to discern the depth and form of discussions surrounding funder/donor expectations and behaviour, organisational efficiency, legitimacy and reputation rather than a narrow revision of associated studies.

As expected, direct engagement with the myths did not appear in the literature reviewed, but, instead, the contestation brought on by these concepts has been tested extensively. The most pertinent examples of this are across the areas of nonprofit efficiency and performance, marketisation and competition, and donation behaviour. The clearest example of direct analysis appeared in Mitchell and Calabrese (2019, p. 649)'s examination of the four 'proverbs' of nonprofit management, these being to "minimize overheads, diversify revenues, be lean and avoid debt". The authors state that these proverbs have instilled a bias into management practices while their coherence is derived more from external suspicion and organisational trustworthiness rather than program growth, effectiveness or continuity considerations. Further, any deviations from these proverbial norms are argued to indicate mismanagement or impropriety.

Despite little prior scholarly investigation of the merits and substance of these myths, ample research has investigated the questions these myths propose and has attempted to decipher core sector contestations. Perhaps the most relevant is the exploration of donor or funder behaviour and attitudes toward nonprofit performance and management. A plethora of prior research supports that notion that resourcing is influenced by an organisation's operational characteristics. For instance, nonprofits with lower administrative or fundraising overheads (Prentice & Clerkin, 2023; Hung et al., 2023; Zhao & Lu, 2019; Lu, 2015), salaries and renumeration (Yan & Sloan, 2016; Lu, 2015), reported profit (Basu et al., 2022; Pizzini & Stern, 2023), as well as higher direct program spending (Prentice & Clerkin, 2023; Hung & Berrett, 2021) are expected to attract greater levels of donations and procurement contracts. That said, the literature is mixed on the estimated effect size, strength, and direction. It also appears these relationships are significantly confounded by organisation size, age, governance and the industry in which they operate (Prentice & Clerkin, 2023; Pizzini & Sterin, 2023).

Despite the evidential inconclusiveness, it is clear that donors, governments and scholars have a keen interest in these factors as not only indicators of efficiency and quality but also proxies of reputation and trustworthiness. These aversion characteristics also appear to betray donor attitudes and expectations of nonprofit and charity organisations. Qu and Daniel (2021) examine the current framing of overheads on donor aversion using experimental survey design, finding that by providing context to overheads adverse sentiments were reduced. This effect increased when the word 'overhead' was simply substituted for another phrase. Concerningly, nearly half of respondents could not give an accurate example of overhead expenses but were, in fact, responsive to notions of capacity-building and investment to achieve efficiencies. An earlier study of donor overhead attitudes (Charles et al., 2020) found that some donors are reluctant to donate in the presence of perceived high overhead ratios yet showed a marginal easing of giving attitudes if a proportion of overheads were covered by a third party. This relationship became greater the more of the total amount was anonymously covered.

Inversely, production or productivity—that is the efficiency of producing outputs—is a relatively insignificant predictor of donations. Using U.S. nonprofit housing data, Coupet and Broussard (2021) found donor responsiveness to performance was negligible when factoring in actual output produced rather than input-based administrative and fundraising ratio efficiency metrics. Consistent evidence is presented in Coupet and Schehl (2022). However, governments were found to respond slightly to a ratio of 0.28:1. When coupling these findings with those on overhead adverse behaviours it appears that financial or operational performance may only offer a partial explanation for donor attitudes. Instead, it is likely that donor's anchor their giving to how they believe a nonprofit 'ought' to behave not what indications best reflect actual nonprofit performance and impact (Schubert & Boenigk, 2019). As this anchoring is inherently heuristic, it leaves ample explanatory room for the myths outlined in this paper to influence or even directly inform nonprofit resourcing (Charles & Kim, 2016). This assertion is supported by a systematic review conducted by Chapman et al. (2022) that placed a central tension between integrity and competence violations during instances of scandal. Given that adverse sector wide resourcing effects are observed during these nonprofit scandals, we can infer that such backlash is driven by concerns over trustworthiness of the whole sector rather than the competence of a single organisation.

## How these ideas connect, distort decision-making and impact sector sustainability

Myths and biases translate into policy that constrains nonprofit strategic operations. The strategies and avenues open to other sectors, as well as the relationship with government are often denied to the third sector with the alternative resulting in the policies and programs that don't work and hold little internal consistency while decreasing sustainability in the short-, medium- and long-terms. It is the misconceptions and unchallenged understandings of the sector that create this environment. As seen in the figure below, each of the sector myths feed into the set of biases that effect policy and sectoral relations with government and the general public.

The difficulty in outlining and linking each myth and bias, along with the most noteworthy consequences, lies in the overlapping and complex relationships shared between them. While some channels are perhaps clearer and more robustly understood than others, it does take some effort to consider exactly how pervasive these ideas are and their impact on how the sector is perceived.

### Nonprofits should not make a profit

Perhaps the most widespread myth is that nonprofits should not make a profit or surplus in the process of furthering their mission. Indeed, this may partially be a misunderstanding attached to the label not-for-profit/nonprofit/charity wherein organisations cannot distribute profit to owners or shareholders or distribute residual assets on winding up unlike for-profit businesses. Indeed, there is evidence that executives of nonprofits undertake reporting management in order to ensure they are not perceived as over-profitable (Gilchrist et al, 2024). However, there is a deeper held view that profitability is antithetical to the social cause of an organisation. Even the use of the term "surplus" is contrary to the needs of the sector wherein the suggestion that an excess of income over expenditure is unneeded restricts the capacity of nonprofit organisations to invest in their operations. Nonprofits, and charities in particular, should not be pursuing profit, as this is not only thought to be at the expense of those in need, but also seen as a waste of money given the myth of nonprofits as fiscal sinks as discussed below (Basu et al., 2022).

This view, of course, neglects the importance of an organisation generating untied funds for reinvestment to further its activities and capacity, as well as promoting greater effectiveness, not to mention their need to invest to meet changing government policy, changing quality requirements and ever-increasing need (Calabrese, 2011). It also prevents organisations being able to forward plan and respond to economic and other shocks (e.g. Covid and Bushfires). Thus, the myth unnecessarily distinguishes the effective and efficient operation of third sector organisations from those in other sectors to the detriment of service delivery sustainability. It also flies in the face of logic where for-profit organisations might be receivers of procurement orders from government and then distribute some of the profit from that exercise to shareholders, directors and staff while nonprofits must retain such profits on their balance sheet for application against the mission.

Under resourcing is a familiar issue among human service nonprofit organisations with most providers invariably breaking even or operating at a loss—this is especially the case when the procurements made by governments do not cover the comprehensive cost of service delivery and therefore nonprofits contribute their balance sheet capacity to service delivery over time. The denial of profitability can be seen as creating a bias in how the resourcing of these organisations is approached and what parts of the operation are prioritised. In many instances, current practice is for resources to cover only those direct program costs required to deliver a program in the short-term (Prentice & Clerkin, 2023). For example, government procurement, which constitutes many of the resources received (Cortis & Blaxland, 2021), is often for short durations (e.g. one-off/pilot, 1 year, 2 year) and can entail strict stipulations of how funds are to be used. In many cases, the funds not utilised for program delivery must be returned to the relevant department rather than reinvested into the organisation (Blaxland & Cortis, 2021). This not only leads to under-investment, but it also leads to government commissioners misunderstanding the true cost of service delivery and the appropriate price to be paid. Year-on-year under funding impacts the service mix actually provided to service users but this goes unnoticed as the need for services is not well understood by government procurers.

Tying this back to profitability, contract lengths and particulars are designed to ensure that only the resources required to deliver the immediate service are provided and even then it is highly unlikely that the necessary resourcing is provided. No priority is given to how costs are absorbed by the provider or the importance of capital surplus and cash reserves for building effective service models and maintaining sustainability. On the contrary, the myths suggest that if the generation of profit is inappropriate then by extension the utilisation of surplus on non-direct activities should also discouraged. Thus, in the same breathe, raising capital from other sources for the purpose of improving sustainability and revenue security places organisations into similarly unsavoury territory (CAANZ, 2020). Collectively the resourcing bias informed by the notion that nonprofits should not make a profit embeds vulnerability and disruption into the human services sector.

Overall, the persistence of this myth, and the subsequent biases perpetuated, impact the sustainability of service delivery as those charged with governance in nonprofit service providers must ensure financial solvency. Service providers cannot change the price or quality levels in most cases and so they must change the quantity (or service mix). These changes often go unperceived by governments and the impact is felt by those needing services and supports in the community. That is, the service user is the shock absorber for the system. Indeed, the impact on governments is to increase the risk of cost blow-outs as emergency supports and services as well as replacement services must be provided at some point and the problem becomes exacerbated and thus more expensive in the medium term (Ben-Amar et al., 2023).

## Nonprofits should not pay competitive salaries to executives or reward leadership

A closely related misconstruction to the denial of profitability is the notion that sector employees, particularly those holding executive roles, should not be competitively renumerated. While differences in renumeration between nonprofit and for-profit organisations can be dependent on characteristics such as size, industry and output type, it is not controversial to say that salary levels between the two types of organisations are often disparate with those in the nonprofit sector paid significantly less than those in the for-profit sector, notwithstanding the fact that the nonprofit sector is much more complex and higher risk than very many for-profit activities with often far greater negative human impacts when things go wrong.

For instance, a 2019 Pro Bono survey of nonprofit CEO salaries in Australia placed the average salary at AUD$133,260, with an additional approximately AUD$100,000 being paid to the CEOs of nonprofits with budgets over AUD$25million and those operating in the aged cared and disability sectors (Coggan, 2019). In contrast, for-profit CEOs received an average of AUD$420,854 in salary, as well as an average bonus of around $300,000. Those in the largest Australian companies can take home upwards of $10million (Yan & Sloan, 2016).

Of course, it is unreasonable to compare these salaries forthright. However, the skills and responsibilities are comparable, as are the characteristics of successful individuals and the benefits borne from high quality executive leadership. Notably, the risk and complexity in most nonprofit human services organisations are very significant and any failure in terms of quality and/or quantity can be catastrophic to service users and staff.

As it stands, the best talent cannot be drawn to the sector because of the dual expectations of low pay and high sacrifice expected of the workforce. By way of example, recent MBA graduates are likely to earn around AUD$55,000 less in the nonprofit sector and career progression is significantly limited (Coggan, 2019). Despite the pursuit of competition being a central bias informing much reform in the sector, it is only competition within the sector that is viable and an inability to invest in talented people limits internal development, the cultivation of new ideas. Put plainly, sector organisations need high levels of commercial, social and clinical acumen but cannot deploy the incentives necessary to draw in those with the skills and capacities required (Gilchrist & Perks, 2023).

The centring of sacrifice and low pay encourages a number of biases which are reinforced continuously. Certainly, public scepticism has grown over the decades towards executive salaries and notions of siphoning funds earmarked for charitable causes (McKenzie & Baker, 2020). When coupled with the myths of no profit and no administration spending, it becomes impossible for compensation to ever outweigh the charitable sacrifice required of workers. The perceived inappropriateness of incentivising talent and development speaks to the bias in how we recognise the economic contribution of the sector and the benefits of having the brightest minds working for its betterment, as is the case in every other industry (Stahl, 2013). For-profit organisations understand the return available when they bring in quality employees and invest in them, the nonprofit sector is not given the same advantages (Chertavian, 2013).

## Nonprofits are inefficient and non-innovative as compared to for-profits

Combined with the admonition that nonprofits should not make a profit described above, a particularly pervasive misconstruction, whose influence over policy design is perhaps most insidious, is that nonprofit organisations are inefficient and static with minimal capacity for innovation or improving quality or services. While not always stated explicitly in policy and public discourse, there is a working assumption in policy circles, philanthropic entities, as well as government that without a profit motive and without appropriately skilled leadership, nonprofits lack the necessary motivation to pursue cost-effectiveness and investment in quality improvements (Jegers, 2022; Perroni et al., 2019). Evidence of this can be gleaned from the Australian Productivity Commission's oft quoted 2010 report on the contribution of the nonprofit sector. Despite the report outlining the administrative and resourcing barriers nonprofit organisations face, the Productivity Commission still suggested that the sector was bloated and non-optimal in its delivery or effectiveness (PC, 2010).

There is an abundance of literature examining the conceptualisation, measurement and comparative merit of nonprofit efficiency and performance. A sustained and growing literature now criticises how efficiency is conceived and utilised in funding and compliance processes, stating these ratios say nothing of service quality nor the relationship between inputs and outputs (Jegers, 2022; Feng et al., 2021). Commonly used input-centric measures of financial health, such as program spending, administrative and fundraising ratios have been interrogated extensively with alternative measures focused on the full production process (i.e. input to output) being advanced as appropriate alternatives (Prentice, 2016; Harris et al., 2022).

Expectedly, the aggregate findings present a complex picture that requires consideration be had of data quality and relevance, revenue diversity, industry, and the regulatory environment (Coupet & Berrett, 2018). Much of the comparative literature uses U.S. nursing home and hospital data to study differences in performance and service quality between public, nonprofit and for-profit organisations (Song, 2022; Walker et al., 2022; Herrera et al., 2014; Rosenau & Linder, 2003). Although the available evidence on nonprofit efficiency is mixed and methodologically inconsistent, it is largely unsupportive of the simplified claim that nonprofits are inefficient. Commercial entities possessing greater efficiency by merit of a profit-motive solely is also poorly supported within the empirical literature when operating in human service sectors. Contrastingly, Rosenau and Linder (2003) and Harris et al. (2022), among others, suggest that since profits must be reinvested into the nonprofit organisation rather than distributed to shareholders and volunteers is such an integral feature in the sector that nonprofits may actually exhibit higher levels of efficiency on average (Herrera et al., 2014).

Regardless, popular reform in human services delivery has predominantly involved the introduction of competition in some form to organisations. The resting assumption is that competition over resources will correct the drive among nonprofits towards cost-effectiveness and innovative differentiation of their 'product' because, in the case of quasi-market[3] structures, the consumer has greater control (Song, 2022). A demonstration of this bias is in the preference for quasi-markets to facilitate greater competition. While this has been seen to be effective in select circumstances, social service markets functionally do not exist. Since

[3] A quasi-market is a market where the government is the sole buyer, determining the price and supply through funding decisions (e.g. NDIS, employment services)

governments determine program demand through budget allocation and regulation activities, and determine the price based on their capacity to pay rather than on the comprehensive cost of service delivery, price signals and commercial flexibility are not present. As quasi-markets continue to be introduced, a slew of common causes of market failure can be identified (Song, 2022; Herrera et al., 2014). With sustained government involvement, faux market arrangements will never be able to provide a more efficient level of service delivery. Yet, despite the evidence to the contrary, this remains the primary reform instrument intended to improve service outcomes (Considine, 2022).

Concomitantly, the current resourcing framework disincentivises innovation and risk taking by not affording the stable revenue required for long-term value generation consistent with business better practice. Any attempt to introduce novel ideas or practices are scrutinised and often punished by means of non-renewal or stricter contracting (Gilchrist & Perks, 2023). Therefore, short-term efficiency-centric compliance regardless of impact or potential, is institutionalised in contracting, indexation and capital raising activities; an attitude that is reflected and reinforced by narrow public tolerance for what is seen as misuse of funds earmarked for service recipients (Pizzini & Sterin, 2023).

## The third sector is a fiscal sink

The notion that the third sector is a fiscal sink is a persistent myth that suggests organisations are purely receivers of financial support from which no return is generated. This myth suggests that money spent in the sector is wasted and focuses policy makers and others on the issue of reducing expenditure rather than considering the quality of the purchase and the outcomes—economic and social—actually achieved (Cheng, 2019).

Moreover, since the social challenges the sector is tasked with alleviating continue somewhat unabated, the need for further financial support is manifest. Notwithstanding the abundance of economic evidence confirming the broader substantial economic contribution of the sector, this myth is sustained in how funders evaluate and fund organisations (Kim & Kim, 2015; Pennerstorfer & Rutherford, 2019). The administrative processes involved in contracting and granting, while to an extent reflect prudent public financial management, also require organisations to expend significant time and money to demonstrate the legitimacy of their spending. The starvation cycle is a symptom of this dynamic, as much as it is of ordained competition, since organisations must compete to be considered the least wasteful provider (Schubert & Boenigk, 2019).

Two broad biases stem from the fiscal sink myth. The first is the downplaying or selective recognition of the economic and social contribution of the third sector to the wider community. As of 2023, the Australian Charities and Nonprofit Commission (the national charities regulator) reported that the sector employed 10.5% of the Australian workforce and generated AUD$190b in revenue of which approximately 50% was self-generated (ACNC, 2023). Further, charities purchase goods and services from other sectors and can inject funds into local communities in ways that are localised and efficient. Non-monetary or social production spill overs further strengthen the sector’s contribution by billions of dollars (Tran et al., 2023). Certainly, this can be extrapolated to the contribution of those who access services, as well as the cost offsets of emergency and crisis services often directly delivered by governments.

The second bias comes by way of an assumption that has come to underpin the relationship and the language used between governments and the nonprofit sector. Namely, the working state that nonprofits require support to provide services and the government supports this mission through funding (Mosley, 2012). More accurately, the government is purchasing services from organisations that are offering said services instead of delivering services they are otherwise responsible to deliver.

**All funds can and must be spent on programs**

The idea that all funds received by a charity or nonprofit can and must be spent directly on program delivery is well-intentioned but is a myth that warrants careful consideration. This is because such ideas place unrealistic and undue constraints on the practices of those operating programs. Of course, a significant proportion of funds should be allocated to direct program efforts. However, the assumption that this is the appropriate and most effective means of resourcing nonprofit organisations is incorrect. In many cases, this wholly prioritises a short-term service view that, while it may address the initial needs of those in the community, severely limits collective capacity to tackle issues systemically (Garven & Hofmann, 2016).

The expectation that all available funds are reserved for service delivery biases how we view efficiency and effectiveness within the sector, and in turn, how assessment of these characteristics is undertaken. Many resourcing contracts and grants are closely tied to financial ratios that demonstrate low overheads or indirect costs relative to direct spending (Kotsi et al., 2023). That this is now coupled with increased competition among organisations has intensified instances of the ‘starvation cycle’ whereby providers under-report their overhead requirements in order to secure funding which causes further tightening of indirect spending. A growing body of evidence has confirmed that, not only do funders expect indirect spending levels as low as 10-15% when the median ratio is around 40%, but that these rates are significantly lower than what is considered financially healthy for an organisation in other sectors (Eckhart-Queenan et al., 2016).

There is currently no evidence of a relationship between cost-effectives and overhead spending with those organisations considered effective exhibiting a range of spending levels (Johansen & Zhu, 2014). Non-program costs, such as administrative overheads, training and development and evaluation assessment serve to bolster the effectiveness of organisations and are an essential component of the operation of any business—they also potentially reduce risk and long-term spending requirements. Despite the underlying notion of charity as a sacrificial act, organisations are expected to operate like entities in other sectors and, unsurprisingly, those practices (marketing, research and development, strategic investment, competitive salaries) that produce positive returns in other sectors would do the same in the nonprofit sector (Kotsi et al., 2023). Since this behaviour is embedded in many donor expectations, the ability for organisations to diversify their revenue to fund indirect costs and invest in efficiency technologies is severely restricted. This restriction being an experience felt differently across a diverse sector (Johansen & Zhu, 2014).

With this in mind, such pervasive yet inaccurate contractual monitoring furthers the reluctance on the part of institutional funders to recognise the comprehensive costs of service delivery. For instance, it would not be reasonable to expect a construction company to build a bridge having received only 70% of their operating costs much less their profit rate, the same thinking should apply when purchasing human services. Instead, systematic underinvesting in indirect costs within the sector has weakened its capacity to provide the meaningful long-term benefits sought after by providers. These circumstances are likely buttressing notions of inefficiency and fiscal wastage, which only further solidifies perceptions that direct program funding is the only appropriate approach to resourcing nonprofit organisations.

## Understanding the unintended consequences

The myths and biases present in the sector have far-reaching and largely unintended consequences, many of which have been experienced by organisations and documented by researchers for a considerable time (for instance, see Lyons, 2001). Firstly, under resourcing through non-comprehensive contracting, strict metrics, limited capital raising and inappropriate indexation leaves organisation's unable to invest, innovate and diversify their revenue streams thus impacting service sustainability negatively and increasing service risk to the detriment of service users (Adelino et al., 2015). Restructuring of expenditure priorities can see organisations needing to narrow their service mix to avert continuity risks, decreasing effectiveness, and threatening quality, in addition to exacerbating sector capacity to meet demand. It is well-understood that unmet need in initial services result in cost spillovers to other sectors, such as emergency services, healthcare, the justice system and safety net welfare programs. These social and economic costs are borne by the public both in terms of civic quality and taxation (Lyons, 2001).

Another consequence of these myths and biases is the continued practice of governments and other donors prioritising short-term outcomes over a return-on-investment approach. Rather than investing in building a robust social infrastructure capable of efficiently and effectively addressing long-term social issues, the focus remains on policy mechanisms that are informed more by myths than the existing evidence. This perpetuates the cycle of myopic thinking, preventing the development of sustainable solutions that can truly address the root causes of wicked societal challenges.

A final notable consequence is the presence of conflicting expectations whereby third sector organisations are treated as both fundamentally distinct and comparable with commercial businesses in other sectors. On the one hand, the sector holds a unique position in society as it attempts to address the social issues demonstrably beyond the capacity of the market system. With this mission-orientation comes the familiar expectations of charitable sacrifice, coupled with suspicions of inefficiency and wrongdoing in the absence of a profit motive. Conversely, nonprofits must also navigate the practical expectations and pressures associated with economic principles, competitive contracting and strict performance metrics and accountability. This tension places sizable pressure on a sector that seemingly has the expectations to operate like commodity for-profits yet has extremely limited access to the practices and tools that are commonplace for a successful business. Resultantly, these conflicting expectations trickle down into the quasi-market and resourcing environment, effectively economically isolating human services organisations.

Unfortunately, it is impossible to attribute the plethora of misconstructions to one source. However, there are two core barriers to a broader movement that would challenge these ideas. The first is the lack of understanding in governments and the for-profit sector of third sector operations and their role in the community or how prolific under-resourcing and its consequences are among organisations. For example, the legal distinction of non-distribution is theorised as extending in the public's mind to executive salaries as with some forms of capital acquisition (Yan & Sloan, 2016; Lind, 2019). To rectify this poor understanding, a timely and functional array of data is required to challenge the fallacies imposed on the sector through policy bias and to facilitate dedicated examination, as well as communication of the myriad of ways a sustainable human services sector can contribute to a shared prosperity and enrichment of our communities (Lim et al., 2023).

A second notable influence is the absence of sustained political pressure on these myths and biases via the discourse and policies that rest on them. Certainly, there is sizable sector advocacy for fairer funding and conditions for service providers (Gilchrist & Perks, 2023). However, resource dependence and frontline short-sightedness passively deter organisations from challenging the causes instead of the immediate symptoms. Instead opting for selective language and strategies that prolong the misconstructions driving unsustainable and precarious operation (Elliott & Haigh, 2013). Within this restraint is an inability on the part of the sector to strategically engage with the media in challenging policy bias, reshaping public opinion, nurturing trust and easing scepticism or suspicion beyond mandatory reporting (Adena, 2016).

## Strategies to begin dismantling these myths and biases

Challenging the myths and biases related to nonprofit human services providers, and in turn the impact on the sector, necessitates a multi-faceted approach that addresses the drivers of the core ideas as well as the negative impact on organisations. Currently, there is little functional means of substantiating or challenging these myths that have embedded bias so effectively. The following strategies represent some critical steps to dismantling the misconstructions shaping sector policy and sustainability.

> **Development of robust data assets:** To effectively challenge prevailing perceptions of the sector, comprehensive data collection will need to occur to build appropriate data assets. Focus should be placed on performance measurement, economic impact, the building up of detailed organisation profiles and the construction of fit-for-purpose metrics and operating principles. By embracing data asset development, the sector can more confidently communicate its value and counter misconceptions decisively. Coupled with better access to data, is consensus building towards a more robust understanding of performance. Key areas should include performance related not only to traditional financial information, but also stakeholder engagement, mission delivery, as well as the quality of an organisation's commercial strategy (Harris et al., 2022).
>
> **A national measurement and evaluation framework:** A related strategy would be the development of a framework to robustly assess the performance and contribution of the sector. At its most effective, this framework would require a substantial consultative period that involved data-driven investment into evaluation metrics and fit-for-purpose performance benchmarks (Kirk & Nolan, 2010). It would also require a system-level focus rather than the micro-economic focus now prevalent. Not only would this aid in the communication of sector value, a standardised approach would instil transparency and accountability into the funding relationship that would likely bolster public engagement. Indeed, educating the community about the modern and professionalised role of the human services sector would be a critical pillar of such a framework (Souder, 2016).
>
> **Transparent and well-defined goal setting and industry planning with real collaboration between sectors:** A critical third strategy would be the development of a set of goals and a long run industry plan for the sector. Integral to this process would be the recognition of the importance and role of the sector in addressing societal change, in addition to its value

in stimulating economic growth in the short- and medium-term. A core component would then be the adoption of a return-on-investment approach rather than a strictly procurement focus. It is well-established that innovation and productivity gains require a solid governance and administrative base in which to propagate (Richardson et al., 2023), while talent, capital and the capacity to absorb risk will be necessary components in the development of new service models that tackle social problems. With this in mind, governments jointly collaborating with the sector are able to determine a sustainable and evidence-based approach to capacity-building with a clear profile of expected returns (i.e. economic and social) and safeguards to protect public funds and determine viable investment opportunities.

**Recognition and commitment to funding of the comprehensive cost of services:** Finally, and perhaps most immediate, is the recognition and commitment by funding partners to fully fund the comprehensive cost of service delivery. Despite the limited data available, what evidence is available clearly demonstrates that when an organisation is adequately funded it is better able to deliver high-quality programs and generate greater social and economic returns (PC, 2010; Cordes, 2017). Changes in funding should encompass those costs covered, as well as the duration of contracts, the appropriateness of indexation and flexibility in resource use to allow for capital raising and strategic investment within agreed upon context (Gilchrist & Perks, 2023).

## Concluding thoughts

The defining result of the proliferation of myths about the how the human services industry does or should function contributes to substantial cultural biases in policy design and sector engagement. These misconceptions continue to have significant negative effects on the sustainably of human services delivery in addition to the industry’s ability to reinvest and innovate. As profitability, commercial autonomy and recognition of wider economic and social value are denied organisations, it is reasonable to conclude that the nonprofit sector is becoming increasingly economically isolated from the broader economy. The sector is tasked with addressing complex social problems in an environment where it operates under a different, and often conflicting, set of expectations and rules.

What this amounts to is a relationship between the sector, and governments, the public or the commercial sector that are extractive rather than collaborative. The result is a failing to cultivate of a sector capable of greater social returns while building on its economic contribution—a sector that is increasingly expected to do more with less, and punished if its attempts to reinvest, strengthen revenue or advocate for resourcing consistent with the actual costs of service delivery (Gilchrist & Perks, 2023).

To overcome these obstacles, a shift in perception is needed, recognising the value of long-term, sustainable investments in the human services infrastructure, in addition to a more nuanced understanding of how nonprofit organisations operate and contribute to the betterment of society. Another element, of course, is informing the organisations themselves of the paradoxical environment they are asked to operate in. As for future research, being cognizant of these poorly substantiated ideas when developing and undertaking research in nonprofit fields will help in preventing their perpetuation. Indeed, introspection in research practices and the assumptions being used will be key to influencing policy makers and the policies their design.

## References

Adelino, M., Lewellen, K., & Sundaram, A. (2015). Investment decisions of nonprofit firms: Evidence from hospitals. The Journal of Finance, 70(4), 1583-1628.

Adena, M. (2016). Nonprofit organizations, free media and donor's trust. Journal of Economics, 118(3), 239-263

Australian Charities and Not-for-profits Commission. (2023). Australian Charities Report: 9th edition. Australian Government. https://www.acnc.gov.au/tools/reports/australian-charities-report-9th-edition.

Basu, S., DeVides, Z., & Harris, E. E. (2022). Funding implications of normal and excessive profitability in the nonprofit sector. *J. Account. Public Policy, 41(*1), 1-19.

Blaxland, M and Cortis, N (2021) Valuing Australia's community sector: Better contracting for capacity, sustainability and impact. Sydney: ACOSS

CAANZ. (2020). Not-for-profit Cash Reserves: NFP insights. Chartered Accountants Australia New Zealand.

Calabrese, T. D. (2011). Do donors penalize nonprofit organizations with accumulated wealth? Public Administration Review, 71(6), 859–869. https://doi.org/10.1111/j.1540-6210.2011.02420.x

Caviola, L., Faulmüller, N., Everett, J. A., Savulescu, J., & Kahane, G. (2014). The evaluability bias in charitable giving: Saving administration costs or saving lives? Judgement and Decision-making, 9(4), pp. 303-315.

Chapman, C. M., Hornsey, M. J., Gillespie, N., & Lockey, S. (2023). Nonprofit scandals: A systematic review and conceptual framework. *Nonprofit and Voluntary Sector Quarterly*, *52*(1), 278-312.

Charles, C., & Kim, M. (2016). Do donors care about results? An analysis of nonprofit arts and cultural organizations. Public Performance & Management Review, 39(4), 864–884. https://doi.org/10.1080/15309576.2015.1137775

Charles, C., Sloan, M. F., & Schubert, P. (2020). If someone else pays for overhead, do donors still care? *American Review of Public Administration, 50*(4-5), 415-427.

Cheng, Y. (2019). Nonprofit spending and government provision of public services: Testing theories of government–nonprofit relationships. Journal of Public Administration Research and Theory, 29(2), 238-254.

Chertavian, G. (2013, March). Nonprofits need to compete for top talent. Harvard Business Review. https://hbr.org/2013/03/nonprofits-need-to-compete-for

Coggan, M. (2019, July). Who earns the most in the social sector…and why?. Pro Bono. https://probonoaustralia.com.au/news/2019/07/who-earns-the-most-in-the-social-sector-and-why/

Cordes, J. J. (2017). Using cost-benefit analysis and social return on investment to evaluate the impact of social enterprise: Promises, implementation, and limitations. Evaluation and program planning, 64, 98-104.

Cortis, N., & Blaxland, M. (2021). Meeting community needs in difficult times: Experiences of Australia's community sector. Sydney: UNSW Social Policy Research Centre.

Coupet, J., & Berrett, J. L. (2018). Toward a valid approach to nonprofit efficiency measurement. *Nonprofit Management and Leadership*, *29*(1), 299–320.

Coupet, J., & Broussard, P. (2021). Do donors respond to nonprofit performance? Evidence from housing. *Public Performance & Management Review*, *44*(1), 108-135.

Coupet, J., & Schehl, M. (2022). Government grants, donors, and nonprofit performance. *Journal of Public Administration Research and Theory,* 97-110.

Des Bouvrie, S. (2002). *The definition of myth: Symbolical phenomena in ancient culture.* Norwegian Institute at Athens.

Eckhart-Queenan, J., Etzel, M., & Prasad, S. (2016). Pay-what-it-takes philanthropy. Stanford Social Innovation Review.

Elliott, S., & Haigh, D. (2013). Advocacy in the New Zealand not-for-profit sector: 'Nothing stands by itself'. Third Sector Review, 19(2), 157-178.

Galle, B., & Walker, D. (2014). Nonprofit executive pay as an agency problem: Evidence from U.S. colleges and universities. *Boston University Law Review*, 94, 1881–1934. https://scholarship.law.bu.edu/faculty_

Galle, B., & Walker, D. (2016). Donor reaction to salient disclosures of nonprofit executive pay: A regression-dis- continuity approach. *Nonprofit and Voluntary Sector Quarterly*, 45(4), 787–805. https://doi.org/10.1177/ 0899764015609728

Garven, S. A., Hofmann, M. A., & McSwain, D. N. (2016). Playing the numbers game: Program ratio management in nonprofit organizations. Nonprofit Management and Leadership, 26(4), 401-416.

Gilchrist, D. J. (2020). "Silver Bullets and TED Talks: Sketching Ideas on the Government/Not-for-profit Nexus in the Australian Welfare State." Third Sector Review 26(2): 21.

Gilchrist, D. J., Etheridge, and Liu, F., (2024), Managing Government Commissioning and Philanthropic Expectations: Earnings Management in Australian Nonprofit Disability Service Providers", Journal of Accounting Literature, Vol. 46, No. 2, Pp. 200-213.

Gilchrist, D., & Perks, B. (2022). The Challenge of Sustainability: Not-for-profit Sector and the Impact of Growing Financial Pressure. Centre for Public Value: Perth

Gilchrist, D., & Perks, B. (2023). Policy evaluation in the hands of philanthropists and NGOs: The politics of getting it right. Handbook of Public Policy Evaluation. Varone, F., Jacob, S. & Bundi, P. (eds.). Cheltenham: Edward Elgar Publishing.

Harris, E., Neely, D., & Parsons, L. (2022). Nonprofit performance measurement and reporting: Looking forward. *Journal of governmental & nonprofit accounting. 11*(1), 51-58.

Hendriks, F. (2000). The Mobilization of Bias Revisited: Institutional Design, Cultural Bias and Policy-Oriented Learning. In Governance in Modern Society: Effects, Change and Formation of Government Institutions (pp. 281-297). Dordrecht: Springer Netherlands.

Hoang, T., & Lee, Y. J. (2022). Looking at the nonprofit accountability-charitable donations relationship through the publicness lens. *Nonprofit Management and Leadership*, 33(2), 219–454. https://doi.org/10.1002/nml.21513

Hung, C., Hager, M. A., & Tian, Y. (2023). Do donors penalise nonprofits with higher nonprogram costs? A meta-analysis of donor overhead aversion. *Nonprofit and Voluntary Quarterly. 52*(6), 1587-1608.

Hung, C., & Berrett, J. (2021). Service delivery under pressure: The effect of donor-imposed financial restrictions. *Public Performance & Management Review*, *44*(3), 580-601. DOI: 10.1080/15309576.2021.1916546

Jegers, M. (2022). Donations and the overhead ratio are related even when donors do not bother about efficiency. *Nonprofit and Voluntary Sector Quarterly, 51*(1), 216-225.

Johansen, M., & Zhu, L. (2014). Market competition, political constraint, and managerial practice in public, nonprofit, and private American hospitals. Journal of Public Administration Research and Theory, 24(1), 159-184.

Kim, S. E., & Kim, Y. H. (2015). Measuring the growth of the nonprofit sector: A longitudinal analysis. Public Administration Review, 75(2), 242-251.

Kirk, G., & Beth Nolan, S. (2010). Nonprofit mission statement focus and financial performance. Nonprofit management and Leadership, 20(4), 473-490.

Kotsi, T. O., Aflaki, A., Aydin, G., & Pedraza-Martinez, A. J. (2023). Allocation of nonprofit funds among program, fundraising, and administration. *Manufacturing & Service Operations Management*, 25(5), 1873-1889.

Lim, S., Min, B. H., & Berlan, D. G. (2023). The Nonprofit Role in Building Community Social Capital: A Moderated Mediation Model of Organizational Learning, Innovation, and Shared Mission for Social Capital Creation. *Nonprofit and Voluntary Sector Quarterly*, 08997640221146965.

Lind, A. J. (2019). The non-distribution constraint and social enterprise: Can share capital fund non-profit organisations? Third Sector Review, 25(2), 233-257.

Lu, J. (2015). Which nonprofit gets more government funding? *Nonprofit Management & Leadership, 25*(3), 297-312.

Lyons, M. (2001). Third sector: The contribution of non-profit and cooperative enterprise in Australia. Routledge.

McKenzie, N., & Baker, R. (2020, March). Charity World Vision in allegations of corruption and nepotism. Sydney Morning Herald. https://www.smh.com.au/national/charity-world-vision-in-allegations-of-corruption-and-nepotism-20200306-p547ng.html

Mitchell, G. E., & Calabrese, T. D. (2019). Proverbs of nonprofit financial management. The American Review of Public Administration, 49(6), 649-661.

Mosley, J. E. (2012). Keeping the lights on: How government funding concerns drive the advocacy agendas of nonprofit homeless service providers. Journal of public administration research and theory, 22(4), 841-866. Nonprofit and Voluntary Sector Quarterly, 36(1), 41–64.

Pennerstorfer, A., & Rutherford, A. C. (2019). Measuring growth of the nonprofit sector: The choice of indicator matters. Nonprofit and Voluntary Sector Quarterly, 48(2), 440-456.

Perroni, C., Pogrebna, G., Sandford, S., & Scharf, K. (2019). Are donors afraid of core costs? Economies of scale and contestability in charity markets. *The Economic Journal, 129*(622), 2608–2636.

Prentice, C. R. (2016). Why so many measures of nonprofit financial performance? Analysing and improving the use of financial measures in nonprofit research. *Nonprofit and Voluntary Sector Quarterly. 45*(4), 715-740.

Prentice, C. R., & Clerkin, R. M. (2023). The influence of nonprofit financing and operations on the acquisition of unrestricted and restricted donations. Nonprofit Management and Leadership, 34(1), 211–225. https://doi.org/10. 1002/nml.21556

Pizzini, M., & Sterin, M. (2023). The relation between cash reserves, governance, and donations in nonprofit organizations. *Journal of Accounting, Auditing & Finance,* 1-26.

Productivity Commission [PC]. (2010). Contribution of the not-for-profit sector. Productivity Commission. https://www.pc.gov.au/inquiries/completed/not-for-profit/report

Richardson, S., Kelly, S. J., & Gillespie, N. (2023). How can nonprofit boards innovate for growth? An integrative-systematic review. *Nonprofit Management and Leadership.*

Rosenau, P. V., & Linder, S. H. (2003). Two decades of research comparing for-profit and nonprofit health provider performance in the United States. *Social Science Quaterly, 84*(2), 2019-241.

Schubert, P., & Boenigk, S. (2019). The nonprofit starvation cycle: Empirical evidence from a German context. *Nonprofit and Voluntary Sector Quarterly, 48*(3), 467-491.

Song, M. (2022). Market competition and regulatory compliance in public, non-profit, and for-profit organizations. *Public Management Review*, 1-21.

Souder, L. (2016). A review of research on nonprofit communications from mission statements to annual reports. *VOLUNTAS: International Journal of Voluntary and Nonprofit Organizations*, 27, 2709-2733.

Stahl, R. M. (2013). Talent Philanthropy: Talent Philanthropy: Investing in Nonprofit People to Advance Nonprofit Performance. *The Foundation Review*, 5(3). 35-49.

Tinkelman, D., & Mankaney, K. (2017). When is administrative efficiency associated with charitable donations?

Tran, K., Occhipanti, J., Buchanan, J…& Hickie, I. B. (2023). A contributing life: A snapshot of the value of social production. Brain and Mind Centre: Sydney.

Walker, C. C., Druckman, A., & Jackson, T. (2022). A critique of the marketisation of long-term residential and nursing home care. *Lancet Healthy Longev, 3*(1), 298-306.

Wing, K., Hager, M. A., Rooney, P., & Pollak, T. H. (2004). Lessons for boards from the nonprofit overhead cost project. Urban Institute: Washington D.C.

Yan, W., & Sloan, M. F. (2016). The impact of employee compensation and financial performance on nonprofit organization donations. *American Review of Public Administration. 46*(2), 243-258.

Zhao, J., & Lu, J. (2020). Does government punish nonprofits for high administrative costs in contracting decisions? *American Review of Public Administration, 50*(3), 286-296.