
2 Not-for-profit organisations

Key points

- Many not-for-profit organisations (NFPs) feel they are poorly understood by government and the general public. Pressures to be more efficient have seen overhead spending reduced at considerable detriment to effectiveness and improved resource allocation over time (allocative efficiency).
- The sector is diverse, but NFPs display some common behavioural patterns:
 - Whereas the behaviour of for-profit business is driven mostly by their desire for profits, the behaviour of NFPs is driven mostly by their mission or community-purpose.
 - Demonstrated commitment to their community-purpose underpins support for their activities, whether by members for member-serving NFPs, or by donors and government who provide funding for community-serving NFPs.
 - Processes, often highly participatory, matter for NFPs because they provide value to the volunteers and members, and because of their central importance to maintaining trusting relationships that form the basis for effective service delivery.
 - Control can be a major motivating factor for the managers of NFPs. While generally motivated by altruism, NFP management also benefits personally from their role when it confers status or power, builds their skills and contacts, and where it improves the environment for their other activities.
- These characteristics of NFPs have implications for the drivers of efficiency and effectiveness:
 - Processes that appear messy and inefficient to outsiders can be essential for effective delivery of services, especially those requiring engagement with clients who face disadvantages and are wary of government and for-profit providers. They can also be important to attract and retain volunteers, the involvement of which can be valued as much for the engagement outcomes as for replacing the need for paid labour.
 - It is possible that, for some managers, ‘doing’ can take precedence over ‘achieving’. Unless NFP boards are able to act decisively, such behaviour can undermine efficiency and effectiveness and threaten the sustainability of an NFP.
 - While greater scale and sharing of support services can improve production efficiency, NFPs can be reluctant to merge or collaborate where other interests might be eroded or where the purchase of support services adds to overheads.

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Key points (continued)

- Community-serving NFPs may lack adequate feedback mechanisms on their effectiveness (or lack thereof) as clients are often grateful for the assistance. This contrasts strongly with member-serving organisations, particularly small grass roots organisations, where member satisfaction is paramount to survival.
- While historically Australia fits in the 'liberal' social origin category (where government social spending is low and NFP activity is relatively large), since the 1970s government funding of the sector has grown. From the 1980s, this has increasingly been under competitive allocation arrangements, with greater use of the sector to deliver government funded services. More recently, social enterprise is being seen as a way to harness network governance to address social issues. Along with demographic, ethnic and cultural changes (such as increasing environmental awareness), these forces are increasing demand for NFP activities.
- In responding to rising demand, NFPs report constraints arising from growing regulation and contract requirements, and challenges in accessing funding, finance, and skilled workers.
- Government can assist in addressing these constraints to facilitate sector growth and development; nevertheless the sector remains responsible for its own future.

The diversity of the not-for-profit (NFP) sector makes any attempt to describe how NFP organisations (NFPs) behave challenging at best, and quite likely impossible. Nevertheless, such a description is important as one of the complaints from the sector is that government, and to a lesser extent business, fail to adequately understand the sector. This is reflected in both government and business expressing puzzlement over the reluctance of many NFPs to merge or collaborate, and more generally, what they see as resistance to change.

The general public too, has conceptions about the NFP sector, and perhaps illusions about what is required to plan and deliver effective relief and preventive services. This is well illustrated in the resistance to spending on overheads:

If there is any single issue that vexes managers and trustees of charitable foundations the world over, it is undoubtedly that of overhead expenses. The case against spending overhead dollars is as simple as it can be: every dollar that a foundation expends on overhead expenses is a dollar that it cannot spend on grants. Overhead expenses, therefore are leeches upon grantmaking. The case for spending overhead dollars is rather more complicated. (Orosz 2009)

This chapter provides a general model of how NFPs make decisions on what they do and, importantly, how they go about it. It aims to shed light on the drivers of efficiency and effectiveness in the sector. This provides a segue into sector development and the question of the role of government. This chapter argues that this role is limited to providing an appropriately supportive operating environment,

investing in NFP activities that have considerable public benefit, and governments' use of NFPs to deliver services. As a number of submissions noted, it is important for the sector not to become reliant on government:

The Community/NFP sector ... is crucial to holding the government and market to account, and ensuring that they act legally and fairly to all. There are dangers he identified in any too close a collaboration between the sectors as critical roles are diminished, if their independence is reduced to interdependence. The results can be an undermining of democratic balance of interests. (Women's Electoral Lobby Australia Inc., sub. DR241, p. 3, referring to the work of Claus Offe)

2.1 Are not-for-profit organisations different?

NFPs are driven by their 'community-purpose', which may focus on their members, targeted groups in the community (often the disadvantaged) or, more broadly, the 'common-good'. In production, NFPs care about how (process) as well as what (activities) they do. And in management, those making the decisions often care deeply about the control they have over both process and choice of activities. It is this combination of community-purpose and concern about process and managerial control that characterises NFPs behaviour.

One way to think about how NFPs operate is summarised in figure 2.1. Processes that are participatory, inclusive, quality focused and accessible are central as they:

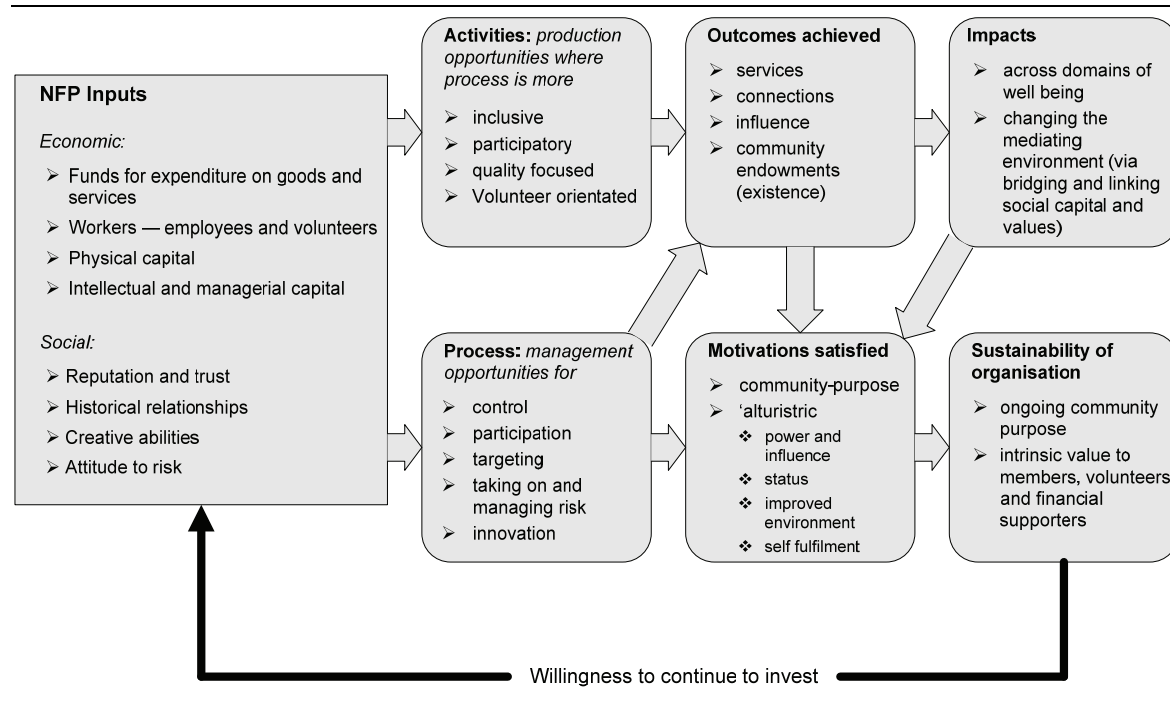
- engender trust and confidence in the organisation, enhancing the reach and quality of the activities undertaken
- facilitate access to resources from multiple stakeholders including volunteer workers, as well as access to funding and in-kind resources, as NFPs can provide value to those making these contributions
- build the capacity and capabilities of staff, volunteers, members and clients for effective engagement over time, including their knowledge and ability to influence the design of future activities.

These 'quality' processes contribute to achieving the outcomes of the NFP, including what might be incidental outcomes such as improved community connections. In some areas of activity, process, in particular for maintaining trust, can be critical to achieving outcomes.

Trust and continuity of relationships is essential. It is the establishment of trust through the continuity of staff and service provision that builds the basis from which change can happen. ... [The] degree of trust rises with extent of trustworthiness of information about the trustee. It is this element of trust where the NFP sector has an advantage over the for profit sector and why the capacity to deliver such programs is as strong as it is. (SDN Children's Services, sub. 160, pp. 10-11)

Billis and Gennerster (1998) argue that NFPs have a comparative advantage in delivering services where the motivation to address disadvantage, and knowledge of and sensitivity to client needs, are in scarce supply. In NFPs there is often a blurring of stakeholder roles, reducing the gap between clients and those delivering services, and between workers and management.

Figure 2.1 A schema of how not-for-profit organisations operate



The bottom half of figure 2.1 emphasises the importance of process as a motivating factor for management. NFPs are usually established by people who want to do something that is not being done or do it in a different way. People who take on the responsibility of managing an NFP are motivated not only by their belief in the community-purpose (often altruistic motivations) but also by their own role and how it contributes to their wellbeing. Whether their role confers status, power, builds skills and contacts, improves the environment for their other activities or provides self-fulfilment from engagement in a meaningful activity, this motivation needs to be satisfied for volunteer, and even paid, managers to remain committed to the organisation. Further, donors are increasingly looking for these types of 'returns' on their investments in NFPs in addition to achievement of the community-purpose.

At an organisational level, sufficient stakeholders (donors, workers including volunteers, members, and clients) need to be satisfied by the outcomes achieved and/or by the process for the organisation to remain viable. Like for-profit business, NFPs can 'fail' and they will fail if sufficient stakeholders lose interest. If clients

find their problems permanently solved, and the services of the NFP are no longer needed, this is indeed a good thing. At a sector level, failure of some NFPs, evolution of others, and establishment of new NFPs is just part of a healthy renewal process.

Sector-wide, inclusive and participatory processes reflect and contribute to social capital – the relationships, understandings and social conventions that form an important part of the mediating environment that shapes economic and social opportunities. NFP advocacy, education of citizens, enabling of engagement in civic processes, and the creation of opportunities for connections work together to form a healthy civil society. Consequently the extent of NFP activity is often taken as an indicator of the health of society (Putnam, Leonardi and Nannetti 1993; PC 2003)

The major differences in behaviour between for-profit and NFP organisations are nicely captured by Collins (2005). His assessment is replicated below in table 2.1.

Table 2.1 Major differences between the business and social sector

<i>Issue</i>	<i>Business Sector</i>	<i>Social sector</i>
Accountability	Primarily responsible to stakeholders	Primarily responsible to constituents (e.g. disadvantaged children and their families) and myriad supporters or stakeholders
Defining and measuring success	Widely agreed-upon financial metrics of performance Money is both an input (a means to success) and an output (a measure of success)	Fewer widely agreed-upon metrics of performance Money is only an input, not an output Performance relative to mission, not financial returns, is the primary measure of success
Focus	Doing things right (efficiency) Competition to deliver the best products	Doing the right things (effectiveness ^a) Collaboration to deliver the best outcomes
Leadership/ Governance	Governance structure and hierarchy relatively clear and straightforward Concentrated and clear executive power often substituted for leadership	Governance structures often have more components and inherent ambiguity More diffuse and less clear executive power with leadership more prevalent
Talent	Often have substantial resources to attract and retain talent Can more easily get the wrong people 'off the bus' for poor performance	Often lack the resources to acquire and retain talent Tenure systems and volunteer dynamics can complicate getting the wrong people 'off the bus'
Access to capital	Efficient capital markets that connect to the profit mechanism Results attract capital resources which in turn fuel greater results, and so on	No efficient capital markets to channel resources systematically to those who deliver the best results

^a This refers to both effectiveness (did it work?), and to allocative efficiency (was it the right thing to do?).

Source: Collins (2005).

2.2 Implications for efficiency and effectiveness

The terms of reference refer to exploring ways to improve the efficiency and effectiveness of the NFP sector. What constitutes efficiency and effectiveness varies across the different types of NFPs. The importance of process, and management control over process, has implications for efficiency and effectiveness of NFPs. So too, does the commitment to a specific community-purpose. Some NFPs have a different conception of efficiency and effectiveness or may eschew such notions altogether. These NFPs have a right to exist and, providing they cause no harm, should be left to do what they do in the way they like to do it. However, where public funding is involved or donors seek to achieve the best returns on their gifts, efficiency and effectiveness are central to maximising community wellbeing.

It is important to distinguish between efficiency in production (how well inputs are turned into outputs) and efficiency in allocation (putting resources to the uses that deliver the best outcomes for the community). While both are important, it is the latter, provided the activities are effective, that matters most for wellbeing, especially over time, a point supported by the Smith Family:

... the nonprofit sector should first ensure that they are focused on ‘doing the right things’ before consideration of how well they are doing them. (sub. DR204, p.4)

Despite this, the attention paid by governments and donors to overhead costs as an indicator of an organisation’s worthiness drives a fixation with production efficiency. This can constrain investment in planning and evaluation which are essential for maintaining and improving effectiveness and efficiency.

At an organisational level, cost-effectiveness in achieving the NFP’s community-purpose is the most appropriate objective for managers. This assessment can be difficult as the results of social investment usually take time to eventuate and are often the product of forces in addition to the activity under scrutiny. Nevertheless, measurement challenges should not be allowed to divert attention from what matters — designing and delivering activities that deliver the desired outcomes (and no unexpected nasties) at least cost. This frees up resources to do more.

Selecting which mix of activities gives the greatest benefit to the community is the ultimate allocation challenge. NFPs, through their advocacy and other avenues of influence, play an important role in guiding the selection of activities. Donors influence allocation through their giving. Government decisions on tax concessions can influence this allocation to some extent, however, their influence over allocation is greatest for direct funding decisions. Unlike the market for goods and services, where prices serve as an allocation mechanism, these forces provide only an indirect discipline on ensuring that the allocation of resources is optimal for the community.

Prevention is a good example of the allocation challenge. There is almost universal agreement that prevention is better than cure, and generally costs far less. Nevertheless, as it is difficult to demonstrate the value of avoiding a cost that would otherwise be imposed by a problem, prevention tends to attract less donor support. This issue is compounded by the exclusion of prevention in the definition of charity as applied for deductible gift recipient status.

Figure 2.2 reflects the different roles that the NFP management, donors and government play in driving efficiency and effectiveness. While to some extent these stakeholders act like consumers in imposing discipline on NFPs to be efficient and effective, there are some significant differences from the market disciplines that drive efficiency and effectiveness in the (for-profit) business sector.

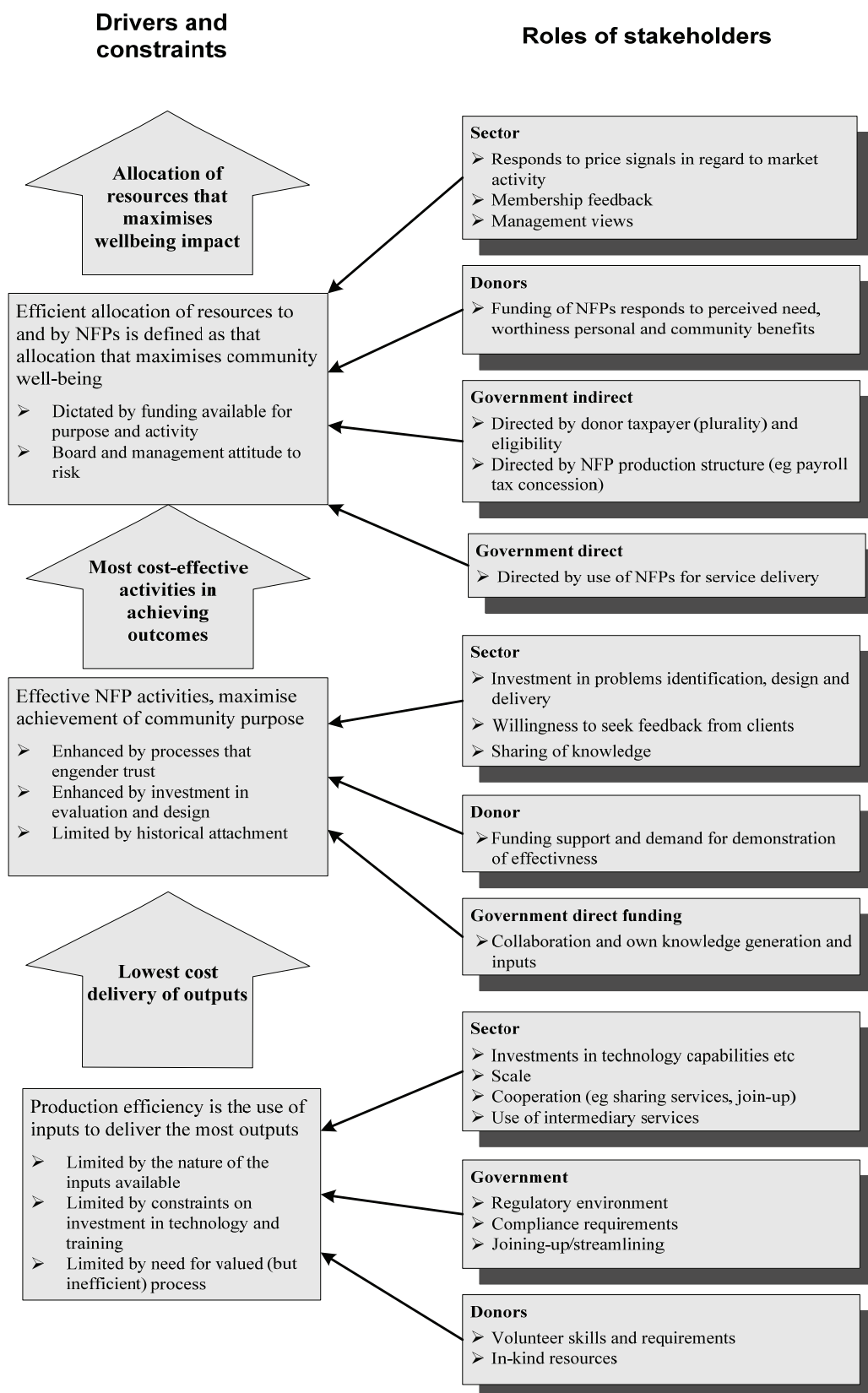
The drivers of efficiency and effectiveness in NFPs

Many NFPs argue that they operate on ‘the smell of an oily rag’, stretching their resources to the maximum. While often true, the importance of process can make NFPs appear messy and inefficient to outsiders, and even to some of the insiders. However, process can be central to the ability of a NFP to garner resources and deliver activities effectively. On the cost side, more participatory and inclusive processes can reduce the volume and/or quality of outputs by absorbing resources and slowing down delivery. This is observed in activity development and implementation that requires more one-on-one service delivery, time and resources to support participation in decision making and greater individualisation of the service. Yet, on the benefit side, it may be these processes that give NFPs an advantage in trustworthiness or network governance¹ that make them more effective, especially in the delivery of some human services.

While a trade-off between production efficiency and quality is not unique to the NFP sector, NFPs often place a relatively higher weight on quality. In some cases quality, including quality of process, is strongly linked to effectiveness of the activity, but in other cases the ‘doing’ can take precedence over the ‘achieving’. Where these processes are central to the governance of the organisation and part of the value it provides to its volunteers and members, processes should be seen as essential outputs for the sustainability of the NFP. However, as NFPs grow and become more ‘professional’ in their management, this type of ‘value’ from process tends to diminish.

¹ Network governance is the relationships between organisations and individuals that is characterised by organic or informal structures, in contrast to bureaucratic structures of contractual relationships.

Figure 2.2 Efficiency and effectiveness of not-for-profit organisations: drivers and constraints



Production efficiency tends to improve with scale, but mergers and growth can detract from valued processes, particularly in smaller organisations. NFPs can also be reluctant to collaborate to share support services such as back office and fund raising, possibly reflecting the transaction costs associated with establishing joint approaches. There are relatively few intermediaries offering these types of services to NFPs in Australia. This may be due to reluctance of NFPs to spend scarce funds on support activities thus offering little opportunity for such services to develop.

Over time, efficient production requires investments in skills, capital, planning, research and relationships that allow the ‘best’ (defined by quality as well as quantity) outputs for the level of inputs. Many NFPs would agree that they face constraints on increasing their production efficiency due to difficulties accessing finance and in freeing up resources to invest in training and enabling technologies such as management systems. These constraints can create a tension between delivering now and being efficient in the longer term.

Unlike businesses, where the financial bottom line is a good measure of their effectiveness, NFPs have to rely on other signals. NFP managers may resist honest feedback on effectiveness, or may, as with some donors, regard evaluation as wasted money. Member serving organisations are more likely to get direct feedback from their membership on how they are performing where members can ‘vote with their feet’. Client serving organisations, on the other hand, are less likely to get negative feedback especially where clients have no alternative services available.

The community development literature of the 1970s stressed the value of ‘grass roots organisations’ as vested interests of members should result in the best or optimal selection of, and resource allocation to, activities. However, for larger organisations, the allocation of resources to the different activities will usually reflect management’s views on the contribution these activities make to their community-purpose. If donors and government funders want to influence the allocation of resources tensions can arise even in situations where they have provided the resources.

Philanthropy is an important mechanism for allocating resources to organisations and activities that donors see as providing the greatest value for their gift. Given that wealthier individuals have greater ‘giving’ power, it is their (or their foundation managers’) assessment that tends to dominate this allocation. Similarly, large businesses also have the potential to influence activities undertaken by NFPs.

The productivity of an organisation improves when it raises the efficiency and effectiveness of its resource use in the short term and when it invests wisely in resources that enhance its efficiency and effectiveness in the longer term. This will improve the productivity of the sector, especially when other NFPs follow suit.

However, the productivity of the sector also improves when resources shift to those organisations that make better use of resources in terms of their contribution to the wellbeing of the broader community (PC 2008). These issues are explored further in chapter 9.

The central message here is that NFPs may face significant resource constraints to achieving efficiency and effectiveness. More difficult to address is lack of incentive for some NFPs to minimise costs in the short run, or to invest in finding out how effective their actions are. Indeed, such actions may reduce the return to the NFP management if they interfere with valued processes. In addition, at a sector level, pursuit of community-purpose does not guarantee efficient allocation of resources. In addressing these constraints and challenges, it is useful to understand what drives sector growth and development.

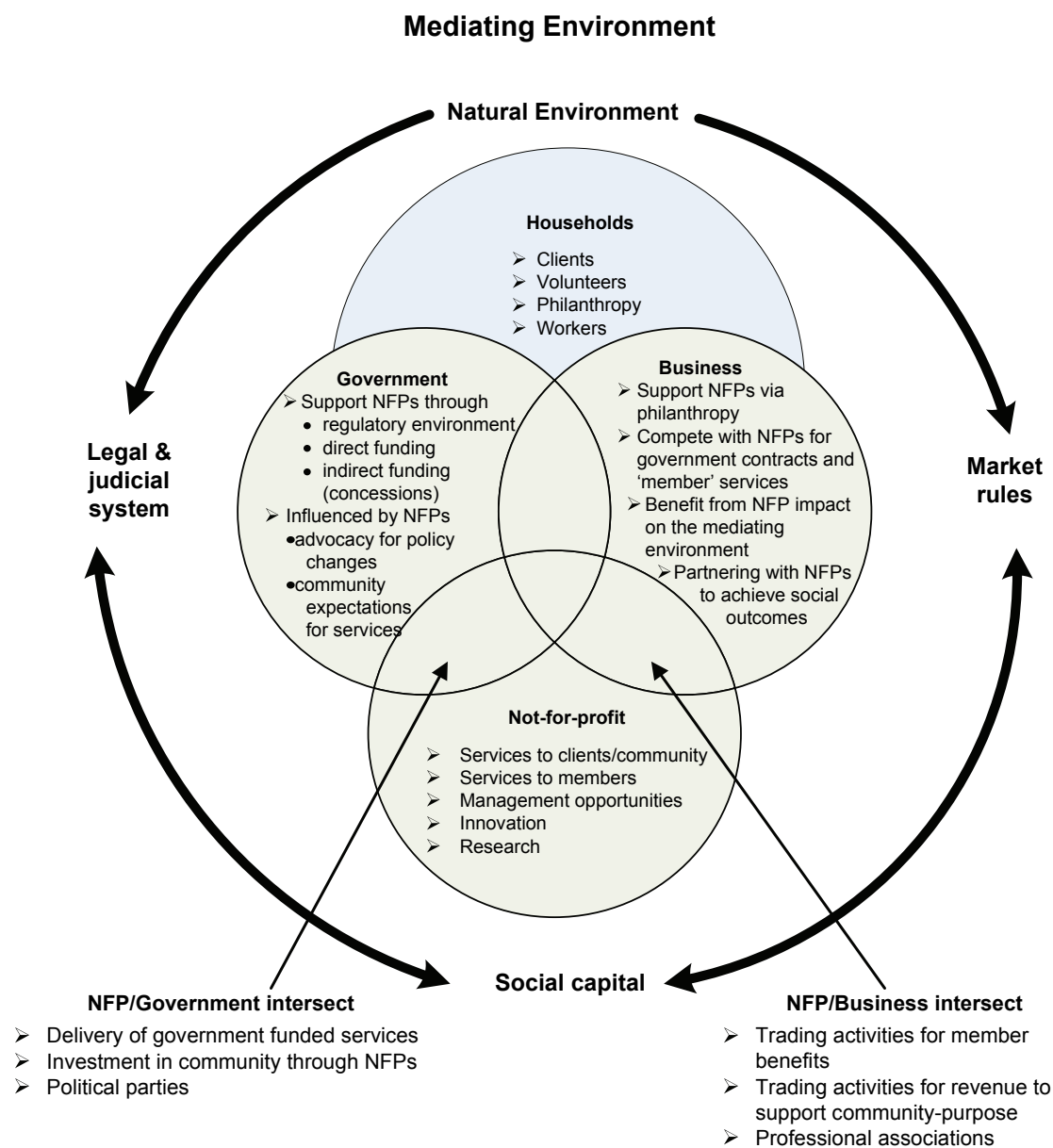
2.3 What drives sector growth and development?

The NFP sector in a broader context

The term ‘third sector’ distinguishes the NFP sector, the for-profit business sector, and the government on the basis of where production occurs. The household sector also engages in production and is ultimately the source of labour and capital. Focusing just on production of goods and services, expansion of production in one sector by necessity reduces production in another sector if resources are fully employed. It is this conceptualisation that views NFPs as undertaking activities that the business sector does not find profitable to undertake, governments lack a mandate to provide, and households cannot undertake alone. In reality the picture (summarised in figure 2.3) is far more complex:

- Government engages NFPs, for-profit business, and households (for example, through carer payments) in delivery of goods and services that government funds; consequently there can be some competition for government business. Similarly, the sectors compete for household resources and, in some situations, for markets, a classic example being the market for second hand clothing.
- Government, for-profit business and households recognise value in community and other activities provided by NFPs (complementarity) and provide resources (funding, in-kind resources and volunteers) to support these activities
 - some are of direct benefit to the funders, such as professional associations and children’s sporting activities
 - some are only of indirect benefit to funders, such as community welfare activities, and environmental protection.

Figure 2.3 Interactions between not-for-profit organisations, government, business and households



- Governments, for-profit businesses and households sit within a mediating environment with institutional, legal and market rules and conventions and social capital. While the product of history and the natural environment, this mediating environment is not static, but evolves over time as a result of the activities and processes in all four sectors. The mediating environment can both constrain and facilitate the development of the NFP sector.

The likely relative scale and roles of the NFP sector depend on the mediating environment and the historical levels of competition and complementarity between

the sectors. The view that NFPs passively fill the gap between what the market delivers and what governments have a mandate to fund is too simplistic; rather the role of NFPs reflects the inherent social compact that exists in a country. Social origins theory, developed by Salamon and Anheier (1997), points to different ‘historical moorings’ where the roles of government and the third sector reflect the ‘constellation of historical forces’. It identifies four types of non-profit regimes:

- statist, where government social spending is low and non-profit activity is small (such as in Japan)
- social democratic, where government social spending is high and non-profit activity is low (as in Scandinavian countries)
- corporatist, where government social spending is high and non-profits have a large economic size (France and Germany)
- liberal, where government social spending is low and non-profit economic activity is large (the US and UK) (Anheier 2005).

The scale and scope of the NFP sector depends on the demand for the activities that the sector is well placed to provide, competition for supplying these activities and constraints on the sector’s ability to respond to these demands and to compete for resources. Sector development is not a defined pathway, rather it is the response of the sector to changes in the nature and scale of demand. The ability of the sector to respond depends on the constraints it faces, including the extent to which NFPs resist change.

The evolution of government support for the sector in Australia

Historically, Australia fits into the ‘liberal’ category, where accessing and funding human services has traditionally been the responsibility of the household. Households purchased these services from the for-profit business sector and NFP (often mutuals established for the purpose). NFP ‘community social welfare organisations’ supplied services to those who lacked a capacity to pay. An implicit bargain between for-profit business and government on industry support underpinned paying workers a ‘living wage’ and workers accepting responsibility for purchasing their own human services. The 1970s saw a major shift toward a welfare state with government taking on a greater role in funding human services. Much of this expansion was achieved through increased public support for NFP service delivery (Smyth 2008).

In the 1980s and 1990s, governments moved to a greater reliance on competitive market mechanisms for allocating resources and driving production efficiency. Described as ‘new public management’ this saw the privatisation of government

owned enterprises across a range of industries starting with banking in the 1980s and moving through to utilities, and the application of a competitive neutrality test to government trading enterprises (Banks 2008). Despite governments moving away from producing goods and services, community expectations of what government will fund appear to have risen. Reflecting these two forces, there has been a shift to greater utilisation of segments of the NFP sector by governments for the delivery of services (Lyons 2009b).

Government has provided indirect support to the sector in the form of tax concessions from before federation. The access to concessions varies across the jurisdictions, but most are based on a common law definition of charity (established in England in 1891 in *Pemsel's case*). The *Extension of Charitable Purpose Act 2004*, sought to clarify that certain purposes (childcare, self-help groups and closed/contemplative religious orders) were indeed charitable.

More recently, there has been a growing interest in the 'third sector' as an alternative way of organising production and the allocation of resources (see for example, Blond 2009; Shergold 2009a). NFPs are seen as able to harness network governance to address social issues that markets and government cannot (Barraket 2008). Interest in alternatives to market and government allocation is also seen in the increase in philanthropy (chapter 7), the rising participation in volunteering (chapter 10), and growing engagement by businesses with NFPs (chapter 13).

Demand growth and supply constraints on the sector

As explored in detail in chapter 4, the sector has grown rapidly over the last eight years. This can be seen as arising from growth in demand, a significant share of which is related to the expansion of government funded services (chapter 12). Demographic factors have also played a role, for example, the baby-boom echo has seen a growth in school-aged children and with this demand for children's activities. Similarly, the ageing of the population and early retirement has created a demand for more leisure and cultural activities. Increasing ethnic diversity of the population has generated new niches for NFPs both in community services and in member services. The ability of the sector to respond to these growing and changing demands depends on the constraints it faces on supply.

Consultations and submissions identified four major sources of constraint on NFPs' ability to grow and develop:

- *Regulatory constraints*: For unincorporated associations there are few legal requirements. However, this also limits the scope for activities that require a legal form (such as owning assets, contracting for services and purchasing insurance). NFPs that have a legal form face varying compliance costs, and can

face difficulty with evolving their legal form and with changing their community-purpose. These issues are discussed in chapter 6.

- *Contracting constraints*: These apply to NFPs receiving financial support from government for their activities, either in the form of grants or through government purchasing of their services (although not always with full funding). While the funding allows for expansion of NFP's activities, it generally comes with strings attached. These can include restrictions on other activities, but are more generally related to the delivery of the activity, including specification of quality standards and staff and volunteer qualifications. These issues are the subject of chapters 11 and 12.
- *Funding and financing constraints*: Unlike for-profit business, where demand comes with funds to purchase the goods and services, many NFPs face demand that is independent of the funding stream. To meet demand, especially in community serving NFPs, NFPs seek funding from government and donations from households and business. Many also look to generate income from their activities. In the absence of price as a rationing mechanism, demand will generally exceed supply, and many community-serving NFPs have to ration their services in some way. Member-serving NFPs face less of a funding constraint, but like community-serving NFPs, may face financing constraints which make it difficult to make investments such as in information systems, housing or training for staff. NFPs without a proven cash flow to service debt, or substantial assets for collateral, often have difficulty accessing capital markets. This matter is taken up in chapter 7.
- *Skill constraints*: While access to paid labour is strongly influenced by the ability to pay competitive salaries, and hence funding, NFPs are also concerned about access to skills. Many areas of NFP activities are becoming 'professionalised', resulting in a shift to paid employment to attract qualified workers. This can complement or crowd out volunteer labour. The former situation arises where employees (and their skills) add value to the volunteer experience. It is only in community services that crowding out of volunteers appears to be apparent, for reasons not well understood. In some sectors, notably community services, skill shortages are a sector-wide issue related to low wages and lack of career paths. Boards too need to develop their governance skills as their tasks have become more complex with delivery of government funded services and demands by donors, members and clients for greater accountability. BRI Ferrier (2009) found that most NFP failures stem from inexperienced, weak or sympathetic supervisory groups. These issues are considered further in chapter 10.

Is there a role for government in sector growth and development?

Government plays a considerable role in shaping the environment in which NFPs operate, directly through its regulation of the sector, and indirectly in the ‘social contract’ it has with the community. As discussed above, the latter has shifted from a living wage based arrangement to a social safety net, providing income support to those not able to work or whose wage income is below that required to be self-financing. In addition, a number of human services are funded by the government on a (non-income tested) needs basis, including health care and disability services. NFPs provide many of these services, some in competition with government or for-profit providers (for example, hospital care and employment services). Some of these government funded services are contestable only between NFPs, while others are delivered by sole providers.

The choice by government to involve NFPs as providers involves consideration by government of value for money. Discussed in detail in chapter 12, value for money considerations should include:

- cost-effectiveness of service delivery — and the extent that this depends on the development of relationships with clients
- complementarity or joint-production with other services — which can enhance client wellbeing beyond that arising from the particular service being funded
- spillovers (positive and negative) associated with the service delivery — these arise as a by-product that affects others in the community, such as the utilisation of a community centre as a base for services for other groups, and the benefits that flow on from improvements in the lives of individuals as a result of their engagement with NFPs
- sustainability of the service delivery and/or client relationship, where the long-term effectiveness depends on the continued presence of the provider.

Governments also invest in NFP activities through grants, and provide indirect support through tax and other concessions. In providing this support, governments usually look for ‘additionality’ — that is, the government funding attracts more resources into NFP activities than would otherwise have been the case. The net value added of expanding NFP activity in this way comes from a combination of greater direct benefits of these activities and higher spillovers than the alternative use of the resources. For household donations, this alternative use might be savings or consumption. For NFPs, the opportunity cost comes with the diversion of their resources into the activities for which the government provides support instead of other (preferred) activities. In these ways government both increases the funding available to the sector and influences its allocation across the various activities.

Governments, especially state and territory governments, may also take a proactive role in sector development. In part this is related to their utilisation of the sector for service delivery. Government investments may be to strengthen the quality and/or financial viability of the NFP service providers, or to increase the number of potential providers and hence provide greater choice for clients and/or government agencies in tendering. But investment in the sector is also related to the role it plays in providing social capital and, in turn as discussed above, the value that this provides to wellbeing.

This report looks at the role of government as a regulator of, investor in and procurer of NFP services and activities. It also considers the role of government as a facilitator of philanthropy and the engagement of other sectors with NFPs. These roles differ across the segments of the NFP sector, and for many parts of the sector government plays little role beyond providing a sound regulatory environment. The Commission's view is that government's role in sector development should be limited to where it utilises the sector for service delivery and to where it sees considerable community benefit from its investment. This view, that the sector should be largely responsible for its own development, reflects the importance of independence of the sector. The link between government funding and loss of independence has been well recognised:

One of the key traditions learned the hard way in the early days nearly 75 years ago, was that to accept funding from outside sources was to create outside interference with the manner of spending, and vulnerability to sudden loss of or short term, not necessarily reliable, funding. (Dr Vanda Rounsefell, sub. DR260, pp. 1-2)

The next three chapters turn to measuring the contribution of the sector at an aggregate, organisation and activity level. This is central to improving the understanding of the sector by government funders, philanthropists and NFPs themselves.