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# Is Canadian Charity Designed to Fail?

The Trends, Mental Models, and Structures that Contribute to the  
Unsustainability of Canada's Charity System

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# The Issue

## Context

Charity plays an important role in society: it fills social deficits that other service providers, particularly the government, are unable to fill. While the scope of work of charities is broad, a charity in Canada must partake in work regulated by the Canada Revenue Agency (CRA) that fall into one of four categories, defined in the Pemsel Case (Canada Revenue Agency, 2006):

- a) poverty relief
- b) the advancement of education
- c) the advancement of religion
- d) other purposes beneficial to the community in a way the law regards as charitable

The charitable and nonprofit sectors of Canada serve as major actors within the Canadian economy, outweighing contributions from and outpacing growth compared to other economic drivers such as construction, agriculture, and oil and gas (Statistics Canada, 2003). Charities also play a role in supporting employment in Canada, with over 86,000 charitable organizations employing over 2 million in staff and producing 8.1% of Canada's GDP (Emmett, 2018; Statistics Canada, 2003). In these ways, the charitable sector adds value to the marketplace, making it a valuable component of Canadian society. However, they are also dependent on government funding and donations, with the former alone accounting for 68% of total revenue for charities with over 200 employees (Canada Helps, 2018).

## The Problem

Pre-COVID-19, according to Imagine Canada (Emmett, 2018), the charitable sector will need an additional \$25 billion to keep up with the increasing demand for services. This statistic is startling, especially when we know that the most vulnerable Canadians will bear the effects of this. We think of those closest to us, and how much it would hurt to see them suffer. This social deficit is not simply a revenue issue—it is made worse by the piecemeal, many-strings attached nature of many funding avenues, precarious employment, archaic policies, cultural expectations, and ideas around charity (P. Elson, personal communication, 2020). The social deficit is a “slowly intensifying crisis” of increased demand, complications in charity operations, and current events (Special Senate Committee on the Charitable Sector, 2018).

## Why Does this Problem Matter?

The social deficit is made more urgent from a number of factors, including an increase in income inequality, rapidly aging populations, transitional needs of immigrants and refugees, and the impacts of climate change, among others (Emmett, 2018). Despite the size of the charitable sector, something we cannot ignore is the fact that social issues still persist.

In Canada, the social deficit also undermines our ability as a society to deliver on reconciliation with Indigenous peoples (Public Health Agency of Canada & Pan-Canadian Public Health Network, 2018). It is worth acknowledging that through residential schools, a policy of state-funded, church-run cultural genocide, Indigenous peoples were victimized by Canadian charity, largely justified by Canada's defined charitable purposes of advancing education and religion.

Today amidst the COVID-19 pandemic, we are seeing how fragile our social systems can be. The necessity and urgency to ensure Canada's resiliency has become more apparent than ever. This pandemic poses threats to food security, fears of domestic violence, and pressure on many more services that highlight the necessity for, and fragility of, charity systems in Canada (Omidvar & Pearson, 2020).

In 2016, provincial governments funded charities with \$177.2 billion, constituting 68% of charity revenue (Canada Helps, 2018). However, Elson (2007) writes:

*“The irony in all this is that the very attributes of the voluntary sector which make it such a worthy recipient of government funding are being undermined by this financing regime: accountability to multiple stakeholders; an organizational structure which balances public and private interests; a defined interest in helping those in need at a personal, community, and societal level; multiple and independent sources of income; and a creative mix of paid and unpaid workers.”*

Clearly, the charitable sector in Canada is deeply rooted in its complex path dependency, and Canadians are feeling the effects. If the system cannot adapt, then social issues will continue to persist, often at the expense of the most vulnerable Canadians.

# Problem Landscape

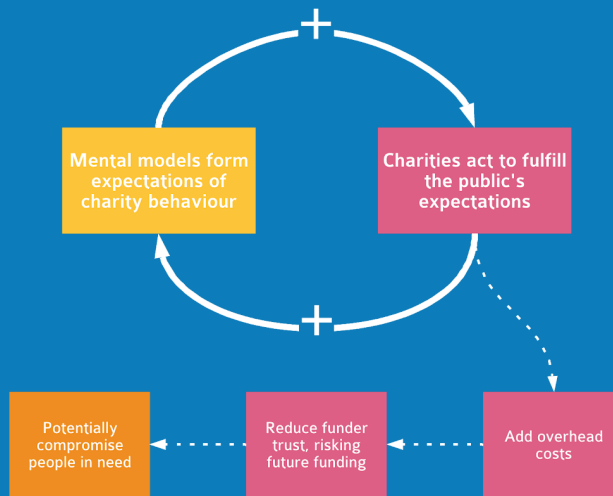
## A Complex System

### Path Dependency, and Unsustainability

Systems thinking is a tool that connects the Canadian charity system in a comprehensive way, consolidating the mental models, history, policies and structures, and human factors that affect the functioning of the charity system, creating a complex and path-dependent system.

There is a continuous cycle of structures and policies that inhibit innovation, perpetuating social issues and increasing the demand for services. This cycle creates a mutually reinforcing feedback loop between our thoughts and behaviours (mental models, human factors) and existing structures and policies.

### Why is charity so stuck?



Consequently, donors and funders demand more and more results, forcing charities to focus more on short-term fixes rather than long-term solutions or innovation. Leaving this path is difficult, especially since the beneficiaries of charities can be put at risk when we try to break out of the status quo. Structures and policies inform our concept of charity and vice versa, deepening path dependency.

## **Power Dynamics and Barriers to Innovation**

There is an unequal power dynamic between funders (donors, foundations, government) and charities, leaving charities with little leverage. Funders hold control of the system, giving them the ability to leverage mission drift, asking charities to do things beyond their initial purpose (C. Glover, personal communication, 2020). This power imbalance also leaves charities with the inability to scale, market themselves, or innovate. This decreased capacity ties into a number of factors, including:

- historic restrictions on public policy advocacy
- primary relationship being with the CRA under the Income Tax Act
- lack of dedicated resources, human or financial, to lobby or conduct government relations
- charities not being viewed as vital employers and businesses

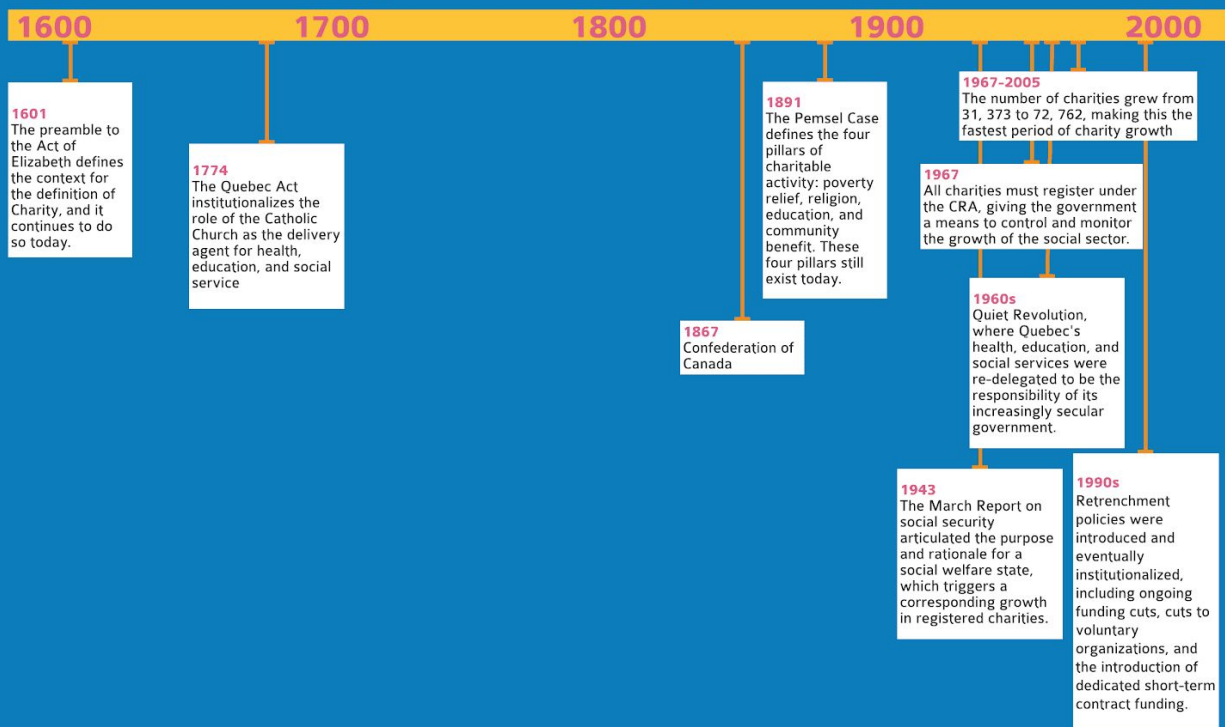
Historically, charities have always operated reactively, which can be expected given the restrictive structures and policies governing them (G. Rotstein, personal communication, 2020). Social progress is difficult to quantify, especially for smaller charities with fewer resources, which makes funders hesitant to invest more into the growth of charities (D. Blais-Amare, personal communication, 2020). Breaking out of these established patterns is necessary for innovation, something that charities have yet to do.

## History and Structures

### The History of Canadian Charity

Canada's history is largely influenced by its two founding countries: the United Kingdom (UK) and France. As a result, our business structures and ideologies carry both British and French influences.

#### Key Points in the History of Canadian Charity and Governmental Relations



Where this leaves us today is with a high level of government control over charities, strained funding, and massive amounts of charities seeking to serve charitable purposes that were largely defined over 400 years ago. This begs the question: who is more efficient at providing these services? Is it the government's job to provide these services, or is it better to delegate them to charities? Without the proper frameworks, funding, and policies to help charities scale and professionalize, the social deficit will continue to exist.

## **The Social Deficit**

The social deficit describes the issue of revenue to charities not keeping up with demand for services (Emmett, 2018). Charities serve important causes that range from poverty to environmental concerns, among many others, and rely heavily on funding from foundations, government grants, and individual donors to deliver these services.

In 2013, the tax credit amount in donations totalled \$8.6 billion, compared to \$9.6 billion during the 2017 period (Special Senate Committee on the Charitable Sector, 2019). While this could be perceived as an increase in donations, a closer look at the statistics reveal a comparative decrease in the amount of people who choose to donate and a heavier reliance on an older generation of donors (Special Senate Committee on the Charitable Sector, 2019; Statistics Canada, 2013, 2017).

There is inequality in charities' ability to generate resources. For example, in 2016, the government funded charities with \$177.2 billion, yet most of that government funding only went to charities boasting a significant scale, leaving smaller charities "out in the cold" (Canada Helps, 2018).

## **Policy and Structures**

The combination of the extensive reporting, heavy reliance on government funding, and short-term nature of funding makes it difficult for charities to diverge from the status quo. Canadian charities are required to register under the CRA and report their spending. Additionally, charities must report annually to the CRA their fundraising efforts and expenses, revenue sources, payments to directors, cash and non-cash gifts received, partnerships, and much more (Canada Revenue Agency, 2018). Any sort of overhead costs over 8-10% are generally discouraged (J. Marshall, personal communication, 2020). Furthermore, acquiring a year-over-year surplus or building a reserve fund is discouraged, leaving charities far more vulnerable to economic downturns than commercial businesses who can prepare (J. Marshall, personal communication, 2020). This also makes it quite difficult for emergency planning, scaling, or budgeting for future expenses (G. Rostein, personal communication, 2020).

## **Human Elements**

### **Expectations and Mental Models about Charity**

Canadians have mental models about how charities should function, which shape how the social sector operates.



Dan Pallotta (2013) posits five major differences between how we think about non-profit vs for-profit organizations. These mental models and their impacts on the nonprofit sector are summarized in the following table:

	Mental Model	Impact
<b>Compensation</b>	Charities should not seek compensation the same ways businesses do.	We construct a limiting, mutually exclusive choice between doing well for yourself or doing good for the world.
<b>Advertising and Marketing Costs</b>	Charities should not spend money on advertising and marketing. All revenue should go <i>directly</i> to the cause.	Charities have to compete for market share of the public's dollars with no marketing, increasing the difficulty of revenue generation.
<b>Risk in Pursuit of New Ideas or Revenue Generation</b>	Fundraisers must produce a return on investment immediately, or else the organization has no integrity.	Charities are reluctant to attempt any brave, daring, giant-scale fundraising endeavors for fear that if the endeavour fails, their reputations will be tarnished.
<b>Time</b>	Charities need to produce results immediately.	Charities are heavily discouraged from scaling, investing in the future, or budgeting for future risk scenarios.
<b>Profit</b>	Charities should not be able to generate a profit.	Charities struggle to attract talent for new ideas, therefore starving the sector for growth and idea capital.

While Palotta refers specifically to the American system of charity, these mental models surrounding charity operations are closely held in Canada. However, Canada is also highly influenced by the UK in its views around how social good should be defined and achieved. As a result, Canada embodies a unique mix of two distinct mental models. For example, the UK generally sees the provision of basic social services as the responsibility of the government, with any additions to what they provide as the responsibility of charities or the individual. This view is also held in Canada.

In comparison, social good in the United States of America tends to take a more economic definition, and it is the responsibility of the citizens to take care of themselves. For social services,

citizens can choose democratically which issues they support more through political activity or charity involvement.

### What Drives Us to Give?

There is no standardized list of reasons why people give. However, we do know that we give time, money, and energy in pursuit of some kind of meaning, intertwined with community connections and a purpose to life (Stockton, 2008). But what is it that creates meaning? We believe meaning is situated in four things: reciprocity, relevance, results, and risk-aversion.

Expectations	Definition	Example
Reciprocity	We donate to get something in return. (e.g. Emotional benefit, tax-deductible receipt)	We donate because an issue means something personally and it feels good.
Relevance	We donate to what is on our minds or relatable to our lives. This is closely connected to current events.	The Australian wildfires in 2019-2020 covers our facebook feeds, so we donate to fighting the wildfires because it feels pressing and current.
Results	We donate where we can picture results and tangible change.	We donate to feed families over the holidays. It feels more rewarding to feed families than to fund financial management education because it is easier to see the direct results of feeding a family.
Risk-aversion	We donate to places that have transparency and certainty.	Our neighbours collect funds to help a sick family member. We donate to their GoFundMe campaign because we trust our neighbour to use the money appropriately. Alternatively, we could engage in slacktivism by sharing a post or signing an online petition. This is an easier way to contribute without dipping into our funds.

These human factors are also closely related to social media and current events. Social media makes certain issues feel more top-of-mind and amplifies the perceived importance of current events.

## Solutions Landscape

While there are certainly many different issues that complicate the capacities of charities, other avenues have arisen to shape the current solution landscape: social enterprises, co-creation, data reporting and transparency, social innovation labs, and sharing failures and insights.

### Social Enterprises

Definition	Gap	Examples
Any organization or business that uses market-oriented production and sale of goods and/or services to pursue a public benefit mission (Canadian Task Force on Social Finance, 2010)	Charities do not use business practices and costs (marketing, data research, financial team, digital strategy)	<ul style="list-style-type: none"> <li>→ BUILD</li> <li>→ Textbooks for Change</li> <li>→ HelpSeeker</li> </ul>

Social enterprises are becoming more popular among younger generations as a way to solve social issues (Aptowitz, 2020), with the support of the federal government's social finance investment fund. As charities take more of a "crisis control" approach towards social issues, they leave a space for social enterprises to come in and create a social business that has more flexibility and freedom to solve the problem (Klein, 2015). However, if start-up funding is not maintained through sustainable business practices, the enterprises are at risk of failure (P. Elson, personal communication, 2020). Social enterprises, however, are not expected to reach the scale necessary to address the social deficit (Jackson & Munro, 2020).

### Co-creation with Beneficiaries

Definition	Gap	Examples
Designing products and services with and by its intended beneficiaries. Co-creation seeks to put people first, which is generally a shift from typical organizational functions	In its optimal form, co-creation has the dual benefit of reducing public sector costs and increasing stakeholder satisfaction (Gouillart & Hallett, 2015)	<ul style="list-style-type: none"> <li>→ City of Calgary Inclusive Futures</li> <li>→ Canadian Community Economic Development</li> </ul>

The process of co-creation typically involves identifying community targets, building engagement platforms, fostering interactions among stakeholders, enabling individual experiences, and assessing new value. Co-creation in public services, agencies, and communities is an effective way to ensure services are embraced and welcomed by communities (Gouillart & Hallett, 2015).

## Data Reporting and Focus on Value

Definition	Gap	Examples
Collecting data on program success and using evidence-informed strategies	<p>Lack of public transparency on program success or value</p> <p>Lack of competition between charities to create and offer return on investment</p>	<p>→ Calgary Counselling Centre</p> <p>→ HelpSeeker</p>

Pallotta (2013) states that a primary barrier to the nonprofit sector regards limitations on marketing and advertising, a point echoed by Rotstein when advocating for charities to engage in market research (G. Rotstein, personal communication, 2020). This dynamic of charities receiving funding regardless of the results they produce harms the market, since there is little accountability or incentive to innovate (G. Rotstein, 2020, personal communication). Better measurement of societal contribution is one crucial ingredient in boosting societal understanding and winning back societal trust in the charitable sector (Haldane, 2019). Donors appreciate transparency, so program success data is key to demonstrating a return on value. Data can also inform future decisions by allowing charities to identify how to create value and make a tangible difference.

## Social Innovation Labs

Typically, opportunities are limited for charities to innovate and collaborate. Labs are well-positioned to be convenors for such opportunities.

Definition	Gap	Examples
Places where social innovation takes place in an intentional and imposed way	Need for innovation and collaboration	<p>→ The Social Impact Lab</p> <p>→ MaRS Solutions Lab</p>

Social innovation labs are defined by ten characteristics, according to Gryszkiewicz, Toivonen, and Lykourantzou (2016):

1. Imposed but open-ended innovation themes
2. Preoccupation with large innovation challenges
3. Expectation of breakthrough solutions
4. Heterogeneous participants
5. Targeted collaboration
6. Long-term perspectives
7. Rich innovation toolboxes
8. Applied orientation
9. Focus on experimentation
10. Systemic thinking

Labs can be expensive to run. The most effective labs are embraced by funders, therefore removing the risk for a charity to participate in a lab. For example, the United Way of Calgary and Area funds the Social Impact Lab, allowing for collaboration between its fund recipients and removing the financial risk of participating.

## Sharing Failures and Insights

Definition	Gap	Examples
Reducing stigma around failure through promoting, learning from, and sharing failures	Stigma around failure for charities	<ul style="list-style-type: none"> <li>→ The Fail Forward Project</li> <li>→ Fuck-up Nights</li> </ul>

Gino & Staats (2015) observe that the reason organizations fail to learn include biases which cause people to focus too much on success, take action too quickly, try too hard to fit in, and excessively depend on experts. This is common in the social sector: we demand immediate results from charities, limit scale and innovation, and force them to rely on outside experts and “best practices” rather than learning themselves.

Sharing failures and insights can reduce the stigma around charities failing, and contribute to changing the mental models about charity. These stories remove the perceived risks of making changes, as organizations can learn from each other’s mistakes.

## Community-Driven Outcomes Purchasing

Definition	Gap	Examples
Charities functioning like for-profit businesses by selling their value and community outcomes to government funders, enabled through impact investors	Governments are the main financial beneficiaries of non-profit services. Charities need to sell their outcomes.  Governments do not create a market for problem-solving.	→ Aki Energy

In community-driven outcome purchasing, the government creates a market for solutions to problems in which charities can participate, as opposed to funding charities up-front for pre-determined purposes (S. Loney, personal communication, 2020). Impact investors, who seek both social and financial gain, allow charities to be able to pivot more easily and remove the strict obligations of contract funding (S. Loney, personal communication, 2020). The government can then purchase the outcome with demonstrated results, and excess revenues are returned to impact investors (S. Loney, personal communication, 2020).

## Gaps and Leverage Points

The Special Senate Committee on the Charitable Sector (2019) asserts,

*“...The charitable and non-profit sector has suffered from benign neglect for too long. Legal rules have been reformed in a piecemeal fashion; task force recommendations have gone unimplemented; and kind words have all too often served as a substitute for meaningful action. The time for real change has come.” (p. 11)*

The following are leverage points where meaningful change can be implemented.

### Changing Mental Models of Charity

<b>Definition</b>	<ul style="list-style-type: none"> <li>→ Adjusting mental models around charity, including unrealistic expectations around compensation, marketing, risk taking, results, timelines, and profit</li> <li>→ See charities as more than pocketbooks, but rather as vehicles that can collaborate and solve issues</li> </ul>
<b>Why is this a leverage point?</b>	<ul style="list-style-type: none"> <li>→ Our mental models and ideologies directly impact our interactions with, expectations of, and structures surrounding the charity system</li> </ul>
<b>Strategies</b>	<ul style="list-style-type: none"> <li>→ Update legislative policy on charity classifications</li> <li>→ Reduce stigma around failure so charities can learn from each other and embrace risk</li> <li>→ Utilize social innovation labs and creative spaces to challenge existing ways of thinking</li> <li>→ Utilize and share program success data so donors can make informed decisions about where to donate, concentrating revenue on successful programs rather than funding ineffective programming</li> <li>→ Articulating the long-term community and financial benefit of non-profit work</li> </ul>

## Beneficiary-Centric Models

<b>Definition</b>	→ Placing focus of services on the beneficiary
<b>Why is this a leverage point?</b>	→ In a complex system, becoming distracted by politics, finance, and expectations is easy. Charities exist to help their beneficiaries, and this purpose needs to be central to how the system is designed.
<b>Strategies</b>	<ul style="list-style-type: none"> <li>→ Human-centered design</li> <li>→ Co-creation</li> </ul>

## Giving Charities the Flexibility and Security to Innovate

<b>Definition</b>	→ Removing barriers to innovation, experimentation, and scaling
<b>Why is this a leverage point?</b>	<ul style="list-style-type: none"> <li>→ The nonprofit sector cannot innovate the way the for-profit sector can</li> <li>→ We need to solve problems at scale in the long-term, not just fix symptoms of problems</li> </ul>
<b>Strategies</b>	<ul style="list-style-type: none"> <li>→ Offer core funding in addition to contract funding</li> <li>→ Creating a market for charities to solve problems, with the assistance of impact investors</li> <li>→ Find ways to attract idea capital, business acumen, etc. to help charities scale</li> <li>→ Reward charities demonstrating innovation and producing results</li> <li>→ Use equity financing and the government's social finance investment funds to leverage more capital</li> </ul>



## Key Insights

In conclusion, there are many factors affecting the charitable landscape in Canada.

1. **Increasing demand for services is causing a social deficit.** Charities are unable to keep up with this demand, which could be detrimental.
2. **The Canadian charity system is complex,** composed of:
  - a. **mental models** around how we conceptualize non-profit vs for-profit organizations and how we should work toward social good
  - b. **historical legacy** of laws and events over the past 400 years, including influences from the church, the UK and the USA
  - c. **policies and structures** that make charities heavily reliant on outside funders and short-term funding contracts, as well as reinforce funder/recipient power dynamics
  - d. **human factors**, including our need for reciprocity, relevance, results, and risk-aversion when we give
3. **The system enables unsustainable path-dependency.** Breaking out of existing paths is perceived as risky for securing future funding and providing needed services.
4. **Current funding models establish power dynamics,** reinforcing barriers to innovation, marketing, or scale in charity.
5. **Current solutions seek to fill gaps in social services** through collaboration, social finance, and innovation.
6. **The first step to enact change is shifting how we think about charity and social good.** Until we change our mental models and behaviours, we cannot change our systems.
7. **Future systems need to be beneficiary-centric.** Focus needs to prioritize what is best for the beneficiaries of charities, not managing politics and finance.
8. **Charities need the flexibility and security to innovate if they are going to solve social problems.** This flexibility can allow charities to reach their full potential, meeting the demand for services more effectively and increasing resiliency in pressing times.

## Appendix A: Research Method

Our team is very inter-disciplinary, with knowledge ranging from information design and communication to business, management, social innovation, and behavioural science. Our team used an exploratory approach to the research we conducted.

Some of our research questions included:

- What are the implications of the social deficit?
- How and why do people give to charity?
- What mental models, structures, and trends created the social deficit?
- What are the leverage points to create a more sustainable charitable system in Canada?

In terms of methodology, we conducted a literature review of 44 articles, opinion pieces, government reports, and reports from umbrella organizations in Canada's charitable sector. We also conducted interviews with 11 different experts in the social sector in Canadian and International contexts.