Collaborations and strategic restructuring for Not-for-profits

Working with other organisations to improve performance

Case Studies and Vignettes

BaxterLawley

Document information

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Introduction

This course aims to provide Directors, Chief Executive Officer's (CEOs) and others tasked with leading their Not-for-profit organisation, with a step-by-step framework intended to assist decision makers within your organisation to assess whether it would be advantageous for your organisation to collaborate with another organisation or to undertake a major restructure, such as a merger.

It is designed with a focus on meeting the needs of leaders of organisations that operate in the human services sector – including disability services, mental health support, aged care, community services, child protection, child care and other services. However, it is also applicable to NFP organisations operating in other sectors, including sports, arts, housing and education.

The aim of this course is to give leaders:

- Insight into the range and types of collaborative strategies and merger options that could be considered
- A common language with which to discuss strategic options
- A framework for determining which, if any of these, should be explored by your organisation
- Examples of tools that can be used to analyses options

This course does not aim to promote collaborations or restructuring per se. The needs of each organisation are unique and collaborations or restructuring may or may not be the right strategic choice.

Learning Modules

This course and is presented in six modules.

The modules are presented in sequence, but because participants have different background knowledge and training needs, it is designed so you can focus on the sections that are most relevant to you and to choose your own path through the materials. It is likely that you will want to re-visit parts of this guide as the material becomes relevant to you.

We recommend all participants start with Module 1, as this guides you through evaluating the key issues impacting your organisation, its overall performance and whether collaborations or a merger may be right. It lays the foundation for the rest of the guide.

From there, you can choose which module to learn next. To help you work how to progress, each module begins with a series of challenge questions.

Modules

Module 1: Context and Principles

Module 2: Strategic Planning

Module 3. The language of collaborations and restructuring

Module 4: The collaborations "menu"

Module 5: Strategic Restructuring - Mergers, acquisitions, sales and winding-up

Module 6: Summary and next steps

There is a lot theory and examples of how to achieve effective collaborations and restructuring, but they often don't achieve objectives.

There is a large body of knowledge about collaborations and restructuring and many books and articles are available on how to get these right. But research shows that boards and CEOs are often not accessing these resources. Research also shows that many collaborations or restructuring do not achieve the outcomes intended.

Why? There appear to be several factors at play.

- The overall strategic goals of the organisation(s) are not themselves clear.
- The aims and goals of the specific collaboration or restructuring activity are not clear.
- Collaborations and particularly restructuring are often infrequent and therefore there is less opportunity for senior staff and Directors to develop skills
- Directors and CEOs, particularly those undergoing their first collaboration or merger underestimate the complexity and the

new skills required and therefore do not access training and support when needed.

- NFP organisations work with tight budgets, and often have few resources for board and staff training.
- Boards and CEOs can be overly reliant on, or overestimate the quality of, professional advice received from legal and accounting services.
- Organisations underestimate or lack the resources to fully execute the arrangement and therefore synergies are not achieved.
- The implementation takes longer than expected and delays the date at which the collaboration or restructuring begins showing returns on investment.

One of the main reasons organisations collaborate or restructure is to improve efficiency – through reduced costs. But several studies have shown that the synergies or costs savings are often not as large as estimated prior to the collaboration or restructuring[1].

About this course

This course brings together the best existing knowledge and theory rather than repeat existing information available. The material is presented in a succinct format that is quick and easy to understand. It also provides a body of resources that participants can explore when they need further information and support.

The course comprises the following elements:

1. Study guide
2. Case studies and vignettes (**this document**)
3. Online video course
4. Collaboration options analysis tool

[1] CITATION

Case Study One: Board Members & Collaboration – Framing a Successful Collaboration

Overview

Directors of any corporation are jointly and severally responsible for all aspects of the operation of the corporation and the activities it undertakes as well as how it undertakes those activities. One of the most significant activities they can oversee is that of a collaboration arrangement with another corporation.

This case study examines the chief decisions to be made by boards when considering collaborations by describing a developing relationship between three fictional associations which provide services in the disability sector.

Context

The disability sector has undergone, and continues to undergo, considerable change. This change impacts service users, service providers and the government on a number of fronts including in relation to funding arrangements, income generated by service providers, how service providers recruit clients and how services are provided.

The Problem

While this is a complex and significant set of changes, for the purposes of this case study, the chief issues faced by disability services providers include:

- Funding / Prices are not necessarily sufficient to cover all costs of services delivery;
- New descriptions of services do not necessarily equate to the services needed, in an holistic sense, by the clients' needs; and
- Increasing costs of services delivery, including in relation to remuneration of care staff, are decreasing financial sustainability.

Overall, the impact of these changes is to reduce the sustainability of disability services organisations thus impacting the chief concern of board members.

The Players

Eagle Care Services (Eagles) operates in Busselton, Western Australia, and employs 120 Full Time Equivalent (FTE) staff providing In-Home Care Services to 250 people living with disability. Docker Community Supports (Dockers) provides similar In-Home Care Services to about 100 people, employs 50 FTE and operates in the regional areas surrounding Busselton. Hawks Accommodation Services (Hawks) provides accommodation and care to 30 people in a group housing setting.

The board of Eagles has seen their organisation's financial performance deteriorate over the past six months. Like many Not-for-profit human services providers, they have never been highly profitable. However, they have also never been concerned with respect to the financial future of the organisation as it has operated in an efficient way for the last two decades of its life. Eagles does have a small financial reserve which it can use to invest once it has identified a solution for improving its financial performance.

While Dockers and Hawks have a similar financial history to that of Eagles, these two organisations are less financially secure. Dockers has a smaller reserve than Eagles and Hawkes does not have any substantial reserves available for investing to correct its financial performance. Both have a significantly smaller financial operation than Eagles.

Eagles, the Dockers and the Hawks all know each other well from years of operating in the same communities and from their respective roles in the local peak body, Human Services SouthWest. Eagles raised the prospects of collaboration with the other two organisations and had a positive reception although all agreed that any collaborative arrangement should be approached cautiously and deliberatively.

The Initial Decision—Whether to Progress or Not

The first decision to be made by the three organisations was whether the organisations should embark on a project to explore collaboration. Collaborative projects cost time, effort and also focus—taking away scarce resources that could be applied to other responses to the financial pressures being felt. Therefore, any board considering the idea of collaboration with another entity needs to complete sufficient exploratory work to ensure the prospects for success are reasonable and that it is rational for the organisation to proceed to implement a project to explore the idea further. The finance managers of each organisation were tasked with an examination of the financial goals needing to be achieved in order to make the collaboration worthwhile and this aspect is dealt with in Case Study Two.

All three boards felt that the foundation for a successful collaboration were present:

- All organisations knew each other well;
- All were secular and had very similar missions;
- All were operating in the same sector and providing similar services; and
- All were operating in the same region and had a similar conservative viewpoint.

Prior to taking a next formal step in the implementation of a collaboration assessment project, Eagles, Dockers and Hawkes established a Memorandum of Understanding (MOU) which did not preclude an organisation exiting the process at any point but did set out the general principles relating to the relationship as it developed toward a collaboration, including in relation to good faith sharing of information and the maintenance of inter-organisational confidentiality.

It also set out the stages at which particular information would be required. This is important because, as the collaboration escalates, the organisations increase their knowledge of one another—this includes in relation to highly sensitive information such as pay rates, CEOs terms and conditions, income levels and so on—and potentially impacting their respective ability to work separately. Importantly, the MOU would apply if an organisation subsequently left the collaboration while it was still being developed.

Once the boards had agreed to progress a review of the prospects for an effective collaboration, each of the organisations' CEOs had developed a paper for their board's review which described the rationale for collaboration and had sought permission to continue discussions with the other two entities. In these papers, the CEOs had outlined what the nature of the problem was that collaboration was to resolve, what the risks were to the organisation, what the stages of collaboration might be and how the relative success of the collaboration might be measured. This included in relation to the savings needed to make the collaboration a worthwhile process and the estimate of costs related to implementing the collaboration. This last element—the financial impact—is dealt with more fully in Case Study Two.

The Type of Collaboration

At first, all three organisations talked of a merger of their respective operations into a new entity and the winding up of Eagles, Dockers and Hawks. The boards met as a group three times to get to know each other and to discuss in broad terms the prospects for merger, what it might look like and what advantage they thought it would provide to their respective organisations. They also had presentations made to them from external experts in order to understand their responsibilities and to assess the activities needing to be undertaken in order to achieve an effective collaborative arrangement.

It soon became clear that a merger would not be possible in the medium term. Board members were worried about such issues as their organisation's community relationship, history and survival, as well as who would be on the remaining board and who would be the new organisation's CEO and senior staff. They were also worried about the time and resources needed in order to achieve an effective merger and had concerns that they were not really sure what the outcome would be.

Further, the boards jointly reviewed their purpose for getting together in the first place and identified it was to try and mitigate the financial impact of the recently changed funding arrangements. As such, it was felt that the real and immediate opportunity for savings could be made in combining the administrative processes. These were to cover: (1) payroll; (2) general bookkeeping; and (3) motor vehicle fleet management. Such a collaboration would have advantages in that it would:

- Allow each organisation to retain sovereignty;
- Allow each organisation to retain its own clients, staff and operational arrangements;
- Would have the benefit of allowing the Eagles, Dockers and Hawkes to get to know each other, meaning they could reassess their prospects for a more substantial collaboration in future;
- The members of each organisation would not need to be approached for permission nor would there need to be an corporate structure changes as the associations would continue to operate at they had done but were simply sharing resources (although a communications plan would need to be established in order to keep members and other stakeholders informed at the right time); and
- It was a conservative first step that would allow for the arrangement to be reversed without significant cost or operational impacts.

As such, the CEOs were asked to reconvene jointly to develop a plan for the establishment of an administrative hub that would allow for savings to be made by each organisation, for investment to be leveraged in terms of new IT and other systems required, to identify where responsibility lay for the implementation and to identify the measures of success for such a collaborative arrangement. The project plan also included a requirement that the CEOs describe a collaboration wind up process as the boards agreed to establish a five-year horizon on this arrangement. The thinking being that they would either move closer together and a more significant collaborative arrangement—perhaps even merger—could be considered at that time, the arrangement could be reviewed and wound up or simply continued in its current form.

Importantly, the establishment of the formal project also required the creation of a project budget and agreement as to what proportion each organisation was to contribute. At this point Hawkes indicated that it was unable to contribute funds to the project and that, while it was committed to the collaboration, it would need to be agreed that Hawkes would only provide in-kind resources. Given the Hawkes provided a differing service to that of the Eagles and Dockers and given the fact that the Eagles and Dockers had minimal reserves too, the prospect of Hawkes not providing any capital and sharing the financial risk with Eagles and Dockers was not acceptable and so Hawkes were unable to continue in the project and withdrew, confirming that they would continue to fulfil the MOU arrangements with respect to confidentiality.

Collaboration Implementation Governance

The plan put forward by the remaining two CEOs was accepted by the boards who then went about establishing a governance framework for the project. The Eagles and Dockers were the only organisations involved now and so it was agreed that each organisation would contribute the budgeted resources in proportion to their turnover. The agreement was formally documented and included:

1) A committee of oversight established with two board members (one being the chair) from each organisation.
2) The recruitment of an independent chair for the committee who would be a volunteer with significant business skills but no relationship with either of the three participating organisations.
3) A project plan was created which included a prospective view of the structure and savings inherent in the sharing of

administrative resources that was envisaged to arise out of this project.

4) The project plan also included the development of a propose structure which needed to be approved by both boards before being implemented. This structure included the proposed human resources requirements under the new arrangement, where those resources would sit (i.e. in which organisation) and how they would be selected. The plan was also to deal with the ramifications of making savings, including the termination of staff employment.
5) A project budget was created, including detail regarding the payments due from each organisation and the timing of such payments. The committee of oversight was also responsible for meeting the budget outcomes for the project and tasked with financial governance although they also had to report to each organisation’s board.
6) The creation of a communications plan was also included in this agreement allowing for all external communications to be jointly approved and jointly issued. This included in relation to the human resources communications that would become necessary within both organisations.
7) A decision was also taken to recruit an appropriately qualified project manager to implement the project. This would ensure that there was no intentional or unintentional bias in the execution of the project and that adequate human resources could be applied without impacting the day-to-day operations of the participant organisations by relying on existing executives to implement the project on a part time basis. This person would also report directly to the committee of oversight.
8) Each board would receive a monthly update form the committee of oversight including in relation to expenditure and whether or not the original intentions of the project continued to be achievable.

Importantly, the boards also sought to agree a set of targets in savings for the collaboration so that the success or otherwise of the collaborative arrangement could be assessed over time and, particularly, at the point of review in five-years’ time.

Case Study Two: Financial Analysis of Collaborations: A Marginal Approach

Overview

This case study continues on from Case Study One, and looks at the financial impact of the decisions made by the boards of Eagles and Dockers subsequent to their agreeing to implement a collaborative project. As such, this case study takes the perspective of the Eagles' finance manager and seeks to demonstrate the areas that the finance manager needs to consider in the context of a prospective collaboration.

A finance manager's role can be different in practical terms from one organisation to the next. For instance, a small organisation's finance manager may have other roles and responsibilities besides managing the financial aspects of the organisation. Such a finance manager may also undertake transaction recording and other bookkeeping activities. On the other hand, the finance manager or CFO of a larger organisation may have an oversight and management role, leaving the practicalities of transaction recording and the like to subordinate staff.

Regardless, in the case of evaluating and planning the financial outcomes associated with a collaboration, the focus areas remain the same for the person charged of an organisation's finances. They must estimate the financial impact—positive and negative—on the financial position and performance of the organisation both immediately and into the future. There are many other considerations as well, including the very important human resources implications. However, we are only looking at financial implications here.

The Context

Philomena Footyfan is the finance manager of Eagles Care Services and has been working with Eagles' CEO, Pat Rafter and his counterpart at Docker Community Supports (Nigel Nidel) to provide advice and support to the Eagles board.

As identified in Case Study One, the respective CEOs provided support to their boards relating to the initial decisions as to whether they should invest in the collaborations process. As part of his support to his board and CEO, Philomena provided the following key indicators which suggested that the prospects for savings to be made in an administrative collaboration were sufficient to make the pursuit of the collaborative arrangement appear worthwhile. It will be recalled from Case Study One that the contributions for each collaborator were to be calculated as a proportion of organisational turnover and that the initial agreement was to develop a collaborative arrangement that spanned five years, with the prospect of termination, amendment or continuation at that point. Therefore, the financial horizon is five years.

The reference turnover year was the financial year ending 30th September 20XX and for the purposes of this exercise, the proportion of costs borne by each organisation was set at:

Eagles	65%
Dockers	35%

Additionally, whenever we are evaluating the financial impacts of an investment (this collaborative processes is an investment from a finance perspective) we are interested in the marginal cash flow impact. That is, we are not interested in the total cash flow process but only those cash flow elements that make a difference to cash flow for our organisation—a different cash flow outcome that that is caused by the investment itself.

Prospective Savings – Initial Analysis

The prospective annual savings, conservatively calculated by Philomena, were listed as:

Prospective Financial Impacts	Conservative Estimate $
Staff – 2 FTE x Payroll Clerical Staff Plus On-costs	100,000
Staff – 1 FTE x Motor Vehicle Manager Plus On-costs	60,000
Staff – 1.5 FTE General Accounting / Clerical	90,000
Business Platform – Subscription Greentree (Net Saving –Shared 65%/35%)	6,500
Business Platform - Human Resources Management (Shared 65%/35%)	4,355
Total Prospective Annual Savings	**260,835**

However, in order to establish the collaboration, Philomena also identified a number of one-off costs that would need to be met and which constituted an investment. Again, in order to assist his board and CEO, Philomena provided this data in the following matrix:

Investment Item	Conservative Cost Estimate $
Legal Expenses	(35,000)
Industrial Advice – Staff Redundancies	(20,000)
Share Project-specific Personnel (Consultancy) (Required for 18 months)	(90,000)
IT & Comms Upgrade Required to Enhance inter-organisational comms, electronic approval systems and data transfer and storage	(65,000)
Documentation of Business Rules	(25,000)
Documentation of Decision Structures & Approval Processes for new administrative arrangements	(25,000)
Termination Payments (Including Redundancy)	(165,000)
Realisation Excess Motor Vehicles (Income)	27,000
Total Investment	**(398,000)**

It was standing policy at Eagles to assess project investments using the Accounting Payback Period. This is a relatively simple tool that calculates the total number of years it takes for the receipts from an investment (in this case, the savings achieved) to repay the investment made to achieve the additional income. It is a very subjective measure (as most are in this type of activity) and the board must place parameters around what they believe to be an appropriate return. Obviously the investment must be repaid within timeframe of the project—in this case, five years—in order to at least breakeven. The calculation is made by dividing the investment value by the net return (or savings here).

In aggregate for the period of the project, Philomena calculated the following payback period:

Total Marginal Investment Costs =($398,000) = 1.53 years
(or 1 year and 6 months[2])

Total Marginal Annual Savings $260,835

That is, in the first year, Eagles will need to provide a net investment before seeing a return of its capital. Therefore, not only does Philomena need to take into account the net position over time, she also needs to consider the cash flow implications of the process and note the risk associated with the fact that the payments out need to be made prior to the receipts can be received.

Therefore, Eagles will likely need to use its own capital (that is, cash reserves) in order to pay bills and invest in the collaboration investments. If all goes well, the collaboration savings will refill the coffers. However, in the meantime, the funds are at risk and if the estimates are badly made or, say, its collaboration partner—Dockers—does not pay its share of the investment funds, Eagles could lose its cash.

However, the above information was sufficient, combined with other information and what the board had come to know of Dockers, for the board to approve the project. As such, Philomena was able to invest further time into the creation of more considered budgets which would be used as control documents for the project itself.

Project Budget

Philomena now moved to create a project budget based on further and more detailed investigation as a result of which she found the following:

1) The staff terminations would not occur until the middle of year two as these staff would be needed to maintain the current processes while the new processes were being built.
2) Eagles currently has income of $14,800 per annum from interest it earns by investing its spare cash. It currently has a reserve of $370,000 earning 4% per annum.

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[2] There are a number of ways an investment assessment can be made. We use the payback period here as it is simple gives a conservative view as to how long your organisation's capital is at risk—the longer between payment and pay back, the greater the risk being faced. It provides a basis for directors and others to place the marginal cash flow implications of the investment in context. Other methods of analysis can be found at Peirson, G., et al, (2002, Business Finance, 8th Edition, McGraw Hill, Boston.

3) The realisation of the motor vehicles was also unlikely to occur until the middle of year two as they were needed while the new arrangements were put in place.
4) The business platform subscription savings were not actually possible to be achieved as the platform providers refused to allow two organisations to use one platform licence.
5) The outside project manager was more expensive than expected, the total cost for the 18 months project was now estimated to be $120,000. Therefore, the cost to Eagles was now $90,000 in total.

Therefore, Philomena now needed to recast the budget using the original format above but incorporating the newly found information. She is also needs to review the figures over the period of the investment or five years. These new figures are laid out below.

The overall investment budget is now:

Prospective Financial Impacts	Year 1 $	Year 2 $	Year 3 $	Year 4 $	Year 5 $
Staff – 2 FTE x Payroll Clerical Staff Plus On-costs	Nil	50,000	100,000	100,000	100,000
Staff – 1 FTE x Motor Vehicle Manager Plus On-costs	Nil	30,000	60,000	60,000	60,000
Staff – 1.5 FTE General Accounting / Clerical	Nil	45,000	90,000	90,000	90,000
Business Platform – Subscription Greentree (Net Saving – Shared 65%/35%)	Nil	Nil	Nil	Nil	Nil
Business Platform - Human Resources Management (Shared 65%/35%)	Nil	Nil	Nil	Nil	Nil
Legal Expenses	(35,000)	Nil	Nil	Nil	Nil

Prospective Financial Impacts	Year 1 $	Year 2 $	Year 3 $	Year 4 $	Year 5 $
Industrial Advice – Staff Redundancies	Nil	(20,000)	Nil	Nil	Nil
Share Project Specific Personnel	(60,000)	(30,000)	Nil	Nil	Nil
IT & Comms Upgrade	(65,000)	Nil	Nil	Nil	Nil
Documentation Business Rules	(25,000)	Nil	Nil	Nil	Nil
Documentation of Decision Structures & Approval Processes	(25,000)	Nil	Nil	Nil	Nil
Termination Payments (Including Redundancy)	Nil	(165,000)	Nil	Nil	Nil
Realisation Excess Motor Vehicles	Nil	27,000	Nil	Nil	Nil
Loss of Interest Income	(8,400)	(3,600)	Nil	Nil	Nil
Total Marginal Cash Flows	**(218,400)**	**(66,600)**	**250,000**	**250,000**	**250,000**
Cumulative Cash Flow	**(218,400)**	**(285,000)**	**(35,000)**	**215,000**	**465,000**

Therefore, the refined budget paints a very different picture to that provided after an initial review. The payback period is now calculated as 3 years and 2 months in round figures.

Therefore, financially the project remains worthwhile as the outcomes is ultimately positive for Eagles. Clearly other issues such as human resources impact, strategic impact and risk in the context of working with Dockers or an eventual need to re-establish the current arrangements need to be considered as well.

Vignette 1: Cash Flow Analysis

The consideration of any collaboration requires an analysis of the financial impact likely to accrue. While collaboration is a term that covers a wide array of methods of working together, including up to merger, there are very few instances of collaboration where there is no financial impact.

If a potential collaboration has a financial impact, we are invariably concerned with the cash flow associated with it. This includes any increased cash outgoings and any increased cash incoming. We do not talk of profits or other accounting calculations as the collaboration (which is akin to an investment) may include increased outgoings of a capital nature as well as changed operating cash flows.

Generally, we undertake a collaboration partly to improve our financial position and performance, but that is not the full story. We also undertake such activities in order to widen our service offerings, to enhance our skills base and experience, to increase our efficiency and to better support our clients. While financial return may not be the driving purpose, we do need to evaluate the financial impact of the cash flow every time.

When considering the cash flow impact of the collaborative arrangement, always commence with the marginal cash flow impact—that is, what is going to change from a cash flow perspective if we undertake this collaboration? Changes can include:

- Investments that must be made to enable the collaboration (e.g. an IT system)
- Investments that must be made in order to support the decision making process itself (e.g. the cost of due diligence)
- Investments that must be made in order to functionalise the collaboration (e.g. training of staff, consultants)
- The realisation of superfluous assets will result in cash inflows to the organisation
- Any additional operating expenses or operating income must also be added

The rule is, all changes in cash flows should be included in the assessment.

Vignette 2: Merger Timings - The Human Factor

Any collaboration represents an investment in resources and time. The time can be taken up in decision making, research, due diligence and the actual process of implementing the legal and practical elements. Depending on the type of collaboration, the process can become lengthy.

This is especially so when considering a merger. Arguably, a merger is the most significant of collaborations not least of which because it involves people beyond the boards of the collaborating organisations.

From a timing perspective, it is imperative that in planning for a merger, you consider:

- The time it takes to negotiate with your organisation's membership;
- The time it takes to respond to the membership's queries and concerns; and
- The time it takes to undertake each of the regulatory steps needed in order to effect a change of this magnitude.

Of course, depending on how the merger is to be established, the human factor may include the members of only one entity—in the case where the assets are to be transferred to the other merger partner—or of all entities involved—where the plan is to establish a new organisation and wind up the partner organisations.

Boards can fall into a number of traps that will impact the timing of a merger. These include:

- Failing to plan for the notice required to call a special general meeting;
- Failing to brief the members well enough at the appropriate time so that the merger plans are not well received by the membership;
- Failing to communicate with the membership regarding the drivers for the merger, especially where financial or operational changes make a merger imperative; and
- Failing to take into consideration the time it takes to wind up an organisation together with the time it takes to obtain the appropriate regulatory permissions.

Overall, experienced directors will say that a merger can only be successful when the organisations involved have a cogent, uniform and mutually agreed communications plan which includes timings of communications as well as transparency of the arrangements.

As such, any merger plan should also build in contingency timings against the possibility of any adverse reactions from members, difficulties in negotiating the merger terms and difficulties that might be confronted as a result of regulatory complexity.

Planning for the human factor is critical in the merger process.

Vignette 3: Marginal Costing

When considering the costs and benefits of a collaboration, some attention should be paid to the less transparent impacts of changing your organisational structure. These impacts usually relate to extent to which changes in your income stream modify the way your organisation recovers its overheads.

Overheads are those costs that are generated regardless of the level of service activity your organisation undertakes. That is, they will be incurred if the organisation does not provide one service. Typical examples of such costs are the CEO's salary, the head office rent and power.[3]

When you merge with an organisation, your income stream can change and, often, when analysing the impact of these changes, analysts often don't consider their marginal impact—that is the net impact the changes have on the organisation.

For instance, if a program generates $100 in income but has direct costs (e.g. staff time, motor vehicle costs) of $75 and overheads of $30, then the program results in a loss to the organisation of $5. This $5 needs to be covered by other income streams of course.

If the program is not critical to mission, it is tempting then not to continue the program. The idea would be to discontinue the program in order to save the $5.

However, there is a very important "but" here. The direct costs to the organisation are $75 in this example. That is, when the program is run, the organisation physically pays out that money. However, the organisation has also allocated $35 in overheads to this program. Currently other programs have to bare the $5 cost overrun. However, we should also ask: how much would the organisation's other programs need to meet if this program was discontinued.

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[3] See the NDS Curtin National Costing and Pricing Framework for further information regarding costing. It is available at: www.cplp.nds.org.au

The answer is $35. In other words, the organisation is better off by $30 by running the program than not running it. This is the marginal contribution the program makes to the overheads—it does not cover all of its overheads but it drastically reduces the cost borne by other programs.

The general rule is, programs save money if the expenditure they represent is avoidable—that is, in this case, if the $35 in overheads was able to be saved as a result of discontinuing the program, that would be the best way forward economically.

Therefore, the re-allocation of overhead costs against other programs is necessary unless the overheads can be saved.