FINANCING THE VOLUNTARY AND COMMUNITY SECTOR - FUTURE PROSPECTS AND POSSIBILITIES

The Charity Acountants' Conference
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Introduction

This also the title of the paper I prepared almost exactly 12 months ago for the NCVO as a contribution to a book, *Voluntary Action: meeting the challenges of the 21st Century*.

4 of us were asked to 'speculate' on what we believed "some of the anticipated developments in the public policy environment might mean for voluntary and community organisations": Nick Deacon on Civil Society, Gerry Stoker on Localism, Andrea Westall on the diverse forms of legal entity, and me on money.

In my paper I wandered round a fairly large canvas of possibilities, trying to get to grips with two basic questions:

1. Can existing sources of funds be increased, used more effectively, made to 'work harder'?
2. Are there additional sources of funds that might become significant over the next 5 years?

I found crystal ball gazing was quite fun. You can find details of the book on the NCVO site (if you just want my paper, email me via my website and I'll send it to you).

There are a number of reasons why I think it's an intriguing and rather exciting time to be debating charity finance:

- there are a lot of developments on the supply side which are or could transform various aspects of funding
- and there are some serious challenges to the orthodoxy of the fund-seeking world, how the demand side operates.

The changes and developments include:

- new people: new types of donor, different backgrounds, different ages (a digression but one feature of this is the intriguing renaissance or positive redefinition in the UK of the term philanthropy; even 10 years ago, it was seldom used or only with reference to nasty capitalists buying their place in heaven)
- changes in donor attitudes (individual, corporate, governmental and charitable trusts and foundations) – changes that are a reaction against what are seen to be weaknesses or failings in present funding methodologies (especially grant-making); combined with
- attempts to adopt more creative donor practice, more engagement with the work that is being funded and to focus on the capacity of the

organisations that are being supported, together with a wish for clearer understanding of the impact and outcomes of what is being funded

- changes in the operating environment – the relationships with government (as a funder or as a encourager of charitable giving), the new style Charity Commission, for example
- rapid advances in technology – this is not just impacting on individual giving (redbutton interactive TV; texting etc) but on the practice of institutional funders – foundations, corporates, public sector organisatuions; there are real opportunities for reducing the transaction costs of such funding and of making much richer use of the data and information their work enables them to collect
- extensions and enhancements to the funding 'menu' – the increasing acceptance and creative use of debt and other forms of 'double bottom line' social investment; and the current debate about using some capital and endowment funds to support charitable purposes, mission related investment
- the maturing of the market and the growing recognition that organisations within the charity sector must ensure that their core mission is neither diverted or distorted (sometimes fatally) by a short-sighted (albeit tempting) chase after new, but inappropriate, funding opportunities; and that they should avoid the near suicidal tendency of some charities to sign up to poorly conceived and/or under-priced contracts, some with terms and conditions that are so inappropriate that they threaten other aspects of the charity's work.

In this talk I propose to be a bit self-indulgent and look at just three themes:

- the challenge to the orthodox grant culture
- the use of new forms of funding – going beyond grants
- new possibilities for directing some charity assets and endowments towards funding things that are mission related.

Health Warning

As with almost every discussion of the voluntary and community sector, however, some cautionary words are needed right at the start about the risks of making any generalisations about the sector or its finances.

First – what does this sector consist of? How can one generalise about:

- a sector which is often defined by what it is not: i.e. not for profit
- a sector which took the old Community Fund 13 pages to define for funding eligibility
- or which the government (in the Cross Cutting Review) laboured to describe as:

"…wider in scope than "general charities" and the "voluntary sector", inclusive of organisations reflecting the characteristics of social enterprise but narrower in scope than "non-profit", "third" sector or "social economy".

This is not semantic pin head dancing – the definitional problems can lead to major misunderstanding and misleading information – for the sector itself and for the general public.

In my paper for NCVO I drew on data from the UK Voluntary Sector Almanac – the information in that relates to the 153,000 organisations classified as General Charities – that's a classification that does not necessarily fit what the public might regard as charities. For example:

- It does include some large organisations which have recently become registered charities having previously been part of a local authority.
- It does not include most housing associations, sports and social clubs, universities, cooperatives, organisations whose primary purpose is the promotion of religion, and most private ('public') schools – that's a lot of voluntary and community organisations!

There's also a major problem of out of date information. At the time I wrote the NCVO paper, I used the 'new' Almanac; published in February of last year, this was based on 2001/2 charity accounts. A lot happened in the intervening years to change and influence charity finances. Yet the data being used for many current pronouncements about the state of the voluntary sector's finances is likely to be 2 or 3 years old.

Even if you can get your head round the definitional problems and the fact that we are having to deal with old information, how can one generalise about a sector where, according to the Almanac:

- 1.6% of the organisations within it account for 68% of the income?
- just 306 charities receive 39% of the total annual income?
- 59% of charities receive 1.4% of the income; and
- 64% of the fall of £856 million in the sector's total income between 2000/1 and 2001/2 fell on the organisations with a income of between £100,000 and £1million, a group that makes up only 10% of the sector.

The diversity of the voluntary and community sector and the complexity of its funding makes it unwise to rely over much on generalisations about the whole sector's needs and circumstances. The different functions, scale, structure, history – even the location – of organisations which make up the sector all have distinctive consequences in how organisations are funded.

So that's my health warning which I recommend you take account of whenever any voluntary sector sage or researcher assures you that they know what they are talking about – including this one!

There is another generalisation I'd like to challenge – the persistent negative assertion (often by people with little or no direct knowledge of the sector) that non-profit organisations are grant dependent, feather-bedded by subsidy, risk averse and insufficiently hard edged financially – I'll come back to that later!

The 'Grants Culture' – Perverse Outcomes
I am delighted to see that there is a growing recognition that some grant-making systems have perverse outcomes, that they can weaken rather than strengthen the organisations that they are intended to support. Grantee organisations can be subject to costly, mission distorting and financially disabling action by grant-makers.

The way some grants are made, their restricted purpose, the conditions attached, can have a "Born to Fail" effect – doomed from the start not to achieve what both the grant-maker and the grant seeker were aiming for. Some examples of routine practice among funders illustrate this:

1. "Project-itis"
'Project-it is' – a disease that creates what has been described as a 'dance of deceit' between funder and funded as the fund seeker tries ever more desperately and/or ingeniously to describe ongoing work in ways which enable it to be presented as a new (and no doubt 'innovative') project which meets narrowly defined (and funder imposed) programme aims.

2. Short term funding
Many funders adopt arbitrary funding cut-offs that take no account of the length of time that may be needed for a project or activity to achieve its objectives or become self-sustainable

3. Underfunded intiatives
Many funders have been unwilling to pay for the full price of the work they agree to support; and the costs they have been most reluctant to support have been those which are essential to an organisation's long term and healthy survival, the general operational overheads and forward planning costs. As a consequence, a project grant can be awarded that is inadequate for the effective development and management of the project it is intended to support – leaving the grant recipient either to meet those costs from its own (probably limited) resources or to run the project knowing that it does not have sufficient funds to do so.

4. No Incentive to Outperform
The restricted grants culture that has become so dominant ties funds to tightly defined outputs and quantitative monitoring – success is measured by compliance not by achievement. Restricted grant systems do not usually enable a funded organisation to retain unspent funds that have been saved through efficiencies and add them to their general reserves and working capital.

5. Reward Failure – Penalise Success
Some funders have demonstrated the supreme perversity of rewarding failure (the project which nears the end of its grant and reports that it has not yet managed to achieve any of the agreed objectives – but is confident it will do so if the grant is extended) and penalising success ("well done for achieving what you said you would – now you don't need our funding to take it further").

5. High Transaction Costs

Grant-making transaction costs can be formidable – for both grant-seeker and grant-maker.

New Grant-making?

This perversity was well summed up in one of the quotations from grantees used by Julia Unwin in The Grant-Making Tango:

> "Lots of funders behave as if they are going into Marks and Spencer and trying to buy a jumper without being prepared to pay for the design, or the advertising costs, or the laboratory testing of the new yarn, and they are actually rather unwilling to meet the cost of the right hand sleeve. Then they are surprised that they have bought a rather grotty jumper."

These are probably common grumbles among many of your organisations – does it always have to be so? Fortunately not – and fortunately self-assessment and debate among grant-makers is leading to changes. There's also a growing recognition that grant-makers have sometimes been too arrogant to recognise that their aspirations can only be realised if the organisations that they support have the appropriate level of resources and the necessary capacity, confidence and competence to address the mutually desired objective effectively. The grant-maker is no less dependent than the grantee.

In the next section of this talk, I want to talk about some new forms of funding that some grant-makers have been introducing – going beyond grants. But it's important, I believe, to end the discussion about how some grant-making can be harmful and to preface discussion of alternative funding with an assertion about the legitimacy of grants; to challenge the all too common assertions about the sector's alleged grant dependency. To be sure, it is important that full grant subsidy is only used when no other form of finance (earned, borrowed or self-generated) can be more (or as) effectively used to deliver a specific public benefit. Grants and donations, however, are a legitimate – and, for many organisations in many situations, the only form of – funding that can ensure an organisation can achieve its purpose. But there is a rich diversity of other financing possibilities that organisations in the voluntary and community sector can also deploy – for different purposes and at different stages of their development.

To justify full subsidy in a world where there will always be a shortage of funds, therefore, I believe an organisation needs to be able to demonstrate that it has thoroughly investigated and, where appropriate and feasible, built up:

1. a range of income generating activity (from customers and service users, from appropriate marketing opportunities, from work done under properly priced contracts with statutory organisations) without exposure to excessive risk or mission distortion
2. a loyalty among supporters and its community that is reflected in a regular and unrestricted income stream from committed donors

3. a financial strategy to maintain and further develop its work that makes intelligent use of recyclable funds – recyclable from its own reserves and/or from borrowing.

If all three of these are in place, then the case for grant income and subsidy to meet the rest of the price of delivering the mission can be made without apology or defensiveness, but strongly, legitimately and with confidence. Grants are 'OK'!

2. New forms of funding – going beyond grants

In recent years, a number of new funding schemes have emerged which go beyond grants. Each of them has its own roots and specific purposes but all combine funds and technical support; they usually also combine loans with grants. The loans that are provided have a variety of terms, are usually below market, and are tailored to the individual borrower's particular plans and circumstances – as such, they are often characterised as 'patient capital' or 'patient finance.' Most are also able to provide funding 'in advance of need' to enable a new or expanding organisation to prepare and to equip itself for the proposed undertaking – to become 'investment ready.'

These new funders are beginning to alter the 'landscape' on which all funders function; they are also influencing the practice of existing funders, especially among trusts and foundations. When loans or other forms of patient finance 'beyond grants' are made by a charity they will be Programme Related Investments or Social Investments – 'Double Bottom Line' investments that aim both to achieve social objectives and to deliver a financial return which can come back to the funder so that the money can be used again…and again.

Some of the new funders, such as the Charity Bank and Venturesome, have been set up within the voluntary and community sector; some, such as FutureBuilders and the Adventure Capital Fund are the product of joint initiatives by Government and the voluntary and community sector. They are broadening the spectrum of how different types of spending can be financed at different times in a voluntary organisation's life and development through different forms of 'patient capital', underwriting, below market loans or equity type investments.

And they are growing: Charity Bank has just announced a further £25 million of loan funds; Future Builders has been increased to £215 million; the Adventure Capital Fund is now deploying its third 'tranche' of funds; Venturesome is securing a steady stream of additional funds from individuals and foundations, now up to nearly £5M.

Some of these developments were prompted or encouraged by the work of the Social Investment Task Force. This reported first a few years ago and – in relation to charitable funds – urged all charities to look at how some of their aspirations could be funded by Programme Related or Social Investment. PRI/SI has always been an option for most trusts and foundations in the UK but few have practiced it. The Charity Commission has been supportive of the use of PRI/SI as a legitimate way of extending the menu of options for financially supporting charities. They issued some rather splendidly titled 'useful guidelines' – which at least opens up the possibility of them issuing some 'not useful guidelines' at some point. The Commission observed that many financial advisers and trustees had become confused about what was permissible; they commented that:

> "Many charities, their trustees in particular, have had it drummed into them that, when you are investing charity money, you have got to get the best possible return. That's where the confusion has arisen".
>
> "Any charity that can give grants can undertake programme related investment unless it is specifically prohibited in the charity's governing document."

Obviously the trustees must try and protect and build the assets they hold 'in trust' – but their primary obligation is to use the charity's assets as effectively as possible to achieve their charitable mission or purpose – to assist their beneficiaries. If the best way of doing that is to invest in something with a low likely return then that may be OK. It won't be classified as an 'ordinary investment' because the motive for making the investment is not informed solely by the prospects for a financial return – there's a 'double bottom line'.

3. Mission Related Investment

PRI or SI may not be classified as an 'ordinary' investment, but there is only a small step to take intellectually to apply some of the same logic to what are ordinary or mainstream investments – to make Mission Related Investments: the deliberate selection of investments that will serve the investing charity's mission directly, the asset allocation and investment selection being subject to the same risk appraisal and fiduciary disciplines as are used when making 'normal' investments. Earlier in the month, we were lucky enough to have in this country Luther Ragin, the head of Investment at the F B Heron Foundation in New York. His foundation has adopted a Mission Related Investment strategy. They have found (or supported the development of) investment opportunities across the spectrum of cash deposits, fixed income bonds, property, publicly quoted equities, private equity and other 'alternatives' that all generate market rate returns while directing resources at work which addresses the foundation's mission of helping low income communities and people. This goes well beyond what is already not uncommon here, the positive or negative screening that would operate within a Socially Responsible Investment strategy. Heron's success is impressive and has now encouraged through example a number of other, much larger US foundations also to do adopt the approach for some of their investment portfolios.

The decision of the Heron trustees 10 years ago to develop a MRI policy stems from their wish to address the question:

> "Should a foundation be more than a private investment company that uses some of its excess cash flow for charitable purposes?"

As a result of the Heron visit to the UK, that is a question now being discussed here, too.

The challenge to the Market
Finally, the challenge to the 'Market' – the charities that are seeking funds. A spectrum of different types of finance support the voluntary and community sector – a spectrum that extends from cash donations in collecting boxes at one end to commercial overdrafts at the other, including on route grants, legacies, endowments, membership fees and subscriptions, sponsorship, contracts, sales and trading income, payments by users, specialist and commercial loans.

Different combinations of these types of funds are appropriate for supporting different types of activity or development in different ways at different times in an organisation's life.

A key skill for the financial and fund-raising executive leadership of any organisation in the voluntary and community sector, therefore, is to be familiar with, and confident about the use of as wide a range of the financing options on the funding spectrum as it is feasible and appropriate for their organisation to access at each phase of its growth and development.

It's a challenge. Many of the developments to which I have referred have been 'supply side' led – and that's probably for the best as there would be nothing more frustrating or debilitating for fund seekers if they were trying to adopt these different combinations of funding, this extended menu of possibilities, and those with the funds were completely stuck in a narrower and more limited orthodoxy.

For the challenge to be met, however, the market has to engage with these developments and with the funders, to be willing to try out and test the appropriateness of the new forms of finance, to resist collusion with perverse grant systems, to challenge procurement and contracting practice that fails to pay the right price for a service.

At present we are in transition, but I have no doubt that in 10 years time the sort of diversity of funding and quality of investment practice that I have described will be well and widely established in the UK.

Adventurous, intelligent and creative funding will the norm – but only if those seeking funds, the market, match, complement and build on the efforts being made by the 'supply' side – the providers of funds – to extend and strengthen these additional and enhanced forms of funding.

Little of this is new – none is 'rocket science'. But the orthodoxy is strong – among charity investment managers and advisers, resisting possibilities for opening up Mission Related Investment opportunities; and among charity finance staff, tentative about looking beyond established forms of subsidy or earned income. I remember a meeting only three years ago when we tried to interest the FDs and Chief Fund Raisers of a number of the top 50 charities to consider how they could use programme related (or social) investment within their own organisations. No progress at all. It seemed to be just too far outside their respective comfort boxes.

Times change, however. Last year I met with the fund raisers for a charity which was about to launch a large appeal to raise capital funds to build a new special childrens' facility. This will replace and substantially extend an existing project which has already established that a market for the service exists and that local education authorities will pay the full cost of the service provided.

You won't be surprised that I suggested they look again at their revenue projections since it seemed to me that minimal 'tweaking' should enable them to build a sufficient margin into their pricing projections to fund most of their capital needs with borrowed money – the fees they could charge were sufficient to include the repayment of the loan. They did not need to raise charitable, philanthropic funds for a lot of what was in their original appeal draft document.

Not only that, but financing a large chunk of their plans through debt would produce results quicker – and cheaper. Quicker and cheaper? Well, a loan (or combination of loans from commercial and charitable sources) would be secured a lot quicker than any capital appeal could achieve – so:

- they would not have to invest so much of their resources in the costs of fund raising; and
- they would be able to go on site within a few months so they would not need the considerable contingency they had built into their capital cost projections to allow for the two or three years that the capital appeal would take to raise the funds.

The possibility of using debt finance along these lines was not part of the 'culture' in that charity either of the fund raisers or the financial staff or trustees. It is now. They are making the charitable funds they raise

- work harder
- go further
- do more

Not only not rocket science; it's also not new! My first job when I left university was at a project in Yorkshire for what were then called 'delinquent youth.' The organisation employed 4 people and cost just £14,000 a year to run – we did not get paid much and it was a very long time ago! We raised that money from all sorts of sources – I reckon we were reasonably enterprising:

- from individuals – who sent us donations or covenanted annual contributions;
- from churches and rotary clubs
- by getting gifts in kind from local firms
- by selling Christmas cards designed by the children
- by earning fees for speaking at seminars and conferences
- from 'per capita' payments made by children's departments and probation services to pay for the costs of our service for specific individual children.

Our one asset was the number plate of the mini-bus we used to cart the children around: 1 ALF (those of you who are alert to football history will know that the England football manager in the late 60's was Alf Ramsey – so that number plate had value! Also shows how old I am!).

When we needed a few thousand £'s in a hurry to do extend the beaten up old farmhouse (itself a gift) which was our base, we did something that seemed entirely ordinary and normal at the time – we went to see our local bank manager and borrowed the money.

At no time in the three years I worked there did we ask for or get a grant from any organization, charitable or otherwise, which was restricted in purpose to pay for a specific post or activity. We did have some grants from trusts and foundations – but they were contributions to the general work of the organization – they liked the idea of what we were doing so they backed the organisation. The restricted grants culture that has become so dominant among funders of all kinds in the last couple of decades was not a major problem – then.

End with another quotation I used in my paper for NCVO – one taken from *The Magic Roundabout – how charities can make their money go further,* a splendid booklet co-authored by, among others, Kate Sayer and the now Chair of the Charity Commission, Geraldine Peacock. The book extols possibilities for how charities could make and use Programme Related Investments. It also speculates about the future:

> "Who knows? Maybe in 20 years time a new age of individual giving will have dawned. Government grants will have expanded, lottery ticket sales will have recovered, all the UK's companies will donate 1% of pre-tax profits to social action and an ever expanding stock market in a period of unprecedented growth will sustain charity investments and boost the endowments of grant-making trusts. But right now would you bet your money on any one, let alone all, of those things actually happening?
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> "We can't control the future. But we can develop ourselves. We have the resources. Do we have the courage? It is clear from all available evidence that heavy reliance on time-limited grants and charitable donations is not a safe place to be. For the voluntary sector to flourish, new financial instruments are required to catalyse and enable enterprise and growth. Sensibly broadening investment approaches to allow exploitation of greater latitude is not risky for charities, however, the status quo is.
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> "So, if charity funding is in trouble, here's to the Noah effect: no more prizes for predicting rain – you only get a prize when you build an ark."

David Carrington
September 2005