FINANCING THE VOLUNTARY AND COMMUNITY SECTOR – FUTURE PROSPECTS AND POSSIBILITIES

David Carrington
November 2004

Paper prepared for NCVO Future Strategy consultations and published within
'Voluntary Action: meeting the challenges of the 21st Century'
(NCVO 2005)

FINANCING THE VOLUNTARY AND COMMUNITY SECTOR - FUTURE PROSPECTS AND POSSIBILITIES (NCVO Strategic Agenda paper)

SECTION 1

Introduction

This paper addresses two main questions about the future financing of the voluntary and community sector:

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?

The paper has been prepared to help in the exploration[1] of future funding possibilities; to provide background to debate about how positive opportunities can best be seized – and potentially negative ones avoided.

As a preface and to provide some indications of the context for this debate, some key data is presented in this section along with a series of quotations which illustrate a number of current themes that preoccupy people working in the voluntary and community sector.

The second section of this paper identifies a number of critical issues that will have to be faced if the funding prospects of all parts of the voluntary and community sector are to be approached with optimism:

- The dominance of the grants culture
- The quality of service provision purchasing practice
- Capacity, competence and confidence
- Investment in Knowledge – in learning about what works

In the third part of the paper, the first of these issues, the dominance of project grants within the financing of the sector is discussed in a little more depth. The case is made that funders – in all sectors – will have to abandon those aspects of grant-making practice which seem to weaken rather than strengthen grantee organisations if grant-making is to be a credible and fully effective funding option.

The concluding section speculates about might happen to the financing of the voluntary and community sector, drawing on current trends and suggesting possible developments in government, philanthropic and corporate funding.

A final introductory observation – nothing in this discussion of the financing of the voluntary and community sector is likely to be wholly new. The long history of entrepreneurial ingenuity in the sector is a rich one – and this will no doubt continue. What can be enhanced is the environment within which such ingenuity

[1] The brief from NCVO was to outline "trends and potential developments over the next 5 to 10 years in relation to how voluntary sector's funding base may change or be broadened"

can be exercised and the skills and knowledge of those seeking (and providing) funds.

Setting the Scene

The complexity and diversity of the financing of the voluntary and community sector is illustrated by two tables:

- The first shows the spectrum of income sources and the proportionate significance of each
- The second illustrates the diversity of financial scale within the sector and the significant challenge that this represents to the prospects of any generalisation about the funding of the sector as a whole having much validity:

Table 1: Income Sources

2001/2	%
Fund Raising	**47.2**
▪ Donations from Individuals	13.6
▪ Legacies	6.3
▪ Public Sector/Statutory Grants	16.9
▪ Trusts and Foundations	5.3
▪ Lottery Fund Distributors	2.6
▪ Corporates – donations	2.5
Public Sector Contracts	**17.7**
Enterprise	**26.6**
▪ Individuals – fees, sales, subscriptions	16.8
▪ Trading Subsidiaries	5.2
▪ Other voluntary and community sector	1.3
▪ Corporates – sponsorship, fees	1.8
▪ Property Rental	1.5
Investments	**8.5**

Table 2: The Different Funding of Organisations of Different Size

2001/2	Under £10K	£10K-£100K	£100K-£1M	£1M-£10M	Over £10M	All
Average Income	£3,363	£35,647	£320,594	£2.802M	£35.135M	**£3.588M**
Proportion % of Sector (No)	59.4	28.7	10.3	1.4	0.2	**100**
Proportion % of Sector (£)	1.4	7.5	23.7	28.9	38.6	**100**

The NCVO Almanac[2] (from which the information in both these tables is taken) does not distinguish between the local and national government shares of voluntary and community sector funding. In the Treasury cross cutting review of *The Role of the Voluntary and Community Sector in Service Delivery*[3], however, a

[2] *The UK Voluntary Sector Almanac 2004* NCVO Publications
[3] *The Role of the Voluntary and Community Sector in Service Delivery, a Cross Cutting Review* H M Treasury 2002

breakdown was provided of the respective contributions to the sector from different tiers of government in England. Excluding the funding of Housing Associations/registered Social Landlords, this showed that:

Table 3: Public Funding (England)[4]

2000/1	£M	%
Local Authorities	1.060	42.4
NHS	0.557	22.3
Central Government*	0.882	35.3

*this includes funds provided by government agencies and Non-Departmental Public Bodies such as the lottery fund distributors

In the NCVO Almanac, public sector funding from these different tiers is aggregated, but the split is made between grants and contract fees – and shows that the largest charities are securing more funds from each of these income streams, whereas the middle sized and small charities are not:

Table 4: Public Sector Grants and Contract Fees

	Under £10K	£10K-£100K	£100K-£1M	£1M-£10M	Over £10M	All
Grants 2001/2 £M	18.4	250.7	1206.6	1039.6	990.1	**3502.4**
Proportion % of Total Income	6.4	16.2	24.5	17.3	12.4	**16.9**
Change from 2000/1 %	*-34*	*-6.5*	*-3.2*	*+6.6*	*+7.5*	***+1.9***
Contract Fees 2001/2 £M	2.3	73.7	599.5	1180.2	1823.1	**3678.8**
Proportion % of Total Income	0.8	4.8	12.2	19.6	22.8	**17.7**
Change from 2000/1 %	*+340.0*	*+38.5*	*+13.2*	*+7.0*	*+8.1*	***+9.0***

The complexity of the issues with which any discussion of the financing of the sector has to grapple is illustrated by the following extracts from eight recently published reports:

1. "Changes in the economy, the interests of foundations and the priorities of government can quickly reduce or redirect money…The stress and effort inflicted by this uncertain funding environment…breeds a scarcity mentality that can shrink an organisation's ambitions."[5]

[4] Source: Home Office

[5] Letts, Christine W and Ryan, William P *High Engagement Philanthropy* Stanford Social Innovation Review Spring 2003

2. "Financial insecurity is invariably endemic. Access to financial resources and the relationship with funders is a critical factor that can influence the effectiveness of a community organisation and its ability to meet its goals. Their income is often made up of a complex puzzle of numerous sources, many of which are secured for individual projects. Funding difficulties can stifle creativity, reduce risk-taking and inhibit the ability of community organisations to develop the necessary assets and capabilities to secure positive results. Moreover much time is spent on completing application forms and diverse reporting requirements of funders. Short-term funding and low salaries also inhibit the ability of community organisations to attract appropriately experienced staff and threatens staff retention, thus risking the loss of the most important asset held by a community organisation - the staff."[6]

3. "Although grants have the clear advantage of being non-repayable, conditions attached to them designed to ensure that the money is used for the purpose intended may limit the capacity of an organisation to operate and expand or to leverage in commercial finance."[7]

4. "Funders, therefore, face a constant dilemma. Like a bird on a nest, there will always be hungry mouths to feed. Unless their income matches existing and emerging demand they will always be in the position of terminating funding to organisations that they have supported in the past."[8]

5. "We now have a funding environment in which the dominance of such project funding is taken for granted both by grant-makers and by many charities. Their staff have grown up with this and know no other. It is a sector wide disaster. Never has the sector been given so much money as in recent years, but it has arrived in a way that is both ineffectual and deeply demoralising for all concerned, givers as well as receivers. We have a quite new funding culture. Charities rely less and less on raising or earning their own money and more and more on persuading external organisations to fund their work. These bodies…have their own agendas to which the charities must adapt or die. As a result many charities are living in a new world of extreme and demoralising financial insecurity."[9]

6. Grant-holder comments about funders:

- "They behave as if they know best"
- "Sometimes they arrive with ideas about how we should be operating"
- "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

[6] Botham, Claudia and Setkova, Lenka *Local Action Changing Lives* New Philanthropy Capital July 2004
[7] Bank of England *The Financing of Social Enterprises* May 2003
[8] Thake, Stephen *Report on The Adventure Capital Fund* (unpublished) 2004
[9] Fitzherbert, Luke *Making Better Grants* Directory of Social Change News, September 2004

actually rather unwilling to meet the cost of the right hand sleeve. Then they are surprised that they have bought a rather grotty jumper."

- "I hate it when they say they have achieved things. All they ever did was agree to give us a cheque."[10]

7. "What distinguishes social entrepreneurs is their focus on creating social value. They measure productivity and yield in terms of social impact. They help us find better ways to use resources to improve the world in which we live. They will not be shy about using philanthropic and government resources when they are appropriate and available. They do not see donor dependency as a disease, nor do they see earned income as a panacea. They recognise the strengths and weaknesses of both forms of revenue. Despite popular conceptions, neither form is inherently more reliable or sustainable than the other. Businesses fail all the time, and many donor-dependent non-profits have been around for many decades, even centuries. Social entrepreneurs look for strategy, structure, and funding mechanisms that are most likely to ensure effective and efficient social performance given specific mission objectives and a particular operating environment."[11]

8. "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? 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. Programme related (social) investment is about sweating charitable assets harder – asset sweating not asset stripping. 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."[12]

[10] quoted in Unwin, Julia *The Grant-making Tango: Issues for Funders* The Baring Foundation June 2004
[11] Dees, J Gregory *Putting Nonprofit Business Ventures in Perspective* – from *Generating and Sustaining Nonprofit Earned Income* Jossey Bass 2004
[12] Peacock, Geraldine; Hickey, Keith; Voller, Paul; Sayer, Kate; Wilkie, Nick *The Magic Roundabout – how charities can make their money go further* Bircham Dyson Bell and Sayer Vincent 2003

SECTION 2

The Issues to be Addressed

Prospects for Change

The two questions at the heart of this paper can both be answered positively:

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?

A positive answer to each question will only be possible, however, if:

- funders adapt their ways of working so that their use of grants is used selectively and deliberately within a more 'mixed economy' of financing alongside other forms of funding
- funders ensure that the terms and conditions that they apply with their funds are justifiable and appropriate given the nature and scale of the activity that is to be funded and of the organisation they are supporting and the risks that it is taking on
- data and 'lessons learnt' about financing alternatives are better documented and shared
- advocates of enhanced financing systems are more successful than in the past in persuading established and new funders to 'look beyond grants' in the menu of ways through which they can support work within the voluntary and community sector.

Financial Diversity

As with almost every discussion of the voluntary and community sector, however, some cautionary words are needed about the risks of making any generalisations about the sector's finances. How can one generalise about a sector where, as was illustrated in the previous section:

- 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
- the charity press can headline reports from the same organisation's research which asserts that "international aid remains the UK's most popular cause, attracting 18% of the donations – one and a half times more than cancer charities attracted" whereas a few months earlier the headlines (drawing on research which used a different source material) trumpeted that "medical research and children/young people drew the widest public support", 'overseas relief' being relegated in the table to a position behind animals and religious organisations
- 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 the 153,000 organisations which make up what are described as 'General Charities'[13] all have distinctive consequences in how organisations are funded.

Making assertions with confidence about the sector is made more difficult because different data sources use different definitions of what constitutes the voluntary and community sector, accounting practices within the sector vary in the way different income sources are classified and the data takes time to reach the public domain (the 2004 Voluntary Sector Almanac, for example, was published in February 2004 but is reliant on data for 2001/2).

There are, however, "common issues and preoccupations – not least:

- the universal hunt for the holy grail of long-term financial sustainability
- the ease with which an organisation's core mission can be diverted or distorted (sometimes fatally) by a short-sighted (albeit tempting) chase after new, but inappropriate, funding opportunities
- 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." [14]

Key Issues

Four aspects of the current financing of the voluntary and community sector will have to be addressed if the questions set out at the beginning of the paper are to be tackled:

1. ***Grants Culture:*** the dominance of a grants culture – which can have perverse and expensive consequences:

- organisations can be weakened rather than strengthened by some grant-making practice
- the prospects of successful outcomes can be undermined by the imposition of counterproductive grant terms and conditions
- multiple funders subjecting applicants/grantees to near identical assessment and compliance procedures and maintaining separate grant payment and administrative processes which add to the transaction costs[15]

---

[13] *The UK Voluntary Sector Almanac 2004* NCVO Publications. It should be noted that the 'General Charities' classification 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.

[14] Carrington, David *'The Funding Environment' at 'Mission, Models and Money'* conference (Arts & Business and The Jerwood Charity) June 2004

[15] One indication of this: "in the for-profit capital market, costs of raising capital consume just 2-4% of funds raised. In the social capital market…the costs…consume 18% of funds raised" Bradley, Bill in Foreword to *Generating and Sustaining Nonprofit Earned Income* Jossey Bass 2004. Another graphic indication of the costs comes from The Arthritis Foundation (quoted in *Foundations for Success – Emerging Trends in*

of both grant-maker and grantee – using up financial and human resources that could otherwise be directed towards charitable purposes.

Further discussion of these and related issues is to be found in the next section of this paper.

2. ***Service Purchasing:*** service provision purchasing from voluntary and community sector providers by the public sector – when the priority is for a cheap price procurement system and the avoidance of shared risk. This can lead to an outcome where all three participants – the user, the provider and the purchaser of the service all lose. The practices of both the public sector purchaser and the voluntary sector provider have to change radically if these problems are to be overcome – not least the reluctance of voluntary and community sector organisations to 'walk away' from poorly conceived and/or under-priced contracts, some with terms and conditions that are so inappropriate that they threaten other aspects of the provider organisation's work. Given the amount of attention devoted to this type of funding at the moment (for example as a result of the Cross-Cutting Review *The Role of the Voluntary and Community Sector in Service Delivery*, the introduction of Future Builders, and the work being undertaken by ACEVO/New Philanthropy Capital) the issues are not explored further in this paper.

3. ***Capacity:*** the need for additional capacity and entrepreneurial confidence. The ability of trustees and staff of voluntary and community sector organisations to juggle skilfully a complex mixture of different types of earned income, sponsorship, legacies, subsidy and donations would be the envy of many entrepreneurs in the for-profit sector, but even greater 'smart and canny' ingenuity is likely to be needed as voluntary and community organisations look increasingly for enterprising ways of utilising their own capital assets (physical, intellectual and human as well as financial) to generate additional resources and more sustainable income streams. Most voluntary and community organisations are chronically undercapitalised for the work they do – or would like to undertake. They often have insufficient reserves to meet the obligations (and levels of risk) they take on; and they have little or no working capital or funds to resource initial work on new developments. Increasingly, funders will have to incorporate the financing of capacity strengthening and technical assistance when they wish to support an organisation take on unfamiliar territory or be exposed to new risks.

4. ***Knowledge Investment:*** there is a tendency for all funders to make very little of one of their major assets, the intellectual capital that their experience will have built. They tend then to ignore what could be argued

---

Grantmakers' Use of the Internet 2004) that "in a typical grant cycle it moved three tons of paper five times in 30 days."

to be a key obligation of their role[16] – that the extensive learning acquired as a result of their funding activity be fully documented, shared and applied (in their own subsequent funding decision making, in the further development of the work they have been funding, and within the rest of their network and the wider community). Funders and funded both need to develop – proportionately and in ways that enhance operational practice without involving excessive accountability burdens – performance and outcome measurement indicators and up to date information systems which do justice to the often complex multiple 'bottom lines' (social and environmental as well as financial) that their work is intended to target.

Legitimate Grants

It will also be vital to avoid slick prescriptions about the financing of the sector, prescriptions which often ignore the reality and diversity of what is achievable by many organisations in the voluntary and community sector – negative assertions such as those that are commonly made about 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 financing possibilities that organisations in the voluntary and community sector can deploy[17] – for different purposes and at different stages of their development.

To justify full subsidy, an organisation needs to be able to demonstrate that it has thoroughly investigated and, where appropriate and feasible, built up:

- 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
- a loyalty among supporters and its community that is reflected in a regular and unrestricted income stream from loyal donors
- 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.

---

[16] "Foundations spend millions on programme evaluation and research but, when it comes to sharing their findings, philanthropy suffers from a serious case of clogged arteries." Williams Group *Marketing Your Knowledge: a Report to Philanthropy's R&D Organizations* David and Lucile Packard Foundation 2003

[17] See, for example, Kingston, John and Bolton, Margaret *New Approaches to Funding Not-for-profit Organisations* International Journal of Nonprofit and Voluntary Sector Marketing, Vol 9 No 2, 2004 Henry Stewart Publications; and New Economics Foundation and Shorebank Advisory Services *Unlocking the Potential – a guide to finance for social enterprises* Social Enterprise Coalition 2004; and the guidance produced by the Sustainable Funding Project at NCVO: http://www.ncvo-vol.org.uk/Asp/search/microsites/main.aspx?siteID=3&sID=27

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.

SECTION 3

The 'Grants Culture' – Perverse Outcomes?[18]

That there is a tendency for some grant-making systems to have perverse outcomes, to weaken rather than strengthen the organisations that they are intended to support, has been an increasingly prominent focus of debate in recent years[19], especially in the USA.

Grant-makers – in all sectors – have made substantial efforts over the last decade to enhance:

- the clarity of purpose of their programmes
- the openness and transparency of their application and decision making processes
- their approaches to the measurement of the outcomes and impact of what they do.

These efforts have not always been matched, however, by appropriately 'intelligent', proportionate, supportive or flexible changes to:

- the assessment and due diligence methods they use
- the criteria they adopt about what costs can be funded
- the grant terms and conditions they apply
- the systems of compliance and accountability they impose.

As a consequence, funded organisations can be subject to costly, mission distorting and financially disabling action by grant-makers.

Surely the perversity lies in arguing that a grant could be anything other than a 'good thing'? The reality is that 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"

Voluntary and community organisations despair of the tendency of so many funders to tie their grants to very restricted purposes: 'project-itis', a disease that creates what has been described as a 'dance of deceit'[20] 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.

---

[18] This section of the paper is largely drawn on a report on voluntary and community sector funding issues prepared for the Big Lottery Fund (October 2004)

[19] See, for example, Unwin, Julia *The Grant-making Tango* Baring Foundation 2004; and *Unlocking the Potential* The Social Enterprise Coalition 2004

[20] *Grantee-Grantor Relations: Mutual Accountability and the Wisdom of Frank Capra* Jed Emerson:, Foundation News and Commentary March/April 2001

2. Short term project funding

Many funders:

- concentrate on short-term support, tied to tightly defined outputs and quantitative monitoring – success tends to be measured by compliance not by achievement
- 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
- demand 'exit strategy' plans, many of which are regarded with some scepticism, either because they rest on unrealistic timetables or because the project's future sustainability relies on replacing one source of time-limited grants with another.

Yet those same funders acknowledge that the social and community problems they are trying to address through their grant programmes are complex and deep-rooted, unlikely to be 'solved' by short term efforts. Some funders explain their reluctance to make long-term funding commitments by expressing concern that the organisations that they are supporting may become over dependent on their grants and that their grant-making resources will 'silt up' – implying that a funder's freedom to switch support from organisation to organisation is a greater priority than funding a single organisation for sufficient time for it to achieve the aims that the funder has agreed to support. It seems more likely that the often ambitious objectives of funders to use their resources to tackle challenging social problems might be better served if the pattern and duration of their grant-making related more realistically to the time it will take grantee organisations to achieve those objectives.

The recent Treasury guidance[21] about what are – and are not – Treasury 'Rules' (i.e. Government Accounting) has much to say that is relevant to grant-making (and to contracts), for example, on short term funding:

> "The lesson here is clear: short term funding can often produce sub-optimal outcomes for both the VCO and the client group that benefits from the work of that VCO. Longer term funding can reduce such dependency, allow the VCO more flexibility to carry out its core function, and produce clear benefits for the – often highly vulnerable – client groups supported by such VCOs."

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

[21] *Guidance to Funders – improving funding relationships for voluntary and community organisations* HM Treasury 2003 This Guidance was produced as a response to the 2002 cross cutting review of *The Role of the Voluntary and Community Sector in Service Delivery*, which had reported that Treasury Rules were perceived by both funders and recipients (and used by some of the former) as "a barrier to effective funding relationships."

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

Grants classified as restricted in purpose and tied to inflexible compliance monitoring systems provide no incentive or encouragement to a voluntary or community organisation to adopt efficiencies or more effective practice as the funded project progresses and experience of managing it generates learning about what works and what does not. Restricted grant systems do not 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. High Transaction Costs

Grant-making transaction costs can be formidable – for both grant-seeker and grant-maker. This is exacerbated by the way the funding of so many projects resembles a jig-saw – with multiple funders all subjecting the application and then the management of the grant to separate (and different) terms and conditions and reporting requirements. These are sometimes designed defensively – more to minimise the funder's exposure to what it regards as risk, rather than to be supportive of the project or to make positive capital out of the lessons learnt from its work. On other occasions they seem to completely overlook the amount of time that grantee organisations have to spend meeting many of these requirements – time that can often be largely unproductive. Given that those same organisations usually have limited capacity, it is hard to see that grant-maker or beneficiary interests are well served by so much grantee time having to be spent 'servicing' funder imposed systems.

New Grant-making?

A grant-maker's aspirations can only be realised if the organisations that it supports 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. It is in the grant-maker's interests to audit all of the systems that it adopts:

- for inviting and assessing applications
- for commissioning work from voluntary and community organisations
- for developing partnerships with intermediaries
- for setting and monitoring grant terms and conditions…

…to ensure that they are appropriate and proportionate for what is to be attempted and are supportive of the grantee organisation's prospects of success.

Organisations seeking to increase and enhance the effectiveness of existing funding arrangements will need to work with grant-makers in all sectors to help ensure that these standards are attained.

SECTION 4

So – What Might Happen?

Introduction

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 used to support different types of activity or development in different ways at different times in an organisation's life. Different funders apply different terms and conditions and levels of engagement to different types of organisation and activity. The motives or interests of different funders (individual, charity, corporate, lottery, government) can also vary considerably, even if the type of funding they provide is similar.

A key skill for the 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 this funding spectrum as it is feasible and appropriate for their organisation to access at each phase of its growth and development. A key task for infrastructure and representative organisations within the sector, therefore, is to help ensure that organisations' leaders have access to high quality information and tactical and strategic advice on financing their work.

Over recent years, several options on the financing spectrum have been 'stretched' and extended. Organisations (both funded and funder) have become more confident about going beyond the single or few types of finance that they have used for decades:

- grant-makers have explored loans, made either direct or via a specialist intermediary
- commercial lenders have supported below market social investment funds
- trustees of community organisations (even of small ones) have found that they can establish sustainable income streams and move away from a wholly subsidised existence
- charities (of all sizes) have learnt that they can borrow money to see them through uneven cash flow periods or to acquire/refurbish income generating assets.

Increasing numbers of funders and funded organisations have broken free of a 'one size fits all' prescribed approach to funding the sector's work and recognise that an individual organisation's specific circumstances, track record and capacity will enable a variety of combinations of finance to support – and other forms of funding to cripple – the development of new (or the maintenance of existing) initiatives.

That the language of 'investment' is used increasingly by both funder and funded is not just rhetoric (though there is a danger of it being so overused that its meaning becomes diluted). For both organisations in a financing transaction, the use of the term can demonstrate that they are engaged in a long term venture, from which both – and the beneficiaries of the activity or service – will derive a measurable return, albeit not necessarily a financial one.

Predictions

The rest of this section brings together some predictions of what might happen to the financing of the voluntary and community sector over the next few years – each derived from current trends which seem likely to continue. Some may warrant further encouragement – for some, active discouragement may be more appropriate! Their potential to influence the future financing of the sector seems significant – and, therefore, any strategy for the further development of the voluntary and community sector, locally, regionally and nationally will need to take account of them.

Current funding trends within the voluntary and community sector

1. ***Continued Growth and Pressure on Available Funds:***
   The voluntary and community sector will continue to grow in size, especially at the top and bottom of scale as measured by annual income. There will be no shortage of demand for funds from all sources as the number and ambitions of charities increase; competition between charities will, therefore, intensify but there will also be increased pressure (on funders and on fund-seekers) to make every penny work harder, to encourage ingenuity in financing work, to demonstrate efficiency and cost effectiveness, to share or pool resources and efforts. One consequence will be a sharply changing agenda for fund raisers as they will need to demonstrate that a chosen fund raising option is the most appropriate way to finance a specific planned capital asset development or new venture – why loan finance, for example, would not be more appropriate than a traditional capital appeal for some or all of the financing of a new project.

2. ***Large Charities Get Bigger Slice of Donated Funds:***
   Donations and grants from most sources will remain static or continue to fall – but the charities with the largest incomes will continue to increase the funds they receive as a result of their high level of investment in fundraising; the increased polarisation will also become more marked, the big brands getting bigger and hoovering up more and more of individuals' charitable donations and corporate sponsorship – at the expense, primarily of the middle sized charities that cannot afford to invest in substantial fundraising or brand development.

3. ***Contract Fees Increasingly Dominate Public Funding of Sector:***
   Fee income from contracts with the public sector will continue to replace grants as the main source of public sector funding of the voluntary and community sector – but the organisations that are most vulnerable to losing grant income (the middle sized ones) are not necessarily those that will gain

contracts and fee income. (Contract type arrangements could also extend increasingly to financing relations with other sources – lottery distributors, trusts and foundations, companies; if so, and if the work is properly priced and fully funded, some of the present pressures of underfunded work and the inflexibility of restricted grants would be eased).

4. Full Cost Recovery Pricing Takes Root:

Moves towards 'full cost recovery' pricing (including an appropriate margin) of publicly funded services provided by voluntary and community sector organisations under contract to statutory purchasers will continue and gain momentum as risk sharing and more 'mature' procurement practice takes root – but securing appropriately priced and structured contracts will also continue to be a struggle, especially locally, unless effective challenges are mounted to address:

- the endemic tendency of charities to collude with taking on underfunded and/or excessively risky contract terms and conditions
- performance of staff with procurement responsibilities being judged by narrow output and low cost measures
- impact on pricing of staff costs continuing to rise significantly faster than overall inflation increases.

5. Community Sector Develops Own Funding Routes:

Organisations describing themselves as being within the Community Sector may distance themselves increasingly from the large charity 'brands' and the service provider voluntary sector and look to government and other funders to back their emphasis on asset development (and asset transfer) and community service agreements as key routes to greater sustainability. The success of funding schemes such as the Adventure Capital Fund[22] will encourage funders – in all sectors – to:

- link the provision of start-up funds directly to capacity building/technical assistance programmes
- combine a variety of patient capital investments with grants[23]
- introduce low cost loan and social venture type funds to support new enterprises or to grow existing ones.

6. Voluntary Housing Sector Goes Beyond Housing:

Housing Associations (Registered Social Landlords) – by far the financially strongest and asset rich sub-sector within the voluntary and community sector – will become increasingly prominent in local economic development, community finance and neighbourhood regeneration/renewal; but will also have to recognise that their 'business interests' require them to link with and underpin the resources of community led organisations if their 'housing plus'

[22] Thake, Stephen *Primed For Growth, Adventure Capital Fund Baseline Report* New Economics Foundation 2003

[23] Carrington, David *Patient Capital, a new approach to investing in the growth of community and social enterprise* Home Office Civil Renewal Unit 2004

work is to be perceived as legitimate by government agencies and the communities within which they are working.

7. ***Collaboration between organisations within the voluntary and community sector:***

Partly of their own volition and partly in response to funder encouragement, it seems probable that a variety of financial collaborations between organisations in the voluntary and community sector will develop, for example:

a. charities making deposits with Charity Bank and other CDFIs
b. large charities subsidising, underwriting or lending funds to smaller ones; housing associations providing financial 'cover' and protection to community organisations
c. organisations pooling reserves to support joint initiatives or to enable a lead organisation to take on a development that is larger than otherwise could be supported
d. 'business to business' developments between social enterprises.

Government

It seems probable that Government…

1. ***Commitment to the Voluntary And Community Sector***

…commitment to the role of voluntary and community sector (in service provision, volunteering and civil society, neighbourhood regeneration and civil renewal) will remain prominent – but is unlikely to be matched during the next public spending review periods by very large single injections of additional resources such as FutureBuilders or Change-Up; more modest funding initiatives may target specific aspects of community cohesion e.g. faith groups, the Black and Minority Ethnic voluntary and community sector organisations.

2. ***Enthusiasm to outsource fund distribution***

…will continue to be keen to 'out-source' some innovative funding distribution to consortium of voluntary sector organisations (as it has done for the Adventure Capital Fund, the Parenting Fund and Futurebuilders). It is likely also to be persuadable to extend these programmes if they can be shown to have met their initial targets.

3. ***Endowment***

…may be interested in using endowment as a means of making a lasting (but one off) investment in new funding vehicles (as demonstrated by the investment of lottery funds in UnLtd, NESTA and Fair Share); this might be especially relevant in boosting the scale and the potential for a sustainable future for community finance organisations.

4. ***Encouragement of Personal and Corporate Philanthropy***

…will seek to encourage more philanthropy and social investment (especially by those with most wealth) by the:

- introduction of new planned giving measures similar to the split interest trusts (including charity remainder trusts) that exist in the USA

- extension and further development of incentives similar to the Community Investment Tax Relief
- encouragement of the further promotion of initiatives such as the Corporate Challenge and Payroll Giving among SME's
- long term support for initiatives such as Guidestar in order to address what are perceived to be transparency and information deficits.

5. Addiction to Short-termism

…tendency to adopt short term funding programmes to address complex and long term community finance and regeneration needs and aspirations (to adopt impatient capital measures when patient financial capital is needed) and to chop and change funding criteria (e.g. Phoenix Fund, Neighbourhood Renewal) may be moderated as a consequence of lessons learnt since 1997, but is likely to continue to be often overwhelmingly tempting – the negative impact of this happening being greatest on those community organisations which have the least financial and organisational capacity.

6. Ambivalence about Delegation

…will continue to be ambivalent about moves to delegate direct statutory funding of local and sub-regional activity to local and regional statutory organisations and agencies – and will continue to adopt the rhetoric of devolved funding but default all too easily back to micromanagement and central direction of priorities, criteria and compliance requirements.

7. Holistic Approach to Financial Exclusion

…will edge tentatively further towards an approach to local economic development and household poverty alleviation measures in the poorest neighbourhoods that combines community finance 'instruments' that address both area based development and individual household income (through community banking, micro-credit and a range of CDFI schemes).

8. Mainstream Social Enterprise

…will open up further access for voluntary and community sector organisations to 'mainstream' economic development services (e.g. from DTI and DEFRA) as those services adapt to focus more on social and not-for-personal profit enterprises as well as the for-personal profit sector

European Funds

Organisations and areas which have been able to draw significantly on European Funds are going to be especially under pressure as 'enlargement' dilutes the available resources; it seems unlikely that, for the foreseeable future, there will be significant growth in the availability of European funds for the voluntary and community sector in the UK.

Personal Philanthropy

It seems probable that the proportion of individual donations made with Gift-Aid will grow – but so too will donor expectations of their relationships with the charities they choose to support:

1. An increasing proportion of personal donations will be made tax efficiently but the larger donations will tend to go to the larger, better branded fund-raising charities and institutions.
2. An increasing proportion of new and larger scale individual donors will expect a higher level of accountability from, and a more active engagement with, the charities they choose to support.
3. For some existing donors (and for some with no previous history of personal philanthropy), opportunities to make social investments (especially if there is an incentive such as the Community Investment Tax Relief) could add new money to the sector (i.e. such investments would be made in addition to, not instead of, philanthropically motivated donations).
4. New charity products and donor services are likely to be introduced for individual and family donors, including:
    - outsourced 'back office' administrative services
    - 'research and assessment' services to assist donors make choices between competing charitable appeals such as New Philanthropy Capital
    - pooled philanthropy funds such as the Impetus Ttrust, Venturesome or the Acumen Fund
    - 'sign-posting' and advice services about new social investment opportunities.
5. Donor attitudes to some charities (or to the whole 'brand') are likely to be increasingly directly influenced (for better or for worse) by 'service user' experience of growing proportion of population (themselves, families or close friends).

Corporate Philanthropy and Corporate Social Responsibility

Further growth seems likely – but will be combined with greater focus and the expectation of greater accountability; there will also be further moves to release unclaimed assets:

1. Corporate philanthropy: a continuing growth in the number of corporate foundations is likely – prompted/resourced by further demutualisation, ownership changes, Corporate Social Responsibility (CSR) development – but this will be accompanied by higher levels of:
    - more purposeful philanthropy, tied closely in many cases to corporate aspirations and brand links
    - employee involvement in CSR
    - expectations that 'partner' charities should provide impact data.
2. Prominent charity 'brands' are likely to gain most from many of the new donors as they are more likely to be selected as partners if the choice is made by employees or by marketing staff.
3. Growing commercial interest in 'business to business' relationships with social enterprises and service providers within the voluntary and

community sector can be anticipated; also a parallel interest in Business Schools and in staff development within the corporate sector in engagement with the emerging social enterprise sector.

4. Unclaimed Assets: further publicity about the existence of unclaimed or 'orphan' assets (not just in banks but within insurance companies and other financial institutions) will intensify pressure for them to be released for philanthropic use, whether directly though the asset (or the income derived from it) being gifted to corporate foundations or Community Development Finance Institutions or other intermediaries; this will also expose scale of unclaimed assets held by Government e.g. in National Savings.

Endowed Trusts and Foundations – going beyond grants

Further innovations in practice and priorities seem likely to emerge as trusts and foundations try to carve out a niche that distinguishes their funding roles from those of public or corporate funders:

1. Concern about the negative aspects of the 'grants culture' (see Section 3) will lead to the adoption by an increasing number of endowed trusts and foundations of new funding strategies which lead to longer term and financially more ambitious relationships with chosen organisations. This is likely to include more provision of risk capital (on patient terms) for new ventures or the extension or enlargement of existing ones, to help strengthen skills and competencies of organisations' leadership, and to enable wider learning about both what works and what can be learnt from initiatives that fail.
2. The experience of how their specialist investment managers dealt with the decline[24] and volatility of the equity market in recent years will have encouraged a more robust questioning of those managers by trustees of endowed charities and further moves to diversify and extend the range of assets in which funds are invested – albeit substantial changes in investment strategies will be slow to be implemented.
3. A small but growing and influential group of endowed trusts and foundations will adopt Mission Related Investment[25] strategies for some of their assets – a move which could over time add significantly to the funds available to the voluntary and community sector – and, when their charitable mission is directly effected, adopt more activist investment practice.
4. A growing internationalism will reinforce recent steps to bring UK trusts and foundations into closer contact with the work of peers elsewhere in Europe and beyond.

---

[24] WM Annual review of UK Charity Funds 2003: "the average charity yield has fallen by over 30% (5.6% to 3.9%).

[25] Ragin, Luther M Jr *New Frontiers in Mission-Related Investing* The F B Heron Foundation 2004 http://www.fbheron.org/viewbook_frontiers.pdf

Lottery Funds
The decline in overall 'good cause' income is likely to continue – and to accelerate if the Olympics bid advances – but the proportion of lottery funding going to the largest organisations (as a result of the likely reduction in wholly open programmes) and to the smallest (as a result of the planned increase in the scope and scale of Awards for All) will increase – at the expense of middle sized national and sub-regional organisations.

Consumerism
The prominence of the voluntary and community sector in the provision of publicly funded services together with continued growth of consumerism in individual and community attitudes to services is likely to necessitate significant attitude changes by charities towards service users and their families/carers and to lead to higher costs as organisations have to take on additional insurance protection. Just because a service is provided by a charitable organisation, even a locally managed one, community or individual good will cannot be assumed (See also Personal Philanthropy: 5 above for potential impact on donor attitudes).

IT
Further developments in IT and web based systems[26] should lead to

- reductions in transaction costs – for funder and funded during the application, assessment, monitoring, evaluation and payments management phases; the introduction of Guidestar should reinforce this, not least in cutting out the need for what is now time consuming duplication of work by applicants and grant-holders
- greater collaboration between funders with overlapping interests as current reluctance to share assessment and evaluation/monitoring reports becomes increasingly indefensible
- web based information about the merits (and demerits) of different financing options should provide reassurance to trustees aand staff who are nervous of seeking new types of funds for the first time; web based information sharing about what works (and what does not) should also enable funders and funded to be better informed and to better able to avoid taking on new initiatives that are likely to fail.

David Carrington
October 2004

[26] iapps (Interactive Applications Group) *Foundations for Success – Emerging Trends in Grantmakers' Use of the Internet* 2004