NCVO 3 April 2006: Blended Value and Social Investment

In this session, I'll concentrate on two of themes that Jed Emerson has just presented in his talk about 'blended value' – applying them within the UK environment:

1. **Mission Related Investment:** what are endowed trust and foundations in the UK doing to ensure more of their financial assets are focused on supporting the charitable purposes and public benefits for which the endowment was created? To quote one US Foundation to which Jed has already referred, the F B Heron Foundation[1]. Their trustees have been grappling with one key question for a decade: how can a foundation be "more than a private investment company that uses some of its excess cash flow for charitable purposes." *(Emphasise that this discussion is about endowed Trusts and Foundations – not grant-givers like Children in Need or Comic Relief that raise from the general public the funds that they subsequently give away; or foundations that derive their income in annual donations from the companies with which they are linked – like Northern Rock or Lloyds TSB or the Camelot Foundations)*

2. **'Going Beyond Grants'** – what are UK trusts and foundations up to when they talk about 'going beyond grants':
    a. first – this is about adding loans or other forms of 'patient capital' to their funding repertoire, alongside grants – seeking to introduce Social Investment (what in the USA is called Programme Related Investment) – funding that is provided to achieve a charitable purpose but also to be repaid
    b. the other meanings are about how a foundation organises its work – not the forms in which it provides funds – in the ways, for example, they engage with the organisations they are supporting or considering for funding, becoming more proactive in shaping the case for funding and/or in their involvement with the organisations they decide to fund
    c. in the ways they are trying to learn more about work they support, and to use that learning to influence future policy or community developments

(I'll be concentrating in this presentation primarily on the work of trusts and foundations, on institutional philanthropy – but it's pertinent, in passing, to acknowledge that this second theme is not particular to trusts and foundations. Indeed, as the briefing for this seminar emphasises, developments around strategic funding, a focus on outcomes, more engagement in capacity development are preoccupations for some funders across all the spectrum – individual philanthropists, foundations, corporate funders, lottery distributors, even government; but it's also the case that many funders in all those categories are not remotely bothered about any of this, they are not engaging the debate – just going on as before. If you are looking for funds, therefore, it's going to be more important than ever to understand what is motivating and preoccupying each funder, whatever category they may be in).

Mission Related Investment (MRI)

In the UK there's more movement on the second of these themes and I suspect that is where most of our focus will be in discussion – but I draw your attention to the first as I

[1] http://www.fbheron.org

think it will become increasingly prominent over the next few years – and could have dramatic impact on the use of charitable assets. After all, when we talk now about what is done with the resources of charitable trusts and foundations, we are talking about the use of a tiny proportion of their total assets: £2 billion a year; that may sound a lot but endowed foundations in the UK actually have more than £50 billion of financial assets.

Think of the possibilities if we can construct investment products which could attract some of that £50 billion – and serve social and public benefit ends at same time.

There's quite a lot of current chatter and work on this, here, in the rest of Europe and USA. It's a tough nut to crack, not least because of the culture within which investment advisers and investment managers (and most members of the investment committees of endowed charities) work and have been trained. Perhaps a little cynical to suggest that that culture seems to breed an approach to investing a foundation's endowment that is characterised by having as little connection as is possible with the charitable purposes of the foundation – except when there is an opportunity to make an investment choice that will directly contradict the charitable purpose or mission of the foundation – those opportunities are invariably seized without any hesitation! The orthodoxy of the investment community in the UK does not even acknowledge there might be a contradiction.

If the current chatter goes beyond rhetoric then we will see Foundations beginning to apply mission related criteria to their investment strategies. By the end of the decade, I anticipate that there will be mission related investment products in place in Europe in all asset classes, including cash, property, public and private equity. We already have a few such possibilities in the UK – but they are not necessarily structured in the right ways – work is needed to make them more accessible and marketable.

I reckon the market is there – trusts and foundations that want to ensure that much more of the endowment assets that they hold for charitable purposes are actively used to demonstrate that communities currently defined solely as being 'disadvantaged and in need' are actually emerging markets in their own right – potential targets for successful and sustainable entrepreneurial investment, asset development and wealth creation.

'Going Beyond Grants'

Now back to 'going beyond grants' – start with a bit of background: why are things stirring in this environment? Lots of factors – mention just 3, all of which are about the wish to ensure that funds are used more effectively – you may have others that we can pick up on in our subsequent discussion:

1. Concentrate subsidy – grant funding – where it's most needed in the development of a voluntary or community organisation. There has been what I think is a rather dreary tendency for commentators to assert that the Voluntary and Community Sector is grant dependent and that this is some awful disease. Not so – a campaign is needed to argue that "Grants are OK," a legitimate – and, for many organisations in many situations, the only – form of funding that can ensure an organisation can achieve its purpose. But the campaign must also recognise that, as organisations grow and mature, their funding needs and opportunities change –

they can use different types of funding at different stages of development; they can generate and earn funds in different ways at different times, too.

Grants/full subsidy will be the only form of funding that can deliver the goods at some points in an organisation's life – and for certain types of activity – but it is important that they are 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.

As the Charity Commission has acknowledged, a charity that can make a grant can (unless expressly forbidden in its governing document) make a loan to fund the same thing. The more that trusts and foundations use loans or other forms of social investment to support organisations when it is appropriate to do so, the more their funds will be recycled and reused to support new activity. Charitable funds will go further and be worked harder – and be more effective.

Draw attention here to the new report published by Esmee Fairbairn Foundation, *Foundations and Social Investment*[2] – which has the sub-title "making money work harder in order to achieve more." Worth spending time with as it sets out the spectrum of funding possibilities clearly and includes descriptions of SI in practice, including details of some of the specialist intermediary organisations that have been set up in recent years – for example, Charity Bank, Venturesome. The report also discusses MRI – what it calls 'Investment Plus.'

2. Funder frustration – realisation that publishing long lists of the activities they had funded – of the outputs – told them nothing about whether the ambitions that had led them to provide the funding had been met. Has it worked? What are the outcomes? What's changed? What is the impact?

   Understandable frustration at the lack of data or measurement – however, I believe that this frustration has led on too occasions to the imposition of funder dictated monitoring and evaluation systems which can be both clumsily inappropriate and resented – a further burden on already heavily pressured workers or volunteers.

   Far better, to my mind, for a funder to recognise that clarity of purpose and outcomes – and systems for keeping tabs on progress and adjusting plans to take account of learning as you go along – are all about good management. Help ensure the organisation that you have chosen to help has the knowledge, skills and time to appraise and make sense of its own work – and can apply the lessons learnt to improve the prospects of achieving the mutually desired outcome. It will be a better investment if effectiveness is the goal.

3. That ties in with the third factor – the growing recognition that a bit of funder modesty does not go amiss! It is not the funders who deliver the services that

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[2] Bolton, Margaret *Foundations and Social Investment – making the money harder in order to achieve more* Esmee Fairbairn Foundation, October 2005

change people's lives for the better or that protect those who are vulnerable or exploited – it is the organisations that they fund who do that; the funders are dependent. It is in their interests to ensure that the organisations that they choose to support in order to realise the funders' mission are as well equipped as possible to deliver the service or development.

So – invest in capacity, in strengthening the organisations, in helping them build up working capital and assets. Again – a more effective use of charitable funds.

Perverse Funding
And that touches on another key factor generating change among funders – the recognition that quite a lot of funder practice does harm!

A plea to all funders: do no harm! Some grant-making systems have perverse outcomes, they can weaken rather than strengthen the organisations that they are intended to support.

A growing number of funders do now accept that grantee organisations can be subject to costly, mission distorting and financially disabling action by grant-makers – and those funders are re-thinking their practice to prevent that happening.

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The way many grants have been 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 Jed has described[3] 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

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

(probably limited) resources or to run the project knowing that it does not have sufficient funds to do so. The case for full cost recovery relates to grant funding as well as to contract funding.

4. *No Incentive to Outperform*

The restricted grants culture that has become so dominant ties the use of donated 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.

This perversity was well summed up in one of the quotations from grantees used by Julia Unwin in The Grant-Making Tango[4]:

> "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."

So What?

In this seminar, we are meant to be asking the question – so what? If some parts of the 'supply side' funder landscape are changing – then the most immediate 'so what?' is to assess if the 'market' is up to the challenge? So what are the challenges to the fund-seekers? Here are four – I'm sure you will have others:

1. First challenge, do not collude with perverse funding – challenge short termism; refuse underfunding; show how poor funder practice will do a disservice to the individuals, groups and communities the funder claims to want to help – it's surely a breach of trusteeship to do otherwise?

2. Ensure that the financial/business plan for a proposed development draws on different types of funding – demonstrates the need and justification for full subsidy if it is required, but also makes maximum use of other forms of finance where possible and without putting the whole enterprise at unacceptable risk (This is not wishful thinking – we now have examples of charities undertaking capital

[4] The Baring Foundation 2004

developments who, by building a proportion of debt into their funding model, will be able to complete the new development quicker and more cheaply than if they had relied on a traditional charity capital appeal from donations)

3. Be ahead of the funders on outcomes – demonstrate to them that you have already thought through how to set out clear outcomes and ways of measuring progress towards them that mean you can also provide the funder with the information and lessons learnt that will meet not only their concerns about the public value and social impact of their funding – but also help them be better informed and influential in the future

4. And challenge the tendency for funders which are simultaneously supporting the same project or organisation to insist on individual (and probably different) reporting systems and timetables – engage with them jointly with a proposal for a reporting template which meets all their needs and is manageable for (even helpful to) you.

If funders want to adopt better practice, to become more strategic, more long-term in their commitments, to work more like investors – then action by fund-seekers can have a huge impact on helping realise those aspirations. Such action can also help overcome at the same time some of the problems with funders that the VCS – with some justification – complains about.

A win-win possibility.

Of all funders of the VCS – except individuals, perhaps – endowed foundations are the most privileged. They have real independence – no harassment from the Daily Mail or interrogation by the Public Accounts Committee.

Trusts and foundations, as independent operators, can:

- do wonderfully imaginative and creative things
- take risks on maverick individuals
- provide essential seed capital for clever and original social entrepreneurs and enterprises
- support noisy advocates
- be patient and long-term in their support for people and organisations.

They can be genuine risk takers and can afford to back some brilliant ideas that despite best efforts go spectacularly wrong.

The "market" can help encourage foundations to live up to the opportunities provided by their independence – they can ensure that the propositions they take to foundations are the ones:

- that push at the boundaries
- that are unfundable by other, more constrained funders
- that encourage the foundation to join in an adventure

- that can link practical achievement and learning gained at a local level to policy recommendations and advocacy nationally
- that can make charitable funds stretch further, work harder – and, if possible and all goes to plan, be recycled.

End – before the discussion begins – with a couple of quotes to demonstrate that not all the things that Jed and I rant about in our respective continents are new:

- First, from USA, where, many decades ago, Rockefeller argued: "foundations can undertake the imaginative pursuit of less conventional charitable purposes than those normally undertaken by established public charitable organizations."
- And then, from here in the UK where the settlor of the Nuffield Foundation observed: "Those responsible for the disposal of private funds have a healthy duty imposed on them to accept risks which cannot be proper to those accountable for the tax payer's money; they should venture those funds for experiments about whose success there may be some measure of doubt."

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