Enterprising charities

Transitioning from grants to trading

CEO Roundtable

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Venturesome is a social investment fund, an initiative of the Charities Aid Foundation (CAF). Venturesome provides capital to civil society organisations, operating in the space between providers of charitable grants and providers of bank loans at market rates. Since launch in 2002, over £12.5 million has been offered to some 200 organisations. In addition to accumulating practical deal experience, Venturesome has endeavoured to have a central role in building a robust social investment market, adopting an open-book approach to share knowledge and build experience, but also ready to operate in competition so as to raise standards.

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Introduction

Venturesome has worked with a number of charities and voluntary organisations seeking to make the transition from grants to trading. It has helped some of these charities by providing a range of financing (including underwriting, unsecured lending, and quasi-equity). This financing has enabled these organisations to develop new income-generating products and services.

This short paper summarises Venturesome's learning from this work. It is based on a recent discussion with a small group of Venturesome investees.

Shaping the debate

Charities and social enterprise are not mutually exclusive

An increasing number of charities are using entrepreneurial ways of working to solve social problems. This often means that they derive income from trading. Some seek to distinguish charities, regarded as grant dependent, from social enterprise proper. However, this characterisation does not reflect reality – not least because many charities have always traded in pursuit of their primary purpose: for example, a charitable arts organisation which relies on selling tickets for performances.[1]

Resilience, not sustainability

The funding environment is clearly becoming harsher for charities and other voluntary organisations:

- because of increased competition for grants
- as public sector agencies move from grants to contracts, often with a competitive bidding element

The response in the charitable and voluntary sector has been to focus on sustainability - described as an approach *'which encourages organisations to explore opportunities for diversification across a spectrum of opportunities from charitable donations...through grants, service level agreements and contracts to social enterprise activity.'*[2]

1 For a discussion about how to categorise social enterprises, see '*The 3 Models of Social Enterprises*', Paul Cheng and Joe Ludlow (2008), CAF Venturesome

2 Sustainable Funding Project – www.ncvo-vol.org.uk

Working to achieve sustainability therefore means seeking to develop a range of income streams including, but not exclusively, trading income. Income from trading surpluses is particularly prized because it is unrestricted and considered to be a more predictable income stream than grants or donations (which are assumed to be more dependent on variables outside the control of the charity). Whether or not this is in fact true is the subject of the debate below.

Furthermore, the term 'sustainable' has come to have an unfortunate connotation. It is often taken to mean the holy grail of 100 percent trading income. This ignores the fact that for most charities and voluntary organisations, including those that are socially enterprising, grants are, and will continue to be, an important part of the funding mix.

Grants fulfil a variety of functions, for example, enabling organisations to:

- develop and test new innovative or unproven services
- meet initial deficits as a service develops to capacity
- build organisational capacity (for example, consultancy help with business planning or board development)
- provide services which are not a priority for the public
- move on to the next stage of development: for example, replicating a service that has proven its efficacy in a particular area

From our perspective, '*financial resilience*' is a better descriptor than *'sustainability'*. It suggests organisations that are better able to withstand financial shocks: for example, a major funder withdrawing a grant. It also suggests that gaining financial strength, progressing towards a healthy balance sheet, and securing an appropriate level of reserves is difficult and on-going, rather than a one-time fix.

Improving financial resilience is, in our experience, an on-going struggle, *'a journey rather than a destination'*.[3] It is important in this context to dispel a myth – it is sometimes assumed that trading income is more secure than grant or other public sector income, but it is not. The private sector knows only too well that the market is fickle; purchasers can decide to change their habits. Fashions may change, and businesses may fail as a result.

One of the Venturesome investees describes the situation very well:

"One of the issues I am trying to convince my board of is that there is no guarantee of 'sustainability', even with a diversified income base, but at least the odds are better than if we were 100 percent grant dependent."

3 *Sustainable funding: a basic theoretical introduction*, Nick Wilkie for Civicus, Jan 2006

Venturesome's learning

Developing different sources of income

Charities and voluntary organisations are more resilient if they have a range of different funding sources across the spectrum from the philanthropic at one end to the commercial at the other[4]:

Donor	Funder	Purchaser	Consumer
Individual giving	Grants	Contracts	Trading[5]
Unrestriced	Restricted	Restricted[6]	Unrestricted

This has a number of advantages – including helping organisations to:

- weather particular difficulties, for example, Government policy and therefore funding programmes change emphasis, or a local authority decides to de-prioritise a particular service and therefore stops contracting for it
- achieve a balance between income that is restricted, for example, tied to the delivery of a particular level of service and income which is unrestricted, for example, members' subscriptions

Unrestricted income is, of course, particularly valuable since it enables organisations to invest in building their own capacity (something that most funders remain reluctant to support) and to develop initiatives which, while valuable, do not match funders' priorities.

Venturesome has provided a range of financing to help organisations diversify their funding for example, providing:

- underwriting to give a charity confidence in building a new funding stream based on individual subscription
- development capital to enable a charity to appoint appoint a fundraiser
- quasi-equity enabling a charity to develop and market a new product to local authorities

This is not to say that the process of diversifying income streams does not generate its own particular challenges – for example, organisations have to manage an ever more complex range of diverse reporting, monitoring and evaluation requirements. Developing trading initiatives also raises legal and regulatory issues which charities need to consider.[7]

4 Based on material produced by the Sustainable Funding Project.
5 In this paper references to charity trading cover both contracts and other trading in the market.
6 If a surplus is made on the contract price, then this will be unrestricted income.

Identifying what to do

Organisations often need help in developing appropriate trading strategies. This work is significant for a number of reasons not least because:

1 sometimes organisations find it difficult to conceive that individuals or groups might be willing to purchase their services – services have generally been developed because of a passionately held view that they are needed without regard to whether anyone wants to pay for them

2 increasingly, charities and voluntary organisations believe that they should be socially enterprising and should be developing new trading activities regardless of whether they have the experience and skills to do this successfully

A key question for charities developing their thinking on this issue is – how is trading related to, and how will it impact on, the organisation achieving its mission? Sometimes the trading activity that the organisation wants to develop is mission-related; sometimes it is unrelated but designed to generate resources to support the mission. Well-known examples of the latter are charity shops.

Generally, organisations should prioritise trading activities which are most closely aligned to organisational mission and the organisation's current activities, knowledge and expertise. Taking a punt on new and largely unrelated trading activities is much more risky and involves investment which will not contribute directly to mission. Venturesome and other funders often play a role in helping organisations think through their finances and develop appropriate and feasible trading activities.

An important factor to note in this context is that not every charity will be able to generate mission-related trading income. Some, because of the nature of the service they provide and/or the beneficiary group they work with, are unlikely to be able to trade successfully, and will continue to be largely dependent on grant aid: for example, a small community group running a drop-in centre for homeless people.

7 If a charity intends to develop significant non-primary purpose trading activity – it will need to set up a trading subsidiary which covenants profits backs to the charity

Time and patience

It takes much longer to develop income-generating ventures than is normally assumed. Organisations need to go through an iterative process likely to involve all of the following stages:

- ideas generation
- interrogating ideas and refining options – which may include some crude financial modelling of their likely implications for income and expenditure
- market research to test the feasibility of a particular option
- developing an operational plan
- piloting the project
- development and implementation
- successful generation of a surplus

It can take months, or even years, to generate a surplus – this reflects the experience of commercial entrepreneurial ventures.

Sometimes charities and voluntary organisations try to move straight to the stage of development and implementation, without having done the necessary ground work. Initiatives developed without much preparation and research may of course succeed, but are generally less likely to do so (alignment with mission will obviously be a key success factor in such circumstances).

Trustees and key staff need to 'buy into' the approach – obtaining their support takes time and generally negotiation. Also, where organisations are pursuing development work in a systematic way, it may have to cease at a key stage, say, at the stage of market research or piloting because the organisation does not have reserves and can not otherwise access resources to pursue the work.

Fickleness and slow decision-making by purchasers can also make the process time consuming and difficult. Even after a local public spending body has made a firm commitment to purchase a service, many months can elapse before a contract is signed.

Developing new income-generating ventures also takes considerable time and patience because it requires organisational change – in some instances, quite fundamental organisational change.

Change of organisational culture

Making the transition from grants to trading often means changing the ethos of a charity.

For example:

A charity, which provides information and advice on environmental issues, had developed a consultancy service for companies on how they might develop and implement environmentally friendly policies. The key challenge for the organisation was to shift the culture and values of employees working on restricted grant projects. Many of these staff were focused solely on the specific targets contained within grant conditions. They tended not to look at other opportunities for working with partner organisations that could potentially generate consultancy income and increase mission impact. Changing their outlook and the culture of the organisation has taken time - for some staff it represented too big a shift; they decided to leave because they felt uncomfortable with the organisation's new way of working.

This example also illustrates the point that different skills sets are needed if a charity is to successfully generate trading income. In this case, staff are required to be entrepreneurial and to proactively generate consultancy opportunities.

The CEO of the charity commented that:
"Our board of Trustees has embraced the need to secure more consultancy income and has started discussing bonus-related pay for staff who generate such income. While this would probably help secure more money for our charitable work - it could have a detrimental impact on morale and working relationships. This illustrates that having a wide variety of income sources creates tensions that need to be managed."

The capacity-building challenge

A major challenge in developing new income streams is to keep 'all the balls in the air at once' – organisations struggle to keep current projects afloat and existing funders happy while they explore and pursue new funding options. A key issue is how much pressure staff in the organisation, particularly the chief executive, come under when developing a trading strategy:

"the normal work load in a small to medium-sized charity is always heavy, but when you couple it with the extremely steep learning curve that trading demands and the array of new work, which is usually not accompanied by new or trained staff - well, the work becomes virtually never ending and the risk of burn out is very, very high."

Developing trading income generates its own particular capacity-building challenges, for example, it requires charities and voluntary organisations to:

- understand their finances much better than they may have done previously, not least because they need to know the real cost of products or services in order to price them
- become skilled in marketing their services to a range of potential purchasers – often charities and voluntary organisations do not have the right marketing experience - applying for a grant is very different to selling a service in a competitive market

Much of their income is likely to be restricted and/or they may lack reserves and/or trustees may be cautious about investing in work of this kind. This makes it very difficult for charities and voluntary organisations to find the resources to develop their capacity to generate income.

The role of funders is key, as a Venturesome investee said:

"I'm interested in funders being brought more into the discussion - how do we all come to the table to validate the need for more core investment ie investment which develops the capacity of organisations, including the financial resilience, to achieve social impact?"

In summary, it's harder than people think….

The general theme of this paper is that it is harder, and takes longer than is frequently assumed, for charities and other voluntary organisations to successfully diversify their income base - including the development of trading income.

This is not to argue that it is something that charities and voluntary organisations should not do – on the contrary, it is necessary to the survival of some, and key to the financial health of others; rather it is to say that it often demands more capacity building and financial support than is generally recognised.

Building financial resilience is crucial to achieving social impact over time and requires insight and hard work by charities. It also requires a new approach from funders so that thoughtful, relevant funding is provided.

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