

First meeting of the Funding Commission
5th February 2009, 6pm onwards, The Reform Club, 104 Pall Mall, SW1Y 5EW

1. Introduction

This marks the first of five meetings of the Commission throughout 2009. The first meeting will take place over an informal dinner and will provide an opportunity for Commissioners to:

- meet each other;
- discuss the draft work plan and terms of reference;
- discuss the session on the Funding Commission at NCVO's annual conference.

This paper provides background information to inform the discussion. It contains:

- Draft work plan
 - terms of reference;
 - scope of the Commission's task;
 - activities of the Commission;
 - critical success factors;
- Outline of the workshop at NCVO's annual conference;
- First think piece (Annex A)

2. Work plan

Following NCVO's announcement that it would be launching a Commission, we developed a draft work plan, as follows:

2.1 Terms of reference

The Funding Commission aims to set the agenda for the funding of the voluntary sector in the next decade. The Commission will look ten years into the future and ask, what are the opportunities and challenges for VCOs in relation to their funding (what new sources could be developed, how can the sector make better use of existing resources, what new skills, models or tools are needed?).

Its objectives are:

- To set a new agenda for the funding of VCOs in the next decade by publishing a report outlining the key issues and making a set of practical recommendations;
- To raise awareness and understanding of the future funding issues facing civil society among VCOs;
- To engage with funders and policy-makers to ensure they understand and are supportive of its findings.

2.2 Scope of the Commission's task

The scope of the Commission's work is potentially huge. To ensure that the task is manageable, the following six issues have been identified.

The diversity of the sector

Current funding issues vary widely for organisations depending on their stage of organisational development, geography, asset base, cause, and size – to name but a few of the key factors. It would be unrealistic to attempt to explore the implications of funding issues for the full range of different types of organisations that comprise civil society. However, the diversity of the sector and the implications for funding needs to be acknowledged through the

range of experience of the Commissioners and the evidence presented, and also through the range of topics or questions considered by the Commission (for example, not all topics will be relevant to smaller or rural organisations so we might want to ensure some of the areas covered are pertinent).

Setting the agenda, not offering support

The Commission will make practical recommendations, which could inform capacity building and public policy activity, but it won't seek to create practical tools itself.

Focussing on areas of growth and opportunity

Funding is a potentially vast subject including, as it does, public grants (from Treasury and Lottery sources, channelled via central and local government structures), contracting with the public sector to deliver services, trading or social enterprise, and fundraising from individuals, corporates and Trusts and Foundations. Within each of these broader income areas there are many specialised issues ranging from Community Asset Transfer through to legacies or online individual giving. Therefore, it is proposed that for the Commission's work to be of greatest use, when considering individual sources of funding rather than funding practice, it should focus on those potential areas of significant change or growth in the coming decade, rather than aim to provide a comprehensive survey of all funding options.

Building on success, not preaching to the converted

In the past five years there has been much attention – and some progress including the Compact Funding Code – on ways in which public funding, whether through grants or contracts for services, can better meet the needs of VCOs. The 2005 NAO¹ and NCVO² reports set out clear recommendations to government, and the voluntary and community sector, as to what needs to happen to improve the funding relationship. Therefore it is proposed that the Commission does not need to revisit these issues, but rather focuses on new issues likely to arise in the next decade. The Commission will need to be careful that grant funding and public service delivery don't dominate the agenda to the exclusion of other issues.

VCO skills and knowledge

Whilst the Commission will focus on the external funding environment for civil society, it is also important to consider the internal changes VCOs will need to make to be able to position themselves in relation to these challenges and opportunities. Therefore it is suggested that the Commission considers the future development needs of VCOs. However, we do not intend the Commission makes recommendations about how best to meet these needs as this would begin to overlap with CapacityBuilders' remit and require both mapping and quality assessment of existing provisions – which the Commission is not equipped or resourced to do.

Geographical scope

The Commission will focus on England.

2.3 Activities

Now that Commissioners are in post, we have identified four remaining phases of activity.

Research (Feb-April)

We have appointed Emma Weddell, an ESRC student, to conduct some desk based research. She will begin on 9th February for a three month period.

¹ National Audit Office (2005), *Working with the Third Sector*, London: The Stationary Office

² Bhutta, M. (2005) *Shared aspirations: the role of the voluntary and community sector in improving the funding relationship with government*, London: NCVO

Consultation with the Sector (timing tbd)

1. *When to consult*

The Commission has two options:

- To consult the Sector now to identify key themes. The Commission would use the findings from this to choose which areas to analyse in greater detail later in the year.
- The Commission identify key themes and ideas now and use the consultation stages to test out and refine ideas.

We suggest that the second option may be more useful given that many of the funding issues are already known to us and could be pulled together through the research element. Consulting at a later stage would also help reduce the likelihood of receiving an array of responses on issues the Commission do not want to focus on.

2. *How to consult*

We suggest three modes of consultation:

- Two or three facilitated consultation events;
- Three think pieces by funding experts on funding challenges and opportunities. We commissioned David Carrington to write the first piece (Annex A);
- Invitations to submit written evidence.

Whilst VCOs feel strongly about funding issues they are not always aware of their own funding options or needs, as recent research publishing by Venturesome indicates.³ Therefore, it will be important to frame the consultation in a way that helps VCOs articulate their needs, and acknowledges they may not always have the language or analysis to express their needs clearly. This is why we are proposing the 'think pieces' to fuel debate and having a series of facilitated face-to-face meetings, alongside more standard consultation tools.

Analyses (timing tbd)

Once Commissioners have identified key themes to work on, we propose that invitation only evidence sessions are held to enable Commissioners to explore issues in greater depth.

Final Report and dissemination (Sept-Dec)

In order to continue to stimulate interest and engagement throughout its lifetime the Commission will share its findings as it goes along – through feedback from consultation events published online (or covered in media) and through its own website. Commissioners will also have a role in disseminating findings and promoting the Commission's work amongst their networks.

The consultation events, particularly the invitation-only events later in the process, will also be opportunities to share findings on a more peer-peer level with key stakeholders and to engage them in a discussion about practical ways forward.

The final report will be completed by December 2009.

³ Venturesome (2008), *'Financing Civil Society: a practitioner's view of the UK social investment market'*, London: Charities Aid Foundation

2.4 Critical success factors

- For the Commission to attract participants and reach its intended audience it will need to have a high profile within the sector. Louisa will work with NCVO's communications team to ensure that the Commission attracts media coverage.
- The Commission will need to engage effectively with funders and policy stakeholders as their recognition of the agenda will be critical in ensuring the necessary changes in the funding environment.
- We need to ensure that VCOs see the Commission as representing their interests, understanding their needs and being responsive to them so that they contribute to the Commission and are receptive to its recommendations.
- Funding is perhaps one of the most complex issues for VCOs, with many specialist organisations involved in trying to shape the debate. Therefore, for the Commission to have maximum impact it needs to involve other stakeholders. It also needs to think carefully about the scope of its activities so it does not dilute its efforts.
- The work of the Commission needs to be evidence based

3. Session at NCVO's annual conference

NCVO's annual conference takes place on 18th February 2009. One of the workshop sessions will be on the Funding Commission. The session has proved very popular with 85 delegates registered to attend. This presents a very good opportunity to engage and enthuse people in the work of the Commission.

The proposed outline for the session is:

- Ten minute opening from Rachel during which delegates will hear about the Commission.
- Short presentations from Toby Eccles and Brian Horner to offer funding challenges and opportunities from their perspectives.
- In the remaining hour a facilitated discussion will follow on the question

“What are the questions that the inquiry should be asking that might unlock some new ways of thinking”?

In doing this, we hope to provide a meaningful opportunity for delegates to inform the Commission's work and to feel part of the process.

Policy Team, NCVO
January 2009

Annex A – Think piece by David Carrington

FUNDING COMMISSION

Funding Challenges and Opportunities for VCOs

Introduction

This paper is a response to a request to prepare a ‘think piece’ for the Funding Commission which focuses on “where the money is likely to come from for voluntary and community organisations (VCOs) over the next ten years and the opportunities and challenges that exist.”⁴

Predicting financial futures is never easy; the more so:

- For a sector in which:
 - 0.2 of the 164,000 general charities consume 42% of sector’s income; 2.2 receive 72%; and 55% share just 0.9%
 - the 2.2% with an annual income of more than £1M share 83% of individual giving and 91% of legacy income
 - the volatility of income year on year is such that 22% of those charities with an income of less than £1m experienced income changes in excess of 20% between the two most recent years (Of the 353 charities with an income in excess of £10M, the comparative proportion was 5%).
- In a week when thousands of jobs are being cut in banking and retail, car plants are stopping manufacture for several months, unemployment is forecast to pass 3 million, property values continue to slide and the day’s headlines report a recession induced “surge in burglary and robbery.”
- At a time when some commentators on the charity/VCO sector state with deep certainty that “charities lose faith and hope” and face a “bleak” future. And when the press carries stories that:
 - local charities are being forced into liquidation because of cash-flow or borrowing difficulties or because they cannot afford revised pension contributions
 - endowed foundations are reported to have lost 30% or more of the value of the assets from which they generate the income they use to make grants to the sector – and now face a new year when record low interest rates and no or low dividend payments will impact severely on their income
 - individual donors (small and big) are quoted as “scaling back” or “pausing” their philanthropy
 - companies are sharply reducing CSR and related activity
 - local authorities are reported as cutting back on ‘discretionary’ and ‘non-essential’ funding – including grants for local community activity
 - public sector ‘purchasers’ are reported to be under increasing pressure to pay as little as possible for services they contract with VCO providers
 - prospects for the next public spending round are said to be grim – and fears remain that saving the Olympics budget will eat further into funding that would otherwise have gone to VCOs

⁴ As this is a ‘think piece’, an opportunity to set out a personal perspective on future funding, I have not provided comprehensive references. Inevitably, it also draws on previous (and longer) reports to which I have contributed and to which the Commission may wish to refer; for example a previous paper for NCVO [Financing the Voluntary and Community Sector - Future prospects and Possibilities](#), published within *Voluntary Action: Meeting the Challenges of the 21st Century*, 2005 and [New and Alternative Financial Instruments](#), jointly authored with Margaret Bolton for [Mission, Models & Money \(MMM\)](#), 2007.

- and so on...
- While other commentators assert no less vigorously that “fatalistic comments may serve only to undermine confidence and deepen any recessionary impact on giving – reports of dramatic falls in charitable giving are overblown and potentially self-fulfilling.” “If the sector considers itself so easily expendable, why should others disagree?” And the press carries many positive stories indicating that VCO funding will hold up and may continue to advance:
 - “top donors step in to bail out charities whose services have been hit by the recession” – “pledged gifts remain firm”, with many leading individual philanthropists “recognising that it is during this time of financial crisis that charities need their support most”
 - endowed foundations protected their wealth during 2008 by substantially reducing exposure to equities and some have also put liquid capital into dollars and euros for the time being – they expect to maintain levels of support to the sector and are proactively discussing immediate financial needs with VCOs that they consider to be a priority
 - companies – especially in financial services – anticipate having to win or renew a ‘licence to operate’ from the public and plan to restore or even increase their profile in community support
 - new (and some long established) individual donors are looking for ways of adding to their philanthropy by joining the growing social investment market through which they ‘do good’ but should also get their money back to use again for further public benefit
 - greater willingness to establish ‘funder collaboratives’ within and across funding sectors (e.g. the Bridges/NESTA Social Entrepreneurs Fund) or to syndicate funding opportunities
 - public sector procurement practice is finally improving as training and experience grow – purchasers increasingly recognize that paying the proper price is the only way to be sure that quality services will be delivered
 - central government (and some ‘public’ funders such as NESTA) is still actively exploring new ways of adding to the ‘menu’ of finance available to the sector and is now alert to the need to help tackle the under-capitalisation of so much of the sector. Opposition parties are also engaging in similar debate. Moreover there are indications that there is some political willingness to revisit some proposals for tax relief/incentives that have previously been rejected.

Generalisations about ‘the state of the sector’ – from all quarters – are easily made but are seldom based on more than just a few anecdotes, not on evidence from across the sector⁵. Three, however, are probably correct:

1. Uncertainty is widespread – among VCOs and the organisations and individuals which support them. Uncertainty breeds short-termism and ‘straw-clutching’ and can paralyse long-term strategic planning and development.
2. Many VCOs will respond to the impact of recession by trying to do more to support the individuals and communities that are the focus of their mission – to try and do more without having access to more resources, probably weakening further their already overstretched revenue finance and risking what limited reserves they may have built up.

⁵ This reinforces the current value of the work of researchers within the sector – for example the briefing on the impact of economic downturns on the VCO sector prepared by NCVO Research for the first Recession Summit (24 November 2008): [http://www.ncvo-vol.org.uk/uploadedFiles/NCVO/What_we_do/Research/Background_paper_for_recession_summit\(1\).pdf](http://www.ncvo-vol.org.uk/uploadedFiles/NCVO/What_we_do/Research/Background_paper_for_recession_summit(1).pdf)

3. No two parts of the VCO sector (or organisations within each) will be similarly affected – some organisations will die, some will (just) survive, and some will thrive.

While efforts to ameliorate, where feasible, the savagery of the impact of recession on the work of the sector and the communities with which they work are clearly essential, the aim of all involved in trying to strengthen the role and the quality of the future work of the sector must surely be to increase the proportion of organisations in the 'thrive' category – to help build organisations that are financially and organisationally resilient, that focus all their resources effectively on their core mission, that are able to withstand the impact of sudden and/or short term changes in income.

This paper argues that, though some of this aim will be realised through the development of new income streams and funding innovations, a vital key to building a positive future lies in transforming the 'behaviour' of both funder and funded – and, in particular, of addressing the perennial weakness of the balance sheets of so many VCOs.

The sector has been described elsewhere as “undercapitalized and overextended.” The recession is likely to further expose and exacerbate that situation. But those problems existed before the beginning of the recession. They will remain after the economy recovers unless they are at the centre of the focus of all efforts made to address the future funding of the sector.

It is my view that the challenge facing those who seek to build a stronger, higher performing and more financially resilient VCO sector is not only to maintain and, if possible add to, existing levels of funding, but to transform the ways that finance is made available and managed.

The attitudes and practice, the 'behaviour' therefore, of both funder and funded (internally and towards each other) are at the heart of building new hope and opportunity within the sector and the communities with which they work.

Key Issues for the Commission

This analysis of VCO funding leads me to outline below three particular issues for NCVO and the Commission that I believe should be at the centre of their attention:

1. How to transform the 'behaviour' of the participants on both 'sides' of the sector's funding market place.
2. The urgent need to ensure the focus of VCO funding is more evenly balanced between addressing revenue income needs and the strengthening of VCO balance sheets.
3. The continuing need, even at a time of uncertainty, to innovate and explore new ways of bringing resources into the sector.

1. Behaviour – of all 'players' within the 'market'

The financing of the VCO sector constitutes a market⁶ of many different transactions between VCOs (the funded), and the many and various sources of funding to which they look for support. As the Sustainable Funding Project at NCVO has demonstrated,⁷ the VCO income 'menu' is a spectrum of different types of funder – giver, project grant-maker and purchaser. There is a great diversity of motivations, aspirations and ways of working between

⁶ In her exploration of 'The Intelligent Funder', Julia Unwin makes an important distinction between the 'funding economy' and the 'funded economy' which the Commission is likely to find useful:

<http://www.civicassembly.org/upload/File/Intelligent%20Funding%20Background%20Paper.doc>

⁷ <http://www.ncvo-vol.org.uk/sfp/?id=2090>

and within each type of funder. The effectiveness and efficiency of this market is shaped by the participants – within both supply and demand, funder and funded.

For such a market to operate successfully – and to the satisfaction of both funder and funded – it must be made up of well informed participants on both ‘sides’, who are understanding of each other’s motives (or mandates) and expectations. It will always be important for the funded organisations to communicate to their funders the passion for their cause that drives their work – but it also vital if transactions are to succeed that VCOs can be as good at demonstrating and communicating the quality and outcomes of their work and the impact of their efforts to be advocates for – and with – the communities with which they work.

At this time, too, of increasing financial hardship within many already poor or excluded groups, it is likely that most funders, faced with additional pressures to ration their spending, will be keen to see that the VCOs they support have reviewed their work to give special attention to those within their target communities who are most vulnerable to the impact of the recession – through increased poverty and financial exclusion, additional barriers to opportunity, or exacerbation of social divisions.

What would a ‘Successful Market’ Look Like?

A successful VCO funding market will be one within which, for both funder and funded:

- the funding is firmly mission focused – most funders are dependent on the funded to deliver their aspirations, but these aspirations (and their motivations), though overlapping, will not necessarily be identical. For such joint endeavour to succeed, both ‘sides’ need to understand what each hopes to see achieved, and to be clear about what each needs to do if their joint aspirations are to be realised
- the administration of the application, decision making and fund management processes are efficient and timely, and transaction costs are as kept as low as is possible – and are proportionate for both funder and funded to the scale and risks involved
- a primary focus is on how to ensure that funding strengthens the longer term prospects of the VCOs which are delivering the funded services, activities or products; to help them become more resilient and sustainable and, therefore, better able to deliver those services – and not one which only has regard to immediate income/expenditure (‘cash-in cash-out’) needs
- high and improving performance is not only encouraged but rewarded
- learning about what works and why (and what does not, and why) is generated and adequately resourced; and is, indeed actively pursued – by both ‘sides’ – and that real priority is given to the application of that learning in practice so that transactions and behaviour are constantly improved, that income streams are enhanced and diversified, and that VCOs know how best to invest in their own further development
- risks are identified and are kept under review as work progresses – and are retained by the stronger organisation where possible and shared when appropriate
- greater efficiencies are always being sought – so that funded organisations are able to justify their fixed costs but also to keep them under constant review, reducing them where feasible without impairing quality or outcomes; and are also able to demonstrate why they believe that their chosen way of working is the most cost effective and efficient way of carrying out a particular function; and that funder organisations are looking all the time to be as proportionate and ‘light touch’ as possible in the processes they establish for accessing, deciding on and managing the funds they have available
- where it can be shown that the quality of outcomes and the cost effectiveness of funding transactions will be enhanced, opportunities to work within collaborations and joint ventures (between funders and between funded organisations) are fully explored – as a ‘routine’ not exceptional method of achieving a specific goal
- different types and sources of funding are well enough informed about each other and the ‘inter-connectedness’ of their interests, so that a diversity of complementary types of funding can be offered/accessed that enable funded VCOs to develop and operate an

integrated 'package' of income – which not only makes it possible for them to work towards the desired outcome with confidence but also to strengthen their financial resilience as they do so.

The Current Reality

This is not the current reality for many VCOs (and their funders). Many aspects of the present funding system are inefficient and wasteful. As many commentators have observed, there are perversities at the heart of many VCO funding transactions that can weaken the organisations the funder seeks to support. As another commentator observed, somewhat ruefully: "Funders often give the wrong type of money."

There have, however, been many improvements in recent years in funder practice and in the quality and extent of information and capacity building services that are accessible by both 'sides'. There have also been encouraging signs of funders engaging increasingly and purposefully with each other and with VCO sector organisations in order to develop more effective programmes and processes.

Despite the resistance of some VCOs to unfamiliar forms of funding like contracts or loans, it is not the ingredients of the funding system that are inappropriate – their implementation and management can be; hence the emphasis in this paper on the 'behaviour' of funder and funded. At worst, much present funding practice can fail to achieve the aspirations of both 'sides' of the transaction because some funders continue to:

- expect the funded VCO to achieve complex project goals within a period of funded time which all involved know is not long enough for them to be attainable and/or to undertake a level of work so ambitious that both the applicant and the funder know it's not within the capacity of the applicant
- don't observe full cost recovery in grants or pay the correct price in contracts
- talk in terms of their grantees being partners, then impose terms and conditions which are entirely one way, without any mutual expectations; terms and conditions which require the volunteer boards of recipient organisations to take on unwise risks – while funders adopt for themselves risk averse and over complex assessment or tendering-type procedures; and also apply conditions which "add burden – not value", that are compliance fixated, focused on outputs and not on the quality of achievement
- impose transaction costs (on themselves as well as on those they fund) which are disproportionate to the scale of the funding and which use up an excessive amount of charitable or public funds
- agree short term project funding in circumstances where they know long term operational and organisational underpinning finance is what the funded organisation needs – indeed, is essential if the funder's own objectives are to be realised
- don't help VCOs prepare for or build up the resources needed to survive effectively beyond the period of their funding.

One commentator has described this sort of funding practice as a "Dance of Deceit" – the funder may set the terms and processes, but the funded, fearful of there being no alternative, go along with them, accepting levels of funding and conditions that they know will probably impede progress towards the desired outcomes. Organisations seeking funding have always found that they have to reshape their description of what they are trying to do in order to meet different funders' enthusiasms and criteria – but these 'negotiations' can be taken too far and fund raising can lead to a distortion of an organisation's mission by "bending too willingly in whatever direction money is blowing."

Too often, too, funders complain that the organisations that they assist are less than fully open about progress, either 'gilding the lily' or failing to report problems. There are recent examples of funders hearing second hand of organisations they have been funding becoming insolvent. The behaviour of both 'sides' needs to be transformed.

Transformation – possible?

Does it have to be like this? No – funders can transform their ways of working to meet the standards for a ‘successful market’ set out on pages 4 and 5, for example:

- Small changes to a funder’s administrative procedures (e.g. making payments in advance, making payments in full without any report requiring retentions, imposing less compliance focused restrictions) may ease transaction management burdens, especially on smaller and financially weaker organisations, and will also be a tangible demonstration of greater trust by the funder in the funded.
- Funders can also engage directly with funded organisations when reviewing their own practice – the consumer perspective is likely to provide especially important learning.⁸
- Funded organisations can adopt ways of working and ‘relationship building’ with their funders (of all kinds) and of reporting to them which are more transparent and which will help with such transformation.
- Both ‘sides’ can adopt a more patient and long-term approach to what they are trying to see achieved – and be more realistic about and mutually determined to identify and meet the capacity needs a VCO may have to address if it is to undertake a task which both aspire to see tackled.
- Funded organisations within a single funding programme can also collaborate with each other and with the common funder so that all learn from each other’s experience.
- Organisations that provide information and guidance to VCOs seeking funds can help them develop ways of preparing and communicating financial and organisational plans that will assist funders that wish to follow Joseph Rowntree’s entreaty that funders should always try to “strengthen the hands of those that do.”

Amidst current concerns about the maintenance of priority services and the survival of established VCOs, it is vital for funders and funded organisations to keep the ‘health’ of the longer term funding environment at the centre of attention. It will – as was demonstrated by the recent ‘Recession Summit’ meeting that NCVO convened – be necessary to give priority to some short term and crisis interventions, but, even when so doing, the interventions should be constructed to have positive long term potential and help overcome some of the more dysfunctional features of current funding systems.

2. Capital Funding⁹ – Strengthening Balance Sheets

The focus of most VCO funding transactions is short- term income/expenditure that is often restricted to a specific project or task. Even three year funding hardly scratches at the long term challenges and social complexity that much VCO effort is designed to address. If a funder believes that a specific VCO is best placed to deliver a service or actions that it wishes to support, then a primary focus should, surely, be on ensuring that the VCO is capable and sufficiently resilient to take on the task. The reluctance of so many funders to encourage VCOs to build up levels of unrestricted reserves works contrary to this simple objective.

The weakness of the unrestricted reserves of many VCOs (and the reluctance of so many funders to help them address that weakness) creates a vicious circle – the VCO has little or no capital of its own to invest in enhancing its work or in generating new resources; it remains bogged down in a financially unsustainable or vulnerable situation. Inadequate

⁸ The successful development of the work of the Centre for Effective Philanthropy with foundations in the USA (soon to be extended to the UK) is a vivid illustration of this: <http://www.effectivephilanthropy.org/>

⁹ In this discussion of capital funding, I am not addressing ‘capital appeals’ – the focus of so much fundraising effort – ‘one off’ appeals for money to help with the costs of a new or refurbished building.

reserves weaken a VCO's ability to withstand periods of uncertainty – too many are routinely on the verge of insolvency. This weakness is made worse by the unwillingness of so many funders to pay the full 'price' for work they wish to see carried out. The successful market outlined on pages 4 and 5 is one within which VCOs would be able (and be encouraged) to build up unrestricted reserves and to strengthen their balance sheets.

The challenge of this is profound. It involves a significant shift in the 'mind-set' – not only of funders but also of the Boards and staff of VCOs. Funders who are actively trying to address this challenge report how difficult VCOs often find it is to set out longer term capital funding needs – the 'mind set' is locked into devising and presenting funding bids for short term projects. Many VCO Boards struggle to map out a coherent and convincing longer term financing strategy or to explore the potential value for their organisation of different types of capital finance, whether it be needed to soften cash flow volatility, to provide working or development capital or to introduce types of 'quasi-equity' funding.

Funders also struggle – Venturesome, in a recent report, described funders that seem unable to distinguish between the capital and revenue funding needs of VCOs they are being asked to support, or to analyse or stress test financial projections, or even to read balance sheets.¹⁰ Funders need better understanding of how small scale investments can add value to and strengthen the work of VCOs – the funders themselves, and not just the organisations they support, have knowledge and capacity building needs which have to be met if we are to see the emergence of a rational, cost effective and 'smart' funding environment.

NCVO could – through the Sustainable Funding project – and in partnership with others across the funding spectrum, be an even more important source of information about and celebration of the effective application of ways of strengthening the financial base of VCOs – information and practical experience designed to equip both VCOs and their funders with greater understanding and skills. For too long, I believe, funders and the funded have kept within their own silos; talking to their peers but not engaging sufficiently actively in direct discussion with all the participants in their market.

Building the balance sheet, for most organisations, means building up unrestricted reserves (and being 'allowed' by funders to do so) – so that they can 'invest in their own development' and the enhancement of their work and to provide a buffer enabling them to take on a higher level of risk than their often inadequate reserve levels mean is currently feasible. Some capital funding can also be made available to VCOs in ways which, assuming the purpose of the funding is eventually successfully achieved, enables some or all of the funding to be recycled subsequently – thus generating the means for further investment in the same or other VCO. Whatever the route to a stronger balance sheet, the VCO which has one will be better able than before not only to cope with sudden or short-term problems but also to enhance and develop its work.

3. Innovation – in the use of existing funds and in attracting and using new resources

Given the inevitable current preoccupation with weathering the impact of the recession, it is understandable if funders and VCOs should be tempted at the moment to 'default' to the familiar and the orthodox. However, much has been learnt in recent years about innovative ways both of adding to the funding 'menu' that can support VCO activity and of enhancing existing ways of making money flow through the VCO system. This continues to be a time for further testing and exploration. It is also a time when external developments (e.g. in IT and digital media) and global demands (e.g. climate change) demand or make possible further

¹⁰ Financing Civil Society: A Practitioner's Guide to the Social Investment Market, 2008: <http://www.cafonline.org/pdf/Venturesome%20-%20Financing%20Civil%20Society%20-%20Sept%202008.pdf>

changes to the working of the 'market' within which VCOs and their funders operate. For example:

- **New technology, digital and new media** – rapid change continues and many of these have direct or potential impact on the ways VCO and their funders manage their work, communicate with the wider public and possible partners, raise and use funds. On both 'sides' of the funding market, technological developments will provide further opportunities to streamline administration and reduce costs, to outsource or pool and share work more easily, to develop more integrated initiatives and joint ventures. These opportunities, the tasks involved in seizing them, and the results of so doing, need to be well documented – for funder and for funded alike.
- **New forms of finance** – new thinking within the sector is generating new possibilities, for example the Social Impact Bond, to 'stretch the funding menu' beyond traditional income streams and to explore ways of introducing new types of financial 'product' into the work of the VCO sector. In recent times, the development of some new VCO financing ideas has been too 'supply side' dominated. The innovators (and organisations like NCVO) need to ensure that both sides of the market are involved together in exploring and testing out these possibilities – otherwise, they can be too easily seen by VCOs as a threat rather than a potential asset to the funding menu and/or they may contain flaws that more 'joined up' planning could have avoided.
- **New uses of existing funds** – for example the use of funds that were previously provided to VCOs as grants which could be made available as forms of social investment so that the same funds can be recycled; and the deliberate use of a foundation's financial assets to invest in products and services that directly 'connect' to the charitable mission and values of the foundation that is making the investment. Current experiments on these sorts of opportunities in the USA and elsewhere in Europe need to be studied actively and applied, where appropriate, within the UK. These developments could also lead to a new understanding of 'fiduciary duty' by trusts and foundations which would have regard to the use of all their philanthropic resources, not just those that are directed explicitly at charitable purpose through grant-making. It is also possible that one consequence of the precipitous fall in the value of many foundation endowments will be to prompt some potential settlors of new endowed foundations (and, indeed, the trustees of some existing foundations which have expendable endowments) to consider adopting a 'spend out' (rather than an 'in perpetuity') investment strategy, thus releasing much more funding into the VCO sector.
- **Climate Change** – the VCO sector has been criticised for being slower than others to ensure that, in the ways that they work, VCOs implement feasible steps to reduce their use of energy of all kinds. It is likely to be increasingly important that VCOs, in approaching all types of funder, are able to show that they are actively engaged in so doing – and are investing time and effort in understanding the connection between the social and economic challenges facing the communities within which they work and the wider challenge of climate change. Funders, too, should expect to be asked to demonstrate the efforts they are making themselves to reduce their own energy use and also to make scrutiny of that a standard part of their 'due diligence' process when assessing requests for funds – and to provide funds to help the organisations that they support regularly to raise their own standards in reducing energy use.

Conclusions

Over coming years, in order to attract the funds they need, VCOs and the charity sector are likely to have to demonstrate even more than in the past that their work is high performing, well targeted and cost effective. Trustees of charities and Board members of social enterprises are also likely to be increasingly expected to review, periodically and rigorously, whether their continued existence is the best way of 'delivering' their charitable purpose or mission (Indeed, they should be asking that question regularly, anyway, without the need for any external prompting). If their financial resources could be better used by another

organisation with a similar purpose or by joint work or merger – then so be it. Funders should never force mergers on organisations – but opportunities for more effective service or mission delivery should never be secondary to a wish to ‘preserve’ the continued existence of an organisation that has been set up ‘for public benefit.’ Funders can facilitate that examination and process.

Changes to a funder’s practice need to serve their mission and purpose and to ‘add value’ – and not be made just to secure administrative convenience. The funding market is the healthier for having within it a diverse mix of differently motivated, independent organisations – and individual philanthropists and social investors who are willing to challenge the ‘orthodoxy’ and explore different ways of behaving. In the same way that it is too simplistic for pundits to argue that ‘there are too many charities and consolidation would solve lots of problems’, so too are arguments that funders should adopt standardised procedures or merge into ‘mega-funders’. There are many opportunities for effective collaboration – between similar funders and funders from across different sectors; there are ways in which funders could share some back office or web based functions; there are ways through which funders and funded could reduce the transaction costs resulting from their current ‘behaviour.’ But all such developments should be implemented in ways that help create a more informed, ‘better behaved,’ and more efficient and flexible market – among existing and new funders of all kinds and also among VCOs themselves. The common aim should be to work towards a funding environment within which the Boards and staff of a VCO can think of their organisation as “assets to be nurtured and less as a cost stream which has to be subsidised” and in which funders of VCOs always have regard as to how they can not only help to enhance the quality of the services or activities which are delivered with the support of their funds, but also strengthen the longer term potential of those VCOs.

In preparing this paper, I have followed the request of those who commissioned it and not concerned myself much with future prospects for statutory funding – except where the ‘behaviour’ of local and central government departments and related ‘agencies’ can help build a ‘successful market’ of the sort discussed on pages 4 and 5. However, government has also got a potentially powerful role in encouraging and supporting the priorities set out in this paper. The Office of the Third Sector, for example, can, through its own work, its dealings with other government departments, and in the deployment of its own funding, evaluate, celebrate and reinforce the emergence of a transformed and strengthened VCO funding market.

I hope that the Funding Commission (and NCVO in its subsequent advocacy of the Commission’s findings) will address and seek to work with both ‘sides’ of the funding market place – the funders as well as the funded – as it is the behaviour of both that has shaped the flaws and vulnerability of the present funding system. I hope that this paper has given some indications of the sort of ‘reshaping’ of the market and of the behaviour of participants within it that is needed – and also provided some confidence that building a financially stronger and more resilient VCO sector is an achievable aim, even at a time of recession and economic uncertainty.

David Carrington
January 2009