

Funding Commission: proposed themes for investigation

1. Introduction

Following the Commission's first meeting in February, we have been assessing the landscape to identify where the Commission would be best advised to focus its efforts. This has included:

- a twelve week consultation period with VCOs and experts;
- a roundtable to consider what the VCS operating environment will look like in the next decade;
- a piece of desk research on past, current and future funding trends.

This paper proposes three themes for investigation by the Commission over the next eight months. It contains:

- strategic context;
- findings from the consultation;
- criteria for choosing themes;
- proposed themes;
- IFS graph on spending plans (Annex A)
- summary of consultation responses (Annex B)
- summary of financial products (Annex C)
- desk research on VCS income trends (Annex D)

2. Strategic context

A number of challenges face communities in the UK today, from the impact of globalisation, economic recession and climate change to concerns about street crime and anti-social behaviour. At the same time society is more polarised in terms of wealth (and power) than it has been for many years.

These challenges have come about in a period where priority has been given to market solutions and the role of government, both of which are now experiencing record levels of distrust. The Edelman Trust Barometer¹ 2009 found that NGOs command more trust than business, government and the media in every region except Asia Pacific.

The need to re-balance the relationship between civil society, the market and the state and to open up the space for independent action is becoming more and more apparent. An active and vibrant civil society is necessary to hold government and the market to account and to enable effective communities to thrive; helping to build connections, generate trust and strengthen democracy. This is something that NCVO, with its partners, is seeking to address through its civil society framework.

In order to support this, appropriate funding and financial tools must be in place. This continues to be a challenge for VCOs who often cite funding as their most pressing issue. VCS income has grown steadily over the last ten years but there is vast inequality, with 411 of the major charities (0.2%) controlling 43% of total VCS income and one third of the sector's assets being held by just 54 organisations². Income volatility also poses challenges, particularly for smaller organisations, and lack of reserves can present continuous threats of closure. Over 57% of charities do not have enough funds to cover twelve months worth of expenditure.

¹ Edelman Trust Barometer (2009) available at http://www.edelman.com/trust/2009/docs/Trust_Book_Final_2.pdf

² NCVO (2009) 'The UK Civil Society Almanac 2009', London: National Council for Voluntary Organisations

The recession has exacerbated these problems. For example, a recent charity commission survey found that just over half of all respondents (52%) reported that they had been affected by the economic downturn with 58% reporting a reduction in income.³

And at the same time, the number of organisations in the sector continues to grow, increasing competition for scarce resources. There were 6,810 more charities in 2006/07 compared to 2005/06 bringing the total to 170,900.

Government and the VCS are responding to the immediate effects of the recession, but it is clear that there is a need for longer-term proposals. The Commission's task will be to look ten years into the future and ask what financial tools are needed to encourage more independent civil society action.

In thinking about VCS funding over the next decade, two major trends are likely to affect it. Firstly, the economic context means that we are entering a period of high taxes and low public spending. Budget 2009 stated that spending would grow by 0.7% in real terms over the next spending round. These are the deepest cuts to public spending since the 1970's. (see Annex A). However, the Institute of Fiscal Studies has claimed that, in order to make up the £90 billion fiscal hole presented by the economic crisis, spending across government departments will have to be cut by 2.3% per year in real terms.⁴ While public services will remain high on the Government's agenda, there will be an increasing need to explore new ways to co-finance services, through the pooling of public and private money.

Secondly, the political context means that there is an increasing possibility that we will see a Conservative government in power following the next election, one with a localist agenda keen to increase access to local services delivered by niche, local providers. This will mean ensuring that funds flow to the local VCS.

If these trends are correct, they suggest the need to develop a new relationship between government and the VCS, one in which the VCS is placed on a more equal footing. It will require a new social contract to set out the terms of the relationship.

3. Findings from the consultation

The consultation period ended on May 13th and included:

- a think piece by David Carrington;
- invitations to submit written evidence;
- a consultation questionnaire;
- meetings with key stakeholders.

We received approximately 40 questionnaire responses and ten formal written responses. A summary of the findings and list of the respondents can be found in Annex B. The following broad themes were identified:

- Social investment,
- Local funding including grants, endowments and asset transfer;
- Philanthropy, including corporate social responsibility;
- Public service delivery;
- Funding practice;
- Capacity building issues;

³ Charity Commission (March 2009) *Economic survey of charities research report*, 4 - YouGov poll (2008) for social enterprise day, 5- Cabinet Office (2009) *Real help for communities*

⁴ IFS (2009) 'Reactions to the budget: public spending' available at http://www.ifs.org.uk/budgets/budget2009/public_spending.pdf

- Volunteering;
- Trading;
- Issues around irrecoverable VAT.

Themes that came out particularly strongly included:

Local funding – respondents stressed the importance of funding (grants, endowments and assets) for the local VCS and the role of Community Foundations in connecting local investors and local organisations. Challenges and opportunities relating to the devolution of statutory funding were also raised, as were the difficulties certain VCOs experience accessing funding because of where they work and the issues they work on.

Funding practice – respondents referred to the need to make better use of existing resources by improving funding practices. They referred to the challenges presented by poor practice, including onerous application forms and reporting requirements, difficulties obtaining full-cost recovery and short-term funding. These issues were also raised by David Carrington and supported by The Big Lottery Fund. New Philanthropy Capital also made the case that a VCS with finite requires funding that is allocated according to need and effectiveness; designed proportionate to need, and monitoring that is useful and proportionate.

Public service delivery

VCOs were particularly keen to develop income from public services. They raised a number of concerns about poor commissioning practices which they thought were resulting in VCOs losing contracts to private sector organisations. The Barings Foundation raised a number of issues relating to protecting VCS independence. This included exploring funding models that get the best out of the Sector at the same time as meeting government's reasonable requirement for accountability and service quality.

Capacity building issues

A range of capacity building issues were identified from the consultation, including the difficulties organisations experience demonstrating their outcomes, accessing a range of funding streams and managing their income. David Carrington also referred to the need for organisations like NCVO to help VCOs build their financial base, to try and avoid problems related to weak balance sheets. The Barings Foundations argued that the VCS need to develop the skills and resources to protect their independence through enhancing their ability to demonstrate their legitimacy and their ability to act with confidence.

Social Investment

A couple of respondents made a case for building the social investment market. Citylife made a case for building on the success of social investment bonds through a 3% tax relief on investments and there was support for social impact bonds. Social investment was also supported by David Carrington who referred to a broader need to think about new and innovative practices, including:

- new technology to provide opportunities to reduce costs and reach a wider pool of supporters;
- new forms of finance (Social Impact Bonds);
- new uses of finance (e.g. grants being made available as loans).

Volunteering

Volunteering England made a case for the inclusion of volunteering within the Commission's remit, suggesting a number of areas for improvement.

4. Criteria for choosing themes

In choosing which themes the Commission should focus on, we applied the following criteria:

- Is there political support for the issue?
- Is the issue viable in the economic context?
- Is new policy or thinking required?
- Is it an area that has VCS support?

Applying these criteria led us to dismiss a number of the consultation themes for further consideration by the Commission. For example there has been a significant amount of policy work done around public service delivery and government funding through the Cross Cutting Review, 2008 Public Administration Select Committee Inquiry and the Compact. Many of these issues require policy implementation rather than policy development.

5. Proposed themes

We consider that the following themes are fruitful areas for the Commission's consideration:

- Social investment;
- Local funding;
- Philanthropy.

This section provides more detailed justification for each.

Social Investment

a) New thinking/ policy

According to Venturesome's⁵ definition, social investment is the use of money to achieve social and financial returns. It is an area that has received significant attention over the last few years. The Social Investment Taskforce was set up in 2000 which resulted in a number of achievements including the introduction of Community Investment Tax Relief, the launch of the Community Development Finance Association and Charity Commission guidance on programme-related investment. Following this, the Commission on Unclaimed Assets was set up in 2005 proposing the development of a Social Investment Bank. And numerous other products (see Annex C) and proposals have been developed including a Social Stock Exchange and Social Impact Bonds.

Despite these gains, the evolution of the market has been fairly limited. Venturesome put this down to the following supply and demand side barriers:

Financial risk aversion:

- VCOs/ trustees are apprehensive of borrowing money for fear of personal liability;
- suppliers can perceive VCOs to be higher risk than they actually are.

Lack of understanding of financial needs:

- VCOs are unable to identify their financial needs or understand solutions presented by different products;
- Venturesome has witnessed advisers and funders who are unable to distinguish between capital and revenue or read balance sheets.

Inefficiency of the market place:

- the market does not always provide appropriate products to civil society organisations;
- there is also little co-ordination and co-investment between advisors;

⁵ Venturesome (2008) 'Financing civil society: a practitioners view of the UK social investment market', Venturesome: London

- little advice and general infrastructure in the form of brokers developing alongside the emerging suppliers of capital;
- the market is not calibrating risk and opportunity e.g. most grant-making trusts are not operating in a way to leverage in finance and banks are not operating in a way that can layer grants.

A range of proposals have been suggested to improve the market. For example, Venturesome calls for greater collaboration among suppliers including, increased co-investment and pooled funds, greater sharing of information and knowledge and the development of a common language. And in a recent article for the Smith Institute Paul Palmer⁶, Professor of Voluntary Sector Management at CASS Business School, raises the need for more thinking on legal structures, tax incentives and business education for social entrepreneurs. He accuses the Government's existing approach, of funding organisations such as Futurebuilders to provide finance to VCOs, as 'meddling with the market'.

This is something that was echoed by Triodos in their consultation response. They argue that government initiatives that have commenced with the intention of addressing particular market gaps, have often ended up displacing the market when results are not achieved quickly enough or the cost of delivering to these markets proves to be too high. They also refer to the need for high quality business advice for charities and social enterprises, arguing that Business Link is not an obvious choice for many social entrepreneurs.

Citylife made a case for building on the success of social investment bonds which they have been using to fund the VCS for the last ten years. These work as follows:

- Individuals and investors invest in a fixed term bond with Citylife.
- Citylife immediately gives up to a quarter of the money to charity. The rest is lent to a social housing provider to build affordable housing for local communities and key workers.
- After five years, the housing provider pays back the loan plus interest that matches the sum given to the charity.
- Citylife gives the investors back all the money they put in. They have only given away the interest they could have earned.

Citylife argue that the success of Social Investment Bonds could be greatly increased by the provision of similar tax incentives as those available for other funding mechanisms. They suggest rebates on investments of 3% per annum.

NCVO has developed a proposal paper on how to fund a Social Investment Bank which we will share with the social investment sub-group.

b) Economic and political context

The economic climate suggests that limited funds will result in:

- an increasing need for government to explore ways to pool public and private money;
- an increasing desire by funders to explore ways to recycle funds to make scarce resources go further.

Social investment is also an area that has received significant support from both of the main political parties. For example, social investment has been identified as one of the priority areas to receive money from dormant bank and building society accounts and both parties have shown support for the development of a Social Investment Bank.

⁶ Ibid.

c) Support from VCS

It is becoming more and more apparent that a fully functioning VCS will require an evolved social investment market to support it. Venturesome argue that they have experienced additional calls for social investment in recent years, and that there is a significant amount of latent demand i.e. demand that is not realised. Guidestar data also show that charities are borrowing. There are 7,000 charitable organisations that have bank loans in total of £5.2 billion⁷.

However, the consultation response also identified some caution in relation to social investment, particularly from those that have championed the role of grant funding. For example, in their consultation response NAVCA referred to the 'limitations of loan finance'. And one respondent referred to the need capacity building around social return on investment so that organisations can demonstrate the impact of investing in the VCS.

Local agenda

a) Political and economic context

Within the 2007 Third Sector Review, the Government identified a key role for the VCS in strengthening communities i.e. bringing people together and providing local services. It committed to support this role through:

- £80m in small grants for local community groups delivered by local funders to enable people and groups to make a difference in their local areas;
- £50m in endowments to ensure that local funders can provide grant funding for community groups in the future;
- a £30m Community Assets Fund to provide communities with the resources to develop community owned buildings, accessible to the whole community;
- support for community anchors to become sustainable through support to develop assets and generate income.

In addition to this, the Government has devolved a lot of statutory VCS funding to the local level. This is a trend that is set to continue under a Conservative Government.

The economic context also suggests that there may be a number of opportunities to further develop certain initiatives. For example, there may be potential to increase asset transfer as the value of local authority buildings decreases and businesses are forced to vacate their premises. But the consultation also identified concern that asset transfer has resulted in the transfer of a liability rather than an asset. It will be important to ensure that revenue funding is also in place to support effective management.

b) Support from VCS

The importance of local grass roots funding came out heavily from the consultation and the need for endowments of cash, land and property to protect the long-term sustainability of the local VCS. Volunteering England called for local infrastructure to support volunteering opportunities locally, and a case was made for local social investment opportunities. Respondents referred to the difficulties they experience accessing buildings and there was significant support for the role of Community Foundations. For example, NAVCA referred to the success of Tyne and Wear Community Foundation in leveraging in funding for the locality, having raised £2million in new donations in 07/08.

In connecting local people with local organisations, Community Foundations are also able to help address some of the unequal distribution of resources within the sector, as donors

⁷ Palmer, P (2009) 'Banking on the third sector', in '*Social enterprise for public service: how does the third sector deliver?*', The Smith Institute: London

become aware of local organisations working on particular causes and not just national household names.

The difficulties particular parts of the VCS experience accessing funds were raised by a number of respondents. For example, Children England's⁸ research into small children's charities found that many are in a vulnerable position with regards to their funding, with 44% reporting a negative change in funding over the previous two years. Similarly, a recent report by the Women's Resource Centre⁹ highlighted that a number of equalities groups were being forced to close as a result of lack of funds. Difficulties experienced by campaigning organisations were also raised, as well as environmental organisations and VCOs working in the East of England or deprived pockets within more affluent areas.

A number of respondents also mentioned the opportunities and challenges presented by the devolution of statutory funding. For example, Fairbridge and New Philanthropy Capital (NPC) argued that it can result in organisations having to develop relationships with individuals across a number of local authorities which can be resource intensive. Fairbridge argued that high quality second tier organisations can improve the situation by building links with the Local Authority and acting as a representative for the VCS.

NPC also argued that devolution can mean that charities struggle to access funding in cases where a problem affects a large number of people across the nation, but not many in one area in any one year e.g. sexual violence. However, devolution also provides the opportunity for charities to make personal relationships with people delivering the funding, providing they have the time and inclination.

c) New thinking

A number of interesting ideas to improve local funding were proposed by questionnaire respondents. These included proposals to divert a percentage of Council Tax to create community local endowments, Neighbourhood Funding Panels operating through a combination of Business Improvement Districts tax and National Lottery income and proposals for proceeds from local crime to be returned to the local area for endowment. There were also calls for local social investment. For example, it was suggested that local authorities could provide interest free loans to individuals wanting to start-up organisations working on areas of shared interest.

There is also potential to increase the role of new technology in connecting donors with local community groups. The Community Foundation Network is currently working to support Community Foundations in this role through the development of web 2.0, a concept similar to that of the Big Give.

Philanthropy

a) Political and economic context

Increasing the amount of giving/philanthropy is supported by both of the main political parties. The Government published a strategy to increase charitable giving in 2005 and the Prime Minister has recently appointed Dame Stephanie Shirley as the Government's ambassador for giving and philanthropy. The Conservatives have also argued for the creation of a social norm around giving.

⁸ Thompson, J. and Whitaker, E. (2008) *'Small change? A survey of small voluntary and community sector organisations working with children, young people and families'*, Children England: London

⁹ Women's Resource Centre (2009) *'Not just bread, but roses, too: Funding to the women's voluntary and community sector in England 2004-07'*, Women's Resource Centre: London

Despite this interest, the amount given to charity over the last decade has remained fairly stable. And yet there is potential to increase the amount of income from it. For example:

- Legacy Foresight have predicted that legacy giving will rocket in 2025 with the rise of single affluent women and this year's Rich List demonstrates that there are a significant number of very wealthy people who give a fraction of their wealth to charity.
- Gift Aid is only applied to one third of donations, providing £750 million in income for the VCS in 2005/06. And yet, NCVO has estimated that the maximum that could possibly be raised under the current system, including events, is £1.9 billion¹⁰.
- Income from the private sector accounts for just 5% of VCS income and yet, following the economic downturn, it is an area that there could be a lot of support for from the business sector as they seek to regain trust and respect from the general public.

b) New ideas

A range of proposals have been suggested to help increase income from donations, in particular changes to tax effective measures. For example, parts of the VCS are lobbying for an opt-out scheme for Gift Aid, changes to the rules around higher rate tax payers so that charities can claim back the full rebate, and the development of lifetime legacies. There is also support for educating professional advisers of the benefits of investing in charities/ foundations.

There are also lessons that could be learnt from abroad. For example, countries in Eastern Europe have experienced a boost in giving following a policy which allows citizens to forgo 2% of their tax to direct toward an approved charity of their choice.

c) Support from VCS

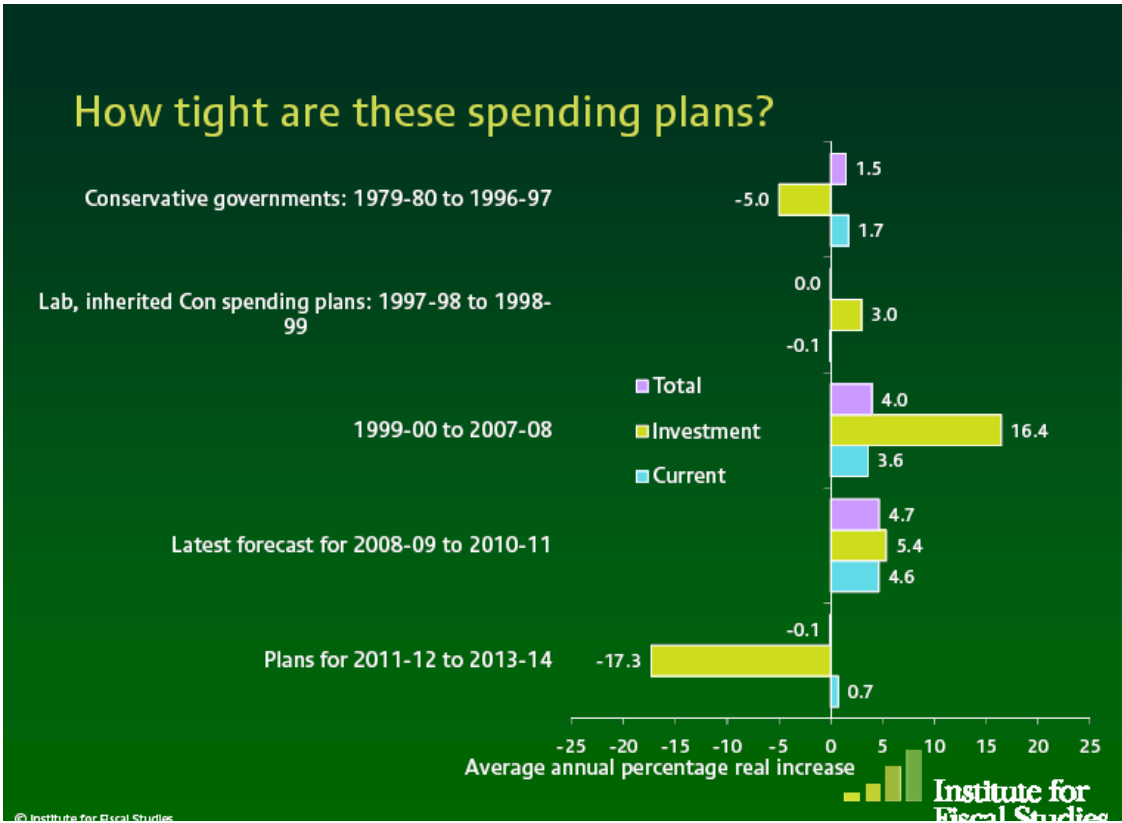
There is fairly widespread support for the development of charitable donations within the VCS. Donations can provide an important source of independent, unrestricted income and provide a pool of supporters. In the consultation, there was significant support to explore how to increase the amount of corporate social responsibility. Some VCOs said that they needed skills in how to fundraise from corporates and support to manage the relationship effectively. There was some concern about the amount of control over the organisation that donors want in return for their gifts.

However, a number of respondents also referred to the difficulties they experience accessing donations and match funding because they do not work with 'fluffy or cuddly' issues. New Philanthropy Capital also felt strongly about this, referring to the large amounts of money that go to donkey sanctuaries over domestic violence charities. They identified a need for donor education and for tighter rules around measurement of charity effectiveness.

NCVO Policy Team
May 2009

¹⁰ NCVO (2007) 'Proposals for the future of Gift Aid' available at <http://www.ncvo-vol.org.uk/policy/index.asp?id=5524>

Annex A – IFS graph on spending plans



The full presentation can be found at http://www.ifs.org.uk/budgets/budget2009/public_spending.pdf