

# **Research on Third Sector Access to Finance**

Report to the Office of the Third Sector

May 2007





## **Acknowledgements**

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# 1: Introduction and methodology

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- 1.1 SQW Limited was commissioned by the Cabinet Office's Office of the Third Sector (OTS) to undertake qualitative research on Third Sector access to finance. The research is intended to feed into policy development within the Office of the Third Sector and the Comprehensive Spending Review (CSR) within which HM Treasury and the Cabinet Office are jointly leading a review of the future role of the Third Sector in economic and social regeneration<sup>1</sup>. This report presents the findings from this research.

## Terms of reference

- 1.2 The research brief outlined the key objective of the assignment as to acquire further understanding of current and potential future demand for external finance to support the establishment and development of Third Sector organisations. The focus of the research was the sources of demand, the Third Sector organisations (TSOs) themselves. A parallel but separate piece of research was undertaken internally by the OTS focusing on the supply side of Third Sector finance.

- 1.3 The research sought to explore and develop understanding across the following four areas:

- *Third Sector Organisations' current understanding of and use of finance, looking at: need for finance; known sources of finance; preferred sources of finance; use of finance in the last three years and reasons for use; experiences of being turned down for finance; the extent to which innovative projects are not able to progress because of lack of finance and the potential areas of unmet demand*
- *Support that was available with the finance and its importance: whether development finance was included as an element of project funding; packaging of finance and support from funders for bid development*
- *latent demand for undertaking developmental activity and for the types of finance that might support this; anticipated demand in the next three years; barriers to types of finance and how these have been overcome*
- *how demand for finance changes within TSOs vis-à-vis the category, scale and lifecycle of organisations.*

## Methodology

- 1.4 Given the limited timescale for the work, defined by the demands of the CSR review work, the brief specified that the research was likely to be qualitative and recommended that focus groups might form the core of the most viable approach. The study commenced on 17 November 2006 and the fieldwork was completed by early January 2007, with the main body

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<sup>1</sup> Research specification: Third sector access to finance – qualitative research. Office of the Third Sector, October 2006.

of the primary research being carried out over a two week period in early December 2006. SQW's methodology broadly reflected the brief's guidance, with the research consisting of the following key elements:

### ***Literature review***

- 1.5 An extensive review of literature was undertaken exploring current research papers and reports on issues of relevance to the study.

### ***Initial consultations and stakeholder meeting***

- 1.6 As well as a client briefing, a number of early consultations were carried out with sectoral stakeholders and TSOs to inform the shape of the research. The consultees were a combination of those targeted by the research team due to their profile in the sector and/or insight into the subject, and those who, in the course of the research, were identified as able to bring a specific perspective to the research.
- 1.7 An initial meeting of invited delegates from a range of the OTS's stakeholder organisations was held at the end of November. This meeting was used to present and refine the methodology and to finalise the focus group structure and themes for exploration. The aide memoire developed to structure the focus groups is contained in Annex A.

### ***Focus groups***

- 1.8 Nineteen focus groups were organised and run during December 2007 – two in each of the nine English regions<sup>2</sup> and one additional event in London for nationally-focused TSOs. Each focus group lasted between two and three hours, with SQW facilitating and recording the discussion. In each region one of the groups was constituted primarily of participants from voluntary and community organisations (VCOs), and the other included mainly social enterprises, co-operatives and development trusts. The constituency of the focus groups was self-selecting in that they could elect which of the focus groups to attend. The aim was to attract a maximum of eight participants per group, aiming to achieve representation from TSOs serving different sectors and special interest groups. One hundred and twenty three TSOs participated in the 19 events, from an invitation list of 846. The lists were compiled through a combination of contacts supplied by regional and national organisations and an e-mailing list developed from the internet. Invitations were sent out by e-mail, or via the regional 'partner' organisation. Regional participation is illustrated in Table 1-1 below.

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<sup>2</sup> East Midlands, East of England, London, North East, North West, South East, South West, West Midlands and Yorkshire & Humber.

Table 1-1: Focus group participants analysed by region

Region	Number of Invitations issued	Regional invitations as a percentage of total invitations issued	Number of participants		Total number of participants per region	Participants as percentage of invitations issued in the region
			'VCO' focus groups	'Social Enterprise' focus groups		
East Midlands	107	12.6%	6	8	14	13%
East of England	65	7.7%	9	7	16	24.5%
London	101	11.9%	4	5	9	9.0%
North East	92	10.9%	10	4	14	15.0%
North West	83	9.8%	7	8	15	18.0%
South East	120	14.2%	13	2	15	12.5%
South West	103	12.2%	9	6	15	14.5%
West Midlands	64	7.6%	2	3	5	8.0%
Yorkshire & Humber	85	10.0%	8	6	14	16.5%
National	26	3.1%			6	23.0%
<b>Total</b>	<b>846</b>	<b>100%</b>	<b>68</b>	<b>49</b>	<b>123</b>	<b>n/a</b>

### ***Electronic survey***

- 1.9 In addition to, or instead of, participation in a focus group, TSOs were given the opportunity to feed in to the research through submitting an electronic response, either to supplement their input at the focus group or in lieu of being able to attend. Ten organisations fed into the process electronically.

### ***Emerging findings workshop***

- 1.10 A workshop to present emerging findings from the research was held with the OTS and 13 key stakeholder organisations on 24 January 2007 at the OTS offices in London. The emerging findings from the research were presented and debated. The process identified the need for some areas of additional probing through targeted telephone interviews.

### ***Additional targeted case interviews***

- 1.11 Nine additional targeted and structured interviews were carried out. The parameters for these additional consultations were to explore in greater depth than was possible:

- aspirations and plans for development<sup>3</sup> and growth<sup>4</sup>

<sup>3</sup> A deliberate, managed and organisation-wide effort to increase the organisation's effectiveness, health and sustainability through planned interventions, diversification and processes.

<sup>4</sup> The expansion of an organisation, generating greater income with associated surplus.

- latent demand for finance (defined narrowly) and the factors that would act as a catalyst to converting latent to actual demand.

### **Synthesis of research**

- 1.12 The analysis of the research was mainly structured to distinguish between the material representing responses from the VCO segment of the Third Sector population and the social enterprise segment. The report broadly follows this distinction, with a finer grain of analysis relating to specific groups of TSOs with special interests and/or client groups being presented where it was possible to draw some meaningful learning from the small sample size.

### **Clarity of terminology: the term ‘finance’**

- 1.13 An early task in the research was to clarify the term ‘*finance*’. Initial scoping discussions with TSOs revealed the term to be a confusing one – conveying different meanings to different people and organisations. For the purposes of this research ‘*finance*’ has been defined to cover the broad spectrum of both developmental funding and finance for the Third Sector. This broad interpretation was felt to be important in order to ensure the participation from as wide a range of TSOs as possible. Therefore rather than ‘*finance*’ simply relating to loans, overdrafts, equity investments, mezzanine finance and patient capital from commercial banks and Community Development Finance Institutions (CDFIs), it was also taken to cover what many TSOs might otherwise term ‘funding’, i.e. grants<sup>5</sup>, Service Level Agreements (SLAs)<sup>6</sup> and contracts<sup>7</sup> from a wide range of public sector and European sources, Big Lottery, Charitable Trusts and Foundations.

## **Structure of this report**

- 1.14 Following on from the introduction, this report is structured as follows:
- Chapter 2 describes the context within which the research is located
  - Chapters 3 – 6 present the evidence from the research
  - the key findings from the research are presented and conclusions emerging from the study complete the report in Chapter 7.
- 1.15 The report is accompanied by two annexes containing:
- the template structuring the focus group discussions
  - the text for the focus group invitation.

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<sup>5</sup> A gift or award of money for a specific purpose.

<sup>6</sup> A formal negotiated agreement between two parties – often between a TSO and a public sector organisation. The contract records the common understanding about services, priorities, responsibilities, guarantee, etc with the purpose of agreeing the level of service, budget, output and outcomes to be delivered. This may previously have been a grant and therefore not necessarily open to competitive tendering.

<sup>7</sup> Contracts awarded by public sector organisations, through competitive procurement processes, for the delivery of services on their behalf.

## 2: Context

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- 2.1 It is important to place this research into a wider context and one which involves:
- defining and delineating the Third Sector
  - the sector's operating environment and the Cabinet Office's review of the role of the Third Sector
  - changing funding environments
  - changing availability and nature of finance offers
  - public sector contracting
  - the social enterprise agenda
  - supply of finance.

### Defining the Third Sector

- 2.2 Defining the Third Sector is a difficult task. Indeed, the debate continues as to what constitutes the Third Sector and which organisations make up its constituent parts. Historically organisations established on a '*not-for-profit*' basis and not directly controlled by the state (i.e. not part of the public sector) were widely referred to as TSOs. However, with the emergence of social enterprises and other organisations which trade and generate a profit (albeit a '*not-for-private*' profit), this profit-based definition has been subject to some refinement.
- 2.3 The Office of the Third Sector has adopted the following definition for the Third Sector: "*The third sector comprises non-government organisations which are value driven and principally reinvest their surpluses to further social, environmental or cultural objectives. It includes voluntary and community organisations, charities, social enterprises, co-operatives and mutuals*"<sup>8</sup>. This revised definition acknowledges the changing nature of the Third Sector and recognises TSOs' important economic dimensions.
- 2.4 Current debates within the sector coalesce around distinguishing it from the public and private sectors and relate to the degree to which sectoral borders are seen as clearly demarcating it. For instance, at what point does a TSO's tight links and focus on public sector service delivery turn it into an arm's length delivery agent for the public sector? Similarly, when does a TSO's focus on economic stabilisation, sustainability and profits more closely align it with the private sector, and particularly those private sector organisations with an ethical focus and/or strong corporate social responsibility ethos? These questions demonstrate how the boundaries between sectors are increasingly hard to draw and throw up '*grey zones*' of transition between sectors. They also underpin a viewpoint that argues that it is neither the

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<sup>8</sup> HM Treasury, Charity and Third Sector Finance Unit. [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)

total absence of state concerns nor profit considerations which defines a Third Sector organisation but rather the degree to which these motives are outweighed by others – namely social mission, value and objectives.

2.5 Notwithstanding the flexibility of definition, what does seem to be accepted is that the Third Sector and hence its constituent organisations:

- is not static
- has highly contested norms, politics and attributes
- is owned by no-one or no set of organisations
- is not defined by charitable status, expression or meaning
- possesses no sector kite mark or brand
- and is often mystifying and highly contradictory.

2.6 This is why TSOs are often described using extended family analogies to describe amongst other things; common features and similarities or organisational form; organisational behaviour; mission; philosophical compatibilities and the charitable, funding, subsidy, commercial and tax treatment they demand, receive or endure.

2.7 TSOs can adopt a wide range of legal forms, including for example: Companies Limited by Guarantee, Registered Charities, Share Capital Companies, Charitable Trusts, Co-operatives, Industrial and Provident Societies and Community Interest Companies (CICs)<sup>9</sup>. Others operate without a separate legal identity as Unincorporated Associations and Trusts, each of which is associated with a range of conditions which facilitate or preclude certain types of behaviour, including the propensity to access finance. It is interesting to note that social enterprises are not a legal form of TSO, but a model which may adopt one of a number of legal forms. They can be defined, in simple terms, as “enterprises that trade in order to pursue a social aim”.

## **Cabinet Office Review of the role of the Third Sector**

2.8 In May 2006, HM Treasury and the Cabinet Office launched a review of the future role of the Third Sector in social and economic regeneration (the Third Sector Review) as part of the Comprehensive Spending Review (CSR) process. The interim report, published on 6 December 2006, draws together emerging findings from the consultation phase in the following six key areas:

- stronger and connected communities
- enabling voice and campaigning
- volunteering and mentoring

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<sup>9</sup> Note that the research sample contained very few examples of CICs (which came into being in 2005), and whilst their potential benefits were alluded to, there was little experience contributed of this legal form of TSO’s experience in accessing finance.

- promoting enterprising solutions
- transforming public services
- creating an environment for a healthy Third Sector.

2.9 Not surprisingly, the interim report identified funding and finance as the single biggest concern facing TSOs and one which cuts across the above six key areas. Government has recognised the need for both greater clarity and greater sustainability in its relationship with the sector and calls for both central and local government to pass on the security of their three year funding arrangements to TSOs from April 2008 onwards. In his pre-budget report statement, Chancellor Gordon Brown confirmed “*I can announce that in the spending review the norm should not be one year funding but three year funding for Third Sector organisations.*”<sup>10</sup>

## Changing funding environments for TSOs

- 2.10 The past fifteen years have seen TSOs benefiting from greater access to and funding from European Structural Fund programmes and from national and regional regeneration funding programmes, provided through a range of urban and rural programme initiatives, but particularly through Single Regeneration Budget (SRB) for the period through to 2007. Additionally, funding from the Big Lottery, Charitable Trusts and Foundations and from the Learning and Skills Councils (LSCs), New Deal for Communities (NDC) and Neighbourhood Renewal have also served to grow and develop the sector. Indeed these programmes have been essential to fund the delivery of TSO projects.
- 2.11 However, these core funding programmes, upon which numerous TSOs have developed different levels of reliance, have either changed or are set to change in the second half of the decade. TSOs must therefore prepare themselves for a new suite of funding programmes and develop their future in the context of new Sub-Regional Investment Plans, Local Strategic Partnerships, Local Area Agreements, public sector contracting, reduced grant availability and greater levels of competition and finance option considerations. These new programmes are not fully able to replace SRB and European funding as their aims are broadly to improve the TSO infrastructure and facilitate the growth of social enterprise, not to fund project delivery.
- 2.12 The Government has been keen to advance the entrepreneurship and social enterprise agendas and enhance the ability of the sector to engage successfully with the procurement agenda. The Local Enterprise Growth Initiative (LEGI) is another example of Central Government’s renewed focus on capacity, skills and entrepreneurship for TSOs.
- 2.13 There is therefore understandable concern within the sector regarding future sustainability and genuine feelings of fast approaching what a number of TSOs refer to as a ‘*cliff edge*’ in terms of current funding regimes.

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<sup>10</sup> Pre-Budget Report 2006. [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)

## Changing availability and nature of finance

- 2.14 Until recently, high street banks were the main providers of finance. However, the past few years have seen the launch of a number of specialist lenders<sup>11</sup> that focus on providing loans to TSOs and small enterprises. These lenders are interested in social investment and look to achieve wider social benefits through their investments.
- 2.15 Finance, unlike funding, is a relatively new concept for many TSOs. However, many larger voluntary and community organisations have been using finance from high street banks to purchase buildings, develop new activity or to smooth cash flow. Such loans have provided cash injections to catalyse action which would otherwise have been subject to delays in funding decisions. They have also provided greater flexibility, unlike grant funding which is often tied to specific project inputs, outputs and outcomes.
- 2.16 Loans can also encourage business planning and thinking beyond the short-term (a frame of mind often encouraged by time-limited grant or contract funding). Admittedly, loans require a greater degree of financial discipline and financial literacy and importantly repayment, but this can be beneficial to organisations.
- 2.17 There are broadly two main types of finance: loans and equity. Loan (or debt) finance can be defined as “money lent which has to be returned to the lender usually with interest”<sup>12</sup>. Equity investment is “medium to long-term finance provided by an investor in return for taking shares in an organisation”<sup>13</sup>. Additionally, there are a range of variations on the two themes, including ‘quasi-equity’ sometimes referred to as ‘*patient capital*’, a form of investment which is a mix of grant and loan or equity, incorporating social returns often with flexible repayment terms.

## Public sector contracting

- 2.18 The Government has a policy objective to increase the role of the Third Sector in public service delivery and initiatives such as Futurebuilders<sup>14</sup> have been set up to support this. Public sector contracting represents a significant shift in the way many TSOs engage with public bodies. Full cost recovery, contracts that generate surplus (rather than requiring TSOs to subsidise public sector services), understanding procurement processes, how to tender, external perceptions of the sector as professional delivery agents, cash flows for contracting, developmental finance, legal requirements, capacity, scale and joint venturing are just some of the issues that need to be worked through to bring about the successful engagement of the sector in the procurement agenda. This is currently under consideration and the recently

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<sup>11</sup> Specialist providers include: the Charity Bank, Futurebuilders, Unity Trust Bank, Triodos and a range of Government developed Community Development Finance Institutions (CDFIs) which aim to support economic, social and physical renewal in deprived areas and underserved markets.

<sup>12</sup> Community Development Finance Association. ([www.cdfa.org.uk](http://www.cdfa.org.uk))

<sup>13</sup> Ibid

<sup>14</sup> Futurebuilders England is a government-backed fund offering support and investment to third sector organisations to deliver public services, offering a combination of loans, grants and professional support to build the capacity of TSOs who want to deliver better public services. ([www.futurebuilders-england.org.uk](http://www.futurebuilders-england.org.uk)).

published public service delivery action plan<sup>15</sup> is designed to take the third sector's involvement in public service delivery forward.

## Social Enterprise agenda

- 2.19 “*Britain has some of the most successful and vibrant social enterprises in the world*”<sup>16</sup>, and the agenda is championed by government and growing in scope. There are currently more than 55,000 social enterprises in the UK, generating more than £27 billion turnover and contributing more than £8 billion to GDP per year. This is a growing segment of the economy and the government has stated that it wants to create the conditions for thousands more social enterprises to thrive.
- 2.20 Social enterprises contribute to society in the following ways: they tackle some of society's most entrenched social and environmental challenges; they set new standards for ethical markets, raising the bar for corporate social responsibility; they improve public services, shaping service design and pioneering new approaches, and they increase levels of enterprise, attracting new people to business. The Government's vision is for “*dynamic and sustainable social enterprises, contributing to a stronger economy and a fairer society*”<sup>17</sup>. The Social Enterprise Action Plan states that Government will: foster a culture of social enterprise; ensure that the right information and advice are available to those running social enterprises; enable social enterprises to access appropriate finance; enable social enterprises to work with government.

## Supply of finance

- 2.21 For some organisations, the transition to debt finance is seen as too great a leap and in response to this initiatives have been developed with financial products that bridge the gap between grants and loans. The Adventure Capital Fund is an example of a specialist finance provider that works in this way, allowing the borrower an extended period of time before requesting repayment. Similarly, Futurebuilders provides a mix of grants and loans for organisations' enterprising approaches to the delivery of public services.
- 2.22 Earned income is an important source of money for TSOs. Earnings from trading on the open market or delivering services under contract now account for nearly half of the total income of the sector, outstripping all income from grants, gifts and donations. This represents a major change in how the sector is funded and demonstrates the sector's ability and willingness to adapt to changing funding circumstances.
- 2.23 Earned income should not be confused with surpluses or profit, since much income generation within the sector is simply used to cover costs. The public sector is an important source of earned income for TSOs (through contracting), but it is by no means the only

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<sup>15</sup> Partnership in Public Services: an action plan for third sector involvement. Cabinet Office, Office of the Third Sector. December 2006.

<sup>16</sup> Margaret Hodge, Industry & Regions Minister, DTI. January 2007.

<sup>17</sup> Social Enterprise Action Plan – Scaling New Heights. Cabinet Office, Office of the Third Sector. November 2006.

source. In 2003/04, TSOs earned almost £7.5 billion from trading with private individuals, businesses and other TSOs.<sup>18</sup>

- 2.24 Earning income from trading goods and services on the open market is increasingly being pursued by TSOs. The margins from such income can provide a valuable source of unrestricted<sup>19</sup>, independent money and provides a real contribution to supporting organisational independence and growth. Where earned income does not generate a margin, it is all too often used to subsidise delivery.
- 2.25 Enabling TSOs to access appropriate finance is a priority within the Government's Social Enterprise Action Plan. TSOs, like all businesses, need access to capital to develop and to operate efficiently. Loan finance has been a staple for businesses but the Third Sector has often been more cautious or has been precluded from the borrowing route due to constraints imposed by their legal form, culture and/or costs. Even with the introduction of sector-specific loan financing options, there are still a number of barriers that Third Sector organisations face when applying for loans.
- 2.26 The next four chapters present the evidence from the research, under the following chapter headings:
- Current understanding of and use of funding and finance
  - Support that was available with the finance and its importance
  - Barriers relating to accessing funding and finance
  - The future – aspirations for growth and latent demand.
- 2.27 The imperatives driving the need to access money, of whatever type, and the main views relating to the four key research themes set out in the brief, are presented in these chapters. The evidence has been analysed using the same segmentation as that employed for defining and populating the focus groups, that is the two sectoral sub-sets of 'voluntary and community organisations' (VCOs) and 'social enterprises, co-operatives and development trusts' (social enterprises). Where there were found to be different characteristics which related to a specific group, these are also identified.

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<sup>18</sup> NCVO: UK Voluntary Sector Almanac, London (2006).

<sup>19</sup> Money which has no restrictions placed upon how it is spent and does not require delivering certain inputs, outputs and outcomes (for example, a TSO's own reserves are unrestricted funds)

## 3: Current understanding of and use of funding and finance

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- 3.1 This chapter explores the existing experience of TSOs and reports on approaches they have taken thus far to financing the start up and development of the organisation.

### Need for and use of money

- 3.2 The predominant need for, and use of, money by voluntary and community organisations was for working capital to cover the short-term costs of delivering their service. VCOs typically reported resource constraints, caused by insufficient funds to cover their operating costs, with the result that there was rarely reported any surplus<sup>20</sup> available either to develop reserves or to invest in the development of the organisation.
- 3.3 Similarly, social enterprises sought money primarily as working capital, to cover direct costs of service provision and core operating costs. Where the primary activity of an organisation delivered against its social and economic objectives, full cost recovery was more achievable, as was the generation of a surplus. However, where a TSO had set up a trading subsidiary and the revenues generated through this activity subsidised the organisation's primary activities, it was less straightforward to cover the full costs since the trading and service delivery activities were not necessarily intrinsically linked. There were many instances of TSOs operating a trading subsidiary model relying on subsidy from voluntary work, donations of resources and working for a lower than market-rate salary. In these instances, and where a TSO relied on grants and contract funding, their prime concern was to survive - development of the organisation was a luxury many could not afford whilst they were primarily operating in a "fire fighting" mode. As discussed elsewhere in this report, the short-term nature of grants and contracts, and the restrictions inherent in many sources of funding, affect many TSOs' ability to cover their costs fully or to undertake any development planning. This is particularly the case for VCOs. The consequence is that the majority of TSOs involved in this research reported that their primary, and indeed only, use of money related to maintaining current operations and delivering their service, rather than being in a position to invest money in securing their future and growing the organisation.

### Current sources of money

#### VCOs

- 3.4 For VCOs, grants, Service Level Agreements (SLAs) and public sector contracts, alongside funding from the Big Lottery and charitable trusts, represent key sources of revenue. These organisations often deliver services to client groups which are defined as hard-to-reach or vulnerable, and who are unable to contribute to either any or some of the cost of the service.

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<sup>20</sup> The surplus income generated from trading and other income generating activities, which can then be used as unrestricted funds.

Traditionally, these services have been funded by statutory sector grants and fulfil functions that conventionally fall within the remit of local authorities, county councils etc.

3.5 Other sources, such as donations, membership fees, funding from the private sector and their own internally generated revenues reportedly represented a relatively small percentage of the sub-sector's overall income base. Indications would seem to suggest a regional difference in the importance of funding from Charitable Trusts. Most notably, the North East region seems to demonstrate a greater degree of reliance on funding from Charitable Trusts<sup>21</sup>.

3.6 Notwithstanding these generalisations, the sources of funding accessed by individual VCOs are influenced by a number of factors:

- **activity**, which can influence eligibility to apply to particular sources of funding. In particular, VCOs that deliver activities such as training which lead to recognised National Vocational Qualifications (NVQs) often find it easier to access funding than others
- **client group**, whereby the funding available for some special interest groups is greater than for others, although in some cases this may reflect the higher costs of delivery to particular groups
- **location** will also inform their ability to access funding, given that the statutory sector agencies' strategies and priorities vary by region, at the local level and there are also specific area based initiatives
- the **legal form** of the organisation may also have a bearing on the type of funding and finance they are able to access. For example, some grant funding agencies will only grant aid registered charities, whilst others will not fund social enterprises because of their sometimes greater levels of reserves and perceptions of being arm's length public service providers and therefore not really charitable in their aims and objectives.

3.7 Significant numbers of the VCOs consulted are involved in some form of income generation, either to supplement, or in many cases to subsidise, project delivery where grants or contracts are insufficient to meet full cost recovery. Where the activities of a VCO are rectifying a market failure, their core activity is unlikely to generate a significant income stream. Any trading activity is likely to be somewhat marginal to VCOs' mission and therefore brings with it the danger of diverting resources from the core activities and objectives of the organisation. Several examples of VCOs that had established trading arms were present amongst the participants. Where the trading activity was labour-intensive - consultancy and training are examples where predominantly time is being sold – this was reported to have the potential to divert core resources (human and physical) away from the organisation's central activity. In other cases, where products were traded through an associated trading subsidiary, the resourcing of this could have a less critical impact, if the activity was managed and delivered by separate staff and where full cost recovery with surpluses could be achieved. Trading can therefore be classified either as a natural extension of core activities, or as a displacement

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<sup>21</sup> The North East focus group cited a report published by NCVS entitled 'The voluntary sector in Newcastle upon Tyne (2005)', which cites that Charitable Trusts' average contribution has risen by almost 65% in Newcastle.

from these. In the case of the VCOs, the latter is more likely to be true, bringing with it a resultant tension created by the need to generate income to survive, and the pressure to deliver outwith core objectives.

### **Social enterprises**

- 3.8 As with the VCO cohort, social enterprises overwhelmingly reported that they obtained money from multiple sources, in a range of forms. However, for social enterprises these included, most typically, revenue generated from trading and from their asset base. Where physical assets were owned, asset-related income was a significant source of money, either through rental from tenancies or through short-term rental of facilities for activities such as training and conference/meeting facilities.
- 3.9 Rental income was a significant factor for Development Trusts; all but one that participated in the research had acquired assets and, in line with their ethos, were looking to extend their income generation through this route in the future (both through further acquisition of assets and through increased efficiency of usage).
- 3.10 Whilst revenue generated from trading was most common for social enterprises, this cohort also drew heavily on grant and public sector contract funding. For this group, membership fees, donations and subscriptions were not reported to be significant sources of money.
- 3.11 The use of loan finance was explored and a considerable number of social enterprises had accessed loans from commercial banking sources. Social banks<sup>22</sup>, providing loans at a competitive rate, were also used, particularly the Co-op Bank, their attraction being either their social and ethical policy or particular benefits offered associated with lending (for example, instances of loans being offered without a requirement for security).
- 3.12 Few social enterprises reported accessing finance through CDFIs or alternative financial providers. Where there had been contact with a CDFI, they were commonly reported as more expensive than commercial sources of finance (typically from 1.5% to 2% above the commercial lending rate), and arranging the loan took longer<sup>23</sup>. Social enterprises reported that they had been expected by CDFIs to “go to the high street banks, be turned down, and then approach the CDFI” – causing a considerable time to elapse before they started the loan negotiation process. The procedures associated with loan applications to CDFIs were also reported to take longer than those with commercial banks and were a source of frustration with those social enterprises that had approached CDFIs. Most organisations reporting they had accessed loan finance had therefore opted to borrow from a commercial bank, or social bank at a commercial interest rate.
- 3.13 It should be noted, however, that these social enterprises were in a position to access loan finance through commercial sources because they met the lending criteria (sufficient collateral, acceptable credit rating, appropriate legal form and the ability to repay the loan on

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<sup>22</sup> Fully regulated banking entities with a social purpose.

<sup>23</sup> A range of reasons for the length of time experienced to negotiate finance from a CDFI were put forward, including time needed to conduct the due diligence process (particularly in the absence of collateral), the need to negotiate social impacts and outcomes, and the non-traditional repayment terms (for example the inclusion of repayment holidays), amongst others. However, these data were speculation from the demand side, and need to be substantiated by further investigation.

commercial terms over an agreed timescale). Where TSOs were not able to meet these conditions, there was little evidence of either seeking or accessing loan finance from a CDFI or alternative finance provider, or exploring options such as ‘patient capital’, despite their aim being to provide finance to Third Sector organisations that are excluded from accessing finance from commercial lending sources.

- 3.14 Of those that had used CDFIs, TSOs welcomed the packaging of grants and loans in the form of ‘patient capital’ and valued the support accompanying loans. A number of organisations who had pursued support from the Futurebuilders Programme voiced their frustrations with the public sector contracting threshold of 51%<sup>24</sup>, which effectively debarred them. Others, delivering services mainly on behalf of the public sector, reported positive experiences with Futurebuilders. A small number of organisations consulted had made use of the Adventure Capital Fund’s developmental grants to explore and develop enterprising activities. This approach, regarded as an entry level finance mechanism with support, was particularly valued by recipients and described as a good model.
- 3.15 Evidence from the research showed that negotiating and agreeing patient capital investments from CDFIs tended to take much longer than mainstream loans. This was attributed to the time taken to tailor loans to the TSO and negotiating social as well as capital returns on investment.
- 3.16 Growth funds which use the patient capital model offering a mix of grant and loans to encourage movement away from grant dependency towards controlled growth were also considered valuable. There were a few examples of such packages being accessed. Case 1 below describes the mixed experience of one TSO in the healthcare sector.

Table 3-1: Case 1 – Impact Integrated Medicine Partnership

Impact Integrated Medicine Partnership (IIMP) was started in 2001 by two complementary medicine practitioners. In 2003 it was set up as a not-for-profit company limited by guarantee and currently has a staff team of three. The organisation won the NHS Alliance Acorn award 2006 for complementary and integrated healthcare. IIMP provides acupuncture, chiropractic and homeopathy, which are health related services typically available within the private sector but not available to those who cannot afford to pay. A considerable percentage of their patients have come from disadvantaged communities and require long-term support. IIMP originally received four year funding from a New Deal for Communities (NDC) programme, but this contract terminated in December 2006 and they are currently experiencing a hiatus between contracts. This gap in funding has caused employees to be put onto reduced hours, and the organisation to face uncertainties in terms of their survival.

In January 2007, IIMP received a Futurebuilders grant to develop the organisation’s business skills and they intend to negotiate additional finance from Futurebuilders to take the organisation forward. However, further Futurebuilders’ investment can only be secured on condition that a public sector contract is in place. The local Primary Care Trust, whilst keen to commission IIMP’s services, are still in the process of working on practice based commissioning priorities and are unlikely to be ready to commission until the end of 2007 at the earliest. The Impact team therefore are now working in private practice, and exploring other public sector contracts to ensure the organisation’s survival.

- 3.17 ‘Lead-in’ funders were valued by recipient organisations because of the way they aided the transition from grant dependency to trading and use of finance. Thus CDFIs which provided relatively small scale grants, for instance the Key Fund South Yorkshire Ltd whose ‘Enterprise Fund’ provides grants of up to £5,000 for enterprise development and start-up costs, were seen as an effective way of helping to achieve cultural change amongst TSOs.

<sup>24</sup> The Futurebuilders England Limited 2007/08 Investment Plan states that “the cash flow projections for the proposal have to show a realistic likelihood that more than 50% of the required income, flowing from the proposal once up and running, will come, directly or indirectly, from statutory bodies.” The Chancellor’s Pre-Budget Report (2007) recently announced a relaxation (widening) of the public service delivery areas eligible for Futurebuilders’ investments.

- 3.18 Some organisations felt that it was easier to access finance as gap funding, once other grant and contract avenues had been explored and exhausted. However, other organisations claimed that securing a loan for part of a project helped to lever in grant funding, since the grant funder was then seen as the gap funder and not the main provider.
- 3.19 Despite some forms of legal structure either precluding borrowing or making it considerably more difficult, this in itself did not seem to be a significant barrier to accessing finance, as other factors influenced the consideration of loan finance before legal structures were considered – notably lack of awareness of sources of finance and the potential benefits; lack of collateral against which to secure a loan, and the risk associated with potentially insufficient and unpredictable income streams. Case 2 illustrates one social enterprise’s approach to date, and the change in their thinking as a result of recent experience.

Table 3-2: Case 2 – Daily Bread Co-operative (Cambridge) Ltd

Daily Bread Co-operative (Cambridge) Ltd, based in Cambridge, describes itself as “a combined social enterprise and workers’ co-operative with Christian values and an ethos that everyone is equal”. The organisation is entirely self-financing, which is one of its aims, and its ethos is described as ‘people before profit’ (an acceptable break-even being to balance the books and pay all staff, but not necessarily to generate a surplus). As a result, Daily Bread Co-operative had not built up any reserves, nor does it have an asset base since the premises are rented and they “own nothing except the furniture”. They had, in the past, considered purchasing premises, but for reasons of prohibitive redevelopment costs, the high risk associated with taking on a loan, and the potential loss of customers and business linked with moving premises, they stayed in their rented premises.

However, just over a year ago the rent on their premises doubled with the arrival of a new landlord who was seeking a market rent for the site. As a result, the co-operative had to seek finance to pay the increased rent enabling them to remain in their premises.

The finance has been sourced through an overdraft facility of £35,000 from the Co-op Bank at an interest rate of 8%. This option was chosen following discussions with a range of institutions providing loan finance to TSOs. The need for the finance was urgent, and one institution was ruled out on the basis of the length of time to undertake due diligence prior to providing the loan. Two other institutions would have provided large loans to purchase a building, but did not offer a relatively small (c. £30,000) loan on a short-term basis.

As a result of this experience, Daily Bread Co-operative’s attitude to finance has changed. They now understand they need ‘a contingency’, and their intention, once the overdraft is paid off, is to build up a reserve which will enable them, in the future, to buy a unit. This will provide them with an asset base, provide the means to develop an additional stream of income through renting out part of the unit to another social enterprise, and to generate a return on their investment.

- 3.20 The concern about risk was caused by a perception that banks will not lend against revenue streams which are generated through short-term contracts; and a concern that the short-term nature of the organisation’s income streams may leave them unable to repay the loan, with the consequence of the trustees being liable for the debt.
- 3.21 However, despite there being little evidence of loan finance being accessed so far, there existed a considerable intent to shift the balance of the funding structure away from a dependency on grants. A number of factors influenced this thinking, not least the reduction in sources and volumes of grants available. The increasing accountability and associated bureaucracy reported to be required from some grant providers also influenced the desire to be less reliant on grants and gain more control. That said, plans to reduce dependency on grants revolved mainly around increasing internally generated income. Whilst for many social enterprises their core activity generated income and, depending on the success of their operation, they were well positioned to grow the enterprise and increase income and surpluses; for others – and the majority of VCOs - the ability to generate income through their own activities required the introduction of additional income-generating activities, which in many cases had the potential to displace their core activity and their limited resource base.

### **Other sources of finance**

- 3.22 Lenders specialising in particular sectors were valued for their understanding of the industry. An example of this was a lender dealing with the printing industry, whose understanding of the high cost of machines and willingness to accept existing machinery as collateral was valued by a social enterprise that had no property to offer as security.
- 3.23 Interest free loans had been accessed by two TSOs located in the North East of England through the Northern Rock Foundation's interest-free loan programme, open to community businesses and voluntary organisations for running costs or to build their asset base.
- 3.24 Amongst consultees, the use of equity to finance operations and development was practically non-existent. The inclination to consider this source of finance was extremely difficult to explore because, even where a TSO was in principle qualified to accept equity investment, there was a reluctance to consider this due either to the potential loss of control over the organisation and governance issues, or due to an imperfect understanding of the benefits, the process and the implications. One Development Trust had won a competition run by Business in the Community and received as a prize what they described as "no strings equity investment" from BT and the Post Office, who were seeking unspecified social returns. This organisation is also looking to raise capital from their asset base through releasing equity in one of the buildings they own to finance future development. Beyond these examples of unconventional forms of equity finance, the research did not uncover examples of equity-based financial packages in place.

## Preferred sources of money

### **Grants and contracts**

- 3.25 The preference for the type of money to fund the organisation is determined by a number of factors. As already noted, the majority of VCOs were largely dependent on grant and contract funding, rather than accessing debt finance or other forms of investment to finance the operation or development of their organisation. The preference for grants and contracts is influenced by:
- structural inability – in many cases – to consider debt finance or investment
  - a comfort with the status quo – grants and contracts being the traditional source of funding for their activities
  - the funding essentially being 'free', not linked to repayment obligations
  - their inability to generate surpluses to service loans.
- 3.26 Whilst grants and contracts are the 'preferred source' of money for many VCOs, their short term nature – commonly awarded annually or over a three year period - has adverse effects. In order for VCOs to achieve the stability which will enable them to undertake longer term planning than merely a responsive and 'fire fighting' approach, longer term funding is desirable. This would enable structures and experienced resources to be put in place and

retained and strategic planning to be undertaken with some confidence. As discussed in more depth in Chapter 5, the short-term nature of funding also affects:

- the ability to recruit and retain well qualified and experienced staff – if the funding available only covers one year, the likelihood is that existing employed staff facing an uncertain future will look elsewhere for alternative employment in case the funding ceases. The inability to offer more than a few months' certain employment also makes it difficult to recruit appropriate staff to the organisation to deliver against the contract and to maintain up-to-date intelligence on sources of funding
- the consequent ability to develop stable working partnerships with complementary organisations and key stakeholders - whilst partnerships should ideally be between organisations, they inevitably rely on relationships between individuals and are difficult to maintain with changes in staffing.

### ***Debt and equity***

3.27 One of two conditions needs to be present for debt or equity-type investment to be considered:

- the ability to generate a stream of revenue which will enable regular loan repayments to be made
- the existence of an asset base which either generates revenue (from rental income or from interest earned on capital) to service the debt or which provides security against which to borrow.

3.28 Without either one or two of the above conditions being in place, TSOs are precluded from accessing debt finance or investment if the investment requires the payment of a dividend or the existence of an exit route for the investor.

3.29 This was true for the majority of the VCO cohort. The research revealed that the use of debt and equity finance was also reportedly not widespread amongst social enterprises. Loans, whilst in principle appropriate for the social enterprise cohort, were in simple terms perceived to be too high risk by many organisations due to:

- the ownership of the risk
- the constituency of their boards
- the unpredictability of their income streams
- a lack of detailed knowledge about the products available, the respective characteristics and benefits, and the sources offering debt finance.

3.30 In addition, some trading TSOs were precluded from borrowing because their legal form militated against accumulating reserves and therefore offering collateral. There was some concern expressed by social enterprises seeking to engage with commercial lenders that the lenders could be risk averse in the face of an enterprise they did not fully understand, and that lenders' lack of understanding of the concept of a social enterprise could influence their

willingness to engage with these organisations. However, without close examination of individual cases, it was not possible to identify how widespread this was, and whether an enterprise had failed to access a loan because of the lack of knowledge of the lender, or whether it was in fact due to the quality of their loan application.

- 3.31 Equity investment invited even less engagement. Currently, this form of investment is either not accessible by social enterprises, due to their legal form whereby they are unable to issue shares in the organisation or do not distribute their profits<sup>25</sup>, or is unattractive to potential investors because there is, as yet, no widely recognised and accepted means of quantifying the Social Return on Investment (SRoI). In terms of the economic RoI, social enterprises fare poorly compared with other, commercially-based, investment options given the higher costs of service delivery they often face and their reinvestment policies<sup>26</sup>.
- 3.32 The adverse experiences faced by social enterprises when seeking finance have, in some cases, been overcome through:
- the organisation itself achieving a clear and accurate understanding of its cost base, which has enabled an appropriate form, and realistic scale of finance to be accessed
  - accounting transparency, enabling external agencies to appreciate the sources and use of money, the cost base (including salaries paid) and the financial structure and asset base
  - educating risk averse board members of the true level of individual risk a secured loan represents
  - identifying the right person within a bank with whom to deal, and educating the bank staff about the objectives, structure, current and potential performance of the organisation.
- 3.33 Relationships with the bank are also reported to be key to overcoming barriers to accessing finance – as well as ‘educating’ the bank, instances were reported of social enterprises changing their bank when they were dissatisfied, and in one case (of a highly growth oriented and successful social enterprise) inviting the bank manager onto the board of the TSO.
- 3.34 The research revealed that the VCOs’ attitude towards debt finance and investment is exacerbated by the attitude of trustees or directors towards debt and risk capital.<sup>27</sup> This is discussed in greater detail in Chapter 5.

### **Corporate philanthropic funding**

- 3.35 Corporate philanthropic funding is, on the face of it, attractive to small cash-constrained VCOs who would benefit from unrestricted funding to support their core costs and service delivery activities. However, the prevailing view reported was that this source of funding is

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<sup>25</sup> Unincorporated Associations; Trusts; Companies Limited by Guarantee; Community Benefit Societies

<sup>26</sup> Surpluses are principally reinvested in the business or the community for the purpose of achieving social objectives, rather than being driven by the need to maximise profit for shareholders and owners.  
([www.businesslink.gov.uk](http://www.businesslink.gov.uk))

<sup>27</sup> Note that OTS has developed training materials for board members making the transition from VCO to social enterprise.

not a realistic substitute for grants and public sector contracts since it tends to be too small and ad hoc to provide security and stability. Moreover, in some cases, the granting process tends to reflect the needs of the donor and their shareholders rather than the beneficiary organisation and the community they serve.

### ***Awareness of finance options***

- 3.36 There appeared to be low levels of awareness, knowledge and even interest in finance amongst the VCOs, largely because finance options do not, on the surface, appear to be suitable for VCOs, given their inability to be confident of making regular repayments or offering a financial return on investment. This is magnified by the fact that many of those working in the Third Sector tend to be socially and environmentally rather than economically driven, with their limited resources invested in service delivery rather than researching finance options.
- 3.37 Nonetheless, in certain circumstances finance could be a route to operating and developing the VCO, but the lack of awareness the research revealed in relation to the spectrum of options available suggests that there is a considerable need to inform and educate VCOs as to the merits and sources of a range of models and financial instruments that have been, and are being, developed to meet the needs and conditions of the Third Sector. This need extends to the sector's intermediary and support organisations.
- 3.38 VCOs were found to be lacking in up-to-date information about the benefits and qualification criteria of the range of financial instruments available to them and the institutions offering them. Whilst, for the reasons discussed earlier, such financial instruments may not be appropriate means for many VCOs to finance their activities, the situation appears to be exacerbated by a lack of understanding on their part, and by the dearth of informed advice on this subject reported to be reaching TSOs from within the sector.
- 3.39 Evidence from the research reveals that considerably greater numbers of social enterprises were aware, had considered or taken up finance options or were seriously exploring these as a future possibility. Suggested anecdotal reasons for this greater awareness amongst this cohort include:
- differing business models adopted by social enterprises which have an explicit objective of generating surplus for community reinvestment
  - a stronger focus on primary trading activities which generate a surplus, rather than on secondary trading activities which generate an income through more philanthropic routes
  - a stronger focus on asset based development, which enhances trading opportunities
  - explicit income generating targets and developmental trajectories
  - less of a tradition of grant dependency and a much stronger enterprise culture
  - greater levels of staff previously employed in the private sector

- the quality of the boards for social enterprises was considered to be a key determinant of the propensity to take up finance options.

## The requirement for innovation

- 3.40 the brief also sought understanding about ‘the extent to which innovative projects are not able to progress because of lack of finance’. Rather than there being a lack of finance for innovation, funding providers often require demonstration of new and innovative solutions to projects, as opposed to providing continuation funding for the delivery of tried and tested services. Where a service or process was effective, the need to demonstrate innovation as a condition of funding was questioned by consultees. In reality, this requirement to demonstrate innovation often led TSOs to engage in what they perceived to be time-consuming repackaging of existing projects or unnecessary changes being made to projects in order to qualify as ‘innovative’. Essentially this was described as *‘putting old wine into new bottles’* rather than genuine innovation.
- 3.41 The duration of grants and public sector contracts also has a considerable bearing on the ability of an organisation to be innovative:
- innovation requires development time and therefore funding/finance extended over a sufficient period to cover this investment in innovation
  - the cost of innovation, such as new systems and structures needed in order to refine the method of service delivery, tends to be incurred up front and revenue returns that compensate for the additional investment take some time to generate.
- 3.42 Nonetheless, many TSOs were engaged in developing innovative services and processes; for example treatment and support within segments of the health and social care sectors. It is precisely because their models differ from accepted approaches that they require funding to prove the concept and amass sufficient evidence of effectiveness to put themselves in a position where a public sector contractor will purchase their services. Without being able to provide evidence of a robust ‘business case’ to a finance provider, accessing a loan to underpin the development of innovative projects was seen to be extremely difficult, particularly given the other constraints to accessing finance many TSOs face in addition.
- 3.43 Equity investment would, of course, be an appropriate means of financing innovation but, as is discussed in more detail in Chapter 5, there are many barriers currently which preclude TSOs from considering equity investment as a route to developing the organisation.

## 4: Support that was available with the finance and its importance

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- 4.1 Experiences were very mixed regarding the non-financial help TSOs were able to access in conjunction with their attempts to access finance. This support can broadly be divided into two types:
- Support offered by the funding/finance provider (linked)
  - Support available from other sources unrelated to the funding/finance provider (arm's length).
- 4.2 There were differences, whether the TSO was categorised as a VCO or a social enterprise, in the sources of the support, the nature of the support provided and the future needs in this sphere. The experiences of both groups are discussed below.

### VCOs

#### ***Support offered by the funding/finance provider***

- 4.3 VCOs focused their discussion on the support they had received from different grant funding agencies and, in some cases, contracting agencies. The main support available for this group was at the pre-bid stage in the preparation of funding applications – which was also where VCOs' need was reportedly most acute. This reflects the time senior resources spend on bid preparation, and the frustration reported when bids fail because the VCO either has not fully understood the parameters of the call for applications/tender, or the brief has not been completely transparent (there were several instances where VCOs learned in retrospect that the scale of the output targets associated with the contract excluded them from bidding). The lack of feedback from grant and contract providers is also problematic in that, without understanding the weak points of an application, it is difficult to identify what support is needed. One VCO described the difficulties of *“juggling between different hats – an application must be professional and streamlined for contract funding, but more aimed at the heart when applying for grant funding”*. Whether or not this is strictly accurate for all grant and contract funding, it nonetheless demonstrates the range of skills even a small VCO needs to draw on in order to prepare successful funding applications. Generic VCOs that work across different geographical areas and with different groups of excluded people need to acquire a range of skills in order that they are positioned to write bids for funding located under different Third Sector funding and finance regimes (e.g. Councils for Voluntary Services, arts based organisations, organisations working with homeless people).
- 4.4 Their experiences of support for bid development were patchy and ranged from very good to reportedly poor. Whether support was offered depends on the funding provider. Some funding organisations were described as highly engaged in providing support – one example was cited of a provider only accepting applications if the TSO has received advice from one of their representatives, typically an ex-bank manager. Other funding providers were reported

to make support available, but the people providing the help were described as inexperienced and possessing poor knowledge of the Third Sector.

- 4.5 Many VCOs highlighted the need for, but lack of, ongoing support once funding had been awarded. This need was raised in the context of the complexities and administrative burdens associated with managing and monitoring grants and contracts, and a strong call was made for the standardisation of application forms, monitoring and reporting systems across different funding streams. Support relating to the use of, and payment for, in-sector mentors and non-executive directorships for VCOs wanting to pursue finance were also requested.

#### ***Support available from other sources unrelated to the funding/finance provider***

- 4.6 Help from the local CVS was relatively common in bid preparation; however, these organisations' resources are stretched and whilst there was considerable satisfaction reported with some of the help received, they are reportedly not always able to devote sufficient time, nor provide sufficiently specialist advice to meet the varied requirements of bid applications.
- 4.7 The professional skills of the VCO's members/trustees were also accessed in some cases, highlighting the importance of ensuring the board constituency brings the right skills and experience to the VCO. Another source of affordable professional expertise was through schemes run by banks and accountancies whereby their junior staff are attached to a TSO to gain experience in the sector. The research suggests that this type of support is easier to access in London and other large conurbations.
- 4.8 For these resource-constrained VCOs, paying for support either at the pre- or post-bid stage is often not an option. The research suggested that culturally VCOs were also not oriented towards the services available through the 'mainstream' business support infrastructure. There was therefore little evidence of 'mainstream' business support sources being accessed, although there is, in principle, considerable commonality between the skills and know-how a TSO and an SME require for the preparation of a bid for a tender.

## **Social enterprises**

#### ***Support offered by the funding/finance provider***

- 4.9 The support available from finance providers was reported to have been offered mainly by the social banks. The advice and guidance was normally linked with a lending opportunity. Commensurate with the low levels of borrowing evidenced by the research, there was little detail reported of the nature of the accompanying support received, other than that it was targeted primarily at the pre-finance stage, with less support usually available once the finance was in place (reflecting the VCO experience). The consensus was that as TSOs become more sophisticated, moving from simple loans to more complex finance packages, so the needs for advice become more highly developed, and consequently less commonly available.
- 4.10 In relation to support for bid development for finance, the 'money with management' model, whereby pre-application and pre- and post-finance award support is available, was deemed to be attractive and helpful amongst organisations consulted. A strong emphasis was placed on

the skills, experience and expertise of the people providing this support and the need for ongoing support, including the use of and payment for in-sector mentors and non-executive directorships for TSOs wanting to pursue finance options.

***Support available from other sources unrelated to the funding/finance provider***

- 4.11 A range of institutions exist to help social enterprises, and provide advice and signposting on – amongst other subjects – funding and finance. This encompasses sources of finance, preparation of bids and finance applications, wider ‘investment and finance readiness’ support to strengthen the social enterprise so it is well positioned to access finance, and post-investment support.
- 4.12 The experience again was that the support was available mainly to organisations starting up or at an early stage of development, and was less satisfactory as the TSO grew and required more sophisticated advice.
- 4.13 The satisfaction levels appear to be greater with support received from mainstream business support organisations (Business Link was particularly praised), and there were several instances of a social enterprise reporting that they had “masqueraded as a business and not a social enterprise because the advice is better”. Disappointment was expressed with the sector-specific support provided by social enterprise advisers from general business support organisations (Business Link was again mentioned); the support was described as “behind the times” in relation to issues faced by TSOs.
- 4.14 Views on financial advice from intermediary organisations within the sector was mixed – some was praised whereas there was also considerable criticism of it being out-of-date, simplistic, ill-informed and “delivered by dedicated amateurs”. With the rapidly changing landscape in this field, the need to be fully informed about the range of current finance packages available, their benefits and the conditions attached is essential. Stakeholder organisations involved in the research acknowledged that, in relation to providing advice on sources and types of finance, there is a need to address the quality of support available. Some social enterprises were also concerned that in some cases the advisory organisations were competing for the same pots of funding as the TSO. This was, however, in relation to information on grants and contracts rather than debt and equity finance.
- 4.15 Some TSOs reported positive experiences accessing sector-specific support and, in a few cases, paying for it. An example cited was ‘Tendering for Care’ for which one TSO paid an annual subscription of £3,000 to access a range of advice, and had the option of paying an additional fee to buy-in help to write specific bids, and felt this represented value for money.
- 4.16 Others did not take up formal support provision, but favoured networking events to access ‘peer support’ from other experienced practitioners.
- 4.17 Another concern related to the difficulty of locating advice and support. Whilst there are a large number of organisations providing different forms of support, there is little cohesion across the sector enabling TSOs easily to identify appropriate providers. This impacts on TSOs in that they have to dedicate already stretched resources to locating appropriate advice, or they decide against seeking support because they do not have the time to search.

- 4.18 There were geographical variations reported in the availability of support, most notably in London where the level of support was reported to vary across the boroughs, apparently depending on public sector procurement policies.
- 4.19 Finally, whilst there was some evidence of using the internet for accessing information and support, the main tasks for which TSOs felt they needed help really require more intensive, face-to-face interaction. The key needs appear to be to understand the complexities, nuances and benefits of the rapidly expanding range of financial tools and packages available to the Third Sector and, once the route to financing the organisation had been decided, hands-on help with preparing finance applications and the organisational development support that may be necessary to demonstrate a robust case for finance. Where they had been accessed, buddying schemes and mentoring were praised and recommended, and there was a clear request for this type of support once the finance was in place.

### **Future needs**

- 4.20 There was sufficient commonality in the future need for support identified by the two groups to consider them collectively. Where there are differences, these are noted. The needs identified fall under two broad headings: support to develop the internal capacity of the TSO, and improved support from funding and finance providers.
- 4.21 In terms of the TSOs' internal capacity, the main needs related to the acquisition of what can broadly be termed 'business expertise'. Both VCOs and social enterprises highlighted the need to become more professional in the management of their organisations and, in the context of accessing funding/finance, not surprisingly the need was for financial and accountancy know-how. The specific nature of this know-how will vary depending on both the type of organisation and the funding sources it typically accesses, its legal form, and also on the stage of development of the organisation (that is, its size, maturity and sophistication). Organisations identified a particular need:
- for handholding in the bid preparation process
  - for language skills – for some VCOs, representing particular ethnic or national groups, preparing bids in English means they are working in their second language
  - for advice, guidance and skill development as TSOs move from grant reliance to income generation
  - for training and information to help them understand the financial and tax implications of different funding sources – grants, contracts, SLAs and trading – and their state aid implications
  - for help to prepare accurate full cost calculations in order to derive full cost recovery from grant/contract funding. Not only is this point important for individual organisations, but the importance for the sustainability of the sector was underlined (the current situation where bids do not always aspire to full cost recovery either because of lack of financial acumen in calculating the costs of the bid, or because a TSO relies on considerable cheap or voluntary resource, means that effective and

qualified organisations may be undercut by bids that are not based on full cost recovery

- for financial and strategic training for trustees
- to restructure boards, to ensure they include professionals who can provide practical help with bid preparation
- for post-application support, both for successful and unsuccessful bidders
- subsidised legal support for TSOs to obtain professional advice regarding property and resource-related issues
- for TSOs starting the process of trading - money to enable them to undertake feasibility studies and test trading to ensure their operations are as robust as possible and to minimise the risk of failure.

4.22 The main suggestions for improvements in support revolved around a clear message to funding organisations regarding their communication with organisations submitting bids. Specifically, the following was requested:

- comprehensive briefing and guidance pre-bid, covering in particular:
  - a clear indication of what the deliverables are
  - the scale of outputs sought in relation to a grant or contract (considerable time was reported to have been wasted submitting bids for which the organisation turned out not to be qualified to deliver due to the scale of outputs required)
  - an explanation of how the core objectives of the TSO connect with the ‘floor targets’ against which the public sector funder reports
- financial tools that facilitate the preparation of bids
- a mechanism to reduce the duplication of effort involved in providing the same qualifying information for every bid opportunity
- the provision of improved feedback and greater transparency from funders post-bid, so the TSO can learn from the experience, and improve the quality and targeting of their bids. Examples were widespread of a standard response being sent to all unsuccessful applicants offering no feedback or right of appeal. Intermediary organisations complained of the same problem
- a particular grievance concerned the use of external assessors for grant applications. A common perception was that bid writing skills were rewarded rather than the proposition itself because the external assessors were not ‘stakeholders’ and consequently did not necessarily understand the relevant context. Whether or not this is the reality, there is clearly a need to improve communication and transparency.

- 4.23 The idea of ‘funding angels’ was floated, whereby a TSO could be matched with an experienced individual who could provide hands-on support with the capacity development of the organisation, and in particular practical input with the bid preparation process.
- 4.24 Finally, in respect of all TSOs but particularly social enterprises, the existence of a widely embraced model for calculating social return on investment would enhance the development of an equity market in the Third Sector, with a consequent widening of finance options and potential access to sources of finance for Third Sector organisations currently disadvantaged as a result of the social contribution they aspire to make to the community.

## 5: Barriers relating to accessing funding and finance

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- 5.1 Whilst this research set out to understand the routes that TSOs had taken to fund their operations, and in particular their development aspirations, inevitably the exploration of these issues broached discussion around the barriers TSOs had encountered in accessing money, whether it be funding or finance. The following section identifies the key barriers to accessing money faced by both VCOs and social enterprises.

### Issues associated with public sector contracts

#### ***Shift to larger contracts***

- 5.2 The shift to larger contracts and packaging of contracts under one tender amongst local authorities and other public sector agencies has had a number of negative repercussions for smaller TSOs - VCOs and social enterprises alike:
- bidding for large contracts often requires a consortium in order to deliver all the dimensions of a tender. Small TSOs often either do not have sufficient resources to deliver the scale of the contract, or lack all the components of expertise necessary to deliver the entire service
  - the shift to regionalisation of service delivery also has the potential to exclude those TSOs that cannot offer full regional coverage, even if they may be the most qualified to deliver the service on a local/sub-regional basis
  - putting a consortium together requires an investment of time, resource and expertise. This is particularly the case in relation to identifying and engaging with consortium partners, delineating the bid and respective roles; drawing up legal formalities, and preparing a rigorous bid document. Small TSOs report that they do not have the resource available to engage in this process, nor do they necessarily possess the expertise to develop a robust consortium
  - Delivering the service is also costly due to the cultural change demanded of TSOs in terms of collaborative working
  - There is a perception that this move to larger contracts represents a conflict between quality and cost, with the drive for economies of scale and value for money resulting in:
    - a reduction in the quality and customisation of the service (the argument being that private sector organisations, with less commitment to the social objectives of the service, are able to undercut TSOs)

- a reduction in the differentiation of services which have traditionally been targeted at very specific needs of sometimes small communities (defined by client group or by geography).

5.3 Whilst the intention of local authorities is to shift to a greater use of Third Sector service delivery, there is a concern that the drive to produce economies of scale and the downward pressure on costs will exclude the very organisations the public sector seeks to engage, since the small TSOs do not have the capacity either to engage in the bidding process or to deliver large packages of services.

### ***Demonstrating full value for money – the need for social as well as economic measures***

5.4 Despite social enterprises being encouraged to tender for public sector contracts, the selection criteria for these opportunities do not always fully recognise the social returns and added value associated with the delivery of a service. This manifests itself in two ways:

- In assessing value for money, where the high cost of delivering services tailored to meet the needs of specific communities of people, or geographic communities, may militate against winning the contract if it is couched in relatively broad terms, as is the trend with packaging of contracts and increasing their size. An example cited illustrated the difference in cost between delivering services to the deaf and to the deaf-blind communities, whereby the cost of delivering a comparable service to the deaf-blind group is considerably higher than for the ‘deaf’ group, with ‘value for money’, when measured in terms of individuals accessing the service, consequently appearing to be lower for the service to the deaf-blind. It was reported that services to these two communities were competing for funding from one funding source, but in fact the comparison of the two tenders was effectively comparing ‘apples with pears’, with the services to the deaf-blind reportedly losing out in the selection process.
- The problems of demonstrating full value for money, when some of the benefits are indirect. For example:
  - encouraging local purchasing generates added value through local multipliers, but there is no simple – or accurate – way of quantifying this, particularly prior to the delivery of the service
  - a similar problem is faced by TSOs operating in the Health sector, where the wider benefits of the services delivered are only measurable over the long-term, and are therefore extremely difficult to quantify. An example is described in Case 3.
  - TSOs operating in rural areas face greater problems meeting standard value-for-money indicators due to the higher cost of delivering services to dispersed rural populations (greater costs associated with the time needed to take a service to a beneficiary, and the associated direct costs of travelling greater distances, as well as the effort needed to identify and connect up relatively invisible communities).

Table 5-1: Case 3 – AS-IT

AS-IT was founded in 2005 and was granted Community Interest Company status in 2006. The overall aim is to create supported employment opportunities in IT for people with Asperger syndrome, one of the autism spectrum conditions, at their ability level and with proper career progression opportunities. Only 12% of people with Asperger syndrome are in full-time employment, although many are educated to degree level and beyond. It is estimated that there are almost 230,000 unemployed adults with Asperger syndrome in this country. The estimated lifetime cost to the Exchequer of a person with higher functioning autism or Asperger syndrome is £750,000. But the reduction of cost to the state is only part of the story. Adults with autism say that finding a suitable job would improve their lives more than anything else (National Autistic Society). The lifetime exclusion from work that many people with autism experience is one of the factors that lead to secondary mental health problems, such as depression - people with Asperger syndrome are widely recognised as being a high risk suicide group.

AS-IT sought funding for a three year pilot to develop a model that will help large numbers of people with Asperger syndrome into employment at their skill level and with proper career progression opportunities. The application failed on the basis that the project was 'high cost/low yield' because there were only five people with Asperger Syndrome on the pilot. However, the pilot was intended to develop a model which would help thousands of other people with Asperger syndrome into work without any further financial investment. AS-IT requested funding equivalent to less than the lifetime cost of keeping one person on benefits for the three year pilot, so even if the only outcome of the pilot was that the five participants achieved full time employment, the long-term saving to the economy achieved by the project would be at least £3,000,000. With nearly 230,000 unemployed adults with Asperger syndrome in the country the potential savings are enormous, but AS-IT report that these wider benefits were not fully acknowledged in the assessment of their funding bid.

### **Standard value for money indicators**

5.5 Whilst the need for cost-efficient deployment of the public purse is recognised, the value for money measures can encourage cost reductions which have the potential to affect the quality, or the nature, of the service delivery. The research identified that value for money considerations can discourage working with particularly disadvantaged groups of people, who tend to be the client groups of small VCOs. While social services are driven not only by economic considerations but also by a social 'bottom line', at present there is no consistent approach to factoring in social 'value for money' considerations into contract targets and indicators. This has the following effects:

- TSOs, and indeed all delivery organisations, are under growing pressure to conform to economic measurements in order to access funding, but the economic imperatives may operate against, or make it harder to deliver, the social objectives which are fundamental to the services being delivered
- there is a difference between the drivers of TSOs and 'mainstream' enterprise with whom they may be competing for a contract. If an enterprise is driven wholly, or primarily, by economic objectives, it may be easier for them to deliver against the economic 'value for money' measures set out for the contract. This is not meant to suggest that mainstream enterprises are more likely to forsake quality; rather that the social objectives of TSOs will require them to deliver services which are high cost - and can therefore appear low value for money - in order to ensure the hard-to-reach and vulnerable communities receive an adequate service. In this context, many TSOs are essentially stakeholder deliverers, which means that they are anchored in communities. This is different from commercially driven providers who can 'parachute in' if there is a profit and withdraw if not. One way of avoiding this is through the use of social clauses in public sector contracts – thereby compelling the private sector to compete on an equal footing and arguably promoting corporate social responsibility

- it was reported that services carrying particularly high costs can be disadvantaged in terms of accessing funding because, due to the indicators used to measure value for money, the services appear to be performing poorly. The underlying reality, which is not always made explicit in the monitoring and measurement process, is that the cost of delivering services can vary considerably, depending on the needs of the target beneficiaries and current approaches to assessing value for money may not be sufficiently finely grained to accommodate the variation in the cost of delivering what are ostensibly similar services. The deaf-blind example cited above further illustrates this point.
- a further obstacle faced by TSOs is the requirement to monitor outputs, rather than outcomes<sup>28</sup>, which can lead to the true value of the organisation's activities not being acknowledged by the funder's assessment methods. Examples of this can be found in the health sector, where the ultimate cost savings to the public sector are estimated to be enormous. A novel treatment of substance abuse was one example cited, where results show the success rate to be significantly higher than that achieved using current methods. Adopting the novel approach would lead to a reduction in long-term treatment costs but these were not factored into the output measurements. Support to people with Asperger syndrome (see Case 3) was another example, the premise being that a large percentage of sufferers could undertake full- or part-time employment with appropriate support, which would reduce the cost of both current care and potential intensified care due to mental health problems/depression suffered through being excluded from employment. The true economic benefits of funding such support are not reflected in short-term measurement of outputs, exemplified by reporting on activities such as numbers of individuals 'processed'.

#### *Cost minimisation*

- 5.6 Public sector contracts are often not based on full economic costing/full cost recovery<sup>29</sup>. There is a perception that VCOs are positioned to, and will, deliver at below market rate due to the voluntary time contributed to, but not factored into, the budget; and due to the high level of commitment of the organisations involved which will lead them to perform above and beyond specification. This has resulted in VCOs being well placed to win contracts, but conversely unable to cover their costs and therefore achieve sustainability, with no ability to accumulate reserves and demonstrate revenue streams which might enable them to lever additional funding (of whatever type) or expand their activity. The primary driver of most VCOs is therefore survival, resulting in a short-term perspective, the inability to plan and an externally controlled destiny. Furthermore, the apparent 'cheapness' of VCOs can work against them being seen as professional, credible organisations who can deliver, and serves to underpin reported perceptions of the sector as 'amateur'.

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<sup>28</sup> Outputs are defined as 'the tangible (easily measurable, practical), immediate and intended results to be produced through sound management of the agreed inputs'. Outcomes are defined as 'the results achieved at the level of 'purpose' in the objective hierarchy – the end result that is sought'.

<sup>29</sup> HM Treasury endorsed the principle of Full Cost Recovery in its review "The role of the voluntary sector in service delivery" (2002), and again in "Guidance to Funders" (2003).

### **Funding restrictions**

- 5.7 A further pressure on VCOs dependent on grants, SLAs or public sector contracts is that in many cases the funding is restricted<sup>30</sup> and can only be used to fund direct costs of delivering the contract. Whilst the VCO is able to cover the cost of the direct service provision, a common problem faced is covering the management and central costs, which are not directly related to service delivery, but which are critical for contract/service delivery, i.e. full cost recovery.

### **Cash flow gaps**

- 5.8 Where VCOs have been unable to accumulate reserves, they are vulnerable to the time lags that can occur between submitting funding applications and receiving the funding. This can result in a gap of up to several months between one grant or contract coming to an end and another beginning, with consequent serious cash flow problems being experienced. This situation was reported widely in the research.

### **The preferences of funders**

- 5.9 Two issues were highlighted here which affect VCOs' ability to access funding. Whether or not these can be categorised as barriers faced by VCOs, or whether they should be treated as characteristics of the sector, is debatable. However, in both cases the issue was reported as a barrier to accessing funding.
- 5.10 In the first instance, VCOs reported difficulties in accessing funding from some charitable trusts where their view was that the VCO's services should be delivered by the public sector. There was a consequent unwillingness to fund some projects.
- 5.11 In the second case, the distinction was not based on the division between Third Sector and public sector responsibilities, but on the preference of a charity for certain activities and causes, over and above others, with the result that there is more money available for some beneficiary groups and needs than others. An example of this reported barrier to growth is illustrated in Case 4 below.

Table 5-2: Case 4 – Interlink Foundation

Interlink Foundation was founded to support the Charedi/Orthodox Jewish voluntary sector, in a similar way to a CVS. Lack of capacity has been a considerable barrier to Interlink and its member organisations' development. They have been working in partnership with a Local Authority to renovate and develop a building through the asset transfer process. With the current climate, however, they have had difficulties in achieving this because they are seen as not universal, but a faith-based group. However, in Interlink's opinion, a faith-based group might be best placed to manage such a building as they understand the needs of their own and other communities at grass roots level.

They claim that the focus on community cohesion and providing services which are accessible to all can result in marginalising certain minority communities, and that Interlink has suffered from funders' reluctance to fund what is perceived as separate. They acknowledge that some degree of separation is necessary to preserve their culture but are keen to engage with others in partnership-working and to promote cultural awareness and understanding. Interlink's inability to access the funding to take on the asset is acting as a barrier to future borrowing, and therefore risks stunting the Foundation's own growth as well as that of its member organisations.

<sup>30</sup> Money which can only be used for certain activities, certain groups of people or for certain geographical areas. Restricted funds are effectively money which comes with 'strings attached' relating to the delivery of certain inputs, outputs and outcomes.

## The burden on resources of applying for, and reporting on, funding

- 5.12 The problems of covering the core costs of a VCO have been alluded to earlier in this chapter. A large majority of VCOs reported that they were resource-constrained and the need and demand for their services outweighed their ability to deliver the service. An additional burden on the already extended resources is the cost related to the senior executive time involved in applying for funding and ensuring sufficient funding is in place to secure the immediate future of the organisation and the delivery of its services (and therefore objectives). Devoting up to 50% of a senior member of staff's time to the preparation of funding applications was reported to be not unusual, and spending at least 25% of a person-year on fundraising was commonplace. In many cases, this resource may well be the only resource, or one of few, available to the VCO, with the inevitable consequence of deflecting resource from delivering the objectives of the organisation. Whilst this pattern can reflect that faced by small commercial businesses, the distinction is the ability of businesses to factor the marketing costs into their pricing – competition allowing - whereas grants and contract funding often exclude coverage of core costs.
- 5.13 Reasons for the time devoted to the funding application process include:
- the need to apply to a wide range of funders because of uncertainty regarding which bid wins
  - the small amount of support, in the form of help with applications, given by funders and their special requirements
  - lack of clarity regarding funders' priorities, unclear eligibility criteria, lack of information from the funders and confusion regarding the information required
  - the complexity of putting together a funding application
  - the difference in funders' requirements for information and the format of funding applications, and the challenge of having to deal with up to 15 different funders' requirements.
  - once the funding has been accessed, there are similarly heavy demands on staff time to collect, collate and provide monitoring information and data and to report to the funding provider(s); again, multiple providers with different reporting formats mean a multitude of reports in different formats and reporting to different timescales.
- 5.14 All of the above contribute to a short-term focus. Analogies with Maslow's Hierarchy of Need<sup>31</sup> are relevant here since if an organisation cannot satisfy its requirements for day-to-day operation, it will be unable to step back, be reflective, to think more strategically about its future and to address its funding issues/needs in a long-term developmental strategy.

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<sup>31</sup> A Theory of Human Motivation. Abraham Maslow, 1943.

## The burden of reporting

- 5.15 In relation to funding, the burden of reporting was raised as a sizeable drawback associated with some grants and the majority of public sector contracts. The burden is due to three aspects of reporting:
- **timing**, which can differ amongst different funding bodies (i.e. annual, quarterly, monthly, and to different milestones)
  - **indicators**, where funders set out different ranges of indicators in their monitoring requirements. These can, for example, relate to regional Tier 2 Outcome Targets and Tier 3 Output Targets, or local economic development indicators, or social and environmental measures. Collecting relevant data and reporting against a wide range of measures consumes senior time and displaces this resource from core activity
  - **collecting beneficiary data**, many of whom are not easily accessible (for example, the homeless).
- 5.16 Whilst there was little serious demand for money to be provided without any need to account for it, the research identified a strong request for funders to streamline their reporting requirements so that TSOs are required to respond, as far as is possible, to a coherent and standardised set of core indicators.

## Size and robustness of the social enterprise

- 5.17 Whilst less central to their operations than for VCOs, both grants and contracts were still an important funding component for social enterprises. Some social enterprises reported that they had become ineligible for some grants as a result of growth. Clearly, the shift in the public sector to larger contracts can favour the larger TSOs, so there are benefits to achieving growth. However, considerable frustration existed that the accumulation of reserves – vital to building up a sustainable and growth oriented enterprise – could act as a disqualification to accessing grants, in many cases which shared the same aims as the enterprise.
- 5.18 In other cases, the converse was true, with accumulated reserves, covering a specified duration of trading, being a condition of being included on local authority tendering lists.

## Personal liability

- 5.19 Considerable discussion ranged around the subject of the personal liability of trustees and individuals involved in the conduct of the organisation, and the consequent barriers to raising loans because of the potential liability faced by the members/trustees if the TSO were to be unable to repay the loan. This barrier can be traced, mainly, to two conditions:
- first, some forms of TSO require their members/trustees to carry the risk of personal liability – typically, these are Unincorporated Associations and Trusts, since neither form have a separate legal identity. Companies Limited by Guarantee, a typical legal structure for a social enterprise, whilst limiting the liability of the members, requires them to give a guarantee for a certain sum that will be put towards the entity's

finances if it is wound up.<sup>32</sup> Co-operatives were reported to find it difficult to borrow money because it would require an individual, or individuals, to take on the risk of the loan. However, given all co-operative members are equal, it was unclear which individual(s) should take on the risk. Whilst this did not preclude co-operatives from borrowing, it affected their willingness to consider debt as an option for financing the organisation

- second, the reliance of many TSOs on short-term grants and contracts (typically one-year) means that they find it difficult to demonstrate evidence of their ability to repay a loan taken out over a longer repayment period (for example three years). The narrow base of their sources of income heighten the risk of money ceasing to come in; whilst TSOs reported accessing money from up to fifteen sources, more typically they rely on funding from a small number. If one ceases, this has the potential to have a devastating impact on the organisation. Merely the possibility of such uncertainty renders these organisations high risk in the eyes of potential lenders. This situation is true of small social enterprises seeking to grow, where they have yet to establish a wide customer base and a strong internally-generated revenue stream, as well as for VCOs with limited potential to generate trading-based income.

5.20 The consequence of these conditions is that, whilst there was little evidence offered of trustees and members actually being held liable for debts incurred by the organisation, the prospect of this occurring was sufficient to deter boards from considering loan finance. There was also some frustration expressed about the tension in acting as a personal guarantor, when the risk is personal but the benefit is collective. This concern was widespread, and pointed to the need for:

- education about the benefits and disadvantages of the various forms of TSO; and about the true level of risk facing personally liable trustees/members
- advice for organisations to ensure they select, or restructure into, the most appropriate and least disadvantageous legal form for their needs.

## Board constituency

5.21 Closely related to the above was the issue of board constituency, where the governance of the organisation was seen to determine its attitude towards risk and entrepreneurialism. The boards' quality, in terms of mix of skills and experience, was widely seen as acting as a barrier to accessing finance. In addition to the a shortage of 'business' know-how, there was reported to be a prevailing resistance to generating surpluses on the basis that it conflicts with the principles of the organisation. Many of the participants, however, recognised that income and surplus generation are now, in face of reducing grant funding, preconditions for realising a TSO's mission and for undertaking core activities, and acknowledge the need to embrace a more 'businesslike' approach to managing the organisation in order to ensure its sustainability.

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<sup>32</sup> [www.businesslink.gov.uk](http://www.businesslink.gov.uk) – Practical Advice for Business

- 5.22 In light of these barriers, there was a clear consensus that board restructuring is a key task facing many TSOs in order to increase the level of business and management skills. There was some evidence that this was starting to happen, reported both by social enterprises – who, mindful of the functional skills necessary to trade effectively were selecting their board accordingly – and by Development Trusts where the initial board constituency had been restructured in some cases to recognise the breadth of skills necessary for such an organisation to operate effectively.

### Fitting ‘conventional’ models

- 5.23 As already discussed, the legal form of a TSO can preclude commercial borrowing, or can require TSO members to take on too great a personal risk to be acceptable. In this sense, some social enterprises can fall outside ‘conventional’ models of enterprise which acts as a hurdle, if not an outright barrier, to accessing loan finance.
- 5.24 Conversely, some social enterprises reported that they were considered “too commercial” by funding and finance providers serving the Third Sector to have qualified for money:
- grant providers can penalise social enterprises because they have accumulated reserves, necessary for growth and sustainability. This was described by one contributor as “funding the needy rather than the capable”
  - Some finance providers that support TSOs, amongst others - for example CDFIs - act as funder of last resort and therefore where a social enterprise is technically qualified to access a loan from a commercial bank, they are precluded from doing so from a specialist Third Sector finance institutions, despite their ideological preference to work with these institutions, and – given their higher operating costs associated with their social objectives - the preference for the return on the investment to take into account their social as well as economic returns.

### Meeting funding priorities

- 5.25 This issue relates to the need for TSOs to frame funding bids to fit government targets and policy rather than reflecting their own aims, leading to ‘mission drift’. There was considerable unhappiness expressed at the constraints within which TSOs need to work if they are to obtain funding for their activities, and the inability to access a particular pot of funding from the public sector if their activities do not reflect the funding priorities. We would make two observations here:
- first, that the research revealed an expectation, amongst some TSOs, that because their services have a social or environmental objective they have a right to be funded. If the public sector priorities do not mesh with the TSOs’, there was widespread belief that the public sector was not sufficiently flexible to embrace the TSOs services, rather than a recognition that public sector priorities may be underpinned by a strong rationale and that there may be a case for TSOs to refine their services to reflect the priorities of the public sector

- second, given the belief that grant and contract funding represented a potential threat to the TSO retaining the purity of their mission, the case for financing the organisation through some form of debt or equity finance can be recognised. Indeed, many social enterprises reported a strategic decision to reduce dependency on grant funding through shifting to debt-based finance structure in order to retain and increase their independence and control over their objectives and activities.

## Reliance on limited, short-term sources of money

- 5.26 This issue has been alluded to earlier, but appears to be a wider issue than simply influencing boards' propensity for risk taking. It concerns two aspects of grant and contract funding: the short-term nature of the majority of grants and contracts, and the funding structure experienced by many TSOs, whereby they are often more vulnerable to the loss of one source of funding than commercial SMEs where a virtue is made of a wide customer base.

### **Limited sources of funding**

- 5.27 Not only does the reliance on a limited number of income sources make the TSO particularly vulnerable to the loss of any one of those sources, but the organisation also has to manage the uncertainty of the bidding process and the prospect of failing to access a significant portion of their anticipated funding.
- 5.28 The need to invest in order to be in a position to deliver a contract can cause financial pressures particularly where the investment needs to be made prior to bidding for a contract in order to demonstrate they are able to deliver. However, if the TSO either does not win the contract, or it is not renewed, it will then be left with an investment which they may be unable to use, or to pay for (for example, a mortgage or lease on a property). The short-term nature of the funding, together with the high risk associated capital investment, acts as a barrier to considering loan finance as a route to development.

### **Short-term funding cycles**

- 5.29 Another pressure caused by short-term funding cycles is the inability to plan, or to assure the future of the organisation. The impact of this includes:
- problems with recruiting and retaining good quality resources
  - high levels of senior resource time being spent on casting around for funding and preparing bids on a regular basis – this includes:
    - the preparation of the bids themselves
    - preparation of supporting documentation (such as policies) to fulfil requirements of a range of procurement processes (many with different demands)
    - the pressure on the senior resources can be exacerbated by a lack of detail provided by funders about the outputs required, which can result in time

being wasted applying for funds for which the TSO turns out not to be qualified

- a concentration on service delivery rather than strategic development of the organisation.
- 5.30 In other words, the short-term nature of the majority of funding, be it grant or contract based, contributes to the difficulties TSOs face building a sustainable and self-financing enterprise. The time cost of sourcing money was identified, in particular, as a serious burden on organisations operating with very limited resources, and to tight – and often overstretched – budgets.

## Funding gap

- 5.31 Two key gaps were reported to exist.
- 5.32 First, the availability of small packages of finance which are easily and quickly accessible. The need here appears to be primarily at the early stage of a social enterprise’s development for small sums as start-up and working capital<sup>33</sup>, and rapid accessibility on an ‘as needs’ basis appears to be a key requirement. Again, it was reported that it takes “months” to access a loan through the CDFI route, whereas the need for these small amounts is often urgent. Whilst larger loans are available (for example Futurebuilders, targeted at organisations that have never borrowed before, typically has a minimum investment package of £50,000, although they do offer smaller development grants in some cases<sup>34</sup>), small, easily accessible loans available to TSOs unable to demonstrate a trading track record are reported to be a gap.
- 5.33 The second gap exists at the point where an organisation has grown to a size sufficient to disqualify them from the ‘start-up’ and early stage support they received, but are not yet robust enough to be completely and commercially self-sufficient. Packages such as ‘patient capital’ should address the need of TSOs at this vulnerable stage of development, but the research detected little evidence of organisations being aware of, or engaging with, such finance models.

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<sup>33</sup> Note that this is anecdotal evidence and requires more rigorous underpinning to confirm the scale of the finance gap.

<sup>34</sup> [www.futurebuilders-england.org.uk](http://www.futurebuilders-england.org.uk)

## 6: The future – aspirations for development and growth and latent demand

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### Need for money: VCOs

6.1 VCOs are primarily seeking stability and some ability to secure at least the medium-term future (2-5 years) in order to establish a more assured platform for the organisation and the ability to plan its future development. Apart from the immediate costs of delivering their service over the short-term, the need for money relates to the following priorities:

- Funding to cover core organisational costs to:
  - invest in organisational development through:
    - starting the process of developing sustainable organisations, reducing the need to rely on voluntary resources
    - increasing the skills of existing employees and volunteers
    - buying in appropriate skills and experience where necessary
  - reduce the burden of the short-term bidding cycles on core resources
  - start the process of reducing the distortion of the market, particularly where VCOs are delivering public sector contracts and SLAs
- Longer term funding which would enable them to:
  - recruit and retain staff
  - plan the development of the organisation
  - devote time to innovation and development of their core produce/service/processes and the project-related activities
  - give confidence to staff, volunteers and clients that the organisation will still exist and be positioned to deliver the service beyond the one-year funding cycle
  - break out of the resource-intensive funding application cycle which displaces senior resource from core activities
- Acquisition of an asset base to provide security for future financing; to generate an income stream which would spread and reduce financial risk (either through rental or through earned interest), supplement and cross-subsidise core activities
- Diversification of funding sources to:

- reduce the risk of relying on too narrow a 'client' base (examples were given of VCOs depending solely on a County Council for funding, which could lead to the collapse of the organisation if the support ceases)
- offset the reductions in funding some VCOs are facing from existing sources (examples included a local authority which has asked for efficiency savings of 5%, leading to a decrease in the funding received; with another organisational review looming which will likely lead to a further reduction in funding)
- provide gap funding to cover sectoral restructuring, and accompanying funding interruptions. A particular example cited was the learning and skills field where a hiatus in contracting was anticipated with the planned changes in the LSC structure and the move towards sub-regional provision.

6.2 There were some limited examples of VCOs planning to change their funding structure, shifting towards borrowing money to reduce the reliance on grants (either motivated by reduced availability of grants or by a recognition of the benefits loan-based finance can deliver to a TSO possessing the right characteristics). Where such a decision had been made, the VCO tended to have some income generating ability internally. There were also a few instances of a VCO changing its legal form in order to reduce the barriers to accessing debt finance (personal liability and the inability to accrue reserves being the main obstacles).

6.3 The scale of money required amongst VCOs was so diverse that it is difficult to extract any implications for finance providers from the research. Scale depends on the size and activity of the organisation the specific purpose for which the money is required, and – of course – whether or not the organisation qualifies for debt finance or investment.

6.4 However, some categories of money can be identified from the research, and these can provide broad guidelines as to the scale range that may meet the needs of this group. Key categories include:

- Easily and rapidly accessible start-up and early stage 'seed' money, with sums typically ranging from around £3,000 to £10,000
- Longer term finance to consolidate the strength of the VCO and enable it to plan for development – the scale of the financial packages needed here are less homogenous, but a range between £10,000 and £50,000 would seem appropriate, with the upper limit of the spectrum defined by Futurebuilders' parameters whereby finance packages normally start at around £50,000.

6.5 Both these categories would need to be offered on an unsecured basis, with lending/investment decisions being based on criteria other than the collateral available to cover the risk. Equally, as discussed elsewhere, given the objectives and the nature of activities of the VCOs, the return on investment would either need to be measured by a mix of economic and social returns; or a different and lower economic return on investment would need to be attached to the lending decisions for this segment of the Third Sector.

## Need for money: social enterprises

- 6.6 The social enterprise cohort shared a lot of the same needs for money as the VCO group, with survival also featuring as a key driver for many social enterprises. Despite the social enterprise cohort's greater capacity to generate 'market-based' income, grant and contracting funding were important elements of the overall income for many social enterprises, and they too sent out a strong call for longer term funding in order to achieve stability necessary to develop a longer term vision. A five year project funding cycle was identified as the ideal (depending on the nature and scale of the project), but there was recognition of the constraints faced by the funding providers, and – in line with the Chancellor's 2006 pre-budget announcement<sup>35</sup> - a three year cycle was seen to be a considerable improvement to the current annual cycle many TSOs are having to manage.
- 6.7 Scale of organisation appears to be a key determinant in the shift to debt finance. The critical point appears, in simple terms, to be when the organisation is able to cover their core costs through internal income generation and hence achieve a minimum level of sustainability and independence. Beyond that, they have far greater freedom to determine the mix of their money. Despite grants being in some senses 'free' money, they come with conditions attached which can influence the shape and direction of the organisation. As a consequence, there was a detectable desire to assert control over the organisation through shifting to greater use of borrowing in particular, and finance in general.
- 6.8 The range of activities the finance was intended to cover was wide, but many of the needs related to covering working capital, and/or reducing current debts. In these cases, loan finance was the preferred option, as it was for financing the recruitment of additional staff. Some social enterprises planned to acquire property or increase their asset base and were looking to undertake this capital investment generally through a portfolio which includes loan finance and equity investment (and grants where available and appropriate. Asset transfer from the public sector was also being explored). In relation to raising equity, the sources most often mentioned included existing partners and – in a few cases – Third Sector specialist finance institutions. However, the clear message from the research was that there was a lack of knowledge about where to seek equity finance, the range of packages available and the associated benefits.

## Anticipated demand for money

- 6.9 The research explored the degree to which money sought in the future would be for developmental purposes. A large majority of the respondents intended to develop the organisation, although a caveat needs to be attached to this finding that it is likely that the organisations that had development plans were the ones which were most vociferous on this subject in the research, whereas those TSOs struggling to survive did not feel they had much to contribute. Nonetheless both the VCOs and social enterprises reported plans to grow, although the route to growth differed markedly.
- 6.10 Where VCOs had aspirations to grow, they envisaged this would be achieved through establishing or developing a trading subsidiary, as well as expanding their core activities.

<sup>35</sup> Pre-Budget Report 2006. [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk).

Planned activities included developing the trading arm; employing a development manager to achieve a greater degree of sustainability; and moving to a larger building to increase the capacity of the organisation, but also to develop a stream of revenue and strengthen their control through rental.

- 6.11 The growth aspirations of social enterprises, on the other hand, were more closely allied to their core activities, where demand often reportedly exceeded supply. Growth would therefore be primarily through increasing capacity of their core activity. There were instances, however, of diversification being planned as a route to growth, and also one example of an enterprise intending to grow through acquisition, planning to take over other less competitive organisations. Most examples were, at the time of the research, aspirations rather than reality, but provide an insight into the strategic thinking of these social entrepreneurs.
- 6.12 Co-operatives described a particular barrier to growth that they face due to the nature of their structure, whereby all members are involved in every decision. The consequence of this is a caution about expansion above around 20 employees.
- 6.13 Despite these cases, development and growth were aspirations, rather than tangible realistic plans, for the majority of the participating organisations, either because they were still at an early stage of development where establishing and consolidating the organisation were the primary drivers rather than growth; or because the environment in which they are operating is so rapidly changing, resource-constrained and the margins with which they operate are so tight that survival, rather than growth, is their foremost concern.

## Potential changes in the type of money sought

- 6.14 Key changes in thinking about financing the future of the organisation, amongst all TSOs, include the following:
- introduction of, or increase in, charges for services where possible (to offset increasing costs of delivery and to gain greater independence)
  - shift away from small grants to large sums of money, on the basis that this is more resource-effective (fewer applications), and the expectation is that the larger sums of money are likely to provide a more solid and longer-term platform from which the organisation can grow
  - partnership bids to access larger tranches of funding
  - use of the patient capital route, which was identified as opening up several options for TSOs, including the ability to buy and let property. This was particularly interesting to community organisations and development trusts, where asset development was central to their activities
  - community based organisations also demonstrated innovative thinking in terms of expanding their revenue sources through adding to the services they may be able to offer their community. Delivering ‘incubation’ services to people working from

home and developing alternative uses for public facilities that were not fully utilised are examples of two options being considered

- reassessment of the legal form of the organisation, to ensure it enables optimal access to finance – this was identified as an option for TSOs which have an income generating stream of activity which would enable them to service a loan.

### **Use of loans and equity**

- 6.15 Increasing the use of loan finance was a relatively common intention articulated by the social enterprise cohort, many of whom were considering this form of finance because they were persuaded of the benefits of borrowing, rather than feeling forced towards loan finance because of the difficulties associated with accessing grants and the constraints associated with contract delivery.

**Table 6-1: Case 5 – Ibstock Community Enterprises Limited**

Set up as a Company Limited by Guarantee in 1996, Ibstock Community Enterprises Limited (ICE) is a Development Trust currently employing 3.5 staff with a board of nine directors, primarily drawn from the private sector. The organisation is supported by 50 volunteers drawn from the local community. The main activities include community engagement and development, provision of information and advice, social enterprise consultancy, voluntary sector capacity building, business services and support, rental of space, and financial services (including an ATM machine and a credit union collection point).

ICE started with less than £1,000 to its name and no paid staff. Its first 'growth point' was winning a competition run by Business in the Community in 1997, the prize for which was "risk capital with social returns" from British Telecom and the Post Office. This enabled them to purchase an old bank as their premises and to employ staff, as well as to use the building to lever in EU, local authority and government grants to develop the building.

The second 'growth point' occurred in 1999 with the purchase of their second asset – an old school – with a mortgage from Lloyds TSB Bank. A CDFI loan was ruled out on the basis that it was more expensive, more demanding in terms of information requirements and reporting, and took longer to put in place than finance from a commercial bank, which they accessed "after a quick phone call". Grant funding from the Adventure Capital Fund (ACF), emda and the Coalfields Regeneration Trust enabled them to refurbish and develop the building into an ICT suite and managed workspace which generates an income stream. However, ACF did not consider a blended package as being appropriate on the basis that ICE's existing mortgage rendered the blended proposition too high risk.

Growth has always been planned rather than responsive and they have never allowed grants to form more than 20% of their total income, the remainder being generated by ICE through trading and rental.

Future growth will be achieved through diversification in response to external changes and opportunities, both geographically and in the ways that ICE works. This will reduce dependence on restrictive funding, take advantage of greater public sector contracting opportunities and "set the genie free" to develop new possibilities.

- 6.16 Nonetheless, there still exists considerable concern about the personal risk associated with borrowing and lack of awareness of sources and benefits of loan finance. This was exemplified by the awareness raised by the focus group discussions whereby several participants left the focus group intending to explore finance options they did not know existed before participating.
- 6.17 Equity is still a rarely accessed commodity. The vast majority of TSOs had not considered this option, and were not fully informed about the different equity routes and providers. Business angels, for example, were described as "more a concept than a reality" in relation to the Third Sector. The benefits and disadvantages of such finance were therefore not really a serious consideration since the TSOs had not got as far as even thinking about equity, or were not in a position to consider investment since their legal form precluded it, or were unable to offer a competitive economic return on investment. There was also concern about the potential loss of control over the direction of the organisation, its ethos and mission if an external investor were to take a stake.

6.18 The circumstances where loan finance and equity investment would be considered are simple to describe, but represent a serious challenge to the sector to put in place the conditions which will lubricate the use of these forms of money, and thereby generate the sought after development of the sector. In simple terms, finance will be considered where:

- the TSO is confident they can pay the loan back
- unsecured loans, with innovative security arrangements, are made available to the large segment of the Third sector which do not have access to conventional types of collateral
- the speed of loan arrangements is increased
- the cost of borrowing from Third Sector specialist financial institutions is reduced so that it is competitive with borrowing from commercial banks (on the basis that Third Sector organisations are not always higher risk than commercial businesses, rather due to a range of factors they lack the ability to meet conventional commercial collateral requirements)
- the social return on investment can be quantified and factored in to the finance package so that both the investor and the investee are content with the rate of return being delivered
- the risk is commensurate with the return, and the imbalance between personal risk and social/community return is reduced
- the advantages and disadvantages of the range of legal forms available to TSOs are clearly understood in relation to accessing finance.
- the TSOs have a fuller understanding of the benefits and mechanics of the range of financial packages available.

6.19 Case 6 describes one organisation's development and plans for financing their future growth.

Table 6-2: Case 6 – The Indigo Foundation

The Indigo Foundation is an organisation designed to help individuals with dyslexia reach their potential, offering advice and guidance on the topic of dyslexia and a range of services. Started in 2003 on an unincorporated basis by two people affected by dyslexia, following a grant for £3,500 for a computer from 'Unlimited', Indigo started generating income, initially through diagnostic services. To create a second income stream and to separate Indigo from personal life, the organisation took on premises at a rent of £7,000 p.a. – in their view “a huge gamble and risk” but one which would give them sufficient room to meet the increasing demand for their services.

A key contribution to the second year was 'second level funding' accessed from 'Unlimited', which granted them £13,500 to cover part of the Managing Director's time. The Indigo Foundation now has a network of 20 volunteers.

Their financial structure has shifted from grants to earned income - 70% of the first year's money was grant funding whereas in the current, third, year of operation they have moved to 85% earned income, albeit still extremely dependent on voluntary resources. They have achieved the shift from grants to income through:

- “marketing like crazy”
- developing a more business-like approach
- acquiring additional 'marketable' skills
- expanding and refining their product line
- 'professionalising' the organisation through accreditation
- increasing their prices in light of the considerable demand for their services.

Over the past two years they have accessed a range of small grants but, given the time needed to apply for grants and the displacement of key resources from core service delivery, their intention is to become self-sufficient. They also have the option of contracting with the public sector and believe the building blocks are in place to do this (skills, technology, accreditation etc); however, their view is public sector commissioners of services do not understand the dyslexia field and contract funding may therefore influence the focus of their core activities.

They are now going through the process of achieving full charitable status, setting up a wholly owned subsidiary which will be registered as a limited company. This will enable them to trade their products/services on a more commercial basis. They have considered borrowing or attracting external investment, but rejected both options up to now because they believe the additional finance would exert pressure on the organisation to grow too quickly. They intend to grow, but in a controlled way once charity status has been formalised and the board strengthened.

As well as the desire to “keep hold of the pace of change” and maintain independence, barriers to accessing finance include lack of confidence that they possess a full picture of the financial instruments available, and the difficulty of consulting the different finance providers given the demands on The Indigo Foundation's very scarce resources.

## Potential for future sustainability

6.20 The concept of sustainability is clearly a very large challenge to the Third Sector. A sizeable segment of the sector delivers services which address a market imperfection or failure and are consequently funded through the public sector (contracts or SLAs) or through grant funding. Indeed the very existence of many of these organisations, relying to a great extent on goodwill and voluntary contributions, is due to the market being unviable and the private sector consequently uninterested or unable to service it. This segment of the TSO population can be described as organisations where their core activities cannot generate a commercial return.

6.21 For some of these TSOs there are opportunities to generate an income. However:

- the income generation is either unlikely to be through its core activities, with the potential impact of mission drift
- or if the income-generating activity is linked to the staff's core competences (for example consultancy), this activity is still likely to divert scarce resource away from the central purpose for which the organisation exists

- or the costs associated with income generation are higher than commercially viable because the focus of the activity is on meeting social as well as economic objectives; generating a surplus is therefore commensurately more difficult.
- 6.22 The consensus from the research is that for many of the VCO population, no matter how enterprising they are they will never be able to achieve sustainability due to the “subject matter” they are dealing with, which cannot command a market rate either because the ‘clients’ are unable to pay for the service, or because the costs of delivery are too high to be priced at a commercially affordable rate.
- 6.23 The acquisition of an asset base was seen as one route which would provide the ability to generate an income stream to support the activities of the organisation, but without reserves or collateral small VCOs described themselves as in a “Catch 22” situation. The other option for asset acquisition is the Government’s recently launched initiative the ‘Community Assets Fund’ whereby a fund was established which “will facilitate the transfer of management or ownership of assets from local authorities in England to the Third Sector, by offering capital to refurbish assets”<sup>36</sup>. Whilst this initiative was cautiously welcomed by some of those consulted, there was widespread concern that the TSOs most in need of such support were reliant on project funding from grants or contracts - without any means of generating income themselves they would be unable to service the costs of running and maintaining a building, and would therefore not be in a position to benefit from the transfer of assets.
- 6.24 Development Trusts, in possession of access to, and use of, significant assets generally reported an intention to achieve financial independence, and the asset-related tools to do so.
- 6.25 As has been discussed earlier, many social enterprises reported that a considerable proportion of their income was grant or contract-based, rather than linked to trading activities, and that in some cases there was an intention to shift this balance towards a greater independence through increasing the proportion of income generated through trading. Consequently, a far greater percentage of the social enterprise cohort had an aspiration to work towards sustainability, and embraced the implications of this (for example, an expectation to borrow to build the business; to develop new geographic markets; to widen the scope of their offer). Nonetheless, the reality of achieving sustainability was mixed:
- some social enterprises, where their core activity could be traded at an acceptable price, were already financially independent
  - others, in a similar position, still needed ‘subsidy’ from grant funders or the public sector because their cost base was too high for their services to be traded commercially.
- 6.26 Finally, whilst the expectations about becoming sustainable were very mixed, especially in the short- to medium-term, a large percentage of those consulted had a strategy for future funding/finance. However, in many cases the strategy in part relied on some continued grant or contract funding, rather than achieving financial independence; and whilst strategies were in place, the existence of these were often driven by external requirements, and were based on existing knowledge of funding/finance available, rather than a comprehensive assessment of

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<sup>36</sup> Consultation on the Community Assets Fund. Cabinet Office - Office of the Third Sector, March 2007.

the finance options available to the TSO to enable them to move towards achieving future sustainability. Sustainability for TSOs tended to involve diversifying income sources, obtaining longer term funding, generating income through trading (where appropriate/possible), looking to generate surpluses and reserves to gap fund and aid future development and growth.

## 7: Key findings and conclusions

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### Introduction

- 7.1 This chapter summarises the key findings from the evidence presented in the previous four chapters, and draws out conclusions regarding Third sector organisations' current and future needs for, and use of, finance. It examines the associated issues which either lubricate access to finance, or form barriers to accessing money necessary to ensure the survival and continuation of the TSO, and – of greater relevance to this study – to support the development of the organisations which will contribute to a robust and sustainable Third Sector in the future.

### Purpose of the research

- 7.2 The research set out to explore a range of aspects relating to current and future demand for finance (Chapter 1 sets the brief out in detail), from the perspective of recipients of finance - the Third Sector organisations themselves, or the 'demand side'.
- 7.3 Whilst the Terms of Reference specifically referred to the term 'finance', much of the Third Sector is currently not structurally in a position to consider finance – either from the standpoint of the TSOs or sources of finance (the supply side). The sector is evolving rapidly and there is considerable change taking place in the policy arena (for example, the introduction of asset transfer initiatives such as the Community Assets Fund), the institutional infrastructure (with the development of institutions and finance instruments), and in the development of mechanisms designed to facilitate the uptake of finance by the Third Sector (the main focus being on the development of a commonly acceptable measure of Social Return on Investment, and the shift away from conventional measures of collateral). However, until these developments have been widely implemented and consolidated, there remain significant barriers to a large section of the TSO population accessing finance in the form of either loans or equity investment.
- 7.4 Early discussions in the study resulted in the focus of the research being defined to include both 'funding' and 'finance', examining where possible access to these monies for developmental purposes. Nonetheless, given the importance of grant funding, SLAs and public sector contracting to a large proportion of the Third Sector population, the research necessarily focused on issues relating to finance in its broad definition<sup>37</sup>. Until a common Social Return on Investment measure is put in place and widely adopted, neither loans at an affordable level, nor equity will be relevant to many TSOs, which by the very nature of their mission and objectives are unable to deliver a competitive economic return.

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<sup>37</sup> Refer to paragraph 1.13 of this report.

## Current understanding of, and use of, finance

- 7.5 The Third Sector is facing a significant transitional period whereby many TSOs are moving from grant reliance to contract based funding sources or to a more independent, self-determining financial basis drawing, where possible, on organisationally generated reserves and debt finance. The nature of their financial foundation depends on a number of factors, including – in simple terms - the type of service delivered, the culture of the organisation and its key ‘stakeholders’ (management and board), the organisation’s legal form and the asset base it has accumulated.
- 7.6 Many TSOs have survived through adapting to secure external funding, often requiring them to broaden their mission to encompass political priorities at a local, regional or national level. However, funding typically supports programme and project costs rather than core operating costs and, as a result has often not supported investment in organisational capacity and growth. This situation is exacerbated by TSOs’ widespread dependence on goodwill and voluntary resource which has resulted in many organisations being under-resourced, under-capitalised and over-stretched, and consequently not sustainable without continuing grant aid or contract awards.
- 7.7 The evidence from the study illustrates that the majority of TSOs are in the position of focusing continually on organisational survival, sometimes necessitating some mission drift, and certainly in many cases at the expense of concentrating on the future development of the organisation. Their predominant need is therefore for working capital to cover the short-term costs of delivering the service, and to contribute to operating costs.
- 7.8 Rather than being in a position to take a strategic view about the development of the organisation, VCOs in particular typically report resource constraints and rarely have surpluses available to position the organisation more robustly for accessing finance, or to invest in its development. Social enterprises share this prime focus on accessing or generating working capital, although full cost recovery and the generation of surpluses is more attainable given the ability to generate a revenue stream through their primary activities.
- 7.9 The research identified a discernable difference between the current development activity of social enterprises and VCOs, with a considerable number of social enterprises currently engaged on an organisational development trajectory, but few VCOs being positioned to do so despite the high level of demand reported for their services in many cases. The characteristics that facilitated the ability to engage in organisational development, and access finance to support this, include:
- a strong focus on primary trading activities which can generate a surplus
  - the ability to acquire and develop assets which enhance trading opportunities
  - less of a tradition on grant dependency and a strong enterprise culture (including staff with private sector experience and attitudes)
  - board constituency with requisite business and functional management skills and ethos

- a legal form which supports organisational development and growth.

## Current sources of funding and finance

- 7.10 Both VCOs and social enterprises report accessing money from multiple sources, often necessitating the management of a relatively complex portfolio of funding providers, finance providers and clients, which can reportedly consume large amounts of senior resource time.
- 7.11 The predominant sources of money for VCOs remain grants, SLAs and public sector contracts. Clearly, the situation differs according to the individual VCO, but the overall message was that donations, membership fees, private sector funding and internally generated revenues represent overall a relatively small contribution to their income streams. The ability to source different forms of money, and the availability of money, are influenced by the activity of the organisation, the client group they serve, their legal form and, to a lesser extent, the location of the VCO. VCOs typically find it more difficult to acquire an asset base than social enterprises due mainly to lack of ability to acquire reserves and the restricted usage of grant and contract funding. Nonetheless, there were examples of VCOs with asset bases, acquired mainly through bequests and subsequently developed through the revenues generated by the assets. Asset transfer through the Government's Community Assets Fund is at an early stage and was perceived to represent as many challenges as benefits, due to associated costs of maintenance and management.
- 7.12 The research suggests that significant numbers of VCOs are involved in income generation, although because their activities are often rectifying a market failure the income generation tends not to be linked directly to their primary activities and supplements or subsidises project activity. The trading activity can therefore displace resources from primary activities and cause mission drift.
- 7.13 Social enterprises more typically generate revenue from trading and from an asset base, which can represent a significant source of money through rental. However, grants and SLAs are also important to social enterprises, depending on the sector they serve. A focus on SLAs and public service contracts is particularly true for the large numbers of social enterprises delivering services for the health sector, and for organisations whose services fulfil functions that have conventionally fallen within the remit of the public sector but which now are being contracted out (waste management services are a typical example).
- 7.14 Accessing both overdrafts and loans through banks is relatively common with social enterprises that fulfil the lending criteria. Conditions that facilitate access to loans include either:
- the ability to generate a stream of income which enables loan repayment
  - the existence of an asset base which generates income to service the debt or which provides security against which to borrow.
- 7.15 Whilst in principle loans are an appropriate type of finance for many trading TSOs, the risks associated with this form of finance have precluded greater take-up. Simply put, debt finance is still widely perceived to be high risk because for many TSO legal forms because the

ownership of the risk resides with individuals; lack of collateral to secure the loan; the constituency of the boards tends to be risk-averse and poorly informed about the mechanics and benefits of debt finance; and where TSOs do not generate trading income, their income streams can be unpredictable due to the short-term nature of many sources of funding which would generate the ability to repay the loan.

7.16 Specialist finance institutions have been set up to overcome some of these hurdles. However, despite the attraction of these institutions for social and ethical reasons, little use has been of institutions such as CDFIs, due to:

- a lack of awareness of the benefits
- the higher cost of borrowing compared to commercial banks
- the time taken to arrange a loan.

7.17 Although these specialist institutions have been set up to meet the needs of organisations excluded from accessing commercial funding, the evidence suggests they are not yet servicing this gap. This is either because even with favourable conditions attached to loan packages, TSOs still in many cases face a structural inability to consider debt finance, or because the relatively higher cost of borrowing exacerbates the difficulties TSOs face in considering debt finance, rather than easing them.

7.18 Considerable interest was expressed in the range of innovative financial packages being developed for the Third Sector, in particular in 'patient capital', grant/loan combination packages and lead-in funds, but little evidence found of these innovative finance initiatives yet being accessed, or of specialist Third Sector institutions with customised financial packages, such as Futurebuilders and the Adventure Capital Fund, being used, although their existence was clearly valued.

7.19 The use of equity to finance operations and development was practically non-existent. There are significant barriers to TSOs accessing equity investment, some of which are being addressed by the sector. The main obstacles for TSOs to consider financing their development through external investment sources include:

- the inability of many TSOs to pay dividends due to structural considerations
- where they would in principle be able to pay dividends, given the costs of meeting social objectives the return on investment is often unable to compete with returns achieved on a commercial investment
- the lack of a widely accepted model for quantifying social return on investment which would enable a social equity market to be established and investors to be offered an exit route for their investment.

7.20 In common with commercial SMEs, concern about relinquishing control of the organisation also counteracts seeking external investment.

## Barriers to accessing finance

- 7.21 The study uncovered an array of issues and barriers TSOs face in relation to accessing money. Many of these will be well known and well understood, but are recorded here since they are inextricably linked with a TSO's propensity to access finance and consequently to develop, and are key to understanding the context for Third Sector organisations' future aspirations and plans. Chapter 5 contains a detailed examination of the various issues; they are drawn together here in order to provide guidance as to the key issues that the sector faces in facilitating TSOs' future access to finance.
- 7.22 Many of the issues identified in the course of the research are a consequence of the structure of grant and public sector contract funding; however, the knock-on effect of many of these conditions is a barrier to accessing finance.

### ***Funding issues***

- 7.23 The developments in public sector contracting appear to be having detrimental impact on the stability of, in particular, small, single-issue TSOs, through the shift to larger contracts and the packaging of contracts. The drive to produce economies of scale and the downward pressure on costs excludes some of the very organisations the public sector seeks to engage, since small TSOs do not have the capacity either to engage in the bidding process or to deliver a large range and scale of services. In the process, small specialised TSOs are being excluded or are having to adapt their focus to secure future survival, to the potential detriment of groups with specialised needs. In addition, the high cost of some specialised services places further pressure on delivery organisations where competition for funding is often fierce and based on broad value-for-money indicators.
- 7.24 Short term funding also creates barriers to accessing finance. The need to invest in order to win and deliver a contract can place a TSO in a highly vulnerable position if they subsequently fail to win the contract. Investment can also be over a longer timescale than the contract, which may result in taking on debts and costs they are unable to cover once the contract expires.
- 7.25 The resultant struggle to secure sufficient funding to ensure continuity of service delivery contributes to a short-term focus, with already resource-constrained organisations spending significant proportions of senior time on applying for and reporting on funding, displacing resource which could otherwise focus on strengthening and developing the organisation.

### ***Risk and liability***

- 7.26 Much was made of the risk-averse nature of large swathes of the Third Sector. Three main factors contribute to this. The legal form of some TSOs, which hold individuals personally liable for loss – albeit in some cases limited – influences some organisations' propensity to take on risk in the form of loan finance. Faced with the potential to be held liable for unpaid loans, board trustees and other key members understandably favour the status quo rather than embracing new routes to development and growth. This situation is exacerbated where TSOs' main sources of money are short-term restricted funding which creates difficulties in

demonstrating their ability to repay a loan, and compounds trustees/members' anxiety about personal liability.

- 7.27 Whilst the danger of personal liability exists, there also appears to be a widespread perception that the risk is higher than it may be in reality. There was a strong recognition that the constituency of boards would benefit from being professionalised with strengthened business and functional skills representation. Some evidence exists that this is already happening, and the need for training and education in this field emerged as key in implementing the cultural changes that will contribute to overcoming some of the barriers that currently exist to taking up finance options.
- 7.28 The sector's apparent aversion to risk, in the form of finance, is both understandable and, in many cases, appropriate, given the current economic reality characterised by short-term grant and contract reliance, relatively low level income generation activities – often yielding little if any margin, reluctance on the part of the funders to allow for full cost recovery and, importantly, TSOs' (in)ability to repay loans. Given these operational constraints, whilst there was some criticism of the risk-averse nature of boards', it would be poor governance to take organisations down the finance route without robust business plans and models in place from which surpluses could be identified to repay the debts. Adding to this other issues such as inappropriate legal structures, uncertain operating environments, lack of investment readiness in accordance with due diligence, and supportive Government policy still seemingly out of kilter with practice on the ground, this has contributed to a low level of demand for finance.

### ***Legal restrictions and social return on investment***

- 7.29 TSOs embrace a range of legal forms, some of which preclude accumulating reserves, which can act as a barrier to accessing finance, since without collateral against which to borrow, loan finance from commercial sources is not an option. Lack of reserves is not in itself a barrier to accessing finance, given the Third Sector specialist financial instruments available; however, the research showed these to be both costlier and more time-consuming to access than commercial finance, discouraging the use of these sources. Equally, the accumulation of reserves can also disqualify TSOs from accessing some grants. In other cases, accumulated reserves are a condition of being able to tender for public sector contracts. This could suggest a simple transition from reliance on grant to contract funding, or financing the operation through loans. However, a seamless progression may not be possible and TSOs can be excluded from accessing funding when they are in fact excellently qualified to deliver the service.
- 7.30 Non-distributive models of TSO also act as a barrier to opting for the equity investment route to financing the organisation, since no mechanisms exist to pay investors either a dividend, or to offer them an exit route whereby their investment can be realised even without generating a return.
- 7.31 The situation is compounded by what is probably the most significant issue facing the Third Sector in terms of encouraging TSOs to shift their financial structures to a greater engagement with financial instruments – the present lack of a widely accepted model to quantify social

return on investment. Work is currently being carried out<sup>38</sup> to develop procedures which are intended to lead to harnessing social investors, to developing a market for trade in social equity, and to opening up the ability to invest in the social economy. In parallel, a recognised method of calculating social return on investment will facilitate the ability of TSOs to access loan finance where they are currently precluded from borrowing due to the inability to repay a commercial loan.

## The future – aspirations for development and growth and latent demand

- 7.32 The findings thus far have concentrated on the existing experience of TSOs in relation to different forms of funding and finance. The research also explored the future intentions of TSOs in order to gain an understanding of the level of latent demand for different forms of money to take forward the development of the organisation. Whilst the brief was interested primarily in TSOs' intentions to develop and grow, such were the challenges faced by large numbers of consultees to continue to operate at current levels that it is impractical to ignore the evidence gathered in respect to survival as well as development and growth.

### ***Funding survival and stability***

- 7.33 Before considering planned development, conditions for continuing to work at current levels need to be relatively secure and stable. Faced with the uncertainties caused by short-term (often annual) funding cycles, the ability to secure at least the medium-term future (between two and five years) was the prime driver for the majority of VCOs.
- 7.34 However, within that medium-term horizon, the need for money was for a mix of operational and development purposes, and there was evidence that whilst many VCOs were precluded from actually developing their organisation through lack of money, they were systematic in their planning and were able to articulate their goals clearly and the steps they needed to go through to achieve them. The need for money broadly related to four priorities:
- ***Short-term funding/finance*** to cover core organisational costs
  - ***Longer term funding/finance*** to build and strengthen the organisation and position it more robustly for the future
  - ***Acquisition of an asset base*** to provide security for future financing
  - ***Diversification of funding*** sources to reduce risk.
- 7.35 There were limited instances of VCOs taking proactive steps to change the nature of the funding sought, usually where the VCO had some ability to generate income internally. A large majority predicted no change in their funding sources in the future. Where they had aspirations to grow, a common route to achieve this was through development of a trading subsidiary to cross-subsidise their core activity.

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<sup>38</sup> Social Return on Investment – Valuing what matters. New Economics Foundation, 2004.  
Developing a social equity capital market. New Economics Foundation, 2006.

7.36 Survival and stability were also significant drivers for social enterprises and, in common with VCOs, they strongly advocated longer project funding cycles. With some exceptions, the needs of many social enterprises mirrored those of VCOs to cover working capital, reduce debt and strengthen the resource base (both human and physical). However, whilst these short-term hurdles needed to be addressed, the majority of TSOs professed the intention to develop the organisation, conditions allowing. Many had been through a rigorous business planning process and had a clear longer term vision and strategy, including a funding strategy. However, development and growth were aspirations for many at present, rather than reality.

### **Financing growth**

7.37 In terms of finance, there was a clear intention articulated by social enterprises to shift to a greater utilisation of borrowing, motivated by the desire for greater control over the shape and direction of the organisation. Scale of organisation appears to be an influential determinant in the ability to access finance, together with a range of previously mentioned pre-conditions. However, the level of understanding of the benefits and nuances of different finance packages was generally low, and commercial banks are still seen as the main source of finance to support future development and growth.

7.38 Considerations about equity as an option to finance development were rare. For some social enterprises it was the preferred route to growth, and where this is the case investment is likely to come from existing partners and possibly Third Sector specialist institutions. But these plans were based on a highly imperfect understanding about the sources, options and benefits of equity finance, and the barriers to accessing equity need to be lowered considerably before this form of finance can become a genuine option for most TSOs.

7.39 Finance, whatever the form, will be considered where certain conditions are in place:

- the TSO is confident they can repay the loan
- unsecured loans are available where the provision of conventional collateral is not an option
- the risk individuals are required to bear is reduced
- gaining access to loans is more rapid
- the cost of borrowing from specialist institutions is reduced and accurately reflects the risk of the investment
- social return on investment can be quantified and factored into the finance package
- the advantages and disadvantages of the range of legal forms available to TSOs are clearly understood in relation to accessing finance.

### **Sustainability**

7.40 Much Third Sector activity relies on accessing funding, rather than finance, because the services delivered are unable to generate any or an acceptable level of income. Whilst many TSOs expressed the intention to strengthen their financial base through adding to, and

diversifying, their activity the impact of such shifts is likely to be to displace core activity and, in extreme cases, change the nature of the organisation. Without fundamental structural changes in the nature of grant funding and contracting (including longer funding cycles and full cost recovery models being introduced) and in the constraints attached to certain legal forms of TSO, it is unlikely that many VCOs will attain significant long-term stability and financial independence.

- 7.41 Where core activity can be traded at price sufficient to cover the, often high, costs of operation, working towards sustainability is more viable. The possession or development of an asset base also contributes to the potential for achieving sustainability. However, this latter situation does not necessarily reflect an organisation with a core strength that has the potential to develop and grow, based on its primary activity. Without those conditions in place, sustainability is perhaps not a sensible goal for many TSOs at present, meeting the needs as they do of the most vulnerable and hard-to-reach sections of society. Indeed, a recent Department of Communities and Local Government report sets out the challenge succinctly:

*‘Although the vitality of community based organisations impacts on the wellbeing of society as a whole, virtually all are organisationally and financially fragile and reliant upon over-stretched staff, volunteers and uncertain funding. Their prospects have deteriorated in recent years as a consequence of changes that have taken place in the funding and structure of the non profit sector.*

*The existence of strong sustainable community based anchor organisations offers significant benefits to public service providers ... however, supporting community organisations is neither a cost free nor a risk free initiative. Until there is an understanding of the scale and pattern of under-funding of community based organisations, it will not be possible to establish whether the response is appropriate.<sup>39</sup>*

### **Anticipated demand for money**

- 7.42 The nature of the TSO population is so diverse that, on the basis of the evidence from this research study, it is difficult to make recommendations as to the types and scale of finance that may meet the needs of this segment of the Third Sector. Nonetheless, some broad guidelines have emerged, including the following key categories:

- start-up and early stage ‘seed’ money, with sums typically ranging from around £3,000 to £10,000
- for TSOs with access to some unrestricted money, longer term finance to consolidate the strength of the organisation and to support development planning. The scale of finance required varies dramatically depending on size and activity of the organisation and purpose for which the money is required, but packages ranging in scale between £10,000 and £50,000 fit the needs identified in the research.

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<sup>39</sup> Community Assets – the benefits and costs of community management and ownership. Department for Communities and Local Government. 2006

- 7.43 Specific conditions would need to be attached to the money, including it being unsecured; the risk offset by criteria other than conventional collateral, and return on investment recognising social as well as economic returns.

## Need for accompanying support

- 7.44 Finally, the need for accompanying non-financial support is summarised.
- 7.45 Experiences of TSOs were wide ranging in terms of the type of support, from where it was accessed, and whether or not it was linked with the funding/finance provided. There were discernable differences in relation to the non-financial support required, depending on the stage of development of the TSO, where on the ‘trading continuum’ the organisation lay and therefore the type of finance they sought, the sophistication of the business skills to which they have access, and their legal form and therefore the structure of the board. The particular skills required by chief officers and staff within TSOs have always been broad ranging. Indeed, with limited human resources, staff within TSOs are often required to wear a range of ‘hats’, and the rapidly changing environment now calls for staff to also become enterprising, as well as to develop different areas of expertise in relation to different funding and finance types.
- 7.46 Experiences varied depending on whether the support was delivered by the source of funding, or by an independent support organisation, and whether that organisation was a ‘Third Sector specialist’ or a ‘business support generalist’. However, no homogenous findings emerged from the research in respect of these segmentations, and at best this report can conclude that the quality of the support is to a large extent determined by the individual delivering it.
- 7.47 The main needs for such support that emerged from the study, together with the suggestions for improvements in the support, are summarised in Table 7-1.

Table 7-1: Associated non-financial support – future needs and suggested improvements in support

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**Need identified for:**

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- Handholding in the bid preparation process
  - Language skills to support TSOs preparing bids in their second language
  - Advice, guidance and skill development as TSOs move from grant reliance to income generation
  - Training in the preparation of full cost calculations to secure full cost recovery
  - training and information to help organisations understand the financial and tax implications of different sources of money
  - Financial and strategic training for trustees
  - Support in board restructuring – both defining the constituency and identifying candidates
  - Post-application support, both for successful and unsuccessful bidders
  - Small packages of money for TSOs embarking on trading activity, to cover costs of undertaking feasibility studies and test trading
  - subsidised legal support for TSOs to obtain professional advice regarding property and resource-related issues
-

**Suggested improvements in support:**

- Provision of comprehensive briefing and guidance pre-bid, by the contracting organisation
  - Provision of financial tools that facilitate the preparation of bids
  - Introduction of a mechanism to reduce the duplication of effort involved in submitting bids
  - More detailed feedback and greater transparency from funding bodies post-bid to aid the TSO's ability to learn from the experience and to improve their bidding skills
  - external assessors for grant applications with an understanding of the relevant context – this may be underpinned by a perception rather than reality, and there may be considerable variations. Nonetheless, this suggestion highlights the need for improved communication and transparency
  - the introduction of 'funding angels' – matching a TSO to an experienced individual to provide hands-on support with bid preparation and capacity development
  - the introduction of a widely embraced model for calculating social return on investment, and the consequent development of a social equity market.
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## **ANNEX A: Focus Group Structure**

## Aide-memoire to guide the focus groups

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### Topics to guide the focus group discussion

#### **Main sources of money you currently access:**

- How do you fund or finance your organisation's current activities? What are your main sources of money?
  - Has this changed over time as the organisation has developed? If yes, please describe how?
- Do you have an asset base (land and buildings, reserves) that provides either security/collateral which enables the organisation to access funding/finance, or which provides a stream of income from the interest/income the assets generate? If so:
  - how large is this, and how much of your operating costs does it account for?
  - Do you rely completely on cash generated either by your asset base, or through membership fees or trading revenues, or do you access any other sources of money from other sources as well?
  - In relation to the above, if you have internally generated revenue streams, for how long in the future do you expect them to be secure? And do they remain at a constant scale, or are they growing?
- Above and beyond internally generated funds, can you give a broad breakdown based of the other funding sources you access:
  - Grants (from government initiatives, European funding streams, charitable trusts, companies, the Lottery, etc)
  - Non-grant finance/debt finance (fixed repayment loans, variable repayment loans, 'standby' loan – from specialist finance sources (for the Third Sector); from commercial banks, or other)
  - Investment (patient capital, ethical share issues)
- Can you say anything about the purposes for which you have used the different types of money you have accessed (in particular, have you accessed debt finance for a particular purpose and, if so, what was that?)

#### **Barriers to accessing money**

##### *Legal status of the TSO*

- Does the legal status of your organisation preclude you from considering certain forms of funding/finance? If so, can you describe:

- What forms of funding/finance you cannot access
- Where the problem lies – precisely why could you not access this/these forms of funding/finance?
- The solution to your problem

Regardless of legal structure, there may be limits to an organisation's ability to access funding/borrow money or raise investment:

*Possible barriers relating to funding:*

- If you have tried to access funding, these might include:
  - the funding 'product' does not suit the organisation (please describe why)
  - the restrictions defined by the funding source (for example, European or government grants may be designed for specific purposes)
  - the length of the funding – for example, the grants available are short-term and the organisation's funding needs are long-term
  - the organisation's funding needs are cross sectoral so it does not qualify for specific grants
  - funding perceived to be statutory responsibility
  - Value for money (e.g. if make a funding application for £100K to support the deaf-blind, the outputs (in terms of benefits to numbers of people) will be much lower than those possible to deliver to the deaf, for the same amount of funding, because the cost of supporting the deaf-blind is higher, and also there is a smaller population. The argument is that you can therefore deliver a service to far more deaf than deaf-blind, and the support for deaf-blind may not therefore appear to be such value for money.

*Possible barriers to borrowing money and raising investment*

- Are there limits to your ability to either borrow money, or to raise investment (if appropriate) due to reasons other than your legal status? If so, please describe what, and which forms of borrowing or investment they relate to.
- They might include, for example:
  - restrictions from Trustees (please explain)
  - lack of resources and capacity
  - cultural issues (such as a desire not to take on debt; or unwillingness to take risks because of the consequences of failure, i.e. cannot repay debt) mean the organisation only uses certain sources of money
  - lack of reserves against which to borrow

- mainstream finance providers do not understand the type of organisation and its activities
- confidence in ability to repay loans and loan periods
- Are there actual or perceived risks to borrowing money or raising investment due to the activities of your organisation, or because your client group or geographical location is not a priority? If so, please describe:
  - what they are
  - whether you believe them to be actual or perceived risks
  - what impact this has had on your organisation
  - and what solution you have found (if any)
- Are there any restrictions to your operations due to how you fund/finance the organisation? For example: loans (of any type) with conditions attached; some form of equity with investors who influence the operations of the organisation. If so, please describe the restrictions

### ***Experience in raising money in the past year***

- Have you been unsuccessful in accessing funding/finance in the past year (for example, grants (from any sources), loans, sufficient donations, sufficient membership fees)?
- If so, how have you overcome this problem?
- Do you think any problems you have experienced in the past will still be relevant now, or have your circumstances changed? Either way, please explain.
- How easy have you found it to find out about sources of money?
- What more could be done to signpost/advertise sources of money?
- Approximately how much time does your organisation spend applying for money each year?
- How would you compare your experience of accessing grant and other forms of external finance? How long after you submit an application is it before you hear of the outcome, and – if successful – before the money is made available? (please identify source). Can you describe any consequences this has had on your operations, if relevant.

### ***Location of the organisation***

- Depending on where an organisation is located (either in a city or town, or in a rural and remotely located area) do you think this makes any difference to the ease of accessing money?

- If yes, why do you think this is the case?
- Are any difficulties experienced related to the following:
  - Distance from sources of money (please explain – is this from the grant providers, from the lenders, from investors or from members)
  - If you raise money from membership fees, does it make any difference being located in a rural area compared to an urban area – or is it difficult to say

### ***Additional related support***

- In conjunction with any funding/finance you have considered or accessed in the recent past (say, the last three years), has there been any other support provided? For example:
  - Support before you have accessed the money – for example, to develop capacity and knowledge prior to applying for the funding/finance; to develop the funding proposition (the idea), or the plan; to develop and rehearse the presentation of the funding proposal, or other
  - help with the funding application
  - after you access the money – for example, support to help with managing the funding, or to develop financial management capacity once you have accessed the funding/finance, to provide investment advice, or to develop the broader capacity of the organisation to ensure the funding can be used optimally.
- Please describe what, if anything, you received in terms of support, from whom (was it the funding provider, or another organisation/individual), the duration, the quality and relevance of the support, and what difference it made
- If this support was not from the provider of the funding, how did you identify the support, and make a decision to access it? And did you have to pay for it? (If yes, roughly how much?)
- In the future, what forms of support would you find useful to accompany your organisation's efforts to raise money?

### ***The future***

- Do you currently need any more money? If so, have you views as to where you will get that money (which sources you would approach [SQW to refer to a list of funding providers to test awareness])? Do you expect to become self-sufficient in the future? (if yes, discuss timescales)
- If not: how do you anticipate funding your organisation in the future?
- What requirements for money do you anticipate over the next three years?

- approximate scale, and over what period(s)?
- for what purposes? (please tease out where it is developmental, i.e. to grow or to develop a new service etc)
- what, if any, barriers do you anticipate to accessing the money?
- Do you think the balance of funding will change in the future (for example, you may receive a considerable proportion of your money from European sources but this is likely to change in 2007) If this is true for your organisation:
  - check whether the influence will be push or pull factors
  - where will you look to make up the balance in the future?
  - please explain the reasons for the changes in anticipated sources of money
  - or, if you do not expect to be able to make up that balance, what impact do you anticipate it will have on the operations of your organisation? Please describe
- Under what circumstances would you consider debt finance? Or equity finance?
- Are the plans for the future, and where you will access money, linked to a plan to develop your organisation or to diversify your activities/focus, or are they more to do with survival?
- Does your organisation have a sustainability strategy which looks at future funding and finance? If so, for what period?
- Would developmental funding in the form of grant make you more willing/able to explore alternative sources of funding/finance to diversify your income base?

## Finally ....

- To overcome barriers to your organisation borrowing money/raising investment, what could be done by:
  - Government
  - specialist providers of funding to the Third Sector
  - other (mainstream) finance providers.

## **ANNEX B: Focus Group Invitation**



Dear \_\_\_\_\_,

**Invitation to a focus group on Third Sector Access to Finance**

SQW Limited, an independent economic development consultancy, has been commissioned by the Office of the Third Sector within the Cabinet Office to undertake research into third sector access to finance. The main aim of the research will be to assess the level and nature of the demand for finance within the third sector and to examine issues faced by third sector organisations in accessing finance. It is the intention that the research findings will feed into the Comprehensive Spending Review 2007 and will also inform future policy development.

As an element of the Comprehensive Spending Review 2007 HM Treasury and the Cabinet Office are jointly undertaking a review of the future role of the third sector in social and economic regeneration. A significant consultation exercise with the third sector has already been completed and both departments wish to express their thanks to all those who participated. This research is aligned to the work of the review, and will build from the consultation responses received to date, but is specifically focused on understanding in more detail issues around access to finance for the sector.

In order to gain a first hand understanding of the issues from as wide a range of organisations as possible, we are running a series of regional focus groups as part of the research. Two focus groups will be run in each region in England, each lasting approximately two hours and involving between eight and ten participants.

We appreciate that the needs of third sector organisations may differ considerably depending on the type of organisation involved, the size and the stage of development. We are therefore offering two focus groups in each region, one for the voluntary and community groups, and the second for social enterprises, mutuals and co-operatives.

The broad issues the discussion will cover include:

- the types of finance required and preferred sources
- barriers experienced in accessing finance
- what, if any, support is available with the finance
- anticipated demand for finance over the next three years
- how demand for finance changes as organisations develop and grow.

We are very keen to hear your views on these themes and hence would like to invite you to join a focus group on \_\_\_ December at: \_\_\_\_\_.

We will be running two focus groups that day:

10.30am – 12.30pm: Voluntary & Community Organisations

2.00pm – 4.00pm Social Enterprises, Mutuals and Co-operatives

If you would like to participate, please let us know as soon as possible as attendance will be on a ‘first come’ basis. Please indicate in your response which focus group you consider would be most appropriate for your organisation. Please respond via email or telephone to \_\_\_\_\_.

We recognise that costs will be incurred travelling to the venue – to offset these, we are able to reimburse the direct costs of travel at up to £30 per participating organisation.

If you are unable to participate in the focus group but would like to feed your views into the research, please let us know.

Finally, in order to ensure that we are inviting you to the most appropriate focus group, we should be most grateful if you would complete the following short table and return it with your reply (or give the information over the telephone):

<i>Date your organisation was established?</i>		
<i>Number of people working for your organisation?</i>	<i>Paid employees</i>	
	<i>Voluntary helpers</i>	
<i>How wide is the reach of your organisation? (Please tick one box)</i>	<i>Local</i>	
	<i>Regional</i>	
	<i>National</i>	

A separate focus group will also be offered in London specifically for the large third sector organisations with national coverage, so if your organisation’s profile is more suited to this focus group, the above details will enable us to send you details of the date and venue for this event.

If you have any questions about the research please call either Sarah Livingstone (on the above number) or Isabel Sutcliffe at the Cabinet Office.

Thank you very much in anticipation for your interest.

Yours sincerely,