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NPC perspectives

Preparing for cuts

How funders should support charities in a world of government cuts and changing funding structures

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Executive summary

A fast-moving environment

Government-funded charities are entering a maelstrom of reduced funding and changes to funding mechanisms. Nearly a quarter of charities in the UK are funded by government: 13% get over half their income from government, and some get more than 90% from government. The government's total funding to the voluntary sector amounted to £12.8bn in 2008/2009—a third of the sector's income.

The coalition Government is cutting public services by between 25% and 40%, so NPC expects the sector's income to drop by between £3.2bn and £5.1bn—too big a gap for trusts and foundations, which provide £2.7bn, to fill. Funding from the public and philanthropists (£13bn in 2008/2009) cannot help either, as donors appear unwilling to plug gaps left by government cuts.

Challenges for charities

The coalition Government is retreating from providing many public services, which had previously increased under Labour. The size of the cuts will make it unfeasible for government to continue to fund what it sees as non-essential services.

Charities funded by local authorities (which will bear particularly heavy cuts) are at great risk. Charities providing social services, such as services for children and vulnerable groups, will be hit hard. For instance, we know of one charity that supports women affected by domestic violence, whose entire funding is likely to cease in one local authority area. Also, many charities that provide services to young people are anxious about the safety of their contracts.

Changes to commissioning and contracting arrangements are causing further confusion and threats to cash flow. For instance, the plan to move responsibility for commissioning health services from Primary Care Trusts to GPs will be a complicated transition for charities. Competition for contracts is also increasing: charities are competing against the private sector as well as against each other. And payment by results will mean that charities are paid for services in arrears, putting a strain on cash flow.

All this means that charities will have to adapt their strategies. For example, they may decide to shrink their public service provision and increase low-cost volunteer-led activities. Or they may change policy tactics, and move efforts away from Whitehall, focusing instead on local policy-makers. Charities will need to partner with each other or private sector providers if they are to offer attractive services to commissioners, and they will need to meet the increasing demand for evidence of outcomes.

To weather this storm and adapt to the changing circumstances, charities will need support from non-government funders.

Challenges for funders

Funding will be harder, and decisions tougher. Funding decisions will need to take into account the evolving financial and political landscape if funds are to be used effectively.

Charities' new funding needs will take funders outside their comfort zones. For instance, charities may need interim funding to smooth the transition to new funding arrangements. Or they may have to restructure and find funds for redundancies. They may ask for support to develop partnerships with other organisations. Risks will escalate, and there will be fewer proposals for funding for straightforward growth or new projects.

Funders may want to think more carefully about what they should be funding. Should they be funding innovation or supporting existing methods? Should they bail out charities in trouble? Should they fund services previously paid for by the government? None of these issues are new, but in this environment, they are thrown into sharp relief.

Not every charity has a future, and as resources become scarcer, funders will be faced with deciding whom to back and how.

How funders can respond

Funders are already thinking hard about their changing role and what they should be funding. Practical measures, such as speeding up response times and reducing the costs of reporting, will save time and money. Sharing knowledge with other funders and charities, such as the Association of Charitable Foundations' summer debates, will raise awareness of effective approaches and avoid duplication or mistakes. Keeping in close touch with grantees will be essential. Now may be the time for funders to review their strategies and think about difficult issues, such as how to support organisations that speak up for the voluntary sector.

Choosing charities by looking for evidence of effectiveness (potential or current), based on careful analysis and knowledge of the charity, will boost impact. Strong leadership, adaptability, strategic thinking, evidence of results, and sound financial planning are all indicators of a charity's likelihood of surviving and making an impact. Alternatively, funders may choose to strengthen weak charities in vulnerable sectors.

The environment may be riskier, but funders should not shy away from risk: they can still be willing to back grantees and interventions they believe in. Understanding the new context in which charities are operating will help funders to make grants that lead to long-term impact.

Evidence

As funding for public services and charities shrinks, it is evermore important that what is funded is effective. To determine this, we need evidence. Yet charities are still telling NPC that their funding applications for evaluations and measurement systems are being rejected.

The coalition Government's rhetoric is that commissioning should focus on outcomes, not outputs. This transition may be slow, as local commissioners with tight budgets are, in the short term, fixated on price. But in the medium term, commissioners will demand evidence of outcomes, and charities will need to drive the agenda for reasonable evidence and measurement, rather than have unreasonable demands dictated to them. Non-government funders' support for charities in this endeavour will solve this problem.

Rising to the challenge

All of this presents real challenges to funders, be they large established foundations, small family trusts or individuals. But these funders have greater flexibility than government to respond to such challenges. Those who cannot adapt will find their impact curtailed.

Non-government funders have a huge contribution to make. But maximising impact in such a difficult environment will require thought, imagination and courage.

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Introduction

This paper is aimed at the full range of charity funders, including long-established foundations, new family trusts, corporate foundations and individuals. Some readers will be familiar with some of the material and will have thought about many of the issues raised already: forgive us for teaching grandmothers to suck eggs. In particular, we have not gone over ground already covered by the Association of Charitable Foundations (ACF). In summer 2010, ACF hosted a series of debates that examined some deep philosophical issues, such foundations' legitimacy in directly campaigning on issues. ACF members can access the information on the debates for themselves.

Even if it is familiar territory, experienced funders may find the material in this paper useful for marshalling thoughts or sharing with others. Other readers may not have so much experience, or be short of time to get up to speed on many of the issues. We hope this helps them.

Although the paper is mainly focused on charities affected by government cuts (just under a quarter of all charities are part-funded by government), it holds many messages for funders of all charities. If a double-dip recession becomes reality, then voluntary-funded charities may feel the pinch even more than they do now.

The problem of cuts will be compounded by changes in the way services are commissioned, so even if a charity is answering the challenge of the Big Society, it may be flummoxed by a new commissioning regime. Again, the paper addresses this issue.

The change of government also means changes in policy, and how policy is devised. This impacts charities, particularly those seeking to influence policy. This is not strictly about cuts, but we touch on the issue in the paper because it is so important.

This paper is not comprehensive. If we covered every angle and eventuality it would go on for 100 pages. But we hope it provides some food for thought.

1. Background: A fast-moving funding environment

Charities are entering a maelstrom in their funding arrangements with government. They will need support from other funders to weather the storm, and speed of decision-making will be key. Even good charities are finding it difficult to plan, as it is not yet clear where cuts will fall and how they will affect service delivery. So although charities should be prepared, they may be developing solutions in a policy void that they cannot action just yet.

Why are charities affected by government cuts? Government funding to charities has increased year on year from £8.4bn in 2000/2001 to £12.8bn in 2007/2008, and accounts for just over a third of the charity sector's income.¹ Much of this rise is due to an increase in contracts to provide public services. But spending on charities represents only 2% of government funding: a mere speck, which puts charities somewhat low on spending departments' agendas, regardless of the coalition Government's rhetoric about 'Big Society'.

Although government is cutting funding for public services, Nick Hurd, the Minister for Civil Society, has promised charities a larger slice of the pie. But the proof of the pudding (or pie) will be in the eating. In the meantime, NPC estimates that government funding for the voluntary sector will be reduced by between 25% (£3.2bn) and 40% (£5.1bn). By contrast, total grant-making from trusts and foundations in 2008/2009 was £2.7bn²—insufficient to fill the gap even if trusts and foundations had any appetite to do so.

Funding from individuals and general public, which is similar to government funding at £13bn, looks a promising alternative, except that many mid-sized charities do not have strong fundraising bases pulling in pounds from the general public. Fundraising aimed at the public tends to be the preserve of charities big enough to have a fundraising team. It also helps if the charity is fundraising for a cause that the public cares about or understands—many charities deal with vulnerable and excluded groups which do not attract public pennies. In any case, charities typically do not fundraise to pay for providing government services. So charities with big government contracts but no fundraising aimed at the public or wealthy individuals are the ones that look most exposed.

Between a fifth and a quarter of charities are funded by government and will feel the cuts to public services keenly.³ For 13% of charities, over half their income comes from government (for some, this figure rises to over 90%), so depending on the sector they operate in, these charities will be extremely vulnerable. A charity that only has 30% government funding may hurt a bit, but should survive.

¹ Clark, J. et al (2010) *The UK Civil Society Almanac*. More statistics are available for download at www.ncvo-vol.org.uk/almanac.

² Pharoah, C. (2010) *Charity Market Monitor 2010*.

³ NCVO research (2010) <http://www.ncvo-vol.org.uk/documents/press-releases/research-showing-importance-of-charities-delivering-services-prompts-no-so>.

Areas facing reduced funding

Here are some examples of areas facing reduced funding. The list may not be comprehensive: NPC does not cover every sector and may lack prescience ahead of the Comprehensive Spending Review. We are most concerned about local authority funding. Not only will central funding be cut, but a combination of centrally protected education budgets and local political pressure to protect services like rubbish collection, will squeeze other services, especially those for minority groups.

Health and social care

- Social care is one area in particular that will be heavily affected by local authority cuts. Local authority funding will be slashed, so charities with local authority contracts will be under pressure to reduce prices or may even lose contracts. If this happens, they will also lose the full cost recovery contribution to overheads: this will compromise the funding of core costs. Charities providing services to older people, disabled people, and people with mental health services will be affected.
- Health more generally should not be as badly affected as other sectors, not being in line for 25–40% cuts like everyone else. However, the NHS still has to find efficiency savings of £15bn–£20bn between now and 2014, so no services are immune.¹

Social services, such as services for children and vulnerable groups

- Again, many of these services are funded by local authorities, who will have to slash budgets, and indeed have started to cut in expectation of the Comprehensive Spending Review. Children's charities are anxious about losing contracts; we know a domestic violence charity that lost its contract in a key borough; a community organisation working with NPC on a research project recently folded due to withdrawal of local authority funding.
- Funding pots dedicated to specific issues (such as Supporting People, which funds housing-related support for vulnerable and older people) are liable to be cut. In the employment sector, the Future Jobs Fund—which funded initiatives targeted at unemployed young people—has already been shut down. There will be little or no ring-fenced funding for specific issues or groups, so the cuts will affect everyone. Reduced ring fencing is not new, but its absence will now be more keenly felt.

Sector infrastructure

- Some funding pots set up by the previous government to benefit charities and social enterprises (such as Futurebuilders and Capacitybuilders) have been closed, and many more are under review.
- The Office for Civil Society is cutting the number of its strategic partners, such as ACEVO², NCVO³, CVS⁴, or Volunteering England, from 42 to 15. Moreover, it is changing its funding criteria so that any organisation receiving a grant will get (a) no more than £0.5m, and (b) no more than 25% of its total costs. (Some are currently receiving grants of two thirds or more of their costs and some current grants are worth several million.) There are already murmurings of organisations closing or planning to reduce their services drastically.

Funders must expect to hear from charities that are having to shrink activities. A charity chief executive recently observed: *'I run a charity with over £20m of income. But by January it may be down to £15m. What will that mean for the organisation and its objectives? Who will pay for the redundancies?'*⁵ Funders will have to decide whether to help, and how.

¹ Figure widely reported in press and by Royal College of Nursing (July 2010).

<http://www.telegraph.co.uk/health/healthnews/5524693/NHS-chief-tells-trusts-to-make-20bn-savings.html>.

² Association of Chief Executives of Voluntary Organisations.

³ National Council of Voluntary Organisations.

⁴ Council for Voluntary Service.

⁵ Confidential communication with author 2010.

Areas of uncertainty over funding mechanisms

Funding mechanisms are also likely to change, and this may result in temporary or permanent reductions in income, as commissioners switch, say, from block contracts to individual budgets.

- In the NHS, Primary Care Trusts (PCTs) will vanish, to be replaced by consortia of GPs. The latter do not exist yet, although in a few areas they are starting to emerge. This will fragment the market: each former PCT area will have several GP consortia. So charities that have contracts with PCTs will have to persuade GP consortia to take them up. This may be a complicated transition.
- Local authority commissioning methods are in flux in some areas, which is causing confusion for charities.
- The personalisation agenda¹ is continuing, so charities offering health and social care services will still have to adapt to this over the medium term. Many charities have already started preparing for this.
- The line between health and social care continues to be unclear. NPC knows of charities that are finding themselves caught up in lengthy and protracted negotiations on who will pay for what. This is intensifying as money becomes scarcer in local authorities and the NHS.

Domestic violence sector: an example of a sector where some important charities are vulnerable.

NPC knows good charities with first-hand experience of cuts.

We know a local charity that provides advocacy for victims of domestic violence, helping them to escape from violence. The charity has learnt that funding from one of its local authorities is under threat. This will mean that victims in that area will not have access to a service that has repeatedly shown that it works. Over the years, this charity has consistently shown that around 70% of women report that the abuse has ceased after its intervention. In a sector such as domestic violence, where lives are at risk, statutory funders will hopefully prioritise frontline services in a period of budget cut backs, but even so may not have the cash to preserve some. Many grant-making trusts will also want to put their funding in frontline services where it will have an immediate impact.

Funders will have to support charities during periods of transition. This is not the same as back-filling for government. This is to ensure that good charities survive and are given a chance to adapt.

¹ Personalisation: increasingly users of social care, eg, disabled people, older people, and people with mental health problems, are being given individual budgets, to spend on the care they choose. This is being extended to health care.

Other themes emerging from the cuts debates

Increase in demand for services

Charities are experiencing increasing demand for services. NPC has identified three causes (there may be more), and these will have a range of consequences for charities:

- **Recession:** For example, unemployment will result in increased poverty, and its consequences (often dealt with by charities), and there will be greater demand for employment services; rising household debt will negatively affect mental health and increase demand for debt advice services.
- **Cuts in public services:** For example, people who were receiving services from the state may well turn to charities for support.
- **Benefit changes:** For example, disabled people may be affected by changes to their allowances, and so charities helping disabled people will need to offer more information and advice, and/or campaign for better understanding of disabled issues.

The survival of effective prevention services

The problem here is the short-term squeeze, which is likely to mean that crisis services will keep their funding while 'peripheral' services will be let go. Having said that, much government rhetoric centres on the importance of outcomes, especially value for money, and some local commissioners may see advantages to commissioning prevention services if it will save money in the long run. The development of initiatives like the Social Impact Bond¹ recognises these advantages.

So for charities, the situation is a mix of threat and opportunity, as we will demonstrate later in the paper. To convert threats into opportunities, charities will not only have to depend on their own effectiveness and ability to evidence impact, but will also have to depend on their local funding environment.

The shifting boundary between optional and mandatory state provision

The previous government took on an increased responsibility for people's needs and so expanded its remit in service delivery. For instance, it increased funding for palliative care and for short breaks for families with disabled children. The coalition Government is retreating on some of these lines, and many of the 'added value' services previously paid for by the state are now deemed as someone else's problem. This will present dilemmas to funders who are reluctant to fund services they believe should be funded by government. There will be greater demand for funds which funders will not be able to match, so they will have to be clear on their own boundaries.

The private sector's major role in service delivery

Charities will need to partner, subcontract and work in other ways with private sector service providers in order to support beneficiaries. The charity Contact a Family successfully partnered with Serco, a £4bn turnover company, to help local authorities develop schemes to provide short breaks for families with disabled children. By consulting with families, the schemes delivered better outcomes for families and in many cases reduced costs for the local authorities. This is a model that other charities could emulate.

¹ See www.socialimpactbond.org.uk.

Government rhetoric about developing social enterprise

The government has said it wants to support social enterprises, and this could be an opportunity for charities and funders, although social enterprise presupposes that someone pays for goods and services. But government is no longer paying for many goods and services, and we are not sure who will pay for them instead. So it is not clear how this market will actually develop.

The effect of payment by results on cash flow

In many areas, government is pursuing a payment by results policy—where service providers are paid in arrears when they deliver benefits, as opposed to being paid upfront for outputs. NPC hears this being talked about in areas ranging from mental health to children's services, although the timing of its introduction varies. Eventually however this will present a cash flow problem in the short term. Moving to new business models will need investment to bridge the hiatus and fund structural changes to cash flow. Small grants are unlikely to be the answer.

What does all this mean for funders?

- As revenue streams end, some good charities will shrink in size, and this will be very disconcerting for funders accustomed to funding growth.
- Charities will have to switch from growth strategies to other ways to achieve impact: funders will need to understand this.
- Funders used to exit strategies based around government taking up future funding may find such exits unavailable.
- Competition for contracts will become intense. Charities will have to:
 - rethink their tendering methods—for example, through partnership, or by improving their 'offer' by being more efficient (which is difficult!); or
 - reconsider their role in public service delivery—for example, should they get out of it?Again, funders will need to understand these challenges when supporting charities.
- The importance of measuring and communicating impact will increase in the medium term. Outcomes may not affect contracts next year, but they will over time. Funders can help to fund better measurement.
- Funders must expect charities to have cash flow difficulties and increased financial risk. How these difficulties are managed will be important: but funders should not expect a charity to have all the answers immediately and should expect to be asked to respond to emergencies.
- To keep abreast of events, funders may find they need to spend more time staying in touch with grantees and talking to fellow funders.

2. A possible scenario

The scenario set out in this section is about changes to funding arrangements. We think that the complex problems arising in this scenario will be fairly common, and where appropriate will justify the support of private funders.

This scenario is fictitious:

- The charity is invented, although some of the material is taken from discussions with a number of charities.
- No one is sure what will happen to government funding in the future and how it will affect charities' commissioning arrangements.
- Some aspects of the scenario have been simplified.
- Our scenario has a happy ending. This will not always be the case, however supportive funders are.

The charity

Pink Elephant is an activity club based in a deprived London borough for people with (mainly severe) mental health problems. Around 390 regulars come for sessions, such as exercise, painting, drama, music, and employment advice. The service typically costs £1,200 per member per year, and all are referred from local mental health services—mainly mental health specialists working in the community and acute mental health teams. Referrals from GPs are rare. The local Primary Care Trust (PCT) pays for the bulk of this cost, with a contribution from the local authority, contracted on a per person basis, depending on usage rates. The charity has fostered a good relationship with its local PCT, which sees value in people with mental health problems having somewhere to go that offers them constructive activity, a welcoming community, and a chance to improve skills. Clinicians report that the use of acute services is reduced in patients who use the service, which is enough to convince the PCT of its value. Neighbouring PCTs also send some patients from outside the borough.

Around 30 of Pink Elephant's members are experimenting with personal budgets, as part of the government's drive for personalisation in health and social care.

The data on Pink Elephant's outcomes has not been collected formally and analysed. The charity tracks some straightforward results, such as whether or not its members go on to employment or education, and it collects case studies. However, it has not had the resources to track its impact on how its members use health services or on their well-being. The charity has often thought of doing a full evaluation to include effects on use of health services and on well-being, together with a cost-benefit analysis, but has not been able to get this funded.

The charity receives some funding from a handful of trusts, foundations, and a wealthy individual. But these grants are usually for projects that are not part of its core service, for example, the development of a horticultural social enterprise next door. The charity prides itself on keeping in close contact with its core supporters.

2010: Switch to GP-based commissioning is announced

A white paper published in July 2010, *Equity and excellence*, describes the coalition Government's strategy for health.¹ PCTs are to be abolished by 2013 and replaced by consortia of GPs who will commission services on behalf of their patients. Funding will be transferred to the GP consortia by April 2013, although the government is expecting most consortia to have been formed during 2011/2012 and to start taking on the commissioning role.

¹ Department of Health and NHS (July 2010) *Equity and excellence: Liberating the NHS*.

At the same time, there has been a steady move towards personalisation of budgets, whereby individuals hold their own health and social care budgets. Around 30 of Pink Elephant's 390 members are on personal budgets. The charity has noticed that this increases administration costs considerably—effectively it has 30 contracts to manage instead of just one—so it will charge extra in future for people with personal budgets. Members may also need extra support navigating the changeover if they find a new person is in charge of allocating their budgets.

Charity action

Pink Elephant briefs its funders on the situation, explaining what the change in policy might mean. It is honest about its uncertainty, but promises to come up with plans as soon as it can.

The charity's management team starts to make contingency plans, including cost-cutting, but also thinks about how it might get 'on the front foot' with future commissioners.

Funder decision

None at present, although funders conclude they must stay in touch with the chief executive, and learn as much as they can about the funding environment.

2011: Reality begins to bite

Pink Elephant's contracts with PCTs are negotiated in April each year. PCTs are being phased out in 2011/2012, which complicates the April 2011 negotiations somewhat. The departure of some key personnel, with whom the charity had long-standing relationships, does not help, but the charity manages to squeeze an extra year's funding from the PCT. However, the charity understands that during this final funding period, it must start to negotiate contracts with the GP consortia.

To make matters worse, the local authority has a massively reduced budget, so local authority funding is halved. Fortunately this represents a manageable loss, if costs are cut and part of the premises are developed for letting to local social enterprises.

Charity action

Pink Elephant starts to cut costs by stopping an unpopular activity and moving to a new energy supplier offering better rates. It updates its plan for the building development and lettings.

It also spots a recruitment opportunity and decides to hire a former PCT employee to help manage its relationships with the new GP consortia as well as run the administration of members with personal budgets. The candidate is in demand, so the charity will have to act quickly. But the charity has no budget for this, so approaches Green Albion Trust for funding.

The charity also approaches Mr White, a financier, for funding to develop part of the building for letting.

Funder decision

Should Green Albion Trust fund Pink Elephant's new post in such an uncertain environment?

In the past Green Albion Trust has been impressed by management's ability to adapt and manage change, so agrees to pay for the post.

Should Mr White provide funds to develop the building?

Mr White has known the charity for a while, but carefully assesses the charity's development plans, in particular whether the lettings are credible. He discovers there is a shortage of space for local enterprises, so decides to fund the project through a mix of loan and grant. This should allow the charity to retain a small surplus on the development, while returning part of his capital.

Late 2011: slow progress

By late 2011, three GP consortia have emerged in the PCT's old territory. One of these, Donhead Street Practice, has hired a PCT employee to help run its practice, budgets and commissioning. Pink Elephant knows this employee well, so it successfully pursues negotiations with Donhead Street Practice to look after the consortium's mental health clients, most of whom are members of the charity. This covers about a third of the membership—120 on the usual basis, and ten on personal budgets.

However, the charity has problems with the other two consortia, which cover about half of its membership (about 195 members including some on personal budgets). They prefer to run the commissioning side themselves and have not employed practice managers. The GPs working in them are not familiar with Pink Elephant's work. In any case, they prefer clinical approaches, such as drugs and psychotherapy, to social support, when managing patients' conditions. Pink Elephant is having difficulty getting access to the consortia to make its case. However the charity hears that one of the consortia, Shaftesbury Road Clinic, is keen on evidence.

Pink Elephant is also worried about around 65 of its members, who are not registered with GPs joining any of the three main consortia. So Pink Elephant starts the tedious process of helping some of the more vulnerable members to re-register with Donhead Street Practice.

In the meantime the charity is concerned about how it will fund about half of its members (195) given they are covered by the two consortia proving tricky to deal with.

Charity action

Pink Elephant goes through the difficult process of restructuring so that it protects the services it provides to its members who are fully-funded by their GP consortia. It then offers a more basic service to its unfunded members. This manages to save some money, but as the PCT contract comes to an end, it will be difficult for the charity to cover its core costs, and it budgets for a deficit in 2012.

The new staff member hired from the PCT starts work in autumn 2011, and is optimistic that over time, the problems with the other consortia will be resolved. In the meantime, the charity needs to improve its evidence base and be patient.

In November 2011, the charity starts looking for funding for an evaluation, including some cost-benefit analysis.

In December 2011, the charity approaches a group of its longstanding funders, Green Albion Trust, Blue River Foundation and the Grey Family Trust for unrestricted core funding for a year from April 2011 while it sorts out the unfunded portion of the membership.

Funder decision

Should the funders give unrestricted core funding without a coherent business plan and evidence base? Should they fund better evidence collection?

The Grey Family Trust agrees to cover the evaluation costs immediately, recognising the value of demonstrating results.

The other funders wait for more progress on business planning and contracts, and stay in touch.

2012: The new world is in place

An evaluation gets underway at the start of 2012, with interim results due in July. The full results and cost-benefit analysis will be known in December.

In April 2012, the PCT contract comes to an end. Transition of the members under Donhead Street Practice has had a few wrinkles, but the new staff member has managed to iron out some of the practicalities. However, the payment terms (by which payment is received quarterly in arrears, rather than monthly in advance) are disrupting the charity's cash flow: reserves are now down to the equivalent of two weeks' expenditure.

The development project is finished, and filled by a tenant known to the charity, in preference to a start-up offering more cash. This starts to bring in some welcome unrestricted income.

The new staff member has managed to speak to Shaftesbury Road Clinic, but is told to come back with better clinical evidence of the benefits of the club.

Charity action

In the first quarter of 2012 Pink Elephant's new staff member rewrites the business plan so that it is more coherent.

In April 2012, Pink Elephant approaches a social investment lender for a loan to cover the change in payment terms. The lender says it is interested, as long as the charity can get some core support for 12 months to help fund the deficit.

The charity presses the three funders for a funding decision on the core support, representing the business case.

Funder decision

Should the three longstanding funders back the charity's new business plan? Can they be sure this will leverage the loan required?

All three longstanding funders are more comfortable with progress on contracts, and the new business plan presented in April. A phone call to the social investment organisation confirms seriousness of interest. The funders react quickly to the new business plan, and coordinate their decision, agreeing funding by May 2012, just before the charity runs out of cash.

2013: Life is looking up

The interim evaluation results convince Shaftesbury Road Clinic to come on board. The third consortium, the Well People Centre, finds life a struggle and eventually appoints a practice manager keen on saving money in the long term, especially by controlling mushrooming crisis costs. On receipt of Pink Elephant's cost-benefit analysis, clearly articulating how it prevents crises, the manager quickly concludes that the charity represents good value for money.

In a neighbouring borough, personalised budgets have caught on in a big way. Word of the club has spread to other people with mental health problems, and they have started requesting referrals from their GPs.

Pink Elephant's staff run a series of road shows and workshops with other GP consortia in nearby boroughs, and there is a steady stream of new clients.

Pink Elephant also finds that a number of new services are being demanded. For example, support for people moving to personal budgets is a service the local authority needs to offer, so the charity cautiously bids for the contract to provide this service on the local authority's behalf—despite misgivings about the previous cuts. The charity's relatively low overheads also mean it can offer talking psychological therapies more cheaply, and in a cosier environment, than the local hospital, which in any case is short of space for outpatients. The GP consortia welcome this new service.

Lessons from this scenario

At each point of action by the charity, it urgently needed funder support, but it could not provide the funder with much certainty as to whether the funding would bear fruit.

All the funding requests were potentially risky, as the charity could not prove that it would sort out its relationship with the GP consortia. But the funding for the ex-PCT-employee post and the evaluation helped to mitigate the risk of providing core support.

The charity had a proven track record of leadership and adaptability which the funders had seen for themselves, and were witnessing again. The charity was attacking the problem as constructively as it could. It presented plans (first the development, then the overall business plan) which were eventually credible with the funders. One funder recognised the importance of evidence, a long-standing weakness of the charity.

In the longer term, the outcomes of the funding decisions are beneficial. The charity has ultimately been able to expand both its membership and its remit, and it now has better evidence of its impact.

In reality not all scenarios like this one will go so well. A crucial link in the chain of events may get broken and disrupt progress.

3. How funders can respond

The scenario painted in the previous section shows how complicated charities' lives might be and the difficult decisions confronted by funders. Grant-making has just got harder, and responses will need greater thought. Advance preparation for difficult scenarios will make dealing with them easier.

In a series of debates for trusts and foundations run by the [Association of Charitable Foundations](#) (ACF), it was clear that those attending wanted to do the best they could for their causes and grantees. As one attendee remarked: *'Charities and funders need to sit on the same side of the table confronting the challenge, not on opposite sides of the table confronting each other.'*

The discussions mainly centred around 'what to fund' (see box), but in one of the sessions, one attendee's comments were striking. He talked about his foundation's journey to become 'match fit' for any eventuality. This trust, the Roald Dahl Marvellous Children's Charity, had recently enhanced its board's capability, and reviewed its strategy, and so was confident of being able to have an impact even in these uncertain times.

In the same way that charities need to ensure they are ready to cope with the new environment, so too should funders examine themselves and ask whether they are best placed to maximise impact. Are their internal processes able to cope with rapid changes and demands from grantees? Where the policy and funding environments are extremely complex, do funders have sufficient expertise to make the best funding decisions? Do funders' strategies need updating? And should they collaborate more?

Association of Charitable Foundations debates, June/July 2010

This is an example of a group of funders sharing their thinking and experience in an open forum. The themes discussed at these debates included:

- What are foundations' unique role? What additional value can they add (for example, convening power, brand or access to influence)? Should they do more?
- Where is the line between statutory obligation and civil society? Where should foundations draw the line on funding services?
- Should foundations 'bail out' charities, and under what circumstances? Should they fund mergers?
- Can foundations collaborate on funding while preserving the diversity of funding options available to grantees?
- As groups become ever more marginalised, should foundations speak out on their behalf directly, or fund charities to do so?
- Should foundations prioritise the funding for survival, or still offer funding for innovation?
- Should foundations fund or work with the public sector as well as charities and public bodies? Would this compromise independence?
- Should foundations be directly involved in policy-making? Should they let each other know about their actions? Should foundations stop supporting policy work if it seems to be irrelevant or thankless?
- Should foundations expose themselves to more scrutiny and criticism from grantees and the general public?

We will rehearse only some of the themes covered in the ACF debates here, as the papers and responses are available to members on ACF's website.¹ Instead, we take a slightly different tack: focusing on the 'how' of funding as well as a few pointers on the 'what' to fund.

Recognising horses for courses

This paper is aimed at funders beyond the ACF debate attendee list, including regional and local trusts, individuals, and newly-formed family foundations, as well as large London-based foundations. NPC has been struck by the huge range of funders. We have met tiny grassroots local funders with a single employee, and endowed foundations with a dozen employees with several funding strands. An individual donor, or single employee funder, and a large grant-making trust will face very different challenges in funding effectively. Individuals may have the freedom to act swiftly, but lack knowledge. Larger foundations have resources dedicated to developing experience, knowledge and strategy, but may find it harder to act swiftly. Smaller foundations may lack the resources to keep abreast of changes.

This diversity is welcome. Different types of funder will be able to make their particular contribution. So funders should understand their own strengths and weaknesses in order to operate effectively.

Increasing expertise

In the coming months and years, the composition and nature of each sector will change drastically as a result of cuts, changing funding arrangements and government policy. Funders will be faced with some extremely difficult decisions. In a world of scarce resources, they may have to triage funding options: they may have to reduce the areas they fund, or reduce the charities they support. Many of the larger, established funders have staff experienced in funding the areas they support. But even the most experienced grant officers may not have seen before anything quite like what we are seeing now, and may need to access additional expert advice.

Funders' instincts may be to spend less on their own central costs, reserving more for the charities they fund. But if they can make better funding decisions by spending more on gathering information and assessing the environment, then in the long run, they will have a greater impact.

Where the ultimate funding decision lies varies, and may depend on the size of grant: with some foundations, it rests with the management; with others, the trustees. Trustee boards of foundations vary too: some are mainly oriented towards the family of the original benefactor; others have a broad skills mix including sector expertise. Our main concern here is that the body making the funding decisions, be it executive or trustee level, is sufficiently informed and expert to make good decisions. And if the body lacks expertise, finding ways of accessing good advice is likely to increase impact. The current environment accentuates this risk to funders' impact.

These are short-term considerations. Over the medium to long term, funders may want to revisit their strategies and adapt them to the new environment. The trustee board is essential to this process and funders may want to ask themselves if the board composition is right, or if complementing the board with additional expertise would be helpful.

Sharing knowledge

One way to increase impact is to share knowledge. By sharing what they know, funders can ensure that the best approaches are adopted, efforts are not duplicated, and mistakes not

¹ <http://www.acf.org.uk>.

repeated. A group of funders can build expertise, share messages and span boundaries. At a time when financial resources are stretched, making the most of 'intellectual assets' is one way to increase impact. The ACF debates showed that sharing ideas can be useful in forming networks to solve problems.

NPC has been researching knowledge sharing among funders and has found that it is a low priority for most funders. Much relies on personal contact; reports authored by funders are not well targeted and do not get read; funders are reluctant to publicise mistakes. The infrastructure for sharing is underdeveloped and initiatives to improve it are fragmented and poorly resourced. The results of this research are not yet published but will be available by early 2011.

Funders could invest more in knowledge sharing to cope better with rapidly changing environments and emerging needs. A good intelligence-gathering infrastructure—for example, using charities with good local knowledge—can inform rapid responses to local problems in terms of both needs and funding issues.

As the environment rapidly evolves, keeping in touch with peers will help funders stay up-to-date.

Speeding up response times

The loss of a key contract, or a change of commissioning processes, could result in a sudden loss of cash flow even if the event has been anticipated. There will be times when the window between when charities can come up with a viable plan, credible to the funder and in tune with a new commissioning environment, and when they need the cash to survive or take advantage of an opportunity, is very narrow. Speed of reaction will determine success or failure.

NPC has met funders who are thinking about their processes. Processes vary, and applying for funding can be a lengthy procedure. As the director of the Friends Provident Foundation, Danielle Walker Palmour, observed at the 2010 ACF annual conference, '*Foundations are not known for their speedy response—glacial is a term that has been used.*' A six-month application process would be too long in the circumstances described in our scenario in Section 2.

Some funders have strong existing relationships with charities in this position and are able to react fast. But this is only possible if internal processes allow it. Funders may want to ask themselves:

- Is the initial application process quick and easy for charities under stress?
- Are the decision-making bodies meeting frequently enough to agree funding decisions?
- Would delegating more authority to management get round the need for more frequent trustee meetings, and enable flexible decisions to be made quickly?
- Once funding decisions are made, are the disbursement processes quick?

Communicating closely with grantees

If funders are to react swiftly to changing circumstances, they will need excellent communications with grantees. A culture of open and honest exchange will give charities the confidence to warn funders of impending difficulties, but also to keep them updated of any solutions. Armed with this information, funders will be in a better position to make decisions.

Good information on the sector often comes from charities. So by keeping in touch funders will learn about issues that may affect several grantees.

Reducing transaction costs

Given drops in charities' overall incomes, charities' resources are still going to be very scarce, even after a grant has been made or adapted. In our two *Turning the tables* reports (one in England¹ and one in Scotland²), we identified that the reporting requirements of multiple funders can be unnecessarily onerous and costly. In 2008, we calculated that for the charity The Place2Be, the cost of reporting to funders, in addition to The Place2Be's own internal reporting processes, was between 4% and 7% of project costs. So by developing a single, relevant report—ideally focusing on outcomes rather than just outputs—charities could save thousands of pounds' worth of management time.

Funders are starting to show interest in this approach. At the recent ACF debates, some funders called for better collaboration to reduce this burden. In August 2010, building on NPC's *Turning the tables* research, the Scotland Funders' Forum published a paper on harmonising reporting. The paper identifies practical steps that funders could take to make reports more useful for themselves and for grantees. This group of funders, which includes the Big Lottery Fund and the Scottish Government, is now planning to implement the paper's recommendations.

This approach could be extended to the application process, where funders have common interests in sectors. One application to several funders, sharing their due diligence processes, would cost less than multiple application processes. Collaboration between funders on applications and reporting could generate savings.

Some funders recognise that greater clarification of eligibility would help to reduce the cost to charities of failed bids. According to the Directory of Social Change, a third of applications to UK grant-making trusts were ineligible in 2009. That is 361,000 applications.³ We estimate that most applications take at least a day to put together, and then the application has to be processed by the grant-maker. This is a horrifying cost: a millennium of executive time spent with no result. At £300 a day, that is over £100m—3.7% of trust and foundations' total grant-making. Not all of this is the fault of funders: many charities ignore funding criteria in the hope that they will be the exception. But some published funding criteria are broader than what the funder will fund in reality. So the current environment is a good moment for funders to thrash out guidance on what they will and will not fund and trumpet it on their websites.

Reviewing their strategies

We have said earlier how the world will change and funders will have to keep pace. On top of this, funders' resources are scarce. Although the capital value of investment portfolios has recovered from the 2009 low point, investment income is still down: it dropped by about 15% between 2007/2008 and 2008/2009.⁴ So many funders have less income to give away: a state of affairs born out by a drop of 7% in grant-making over the same period—a £159m drop in grants paid out. A few trusts and foundations have said they will dig into capital to support levels, but this will not be the norm. Meanwhile, after a lull during which applications dropped, applications are now soaring—allocating scarce resources is a challenge.

Funders will almost certainly have to revisit their funding strategies. This will mean considering:

- what to fund—which sectors and which activities (prevention versus crisis intervention; lobbying versus services); and

¹ Heady, L. and Keen, S. (2008) *Turning the tables in England: Putting English charities in control of reporting*. New Philanthropy Capital.

² Heady, L. and Rowley, S. (2008) *Turning the tables: Putting Scottish charities in control of reporting*. New Philanthropy Capital.

³ Directory of Social Change (2010) *Ineligible Applications*, as summarised in ACF's Trust and Foundation News, September 2010.

⁴ Pharoah, C. *How do trust finances shape up in relations to Big Society?* (2010) ACF's Trust and Foundation News, September 2010.

- how to fund—for example, funder collaboration, processes, role of pilots and so forth.

For instance, under the Labour Government, many projects were funded in the expectation that, if successful, the intervention would be absorbed into mainstream services and paid for by government. Although this now seems less likely to be achievable with cuts in the offing, interventions saving money in the long term may still be attractive to local commissioners trying to save money in future. But charities and funders will have to make a powerful case and ensure that there is genuine appetite from commissioners before beginning work in this way.

Funders may also want to revisit which sectors they consider most financially vulnerable, and which they consider most worthwhile. Some of the most risky sectors will be supporting the greatest need and the most marginalised groups. There will be a trade off between sector vulnerability, which means investments will be much more risky, and supporting charities that are likely to survive and grow. Some funders will want to be the 'voice of the voiceless', and support groups that are even worse off than before. Some funders, such as the London Housing Foundation, have even decided to increase spending (and spend part of their capital) while times are so difficult.¹

An example of funder collaboration is the Corston Coalition, a group of funders that developed a strategy before the cuts to achieve longer-term impact. Several funders formed the coalition to put pressure on the government to improve conditions for women prisoners. Funders could form similar coalitions to address new issues as they arise.

But all these changes to strategy and process will require investigation and thought, which is why NPC believes that now is not the time to reduce funders' central costs.

Supporting sector infrastructure and philanthropy

The 'bonfire of the quangos' will put greater pressure on charity umbrella bodies to perform some of the functions of the quangos. It will be evermore important that charities collaborate and share best practice, and much of this happens through umbrella bodies—which need funding. Supporting local groups will help them to gear up for the Big Society (whatever this may entail).

Many funders offer charities access to their own infrastructure (for example, rooms and facilities) and this is very helpful. There may also be opportunities for funders to support coalitions and partnerships which take resources to develop. Funders can also encourage charities to collaborate, making introductions or hosting networking events.

Funders may also want to think about how to stimulate philanthropy. Warren Buffet recently asked his fellow billionaires to contribute 50% of their wealth to philanthropic causes. However he had 422 to choose from in the States. The UK has around 30 billionaires—far fewer. But that would still amount to £60bn if they agreed to give up half their wealth.² Finding ways to encourage individuals to give more is desirable, but not easy, as NPC has found in the past.

¹ Personal communication with New Philanthropy Capital 2010.

² Jonathan Reekie, ACF annual conference, September 2010.

4. Funding for greatest impact

Funders are perpetually faced with choices in terms of resource allocation. There will be more demand for lower available funding. So funders need to revisit:

- what they want to achieve;
- how they might do this (the best route to impact);
- areas to fund (have priorities shifted?);
- activities to fund; and
- terms of grants (size, length, product, requirements).

Understanding the context

The funding and policy environments are radically changing under the coalition Government, so charities and funders will have to adapt their strategies. To achieve impact and determine the best route to success, funders will need to understand how external factors are affecting this. For instance, they will need to assess whether a charity will survive, and also have impact in its sector, in a very different environment. In the earlier scenario, funders needed some understanding of the context in order to appreciate why Pink Elephant needed urgent support, and to decide whether to provide it. Here are three examples of changes to the environment likely to affect funding decisions.

Funding sources

Many voluntary funders will be reluctant to pay for services cut by government. They will have to weigh up the benefits and disadvantages in each case.

Whatever funders decide to do, they will need to be as clear as possible on where the charity's income will come from in future, what is still uncertain, and the risks. A broad knowledge of where the funding environment is going will help funders judge charities' plans and make decisions as to where funding will have most impact.

For instance, a charity might operate in a sector where all funding for a particular service or vulnerable group is being cut drastically, in which case the future of the service is looking very uncertain. If the service is effective, what might a funder do? It might decide to support a campaign highlighting the importance of the service; or it might support better collection of evidence by a beacon service; or it might fund the development of a new business model (for example, if personal budgets look like a possible funding option). Some of these options go beyond straight grant-making.

Policy drivers

Charities aiming to change policy and improve practice will have to adapt their methods as the policy environment changes. Under the previous government, lobbying a central government department that was likely to issue a 'services framework' or national strategy was a sensible first step to achieving policy and practice improvements. The next step was convincing local commissioners to follow national policy and best practice.

In the future, there will be fewer central directives—instead, policy and practice will be firmly rooted in local initiatives. This is a potential headache for lobbying charities, but it does mean that carefully targeted local projects can then serve as beacons for service providers and commissioners elsewhere.

In the meantime, local commissioning arrangements are changing, and this affects practice. For instance, health charities, such as Macmillan Cancer Support, are used to working with

Primary Care Trusts (PCTs) to improve local services. Macmillan's recent work with Monitor Consulting on cancer pathways showed how improvements in care coordination could save money as well as help patients. Macmillan was proposing to work with PCTs in Manchester to run some pilots to demonstrate what works best.

But PCTs will disappear, and GP consortia will become responsible for commissioning services. For each previous PCT there will be several GP consortia, so the change will fragment the picture somewhat. A charity like Macmillan, which has access to abundant resources and influence, is not daunted by this. It will adapt its tactics with the expectation that future GP consortia will be keen to work with it to improve outcomes for their many cancer patients. The implication for funders is that it needs to support charities if they want to use grants for changed purposes. Transition funding may be needed.

Smaller health charities, however, representing people with rarer conditions, may find the fragmentation of the policy arena frustrating, and find gaining the attention of GP consortia difficult. In this instance, it is hard to say at this point what funders should support. Muscular Dystrophy Campaign is particularly vociferous on the risk of changes, particularly the uncertain future of Specialist Commissioning Groups, and the effect this will have on patient care. It is sceptical about GPs' abilities to diagnose muscular dystrophy, let alone manage complex care pathways. So the education of professionals will continue to be an important and popular charity activity. Funders may want to explore ways of supporting or funding this.

In the education sector, the drive towards turning more schools into academies will take money away from local education authorities (LEAs) and put it straight in the pockets of headmasters. They will then be responsible for buying in services, such as support for pupils with special education needs, which traditionally may have been funded by the LEA.

So in some sectors, charities will need to re-map the 'agents of change' who are going to enable them to achieve policy goals. Funders should look for evidence that charities are thinking about this, and that it is reflected in charities' revised strategies.

Increasing financial needs

There may be a hiatus while new funding arrangements are negotiated, and the timing of payments may change so that charities need extra cash flow support. These two factors combined suggest that charities may need larger grants to see them through the transition period. They will also need a more intense level of contact, so that they can keep funders updated with developments and get speedy decisions on funding.

Funders will need to keep abreast of important but vulnerable charities, as we demonstrated with the example of the charity in the domestic violence sector, in Section 1.

It may be tempting to parcel out funding to everyone, but in small quantities, particularly as many funders themselves are experiencing reduced incomes. For smaller charities, this may be sufficient: NPC is completing an evaluation of a fund supporting small charities during the recession. It will be published by early 2011. Our findings so far suggest that where the charities' maximum income was £250,000, grants of between £10,000 and £40,000 were useful and would have a lasting impact. For larger charities however, NPC believes larger sums may be required to support them through transition. In this case, funders may have to be more selective about whom they support.

In any case, if funders have less to make grants with, they may have to be more selective.

Interdependence of charities

What would happen if a charity disappeared? Would it affect other charities' abilities to deliver impact? This is a particularly difficult problem to deal with in practice. A charity may not be an attractive funding proposition, but other, more effective charities may rely on it to deliver an

activity upon which their own impact is dependent. In which case should funders back a merger? Or some other solution?

Need to increase efficiency

'Cost avoidance' is a popular term in government circles, and in a world of scarce resources efficiency becomes a priority. Funders could help here, for instance funding better computer infrastructure to improve management information or procurement efficiencies. Redundancies—unpalatable but necessary—are in danger of eroding reserves unless funders are prepared to fund these.

Picking winners

Funders are most likely to make an impact if they fund effective charities. Where resources are scarce, and where charities need more funding, determining effectiveness becomes more important. We saw in Section 2 that Pink Elephant was a determined charity, able to adapt to new circumstances, but funding it was still risky. However, the risks were mitigated by a combination of charity action and swift funder decisions.

Good relationships

Established funders have existing relationships with charities, which help to inform decisions about further support. Close relationships put funders and charities on the same side of the table when confronting challenges. Frequent information should help funders to react quickly to evolving situations. The relationship has to be two way, however: there is no point in charities supplying information that is filed without being read. If a funder does not find the information useful, it should feed this back to the charity so that the charity can provide more useful information.

Funders should also encourage transparency and open communication. Fear of blame or rejection may result in charities withholding information when things go badly.

At the same time however, funders should beware of becoming too emotionally involved. Seeing a much-liked chief executive struggle will be very tough on funders passionate about a cause, but funders should try to retain their neutrality.

Information can tell a funder a lot about a charity's abilities:

- Good information tells funders what is going on in a charity. For example, how is its funding? Are finances under pressure? Is it achieving results? Are there any changes to management?
- Good information flows also indicate that a charity is on top of its environment or can identify and react to problem areas. Poor information often conceals problems.
- Honesty in communication is often (but not always) an indicator of confident leadership, realism and the potential to adapt.

It also helps funders to react:

- Good information educates funders on what is going on in a sector, the challenges and the opportunities.
- Funders can react quickly to information that is up to date, useful and accurate.
- Regular communication fosters trust between both parties, which is necessary when charities need flexible funding and rapid decisions. It also helps funders understand what support charities really need.

Funders need to be satisfied with their grantee relationships when considering further support. Poor communication bodes ill in difficult environments.

Effective charities

While close relationships go a long way to helping determine who is likely to succeed, dispassionate analysis will help with difficult decisions or help to flush out issues that a funder may not have addressed. And where funders want to develop new relationships, analysis is doubly useful. NPC's [The little blue book](#) covers [charity analysis](#) in detail and may provide a useful reference point for funders.¹ Analysis has several benefits:

- For funders, analysis can determine a charity's effectiveness and help to track progress over time. This helps to inform funding decisions.
- Analysis can identify areas for investment and improvement: this is useful to both charities and funders in discussions about what to fund.
- For charities, analysis can be a useful diagnostic tool for areas needing attention. Independent analysis can help management or trustees garner support for a course of action that may not be popular with some stakeholders.

Independent analysis may not be an option in the short term for time or cost reasons. But here are some questions to focus on in the context of the current environment, adapted from the analysis framework in *The little blue book*:

Area for analysis	Questions to consider in turbulent times
Activities	Is the charity showing an ability to adapt to a rapidly changing environment? Is it reviewing its theory of change?
Results	Is the charity collecting good evidence of the effectiveness of its activities? Is it learning from the data? Is it making a good case to other funders? Does the charity need investment in results measurement in order to convince commissioners and other practitioners?
Leadership	Are the trustees and chief executive planning ahead for changes and potential difficulties? Are they reviewing the strategy? Are they meeting frequently enough to make key decisions? Is management able to maintain morale and key staff during a turbulent period?
Finances	Is the charity on top of its financial information and planning ahead for financial changes? Is it conducting any risk analysis? Has it got good cost data for making a case to government funders? Is the charity looking at other business options? For any charity with government contracts, funders should expect the risks to increase. Income will be risky, and reserves may become depleted.
People and resources	If money is tight, is the charity managing its non-financial resources as well as it might? Are volunteers used to maximum benefit? Is the charity able to leverage pro bono support or gifts in kind? What are the dangers of losing key staff?
Ambition	Does the charity see any opportunities in the new environment?

¹ Copps, J. and Vernon, B. (2010) *The little blue book: NPC's guide to analysing charities, for charities and funders*. New Philanthropy Capital.

Opportunities for scaling up

The changing policy and funding environment may also present opportunities for charities. NPC's paper [Scaling up for the big society](#) identifies examples of charities delivering services that could be extended.¹ A charity itself might be scaled up, or other models of replication could be used—for example, training other service providers in successful techniques, going into partnership with other organisations, or franchising. Funding partnerships may be increasingly important. Commissioners will want to commission a complete suite of services for particular groups, and the only way charities will be able to compete with the private sector will be by partnering with others so that the 'offer' is complete. This process will require investment.

But before investing heavily in expansion, replication, or partnerships, funders would be wise to consider whether the charities they are considering have the organisational capacity to achieve their plans, and in what areas they are most likely to be successful. We would ask these questions:

- Is the service genuinely scalable or replicable? Or is its success specific to the local area? If the latter, are there easy ways to share the lessons?
- Who at the charity (or charities) is doing the business planning for expansion or replication? What is their experience—does the charity need more expertise?
- What additional resources—human or financial—would be required to execute the plan? For example, will the charity need to develop a training programme? Are people available? How might the plan be funded?
- What are the risks to success?

Funding conundrums

Should I bail out a charity?

The National Council for Voluntary Organisations (NCVO) reports worryingly low levels of reserves among operating charities: one in three has no reserves.² If a charity with no reserves loses just one contract, it will struggle to survive. When funders see the charities they know coming perilously close to the edge of going bust, should they come to the rescue?

Some trusts are developing emergency funds for compelling situations. At the same time the response from many voluntary funders is that they will not replace government funding.

But the situation may be much more complex than that. Emergency funding does not necessarily have to replace government funding, but it might give the charity breathing space to reconfigure itself with fewer government contracts and an adjusted role—particularly if it has insufficient reserves.

If government funding for some services disappears, the charity may lose a contribution to its core costs. So the charity may need the chief executive's salary and office rent paid while it develops new funding streams or reduces its cost base.

Funders should only support mergers if they genuinely make sense. A charity may need time to pursue a merger, in which case a funder can bridge the gap until agreement is reached, and then provide appropriate support to implement it.

In some cases, the services provided by a charity might originally have been additional to statutory requirements, rather than mandatory, but the previous government elected to widen the statutory net. The current government may now be concluding that the same services should be paid for voluntarily rather than by the state—even if the services are valuable. In this

¹ Brookes, M., Lumley, T. and Paterson, E. (2010) *Scaling up for the Big Society*. New Philanthropy Capital.

² NCVO research (2010) <http://www.ncvo-vol.org.uk/news/funding/one-three-charities-have-no-reserves>.

case, funders will have to decide whether they agree, and whether they would find it acceptable to fund the activity.

In all these situations, funding is risky, and funders will need to rapidly assess whether the risk is worth taking. They should ask themselves:

- Is the charity doing something really effective and worthwhile? If the charity went under, would there be great social loss? Are the activities linked to the funders' objectives?
- Does the charity have a plan, however sketchy, for what happens next? Is management up to making a transition?
- Should the charity explore options for merger, or continue alone?
- Does this look like a perpetual funding hole or just a temporary one? Is it possible to fix it?
- Can funders act in concert to help share the risk?

Once emergency funding has been provided, it is highly likely that the charity will also need a slug of transition funding. [Impetus Trust](#) is highly experienced in providing significant investment in charities wanting to achieve a step change. Funders may want to learn from some of its case studies—although historically Impetus has funded growth rather than survival.

Should I fund innovation or business as usual?

Many funders have been pondering how they should balance funding existing approaches while still supporting innovation. NPC favours a mix.

As we have said earlier, many charities will need additional support for existing effective activities and core management in order to survive, and in the short term, piloting radical new approaches may not be appropriate.

However in a period of revolution of service delivery, innovation may be a necessity. To survive in the longer term, charities may have to develop new joint working practices, or adapt to personal budgets, or find ways of delivering services for lower cost. But disruption could be seen as an opportunity. By looking at processes, and examining what works and what does not, charities (supported by funders) could arrive at better outcomes and greater efficiencies.

Economists such as Paul Corrigan argue that disruptive technologies are the only solution to rising healthcare costs.¹ We have witnessed for ourselves how innovation from outside and within the NHS have revolutionised end of life care. The Gold Standards Framework (GSF) to plan care and emergencies coherently in the last year of a patient's life was originally devised by a GP, but the pilot was supported by a charity, Macmillan Cancer Support. GSF is now common practice among GPs, and is rapidly spreading to care homes as best practice. Its expansion was mainly funded through fees for training, on top of a modest grant from the Department of Health. Marie Curie Cancer Care meanwhile has been trying out ways to deliver greater choice of where people die, in particular, organising better home care. These initiatives both advocate significant changes to NHS processes.

Charities have also contributed to practice improvement. The Liverpool Care Pathway, a protocol for managing the last few days of life, was developed jointly by Marie Curie Cancer Care and a renal specialist based in a Liverpool hospital. This too is now routine practice. And hospices up and down the country have developed various techniques of coping with specialist conditions, such as respiratory problems. Overall, in the last decade and a half, there has been a revolution in clinical attitudes and approaches to managing the end of people's lives. And a lot of it has either been driven by or facilitated by charities and charitable funding.

¹ Corrigan, P. (2010) *Saving for the NHS: The role of the third sector in developing significantly better health care outputs for the same level of resource*. ACEVO.

So it would be a shame if such innovation was stifled for lack of funding. But innovation is risky. Even successful pilots with proven benefit¹ have not always been taken up elsewhere because commissioners have not behaved rationally. The short term financial and human investment required to change working practices and create impact for the longer term has been too difficult. But as the pilots themselves benefit service users, they are still worthwhile even in a hostile commissioning environment, albeit with reduced impact.

Funders will need to balance their support of tried and tested approaches, familiar relationships, and the pursuit of new opportunities.

Should I fund frontline services or charities trying to change the longer term?

We mentioned the domestic violence charity earlier. It helps victims of domestic violence escape the violence. Its frontline services one local authority area are to be cut. In a sector such as domestic violence, where lives are at risk, grant-making trusts may justifiably prioritise frontline services in a period of budget cut backs.

But the domestic violence sector has been transformed in recent years by the work of second-tier organisations that may lose their statutory funding if government decides to prioritise frontline services. Over the last decade, these organisations have changed and improved the domestic violence sector. They include [CAADA](#) (Co-ordinated Action Against Domestic Abuse), which trains domestic violence advocates who help victims navigate their options and become free from a violent partner. Another example is [Standing Together Against Domestic Violence](#), which helps to improve organisations dealing with victims of domestic violence.

Voluntary funders should support second-tier organisations as well as frontline services to ensure that the expertise that has been built up does not disappear in times of funding cuts. If that does happen, then long-term outcomes could be jeopardised as experience leaves the sector. Funders will need to keep a close eye on second-tier organisations to make sure that they are not in danger of closing.

How do I balance need with effectiveness?

A common conundrum is whether to fund an organisation, which is not particularly effective, but works in an area of acute need where there is nothing better on offer. Many of the sectors most under threat deal with the most marginalised groups. And many charities working with these groups have not benefited from the necessary resources to ensure effectiveness.

There is no easy answer, but one suggestion might be to work with the grantee to improve effectiveness. This requires sustained effort: imposing a pro bono consultant onto an unwilling recipient for a couple of weeks is unlikely to work. But some funders, such as Impetus Trust and Lloyds TSB Northern Ireland, and many others, can provide successful examples of boosting charities' confidence and abilities, through structured support.

Should I use new types of funding?

Funders may want to think about how new funding structures to make their money go further.

One way of doing this is through social investment, where funders lend to charities, rather than giving them donations. Where there is future revenue to service loans, they can be used to fund the purchase of a new building, to invest in new services, or to provide working capital when charities are paid in arrears. And because funders get their investment back, the funding can be recycled many times, so the same money goes further.

¹ Private discussions with a group of children's charities, 2010.

Some charities are now beginning to ask funders and banks for loans rather than grants, in certain situations. One example is Scope, the national disability charity. It wants to develop new adult residential facilities to replace its current outdated facilities. The new facilities will be more suitable to residents' choices and needs. Fundraising for this type of project is tremendously time consuming, takes ages, and runs the risk of cannibalising the charity's other donations. So Scope has developed a financing model that combines an interest-free loan with a donation. The interest-free loan is repaid from the sale of the old facilities. Together with a commercial interest-bearing loan, Scope believes that the loans and donations will meet the costs of developing the new facilities.

Other charities are seeking interest-bearing loans from funders. A fuller discussion of the range of products is explored in NPC's paper, [New facilities, new funding](#).¹

The coalition Government talks a lot about developing the social enterprise sector. But sources of government loan finance, such as Futurebuilders, have been withdrawn. The Big Society Bank may meet some of the sector's needs, but not all. In any case discussions are still continuing on exactly how the Big Society Bank will work. So overall it is likely that lending for the social enterprise sector will come from the private sector and voluntary sources.

An institutional funder can make loans either from its grant budget, or set aside part of its investment portfolio for social investment. *New facilities, new funding* talks about the trade off between social impact and financial return: investments with high social impact (and potentially high risk) but low financial return may be best suited to coming out of the grant budget. Investments offering commercial returns with medium social impact could comfortably sit in the funders' investment portfolio.

¹ Hedley, S. and Joy, I. (2010) *New facilities, new funding: A proposed financing model from Scope*. New Philanthropy Capital.

5. Evidence

Evidence is more important than ever: resources are scarce, and so using them to support effective activities becomes more desirable. And the coalition Government's rhetoric is that local commissioning should focus on outcomes, not outputs. We saw in the earlier scenario how the charity, which had previously failed to have its evaluation work funded, now urgently needed to remedy this gap.

The commissioning picture is mixed. Some government commissioners are only interested in price, which is frustrating for charities diligently collecting outcomes data. Other government commissioners are extremely risk averse, and are reluctant to fund activities that do not have proven results. But over time the move to payment by results will put pressure on commissioners to have good results data.

Yet in our experience, although statutory funders require the most evidence, they are least likely to fund its collection. A third of commissioners admit they never fund monitoring and evaluation, while half of charities say they never get it.¹ There are also flaws in the way that government seeks evidence:

- Commissioners do not always know what good measurement looks like.
- Historically, reporting requirements have often focused on outputs rather than outcomes, so shifting to the latter requires a change in culture.
- Reporting requirements can be disproportionate. Half of charities confirm this.²
- Level of evidence demanded may be impractical.

Reasonable evidence

When a charity is looking at its impact, it can use various different measurement tools, depending on what it wants to discover. If a charity is piloting a new approach, then it may need a detailed evaluation answering key research questions. If a charity is running an established activity, it may want to track its success with participants over time. But it will not need as much detail as it would for an evaluation of a pilot. Understanding how much detail to go into, in what circumstances and when is a complicated technical decision, and many funders are unsure what to do: either they go for overkill or they do not demand enough.

We can break the problem down by the following considerations:

- Stage of development of intervention: pilots require more detailed evaluation than established interventions.
- Numbers of beneficiaries: if there are large numbers, the intervention may lend itself to a randomised control trial ('RCT') (see below), but if the intervention only deals with a few people, an RCT will not work statistically. More qualitative appraisal may be required.
- Timescale of intervention: how long will it take for the outcomes to be known, and how difficult is long term follow up? Or are there intermediary indicators which may help determine success?
- Cost: this must be proportionate to the cost and scale of the intervention.

So funders need to be realistic about requirements.

¹ Lofgren, G. and Ringer, L. March 2010. *Well-informed: charities and commissioners on results reporting*. A National Performance Programme report. NPC and Charities Evaluation Services.

² Lofgren, G. and Ringer, L. March 2010. *Well-informed: charities and commissioners on results reporting*. A National Performance Programme report. NPC and Charities Evaluation Services.

For instance, RCTs can be used to prove efficacy by allocating participants at random to receive different interventions, then comparing the results. This is entirely appropriate for testing a drug designed for large-scale use. An RCT is not practical, however, to prove the effectiveness of a small local initiative working with a handful of teenagers to keep them out of trouble. It would need hundreds of participants before there could be any meaningful statistical conclusions. Instead, a charity should design or commission an evaluation that is more appropriate to size. Government has sought RCTs for some activities which are not of a sufficient scale.

Some tools track participants over time, for example, measuring improvements in behaviour and well-being. We are currently developing NPC's [Well-being measure](#), which is a tool that enables organisations to demonstrate their impact and understand the well-being of the young people they help.¹

Charities may want to develop their own theories of change and measurement processes. But development, data collection and data use take time and money.

Measurement needs funding

The real problem is funding. As mentioned earlier, commissioners do not provide enough funding for monitoring and evaluation activities, regardless of their demands. Government sometimes provides sufficient resources to fund the evaluation of a pilot project. But the cost of routinely collecting data on existing interventions is not budgeted for: it is usually up to the charity to prove the benefit without being provided with any resources to do so.

Charities would like trusts and foundations to provide more funding and non-financial support for this.²

Only recently, a charity told NPC that its funding request to undertake an economic evaluation of its work was turned down, and how frustrating this was, especially given the commissioning environment. The charity has no unrestricted funds to spend on this evaluation, even though it is a priority.

Non-governmental funders can therefore be very helpful in funding evaluations and systematic measurement.

Driving the agenda

The government rarely provides feedback on evidence or information on what it is looking for, so it is often up to the charity to develop tools and systems in the hope that what it comes up with is acceptable. Charities have to be proactive and develop the best systems they can because:

- the better the system, the more the charity can learn from the data;
- the better the system, the more likely it will be to prove the activity's worth; and
- the charity can achieve better outcomes.

But they need funding to do it. This is where non-government funders play a central role and add more value than just the money, They can:

- act as a sounding board to help charities to work out if they are asking the right questions;

¹ See http://www.philanthropycapital.org/how_we_help/big_ideas/Wellbeing_project.aspx.

² Lofgren, G. April 2009. How are you getting on? Charities and funders on communicating results. A National Performance Programme report. NPC and Charities Evaluation Services.

- share knowledge and information about systems they have seen at other charities—this may save the reinvention of an existing wheel, or charities can build on other people's efforts;
- encourage collaboration between charities and other stakeholders, even funding joint measurement initiatives (see below); and
- convene discussions with government funders on measurement issues, so that charities get the feedback they need.

Before funding a new measurement system, funders should check that the charity has spoken to other funders first, to ensure that those funders will not demand something entirely different in future.

One funder that has driven the development of a widely-used measurement tool is the London Housing Foundation, which funded the development of the Outcomes Star using St Mungo's as a pilot.¹ The tool was developed with Triangle Consulting. The Outcomes Star is now used widely in the homelessness sector and is a helpful tool not only for demonstrating the benefits of different services, but also for use in discussions with service users about their objectives and progress. A related tool, the Recovery Star, has since been developed for use for people with mental health problems.²

Indigo Trust recently funded the development of a tool to be used by a group of charities working with families of prisoners. This will be published by early 2011. The development was a joint effort between the group, coordinated and supported by NPC.

¹ See www.outcomesstar.org.uk.

² See www.mhpf.org.uk/recoveryStarApproach.asp.

Conclusion

Grant-making will have to change if it is to achieve lasting impact. Gone are the days when non-government funders could fund charities' additional activities without having to worry about the statutorily funded services, and how government funding affects charities' core strength. The old model of funding activities to leverage government commissioning is receding—at least in the short term.

Funders who do not engage with current upheavals will waste money and lose valuable charities reliant on disappearing government funding. Many funders are already adapting their thinking and processes, so here are some key pointers for all:

- Keep up to date with the context of the areas you cover, and with what is happening to the charities you are funding or intending to fund. Close communication with charities, and sharing knowledge with fellow funders, will help you to understand what is going on.
- Be open-minded about charities' demands and see the process as a dialogue. Charities will not be asking for easy-to-fund items. Their stories will be complicated and they will need funding for difficult things like interim core funding, partnership development, measurement infrastructure—even redundancy money. Fund what they need, BUT
- Make sure you are convinced by the reasons for funding both the charity, and its request. Is the charity effective? How well do you know it? If it is not effective, but there are compelling reasons to fund, can you help it to improve? If the plan is uncertain, is it at least credible? Is the charity adapting its strategy to improve impact?
- Expect financial risks to escalate. Few government-funded charities will be able to avoid this. But do expect to be kept informed. The charity should know its current financial position at all times and be planning (or attempting to plan) for different scenarios. You may have to take more risks than before.
- Review your own capacity and processes: can any be improved upon or speeded up? Do you need more expertise in a particular area? Are your trustees in the picture? Do not scrimp on your own staff as their time will be needed to keep close to charities and interpret sector changes.
- Review your own strategy: the areas that were a priority, and the activities that were valuable to fund under the Labour Government, may no longer offer impact under the coalition Government. Should your funding priorities change? Should you fund different types of activity or organisation in order to achieve desired outcomes? Or approach things differently altogether?
- As a non-government funder with limited resources you cannot solve everything. Refocusing on a narrower field, or funding fewer charities, will prevent you from spreading yourself too thinly.

Most government-funded charities are facing major upheavals: shrinkage; changes in the way they are funded; and changes to how they achieve impact. Some are looking at an abyss, but see opportunities if they can bridge it.

Non-government funders can make a vital contribution to safeguarding the sector's impact. But their grant-making will require thought, imagination and courage.

Appendix: Resources

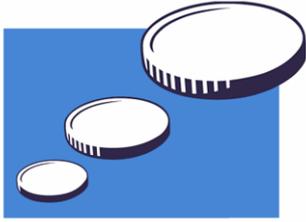
Below is a list of additional resources readers may want to consult. It is not comprehensive: there are many more reports, websites and blogs covering different topics.

Organisations

- **Association of Charitable Foundations (ACF)** (www.acf.org.uk): ACF will be publishing notes on the members' discussions during June and July 2010 on how to react to the cuts and new government policy.

Publications

- **McKinsey & Company (2010) *Learning for social impact: What foundations can do.*** This paper discusses how grant-makers can undertake social impact assessment, but its thinking can also be applied to everyday life.
- **Brick, P., Kail, A., Järvinen, J. and Fiennes, T. (2009) *Granting success: Lessons from funders and charities.*** New Philanthropy Capital.
- **Brookes, M., Lumley, T. and Paterson, E. (2010) *Scaling up for the Big Society.*** New Philanthropy Capital.
- **Heady, L. (2010) *Social Return on Investment position paper.*** New Philanthropy Capital.
- **Lofgren, G. (2009) *How are you getting on? A National Performance Programme report*** by New Philanthropy Capital.
- **Lofgren, G. and Ringer, L. (2010) *Well-informed. A National Performance Programme report*** by New Philanthropy Capital.



New Philanthropy Capital

New Philanthropy Capital (NPC) is a consultancy and think tank dedicated to helping funders and charities to achieve a greater impact.

We provide independent research, tools and advice for funders and charities, and shape the debate about what makes charities effective.

We have an ambitious vision: to create a world in which charities and their funders are as effective as possible in improving people's lives and creating lasting change for the better.

For **charities**, this means focusing on activities that achieve a real difference, using evidence of results to improve performance, making good use of resources, and being ambitious to solve problems. This requires high-quality leadership and staff, and good financial management.

For **funders**, this means understanding what makes charities effective and supporting their endeavours to become effective. It includes using evidence of charities' results to make funding decisions and to measure their own impact.

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