Growth Fund Financial Resilience Research

Ecorys, April 2024

Introduction

This report outlines key learning on how VCSEs perceive financial resilience and what helps or hinders this. The report may be of interest to VCSEs and the organisations who support them (including funders, social lenders, infrastructure organisations, and commissioners). It highlights learning on **what works to support VCSE financial resilience** and **what could be done differently in the future** to support the resilience of the VCSE sector. The research is part of a wider evaluation of the Growth Fund.

The **Growth Fund** was launched in May 2015. It was designed to provide flexible unsecured loans of up to £150,000 for voluntary, community and social enterprise organisations (VCSEs) and make them affordable by combining grants with loans. The Growth Fund blends a commitment of £22.5m of grant from The National Lottery Community Fund with at least £22.5m of loan finance from Big Society Capital and other co-investors (such as community foundations). Access - The Foundation for Social Investment, manages the programme, working with a number of social lenders who manage funds under the programme and provide investments to VCSEs. The programme itself aims to provide relevant finance to over 700 organisations in England. Further information on the Growth Fund can be found in the latest summary evaluation report.

Ecorys and ATQ Consultants were appointed to evaluate the Growth Fund, with the aim to assess and track its effectiveness in enabling a wider group of VCSEs to successfully access social investment, become more financially resilient, and deliver greater social impact. The evaluation commenced in 2016 and will run until 2025.

Recognising that social investment is only one route to increasing VCSE financial resilience, the Growth Fund programme partnership were interested to explore how this fits within a wider context of other routes to resilience. Beyond the main evaluation, Ecorys is therefore conducting **research on the wider financial resilience of VCSEs**. The overall aim of this piece is to explore what financial resilience means to VCSEs, what the enablers and barriers to financial resilience are, and how resilience can best be supported.

This research primarily draws on a Rapid Evidence Assessment (REA), research with 20 case study VCSEs, and inputs from a Research Advisory Committee (RAC). Where relevant, it also draws on wider findings from the Growth Fund evaluation (including findings presented in the 2021 evaluation update report, consultations with social lenders involved in administering the Growth Fund, and interviews with Growth Fund case study VCSEs). The methodology slides in Annex 2 provide more information.

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Research questions

Following the REA, Ecorys consulted with the Programme Partnership and with the Research Advisory Committee (a group of 30 sector experts set up specifically for this research). The group finalised the following research questions:

1

What does resilience mean and look like for VCSEs through PESTLE[1] periods of stability, change, shock and recovery – and what is needed to help them span those periods resiliently?

2

How do (or could) VCSEs' use of enterprising **business models** and sources of income help to build long-term resilience?

3

How should **social investment be designed** to help micro, small and medium VCSEs maximise resilience while minimising exposure to risk?

4

What **implications** do the findings from the research have for government, donors, social lenders and VCSEs?

[1] PESTLE: Political, Economic, Social, Technological, Legal, Environmental

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What is financial resilience?

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Defining financial resilience

Based on the literature and views of the case study VCSEs, financial resilience is having a stable organisation, and confidence that the organisation will remain viable in the medium- to long-term and survive in the 'worst-case scenario'. It means having good financial management, a predictable income which includes unrestricted funding,[2] and diversity of income streams.

Specifically, it meant:

- Having **predictable and stable income**, which includes **unrestricted funds** which could be 'flexed' responsively to changes in circumstance, enabling them to be 'nimble' to absorb, adapt or transform under pressure. This aligns with Whittaker's (2022) definition as '*the ability to respond rapidly to changed circumstances, finding nimble and opportunistic ways to continue to make a difference*'. This also chimes with social lenders' assessment of financial resilience.

- Being **stable**, without necessarily seeing growth in income, assets or other financial metrics.

- However, resilience moves beyond predictability and stability. Echoing Searing et al's (2021) definition of resilience as *'the ability to withstand sudden revenue shock',* VCSEs related financial resilience to simply being able **to sustain operations and avoid closure in every eventuality**, including times of crisis.

- Having **diverse income streams** helps organisations to absorb, adapt and transform in response to shocks. This included diversity *across* different revenue streams (e.g., earned income and fundraised income) and – for organisations who were majority grant-funded – diversity *within* revenue streams (e.g., diversity of different grants).

- Case study VCSEs foresaw challenges arising from any common measurement framework for financial resilience, see Annex 2 for more details.

[2] A VCSE can use unrestricted funds for any purpose, as long as it meets the aims and objectives of the VCSE outlined in their governing documents. (Adapted from Vaslan).

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What challenges to financial resilience do VCSEs face?

Challenges to financial resilience

Whilst case study VCSEs may look financially resilient on paper, they ultimately operate within a financially insecure environment and therefore do not feel financially resilient.

- Some case study VCSEs who experienced risks (sometimes multiple) described their organisation as being generally **resilient by virtue of their continued survival** and ability to continue to deliver their social impact through tough times. However, they still reported feeling **uncertain about their future**.
- Even case study VCSEs who had not necessarily experienced substantial financial risks in the past did not feel financially resilient because their existence and survival depended on external funders within an **insecure funding environment**.
- Factors that create this **insecure environment** include:
  - When organisations are reliant on funding applications, financial resilience can be restricted by the **uncertainty about where funds are coming from** (particularly when funding is short-term). Case study VCSEs reported a **lack of long-term funding** available, which can support future planning, forecasting, and 'stability of income'. Grants of 3+ years were preferred for the stability this provided.
  - **Local context** – not being able to secure funding in areas which lack opportunities for funding (e.g., rural areas). This can include a lack of opportunity to secure matched funding from local funders where they do not exist (e.g., a lack of public funders, local fund-givers, social lenders or corporate donors), which can be a requirement of some larger funding applications.
  - Echoing factors highlighted in the literature, **external economic factors** included the cost-of-living crisis (increases and unpredictability of utility bills and staff wages) and the pandemic (where case study VCSEs had to reduce or change activities).
    - Case study VCSEs also reported challenges in predicting the additional resources required to meet the increased level and complexity of needs, as a result of wider challenging economic circumstances affecting service users.

"Income's good that it's level or increasing, but then, you know, you take into account something like the massive increase in electricity bills over this year, that's gonna have a huge impact on our total, like, income to expenditure [ratio]. But the income itself shows that the organisation is still steady."

(VCSE interviewee)

Challenges to financial resilience

Case study VCSEs expect this financially insecure environment to continue.

The future of income from Government:

- **Context of LA bankruptcy** is unnerving for case study VCSEs who receive council funding. One VCSE developed a funded work placements programme which their local council pays for placements on – but now the council is facing bankruptcy and the VCSE believes that income stream is likely to be cut. Where the council currently funds lots of providers for a service, they are streamlining to fund a single provider for efficiency (which may make larger providers more attractive)

- Case study VCSEs perceived that **smaller VCSEs may be cut first** in the context of local government budget cuts (easier to let go/make less ‘noise’)

- Case study VCSEs shared experiences of governments **expecting same outputs/service delivery for less money** because they are feeling the squeeze themselves.

Income from the public:

- For some case study VCSEs, the **reduced level of disposable income of their community members** was a concern – they were worried this would have a negative impact on their revenue stream from customers who paid for VCSE services

- However, a small number of VCSEs reported no negative impact on their sales in their trading arm (e.g., coffee shops) amongst the public. They attributed this to having an affordable/accessible price point.

Income from the private sector:

- Case study VCSEs who provided services to businesses (e.g., consultancy support or corporate event days) were concerned about **businesses reducing their ‘non-essential expenditure’** as they too feel the squeeze of inflation and increased running costs.

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What do VCSEs need to be resilient?

Financial resilience journeys: Absorbing, adapting, transforming?

Whether organisations are able to survive within this insecure environment depends on their capacity and ability to adapt, absorb or transform. This varied across case study VCSEs.

- Bene et al (2012, 2016) frame resilience in terms of an 'ability' to **absorb, adapt or transform**:

Absorbative coping capacity

The capacity or abilities of a VCSE to be able to **cope, moderate or buffer** the impact of shocks

Adaptive capacity

The capacity or abilities of a VCSE to make **adjustments** in response to change

Transformative capacity

The capacity or abilities of a VCSE to undertake **widespread and lasting change**

Resilience

Adapted from Bene et al (2014)

- All of the case study VCSEs demonstrated these capacities to varying degrees; most had experienced some form of financial shock and had been able to respond. However, the evidence suggests that whilst VCSEs can absorb, adapt and transform, there are factors within and beyond their control which inhibit their ability to do so.

Detailed discussion of selected case study VCSE journeys are included in the next 6 slides – click here to skip to the summarised findings.

Financial resilience journeys: Absorbing[3]

Several VCSE case studies demonstrated the capacity to **absorb** financial shocks by using reserves, stripping back outgoings, or taking on funds to cover outgoings or shortfalls in income.

- Absorbing financial shocks to survive a crisis was a strong theme amongst the case study VCSEs. Examples included:
  - **Using reserves** during times of delays to grants/funding, or to pay for unexpected costs.
  - **Stripping back** to reduce costs by giving up buildings (that were rented), restructuring/letting staff go, or 'bootlegging' to get things for free.
  - Taking on **social investment** to pay for costs they would otherwise not be able to fund (such as building repairs, due to grants being restricted and not having enough in reserves to pay for capital works upfront).
  - **Passing on the cost of increased outgoings to customers** by increasing the price for services (such as activities or goods for sale).
  - Whilst the pandemic represented an 'external shock' to the VCSE sector and wider economy, VCSEs commonly reported that this was mitigated by the **increased availability of 'Covid-relief' type funds,** which helped them to absorb the financial shock associated with restrictions to activities, increased need for services, staff illness, and reduced revenue.
- Social lenders believed that the personal tenacity of VCSE leaders to sustain operations was a unique quality of the VCSE sector. They saw VCSEs as being more likely to 'absorb' shocks than the business sector due to VCSE leaders' personal determination to keep an organisation running to continue delivering social impact. Social lenders believed business leaders in the for-profit sector may be more likely to enact a 'go under' response when profitability is threatened.
- VCSEs had mixed views on the extent to which their ability to 'absorb' financial shocks represented financial resilience; whilst for some VCSEs, absorbative capacity meant they were 'resilient enough', others expressed a desire for more adaptive or transformative capacity.
  - For example, a VCSE who **bolstered their reduced income from commercial trading during the pandemic with more grant funding** said it didn't help build financial resilience because it couldn't be put into reserves, which they saw as essential for financial resilience.
  - This echoes Bene et al's conceptualisation of resilience as the ability to adapt or transform.

The next slide visually depicts an example case study VCSE journey in absorbing shocks. [Note: the Y-axis scaling varies across the charts]

[3]This slide presents examples of VCSE actions which we have interpreted as 'absorption' coping techniques, where after absorbing the shock the VCSE returns to the pre-shock state. However, we recognise that the ability to absorb, adapt or transform is a spectrum, and VCSEs have different levels of ability to choose different absorb, adapt, transform response options.

Visual depiction of a VCSE case study journey: Absorbing shocks

At the time of research, this VCSE was almost entirely grant funded; they received mostly grants from trusts and foundations, but had received Government grants in the past too.

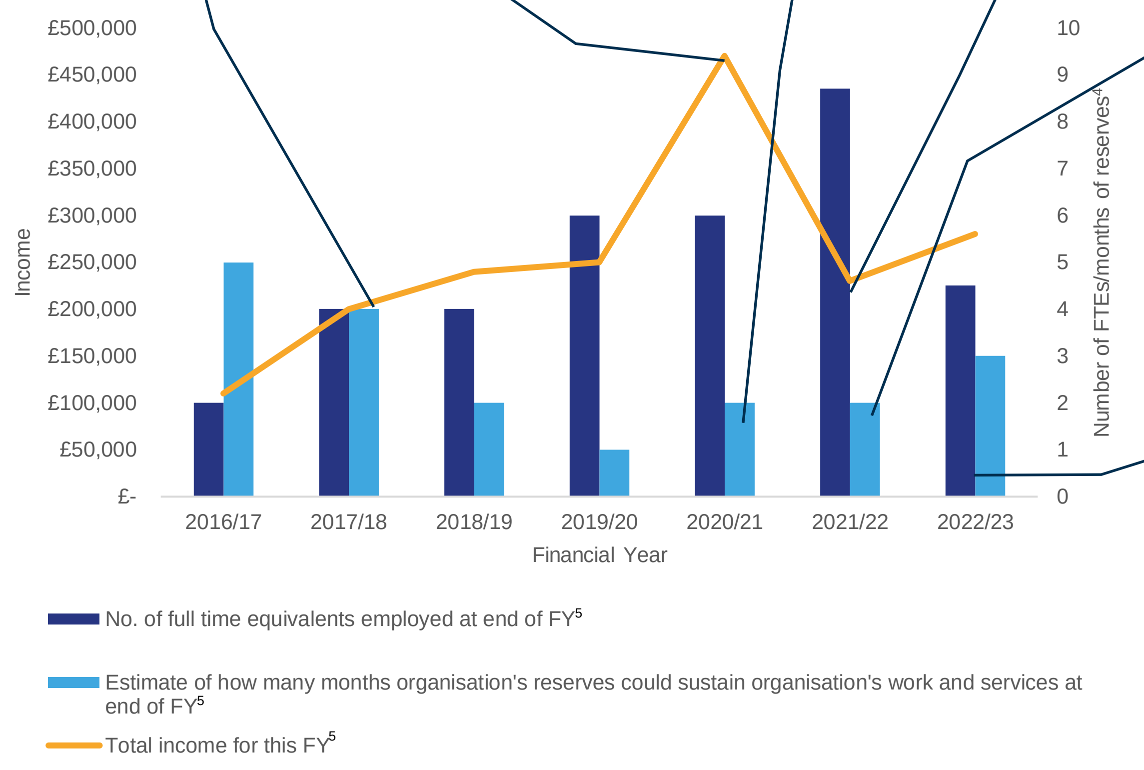
They felt financially resilient as they had recently received two successful grant awards which would sustain them for a few years. But in general, how resilient they felt was tied to their grants forecast. They said that, ideally, they would like to build up their reserves to help them 'buffer' any future financial shocks, but are hesitant to do so in case it makes them ineligible for grants again in the future.

VCSE describes the first few years of operating 'stable' as their income from grants gradually increased.

Spike in income due to receiving Covid-relief grant funding.

The increased levels of unrestricted grant funding from Covid were put into the VCSE's reserves.

Income then decreased by more than 25%, to 'normal' levels, representing a 'funding risk'.



Due to having more funds in reserves from the Covid relief funding, the VCSE were deemed ineligible for some of the grants they usually apply for. Several grants also came to an end at the same time. They absorbed this shock by using their reserves to deliver their programmes (resulting in a <-25% decrease in net assets / a 'financial risk').

The VCSE then adapted further by reducing their staff numbers, when they were unsure if they would receive more grant funding.
They received a successful grant application 'just in time' as they were 'looking over the cliff edge'.

[4] Estimate of how many months organisation's reserves could sustain organisation's work and services at end of financial year (FY)
[5] Across all charts, No. of FTEs, estimates of reserves, and where not available through Companies' House), total income for this FY, are organisations' own estimates

Financial resilience journeys: Adapting

Other case study VCSEs adapted to financial shocks by tweaking their income-generating activities.

- Our REA identified how the pandemic demonstrated VCSEs' adaptive capacity to successfully 'pivot' their business models. There were **examples amongst the case studies of business model adaptations forced by the pandemic**, demonstrating their adaptive capacity.

Changing business hours	Opening an online shop	Changing services to meet need
One VCSE used to operate only in Summer (outside activities) but lost so much income during the pandemic when they had to cut down delivery, and they needed a way of making more money. So looked for a new indoor venue they could open year-round. This worked out well and they have continued to operate year-round.	A VCSE opened an online shop to sell merchandise during the pandemic to make up for lost income when they had to stop activities. They have continued operating the shop and are turning over increasing amounts, and becoming more profitable	A VCSE changed their services to meet emerging needs coming out of the pandemic period, including pivoting familial support to address social isolation and loneliness. Once the local authority then picked up this support, the VCSE adapted their service again to reduce duplication of efforts and secure funding for needed services.

- More broadly beyond the pandemic and **outside of acute periods of crisis**, there were also examples amongst the case studies of VCSEs who adapted their business model to build long-term resilience:
  - One VCSE had continuously **increased the number of corporate event days** they held to increase their earned income (unrestricted) and reduce their reliance on grants
  - **Hiring external experts** to support business/organisational development
  - **Changes in fundraising strategies** to source income from new places (e.g., refreshing fundraising efforts to focus on corporate donations rather than public donations)
  - **Developing a new activity** that could harness local authority funds (i.e., funded work placements for young people who were not in employment, education or training).

The next slide visually depicts an example case study VCSE journey in adapting their business mode. [Note: the Y-axis scaling varies across the charts]

Visual depiction of a VCSE case study journey: Adapting to shocks

This VCSE is a local independent charity dedicated to providing information and support to people with visual impairments and their families, friends and carers. They receive most of their funding through delivering services on behalf of their local council, and through public donations and legacies which go into their reserves.

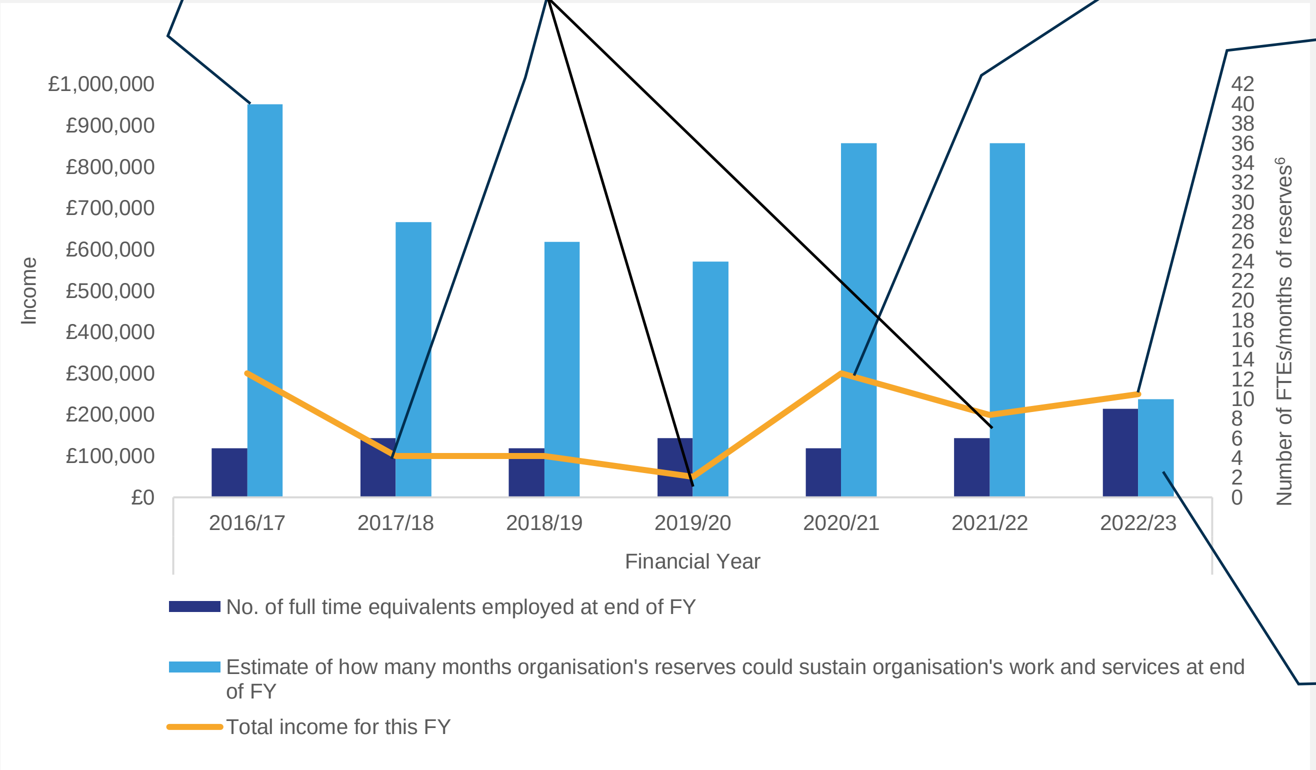
The VCSE feels financially resilient because of their significant reserves and assets.

In 2016, the VCSE received several very large inheritance payments which were put towards their reserves

For the years 2016-2022, 80% of the VCSE’s income was from public donations, legacies and fundraising. Between 2017 and 2022, the VCSE experienced a funding risk in three financial years due to year-on-year fluctuations in receiving legacies

However, in 2020/21, they received 80% from the voluntary sector in the form of Covid-relief grants.

Whilst their reserves are high, the VCSE had no means of covering their costs when no legacy payments were received and would make a loss. The VCSE therefore developed a new service for generating income through a council contract in 2022 to secure more sustainable income. This new revenue stream accounted for 80% of their income in 2022. This positively affected their financial resilience.



However, the VCSE used up their free cash reserves to pay for the increase in staff wages after taking on staff to deliver the council contract.

[6]Estimate of how many months organisation's reserves could sustain organisation's work and services at end of FY

Financial resilience journeys: Transforming

Where VCSEs had **transformed** their business models, in response to financial shocks or in times of business as usual, this had only been possible by having the unrestricted funds available to support business development.

- Just two of the case study VCSEs demonstrated transformative capacity.
- Where VCSEs had transformed their business model, this had been facilitated by a one-off receipt of a substantial asset in the form of a large legacy donation, or a Community Asset Transfer of a building from the local authority, whereby the VCSE was able to take over the ownership of a publicly-owned property.

The next slide visually depicts an example case study VCSE journey in transforming their business model [Note: the Y-axis scaling varies across the charts].

Visual depiction of a VCSE case study journey: Transforming in response to shocks

This VCSE focuses on violence reduction and prevention by delivering youth activities facilitating community engagement.

They were almost entirely grant funded until they received a Community Asset Transfer. Now, most of their income comes from hiring out their building for public and corporate events. This has increased their financial resilience as it has meant they can expand their offer by having more space for delivery without the additional cost associated with hiring space externally.

However, the VCSE would still feel more resilient if they diversified their income streams further.

In the lead-up to the Community Asset Transfer, the majority of staff time was dedicated to obtaining the building, at the expense of other income generating activities.

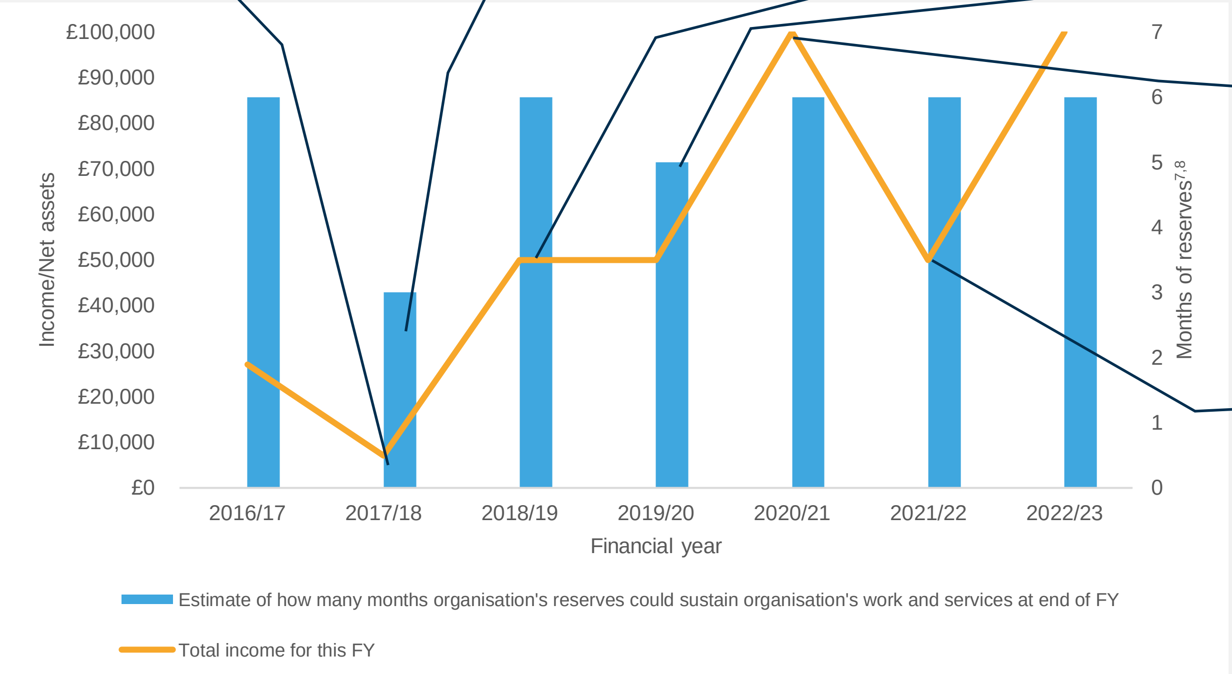
The VCSE spent some of their reserves on immediate renovations. They decided to go ‘above and beyond’ repairs to bring the building up to a high-quality standard, to ensure the building could be rented out for high market rates. This increased the value of their assets.

Having the building wasn’t initially as profitable as they would have liked, as they did not feel equipped to optimise its’ profitability and were undercharging for its use.

To increase profitability, the VCSE invested some reserves in support from a business consultant to establish how to maximise the profitability of the space. This resulted in them buying more equipment for the rooms and increasing the rate for hire.

The VCSE now generates 70-80% of their income from renting out the building, which makes them feel financially resilient and gives them their own, suitable space to deliver activities without having to pay for external rooms.

Although this income took a hit during the pandemic, it has returned to pre-pandemic levels.



[7] Estimate of how many months organisation's reserves could sustain organisation's work and services at end of FY

[8] This VCSE did not provide data on the number of FTEs.

Financial resilience: enablers and inhibitors (1)

Case study VCSEs' ability to absorb, adapt, or transform in response to financial shocks relies on several **internal factors** which enable them to be nimble in an insecure environment.

Skills and capacity for effective financial management

- Whilst case study VCSEs saw financial skills as a key factor underpinning financial resilience, they highlighted this as a gap in their skillset:
    - **Lack of finance-trained staff and trustees** to understand the impact of business decisions and financial resilience. Very small/volunteer-led organisations expressed not knowing "***where to start"*** with making the very first steps towards financial resilience. They described a **lack of 'entry level' business skills.** ***"We're surviving, but we don't have the capacity to thrive" (VCSE interviewee).***
    - Whilst employing specialist staff, particularly finance personnel, was a key enabler to building financial resilience, VCSEs reported **challenges in recruiting staff with the salaries they could offer**.
- Using **experienced external professionals** had helped a small number of case study VCSEs to plug some of these skills gaps and support the development of organisational structures which support financial resilience and the ability to absorb, adapt or transform. Having access to these professionals had been achieved through VCSE leaders' personal networks or through capacity-building support programmes.
- Social lenders and case study VCSEs saw **VCSE leaders' personal tenacity** (i.e., their dedication and commitment to sustain operations) and ability to 'run a tight ship' by operating on a shoestring or stripping back outgoings as needed, as fundamental skills for financial resilience. Social lenders saw this as a key strength in the VCSE sector. However, case study VCSEs raised several constraints on their ability to 'strip back' when needed:
    - There have been challenges in replacing the volunteer workforce lost during the pandemic.
    - Where VCSEs had committed outgoings, such as building rent, they saw this as a constraint on how much expenditure they could claw back in tough times.
    - Some case study VCSEs perceived themselves to be already operating as leanly as possible with no further room to flex.

"By default, not-profit led and not in it for the money. They are in it for the impact and difference they can make. They will do their darndest to make sure that it works"

(Social lender)

Financial resilience: enablers and inhibitors (2)

Case study VCSEs' ability to absorb, adapt, or transform in response to financial shocks relies on several **internal factors** which enable VCSEs to be nimble in an insecure environment.

Assets

- Case study VCSEs found it important to have **assets which can be monetised** to produce unrestricted, earned income.
- However, **not all case study VCSEs felt they had opportunities to monetise their activities**, due to:
  - Being asset-poor.
  - Facing challenges in balancing the monetisation of assets against their social mission, which is echoed in our VCSE Business Models report. For example, VCSEs reported they could not be tied to an activity only to generate income if this is not what their beneficiaries wanted e.g., a youth-led VCSE changed their activities often as their beneficiaries decided what programmes they run.
  - Geographical location. For example, where VCSEs operate within particularly rural or isolated areas with limited demand for wider commercial services beyond their charitable offering.
  - The cohort they serve - who may not be able to pay for services themselves, and where funding may not be available from other sources for some cohorts.
  - The saturated local market for the services they could offer – for example, VCSEs who own buildings which could be rented out may be operating within a local economy where other VCSEs are also doing this, affecting profitability.

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Financial resilience: enablers and inhibitors (3)

Case study VCSEs' ability to absorb, adapt, or transform in response to financial shocks relies on several **internal factors** which enable VCSEs to be nimble in an insecure environment.

Governance

- Case study VCSEs and social lenders highlighted a **lack of effective governance processes** in place which enable efficient absorb or adapt responses in periods of 'shock'.
    - For example, one VCSE described the slow and inefficient process of decision-making through their existing governance arrangements, which delayed their adaptation response when a grant they were expecting was not awarded.
- Social lenders and VCSEs also explained that the lack of financial expertise amongst their Trustees inhibited their ability to anticipate risks or make good business decisions. Case study VCSEs expressed specific **challenges in securing effective Treasurers**.
- VCSEs highlighted that **changing governance structures requires resources, skillset and capacity** to change, which they often did not have access to.

"As to our Board of Governors, they are all wonderful people, they give up all of their time, but I can't even get one of them to be the Treasurer. They just don't have that skill base"

(VCSE roundtable attendee)

Financial resilience: enablers and inhibitors (4)

Case study VCSEs' financial resilience or ability to absorb, adapt, or transform in response to financial shocks also relies on having the **funds available** to respond to shocks. **Funder flexibility** is crucial.

Case study VCSEs expressed **needing unrestricted funds available to respond to shocks or adapt/transform in times of business as usual**.

"We already know where our vulnerabilities lie, but we don't always have the power or ability to fix them because the [unrestricted] money for that isn't there"

(VCSE roundtable attendee)

This includes:

- Having the **funding for core costs** to pay for the time of staff with business acumen to take action.
  - Case study VCSEs valued having unrestricted funds available to pay for leadership team time to work on organisational development.
  - For social enterprises, this means having earned income to cover organisational development activities.

  "If you want us to be financially resilient, you have to fund us to have good financial management" (VCSE Roundtable attendee)
- Having **reserves available to buffer shocks**, accrued through earned income, grants which are allowed to be put into reserves, or large legacy donations.
  - Case study VCSEs highlighted that internal reserves policies also need to enable reserves to be accrued and used as needed.
- Being **supported flexibly by funders during times of crises**.
  - Funders providing covid-relief grants or being flexible with existing grants to enable case study VCSEs to 'pivot' activities.
  - Social lenders writing off loans.

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How could VCSEs become more financially resilient?

Income source diversity and financial resilience

Case study VCSEs were generally **keen to diversify** their income streams to improve their resilience. They saw this as giving them **safety** if any one income stream dried up.

- Echoing findings from our VCSE business models report, case study VCSEs reported a particular interest in **accessing unrestricted funding through earned income,** which they believed would provide financial independence to invest in staff, organisational development, add to reserves, fund unanticipated/emergency costs, and enable growth.
- Some case study VCSEs believed they could not move away from their main sources of income coming from grants, due to the nature of their VCSE. They cited reasons such as struggling to attract income from other bodies (e.g., as in the case of VCSEs working with perpetrators of domestic abuse), inability to raise income from payment by service users, and a lack of opportunity to monetise their assets (see here for more detail).
    - For them, having **diversity of different grants** was seen as important for resilience, as over-reliance on one grant produced a risk if that funder decided to stop funding them (e.g., changing requirements or thematic interests; not wanting to fund the same organisations for too long)
    - For example, one VCSE who described themselves as being reliant on a large grant with The National Lottery Community Fund believed this made them vulnerable - if that dried up, they would need to win 4-5 other smaller grants to make up the value (or cut two thirds of their staff).

Income source diversity and financial resilience

However, case study VCSEs faced internal barriers to diversification included a lack of the required **staff capacity or skillset**.

Barriers to diversification:

- **Needing investment for a member of staff for business development work** e.g., following up leads, getting back to people on time, networking.
- **Investment for finance staff:** case study VCSEs reported a skills gap in the sector, and often salaries that VCSEs can pay aren't attractive to people with this skillset
- **Limited business acumen** was identified as a barrier to understanding case study VCSEs' business model and opportunities.
- **Barriers to diversity across grants:** diversifying can be difficult because funders have different requirements for applications and reporting, which take both time and knowledge to understand the nuances of. One VCSE valued the expertise of an external consultant hired to help navigate this.

Enablers to diversification:

- **Consultancy support** to help consider how to develop business models further and diversify. This was particularly valued where this had been funded as part of a grant or loan.
- **Clear understanding of weak spots in VCSE business models:**[9] Our business models report highlights how VCSEs having a clear understanding of their current business models helps them to identify any 'weak spots' and if revenue or social impact could be increased by taking different approaches. Case study VCSEs highlighted a need for business acumen and finance skills to enable this understanding.

[9] By 'business model', we mean how an organisation plans to raise money to pay for activities that will help it achieve its overall social mission (the social impact that it is setting out to achieve).

Social investment and financial resilience

Social investment can support the financial resilience of some organisations, through providing flexible funding.

- Three case study VCSEs had taken on social investment in the past. In all cases, they had chosen social investment when they had **no other finance options** to fund the planned work (a rationale widely acknowledged by social lenders).
  - These case study VCSEs valued the **flexible nature** of the social investment, which they believed supported their financial resilience.
- This chimes with wider Growth Fund evaluation findings which outline how social investment can be used to **sustain** existing business, **adapt** existing business models, or **scale-up activity** – often funding activity which falls outside of the scope of grant-funding (see the Business Models report for further detail).
  - Indeed, case study VCSEs interviewed as part of the main Growth Fund evaluation described how the loans they received had been used to, for example, purchase assets which subsequently increased in value, employ staff to focus solely on business development, establish new or expand existing traded income channels, diversify, and support cashflow in times of financial shocks. These are all elements difficult to fund with grants.

Below we provide examples of how case study VCSEs used alternative (non-Growth-Fund) social investment to strengthen financial resilience.

Funding emergency roof repairs

A case study VCSE usually generated a substantial portion of their income through hiring out their building spaces, but issues with the roof meant the spaces were unusable. The VCSE failed to raise enough funds to repair the roof, and were ineligible for a bank loan, so they took on social investment. The VCSE was grateful to have had social investment as an option to fix the roof and enable them to restart their income stream. They also emphasised the importance of social investment loans having a low interest rate.

Equipment upgrades

A VCSE took on a small social investment loan to pay for new equipment to increase the profitability of their activities, which they did not have the cash to otherwise pay for. They found the interest rate and loan comfortably repayable. After their first positive experience of social investment, they are considering it again to fund future growth activities like buying a new building. The VCSE described the flexibility of the investor, and the willingness to change repayment terms, to be particularly helpful in minimising the risk of taking on social investment.

Social investment and financial resilience

However, it is well known that social investment isn't suitable for many VCSEs in its current form.

- Most of the case study VCSEs (17 of 20) either were not aware of social investment or thought it was not suitable for them, because they had **limited or no trading income** which meant they would be **unable to repay a loan**.
- Developing a **trading income was not deemed appropriate or feasible** for some VCSEs.
    - However, others identified **limited 'business acumen', financial capabilities, and capacity** to develop business/trading arms or proposals for social investment.
- Feedback from Growth Fund social lenders also suggested that whilst the Growth Fund had enabled them to lend to VCSEs deemed to be more 'risky' (e.g., those without such developed governance structures or business acumen), as responsible lenders **they could not lend to organisations who were not, to some extent, 'investment ready'.** They looked for **strong governance and financial capabilities** in potential investees.
    - However, case study VCSEs reported several challenges in forming those foundations, as outlined on previous slides
    - So, whilst social investment can support the financial resilience of some more investment-ready VCSEs, less developed organisations need earlier-stage support to develop entry-level business and finance skills, and support to strengthen governance.

How can funders, social lenders, commissioners and donors support VCSEs' financial resilience?

How can trusts and foundations help?

Case study VCSEs believed grant-funders could help by offering unrestricted funding, being flexible, offering longer-term grants, and speeding up award processes.

Case study VCSEs wanted grant-funders to:

- Move towards **funding core costs or providing unrestricted funding** which could be used for business development or reserves to provide financial resilience. However, VCSEs recognised that, when faced with difficult choices of how to spend unrestricted funds, they may prioritise frontline service delivery instead of increasing financial resilience, suggesting that unrestricted funding alone may not be a water-tight solution.
- Provide **funding for stability** – providing grants for the provision of existing, successful programmes rather than grants for growth or innovation, which could push VCSEs to take risks which could put them at financial risk.
- Offer **more flexibility around grants** – being able to put unspent money into reserves or change what they are spending it on without going through resource-intensive change requests. Case study interviewees had appreciated this flexibility where it had been offered through the pandemic.
- Opt for **longer-term grants** – interviewees described how this enabled them to plan into the future, and better forecast their financial status.
- **Speed up grant award processes** – VCSEs reported having to dip into reserves whilst waiting for decisions, which are often delayed.
- **Work together to streamline the application process,** reducing burden on VCSEs who are stretched for capacity.
- **Have more direct dialogue between funders and small VCSEs** to improve VCSE understanding of what grants are available to them and any existing capacity-building support on offer, which could help VCSEs diversify their grant funding streams or support further diversification.

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How can trusts and foundations help?

The case study VCSEs also believed funders were well-placed to offer much-needed capacity- and capability-building support, including support to help them diversify the grants they receive.

Echoing findings from the REA, the case studies also highlighted a need for **capacity-building support and business skills development** (e.g., finance skills, social media, fundraising).

- Interviewees valued that some funders already offer a set number of days of **consultancy support for organisational development** alongside the grant. This was regarded highly and VCSEs shared stories of how this had supported business development decision-making (e.g., recognising that their organisation was not social investment-ready but should be applying for a more diverse range of grants)
- Small VCSEs in particular described the need for **'basic-level' business skills** (including how to set up governance structures or understanding accounting processes), seeing this as a gap in the existing support offer which they felt was targeted at medium to large organisations.
- There are models of capacity-building which focus **funding on organisations, rather than projects**, e.g., the Impetus PEF approach which provides long-term unrestricted funding alongside capacity-building expertise.
- However, they noted that **existing offers of capacity-building support they were aware of, particularly relating to financial skills, did not meet their needs**. The reasons provided were that support was not 'entry-level' enough (e.g., short online courses were not intensive or basic enough), or came with a cost-barrier.
- The RAC and consulted VCSEs also recognised they face **capacity barriers to engage** in this kind of support, highlighting a need for funding for their time to enable their participation.

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How can public sector commissioners help?

VCSEs wanted to secure public sector contracts to help secure a regular and reliable source of income, but there are supply and demand side barriers.

- There was clear **desire to obtain public sector contracts** amongst some case study VCSEs, because this was seen as a regular and reliable source of income. However, case study VCSEs who had already secured income through public sector contracts also raised challenges around this (such as public bodies tightening their purse-strings, and delays to being paid), highlighting that improvements to public sector contracts are still needed to make this viable for VCSEs.[10]
- Case study VCSEs highlighted a range of demand-side barriers to furthering their participation in public sector procurement such as a lack of public sector commissioner understanding of and engagement with the VCSE sector, and contracts not being designed with VCSEs in mind, echoing Perspective Economics (2022) research.
- Case study VCSEs also expressed want for local governments to **provide more information about the opportunities available** for the VCSE sector to engage with e.g., upcoming tenders, or capacity-building or financial support there is available in their local area
    - A strong theme in the interviews with case study VCSEs was a desire for **commissioners to be more motivated to commission VCSEs.** They suggested that further recognition of the social value VCSEs offer could increase commissioners' efforts to boost VCSE commissioning.
- However, the RAC highlighted supply-side barriers to VCSEs accessing public sector contracts, again echoing Perspective Economics (2022) research. For example, the need to have robust compliance, governance, and policies in place; or the capacity to deliver and meet contractual requirements. Other programmes seek to support VCSEs to address these supply-side barriers, such as DCMS' Contract Readiness Programme.
- When VCSEs had secured public sector contracts, they expressed the need to **be paid on time** to avoid needing to dip into their reserves, which can present a risk to their finances.

[10] The new Procurement Act is expected to be published in Autumn 2024 with the aim of diversifying public procurement by opening up to new entrants such as small businesses and VCSEs so they can compete for and win more contracts. For further information, see here.

How can social investment help?

Whilst Growth Fund has helped to de-risk social investment, future programmes or funds should consider elements of design which could better support VCSE financial resilience.

- If the loan were **only repayable once making profit**, that would be more attractive and enable VCSEs to ‘take the risk’ on a new venture which could, if it succeeded, provide them with a new earned income and increase their financial resilience.
- If **low interest rates,** and **long-term, flexible repayment plans** could be secured to fund business development and growth. E.g., patient capital.

“[Repayment over] a longer period of time because the problem with all of these things… I would hate to get into that same situation that you're making short term decisions to financially gain ABC when actually, [a] long-term decision would be a way better way of going forward.”

(VCSE interviewee)

- Consulted **social lenders said they support considering alternate social investment designs**, but highlighted that the challenge is finding the grant funding to blend with loans to support these models.

What else can help VCSEs?

Charitable donations from the public or corporate donors provide helpful unrestricted funds. Private sector organisations could also subsidise costs for VCSEs during times of crisis, in recognition of the social impact they deliver.

- For VCSE infrastructure organisations or funders:
  - VCSEs struggle to recruit finance professionals to their Boards. VCSE infrastructure organisations and funders could support these endeavours by **promoting Treasurer roles to the finance sector**.
- For charitable givers:
  - **Large, one-off corporate and legacy donations** can be highly beneficial to support VCSEs' financial resilience due to the unrestricted nature of the funds.
  - Whilst one-off donations from the general public are helpful, **regular donations** support VCSEs to forecast and offer a more predictable income, however VCSEs highlighted that this can still vary year-on-year and therefore does not provide the predictability they need.
- For private sector organisations
  - To offer subsidies and other financial help to VCSEs in times of crisis, in recognition of the social impact they deliver, e.g., reduced rent and utilities rates during the cost-of-living crisis.
  - In-kind support can help VCSEs to free up project costs, but when these costs are grant-funded, VCSEs **cannot retain the savings this creates**. In these cases, one-off corporate donations may be a better offer to support financial resilience (as above).

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Conclusions and recommendations

Conclusions

This research has shed light on perceptions of financial resilience within the VCSE sector in 2023 and 2024. The research was small-scale and caution needs to be taken in how much can be extrapolated for the wider sector (particularly micro-organisations). However, what the research has highlighted is that the financial environment VCSEs operate in is insecure; within a context of high inflation, reduced public spending for VCSEs and relatively short-term grant funding cycles. To improve their financial resilience, case study VCSEs wanted predictable and diverse income streams which included access to unrestricted funds, to enable them to survive financial shocks.

A lot of the findings within the research are not necessarily new, and are widely known. This does, however, raise the question of why these issues still exist for the VCSE sector, and why they have not been resolved? There appears to be a mismatch between how VCSEs want to be funded, and what VCSE funders (public, government and donors) are willing to fund. The public tend to prioritise specific causes; the government are inclined to focus on achieving value for money and so drive down VCSE costs; social investment focuses on organisations with reliable income streams; and donors often prioritise funding directed towards service users via projects. None of these funding priorities necessarily support overall VCSE financial resilience.

This is not to mean that nothing is done to support financial resilience. VCSEs involved in this research were complimentary of donors that provide capacity-building support; some donors do provide more flexible grants that can be used to support organisational resilience; and programmes like the Growth Fund are making social investment more accessible to a wider range of VCSEs, which is having a positive impact on their financial resilience.

However, this research would suggest that VCSEs perceive that these endeavours are not enough to achieve VCSE financial resilience. To further aid this, VCSEs would benefit from a greater shift towards longer-term and more flexible funding arrangements, and a wider range of social investment products that provide riskier, more patient and equity-like capital. This highlights a need to continue exploring blended financing of social investment to test if this supports the resilience of a greater range of VCSEs.

Recommendations

- Case study VCSEs made several recommendations for **how funders could better support their financial resilience**:
  - Grant-funders could support VCSEs to access a mix of **unrestricted and project funding**
  - **Funding stability** i.e., the continuity of existing VCSE project delivery or activities rather than focusing on the development of new services
  - Continue being **flexible** about the use and reallocation of grants, as demonstrated through the pandemic
  - Offering **longer-term grants**
  - Supporting VCSEs to **diversify the grants they apply for**
  - **Speeding-up the grant award process** to reduce the time VCSEs are in 'limbo' for between application and decision, which can impede decision-making around funding.
  - VCSEs believed funders were well-placed to offer much-needed **capacity- and capability-building support** (including, but not limited to, development grants and consultancy support). This would need to be free of charge, and go beyond light-touch support offers (e.g., 2-hour online courses) which case study VCSEs believed are not intensive enough.
- Funders and VCSE infrastructure organisations could also play a role in **supporting VCSEs to recruit accounting and finance professionals as Trustees**, for example by match-making interested parties or running a campaign to promote Treasurer roles to the finance sector.
- Social lenders should continue to **experiment with different forms of social investment and blended finance**, to find solutions that work for wider pools of VCSEs.
- VCSEs should ensure that **internal reserves policies enable the accrual and use of reserves** to enable leaders to use them flexibly as needed.

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Annex 1: Measuring financial resilience

Measuring financial resilience

Views on the most effective metrics for assessing financial resilience varied amongst the case study VCSEs.

- VCSEs expressed that any measurement of financial resilience should be **proportionate to the size of a VCSE** (in terms of both levels of any financial indicator, and in appreciation that smaller VCSEs may face challenges in producing some metrics); and
- **Consider the nature of different VCSEs** (i.e., some VCSEs cannot monetise activities and will therefore have less diversity of income streams, others have a requirement for much greater levels of reserves which can ebb and flow such as needing to retain funds to pay for livestock veterinary bills)
  - As outlined on the REA preceding this research, while there is general consensus that having reserves is important, there is not a set standard of what is considered to be a 'good level of reserves' with recommendations ranging between 3-6 months of expenditure, however several case study VCSEs highlighted the need for more than this owing to the nature of their services. This is further complicated by views that VCSEs should be 'strategic' in their accumulation of reserves by ensuring they have enough to be resilient but not too much; a challenge echoed by the case study VCSEs.
- Whilst owning assets that could be monetised or reduce regular expenditure was seen as an enabler for financial resilience, **net assets was considered an unhelpful metric** for measuring resilience by many VCSEs who had few (if any) assets, assets that changed as the organisation developed, and also factoring in challenges mentioned above in terms of levels of reserves (which are also included in reported net assets).
- VCSEs believed organisations should be checked to see **how they would cope in different future scenarios** (e.g., if any source of income 'dried up'), however they did not specify how to measure this. ***"There's no point looking historically – resilience has got to be about the future." (VCSE interviewee)***
  - One VCSE suggested that funders could use 'financial modelling' to forecast different scenarios
- Social lenders also placed heavy emphasis on the extent to which individuals within VCSEs' leadership were resilient and could ensure the viability of the organisation. This could only be measured qualitatively, by getting to know them on a personal level.

Annex 2: Methods Note

Methodology

This slide deck primarily summarises the findings from the financial resilience research project.

The research started in March 2023 with a **Rapid Evidence Assessment (REA).** This drew together existing evidence of what resilience looks like in the VCSE sector, and identified gaps in the evidence base. The REA can be accessed here. From this, a Research Advisory Committee (RAC) of policymakers, academics, VCSE infrastructure organisations, and funders supported the refinement of the research questions to be addressed by the research, to ensure the study builds on, rather than duplicates, the existing evidence-base.

Ecorys and ATQ then interviewed **20 England-based VCSEs selected as 'case studies'** to investigate their work and their journey with financial resilience. These findings have been synthesised with findings from consultations with social lenders involved in administering the Growth Fund, and further inputs the RAC.

The findings have also been sense-checked by VCSEs through a **Roundtable with participating case study organisations.**

The following data collection activities underpin this report:

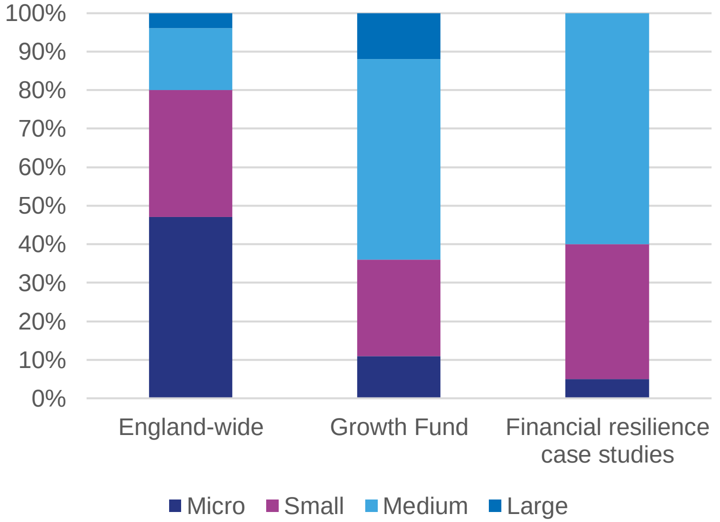
- Interviews with 20 England-based VCSEs selected as 'case studies' completed in June – November 2023
- 11 consultations with Growth Fund social lenders completed in October - November 2023
- 2 Research Advisory Committee meetings with policy-makers, social lenders, VCSE infrastructure organisations, funders, and academics, held in October 2022 and November 2023.
- A Roundtable event with 6 participating VCSEs to sense-check and enrichen the findings in February 2024.

Methodology

Case study methodology:

- VCSEs were recruited with the support of The National Lottery Community Fund and members of the RAC in March and June 2023.
- 138 VCSEs submitted an 'expression of interest' in taking part in the research.
- VCSE case studies were selected based on a quota sampling approach to include a diverse range of VCSEs according to the following criteria: organisation legal structure; region; annual income (see table); sustainability of reserves; whether they had previously received social investment; thematic area; and leadership team diversity indicators.
- There were several challenges in arranging interviews with sampled VCSEs, namely, that VCSEs who had expressed an interest were capacity-constrained and a small number withdrew from the research. Where this occurred, a suitable substitute VCSE was selected to maintain the overall diversity of the sample pool.
- Interviews with VCSEs took place online via MS Teams (or via telephone call for VCSEs with additional accessibility needs) and lasted 1.5 hours. Ahead of interviews, VCSEs were asked to complete a form detailing 7 years of financial data to enable in-depth exploration of periods of financial strength and difficulty through semi-structured interview questioning.

Proportion of VCSEs of different sizes[11] England-wide, in the Growth Fund cohort, and Financial Resilience case study sample



Limitations: We recognise that there is a risk of bias in recruitment, as people willing to engage will be the ones with enough capacity and interest in this area (thus likely resilient and well-structured organisations). The quota sampling approach will mitigate against this risk to some extent. Note that, as with any non-probability sampling method, quota sampling only provides information on the responding sample, and findings, although helping us to draw rich considerations and findings, cannot be generalised to the entire UK VCSE sector. The case study sample inclusion criteria excludes the views of larger organisations.

[11] Aligned with the NCVO Almanac VCSE size categories