

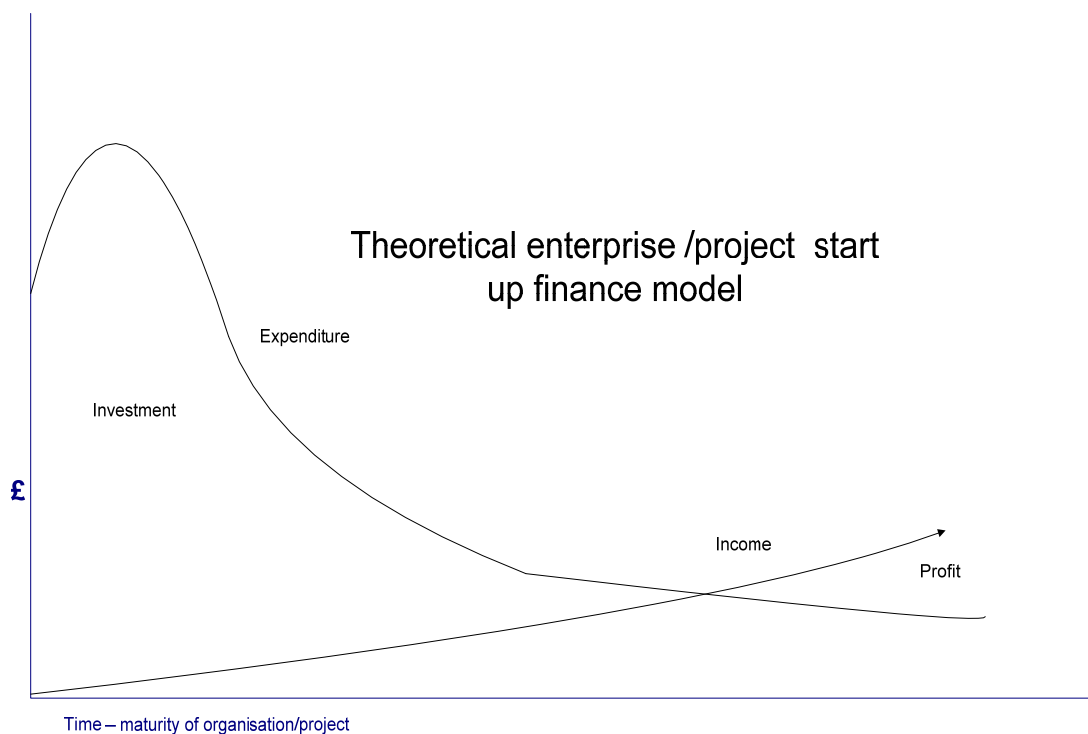
Why is funding and finance important?

A common problem for every organisation, whatever its size or status, is the lack of sufficient finance. For pre-start or small social enterprises the problem can be so acute that money is an emotional issue.

There are a number of reasons why cash is required by an organisation, much the same as individuals require cash; to buy an asset such as a house or a car, to start a project such as a holiday, for sustenance such as buying food and paying for utilities, clothes and so on. Just as we make different decisions on how we will fund our own requirements depending on our circumstances, an organisation also has to define what it needs funding for, how and from where it will source the funding and how much effort is appropriate to accomplish it.

When starting an enterprise, launching a project or service, or buying an asset, you may need to invest a large sum of money. This is to allow for the purchase of equipment, rent deposits, web site, marketing, recruitment costs, initial salaries and other expenses. Usually the amount required exceeds the entrepreneur, or enterprise's, own resources. Other sources of income therefore need to be approached to fund that initial "lump".

Once an enterprise, or project, is operational, operating or running costs also need to be covered. The entrepreneur's hope is that with the investment in place the enterprise will start generating an income that will in time overtake the costs and create a profit. See the illustration below:



Determining your funding requirement

Knowing how much funding you need, what you need it for, and how long you need support for will all assist you with the planning and control of your enterprise start-up or project. Equally this will demonstrate to the funder (whether they are investors, lenders or grant makers) that you have an understanding of the financial function, which will greatly reduce the perceived risk in letting you have what you have asked for.

The starting point in understanding your funding requirements is to document your enterprise or project. That is, what it is you are going to do, how you will go about doing it, and what resources will be required. This is usually done in the form of a business plan. The business plan needs to be supported by financial forecasts (see our guides on developing financial assumptions and cash flow forecasts for further information).

The forecast will help you determine what you need to get started as an enterprise; this is your **start up capital**.

In theory an enterprise's cash flow looks like the graph above. However, cash never behaves as you want it to. It comes in at unexpected times, usually late, in unanticipated amounts, usually amounts smaller than expected. There is also a constant demand to pay your liabilities.

In order to cope with this erratic nature of cash movement you need to have sufficient access to funds to meet the daily requirements of the enterprise. This is known as your **working capital** requirement. This could be built into the start up capital request. More often this is separately negotiated with banks, usually in the form of an overdraft.

If you also need to fund a specific project where the costs are separate from the organisational costs, then this is your **development capital** requirement.

Managing finances

Managing finances and cash flow are skills that are a requisite for running a successful enterprise. Often, evidence of your ability to manage finances and particularly cash are a pre-requisite to receiving funding. You can use your business plan to demonstrate that the enterprise has the skills, or has access to these skills as required.

Sources of funding

If you are starting up an enterprise you have a choice of funders to approach. However, if what you are intending to do has mainly, or only, a social outcome and has little or no generated (trading) income than your choice is limited to applying for grants or grant-type funding.

Many of the areas and types of activities that social enterprises are involved in are often considered too risky for any form of commercial finance. This may be so even if the strategy is to be trading and become financially self-sustaining. You may, therefore, have to look for grants to get started or approach funding sources that consider social outcomes as part of the return they expect from their financial investment.

The appropriateness of each type of potential funding is further complicated by the complexity of the enterprise's legal structure, cultural values and type of work being undertaken.

Each type of funding also requires different approaches and differing internal resources and skills. Care needs to be taken to ensure that you have the necessary skills or support to maximise the chances of success. You need to carefully plan your funding strategy before embarking on any action.

Grants

Grant funding is an attractive option for many organisations as they don't have to repay the money. However, there are a number of important points that you need to consider about grant funding.

Rarely do funders grant money for the running costs of an organisation. They generally give money for finite projects with clear outcomes, although some of the project grant can be used to cover some running costs directly apportioned to the project (staff costs, expenses, etc.). Therefore, at the start up phase, you will probably feel frustrated if you are trying to get a grant to pay for new premises, hire staff, and other general running costs. You may find it easier to access a grant for a pilot project, which you can use to develop a track record, test your idea, and be in a better position to access larger grants.

There are certain grants that are available only to charities. Other grants are available to organisations that are non-profit distributing and are undertaking projects with a social benefit. These could be companies limited by guarantee, Community Interest Companies, membership or community or voluntary

organisations. Sole traders, partners and companies limited by shares are highly unlikely to receive grants.

Often grant funders require that governance issues have been addressed. They will want to see robust procedures and processes in place as well as adequate oversight of the management by other directors or stakeholders. Grant funders usually don't require a business plan but will require the completion of an application form. However, the information requirement is similar so having a business plan assists when completing an application form (see our guide on board governance and trustees for more information).

Grants are usually made available to organisations and not to individuals. The exception is Unltd (www.unltd.org.uk), which supports individuals involved in social enterprise activity. The grant is for projects at the pre-start up or early start-up stage. Grants of up to £5,000 (Level 1) are available. The grant is given specifically to assist the individual to realise a project, such as a one-off event, or to launch a longer term and sustainable project. Unltd also offer the budding social entrepreneur other support in terms of workshops, networking, seminars etc.

Care needs to be taken when accepting grants continuously over the long term. All organisations should avoid being reliant on a single form of funding. Social enterprises in particular are meant to aspire to financial sustainability, and should be able to demonstrate that over half of their income is generated through trading or contracts.

Resources to help you with your grant funding research are listed in the further information section below.

Contracts and Service Level Agreements (SLAs)

Contracts and Service Level Agreements (SLAs) are formal arrangements to provide funding in return for the delivery of a service or services. The public sector is increasingly turning to voluntary and community organisations and social enterprises to deliver services under contract.

Contracts are beneficial for social enterprises because they can increase the financial stability of the organisation and improve the services they deliver. However, taking on the role of a public service provider can also undermine an organisation's independence and pull it away from its primary purpose.

Most contracts are awarded through a competitive tendering process (procurement), whereas SLAs tend to be less bureaucratic and competitive and are generally used for smaller scale service delivery.

An SLA can be compared to a grant with formal conditions attached to it. They have been widely used where a funder (usually a public body) wants to ensure that it gets specific tasks or services delivered for its money, but where it does not want to enter into a more onerous form of agreement.

Loans

Loan finance is appropriate only for supporting a project or enterprise where there is a good possibility that the loan can be paid back. As well as the loan repayments the social enterprise will have to pay interest charges. You therefore have to be convinced that your enterprise will generate sufficient income from trading activities or other sources not only to meet your running costs but enough to repay the loan and pay the interest charge. More importantly, the lender will need to be convinced that you can meet the repayment obligations. The lender will therefore be very interested in your business plan and financial forecasts.

Loan finance is available from all of the well known high street banking sources. However, there are now an increasing number of social lenders who have a better understanding and empathy with the social sector.

Therefore, don't be put off or automatically fearful of taking out a loan for your social enterprise. A key advantage of approaching social lenders is that they do not require personal guarantees from the directors of the enterprise/organisation. These lenders are therefore prepared to take a greater risk than commercial lenders in supporting social enterprise activity.

Another advantage that social lenders have alongside their understanding of the sector is that they are looking to support social outcomes, are more supportive of social enterprises facing short term cash flow

problems and will consider extending loans and easing terms (soft loans) to accommodate deserving enterprises. They bring with them contacts and networks that can prove invaluable to a social enterprise.

Loan finance is available for all types of funding requirement. Some lenders do have certain criteria such as minimum and maximum amounts available and length of repayment periods. The lenders web sites should be checked to ascertain the appropriate lender.

There are a number of lenders who have very specific criteria, for instance that at least 50% of the enterprise activity is used to deliver statutory contracts, such as Futurebuilders (www.futurebuilders-england.org.uk). The Adventure Capital Fund, ACF, will also only lend to community based projects (www.acf.org.uk). Both organisations are now part of the Social Investment Business (www.socialinvestmentbusiness.org). This organisation also manages the Social Enterprise Investment Fund for health related social enterprises on behalf of the Department of Health. In addition, Charity Bank will only lend to a social enterprise if its activities are deemed as being "charitable" (www.charitybank.org).

The following lenders have a more flexible approach to social enterprise:

- Triodos Bank - www.triodos.uk
- Unity Trust Bank - www.unity.uk.com
- The Co-Operative Bank - www.co-operativebank.co.uk
- The Social Enterprise Loan Fund – www.tself.org.uk
- Big Issue Invest – www.bigissueinvest.co.uk
- London Rebuilding Society - www.londonrebuilding.com
- GLE One London – www.gle.co.uk
- Various local and regional community lenders (CDFI's) can be accessed via the umbrella body's web site: Community Development Finance Association (www.cdfa.org.uk)

Working Capital/Overdrafts

The banks listed above, as well as the high street banks, are able to offer social enterprises business banking facilities as well as overdraft facilities.

Investment

If your enterprise's legal structure is appropriate you may be able to access investment funding. This requires that you sell shares in your enterprise to a financial institution or individuals. This means that your enterprise has to have shares to sell.

The investment money is used by the social enterprise to further its activities/grow. The investors participate in the future profits generated through a profit distribution. Most social investors are looking for a social return and will accept a lower financial return than if they invested in a purely commercial company.

The majority of the banks will be able to guide you on sourcing ethical investors. Specialist social investors are listed below and you can visit their websites to ascertain whether the investor offering is appropriate for you:

- Venturesome – www.cafonline.org
- Bridges Community Ventures – www.bridgesventures.com
- The Big Issue Invest - www.bigissueinvest.co.uk
- Clearlyso – www.clearlyso.com

There are also an increasing number of wealthy individuals who are interested in investing smaller amounts (possibly up to £150,000 to £200,000) in social enterprises. They are known as Venture Philanthropists or Social Business Angels. They may also be interested in active involvement in the social enterprise. Social banks will normally have lists of such individuals. Specialists in angel investment include:

- Equityplus – www.equityplus.org.uk
- Clearlyso – www.clearlyso.com

Internally generated funds

Trading or fulfilling contracts will generate an income for a social enterprise. This income should also generate a profit. The profits can be used to re-invest in the enterprise, which is something that most social enterprises do. The profits will allow the enterprise to grow its activities, whilst also supporting the case for investment or loan finance. Grant funders are happier supporting organisations with alternative income streams as this reduces the risk for the funder and for the enterprise.

If you are thinking of launching new products as a means of raising money for your core activities, be sure that you research your market well and that there is enough of a market and demand out there that will generate a profit for your organisation. Don't make assumptions that people will buy from you just because you are a socially focused organisation. The products you sell must also be competitive and good value for money (see our guide on Market Research for further information).

Membership fees

Another source of income for social enterprises is membership fees. This is particularly relevant for organisations that provide services which their members can subscribe to such as sports or arts clubs for example. However, this method is not yet being widely used by social enterprises to generate revenue, as many organisations want to keep their membership accessible to everyone and keep any membership fees that they do charge at low cost to members.

However, do not undervalue what your members may be prepared to pay in exchange for the benefits or services you offer. You can run a small survey group to help determine if and how much you can charge, and for what. You can still provide a necessary service which is value for money whilst helping subsidise your organisation's work.

Things to look out for with funding and finance

There are an increasing number of different financing methods available for the social enterprise sector. The following websites regularly update on new initiatives:

- Social Enterprise Coalition – www.sec.org
- Clearlyso – www.clearlyso.com
- Unltd – www.unltd.org.uk
- Office of the Third Sector - www.cabinetoffice.gov.uk/third_sector

Top tips for raising finance and funding

- Be clear about why you need funding.
- Quantify the amount you need and when you need it.
- Research and understand what type of funding or finance is appropriate for you at this stage of your enterprise's life cycle.
- Ensure that your legal structure and values are compatible with the type of funding you are seeking.
- Start planning your approach to the funder.
- Ensure you have the skills and resources internally, or support externally, to maximise funding success.
- Be ready to accept less from one source if you can then top up the funding through another source.
- Grant funding may be most appropriate, or indeed your only source of funding. Do not however become dependent on grant funding in the long term.
- Diversify your sources of income to reduce your exposure and financial risk.
- Ideally become cash positive through trading or contract fulfilment which makes you a better prospect to raise finance.
- Keep thinking long term. Short term decisions may damage your chances of different forms of funding later.
- Keep abreast of new financial products. New forms of funding are constantly coming on-stream.
- Make sure that you are well networked.

Further information

Sources for Grant Funding research:

- www.funderfinder.org.uk
- www.trustfunding.org.uk
- www.companygiving.org.uk (corporate donations to charitable work, generally distributed in the form of grants)
- www.governmentfunding.org.uk
- www.grantsonline.org.uk
- www.J4b.co.uk
- www.fundingcentral.org.uk
- www.grantfinder.co.uk
- www.grantsnet.org.uk

Read our guide on Charity borrowing:

www.blondon.com/SocialEnterprise/Fundingandfinance/Sourcingfinance/Charityborrowing.aspx

Read our guide on Commissioning and the tendering process:

www.blondon.com/SocialEnterprise/Fundingandfinance/Sourcingfinance/Commissioningandthetenderingprocess.aspx