

Finance Think Tank

Issues for
Social
Enterprise
Finance

Findings of work undertaken
from November 2004 to
October 2005.

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“Annual income twenty pounds,
annual expenditure nineteen
nineteen six, result happiness.
Annual income twenty pounds,
annual expenditure twenty pounds
ought and six, result misery.”

*Mr Micawber's famous calculation from
Charles Dickens' David Copperfield*

FOREWORD

Andrew Hibbert

From Co-operative & Community Finance

The management of finance is essentially the same for any organisation that wants to survive into the foreseeable future. Mr. Micawber got it right when he spoke of the importance of income exceeding expenditure.

Social enterprises tend to be driven towards the achievement of social goals, unlike the majority of conventional business, which is finance or income driven. As a result they tend to think that the world owes them a living and look for grants to provide it. Often they are perfectly correct, thoroughly deserving, and so the begging bowl is brought out each year. However this means that the emphasis stays firmly on the "social" side of the organisation, rather than on the "enterprise". There is, moreover, no guarantee that the bowl will be filled, and it is a time-consuming and unpleasant job to stand there and hold it.

To be more enterprising means to start thinking about earning your own income rather than relying on others. It means generating profits and understanding that this is the way towards independence. It means understanding that profits are about more than cash surpluses, but in the long term this is what they will generate. At this point a social enterprise can become driven by its own objectives rather than by those of people giving money.

Result - *happiness*.





INTRODUCTION

So what's it all about?

The results of an EEDA research report Lend me your Fears showed that social enterprises lack the knowledge to make the right financial decisions. A new analysis of the financial skills required by social enterprises was needed... so the Finance Think Tank was born!

Who were the members?

People with first-hand knowledge of social enterprise finance who were willing think innovatively and be open to questioning.
The members attended 5 meetings to share their ideas.

What were the meetings like?

The members arrived with assumptions about social enterprise finance based on their previous knowledge and experience. "Witnesses" were then asked to attend to talk about an area of expertise.
The Think Tank then revisited their assumptions and discussed the findings.

A bit like The Moral Maze?

Yes, the meetings provided an opportunity to challenge established practices and ask basic questions about what Social Enterprises need.

QUESTIONS

These are the basic questions we asked about social enterprise finance:

- What do social enterprises need?
- What support is on offer?
- Are attitudes to opportunities and risk changing or staying the same?
- Can the degree of risk be addressed through skills acquisition?
- Should loans be a substitute for statutory investment?
- Lenders need security but what does this need to be?
- Are the agendas of funding agencies the same as those of the organisations seeking funding?
- Do we concern ourselves about levels of borrowing - or do we leave this to the lenders?
- How do we present profit?
- What do we do about pricing, marketing and assessing levels of demand for social enterprise good and services?
- Are more sophisticated measurements needed for value for money and quality issues?

CASE STUDIES

Two social enterprises were invited to attend the Think Tank to talk about their own experiences of financing their organisations. Recycle IT! set up as a social enterprise, earning the majority of its income through trading. Workwise started up as a more traditional voluntary organisation and has gradually sought to become more financially sustainable. Both offer employment opportunities to people who would not easily find employment in mainstream businesses.

CASE STUDY 1 RECYCLE IT!

Recycle-IT! Limited is the largest national not-for-profit computer recycling company providing computers for communities. The staff are people who have experienced long-term unemployment. It is important to the workforce that Recycle-IT! is a business not a project.

Recycle-IT! has received grant funding as well as a high street bank loan. As with any business, cash flow is sometimes a problem. Grant applications are time-consuming, and the board feels time could be better spent on marketing the organisation. Suppliers don't know that Recycle IT! is a social enterprise so they are given no special dispensation.

The board of Recycle-IT! is made up of business people, therefore they don't have the same discussions as they would if they came from the voluntary and community sector. The board knows about risk-taking and is ready to pursue it.

Since the think tank programme, Recycle IT! Luton has stopped trading

CASE STUDY 2

WORKWISE

Workwise, a registered charity based in Bury St Edmunds, Suffolk was established in 1986 with the backing of the West Suffolk Health Authority, Suffolk Social Services and local commerce and industry. Workwise provides a purposeful activity in a sheltered environment for adults with mental health problems.

Since its inception, Workwise has developed from providing basic assembly and packing work to a successful social enterprise, thriving work resource centre and a limited company by guarantee. The project runs as a multi-activity workshop with additional craft areas and training facilities designed to provide work based rehabilitation, interpersonal and vocational skills for approximately 40 adults per day who are recovering from various forms of mental health problems.

Income is generated from sales on a weekly market stall and contracts to provide corporate products such as name badges and embroidery. Workwise have a Service Level Agreement with Suffolk and Norfolk PCT and grants have been received from Trusts and Foundations and The Lottery. Long-term sustainability is their aim with the development of social enterprises being the main objective. This will provide them with a secure income. However as clients are responsible for production it is difficult to ensure large-scale production of any of the products.

Funders need to understand what social enterprises can do and that sometimes the timescales they are asking are unrealistic; also the beneficiaries are not always a reliable resource.

The board of trustees are not keen on loans - their view is that they will damage you. "Why put yourself through a loan process when people will give you money?"

One critical conclusion drawn by the Finance Think Tank as a result of the evidence from the social enterprises was the need to divide finance for social and business activities. It became clear that many social enterprises cannot earn enough to cover the added social costs of their services through trading income alone. The grant funding for social purposes (such as ongoing training for workers disadvantaged in the labour market) should not be treated as part of the business costs. Equally, this additional funding should not be used as a subsidy for an unviable business. This is particularly true of social enterprises that developed from a traditional voluntary sector background.



TESTING THE THEORIES

During the project, assumptions about finance were tested by the Think Tank members through their own social enterprise advice programmes:

- Fit For Finance (Essex Business Link)
- Anglia Ruskin Finance Fridays
- Judge Institute MSt finance units
- Work with Action for Market Towns (The Guild)
- Select Leadership Training (Business Link Hertfordshire)
- Business Link advisers' network

Some thoughts arising from discussions at the Think Tank and the finance programmes:

“Once social enterprises consider borrowing, they need to adopt a business-like approach and to take a realistic view of profits.”

“Not everyone has to become a social enterprise - grants are best for some organisations.”

“Being risk averse is rational.”

“Financial education needs to grow as the enterprise grows.”

“How about giving grants on the condition that organisations attend finance training?”

INTERVIEW

We were invited to interview a business adviser with experience of working with both traditional small businesses (SMEs) and social enterprises to find out if there were significant differences in the skills required to run social enterprises and to provide business support.

Bob Westrip is a business advisor in Essex and Suffolk working with mainstream business and social enterprises. Bob was interviewed by Nicky Stevenson.

NS Tell us about the programme you run for Social Enterprises.

BW The course comprises three events: a finance session, a coaching seminar and a presentation to a panel. The finance session is a half-day event aimed to give participants an understanding of the finance options available to them, including grant and loan funding. The one-day coaching seminar enables people to learn skills including how to present their idea, how to tender and how to create a business plan. The course culminates in a presentation to a panel who assess the proposal and ask questions about the venture. In addition, we have the successful East 3 feasibility programme which works on a one-to-one consultancy basis.

NS What sort of feedback have you had from the participants?

BW The majority found the coaching seminar the most useful element. In general, the programme was very successful. It helps social enterprises plan their resources and start to see their venture as a real business. Those social enterprises who have gone through the whole process - particularly with the Feasibility studies - feedback far more positively than those who dropped out part way through. This implies we need to get them to stay the course.

INTERVIEW

NS How would you change the programme in the future?

BW The panel event was the least popular part - this was partly due to timescale because some social enterprises needed more time to process their ideas. In some cases there was resistance from trustees who were reluctant for their organisations to take part if the business plan hadn't been formally approved...so I'd try to get the trustees involved in the process.

NS Why do people come to finance events?

BW They think they're going to get grants! It's a difficult situation because if events are advertised in a different way, people won't attend.

NS What sort of financial problems have you seen Social Enterprises encounter?

BW Often businesses run out of money in the first month. They don't anticipate expenses such as insurance and capital expenditure. Businesses need to look at finances on a month-by-month basis rather than just the whole year.

You can't get funding for your core operations; the majority of social enterprises do not build this in to their applications.

There is an issue over the cost versus the value of the service. Social enterprises need to increase their prices; otherwise they will be undervaluing their own services. They often do poor market research and view themselves as separate - they don't see themselves as competitors but think they are unique.

NS Do you treat Social Enterprises and mainstream businesses in the same way?

BW As a business adviser, my approach is different. I wouldn't wear a suit to visit a social enterprise because they sometimes find a "finance" person threatening. When I first visit an SME, I would expect them to produce a forecast. I wouldn't expect this from a social enterprise; more hand-holding is needed.

Advisers need to know different rules to deliver social enterprise business advice, such as who are the funding providers.

NS Do you think Social Enterprises and mainstream business require the same skills?

BW I find small traders are less naïve than social enterprises because they've gone into it to make money. They are physically and financially committed and keep their eyes open. Social enterprises are more prone to getting ripped off because they assume people will give them a good deal because they are a worthy cause. If social enterprises are to change their attitude with regards to this then they require the same skills set as SMEs.

FINDINGS OF THE THINK TANK

This is a summary of the findings of the Think Tank

Attitudes

The approach to finance varies from one organisation to another depending on their circumstances and the perceptions of the people involved.

- **There are different attitudes between new social enterprises and converting voluntary organisations.**
- **Risk is different when you set out to achieve social rather than financial benefits.**
- **We need to encourage trustees to develop risk management skills if they want to trade.**

Context

The findings show how social enterprises operate in the wider business environment.

- **We need to differentiate between financing the business and financing the social benefits.**
- **Contracting organisations (public sector) view social enterprise contractors as an instrument to achieve their own targets.**
- **There is a difference between individuals developing social enterprises and traditional entrepreneurs who use their own money/resources.**

Content

The following points identify the practical areas social enterprises need to focus on to make the best financial decisions.

- **We should encourage use of profit and loss forecasts as well as cash flow.**
- **The business plan needs to contain more numbers than words.**
- **Social enterprises need to develop understanding of profitability.**
- **Social enterprises need to understand how to test feasibility.**
- **It may be wise to review the make up of the board and recruit more business people.**
- **The approach to business support should be different for VCS conversions from that adopted for new start social enterprises.**

USEFUL PUBLICATIONS

Members of the Think Tank used these publications as references. To obtain these publications, go to the websites provided. Some publications maybe freely downloaded, others can be ordered and a charge will be made.

Unlocking the Potential - Social Enterprise Coalition
www.socialenterprise.org.uk

Social Enterprise in the Balance - Charities Aid Foundation
www.cafonline.org

Co-operative Capital: A new approach for investment in co-operatives - Co-operative Action
www.cooperatives-uk.coop

Lend Me Your Fears - The Guild
www.the-guild.co.uk

Succeeding with Social Enterprise
by Warren Tranquanda and John Pepin.
www.pepin-associates.com

Starting a Social Enterprise - In Credit
www.incredit.org.uk

The Financing of Social Enterprises - Bank of England
www.bankofengland.co.uk



MEMBERS OF THE THINK TANK

Andy Brady
Anglia Ruskin
University

Daniel Durrant
In Credit

Anne Laing
Voluntary Action
Luton

Chris Lee
Raising the Ceiling

**Maria Di
Domenico Judge**
Institute of
Management

Helen Marini
Business Link
Hertfordshire

Paul Henry
Business Link
for Essex

Petra Dreyer
Social Firms Eastern
Region

Sue Lawton
In Credit

Nicky Stevenson
The Guild

Sally Kelly
The Guild

SPEAKERS

Andy Brady
Anglia Ruskin
University

Nicky Stevenson
The Guild

Andrew Hibbert
Co-operative &
Community Finance

Michele Rigby
Recycle IT!

**Valerie Beresford
and Melanie Jones**
Workwise

Peter Gilson
Futurebuilders

Ros Boyle
Social Enterprise
Coalition

QUESTIONS FOR SOCIAL ENTERPRISES

The discussions of the Finance Think Tank highlighted important questions that should be addressed before an organisation makes any financial commitment.

The next four pages comprise questions for social enterprises, lenders and advisers.

The questions have been divided into those for social enterprises to ask themselves, for public authorities seeking to support social enterprises to examine how the support might best be structured and for business advisers when working with social enterprises.

Questions for Social Enterprises

- Do you know how much it costs you to make your product/deliver your service?
- Do you know if your customers would pay what you need to charge?
- Do you know how many "units" you need to sell before you break even?
- Do you know when you will get paid for your service/products?
- Do you know what additional costs you will incur by trading?
- Where will the money come from?

a) Your own resources

b) Grants - free money

c) Loans—money you have to pay for

a) Your own resources

Is this money you can use for any purpose - i.e. is it unrestricted?

Are you cross subsidising your trading activity with money from elsewhere in the organisation?

b) Grants

Do you need one-off investment funding i.e. training for staff, new equipment etc - or is it to subsidise unprofitable trading?

Can you identify how to pay for the social benefits of your work - e.g. on-going training for beneficiaries?

What happens when the money runs out? Will you be self-sufficient or will you need more?

c) Loans

Do you understand the risks of taking a loan?

How are you going to pay the money back - and is this reflected in your costs?

Have you found out about specialist social enterprise lenders and how their offer differs from mainstream lenders?

Is the money being used to cover a gap between incurring costs and getting paid? Is there anything you can do to reduce this gap?

General Questions

Does your constitution empower you to trade?

Who is liable for any risks and are they clear about the implications?

Have you researched your market?

QUESTIONS FOR FUNDERS

- How is giving this grant to a social enterprise going to help it develop its trading skills/activities?
- How are you going to measure the impact of this grant/loan?
- Is there another way that you could put money into this social enterprise that might have greater impact on its ability to develop trading skills/activities?
- Have you thought about the implications of state aids rules - if you are giving directly to a social enterprise?
- If you are giving money to a (potential) social enterprise - conditional upon it becoming sustainable - what steps are you expecting it to take in order to achieve this?
- Where do you expect them to seek help?
- Are you enabling your money to circulate within the sector - for example through inter-trading or cluster development?

CHECKLIST FOR SOCIAL ENTERPRISE ADVISERS

- 1 Has the social enterprise got the financial skills to trade?
- 2 Has the social enterprise done a thorough costing of its service - including indirect costs?
- 3 Does the social enterprise understand the difference between fixed and variable costs?
- 4 Is the social enterprise managing its finances using a cash flow, profit and loss and/or balance sheet?
- 5 Is the organisation empowered to trade? Is it aware of the options it has for developing its legal structure?
- 6 Is the social enterprise using grants/loans/trading income appropriately?
- 7 Does the social enterprise have a long-term plan to develop its trading activity?
- 8 Is the social enterprise clear about what benefits they want to derive from trading?
- 9 Are they aware of the different types and sources of finance?
- 10 Are they aware of how to assess the financial products?

Social Enterprise Lenders

from Lend Me Your Fears

	Area Covered	Target Group	Amount in Fund Loan/ Grant	Amount of
Charity Bank	UK and Northern Ireland	Charities, non-profit-distributing companies Ltd by share or organisations with charitable objectives. Do not lend to individuals.	£3-4 million approx.	Loan of between £5,000 - £250,000.
ICOF	Mainland UK	Specifically co-ops, more recently SEOs. Do not lend to individuals.	£1.5 million.	Loan of between £5,000 - £50,000.
CCDA (Cambridge Co-operative Development Agency)	Eastern Region	SEOs, co-ops, social firms.	£20,000.	Loan of £1,000 - £4,000. For a new organisation for business registration can offer loan under £1,000
LIF (Local Investment Fund)	Runs a national loan fund across England, and a regional loan fund in most areas. Currently there is no regional fund for the East.	Registered Charities, community businesses, social enterprises and voluntary associations that are unable to access finance from traditional sources.	£2.5 million.	Regional funds make loans of between £15,000 and £100,000. The national fund provides larger loans of between £25,000 and £250,000.
Prince's Trust	Business support programmes operate on a regional level	Targeted at young people between ages of 14 -25 yrs. In particular young people who are regarded as disadvantaged. Increasing number of graduates who cannot secure loans due to large amounts of student debt.	£500,000.	Initial test marketing grant of up to £250. Then after a business plan is produced they can apply for a grant of up to £1,500 or a loan of £5,000. The trust also offers development grants of up to £250 to help people into work.
SRT (Suffolk Regeneration Trust)	County of Suffolk	Start-up businesses.	£400,000 approx.	Loans of between £3,000 -£50,000.

	Area Covered	Target Group	Amount in Fund Loan/Grant	Amount of
Enterprising Communities/ Revolving Loan Fund	Hertfordshire	Any type of business but its priority groups for loans are young people, women and ethnic minority groups.	£20,000.	£50 - £1,500 for first loan and £2,500 for a second loan.
Full Circle Fund	Norfolk, parts of Waveney and Mid Suffolk	Socially and/or financially excluded women. Most likely to be sole traders but can be SEOs	£47,000.	Loan of up to £1,000 on the first application and then second and potentially third loans of up to £2,000. The project also runs a smaller initiative targeted at childminders, where they can borrow as little as £60 to meet registering requirements of a childminder.
The National Learning Skills Council grant scheme (Run by Norfolk and Waveney Enterprise Services)	East of England	Business Start-up	£283,500 this year	Grants are available for up to £3,500 per business They are working on introducing a loan scheme.
Adventure Capital Fund	Runs at both national level and regional level	Community enterprises or those aspiring to develop their first trading activity.		The national fund supports 'Patient Capital' investments of up to £400,000 per business and a bursary development grant fund of up to £15,000 per business.

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This report was compiled by
The Guild
Burlington Buildings
11 Orford Place
Norwich NR1 3RU

“For me, ideas developed and contacts made will have a long-term value beyond the Think Tank itself.”

“It was a wonderful opportunity - regrettably too scarce! - to have time to reflect and share ideas and aspirations with like-minded people.”