
Sustainable Financial Strategies for Charities in a 'Perfect Storm'

The sustainability of Financial Strategies in charities was the subject of debate at our latest Honorary Treasurers Forum meeting on 22 September 2015.

How can Treasurers spot when something is going awry? What questions should they be asking about their strategies to ensure a sustainable business? What lessons can be learned from the closure of the Kids Company?

These were questions posed by guest speaker Mark Salway, Director of Social Finance and Social Impact Investing, at [Cass CCE](#). Former Director of Finance at CARE International UK, Mark shared his experiences of implementing sustainable financial strategies.

Mark was joined by Carolyn Sims, Head of Banking at [Charity Bank](#), who is also Treasurer at three different organisations. Carolyn discussed the current lending landscape, how banks can tell when things are going wrong and what charities should do if they are struggling financially.

A Perfect Storm

Mark highlighted that sustainability is a major issue for many organisations and it 'worries him greatly' – particularly for organisations serving countries like Africa.

Grants have reduced significantly; they have a high dependence on philanthropy through INGOs and a very small trading base from social enterprise. He suggested that the re-balancing the income streams across these three elements will be critical for future sustainability.

But, he stressed that all charities are in a 'perfect storm.'

Donations are down by 25%, and according to this year's [NCVO's latest Almanac](#) there is a predicted £4.6bn shortfall in voluntary sector finances by 2018/19, so charities must consider the sustainability of their financial strategies. Charities must start to think about their business models and how they ensure sufficient money to pay for their infrastructure and maintain their impact.

He said charities have never been the subject of so much scrutiny. It started with CEO salaries, questions about the levels of overheads and fundraising issues, but the recent closure of the Kids Company has changed things, making people question the very legitimacy of charities.

How can charities implement a sustainable financial strategy?

Financial sustainability is a big and complex subject for Honorary Treasurers. Mark advised that one way to approach a financial strategy is to focus on the beneficiaries and the impact on people's lives and have this at the forefront of all plans.

We learned that Care International approached its financial strategy by priority setting – having a 'must do' list that everyone agreed on, rather than holding tight to priorities.

Its strategy plan included KPIs and an analysis of the negative and 'positive' risks were a key aspect of the plan, such as the potential consequences of not doing something like using the peer to peer lending platform lendwithcare.org which has now lent £7m to poor people to set up businesses abroad.

How the beneficiaries would benefit, whether the resources were sufficient and what to do if the organisation can no longer sustain itself, were other considerations. Existing and future income levels were also looked at. Questions were also asked about whether income levels could be raised. Does the organisation need to invest to grow? How are reserves being used? Can cost reductions be made? Is there a case for social investment?

Another issue is poor cost recovery. Mark said that a third of charities don't currently know their overheads which means they are unable to negotiate contracts properly. He alluded to a report called *The Current and Future State of Charities 2015*, by the financial services firm Baker Tilly, which found that 6 per cent of charities offering services made no attempt to recover their overhead costs. The flip side is that charities should be funded properly and funders should look at the impact of work rather than the low overheads, but charities also have a responsibility to help tell a strong story.

He also confirmed that in his experience funders are happy to discuss additional funding for overheads and cost per intervention, but that charities need to make the case as to 'why' it costs more to help marginalised groups who are the hardest to help. Charities should not just assume that funders understand this.

What can Honorary Treasurers do to influence financial strategy?

Honorary Treasurers must focus on whether or not taking the organisation's work to scale is feasible and sustainable. Cutting overheads isn't the answer and instead, charities need to diversify their income and focus on cost recovery in the context of financial sustainability.

Charities should not be afraid to use their reserves in light of rising expenditure or a dip in income on the horizon – but this is not a long term solution. They also need to look at positive and negative risks and whether budgets are optimistic or realistic as most organisations are around 20% optimistic. He postulated that optimism bias in the sector, where people under-budget and over-promise is reducing, but needs to be addressed to ensure future sustainability. It is an area which the Government's Green Book addresses, but which charities pay little attention to.

A good financial strategy is helped by the Honorary Treasurer and the Finance Director having a great relationship based on trust and confidence.

Mark closed by saying that in light of the Kids Company closure, Treasurers must be alert to any signs things are going wrong, not be surprised by what they find in accounts and ask tougher questions. Equally executives should not be defensive when asked these tough questions. If harder questions had been asked by trustees at the Kids Company, would things have turned out differently?

What does it take for a charity to secure a loan?

Having a robust cash flow and business plan and a good reserves policy are all essential criteria for organisations looking to secure a loan from Charity Bank.

Carolyn Sims, Head of Charity Bank, said that before agreeing a loan the bank always meets with the Chair of Trustees and/or the Treasurer as well as the management team.

They look at the skill set on a board and whether it has all the necessary experience. It also looks for any potential problems such as the presence of an over dominant trustee. Some lenders require sight of board minutes to ensure that this isn't the case.

They also look for key signs that an organisation is a good bet. This includes careful analysis to see whether the cash flow is under pressure and that the income is stable. Stress tests are carried out to determine what would happen if grants are reduced or cut or to see if over-reliance has been made about future donations. The bank also looks at the starting point for any business plan – for example is there any foundation to the levels of occupancy assumed?

The bank also considers other factors including:

- Changes in interest rates – could the loan be repaid if higher rates were introduced?
- The cost of borrowing in light of predicted higher cost of living
- The competition – who is the competition and who might compete with the charity in the future?
- The growth plan – is it viable and realistic?
- The reserved plan – is it cogent?
- The management information – how good is it? Non receipt is often a sign that something is going or has gone wrong.
- Does the organisation compare actual performance against budget? Can it articulate reasons for variances?
- Are there swings in cash balances – how are these managed?
- If the bank has concerns its first port of call would be its original point of contact, usually somebody from the management team. In some instances it then writes to the Chair or Treasurer. The Bank's aim is to ensure that all its borrowers both deliver social impact and remain financially viable in the long term.

Discussing the current lending climate, Carolyn said that whilst there has been an overall rise in the number of charities borrowing in the recent years, there has been a decline in the last three to four months.

However, she feels that this pause could be down to the fact that organisations are awaiting the outcome of the government's Comprehensive Spending Review on 25 November which will decide much money is available to spend in each government department.

If things do go wrong financially, then the most important thing for the charity to be is open and honest. Communication is essential. Carolyn stressed that the lender will find out everything and there should be no surprises - "It will all come out in the wash."