New and Alternative Financial Instruments

final report for

Mission, Models, Money

Catalysing a more sustainable arts and cultural sector

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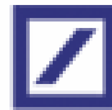
Deutsche Bank 

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Section 1 Introduction

This report considers methods of financing arts and cultural organisations (A&COs) which extend beyond the mainstays of contributed income including grants, ticket sales and other earned income. This is not because alternative methods can replace reduced contributed income or compensate for declining earned income for example, from box office but because they can complement them. And by complementing them, they can help arts and cultural organisations become more sustainable and better able to take creative risks.

So what is meant by 'new and alternative financial instruments'? At the stage of project initiation we considered that the main focus of the report would be access to loans, equity and quasi equity finance (see the glossary). However, as the project developed a range of experts from both financing and A&COs encouraged us to look much more broadly and our case studies in section 3 include barter and exchange arrangements, public service contracts and endowments.

The purpose of the report is not to promote particular tools but to prompt A&COs to think more broadly about the range available and to encourage them to use them creatively and well in support of their mission. We should stress at the outset however, that this latter objective involves a leap of faith. It is clear from our research that there are issues and problems that need to be resolved before A&COs work confidently with a range of new financial tools. Many of the problems are problems of perception for example, about what charities – the legal structure used by most not for profit A&COs - can and can't do. However, others signal capacity issues that need to be addressed if A&COs are to be able to survive and prosper in an ever more competitive funding environment.

In addition to arts and cultural organisations, the report addresses finance providers and infrastructure or second tier organisations. It seeks to encourage funders and financiers to review their funding policy and practice and infrastructure or second tier organisations to consider what advice, information and support they might best be providing.

The report is based on:

- initial research examining use of loan, equity and quasi equity finance by A&COs ;
- a meeting with individuals involved in providing finance to charities and other organisations with social purposes;
- a meeting with mature A&COs;
- the comments of these two groups on a draft of this paper

This work was initiated by MMM but a number of other organisations have made a contribution to developing it. Their commitment and enthusiasm to the issue and to moving work on the topic forward is much appreciated.

The analysis in this report is closely linked to other strands of MMM work on governance, capital structure and intelligent funding generally. In its next phase of development MMM aims to bring these strands together in a series of pilot projects, focusing on common themes and issues practically demonstrating how A&COs can expand their financial toolbox in different ways and how private and public sector funders can help them do so.

Section 2 The challenge

This section considers three main issues or questions – the financing of A&COs, how is the funding environment evolving and finally, what needs to change in order for the arts to flourish? The challenge is to help A&COs become more sustainable by enabling them to access forms of financing beyond those they are familiar with i.e. contributed income and earned income

The financing of arts and cultural organisations

There is a lack of comprehensive hard data about the financial dynamics of A&COs (see the annex). It is clear however that A&COs are very diverse – and financing structures reflect this. Museums and galleries have a very different financing structure from performing A&COs. Even within particular art forms, financing patterns are likely to vary enormously for example, between a theatre company that owns its own theatre and a touring company which doesn't.

Despite this diversity – there are some recurrent themes that emerge from discussions with A&COs about their finances. These include the difficulties of raising funds to invest in developing their organisations. The perception is that the 'subsidy jam' – what we call grant-based contributed income is being spread ever more thinly. A&COs report that they are constantly under pressure to produce more for ever decreasing amounts of revenue funding. Generally, and this applies across the voluntary sector, the emphasis is on investing in more product rather than in making the organisation more efficient and effective.

Not only is there a lack of money to support organisational infrastructure but there is also an associated problem – many A&COs are constrained because too much of their funding is restricted. However, even where funds are unrestricted - it is the instinct of most organisations to spend on product rather than infrastructure.

The Arts Council's latest survey of regularly funded organisations provides concrete evidence of reduced spending on overheads while programme spend has increased. Artistic programme costs for its constant sample in 2004/2005 increased by 46 per cent and marketing costs by 11 per cent since the last survey in 2003/2004 but education programme expenditure decreased by 3 per cent and overheads, staffing and other costs by a staggering 20 per cent over the same period.

There is then insufficient investment in the core of A&COs – the leadership, management and systems that help to ensure organisations run efficiently and effectively. The lack of investment creates a vicious circle, organisations lack resources - skills, expertise and money - to invest in creative ways of generating revenue (for example for investment in research and

development and to exploit the intellectual capital generated). So A&COs tend to lack tangible assets and reserves (see the box below).

Capitalisation

One of the strands of MMM work is on capitalisation. This seeks to help A&COs better understand their financial structures and build reserves. Reserves can be used for example, to ease cash flow or to fund riskier developmental projects. The work aims to help A&COs think about their finances more strategically and over the longer term for example, it encourages them to ask whether they will need to refurbish their building or purchase new equipment and how these costs will be met.

Generally A&COs do not understand their capital structure, either their capital needs or the value of their assets. This is in part because in many cases their major assets are intangible for example, intellectual capital and/or a reputation for high quality work. As one commentator puts it:

A&COs do not think in terms of capital, investment in capital – except buildings and the return on that investment. This means in turn that not only do organisations not optimise their assets for example; their intellectual capital but there is no capital investment mechanism to drive change in the sector.

There is a culture of crisis management and short termism in the sector. And, A&COs appear not to be willing or able to access the staff time, training or support to enable them to manage their finances more strategically or plan over the longer term.

Regardless of the funding issues i.e. whether funders are willing to support core costs and invest in organisational infrastructure, there's a deeper problem here – many A&COs tend not to think of the company as an enterprise in which management and financial discipline matters. There is a real paradox at the heart of the arts – most organisations have to think commercially to survive i.e. they have to generate sales but many still regard themselves as 'subsidy' or contributed income reliant organisations. For some a deficit is a badge of honour, as one commentator put it: 'one measure of the excellence of the artistic product is the size of the deficit'.

The state of affairs described here is unsustainable for two main reasons:

The current environment is too limiting on the imaginations and aspirations of A&COs – the best organisations want to be able to take risks and innovate

and to exploit opportunities to ensure their product reaches a broader audience; they need capital to achieve this – as one commentator said:

There is a growing interest in culture (including the commercialised and non profit arts) and a proliferation of distribution mechanisms with the associated thirst for content. Venture philanthropists talk about taking businesses to scale. Applying this to the arts digital distribution of content deserves to be mentioned.

Voluntary organisations outside the arts are modelling a different approach, many are seeking to become more sustainable through public sector contract and other trading income - funders are likely to expect A&COs to follow suit.

How is the funding environment evolving?

Funders, like A&COs, are very diverse – public sector bodies, independent grant making foundations, individuals and corporates all have different motivations for funding and practice can vary markedly. Nonetheless all funders are to some extent or other influenced by new funding themes or approaches. While these may currently be at the margins in the sense that they are core practice for relatively few funders - they inform debate in the sector and perhaps mark out some future directions.

A number of new funding themes or approaches can be traced in funding for voluntary organisations generally, as opposed to the arts in particular. These include:

Investment in capacity building

There is a growing recognition that in order to provide high quality services, voluntary organisations need to invest in their people and systems and they need core funding or to achieve full cost recovery to enable them to do this. A small but growing number of funders are also starting to invest directly in capacity building or organisational development for example, providing voluntary organisations with direct access to leadership development training or small grants for organisational reviews and systems improvements. There is also a growing recognition of the need to build capacity in order to enable A&COs to reap the benefits of major capital development or other opportunities for growth.

Achieving impact

Funders are starting to discuss amongst themselves how they can increase their impact. This can mean different things for different funders. For some it means spending their money in a more focused or strategic way i.e. with a much clearer idea about what they want to achieve, who they need to work

with and what improvements they are expecting. It generally results in funding tied to particular outcomes – which voluntary organisations have to demonstrate they are achieving.

Encouraging sustainability

Increasingly funders expect charities and other voluntary organisations to investigate a wide range of options for income generation. For example, opportunities to deliver services under contract to the public sector and/or develop other mission related or subsidiary trading initiatives. Some funders are making a specific investment in helping organisations become more entrepreneurial and sustainable including through the provision of loans, equity or quasi equity finance for income generating projects alongside grants and capacity building support.

Loans and quasi equity finance

Some funders regard loans and quasi equity as 'making money work harder'. Recycling means that money can be used many times over to help a greater number of organisations. Some experts also consider that scarce grant funding resources should not be used for projects for which loan or equity or quasi equity finance would be appropriate for example, building projects where loan repayments are equivalent or less than previous rental changes.

Individuals and new philanthropy

There is a small but growing pool of individuals interested in new approaches to philanthropy for example:

- investment in ethical bonds or ethical share issues;
- venture philanthropy - the provision of core funding over an extended period and in kind support to build organisational capacity and increase impact;
- provision of patient capital – generally loans provided over a long period, with repayment holidays and at lower than market rates once adjusted for risk.

Each of the new funding themes or approaches discussed in this section is positive. Collectively they offer a point of departure from some of the most perverse or counter productive aspects of funding practice for example:

- the stipulation that organisations should be well run but without a consequent willingness to invest in the organisational infrastructure which would enable them to achieve this;
- a reluctance to fund organisations which have reserves when reserves offer a safety net against harsh times and capital for research and development;

- expecting organisations to be entrepreneurial without providing them with the support and investment necessary to successful enterprise.

These changes also promise greater opportunities for investment in income generation and organisational growth and development through the provision of loan, equity and quasi equity finance.

But, these shifts also present challenges for voluntary organisations – and in this new environment it seems likely that A&COs, like other voluntary organisations will be expected to - :

- take seriously and be willing to address their capacity building needs - including the need to build financial management capacity, and address governance issues (even considering diversifying their legal structures in order to help them become more sustainable);
- demonstrate that they are both efficient and effective;
- be aware of and have the capacity to exploit a range of funding/financing opportunities.

What needs to change if arts and cultural organisations are to flourish?

A&COs report that they are struggling to maintain and increase their revenue funding. Although some funders' policies and practices are moving in the right direction, there is still a long way to go and significant work is needed to make what is accepted good practice in funding into a reality.

Capacity building support is required to strengthen financial management in A&COs – to help them think strategically about the organisation as a whole and as an enterprise – not just a collection of projects or series of exhibitions or performances. A&COs need to better understand their financial model and what sort of funding/financing developments would enable them to flourish. Without such an understanding investment of resources in accessing new forms of financing may be at best unproductive and at worst counterproductive:

> *It's no good accessing investment to enable you to make more widgets if you're making a loss on each one; it simply makes your situation worse'.*
> (Clara Miller from the Non Profit Finance Fund in the US)

Infrastructure or support organisations/initiatives have a crucially important part to play in providing the information, advice and support needed to help A&COs understand their financial models. They also have a role in:

- raising awareness of funding/financing options available and how to access/develop them;

- exploring and developing collaborative financing mechanisms for example, endowment funds;
- co-ordinating activity promoting and developing this agenda on an on-going basis;
- raising awareness of the range of different legal structures available to mission-led organisations and how these may help organisations become more sustainable.

The next section, section 3 provides case study illustrations of alternative financing methods.

Section 3 Alternative forms of financing

The 14 case studies prepared for this project and included in this section are not all real life case studies – although they include some elements of current practice both here and abroad. They were developed to illustrate the range of alternative financing methods available:

- loans, equity and quasi equity finance;
- bonds;
- share issues;
- barter and exchange schemes;
- endowments; and
- contract income.

Some are at the philanthropic end of the spectrum and therefore might be perceived as lower risk, others are more commercial. Some are designed to be relevant to individual organisations; some would in most instances require a collective fundraising endeavour.

Lending and investing

The majority of the case studies involve forms of loan, equity and quasi equity finance. No research data exists examining the extent to which A&COs are using these forms of financing. However, we know that some A&COs have accessed this finance, the most commonly cited examples are:

- angel investors supporting theatre productions;
- the selling of licenses to stage particular productions (thereby selling a short term share in intellectual property);
- film financing;
- loans for live/work studios or other property development projects.

Our enquiries suggest however, that there is a general reluctance to explore such financing. It tends to be perceived as risky, complex and expensive. However, as the case studies indicate, loans and equity finance come in many different guises with different risk profiles, levels of complexity and expense. And, some loans and equity arrangements will be appropriate and beneficial to particular organisations.

The case studies illustrate some of the benefits of this form of financing for A&COs. For example:

- a loan can ease cash flow problems for an A&CO where expenditure has to be committed sometimes far in advance of income (case study 1);
- a loan can reduce the need for a large capital fundraising campaign enabling building work to proceed more quickly and at less expense (case study 2);

- a loan can enable A&COs to recruit the staff they need to help make a new initiative a success for example, a project manager (case study 13);
- a quasi equity investment can enable an A&CO to develop a new income generating venture (case study 3).

The case studies also illustrate that there are a range of providers of loan finance including a limited number of charitable foundations and other specialist providers in addition to the mainstream banks. Charitable foundations and specialist providers offer advantages over the mainstream banks, they:

- offer loans without security (Venturesome);
- have the expertise to value intangible assets like intellectual property in productions (Triodos);
- offer loans over an extended period for example, over a 20 year period with capital and repayment holidays (Charity Bank);
- offer loans at below market rates (once adjusted for risk – Venturesome);
- provide in depth financial management advice and support (Venturesome).

(See the box below for further information about specialist providers).

Specialist providers of finance

Triodos is an ethical bank. It only lends money to organisations and businesses pursuing positive social, environmental and cultural goals. It was established in 1980 and has been lending to A&COs since. It currently lends to projects that integrate 'arts into the community'. In 2004 it had a loan portfolio of £548 million. A&COs received 42 per cent of the value of this loan pool. However, the category arts and culture covers in addition to artists both individually and in groups: organisations active in education; care for people with physical and learning disabilities and holistic health care. A publicity brochure published last year by Triodos called *Inspiring Change* features nineteen A&COs in receipt of loans. These organisations include the Electric Cinema, Glastonbury Assembly Rooms, Year Zero Films, the Straysparks Creative Metalworks and the London Tamil Centre. Examples of financing include: an overdraft to enable a documentary to be made, loans for affordable studio space for artists and a new gallery space.

Charity Bank was established in 2002 building on the work already undertaken through Investors in Society (launched in 1995/96). Overall it has approved 489 loans totaling £45 million. Its website provides information

about 16 loans made to A&COs with a value of over £2 million – examples include:

A £70,000 loan to The Living Paintings Trust which seeks to make art accessible to blind and partially sighted people through sight and sound. The loan made it possible for the organisation to buy a new building before it had raised all the necessary grant funding.

A £500,000 loan to enable the Wigmore Hall Trust to purchase a 250 year lease on its building. The Royal Bank of Scotland provided £2.6 million towards the lease cost but was unwilling to cover the remainder leaving the Trust with a shortfall that prevented it from going ahead with the purchase.

Loans totaling £25,000 enabled the International Guitar Foundation and Festival to print, design and distribute its annual events programme

A £60,000 loan towards the costs of restoring Plaza Community Centre's building, with further funds coming from the local bank and charitable trusts. A second loan of £14,000 helped to part finance promotion and development posts.

A £125,000 loan enabled Age Exchange Theatre Trust to purchase much needed computer equipment and helped stabilise the charity's financial position.

The Arts Council and Charity Bank are working together to encourage more A&COs to consider loan finance.

Venturesome seeks donations and loans from grant making foundations to support its provision of risk capital to charities. It was established early in 2002. It has made 120 loan offers and now has a loan portfolio totally over £6 million. It estimates that A&COs make up less than 5 per cent of the portfolio. It has for example financed Circus Arts, Escape Artists which works in prisons and Youth Music Theatre UK. Underwriting is a major part of its work. A very small proportion of this financing is called down but Venturesome has demonstrated the vital role it plays in enabling organisations to access mainstream finance.

Some grant making foundations, for example **Esmee Fairbairn** and **Northern Rock** have also run loan programmes.

Different types of loans carry different levels of risk. The least risky is a loan which can be repaid from already committed income from a public or other funder i.e. a loan providing an organisation with working capital. Such a loan is needed because for example, a public sector funder makes its grant payments three months in arrears. The most risky is where the loan is not to develop a tangible asset but for new artistic product for which the market,

and therefore revenue income, is uncertain (sometimes called soft development capital).

Some experts have suggested that loans may not be an appropriate form of investment for new artistic product for which the market, and therefore revenue income, is uncertain - they suggest that there may be a need for more equity and quasi equity investment tailored to the needs of A&COs for example:

- specific angel investor schemes where knowledge of a particular art form enables investors to work alongside producers contributing their finances, time and expertise;
- quasi equity for product development where repayment only kicks in when sales or profits reach a certain level.

Investors at the philanthropic end of the market, committed supporters of A&COs grant making foundations, are more likely to make quasi equity investments in the arts and other social enterprises. The main advantage of such investments for the borrower is that risk is shared with the lender (see case study 3).

Individual artists or groups of artists, as well as organisations, have raised investment on a quasi equity basis (see case studies 6 and 9).

Blending the commercial and the philanthropic

In most of the case studies the philanthropic and the commercial have been blended. For example:

- although a return is expected on the loans given, it is not at the market rate once adjusted for risk;
- loans from philanthropic or other specialist providers can help A&COs leverage loans from mainstream banks (case study 2);
- a savings product is developed for individuals with the return donated tax efficiently to an A&CO (case study 7).

Two of the case studies are purely philanthropic i.e. there is no financial return but there is a psychic return or the good feeling generated by the investment of time or money:

- the barter and local exchange case study (case study 13); and
- the endowment case study (case study 14).

There are many examples of investment in the arts where the financial return is secondary to the psychic or ‘feel good’ return. A good example is a violin trust – investors take a share in a valuable violin used by a musician, although there is the possibility of a long term gain on this investment, the

primary return is the pleasure investors take in hearing the violin played well and in having made an important contribution to the musician's development.

It is worth noting that in the three most 'commercial' case studies – the return goes to the A&CO/artist or is shared between the commercial investor and the A&CO i.e.

- the music download partnership between an orchestra and an online
- retailer (case study 10);
- the profit share structure for cast and crew in a film predicted to be commercially successful (case study 11);
- the theatre company offering presentation and communication skills training to the private sector under contract (case study 12).

In all three contributed income through grants and fundraised income would have enabled the development of content (the film is based on a successful production in a non profit theatre).

Collaborative arrangements and partnership development

Some loan arrangements are very straight forward and therefore relatively cheap to set up. Some loan and equity based financial tools for example; bonds (case study 6) and alternative share issues (case study 5) are complex and therefore expensive to set up. But these are examples, where groups of A&COs might work together to pool costs, thus ensuring they can access the right technical expertise.

In some instances, partnership with the commercial sector is key to accessing the expertise needed for the success of the venture for example, case study 8, a music download partnership between an orchestra and an online retailer. The arrangement outlined in this case study enables the A&CO to develop an income stream in a way that would have otherwise been beyond its technical expertise.

1. A cash flow loan

An annual theatre festival secures a short term (9 months) loan (6 per cent interest) from a specialist lender with repayments 'frozen' for 9 months (until after the festival finishes). The loan pays for the production and dissemination of the festival brochure and for a marketing 'blitz.'

For the investor: the festival's previous track record gives confidence that they can step in where a commercial lender would not. The funds are recycled quickly and so are reusable within one year

For the investee: the loan not only eases financial pressure on an organization that is always working to very tight cash flows and that has inadequate reserves, but also enhances the level and 'reach' of festival publicity, helping to achieve a stronger box office return.

2. Bringing a building into use quicker and cheaper

A cross-arts organisation has the opportunity of being given a building within which to develop a multi-purpose arts centre, which will include performance and exhibition space as well as a dozen workshops/studios and facilities for public hire – all potentially income generating. It planned a 'traditional' capital appeal for charitable donations and gifts to raise the £7.5m funds needed to convert, refurbish and equip the building, an appeal which it estimated would take 3 years to complete. Of the £7.5m, 20 per cent was a contingency against building costs inflation over the appeal period. The appeal was not necessary. Unsecured loans from a charitable foundation (a programme related investment charging 1.5 per cent interest) and from a specialist lender (6 per cent) provided 40 per cent of the total. These were provided on a very 'patient' repayment timetable and were also offered as subordinate to any commercial loans that might be secured. The organisation was able to use these loan offers to 'lever' a further 45 per cent from two commercial lenders and a single donation from an individual towards the bulk of the fitting out costs of the performance and exhibition spaces.

For the investor: the philanthropic lender was able to help lever loans more than100per cent bigger than its own offer and also made a larger contribution than it would if it had made a capital grant. It will also get the funds back for use for other philanthropic purposes in the future

For the investee: the building was completed and ready for income generating use in 18 months and at a lower cost – quicker and cheaper than if a traditional, more expensive, capital appeal approach had been adopted. The residual fundraising challenge was manageable without distorting the standard routine revenue fundraising task.

3. Building project development capital

A community arts centre leases additional space in a neighbouring property, converts it to provide additional studio and exhibition space, meeting rooms and a café. To fund the development, it 'invests' about a quarter of its own reserves and secures grants from the district council and two foundations. This funding pays for almost all of the building costs. A loan is provided by a specialist lender to pay for the remainder of the fitting out costs and for the salary of a part-time experienced project manager to supervise the whole building project (these being skills that the staff of the centre do not have) and to subsidise the running costs of the expanded centre during the first 9

months of the use of the new facilities. The loan is to be repaid over 6 years, the first payment being made 18 months after the enlarged centre becomes fully operational – the repayments being affordable from the additional revenue generated by letting the meeting rooms and the use of the centre for corporate events.

For the investor: the specialist lender is reassured by the success of the centre in raising almost all of the capital funds and in the strength of the business plan; the investment in skilled project management and protecting the expanded project against initial losses as the new facilities gain 'commercial' momentum, along with the 'patient' repayment terms, are felt likely to increase the prospects for the project's success and, therefore, in lowering the risks faced by all the funders and the centre itself.

For the investee: the grant funders are made more confident that their funding will deliver the intended results by the centre having raised loan finance to pay for skills that it does not possess and to help with the inevitable cash flow pressures of bringing a new community resource into operation. The patient repayment terms of the loan are affordable, if the business plan targets are achieved without putting undue strain on the centre's general financing at a time of expansion and change – grant funding for those purposes would have been difficult (and time consuming) to obtain and a commercial lender would not have agreed comparable (or affordable) terms. **NB** New buildings can save on rent payments but many new buildings cost more to run than anticipated.

4. A product investment

A dance development organisation obtains a 'quasi equity investment' from an individual philanthropist to finance the production of a series of dance DVDs, each of which was then sold with a reasonable profit margin. No repayment of the investment is required until DVD sales reach an agreed level – then the investor gets a proportion of his original investment plus a 'royalty' on each batch of subsequent sales.

For the investor: based on a business plan to which he has contributed and agreed, he should get his investment back for subsequent use for other purposes plus a return, albeit modest, on the programme of DVD sales reaching planned targets; the investor is also convinced that the form of finance will act as an incentive and driver to the organisation to work more vigorously to achieve sales than it might have done if the full costs were subsidized.

For the investee: it had had no success in attracting a grant for the DVD production from statutory or philanthropic funders or from sponsors. Its board are keen to reshape the direction of the organisation as a social

enterprise rather than a primarily subsidised entity – this project encourages that approach at a relatively low level of risk.

5. Arts property share issue

A 'non-profit' property development company is developing a city centre resource centre for small A&COs, charging rents at no more than 55 per cent of local commercial levels. The company works to exceptional environmental standards in property development and management. It is a share based company, investors being a mixture of individuals and foundations committed to either or both of the environmental objectives and the need for an arts resource centre. The shares have paid a dividend in each year of just over 3 per cent and their value has increased by 20 per cent in 3 years. Shareholders are able to waive dividend payments and to route them into a special fund to support start-up A&COs in the building – 10per cent of the individual investors do this.

For the investor: the property base of the investment is secure and likely to increase in value steadily. For the 'responsible' investor the company's emphasis on triple bottom line (financial, social/artistic and environmental) is attractive and the dividend waiver opportunity encourages an extra philanthropic dimension if that is also welcome.

For the investee: the opportunity for the A&CO to be housed in high quality, supportively and well managed, city centre, low cost space – and to make social and operational links with other A&COs. **NB** Currently most investors in the UK are gloomy about the prospect of capital growth and yields are low.

6. A building renovation bond

Three venue based A&COs in a county town combine to launch a bond to provide funds to help them all renovate outdated facilities, the bond being secured against future box office receipts and paying a modest return (3.3 per cent). The local authority is an initial investor, joined by the local building society and a high profile local philanthropist.

For the investor: an opportunity to make a small, low risk investment in a high status and locally celebrated initiative – with confidence that funds will be returned and retain their value

For the investee: a source of funds that are in addition to regular income from donations and gifts – and include not only traditional 'friends' but also many individuals with whom the organisation had no previous involvement or only as occasional customers. The local collaboration between the venues led to other collaborations (e.g. with suppliers and outsourced caterers) and co-

promotions/ticketing. The funds were cheaper to secure than if they had been borrowed from a commercial lender.

7. Funding for a dance company – that simultaneously supports environmental and social projects

A partnership between a dance company and a 'social' bank that provides a bond that is marketed to individual and corporate 'friends' of the company – fixed units of savings locked in for 5 years paying 3 per cent interest annually. The money is invested by the social bank in commercially viable environmental and social projects and companies – the interest payments are made as charitable donations (with tax relief) to the dance company

For the investor: their capital is secure, is used for social/environmental purposes and generates a return that they can then donate, with tax relief, to an A&CO which they are keen to support

For the investee: their link with friends is strengthened and a guaranteed 'unrestricted' income stream established, secure for a 5 year period

8. A share in the products of an individual artist
An artist sells 'shares' in her time as a painter, each of the 12 individual investors in the 'club' receiving one 'free' picture each year and a share in the sale price of each picture the artist succeeds in selling (the club 'share' of such sales being 25per cent of the net proceeds).

For the investors: an "angel" relationship with an artist in whom they have confidence and about whose work they are passionate advocates – plus a limited financial return from her success.

For the investee: cash flow support without generating financial debt – plus a highly motivated support group likely to want to assist with marketing of artwork.

9. Micro-loans to artists and crafts people setting up own businesses
A 'managed' workspace scheme providing studios for small enterprises set up by artists and crafts people – the project also provides a small public exhibition area for tenants' work – secures a deal with a local micro-loan community development finance institution (CDFI) which will provide loans combined with business advice/technical assistance to incoming tenants to help them establish their businesses, the workspace also providing an initial rent free period as an extra cash flow support.

For the investor: the collaboration with the workspace provider strengthens

likelihood of the success of the new enterprises (and therefore of repayment of the loans) as well as encouraging mutual support between tenants

For the investee: for the individual artist/crafts person, facing a commercial banking system which not only may be unimpressed by their credit worthiness but may also be reluctant to regard their plans as 'proper' businesses, the combination of a supply of small loans and immediate business support at a crucial 'start up' point in their development. The workspace provider gains from the reduction in the level of risk of business failure among the new A&COs and is also a beneficiary of one of the business consultants recruited by the CDFI.

10. A music download partnership between an orchestra and an online retailer

A partnership between a national orchestra and an online retailer which enables the orchestra's website to offer access to a downloadable archive of its own recordings and new releases as they are produced – plus links to over 50,000 other tracks from 40 mainly classical record labels (including tracks from – and links to the websites of – most other major UK orchestras). Subscribers pay £8 monthly for an unlimited stream of music to their computers along with a limited number of free downloaded tracks from the orchestra and other special promotions. The retailer and the orchestra share the setting up costs (65 per cent the retailer; 35 per cent the orchestra)

For the investors: the commercial online retailer gains from the orchestra's brand and loyal customer/friends base, a steady and committed subscriber income flow; the orchestra has a subordinate stake but, if the venture is a success, will recover its initial investment

For the investee: the orchestra creates an integrated web service, combining marketing materials about its own programme of work and performances with a substantial downloadable supply of music of all kinds through which it can maintain a continuing link with established supporters and gain access to new ones – and it generates a new and steadily growing income stream.

11. Artists as Investors

The producers of what is anticipated will be a commercially successful film face problems raising the funds they need. They come up with a business model that will keep the budget low by negotiating minimal fees for almost all the cast and crew (and the production company's lawyers!) in return for a share in the profits. The production costs were fully funded, the film costing 'up front' less than 50per cent of normal costs; the funding also necessitated a much simpler rights package than standard and the production company

was able to take advantage of a preferential tax break, higher than it would have been eligible for if production costs had been higher. The film was generating profit from its first commercial showing.

For the investors: if the film generates income to the now anticipated level, the cast and crew will individually be better off from their profit share than they probably would have been if paid normally – albeit there was risk and an income delay resulting from taking a profit share. The funding method also provided a strong incentive for everyone to concentrate their talent and efforts in the production process

For the investees: the production company was able to put together a simple package for assembling the production costs and could look to cast and crew for an exceptional level of personal investment in the quality of the production and to participate actively in marketing and promotion.

12. From grant to contract

A theatre company 'sells' the time and talents of three of its actors and a producer to work with the human resources team of a large private sector employer who want to improve the communications and presentational skills of some of their senior and middle management staff. The first programme is paid for by a donation to the theatre. It is a success and the theatre company persuades the private sector employer to extend the programme for a three year period on a contract – which is also properly 'priced' so that the theatre will make a small surplus if it delivers the work successfully and efficiently. The success of and publicity surrounding the project prompts enquiries from other public and private sector employers and also results in the original lead company agreeing a three year sponsorship of the theatre's marketing materials.

For the investor: following the successful pilot, the company secures a well regarded and good value addition to its staff development and training programme, the three year contract making it easier to organise individual and team training plans well in advance. The success of the programme and subsequent sponsorship link cements the reputation and high profile of the company locally as a 'good corporate' citizen

For the investee: the regular and assured income is a significant asset for an organisation which has very uneven income flows as so much of it is tied to the success of specific productions. The enhanced security for key personnel is also a boost. The switch from one-off restricted grant to a properly priced three year contract (the income from which is unrestricted) is also a considerable advantage to the theatre company's reserves.

13. Barter and local exchange

A local network of organisations is established to exchange or 'barter' various skills and products, centred on an arts venue. The venue provides exhibition space in its public areas for artists and facilities for selling or promoting their work; design, print and merchandising companies provide professional services; local firms provide products to be used in productions; corporate social responsibility organisers in local companies provide employee volunteers at the venue and for community organisations with which the venue works – all 'cashless' and in return for tickets and high profile advertising in programmes etc.

For the investor: the participating companies secure some additional work and an involvement in a local arts centre which excites and motivates staff and secures a positive profile within the customer community – at marginal cost

For the investee: the venue obtains 'in kind' support (probably long term if well managed) for costs that are often hard to meet plus a widening and diversifying of corporate and individual 'friends.' **NB** Such barter and exchange arrangements may be liable for VAT.

14. An endowment to support work in a new centre long into the future

A large scale new multi-purpose regional arts centre is being developed with funding from government, lottery and some very large scale corporate and foundation donors. During this development an endowment fund is launched aimed at smaller donors (individuals, foundations and companies) and at donors who prefer not to fund buildings and/or are attracted at being associated with the long term development and use of the building. The fund will be used to support education projects and new commissions to be premiered in the centre. The local community foundation takes on responsibility for the management of the fund (and for the decisions about the allocation of the funds, so the arts centre does not have unfettered control of the funds).

For the investor: an opportunity to 'have a stake' in the long term development of the centre, to build an 'in perpetuity' resource for the community without being 'just' one small donor among many towards the huge building costs. Though no financial return will accrue to the investor, they will know that their contribution continues to grow in value and to generate income that will be of use each year to the artistic work

For the investee: access to donors who might not have been willing to contribute to the cost of the building; the creation of a secure income stream, reducing ongoing pressure on fundraising staff; becoming part of the community foundation's portfolio of restricted funds, thus gaining access to

further investor/donors/friends in the future. **NB** For an endowment to return a significant and long-term income stream a substantial capital sum would have to be raised. It might generate around 4% allowing for inflation.

Section 4 Issues and problems - perspectives of arts and cultural organisations

We discovered in our research a number of perceived problems or issues which prevent A&COs from considering a wider range of financing approaches. In a number of cases barriers are perceived rather than real. (The next section considers the perspectives of funding and/or finance providers).

Charity law and trading

Some A&COs believe that charity law prevents them from trading. They therefore assume that they can not develop income generating schemes of the sort highlighted in some of the case studies contained in the last section. It is not the case that charities can not trade. The rules are relatively complex (see the box below) but they allow scope for charities prepared to make an investment in trading to develop innovative income generating schemes. While charity law does not prevent charities from trading, a new legal structure, the Community Interest Company (CIC), has been developed tailored to the needs of social enterprise (again, see the box below for more information).

Trading and charity law

Many charities trade in pursuit of their primary purpose for example, arts and cultural organisations selling tickets for performances. Restrictions apply to non primary purpose trading activity for example; an art gallery sells a range of gifts in its shop and by mail order. Charities may develop some non primary purpose trading within the charity up to a de minimus level. If they want to engage in larger scale trading they must set up a trading subsidiary. The trading subsidiary can donate its profits back to the charity tax effectively using the Gift Aid mechanism. The trading subsidiary model is not without its difficulties for example, that of capitalising the new entity but nonetheless many charities of all sizes have operated it successfully.

Community Interest Companies (CICs)

The CIC is a new legal form designed to encourage social enterprise. Over 700 CICs have already registered, including a number of A&COs.

CICs can be established for any lawful purpose, as long as their activities are carried out for the benefit of the community. CICs can pay dividends to investors – although these dividends are capped. There is an asset lock – i.e. accumulated assets can not be sold and the proceeds divided between shareholders – assets have to be used for the purposes for which they were accumulated.

The perceived advantages of the form:

- the broader range of purposes that can be pursued (charities must have exclusively charitable purposes);
- the capacity to attract investment and pay dividends (charities can not offer equity);
- a capacity to pay board members for example, founding directors (possible for some charities but more difficult);
- the asset lock which provides reassurance to stakeholders, including funders, that assets will not be privatised (the charitable form offers a similar asset lock provision).

CICs do not receive tax benefits. However, in return for the benefits of charitable status charities are subject to more onerous regulation by the Charity Commission.

An organisation can not be a CIC and also a charity but a charity can convert to a CIC with the consent of the Charity Commission. A charity might also set up a subsidiary with the CIC form.

Contracts and full cost recovery

Some of the experts consulted as we developed this strand of work believed that A&COs were missing opportunities to access public sector contract income. Services previously provided directly by the public sector are increasingly being contracted out to third parties (see the box below which describes Futurebuilders and some of its investments). One of the barriers to A&COs engaging with this agenda is concern that contracts will not be priced to enable recovery of costs plus a margin for re-investment in the organisation/service (or 'full cost plus'). However, there is some evidence that the public sector is becoming more aware of this issue and that practice is improving (see the box below).

Futurebuilders England

Futurebuilders England is a government backed fund providing investment to voluntary organisations to enable them to deliver better public services. It offers a combination of loans, grants and professional support. Over 70 per cent of the investments it made during its first year were to first time borrowers. Some investments have been made in A&COs to enable them to engage in public service delivery. These include investments of:

- £525k to Dance UK to support a three year action research programme to demonstrate the impact of dance in reducing re-offending;
- £1.1m to Doncaster Community Arts to develop and extend service delivery in education and health;
- £133k to Sound Base Studio Trust to enable it to develop its educational and vocational work with disaffected young people.

Full cost recovery

Full cost recovery means that the price of contracts and grants reflects the full costs of delivery, including a legitimate portion of overheads. It poses challenges for both organisations and their funders.

- voluntary organisations must cost their projects and services on an accurate, and defensible basis.
- government must ensure that all public bodies fund services sustainably, by permitting the inclusion in prices of the relevant portion of overheads where these costs are determined on a realistic basis.

HM Treasury first endorsed the principle of full cost recovery in its 2002 cross cutting review *The role of the voluntary sector in service delivery*:

> *Funders should recognise that it is legitimate for providers to include the relevant element of overheads in their cost estimates for providing a given service under service agreement or contract.*

The review stated that government would implement the review's funding recommendations, including this recommendation, by April 2006.

An edited extract from the ACEVO full cost recovery website: www.fullcostrecovery.org.uk

Full cost plus

Full cost plus goes beyond full cost recovery. Not only should contracts and grants reflect the full cost of delivery, including a legitimate portion of over head costs – they should also allow a margin for re-investment in the organisation/service. This is important - voluntary organisations tend not to recognise that they can only maintain projects or programmes if they invest periodically in their capital and human resource base.

Debt on the balance sheet and insolvency

Some A&COs asked how debt would impact on the balance sheet. There is no single answer to this question. The requirement to repay a loan is shown as a liability on the balance sheet. The impact of this on the strength of the balance sheet and, therefore, on the overall financial health of the organisation varies depending on several factors; for example, whether the loan has been taken on to purchase or enhance a fixed asset or for some other purpose, if and how the loan has been secured, the repayment terms and how much is repayable within the next twelve months.

A&COs expressed concern that taking on loans could lead to questions about whether they continued to be 'going concerns'. However, one of the responsibilities of both lenders and borrowers is to ensure that the organisation's cash flow and balance sheet are sufficiently robust and that taking out a loan does not present an immediate danger of insolvency.

Tying the hands of successors

The seminar for A&COs , held by MMM as part of this project, revealed a specific concern that by entering into arrangements similar to those in the case studies, the managers of A&COs would be binding their successors. However, if the arts and cultural sector is to move away from the dominant model of crisis management and comprise organisations that are more financially stable and sustainable – organisations will need stronger long term financial planning and board ownership of strategy. And, this will mean that boards and managers make long term commitments. Some of these commitments may comprise patient capital i.e. long term loans (with 15- 20 year terms), sometimes with repayment holidays. It is precisely the patient or longer term nature of this financing that makes it so potentially useful to A&COs .

Why use debt financing when grants may be available?

Some A&COs ask – why use debt financing when grants and other forms of contributed income such as donations may be available? Here are some examples where it adds distinctive value to those forms of subsidy - it may be difficult for an A&CO to:

- raise all the finance for a capital development before it has to commit to a contract price for the work, a loan given to underwrite the project enables the work to start, giving confidence that the money will be available to cover costs;
- raise money to develop a new income generating venture – most grant givers might consider the project too commercial, the banks might consider it not commercial enough;
- function because some of its grants are paid three months in arrears – a loan might enable the organisation to smooth out bumps in its cash flow thus avoiding large over draft fees.

Attracting new funds or replacing grants

There is some concern amongst A&COs that loans and equity or quasi equity may start to replace traditional grant aid. In one sense they may - some funders may consider that loans are more appropriate for some types of projects than grant aid for example, building projects where repayments are less than or equivalent to the rent previously paid or quasi equity for new product. However, it seems unlikely that most existing funders will dedicate more than a small proportion of their resources to these new forms of

financing. It is likely that they will be used alongside grants complementing rather than replacing them. New sources of finance, focused on offering loans and other alternative forms of financing to help develop more financially sustainable A&COs, may also emerge.

The impact on other funding bodies

A major reason for seeking to access loan and other alternative forms of finance is that it can help A&COs develop new income streams for example, from new product, the exploitation of product or subsidiary trading activities. However, A&COs are concerned that if they generate additional income and accumulate some reserves, traditional funders will simply penalise them and reduce their grants. The view is that the Arts Council England for example, tends not to reward but penalise success.

Risk averse boards

The boards of A&COs are generally risk averse. They are resistant to loans and other alternative forms of financing because they are new and unfamiliar. Grants are much easier to manage because they do not tie an organisation to a particular level of financial performance. Sometimes staff have difficulties persuading their boards of the benefits of loans or other alternative forms of financing. Often when an organisation enters into such financial arrangements it signals a mature relationship between the board and staff. It indicates that the board has confidence in the quality of the organisation's financial management and that the staff has confidence that board members will support them if any difficulties emerge. (See the box below for information about trustee responsibilities and loans)

Trustee responsibilities and loans

Trustees should ensure that they have the power to borrow i.e. that there are no restrictions on borrowing in their governing document. In their oversight of the process, they need to bear in mind their general duty to protect the assets of the charity:

Risk management - They should consider the risks associated with taking out a loan and should implement measures to minimise those risks, for example, satisfying themselves that repayments can be made to schedule.

Taking advice - In advance of agreeing to a loan, trustees should consult with and have taken advice from both their legal adviser and auditor.

Reporting - The terms of any loan should be clearly explained in their annual report and in an appropriate note to the accounts, especially if those terms are more patient or soft than a normal commercial loan.

The Charity Commission produces guidance on Borrowing and Mortgages (OG22) which trustees should consult -
http://www.charitycommission.gov.uk/supportingcharities/ogs/g022a001.asp

We tend to think that loans require security. This is probably because the majority of loans offered by mainstream banks are secured. However, some of the specialist lenders described in the last section does not require security. They make their loan assessment based on the organisation's track record. They ask whether the organisation is likely to be able to generate revenue capable of accommodating repayments. In effect, the lender is assessing the value of the artistic capital of the organisation and how much income it is likely to generate over a specified period. Quasi equity arrangements are different again – here both the investor and the organisation share the risk that a particular artistic product will generate sufficient revenue to cover the investment.

Fear of losing control of artistic product

A major cause of concern for A&COs is that use of new and alternative financial instruments could lead them to lose control of artistic product. For example, quasi equity investors might force the organisation to put on more populist work in order to increase box office receipts and thus their return. However, A&COs are free to avoid any financing deals which tether their discretion. And, in practice most people are likely to invest because they have respect for the organisation's artistic vision or to support a particular pre-defined artistic product or endeavour.

Section 5 Issues and problems – perspectives of funders/investors

Our discussions with experts involved in financing charities and other not for profit organisations suggested a number of problems or issues that this project needs to tackle. These relate to the supply of investment to A&COs and some of the challenges it poses.

Accessing existing financing opportunities

Section 3 highlighted some of the benefits of accessing finance from specialist providers - Venturesome, Charity Bank and Triodos were discussed. However, these three providers say that relatively few A&COs are taking advantage of their offers. Two said that in their experience A&COs are more reluctant to take loan finance than other voluntary organisations. They suggested that this may be because of a culture which assumes contributed income. Another expert consulted suggested it might be because A&COs are less inclined to plan and more prone to crisis fundraise. However, it is probable that the main reason why A&COs are not approaching these specialist providers is a lack of awareness amongst managers and boards of the different forms of financing on offer and of their benefits.

Organisational capacity and loan and equity finance

Specialist providers report that in some cases it is difficult to lend to A&COs . This is not necessarily for the reasons that you might expect i.e. the organisation does not have tangible assets against which a loan might be secured (the lender may be prepared to provide a loan without security) or the difficulty of valuing the intellectual property in the production (the lender may be happy to lend based on the previous track record of the organisation). The biggest issue, as reported by the three specialist providers whose views were canvassed appears to be, the financial management capacity of A&COs– more specifically, their ability to understand the financial dynamics of their organisation and how their business model functions and/or their confidence and capacity to plan for the long term.

A new market – still a lot to learn

One of the features of the market for loans, equity and quasi equity within the broader voluntary sector is that it is a relatively new one. However, some specialist providers are already reporting key learning from their experience so far. This learning includes:

- the need to build the financial management capacity of investees to reduce the risk of non payment and
- the value of underwriting - providing a safety net of financing which may be called down if needed, such arrangements can give organisations the confidence to proceed with or develop innovative schemes when other sources of funding are as yet uncertain.

The debate around social enterprise and sustainability

In the wider voluntary sector there is significant debate on the theme of social enterprise and sustainability. Put simply voluntary organisations are being encouraged to exploit a much wider range of potential income sources including public sector contract income and income from subsidiary trading ventures for example, charity shops. It was generally believed that A&COs should be engaging more with this debate and learning from it (see the box below for information about an arts organisation which won a Community Enterprise Award in 2006).

Galeri

Galeri Caernarfon Cyf (formerly known as Cwmni Tref Caernarfon) was set up as an independent Town Development Trust in 1992:

To pursue sustainable projects in a creative way in order to realise the cultural, economic and environmental potential of the local community and its environs.

It is responsible for establishing and implementing numerous projects within the local community. Its work programme includes property development, setting up and managing SBARC!, the Caernarfon Arts Project and managing Galeri, the new £7.5 million Creative Enterprise Centre in the town's Victoria Docks. Galeri houses:

- a 400-seat theatre, acoustically suited to music concerts and also used as a cinema;
- two large rehearsal studios;
- the Art Space which offers an experimental programme in which artists work with the local community on specific projects;
- a café; and
- 27 enterprise units for creative companies.

Galeri also offers conference facilities.

Philanthropic and commercial forms of investment

The majority of investment into A&COs is philanthropic or quasi philanthropic - as discussed in section 3. There is a view that at the philanthropic end of the spectrum a larger number of A&COs could do more to exploit the good will of supporters and their desire to be associated with particular organisations. For example, a group of orchestra supporters contribute large sums for the commissioning of new music and in return receive a range of special privileges.

In the short to medium term, forms of investment which blend the philanthropic and the commercial may be the best option for arts and cultural organisations. They could be considered as the first step towards use of more sophisticated mechanisms. And, over the longer term there is interest in encouraging/developing forms of investment which move along the spectrum from the philanthropic to the more commercial (see the box on the next page).

Some of the experts whose views were canvassed also held the view that more could be done to encourage giving to A&COs more generally (see the box below).

Encouraging philanthrophy

One expert we consulted said:

Considering that 1 per cent of the UK's population now owns a quarter of the nation's wealth (and 10 per cent over half) perhaps we should revisit the concept of individuals being nurtured and encouraged to become patrons of the arts through regular personal philanthropic giving and leadership.

If more was done to share experience (particularly at trustee level) with for example, large organisations fostering the development of small ones (possibly even across disciplines) then the build-out of benefactor giving could be widened to all sizes and types of organisations.

Valuing and exploiting assets

The general view is that A&COs need to be better at identifying and exploiting their assets. For example, they should be asking:

- are there ways of reaching a larger/broader audience and generating some additional revenue through new technology for example, sales of DVDs, music downloads etc?
- would it be possible to sell licenses for future productions of the work we have made a significant investment in creating?

- would our supporters be willing to do more – both in terms of voluntary labour for example, fundraising for the organisation or more commercial financial investment?
- might the public sector want to purchase some of our education or other services?

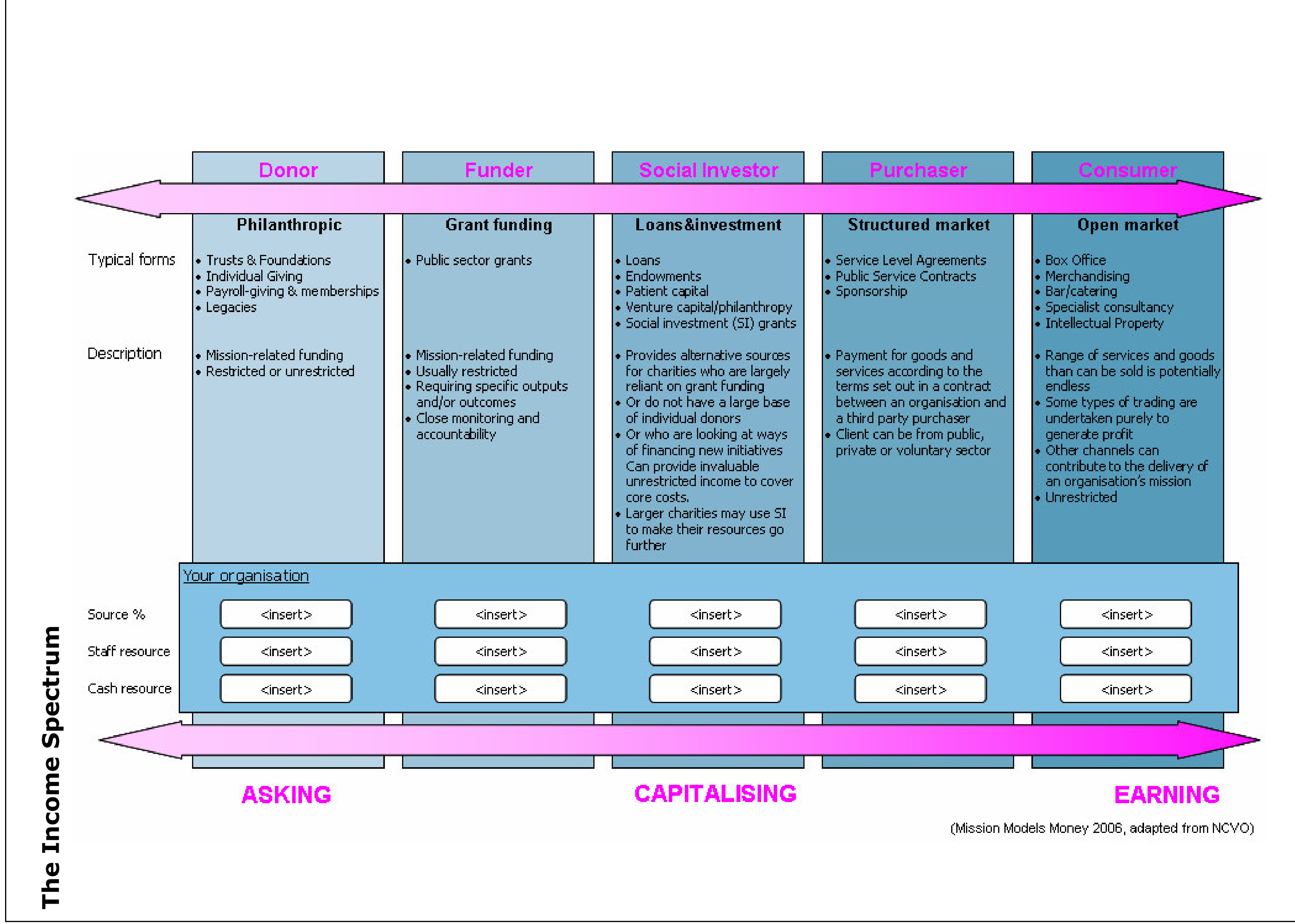
New approaches

The experts were hopeful about the scope for leveraging additional funds into the arts; they made specific reference to the following options:

- a new tax relief for direct investment by individuals and corporates in A&COs (see the next section);
- the establishment of a new pooled arts investment fund (see the proposals in the next section for an underwriting fund and a property fund).

Both were recommended on the basis that there are many individuals with a strong commitment to the arts who might be willing to contribute.

The Income Spectrum



Section 6 Outline action plan

The discussion in this report indicates the need for further work in a number of specific areas – at this stage in the project these are only initial ideas – on the basis of further consultation a more comprehensive and detailed action plan will be developed.

Encouraging arts and cultural organisations to engage more actively with developments in the wider funding environment

This report notes that A&COs do not appear to be engaged with current interest and debate in the wider voluntary sector about sustainability and enterprise. This means that A&COs are not accessing advice, information and support which could help them to develop income generation strategies. A&COs need to be made more aware of this work and to be provided with practical examples from the arts and other sectors of its benefits. And, support organisations for the wider sector need to make more of an effort to engage A&CO's with this work.

Providing a link between investors and investees

It seems clear that A&COs are not aware of some of the opportunities for investment that already exist – whether it be loan, equity and quasi equity investment in voluntary organisations on preferential terms by specialist providers or ideas to develop investment through supporters schemes. Neither perhaps are interested individuals aware of the numerous ways in which they could give money or time to A&COs. This suggests that more work needs to be done promoting such opportunities perhaps through a dedicated website.

Meeting the capacity building challenge

The proposal is that pilot work is undertaken with a small number of A&COs assess and build their financial management capacity. The objective would be to help them understand their business model and support them in developing income generating projects based on alternative forms of financing – particularly loans and equity or quasi equity investment. The intention is that these projects would produce learning about:

- the financial dynamics of A&COs ;
- mission led A&CO business models;
- income generation in arts and culture;
- appropriate loan, equity and quasi equity models;
- appropriate capacity building support.

This learning would inform the development of further work.

Development of a fund providing underwriting to A&COs

It is clear from our discussions with A&COs that many are nervous about the prospect of borrowing, however underwriting is regarded as very valuable (because for example, it provides a safety net for organisations without any cash reserves). It is proposed that a pilot underwriting fund is developed for A&COs in partnership with a specialist provider. A fund of this sort would give A&COs the confidence to develop new initiatives or take artistic risks or simply provide them with the cash to weather cash flow difficulties

Consider the feasibility of developing an arts and culture property fund

Many A&COs do not own their own property and are therefore making large rental payments from scarce revenue funding. Individuals and corporates might be willing to invest in a new arts property fund which purchased property to let to A&COs at below market rents. The investor would receive a share in the capital appreciation of the property and satisfaction in the knowledge that they were helping A&COs. The fund could purchase particular properties for particular A&COs. As it grew in scale – it might be able to sell properties to A&COs at discounted rates.

Community based assets

Work is underway in the wider voluntary sector examining the transfer of local authority buildings to local communities. This includes helping build the capacity of voluntary organisations to manage such buildings after transfer. This work should be better promoted amongst A&COs.

A new tax relief

It is proposed that work is done examining the pros and cons of a new tax relief for investment by individuals and corporates in the arts. This might be limited to specific types of organisation, specific types of investment or to investment in a specific fund for example, the underwriting fund and/or the arts property funds suggested above.

The bonus culture

Many city institutions offer large bonuses to their employees. Some of these employees might be willing to donate part of their bonus to a new arts and

cultural fund for example, a new endowment fund aimed at supporting small and medium sized A&COs which find it difficult to raise donation income. The feasibility of employer promotion of the scheme should be investigated.

Next Steps

The intention is that working in collaboration with the social investment community and other partners, MMM's next generation initiative should act as a further catalyst for this agenda to ensure that:

- additional consultation takes place on each of the above ideas and that
- where immediate steps can be taken through for example pilots and/or the setting up of specialist funds, immediate action is forthcoming and effectively implemented.

Annex The financing of arts & cultural organisations

The Arts Council of England undertakes a survey each year of A&COs in receipt of regular funding. For 2004/2005 the sample comprised 880 organisations. These organisations worked across a wide range of art forms including dance, the visual arts, theatre, literature and poetry. Their total income in 2003/2004 was £845.5 million

Survey organisations received their income from the following sources and in the following proportions:

Earned income	44 per cent
Arts Council England grants	36 per cent
Local authority and other Public grants	12 per cent
Contributed income – Sponsorship, trusts and Donations	9 per cent

Between 2003/2004 and 2004/2005 there were increases in all areas of income:

- earned income (11 per cent);
- Arts Council grants(5 per cent);
- local authority and other public grants (5 per cent);
- contributed income (16 per cent)[1].

There were also increases in two areas of expenditure. Artistic programme costs increased by 46 per cent and marketing costs increased by 11 per cent. Education programme expenditure decreased by 3 per cent and overheads, staffing and other costs by 20 per cent.

There are however, a number of problems with this survey data.

- The six large national companies[2] skew the sample. They represent 26 per cent of all income and also 27 per cent of all earned income. They also represent 33 per cent of total contributed income.

- The earned income category is very broadly defined and therefore the data is not helpful for our purposes. For example, it includes income from ticket sales, licensing agreements but may also include income from specific projects for example, education work.

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[1] These figures are for the constant sample - the 571 organisations that responded to the survey in both years.

[2] The Royal Opera House (including the Royal Ballet), English National Opera, Birmingham Royal Ballet, South Bank Centre, Royal National Theatre and Royal Shakespeare Company.

- It is also unclear whether the earned income category includes the funds generated by trading subsidiaries. A proportion of charitable A&COs set up trading subsidiaries and the income from these is generally Gift Aided back to the charity to avoid income tax. It is therefore likely that some trading income is included in the contributed income category.

The last two bullets illustrate the general point that we have insufficiently detailed information about A&COs earned income. This income category is obviously important in this context because A&COs use it to service loans or quasi equity arrangements.

Another flaw in the survey data, for our purposes, is that it does not include any analysis of the extent to which A&COs are accessing loan and equity or quasi equity finance. However, we know that some A&COs have accessed this finance, the most commonly cited examples are:

- angel investors supporting theatre productions;
- the selling of licenses to stage particular productions (thereby selling a short term share in their intellectual property);
- film financing;
- loans for live/work studios or other property development projects.

It would also be helpful to have information about the assets held by A&COs and the nature of these assets for example, the extent to which arts organisations own their own buildings or hold other assets against which loans might be secured.

Glossary

Bond: bonds are issued for a period of more than one year with the purpose of raising capital by borrowing. Generally, a bond is a promise to repay the sum invested along with interest (coupons) on a specified date (maturity). Some bonds do not pay interest, but all bonds require repayment of the sum invested.

Business angel/s: A term used for an individual or groups of people, who offer financial investment and business knowledge to assist development and growth. Considered as a high risk form of investment it has been used to support commercial musicals and theatre productions in the West End.

Endowment: money that is given to an organisation, which is invested, in order to provide it with an income (or the giving of this money). The Sage in Gateshead has established an endowment to help it meet its revenue costs.

Equity investment: buying shares in a company. Each share is a proportion, usually a small one, of the whole company; shareholders own the company.

Loan: a sum of money which is borrowed and has to be paid back, usually with an additional amount of money paid as a charge for borrowing

Patient capital: loans are offered on a long term basis and on soft terms (e.g. capital/interest payment holidays and sub-market financial returns).

Quasi equity: the funder takes a financial stake in a venture for example, in return for providing the capital for the development of a new piece of software the funder receives a percentage commission on each sale (i.e. the return the funder receives is linked to the financial success of the venture).

Venture philanthropy: funders using this approach seek to develop the capacity of a relatively small number of charities and other voluntary organisations. They provide core funding and intensive support with management development. Generally, a collaborative approach is taken to business planning and objective setting before the initial grant is made.