

It's an
idea,
but is it
business?



A guide to third sector trading

It's an idea, but is it business?

A guide to third sector trading

October 2011

Compiled by Mel Witherden

ISBN 1 903416 84 1

Published by Wales Council for Voluntary Action

WCVA is the national umbrella organisation for the third sector in Wales. For over 75 years we have been working with the sector to improve communities and change lives.

WCVA, county voluntary councils (CVCs) and volunteer centres (VCs) form a network of support organisations across Wales that help people who are inspired to make a positive difference to their communities. We work with charities, voluntary and community groups, social enterprises, trustees and individual volunteers. WCVA works at a national level, while CVCs and VCs work at a local level.

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Registered charity 218093

Company Limited by Guarantee 425299

Registered in Wales



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Introduction

This is a guide to trading for charities, community groups and social enterprises.

Not for profit organisations who raise or intend to raise a significant part of their income from trading are sometimes called social enterprises. Exact definitions don't matter. What matters is deciding whether trading is for you, and that you should do it efficiently.

This guide takes you through the process step by step.

It considers – why start, business planning, governance, funding and resourcing, monitoring, managing growth and sources of support.

It also contains useful insights and models.

I hope it will help all those considering and undertaking trading within the third sector.

Graham Benfield OBE

Who is this guide for?

This guide is intended for people who:

- are working in any capacity in a third sector organisation, or intending to start one, and
- are hoping or planning to carry out trading activities, or already doing so
- want those activities to be continuing, and not one-off ventures
- want them to be sustainable, or self supporting in some way (we will try to be clearer about what this really means)
- want the trading to create 'profits' or 'surpluses', and
- want to use those surpluses for a social purpose, usually to achieve some charitable, social or community benefit.

What do we mean by 'third sector'? Different types of organisation have different aims. This guide is intended for any organisation which shares the ethos of most voluntary organisations, which means

- working collectively
- having a defined purpose
- working *on behalf of others*, who can be almost any individuals or groups (but not usually shareholders) and include:
 - the designated beneficiaries of charities
 - the members of clubs and societies etc
 - all the residents of a community or district (for instance, if your organisation is a community centre or a regeneration partnership)
- using a constitutional model (and a constitution is essential) which constrains you to operate through some kind of group or committee structure, which may or may not be democratic
- all or most of the members of the committee or governing body of the organisation do not get paid for the job of running it.

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What if you don't quite fit? There is no point in being contentious about it. There are exceptions to this definition, and if you fall outside it, that's not a reason why you can't succeed. Good luck.

Trading

This guide is about trading by third sector organisations in the widest sense. Customers may be public or private organisations, the users or beneficiaries of charitable projects, or the general public. The business activities themselves can be extremely varied. This list is not exhaustive, and there are more examples in Section 2.1, but this gives a flavour:

- running shops selling second hand goods
- running visitor attractions and gifts shops associated with them
- charging entrance fees to regular entertainment events
- delivering contract services for public bodies – for elderly or disabled people, for example
- charging users for services such as nursery school places or training courses
- consultancy work
- letting offices, warehouse space or residential accommodation
- production, repair or recycling workshops and factories
- selling goods at markets or on the internet.

What's special about the third sector?

Producing a trading guide intended 'only' for voluntary organisations (which embrace everything from new steering groups for a development trust with a turnover of zero, to national charities which spend millions of pounds a year) seems rather narrow-minded and partisan on the face of it. There are plenty of people involved in the world of private sector business who will tell you it's just wrong-headed.

- **The 'Business is business' argument:** Many business advisors and experts, economic development officers, public sector websites and real entrepreneurs will tell you bluntly that 'business is business'. It makes no difference whether it's the third sector or the private sector – there's only one way to do it. If you want to be treated as special, they will say, you're probably doing it wrong. Listening to their wisdom and nothing else, can undermine your confidence and leave you wondering why developing a business is so difficult.
- **Doing business on the moon:** *The reality is that doing business is the same, but the environment is utterly different.* The rules of golf don't change whether you play it on Earth or on the Moon, but you need to make some adjustments to play successfully in one fifth gravity and zero atmosphere.

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- **The third sector environment:** The differences between the environment of the private and the third sectors radically affects the way the enterprise game is played. The following generalised distinctions are not universal, but they are sufficiently widespread to make the point. In the third sector:
 - Personal financial gain is not the main driver. There is no owner and there are usually no shareholders expecting to share in the profits.
 - Ultimate responsibility and often all the key decisions are in the hands of unpaid volunteers, rather than people who have a personal financial stake.
 - Volunteer directors are much less inclined to take risks. They are likely to be trustees of assets which belong to their community or charity, and there is little incentive to gamble with them.
 - Businesses run directly by volunteer committees on the whole don't work, and it can be hard for groups to hand control to paid individuals and even harder to supervise them effectively.
- **The third sector market place:** Many community and charity organisations trade on the margins, and have to make special management adaptations, such as using unpaid staff or exploiting public goodwill:
 - they work in markets which have been ignored by the private sector (and sometimes abandoned by the public sector) because they are unprofitable or too small
 - they often provide services for people who are the least able to pay, or work in communities already hampered by economic disadvantage.
- **Not special, but distinct:** Some other, though certainly not all, forms of third sector trading have much more in common with the private sector because of their scale (eg public utilities) or their origins and management (eg environmental businesses started by visionary entrepreneurs). Others, like housing associations, are so well established that they do not need generalist guides to show them the way. The point about the third sector is that, despite its variety, its common characteristics mean that a comprehensive guide does make practical sense.

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The 'non-trading third sector'

This guide uses the term 'non-trading third sector' to bracket together organisations which are *not* in the business of trading and enterprise. This is not intended to suggest that such organisations are not enterprising or that they never trade. Running jumble sales and coffee morning is a form of trading, and so is selling tickets to a choir concert and selling a fundraising calendar once a year. But these activities are small-scale and usually occasional, and raising money is not a major purpose of the group which is responsible.

'Social enterprise'

Despite its widespread currency, the term 'social enterprise' has been kept to a minimum in this guide. It might be applied to much of the third sector trading described here. But it can also provoke unhelpful and irresolvable debates about definitions, areas of interest, and the 'correct' objectives of those who practise it. 'Third sector trading' is more to the point for the many charities and community groups who are now embarking on business activities for the first time, and hopefully less contentious.

Table 1.1: Why third sector trading really is different

Activity	Private business	Community trading	Charity shop
<i>Reason for starting</i>	to make money for the owner (and possibly shareholders)	to make community activities more sustainable	to increase charitable funds
<i>Who is ultimately in charge</i>	owner, MD or board – all paid	volunteer board	volunteer board
<i>Decision taking</i>	owner or paid manager	volunteer board or paid manager	volunteer board or paid manager
<i>Primary purpose of the business</i>	profit	social (or economic or environmental) benefit	to fund charitable activity
<i>Secondary purpose of the business</i>	could be almost anything	profit or sustainability	profit
<i>Main personal motivation of directors</i>	financial gain	no two directors will have the same motivations	no two directors will have the same motivations

1: Getting started – the absolute basics

This chapter is a checklist for absolute beginners to show what will be expected of them if they are going to develop a trading operation.

New and established organisations

Established community and voluntary organisations can be assumed to have a head start on new groups which are starting social enterprises. They are likely to have:

- objectives and aims as an organisation
- a constitution
- a basic management structure
- committee skills and decision making procedures
- some financial record keeping arrangements.

You can't assume that these advantages will be suitable for or robust enough to run trading activities. But it does mean that you can probably skip over much of the groundwork on starting new organisations (sections 2.1 to 2.4).

Knowing where you are starting from

- **Avoid preconceptions:** Groups of people who are exploring trading possibilities can easily become distracted by preconceptions and confused by the assumptions of others about what they are trying to achieve and which types of activity are realistic or appropriate or legitimate. In fact, every new business is different. There are not many rules which apply equally to everyone who is starting out – the choices are yours.
- **Be clear what you want to achieve:** So if you are beginning from scratch and planning to use this guide, you need to think carefully about where you are starting from and generally what you are trying to do.
- **Share your ideas:** It's also particularly important to share these with those working with you so you can minimise misunderstandings and false expectations.

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10: Sources of support

The start up checklist

Working through this list of questions should help you and your colleagues to start clarifying where you are heading and what help or planning you are likely to need. For example:

- will this be a new organisation or the development of an existing one?
- what are your reasons for starting to trade (and does it matter what sort of business this is)?
 - to achieve your charitable or social objectives directly? (ie will the trading itself have social benefits?)
 - to extend or improve the benefits of an existing service or services?
 - to generate income to support an existing project or organisation (will the trading have only indirect social benefit?)
 - to provide jobs, training or some other direct economic benefit?
- what are the particular benefits you want to achieve?
 - what geographical area or which group of people will you benefit?
 - what are the needs of the community or group of people you aim to help?
 - do you have evidence of these needs? (even if you are sure of the need, funders and potential supporters may need to be convinced)
- is there any good reason to limit your trading options, or should you improve your chances of success by taking a broad view of your possible activities?
- what type of organisation (if one already exists) is starting the initiative?
 - is it well established?
 - is it well run?
 - is it a charity?
 - does it have community support?
 - do you/will you work in partnership with other organisations? who?

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- do you have a clear idea of the business/es you want to run?
 - can you be flexible about this?
 - do you have any alternative ideas if the initial suggestions aren't viable?
- what knowledge and skills does your group already have, and what might it need?
 - business expertise, such as management, marketing and human resources?
 - community development? knowledge of social enterprise?
 - fund raising?
 - market research, feasibility studies and business planning?
 - project and financial management?
 - professional skills? architectural, legal etc).

Planning the business

You should remember that there is no such thing as a reliable sat nav for trading. This will be an unpredictable journey which will be heavily influenced by your starting point, your end goal, and the traffic jams and diversions you encounter on the way. Here are the basic steps you are likely to need to take, though not necessarily in this order:

- establish a steering group to develop the trading project
- identify the social benefits you want to achieve
- identify the business ideas
- get constituted (including company and charity registration if appropriate)
- consult (with your community, beneficiaries, parent organisation)
- involve others in the planning
- write a business plan.

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Starting the business

There are a huge number of issues to cover. Here are some of them:

- form the trading board and provide training for the directors
- fund raising – for equipment, premises, initial starting, 'working capital'
- set up the business systems: financial record keeping, credit control, payroll, VAT, purchasing systems, financial reporting,
- set up the business – marketing and sales, cost control, stock control, customer care, quality control
- establish and operate personnel systems – recruitment, contracts, staff supervision, complying with employment law etc.

Some of this is the familiar work of many conventional voluntary organisations. But if some of these phrases are meaningless at this stage, that's understandable. Don't imagine they won't apply to you and your business, though. Read on.

Developing the business

What happens after enterprises have been started is even less likely to follow in a simple step-by-step sequence than the start-up process. But here are some of the issues which the directors of developing businesses will need to handle. They are dealt with in later sections.

- Overseeing commercial activity and managing business risks
 - developing and marketing services
 - financial monitoring and reporting
- Understanding how businesses grow
 - controlling the pace of growth
 - developing property assets
 - moving from grants to loans
 - building reserves, reinvesting profits, managing taxation
- Evolving governance and management arrangements as circumstances change
 - evolving constitutions
 - board recruitment and retention
 - company membership
 - management succession
- Operating with social objectives
 - handling community/business tensions
 - community participation
 - user involvement in governance.

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Table 1.2: Establishing different types of trading organisation step by step

Action	Guide section	New and small-scale trading organisations	Community organisations generally	Existing and prospective charities
Get started				
bring people together	2.3/2.4	form a broad-based group	attract wider support	involve partners
decide your basic aims	2.5	essential	essential	essential
explore business idea/s	2.7	draw up a list of possibilities	draw up a list of possibilities	consider several options
form a partnership	2.4	advisable	if appropriate	if appropriate
get help and advice		essential	if necessary	if necessary
consider charity status		is it an advantage?	is it an advantage?	will trading affect status?
Investigate business ideas				
do back-of-an envelope costings	2.7	✓	✓	✓
identify markets, competition	3.2	✓	✓	✓
feasibility study	3.2	✓	✓	✓
Decide on constitutional structure				
get a basic constitution	2.4	✓	-	-
decide the trading structure	4.2	✓	do you need a subsidiary trading company?	
develop ideas for 'community ownership'	2.5	if necessary	✓	possibly

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Action	Guide section	New and small-scale trading organisations	Community organisations generally	Existing and prospective charities
Get a business plan				
decide who will do it	3.2	✓	✓	✓
get advice, expertise, or funding for a consultant	3.2	✓	✓	✓
involve your team in planning	3.2	✓	✓	if appropriate
Prepare the organisation				
fund raise as necessary	5.1	✓	✓	✓
identify members of trading board; provide training	8.4	✓	✓	✓
register trading company	4.1-4.6	recommended	recommended	recommended
consult accountant	4.6	if appropriate	discuss plans with accountant	
Prepare the business				
develop a marketing plan and put it into practice	4.2	✓	✓	✓
appoint the manager	8.3	✓	✓	✓
set up business finance systems, VAT, insurances etc	6.2	✓	new systems probably essential	
set up business reporting	6.4	✓	new system probably essential	
set up accommodation		✓	✓	✓

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Action	Guide section	New and small-scale trading organisations	Community organisations generally	Existing and prospective charities
set up quality control system	8.1	✓	✓	✓
appoint staff	8.3	✓	✓	✓
try pilot trading or a small-scale start up	3.2	often advisable	if appropriate	if appropriate
Manage business growth				
maintain community involvement	8.5	✓	✓	if appropriate
involve users in governance		if appropriate	if appropriate	if appropriate
move from grants to loans	7.2	as necessary	as necessary	as necessary
consider developing property assets	7.3	recommended	recommended	recommended
keep business and charitable activities separate	6.2	as necessary	essential for charities	essential
handle tensions between social & business activities	8.1	be ready to act	be ready to act	must be avoided
plan leadership succession	8.4	recommended	recommended	recommended

2: First steps

2.1 Why start trading?

This section untangles the many benefits of running trading activities so that groups can clarify what they are trying to achieve, and distinguishes some of the things which trading ventures can't easily achieve.

What trading organisations *can't* do

The need for a sense of proportion: Trading is not a panacea. Since the idea of social enterprise arrived on the political agenda, we have been confronted with the risks of hype and distorted visions of its potential benefits. There have been appalling misrepresentations of the potential of voluntary organisations to run businesses, and these always need to be refuted to protect the inexperienced from making damaging mistakes. Although there are always a few success stories, here are some of the things community and charity is usually *not* good at:

- **creating sustainable jobs in disadvantaged areas:** Third sector trading rarely creates large numbers of sustainable jobs, especially in community-based groups in deprived areas. When lasting jobs are achieved they should be a cause for celebration, not just a routine tick on a monitoring report. This is because, as

with conventional enterprise in disadvantaged areas, jobs come and go with grants and market conditions.

- **creating well-paid jobs:** Work is often low paid, and this is exactly what we should expect when jobs are created in marginal activities and in places with limited economic opportunities.
- **replacing grant-funding jobs:** Many conventional businesses have a tough time generating enough income to keep their own employees in jobs. The idea that modest voluntary organisations will be able to run businesses which make so much profit that they can divert cash to provide salaries for community and social projects is ambitious and unrealistic in the current climate. Yet this view is sometimes put forward as an argument for trading. For many voluntary organisations trading is always likely to be an additional income stream to their other activities.

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- **donating all its profit to charity:** Any organisation which gives all its surpluses away will have nothing to reinvest in its own business activities. It will not be able to grow, and it may stagnate and fail.
- **providing quick solutions to immediate funding problems:** Although there certainly are ways in which business can help

to sustain existing social and community projects, you should be extremely cautious about predicting when you will see the benefit. It can take many months to get a venture started and it is likely to be several years before there are significant trading surpluses. (In fact, if you need help in a hurry, it's probably already too late for a new business to save you.)

How hard is it to support social jobs? A rough calculation should demonstrate how difficult it can be to use the profits from trading activities to support jobs in social and community projects.

Let's say a successful community organisation wants to use its profits to replace grants for one job with a salary of £20,000. The actual cost of the post, with overheads, is likely to be in the region of £25,000. The business can't give away all of its profits – it may need to retain £10,000 or more of its annual profits to cover future investment in the business, staff redundancies and possible emergencies. So it needs a profit of at least £35,000. If the healthy and somewhat unlikely profit margin (which is calculated by the cost of operating the business minus the value of sales, divided by the value of sales multiplied by 100) is as high as 30%, it would be necessary to have sales of £117,000 or more. With a profit margin of 20%, sales of £175,000 are needed.

That can be a significant amount of trading for a small enterprise. But the real world tends to make things even more difficult:

If any corporation tax is payable on this the required level of sales naturally goes up.

- Then add in the human factor: what are the staff in the business saying about their own wage levels if the profits they are producing are used to employ a non-income generating worker? Hopefully they can appreciate the social benefits. But what if the new job pays more than they are getting?
- Bear in mind too that, although it is absolutely vital to aim to make a profit, most third sector trading organisations in the real world are happy to break even initially, and would not expect to make much profit at all in their early years.

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The real benefits of third sector trading

Types of benefit: Having dismissed the hype and misconceptions we can start to be more positive. The genuine advantages of trading can be enormous. You just need to be clear why you are doing it. The benefits can be divided into two main types:

- the direct impact of the trading itself, such as caring for elderly or disabled people by running a day centre which no one else is prepared to provide
- the indirect benefits of trading, such as creating new economic activity and jobs, irrespective of what type of business is involved.

Direct social benefits:

- **Services not provided by the public sector:** Voluntary organisations have been less active in providing social care than was expected when the private sector involvement in care for the elderly expanded dramatically in the 1990s. But when they do, they commonly claim that they do so because they believe their services are better than those provided by the private sector (which operate with the aim of making a profit) and public authorities (whose overheads are often higher and may be partly hidden).

- **Buildings and services devolved by the public sector:**

Government policy, economic pressures and public spending cuts are encouraging local authorities to transfer the delivery of some services to community groups. Community centres are in the front line of this movement. It is obviously vital for groups taking responsibility for community buildings to have:

- a business plan which shows how they can be run sustainably, or
- a sound contract with the authority (supported by a business plan) for providing the service, which at least covers the costs of the annual deficit.

- **Preserving vital services:** It is not uncommon for community groups to step in to take over services in rural areas (and occasionally in seriously disadvantaged urban areas) which private operators no longer find viable – this includes shops, post offices and pubs.

- **Making community buildings and services sustainable:**

Where buildings are already owned by community organisations or charities it is becoming increasingly important to operate them as businesses to replace disappearing grants and meet rising operating costs.

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- Community centres and village halls may need to become much more involved in their local neighbourhood to accommodate rent-paying users and stimulate the formation of new user organisations
- Sports and leisure facilities may need to be more enterprising to accommodate a wider range of activities and more users.
- Another way to run community buildings as businesses is to accommodate permanent rent-paying tenants which offer essential community services – bringing the defunct local post office into the village hall is a classic example.
- **Formal training:** Community and charity organisations first came into training as a widespread marketable service (often under contracts with educational bodies, private training agencies or local authorities) as long ago as the 1980s. Training is sometimes a profitable business to be in, but it is now highly competitive.
- **Managed workspace to foster economic development:** Managed workspaces and nursery units, which provide a protective environment for nurturing new businesses, have been a significant part of community trading in the UK. But community organisations in Wales have historically been less involved in acquiring and running this type of asset, although there are notable examples such as Gorseinan Development Trust, which runs Pentre Menter Enterprise Village, leased from 3M.
- **Environmental and alternative technology projects:** Some third sector organisations are struggling to find a foothold among new 'green' businesses, because they need to operate on a small scale and to compete with private sector companies (or establish complex joint financing partnerships with them). There may be a pioneering motivation to reduce waste, conserve energy or find less environmentally damaging alternatives. But there is increasing evidence that power generation schemes can be a way to make profits which are large enough to fund community projects.

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The indirect benefits of third sector trading: There are many other ways which enterprises can trade with a 'social purpose'. Here are some of them:

- **Fund raising for core charitable purposes:** Like local community organisations, charities of all sizes with more specific purposes and beneficiaries are increasingly being forced to engage in commercial activities. They do so by:
 - Competing for contracts to deliver services to the people they aim to help.
 - Running charity shops selling donated goods; these are the most obvious and well-known examples of trading which is intended to provide money directly for charitable activities, and they often have an advantage because the public is keen to support their charitable aims.
 - Running trading activities connected with their premises – museum shops, the cafes and restaurants at National Trust properties for instance.

- **Funds to support community and social projects:** The vulnerability of community organisations to changes in grant funding regimes is now the biggest motivation for trading. It is not profits which have the biggest impact in the early days, but the simple capacity to attract extra income. Even quite marginal social enterprise businesses which run alongside existing 'parent' community initiatives and charities can contribute cash directly by:
 - paying rent and sharing underused buildings
 - sharing joint costs such as building maintenance
 - paying for or sharing the costs of equipment, IT services and maintenance contracts
 - making extra staff available to provide services jointly and less expensively – caretaking, cleaning, book keeping, payroll services, general administration for instance.

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- **Improving the effectiveness of charities and community groups:** Trading can have a massive impact on the effectiveness of the parent body by
 - introducing more business-like management practices throughout
 - widening the range of specialist management skills: just one new management job can bring in an array of new talents, often in areas such as business and personnel management, and finance
 - improving the flexibility of staff at all levels simply by making more people available
 - improving technology and other resources – eg by making new shared equipment available.
- **Job creation:** Intermediate labour market projects, social firms and some community businesses are established wholly or largely in order to create jobs and training opportunities for unemployed people.

- **Informal training and personal development:** It is seldom a primary motivation of trading organisations to improve skills and confidence by creating voluntary work and informal training opportunities. But this is one of the most widespread, immediate and effective products of 30 years of community development, both in deprived communities and among charities serving the needs of disadvantaged groups of people. Far from being second best, this type of training is frequently the only viable building block for lives blighted by high unemployment and social isolation which mainstream government schemes have failed to address. Beneficiaries frequently include:
 - young unemployed people
 - adults who have experienced redundancy
 - women returning to the labour market
 - unemployed people from ethnic minorities
 - people with learning and physical disabilities
 - people with mental health problems.

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- **Building assets for long-term security:** Owning building assets such as managed workspaces is now recognised by the UK government and the Development Trusts Association as a major tool in creating sustainable community regeneration organisations. See section 7.3. Any building asset brings risks (in the form of maintenance and affordability). But they can also bring multiple benefits which contribute to the sustainability and freedom of their owners which most charities and community groups find difficult to imagine:
 - regular rental income from tenants, some of which can be used to support social and charitable activities
 - flexibility and space to accommodate new business and social projects as they are developed
 - a sense of independence from the control exercised by public bodies and grant funders
 - a capital asset against which money for future capital developments can be borrowed
 - (sometimes) a saleable asset which could be disposed of to realise significant income.

Trading by communities of interest: The inherently co-operative nature of the third sector ethos lends itself to business enterprises which involve people with a common interest, rather than a common geographical community. Examples include publishing, drama and entertainment, craft marketing co-operatives, environmental initiatives, horticulture, and even (for a brief period in a unique Scottish example) amateur weather forecasters. The commercial ventures which collaboration produces are remarkably diverse. The broader social benefit is often obvious even when it is not the main motivation, for instance:

- co-operatives of publishers and actors foster local cultural or community understanding or involvement
- farmers group together to sell their products for personal profit, but by doing so help to preserve the viability of rural communities.

Some examples of third sector trading

Services not provided by the public sector: These include:

- **Facilities for elderly people:** Some care homes are run by charities, and other innovative projects have emerged to provide day care facilities for the elderly (eg Caia Park Partnership's Deva House project in Wrexham). Income comes variously from private fees and charges, contracts with local authorities.

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- **Projects for people with disabilities:** Council social service departments have often been happy to contract with development trusts and other charitable and community groups to deliver projects which provide social and employment opportunities for people with physical and learning disabilities.
- **Childcare:** A few years ago some community groups were developing nurseries for pre-school age children. The market has declined since schools started to provide nurseries for three- and four-year-olds, and the third sector is in competition with private nurseries. Efforts to run fee-charging after-school clubs as self-supporting enterprises are proving problematic.

Services abandoned by the private sector: Classic examples are village shops and post offices. Rural transport schemes, petrol stations and pubs are sometimes seen in the same light. For example:

- The community in Llanbadarn in Powys, conveniently located on a main north-south trunk route through central Wales runs a shop, post office and petrol station which they took over when a private business closed.

- The Blaengwynfi Community Co-operative took over the running of the local grocery store in the remote Neath Port Talbot village of Blaenllynfi in the 1980s when the Co-operative Wholesale Society pulled out. The shop is still open and plays a major part in community life.

Community recreation and leisure:

- Cwmaman Institute near Aberdare in Rhondda Cynon Taff is one of the largest of many older community buildings which have been adapted to accommodate gyms, cinemas and theatres and other income generating activities.
- The Tonmawr 2000 gymnasium in the isolated village of Tonmawr near Neath is an unusual example of a purpose-built resource which was established using Welsh Office funding in the early 1990s. The challenge of sustainability was addressed by using rental income from letting adjoining unit factories.

Environmental and alternative technology projects:

Successful initiatives – Ecodyfi's wind farm projects, Dinas Mawddwy community biomass heating, Talybont-on-Usk community hydro scheme – are spreading rapidly throughout Wales and some are successfully generating income.

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Business to support social projects: Cwmbran Community Press, which ran from 1974 to 1989, demonstrates how social and charitable activities can be made sustainable by successful community training. It ran a variety of training, community development and volunteering projects, as well as a long-lived community newspaper, which were supported by a profit-making printing business, book publishing and a bookshop. Its eventual failure was due, as is often the case, to poor business management rather than pressures from its community activities.

Businesses with job creation objectives: Typical examples are call centres, landscaping and housing estate and industrial security companies, where relatively large numbers of unskilled or semi-skilled jobs can be created. The main problem with some of them is the ease with which competitors operating in or on the edge of the black economy can undercut the contract rates of more formally managed community projects.

Charity fundraising: The thrift shops and second hand goods stores run by organisations such as MIND, Barnardos, the St David's Foundation and many others are a common sight on the high street. The Welsh cancer charity Tenovus generates over 60 per cent of its £7.5m income from trading.

Training: Dove Workshop and Glynneath Training Centre, both in remote parts of Neath Port Talbot, are examples of a number of community ventures which have made a successful business out of delivering training. Like other training enterprises, Dove also runs a day nursery.

Using property assets to develop community resources:

- The £7m Galeri workspace and arts and entertainment centre is a social enterprise project on the harbourside at Caernarfon. Behind this purpose-built social enterprise landmark are more than 10 years of painstaking work acquiring and redeveloping shops and offices in Caernarfon for commercial use, followed by the huge gamble of constructing the Galeri itself. This fine project is the definitive answer to the many sceptics who are still not convinced that asset development is the right way for social enterprise to progress.
- Westway Development Trust was established in 1971 to upgrade 23 acres of development land beneath the M4 in Kensington and Chelsea. Its astute development of land and buildings have created community-owned workspace and facilities for sports, arts and education, and made it the richest development trust in the UK.
- Dee Valley Community Partnership in Cefn Mawr, Wrexham, has embarked on buying and leasing, renovating and letting properties to bring the pulse back to the heart of the former industrial village.

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2.2 The very beginning

If you're going to be involved in a successful third sector trading organisation you will need to be focused, determined, resilient and inventive. This guide can't tell you everything you need to know. That's because the experts in your business have got to be you and your colleagues. But let's start with what you need to be thinking about and what to look out for.

Before you start

Points to bear in mind ...

- Social enterprise or community trading is an approach to business, not a clearly defined structure for a type of organisation
- Trading organisations are almost unlimited in what they can do. The imagination and creativity is entirely up to you. This guide can only help you talk through what is involved.
- It will take time – perhaps as much as a year.
- There is no single step by step path which every new enterprise follows. Think of the process as less like following a route map and more like zooming in on an idea from a satellite using Google maps.
- The path you take depends a lot on where you are starting from and where you want to go – so you should be wary about closely modelling your planning process on that of another voluntary organisation.
- Obstacles and disappointments are inevitable – be prepared to work round them.
- If you are starting completely from scratch the process will obviously be more demanding than if you are developing an established organisation. Don't expect instant results.

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Get some basic information:

- Find out more about third sector trading.
 - Download material from appropriate web sites; share it with your group.
 - Visit two or three projects in your area – seeing what others do can inspire you with (completely different) ideas about what you could do.
 - Join networks and speak to umbrella organisations about what you want to do. Their web sites can be mines of information, and there is no substitute for talking to people who have already done what you are planning.
 - Some information you receive may be contradictory. Challenge confusing advice and get a second or third opinion.
- Study this guide
- Discuss the idea informally with colleagues and like-minded people. Get a sense of:
 - what you want to achieve and how trading can help to do it
 - who else you can rely on to support what you will do
 - who else you must involve from the start
 - what resources you will need just to start planning – a meeting place, means to communicate, resources for visits
 - what skills you will need in your group
 - who might try to stop you or dissuade you, whether they have a point, why you should go ahead, how you can avoid being knocked off course
 - what outside bodies or individuals might help.
- Be clear where you are starting from. It might sound obvious but there are huge differences, depending on whether:
 - you are working with an existing voluntary organisation which simply wants to start trading (and faces no obstacles to doing so), or
 - you are working with an existing organisation which aims to set up a new organisation to undertake trading activities, or
 - you are starting completely from scratch.
- Make a plan of the next steps you need to take.

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Three basic questions

Three basic issues: Starting to trade does not fit into a neat step by step process. Many tasks described here will overlap. You will need to return to some steps from time to time, perhaps repeatedly, to get them right or to make your plans clearer and more specific. Above all you need to establish three absolutely basic issues:

- **What the business will be –**
 - what is the need for the enterprise?
 - what will the 'social purpose' be?
 - what will you do to earn money?
 - will anyone pay you? how much?
 - how much will it cost to run?
- **Who will be involved –**
 - who is going to provide leadership to get things started?
 - do you need community support?
 - who will form the group which plans the business?
 - do you need to involve other partners?

– who else do you need to consult?

– who will you ask to advise you?

– how will you form a board?

- **What kind of organisational set up will you use –**

– how will you find out about the options?

– are you starting with any kind of constituted group; (if not, set one up now)

– will you use a registered charity?

– will you need a separate trading company?

– when will any new companies need to be formed?

Setting the priorities: Many people get bogged down at an early stage with concerns about their constitutional structure. In fact, it makes no sense to worry about companies and charitable status before you have worked out what your business will be. And it's hard to do this without at least beginning to bring together a group of people to help plan the enterprise or consulting other bodies about your plans.

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2.3 Involving the community

A small group of people in the South Wales Valleys came up with a bright idea for a social enterprise business to expand tourism. They were convinced it was needed, but they were frightened that people responsible for tourism development in the area would try to stop them. So, despite persuasion by social enterprise support workers, they were reluctant to go public with their enterprise proposal or consult others about it. After a lot of planning but little action, they learned that another local regeneration project was pursuing a similar trading idea without them. They were shut out of the project, as they had originally feared – not because they had consulted with the community, but because they hadn't.

Why involve the community

When it's useful

- Most enterprises benefit from community or public support, if only to ensure they can attract customers. For many it is absolutely essential.
- Even if you are promoting a project with a narrow remit, obscure social benefits and no specifically local affiliations (as in the case of some specialist charities) you should still consider the potential benefits of consulting with the wider public or involving outsiders as advisors and directors.
- Don't be a control freak. If you are going to do it at all, do so from the start while there is still room to incorporate clever, imaginative and innovative ideas in your plans.

The benefits: 'Involvement' in this context means getting people who have an interest in the activities you are proposing or the social benefits you are hoping to achieve to contribute, views, ideas, knowledge, skills or practical help to planning and establishing the enterprise. Community involvement can give you:

- evidence of support and engagement, which most funders demand
- local or specialist knowledge of the market for your business
- information about the needs you are trying to meet; evidence for funders that you have researched those needs
- your first board members

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- a pool of future board members to draw on in future as directors change
- opportunities to recruit other volunteers
- supporters to help make your case and open doors
- business contacts
- specialist knowledge and skills to run the business
- ready access to (sometimes free) professional help
- a visible and genuine sense of purpose to motivate your efforts
- validity for your efforts
- feedback: a measure of your impact, and free ongoing market research
- a degree of protection if there are serious internal disagreements.

Going public: holding community meetings

The aims: The work really starts with the first formal planning or consultation meetings. The aim of these is to:

- share your ideas with residents, local organisations, potential supporters and other interested parties
- sound out views and get people to voice support
- keep interested people and bodies informed
- define the geographical area the project will serve
- identify or confirm the needs of the community or other beneficiaries, and how the enterprise can help
- identify possible sources of assistance and funding
- begin to form a broadly-based project steering group to help with planning and developing the enterprise.

Tips on bringing people together: Going public can be worrying. But this is not a time to be shy or defensive.

- Send invitations to named individuals and organisations to come to an 'open meeting'. A fully 'public meeting', may be difficult to handle and unproductive.
- Distribute invitations widely, and suggest that these are passed on to other friends and colleagues.
- Target individuals as well as officers and representatives of local community organisations and public bodies.
- Invite potential opponents too. They can help you to evaluate the difficulties you will face, and shutting them out only gives them ammunition.

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- Circulate an attendance list at the meeting to collect email, phone and address details. Keep a simple database of contacts.
- Feed back notes of each meeting to everyone on your list, including non-attenders.

The agenda for the first one or two meetings might include:

- appointing a chair for the meeting
- a short presentation on social enterprise
- a speaker from another trading project
- a discussion of why a project is needed and its hoped-for social benefits (new organisations will later need to provide evidence of the need for their enterprise)
- the help and funding you need
- next steps and the date of the a follow-up meeting.

Running the start up meetings

- **Have a good chair – someone who can lead and manage the open discussion.** Brief someone in advance if at all possible. (This is about good management, not who holds power).
- **Try to establish common ground**
 - look for consensus, but recognise differences openly
 - acknowledge, but don't be thrown off course by negative views (sceptics often disappear early on; but if they stay with you they can help to keep it real).
- **Be positive and upbeat, but be realistic:** Successful trading organisations can have an extraordinary impact. But this may take years to achieve. Be open about this.
- **Don't try to decide too much:** Share ideas and let people have their say. But don't make binding decisions – you will need more information and much more planning later.
- **Keep going:** The only vital decision you need to make at the first meeting is to meet again soon – in two or three weeks if possible – to keep up the momentum.

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2.4 Forming the steering group

The purpose of the steering group: An important early stage for most new organisations is the formation of a temporary steering group whose job is to plan the new trading venture and help to set up its first board. This is useful, even for established bodies and groups of people who are already firmly committed to the trading venture or who don't intend to involve a wider community. It provides:

- A flexible, open-ended forum for discussion and planning which can easily be opened up later to local residents, partner bodies and others.
- A forum for discussing and consulting on your plans.
- A clear separation from any existing community or charitable organisation which is promoting or supporting the new enterprise to start *independently*.
- A dedicated task group which can manage the development of the enterprise *under the control of an existing organisation*.
- A transitional stage before people are required to commit themselves; you can't ask people to become directors of a trading company before they know what it will do or what their responsibilities will be, so you are simply asking supporters to *help to set up the project*.

- Other advantages:

- it gives you time to plan at a pace which suits the people involved
- you can build the team gradually by identifying missing skills and recruiting other individuals before you establish the company
- you can use the steering group phase to start developing the knowledge and skills of potential directors.

Forming the steering group: The membership of your steering group will depend where you are starting from. New organisations and community organisations should try to make the membership as broad as possible. Depending on your starting point, you will may well want to include:

- representatives of the 'promoting' organisation which is helping to get things started
- partners in other organisations
- someone running similar enterprises elsewhere
- people with particular skills

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- individuals and representatives from other groups with similar interests or aims or the community at large
- support workers such as community development staff
- potential users of your services
- local councillors.

Constituting the steering group: There are advantages to new organisations formally constituting their steering group as a simple unincorporated community association. (Your local county voluntary council can provide a basic off-the-peg constitution to give you a group with a committee and officers and some basic rules.) The benefits of this are:

- simple rules for meetings and membership etc help meetings to run smoothly and prevent arguments
- running a small community organisation is good training for inexperienced members before they take on the responsibilities of directors
- a constituted group can apply for small grants for items like stationery and meeting expenses, or for consultancy work for feasibility studies and business plans.

Keeping up the momentum: After the first one or two meetings you should start some serious planning work together. This helps to build a team with shared objectives and understanding. You will need to:

- Hold meetings regularly and frequently to keep up the pace – every two weeks is usually best at this stage, monthly is too infrequent.
- Keep meetings open to newcomers, even if you have a constituted committee.
- Encourage a mix of people to take part – the best planning is done by people with a variety of different backgrounds and interests.
- If key people are missing send them personal invitations or try gentle persuasion.
- Set the right pace:
 - map out the tasks you need to get through and set yourselves targets
 - work at a rate which most people feel comfortable with
 - don't go too fast, but don't repeat discussions just because someone has missed a meeting

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- deal with frustration effectively (someone is almost certain to complain that you are not progressing fast enough, or that you are becoming a talking shop); so explain why the planning is necessary and how the process works elsewhere
- going too slowly can destroy morale, so if the pace is dragging get advice from someone who has seen the planning process elsewhere
- Listen to the comments of sceptics, but don't be deterred by them.
- Aim high, but be open and realistic about the challenges – colleagues will eventually feel let down if you encourage them to believe they can achieve the impossible.

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2.5 What is the trading for?

***The dangers of depending on telepathy:** It is commonly assumed that defining the community benefit objectives of a new project is so simple a task that it can be performed telepathically, that is, without bothering to discuss them with colleagues. In practice, if you simply assume that everyone agrees on your objectives, sooner or later someone will introduce contradictory aims. That causes confusion and conflicts. One enterprise in a Powys village was so ill-defined when it got started that the group of farmers involved believed, with good reason, that they were part of a marketing co-operative, and would share all the financial benefits among themselves. Others in the community were less sure how profits were to be used. The result was distrust, recrimination, a dismal leadership failure, the waste of a huge amount of grant money, and the collapse of a great business idea.*

Points to bear in mind

The twin purpose: Trading organisations for social enterprises are distinctive because they have two main functions to achieve simultaneously – running a successful business and creating some type of social benefit. You need to plan for both. And you should definitely *distinguish between them* if you want to do both jobs properly.

First steps to the business plan: In your first meetings you need to start pinning down what you are going to do and why. This will provide raw material you will need later for the larger job of producing a business plan or development plan (see Section 3).

A good business plan will require:

- evidence that the project is needed
- evidence that the project is financially achievable and sustainable.
- a clear long-term purpose or vision'
- objectives and goals you can measure
- business activities (including priorities you can manage)
- operational and financial targets you can monitor and use to measure progress.

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Clarifying your ideas - your vision, aims and business: Most steering groups necessarily start with only vague ideas of what they want to do and gradually arrive at a definite, collective idea through planning and discussion. Here is a checklist of questions which can help to guide the process:

- what is the need for the enterprise?
- what will the 'social purpose' be?
- what do you want to change or achieve in the long term?
- what can you realistically expect to achieve within 3 to 5 years?
- what will you do to earn money?
- will anyone pay you? how much?
- how much will it cost to run?

Why all the chat? You may personally find that the answers to the questions above may be very straightforward. But sometimes it can be difficult to be specific or to reach agreement in the group. You are storing up problems for later if you are not clear where you are going and if there is not a fair consensus about this at an early stage within the steering group or the organisation as a whole.

Be clear about the needs

Aren't the needs already clear?

- The need for the proposed trading activity may seem obvious. But a careful analysis of the community or charitable needs you are aiming to meet can be important for deciding who will benefit from your enterprise and how you run the project, or for persuading funders to support you.
- For regeneration organisations such as development trusts it can be confusing and even contentious if you don't acknowledge that you are trying to address a variety of social and economic needs simultaneously, and that they may need to be prioritised.
- Aiming to meet a range of different needs can be good practice – it brings in more potential board members, supporters and funders. But make sure everyone on the steering group knows where they stand.
- Take the simple example of a recycling project which will employ people with learning disabilities. Will it trade to create permanent jobs for people, to develop skills and confidence, to provide environmental benefits, or to maximise income to keep a worthwhile social project afloat? Or will it do all of these things? Without a clear view the business may end up with the wrong contract terms, poor staffing arrangements and an inappropriate board of directors.

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Get consulting: There is no one way to document the needs of the people you aim to help. Here are some suggestions:

- Set aside a meeting of the steering group to brainstorm members' views.
- A larger open community consultation meeting has benefits of generating more community support and giving more valid results (but be careful you don't raise expectations you won't be able to meet).
- If you have the resources consider a planning for real' exercise, where residents are helped to create a model of the changes they would like to see in their community.
- Some social groups can easily be overlooked – you may need to take special steps to find out the needs of disabled people or single parents for instance, who can't easily get to meetings.
- Check what previous research has been done; invite the researcher or the commissioning organisation to come to a meeting.
- Census and health figures and other government statistics can give an excellent idea of the needs of communities and groups of people – they are available on the internet from the Office of National Statistics (www.neighbourhood.statistics.gov.uk) and the policy or economic development section of your local authority have digests of statistics which you may find useful.

- New organisations may need to carry out a community survey with questionnaires (but don't duplicate what's already been done).
- You may employ a researcher or consultant to carry out a feasibility study or write a business plan: pool the results of your own consultations, and if you are paying them to consult, check that they sound out the right people.

Be realistic about 'needs': Keep discussion of community needs balanced and realistic.

- Are you being objective? It is easy to make assumptions about people's needs without checking the facts.
- Are you being swayed? Campaigners may exaggerate the needs of particular groups of people they support; be careful that this does not produce an unbalanced view.
- Are you mistaking wishes for needs? While it's entirely right for people to want to improve the quality of their lives, funders and supporters won't necessarily think everything they ask for is a serious need.
- Are you setting achievable goals? While local authorities are bulldozing swimming pools, there's no chance of residents getting a sports centre in every village. But what about enterprises that make better leisure use of existing local buildings or transport to venues further afield?

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- Are you making it too complicated? Maybe the need is simply to make existing social or charitable activities more sustainable, and the nature of the business you will run is not too important provided it generates income. That's 'social enterprise' too.

Putting your social objectives in writing

Tips on defining community benefit objectives: When you are clear what needs you will be meeting, you can set about defining your 'social objectives' in a form that your steering group, potential supporters, parent organisation and community can understand and sign up to. Unless you can put it in writing there's not much chance that you'll be able to communicate what you are doing to others. Here are some suggestions.

What to do: Aim to produce a list of each type of community benefit which applies to your venture.

Why? You can't start a charity or a Community Interest Company without specifying what you want it to achieve. It is common sense to treat social enterprise activity in the same way.

When? The best time to define your social objectives is early in the life of your steering group. You can use the discussion as a team building exercise which everyone can contribute to.

How?

- **Be systematic:** Allocate time to the discussion. Take notes and circulate a summary afterwards. Discuss your conclusions briefly at the next meeting to confirm what you have agreed.
- **Be specific:** Aim to write an easily understood list of the social and economic benefits you want to achieve.
- **Be realistic:** Use the exercise to reach agreement on what you can realistically achieve. Make sure that individual objectives are not contradictory.
- **Don't confuse objectives with 'mission statements':** Mission statements are generalisations designed to persuade people that you have detailed objectives (even if you haven't!).
- **Be comprehensive:** Don't limit yourself to saying what you will do with your profits. Many trading organisations have broad and flexible social objectives. List them all (economic, social, environmental, cultural), and the ways you will achieve them (eg through the services or goods you will sell, your employment practices, your environmental policies etc).
- **Prioritise:** Put your objectives in order of preference if you can, to guide you later on targeting your efforts and resources.

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- **Set first and second division objectives:** Make a clear distinction between things which you can and will achieve from the start, and other desirable objectives: eg, generating rental income from renting space in your building could perhaps start almost immediately, but aiming to make enough profit to employ a fundraising officer is a longer term goal which you may never realise. If you don't separate objectives in this way your community business may always appear on paper to be failing.
- **Get consensus, not agreements written in blood:** Treat the exercise as descriptive not prescriptive, as clarifying your collective purpose, not laying down policies. Small differences of opinion do not matter as long as there is general agreement on the main objectives.
- **Publish:** Use your list of community benefit objectives to let people know what you are doing – in leaflets, reports, information you give to staff and volunteers etc.
- **Review:** Your list of social benefit objectives should not be fixed for all time. New ideas and approaches may evolve spontaneously, especially if you are successful. Others may simply prove impractical. So just junk them. If you undertake any form of social auditing or annual review or evaluation, the process of revising your objectives should become automatic.

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2.6 Should you be running a business, anyway?

Third sector trading activities are often started by people with little or no business experience who are not very interested in making money. Then they try to put poor trading ideas into practice and wonder why their community café is a failure. This chapter deals with the simple first steps of deciding whether you really want to run a business.

Understanding business: Before you plan any type of trading it is important to understand what you are getting into and why. Some of the main issues which your group will need to deal with are:

- recognising the value of a businesslike approach even for small-scale community-based trading, and
- accepting the necessity for a serious commercial approach to development, big or small
- overcoming anti-business prejudices in your group, your parent organisation or the wider community
- being prepared for the difficulties and sheer hard work of running a business
- evaluating trading ideas thoroughly before you start
- understanding the common ground and the differences between conventional businesses and enterprise activity (no, they are not the same, no matter what some advisors say).

Time for a reality check: It's time to take a close look at what you are thinking of doing, to make sure you are not about to make a seriously painful mistake. The issue now is whether you are prepared to make necessary emotional adjustments, practical concessions and difficult judgements necessary to give you the best chance of success, and to avoid the most common causes of failure. So:

- do you want to run a business?
- can you work out what businesses to avoid?
- do you really want to make money?

If the answers are 'no', maybe you are not ready. Few questions in social enterprise development are as challenging to the way your organisation operates and relevant to your eventual success or failure, yet as apparently daft, as: 'do you want to make money?' The only sensible way to start is to spend some time thinking about the implications of this question for what you want to do.

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Do you really want to run a business?

Burying anti-business prejudices: It is possible (though much less likely than it was just a few years ago) that some members of your organisation or the community will be hostile towards or sceptical about a voluntary organisation which is planning to run a business. (You may encounter similar negativity and dubious advice, for completely opposite reasons, from members of the business community.) Bias and ignorance within the third sector – from those people for instance who argue that you should make ‘business’ subservient to ‘community’ – is one reason why the performance of third sector trading has been rather disappointing for the last 30 years. It’s time to sideline the sceptics and have confidence in what you are doing:

- Don’t be ashamed of making money if your aim is to make your organisation or your community better off.
- ‘Profit’ should not be a dirty word for community trading organisations – *if you only aim to break even you risk the business failing completely the first time you hit a rough patch.*
- Business is only unethical when it’s run by unethical people.
- Business activity is not necessarily incompatible with the needs of disadvantaged people and communities – an open-all-hours corner shop can easily make a greater contribution to the

social and economic wellbeing of an area than a poorly used community centre.

- Community based trading activity is not incompatible with ‘community development’ as some purists used to argue; in fact it can educate, raise confidence, foster skills and create opportunities for people just as effectively as conventional development work, and *very often do so faster.*
- The complaint that businesses tend to exploit their workers is not easy to refute, especially when you are operating with your backs to the wall; but social enterprises
 - may offer greater worker democracy, fairer treatment, and a commitment to improving conditions and pay if and when financial circumstances allow, and
 - may, if all else fails, give workers reason to feel less oppressed, and sometimes even happy, when they *are* exploited.

Hard work and small rewards: People starting out in social enterprise sometimes delude themselves that the experience will automatically be better than work in conventional business, or that their life will be much as it was while they were working for a public body or a charity.

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In this key respect a successful social enterprise business has to be like any other business – challenging, hard work, complicated, and quite possibly insecure, and hopefully personally rewarding in the end. Don't bother starting a trading project if you won't be able to staff it with people who are prepared to work hard for modest pay.

It's an idea, but is it a business?

Starting from ignorance: It's useful to start from the assumption that you don't really know what you're doing, but you are prepared to find out. Countless new third sector trading groups fall prey to over-enthusiasm and self-deception because they fail to make the simple distinctions between:

- providing a service and running a business
- business *possibilities* (things they could do) and business opportunities (enterprising ideas which might work)
- enthusiasm for an idea and knowledge of what it actually involves.

Some wild and damaging misconceptions: Community groups and charities on the whole make pretty poor decisions about the trading activities they get involved in. Let's start by exploring what it probably shouldn't be. Before you finally establish what your trading activity will be, here's what you should *not* be thinking:

- **We have the expertise, we have the technology...** It obviously helps if you have the skills and resources you need to run a business. But those advantages have no bearing whatever on whether customers will part with their money. You need more than a well-equipped kitchen for a successful catering business, more than a unemployed horticulturist to run a plant nursery, more than a computer to run a print design service.
- **Wouldn't it be nice...** Enthusiasm for an idea is a great help if you try to turn a private hobby into a trading venture. But without objectivity and the involvement of people with many other skills and interests it can also be a handicap. Groups of railway enthusiasts, for instance, may struggle for years to reopen extinct lines. But very few of them ever run successful railways.
- **There's a need, so there must be a market...** A particularly common delusion is that if there is a demonstrable need for a particular service, there is bound to be a *demand* for it. A realist might advise that the needs probably exist *because there is no commercial demand*. A good example are children's nurseries: many of the people who need daycare most to improve their employment prospects could never afford the rates that a viable business would have to charge.

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- **Grants are available...** Special grants schemes are sometimes introduced to encourage people to set up particular types of service. But it can take a wizard to turn a temporary financial cushion into an effective investment on which to build a permanent enterprise. In many cases there is no realistic business prospect, no matter how much people wish there could be – as funding for community transport or after school clubs have often shown in the past.

We think it's viable, therefore it is: The most dangerous delusion is the QED approach to developing a business.

- Almost anyone who comes up with a business idea to which they are totally committed can prove that it is definitely going to be viable – to their own personal satisfaction, at least.
- Even when its disastrous fallibility is repeatedly pointed out, they will brush objections away as minor blemishes in an otherwise perfect idea. This remarkable human talent, which is closely allied to being able to prove that black is white, is utterly lethal for business planning.
- Left to their own devices people using the QED approach will also demonstrate that the business will be easy to run and it doesn't really need a business plan. They must be stopped (or at least politely dissuaded) at all costs.

Do you want to make money?

Financial motivation: Third sector trading organisations don't necessarily have to be motivated by the idea of getting rich. *But your business must be led by at least one person who is keen to make money.* Their impulse will perhaps be creativity or power or greed, and they will always be weighing up the financial consequences of their actions – new orders won, expenditure incurred, investments made etc. Without this drive it is much more difficult to be successful.

Management, making money and morality: Not everyone involved will share this motivation. So what is the role of those of you who are motivated more by the prospects of social benefit than the opportunity to accumulate wealth for the business?

- When your business is established you will need directors who can ensure that it is run within the law, and if the business is part of a charity there will be additional constraints; so you are not unleashing a free-for-all.
- Directors also need to ensure that the business is run 'morally', ie honestly and fairly, and that it conforms to the standards which the company lays down.

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- On the other hand, the purpose of the business is to make money, so policy and management decisions should never obstruct this without good reasons.
- Managers must be allowed to exercise business judgements and take risks, often at speed – when they make deals, set charges, make investments, manage debt etc – and not necessarily be limited to a more cautious third sector approach.
- Beware of the appealing high moral view that business is unrestrained and potentially corrupt, and the third sector always looks after money well; sometimes it doesn't.
- If you are really concerned about the ethics of money making, maybe you should stand aside.

Should we gamble with other people's money? Most new business start ups fail within two or three years, including many well planned ones where the proprietors seemed to know what they were doing. So should you be gambling with money which belongs to other people – public funds, community resources, or the assets of charities set up to benefit others? There's no right answer. But if this question bothers you, your approach may be over-cautious. If you safeguard money too carefully, you may not be very good at making more of it.

Bloody-minded leaders: One of the great joys of social enterprise activities is that it is sometimes possible to build sustainable enterprises with apparently hopeless trading ideas and no business knowledge – through sheer bloody mindedness and commitment. Then it is a matter of strong personal leadership (which is dealt with in Chapter 8). But you usually don't need to dig far in these cases to find that ambitious entrepreneurship and a drive to make money are the factors driving success.

2.7 A practical guide to selecting business ideas

A community-based training organisation in a semi-rural area wanted to develop business activities to create jobs and work opportunities for their trainees, and they had four cherished trading ideas which they hoped to pursue. They asked a support agency for funding, but some quick calculations showed that a launderette and a transport business were very unlikely to be viable. Though disappointed, the group concentrated on the remaining two possibilities, and launched them after carrying out feasibility studies. Their catering and child care businesses ran for almost 20 years. Their judgement in picking two sound prospects from a longer list which included duds was undoubtedly a factor in their success – though the funder's advice clearly helped.

Overview:

This chapter describes a process for selecting business ideas from a list of possibilities, which is well suited to the third sector.

Is this really the way to start a business? Don't worry that the following approach may be considered hopelessly unbusinesslike by more single-minded private enterprises. Conventional businesses are more likely to start because people have stumbled on one good idea, or they want to set up independently in the same business as their present employers. Community organisations and charities need a different approach because their needs are quite different.

- They mostly start trading because they want or need to generate income, *in any way which is appropriate*; so they may have several options to choose from.
- They work in areas and in activities where profit margins are *narrow* (because their communities are deprived or their clients and users are vulnerable or disadvantaged); so they need to weigh up carefully which, if any, possible enterprise is sustainable.
- They are run by individuals whose motivations are enormously varied (securing grants, altruistic aspirations, making better use of existing skills or facilities, pursuing personal interests etc) and may not be business orientated; so they need to be as objective as possible.

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A suggested approach: The steps described below involve:

- **Step 1** – Working as a group to brainstorm a number of different possible trading ideas.
- **Step 2** – Preliminary assessments of all the ideas to reduce the list to a small number of possibilities.
- **Step 3** – Some initial financial calculations to see if *any* of these ideas still stand up.
- **Step 4** – Now stop and plan carefully how you will take your trading idea forward.

Step 1: If you want one good idea, think of several

The general approach: In many cases, including community regeneration projects and development trusts, your aim should be to build up a short list of possible trading ideas for your business. Later you can refine your list systematically to find out which is the most promising, and fix your sights on starting that one.

- If your group starts with no idea at all of what you want to do (except vague things like 'create jobs' or 'improve the quality of life in our community') you will need to have a brainstorming session first to list all conceivable possibilities and then to refine that into a short list.

- Aim for a short list of at least 4 or 5 suggestions *even if you think you already know exactly what you want to do*. If your original idea really is red hot it should stand up well against others, and, if it isn't, the time to find out is now and not later.
- Be flexible, open minded and inventive, especially with ideas which seem to you to be winners already.
- Don't dismiss anything at this stage, even off-the-wall ideas because they just might be winners.

Ask the community: A public consultation exercise (calling a public meeting or circulating questionnaires, for instance) can be extremely helpful for many reasons:

- finding out what types of commercial services and community services people would like to see
- identifying services which already exist – and which you should probably avoid
- producing a hopefully lengthy preliminary wish list to select from
- encouraging your steering group to broaden its thinking, since even unrealistic suggestions can stimulate other ideas
- providing a general indication of whether business markets might exist

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- raising interest generally in the exercise and showing that you are open to suggestions.

Producing the preliminary list: You need to hold a brainstorming meeting of the steering group and others who may be interested or have something to contribute. A meeting of a dozen to 20 people from a wide variety of different backgrounds may work best – local groups and charities, third sector support agencies, businesses, local government. Here are some tips on brainstorming for business ideas:

- Start with a brief resume of social enterprise and why you are doing this.
- Get stuck in to the brainstorming as soon as possible; make it fun and get a buzz going – you get better results when people are relaxed and engaged.
- Ask people to think about *any* activities which could generate income run by the community or charitable organisation.
- Use a flip chart or notice board or wall to focus attention.
- Write down all ideas which you come up with, and periodically back track to recap or tidy up your lists.
- Work together as a group to get the widest range of ideas based on local knowledge – even daft ideas can set other people thinking.
- If there are a lot of you, divide into smaller groups for some but not all of the session; don't allow this to slow down the momentum.
- List the existing commercial and community services and pinpoint any major omissions or any gaps which you could exploit.
- Identify groups of people whose needs are *not* met by those services – are there any trading possibilities here?
- Estimate which of those local services are particularly well used – there may be a demand which is not being fully met.
- Try making a list of all the services or products which the individual members of your group would like to see (a wish list is no guide to markets, but it can produce ideas).
- Then perhaps list the reasons that these ideas would make really bad enterprises (this is not necessarily good for team building, but it can be great for sharpening up your critical faculties).
- Remember that good ideas are often originals - don't always go for the obvious, but of course also beware of the hair-brained.

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Even if you *definitely* know what you want to do: If you think there is only one possible idea you could conceivably pursue, you might be inclined to jump past the brainstorming and refinement process in Steps 1 and 2 below and go straight to exploring a preliminary budget. But you should try to remain open-minded and be careful not to jump the gun. For instance:

- **Planning for associated activities:** If a potential funder or client is offering you a contract to run a day nursery there's probably no point in looking at the possibilities of a gymnasium or providing tourist accommodation. But there might be a point to considering ancillary or associated trading activities. Will your nursery need catering or transport? Will it open up new possibilities for providing training courses?
- **Making good ideas better:** If you really are fixed on a single trading idea you can still use a brainstorming method to make it better. Take the simple suggestion that you should run a 'craft shop'. Could different approaches significantly boost its prospects?
 - Should it be a 'gift shop' instead?
 - Should it sell home-produced or ethnic goods?
 - Is there a place for second hand goods and antiques, specialist and collector's items?

- Could it have an exclusive (green?) theme, or a bias towards particular types of products?

Step 2: Apply some business judgements

Eliminate the non starters: The next step is to start making preliminary assessments of each of your ideas, and ditch the ones which don't stand up against a few challenging questions:

- would anyone pay for it? would you pay for it?
- could there be *enough* people to pay for it to make the activity worthwhile commercially?
- is there competition from other businesses?
- are there any serious obstacles/requirements which will put a block on the idea – premises, equipment, legal constraints, planning permissions, political opposition?
- will users, beneficiaries, clients or the public oppose you?
- if you need capital, is this the kind of venture which will attract grants or loans?
- does your group have the skills and knowledge to run this type of business? how easy will it be to employ people who do?
- is this idea too ambitious for you your first steps into business (could you keep it in reserve for later)?

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You only want one or two: You are strongly advised not to try planning for more than one or two at a time, or to start trading in more than one business simultaneously. If the preliminary filtering still leaves you with a short list of several apparently promising ideas, you will need to refine them further. (The attempts by some groups to launch several businesses in the expectation that one of them will work out is as dangerously ill-judged as trying out several partners simultaneously in the hope that one of them will make a suitable husband or wife.)

- Aim to pick the one which self-evidently offers you the greatest chance of success now.
- If the choice between two or more options is difficult you will have to decide later on the basis of feasibility study research.
- If you end up with 'spare' ideas which are too ambitious\expensive\problematic for the time being, or which are just rather more uncertain, you can build them into a long term 'development plan' to guide future policy and convince supporters that you mean business.
- Resist the temptation to start a multinational before you know how to operate a till. If this is the first enterprise, go for trading which will give you useful experience and prospects of early success.

Step 3: The back-of-an-envelope budget

A very basic evaluation: Next, using no more space for your calculations than you might have on the back of the proverbial envelope, work out whether there is the remotest chance that your business idea will work financially.

- There's one simple question: *could you conceivably earn enough money in the course of a year to cover all the expenditure you are likely to incur?*
- The steering group might try this as a collective exercise. But even if one member undertakes to do this on their own they should feed back the results to the group in full.
- Remember, this is not business planning, just a quick, crude assessment of possibilities. The figures will be approximations, but they should be the best guesses you can make at present.
- It's astonishing how many people wilfully avoid this exercise, perhaps to spare themselves the disappointing truth that their pet idea is really a non-starter. It's vital.
- Don't worry that this initial rough estimate will be inaccurate. So far it's the best information you've got. Something to build on.

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- If you plan to employ an outside consultant to write you a business plan, you will save a lot of time and money by being certain that you have an idea which is worth planning for.
- Even more important, doing this ad hoc evaluation yourselves (rather than passing the job straight to a business planner) *will force you to think about what is actually involved in running the business*. No matter how little or much you know, how accurate or inaccurate your estimates turn out to be, you will learn more each time you refine the budget.

Estimating income: Devise a simple way of assessing your earning capacity. The details will vary, depending on the business, but this gives an idea:

- How much on average can you reasonably charge per sale or for each operation to provide your service? (It helps if you know what other people charge for similar services.)
- How many customers can you reasonably expect per day/per week/per month once you have properly got started?
- How many complete weeks per year (or hours per week) will your business actually be working at full capacity, ie after deducting all the time lost to staff holidays, sickness, maintenance, waiting around etc?

- Now using a simple formula, work out how much you *might* earn in a full year if the business worked at full capacity; this is: your average charges per sale multiplied by the number of sales per week, multiplied by the actual number of full working weeks per year.

Estimating expenditure: Now write down the rough cost of everything you can think of which you will have to spend money on to run your business in the course of a full year:

- How many staff will you need to achieve the income calculated above? if you can't calculate it make a guess (bear in mind that the total number of clients/widgets you can process/make/install/repair/dispatch will be limited in particular by the physical capacity of your staff, the equipment they use, the premises etc).
- How much management and administration staff time will you need?
- How much roughly will you pay each staff grade? So how much, roughly, will your total wage bill be? Don't forget to add about 11% to cover National Insurance contributions and more if you plan to make a staff pension contribution.

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- How much will you spend on the stock or raw materials which you will need to provide the levels of sales or services you are predicting? There may be a rule of thumb formula to make this easier – eg assuming that raw materials make up 50% of the cost of food sold in a café, or that the mark up on goods in your shop will average 30%.
- What overheads will there be for running the business? Your expenses will include the costs of the rent on the particular size of building you will need, heat lighting and water, phones, stationery, maintenance, security, insurances, accountancy, regular loan repayments etc (table 6.1 may be useful).
- Ignore any start up and capital costs for now (for instance on equipment and building purchases); you are not calculating profitability, just whether you might have a business.
- You will probably need to build up a reserve fund for the future replacement of any expensive equipment such as vehicles, so you should count this as expenditure here.

So could it be viable? The next step is obvious. But be careful not to read too much into it.

- Add up all the expenditure and subtract that from the total income to see whether you could be heading for a profit or a loss.
- **If the answer is positive** don't get too excited. Remember that this is only a calculation for *working at full capacity in a full trading year* once you are established.
- **If the answer is negative** you may need to come up with another idea. But if the estimated loss is small, you can go back to the figures and sharpen them up:
 - make the calculations a bit more accurate this time
 - dispense with costly inessentials
 - work out whether you can earn more by doing things differently etc.
- If it looks as if the business might be viable, start thinking how you would convince a sceptical grant maker or bank manager:
 - go over every calculation again, refining the estimates as carefully as you can with the information you have available (this time taking notes which you can refer to later)
 - be less optimistic about the income, be more ruthless about the costs and see how that affects the picture
 - build in some of the obstacles and the difficulties which are certain to arise

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- check the result; if its still showing a huge profit you've probably missed something, so try again!
- So far you have proved nothing. But if you are doing the job systematically and you are committed to making progress, at least you will be beginning to be aware of the hundred and one things you still have to find out before you can get your business started.

Step 4: Time to take stock

Now reflect on the progress you're making ...

Keep a sense of perspective: Your steering group needs to acknowledge that this is an early part of the planning process, and things could still go wrong.

Allow yourselves to be smug: You can take satisfaction from knowing that if your planning has been serious and you've got this far, you are already better prepared than many other more reckless groups.

Keep your values: Some members may feel that thinking commercially means abandoning the charity or the community or losing their souls. They won't if you don't want it to.

Start thinking ahead: The next steps will involve serious effort and expense. Think seriously about what you need to do to make further progress.

Take care: The switch from work in the non-trading third sector to social enterprise is like exchanging a spade for a JCB. They're different tools with the same basic purpose, but one of them requires a lot more careful control to avoid the risk of burying yourselves.

3: Business planning

3.1 Do we really need a business plan?

The funding of third sector trading projects in the UK often does little to encourage well-planned projects, and may even provide a disincentive to serious business planning. The problems with European funding for social enterprise – which seems specifically to have excluded business which might become successful enough to be competitive – is perhaps the most obvious example. This chapter describes what funding applicants are up against, exposes the weaknesses of grant applications which set out to deceive the funders, and shows how inexperienced workers can produce good quality proposals which attract funding and create sound enterprises.

Planning terminology: There is no universally agreed terminology for different kinds of research and planning documents required by funders and produced by project managers and consultants. At the risk of offending purists, here's a rough guide to what the different names mean.

- **'Business Plan':** This is a general term for any planning document, which is now widely used as much for conventional non-trading community activities as it is for commercial activities large and small. It can refer to an overall plan for an organisation or to a specific business activity either being planned or at any stage in its

development. Its precise content is commonly governed by who is intended to read it. You should assume nothing.

- **'Feasibility study':** Strictly speaking this is research carried out to determine *whether an activity is worth pursuing*.
 - It specifically answers questions such as: is the idea practical?', 'is there a market?', 'what will it cost?', 'could it earn enough' and 'can the obstacles be overcome?'

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- In practice the term is often seen as synonymous with ‘business plan’. With good reason: the detailed report of a feasibility study may contain exactly the same information as, or may need tweaking only slightly to do the job of, a business plan.
- But the feasibility study may *not* answer the question, ‘how are we actually going to set up and run this operation?’ So it can be critical at the commissioning stage to make sure that you and your consultant agree precisely on what will be produced. Otherwise you could be stuck with an expensive report which says a business will be viable, but tells you nothing about how to go about setting it up.
- **‘Development Plan’:** The term ‘development plan’ is more likely to refer to the overall or longer term development of an organisation, perhaps where it is too complex or too early to provide financial and other details for every individual activity. It can be useful for a new development trust when it is too early to evaluate individual trading activities or grant sources, or to describe the broad evolution of an existing venture.
- **‘Strategy plan’:** A ‘strategy plan’ or ‘strategic plan’ tends to refer to broader brush thinking than the kind of planning needed to develop an enterprise. On the other hand, business plans (or development plans) should include references to general issues such as the fit with relevant government strategies and the overall direction of the organisation.
- **‘Operational plan’, ‘management plan’ and ‘action plan’:** These may appear as an appendix to a business plan or they may be separate internal documents, to exactly how the business or activities will be developed, managed and administered. The exercise of producing one can be valuable for putting complex or multiple enterprise ideas into practice. They sometimes may be useful for supporting applications for funding and demonstrating that an organisation has the capacity to handle change. They are likely to show how things will work for a specified or limited period of time, but not the reasons for them or the broader and longer term objectives of the organisation.

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What's the point of planning?

Persuading funders: The vast majority of business plans produced by third sector organisations have the single purpose of persuading funders to respond positively to grant applications, and less often, requests for loans or buildings. This is a fact of life (even though this can have a seriously adverse effect on the plans themselves and the quality of the resulting enterprises if the planning is badly handled). But the guidance in this section is intended to encourage organisations to take advantage of the demanding planning stage so that they can get as much benefit from it as possible.

The purpose of business plans: The universal scramble to use business plans to secure grants or loans tends to obscure their wider importance in developing any enterprise – with the result that many organisations go to a huge amount of trouble and expense producing documents which bring them rather limited benefits. You should try to take on board the full range of reasons for business planning:

- to support applications for grants and loans
- to define the purpose and nature of the business, particularly where trading is one aspect of an organisation with wider charitable or social objectives

- to promote your proposal to potential supporters
- to attract and inform new directors
- to understand your markets and provide an assurance of the viability or sustainability of the venture before you start
- to provide financial and operational targets which will be used to monitor progress and guide future action
- before all of this, to provide a drafting *process* which allows you to examine the proposal in fine detail – you can properly understand, design and control the future enterprise.

The benefits of the planning process: The final business plan document and the value of the written material it contains are just one type of outcome of the planning process. Other outcomes are the experience of producing it, and the internal documents which have been produced along the way. Don't recoil when a funder asks for a business plan. Good business planning can:

- help you to clarify your objectives, and to share aspirations with your colleagues
- encourage teamwork among members of your group
- force you to test the prospects for viability with figures

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- tell you whether you can afford to run your business
- alert you to future financial dangers
- help to give you a detailed understanding of your proposed trading activities
- help you to identify new or alternative possibilities and encourages flexibility
- clarify what you need to do and who you need to manage and staff the organisation
- create a blueprint for future development
- provide the targets and measures for monitoring progress
- highlight the weaknesses you need to tackle and the reasons why you may not be successful.

Clarifying objectives: Planning is important for development trusts and other initiatives with multiple social, economic and environmental objectives which may have only a vague idea of what they want to achieve and what their priorities are.

- Defining these issues in writing will help to specify your project to yourselves and to the outside world.

- Working together to write objectives for your business plan will help to cement your group's shared purpose and focus on any divisions which you need to be wary of.

Teamwork: If you have not had the chance before to work together as a team, now is the time to learn about your colleagues and your project at the same time. Planning can be an intensive, practical process which encourages collective problem-solving, collaboration and compromise. With the right approach it will be creative, productive, social and usually enjoyable. [See also section 3.2 on using consultants.]

Understanding and forethought: The more you examine the planned activities and finances the more you will become aware of flaws, problems, limitations, options and solutions. This applies to almost every other aspect of your planning, whether you are fitting staff into offices, work into jobs, or widgets into spigots.

Flexibility: Facing up to real and potential problems which emerge during the planning stage will stimulate you to be flexible and inventive, and perhaps to come up with completely new ideas for generating income or managing your operation.

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Managing the organisation: Don't start with a fixed idea of staffing and board roles. Understanding your trading activities in detail will help to show what staff skills you will need and the employment costs and management involved. This may also reveal what qualities and abilities you need the directors to have and the type of roles they should play.

Managing the future: The plan will be a blueprint for the organisation you want to achieve, and will show you whether your objectives are realistic, and what you need to do to achieve them. It will also provide targets and timetables against which you can monitor your progress.

Self awareness: If you are honest, preparing the plan will help you to confront your weaknesses as a group and the underlying defects of your project, even though you may not always mention these in the document you produce. This could be the last chance you get to do anything about them before they start showing up in your work as practical problems.

Planning to be mediocre

The Emperor's new clothes: Community trading in the UK has been for decades locked into a cynical planning dilemma, where groups can often receive generous grants on the basis of feeble or fictitious business plans which only say what they think their funders want to hear. But this can have disastrous consequences for the credibility of community-based trading. The collapse of the community business movement in Scotland in the 1990s is a classic example of what happens when the Emperor's new clothes are revealed to funders for what they are.

Never mind the plan, let's see the money – six types of cynicism:

There are good reasons for starting this guidance with a description of how to do planning badly. Poor business planning is not going to enrich disadvantaged people or poor communities. And it actually helps to foster the very grant dependency which people are trying to escape from. We need to look first at the obstacles to good business planning created by the grant funding system itself.

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- **If that's what the funder wants...** Bad planning starts with the idea that all that is required is a document which simply says what you think the funder wants to hear. The very best you can hope for is the award of a grant to do something which is quite likely to be impossible (not that you will know one way or another).
- **At least we can produce a good bid:** Most people who attempt to develop third sector trading activities don't bother to plan them at all. They *make out a case for investment* (grant funding). This is normally an impressive description of a business idea with neatly blurred answers to all the tough questions about markets, cost, skills and management. This emphasis on presentation to persuade funders (who sometimes know as little about business development as the applicants) may account for the curious fact that third sector business plans are often much better produced than those for larger scale private ventures, and may be more image-conscious than the real-life businesses they describe.
- **We'll decide what to do when we know how much we've got:** It may appear to save time to deliver an impressive, plausible but invented plan to funders and make it fit reality later if the bids are successful. But that means doing the planning job twice, and going into contortions to disguise your subterfuge when the grant comes through. This barmy behaviour is extremely common.
- **We'll get more if we exaggerate:** A common deception is to inflate dramatically the sum applied for in the expectation that the funder will grant something less which may be more or less what the project actually needs. There's a lot to be said for attracting public and charitable money into poor communities – but not when it produces weak enterprises and eventual failures. The approach is deeply flawed:
 - if your plan distorts your funding needs it's highly unlikely that anyone knows what your real needs are
 - your plan is worthless as a tool for monitoring the progress of the business and its finances
 - the practice of producing deliberately misleading business plans is self-defeating because it may well produce unwanted responses from the funding body later – scepticism, suspicion, invasive or obstructive monitoring, unhelpful controls and conditions, and resistance to repeat or follow-up grant requests
 - have you thought what you'll do if a funder foolishly gives you more money than you need? without a good business plan you'll probably waste it.

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- **They won't read our plan anyway:** Unreliable, fictitious or inflated business plans are much less likely to be taken seriously. But that means there is no reliable way to assess grant applications. So funding for trading enterprise becomes a lottery and business plans really do become worthless to funders.
- **It's what they wanted to see:** Funders sometimes participate more or less actively in dubious deceptions, when, for instance, they want money pumped into an area. One government body is known to have refused to approve a six-figure grant for a major community enterprise project until the business plan was rewritten, at great expense, to remove the honest statements about its deficiencies. This was not about business viability of course, but a way to transfer responsibility for risk from civil servants and politicians to an innocent community group.

Damaging your own prospects: Charitable and community organisations are much more at ease with the idea of planning than they were a decade or so ago. But they can still be so fixed on doing handstands and cartwheels that their business plans may be much more useful for impressing than informing potential funders. The real harm of this is that it:

- **wastes time:** what is the point of a busy, knowledgeable worker spending a working week or more to produce a fictional plan?

- **creates unmanageable businesses:** fictional plans which are lucky enough to lead to trading activity can lead to crazy plan-less businesses which never get started properly and quickly run out of control
- **limits growth:** even the best business ideas will be more difficult to develop, manage and monitor with a poor plan; they may survive with permanent crisis management, but they are less likely to grow to their full potential
- **fosters grant dependency:** poor planning encourages aspiring businesses, which should be aiming for sustainability, to be run like conventional grant-dependent community projects
- **looks like failure:** inevitably funders will be less likely to help in future.

Damaging the third sector: Poor planning damages third sector trading generally because it:

- produces poor performance and failure – and confirms the prejudices of those who expect social enterprise to fail
- provides excuses for funders not to take risks
- perpetuates grant dependency in the third sector

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- starves other more worthwhile initiatives of resources
- further demoralises the very people and the disadvantaged communities which the trading is intended to help.

What if no one asks you for a business plan? Write one anyway.

Yes, really! Some bodies which make grants to support third sector trading activities nowadays deal with the poor quality of many business plans by telling applicants not to submit one. Their grant assessment is based entirely on the contents of an application form. This may be fine if the form has required the same level of analysis as writing a good business plan. But if the application process is designed to produce 'public accountability' rather than good planning, as is often the case, this is arguably against the best interests of applicants. *There is really no substitute for writing an honest and detailed plan which explores the realities of the proposed trading activity – whether or not this is required by funders.*

Are bad planners ever good? Bright, highly committed people can sometimes create little miracles in their communities by running successful seat-of-their-pants enterprises despite largely dispensing with the planning process. It's probably their impatience and arrogance which makes them good entrepreneurs in the first place. Arguably they were going to be successful anyway, and they were never going to be slowed down by reading a guide book on how to do it. Most people can't afford to be this impatient.

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3.2 Writing the business plan

A community development organisation on a housing estate in the South Wales Valleys accepted an attractive-sounding offer of free business planning for a proposed new catering venture – which could open up possibilities for job creation and greater financial independence. The fact that the consultancy was free meant that the normal practices of writing a detailed brief, getting references for the consultant, and close supervision by the group were largely bypassed. But the resulting business plan was a fantasy – forecasting an impossible turnover of hundreds of thousands of pounds. Rather than advancing the enterprise, it left members of the group helplessly scratching their heads for months about what to do with a useless plan, and unable to find an alternative way to develop their ideas.

A plan for every occasion?

The business plan format: The basic shape of the plan will be much the same, whatever its purpose and audience. The plan should include:

- a summary and an introduction
- the context and background to your plan
- your business aims and your social objectives
- the practical proposals
- the customers, the competition and evidence there is a market for the service and/or product
- how the business will be managed
- how much it will all cost to set up, and where the money will come from
- how much, in detail, it will cost to run, and how you have calculated the income which you expect to earn
- evidence of a sound cash flow – ie that you will always have enough money in the bank to meet your expenditure.
- the targets you will use to measure progress.

(See also the checklist for the contents of a business plan in Appendix 3.)

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The tip of the planning iceberg: The detailed content of the document you produce at the end of the planning process will clearly depend partly on its basic function.

- **Launching a trading venture for the first time** will require a plan which emphasises both the capacity of the organisation (its resources, the skills of the directors, and evidence that it can manage the business) and its commercial viability and *sustainability*.
- A plan for **expanding an existing business or adding new trading ideas** can depend on the organisation's track record. But evidence of suitable levels of investment or physical capacity may need to be highlighted.
- A business plan laying out a **longer-term strategy** to plot the way ahead for an existing enterprise such as a development trust (which local authority funders are likely to require) will concentrate less on service delivery and more on overall sustainability (see section 5.2 and 8.2).

What about multiple audiences? Your plan probably needs to speak to several different audiences simultaneously, each of whom expects or needs a different style of document. These might be:

- local authority departments which have an interest in the services you will deliver, or which have a role in funding the work

- charitable trusts and other funders, each of which has a different set of funding priorities
- potential customers
- potential supporters and the general public
- prospective directors
- members, users and staff of your own who you may need to win round.

How many plans? Think about how your business plan will be used. It can be tempting to write a different version of the plan for each audience, particularly if you think some aspects of what you are planning will be regarded less favourably by some groups of readers. But be careful not to go to unnecessary effort. Two or three simple options can do the job perfectly.

- Writing different versions of the main plan for each funding application can become impossible to manage and may seem dishonest unless you are exceptionally well organised. Produce a single version, but indicate in a variable covering document how each potential funder could help.
- Many people are unlikely to read a lengthy document. Produce summary documents for wider circulation. These can be tailored to individual audiences.

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- If there are individuals or groups which are likely to pick holes in your plan, you are probably not going to stop this by handing them a doctored version which ignores your weaknesses. The truth is easier to defend anyway.
- Circulate 'drafts for consultation', so a wide range of people get a chance to respond. You can choose what changes to make later.
- Those people who are unlikely ever to read your business plan may still be interested in what it says. You can reach them most easily with a Powerpoint presentation at an annual general meeting or some other event. Circulate print outs of the presentation to others.

Writing a plan for a single powerful audience: Government organisations are the worst (but not the only) offenders for demanding to see business plans which tell a particular story – usually about sustainability. They may want to edit the text or even change your priorities to get the wording exactly right for the councillors or officers who will read it. The intention may be benign (to help release financial support or reinforce a partnership) but it raises questions about the independence of the business and the planning document. It can also be a way for a body such as a local authority to exercise control. You need to weigh up whether it is really in your best interest to bow to every request.

Sometimes resistance on a few individual points is essential to retain the credibility of the document and the self respect of the charity or community group.

Preparing the business plan – the general approach

When?

- In the real world most business plans are written at the point when there is a need for them – when a fundraising effort is about to start, or when someone else asks to see a plan. This can give a clear focus and impetus to the work.
- But you need to start thinking about the job and discussing the *contents* at a much earlier stage, when you are forming the group or exploring the business idea.
- You may need or be able to secure funding to employ an outside consultant to research and write the business plan. You need to allow several months for this, and more if you want to raise money for the consultancy. (See *working with consultants* below).
- Leave plenty of time for the board or steering group to discuss the plan as it evolves, particularly if this is a new trading organisation.

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Who is it for? Remember this is *your* plan. You need to establish a sense of ownership over it.

- It will have little value if you feel that it is directed or controlled by an outside body such as a local authority or a funder.
- If a consultant is involved, arrange regular meetings so that your group can contribute.
- A plan which fails to incorporate the ideas of your group members may miss out on useful practical ideas, constructive criticism and collective approval. This is the best chance you will get to involve members of your group comprehensively in the planning process.

What if you get a steer from the funder? Sometimes you will get helpful advice from a funder, either before you write the plan or after you have submitted a draft, about what the business plan should say. This can be very welcome. But make sure you properly understand the message you are receiving, and think carefully about how you should respond.

- Is the funder identifying a real defect in your proposal? this could be useful information.
- Are you resisting sound advice because you are reluctant to give up on idea that probably won't work?

- Are you being told 'your type of project does not match our criteria'? If so do you fudge your plan to get your hands on grant money or waste time on a bid that will fail?
- Are you being asked to exaggerate the prospects for your project because the funder is keen for you to receive a grant?
- Are you being told you should not try to be profitable because that would produce unfair competition with existing business? This idea is usually so improbable for small community and charity traders and so unhelpful for the prospective trading organisation, that it is worth challenging.

Who does it?

- Business planning is a valuable skill to have at your disposal, so even if there is no one with previous experience it's useful to cultivate it in-house if you can. As with fundraising, you get better with practice.
- The usual approach is to delegate one person to write the plan – a senior worker or manager if there are employed staff, or a volunteer member of the organisation with business planning experience if you can find one. But you should ensure that everyone else is regularly consulted on the ideas which are going into it.

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- A more demanding approach is to delegate members of the group to write or produce information for different aspects of the plan. This is great for team building and sharing ideas in an all-volunteer organisation, but you need to be dedicated and brave. It is hard work to co-ordinate the production of the different parts, there is usually at least one person who does not deliver their draft, and someone is still needed to standardise the writing styles and weld the document together.
- Employing a consultant is a great option for getting a professional result if you can afford it. But it still involves a lot of work.

How long should it take? The preparation and discussion may take a long time, but it's good to condense the writing stage as much as possible. If you take months to write a report, how are you ever going to run a commercial business? Get it written in a month or less, and combine this with two or three intensive planning and report-back sessions involving the full group.

Do you need help?

- Much of the planning process is entirely logical and does not require special skills. So it's not usually necessary to attend specialised training courses in business planning.
- You might feel more comfortable if you invite someone from a county voluntary council or another enterprise to give your group a presentation of preparing a plan.
- Look at examples of plans produced by other organisations to get a sense of what is needed, and ideally check with someone else what they think of the examples you are using – you don't want to pick up bad practice from another organisation.
- There may still be some issues which you find challenging, and need some specific support from a trainer or advisor, or a helpful person in another enterprise, eg:
 - evaluating the need or market
 - costing the product or service.
 - the cash flow forecast
- There are enterprise agencies in most parts of the country which provide advice, support and training for new small business start ups, and these can be a good source of advice on the technical aspects of planning (see the list of contacts below). But bear in mind the warning in Section 1 of this guide that the business expert you are talking to may not be sympathetic with your aims or encouraging about your prospects.

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Writing the plan

The following guidance applies equally well to the development or expansion of almost any kind of charitable or community venture, include those where trading is not involved.

The basics:

- **Use the right tools:** It hardly needs to be said that word processors, spreadsheets, email and memory sticks are vital for any document which is evolving, which may end up in different versions, and which you need to share with colleagues.
- **Be flexible:** You don't need to write the sections of the plan in sequence. Jumping around through the text can help to keep the ideas fresh and connected, and may make the job feel less of a slog. You can fill in the gaps later.
- **Revise the plan progressively:** Your understanding of the project will improve the more you think about it. One possible approach is to build it up layer by layer, starting with an outline plan and then filling in more detailed information in several stages.

What about the truth? The best plans describe real enterprises which have a good chance of succeeding, so it's best to forget about the fiction which you think the funder wants to see.

- Dishonesty is rarely the best policy, and if you want to use it as a tool you need to be really good at it to get away with it:
 - unsupported assertions and exaggerations stand out like sore thumbs to someone who is a seasoned appraiser of plans
 - once you have lost the reader's confidence on one point, the veracity of the whole document comes into question.
 - if you tell lies in your business plan to impress a funder or supporter it is all too easy to lose track of the truth in future dealings with them or even with your own organisation.
- Emphasise the real positives by all means. But don't make statements you can't stand by if challenged on them later.
- Be honest about weaknesses too. A good plan acknowledges what you are less good at and shows how you will overcome deficiencies. This improves your credibility and demonstrates the capacity for self criticism.

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The cash flow forecast

The importance of the cash flow forecast: The cash flow forecast (see section 6.3) is the part of the plan which convincingly shows that the income you generate during a three-year or perhaps a five-year period will *at all times* leave you enough money to cover the expenditure which you may incur. If you are being honest this will highlight the problems and force you to think through the business to find solutions.

Preparing the forecast:

- Never be afraid to ask for help if you need it.
- Don't even think of financial planning without using a computer spreadsheet for the forecast (even if you have never used one before, the time you take to learn spreadsheet work will be a sound investment for the enterprise in the long run).
- Be brutally honest with yourselves about the sums you will earn and spend. Anyone can make an enterprise look good with wishful thinking. But this is about reality. If your forecast is wrong the business may well fail.
- Calculate everything as carefully as you can, and improve the accuracy each time you revise the cash flow. (For example, the first time you enter estimates for building rents and insurances they may be roughly based on figures for a similar organisation;

later you should try to use firm quotes from estate agents and insurance companies.)

- Statistics for items such as levels of expenditure per customer in different types of business and in different areas of the country may be available on the internet. Even when the figures are not directly relevant to your planned activities, you may be able to use these to gauge the accuracy of your own calculations.
- Sales and costs are usually closely linked, so improving the way you estimate sales income will often give you a better idea of costs and vice versa. More fundamentally, don't forget that if you adjust the estimate for sales income significantly your operating costs are also likely to change.
- Financial forecasts for new businesses are notoriously over-optimistic. So you actually need to devise a scenario in which your outgoings are rather higher than you expect (because there are always eventualities and expenses you hadn't budgeted for) and the income takes longer to build up than you would like (because it does). Then work out how you would survive and grow in *that* situation.

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- Keep refining the figures you enter on the spreadsheet:
 - If the forecast shows a profit early on you should look for mistakes and make your assumptions more pessimistic. Then check whether it still works.
 - If the first attempts show the business making a loss, start thinking about where you can economise and whether there are ways you can realistically generate more income.
- Don't expect the first version of the forecast – or even the third or fourth – to be your best or last. As your planning progresses you will think of items you have missed, correct mistakes and make refinements.
- Be patient. This is one of the most valuable parts of the whole planning process, and you will find the rest of the exercise a lot easier when you can get your business idea to stack up financially.

Getting the sceptics on board: Ideally your whole group will instantly see the benefits of good financial planning. But don't count on it. Some people may feel threatened by it, and you may need to persuade the doubters to take the issue more seriously. Here's what they may tell you:

- **'We don't understand these things, so please don't involve us':** Anyone who is going to be legally responsible for the venture should try to understand how it works financially. How else will we know what to do if things go wrong?
- **'Financial forecasts are always wrong':** Yes. But so, frequently, are the arrival times of trains and buses. This is not a reason for abandoning timetables.
- **'We can't reliably predict three months ahead, so what's the point of a three-year cash flow forecast?'** This is an understandable protest, but there are two important points:
 - The forecast forces you to examine and understand the operation of the business over time, and three years is a fair length of time.
 - You usually need a three-year projection to properly assess whether there is even a *reasonable prospect of success*. This is because year 1 always includes a start-up period (and possibly grant funding) which will distort the picture for the year. If you don't start breaking even until some time during year 2 (which is more likely than during year 1) you won't see the business running as you need it until the third full year of operation. Likewise, if you go for grant funding for three years, you really need a five-year forecast.

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- **'We haven't got time'**. You think you can run a business, then?

Plans and studies by outside consultants

Retaining control: Most of the guidance above assumes that the steering group or board is in control of the planning process. This is good practice, even if your organisation receives funding to employ a specialist to evaluate social or community needs, carry out market research, produce a business plan or help to establish a new social enterprise organisation from scratch.

Quality: You need to be aware that the quality of work produced by outside consultants ranges from invaluable to utterly useless. This is perhaps the best, though not the only reason for paying close attention your consultant's work while it is in progress.

Ownership: Whatever the scope of the consultancy, it is important that the work is understood and 'owned' by the group. Ownership means simply that the proposals or plans have the same commitment from members of the group that they would have had if the group had carried out all the research and planning on their own. (The same point applies, incidentally, to a member of an organisation who writes a plan and presents it to her or his colleagues to be adopted without discussion.)

Guidance for using outside consultants

- **Tendering:** Follow any requirements from your funder on tendering, and get advice (from other enterprises or support agencies) if you are not sure how to go about it. Even if you are not obliged to, it is almost always sensible to use a tendering process, unless you want to employ a consultant you have worked with before.
- **The brief:** You must prepare a detailed written brief for the work (or at the very least get a trusted consultant to prepare one which meets your specifications). This should cover the work to be carried out, the time it will take, the completion date and the cost. Examine this and discuss it with the consultant before the work starts to avoid misunderstanding.
- **Check out the consultant:** Never employ a consultant without:
 - checking their web site or CV to see whether they have experience relevant to your project
 - interviewing or meeting them in person to discuss the project
 - getting references or recommendations if you were not previously aware of their work – this is the best way to find out about their competence and any weaknesses you need to allow for.

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- **Get things clear:**

- Make sure the consultant understands what you are trying to do. Conventional businesses, community regeneration enterprises and other charities involved in trading are not all the same.
- Be clear what you are asking for – see the section on terminology in chapter 3.1.
- Indicate the level of consultation with your board or steering group which is expected. The *minimum* arrangement should be detailed discussions with the full group when the consultancy starts, half way through and at the point when a draft plan is produced.

- **Collaborate:** There is really no substitute for the consultant working closely with your group through a series of meetings throughout the process. If you make this central to the consultancy:

- the consultant will be better informed
- you will be able to check the quality and direction of the work
- the group will 'own' the final plan.

- **Your first management experience:** Inexperienced new groups may feel uneasy about telling an experienced consultant what to do, and some groups are just happy to dump the work on the consultant to minimise their own workload. Yet this can be a wonderful opportunity for new groups to take serious management responsibility for the first time (a kind of modest dummy run for the real thing when the business is established). Treat the consultant as your employee, work out the expected outcomes together, and monitor the results.

Pilot trading and small-scale startups

The purpose of 'pilot trading': You can use a 'pilot business' to test a service or market on a small scale before committing resources, and before you even invest time in preparing a business plan with speculative financial forecasts. It does have risks. But it is particularly suited to charities and other third sector organisations where the main thrust of day-to-day activity may be elsewhere, and where experience of trading is limited.

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What it means:

- **Pilot activities:** The pilot business might take the form of:

- counter sales of boxes of fruit and vegetable at the reception of your community centre to see whether people will be interested in a food co-op, home grown food deliveries
- taking a selection of prototype craft items to local markets and fairs to gauge customer reactions
- providing catering for some events run by your partner organisations to establish the implications of your café staff diversifying into an outside catering service
- staging a small conference in your own building to establish the suitability of the premises, equipment and your own organisation to provide similar facilities for other bodies

- **Useful market research:** Pilot trading can be perfect market research – whether or not you have already made a decision about expanding it into a full-scale business. So you should prepare for it properly by collecting and documenting as much feedback as possible – for example:

- measuring material costs, staff time and other associated costs for the items or services you are providing

- monitoring customer or user reactions and inviting suggestions, with surveys if appropriate, or feedback forms and through interaction with staff or volunteers
- checking whether the trading interferes with existing activities (by taking distracting or duplicating markets, for instance)
- look at quality control and establish how the product or service needs to be improved and monitored if you run it on a full commercial basis.

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4: Legal and governance structures

It is quite common for steering groups and boards to devote more nervous energy to discussing the future legal structure of their organisation than to planning the business they intend to undertake. And there seems to be little connection between the length of time devoted to the subject and confidence that the structure is the right one for their circumstances.

In the case of one Welsh charity there was a lengthy debate over whether to establish a wholly owned subsidiary trading company to undertake business activities and look after the charity's building assets, or to take advantage of the prestigious new Community Interest Company structure. Enthusiasm for the CIC won the day, and one was eventually set up. Unfortunately, the process had taken so long that the original objectives were overlooked at the registration stage and the CIC was accidentally established as largely independent of the charity. The full implications of the blunder took a while to emerge. The charity was left with no assets of its own, and the terms of a building redevelopment grant meant that the mistake could not be corrected for several years.

It can be better to keep arrangements as flexible as possible so they can be adjusted as circumstances change or as mistake become apparent.

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4.1 Incorporation or not?

It is recommended that, in almost all cases, enterprise activities are operated by limited companies. The important choices should be about *what type of company*, not *whether* to register. Unfortunately, the apparent legal implications of company formation gives rise to a huge amount of anguish, soul-searching and indecision. The problems are commonly illusory, although there are occasions in more complex organisations when choices genuinely are difficult to make. This section aims to simplify the issues.

Before you start:

Clarifying the language: There are a few points about terminology which you need to be familiar with:

- Organisations which have not registered as limited companies are called **'unincorporated associations'**.
- The process of creating a company of any kind is called **'incorporation'**.
- The **'memorandum and articles of association'** is the special form of constitution used by limited companies.
- The terms **'Board'**, **'Board of Directors'**, **'Board of Trustees'**, **'Management Committee'**, **'Council of Management'** etc are more or less interchangeable. You can call the group which governs your organisation whatever you like.

Don't panic: The decision to register as a limited company does not need to be a traumatic experience if you go about it methodically.

- It's perfectly natural; lots of people like you are doing it all the time.
- There's plenty of experience for everyone to follow among existing community and charitable groups, and there are many advisors in the third sector.
- You do **not** need to spend money on a solicitor to register your company, unless you expect to have an unusual and complicated structure – in which case you probably need a solicitor who is a specialist in company registrations for the third sector, and this can be expensive.
- In the experience of some social enterprise development staff, the company constitutions which have been drawn up by solicitors are invariably the ones which cause most problems for third sector organisations – because they are non-standard.

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- The registration process is fairly easy, and need not deter anyone.
- The registration process is fast – usually within two weeks unless your forms are returned by Companies House because they have not been completed properly.

What is incorporation?

Limited companies are legal entities: Registering your group as a limited company changes the legal status of the people who are running it.

- **Unincorporated associations** (groups which have not yet registered to become limited companies) are regarded in a legal sense as a number of separate individuals who are each personally responsible for the activities of the organisation.
- **Incorporated organisations** – ie limited companies of any type and Industrial and Provident Societies – are seen by the law as single entities, which are separate from the people who are running them. In the unlikely event of legal action being taken against a charitable or community-owned company, it is the company which will usually find itself in court, rather than the directors or staff in their personal capacity.

Limited liability protection: By far the most common type of company in the third sector is a 'company limited by guarantee'. Unlike other types of company, there is no shareholding. So the members do not stand to lose their investment – just a *limited* sum of money (usually £1 or £10) which they have *guaranteed* to pay if the company is unable to pay its debts. *In short, members are not personally liable for their company's debts.*

The formal structure: Incorporation as a limited company *requires an organisation to take on a particular formal structure* – but this is actually not very different from the structure used by most unincorporated voluntary groups. It will include rules about issues such as:

- general membership of the company: (these are the people and organisations who have the power to elect or appoint the directors – although the 'board' and the wider 'membership' are sometimes identical in practice)
- who can be a company member
- the size and make up of the board
- how board and company meetings are conducted
- what to do with the assets if the company is wound up
- how to handle other issues such as reporting, conflicts of interest, and the way directors are appointed or elected.

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A formal public status: The company is publically accountable – it has to put details of its directors and accounts on file at Companies House. But in practice there are relatively few legal restrictions on what it can do or how it should behave, other than those it chooses to impose on itself in its memorandum and articles of association, or those imposed by charity law if it is a charitable company.

Existing legal responsibilities: Concerns about your legal responsibilities are an extremely poor reason for opting not to form a limited company. Members of groups who agonise over the legal implications of becoming company directors are usually missing the point. *They already have legal responsibilities* to the public and the people they do business with, right from the time they form a steering group to plan their enterprise. Company status simply gives them a few extra (and not very onerous) responsibilities in return for the privilege of limited liability protection. To make things even easier, the law on Director's duties has now been codified in the Companies Act 2006.

When to incorporate

Is it a good idea? The decision to form a limited company and timing the registration is entirely a matter of choice. However, serious trading projects are very likely indeed to reach the point when registration becomes strongly advisable because of the scale of their financial or legal responsibilities. The following checklist is a rough guide to judging when to act:

- Are there substantial assets to protect - eg a building?
- Do you have significant employment responsibilities?
- Are you taking legal responsibilities which make it more appropriate or necessary to have a collective identity?
 - for example
 - a building lease – in unincorporated organisations it is common for two of the members to be required to take personal responsibility by signing lease agreements and other contracts as individuals, and this may well be seen as an unfair or unreasonable burden
 - activities which create significant obligations or risks to the public (such as consumer protection and health and safety issues) – any significant level of service provision or trading is likely to qualify

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- Are you getting involved in trading activities which could create personal financial risks for your members – eg if the business failed, or if there were unforeseen and uninsured losses?
- Will it genuinely improve your image with funders and supporters? – groups should be careful about coming under pressure from officers in public bodies who do not really understand the third sector; there may be no harm in registering when you are told to, but get independent advice from a support agency if you are concerned.

What is the best time to register the company?

- **Not too soon:** Some organisations choose to register as limited companies from the very start.
 - if you register before you have done the business planning you risk choosing an inappropriate company structure
 - technical discussions about the memorandum and articles and responsibilities of directors can sometimes be a distraction for a new group, and they may also put off potential members.
- **When activities demand it:** It may be better to leave incorporation to the time when you can see the practical needs for company status, for example:
 - to set up the board of directors who will take responsibility for implementing a newly completed business plan
 - when you have to take action on property or employment issues
 - if your existing unincorporated association structure starts to get complicated.
- **Before registering as a charity:** If you intend to set up a charitable company you need to plan the company incorporation and the charity registration together. The new Charitable Incorporated Organisation (CIO) structure, (which is expected to be introduced in 2011 after some delay) will make this easier than the two-stage process in the past. (See sections 4.3 and 4.4 on types of structure and charity trading below.) If you register an unincorporated association as a charity first and decide afterwards to turn it into a limited company you will have to re-register the charity. This is more complicated, and involves:
 - reapplying to the Charity Commission for charitable status for the new company or CIO
 - transferring the assets from the old to the new organisation (you probably need professional advice on this)
 - formally winding up the unincorporated association.

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What's involved?

There are a few basic steps to company registration:

- make the decision to incorporate
- decide *when* to incorporate
- choose an acceptable name which is sufficiently different from other existing registered names, which is not legally restricted, and which you are confident will not cause conflict with users of similar trading names (see Companies House guidance)
- draw up the memorandum and articles of association; it's extremely easy to base these on a model set available from:
 - your local county voluntary council
 - the Charity Commission (even if you are not planning to apply for charitable status at this stage)
 - your parent organisation (if you are a local independent branch of a national body)
 - umbrella bodies, support agencies and membership organisations which support your group's activities
 - Companies House
- read and complete the relevant application pack and apply to Companies House (with a small application fee), or to the Charity Commission for a Charitable Incorporated Organisation (free application).

Contacts

Companies House: Company formation packs, information leaflets and Companies House forms are available from

Companies House
Crown Way
Cardiff, CF14 3UZ

Phone the Companies House Contact Centre **0870 3333 636**

Web site: www.companieshouse.gov.uk

Charity Commission: www.charitycommission.gov.uk

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4.2 The options for trading organisations

This section describes the options for legal structures for social enterprise organisations, and attempts to remove the terror experienced by many people when they try to make a choice.

Basic issues

Apparent complications: There are understandable reasons why people get nervous about selecting an appropriate legal structure, even though the risks are small.

- Some people new to work in the third sector find it strange that limited companies can also be charities, and vice versa. The idea that 'ordinary people' might become company directors can also be alien, particularly to residents of disadvantaged communities where regeneration organisations often operate. So there may be logical and emotional barriers from the start.
- Recent government efforts to reform charity law and help (albeit in a small way) third sector trading organisations are complicating what was already a somewhat perplexing array of choices.
- The apparently worrying implications of the term 'legal structures' may tend to compound the concerns of some steering group members.

- The options require a string of unfamiliar either/or decisions – not a simple choice from a list – and people may feel unsure where this leads them.

Some assurances: Information alone may not be enough. Sometimes what's really needed is reassurance. Here's a start.

- **You already have legal responsibilities:** Getting legally constituted does not expose you to greater risk – *it helps you to manage your responsibilities better.*
- **Third sector trading organisations need to be run by limited companies** of some kind (see Section 4.1), so you can forget about the unincorporated association option used elsewhere.
- **Basic types of limited company:** There are only four distinct forms of limited company or partnership (which are each defined by who owns them) – and only *two* of these are relevant to mainstream trading activity in the third sector.

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The four are:

- public limited companies (forget these – you will not be forming a plc!)
- limited liability partnerships (designed primarily for individuals)
- companies limited by shares (used occasionally by community trading ventures)
- companies limited by guarantee.
- **Flexibility:** Companies limited by guarantee or by shares allow for enormously flexible arrangements. If people make mistakes, it is not usually structures which they get wrong but the way they adapt them in their individual circumstances. Making adjustments later is also simpler than most people imagine.
- **Structures with special uses:** Two new legal structures have emerged recently. You can treat them as 'optional extras' rather than difficult core choices. They are:
 - Charitable Incorporated Organisations (CIOs) – these will be companies limited by guarantee which have 'built in' charitable status.
 - Community Interest Companies (CICs) – these are specially regulated companies which are either limited by guarantee or limited by shares.
- **The new legal structures in context:** It's true that CIOs and CICs have complicated the choices for new trading enterprises. But they are not important enough to lose sleep over. Here are some more reassurances:
 - The new options are actually only *variations* of the existing structures and arrangements for companies limited by guarantee or companies limited by shares.
 - Most of what they offer small to medium size trading organisations in the third sector can be achieved by the other existing arrangements. *So they don't make a fundamental difference to your choices*, whatever their advocates might tell you.
 - If you see advantages to using one of these structures, do so. They are harmless.
 - But in the unlikely event that you make a bad choice initially you can in most circumstances change the structure at a later stage. You will experience inconvenience rather than legal sanctions. But it is true that poor decisions might possibly mean that you pay more tax.

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- **Other constitutional arrangements:** You may come across other slightly more idiosyncratic legal formats for certain types of social enterprise organisations. But, except for a few very special circumstances, they do not have advantages over limited companies. Newcomers can usually discount them as options.
 - **Industrial and Provident Societies (IPS)** evoke the historically important co-operative movement and sustain its ethos, but they tend to be more cumbersome and less flexible than companies limited by guarantee. They have the significant advantage that they can sell shares to the general public. If you are thinking of raising money for your business in this way this could be the legal structure to pursue. See section 5.4 on raising money with shares and bonds.
 - **Credit unions** are specialised, highly regulated organisations which use the IPS legal structure with a distinct constitutional format (see the Association of British Credit Unions at www.abcul.org).
 - **Trusts** are unincorporated structures that do not enjoy limited liability and face the same problems as unincorporated associations in holding title to property, entering into contracts etc.
- **Terms that have no legal status:** Many terms have no meaning in British law, and have no specific constitutional arrangements associated with them. They are really descriptions of ways of working (sometimes rather indistinctly), and reflect changing fashions and politics in third sector trading over the last 30 years. You do not need to research them, and you should certainly not be constrained by them – although their supporters may sometimes recommend off-the-shelf constitutions. The terms include:
 - community businesses
 - community co-operatives
 - community development trusts
 - community partnerships
 - development trusts
 - not-for-profit organisations
 - social firms
 - worker co-operatives

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The options for trading organisations

Companies limited by guarantee are by far the most widespread format for trading because, as the name suggests, the financial liability of the directors and members is usually limited if the business fails. Though not ideal, they are enormously flexible and are usually the obvious choice. They can be adapted to operate, among other purposes, as:

- stand-alone trading companies – with or without charitable status
- charitable (or non-charitable) holding companies with subsidiary trading companies
- subsidiary trading companies
- community-owned regeneration organisations with multiple activities
- worker-controlled co-operatives (although these commonly use structures under the Industrial and Provident Society legislation).

Companies limited by shares have two main uses in third sector trading organisations, as:

- **Stand-alone trading ventures** (often community-based) in which groups of individuals or organisations can buy shares to invest in, and own, trading activities which are run for social benefit:

- They have been used, for instance, in rural communities to raise funds to buy buildings and businesses such as post offices and shops threatened with closure.
 - The individual shareholders may be offered a share of the profits, via dividends, to entice their investment, or the shareholding may be seen as a long-term interest-free loan to support essential community services.
 - It is extremely important to make sure investors are aware of the terms of their financial involvement, to avoid community resentment if expected dividends are not paid. In one example, a rural community became seriously divided by an ill-defined project to which individuals had each contributed hundreds of pounds. See also section 5.4.
 - Local organisations such as community groups may own shares in social enterprise businesses in order to retain profits for their communities – as in the case of small wind turbines or hydro-electric power schemes (Bro Dyfi Community Renewables has pioneered this approach in Wales).
- **Trading subsidiaries:** Companies limited by shares are used much more widely as wholly-owned subsidiary trading organisations by charities, development trusts and other community ventures. See section 4.6.

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Community Interest Companies CICs

- The CIC has been introduced to help social enterprise organisations which operate for public benefit to register new companies easily and cheaply and to *provide protection for their assets and profits* when they attract outside investments.
- The memorandum and articles of association specifies that their assets are 'locked in' so they cannot be distributed to members or transferred to other companies, except to another asset-locked organisation such as a CIC or charity (as is also the case for charities).
- CICs must make an annual report to the Regulator demonstrating that the company is run in the public interest.
- CICs are covered in detail in section 4.5.

Charitable Incorporated Organisations:

- These are a new type of company with limited liability which come with charitable status.
- *Like all charities*, they are only suitable for trading in certain circumstances,
 - if they carry out permissible trading activities under charity law
 - 'primary purpose trading', 'ancillary trading' or small scale trading (see section 4.3 below for the definitions of these terms)

– if they own subsidiary trading companies which are non-charitable.

- They remove the need for the two stage process of registering a charitable company – first with Companies House and then with the Charity Commission. If you are starting a charitable company from scratch this is the route to use. If you are already a registered charity there is no need to change, but you can if you want to.

Companies limited by guarantee – advantages and disadvantages

Advantages:

- 'limited liability' – protection against directors being held personally responsible for losses if the company runs into trouble, *provided they have behaved properly*
- companies limited by guarantee are very widely used – so information about them is easily available and there are plenty of real-life examples to consult
- they are the standard format for charitable companies
- standard sets of memorandum and articles of association are easily available on the internet at no cost
- the format is extremely flexible, and can fit most types of third sector trading activity

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- they lend themselves well to democratic arrangements at board level and open membership for communities and charities
- they can also be designed to be highly secure, undemocratic organisations which offer protection to trading assets
- they are cheap to set up and cheap to run
- they are legally and publicly accountable, which tends to encourage good practice in their activities.

Disadvantages:

- companies limited by guarantee are not ideal structures for managing streamlined trading activities – for example, arrangements for company memberships and board appointments can be cumbersome
- their flexibility can lead to confusion or disagreements about how they *ought* to be structured and run.
- the possible additional costs of having annual accounts prepared by a qualified individual
- special arrangements (such as those provided by community interest companies) are needed to enable assets to be 'locked in' for community benefit and for commercial partnership arrangements with other organisations

- they do not on their own offer special tax advantages which social enterprise organisations would like (unlike charitable incorporated organisations and companies limited by guarantee with charitable status)
- requirements for annual returns and filing annual accounts mean there is a small amount of extra bureaucracy, this is backed up by an aggressive system of automatic fines for late filing of required reports
- the requirement that the names of trustees, and the accounts, are available for public inspection.
- the sense of unease which some committee members in small organisations misguidedly feel about being called 'directors' or about their 'legal responsibilities'.

CICs – advantages and disadvantages

Community Interest Companies are described in detail in section 4.5. But it is useful to set their advantages and disadvantages alongside conventional companies limited by guarantee which they are most likely to be compared with.

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The benefits: There are only minor benefits for small community and charitable organisations becoming established as Community Interest Companies limited by guarantee. Larger trading ventures may find them more useful.

- CIC's have most of the flexibility of ordinary companies limited by guarantee or limited by shares.
- They are designed for and are well suited to expanding third sector trading organisations which have significant assets to protect.
- The 'asset lock' arrangements means that CIC's can be useful for establishing partnerships with conventional businesses – for instance, in order to attract private investment to support a large-scale community development such as a wind farm without risking the community assets being taken over at a future date by the partner companies.
- The 'community interest' tag may underline the message for the public that the organisation exists for community benefit. This possible public relations benefit is the only real advantage for most small CICs.
- So few CIC's are being established that they are distinctive – and this could be useful for marketing and public relations purposes.

- CICs can be owned by charities as trading subsidiaries (though it is not clear that this is really a benefit over other types of subsidiary company, because charities already have a built in 'asset lock' arrangement).

Disadvantages:

- CICs cause confusion as additional options for the constitutional structure of social enterprises. The confusion is exacerbated because the alleged benefits have often been exaggerated, and so do not make sense to newcomers when weighing up which constitutional route to take.
- There is a small amount of extra expense (£35 annual return fee, compared with £15 for an ordinary company).
- There is a small amount of extra bureaucracy. An annual Community Interest Report must be written and submitted to the CIC Regulator at Companies House to show how the company has in fact acted in the interest of the community.
- CICs do not enjoy any of the tax benefits of charities which also provide the 'asset lock' benefit.

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Contacts

Sources of information: See the organisations listed in 10.1 and 10.2

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4.3 Charities and trading

Many people believe that charities are not allowed to trade. But this is far from true, and the question of trading by charities is an area of great confusion and trepidation for new and even many well-established trading organisation. The result is probably many projects which could benefit from charitable status never being registered, and large numbers of subsidiary trading companies being established unnecessarily on the better-safe-than-sorry principle.

Knowing where you stand

Overcoming the confusion: Some level of confusion is not surprising, since charity and tax law on the subject of trading are hardly straightforward. But the high levels of anxiety they produce can certainly be avoided.

- The first point of reassurance is that people are extremely unlikely to get into serious trouble if they make the wrong decisions about charities and trading. They may lose money – or, more accurately, fail to save money – and they may face the inconvenience of sorting things out later if they make innocent mistakes. This is hardly desirable, but no one is going to jail.
- Secondly, you can't be expected to be clairvoyant when you set up something as complicated as a trading activity for social benefit. Circumstances change, your enterprise will evolve in quite unexpected ways, and legislation may move on too. So some

element of readjustment in your company structures, trading arrangements, provision for paying or avoiding corporation tax etc may be necessary anyway, regardless of any initial mistakes.

- You are much less likely to go wrong if you do some basic homework before you start. See sources of further information below.

Finding your way - other sections of this Guide

- **Types of trading and charity law:** The current section deals with different types of trading and what is generally acceptable and unacceptable in charity law.
- **The pros and cons of setting up a charity:** See section 4.4
- **Trading subsidiaries:** If your organisation is a charity already you may be more interested in section 4.5 on the use of trading subsidiaries.

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- **Managing the finance of trading subsidiaries:** See section 5.3
- **Taxation:** Sections 7.5 and 7.6 discuss the different tax positions of charity and non charity trading.
- **Management:** Chapter 8, particularly section 8.6, looks at the broader issues of managing charities.

Getting advice: This section is an introduction to the main issues. But it is far from exhaustive, and you should get further information and advice elsewhere – wherever possible from an organisation or individual which fully understands what you are aiming to do. Sources include:

- Charity Commission: Useful information sheets are available to download from the Charity Commission web site. These can be quite detailed so persevere with the sections which seem relevant to your needs
- your parent organisation if it is a branch or affiliate of a national body
- umbrella bodies such as the Development Trusts Association Wales and the Wales Co-operative Centre
- local development workers – who should be able to find answers to your questions if they can't respond immediately

- similar projects to yours elsewhere
- your organisation's accountant – who should be able to advise on corporations tax and VAT implications, though perhaps not on constitutional structures
- WCVA's web site is an important source of information and signposting for charities; WCVA also publishes regular e newsletters for trustees and other guidance on issues such as governance, management and employment in charities. Staff can also provide general information on constitutions and legal matters. For more information visit the web site at www.wcva.org.uk or contact help@wcva.org.uk

Why would businesses want to be charities? Very many enterprises grow naturally out of previously existing community development work and community services. In the case of establishing development trusts the whole purpose is to set up an organisation which aims *both* to deliver and support generally 'charitable' activities and undertake trading which contributes to its sustainability. In both situations it will probably be in the interests of the community and the parent organisation to preserve or secure charitable status by registering with the Charity Commission.

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Is there a choice? Note that if your objects are exclusively charitable then, in law, you are automatically considered a charity, and if your income exceeds £5000 per annum you are generally required to register with the Charity Commission (subject to certain limited exemptions). In practice this requirement is widely flouted, leaving the 'choice' of charity registration rather less clear.

Why does it matter whether your trading organisation is a charity?

- Some types of trading are unacceptable for charities under charity law (see below).
- Profits (surpluses) made by charities attract some valuable corporation tax concessions which are not enjoyed by other businesses.
- Charities receive rate relief on commercial properties.
- There are VAT concessions for charities under certain limited conditions (but don't expect the regulations will be easy to follow if you are a newcomer).

Types of trading

What types of trading *are* acceptable for charities? There is more scope for charities to trade than some people think. But you need to be clear what type of trading it is – ie how it will be regarded by the Charity Commission and HM Revenue and Customs. The following distinct categories are explained further below:

- **non-trading** – ie activities which are not technically regarded as trading by the Commission
- **'primary purpose trading'** – ie activities which directly meet some or all of your charitable objectives
- **'ancillary trading'**
- **small-scale trading** which, although it is not primary purpose or ancillary trading, poses a *low risk* to the charity
- **other trading:** some other activities including lotteries.

When trading may *not* be acceptable for charities?

A few rules of thumb:

- the constitution or memorandum and articles of association of some charities specifically rule out the possibility of trading – you must check for this first

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- fundraising itself can never be a charitable objective, so running a trading venture in order to raise money needs to fit under one of the above headings if it is going to be a legitimate activity
- if the trading could pose a risk to the charity the answer is usually to set up a subsidiary trading company (see below and section 4.6)
- the scale of the risk is all important, and trustees may need to weigh up factors such as the size of the charity, the cost of running the business and the market.

Non-trading activities: The following are **not** regarded as trading and are therefore acceptable for charities:

- letting surplus building and land *where no services are provided to the user*, so
 - it is not trading when a tenant simply rents a room from the charity at a proper market rent
 - but it is trading when a tenant rents a room in a managed workspace
- selling or hiring out donated goods
- selling investments and assets used for charitable purposes.

'Primary purpose trading': This means any trading which is carried out in the course of fulfilling the aims specified by a charity's constitution, including trading carried out by the beneficiaries.

- **some examples:**

- admission fees and tickets for theatre shows, museums and art galleries run by charities set up for these purposes
- the sale of goods made by people with learning disabilities in a charity which supports disabled people
- fees charged by a public school

- **charitable benefits:** The charity does not pay corporation tax on its trading profits, provided the surplus is used to support the charity's aims.

Ancillary trading: This is trading which is a bi-product of a charity's main activities, and which contributes to its success:

- Examples include a café run by a charity which provides a community or recreation centre, a theatre or museum, and books sold by a research or educational charity.
- Ancillary trading enjoys the same tax benefits as primary purpose trading.

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- Fundraising alone cannot be considered as ancillary trading.
- There are no clear turnover limits, so watch out for grey areas. Large-scale trading – eg a community centre which is devoted mainly to a commercially successful café operation – might not be counted as ancillary trading for tax purposes.

Small-scale trading: Trading which cannot be justified as primary purpose or ancillary, may be acceptable to the Charity Commission (if it poses no risk) and avoid corporation tax (if it qualifies for the 'small-scale exemption' described below).

- **The benefits:** The fine detail of this tax concession is complicated, as ever. But the benefits are clear for many charities. The arrangement provides the best reason for small charitable organisations which start trading without substantial grant funding behind them to breathe easily in the early stages.
- **The small-scale exemption** allows for trading turnover to be non taxable if it is below £5000, or if it exceeds that figure, it is limited to no more than 25% of the charity's total income, up to trading maximum of £50,000 annually. (For example, a charity with a total income of £20,000 must simply have a *trading* turnover of £5,000 or less; a charity with a total turnover of more than £200,000 should have a trading turnover of no more than £50,000 if it is going to avoid being taxed on its profits.)

- **Warning:** HM Revenue and Customs add in an obscure income category called 'incoming resources from miscellaneous activities' when calculating the trading turnover. So check with them if you are in serious doubt about what qualifies. There is a charities helpline and their web site is www.hmrc.gov.uk/charities

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4.4 Choosing a structure: charities

A charitable regeneration company running social projects had set up a trading subsidiary so that its expanding commercial leisure activities could be managed independently on a more businesslike basis. This also seemed like an ideal opportunity for the charity's chair, a charismatic leader with business skills who had led its formation, to be offered a paid job as managing director of the leisure business. But in their enthusiasm the trustees had overlooked the fact that a charity can only employ trustees, whether in its parent company or its separately managed subsidiaries, if the memorandum and articles give it the power to do so. Even then, specific Charity Commission approval would be needed to legitimise the chair's appointment. The discovery that a distracting bureaucratic process was necessary to put things right was a painful shock. The chair and his fellow trustees had to ask themselves: was it really in the interests of running a dynamic enterprise if it would always be subject to the constraints of charity law?

Deciding whether to register a charity

Pros and cons: Most third sector trading activities are associated with charities (they are either run by charities or by subsidiary companies owned by charities). But this does not mean that a charity is the best arrangement for you. Some senior managers say that it is a boon *not* to be inhibited by the restrictions of charitable status. The choice you make can sometimes be as much a matter of how you feel about your business activities as how you weigh up the benefits.

Advantages for trading organisations:

- **Tax on profits:** Registered charities in Wales and England do not normally pay corporation tax on profits (in Scotland where arrangements are different the tax system offers comparable advantages). This is undoubtedly the most significant benefit for many organisations. It means that:
 - a charity which trades can usually retain all its profits
 - a non-charitable trading company can donate some or all of its profits to charity under the Gift Aid scheme without corporation tax being deducted. (See Section 7.6)

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- **Charitable rate relief:** Rate relief can be a significant benefit for small and marginal enterprises, but it is doubtful whether this alone justifies charity registration. (See Section 7.5.)
 - Local authorities are required by law to grant charities 80% relief on their business rates, and have the discretion to grant relief on the remaining 20% so that no rates are paid. Many charities benefit from 100% relief, and if this is not automatic in your area you should still make a case for it to your council.
 - Premises, such as charity shops, whose sole income comes from selling donated goods also enjoy the mandatory 80% relief. The same benefit applies where the majority of income is from the sale of goods even if a shop sells both donated and purchased items.
 - Some local authorities have also been persuaded to grant rate relief on the premises of third sector trading organisations even though they are not selling donated goods. It is worth making the case to your local authority.
 - Subsidiary trading companies which share premises with their parent charity can also share the rate relief. But you should check the situation with the local authority.
- **Relief from Stamp Duty:** Exemption from stamp duty applies to any conveyance, transfer or letter to a charity – a small point to bear in mind when acquiring property.
- **Tax relief on private donations:** Gift Aid arrangements can be a real benefit to charities – see section 7.7.
- **VAT:** There are very marginal VAT benefits (for a few specific types of trading) See Section 7.5.
- **Public image:** Being registered as a charity demonstrates that the organisation is a charity in law and therefore subject to the Charity Commission's jurisdiction. This may help to create the image of a reputable body. But not everyone will be impressed, so this depends who you are dealing with.
- **Standards of behaviour:** Through its regulations and its recommendations, the Charity Commission lays down standards of good practice in operating public organisations, which should, arguably, apply to any company which uses public money or depends on the public for support. (This does not mean, of course, that your company needs to be a registered charity in order to have high standards, but it can help to keep you on track.)

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- **Funding:** A minority of trusts and donors have a policy of giving grants only to charities. Whether this is a significant factor for you will depend on:
 - whether you are undertaking charitable, social, community or environmental activities as well as, or as part of, your trading
 - the scale and nature of your business activities (don't expect charity funders to invest in a venture which is exclusively about generating income)
 - whether it is mainly grant or loan funding which you need
 - who you apply to for grants.

Disadvantages for trading organisations:

- **Charity regulations:** Charities must comply with charity legislation, which is seen by some people as interfering with the freedom of businesses to operate effectively. It imposes, for example, severe controls on some pretty fundamental aspects of company activity:
 - who can benefit from your work
 - who can be a trustee/director (which can limit your power to appoint employees or their relations to the board)

- the way staff appointments of former trustees are made
- the way accounts are kept in larger organisations
- what you can spend the businesses' money on (charities can only use their resources to achieve their charitable objectives).

- **Charity Commission 'interference':** Charities are subject to the jurisdiction of the Charity Commission, who can institute formal enquiries in cases of suspected misconduct or mismanagement and who have wide powers, including the removal and replacement of trustees. This can result in time-consuming and distracting investigations if your charity becomes the victim of whistle blowers, whether they are well-intentioned or malicious (though in practice, most charities never encounter such a situation).
- **Double reporting:** A company limited by guarantee which becomes a registered charity has to send annual returns and annual reports to both Companies House and the Charity Commission. This obligation is relieved by the new Charity Incorporated Organisation structure.
- **VAT:** You will be in a tiny minority if you receive any VAT benefits from your charitable status.

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Charitable Incorporated Organisations (CIOs)

A better option for charitable companies: The new CIO structure, which is due to come into operation in 2011, combines the previous two tier process of registering a company limited by guarantee and then registering it as a charity. The following compelling list of advantages have been persuasively advanced by the UK government, and it is hard to see why new charitable companies in future would want to use the former approach. It remains to be seen whether it is worthwhile for existing charitable companies to convert to CIOs.

- **Single registration:** A CIO will need to register with the Charity Commission alone, whereas a charity that is a company needs to register with the Charity Commission and the Registrar of Companies. A major problem up to now has been that there was often no assurance that the charitable objectives of the limited company would be acceptable to the Charity Commission.
- **A single annual return and simpler reporting:** A CIO will be required to prepare only one annual report, under the Charities Act 1993. A CIO will make one annual return under charity law, whereas a charity that is a company must prepare an annual return under company law and, if it has an annual income of over £10,000, it must prepare a separate annual return under charity law.
- **Simpler filing requirements:** A CIO will be required to send its accounts, reports and returns to the Charity Commission, whereas a charity that is a company also needs to send them to the Registrar of Companies.
- **Simpler requirements on changing the constitution:** A CIO does not need to report to the Registrar of Companies.
- **Lower costs:** The Charity Commission does not make any charges for registration and filing of information.
- **Other benefits:**
 - simpler constitutional forms, and, it is claimed, greater constitutional flexibility
 - easier charity mergers
 - an enforcement regime that does not penalise the CIO itself for misconduct by its directors.
- **Conversion:** It will be extremely simple to convert charitable companies and charitable industrial and provident societies to CIOs. Converting charitable trusts and unincorporated associations to CIOs should also be relatively straightforward.

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4.5 Community interest companies

Community interest companies represent both a big step forward in the state's recognition of social enterprise in the UK and a disappointing missed opportunity to help smaller third sector businesses. While they undoubtedly have their place for more substantial and asset-rich ventures, opinion is divided on their value for community-based organisations, and predictably they have so far had only limited impact.

What are CICs about?

The new structure:

- Background: CIC's were set up under the 2004 Companies Acts with the stated aim of creating a new type of company whose profits will be used for the public good.
- The government's stated aims were:
 - to reduce the costs and complexity of setting up trading organisations which operate on a 'not for profit' basis for community benefit
 - help to raise the profile of 'social enterprise'
 - help companies which are run for community and social interest to access finance.

The 'asset lock':

- Until the arrival of CICs there was no simple, clear way of locking assets of limited companies to a public benefit purpose, other than charitable status. This meant that buildings and other property owned by organisations that trade for community benefit were vulnerable, particularly if enterprises undertook major commercially-funded investments.
- The community interest company provides a transparent, flexible model safeguard or 'lock in' for assets to ensure they are retained for community benefit. The format is intended to be both clearly defined and easily recognised.
- Charities provide the same protection, but with more regulation and more restrictions on the trading which companies undertake.

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The CIC Regulator:

- Although much of the constitutional structure of CICs is familiar to anyone who has worked with companies limited by guarantee and private companies limited by shares, the introduction of a new regulatory system for community interest companies is a significant innovation.
- The Regulator is responsible for ensuring that companies which use this structure comply with annual reporting requirements and do genuinely operate in the interest of the community.
- This regulation is effectively a trade off for the privilege of the asset lock facility.

The value of CICs

The advantages: (See also section 4.2.)

- **A simpler, more understandable structure:** CIC's offer a relatively simple, standard constitutional format for social enterprise organisations to make it easier for them to attract commercial investments for their development. This was seen as necessary because:
 - some organisations (including larger community enterprise groups, co-operatives, social firms etc) have often been hampered by the need to manipulate existing constitutional

structures (such as non-charitable companies limited by guarantee, charitable companies, industrial and provident societies) none of which are particularly well-suited to their activities

- the resulting hotch-potch of customised constitutional arrangements has frightened off potential investors for some expanding enterprises.
- **The asset lock:** The main purpose of CICs is to provide a form of company which ensures that a company's assets are locked' to be used only for community benefit without the same level of restrictions which are imposed on charities.
- **Community links:** The regulatory arrangements are intended to ensure that CICs create strong links between their activities and the communities they serve.
- **Less regulation than charities:** CICs are an *alternative* to charities. (CICs cannot *be* charities: the choice is either/or.) There are some circumstances when the personal benefit restrictions which come with charitable status are an obstacle – for instance, when an individual entrepreneur establishes a trading venture for community benefit but is forced to give control to the charity's trustees if they want to be employed by the business.

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- **The 'CIC club':** The government hoped that the CIC would become a recognised format for social enterprise trading. This seems to be happening rather slowly, but there is a modest cachet in groups being able to say they are members of a small club using the latest legal structure.
- **Flexibility:** CICs offer almost everything that ordinary companies limited by guarantee and companies limited by shares can already do.

The 'charity lock' – some disappointments for smaller enterprises: The idea that CICs are a way of *encouraging* social enterprise seems somewhat questionable for the many small struggling trading organisations in the third sector which find themselves bound to charitable status as the surest way of surviving. It's not that there's anything wrong with CICs – just that many people won't want to use them and many of those who do will find that that they don't make much difference. (Tax breaks for CICs and VAT regulations to benefit third sector organisation, on the other hand, could have changed the climate and improved the prospects for new as well as established enterprises.)

- **Corporation tax:** CICs do not enjoy any of the tax advantages of charities. For many small community trading ventures (which often depend on the support of volunteers) charity tax relief may be the difference in their early years between survival and

failure. This particularly applies to charities with mixed sources of income and a trading turnover of less than £50,000. There will be few if any advantages for them in converting from charities to CICs and starting to pay corporation tax.

- **Flexibility and constitutional simplicity:** Enterprises which for tax reasons cannot *afford* to be CICs will be stuck with the restrictions of charity law and the existing messy constitutional structures for charity trading.
- **Duplicating the charity asset lock:** The main innovation of CICs is the asset lock, which is already an essential aspect of charitable companies. So enterprises which are able and happy to trade as charities (or through trading subsidiaries owned by a charities) will see little advantage in CICs.

Benefits for larger and expanding enterprises: The main beneficiaries of the legislation which created CICs will be larger and expanding enterprises (not necessarily all of them in the third sector), who will doubtless find that the asset lock makes it easier to access loans to invest in their development and to attract private sector partners to help extend the scope of their activities. The problem, of course, is that the legislation makes it no easier for small enterprises to grow into bigger ones in the first place.

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Key provisions of the legislation

Basic arrangements: CICs:

- can be either companies limited by guarantee or companies limited by shares (under the 1985 Companies Act)
- follow the same basic incorporation process (£20 fee) and annual reporting procedures with annual fees as other companies (with some extra elements)
- must be committed to pursuing community interests, and have to satisfy the CIC Regulator when they are incorporated that they satisfy a 'Community Interest Test'
- are required to produce an annual 'community interest report' to show the steps taken to pursue public and community benefits
- be required to reflect the role and importance of local stakeholders (staff, beneficiaries, funders, shareholders) by involving them as fully as possible in the company and to report on the efforts which they make to involve them.

Assets and finance: CICs

- have a permanent statutory 'lock' on the value of their profits and assets – which means that they can trade and make profits, but the companies' resources cannot be taken over and used for private benefit

- be able to use assets as collateral for loan finance
- be able to raise capital by the sale of shares (although the dividends payable on the shares will be capped to limit distribution of profits to shareholders) but ...
- ... be protected from adverse takeovers and prevented legally from being *controlled* completely by investors
- be free to set up subsidiaries – either other CICs or non-CICs without the cap on dividend payments
- be able to transfer surpluses to charities and other CICs provided stakeholders and the Regulator agree
- be required to use assets for community benefit if they are wound up – ie passed to a charity or another CIC (and not allow them to be distributed to members)
- be subject to insolvency law – ie they can lose their assets if they become insolvent
- prevent assets which have been provided by donors from being seized by unsuitable creditors if the CIC becomes insolvent (the donor can attach conditions to their donation).

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Ineligible activities: The government will not allow the regulator to get involved in political arguments about community benefit, so some types of organisation will be ineligible to become CICs. These include bodies which:

- are or which support political parties
- carry out political campaigning or engage in political controversy, including campaigning for and against vivisection, abortion, the freedom to smoke etc.

Other regulations:

- existing companies are able to convert to CICs
- changes to a company's objects must be approved by the Regulator.

Applications: The application process is like that for other companies in most respects, although there is an extra form for declaring the applicant's community interest. Forms and guidance information can be downloaded from the CIC web site.

Contact

The CIC Regulator:

CIC Team

Room 3.68

Companies House

Crown Way

Cardiff, CF14 3UZ

Tel: **029 2034 6228** (this is a 24-hour voicemail service)

Web site: www.cicregulator.gov.uk

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4.6 Do you need trading subsidiaries?

The trading subsidiary is an extremely well-established means of separating trading from the main activities of the parent charity. When there are several trading activities carried out by the same organisation, creating separate subsidiary companies can protect important assets and financially sound operations from bearing the losses caused by unprofitable ventures. But they can pose risks of their own if management is lax and the people running the businesses want to escape the charity's controls.

The board and staff of a trading subsidiary in South Wales were given freedom to develop their leisure business with little interference from the trustees of the parent charity. But in time the business became more free than anyone had anticipated. It came to see the charity as simply milking it for rent. Requests for trading information and business planning from the under-performing trading operation were ignored. Its staff even started planning to set up a charity of their own. Negotiations failed and the only practical solution to tame the runaway subsidiary was to close it down and set up new management arrangements at considerable cost to the charity and its reputation.

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What is a trading subsidiary?

Subsidiary companies:

- A subsidiary company is a private limited company with a shareholding owned entirely by another company (the shares are occasionally owned jointly by a group of companies when they set up collaborative ventures).
- As the sole shareholder, the parent company (which is sometimes called the holding company) can exercise full control over a subsidiary through its board, including the appointment and dismissal of the directors. There may be several subsidiaries each undertaking different activities.
- Subsidiaries can be set up by charities, by non charitable companies limited by guarantee, by Community Interest Companies and by private companies limited by shares.

What are they for? There are two basic reasons for voluntary organisations and charities setting up a trading subsidiary:

- when you have to – because your registered charity is not allowed to trade in the way you want (see Section 4.3 for details of the types of trading a charity can carry out without needing a subsidiary company)

- when you choose to – because there is an advantage to separating trading activities from the parent organisation or from one another.

What is involved: Setting up a trading subsidiary is relatively straightforward and painless. If you feel unsure, check out your proposals with another trading organisation which has taken the same route or run them past a legal advisor. Registration is a simple process which you can manage in-house without the need to pay professionals such as company incorporation businesses or solicitors.

- It involves registering a company limited by shares at Companies House. Model articles of association are available to download from the Companies House web site.
- The application form requires details of directors (a minimum of two), and the company secretary, the number of shareholders (usually one) and the value of shares (a nominal figure, say £100).

What should they be called?

- The key principle when naming a trading subsidiary is that the separate identities of the parent charity and the trading subsidiary are made clear, which means that the names should be different to prevent any confusion between the two.

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- The parent charity's name can be included in the name of the trading subsidiary, so long as this does not give the false impression. It is acceptable to use a form of name like: "[charity name] Sales Company Ltd" for the subsidiary.
- Company law restricts the use of the words "charity" and "charitable" in the name of any company, and they should only be used in the title of the subsidiary if they form part of the parent charity's name.

Pros and cons of trading subsidiaries

The advantages of trading subsidiaries:

- **charity law:** A charity is not allowed to carry out any substantial trading activity – whether or not it is primary purpose trading or ancillary trading as described in section 4.3 – because this could put the assets of the charity at risk. (For instance, the business might fail leaving debts which the charity would have to meet.) Trading by a subsidiary company instead removes this danger.
- **protecting the organisation's assets:** Non charities are not compelled to take the same course to protect their core activities and their buildings and other assets from the possible failure of trading activities, though they often choose to use trading subsidiaries too.

- **tax benefits:** The most compelling reason for establishing the structure of a parent charity with one or more trading subsidiaries is that if business profits are transferred by Gift Aid to the charity they escape Corporation Tax. For many aspiring enterprises the choice to set up a tax saving subsidiary is a no brainer.
- **clarity:** for charities the split between social (charitable) and commercial activities can provide clarity for staff and volunteers, and be useful for promotion and marketing purposes.
- **management:** It can be extremely useful to be able to create a harder-nosed business culture in the trading operation which is distinct from the parent charity's more socially-orientated role in looking after the interests of volunteers, trainees and disadvantaged groups of users and clients.

Disadvantages of the trading subsidiary approach:

- **cost and complexity:** In some cases parent companies set up every trading activity as a separate subsidiary company. This can become messy and expensive for small organisations to administer if there are more than two or three trading ventures. For instance, accounts must be prepared and filed at Companies House separately for each company.

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- **profits:** The tax incentive can prove to be an illusion – it may be several years before subsidiaries are making significant taxable profits.
- **constraints:** The trading subsidiaries of charities have less freedom than is sometimes thought. Charity trustees cannot take jobs with the trading companies as this is seen as a financial benefit from the charity. The charity must report on the activities and finances of its subsidiaries to the Charity Commission as if they were its own.
- **control:** Charity trustees remain responsible for the activities and assets of their trading subsidiaries. They cannot simply leave the business board to its own devices in order to reduce their own workload.

Partnerships and jointly owned subsidiaries: Subsidiary companies can have more than one owner. An interesting example of a jointly own social enterprise company is Tidy Trev which was established by Ebbw Vale Development Trust and Tredegar Development Trust to carry out recycling and environmental work collaboratively.

- **Advantages:** Formalised partnerships have the advantage of:
 - encouraging co-operation in areas and activities where there could be damaging competition for contracts
 - combining the resources and expertise of two or more bodies to produce service delivery organisations with greater collective capacity and clout than single enterprises can achieve.
- **Disadvantages:**
 - Joint projects can be time-consuming to set up, and require detailed procedural arrangements, including agreement between the partners on how profits are to be shared
 - Collaboration between two separate businesses with their own working practices can pose significant practical problems.
 - Tensions can easily result if either partner is unable or unwilling to completely fulfil its part of the joint service arrangement.
- **Further guidance:** Joint companies can involve complex arrangements beyond the scope of this guide. It is suggested that the Development Trusts Association or legal advisors specialising in company formations (not necessarily an inexpensive option) are consulted for further information.

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Further information

For further information on subsidiary trading companies see the Charity Commission's guidance leaflet CC37 *Charities and Public Service Delivery* or ask for advice from a support agency which specialises in third sector trading. Chapter 5 considers a range of funding and finance issues for charities and trading enterprises generally, including legal restrictions on charities and tax advantages.

5: Funding and resourcing the business

5.1 The right investment for your new businesses

Advocates of social enterprise trading who are not directly involved in community groups or charities sometimes promote an idea of third sector trading which is more about what they would like to see than about what organisations need. It is simply misleading to suggest that groups could be creating jobs or taking over council services if they are struggling to deal with expected grant cuts and cover their core costs.

This section focuses on some key issues to think about when you are starting a third sector business – what exactly are you trying to achieve with your trading activities? What resources do you need? And where will you get them? In other words: how will you invest in your new business?

Planning ahead

Does 'business investment' apply to us? The idea of investing in and starting to develop your business. Newcomers may feel that business investment is something which only larger projects do. But even a modest pilot trading activity is likely to require some resources to get started. A more substantial enterprise will certainly be a costly exercise to get off the ground – both in purely financial terms and in the time, effort, goodwill, and quite possibly the materials and equipment contributed by the people and

organisations involved in supporting the venture. It is essential that you spend time planning what you will need to invest in a new business and how you will secure these resources.

First steps: This section is mainly addressed to new trading ventures and covers:

- clarifying your business goals – so that you can make the right kind of investment
- funding business planning

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- start up capital
- looking ahead to further investment later.

Other investment and resource issues:

Further information can be found in later sections:

- **Pursuing sustainability:** see Section 5.2
- **Funding subsidiary trading companies:** see section 5.3
- **Using property assets to develop the business:** see section 7.3
- **Funding for development and expansion:** see section 7.2
- **Raising money from shares and bonds:** see section 5.4
- **Taking advantage of tax breaks:** see sections 7.5 and 7.6

'Sustainability' or 'growth'

What do you want your trading to achieve? The way you go about funding third sector trading activities depends on what you want to achieve. This may sound obvious, but there may be fundamental differences between:

- **'sustainability objectives'** – where the primary objective is to improve the prospects for survival of an existing organisation, and
- **'growth or development objectives'** – where the main objective is growth, in financial turnover, the number or range of services and activities, numbers of jobs or some other aspect of the business.

Why you need to be clear about your goals: This distinction is rarely made in discussions about third sector trading because it is attractive to say we want both sustainability and growth. But there are good practical reasons why new businesses should be more focused.

- Practitioners and support agencies are far from united on the fundamental issues of 'viability', 'sustainability' and what trading ventures should be trying to achieve. So you need to watch out for inconsistent advice, and be sure that *your* goals are not at odds with those who are advising you.
- Ambitions for long-term expansion can be extremely important. But if you are new to third sector trading it is usually safer to have a plan for developing your business step by step rather than in giant leaps. Making an existing organisation more sustainable is a good place to start, particularly in an uncertain economic climate.

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- Rapid growth can be rewarding and impressive. But it is not always good business practice – especially if you run into cash flow problems or become over-dependent on a single customer or contract.
- If your aims are not clear you could waste time and energy on planning and fundraising which gets you nowhere.
- Successful enterprises do not emerge from nowhere. In most cases they grow from modest beginnings and make only slow steady progress at first. If they don't have strategies for surviving in the early years there will be no experienced organisations in a few years time with the capacity and critical mass to expand into new areas.

Planning for sustainability or business development: Table 5.1 shows how the individual starting point and initial objectives of trading organisations are likely to require different strategies for resourcing their activities. It can make a huge difference, for instance, whether trading is based on an existing organisation and whether the main aim is primarily to make current activities more sustainable, or to develop new trading opportunities.

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Table 5.1: Resourcing and investing different types of trading venture

Sustainability objectives for existing charities and community groups	Funding and resource implications
Diversify income sources to be less dependent on grants, and aim to be significantly independent of grants in the long term	• train staff to run existing activities in a more businesslike way • secure funds for feasibility studies and business plans to develop new trading activities • introduce charges for services, or make prices more realistic • secure commercial contracts • make better use of building assets through lettings • move existing activities into subsidiary companies and make use of Gift Aid
Adapt to changes in the way services are commissioned by public bodies	• turn existing grants into contracts • bid for new contracts in open competition
Expand the range of services offered without increasing the need for grants	• identify new markets for existing services • develop associated services • trial new business ideas with low-level 'pilot trading'

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Sustainability objectives for existing charities and community groups	Funding and resource implications
Develop sharper fundraising strategies and management to make grants go more further	• include management fees in bids • fill spare space with rent-paying projects • explore options for involving volunteers more productively • share equipment more effectively • introduce 'cost centres' to improve financial monitoring
Sustain services such as village post offices and shops which have become non viable for commercial operators	• raise grants and/or loans to purchase/lease premises • raise grant and/or loans for start up working capital
Undertake local regeneration by acquiring and developing building assets	• identify income-generating uses for premises • secure mortgages for building purchases • raise grants and loans for upgrading and redevelopment • raise grants to staff the development process
Find new markets to generate jobs, environmental benefits, and local wealth etc by developing more substantial ventures	• raise grants for feasibility studies and business plans • secure commercial loans for equipment and business start up • raise grants where available

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Planning and start up funding

Do you really need grants to get started? Some voluntary organisations take the submissive view that they must have grant help before they undertake anything new. This is not necessarily the best approach for trading because:

- small scale pilot trading activities which test possibilities and build expertise and confidence can be started inexpensively – a café in a village hall can start with some second hand crockery, a free course in food hygiene for a group of volunteers plus a bottle of milk and a packet of teabags (and the whole point of trading is that it pays for itself)
- a group which would rather write grant bids than roll up its sleeves and have a go at earning some cash may not persuade either potential funders or its own members that it will be able to run a business.

Funding for business plans: If you are applying for grants for feasibility studies and business planning your bids will usually need to show that:

- the idea is potentially viable
- your organisation has the capacity to manage the research process, whether you do this yourselves or employ a consultant

- even before the business plan is prepared, there is some prospect that the project would not be prohibitively expensive to launch and would gain necessary approvals
- there is a credible organisation to drive the project forward if it proves to be feasible
- you are prepared to work in partnership with other interested parties and to deliver results which fit with the existing strategies of public bodies. (In many cases you need to be consulting with and collaborating with others as early as possible in the planning process.)

Unsurprisingly, it is much easier for existing charities and community organisations than for newcomers to get funding at this stage.

Launching the business: When you start a new trading activity, large or small, you are likely to need finance, and perhaps other help, to prepare for and equip the business and to meet initial operating costs. It is particularly important that you distinguish between these different costs in your fundraising (capital and revenue grants are not usually interchangeable) and while monitoring progress in the critical early days of trading. Here are some of the costs you may incur:

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- business planning consultancy
- a building lease (or purchase/mortgage)
- redeveloping, upgrading or redecorating premises
- capital equipment such as computers and office machines, a vehicle and other equipment specific to your service delivery or production work
- the business launch, including recruitment, advertising and any associated promotions or events
- project development, management or staffing throughout the planning period up to the launch
- staff and management salaries in the post-launch period until income is fully able to cover expenditure, however long this might be (*beware – this almost always takes longer and costs more than you expect*).

Internal resources: Existing organisations may be able to cover many of these costs from their own resources – by diverting staff, involving volunteers, making better use of space and equipment, so that they do not appear as distinct items of expenditure. That's good news. (But charities must be conscious that this will technically involve an investment of their charitable funds, unless they are using grants they have received specifically for this purpose.) The development

may also involve acquiring a building asset from a public body and peppercorn rents, donations of unwanted office equipment and furniture, deals with local businesses etc. So it doesn't all have to be about raising grants and spending money.

Outside sources of project funding: Assuming you have a business plan that demonstrates there is a market for what you want to offer, and there are reasonable estimates of cost, many organisations will want to look for grant funding too. Larger projects and more confident organisations will probably seek loans (see below and section 7.2). Grants for trading are constantly changing and you will need to evaluate each potential source carefully to see whether you might qualify and if it could meet your needs. Listing funders can be misleading. But you might explore sources such as:

- funds distributed by the Welsh Assembly Government
- the Big Lottery Fund, which may provide funding in Wales for acquiring and developing building assets
- charitable trusts which have an interest in sustainable development such as the Coalfields Regeneration Trust
- leading funding and support bodies for your particular field of activity, such as the Tourist Board
- European Union funds for enterprise development, skills training etc

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- local authority economic development departments
- Communities First partnerships in qualifying Welsh communities.

Sources of information on grants: Sources of information about funding are easier to locate than grants. They include:

- County Voluntary Councils (CVCs) provide a comprehensive funding advice service to third sector organisations - identifying funding opportunities, writing successful funding applications, preparing business plans and financial costings to support bids
- WCVA and the CVCs produce a common set of regularly updated information sheets on funding, located via WCVA or CVC websites
- WCVA's Funding news bulletin provides all the latest news on funding issues affecting the third sector and signposts readers to funding opportunities, training and events. Sign up to receive Funding news – www.sustainablefundingcymru.org.uk/news
- WCVA's Funding Portal provides access to a searchable database of UK funding opportunities, advice and support on raising funds and tips on how to diversify funding – www.sustainablefundingcymru.org.uk/fundingportal
- Database software for identifying funding sources can be accessed through your local county voluntary councils (CVC). Some databases can also be purchased or licensed:
 - **Grantfinder** - searchable database on EU and UK Government grants and loans, charitable trusts and corporate sponsors used by many CVCs – www.grantfinder.co.uk
WCVA members qualify for free grantfinder searches – contact WCVA Helpdesk on 0800 2888 329.
 - **Funder Finder** is a familiar package used by many CVCs, which groups can access at reasonable cost 24 hours at a time, at www.funderfinder.org.uk
 - **trustfunding.org.uk** is a substantial and highly regarded database of trust funds produced by the Directory of Social Change offering annual subscriptions (though it is not cheap); go to www.trustfunding.org.uk
- Development Trusts Association Wales, Enterprise agencies, Social Firms Wales, The Welsh Social Enterprise Coalition, and the Wales Co-operative Centre (see 10.1 for contact details)
- Expensive directories in book form are published annually by the Directory for Social Change and are available from Amazon or direct from DSC at www.dsc.org.uk.

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Planning for future growth

Wider funding options: Don't let your horizons be restricted by the grant dependent thinking of so many third sector organisations. While newly established organisations are unlikely to have the confidence or credibility to go for loans, existing charities and groups which are planning to trade can consider wider funding options. The following list gives a flavour of the wider possibilities. Some are considered separately in sections 5.3 and 5.4, and Chapter 7 considers the possibilities for growth in established trading organisations.

- grants without strings
- earned income and funding from profits
- contracts with capital funding
- grants linked to loans
- unsecured loans
- mortgages and secured loans
- bonds and shares
- voluntary effort.

Towards a strategy for funding and resources: The business plan should be clear about your approach towards resourcing your business activities. Potential supporters will expect it, and your own directors and staff will need it to guide their decisions. The issues the plan should cover include:

- a statement of where your trading activity stands and where it is heading (ideally with targets) on the huge continuum between grant dependency and total financial independence
- the extent to which earned income (from whatever sources) will contribute to the organisation
- the purpose and nature of additional funding (grants or loans or both) if you need it.

You will need to decide what you want to aspire to and what in the short to medium term is actually achievable.

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5.2 Resourcing sustainable enterprises

The first step to improving the resources of third sector trading organisations sometimes has little to do with generating new grants or earned income, and more about making better use of what they already have. This section covers the range of tactics which organisations can use when faced with demands from funders that they demonstrate their 'sustainability', when current grants are reduced or withdrawn, and when trading conditions in the wider economy are not encouraging. Section 8.2 deals with the corresponding changes to management and governance needed to achieve a more sustainable organisation.

What does sustainability mean?

The imperative for emerging enterprises: Sustainability has to be one of the main goals of new and developing businesses. The imperative applies equally to

- non-trading charities and community groups which want to take advantage of trading to help their survival at a time of funding shortages
- existing trading ventures trying to survive in a harsh economic climate.

Definitions of 'sustainability' and 'viability': The term 'sustainability' needs some explanation.

- 'Sustainability' is a much over-used word, with a host of different meanings depending on whether it is applied to the environment, disadvantaged communities, developing countries, institutions, and development activities of whatever kind.
- For most third sector trading organisations its meaning is simple and practical – that *the combined sum of all sources of income is sufficient to allow activities to continue from year to year*.
- Sustainability involves using any trick in the book to ensure you are still here next year and the year after. And in a business context, the term is not usually interchangeable with 'viability'. Among other things, viability implies that *income from sales alone* covers the costs of running the operation, thus ensuring the survival and growth of the business.

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- In conventional businesses, stand-alone 'viability' is widely regarded as an essential characteristic (though some people argue that everyone is equally keen for grant support if they can get it, no matter what sort of business they are operating).

Building a business with multiple income sources: In contrast with conventional businesses, third sector trading very frequently starts from a completely different premise. Plans for sound new trading activities can be built on a glorious multiplicity of income types and sources, including long- and short-term grants for capital and revenue, sponsorship, service level agreements, service contracts, consultancies, rents, user fees, ticket sales, membership fees, and direct sales. Some even aspire to receive bequests in wills. This variety is one reason why the conventional business world has so much difficulty understanding how third sector trading can actually work.

When survival is the starting point: Ventures which are built on a base of charitable or community activities rarely find it easy to get established. Success, in the early years at least, may not amount to much more than simply surviving. To be blunt, this means:

- recognising that sustainability is not an option or a bonus: it is a critical goal, and you will need to be tough and resilient to get there
- planning ahead to make sure that you are aware of what might go wrong and you are not knocked off course if business activities don't all pan out the way you hoped
- taking the initiative and actively cultivating the conditions in which you are most likely to achieve it.

A 'sustainable business' model: Much of what you have to do in practice to become sustainable sounds like a rather desperate effort to rearrange seats on the deck of the Titanic to improve the view as the ship goes down. But there is a sound business purpose to this which is often overlooked when people talk vaguely about 'increasing earned income' and 'reducing grant dependency'. You may need to aim for an entirely new business model for your organisation. Here are some of the typical before-and-after features which illustrate the type of transformation which might be expected:

- Vulnerable, non-sustainable projects and enterprises tend to be dependent on:
 - a small number of large grants, or a small number of large contracts, or both
 - a cherished key activity, the 'heart' of the organisation, which is probably grant funded and may be a social project with limited income-generating potential

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- other income generating activities which may be successful in themselves, but are being bled financially by the key project and by the need to fund the management team
- a core management team which is grant funded separately or as part of the social activities – and whose vulnerability could bring the whole organisation down if support for it is withdrawn
- staff and volunteer goodwill but not necessarily good practice
- **A model for sustainability:** Not everyone can achieve all these characteristics, but becoming more sustainable involves a shift to:
 - fewer large 'indispensable' grants
 - fewer large irreplaceable contracts
 - a management and administrative core for the organisation which if at all possible is actually generating money as well as spending it on expensive staff (this could include regular income from building rents, or selling senior staff time and expertise through consultancies)
 - recognising a new central role for the more vibrant, resilient, profitable and promising of the existing trading activities
 - recognising the potential to charge for existing free services
 - retaining the cherished activity which gives the organisation its social and ethical heart, but giving it a new place – where it faces the same economies and demands to generate income as everything else, but where its more modest role leaves it less exposed
 - new 'add on' projects and activities which can be developed at any time (and closed if they do not work or when funding runs out) but which do little to threaten the sustainable core.

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Flexible and diversified funding

The flexible, sustainable Press – a case study: Wales' first community business, Cwmbran Community Press became a genuinely sustainable enterprise with the capacity to donate its profits to a sister charity some seven years after it started. It achieved this with a mix of business and community project responses to a succession of crises:

- starting as a grant-funded community newspaper run by community development staff
- switching to commercial advertising and business sponsorship under volunteer control after two years when grant funding ended
- buying a printing press so that the paper could be printed in-house when outside printing bills rose dramatically
- setting up a jobbing printing business to create jobs for two full-time volunteers who were under pressure to leave for paid work elsewhere

- starting a grant-funded book publishing project to expand the work of the printing business
- starting a second hand bookshop to pay the rent when a tenant left
- raising grant money for new projects to attract management fees and rental income – successively a volunteer officer, a parallel community newspaper in the neighbouring town of Pontypool, and a community information and training initiative related to the community paper.

Cwmbran Community Press survived for 14 years in all and recycled profits of about £10,000 for its charity. This flexibility is not exceptional among long-lasting social enterprises – Amman Valley Enterprise took a similarly diverse course and survived for 20 years.

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Achieving sustainability in practice: The best route to sustainability in a third sector organisation is through increased *diversification* of activities and improved *flexibility* in operations. You might still achieve it by winning a single lucrative long-running contract, or stumbling on a sure-fire business idea that will make your fortune. But few organisations are that clever or lucky – and no one has time to wait and see.

- **Sustainability:** *Sustainability is simply about being here next year and in three and five years time; it is not only, or necessarily, about running profitable businesses (no matter what sceptical professional advisors, economic development officers and statutory service providers may tell you). Profits help a lot, but there are other ways to get there.*
- **Flexibility:** Flexibility is what the third sector is almost always good at (although it does sometimes get tied up in knots by political correctness and impractical employment practices). The ability to change quickly and take on challenges are precisely the qualities that trading organisations need.
- **Diversification:** People working in industries in crisis like farming and fishing are typically urged to find additional ways to top up limited incomes, and it works for many of them.

- Diversification can also work extremely well for organisations such as community regeneration charities which have varied objectives and multiple projects, whether or not they are already seriously involved in trading.
- Single-purpose and social charities (which serve the needs of, say, pre-school children, elderly or disabled people) have much less scope, but they can often still diversify the type of facilities they offer, the particular target clients, the geographical areas where they operate, and sometimes even the range of organisations which award them contracts.

What has to change? Being flexible and diverse is not an easy route. It probably involves changing what you do and how you do it, and possibly changing the whole culture of your organisation (or at least the trading parts of it) and working as best you can to change the culture of those you work for so they will understand your needs. Section 8.2 describes five key steps in managing this process overall:

- creating a stable core organisation
- fostering an enterprising culture
- dealing with the negative reactions to change
- securing support and working with partners
- setting targets and measuring progress.

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Key steps: Here's what you need to do:

- **get rid of waste**, which includes stopping money from leaking away in trading activities which cannot support themselves
- **protect the core of the organisation** so that there are managers in place to lead you (making the chief executive of finance officer redundant can save you plenty of money, but who is going to make sure you have any income at all next year?)
- **use your existing assets to the full:** whether they are activities, facilities, people or buildings; explore every possible advantage you can get from the way you use them
- **diversify sources of income** so that you are not over dependent on any one funder, customer or activity.

Practical steps to improving sustainability

Planning for flexible funding and resources: More specifically, the direct steps to improve your financial and trading position will include:

- taking hard decisions on some unsustainable activities
- making better use of existing assets
 - identifying ways of generating income from current activities

- identifying additional products and services which can be added to the current ones

- generating extra income from buildings you occupy

- identifying options and preparing plans for new income generating activities.
- *increasing* the fund raising effort – but to broaden the funding base, not to increase grant dependency
- identifying and taking life-saving business gambles if you really are facing financial disaster and have nothing left to lose (yes this can sometimes pay off).

Axing subsidised activities:

- **Unaffordable cross-subsidies:** It may be painful, but you must seriously consider abandoning loss-making activities which could drag down other activities which are subsidising them. The third sector generally thrives brilliantly in its many activities partly because it is often able to support under-resourced projects from surpluses elsewhere. But this will not work with your businesses unless and until you can create a sustainable organisation to start with.

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- **Last-chance measures:** If a project or activity is a drain on the rest of the organisation you can shut it down immediately. Or you can give it a last chance with a survival plan which changes its structure, staffing arrangements, costings, priorities etc, and give it strict timetabled targets for proving itself.
- **Raising charges with fingers crossed:** In some cases, perhaps a minority, charges can be introduced or raised. A common effect of this is a reduction in the use of a service which actually produces little or no extra income. Be careful – but if you've nothing to lose, try it anyway.
- **Contracts to close the income gap:** When a service is under threat it is often because its outgoings are exceeding income by a relatively modest, but cumulatively unsustainable, amount. So it may be possible to find a contractor who will recognise the benefits of avoiding closure by injecting extra cash to top up what you receive in fees from users. This might be a social services department which buys places for high need users at a community-run day centre for the elderly, or a local business which contracts to buy a handful of places in a nursery project. You will need good negotiation and selling skills and perseverance to win the argument.

Making better use of existing assets: Moderate-sized community projects and trading enterprises which offer a number of different services can usually find a few new ways to use their existing resources more profitably. Staff and trustees may need to work together to brainstorm ideas for generating extra income. Don't limit your imaginations; think laterally about any possibilities and test anything that sounds promising, from the obvious to the completely-whacky-but-might-just-work.

- **new income from current activities:**

- **a new market** for your service you haven't yet tried to exploit before: what about a new mailing list to target publicity for your luncheon club (or your mail order sales, or whatever) for different client or customers, or could you promote your book on local history to a lucrative North American market, or attract users for your bunkhouse accommodation from schools on the other side of the county or country?
- **new products or services** which are a natural extension of what you are already doing – special sessions in your gym targeted at retired people, or sales of seasonal products or gifts at your weekly bingo sessions or day centre.

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- **creating fresh markets** by bringing two existing activities together in interesting new ways – could your community café produce a range of 'home made' cakes and sweets for sale in your post office? Would more people sign up for training or education classes if you offer free tickets for films, plays or concerts in your village hall or theatre? Could the visitor centre or community farm offer pony and trap rides to neighbouring attractions?
- **totally new trading ideas** which fit with your existing activities which can be piloted inexpensively and started quickly to test the market
- **generating extra income from buildings you occupy** – this is one of the quickest and best ways for enterprises to earn money, for example by
 - rejigging the space you occupy to allow more things to happen or let to others
 - starting modest income-generating activities which will at least raise enough money to pay the rent for empty rooms
 - upgrading the accommodation so you can attract higher rents
 - converting unusable areas into lettable offices or workspaces

- developing new partnerships which bring like-minded organisations into your building
- introducing fresh licenses to tenants to make rental income more regular or more secure
- rethinking letting policies to increase the range of potential tenants
- using new ways to advertise the space.

Planning new business activities: You may feel that while you are looking for economies and security it is not the best time to risk your future on new business activities. But there are reasons why identifying options and preparing plans for new income generating activities can make good sense:

- **on the launch pad:** It can be extremely useful to have well worked out plans ready to put you at the head of the queue if a funder suddenly announces new funds for social enterprise development.
- **the early bird:** If you can find a service or market which does reasonably well (or just ticks over) during a recession, there's often a good chance that you will be the first to pick up the trading advantages when the economy improves.

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- **spreading the burden:** Third sector trading organisations usually succeed because they are flexible, not because they have businesses which make them rich or management systems which are brilliantly streamlined. When times are hard it may be to your advantage to try to meet wages costs or building overheads by diverting into *several* different small-scale income generating activities. The more willing you are to improvise the better your chances of survival.

Increasing your fundraising efforts:

- **Yes, seriously:** It's counter-intuitive of course to increase your fundraising to become less dependent on grants, and some people may say it's wrong headed. But this is about sustainability, not viability, and grants may temporarily or even permanently have an important role to play provided you use them wisely. (And don't be made to feel guilty about your 'serious business' credentials: what conventional business turns down grant money when it's available?)
- **What sort of grants?** What you need is fewer 'life-and-death' grants, without which you have to start making key staff redundant and dropping services. This is the hand-to-mouth way the third sector has always been forced to live, and a social enterprise approach offers something better. It could be imperative, while grants remain important to you, to aim to:

- diversify fundraising into raising a larger number of smaller grants which contribute to non-trading core costs, so you become less dependent on any single funder
- stagger the funding periods to avoid the perennial crises when large grants come to an end
- raise grants for activities to *extend* what you already do rather than to preserve your vulnerable projects
- raise grants which encourage enterprise development, and give you breathing space while you turn existing or new initiatives into trading businesses
- secure grants for *any* useful projects which pay overheads to help resource the management core of the organisation. (If you find this approach too cynical, fair enough. But someone else will bag the grant if you don't, and may not produce such good results. It's part of running a business, and it wouldn't be necessary if the third sector was resourced more rationally.)

Last-ditch survival strategies: Gambling is not normally a good course for hard-pressed third sector enterprises. You will seldom get something for nothing. But what if you have been careful, have accumulated reserves, and are planning ahead well enough to see that the end of your organisation is nigh? When you really do have nothing left to lose you can always consider:

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- **the make-or-break investment:** This involves identifying a new business project which can save your organisation if it succeeds, but won't do too much harm if it fails except leading to your otherwise inevitable closure. It has been known to work occasionally. (Some precautions are obligatory: don't do anything like this if you are already in debt or if you will create new debt, and make sure everyone, including staff who may be affected is fully consulted.)
 - **going into cold storage:** Closing down most of your activity may not sound like a good sustainability strategy. But if the only alternative is operating at a loss until you finally run out of money and make staff redundant anyway, then pre-emptive cutbacks and closures may make sense. This way you can perhaps preserve the core of the organisation, some of your reserves and one or two key staff. Then you could be ready to rebuild when conditions improve, perhaps emerging in a totally different form. It happens. But not often.
 - **partnerships and mergers:**
 - The Charity Commission recognise there are too many charities doing the same jobs in the same areas, and encourage mergers where these are viable. But in the third sector, unlike conventional business, too many people believe that it is better for everyone to fail than to give in to a competitor.
 - This is wrong-headed. If organisations facing difficulties were more willing to look for partners before it is too late, many valuable projects and the years of effort and investment which have gone into them could be preserved.
 - If you are starting to doubt whether you will survive, start talking to organisations which might conceivably make suitable partners. Be open minded. Don't expect an easy ride. But don't be surprised if you find an unexpected fit with unlikely colleagues. An effective merger could just as well be with a very different project which complements your activities as with one which overlaps with them.
- Towards long-term sustainability:** These suggestions particularly apply to third sector organisations making the transition to trading activity. Chapter 8, and Section 8.2 in particular, discuss ways of building long-term business sustainability.

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5.3 Financing the trading arm

Charities which carry out trading activities often have uncertain and ambiguous relationships with the subsidiary trading companies which they set up. It is not too difficult to slip into practices which contradict Charity Commission guidance. Strictly speaking the purpose of the arrangement is to raise money for the charity, though it sometimes looks as if fundraising is a less important aim than extending the range of activities. This section examines the responsibilities of charities in managing their financial responsibilities to the trading subsidiaries.

What sort of charity trading?

- **Trading for fundraising purposes:** This section applies to charities which set up and invest in *trading subsidiaries for fundraising purposes*, rather than for primary purpose trading –see section 4.3.
- **Primary purpose trading** is trading that is directly related to the objects of the charity, and in that case funds which it makes available to its subsidiary would be ‘a charitable application of funds’, rather than an investment of funds for profit. (A charity might choose to set up a separate primary purpose trading company for practical management purposes, but this is certainly not necessary.)

Funding options for charities and their trading subsidiaries

Start up costs: Charities may invest in starting trading ventures, subject to a number of restrictions and the overall requirement that the investment has reasonable prospects of making a return for the charity. Any action will need to be consistent with the investment duties outlined in Charities Commission booklet CC14. *Investment of Charitable Funds: Basic Principles*.

Types of investment: Charities may invest funds in a trading subsidiary by:

- making a loan
- purchasing shares (equity investment)

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- issuing a guarantee
- making a donation.

Aiming for profit: The Charity Commission points out that a trading subsidiary should become financially viable as soon as possible.

- Where financial viability is not anticipated within two years of operation, 'careful consideration' should be given to the appropriateness of undertaking the planned trading activity.
- Trading subsidiaries of charities are expected to be completely financially self-sustaining within five years. After this time they should not need loan finance from the parent charity in order to operate.

General requirements for investments: Charities need to be particularly careful if they are loaning money to or investing in the trading activity.

- Before they invest their charity's money in a trading subsidiary, trustees should confirm that:
 - the charity has powers identified in its memorandum and articles of association which specifically permit investment in a trading company that it owns

- the investment is not excessively speculative and risky
- the investment is in line with the charity's own current investment policy.

- Investments can only be regarded as made for the benefit of the charity if they are commercially sound, ie they must be secure and carry a fair rate of return.
- Charities should keep records of all investment decisions including why decisions were made. This is because HM Custom and Excise could ask to see business plans and cash-flow forecasts for the trading subsidiary and could remove the charity's own tax exemption unless they are satisfied that the investment was made:
 - for charitable purposes only
 - for the benefit of the charity and
 - not for tax avoidance.

Loans:

- The advice of the Charity Commission is that an investment in the trading arm by the parent charity should normally take the form of secured loans on market terms.

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- Loan repayments:
 - Interest payments on loans must actually be paid to the charity. This means they cannot be transferred to the outstanding balance of the loan and allowed to accumulate.
 - Loan agreements between charity and trading subsidiary must be in writing and provide for the recovery of the loan.

Equity Investment:

- Equity investment by the charity in the trading subsidiary must be within the investment powers of the charity and be a commercially sound proposition.

Grants and donations: Charities can make donations to a trading subsidiary – eg to pass on a start up grant made by an outside funding body.

Guarantees: Charities may have the power in its memorandum and articles of association to guarantee commercial loans to develop trading subsidiaries. But there may be serious obstacles to doing so.

- Commercial lenders may ask the parent charity to make the guarantee if they regard the subsidiary itself to be an unsatisfactory risk. But this could expose the charity's own assets in a way which is unsatisfactory to the Charity Commission – and if the investment went wrong the trustees could be personally liable.

- An alternative is for individual trustees to make the guarantee in a personal capacity, though they may be extremely unwise to agree to do so.
- The problem may be avoided by securing loans from investors who have an understanding of social enterprise, such as the Charity Bank and the Local Investment Fund. These institutions set out to lend to the third sector and as such are experts in financing commercial venture development.

Transferring profits to the charity: Charities may prefer to pay corporation tax on some of the subsidiary's profits so that they can hang on to finance to develop the business.

- This is because, if all profits are transferred as Gift Aid, the subsidiary could become starved of cash and unable to take advantage of opportunities to expand. This is not a remote possibility. Careless Gift Aid donations can do serious damage to a trading venture.
- On the other hand, if no profits at all are transferred to the charity, the subsidiary company is demonstrably not fulfilling its purpose of funding the charity, and the trustees will need be careful about continuing to offer it support.

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Legal obligations when charities invest in trading subsidiaries

The overriding responsibility: The parent charity's trustees must be able to justify financial support for a trading subsidiary as *an appropriate investment of the charity's resources*. In all cases the interests of the charity must be paramount. Any investment should be consistent with the charity's overall investment policy.

General rules on investments: The Charity Commission offers unequivocal advice to trustees whenever they invest a charity's resources. Exactly the same considerations apply to an investment by a parent charity in a trading subsidiary as to any other financial investment with an outside body. They must:

- be certain that the investment is within the charity's investment powers
- exercise such care and skill in the investment process as is reasonable in the circumstances
- have regard to the suitability to the charity of investments of the same kind as the particular investment which it is proposed to make

- have regard to the suitability of the particular investment in question, as an investment of the kind which it seems appropriate to make
- have regard to the need for diversification of investments, as appropriate to the circumstances of the charity, and
- ordinarily obtain and consider advice about the investment from a person reasonably believed by the trustees to be qualified to give it by his or her ability in and practical experience of financial and other matters; the advice needs to have regard to the suitability and diversification points mentioned above.

Investing in a non-primary purpose trading subsidiary:

When trustees are investing the resources of a charity in a trading subsidiary to carry on a non-primary purpose trade, the Charity Commission expects that trustees:

- consider whether it is in the charity's interests to make the investment by making a comparison with the risks, benefits and returns of other forms of investment which could be selected
- are satisfied with financial viability of the trading subsidiary, based on its business plan, cash flow forecasts, profit projections, risk analysis and other available information

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- take appropriate advice on the investment, and the financial viability of the trading subsidiary
 - ‘appropriate’ will depend on the circumstances
 - the cost of taking advice should be in proportion to the size of the proposed investment.
- pay attention to the length of time that funds could be tied up in the investment – in case they are needed earlier for some other purpose
- consider, and take suitable advice on, the possibility of obtaining independent funding as an alternative to funding by the charity
- take account of the fact that there could be adverse tax implications if the loans to or equity investments in trading subsidiaries are inappropriate.

Loan repayments and inadvertent insolvency: There is a risk that a charity could accidentally make its trading subsidiary insolvent if the trading company pays all its profits to the charity to eliminate its corporation tax liability. This could leave the subsidiary without the resources to continue making loan repayments. Then, without assets to cover its liabilities, it would be subject to the potentially serious restrictions of insolvency legislation.

Sharing the risk with outside investors:

- Charities are free to look for outside investors to help fund their subsidiaries, either with loans or shares.
- Shareholdings are likely to be less attractive than loans for investors whose aim is to profit from the investment, but shares can be a good way to develop local involvement with projects.
- Joint venture loan funding can significantly reduce the benefits of the subsidiary to the charity if the interest rates are high.
- Trustees should be careful to establish a clear understanding with their partners on the objectives of the investment to avoid irreconcilable differences later which could seriously damage the relationship, and they should plan for an ‘exit strategy’ in case the relationship breaks down.
- Joint ventures and gift aid: The treatment of Gift Aid by HM Revenue and Customs changes significantly if charities undertake joint ventures, and trustees should be aware of the implications before they carry out this type of investment.

Further information: More information about trustees’ investment duties is available on the ‘Guidance for trustees’ section of the Charity Commission web site.

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How does this help the charity?

What about the charity? In the real world of third sector trading many entrepreneurs will, and should be, motivated by the promise of developing businesses which are owned by socially responsible organisations. They will be driven by enthusiasm to create perceived benefits which may not in themselves achieve the charitable objects of the organisations which set them up – new jobs, management of resources and services by the clients and beneficiaries and so on. Unfortunately, this is not, in legal terms, the purpose of the trading subsidiary. So are the trustees and subsidiaries out of order?

Returning funds to the charity: A central job of the subsidiary is to help fund the charity. But this is not difficult to demonstrate in a reasonable well-planned social enterprise. The funding might take the form of a direct return on the investment or other indirect advantages:

- the loan repayments and the interest payable on them
- Gift Aid (see section 7.6) which is technically a return on the charity's shareholding in the trading organisation (the benefits of Gift Aid in this context entirely outweigh any reason to pay share dividends)

- rent payments for accommodation which the charity would not otherwise be able to let
- the shared use of (through user charges) of equipment needed by both the charity and its subsidiary (there could be technical tax implications for this as earned income for the charity, but it is very likely to qualify as small scale trading).

Clarifying the charity's objects: One interesting repercussion of planning to launch trading activities is that trustees may come to see the possibility of changing their charitable objects.

- **The area of benefit:** The most obvious example is to extend the geographical area of benefit so that the charity can generate income from selling its services in other towns or counties without this being regarded as a fundraising activity. This does not usually prove difficult to achieve.
- **Changes of purpose:** More problematic is changing a charity's purposes. For instance, a charity which was set up to provide recreational facilities for children up to the age of 11 may see commercial opportunities for providing training for disadvantaged teenagers and young adults. But it would need to change its charitable objects if this activity is to be seen as 'primary purpose trading' rather than fundraising.

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- **Charity Commission approval:** The attitude of the Charity Commission to requests to change the objects clause of the memorandum and articles of association cannot be predicted. They will certainly need evidence that the service is needed and the charity has the capacity to deliver the extended service without adversely affecting its achievement of its other objects. The new activity must of course also be recognised as charitable.

But how does this promote *enterprise*? In the real world where 'social enterprise' is flavour of the month, many third sector entrepreneurs will, and should be, motivated by the promise of independence from the control of grant finders and public bodies. The last thing they want is the restrictions of the Charity Commission and the fear that they will lose money or privilege because they have fallen foul of the bureaucratic rules. If this is the case they may choose to lose the tax advantages of Gift Aid and the other benefits of charity status and establish a Community Interest Company (see section 4.2).

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5.4 Raising money with shares and bonds

What are shares and bonds? Shares and bonds offer a way for third sector trading companies and industrial and provident societies to raise money from supporters to fund their enterprises. The legalities are complex, and it is possible only to give a brief introduction here. Guidance from a specialist is essential.

In simple terms:

- A share issue is an offer of shares by a company or an industrial and provident society (IPS). They are investments in a company which might pay dividends to shareholders, but in third sector enterprises often do not.
- Bond issues are offers to several people to lend money to an organisation on similar terms for several years. It is long-term debt capital.

What types of company? Depending on the type of company involved, there are restrictions on the sale of shares to the public. There are fewer limitations on selling bonds.

- The Companies Acts prevent private companies limited by shares (including community interest companies limited by shares) from offering shares to the public. 'The public' in this context is understood to mean more than 50 people.

- Only public companies limited by shares (plcs), which require a minimum of £50,000 in share capital, can offer shares to the public.
- Companies limited by guarantee (including Community Interest Companies) can offer bonds to the public.
- The Industrial and Provident Societies Acts permit co-operative societies ('for-profit' organisations) and structures known as 'benefit of the community societies' ('not-for-profit' organisations) to offer shares or bonds to the public. For this reason most share issues are carried out by co-operatives under IPS rules.

The benefits:

- A successful share issue can raise significant sums for popular projects. The Centre for Alternative Technology near Machynlleth raised £1m in 1989, and there are examples of exceptional community based projects in England which have raised up to £200,000.
- Share and bond issues can be a relatively inexpensive way of raising capital because they may not pay any dividends or interest in early years, and under some circumstances the value of share will not have to be repaid.

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- Shares and bonds can bring members of a community around a fundraising campaign to support a community trading venture. They attract publicity and volunteers to help get projects going.
- A financial commitment by the community can demonstrate support to other supporters and investors. Share and bond issues can also fill crucial funding gaps if commercial investors are unwilling to lend money to meet the full cost of a project.
- The amount of individual investments can be set at a figure which is appropriate to the needs of the project. In better off areas it is not unreasonable to price shares and bonds at £50 or more but a reasonable figure might be £5 or £10 in poorer communities.

Disadvantages:

- Bond and share issues are relatively expensive to set up and manage – the cost is said to be £2,500 or more, so they are not suited to smaller scale projects.
- The legalities are complex and may not be to everyone's taste.
- A bond or share issue is not guaranteed to raise all the investment you need. Success may depend on the attractiveness of the project, the effectiveness of the business plan, or the impact of the campaign.

- Poorer communities, where the social need may be greater, cannot easily raise the same sums as more affluent areas, where some investors can be prepared to put up £500 or £1000 each. It's worth considering this carefully before going to the cost and effort of setting up a scheme.

Information:

- **The Wales Co-op Centre** are experts in the field in Wales: tel 029 2055 4955; web site www.walescoop.com.
- **The Development Trusts Association** report *Community Share and Bond Issues - The sharpest tool in the box* by Chris Hill of the Camberwell Project, London provides helpful guidance and examples from England. Development Trusts Association tel 0845 458 8336; web site www.dta.org.uk.

6: Financial controls and monitoring

6.1 The basics of financial monitoring?

If a third sector trading organisation fails, the management committee or board of directors is ultimately responsible, and could in some circumstances be financially liable. Yet many ventures which started as community projects are hard pressed even to produce a monthly balance sheet and a reconciled bank balance figure to show how they are performing. This chapter shows how the board can be more in control of their money.

An overview

Board responsibilities: The Board is responsible for the business, and to do this they must have ultimate control (but not usually day-to-day control) over it. They carry out this responsibility by:

- appointing people to manage the business' finances – the Treasurer (a board member) the manager, finance officer or finance administrator to keep records and produce reports, and the accountant to verify the annual accounts and provide expert advice
- monitoring their work
- deciding how financial information is presented to the board and how it is discussed

- controlling most or all of the big decisions on issues such as employment and investment
- ensuring they understand how the business is performing
- taking action if things go wrong.

What's the point of financial monitoring for a business?

Financial monitoring is indispensable. It is the job of both the manager and the board:

- to check that things are being done properly
- to help directors to understand the business so that they are properly equipped to make policy decisions
- to track the performance of the business

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- to pick up warnings of trends in the business so that appropriate action can be planned and appropriate management decisions can be taken in good time.

What if the board and manager fail to monitor?

- As with everything in business, it can be easy to blame staff if things go wrong. But directors need to be constantly aware that their job is to employ and support senior staff and check that systems are in place to alert them to problems. If an enterprise fails as a result of poor financial management the cause is just as likely to be a weak financial monitoring system as poor business decision-making or individual staff errors.
- People who are new to the business world often don't realise how extraordinarily difficult it can be to control what happens. Rather than feeling that they run the business the business commonly ends up running them. Control is not a guaranteed result of effective monitoring. But it certainly won't be achieved without it.
- If a venture fails because the directors did not keep proper control of its financial affairs they can in some circumstances be held personally liable for the losses, even in a limited company (eg if they trade while insolvent, or if they misuse the funds of a charity). Being involved in regular monitoring is a good sign that directors without professional skills have behaved responsibly.

- A business can slump from viability to insolvency in as little as three months. That means it can take as few as two monthly board meetings – while the manager or the treasurer present excuses rather than financial reports – to kill off an enterprise.

- Why would anyone do all the work to set up and run a social enterprise, only to turn their back on it when it might need them most?

Differences from other voluntary organisations: Financial monitoring is a systematic process of examining information prepared regularly for the purpose. There is little fundamental difference in arrangements for financial monitoring in a business compared with any other well-run voluntary organisation or charity with a busy bank account. So if you have a background of work in the third sector much of it will be extremely familiar. But you should also expect to see some important differences:

- you need to be focused on earning money, so the information which is monitored will probably be presented and interpreted differently
- unless the business consists entirely of long term contracts with unchanging income and expenditure arrangements, the monitoring must be carried out at least monthly (many charities leave administrators in charge of finance and involve trustees quarterly)

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- in difficult trading conditions there may be no alternative to weekly or even daily monitoring of progress
- some grant makers impose monitoring conditions on the organisations they fund which are more designed to protect their own reputation for financial probity than to instil good practice among grant recipients, and this has led to monitoring being dismissed as frustrating and bureaucratic; in contrast, internal financial monitoring by social enterprises is an absolutely essential part of the operation which is needed to
 - understand your progress
 - refine the effectiveness of your systems (such as marketing, distribution credit control etc)
 - make informed financial decisions at both a policy and an operational level
 - make swift responses to both new opportunities and potentially damaging problems.

Where monitoring fits in:

- **Day-to-day records:** The enterprise will need to find an employee or volunteer to keep the basic financial records of money received, money spent, bills received, etc. (There are sometimes problems with continuity when relying on volunteers, and many projects find it is essential to pay someone.)
- **Management accounts:** Someone will also need to put this raw financial information into a meaningful and understandable format – the balance sheet, income and expenditure accounts, budgets and budget reports. These are collectively known as the 'management accounts', because they are necessary for running the business. Creating these reports may be a job for a financial administrator, a senior manager or occasionally a volunteer member of the board with the title 'treasurer'.
- **Business management:** The Manager and other staff will use this information to:
 - provide a sense of how the business is performing day-to-day, including individual trading activities, to guide issues such as marketing, quality control

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- guide the way the bank account is managed, when bills are paid, taking action on credit control
- inform longer term planning proposals
- plan budgets
- watch for warning signs which could trigger precautions to conserve or redeploy resources
- **Board level monitoring:** The Board will use these reports to:
 - assess the financial position of the organisation, and ask questions in meetings
 - evaluate progress against projections in the business plan and budget
 - guide their final decisions on policy and investment recommendations made by the Manager
 - guide the timing of other large spending decisions such as staff recruitment
 - watch out for danger signs for the business
 - prompt periodic independent checks on the way the company's financial records are prepared, the security of cash and financial records etc.

Being serious about business

Fear of accounts: Many serious and otherwise careful directors in voluntary organisations and charities which have embarked on trading activities behave in ways which in private business would be considered reckless and irresponsible. They bypass safeguards, ignore simple good practice in financial monitoring, and end up with only the vaguest idea of their ventures' finances. Some actually have an antipathy towards, or fear of, management accounts. How can they expect to succeed?

Spotting the warning signs: Obviously these directors do not intend to do damage. But their innocent abrogation of responsibility betrays a lack of seriousness about running businesses. This may be one reason why voluntary organisations have not already established more long-lasting enterprises. Directors who don't get to grips with financial monitoring can sometimes become a liability. Staff and advisors can make mistakes. But if you have sound policies and systems in place it is not too difficult to spot the flaws. Here are some circumstances to watch out for.

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Avoiding responsibility: Many directors (and some managers) believe that it is enough to delegate full authority to a competent and trusted paid employee to manage the business on the board's behalf, and advise directors on all the important decisions. But the directors – *or at least some of them* – also need to watch and understand the finances in order to:

- evaluate the advice which they receive from staff and other professionals and have different perspectives available for taking sound decisions
- avoid placing too much responsibility in one place, and overburdening or isolating individual employees
- provide supervision, identify skill gaps and training needs
- provide continuity in the event of staff absence or resignation
- offer support and guidance if things go wrong
- detect dishonesty and reduce the possibility of suspicion about dishonesty.

Undermining the business cause: Some directors, while well intentioned, can have a undermining effect on their colleagues if they personally have difficulty in making the transition from grant-funded community group to social enterprise.

- These are the ones still arguing for a jumble sale or a Big Lottery bid to boost poor trading figures, rather than tackling the causes of the problem. Conventional fundraising probably has its place, but not at the expense of sound financial management of trading activities.
- If your directors have this tendency to lose the financial monitoring plot, they need to be exposed to training in basic business management. If they still cannot adapt they will probably be more helpful monitoring the delivery of services than finances.

Obscurity: Don't give ground to accountants and other professionals who use language you don't understand. If they are being paid to provide help they need to learn about social enterprise activity and to speak to directors and staff in an accessible language without jargon or obscure technical terms.

Excuses for monitoring failures: Excuses for failing to carry out financial monitoring are usually transparent and easy to expose:

- **'We don't know how'** – indicates an urgent training issue,
- **'We didn't know it was necessary'** – a sign of faulty business planning or poor communications; make sure that financial monitoring is immediately written into the organisation's policies and procedures

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- **'We are too busy'** – resolved by readjusting priorities; few other issues are more important.
- **'We don't want to'**. We are prepared to work on almost anything but not accounts. Assuming persuasion won't work, the only answer is to find other people who will take responsibility.
- **'We don't understand'** – sometimes resolved by training.
- **'We really don't understand and never will'**. Here's a real, serious and probably universal problem. Perhaps only half the members of an average board are emotionally and intellectually attuned to responding to columns of figures. Examining the accounts is like lifting the bonnet of a car – while some drivers are perfectly happy to get their hands dirty, many others will immediately surrender their physical and financial security to 'experts'. So:
 - ask people to be honest about their level of understanding
 - find out what type of training, if any, which might help them, but don't assume this is an easy matter to put right
 - if training does not help, give the financial monitoring role to a small finance committee composed of people who do not suffer the same affliction

– make it clear that directors still have a responsibility for good financial governance – a problem with interpreting financial information does not, of course, prevent them from taking advice and making sound business judgements once the accounts are explained.

- **'... and the reason why there is no finance report again this month...'**: This could be a cry for help, or a sign that someone has something to hide. You need to take firm and swift action first to explore what the problem is and second to establish regular excuseless financial reporting as fast as possible.

Danger signs when there is no finance report: Understanding why there is a problem is important.

- **Poor skills:** Is it possible that the person responsible doesn't actually have the skills you need and they are covering up? Check their abilities and provide support if necessary. They may be too embarrassed to admit the weakness so it can also be a matter of confidence. But if you fail to deal with the problem there is a serious risk that the business will suffer.
- **Misguided priorities:** Is it possible that the person responsible is not giving the work the priority it needs? Check whether this is a matter of time management or understanding. The board or line manager should give clear guidance on what is required.

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- **Suspicion of something worse:** A much less common reason for producing inadequate financial reports is dishonesty. Since any accusation of dishonesty is severely damaging to an organisation, the board has an obligation to remove any grounds for suspicion by *insisting that full reports are presented to them every month and are open to scrutiny*. (If the accounts don't seem right or requests for information are ignored, the board *must* investigate, no matter how unpopular this may be. Treat the situation sensitively and in confidence. But be decisive and insistent.)

Poor quality reporting: Poor reporting is as bad as no reporting, and the board should take steps to put things right as soon as possible. Here are some common errors by groups who know they should be monitoring, and still can't get it right:

- **no financial report has been produced:** this may suggest a systems failure, especially if this is because
 - there are problems finding a reliable treasurer – then you must do things a different way
 - the manager or treasurer were too busy – operate procedures better or revise work priorities
 - board members were too polite to ask for it – insist on it

- **the wrong information** – the board *must examine a monthly balance sheet* (see section 6.4), but voluntary organisations are often so familiar with looking at budgets and expenditure accounts that there is a good chance that this is what is presented instead
- **irrelevant information** – when boards are told the cost of toilet rolls rather than the costs of providing a commercial service or employing people, then that's what members will talk about
- **too much information** – it is extremely common for an eager (or manipulative) manager to provide so much that the directors cannot sift out what is relevant and important
- **accountantese** – reports should be presented in language which fits the understanding of the directors – formal 'accountantese' is unnecessary, and it turns people off.

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Who does the monitoring?

Varied approaches: The team which oversees the financial affairs can range from all the directors and senior managers together at regular and frequent meetings, at one extreme, to scrutiny by just the general manager or a junior administrator at the other. In practice, agreed arrangements (which may be far from perfect at the start) sometimes run out of steam and become applied only haphazardly. It is certainly not unknown for the *no one* to be overseeing the accounts.

The full board: In some cases the best way to ensure that finance is being properly managed is to review management accounts regularly at full monthly board meetings.

• Advantages:

- good for helping everyone to understand and take responsibility for the business, especially in small community-based enterprises
- useful if business, finance and management skills are spread thinly or in short supply on the board

• Disadvantages:

- people with poor understanding of the business may disproportionately influence monitoring and decision making

- care is needed to avoid the board marginalising the chief executive officer.

A dedicated finance committee: A finance committee will normally include the paid Manager, the board Treasurer, and one or more other board members. A paid finance officer might attend as a member or advisor.

• Advantages:

- more intense scrutiny of financial affairs
- a more appropriate and effective way to use the skills of professionals on the board such accountants or bank staff
- a small standing team can also help with the annual budget and the evaluation of new business ideas
- a clearly independent group which, if it meets monthly, can be trusted to scrutinise the finances and the accounts

• Disadvantages:

- an extra monthly meeting for the Manager and the volunteer members to attend
- less detailed reports from the Finance Committee will need to be prepared for the main board

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- there is a risk that discussions will be repeated when reports reach the main board, leading to duplication and frustration for committee members.

A 'Finance Team': This might take the form of a very small committee and act like one. Its membership might be limited to the manager and the Treasurer.

- **Advantages:** a potentially tight-knit group with a clear focus which is easier than a larger committee to bring together when needed.
- **Disadvantages:**
 - the small size means that scheduled meetings may be abandoned if only one member is unavailable
 - teams of only two people may be efficient, but they do not necessarily provide good scrutiny – members will be less likely to ask searching questions, and may be perceived by the rest of the board to be a clique
 - the finance team can be an excuse for other board members not taking any interest in finance at all.

Scrutiny by the parent charity: As a minimum, a charity should automatically receive the same financial reports as the board of the trading company, and it is free to ask for further information

at any time. It is good practice for the charity board to include a director of the trading subsidiary who has good business skills, and can communicate information to the trustees.

Independent oversight:

- **Dangerous suspicion:** It is vital that there are routine and recognised systems for checking for and detecting fraud by staff and officers. This is not just a safeguard against dishonesty. Everyone needs to be protected against *suspicion of fraud*, particularly those whose roles expose them most to this possibility. This is because of the serious damage which is caused to trust and relationships when anyone is suspected of financial irregularity or misusing resources.
- **The need for 'backstops':** In practice it means that all actions involving the use of the organisation's resources in any significant way need to involve at least two people – in the same way that cheques must routinely be signed by two individuals. The personnel providing these roles as backstops do not need to be selected specially, they simply need to be specified by written procedures – a second person to oversee the recording and banking of cash, authorisation for staff to make purchases over a certain value, someone to verify staff and board expenses, and so on.

6.2 Financial systems and record keeping

When a well-established Welsh community organisation started converting grant-funded projects into trading activities it didn't seem too important to adjust the accounts system in any radical way. There was already a fairly sophisticated computer package in place to analyse how each grant was spent so that reports could be prepared efficiently for funders. And the income and expenditure of each business was recorded carefully so that their progress could also be checked.

After two years of impressive growth as the mix of trading and non-trading activities became increasingly complex, a financial report suddenly showed that the organisation had unexpectedly made losses of thousands of pounds over a period of a few months. This was traced to a member of staff who had been transferred to one of the new trading activities without the cost of their salary being charged against the business.

An investigation revealed some important weaknesses in the financial system.

- *It was extremely difficult to report on the true financial position of each activity because there was no 'cost-centre' arrangement (see below). It was not clear how much money they had started with, and separate departments or businesses did not make cross charges to one another for services or resources.*
- *The quarterly reporting system, which worked well enough for grant-funded projects, allowed the loss to be passed off as a blip after three months and to become seriously damaging over six months; monthly reporting would have picked it up far earlier (see section 6.4).*
- *Multifaceted organisations such as development trusts can be seriously at risk if an activity makes large losses which undermine the enterprise as a whole. The risk of damage can be reduced by setting up subsidiary companies to carry out new trading.*

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Overview of the finance system

Introduction: Businesses run by charities and community groups are not so different from non-trading third sector activities that they need a completely different system for managing their finances. The basic elements are familiar and guidance is available elsewhere (eg the WCVA guide *Faith and Hope don't run charities – trustees do*). But some aspects are distinct, and these are highlighted in the summary below.

What does the organisation need? The following items aren't optional. If you can't provide the minimum on this list you may find it hard to manage effectively:

- a bank account
- secure procedures for handling and banking cash if applicable
- procedures for processing and recording other incoming payments and for paying bills on time
- payroll and PAYE systems
- a cash book or computer programme for recording income and expenditure and monthly totals
- a departmental analysis (also known as 'cost centres') if more than one different activity is carried out

- a credit control system to handle outgoing invoices which are not paid at the point when they are issued
- arrangements in charities carrying out non primary trading activities to separate the staff, assets and finances of the charity from those associated with trading
- arrangements to separate the finances of parent companies and subsidiary companies
- someone to keep the cash book up to date and to prepare financial reports
- a realistic budget which shows you have sufficient income to cover expected spending
- a monthly meeting of the people responsible for the finances – usually the board or a finance committee
- the 'Financial Report' as an obligatory agenda item at that meeting
- a written financial report available to all members in advance of the meetings where they are discussed.

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New procedures: People moving from non-trading third sector organisations may be unfamiliar with:

- the separation of subsidiary companies
- analysis by cost centre
- credit control
- the monitoring team
- the format of the financial report itself (see Section 6.4).

What will you be monitoring? Here are the main issues to watch for, in order of priority:

- Have you got enough money to pay what you currently owe your staff, your suppliers, the HM Revenue and customs (PAYE deductions and VAT)
- Do you have the resources you need to continue trading - ie to pay for your running costs, stock and materials in the coming weeks?
- Where is future business going to come from - ie what orders have you got, what efforts are you making to attract or sustain new and existing business or funding?
- Do people owe you money and are you making sufficient efforts to bring this money in?

- Are you trading economically and profitably - ie are you paying out more or less than you are spending to operate the business?
- Are you trading within your agreed budget?

Income and expenditure records: Only the last two questions can be answered by the monthly income and expenditure records. The other items demand a monthly balance sheet.

Keeping money separate

Separate bank accounts? Many newcomers to social enterprise may feel instinctively that they will have more control over different aspects of what they do if they have separate bank accounts for each. This is usually a mistake. It could actually give them more complicated accounting work, and higher bank charges. The Charity Commission accepts that it is not even a requirement for parent charities and trading subsidiaries to have separate accounts – although arrangements for separate financial records are a legal necessity. You can normally do all the separating you need with a good analysis system.

The need to analyse: Anyone who has any experience of financial records will recognise the principle of analysing income and expenditure under different headings – salaries, rent, stationery etc – although it may not always be obvious why this is necessary.

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Some of the reasons for doing so are:

- comparing different types of income and expenditure against budget forecasts to monitor progress and maintain financial controls
- providing information to funders on the way their grants are used
- separating the activities of different companies, including parent charities and their trading subsidiaries, for legal purposes
- tracking the performance of different trading activities
- identifying items which are treated separately by accountants for tax purposes
- calculating the profitability of trading ventures, returns on investments etc.

Analysing different income sources:

- **Meeting the demands of funders:** One important type of analysis is already familiar to non-trading voluntary organisations. This is the frustrating need to make separate reports to a variety of different funders on the way their money is being spent. So you may have already discovered that keeping track of each grant can be a nightmare unless you have a robust financial record keeping system.

- **Analyse as you go:** The only way to do this efficiently is to analyse your expenditure *as you go along* according to who is funding it. Otherwise you need to go back to your records and carry out a new analysis every time a report is due. The same approach is also vital to monitoring income and expenditure when there is more than one source of trading income or a mix of trading and non-trading activity.

Charities and trading subsidiaries: It is a fundamental requirement of charity law that the resources of a charity are only used to pursue the objects of the charity. So it is unacceptable for the subsidiary company which is engaged in non primary purpose trading (see section 4.3 for definitions of types of trading) to benefit from the staff, premises or facilities or financial assets of its parent charity. The charity can rent or loan its assets to its subsidiary at a fair market rate. But this means it is necessary to keep careful records of:

- any time which the charity's staff spend working for a subsidiary, and the equivalent value of their wages and salaries
- the proportion of the charity's buildings occupied by the subsidiary and its rental value
- a subsidiary's share of use of office and other equipment owned by the charity and its rental value

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- any loans made to a subsidiary – which must be at market rates and repayable in a reasonable period.

You may want to check the details of these requirements with the Charity Commission or consult your accountant on how to make sure your arrangements are appropriate.

Monitoring different trading activities: Many enterprises, particularly those which emerge from community regeneration projects, undertake more than one distinct trading activity at a time. These might be quite closely related (like a crèche and an after school club, or a graphic design workshop and book publishing), or quite distinct (like a crèche and graphic design). Either way, keeping records which allow you to separate out the income and expenditure of each is essential for your understanding and control of the business.

- It allows you to collect valuable information about costing, staffing and marketing your activities.
- It immediately identifies profitable and less profitable activities and allows you to make separate adjustments appropriate to the needs of each of them.
- It helps to reduce the possibility of accidentally using a successful venture to subsidise a less successful one – which can easily leave you with two failed trading activities.

Analyse early: When you are starting out as a trading organisation the levels of income for each activity will probably initially be very small, especially if you have begun tentatively or have tested the market with pilot projects. The need for analysing the finances of each one may not be immediately obvious. But later when they start to grow you will probably regret not doing so earlier because you will have lost the opportunity to collect potentially valuable information. So it is often worthwhile to plan from the start to have a flexible (but not necessarily elaborate) system which gives you scope for analysing several activities as stand alone 'departments' or 'cost centres' (see below).

Using cost centres

Accounting for diversity: A private trading company on an industrial estate would be considered strange, not to say potentially unsound, if it was providing nursery facilities, making craft goods, running a café, and offering consultancy services. But when a community-based organisations does all these things it is more likely to be regarded with admiration than disbelief. Compared with conventional business, the activities of many third sector trading ventures (particularly those with origins in social or community projects) often tend to be unspecialised and diffuse. They need accounting systems to match.

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The cost centres' approach:

- In the context of managing the accounts of a small social enterprise business, the term 'cost centre' can be seen as a division or department of a company to which costs (and income) can be specifically allocated. (Don't be confused by other less relevant definitions.)
- The accounts are maintained centrally, probably using a single bank account. But all the organisation's core costs – running the buildings, providing overall management and administration, professional services, loan repayments etc – are allocated to the different departments or cost centres according to the level of use.
- When the income generated by the activity is added to the departmental account it is immediately clear which trading is profitable and which is not. The approach allows each distinct trading activity to know with a fair degree of accuracy how much it costs the organisation to run it.

The benefits: Computer account codes can apportion these costs automatically across all departments at the point when the record of any payment is entered, and produce instant reports to show the progress they are making. This separation is invaluable because it allows information to be easily extracted to help with issues such as:

- quickly producing monthly financial reports to show how well each activity is performing
- calculating and adjusting aspects such as staffing levels and charges for different products and services
- knowing what level of promotion and investment each activity needs and can afford.

Apportioning costs:

- If each trading activity occupies its own building it may be relatively straightforward to identify some costs exactly with separate bills for rent, heating and power and perhaps even telephones. But it can be more complex if you are dealing only with separate rooms or the shared use of rooms. Then you need to use estimates.

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- When it comes to apportioning core costs such as general management and administration – ie deciding how much each perhaps marginally viable trading activity will contribute to running the organisation – there are unlikely to be any 'correct' figures, only best estimates.
- You may well be tempted to be generous in allocating costs to new or struggling enterprises while others can afford to contribute more. But this is an internal exercise, so there is no harm if some trading shows a loss, particularly when this helps to prevent you wasting resources on a business which is not going to succeed.
- The precise way the core costs are shared out is usually not critical as long as your estimated percentages are fair. They can be adjusted at any time if you think you've got it wrong or if circumstances change.
- Make sure there is a written record to show how and why you have apportioned your costs so that the approach can be shared and understood by people who examine or take over your accounts system.

Making cross charges:

- This approach also allows you to simply record charges which are made from one cost centre to another – for instance if your café contracts to provide meals for the crèche.
- If you limit yourself to one bank account, which is recommended, there is no movement of cash, though it can be useful to issue invoices to provide a paper trail for internal transactions.
- Watch out that you exclude the value of internal transactions from the total turnover of the business, or you will exaggerate your income and expenditure figures.

The core as a cost centre: Many organisations find that they need to treat their management core as a separate department for accounting purposes (although it does generate income) and then show cross charges to the trading departments. This is unavoidable if there is a mix of trading and non-trading community of social activity in the same organisation. But it is not advisable to make the picture too complicated.

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Using accounts software:

- It is possible to record transactions for different departments or cost centres in manual cash books or simple spread sheets. But the more activities there are the more complicated it is to produce reports. Dedicated computer accounts programmes come into their own when there are a minimum of three or four cost centres.
- Some programmes are easier to use than others. More expensive and complicated software provides greater flexibility for long-term development. So you should get advice on what best meets your needs.
- When you start to use a computerised accounts programme, be careful to run a manual system in parallel with it for a while in case there are problems with the set up.

A worked example: It may not be easy to appreciate the enormous power of a cost centre approach in giving you control over your business. Appendix 4 provides some further guidance and a worked example for costing a new contract.

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6.3 Cash flow and credit control

If you run a shop or a café, customers are expected to part with their money as soon as you serve them. But in many types of business it will not be possible to charge your customers till later. Even when you ask them for payment by issuing an invoice it is common practice for the customer to delay payment. You need to be prepared for the complications and difficulties created by this unavoidable aspect of business life.

The importance of credit control: Whether you are providing contract services for public and private bodies, selling goods to retailers, or renting a room for a meeting you probably won't get paid on the spot. So you need a credit control system to keep track of the money you are owed. This has important implications that some people overlook:

- Since you pay to deliver the service some time before you receive payment, it may seriously affect your cash flow, ie you have to pay wages and production and service costs up front.
- Once they have got what they wanted from you, even your most honest and supportive customers may have little incentive to make quick payments, especially if their own cash flow is causing difficulties.

- Large organisations including some public bodies automatically expect lengthy periods of credit. So it is not exceptional to have to wait two months for payment.
- Offering credit to customers immediately adds a new element to your book keeping system – the need to record and keep track of the people who owe you money.
- You are very likely to need systems or at least routines for reminding people to pay their bills, chase late payers and deal with those who won't pay.

Is this the sort of business you want? The burdens of credit control may make the difference between a viable business and one that quickly becomes too difficult or complex to manage cost effectively. Here are some of the factors you need to plan for:

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- **Cash flow forecasting:** Delays in payment should be reflected in a cash flow forecast in your business plan – this is the same as a budget for your project, but it is costed month by month to include the actual times when you need to pay for staff, stock and materials, and the actual times when payments will be received.
- **Bank credit:** Delays in payments could mean that you need to have credit from your bank; this will have to be arranged in advance, and is not necessarily guaranteed for new businesses. Borrowing is not free. Bank interest will add to your operating costs.
- **Working capital:** Even if your organisation is lucky enough to have reserves or grant funding to use as 'working capital', the money that is tied up in customers' unpaid bills will not be available for investing in the business, for instance to buy new equipment.
- **The dangers of business growth:** It can be a shock to realise that a business which offers customers credit faces special problems if it grows very quickly. The more work you do the more money you have to pay out immediately, and more you may need to borrow to fund this in the short-term. It is not at all uncommon for conventional businesses to grow too fast and cripple themselves with debt because they cannot resist the

opportunity to expand. Then it only needs one large customer to default on payment to send your enterprise into insolvency.

- **Payment incentives:** You may need to offer incentives to customers to pay more promptly.
 - The most attractive approach may seem to be to add a penalty of a few per cent for late payment. But this can alienate customers, and in a competitive environment anything which raises their costs unexpectedly could drive them away.
 - Alternatively you could offer a discount for early payment, though this means adjusting your pricing arrangements or accepting that you will earn less than you had hoped.

A credit control system: Even a basic credit control system can be quite complex. It is likely to include:

- Arrangements for issuing invoices to customers at the point (or soon after) they receive the service or goods.
- A record of invoices issued (in a manual system this is the unpaid invoices file).
- A system for identifying paid invoices (paid invoices file).

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- A system for routinely (monthly) issuing statements or repeat invoices to all customers with unpaid invoices (the timing of this depends on the type of business – it might be at the end of the current month or the during or at the end of the second month); a statement lists all of a customer's unpaid invoices and the total sum owed, and is often essential because many commercial business hold back invoice payments until they receive a statement.
- A system for producing the total figure of unpaid debts at any time so this can be included in the monthly balance sheet and reported to directors.
- Monitoring of unpaid invoices to identify seriously late payments (8 weeks or more, perhaps) and telephone calls to politely ask for action.
- Repeat calls to remind persistent late payers you have not forgotten them.
- Possible arrangements with a debt collecting agency to try to collect from people who refuse to pay you, or your own system for taking bad payers to the small claims court.

Chasing late payers: One or two large unpaid bills can make the difference between viability and failure in a small business. But no one finds it easy to pursue late payers. Here are a few thoughts to bear in mind.

- While most of your credit customers will be honourable prompt payers, it is quite likely that a few will, for reasons of financial difficulty or even dishonesty, do their best to avoid payment; you can't afford to be generous to them.
- Any delay in sending your invoices or statement or making calls to chase aging debts will be taken as a weakness; their other more persistent suppliers will be paid first.
- You need to have clear policies so that staff know the steps involved in pursuing bad debts.
- Be extremely careful to keep accurate records of all your written and telephone contacts with late payers. You may need the information if they become *bad* payers.
- There is a difference between persistence and aggression. Telephone calls to late payers should be routine, businesslike, polite; you can be firm but never personal or argumentative.
- If there are queries about whether payments are really due, investigate them fully and apologise if you have made mistakes.

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- Use threats of 'further action' extremely sparingly because you do not have too many options.
- One useful stage is to tell very late payers that you will have reluctantly to follow company policy and put their debt 'in the hands of your solicitors'; this means very little but it can be a final warning before you actually take legal action or you give up on the debt.
- You may find the idea of using debt collecting agencies unpalatable, but they can sometimes be helpful if you have a number of outstanding payments. Check out the approach and reputation of any agencies you employ – you don't want to be associated with heavy-handed methods.
- There is rarely much point in using a debt collecting agency (and paying a substantial commission on any money recovered) until you have exhausted your internal systems.
- It can sometimes be worthwhile exploring the arrangements for pursuing bad debts through the County Court system – commonly referred to as the 'small claims court'. But bear in mind:
 - although the Court is relatively free of bureaucracy and you do not need to be represented by a solicitor, it is sometimes advisable to get legal advice
 - you will have to pay a fee
 - the process can be time consuming, so it may not be worthwhile pursuing very small sums
 - even if the judgement is in your favour it does not guarantee that you will be paid what you are owed by wily debtors
 - more information and forms are available from the HM Courts Service at www.hmcourts-service.gov.uk
- Make sure that people who do not pay their bills are known to sales staff – you won't want to offer them credit again.

6.4 Financial reports

A poorly run business can topple from 'just getting by' to insolvency in as little as three months. If you are not producing monthly financial reports, you may not see this coming. And if you are not producing monthly financial reports there's a fair chance that you have a poorly run business.

What you need

The approach: Boards need financial information which:

- is useful (it contains things they need to know)
- they can read and digest quickly
- they can *learn to understand*
- they can question.

The essential monthly Financial Report: For most businesses most of the time there is only a need to provide directors with two pieces of paper containing:

- **the simplified balance sheet** at the end of each month showing what your activity is worth
- **an income and expenditure account** combined with a **budget report** which brings together

- details of *actual* transactions for the past month and the year to date, and
- previous *forecast* information for the same periods for comparison.

Tables 6.1 and 6.2 are example layouts for these reporting documents. The precise details they contain are a matter for individual businesses to decide for themselves on the basis of their monitoring experience.

The simplified balance sheet:

- **Why?** The balance sheet is extremely easy to prepare (if you keep good financial records) and wonderfully informative. In its simplest form any director can quickly learn to understand it.

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- **What does it do?** The balance sheet is a snapshot of how much money you would have on any particular day (usually the last day of the month) if you could pile up the cash from all your bank accounts and cash boxes, if your customers paid everything they owe you, if you sold all the trading stock you are holding, and if you then paid off all your debts to your suppliers, any outstanding VAT and Inland Revenue payments, and any bank loans. It is a precise snapshot of what the trading part of the business is worth.
- **What does it say?** The sum you end up with is your *net current assets*. It is not a real amount of money, so don't get too excited by it. But it can be a valuable indicator of how your enterprise is performing month to month. If the figure is minus rather than plus there had better be a good reason – such as a loan for investment in the business. Otherwise you could be in serious trouble.
- **What does it *not* say?** Just ignore items which you can't easily or realistically turn into cash – such as equipment and buildings. They will distort the picture, and could be difficult to assess. It won't correspond to the balance sheet in your annual accounts, and this is why it's called 'simplified'.

The monthly income and expenditure account report:

- **What it is:** The income and expenditure account at its simplest tells you what money has come in and what has gone out (itemised under standard headings, including separate sales figures if you have more than one trading activity) in the course of the past month.
- **What it says:** This will help to show whether your bank balance has gone up and down, but not much more.
- **What it does:** The two accounts provide an opportunity for scrutiny of the way the business is spending its money and discussions about how it is earning it. That's entirely legitimate. Unfortunately, there is a terrible tendency for the expenditure account to provoke distracting debates which have little to do with business performance. Managers do well to head off these discussions as soon as possible if they are not relevant.
- **What it does not do:** The income and expenditure account is an expected aspect of the finance report, and many reports will insist on it. But, depending on the type of activity, other information such as budget comparisons, can be more useful.

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Making sense of the balance sheet

Start here: The balance sheet is the single most important piece of financial information that most directors will encounter. If you are not familiar with balance sheets, you need to learn what they contain and how to interpret them. This section is intended for you. You should also refer to the model balance sheet for Anywhere Enterprises Ltd in Table 6.2. With the balance sheet you will get:

- an overview of the organisation's finances
- a simple way to monitor change
- the possibility of tracking different trading activities separately
- the reassurance that most aspects of your financial record-keeping are in good order
- answers to questions which newcomers may not have thought of asking.

Monitoring more than one trading activity: If your organisation has more than one trading activity your balance sheet reports may need to be adapted to show details for each of them separately in addition to the composite picture for the whole organisation. The combined information may be easier to compile and easier for directors to understand. But separate itemised figures for each business should be prepared regularly by finance officers, even if they are not always circulated to the full board.

Knowing you're in safe hands: The requirement that all this information is presented to the directors in writing at a set time every month (together with a system for the treasurer or finance committee to periodically check the accuracy of the information which is reported) provides the best evidence you can get of quality financial controls.

- Simply receiving a full report implies that the accounts assistant, treasurer, manager, or whoever does the graft, has properly recorded all the month's financial transactions, has banked the cheques and cash, paid bills, and extracted relevant information.
- Depending on your organisation's needs, the balance sheet may also include the outcomes of other key checks and procedures, including:
 - ensuring there are no hidden outstanding debts or spending shocks which have not yet reached the bank account
 - identifying who owes the business money, how much, and how old the debts are
 - bringing the PAYE payments up to date
 - maintain an ongoing VAT record
 - balancing the petty cash
 - carrying out a monthly stock check

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- carrying out a bank reconciliation and identifying any accounting errors.

That's a lot of reassurance to get from a simple monthly report.

Monthly comparisons: The balance sheet is excellent as a snapshot of your position at the end of each month. It can be even more useful for showing how things are changing over time when you compare balance figures over a number of months. Even if directors do not usually examine more than one month at a time, officers preparing reports for the board must learn to identify positive trends and danger signs, and be prepared to report them.

Tracking your assets: Here's what you should be aware of in the 'assets' section of the balance sheet.

- **A balanced view of the bank balance:** Don't automatically get excited by big current account balances or depressed by small ones. The amount of money in the bank is not necessarily an indication of the health of the business and it is desperately misunderstood by the directors and proprietors of small businesses everywhere. (If tomorrow you make last month's PAYE payment or bank a big cheque for work which you did two months ago, your bank balance could go up or down by thousands of pounds. But your financial position will not

changed by a single penny.) But you do need to be sure there is enough cash available if you have important payments to make.

- **Deposit account balance:** This may include reserves set aside to cover potential redundancies or savings for equipment or future projects, and you may want this shown as 'reserve funds' to avoid giving a false impression to staff and volunteers.
- **Cash in hand:** You don't want to see large sums under the 'cash in hand' heading. This is usually cash payments you have received but not yet banked – which could represent a security risk.
- **Petty cash:** For convenience this can be omitted if the amount you hold is small. But its inclusion can be a prompt for staff to carry out the monthly petty cash balance check.
- **Debtors:**
 - This information should be available directly from your credit control records.
 - If the number of debtors is small it can be useful to itemise them on the balance sheet.
 - Directors should be alert to high or rising levels of customer credit, and to individual debts which continue in successive months. If these are getting out of hand your credit control system probably needs to be improved.

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- You can include any overdue grant payments to your organisation as assets, either under the heading of 'debtors', or with separate heading if grant payments are frequently late.

- **Stock and the importance of stock taking checks:**

- Businesses involving production and sales, such as craft workshops, cafes and shops, need information about their levels of trade, stock or raw materials for a variety of reasons. The requirement to include the value on the balance sheet can be a reminder to carry out unpopular stock taking tasks at least monthly.
- Business stock may be an important element of the assets, although the way its value is estimated varies depending on the nature of the business. It is obviously important to adopt a consistent approach.
- The act of stock taking provides feedback on what sells, highlights both customer demand and levels of waste which should be reflected in purchasing and the costings of what you sell.

- Stock taking can reveal levels of theft and security needs. No one who sells crisps and sweets can be unaware of their tendency to disappear, but few of them appreciate just how much profit this is draining away in theft. It's one of several factors associated with management and control which accounts for the poor survival rate for community cafes.

Tracking your liabilities: Here's what you should be aware of in the 'liabilities' section of the balance sheet.

- **Creditors:**

- You need regular updates on the level of your indebtedness to suppliers to be sure you have resources to pay bills for raw materials, stationery, utilities etc.
- Month by month increases in your creditor totals might mean that you are spending too much money running the enterprise, and it might also mean that staff are delaying bill payments to conserve cash in the bank. Either way, it could be a warning sign.
- Conversely, if the creditor total is very low, it might be useful to ask whether your business is taking best advantage of credit facilities with suppliers. There is no point in being a prompt payer yourselves if this adversely affects your current account balance or slows your repayments on loans and overdrafts.

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- **Tax, NI and VAT:** Payments due to HM Revenue and Customs can amount to significant sums. Accurate figures on the balance sheet should indicate that payroll and VAT records are up to date and that you will not have difficulty paying them.
- **VAT:** Businesses which are registered for VAT may be net payers or net reclaimers of tax. Either way you should have a financial record keeping system which keeps a separate ongoing record of the VATable transactions and cumulative tax totals.
- **Advance payments:** You may sometimes receive payments for work before you carry it out and even receive some grants early. If you do, your bank balance will be artificially inflated. So, slightly confusingly, you need to record these advance payments as *liabilities* (ie, although it is money in the bank, you technically owe it to someone else at the moment). You may not think this matters, but if you forget to adjust for early payments it will not be possible to make meaningful comparisons between your balance sheets over successive months.

Understanding your 'net current assets': Finally, although meaningless on its own, the net current assets total is the figure you need to show whether your enterprise is making progress.

- By preparing and regularly updating a table showing the net current assets figures for each month for the past year (or perhaps a graph to show the results more vividly for those who don't like columns of figures), you will see whether your financial situation overall is getting better or worse.
- Variations over one or two months may be blips, but anything beyond that probably suggests a trend. A business can only really survive if it is growing, so you are looking for a steady increase in the net current assets figure. If the trend is consistently in the opposite direction it's time to take remedial action.

The budget and budget reports

Why you need a budget:

- **Monitoring progress:** Without a budget you won't have reference points to know your position, and you won't have targets. It is difficult to tell whether you are being successful, and you could miss out on the pleasure of knowing that you are.
- **Planning:** Without a budget you can hardly plan for the future (fix staff pay rises, buy new equipment, develop new enterprises etc), or you will do so in the dark.

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- **Authority for management:** Managers need budgets to give them authority. Once directors have approved the forecasts, the chief executive officer should be free to implement the spending decisions that it identifies (assuming that actual progress is more or less in line with the budget).

What did we know when we wrote the Business Plan?

- If the only budget you've got is the work of fiction in your Business Plan which you used to impress funders, it almost certainly needs to be updated as soon as possible.
- Perhaps you think it's cheating to rewrite your financial forecasts whenever they prove to be wrong? But budget projections are not intended to be a test of your fortune telling abilities, even if it feels like that when you write them.
- Any budget model which presents a picture of the development of your business is going to be useful to some extent. Then as you produce more versions each one will benefit from the feedback of your practical experience, and grow gradually closer to the way your business actually works – giving you more and more control over it.

Refining the forecasts:

- When you compare your actual income and expenditure, heading by heading, against your budget projection you will start to see what works and what does not. This is crucially important for monitoring sales income.
- It can be extremely useful to introduce refinements, by breaking income into different types of sales and reporting on each separately. If you run a catering service, for instance, you need to have separately itemised totals for daytime cafe takings, for sales from your sandwich round and for catering at functions and events. This will tell you both profitability of each activity and may provide feedback on your marketing strategies.
- You can also refine your expenditure forecasts in the light of experience and make them more detailed. But don't forget the downside: the more information you provide, the greater the risk that directors will be distracted by less relevant details and miss the broad brush development of their businesses.

Budget reports: A budget report tracks actual income and expenditure against earlier forecast, and can be a helpful measure of progress. Many non-trading third sector organisations use them too.

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- **When to use them:** Budget monitoring is useful in the following circumstances:

- in the early days of trading when the manager and directors need to know how close their business plan forecasts are to trading realities, so they can allow for timely adjustments to plans
- whenever finance forecasting can be carried out reasonably reliably – eg when there are long term contracts and other stable trading conditions
- when the financial situation is particularly tight: at these times regular reports against budget forecasts are usually essential, and managers should monitor them weekly or even daily at times of crisis (this is not optional good practice: anyone who has been through a financial crisis in their business will confirm that this level of monitoring is indispensable).

- **How much information?**

- **the current period:** A forecast for the current month or quarter is usually informative when set alongside the actual income and expenditure for the same period.

- **year to date:** Totals so far during the financial year - both actual and forecast - give a more balanced picture than monthly totals alone, and are well worth preparing and circulating (though it is tricky to fully automate the monthly updating on spreadsheet-based systems)
- **month-by-month budget reports:** It is possible to bring together all the monthly reports so far the current year, and include forecasts for the full year on a single sheet – and this may be useful for the detailed discussions of a finance subcommittee. But it is rarely useful for a full board meeting to have so much information in front of it. (One way to draw attention to just the current period is to use a coloured highlight or shading. But there is still a risk of producing information overload for directors.)
- **'same period last year':** Seasonal businesses in particular can benefit from reports which contain less budget information, but include a column or columns for comparable income and expenditure details for the same period last year and/or several previous years. This can highlight the growth or decline of different trading activities and focus attention on advertising and promotion issues.

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- **What they say:** The budget comparison may not tell you much if the dates of payments and receipts are not regular, and it usually needs to be interpreted carefully. If the monthly turnover figure suddenly goes down, how can you tell whether a guaranteed payment is a week or so late, or sales have slumped?

Financial monitoring for complete beginners

If you're starting from scratch: Unavoidably many people will become involved in managing social enterprise activity and will act as directors for trading companies out of sheer necessity with little knowledge of or feeling for the way the business world works. Here are a few tips for beginners.

Don't be embarrassed: Whether you are someone who is turned off by accounts or you simply don't know what to be looking for, you should not be embarrassed to tell fellow directors or work colleagues. If you pretend you understand financial reports when you don't you could become a liability.

Don't mention the toilet rolls: People instinctively talk about the things they understand. This is why, when confronted with a detailed financial report for a complex trading organisations, some directors discuss the cost of toilet rolls – or anything else they feel comfortable with. Anything to avoid the less familiar features of business finance. Debating trivialities when you should

be monitoring the budget report may be understandable. But it is often extremely unhelpful for your business. You should resist doing it, and you should drag the discussion back on course as soon as possible when you see others doing it.

Numbers with plain language: Problems with engaging with financial reports can be reduced significantly if directors receive short written reports in plain language to help interpret the figures. Then everyone knows what the issues are.

Don't be afraid to be dumb: Directors have a right, perhaps even an obligation, to ask dumb questions about the accounts if this helps them to understand the business. People are often afraid to ask the obvious, but simple enquiries can be challenging, and the answers may be enlightening for everyone.

Ask difficult questions: This is monitoring after all. So a question which might help you and your colleagues to get closer to understanding the performance of the enterprise is legitimate. If the information is not readily available or directors are not satisfied with the answer they get, there are other options - a report to the next meeting, a chat with the manager or treasurer later, or a private look at the accounts records themselves. It's what directors are for.

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Trust the manager:

- **Work together:** The manager/chief executive (depending which title you use) and the directors need to work together on the job of monitoring and interpreting the accounts. It is in their mutual interest to co-operate and build trust. Most managers welcome directors showing a serious interest in the accounts because it means they can share their concerns and their successes.
- **Be careful what you say:** It is of course right for directors to be wary if they discover there is a reluctance to divulge information. But it is vital for them to be extremely sure of their ground before questioning the competence or integrity of the chief executive – because the relationship will never recover.

Don't take precipitous action: Many decisions about improvements in the running of the business will stem from discussions of the financial reports. That is part of the value of the process. But the manager is probably much more familiar with the financial situation than the board. So directors should be extremely cautious and sure of their ground if they take any decisions which:

- are sudden, unplanned or only partly thought through
- the manager disagrees with, but will have to implement

- undermine the manager's authority or capacity to act independently in the interest of the business.

Distinguish 'sales' and 'income':

- As mentioned earlier, in some businesses which offer credit to their customers, there is an important difference between:
 - **sales**, ie the transactions which create a value for the business but not necessarily a financial payment at the point when goods and services are provided to the customer, and
 - **income**, ie money received when goods and services are eventually paid for.
- People without business finance experience can easily confuse the two when examining trading information. Take a small social enterprise which produces novelty Christmas cards. October, November and December are the best months in the year for sales of the products, and January the worst. But the money from sales during the hectic pre-Christmas period does not start to roll in until January. Awareness of this basic picture is essential for almost all the business decisions you take, from knowing when to recruit and lay off staff to assessing whether it is appropriate to develop new markets and invest in new equipment.

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- Even if you don't follow the detailed running of the business, the balance sheet should tell you what is actually going on. In the above example
 - relying on the income and expenditure report for January may mislead a novice into thinking that you are making a fortune
 - a comparison of the balance sheets over several months (specifically, the monthly change in the 'net current assets' figures) will tell you whether your sales are actually generating a profit.

Get the format of reports right for you: Directors may have a need and certainly have the right to:

- determine the format and content of financial reports to make them more understandable to members
- receive training on business and financial issues, and on interpreting financial reports
- be supported to learn about the special features of third sector trading which make it different from other types of business activity

- interpret their trading activities and business organisation in terms which are relevant to the social objectives of their organisations, and to minimise business concepts which are alien to these social objectives.

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Table 6.1: An example layout for a monthly income and expenditure account report.

The highlights draw attention to the figures for the current month

ANYWHERE ENTERPRISES LTD				
Income and expenditure account and budget report for (month)				
	Forecast for (month)	Actual for (month)	Forecast year to date	Actual year to date
INCOME				
Sales type 1				
Sales type 2				
Sales type 3				
Grants				
Membership fees				
Other income				
Total				

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	Forecast for (month)	Actual for (month)	Forecast year to date	Actual year to date
EXPENDITURE				
Wages/salaries, NI				
Fees				
Rent and rates				
Heat and light				
Phone				
Stationery and printing				
Travel and transport				
Publicity				
Cleaning				
Repairs				
Insurances and audit				
Bank costs				
Miscellaneous				
Capital equipment				
Total				
BALANCE				

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Table 6.2: example format for a balance sheet

ANYWHERE ENTERPRISES LTD			
Balance sheet at (end of month)			
ASSETS			
Current account balance	£		
Deposit account balance	£		
Petty cash	£		
Cash in hand	£		
Debtors (owed by customers)	£		
Value of trade stock	£		
Loans to other bodies	£		
Other assets and receipts due	£		
Total assets		£A	
LIABILITIES			
Outstanding loans	£		
Creditors (owed to suppliers)	£		
PAYE	£		
VAT payment due	£		
Advance payments (not yet due)	£		
Other liabilities	£		
Total liabilities		£B	
Net Current Assets			£A-B

7: Managing growth

7.1 What growth looks like

Third sector enterprises may take years to evolve from vulnerable grant dependent deliverers of services to confident, sustainable organisations with business activities which must to some extent make a profit. Inevitably organisations change in many ways in this process, often haphazardly, and there is no single model of development. But if you understand what the options are and what evolutionary steps to watch out for in your own organisation you will be better equipped to recognise and respond to opportunities for growth as they emerge.

Enterprise growth points

The emergence of growth points: Successful enterprises tend to evolve as growth points in comparison with the third sector activity around them. (The current jargon is 'community anchor organisations') Typically:

- By definition, they get bigger.
- Additional resources give them more robust management structures – the chief executive officer or manager no longer has to act as the chief finance officer, personnel manager, quality control clerk and caretaker (though s/he probably still helps out when necessary).
- They operate a wider range of activities, and may handle several different types of grant and earned income.
- They undertake more demanding and substantial projects, and generate more income from them.
- When new grant money has to be spent quickly (such as end of year slippage in the public sector) it often comes their way because they are sharp-witted, flexible, and have plans on the shelf which are ready to run.

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- They are operating over a wider geographical area, because they have picked up contracts which might have previously gone to smaller organisations, or because they have persuaded councils and others that they are competent to do work which was once carried out by public sector bodies or private businesses.
- The ratio of grant funding to earned income has significantly reduced.
- They own or have long-term leases on property which makes them more secure.
- They work in partnership with public sector bodies, and are treated with greater respect (though rarely as equals).
- Their expertise is recognised by others, so they are sources of advice and support to other voluntary organisations (often formally as organisations which support and promote community development or social enterprise development), and they may sell their staff skills through consultancy work.
- They arrive in their mature, independent, self-supporting form through a mixture of skill, hard work and blind chance helped by the willingness of directors and staff to be flexible and take measured risks.

How growth points work: It is not particularly surprising that successful social enterprise organisations grow in this way. But it has taken government and other parts of the third sector to wake up to the significance of cultivating their success.

- **Growth points are *not* like old-style community businesses:** Successful social enterprise growth points contrast vividly with the stand-alone community business model with just one or two key trading activities which developed in Scotland and in isolated pockets elsewhere in the 1980s and 1990s. Voluntary organisations are not good at replicating the single-mindedness of conventional business.
- **Growth is based on a mix of funding and a range of activities:**
 - if one activity fails it can disappear without affecting the stability of the whole organisation, so they become more resilient over time
 - third sector enterprises often choose to subsidise their loss-making activities while they are getting on their feet.
- **They extend into new markets wherever they can:** As in the case of dynamic conventional businesses,
 - economies of scale make them more efficient

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- acquiring expertise as specialists in their fields (even in relatively mundane areas) adds to their range and attractiveness of what they sell.
- **They sell their skills as trainers, development agencies, advisers and consultants**, ie they are able to realise a market value for expertise and experience (which increase as long as they are delivering other services).
- **They are good for the public sector to invest in:**
 - they give good returns in public service when they receive assets, contracts, grants, new responsibilities and encouragement
 - taken as a *whole* an expanding third sector trading organisation which is becoming more sustainable is a relatively good investment: not everything succeeds, but its diversity ensures that it will not disappear overnight
 - unlike non-trading community regeneration and community development organisations, the return on this investment increases exponentially over time after a usually slow start.

Other models of development:

Different patterns of growth: The 'growth point' version of development applies mainly to robust multifunctional organisations and partnerships, such as development trusts, which have the scope to be flexible. But there are other models which show quite different characteristics and which tend to be judged by different standards. Here are a few examples.

When growth prospects are more limited: Charities providing social services for more narrowly defined groups of people such as children or disabled people, and those addressing specialist needs have more limited opportunities to achieve this scale of operation. They may extend geographical boundaries to raise more contract income. But ultimately the charitable cores of their indispensable social services may never achieve complete sustainability. This is not failure. It's reality which cannot be influenced by grant cuts by public bodies if economies are demanded.

The Oxfam model: Charities may hit on a particularly effective way of trading which takes off more widely and becomes a 'franchise'.

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- Perhaps the best known and oldest of these is the brand of shops which are to be found throughout the UK but which started in Oxford with an overseas development charity called Oxfam. It was a good idea which travelled extremely well and has been imitated many times over.
- It is not necessary for an organisation to own a franchise. Time banking has evolved radical ways and spread throughout the country, and time banks are typically local organisations with their own structures and arrangements designed to fit local circumstances. Sometimes, as in the case of Creation Development Trust in Blaengarw, Bridgend, they become part of another social enterprise organisation. Meanwhile the 'brand' is assisted by national promotion and support by the Timebank charity.

Growing to survive: Another interesting evolution in social enterprise can be found in credit unions which took off in the UK with efforts to emulate their success in small towns in places such as Ireland and Canada. It became clear early on that a very local model was wrong for the UK, and that credit unions would fail unless they were allowed to operate over much larger geographical areas – counties and cities rather than neighbourhoods.

Intermediate Labour Market schemes: Intermediate labour markets are an entirely different model of third sector enterprise, often operated by much larger organisations. Here the core objective is to help people who have difficulties getting into the labour market to gain the kind of experience of employment which will equip them to move into jobs in the mainstream economy. They are heavily grant funded for fixed contract periods (for instance, by the European Social Fund), and do not have the same compulsion to grow in size as other versions of social enterprise. Perhaps because they are usually run by substantial bodies, they do not suffer from the same stigma of unsustainability as community-based groups and charities. But they are not necessarily any longer-lived.

Ways to grow your business

Value Wales and procurement for small enterprise: Welsh Assembly Government has actively promoted the concept of local government procuring services from small businesses in Wales under the Value Wales scheme.

- **Tendering:** Under Value Wales third sector enterprises have access to local authority contract tendering. This includes the outsourcing by public bodies of personal social care services, training, consultancy and research, and can have direct benefits for charities and community-based enterprises.

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- **Value Wales Information:** Value Wales operates under the banners of Buy4Wales (advice for public bodies) and Sell2Wales, which offers a free email service to Welsh businesses with announcements of public sector contracts in Wales plus many from other parts of the UK.

- Any potential contractors can sign up for the service at www.sell2wales.co.uk.

- For more information on Value Wales go to www.wales.gov.uk/improvingpublicservices and click on 'Better Value for Money'.

Other guidance: Other sections of this guide designed to help you to plan and achieve the growth of your social enterprise include:

- Selecting business ideas: section 2.7
- Business planning: sections 3.1 and 3.2
- Ways to fund the business: section 5.1
- Resourcing sustainable enterprises: section 5.2
- Raising money with shares and loans: section 5.4
- Finance for development: section 7.2
- Making Assets Work: section 7.3
- Managing for sustainability: section 8.2

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7.2 Growth: finance for development

Many people claim without thinking and without evidence that the problem for financing social enterprise is that the right sort of funds are not available. The real problem, though, is that many enterprises either don't know what sort of funding they want, and when they choose they are prone to make mistakes. The contribution which is most needed to meet the challenge of financing social enterprise growth is help for isolated practitioners everywhere to understand the options and learn how to recognise what they need as their activities evolve.

The challenge for financing growth

Myth and reality: It is often said that third sector trading is held back by difficulties with finance. This was probably true in the past, and some large and highly complex projects involving partnerships between community and private sector organisations (eg for expensive renewable energy projects) may always struggle to attract backers. But there are many other factors closer to home and rather more controversial which are limiting the growth of businesses. If you don't face up to them frankly they will continue to stop enterprises from achieving their potential.

Why is growth so difficult for social enterprise? Here are some of the often closely related factors which are restricting the natural business growth of third sector businesses. Some ideas may be considered heretical. But even if there is no immediate agreement on the source of problems, it is healthy to have the debate.

- **the massive grant dependency** of the third sector, caused among other things by
 - the long history of grant funding
 - weak funding policies by some grant making bodies which unnecessarily limit risk, flexibility, innovation, and ambition
- **lack of confidence** among charities and community organisations (often cultivated by the permanent insecurity of funding regimes) – caused by
 - the unattractiveness of loans compared with the comfort zone of grant funding
 - unfamiliarity of business investment models and terminology

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- **risk aversion**

- unwillingness of public bodies to allow or encourage community organisations to take up challenges which might involve risks – most obvious in persistently negative attitudes towards asset transfer initiatives
- unwillingness of community organisations to 'gamble with' (ie to invest) the public money they are responsible for
- the necessary restrictions on the use of charity funds

- **the isolation** of innovative projects and their leaders, who may mistakenly feel they

- don't have time for networking or attending conferences
- are 'too different' to fit into other people's funding criteria
- don't need others telling them how to develop.

- **the unrealistic expectations** of quick or unachievable results for businesses which are sometimes cultivated by public officials and politicians

- **lack of skills** among enterprise which have taken the plunge into loan finance but have failed to understand the importance of sound market research, business planning, risk management and financial management

- **obstacles presented by legal structures** – the widespread use of charities as social enterprise vehicles and the failure of the Community Interest Company legislation to provide anything radically better for emerging enterprises

- **lack of coherent leadership** across what is sometimes referred to as the 'social enterprise sector', where

- a variety of support agencies have promoted different and not always consistent approaches to sustainability, grants funding, development, asset transfer, investment etc
- proactive advice and *encouragement for entrepreneurial thinking* is sometimes less accessible than sources of information for those who already know what they need to do

- **confusing finance options** – where it is not the lack of finance but the difficulty for inexperienced people to understand and locate the arrangements they need, which can be caused by:

- limited support for enterprises in making complex finance decisions
- the variety of financial scheme with different levels of funding and different conditions

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– unhelpful marketing; what does it actually mean if a finance organisation says it 'invests in social enterprises' when there are so many types of third sector business?

– limited finance packages suitable for small and emerging enterprises

- **the clash of cultures:** a combination of the suspicion of some community entrepreneurs for the financial investment industry (enflamed by the 2008-09 banking collapse), and the reality that some private sector funders really don't and can't understand third sector enterprise.

Bad risks: Of course, in many cases it would be plainly foolhardy for an institution to provide and a voluntary organisation to accept loan funding. The operation of so many enterprises in disadvantaged communities and in activities which the private and public sectors cannot sustain produces a massive barrier. But if doubts are unfounded, it is up to social enterprise organisations to make their case more vigorously and more convincingly.

Overcoming the obstacles

What does this mean? This daunting catalogue of obstacles also points to what people who are new to business finance ought to do to improve their prospects.

Free up your thinking: Be imaginative and creative with your enterprise:

- third sector business are often astonishingly creative; so use your imagination to dream about what organisation *could* become with the right sort of help
- have regular review meetings for directors and staff (at least once a year) and include sessions on longer term possibilities: if some ideas keep coming back each time you meet, maybe you should be pursuing them more seriously
- don't be constrained by always thinking about what you could do if you had the grant – there are other ways to make things happen
- visit other projects regularly, home in on the initiatives which inspire you, and find out how they were achieved.

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Be serious about loan finance:

- The main point about loans is that they have to be repaid, even 'soft' unsecured loans. So can you meet the repayments?
- Face the fact that if you don't repay secured loans you may actually lose your treasured buildings and projects altogether.
- But don't be timid. If you invest in property sensibly and it does not work out, you should still have an asset you can sell to pay off your debts. A set back, but not total disaster.
- Focus on capital developments at first
 - buildings and refurbishment where you can see a clear way to generate income to make repayments
 - equipment and technology to reach bigger and more lucrative markets, and undertake higher paid work
- Avoid unnecessary risks:
 - don't think about borrowing money for revenue costs if you are inexperienced
 - never borrow money to get out of difficulties or prop up a failing venture unless there is a cast iron plan to show how the investment will work.

Be serious about planning:

- Write realistic business plans – *not* the ones you write to please funders where you'll say anything to get the grant, but plans you write for yourselves to tell you exactly what you need to do.
- Face up to the weaknesses in your project, even when this hurts, and deal with them:
 - get independent advisors to tell you the flaws
 - work out ways to minimise but not disguise the dangers and risks.
- Identify the issues where finance staff, partners and banks will have reservations – and show how they have been or will be addressed.

Get sound advice and support:

- **Do initial homework** to find out as much as you can about the possibilities, the funding sources and the conditions: there is a plenty of information to be gathered by
 - trawling the internet
 - visiting other projects
 - attending conferences and seminars

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- making direct contact with support agencies
- making preliminary checks on financial institutions.
- **Now do the analysis.** Weigh it all up by considering:
 - what is still confusing and incomprehensible, and what questions do you still need to answer?
 - what are the main practical options available to you? do you fully understand them?
 - what seem to be the most reliable sources of information?
- **Work with your advisors:** You need the patience, attention, time and honesty of the people who are advising you. They are more likely to give you that if you have an open relationship, with mutual trust and respect. That means taking their advice seriously. If you ignore your advisors, they will probably ignore you in future. So if you don't want to take their advice, explain why it won't work.

So where will investment funding come from?

Considering the wider possibilities: Don't let your horizons be restricted by a narrow choice between grants and loans. The following list is not exhaustive, but it gives a flavour of the wider possibilities:

Grants: Grants don't have to be bad for you if you are not going to be wholly dependent on them and if they help to release the potential of a dynamic and innovative enterprise. If you talk to the right funders you will find that they will understand what you are trying to do and want to help without getting in your way.

Earned income: This is the way many businesses grow. Letting property, for instance, can generate significant income to re-invest in new trading activities if there are no loan repayments to make and there is a market for the accommodation. Enterprises with a range of different sources of earned income (commercial contracts, fees and charges for services etc) may find themselves with surpluses provided they are not also struggling to fund an expensive core of managers and administrators. But there can be major problems:

- using profits to fund an expansion can involve a lot of painful 'sweat equity' in the form of long unpaid staff hours or voluntary activity
- using the profits on an existing trading activity to fund the start of *another* business could undermine the long-term health of the venture which is producing the wealth: it's obviously better if a successful enterprise invests in its own expansion

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- retaining profits for future investment will also incur corporation tax which normally can't be eliminated through Gift Aid
- most social enterprises (despite the optimism of some directors, and the illusions of others) do not make profits to re-invest in the first few years.

Funding expansion out of current trade: A common practice for many businesses is to buy the new and replacement equipment they need on the strength of their latest big order. Meeting the customer's need might only be possible if you buy an otherwise unaffordable piece of software for a design business or new projection equipment to accommodate a lucrative conference in your community centre. Making the investment now probably means that you will make a loss on the current order. But in future you will be able to charge more, provide a better service or work more efficiently. You will soon be bidding for work which was previously beyond your reach.

Contracts with capital funding: In a similar vein, enterprises can occasionally secure contracts to provide services to public bodies where the cost of necessary investment is covered by the fee they charge. This would be in addition to what is needed to pay salaries and operating costs, and might be used to pay for essential equipment and the improvement in buildings.

These improvements – a new vehicle, kitchen facilities, or building improvements perhaps – should then be made available for other users either now or when the contract ends. (If the opportunity arises you should think hard about getting the best possible long-term benefit from the improvements you invest in. It is astonishing how little this happens and how much flashy equipment and high quality accommodation becomes redundant when contracts are over.)

Grants linked to loans: Funding bodies too rarely provide joint grant and loan arrangements, although this can be hugely valuable for starting to wean enterprises off the grant dependency. The Wales Council for Voluntary Action and the former Welsh Development Agency have both run such schemes in Wales.

Unsecured loans: Unsecured or 'soft' loans are often offered by organisations which have affinity for social enterprise activity and which may support the third sector. A number of organisations help with the purchase of building assets, and so provide an alternative to conventional mortgages. Sound business plans are vital.

Secured loans: Secured loans and conventional mortgages may also be useful for organisations acquiring and developing property assets. Sound business plans are vital.

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Bonds and shares: Bond and share issues are popular with co-operative organisations, and offer opportunities for raising finance which are often neglected by community organisations. More information is provided in section 5.4.

Appeals and voluntary effort: While business loans are clearly a grown-up way to support expansion which can earn credibility with customers and credit with future funders, old-fashioned fundraising may still work. The capacity of volunteers to raise money by doing extraordinary things or just making a big fuss is legendary. It can be appallingly hard work, and takes great commitment. But the effort can sometimes save and acquire treasured buildings, and bring threatened icons of our heritage, culture and the environment back into productive economic use. If you take this route you still have to make sure that you have realistic business plans, achievable income generation targets to sustain your project, and energy left to achieve them. But that's no reason to be snooty about the power of volunteering to change the world.

Sources of loan finance

Sources for 'third sector' projects: Various loan providers offer different levels of finance, each with their own specific criteria and rates of repayment, to third sector groups. Funding schemes come and go, and their objectives and terms and conditions are constantly changing, but may be worth checking out. Providers will usually expect a good financial return on investments, but they also recognise the importance of social, ethical and environmental concerns.

In order to ensure the material in this publication does not date too quickly, the providers and schemes referred to above are listed in information sheet 7.5 Loans, [change to Enterprise?] part of the *Finding and getting money* series available for download from WCVA's website or any CVC website. These information sheets are regularly updated to ensure information and contacts are up to date.

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7.3 Making assets work

Perhaps the single most important step for social enterprise development among charities and third sector organisations is the transfer of redundant building assets from public bodies to community control and ownership. Yet, years after the idea emerged and long after the 2007 government-commissioned Quirk Review recognised its value and provoked policy changes in Westminster and Cardiff Bay, it is still contested in some places as a serious risk to the assets of local authorities which community organisations are not capable of coping with.

There is now a new danger that spending cuts will persuade some public bodies to dump non-viable buildings on unsuspecting community groups. The answer is not to be deterred by the obstacles, but to gear up your organisation to be robust and effective enough to take on the challenge and realise the huge potential which the right asset transfer projects can offer.

The importance of community ownership of assets

Potential benefits: The Quirk Review provided an encouraging vision of revitalised communities driven from within and 'an explosive growth of social entrepreneurs' resulting from this simple shift in ownership. The benefits it identifies for communities where the assets are situated are widely acknowledged in the third sector:

- Users of assets controlled by communities are better able to plan for the future.
- Wealth and job creation activities will bring increased income and improved health.
- Wealth creation can have a powerful multiplier effect – restoring confidence, business viability and land values, and attracting new investment.
- Asset-based, community anchor organisations can play a powerful role in promoting community cohesion, and asset ownership can have a major effect in building community confidence.

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- The surpluses generated by the community organisation remain in the community and can support innovative projects and provide community facilities and development support
- The buildings that are taken over will sometimes occupy iconic status. Restoring them to productive uses which address local needs can give a significant psychological boost and new hope to local communities.

Tough challenges: There are many examples of enterprises which have realised this optimistic vision. But in practice, achieving all these benefits in the real world is inevitably neither easy nor guaranteed.

- Owning assets outright or taking a long term lease both involve organisations taking on significant levels of responsibility, persuading the owners of the buildings they have the necessary skills, striking an advantageous deal, and developing business uses and management arrangements to realise the benefits.
- Choosing the form of asset transfer which is best for the community organisation or charity can be confusing (see below).
- Since not all asset transfers to the third sector are successful, the sceptics now also have the evidence of failures to justify making the acquisition process challenging if they choose to.

- At the same time, spending cuts will inevitably lead to a greater enthusiasm in local authorities for the transfer of loss-making community buildings/facilities to small organisations who may have even less capacity to make them sustainable.
- If local groups are expected to take responsibility for repairs without grant support, they will need to be extremely confident of raising the income they are likely to need. They will be left to take the blame if the facilities are eventually closed.

Asset transfer options

How assets can be transferred: There is a bewildering array of options for community organisations starting to explore possibilities for owning and using property, many of which do not involve outright ownership. They may well find themselves in negotiation or even in conflict with their local authority over the most appropriate form of transfer for them. Table 7.1 objectively analyses the respective advantages and disadvantages of each option. (You need to read it with an open mind. Don't forget that councils are usually happier with a position which gives more residual authority to them and less control to the enterprise. So something which may seem to be a disadvantage to you, may be seen as an advantage by a sceptical authority, and so improve your chances of a successful transfer.)

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Table 7.1 Types of tenure in asset transfer

Type of tenure	Advantages	Disadvantages
Freehold		
Buying the property as full owner through a legal document entitled a 'conveyance'	• Security of ownership • Creates sellable asset • Independence • Can use asset to help raise debt and equity funding • Not subject to service charges • Freedom to improve or redevelop the asset, and to attract grants to do so	• Expense of purchase • Cost of repairs and insurance • May not be sellable if in poor condition or deeds forbid it • It is much harder for a local authority to restrict future use of premises than with other forms of tenure
Long leasehold		
Buying a lease of 22 years or more and paying 'a premium' (initial capital) then a low rent. Lessee has all the responsibilities of a freehold owner	• Security of ownership • Creates saleable asset • Independence • Can use asset to help raise debt and equity funding • Local authorities can restrict use of the premises using covenants placed on any lease	• Expense of purchase • Cost of repairs and insurance • May not be sellable if in poor condition or deeds forbid it

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Type of tenure	Advantages	Disadvantages
Lease		
Taking a lease for a fixed period of years at an annual or 'rack' rent	• Security of tenure (usually) rights under The Landlord and Tenant Act 1954 • Local authorities can restrict future use of the premises using charges placed on lease. • In some cases rent may be low or peppercorn • In some cases maintenance costs may be shared with landlord • The local authority may be better disposed to granting discretionary rates relief	• Expense of rent and service charges (which may increase regularly) • Cost of repairs and insurance • Shorter leases limit a group's ability to improve premises and to raise funds for improvements
Tenancy agreement		
A verbal or written open ended agreement with a monthly, quarterly or annual rent and which can be terminated by either side giving notice	• Easily terminated by the tenant • Rent may be cheaper • Often less responsibility for repairs/insurance • May have security of tenure • More likely to have discretionary rates relief	• Normally little security of tenure especially if verbal or for a period of less than six months • May be restrictions on use of premises • Makes fundraising more difficult

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Type of tenure	Advantages	Disadvantages
License to occupy		
Permission (verbal or written) to occupy for a short period (usually up to one year). Can be terminated by either side giving notice	• As with tenancy agreement, excepting no security of tenure • May be exempt from business rates • May allow a new group a chance to demonstrate its capacity to operate and its case for occupying the premises on a more secure basis	• May be restrictions on use of premises • Local authority may often need to give only short period of notice
Tenancy at will		
A licence to occupy at the will of the owner/landlord. Tenant may be evicted at any time on as little as 24 hours notice	• As with licence to occupy	• As with licence to occupy

Source: 'Acquiring and managing premises' Information sheet, Voluntary Action Sheffield (2007) with amendments

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Pre-empting concerns about risks

Handling the risks: There is not scope in this guide to cover the issue of transfers exhaustively. But one of the most serious practical obstacles to asset transfer is concern about the risk involved, mainly by public bodies, but also by social enterprises concerned about the liabilities for management, maintenance and ongoing community involvement. Greater progress can be made by addressing the risks directly and openly together. There is also evidence from experience with at least one Welsh local authority that once fears of risk are settled, the council may be able to be much more generous in the way it disposes of its asset than was envisaged during the negotiations.

Potential risks: Guidance material produced by the UK government for community organisations and local authorities comprehensively identifies risks and suggests specific actions to reduce them so that the transfer can go ahead. It successfully removes most perceived barriers to social enterprises taking over council buildings.

- **Risk 1:** Community empowerment objectives proposed by community organisation are vague, weak or not aligned to those of the local authority:
 - reviewing the objectives
 - a community needs survey
 - partnership working
- **Risk 2:** The receiving organisation does not have the capacity to manage the asset:
 - skills audit, an agreed organisational development plan
 - access to on-going expertise and advice
 - a 'handover document' setting out responsibilities
 - formal agreement on the minimum level of usage expected
 - requirement for a viable long-term business plan
 - transfer the building on a phased basis, or for a specified period with responsibilities for repairs retained by the council
 - specialist technical help provided by the council
 - legal clause on retaining community use if the community organisation ceases to trade.

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- **Risk 3:** Local authority lacks the capacity to support the asset transfer:
 - sharing the support role across service directorates
 - budgets for council support officers
 - arrange support from other bodies. Manage them.
- **Risk 4:** Community organisation does not have the funds to purchase or refurbish the asset:
 - council commissions or funds a conditions survey, and assessment of fitness for purpose
 - group is provided with a financial picture for different transfer options
 - phasing any improvement programme
 - council retaining maintenance liabilities, or an endowment to cover maintenance
 - price reviewed in relation to proposed use and liabilities
 - transfer on lease with nominal rent, or council retaining tenure while the group manages the asset
 - recognising the value to the community organisation of a long lease or freehold sale.
- **Risk 5:** Community organisation cannot afford to maintain the asset:
 - a long-term business plan
 - an agreed organisational development funded by the council
 - access for the group to on-going financial expertise and advice
 - shared repair options
 - 100% rates relief
 - use local procurement and tenancies to underpin revenue streams.
- **Risk 6:** Lack of knowledge of an historic building asset:
 - council action to carry out initial condition research,
 - commissioning and retaining a surveyor/conservation architect/project manager.
- **Risk 7:** State aid rules could prevent public financial support for a project:
 - explore exceptions on grounds of the minimum ceiling (200,000 euros), contracting rules, “permitted support” for social and economic projects, and local activity which would not affect trade between EU member states

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- ‘permitted support’ includes culture, employment, environmental protection, research and development, regional development, undertakings in deprived areas, aid to SMEs and training, provision of social housing, improvements to physical environment and brownfield sites
- **Other possible risks which are also recognised and addressed:**
 - asset not used in the public interest
 - fragmented ownership of council assets
 - possible confusion in roles between the local authority and the community organisation
 - limited potential for enterprise development
 - reliance on a small number of volunteers
 - use would not fit with wider strategic aims of the local authority.

Further information

The Asset Transfer Unit: The Asset Transfer Unit (ATU), which is based with the Development Trusts Association in London, provides a comprehensive CD-based pack of information and guidance materials to enable enterprises to take advantage of the approach. The unit offers information, advice and support on local asset transfer initiatives, tel 0845 345 4564, web site www.atu.org.uk, email info@atu.org.uk.

The ATU pack: The information pack includes:

- *To Have and to Hold, the DTA Guide to asset development for community and social enterprises*, a detailed handbook describing the processes of acquiring, developing and managing property assets

- *The Green Assets Guide* on the environmental considerations of developing property assets, including energy and water conservation, waste reduction and recycling, key regulations and sources of information.
- *Managing Risks In Asset Transfer - A Guide*, describing how the concerns of public authorities about the dangers of transferring assets to voluntary organisations can be confronted and the risks minimised
- Official government guidance on the disposal of land and buildings
- Charity Commission guidance on issues such as working with local government and managing property assets.
- Background reports and materials to make the case for asset transfer.

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7.4 Online trading

Community organisations and charities working in disadvantaged communities or rural areas and those serving widely dispersed communities of interest have historically experienced difficulties in reaching customers. If they make or sell things their markets have been limited and their aspirations necessarily modest. The internet is changing this.

Powys CIC, trading under the name Ten Green Bottles, is an enterprise based in New Radnor in rural Powys producing goods made from recycled glass. It is an environmental organisation working to find ways to make use of waste materials, and it provides training for unemployed people, people with mental health problems and people with learning disabilities. Its striking range of jewellery, tableware and ornaments is sold on line on a professionally designed site which makes the business virtually indistinguishable from a conventional private sector operation – enabling the enterprise to reach customers all over the UK. The Ten Green Bottles site is at www.greenglassmountain.com.

This section describes some of the issues which third sector trading organisations need to consider if they want to take advantage of the massive potential of online trading.

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What's involved in online trading?

New but not newfangled: Online trading is no more complicated than running a conventional shop. But it's a relatively new way of doing things, so the practicalities may seem unfamiliar to those who have not used this form of selling before. Even so, huge numbers of people are regular customers of sites such as eBay and Amazon, so there's really nothing newfangled about this way of doing business. And most people in business today do not find it difficult to take the simple first steps of advertising their goods and services to potential customers by email.

The basics: If you are interested in online trading, here's what you need to get to grips with:

- basic decisions about how interactive and self-contained the online trading experience will be for customers
- basic regulations governing the way online trade is carried out
- setting up and maintaining the website where the trading will take place
- systems for responding to orders
- marketing and promotion to make the business work.

Contracts: Contracts with customers on the internet are necessarily different from those reached face-to-face or

conventionally in writing. The regulations and the software you use mean that it is fairly clear what you need to do and how you will operate in practice.

Charities:

- **The trading name:** It is important that trading organisations make it clear on their web site exactly which organisation their customers will be dealing with. If it's a subsidiary trading company you must operate under this name rather than that of the parent charity.
- **Donations:** It is good practice to keep the trading facilities quite separate from any online giving arrangements to avoid confusion for users.

Organisational capacity: The fact that setting up a site is fairly easy also means that third sector organisations may be tempted to start online shops before they have developed the capacity to run them properly. Don't risk it. There is too much which can go wrong.

- **Attention to detail:** It is just as easy on line – perhaps even easier – to alienate your customers with poor presentation, misleading information, out-of-date shop windows, late deliveries and generally poor service as in face-to-face trading. The web is a minefield of infuriatingly outdated information, and you won't get return customers if your site is contributing to it.

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- **Business mistakes:** The same applies if you repeatedly make mistakes with orders and charging, but with more serious consequences. It is easy for vociferous customers with a grievance to complain about businesses on line, anonymously if they choose. Your business could be written off by damning reviews of relatively short periods of poor performance, with little hope of recovery.
- **Techno-paralysis:** If you take the DIY approach to setting up your shop, beware of the computer geeks in your organisation who are more interested in playing with the technology than running a business. They can seriously slow you down.

The online shop

What to sell: Consider carefully what your site will sell, and how it will be viewed by customers. The third sector tendency to do anything and everything may not be applicable here – a site selling delicate jewellery made from slate may not appear too sophisticated if it also promotes slate chippings by the ton for garden paths and rockeries.

How to sell: There is no single way to use the internet for trading. Online marketing is becoming big business in its own right, and you will need to get your head round its implications for your business. You should explore the options which are best suited to your organisation, your products and your financial resources. You will probably discover in time that you can productively use more than one approach. Another point to recognise is the opportunity for different levels of activity, and in particular to test the market with market research and pilot trading before making decisions which involve commitments to significant expenditure and preparation.

- **internet advertising:** An existing website or emails to a list of potential customers provide opportunities to test the market before you invest in establishing an online shop.
- **using the “social media”:** Commercial organisations are increasingly taking advantage of opportunities offered by sites such as Facebook and Twitter to reach large numbers of people extremely inexpensively.
- **eBay:** Many individuals and organisations develop businesses by trading on a small scale on eBay and similar sites. These provide marketplaces familiar to customers and purchasing arrangements which give them confidence. There is no need to be restricted to selling by auction.

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- **funding your site with advertising:** Internet service providers and other internet traders give you the opportunity to generate a modest income, or at least to offset costs in a small way, by advertising other businesses on your site. This won't suit everyone, but it can be worth considering if you generate a lot of traffic.
- **3to3:** Being part of a club can be helpful and reassuring for organisations starting out on new activities. 3to3 (at 3to3.org.uk) is a kind of marketing co-operative for the third sector, which might suit your business.
- **setting up your own online shop:** If you have access to the software and the IT skills you can design, set up and run your own website for your online shop. If you don't want to pay for an expensive programme, it is not hard to find open source software on the net, and set up your site for nothing – provided the task is taken on by someone who knows what they are doing and can live with the constraints.
- **web-hosting:** Alternatively you can contract with an independent provider to run your site for you. This may be cheaper and it is said to be extremely simple to set up an online shop this way, which makes it highly attractive to newcomers. The bigger hosts tend to offer the option of a preconfigured "web shop" that you can set up interactively. The downside is that you have less control and the results may be rather bland.

Business planning: As explained elsewhere in this guide, effective business planning and preparation for trading is always necessary. There is nothing about online shops which makes careful and accurate pricing and thoughtful marketing less important than they are in any other trading context.

An effective online shop: Modern software can deliver high quality sites, but the quality of the end result may depend on the designer and the way the site is run. Careful risk assessment, technical checks and staff training will be necessary. You will need to ensure that the site:

- is well presented, and is up to the standards of site run by your competition
- provides the kind of features you and your customers might need, perhaps including opportunities for customer interaction
- has an internet connection which is fast enough to be usable by customers
- is reliable and accessible – you will lose business if the site is constantly going offline
- is secure enough to guarantee both effective two-way communication and confidentiality for your customers and your own systems.

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Customer confidence: The online shop is the public face of the business. Before you can persuade customers to buy your goods in significant quantities you need to win their confidence. There may be more to this than you think. The issues include:

- secure payments
- delivery
- site contents
- advertising and promotions
- technical matters such as web-hosting and your domain name.

Secure payments: You will need to establish a payments system which you know is resistant to hackers, and which your customers can have confidence in. Systems such as Paypal provide reassurance, but they will add to the cost of your sales. It is advisable to include information on the site which describes the security measures which are in place.

Delivery: You need internal order processing and delivery arrangements, using Royal Mail or commercial carriers, which will ensure that goods will be delivered to customers within a reasonable time. This must be robust enough to handle periods of high demands, as in the pre-Christmas period.

Site contents: You will need to have arrangements to regularly check the site to ensure that it is up-to-date and accurate. This is particularly important if your process or delivery charges and other costs change. You will have to adhere to the Electronic Commerce Regulations 2002, and the Consumer Protection (Distance Selling) Regulations 2000 – see below. You may want to reassure customers that you are sticking to the rules too.

Advertising and promotions: There are a variety of way to promote your online shop and you will probably need to use several of them, and test which works best. These will include:

- links on other business websites
- inclusion on a variety of search engines – these are commonly supported by website providers, but your own choice of key words or tags to promote the business could be critical to the response you get, so you should do market research before you start
- traditional advertising in community newsletters, newspapers and specialist magazines related to your products
- collaboration with other like-minded community or charity traders, like the 3to3 third sector online marketplace.

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Regulation

The electronic Commerce Regulations 2002:

- **Scope:** These regulations apply to:
 - advertising goods and services online (using the internet, mobile phones and interactive TV)
 - selling goods and services to business and individuals online
 - transmitting and storing electronic information.
- **Information requirements:** The regulations lay down detailed requirements about the information which must be provided to end users of online marketing and sales services. You should check these carefully before starting. They include obligations to provide (among other items of information):
 - full contact details of the business
 - the VAT number
 - clear price information, inclusive of tax and delivery costs
 - full information in email advertising about the sender and the promotion

– specified and detailed information about the electronic contract which is on offer to private customers (this is optional for business customers, and not applicable at all to one-to-one contracts agreed by email).

- **Penalties:** The Office of Fair Trading can issue “stop now” orders, and the courts can order businesses to publish information (failure to comply is contempt of court).

Consumer Protection (Distance Selling) Regulations 2000: In addition to the provisions above, these regulations give individuals rights to cancel contracts.

Other regulations: Third sector traders are also subject to rules on:

- data protection and privacy
- advertising standards
- the code of practice on premium rate phone services.

Information

Information and advice: This section can only scratch the surface of this important topic. For information more visit Business Link at www.businesslink.gov.uk, and the Wales Assembly Government business site <http://fs4b.wales.gov.uk/bdotg/action/> and select “IT and eCommerce”.

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7.5 Taxation

Taxation is a technical issue whose implications can be financially significant and vary greatly from one organisation to another. This section is intended only as bare overview and a referral point for further information.

Corporation tax

The basic position:

- The taxable profits of trading organisations are taxed at 20% from April 2011 (previously 21%). There is no dispensation for 'social enterprise' organisations of any kind.
- Charities are exempt from corporation tax on most types of income which they use for charitable purposes. But not all trading income qualifies for these exemptions. Section 4.3 discusses the complexities, including the tax exemption which applies to charities with small scale trading income.
- There is a legal obligation for new companies to notify HM Revenue and Customs of their existence for corporation tax purposes as soon as they are set up.
- Significantly, some grant income for trading activities, including start up will contribute to taxable profits. You are strongly advised to seek professional advice on the use and treatment of start up grants as soon as you are awarded them.

Information:

- Information on the liability of charities for corporation tax is available from the Charity Commission www.charitycommission.gov.uk and from HM Revenue and Customs www.hmrc.gov.uk.
- See Section 4.6 on charities and trading.
- See Section 7.6 for details of the government's Gift Aid Scheme which enables charities to retain the whole of financial donations from their trading subsidiaries without paying tax on them.

VAT

The basic position:

- **The turnover trigger:** If the annual trading turnover exceeds or can be expected to exceed the statutory limit, the business must be registered for VAT. The same applies to a charity which carries out trading activities.

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- **Registration below the threshold:** Registration is optional for businesses with lower levels of turnover. This is of benefit for small enterprises which are involved in zero-rated activities such as newspaper and book publication – since they can reclaim the VAT spent on raw materials.
- **VAT accounting:** VAT registration demands that companies keep detailed records in their regular accounts. This includes VAT paid on all purchases and VAT charged on all sales. They must make periodic VAT returns detailing total payments and receipts. Since goods and services are charged at various rates, including zero, the accounts system needs to be robust enough to produce reports simply and quickly when they are needed.

VAT and building projects: Many voluntary organisations which are grant-funded to carry out building work are understandably confused by the way VAT affects them, and they can lose tens of thousands of pounds if they do not take it into consideration. It is essential that you:

- study the guidance from funders on VAT at the time when you apply for grants

- check out the VAT implications of your funding and your future operations when your grant is awarded; there could be plenty of time to change your VAT registration status if that is needed, *but don't wait until you have spent the money in case there are more serious problems*
- get information from HM Revenue and Customs (live officers to speak to may be hard to reach nowadays, but there are comprehensive information packs and details on the HMRC web site)
- talk to your accountant or a VAT specialist to see whether you might lose out when you spend the grant – one or two hundred pounds for a consultation is worth it just to put your mind at rest, and could literally save you a fortune.

VAT and charities:

- You may often encounter the misconception that charities do not pay VAT – this is incorrect – charities do pay VAT like most organisations, although they enjoy certain limited benefits.
- These take the form of zero rated (i.e. chargeable to VAT but at 0%) or exempt, and include concessions on certain charity fundraising events, sale of donated goods, certain types of construction projects, disability aids, advertising etc. Check that you are not charged VAT at the standard rate on these items.

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- The sale of second hand goods is a potentially complex area. But a basic rule of thumb is that the sale or letting of goods which have been donated to charities are zero rated.
 - The benefit is limited by the work which you might carry out on donated items – for instance, cleaning and basic repairs on old furniture and white goods is fine, but you would need to pay VAT on sales if you used the donations as raw materials for producing something different.
 - You should check for more information with HM Revenue and Customs if you are planning to generate income from second hand goods.
- Whilst these limited VAT benefits alone should not be the reason for choosing charitable status, they can be valuable, in certain areas of charitable activity such as healthcare.
- A trading subsidiary enjoys some, but not all, of the VAT privileges of its parent charity, provided there is a formal agreement for trading profits from relevant sales to be passed to the charity. But the wider privileges which apply to corporation tax are not available.

Further information:

Information on VAT, including the current turnover threshold figure can be found on the HM Revenue and Customs web site's charity section at www.hmrc.gov.uk.

Rate relief for charities

The basic position:

- Non-domestic premises occupied and used by a charity are entitled to 80% mandatory rate relief, known as 'charity rate relief'. The remaining 20% may be waived at the discretion of the rating authority. In order to qualify for this relief, a property must be:
 - occupied by a charity, or the trustees of a charity, and
 - used wholly or mainly for 'charitable purposes'.
- Rate relief for charities
 - does not cover fundraising activities (because fundraising itself is not a charitable purpose in law)
 - does include the sale of some donated goods.

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- Third sector trading organisations have no automatic right to receive rate relief. But local authorities have the power to give relief to non charities at their discretion. This may include the trading subsidiaries of charities.
- Premises occupied partly by a charity and used for charitable purposes, and partly by a trading subsidiary, only qualify for the mandatory charity rate relief on the part of the building occupied by the charity. So it may be in the interests of charities to have a presence in all parts of their buildings and to argue that the building is used 'mainly' for charitable purpose.
- The same approach might be used for buildings 'mainly' used for the sale of donated goods and partly for other trading activities.
- The term 'mainly' could be interpreted as more than 50% of the value of sales, but in some cases 50% may apply to the floor area.
- It may be necessary to discuss the situation with rating officers, or to get legal advice. If you can show the benefits of your activities it is well worth taking stand to win the maximum possible rate relief.

Stamp Duty

Charities enjoy an exemption from stamp duty land tax on their purchases of land and buildings. However the relief does not apply to purchases by trading subsidiaries.

Taxation and non-charities

Professional guidance: Taxation is a complex issue. While there is plenty of information on the HM Revenue and Customs web site (and other sites provided by commercial organisations with services to sell), there is absolutely no substitute for having an accountant who understands the special circumstances of charities, the third sector and their trading activities. Professional advice is usually a sound investment – costly mistakes are easy to make, and you will probably be paying an accountant to produce annual accounts anyway.

A third sector beef about tax: Most people who have helped to run trading enterprises for community benefit which are not registered charities will at some time have asked themselves or others: *Why should the state take tax from enterprises which have been set up to benefit society?*

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- Social enterprises often work in areas ignored or abandoned by private business. They are commonly only marginally viable, and yet they pay VAT on most of their purchases and corporation tax on their meagre profits, even when these have been generated by the efforts of volunteers.
- It seems unfair to many people that the fiscal regime is so harsh (or complicated, if you follow the charities and trading subsidiaries route) when government policies are encouraging increasing numbers of voluntary organisations to consider trading. But despite recent major overhaul in charity and company law, tax concessions for anything that stands outside the tightly nailed down definitions of charity are as far away as ever.

A deterrent or challenge? Some voluntary organisations will probably be deterred from starting trading activities by the complications or inequity of tax law. But others will, typically, see it as yet one of many challenges in helping to meet the needs of disadvantaged communities and individuals. They should not, though, in their bloody-minded determination to persevere, close their eyes to the system. There are penalties for infringements such as late payment. Businesses end up paying for misjudgements and mistakes, and fraud can have extremely serious consequences for individuals.

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7.6 Using Gift Aid

How Gift Aid works for companies:

The Gift Aid concept: When a donation of money is made by a company to a charity under the Gift Aid Scheme its taxable profits are reduced by the same amount, and the charity is automatically exempt from paying tax on the donation. This is a clear incentive for giving money to charity, which works just as well for gifts by individuals. And when the donation is made by a *charity's own subsidiary trading organisation* or a trading partner it becomes a way for charities to carry out almost any form of trade without the obligation to pay corporation tax on profits.

The basic arrangements: The following arrangements apply to company donations to charities since 2000.

- Companies (and unincorporated associations) can claim tax relief for qualifying donations to UK charities. Generally, relief for Gift Aid donations is available in the accounting period during which the donation is made, but there are special rules for companies wholly owned by charities.
- Gift Aid donations made to UK charities by companies are paid gross (inclusive of any tax they would otherwise have paid). The donation is treated by the charity as an annual payment for which an exemption from tax can be claimed.

- If a company deducts tax from a donation incorrectly, the charity cannot reclaim the tax but must recover any shortfall from the donor.
- Charities receiving Gift Aid donations from companies should keep normal accounting records of donations received, for inclusion in their accounts and tax return, as annual payments.
- For further information check with HM Revenue and Customs (www.hmrc.gov.uk/charities/guidance-notes)

General tax treatment of companies making Gift Aid donations:

- When a company makes a qualifying donation to a charity it can make a claim in its corporation tax self assessment (CTSA) return to set the amount of the donation against its taxable profits.
- Charitable donations cannot be used to manipulate a company's trading losses, so there is no tax advantage in making a donation which is greater than the taxable profit.
- The donor company should keep normal accounting records of its donations including documentation to show the charity received it.

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Donations which do not qualify:

- A payment will not be treated as a qualifying donation for Gift Aid if:
 - it is a distribution of profit to shareholders
 - the company or a connected person (eg a close relative of a director) receives a benefit which exceeds the 'relevant value' in relation to the payment, as defined by HMRC (see 'donor benefits' below)
 - it is made subject to repayment conditions
 - it is part of an arrangement involving the charity acquiring property (other than as a gift) from the company or a connected person
 - it is made by a charity.
- **Donor benefits:** There are complex HMRC regulations which limit the benefit that a company donor can receive as a result of a Gift Aid donation to a charity. In a few rare cases Gift Aid donations by a subsidiary company could bring benefits to the company or its directors – for example when donations are received from an enterprise's commercial sponsors who may hope for advertising benefits or complimentary tickets to events.

Companies owned by charities

Arrangements for companies *wholly* owned by charities:

- Gift Aid donations versus profit distribution.
 - Gift Aid reduces the profits of the donor – which is why corporation tax is not paid on it.
 - But payments of company dividends are still treated as distributions of the taxed profits of the trading company. They do not reduce the company's tax liability. So there is usually no point in using dividend payments as an alternative to Gift Aid.
- **Jointly owned companies:** Companies owned by partnerships of two or more charities (and which distributed their profits according the shareholding of each charity) were treated differently before 1st April 2006. Now payments (other than dividends) may be treated as donations under the Gift Aid scheme.
- **Gift Aid donations after the end of the financial year:** Companies which are wholly owned by one or more charities have nine months from the end of an accounting period in which to determine the amount they want to donate or are obliged to pay to the charity as a qualifying donation.

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- As long as that payment is made to the parent charity within nine months of the end of a particular accounting period, the company can treat the donation as paid in that accounting period (rather than the current year).
- This gives a charity-owned company time to calculate its profits precisely, so that it can donate its entire profit, and reduce its corporation tax liability to nil.
- If a charity-owned company makes Gift Aid donations of less than the full amount of the corporation tax profit within nine months of the end of an accounting period, it cannot claim further tax relief on any remaining profit which it donates later.
- This nine-month 'carry-back' facility applies only to companies which are wholly owned by one or more charities. This covers:
 - subsidiary companies limited by shares where all the ordinary share capital is owned by charities (or by a company owned by a charity)
 - companies limited by guarantee owned by charities – ie where their memorandum and articles make it clear that their beneficiaries are charities or subsidiaries of charities.

- **Estimated donations:** There is a risk of tax complications if estimated profits are donated to a charity and they turn out later to exceed the actual profit. The original donation must be properly recorded by both the company and the charity. Check the implications with HMRC guidance or your accountant.

Private sector partnerships: Companies which are owned jointly by a charity *and* a separate private company are subject to different rules. Joint ventures are complicated arrangements where mistakes in taxation planning could be costly and even divisive. It is assumed that trading ventures of this complexity will be subject to professional guidance on taxation arrangements even before they are set up. But you should be aware that:

- In practice a donation to the charity which is proportionate to the charity's shareholding will be treated as profit distribution and not eligible for tax relief under Gift Aid.
- Such companies are still able to make Gift Aid donations provided they are not linked to shareholding.

Further information:

For further information and guidance on how to deal with more complex issues check the HM Revenue and Customs web site www.hmrc.gov.uk/charities.

7.7 Gift Aid on donations from individuals and on donations to charity shops

Gift Aid allows charities to reclaim from HM Revenue & Customs (HMRC) the basic rate of income tax on donations made by UK taxpayers. As the current basic rate of income tax is 20 per cent, this means that you can claim an extra 25p for every £1 you are given. All the donor has to do is make a Gift Aid declaration stating that they have paid enough tax to cover that which the charity is going to recover.

Higher rate and highest rate taxpaying donors can reclaim the difference between the basic rate that the charity claims and higher rate tax they pay. Research by CAF (2009) found that half of all higher rate taxpayers are not aware of the personal relief on donations available to them, one fifth only have used it, and most are willing to redirect the personal relief to charity.

Before you can make a Gift Aid claim you need to be recognised by HMRC as a charity for tax purposes. Recognition by HMRC as a charity is a separate process from registering with the Charity Commission for charitable status.

You can claim Gift Aid on gifts of money from individuals.

- A gift of money is a voluntary donation for which the donor receives little or no benefit or reward
- Money can take the form of cash, cheques, direct debit or standing order payments, credit or debit card payments, telegraphic transfers or postal orders.

Additionally, some payments to charities are treated as donations for Gift Aid even though they are not strictly defined as gifts:

- **Membership subscriptions** paid to charities are treated as donations as long as the payment is for membership only and does not give the donor personal use of the charity's facilities or services.
- **Admission charges** to view a charity's property can be treated as donations if the payment gives the donor and their family annual admission to view the property, or if a donation of at least 10% more than the standard cost of admission is made.

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- **Charity auctions** often encourage people to pay more for an item than it is worth, in order to support the charity. These payments may be treated as donations under certain circumstances. For example if someone paid £700 for a pair of travel tickets that cost £500, the extra £200 is considered to be a donation and can be Gift Aided.

Further guidance on the above is available from WCVA's Giving Wales Officer 0800 2888 329, givingwales@wcva.org.uk, www.wcva.org.uk/giving or on the HMRC website.

What else can I claim Gift Aid on?

Gift Aid can apply in other situations if the correct procedures are followed carefully. Please contact the Giving Wales Officer at WCVA or look at the detailed guidance on the HMRC website if you are considering claiming Gift Aid for any of the following:

- **Sale of goods on behalf of an individual**

Because Gift Aid applies to gifts of money, a donation of goods to a charity is not a Gift Aid donation. However, it is possible for the charity or charity shop to offer to sell the donated items for the donor, who may then choose to give the cash proceeds of the sale to the charity using Gift Aid.

- **Volunteer expenses**

If a person incurs expenses while doing voluntary work for a charity but does not claim them back, this is not a gift of money and so Gift Aid cannot apply. However, if a charity's volunteers are paid expenses, and are free to keep the money or make a gift to the charity, they can use Gift Aid on that gift.

- **Adventure fundraising events**

Participants in these events usually pay a deposit and are asked to raise a minimum amount for the charity through sponsorship. Because taking part in the adventure is a benefit to the person taking part, there are restrictions on the sponsorship donations that qualify for Gift Aid – it is likely that donations by the participant and their family will not be eligible for Gift Aid but sponsorship by unrelated people will be eligible.

From April 2013 there will be a new scheme to allow Gift Aid on up to £5,000 of small donations without the need for declarations.

8: Management and governance

8.1 Business management basics

Many aspects of running a business for social benefit are indistinguishable from running good-quality grant-funded activities. So what's the big deal? For organisations and individuals making the transition to trading, these similarities create a damaging sense of security. In fact, some aspects of good business management are not just different. They are so different that some people want to question the validity of running businesses for a social purpose at all. Resolving this is a challenge for management.

Familiar issues: Many of the issues you need to deal with in managing your business should be familiar to non-trading charities and voluntary organisations. They are also covered in the WCVA publication *Faith and Hope Don't Run Charities – Trustees Do*, and include issues such as:

- responsibilities as an employer
- health and safety
- other management policies and procedures
- making meetings work
- good decision making

- monitoring and accountability
- personnel.

Other issues for social enterprise: This chapter deals with further issues important to social enterprises, including:

- quality control
- managing risk
- monitoring, reviews and evaluation
- managing for sustainability
- staffing and job creation

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- succession policies
- the roles of directors of social enterprises
- board membership and officers
- special constraints affecting charities.

What qualities does the business need?

The business culture shock: Many, but not all, non-trading third sector organisations work under the pressure of tight deadlines, exacting standards and limited resources (charities would let vulnerable clients down if they did not). But business applies the same pressures to everyone who is serious about generating income from trading. For some people the change is a severe culture shock.

Business-like management: In many respects all trading and non-trading organisations in the third sector should be run in an equally business-like way.

- This implies good control of finance and other resources, well managed staff, effectively delivered services.
- In practice, running a business often produces a tighter, more focused and disciplined management style than in non trading charities and voluntary groups.
- It may be driven by deadlines and the need to satisfy the demands of customers. It can become a busy, more demanding environment for all the staff. Lateness and casual absences may have more serious consequences, and may demand firmer management responses.
- Trading demands a well-disciplined work environment which is sometimes perceived by staff to be at odds with what they have been used to in the non-trading third sector. This may be resisted and management must be prepared to deal with the fallout.

Effective use of resources: Both trading and non-trading organisations should use resources efficiently, and may be forced to economise if there are reductions in income. But successful businesses should put a monetary value on all their activities. This is not because they are greedy, but because the people working in the business need to know how long tasks should take, how many people are needed to do them, how many spoons of mashed potato or how many sheets of paper they will use and at what price. Otherwise they cannot price their work accurately or ensure they do not work at a loss.

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Co-ordinated activities: Complex charities and voluntary organisations, including social enterprises often offer a range of different, unrelated services in combinations that would boggle many traders in conventional business. This demands a high degree of organisation, co-ordination and communication between the different parts of the enterprise. Without this:

- economies of scale will be missed: work will be harder and earn less income
- isolated staff may resist the introduction of social enterprise if they feel isolated or left in the dark – morale could be damaged.
- monitoring and record keeping will be more difficult
- further business development will seem too challenging or unachievable.

Commercially minded leadership: All managers should be creative, flexible, alert to new opportunities, concerned about standards of performance, aware of targets, waste-conscious etc. But when they are in charge of business activities these are qualities which they are paid for; the earning capacity of their organisation depends on them. Managers need to be constantly conscious of:

- what they have to sell, and what other services or commodities they could be selling

- who might want to buy them, how valuable their services or products are, how people can be informed about them
- the cost of the sales, in human as well as monetary terms
- whether the prices are right, how much income could be generated, and how this could benefit the organisation
- the way customers see them and the organisation, whether these customers will continue to do business with them, who is currently the competition.

It is a tragedy that so many fine leaders in the third sector go into social enterprise activities with no awareness of the challenge which faces them, and then spend months or years discovering business management by trial and error.

A focus on the value of staff:

- All the assets of the business have a value. But you need to consider a reality which principled people in the third sector sometimes find unpalatable: the assets include the employees, and these have a business value (in addition to their value as work colleagues, deliverers of services, friends, etc) which is the equivalent to *the income the enterprise generates as a result of employing them*.

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- In grant-funded projects with tight margins there will already be a direct connection between each worker and the level of grant you receive – it's what they cost you to employ them.
- But in business, the worker's value may also include how much money they could earn for the organisation. This may sound exploitative, but how can you know what to charge customers when you are preparing bids, costing contracts, and calculating the price of products, if you don't put the value of your employees' time into the equations?
- The implications in the simplest terms are that:
 - workers need to be supported to produce at least enough income to cover the costs of employing them and the costs of what they do – otherwise you will operate at a loss
 - workers could quite possibly increase what the business earns if they are managed well.

Being taken seriously: Partners and supporters need to treat trading organisations as serious businesses too. It's no good a local authority telling a community organisation to become more sustainable if officers never give it the chance to behave like a business. Trading organisations usually need to work hard to persuade others of the need for:

- public authority grants and service level agreements to be replaced with formal contracts
- proper lease or licence agreements on its accommodation
- securing and developing property assets
- the opportunity to bid for other public contracts
- income streams which don't outlaw provision for redundancy reserves and commercial profit
- recognition of key skills and capabilities and wider local markets where these can be applied, possibly including its skills in helping others to develop enterprise
- support to identify other new social enterprise opportunities.

Keeping control

Avoiding crisis management: Many conventional businesses and third sector organisations operate in a perpetual state of drama and near disaster under 'crisis management'. Some managers are quite good at *just* keeping control. They deal with every problem, or most of them, at the point when they become a threat or distraction to the business. This is a situation you need to understand – and then deal with.

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- **the reasons for crisis management:**

- pressure of work and understaffing
- poor time management
- lack of time or disregard for proper advance planning
- operations which have tight unmissable deadlines
- temperament – it suits some people to work this way

- **results:**

- poor control, accident-proneness
- failure to deal with longstanding or underlying business weaknesses (eg poor staff skills, work flow planning, quality control)
- frustrated staff, burn out
- (or conversely) gains in efficiency and productivity through working under constant high pressure

- **preventative measures:**

- reviews of productivity and working systems; staff consultation
- redesigning working systems and procedures
- staff and management training.

Credit control: This is critical for businesses which give customers time to pay. See section 6.3.

Controlling service quality:

- **The importance of good quality control measures:**

Maintaining standards can be a major problem for some trading organisation, particularly at the business start-up stage while paid staff are inexperienced, and usually when volunteers are involved. Managers have to be aware that workers may have no concept of what the required quality actually is unless they receive careful and sometimes repeated guidance and training.

- **The results of failure:**

- It is extremely difficult to recover lost standards once they start to slip, and even more difficult to recover lost customers after poor service or substandard products have driven them away.
- Poor quality can be crippling expensive to rectify – a few mistakes can more than wipe out the entire profit on a contract.
- If personal social services are involved, poor service can be difficult to put right, and may in rare cases actually cause harm to individuals.
- Poor quality in areas such as catering can invoke legal action against both the business and responsible staff.

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- **You need to put in place:**

- clear systems and criteria which specify standards to be achieved, and how tasks should be carried out to achieve the best results
- training and information to make everyone aware of legal requirements, external standards and internal policies
- staff training on quality control generally, and the precise requirements of their jobs in particular
- defined staff responsibilities for monitoring quality and taking action
- independent means of assessing the quality of services provided and expected – eg through regular customer or client feedback.

Managing business risks: Risk management has traditionally been a low priority for third sector organisation, although it is recommended for financial systems by the Charity Commission. Its value for social enterprise is that an initial review process identifies and helps to alert staff and directors to weaknesses in their systems and activities which need to be addressed or monitored. The approach is based on common sense, but it can help to improve communications between responsible workers, and allows difficulties to be pre-empted by better planning.

Ask your accountant or a business advisor for suggestions on how to go about it in your organisation.

Dealing with the social enterprise tensions

Changing your own priorities – even if you don't want to: It is sometimes necessary or desirable in organisations involving both grant-dependent social activities and sustainable income generating businesses to give priority to the business activity. This can amount to the downgrading of a social project which was previously the heart and soul of the organisation when it started. And this step can be very difficult.

- **Doing what you want:** When you start developing social enterprises, the activities you are most committed to preserving may not be the ones which earn the most money. They are the projects and services which provide the motivation and focus for the directors, staff, volunteers, partners, supporters and funders. This is probably where the idealism of the organisation resides, its *raison d'être*, and its formal charitable objects. Plenty of people want to be involved in a financially struggling community newspaper, for instance, but what is the attraction of its sister printing service producing advertising leaflets commercially – other than the profits?

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- **Not doing what you want:** But the demands of sustainability mean that your priorities may have to change. The profitable part of the enterprise has to come to the fore, so that:
 - it now gets the lion's share of investment
 - it may occupy the best premises, marketing and promotion
 - it occupies more of the manager's time
 - directors take notice of what it does
 - it may be managed by its own subsidiary company to make sure its interest are properly looked after.

The sources of tension: Is this what all the sweat equity in setting up your enterprise has come to? Some staff and directors may feel uneasy that business has taken over, and there may even be resentment.

- People who joined the organisation to work in the successfully trading business will not have the same feelings for the social project which kicked it all off. To them it's 'just a job'. Volunteering, social activity and board level management may even appear to them as weaknesses.
- To the stalwarts who brought the enterprise this far, their involvement is a commitment, sometimes their whole lives. The new paid workers are undermining the cause, weakening the venture.

These are serious challenges which can undo years of dedicated hard work if they are allowed to become divisive.

Holding it all together: But the damage can be avoided with sensitive but firm management:

- **Keeping your soul separate from your pocket:** It is perfectly possible in most enterprises to separate business activity from social objectives. There is no need to lose your soul if you keep mammon in another room, and make sure the interests of the organisation's social heart are properly served – with separate activities and promotions, volunteer or supporter groups, a proper place in the annual report etc.
- **If they can't be separated:** Sometimes the business and the social purpose cannot be separated – as in the case of the plastics recycling business which provided work for people with learning disabilities and discovered the staff could not work fast enough to fulfil their main contract. This is not an argument for not becoming involved in social enterprise activities, because it is extremely rare for an organisation to abandon its social goals altogether to become a purely trading organisation. But it can raise difficult questions about:
 - the planning and costing involved in preparing contract bids, and

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- what the social purpose really is – as in the low-paid, low-skill housing estate security contracts delivered by community businesses in Scotland in the 1990s.
- **Facing up to the divisions:** The divisions which start to open up between the pioneers who started the venture and the 'just-a-job' workers who will inevitably join later are pretty well universal in social enterprise organisations. So bear in mind that:
 - it's not anyone's fault
 - it's survivable
 - it's something for everyone to talk about together without recrimination or ill feeling, to share your feelings and clear the air
 - it's a sign of growing up, becoming a real business organisation with real staff and real jobs which don't demand appalling self-imposed sacrifice and dedication – in fact, its something to celebrate as well as mourn.
- **Preparation and training for business culture:**
 - New trading ventures should invest in training and support for *all* directors and *all* paid staff, irrespective of their level of involvement. This will create a better understanding of the business environment and the fact that change is unavoidable if the organisation as a whole is to become viable. In practice this type of training happens very little.
 - In the end you have to face the fact that business may not suit everybody, but there may be no alternative. As some business managers have been known to say: 'We have a clear choice between doing exactly what we want today, or still being around next year as and achieving part of it.'

8.2 Managing for sustainability

As well as attempting to define the term 'sustainability', section 5.2 looks in detail at the financial and funding measures a social enterprise organisation can take to improve its sustainability. These are important, but they are only part of the task of creating a robust well-managed enterprise with the potential for development in the long term. This section describes how enterprises can achieve a business culture and structure to underpin this improved financial security.

Recognising sustainability

A continuum of sustainability: Community-based social enterprise organisations range from completely sustainable and perhaps financially viable – as in the case of the landmark Galerie project in Caernarfon which is supported by the income from property assets – to largely unsustainable. Many are working actively to generate income to reduce their dependency on outside support, or to expand what they do. Some of these will eventually be able to survive even if grants are cut drastically, and some will be able to struggle on through limited periods of grant drought ready for revival later. Others will simply be less beholden to grant funders than they once were.

How sustainable? All that is successful third sector trading – though there will continue to be debates about how the sustainability of the resulting organisations can or should be measured.

- There are some who think a social enterprise which survives on a mix of grants and earned income for 20 years, but closes when its hotel business goes wrong – as happened to Amman Valley Enterprise in 2009 – is a failure. To others this is a stunning success to be emulated throughout the third sector, with the lessons of the experience shared as widely as possible.
- The lack of clarity among those promoting and supporting social enterprise can be bitterly frustrating for practitioners. But fortunately groups which achieve sustainability do not have too much difficulty recognising how it changes them.

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Steps to a sustainable organisation

Some essential practical steps: The action you need to take to build a sustainable enterprise inevitably vary from one type of organisation to another. The description that follows is designed for a dynamic community regeneration charity which is making a big switch towards trading activities to reduce its grant dependency. The suggestions will not suit everyone, but many elements of this programme will apply to other forms of third sector trading too. (And, yes, many non-trading voluntary organisations are already familiar with these steps, but not usually as part of a planned and systematic approach.) There are five key areas where you can prepare the way:

- creating a stable core organisation
- fostering an enterprising culture in your organisation
- being prepared for the negative consequences of new social enterprise development
- securing the support you need to help you out when things go wrong
- setting targets and measuring progress.

Creating a stable core: This requires

- diversified funding sources (see section 5.2)
- diversified project activities
- grant funding with realistic management fees to cover overheads
- cost-centred financial management – ie each activity is accounted for separately so that you can see how well it is doing (see section 6.2 and Appendix 3)
- spending economies and waste control
- more flexible working practices; possible changes to staff pay and conditions (see section 8.3)
- sustainable management structures created by training, mentoring and sharing skills
- appropriate financial reporting and monitoring (see 6.4)
- the contribution, where appropriate, of well-managed volunteers to augment the work of paid staff.

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Fostering an enterprising culture: There is little point in attempting to take the social enterprise route, unless your whole organisation is committed to the sustainability goal, and unless you mobilise all the resources at your disposal. Among the steps you need to take are:

- Identifying every potential enterprise prospect in what you are already doing – even if you dismiss them all, the act of analysing the possibilities can get you all to think commercially.
- Put existing projects on a more businesslike footing – your nursery or café or social centre probably need to market themselves better; examine the way they are staffed, the way services are costed, the charges which users pay, how you apply for and use grant money.
- Identify new trading ideas, start the business planning, build up a programme of possible enterprise launches for the next three years.
- Negotiate with local authority and other funders to substitute grants and service level agreements with more commercially orientated contracts.
- Get optimum value from the accommodation you are using – sublet to earn rental income, fill spare space with your trading ventures.

- Explore options for acquiring property assets – they are probably your best prospects for a sustainable future.
- Make management freer, more opportunistic, flexible and business-orientated.
- Give adequate support to the new ventures you establish.
- Communicate the urgency and ethos of enterprise to junior staff who have no experience of business.
- Separate commercial activities from the work of any associated charity.

Spend grants like a business: Grant dependency in the non-trading third sector is unwelcome but it is an almost universal necessity. In trading organisations it may at times be essential, but it can also be a will-sapping evil that should be fought off with the energy of the best vampire hunters. Do whatever you can to:

- stretch grants to go further than they are intended
- use working capital grants to wean your business off dependency with ruthless self-discipline – if you still need heavy financial support at the end of the funding period the enterprise has usually failed (community groups and charities which retain a grant-dependent mentality have the capacity to use business investments in absurdly profligate ways)

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- even if the funder has not awarded a tapering grant (with spending gradually reducing to zero over time) try to budget as if they did.

Managing negative consequences: Directors and managers should:

- plan with the expectation that grant funding will decline (it will be a bonus if it doesn't, but you could be goners if you don't plan for it)
- be prepared to drop business ideas that fail to take off without delay, before they cause damage
- expect staff, volunteers and trustees to become nervous, frustrated and upset (change is always painful); keep people properly informed, use your diplomatic skills to dissipate any aggravation, and avoid getting involved in arguments which no one can win.

Securing appropriate support: Enterprises often fail after two or three years at the point when initial support disappears. Try to establish the best possible support structures for your organisation, internally and externally:

- consult one of the social enterprise support agencies, and keep in touch with them

- but don't cultivate all the support agencies in your vicinity – that will just lead to confusion
- identify and follow good practice in the sector
- get involved in networking with other social enterprises – if you don't you are very likely to start reinventing wheels
- make sure others know what you are doing, and don't disguise your problems (which is the best way of ensuring they you won't get help when you need it).

Setting targets and measuring progress:

- **The approach:** Public bodies which are funding social enterprises are increasingly expecting grant applicants to set targets for raising the level of earned income compared with grant funding which they receive. This might take the form of a written target to 'generate 50 per cent of funds by earned income in three years and 75 per cent in five years'.
- **Monitoring targets:** Targets can be a helpful way for trading organisations to start measuring their progress year by year if the sole objective is to abandon grant income.

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- But remember that crude targets will be less meaningful if, for instance, a sustainable enterprise chooses to run a large new grant funded project. This may be a sign of its mature capacity to carry on a business while supporting new and peripheral activity, not an indication of sinking back into grant dependency.
- **The risks of inappropriate assessments:** In reality, there is as yet no reliable way to predict the balance between earned and non-earned income, and it remains a relatively crude measure of progress. A serious danger could arise if funders begin to set their own targets for the proportion of earned income without taking into consideration the other factors which contribute to an enterprise's sustainability.

8.3 Getting the staffing right

If management and staffing issues are not deal with effectively the transition from grant-funded community project to trading enterprise could be disastrous, as this real-life example shows. A substantial community-based regeneration organisation in Wales was faced with the closure of its childcare nursery project when grant funding was drastically cut. The nursery was designated a trading activity, which would need to become sustainable from fees and contracts and to run as a business if it was going to survive. But the nursery staff could not shake off the inefficiencies of the former grant-funded regime. Despite careful planning, staff retraining, financial targets, persuasion and eventually threats by the chief executive, the nursery became increasingly unsustainable. In a last ditch attempt to save the project, new flexible staffing arrangements and changes to pay and conditions were introduced. Several of the former workers refused to accept the new regime and resigned immediately, allowing a fresh staff team to be appointed. Within weeks the enterprise was starting to hit its financial targets, with prospects of being a sustainable enterprise.

A new type of employment

When jobs depend on it...: If workers have suddenly been moved from being grant funded to being income generators without actually changing what they do, the change may not be at all obvious to them. Telling them that their jobs quite literally depend on how effective they are at earning money may not be enough. In this and in many other situations, a more fundamental change of culture may be needed.

Differences when changing from non-trading organisations:

A number of new factors may come into play when jobs in grant-funded organisations have to become self-supporting. You should take nothing for granted, and look carefully at:

- how paid jobs are defined
- how staff are recruited
- what experience and attitudes are needed
- training arrangements

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- pay and conditions (including the affordability of posts)
- the roles of the chief officer and possibly other senior managers
- the way the organisation now values paid jobs
- the relationship, in some businesses, between paid jobs and volunteering.

Defining roles and jobs: Section 8.1 discussed the need to focus on the value of paid staff as generators of business income. This means that the content of jobs needs to be thought through carefully. You will need to:

- define not just what you would like each worker to do, but *what they must achieve* in terms of contributing essential income to the enterprise
- recruit, provide training and supervision, and monitor the work of employees to ensure that the business gets the value it needs from their work.

This may seem obvious. But the profit margins are likely to be tight, and workers are often oblivious to their own vulnerability.

Recruitment: Interviewing and recruitment for jobs will not change significantly. But you may need to examine candidates for some new qualities:

- their previous experience of working in a business environment
- their capacity to adapt to the curious in-between world of business activity in the third sector – look for flexibility, avoid a laid-back approach
- their capacity to work to deadlines
- the ability to be customer focussed and to deal with the public, perhaps.

Appointing business managers: There are particular challenges in recruiting staff to senior positions. In many enterprises there is only one manager who must straddle the worlds of enterprise and community development or social care. They will need to set the tone of the operation, represent its community benefit credentials to the outsiders, and at the same time understand what is involved in running a small business. Very few candidates will have had previous experience of doing both. This means there may be a choice between:

- employing someone with a business background and making sure they 'learn' the third sector
- employing someone with a charity or community background who is instinctively entrepreneurial (people can learn business practices, but the drive and opportunism of good income generators tend to be more innate qualities)

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- not appointing anyone until you re-advertise, in case you make a terrible mistake.

There is no simple answer, except that many successful social enterprise leaders emerge naturally from within their organisations, and internal candidates who know what is at stake may be able to grow into management roles more successfully than outsiders.

Pay and conditions: No one sensibly advocates low pay – it has adverse social and economic implications for social enterprises as well as for individuals and communities. But it may be impossible to retain levels of pay and conditions in struggling new businesses. It will no longer be grant funders but contracts, customers and markets (including your competitors) who determine wage and salary rates. If accepting this is a moral problem, groups may prefer to concentrate on new activities where entirely fresh staff posts are created, rather than trying to preserve existing jobs where workers take pay cuts.

Training and support: Trading enterprises cannot afford to have poorly trained and poorly supported staff.

- **Staff appraisal and supervision:** Standard appraisal systems for assessing staff needs, and supervision arrangements to identify employee's personal needs and organise ways of meeting them are no less important in trading organisations than in the non-trading third sector. But the pressures of business may mean that there is even greater risk that agreed arrangements will be bypassed and staff will be let down. It is better to scale back the intensity or bureaucracy of your systems, rather than retain arrangements which you know will not work.
- **Induction and training:** The demands of quality control mean that proper training is totally indispensable. Much of it will be on-the-job because of the pressures on time. But enterprises should continue to take advantage of relevant courses whenever possible.
- **Customised training and development:** Where there is a team of staff in a social enterprise organisation it can sometimes be extremely valuable to organise sessions for the whole group, including managers and volunteers. Apart from team building benefits, this can help the review of systems and procedures and aid communications.

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Volunteers: There is some uncertainty about the role of volunteers in trading organisations.

- **The negatives:** It is true that they may have a poor grasp of quality control, and mistakes by inexperienced unpaid workers can do damage to the commercial reputation of the enterprise – but, arguably, no more so than with inexperienced and untrained paid staff. There can be risks of exploitation in a pressured service delivery environment, and the different roles of paid and unpaid workers needs to be handled sensitively.
- **The positives:**
 - Many existing volunteers are keen to make a contribution in roles which create direct social or community benefits. They can be well up to learning the requirements of the job, and may even resent efforts to limit their involvement.
 - They may have better skills and more experience than some paid staff.
 - For organisations which are already committed to capacity building work and skill training, the training potential of work in a real trading environment can transform people's lives.

- A well-organised volunteer team can add significantly to the income generating capacity of an enterprise. (But the extra cost of providing supervision and support needs to be taken into consideration.)
- Less obvious is the fact that the presence of volunteers can underline the social benefit basis of the enterprise, and provide the glue which keeps the world of community service and business together.

A few words about job creation as a social enterprise goal

A history of failure: The historic failure of trading in the third sector to create significant numbers of self-funding jobs after decades of effort is no longer a serious issue. Central and local government have come round to the recognition that, for the most part, trading is a way to strengthen charities and voluntary organisations, not to create employment. Unfortunately it was previously judged primarily on its capacity (or lack of it) to bring employment back into areas of major economic decline, and scepticism about its value is still widespread. This is despite the fact that the task has also largely defeated the massive resources of the public and private sectors since the Depression of the 1930s.

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The lessons of failure as job creators: This experience, which has set back support and development for decades, offers some valuable lessons:

- third sector enterprises should not make claims that they cannot deliver on
 - outsiders should not jump to their own conclusions about what communities and charities can achieve
 - enterprises should not go along with objectives and targets which they know to be unrealistic, merely in the hope of keeping support funding flowing
 - direct employment creation by third sector organisations is likely to remain an important and worthwhile but modest contribution to direct economic regeneration
 - the type of jobs which social enterprises are good at creating does not necessarily meet the needs of disadvantaged communities for skilled, well-paid employment
 - trading to create resilient, independent, entrepreneurial and innovative community organisations and charities may be a more certain way in which trading can contribute to the long-term health and wealth of society
- in the meantime creating employment is still a worthy goal for the third sector, provided it does not become the obsession it was 20 years ago.

8.4 The roles of the directors

This section considers the roles and responsibilities of directors which are special to commercial activity in a third sector environment.

The composition of boards of directors

Parent company boards: Existing charities will have their own structures. But the following good practice considerations apply when creating balanced boards for parent charities and holding companies which will be in charge of trading subsidiaries. In the case of charities, the advice must be considered in conjunction with Charity Commission guidance on the roles and responsibilities of trustees.

- The optimum number of trustees/directors is 8 to 12. This may not appeal to your organisation individually. But these are the numbers which work best in most cases.
- Members should as far as possible be drawn from a range of different backgrounds
- It is not necessary or desirable to include every councillor in every ward covered by the operation, but an interested supportive local member can be an asset.
- The position is different when significant council support is involved, but it is still worth having an open and realistic discussion about the potential role of council-appointed directors, and whether they might be more useful as advisors.
- Although the parent board will not be immediately responsible for the business, it is important that it includes some individuals with knowledge of trading and/or with financial experience to help exercise the board's oversight role.
- One or two of the directors with business/financial expertise should also be directors the subsidiary trading companies.
- At least one member of the parent board should not be a director of any trading subsidiary.
- The parent board should where possible include people and representatives of key organisations who have an interest in the community or client groups which benefits.

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Trading company boards: Trading companies vary quite widely, and there is a range of opinions of what constitutes an ideal set up. Here are some suggestions.

- The optimum number of directors is usually 6. This should ideally include:
 - a treasurer with finance experience
 - a chair with business management experience
 - directors with knowledge of the field of activity of the company
 - at least one person who is a member of the board of the parent company or charity, who can represent its interests when necessary and help two-way communication
 - at least one person who is not a director of the parent company to provide an 'outsider's' view.
- In some social enterprises the directors comprise a small management team of 2, 3 or perhaps 4 directors, including the paid manager. This makes for effective day-to-day business decision making. But it requires that the individuals involved are experienced and skilled, and willing to take what amounts in practice to personal responsibility for the trading venture.

- It will be helpful if the chair of the parent company is a director of at least one of the trading subsidiaries.

Single function boards: When the company is directly responsible for grant-funded social or community activities and trading their boards should blend the qualities listed above.

- The optimum size of 8 to 12 directors applies here.
- Board membership should include a balance of individuals with skills and interests related either to the business or the organisation's social community benefit objectives, and ideally both.
- Directors should be careful to treat social and trading objectives differently, and not to apply the same judgements and criteria to them both.
- It is particularly important that there is an understanding among directors that they are governors of a dual-purpose organisation, whose ethos will be driven by social considerations but whose survival may depend on business success. This is not necessarily an easy balance to achieve.

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Board officers

The Chair: The Chair is a leader as well as a figurehead.

- S/he will have an important role in setting the pace – ie ensuring that key business decisions are taken efficiently, with the right information, and sometimes quickly and at short notice (eg to respond to contract opportunities, or to solve trading problems).
- In trading enterprises it is even more important than in non trading charities and community groups for the Chair to minimise distracting irrelevances and internal dissension. Distractions include politics, unnecessary conflicts with outside bodies, and petty gossip. The directors need to work together as a team as much as possible.
- The Chair and other officers should have written job descriptions. Training should be offered to officers, including the chair, as a matter of course. (This avoids the embarrassing implication that they cannot do their job properly, and provides the opportunity to address problems if they can't.)

The Vice Chair: This is often a neglected function.

- The Vice Chair should receive the same training as the Chair.
- They should be prepared and equipped to deputise for the Chair when necessary, and be regarded as a natural (not automatic) successor when the Chair retires. They should be trained and supported accordingly.
- Boards which find themselves with the 'wrong' Vice Chair can consider appointing a second or joint Vice Chair with different roles. (It often happens that someone takes the role to fill a vacancy and someone else comes in later who would make a better successor.)

The Treasurer has a critical role in helping to oversee (usually not to manage) the financial affairs of the business. The temptation to fill a vacancy with anyone who volunteers should be avoided. At least if the position is left empty everyone knows that this remains a recruitment priority.

Company Secretary: Limited companies need a Company Secretary. The role is usually taken by a paid member of staff because the work is only occasional and continuity and familiarity are important.

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Directors' roles with special importance in social enterprises

Policies and procedures:

- **The need for clear policies:** All third sector organisations risk running into difficulties if they try to operate without clear written policies and procedures. But the survival of businesses is at stake because they will lose money. Some organisations, for instance, can grind to a halt and lose business in the winter snow because there are no arrangements in place to deal with management deputising, building access in emergencies, or home working. Others continue almost without interruption because they already know what to do.
- **Responsibilities:** The board must ensure that all necessary procedures are drafted, adopted, made available to everyone who needs to know them, and acted on. This will include a wide variety of documentation such as:
 - the health and safety policy
 - the environmental policy
 - employment and recruitment policies
 - a policy on volunteering
 - a code of conduct for staff and volunteers
 - procedures for costing contracts
 - service delivery manuals
 - procedures for dealing with members of the public, handling customer complaints.

Monitoring progress: A primary responsibility for the directors is agreeing targets with senior staff and then monitoring progress – particularly with the delivery of the business plan and its financial and business goals. Section 6 discusses the details. Working effectively might involve several distinct activities:

- monthly monitoring of management accounts (including, where necessary, supporting the role of the finance committee)
- annual review and strategy planning meetings to examine progress and update priorities and targets
- external project evaluation contracts if these can be funded
- a social auditing approach to examine the impact of the enterprise on all its stakeholders, including customers and clients.

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Succession policies:

- **The need for succession planning:** Research has shown that social enterprises are complex and vulnerable organisations which can experience severe difficulties when long-standing and apparently indispensable leaders (both staff and board chairs) leave. This is because:
 - innovative initiatives are often led by charismatic or energetic individuals who are difficult to replicate
 - the pressure of social enterprise can lead to rapid burn out and the sudden disappearance of key drivers
 - dependency on key individuals and strategies for replacing them are often taboo subjects for boards of directors – there is often no discussion until a crisis has arisen.
- **Evaluating vulnerabilities:** Open debate is often a first step to breaking the taboo. Organisations also need to:
 - carry out reviews to identify any weaknesses caused by succession issues
 - put in place measures including the appointment and training of deputies.

- A '**Successful Succession**' work pack with guidance materials is available from Community Projects Centre, Sunlea Crescent, Pontypool, NP4 8AD, email mel@communityprojectscentre.org.uk

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8.5 'Community ownership'

Not all enterprises in the third sector are community based. But those that are often taken their initial impetus, objectives, drive and support from disadvantaged communities where they are based. This gives them a particular need to try to turn the much abused term 'community ownership' into some kind of reality. And there can be many advantages to doing so.

Company membership and community participation:

- **The need for engagement:**

- **Membership:** Many community-based companies such as development trusts have membership arrangements designed to involve people who live and work in the areas where they operate. Membership – and therefore the theoretical control of the company – is sometimes open exclusively to these residents. But there is rarely time or energy to sustain and develop this engagement.
- **Support:** Evidence of local support can be a critical factor in persuading backers to provide grant or loan funding.
- **Validation:** Enterprises need to ensure that their development proposals chime with their users or with local opinions and needs, and to take suggestions into account.

- **Customers:** Enterprises providing local services – such as crèches, after school clubs, luncheon clubs, community cafes etc – may need to appeal to potential new customers on a regular basis.
- **Community cohesion:** Bringing people together can in itself be good for communities, and social enterprise trading can provide the catalyst which goes well beyond the business activity itself.
- **Options:** There are many opportunities to meet the public, though some take more effort and resources than others to organise. Some of the activities on the following list can often be combined, particularly to make the Annual General Meeting into a more substantial and worthwhile event. Options include:
 - annual general meetings

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- open events to show off the organisation's work to members of the public
- networking for local groups in the area
- consultation or planning events, workshops and seminars to get feedback on development plans
- community fun days
- business launch events and celebrations of key successes, which can help to create valuable links with local authority representatives, fellow traders, business leaders and enterprise development staff etc.

Recruiting directors: This is a perennial challenge for the sector as a whole.

- **Ongoing efforts:** All the members of the board need to be perpetually on the lookout for potential new directors to strengthen the team. It can be a good idea to have board recruitment as a regular agenda item for meetings.
- **Skills audits:** An informal skills audit among board members can help to illuminate strengths and weaknesses and focus more directly on the type of people you need to recruit.

- **User involvement:** Enterprises which do not have a clear community focus may need to consider ongoing efforts to recruit directors who are users of their services (though Charity Commission rules that directors do not personally benefit financially must be adhered to).
- **A proper job:** You will not retain directors if their role is to rubber stamp the decisions of the manager or the chair.
- **An understandable job:** Third sector trading is a weird world for people who only know the worlds of conventional trading or charity work. Induction and support at the recruitment stage is crucial.
- **Making up losses:** It is disheartening to lose directors, and some organisations tend to give up recruiting if directors keep leaving. But some level of turnover is inevitable, and trading for community benefit is not attractive to everyone. So it is always worth persevering.

Community investments: Giving local residents a financial stake in the enterprise may occasionally produce stunning results. See section 5.4 on sales of shares and bonds.

8.6 Constraints affecting charities and subsidiaries

Charitable status is an advantage to most small-scale trading for community benefit. But some larger organisations with trading subsidiaries choose to avoid charity registration altogether because of the limitations it places on the directors and staff. The greater freedom of a Community Interest Company may suit them.

Irritation is perhaps understandable where it is the technical implications of charity law rather than real concerns about protecting the charity's assets which dictate the restrictions. This section describes the regulations which need to be followed.

Responsibilities for monitoring trading subsidiaries

Overseeing the trading company: The charity's trustees must routinely monitor the operation of the trading company to make sure that the charity's assets are used properly.

- They should be prepared to assert the rights of the parent charity as shareholder.
- If the trading company was set up to generate income for the charity, its success or otherwise should be watched by the trustees. This means that it is not acceptable to set a trading subsidiary in motion and ignore its performance.

- It should take special care if all the charity trustees involved in the monitoring are also directors of the subsidiary.
- If the monitoring only gets under way when the subsidiary is in financial difficulties it is already starting too late.

The charity as shareholder: The directors of the trading subsidiary are responsible for its management. But the trustees of the charity represent the company's shareholder, and they must take some other major decisions on behalf of the parent charity, including:

- the appointment and/or removal of the directors of the trading subsidiary

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- the directors' terms of service, including any remuneration
 - the continuation or dissolution of the trading subsidiary.

Directorships and employment:

- **Employment of charity trustees:**
 - Charity trustees may not be employed by their subsidiaries unless this is permitted by their Memorandum and Articles of Association or the Charity Commission has given specific approval.
 - A subsidiary company cannot be used as means to circumvent the bar on trustees receiving payments from the charity.
- **Membership of the subsidiary's board:**
 - It is good practice for some of the trustees and/or employees of the charity to become directors of the trading subsidiary and to monitor its performance. This is to ensure that the subsidiary is managed in the interests of the parent charity.
 - Anyone involved with the administration of both boards has two distinct responsibilities, and it can at times be difficult to balance conflicting pressures. It can be important that this potential tension is clearly understood by all the board members not just the individual.

Independent or 'unconflicted' directors:

- As a matter of good governance, the Charity Commission recommends that there should be both:
 - at least one person who is a trustee, but not a director or employee of the trading subsidiary (called an 'unconflicted trustee') and
 - at least one person who is a director of the trading subsidiary, but not a trustee or employee of the charity.
- Unconflicted trustees and directors should advise their colleagues when their dual responsibilities result in conflicts of interest. This is important to reduce the risk of challenges to transactions between the charity and its subsidiary.

Handling financial problems in the trading subsidiary

Protecting the charity's interest: The interests of the parent charity must always come first. This will sometimes mean liquidating or selling a failing trading subsidiary.

The Trustees' obligation is to minimise any losses to the charity, irrespective of their loyalty or sense of moral obligation to the directors and employees of the trading subsidiary.

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- **Supporting a failing business:** If the charity uses its funds to continue supporting an evidently failing subsidiary, this could constitute a breach of trust on their part. They risk being required personally to make good any losses to the charity.
- **The need for professional advice:** It is unclear exactly what circumstances might result in such dire consequences for trustees because it is not unknown in Wales for a charity to incur huge losses by supporting a badly managed social enterprise trading company. But trustees are strongly advised to get professional advice if they have any inkling that something like this might happen.
- **Loan defaults:** If a trading subsidiary defaults on a loan agreement with the charity, the trustees must consider enforcing the charity's rights under the agreement. In deciding on their precise course of action, trustees must exercise their commercial judgement, based on appropriate professional advice. Their decision needs to be based on the best interests of the charity which owns the trading subsidiary.
- **The role as a shareholder:** The Charity Commission advises that where a charity has invested share capital in its trading subsidiary it has responsibilities as a shareholder (probably the sole shareholder), Ultimately this can mean:

- winding up the company or
- selling the business as a going concern to a third party.

Protecting the reputation of the charity: The Charity Commission advises that the law which safeguards a charity's assets from trading losses must over-ride any instinct to protect the reputation of the charity. If trustees continue to use charity funds to prevent the trading company from going into insolvent liquidation they risk personal liability for the charity's losses.

Sharing the charity's facilities

Use of buildings:

- The Charity Commission advises that any use of the parent charity's land and buildings by a trading subsidiary should be covered by a formal lease or licence arrangement with the charity, and that for technical legal reasons this needs to be authorised by the Commission. The practical value of doing so may not be obvious to the charity when it owns both the property and the tenant.
- The trading subsidiary must pay a rent or fee which is comparable to that which would be payable for letting the property on the open market.

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- If a charity purchases land for use by a trading subsidiary, this must be justifiable as an investment of the charity's resources in terms of the commercial return received.
- Charities enjoy an exemption from stamp duty land tax on their purchases of land and buildings. However the relief does not apply to purchases by trading subsidiaries.
- The stamp duty exemption will be lost if the purchase of the land and buildings cannot be justified as an investment of the charity's resources; or is made in order to avoid tax by the trading subsidiary.
- Further information see the Charity Commission guidance leaflet CC28 Disposing of Charity Land.

Shared staff and equipment: The use of the charity's staff and equipment by the charity company is treated by the Charity Commission and HM Customs and Excise as 'indirect investment'. This is also subject to restrictions:

- **Sharing as a form of subsidy:** Sharing arrangements must not involve any element of subsidy of the trading company by the charity. This is unacceptable under charity law, and it could also have tax implications because subsidies cannot be treated as charitable expenditure.
- **The right level of charges:** The parent charity should therefore charge for any services and facilities which it provides to the trading subsidiary.
 - This should be a realistic reimbursement of the cost to the charity, and a record of the transactions should be kept.
 - These charges must be paid within a reasonable period of time. Unpaid charges could also be regarded as a form of subsidy.
 - If the charity charges *too much* (more than its actual costs them) this could be considered as trade by the charity, and it could be taxed on the profits.
- **Exclusive use:** The Charity Commission advises that charities should not provide staff and equipment to the subsidiary if the trading company is not actually sharing these with the charity.
 - This draconian restriction seems to limit rational arrangements where economies of scale can be achieved in small organisations by giving the charity the role of employing all the staff and providing all the equipment.
 - The alternative option is for the trading subsidiary to act as the employer, though this may not be possible if the charity was established before the trading arm.

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- It would be worth checking individual cases with the Commission before setting up unnecessarily cumbersome arrangements.

Protecting the charity's work: Sharing arrangements should not be allowed to do any damage to the charity's ability to carry out its objects. The Charity Commission suggests that charities wanting to enter arrangements should get professional advice or speak to the Commission. This is a sign of just how seriously they take the issue, although it presumably doesn't mean that the charity always has to be first in line to use the photocopier.

Internal transactions: Very large charity groups might need to consider company pricing legislation, but this will not affect modest trading charities organisations.

Mixed messages on shared facilities:

- While requirements for the trustees of charities to monitor and take proper responsibility for their trading companies are soundly based in the need to protect the charity's assets, the value of technical and legal restrictions on sharing buildings, staff and equipment seem to be of rather less practical value. They do not offer obvious benefits to either the charity or its subsidiaries, and could deter some groups from registering charities and some charities from taking a social enterprise route.

- This provides an argument for studying closely whether charity law and tax considerations on primary purpose trading, ancillary trading and small scale trading really require a charity to set up a subsidiary in order to run its business activities. Maybe it should all be done by a single charitable company after all. This possibility is sometimes overlooked.
- Yet, a separate trading subsidiary does provide a safeguard for the assets of the charitable company itself in the event of its own financial failure. So the legalistic disincentive to using this model could, ironically, expose charities to greater risks than necessary.

Further information:

Information on tax issues is available on the HM Revenue and Customs web site and on legislation from the Charity Commission.

9: Social enterprise and support bodies

9.1 Working with the public sector

It can be profoundly frustrating for leaders of third sector trading organisations to work closely with local authority partners and other large agencies who appear sympathetic and keen to be supportive, but whose organisations just cannot adapt to their needs. Occasionally it is the front-line officers who fail to understand what they are told by practitioners. But chief officers of charities and community projects often claim it is the bureaucratic inertia of large public bodies which can create the difficulty. This will have to change if community organisations and charities are going to respond effectively to opportunities to tender for public contracts.

The need to change the environment

The challenge: Among the more serious sources of complaint by third sector enterprises are:

- a basic failure to understand what 'sustainability' means to social enterprise organisations, how it can be achieved, and the time spans involved – which can mean that, rather than being fostered, community trading is sometimes obstructed and damaged
- continuing problems with grant funding arrangements, including massively delayed decisions, failures to meet authorities own objectives for three-year funding cycles, and unclear expectations

- lack of commitment to the government's encouragement for asset transfer and social enterprise management of surplus public buildings.

The appeal for public sector support: Public sector appreciation of third sector trading has improved over the past 20 years, particularly in response to Welsh Assembly Government policies. But progress remains slow in some areas. The messages from charities and community organisations is that working relationships are often excellent. But more sensitive responses are needed from the public sector when it comes to the delivery of practical support. This includes appeals to public bodies to:

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- visit local projects to see what trading projects actually do
- take notice of good practice in other authorities and even in other departments within the same authority
- be willing to use procurement arrangements to devolve the delivery of services to voluntary organisations in line with the policies of the Welsh Assembly Government and policy guidance of Wales Council for Voluntary Action
- create opportunities for them to bid for local authority contracts
- allow the same prospects for full cost recovery that are enjoyed by the private sector contracts (rather than the widespread and counter-productive prejudice which denies struggling third sector organisations the opportunity to make a profit)
- facilitate the transfer of income-generating assets, particularly redundant buildings, to full third sector ownership so that they can be used to generate wealth and foster independence from grant funding
- recognise the necessarily slow pace of change when organisations embark on trading activities, and when they shift from grant dependency to more sustainable business models
- understand that:
 - ‘sustainability’ is not the same as ‘viability’, especially for bodies providing services to disadvantaged people,
 - unrealistic targets and attempts at micromanagement by some grant funders are more likely to damage business than to improve performance
 - the claw back of grants from trading enterprises can cause disproportionate damage to their business capacity and confidence
- recognise that delaying funding decisions can have a disproportionate effect on the forward planning of trading organisations, delaying essential developments and seriously undermining efforts to improve sustainability
- work with organisations affected by funding cuts to minimise the adverse effect, and in particular to free up unnecessary funding restrictions so that trading ventures can use limited grants in the most productive ways

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- plan effectively for the long-term future of government regeneration and funding programmes, in order to preserve their achievements and foster realistic engagement by partnerships in trading activities, by:
 - equipping partnerships and projects to operate on a sufficiently large scale to achieve sustainability
 - encouraging community groups and projects to trade with one another more effectively (as already happens in the private sector)
 - gearing funding to discourage grant dependency and to encourage collaboration.

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9.2 Working with development workers

Third sector trading organisations commonly enjoy excellent relationships with social enterprise development staff in support agencies. But there is need for improvements in the way support overall is managed and delivered in Wales so that limited resources can be deployed most effectively.

The challenges: Resourcing for enterprise development in the third sector has tended to be patchy and unco-ordinated. Public spending cuts will certainly make matters worse at a time when the need for trading by community groups and charities is growing substantially.

The possibilities: Developing and sustaining a vibrant and successful trading third sector requires business and third sector support agencies of all kinds to:

- Develop greater levels of specialism among staff so that workers have in-depth knowledge on issues such as finance, business planning, legal structures, quality and service procurement.
- Co-ordinate with other agencies to make best use of resources.

- Encourage links between funding and development support, so that trading organisations can get the best possible value from their grants, and technical expertise is delivered to initiatives which will make best use of it (it's an unpalatable truth that social enterprise support is often rather wasteful, as some sceptics delight in pointing out.)
- **Recognise the value of:**
 - supporting networking between social enterprise practitioners
 - encouraging the sharing of knowledge and experience among enterprises through conferences, workshops, and case studies
 - assisting organisations which host research and learning visits from other groups to generate consultancy income from doing so.

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- **Recognise the need to deploy staff who properly understand:**

- the ethos of social enterprise, and the aspirations of small community organisations and charities in particular
- the critical distinctions between sustainability and viability
- the things which third sector trade is good at and those which they really should not be pushed into.

- Take care of established trading organisations which get into difficulty along with fostering new start ups.
- Employ experienced social enterprise consultants where appropriate to provide specialist guidance and support.

10: Sources of support

The number of organisations which are committed to supporting the development of social enterprise activities is growing all the time. The following lists key national and local organisations which can help groups interested in trading and enterprise. Many of these will be also able to point you towards more specialist organisations and projects, and local initiatives.

Make sure you don't miss the opportunity to access case studies on the businesses they are already supporting, and where possible to visit and be inspired by real life third sector trading organisations.

10.1 Leading organisations to support trading and enterprise

Wales Council for Voluntary Action (WCVA): WCVA is the umbrella body that supports the 30,000 charities, voluntary groups and social enterprises in Wales' third sector. It provides comprehensive services for the sector, is a significant grant giver and helps it play a bigger role in major policy areas. It helps third sector groups to trade through:

- developing and promoting a unique trading website, www.3to3.org.uk
- publishing tender opportunities of interest to the sector
- providing training in how to tender, and tendering masterclasses
- publishing a how to tender guide
- providing flexible loans through CIF2 to support enterprise and asset based development
- helping the sector access European structural funds

Tel: 0800 2888 329, email: help@wcva.org.uk
www.wcva.org.uk

County Voluntary Councils (CVCs): CVCs' key role is to provide advice and information to local charities, voluntary organisations and social enterprises on any issue that may affect them. They support volunteering, advise on good practice, and represent the third sector on cross-sector partnerships. CVCs can provide local organisations with one to one advice and support on business and strategic planning, choosing suitable structures, and funding sources and techniques.

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County	CVC	Web	Phone
Anglesey	Medrwn Môn	www.medrwnmon.org	01248 724944
Conwy	CVSC	www.cvsc.org.uk	01492 534091
Gwynedd	Mantell Gwynedd	www.mantellgwynedd.com	01286 672626
Denbighshire	DVSC	www.dvsc.co.uk	01824 702441
Flintshire	FLVC	www.flvc.org.uk	01352 744000
Wrexham	AVOW	www.avow.org	01978 312556
Powys	PAVO	www.pavo.org.uk	01597 822191
Torfaen	TVA	www.torfaenvoluntaryalliance.org.uk	01495 756646
Newport, Monmouthshire, Blaenau Gwent and Caerphilly	GAVO	www.gavowales.org.uk	01633 241550
Merthyr Tydfil	VAMT	www.vamt.net	01685 353900
Rhondda Cynon Taff	Interlink	www.interlinkrct.org.uk	01443 846200
Cardiff	VAC	www.vacardiff.org.uk	029 2048 5722
Vale of Glamorgan	VCVC	www.valecvcs.org.uk	01446 741706
Bridgend	BAVO	www.bavo.org.uk	01656 810400
Neath Port Talbot	CVS	www.nptcvcs.co.uk	01639 631246
Swansea	CVS	www.scvs.org.uk	01792 544000
Carmarthenshire	CAVS	www.cavs.org.uk	01267 236367
Pembrokeshire	PAVS	www.pavs.org.uk	01437 769422
Ceredigion	CAVO	www.cavo.org.uk	01570 423232

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Development Trusts Association: Development Trusts Association Wales offers a range of services and activities including:

- supporting new and emerging development trusts
- providing advice and training on community owned asset development, transfer and management
- a useful tool kit for organisations to assess how well they match up to recommended best practice
- promoting best practice through case studies
- guidance on social accounting and audit and other quality and impact tools;
- learning networks, exchange visits and conferences
- acting as a voice for social enterprise organisations on issues such as funding.

Tel: 029 2019 0260

www.dtawales.org.uk

Enterprise agencies are sources of business support and training. Search in the Welsh Assembly Government's business directory for information, advice and support services near you.

Tel: 03000 6 03000

www.business.wales.gov.uk

Social Firms Wales: the national support agency for social firm development. It provides business advice to social enterprises. Support services available to Social Firms Wales members include:

- sector-specific tools and resources to measure and improve performance
- advice and guidance on development issues
- networking opportunities
- regular sector news

www.socialfirmswales.co.uk

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Wales Co-operative Centre: is a co-operative development agency working across Wales providing guidance and support to promote social, financial and digital inclusion:

- guidance for new and prospective workers' co-operatives and social enterprises, including mentoring, help with structures and signposting to other agencies
- supporting employee buyouts through a business succession service
- supporting establishment of community co-operatives, credit unions and secondary (including farming) co-operatives
- establishing consortia and clustering models of small businesses to improve growth through economies of scale and enhanced competitive procurement practices
- providing advice on company structures suitable for all forms of social enterprise such as Community Interest Company and Industrial and Provident Society;
- advising businesses on adopting Fair Trade policies and promoting Fair Trade;
- working directly with community groups to encourage the use of ICT

Tel: 029 2055 4955, email: info@walescooperative.org

www.walescoop.com

Welsh Social Enterprise Coalition: Born from Wales' 2009 Social Enterprise Action Plan, the Welsh Social Enterprise Coalition forms the representative voice for Welsh social enterprise. The Welsh Social Enterprise Coalition aims to:

- improve access to finance
- help social enterprises to gain new contracts
- forge links with local authorities
- improve business support.

Tel: Cardiff office 029 2048 6379,
North Wales Office 01492 580503

www.welshsec.org

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10.2 More guidance and support

Charity Commission: regulator and registrar for charities in England and Wales. It offers extensive guidance material for charities, including publications like 'CC35 – trustees, trading and tax details the legalities surrounding charities and trading'.

www.charity-commission.gov.uk

CIC Regulator: Community interest companies (CIC) are a type of limited company designed specifically for those wishing to operate for the benefit of the community rather than for the benefit of the owners of the company. This means that a CIC cannot be formed or used solely for the personal gain of a particular person, or group of people. The Regulator is an independent official who will encourage the development of the CIC brand and provide guidance and assistance on matters relating to CICs.

www.bis.gov.uk/cicregulator

Companies House: Companies House incorporate and dissolve limited companies. They also examine and store company information delivered under the Companies Act and related legislation; and this information is available to the public.

www.companieshouse.org.uk

HM Revenue and Customs: A single reference point for information about tax and VAT for charities along with information about tax relief for charitable donations.

www.hmrc.gov.uk/charities

Welsh Assembly Government: Information on programme, policies and grant schemes for enterprise.

www.business.wales.gov.uk

Appendix 1: Types of legal structure for social enterprise

Summary – most typical features	Ownership, governance and constitution	Is it a legal person distinct from those who own and/or run it?	Can its activities benefit those who own and/or run it?	Assets “locked in” for community benefit?	Can it be a charity and get charitable status tax benefits?	Differences in the law as it applies in Scotland or Northern Ireland?
Unincorporated association						
Informal. No general regulation of this structure and you need to make own rules.	Nobody owns. Governed according to own rules.	No. Can create problems for contracts, holding property and liability of members.	Depends on own rules.	Would need bespoke drafting to achieve this.	Yes, if it meets the criteria for being a charity.	No specific differences.
Trust						
A way of holding assets so as to separate legal ownership from economic interest.	Assets owned by trustees and managed in interests of beneficiaries on the terms of the trust.	No. Trustees are personally liable.	No. The trustees/directors cannot benefit, unless the trust, court or Charity Commission permit.	Yes, if the trust is established for community benefit.	Yes, if it meets the criteria for being a charity.	No, subject to the differences between English and Scots trust law.

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Summary – most typical features	Ownership, governance and constitution	Is it a legal person distinct from those who own and/or run it?	Can its activities benefit those who own and/or run it?	Assets “locked in” for community benefit?	Can it be a charity and get charitable status tax benefits?	Differences in the law as it applies in Scotland or Northern Ireland?
Limited company (other than Community Interest Company)						
Most frequently adopted corporate legal structure. Can be adapted to suit most purposes.	Directors manage the business on behalf of members. Considerable flexibility over internal rules.	Yes. Members’ liability is limited to amount unpaid on shares or by guarantee.	Yes (but no dividends etc to members if it is a company limited by guarantee).	Would need bespoke drafting in articles (which could be amended by members).	Yes, if it meets the criteria for being a charity.	Scotland, no. Northern Ireland, separate (but similar) legislation.
Community interest company (CIC) www.cicregulator.gov.uk						
Limited company structure for social enterprise with secure ‘asset lock’ and focus on community benefit.	As for other limited companies, but subject to additional regulation to ensure community benefits.	Yes. Members’ liability is limited to amount unpaid on shares or by guarantee.	Yes, but they must benefit the wider community as well. CICs can pay limited dividends to private investors.	Yes, through standard provisions which all CICs must include in their constitutions.	No, but can become a charity if it ceases to be a CIC.	Scotland, no. Northern Ireland, no specific differences.

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Industrial & Provident Society (IPS) (Co-operative) www.fsa.gov.uk/Pages/Doing/Info/MSR/						
For bona fide co-operatives that serve members' interests by trading with them or otherwise supplying them with goods or services.	Committee/officers manage an IPS on behalf of its members. One member, one vote (regardless of sizes of respective shareholdings).	Yes. Members' liability is limited to amount unpaid on shares.	Yes, but they should do so mostly by members trading with the society, using its facilities etc, not as a result of, for example, shareholdings.	Would need bespoke drafting in articles (which could be amended by members).	No. It would have to be constituted as community benefit type of IPS.	Scotland, no. Northern Ireland, separate (but similar) legislation.
Industrial & Provident Society (IPS) (Community Benefit Society (BenComm))						
Benefit the community rather than just their own members and have special reason not to be companies.	Like Co-op type, but new legislation provides option of more secure form of asset lock.	Yes. Members' liability is limited to amount unpaid on shares.	Must primarily benefit non-members; asset lock applies.	Yes (asset lock only survives dissolution if new statutory form of asset lock adopted).	Yes, if it meets the criteria for being a charity.	Scotland, no. Northern Ireland, separate (but similar) legislation.

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Summary – most typical features	Ownership, governance and constitution	Is it a legal person distinct from those who own and/or run it?	Can its activities benefit those who own and/or run it?	Assets “locked in” for community benefit?	Can it be a charity and get charitable status tax benefits?	Differences in the law as it applies in Scotland or Northern Ireland?
Charitable Incorporated Organisation (CIO) (from 2011?)						
First ready-made corporate structure specifically designed for charities.	Similar to company but with different terminology (eg for ‘directors’ read ‘charity trustees’).	Yes. Members either have no liability or limited liability.	Members: no. Charity trustees: only if constitution, court or Charity Commission permit.	Yes.	Cannot be anything but a charity, and must meet the criteria for being a charity.	Both Scotland and Northern Ireland, separate (but similar) legislation and Regulators.

Source: www.socialfirms.co.uk/resources/library/legal-structures-social-enterprises-glance

Appendix 2: A model business plan

This model provides an extensive list of items to include in your business plan. Individual organisations will need to decide which topics to include.

1. A cover: Include your name and logo and the date. Indicate whether this is a draft, and number different drafts sequentially – it's easy to get confused with different versions of your plan. You might add the name of the funder it is addressed to.

2. Introduction: The Introduction should include:

- a brief outline of the project or development
- an explicit statement of the amount of grant being applied for and other funding resources available if this is part of a specific funding bid.

3. Background: Describe briefly:

- what you do
- your objectives (and charitable objects)
- the origins and development of your organisation
- your existing and proposed constitutional arrangements

4. Personnel:

- list the trustees with their roles and a little background information about each, such as employment and outside interests
- include details of the chief executive officer and other key staff (whether already in post or proposed) – you can include job descriptions in an appendix.

5. The need and the market:

(Note that needs and markets are totally different issues.)

- what is the social need, if any, that you aim to tackle?
- who are the current and proposed users/clients of your service?
- who will actually pay for the service?
- quantify the demand for the service

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- how did you go about identifying and evaluating this need, ie any market research you have carried out and a summary of the results? (You can present the full results of research and detailed evidence of need drawn from census and other statistics or anecdotes drawn from your experience in an appendix.)
- are there any special characteristics which you have identified?
- who else is providing this type of service, and how is yours unique or better?

6. The development proposal:

- describe the services which you want to provide or develop
- explain how they will operate and why you chose to run them in this specific way; refer to any specialist equipment, processes or approaches which are unlikely to be familiar to people outside your organisation
- what are the targets for this year of operation?
- describe any special legal and licensing requirements you will be required to meet
- what are the potential problems with this service and how will you overcome them?

7. Promotion and service delivery

- how will you let your potential users and clients know about your service?
- who will actually provide the service? where? when?
- what are the targets for the first year of the new operation?

8. Charges:

- how have you fixed your proposed fees and/or charges ?
- how do they compare with similar services available in your area or elsewhere?
- include any detailed calculations in an appendix, and refer to them here.

9. Staffing and volunteering:

- what paid posts will you create to provide the service? what skills are required?
- are there any significant recruitment issues such as salary levels or availability of skills?
- what facilities and training will be provided for staff and volunteers?

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- how and by whom will volunteers be recruited, inducted and supervised?
- is there a code of practice for volunteering?

10. Management:

- who will make overall policy? who will take day to day decisions? who will be consulted?
- how will decisions be recorded and communicated and their implementation monitored, and who is ultimately responsible?
- how will the paid manager and staff work effectively with the trustees?
- how will the financial arrangements be managed, supervised and monitored?
- where appropriate, include a chart to show how the management structure fits together.

11. Premises, equipment and other issues: Describe any other important factors in the launch or running of the service, including:

- the ownership and/or tenancy terms, lease or purchase cost, and suitability of premises

- necessary adaptations and conversion costs
- transport facilities you will provide or use.

12. Training and support:

- what help have you had to develop the capacity of your group, your project ideas and your management skills?
- what training will be necessary for staff and directors in future, and what plans and resources are there for delivering this training?

13. The beneficiaries:

- define all the groups of people who receive benefit from your activities, directly or indirectly (eg service users and clients, volunteers)
- in what specific ways will these groups benefit?
- how will you record and measure whether you are achieving these benefits?

14. Monitoring and evaluation:

- how will the targets be set?
- how will targets be monitored?
- how will progress over time be assessed?
- do you have plans for review days or social accounting?

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15. Accountability:

- how will the public know about your work?
- how will you involve the community in the project or organisation?
- how will clients and users be involved in the planning, delivery or monitoring of the service?

16. Cash flow forecast: Include a cash flow forecast for at least the forthcoming three years. If the Plan supports a three-year funding application the forecast should be for five years.

17. Analysis of the financial arrangements: Describe the financial implications of your proposals in detail by referring separately to the items under the income and expenditure headings in your cash flow forecast.

- explain how your figures were arrived at
- describe the sources of funding which you hope to secure
- assess the overall cash flow situation for the period of the forecast
- explain what action would be taken if you miss your income targets or overspend

- indicate how the project or service will be sustained in the longer term.

18. Project timetable:

- provide a timetable to show the key stages in achieving each of your main objectives, both while the project is being developed and when it is running
- explain the method you will use to monitor your progress against the timetable.

19. Strengths and weaknesses:

- identify the strengths and weaknesses of your organisation to show that you have properly evaluated your capacity to develop the project
- show how you will take steps to remove the weaknesses you have identified or what steps you will take to minimise their impact.

20. Summary of any grant request:

- how much grant aid is needed and for what purpose? what other sources of finance have you explored and secured, particularly matching funding
- what funding will be needed in future years, and where will it come from?

Appendix 3: Calculating unit costs

Third sector trading organisations are often unfamiliar with the technicalities of costing bids and quotations for work. This beginners' guide indicates some of the key features and provides a work example.

A step by step guide for enterprises contracting for services

1. Cost centres: Decide how the expenditure of your organisation can be broken down into separate “cost centres”, identifying a *different cost centre for each distinct activity* – eg:

- Cost Centre 1 – your local headquarters for general activities, volunteering etc
- Cost Centre 2 – a care attendants scheme
- Cost Centre 3 – a day centre
- Cost Centre 4 – a grant-funded development project.

2. When you come to work out the unit costs of any activity, you will carry out the calculation *separately for each cost centre* (project or activity) which you are interested in.

3. Types of cost: Different types of costs need to be considered in different ways, so it is important to understand some basic distinctions:

- **set up costs:** the costs of starting a new project, including the equipment purchased for it and staff time needed to plan and launch it
- **fixed direct costs:** these are any facilities used *which do not change with the level of the service you provide* (eg a minibus which you use to run a day care centre)
- **variable direct costs:** these are the costs which fluctuate depending on the scale of the activity (eg, wages of care attendants, NI, travel costs, training for care attendants)

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- **indirect costs:** these are shared with your organisation's core activities (eg *part of* the normal costs of employing a manager and administrator, and a share of central expenditure on rent, heating, lighting, telephone, etc.); for new projects it should include the staff time devoted to preparing proposals.

Use your judgement on what constitutes an indirect cost and a variable cost. For instance, a project might be expected to contribute a basic 33% to telephone bills or it could have its own line which would be treated as a 'fixed direct cost'. If there is a very large telephone usage which fluctuates according to the service provided, it might even need to be treated as a '*variable direct cost*' related to the size of the project.)

4. Understanding the way your service is delivered: When you are calculating the unit cost of a service you are as yet only planning to deliver (eg to prepare a proposal to a funder or contractor) you must make absolutely sure that you are aware of the physical limitations of your staff and facilities – sometimes known as the 'break points'. For example:

- Your Administrator may be organising staff to deliver 100 hours of care at present, and may be capable of increasing this to 200 hours. But could the same employee handle 300 hours without you needing to recruit and employ another admin worker to help? This leap in staff costs would of course increase the costs of providing the extra care.
- Another break point is the capacity of your office. You will need to estimate accurately whether you have the space, the telephone system, the computer facilities etc to provide new or expanded services, and make provision for any necessary extra expenditure.

5. Deciding on your 'unit': 'Unit costs' refer to what it costs your organisation to provide a specified amount of service. In organisations providing social care, for instance, the most flexible and useful basic unit of cost will be "one hour of care". In other situations you might define the cost per day of training or the cost per individual receiving advice. But the larger, more general or vaguer the unit becomes, the more difficult it will be for you to estimate the price to charge for your service, and to quote that accurately in advance.

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6. Preparation: There are a few points to be aware of before you calculate the unit cost of your service as part of a funding or contract proposal:

- make sure you have considered the break points (see above) and accurate estimates for start up costs
- it is critical that you know all the costs involved in providing a service and include them in your calculations, so make sure you have collected figures for every type of expenditure in the cost centre
- it can be difficult to grasp the fact that unit costs may vary considerably depending on the scale of the service you are providing – so don't lose confidence in your calculations (the variability has something to do with the extraordinary flexibility in the way the third sector is managed, staffed and supported by volunteers)
- don't fiddle the figures; if you want to cross-subsidise one service with income from another source it is still important to know accurately how much the service is costing you – you can deduct the subsidy later when you fix the price you intend to charge the customer.

7. Calculating the *real* hourly rate: The actual cost of employing a member of staff involves a great deal more than their basic hourly rate. For example:

A full time care assistant paid £10 per hour who is paid for 37 hours per week, 52 weeks per year might cost you:

$£10 \times 37 \times 52 =$	£19,240
employer's National Insurance contribution, say	£1,924
recruitment costs, say	£600
Total	£21,764

To establish the real hourly rate you calculate the total number of hours paid for:

$$37 \times 52 = 1924 \text{ hours}$$

and deduct the non productive hours, say 20 days leave, plus 8 days public holiday plus 2 days training, which is 30 days or 6 weeks =

$$37 \times 6 = -222 \text{ hours}$$

$$\text{so the total hours worked} = 1924 - 222 = 1702 \text{ hours}$$

The cost to you of each *productive* hour worked is:

$$£21,764 \div 1702 = £12.79/\text{hour}$$

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Additional items:

- If you provide a **sick pay scheme** you may need to incorporate the extra annual costs of paying other staff to cover your sickness and other absences.
- A combination of **full time and part time care staff** and staff on different rates (eg special rates for unsocial hours) may further complicate the calculation: you would need to take an average across all types of staff, or, better, calculate separate hourly rates for each class of worker and include them all under “variable direct costs” when you calculate the total cost of the project (see paragraph 8 below).
- The “real hourly rate” may also include variables such as any **travel expenses** paid to staff.

8. Example of calculating total costs for the cost centre:

The following example illustrates how the total costs of a project are calculated for a given level of service – the annual cost of 100 hours of care per week for care assistants paid £10/hour. The list of expenditure headings is not exhaustive.

start up costs

computer, printer and software etc £1,500

indirect fixed costs (share of organisation's total costs)

25% of Manager's salary & NI	£6,000
50% of Administrator's salary & NI	£6,000
33% of organisation's rent	£1,500
33% of rates	£300
33% of power	£600
33% of insurance	£200
50% of accountancy and bank costs	£500
33% of advertising costs	£500
33% of repairs and renewals	£200
£15,800	

direct fixed costs:

stationery and postage	£800
telephone (separate line)	£1,000
£1,800	

direct variable costs (see paragraph 7):

100 care hours per week for 50 weeks at £12.79/hr	£63,950
total costs	£83,050

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9. Calculating unit cost: The unit cost in the above example is the total cost (£83,050) divided by the number of hours care provided over 50 weeks (100 X 50)

$$= 83,050 \div 5000 = £16.61/\text{hour}.$$

10. Handling variations in the number of units: Using the same component costs in the above example, but for 50 hours care per week rather than 100, the only really significant change in costs will be that of the care hours (down to £31,975) giving a new total cost of £51,075. Dividing this by 2500 hours for the year produces a significantly higher unit cost of £20.43/hour.

11. Calculating the number of units for fixed price contracts:

Commonly, the contractor will indicate the price of the contract and it will be up to you to work backwards to calculate the number of units (hours of care in the example) you can provide for the money on offer. You could get the answer by trial and error by repeatedly adjusting the number of care hours. The direct approach is to *subtract the total non variable costs from the contract price and then divide the remainder by the variable unit cost* (which in the example is the 'real hourly rate' figure of £12.79).

Say the contract price is £60,000. Subtract the fixed costs of £19,100 to give £40,900 and divide by £12.79, which gives 3198 units (hours) per year – or 64 hours per week over 50 weeks.

It is important to recognise that this approach only works if you do not trigger any break points which could significantly reduce or increase the fixed costs. The only sensible course is to be extremely methodical with calculations and relate them to the reality of your organisation at each step.

12. Profit: Once you have calculated the unit cost and the total cost of a project you are contracting for, you can consider the possibility of adding a percentage of the total on top for profit (which is what the private sector will always do, and which you would presumably use to subsidise some of your other charitable services). Whether the customer will let you get away with this is another matter, of course.

But be careful to make the distinction between *profit* and the financial benefit you create by *charging for a proportion of your core management and administration costs*. These are real expenses borne by the contract which the customer must expect to pay for.

13. Cost centres and the annual budget: Once you have adopted the principle of cost centres for working out unit costs for your various services, you will almost certainly find it useful to prepare your annual budget under the same cost centre headings as well. Paragraph 8 indicates the type of expenditure information that the cost centre budget should incorporate. Itemising your income will follow the same principles. Ask for help if you are unsure how to go about this.

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14. Monitoring: With a budget set up under cost centres and broken down into monthly income and expenditure you will have all the information you need to monitor the month-by-month performance of individual contracts against your original budget predictions. This is a powerful tool for checking that your calculations were right and that the contract or project is running properly.

15. Notes: sharing 'indirect costs' among relevant cost centres (see paragraph 3): There is nothing absolute in the idea of allocating a proportion of core costs to a number of separate cost centres, and you will need to use your judgement and sometimes just informed guesswork to assess how costs should be shared out appropriately. Here are a few tips:

- estimate what percentage of the manager's and administrator's *time* is devoted to the work of each cost centre (project or activity), and use this figure to calculate the proportion of *the total cost of employing them* which should be borne by each cost centre
- keep the arithmetic simple: an approximate breakdown of the Administrator's time, for example, on the lines of 25% headquarters, 50% care attendants scheme and 25% 'Lottery Project' could be all you need
- estimate the portion of the space in the office occupied by (or the amount your office facilities are used by) each cost centre activity; then use these percentage figures to share out the rent and other items such as power and stationery etc
- for some items (the annual audit and bank charges, for instance) the share of costs borne by each cost centre can be related to the total turnover of each
- try to get agreement among the staff involved – you don't want grievances that one project is not bearing its fair share of the phone bill, for instance
- keep things in proportion – it will make very little difference to unit costs whatever way you share out an annual expenditure of only £50
- if you decide later that the apportioning of costs or time or space could be improved on, don't be afraid to make individual adjustments.

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