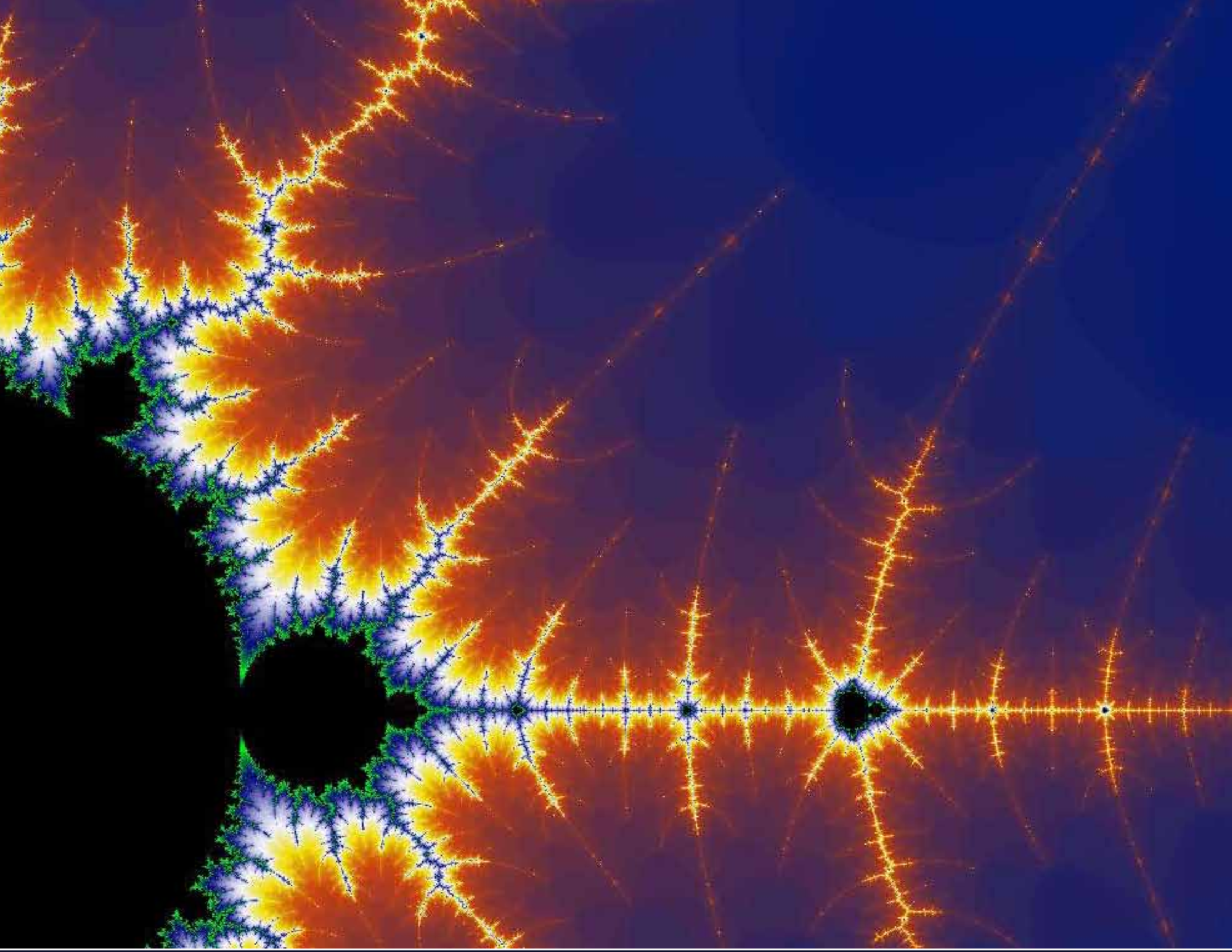

THE END OF CHARITY

...and the Renewal of Welfare

PANAHPUR

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Imagery: All imagery in this pamphlet comes from the Mandelbrot Set, a mathematical formula that forms part of Chaos Theory. The images are created by a simple formula (sometimes called God's Thumbprint) that describes a 'closed feedback loop' - a relationship. Infinite beauty and complexity flow from this relationship. This juxtaposition of creative infinity being derived from a simple equation has powerful resonance with Einstein's theory of relativity, and any theory that seeks to describe relationships. In 1959, C.P. Snow observed that the 'two cultures' of modern society - the sciences and the humanities - have ceased to understand or even communicate with each other. In the 21st century, the same has become true of those who understand the centrifugal forces of modern finance - and those who don't. The imagery of the Mandelbrot Set can be seen as a symbol of the great beauty and infinite possibility that can be released if we have the courage and strength to connect our money with our meaning.

CONTENTS THE END OF CHARITY

INTRODUCTION

Despite the best efforts of charities and governments across the world, the problems that they have poured so much money into trying to solve over the last century persist. **If anything, they get worse.**

Mahatma Gandhi said that:

'...poverty is the worst form of violence'.

Yet today, **forty percent of humanity lives on less than $2 per day**[1] and one in four children worldwide live in poverty[2].

Even in the wealthiest economy on earth – the United States of America – the poor are getting poorer and the rich are getting richer.

From Jan 2002 to Dec 2007 (the last period of sustained economic expansion in the U.S.), the median U.S. household income dropped by $2,000.

Since 1973, income for the bottom ninety percent of U.S. families has risen ten percent in thirty-seven years whereas income for the top one percent has risen by three hundred percent. Whilst in 1973 **CEO's were paid twenty-six times the median income,** now the multiple is > three hundred times.

It was in this context that our foundation was seeking to resource charities who intervened on behalf of the vulnerable, marginalised and excluded from society. We did not have any restrictions on how generous we could be, and we sought to be as generous as possible in our giving. But as we sought to bring ourselves alongside the recipients of our giving, the dysfunction of the dynamic of modern 'charity' became increasingly clear.

Why, despite the sums spent, and the best efforts of so many good people, were the problems getting worse?

We started by looking at **the charity sector.** But of course, charitable pounds are not the only ones deployed to affect positive social outcomes. **Taxation pounds** deployed by government agencies are (despite current questions of sustainability) a significantly greater resource. And increasingly, there is a school of thought that investment pounds can be used to affect positive social outcomes.

The more we looked at charity, the more it occurred to us that **we live in a world where charitable pounds, taxation pounds and investment pounds are operated in isolation of each other, in three completely different ways.**

Why?

Because of how these things have evolved historically. **Happenstance. Chance.**

Is there any reason why these things should be separated and treated differently? Or are we all aligned in our goals – to use our pounds as a resource to address the causes of social and environmental problems, and promote good human outcomes?

Could an integrated approach, treating charitable, taxation and social-investment pounds as the same thing not result in greater 'value creation'? By investment in addressing causes alongside investment in the treatment of symptoms? Prevention as well as reaction?

Our journey into understanding why charity is broken helped light the way to a solution …

A note on definitions

This pamphlet considers institutional charity – giving by institutions, and giving to institutions. In this respect, it discusses the 'capital market' for charities, and concerns charities that must access this 'capital market' if they are to succeed (or even survive). It does not refer to individuals giving to individuals. Nor does it refer to the many wonderful charities which have a community of supporters who are able to meet their needs without the need for external capital.

But there are many other fabulous charities that wish to grow, but who have no reasonable access to capital. It is they who are the motivation for this pamphlet.

1 World Bank Development Indicators, 2008
2 Childhood Poverty Research & Policy Centre)

THE FUTURE FOR
what is currently known as CHARITY

As explained in Part II, it is clear that the ageing charity paradigm, invented centuries ago in response to the failures of an industrialising and urbanising society to address social problems in the old ways, has ceased to function properly.

It is also clear that direct government intervention, funded by taxation, is increasingly unable to address the causes of social problems - instead retreating to deal only with the most acute of consequences.

And it is clear that the states effectiveness at doing even this is significantly hampered by diseconomies of human scale and organisational gigantism.

In essence, whilst the individuals who work for the state may be committed and smart, the decisions that 'the state' ends up making – when applied on a human level – are frequently nonsensical.

A consensus is emerging that charity and direct government intervention are misfiring, and the search is on for better solutions.

ONE POUND, MULTIPLE DISGUISES

The future may be rooted in understanding that the application of finance to a social problem (whether it be as a gift - or 'grant', as a welfare budget, or as 'investment'), is a means of relating.

The financial transaction is certainly not a destination. It is rather an aperture, a moment in time where agreement is reached between all the stakeholders about the intended outcomes, and what is required for them to be achieved.

If done properly it enables the financial resources to be made available in a way that has been engineered to minimise risk and maximise the chances of success.

It can design-in accountability and relevant measurement, as it so successfully does for commercial, for-profit transactions.

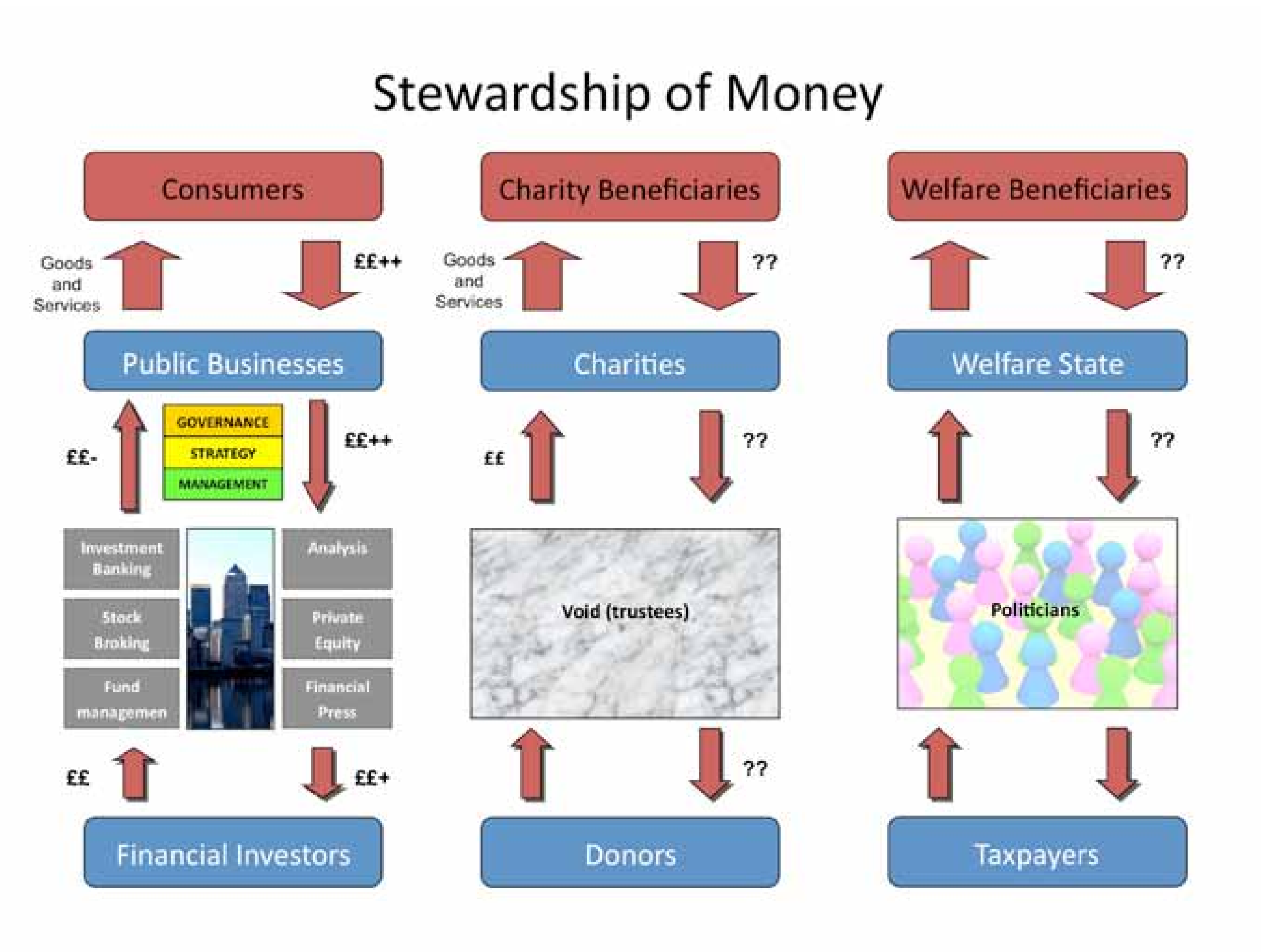
FINANCIAL TOOLS

In the evolving world of investing for positive social outcomes, the conventionally applied grant is the financial equivalent of a flint axe head.

If I give £1 away, that represents a loss to my balance sheet of £1. To earn that £1, I must invest £20 for one year (assuming a 5% return) in something that has no relevance to my purpose - and may even be contributing to the problem that I exist to combat.

This is an inefficient use of capital.

If, for example, I were to lend that £1 interest-free to a high risk social enterprise (e.g. a business employing that marginalized or vulnerable person with the goal of restoring them into the community), and if I were to be able to manage my risk so that there was a ten percent default, then I would be able to lend £10 for every £1 I was to give away.



Please see page 23 - 24 for an explanation

When the current system of institutional charity was invented, capital was deployed in essentially two ways: Debt and Equity.

Giving was done through a gift. And welfare was done through a budget.

Today, investment capital is deployed in a bewildering number of ways, with ever more sophisticated instruments and tools. **Collateralized Debt Obligations and Credit Default Swaps** gained notoriety in the worldwide financial collapse of 2008, but opened one window – the window of derivative debt instruments – into the world of tools used to facilitate capital flows.

Giving is still done through, well, a gift. Despite considerable and valid efforts to improve commissioning, welfare is still done through – yes, a budget.

The purpose of the sophisticated capital tools employed by the markets is to unlock more capital, and to better orientate capital to achieve the objectives for which it is being deployed.

The lack of any tools more sophisticated in the charitable or government sector more sophisticated than a 'gift' or 'budget' assumes that such capital tools have no application for positive social outcomes.

Clearly it is time to re-examine this.

There are a large number of financial levers that can help to catalyse positive change in society – some can help to leverage further funds, and some can orientate the capital to better achieve its objectives.

Engaging the commissioning or donor community with these levers and tools is **a potentially powerful way to build engagement and accelerate change.** But the operators of these capital tools need help in choosing and shaping the appropriate lever – whether it be:

- to orientate the investment towards achieving the desired outcome
- to leverage in further capital, or
- to best suit the investee

…or any combination of these three.

THE SPECIAL ROLE OF NON-REFUNDABLE FINANCE IN SOCIAL INVESTMENT

Taxation pounds are special – they are replenished constantly, as taxation revenues continue to be raised. This magic-porridge-pot characteristic makes taxation pounds the most powerful possible tool in affecting social transformation. But their potential can only be properly realized if they are seen as a capital tool, to be combined with other capital tools to achieve the most efficient and effective possible funding package to address a particular challenge. If taxation pounds are merely seen as something with which to fill a budget hole, much of their unique power is lost.

The taxation pound is the only finance that can sustainably take the key 'first loss' role for leveraging in at-risk capital to deliver social outcomes. It is especially important during the time that track record is being established by this emerging asset class.

By contrast, 'first loss' is sometimes seen as a role for charitable pounds. To use managed charitable pounds in such a way would be counter-productive and would reduce the appetite for social investment amongst the £95 billion of managed charitable capital in the UK.

As charitable treasuries move more into social investments, the monies available for traditional 'grants' will fall. This is because of the 'absolute loss' nature of a grant pound – it is immediately lost, permanently, from the balance sheet. This loss means that the rest of the treasury can take less risk. Were that pound not granted, it could instead be used as a 'loss' pound in the operation of risk capital from the balance sheet – thus increasing the risk appetite of the treasury, and hence its potential for investing its core capital for social transformation.

The more pure grants that are given, the more core capital will have to be invested in conventional financial investments.

The evaluation that charitable trustees will increasingly find themselves making will be whether the deployment of a grant can achieve competitive social impacts as the deployment of higher volumes of repayable risk capital, with that grant pound enabling the risk to be taken as one of the 'loss' pounds.

FROM PROVIDER OF SERVICES TO PROCURER OF OUTCOMES

The funder (including commissioners) need to change their mindset. No longer the people who fund the provision of services, they will instead need to see themselves as people who procure outcomes.

There might be a number of different potential suppliers of an outcome. The role of the funder is to:

1. Decide what outcome to seek
2. Discern who is best placed to deliver that outcome
3. Invest in that agency to deliver that outcome on their behalf – in a way that aligns interests, maximises accountability and minimises risk
4. Manage the investment to achieve the outcomes agreed

The charity sector is well placed to respond to this seismic culture change, as it consists of already-independent enterprises focussed on delivering outcomes efficiently. It is likely to be more problematic for the state sector, which must organise into intelligible and coherent social enterprises capable of winning pitches to deliver the requirements of the procurers.

CONVERSION FROM 'CHARITY' TO 'SOCIAL ENTERPRISE'

Charities (and state providers) have sales, just like businesses do. Every time a charity sends a begging letter and elicits a financial response from its audience, it is making 'sales'. Every time a social service manager pitches for his budget, he is making 'sales'.

The minute that a charity starts to recognise this fact, a magical culture change starts. The accountancy of dependency (income and expenditure) can be replaced by the accountancy of enterprise (sales, cost of sales, overheads). And significantly, the idea of other 'sales' – aside from budget settlements, grants and gifts – can be introduced.

Ultimately, enterprise thinking (often with a variety of income streams for the enterprise) will enable significantly greater access to capital. As increasingly, volumes of capital start to come in as 'social investment' rather than 'grants', so some sort of enterprise model must be introduced. Without the ability to recycle out (at least some) of this capital, it will not be invested.

So by adopting an enterprise model, a charity opens the door to capital deployment, rather than just income distribution. This results in potentially a twenty-fold increase in available capital (assuming a five percent return) as discussed earlier.

DEPLOYMENT OF CHARITABLE TREASURIES

Geoff Burnand, Chief Investment Officer for Charity Bank said in December 2010 that

> *"In recent years we have found ourselves in an absurd situation where many organisations have been obligated to invest in a way that is incongruent to the delivery of their core mission".*

Increasingly, the contradictions of the charitable paradigm have become untenable. The idea of holding one's capital in enterprises whose only purpose is exploiting their assets for financial profit, in order to use that money to invest in enterprises whose purpose is to combat social problems arising from inequality is self-evidently problematic.

Yet until very recently, the statutes – through the definition of what is meant by 'fiduciary responsibility' – have forbidden alternatives.

Fiduciary duty came to be defined as the responsibility of anyone managing funds on behalf of another to maximize the financial return – the exclusion of all other considerations (other than the tolerance of some narrow negative screens, such as a prohibition on investing in alcohol or armaments). It is time for this definition of what is meant by 'fiduciary duty' – for capital set aside for certain purposes – to be re-thought.

The person that pays the piper calls the tune.
It is capital that is the powerful force – not income from capital.
So the idea of deploying it all for our purpose,
rather than merely the income from it, is a revolutionary one.

This is becoming possible for the first time in generations. For example, the review of CC14 (the guidance issued by the government on mission-related investing) – is a potential Kairos moment that could open the doors to the revolution in how capital can be deployed. It suggests that capital can be invested positively to meet social goals, in this case of a charitable trust.

The burgeoning Social Capital sector opens up a real opportunity for this to happen. Social housing and microfinance are probably the first sectors that have achieved some sort of investment-grade.

As the sector matures, more robust propositions will emerge. As they do so, more and more foundations and charitable funds will start to ask the question of whether placing funds in a conventional financial market, where they were being used to extract maximum profit through the modern system of 'shareholder capitalism' is the optimal system.

Aside from the obvious contradictions of this system is the mathematics, the fact that by using more efficient tools (as explained under 'Financial Tools'), **an investment pound can be multiplied and go significantly further than a grant pound.**

PARTICULAR DIFFICULTIES OF SOCIAL INVESTMENT FUND MANAGEMENT

This is all very well, but an investor (e.g. a foundation) transitioning towards the new paradigm will encounter portfolio issues.

Not only must they ensure that they have sufficient liquidity to meet any 'grant' requirements moving forward, but **they must also build in an appropriate balance of risk.**

Both of these things are more difficult in a sector which is still emerging. Liquidity is naturally more challenging due to a longer term investment relationship. This challenge is compounded by a lack of 'critical mass' due to the newness of the sector and its relatively small size. That problem also makes it more difficult to balance risk, as there are fewer lower risk, mature, 'blue chip' propositions relative to higher risk, immature propositions.

Wrestling with the challenge of devising an appropriate and practicable portfolio strategy has led some of the pioneers of this thinking to invest in some of the infrastructure and financial product to help sort out these problems – such as Esmee Fairbairn's support of BuzzBnk, Panahpur's support of the Social Stock Exchange and Bank of Angels concept, and the support of both – and many others – for the first Social Impact Bond issued in 2010 by Social Finance Ltd. This is also what has led to so much lobbying for the Government's Big Society Bank to focus on the development of investable product and infrastructure to facilitate capital flows.

It helps to consider four different kinds of capital that might be deployed, all of which can be aligned with one mission but which help to start to make sense of risk... (*see 'The Emerging Capital Spectrum: 4 Kinds of Capital' diagram on page 12*).

The Emerging Capital Spectrum: 4 Kinds of Capital

GIFT	GRACE CAPITAL	SOCIAL CAPITAL	SHAREHOLDER CAPITAL
-100% return	-99% to -1% return	From 0% to below market returns for financial risk taken	Fully priced financial risk returns

COMMUNITY AND NEW MEDIA

In the original days of institutional charity, it was relatively easy for charities to function with a core community of supporters, in the same way that businesses would often be financed through the family and friends of the entrepreneur, and a good relationship with a bank manager.

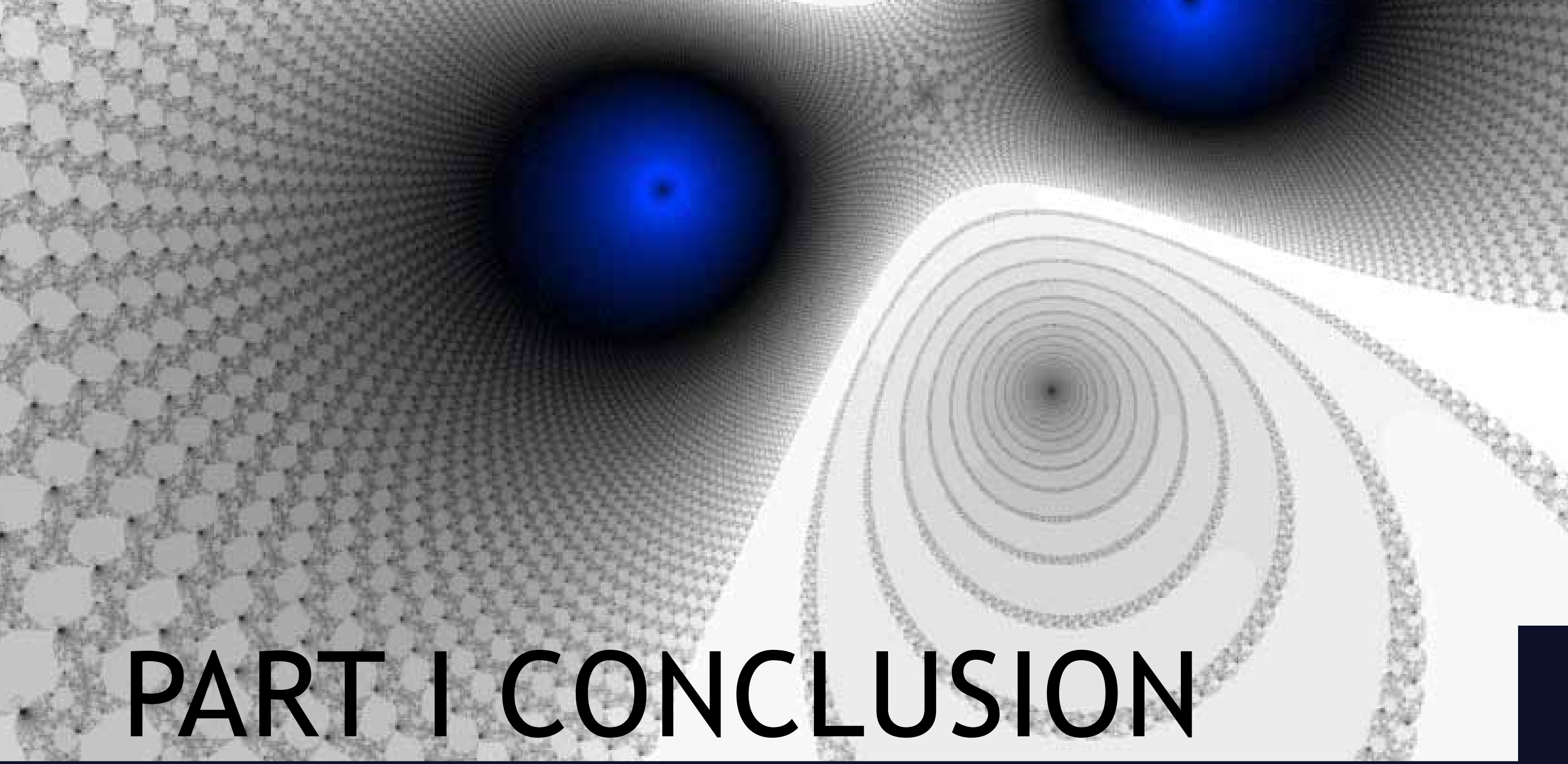
But as time moved on successful enterprises grew, and outgrew their original supporter bases. Connection became more difficult. Capital markets became necessary. Whilst these successfully provided growth capital for for-profit enterprise, they failed to provide it for social or charitable enterprise.

This is possibly due to the difficulty of remaining connected to positive 'social' outcomes in an aggregated market, and reflects the indispensability of retaining such a human connection to those social outcomes. In a financial market, for financial investments, everything could be boiled down to an amount or a percentage, making such connection superfluous.

New media gives social enterprises of all kinds a disruptive new opportunity to connect with and develop a new foundation of community, from which to operate. Participation in the semantic web is a basic requirement for any enterprise seeking to thrive long term by engaging a community of supporters. 'Social networking' and 'online communities' are new concepts, but have achieved unprecedented levels of human participation. Is it possible to harness the undoubted power of this new frontier to create new kinds of funder communities – people with shared purpose, working with full transparency – and involved in governance? Will we see the development of an infrastructure within which individual charities and social enterprises can create this kind of community?

The world is changing at bewildering pace in this field. Retail platforms for regulated social financial promotions such as **www.microplace.com** are proving that there is appetite. New ways to connect with giving have had some success, such as **www.kiva.org.** The developments of 'asset transfer platforms' and Social Stock Exchanges throughout the world are all pointing in similar directions.

No one yet knows what the answers to this question might look like. But there is a growing sense that they are likely to be the cement that ensures that there is no way back from the evolution and confluence of charity, government intervention and that-new-



PART I CONCLUSION

kind-of-business.

The purpose of this is to illuminate some of the 'big concepts' that underpin this new way of thinking about funding social interventions. It is certainly not to be a comprehensive or exhaustive exploration of the issues associated with this new paradigm. **It is a provocation, not a manifesto.**

In his new book, "*Building Social Business*", Mohammed Younis outlines his ideas for a new set of institutions and structures to create a more just world. In it, he says:

> *"The most important feature of this new global economic architecture will be to complete the half-built theoretical framework of capitalism by including a second type of business, social business, in the global marketplace. Once social business becomes a recognised element in the framework, it can play a very important role in solving the financial crisis, the food crisis, and the environmental crisis. Furthermore, it can provide the most important institutional mechanism for resolving poverty, homelessness, hunger and ill health".*

This pamphlet is not an effort to knock charity. Quite the opposite – it is the product of many years trying to help them, and is an effort to explain an alternative system within which the endemic barriers to success that they experience daily in their operations can be removed.

The goal of this new paradigm of funding is to return the power to the agency doing the work, by giving them an opportunity – by delivering superior social returns – to become more demanding of their funders.

WHY CHARITY IS BROKEN

If you put a frog in boiling water, it jumps out. If you put a frog in cold water and gradually warm the water up until it is boiling, the frog boils to death. Charity is the frog, after two hundred years of water gradually warming up. It is no one's fault.

There are a great many reasons why charity is broken. This paper covers some of the more obvious:

1. THE DONOR IN THE DOCK

A fish rots from the head.

But who can criticise donors? They are the ones who have put their hands in their pockets to 'do their bit'. Most people don't.

Donors do not realise the unintended consequences of the way in which they give – why should they? Aren't they already doing enough, by parting with hard cash?

But it is not until one looks through the lens of the recipient charity that one starts to understand. There are a number of unconscious but detrimental behaviours by donors:

ONE-OFF GIVING

A 'one off' gift is a surprise to managers in charities. They did not know that it was going to come. Nor do they know whether it will be repeated. This prevents them from planning their work effectively, and it can contribute to a culture of perpetual 'financial crisis'.

For example, one charity that we have worked with has a monthly salary bill of over £21,000 and other overheads of £10,000. It has regular 'subscription' giving of just under £4,000 per month. Each month, the leadership must sweat on the other £26,000 to 'appear'. Sometimes it does. And sometimes it doesn't.

RESTRICTED GIFTS

One way that charities have found to successfully raise funds has been through the 'restricted gift'. By offering a donor something 'specific' to 'buy' on behalf of the charity, a more direct sense of ownership can be built for the donor in terms of how his funds are used. Sponsoring a child's education, paying for a goat, or a cataract operation. Appeals based on a specific 'product' have proved effective. Paying for office costs, the electricity or phone bill, or toilet cleaning – whilst every bit as essential – are not so appealing to donors.

There are, though, **two hidden consequences of such giving** that may not be immediately obvious to the donor.

The first is that restricted giving (or giving for a specific purpose) unintentionally becomes a vote of no-confidence in the judgement of the charity. It says that the donor does not trust the management and trustees to steward their funds effectively. It says instead that the donor knows better than the charity how the funds should be spent. By soliciting and accepting restricted gifts, charity leadership is effectively endorsing a logic that says they don't know what they are doing.

The second, much more practical consequence is that charities find themselves with pots of money with which to pay for cataract operations or a child's education, but they lack the unrestricted funds to manage the back-office functions that are essential to ensure efficient management of the process.

The consequences of this are tricky. More than one charity that we have been involved with has at times trodden the fine line between 'short term cash management' and fraud. Fraud through using restricted money to fund general activities. We can understand the grey areas and the pressures to rationalise such a practice. Of course the consequences are potentially serious, but the management are in a difficult position. Should they shut down meaningful activities whilst they have cash to pay for them, already given to their charity (albeit for a slightly different purpose)? Should they make good people redundant for this technicality, to the long term detriment of their beneficiaries? Or should they engage in an administrative process to contact all those donors and seek release of the funds? Who will know? Does anyone care?

ADMINISTRATION PERCENTAGE

A statistic often quoted as evidence of efficiency and good management is the percentage of turnover that is spent on a charity's internal administration. The assumption is that a lower percentage is an indicator of efficiency, whereas a higher percentage indicates inefficiency. This may well be true of a commodity output such as the distribution of food aid. However, the usefulness of the statistic quickly breaks down when applied to anyone whose output is bringing about a change in people. For example, many charities that we are involved with are involved in **placing volunteers in the field. These volunteers raise their own support –** such as those working with parts of Oasis International.

Oasis provides an essential function, yet for the purposes of the key statistic, it could be possible that over fifty percent of their turnover is spent on their own 'internal' administration, facilitating the placement of volunteers.

Another example is a foundation like ours. We can spend little time making big donations. The first has a very low percentage for administration, the latter has a very high percentage for administration. But it is the high percentage administration approach that is likely to have the greater impact and ensure funds are not wasted.

This highlights the issue that **such a measure drives funders away from smaller charities and into bigger charities.**

DISCONNECTED GIVING

A consequence of these points, but also a problem all on its own, this is the biggest problem associated with giving: the problem is that when the 'gift' is made, then that is the end of, rather than a part of a relationship.

Dynamics of accountability and engagement cannot exist in this context. Imagine a financial investment where the investor forgot about their investment the minute that they had brought the shares? Of course, a gift is only of any use once it has been put to work by a capable management within the context of a sound strategy. It is the outputs that result from that gift that matter. But most donors do not think deeply about this – they see their job as done when they have written the cheque.

The key to transformation for all charities is for donors to see the moment that they write the cheque as just another part of their relationship with a charity.

One illustration of this is Charities Aid Foundation. The way that their excellent service works is that one gives to CAF, who then operate those funds like a bank account for you to give from, at your direction using banking tools such as a special chequebook.

Clients will give money to CAF, and see it as 'given' whilst it sits doing nothing in their CAF account. There are literally tens of millions of pounds sitting there in limbo, given but not given.

One solution lies in the charity taking a more relational approach. One charity who we supported are, in the context of a holistic response to human trafficking and its consequences, fighting the traffickers of children. In rural parts of India, poor children and young people are lured from their communities, often with parental involvement, with promises of well paid work in the city. The children will send money home and return frequently, they are told. The parents are often in a desperate struggle for survival. The promises are too good to turn down. The children are then accompanied to big conurbations like, for example, in Mumbai, where they are taken to brothels. Often the children are 'supplied to order', with wealthy clients requesting children with a certain look and colouring, of a certain age. Virgins are at a great premium. Boys and girls.

This charity has a network of volunteers across the rural areas, and when the traffickers are looking for children in a remote area, they come to hear of it. The key to their success is rapid information exchange. As soon as they hear of a child being trafficked they inform – ideally with photographs sent via mobile phone – their staff in Mumbai, who scout the main travel termini, looking out for trains and buses coming in from that region. They are able to identify the individual children on arrival in Mumbai, and follow them to the brothels.

The children are not usually raped immediately. There is time to arrange for a police raid on the brothel, and the success rates of recovering the children are good. This particular charity will then follow up the raids by prosecuting the perpetrators. They are experienced at gathering evidence and have prosecutors on the staff. They have been subject to intimidation and threats from both the traffickers and, despite generally excellent relationships with the authorities, some corrupt police. These are people fighting mafias head on; it is not work for the faint hearted.

This charity is pioneering the concept of money as just the beginning of a relationship. By keeping supporters involved and aware, in real time, about the children they are tracking and the progress of the raids, there is no problem over connection. Supporters know what their money is being used for and the effectiveness of it. That is not to say that there is not a role for objective, third party reporting. But it illustrates how good charities will involve a donor community, and by doing so will introduce accountability and engagement that is impossible when the receipt of the cheque is the objective of the relationship.

Of course, the donors would be horrified if they knew the direct consequences of the way in which they give.

2. THE WRECKAGE LEFT BEHIND

STRESS AND OVERWORK

Most charity leaders we encounter are struggling. This is because e**veryone we meet who is running a charity – without exception** – **has two jobs.** Running their charity, and raising the funds to fund it.

Initially I had thought that the trustees might have a role in this, but I have been surprised to see how peripheral the role of the trustee generally is – more on this later.

The culture of one-off giving can reduce those who 'lead' charities to acting as glorified fund raisers. Such is the constant need to 'find next month's overheads'. **Good fundraisers are often not good leaders, and vice versa.**

I had a meeting with a terrific man who ran a charity that took street children from the streets, and housed them in transition homes in South America. His passion was to see those abused, bewildered, complex children rediscover their self esteem, alongside being equipped with some life skills that would enable them to start the long road back into society. He is a man of rare experience and depth. He also has a family of his own. After our long meeting I was exhausted, and longing for the train and home. He was going out that evening to a fund raising ‘curry night’ with a few people that some contacts had put together. I rang him the following day, and learned that he had raised £2,200 from the evening, and he was thrilled. People had been so generous.

This was a man who had to find a budget of over £34,000 per month. That is a lot of curries, and not much time at home with the family, in addition to the day job. There is no way that this man could put his considerable skills and expertise to best effect for the benefit of those street children with that funding model.

Typically, morale is fragile. Often it is a wonder that it is there at all given the circumstances. Leaders are prevented from leading and the sector is trapped in a wasteful cycle. **Contrast this with the private sector,** where capital requirements are addressed through a capital market – with no limitations for a good team with a good strategy – and leadership are freed to lead, and management to manage.

SHORT-TERMISM, DISINCENTIVES TO SUCCEED AND STRATEGIC DELUSION

We are working with a charity who has a vision to impact literally millions of people. They are doing it on a shoestring. The leadership are terrific and quite possibly capable of success. They have track record and management ability. But to get there, they need a strategy that thinks big and sufficient money to put the people in place to deliver it.

But before they even start to plan, they must establish whether the major donations that bankrolled last year will be repeated. They must secure this year’s budget. **So there is an inbuilt imperative to think short term.**

As soon as they think big, they immediately create for themselves a big funding headache. And as soon as they succeed, they need to grow which makes the funding headache unavoidable. **So there is an inbuilt incentive to think small and to stay small.**

And because there is no capital market to go to in order to gain funds for big plans, it is easy to conclude that the small, short term plans that one has will achieve the vision – strategic delusion.

The organisation I have just described could be any number of different charities that we have sought to work with. It is not their fault, they are not bad people.

SURVIVAL OF THE UN-FITTEST

Some charities are effective. Some are less effective. Some are essentially ineffective. But some of those that are ineffective are really good at putting out emotive fund-raising materials. Or throwing fund raising parties. Or are really well connected. Some that are most effective are not well connected, don’t like to emote and don’t do parties.

A major problem with the lack of connection of funders is that it enables ineffective charities to continue, and keeps the oxygen of funds from effective charities. Success is often a function of style (ability to raise funds), rather than substance (results for beneficiaries). There is limited natural selection based on results, which holds back the fittest to the detriment of the beneficiaries.

PAY

The lack of subscription giving and predictable income – and consequent culture of perpetual financial crisis – has led to a culture of low pay levels for those working in the charitable sector. In addition, on several occasions in the last few years I have seen charities share their financial problems with their staff, through wage freezes, enforced salary sacrifices and a withdrawal of benefits and pension contributions. It is a sector sensitised to what would be unthinkable in the state or corporate sector, where strikes and walk outs would result.

Our experience is that, by and large, people who work for charities are not paid an appropriate salary for the responsibility that they take or the skills that they bring to the job. It is not uncommon for someone expected to take senior management responsibilities, live in London and raise a family to be being paid less than quarter of what they might get in the state or corporate sectors. Often it is not really a viable wage.

So the pay rates are undervaluing the roles.

It seems that a culture has developed that views the desire to work for a charity as, in itself, an act of charity on behalf of the worker. It has become acceptable to offer a charity worker a low salary in the belief that the worker should be paid less because it is 'charitable'.

Occupation of either extreme of the salary spectrum is unacceptable. We all know about 'bonus-ed' bankers at one end. But at the opposite end of the spectrum there is a scandal every bit as serious for society, that of low pay for charity workers.

It is morally wrong. **Charitable giving is a decision that each of us makes as an individual,** as a matter of conscience. It is not a decision that is made on our behalves by a remuneration committee. By offering sub-market salaries, donors are saying to those who work for charities that we do not value them, and/or that we expect them to give charitably through salary sacrifice. This dis-empowers and disrespects them. It could be seen as exploitation of their charitable instincts.

Most serious of all is that it prevents employees from being held properly accountable for their performance. It is very difficult to rigorously demand consistent excellence from someone who is being paid half of what their counterparts in the private or state sectors are. Because of these conditions, **we have frequently observed a culture of poor performance for poor pay, and of poor skill levels for the role requirements.**

LEADERSHIP AND ACCOUNTABILITY FAILURE

We have been uniformly impressed with the leaders that we have worked with in charities.

This is not the same as saying that they are all good leaders. Some are what Rob Hay[1] of Redcliffe College describes about as 'toxic' leaders. That toxic leadership is such an issue in charities is another by-product of a fundamental accountability failure.

1 Rob Hay, Worth Keeping

To illustrate:

"I am a leader of a small charity. I am doing it because of a strong vocational calling to positively affect the lives of the beneficiaries. I am living with the stress of raising the funds day by day, and I am living with the stress of running the organisation on inadequate resources. I am underpaid myself. My trustees don't know what's going on other than what I tell them. What, precisely, is the point of them, and why should I hold myself accountable to them?"

The role of the trustee board, of course, should be to hold the vision of the charity and ensure that the right management, strategy and finance are in place to achieve it. Critically, this should include hiring and firing the leadership. This, in our experience (and with exceptions) is not what happens.

Often, trustee boards lack legitimacy, arguably because they are not adding enough value. They are largely reactive bodies, remaining disconnected to the month-in, month-out experiences of the charity – largely due to the practical constraints of the charitable structure. **They tend to limit their ambition almost exclusively to the defensive** – with the compliance and administrative requirements of running a charity under UK legislation as policed by the Charity Commission.

The Charity Commission is often wrongly perceived as some sort of bogeyman, out to get them, which drives highly conservative decision making.

Too rarely do they take ownership responsibility for driving the achievement of that charity's vision. Too often, if the charity commissioners are happy, and if the leader of the charity is happy, then so are they.

Most tellingly however, it is the management, rather than the trustee board who raise the funds that enables the work to continue. It is the management who have the relationships with the funders. It is the management who drive the strategy – and who call the shots. In this context, there is no way that the leader is going to be held accountable to the board because, ultimately, the board has no power.

Over the last few years, we have engaged in discussions with some high profile leaders of charities. Too often they have not been accountable to anyone. **We have stumbled across the twenty-first century London equivalent of a trading station up the Congo, where we encountered Mr Kurtz.** We have heard people say 'I am accountable to God alone', believing that this is all that is required. We have encountered men of real vocation, purpose and humility, who are struggling to remain faithful to their cause in the context an accountability vacuum. We have discovered those who have constructed for themselves a separate accountability system and see their accountability as exclusively to this. And we have encountered a number of variations on these themes. The powerful positive energy which can be created by deep accountability to an engaged and functioning board is something that is tough to achieve within the current paradigm.

As funders, too often we arm our finest warriors and encourage them out onto a battlefield. **We bear a responsibility to be sure that their bodyguards and generals are not sleeping.**

TRUSTEES

A culture of amateurism persists from pre-war and pre-welfare state charitable endeavour. For good reason, trustees are not permitted to be remunerated for their trusteeship responsibilities.

But this makes trusteeship something undertaken as a 'grace and favour'. The governance of the charity is forced to play second fiddle to any other priority that the trustee might have which is remunerated. It becomes something that happens in one's 'spare time'.

With notable and numerous exceptions which shine through despite (not because of) the system, this can lead to a culture of disengagement amongst trustees. Furthermore, those people who are, in theory, exercising ownership responsibility for the charity are too often the wrong people.

This is because so many are ruled out, because they are at a demanding life-stage or have demanding jobs. They simply do not have the capacity to contribute significantly to charities without some sort of 'break' to do so – whether through remuneration, taxation or some other break.

It would be unthinkable for companies not to pay their directors – a demanding and substantial role. The board could not possibly function. Board composition could not be specified and then recruited. Companies would become reliant on whoever was 'available and willing'. Failure to pay trustees risks a situation where nothing meaningful – beyond the legal minimum – can be demanded of them.

MEASUREMENT

'Not everything that counts can be counted,
and not everything that can be counted counts'.

– Albert Einstein

Of course, donors are not wittingly responsible for the problems outlined above. But unwittingly they – to a greater or lesser extent – are. And most donors use the same model, whether they be a charitable foundation or an individual, to assess 'worthiness' and write a cheque.

Whilst increasingly there are efforts to introduce accountability and 'feedback loops', this is not a central motivator. Giving it away has become more important than what it achieves. The problem is always measurement. How do you measure success and efficiency of, say, the re-integration of a street dweller into society? Whilst there are measures, they change according to a number of factors. They change over time. Snapshots are dangerous. Cases vary in complexity and hence cost. Any generalised statement is meaningless.

This is not an argument against Key Performance Indicator (KPI) reporting and measurement – on the contrary, these things are vital and under-utilised. But they are not universal. Different KPIs are relevant to different sectors, even different organisations within the same sector. One size cannot fit all when measuring human or charitable outcomes.

Furthermore, if one is seeking to bring about change in human beings, then things become more complex still. Human change is only possible if the individual chooses change. There are many barriers to an individual making such a choice. Any change requires an individual to be empowered to make a decision to change. Inputs do not automatically translate into outputs. An individual can have world class inputs over a sustained period of time at significant cost to an NGO, and still make a bad decision at the end of it. A child prostitute was rescued from a brothel in southern India. Over a period of five years she participated in programs run by a charity we support. The programs were high quality. She was a particularly complex case who had suffered many years of abuse from a very young age.

After five years, she was fostered by one of the leaders of the charity, who put her alongside her own children in her home. Four months into the foster care, the child chose to return to the brothel – she had not fully broken the relationship with her pimp. Is this failure? If so, whose failure is it?

This is the major disadvantage that the charity sector has over the commercial sector, where everything that the for-profit publicly owned enterprise is interested in can be reduced to a single statistic – that of financial return.

It is the major hurdle to overcome. The 'quants' would sell us the concept of SROI (Social Return on Investment) as a 'black-box' measurement – a universal, comparable measure, measuring anything from famine relief to education, from mental health therapy to solar panel manufacture.

This is, of course, a potentially valuable tool. But there must be recognition that it is not 'the answer'. The diversity of assumptions required to go into any such calculation make this so.

The only currency that is common to all charitable endeavours is relationships. Whilst acknowledging that 'there's nowt so queer as folk', and that human relationships cannot be reduced to quantifiable measures, there are structures that can be applied to mediate human relationships that can lead to significantly greater measurement and hence accountability.[2]

3. IN DEFENCE OF THE DONOR

So as we considered the problems associated with charities, and especially as we looked at them through the lens of the person seeking to run the charity, we looked to the most obvious example of a 'functional' stewardship relationship for pointers – the world of business.

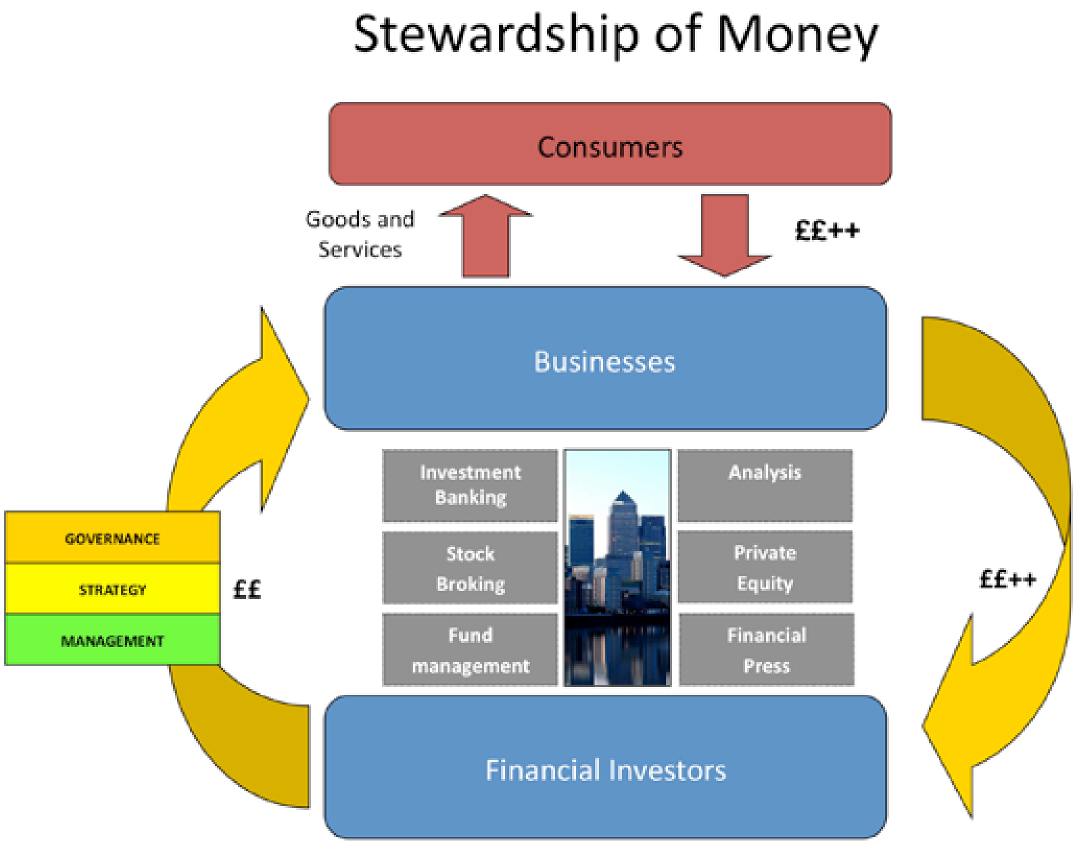
THE COMMERCIAL ENGINE ROOM

At the heart of business is a deeply functional dynamic: *I entrust you, the management, with my money on the basis that you will put my money to work and return more. For doing so, I will pay you a wage and I might share some of the profits with you by way of bonus.*

2 Michael Schluter, Relational Toolkit, Relational Health Audits, the R Factor

Accountability is clear, unambiguous and functional. We all know what role we are performing, we all know what is expected from us, we all know how we will be measured and there is a very simple and universal currency by which we will know whether we have been successful – money.

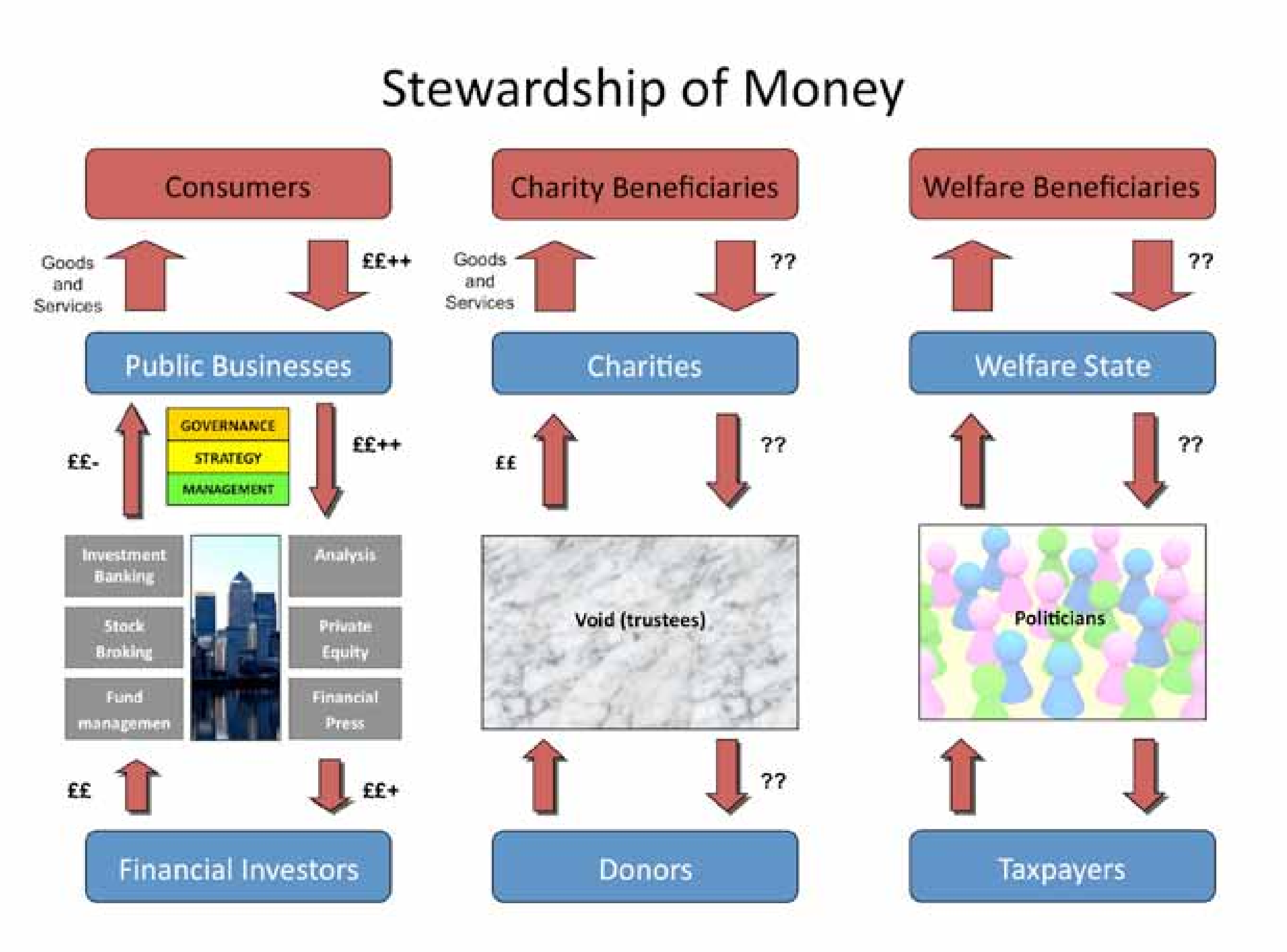
Since the industrial revolution, capital has become more complex. In the modern western capitalist system, most people are not investing directly themselves. An investment industry has emerged which adds real value and which applies knowledge and expertise to the investment process that increases value for all participants in the investment market ***(see image below)***.



To give an example: Sir Terry Leahy, CEO of Tesco does not set strategy and mull his chances of success in a vacuum. There is a massive investment industry that is analysing his every move. Financial journalists, research departments, stockbrokers, strategists, consultants, share tipsters, investors. **Justin King, CEO of Sainsbury's and Andy Bond, CEO of Asda** are operating in the same space, with the same researchers and press asking similar searching questions. They look at the market information, trend analysis and compare the different responses of the different market participants. Searching questions are asked. **Good answers are required.** This is a terrific added value process that makes everyone stronger and ensures that all plans are rigorously assessed and justified.

THE CHARITY VOID

But when we first looked at charities, we did not find this dynamic. This is because in the charity sector, where in the business sector there is a huge industry of highly skilled investment professionals, there is a vacuum, with 'trustees' in there somewhere ***(see diagram below).***



Consequently, I believe that there are three pre-requisites to effective investment, whether it be an investment in a business, by government or a in a charity. These are the key stewardship questions that are being asked by any investment professional prior to funds being released, and sit above a lengthier and more exhaustive 'due diligence' checklist.

These are:

- Is a strategy in place that will achieve the objectives? **(Strategy)**
- Are the human resources in place to deliver the strategy? **(Management)**
- Will full responsibility for my money be taken by a governance body? **(Governance)**

Without these pre-requisites, it would be pointless to 'invest' funds. When Panahpur started to look at charitable funding through this lens, it involved the application of investment criteria to all potential recipients. We quickly walked straight onto a banana skin.

THE PHILANTHROCAPITALIST CONCEIT

When entering the world of charity, 'business people' naturally seek to apply the knowledge that has made them so successful in business. But as we do so, we risk disrespecting or undervaluing the unique knowledge that the 'third' sector possesses, and the unique constraints that it works within.

I learned this lesson the hard way when I first experienced the 'private support' model. The way that some charity workers have traditionally been funded is that they affiliate with a 'sending agency' which helps them with whatever they need to conduct their overseas work – and then the charity workers will be responsible for raising their own funding to pay for it. This will often include a fee to the sending agency, usually to cover an administration contribution to the agency's own fundraising needs.

My first direct experience of this was in a slum community in Africa, where a privately supported leader was not succeeding in his leadership. I started to discuss this with the agency whose local organisation he was running. It became clear that the agency was aware of most of the extent of the failure of this leader. I was indignant. How could they allow something so inadequate to occur in their name, in their organisation, to the clear detriment of the slum dwellers they were supposed to be serving? Through the course of our discussion, it became clear – although the agency did not want to say it in so many words – that this leader was better than nothing, and nothing was the alternative. This was because they were not paying anything towards the costs of this role. Their choice was to try to help this person to be better, or to remove him and be left with no leader. They had, reasonably, opted for the former.

My initial response to this was to see the model as flawed. We must get away from allowing people to raise their own support, it prevents us from holding them accountable and managing them properly, I thought. Whilst this is true, doing so is likely to reduce the staff available to us.

Another solution would be for those who were supporting this individual to have a much closer relationship with the sending agency. For a three-way accountability to be developed that enabled the support for this leader to be switched to another individual in the event of the leader's failure.

The key point here, though, is the fact that **those in charity are operating with a different set of constraints, and are making decisions often in a wholly different context to those in business**. Their decisions are more relative, absolutes are less helpful, the means become every bit as important as the ends. A crude application of business methodology and mindset can be both detrimental and disrespectful.

So whilst the charity sector has little to teach a professional investor about using metrics to drive better performance, the investor – used to unlimited access to capital for good business propositions – has little to teach the charity sector about how to literally make a silk purse out of a sow's ear.

Even more than that, if he fails to understand the impossibility of codifying the complex and unpredictable daily journey of supporting change in human beings and human communities, then the investor is likely to cause considerably more harm than good. One simply cannot crudely apply 'banker roll-out' mentality to the work of human transformation.

To superimpose one methodology on the other is going to fail. Hedge funds would collapse if operated by charity professionals using their techniques. In the same way, charities would fail if operated by investors using their techniques.

We quickly realised this as we sought to impose more discipline and structure onto the charities we worked with.

Because of the difficulty of measurement, **strategy has to be softer and more flexible.**

Success needs to be evaluated from within a context – it often cannot be judged from outside.

Because of the lack of a financial objective, **governance has to be more trusting and relational.**

Because of a different labour market, management recruitment is slower. And so on. All else is not equal.

But just because the problems are different, it does not mean that the system under which funds are stewarded needs to be fundamentally different in the charitable sector. The system does not need to be fundamentally different to the financial sector, but it does need to be adapted.

If we got it right, we could see that removing 'money' as a constraint could catalyse big things.

THE ROAD TO HELL

All this can lead a large donor to start to behave almost like an investment bank, albeit placing funds for philanthropic, rather than financial, return. But doing this does not solve the problem – it merely fills a vacuum with that large donor. Most donors will not do this.

The old problem is that where there should be good stewardship disciplines within charities, there was rarely much of substance. Where there should be rigorous, constant review of governance, management and strategy, there was a vacuum occasionally partially filled by good trustees, or more often a chairman of trustees.

This road to hell is paved with good intentions. By default, the donor starts to fill the vacuum. Ultimately it represents a failure to find the key to real change in charity governance. And the fall back is that – through the power of our money as a donor – one tries to force these disciplines into the charity, 'my way'. Money becomes a means of control.

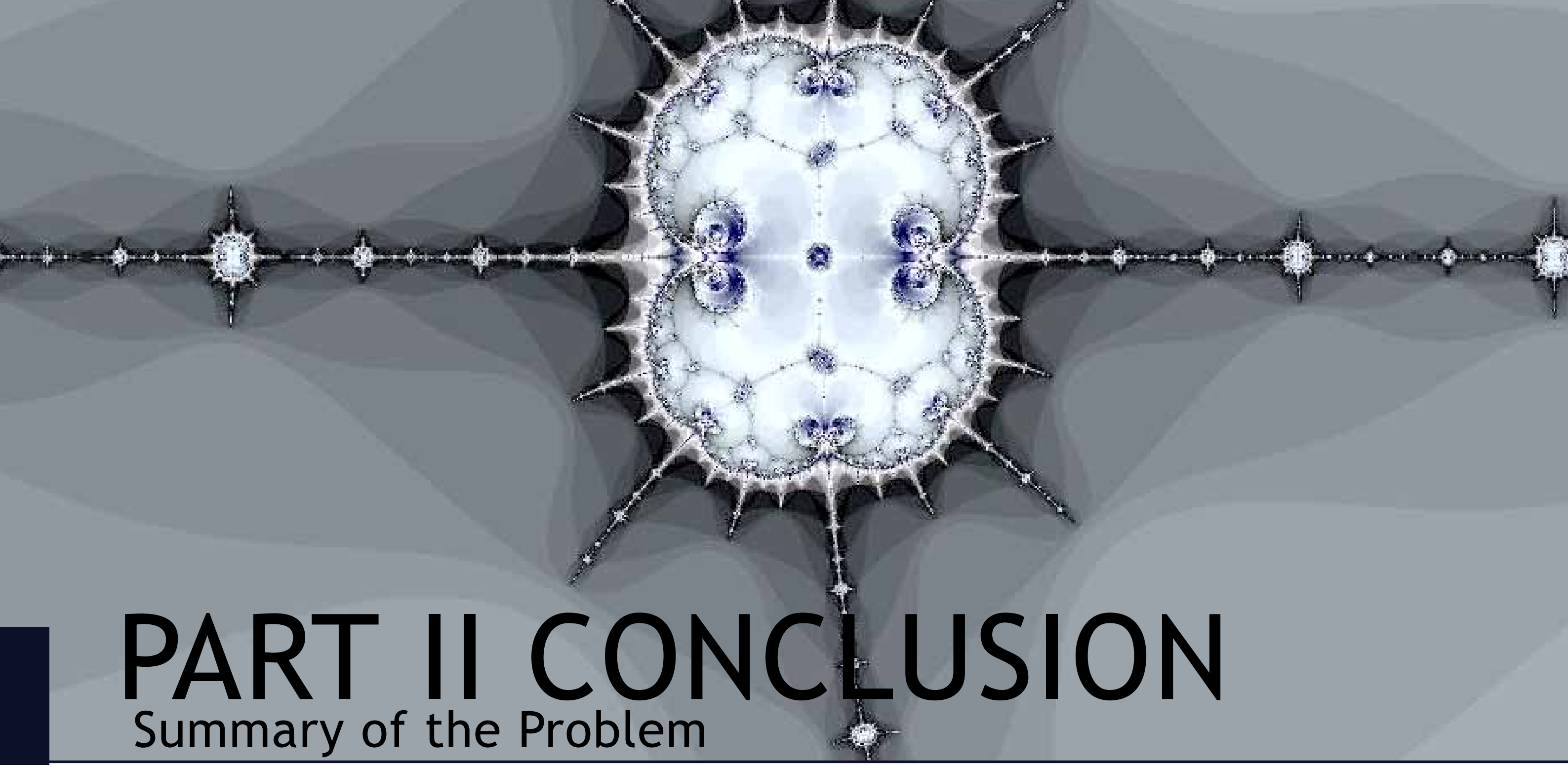
In doing this, the donor's motivation may be good and it may have actually help the charities concerned. There might be a role for conditional funding, with funds which come with strings. But if it is the sole means of accountability for the charity, it puts the donor in the wrong position.

With one charity, we made a loan facility available with the funds made over in two tranches. Certain conditions had to be met, after the first tranche had been paid over, prior to the second being released. Whilst there is nothing wrong in this per se, the fact that this was arguably the only dynamic within the charity to drive them to undertake the basic stewardship disciplines of governance, strategy and management development was wrong. It disempowered the charity, and by externalising those disciplines made it less likely that the charity would decide to develop functional stewardship itself.

This illustrates the Achilles heel, the fatal flaw in relying on the donor. It becomes all about the donor. In this model, the donor is at the centre of it. Remove the donor, and the accountability dynamic collapses.

Donors should seek to empower, and to remove themselves, rather than place themselves at the centre. If the donor is to be designed out of the solution – as they must be – a new system was required.

To be truly different, this system must bring together the charitable pound, the taxation pound and the social-investment pound and see them as the same thing – a resource to be deployed to achieve a certain desired outcome.



PART II CONCLUSION

Summary of the Problem

"Philanthropy is – by design – episodic, donor directed, temporal, fragmented, decentralised and disaggregated"

– Lucy Bernholz

The way in which donors give to charity inadvertently causes problems, through:

- One-off gifts making it difficult for charities to plan
- Restricted gifts contorting management decisions and forcing management to make decisions that are not consistent with their long term strategy
- Feeding the myth that money spent on administration is wasteful
- A passive attitude and lack of engagement with the charity beyond the cursory, leading to the lack of functional accountability dynamics

The inadvertent consequences of these practices are:

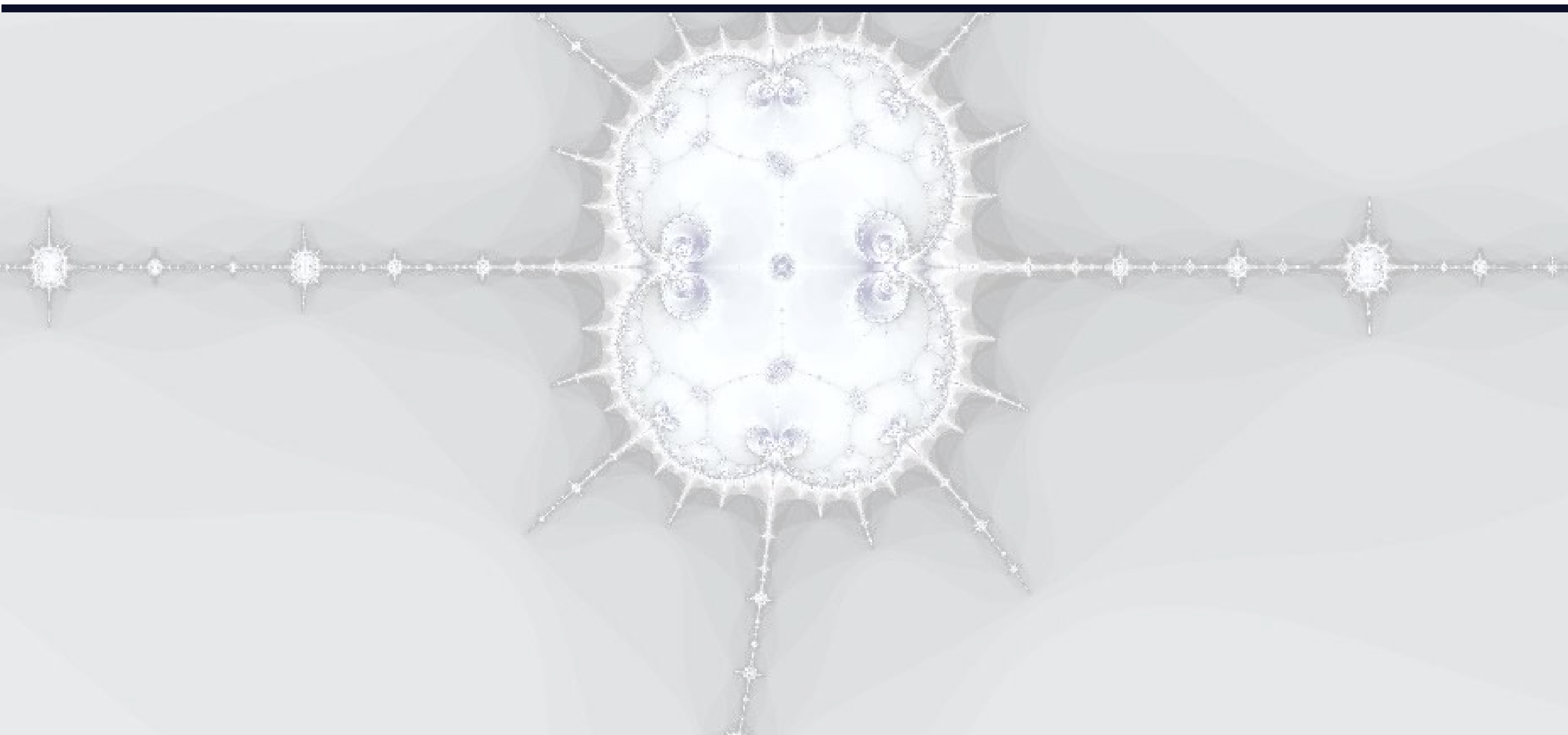
- Distracted and overworked leaders with two jobs, unable to focus exclusively on their leadership or fundraising role
- Short term thinking, aversion to success, delusional thinking
- Level funding playing field, regardless of charity effectiveness
- Low pay for charity workers… and hence inadequate skills and experience

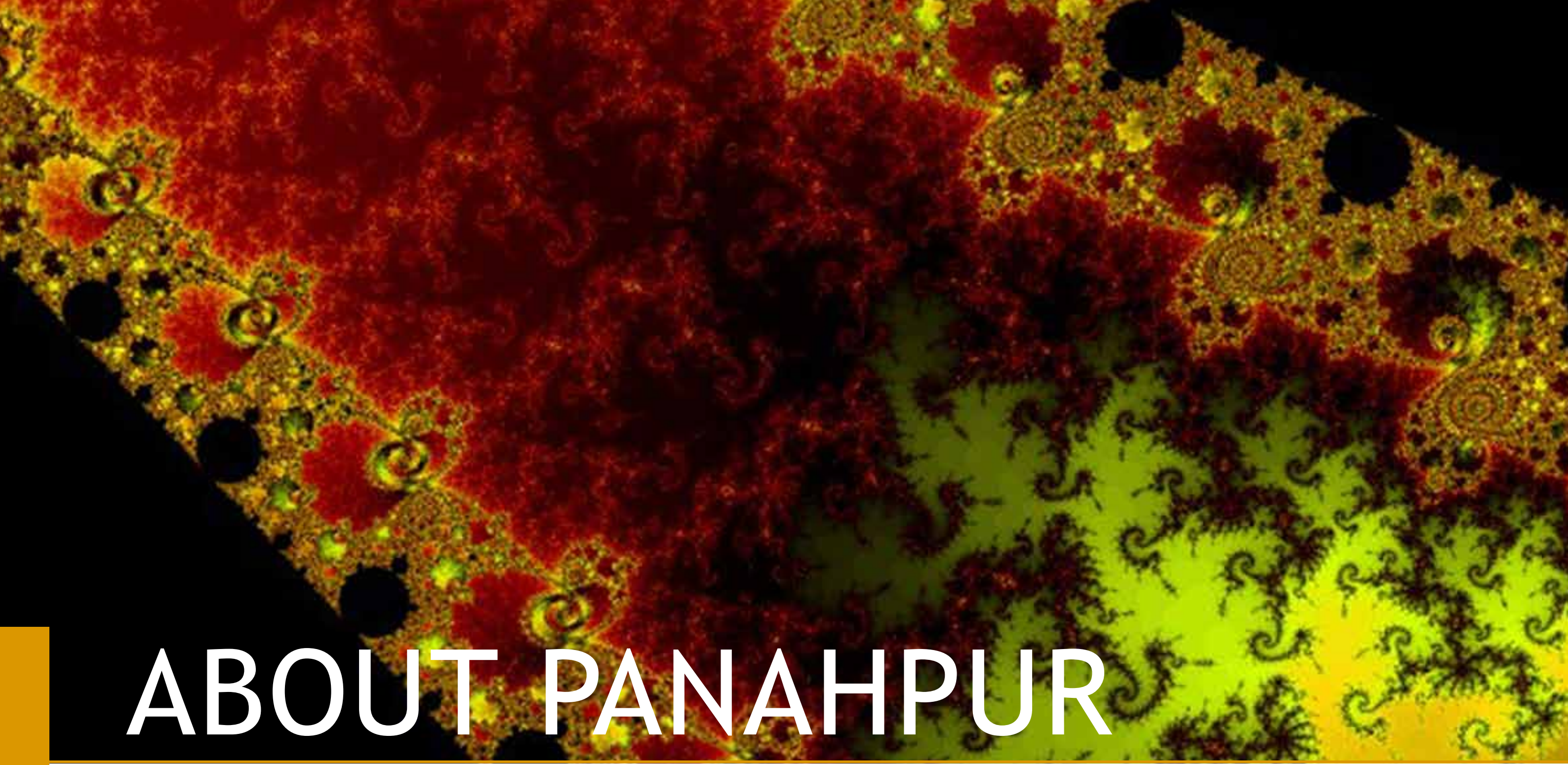
There are some facts of current charitable life that also conspire to make success more difficult:

- Genuine issues around measurement and the probable impossibility of establishing a universal, meaningful measure of effectiveness… the need to engage on an individual charity level to establish optimal measurement
- Accountability vacuum for leaders, caused by the 'gift' culture of donors, the dual-role of the leaders and the structural inadequacies of the trustee system. No answer to the question of where – in reality – ownership of the charity's mission resides

The highly functional world of business has enormous knowledge that can be leveraged for the benefit of charities. But the knowledge must be distilled and re-applied for a sector with a different history, opposing objectives, a different culture, different drivers and some unique knowledge of its own:

- Functional ownership dynamics from business, with funders driving accountability, are key to future success of charity
- This leads to the donor adopting an investment mindset to complement their giving motivation. By so doing, they will force charities to answer questions such as:
  - ***Strategy:*** *what is the strategy that will achieve the vision?*
  - ***Management:*** *are the people capable of delivering the strategy in place?*
  - ***Governance:*** *who will oversee my investment/gift in this charity to ensure that it will be successful, and do they have my confidence to do that?*
  - ***Success Criteria:*** *how will we know that we have been successful, and what are the key milestones?*
- Different financial levers (soft loans, hard loans, convertible loans, equity etc) all have a powerful role to play if the correct lever is employed to contribute to the direction that the investee charity needs to go
- To borrow from L.P. Hartley, charitable donors or investors must realise that charity is like a foreign country, 'they do things differently here'. Business culture does not translate - and charity culture could teach business a thing or two
- In business, competition drives progress. One is not required to look beyond one's own fate. In charity, co-operation drives progress. We cannot move forward without joining with others. We must avoid the trap of placing ourselves at the heart of a solution to the issues in charities, and instead look upwards and outwards with the objective of joining hands with others. United we stand, divided we fall.





ABOUT PANAHPUR

"As in a matter of this sort it is useless to make a trust unless the trustees can be trusted. The fullest powers are accorded to them so that they can do anything the owner of the capital could do himself."

– Colonel Sydney Long Jacob, Panahpur Founder, 1911

Panahpur is a small, private, family trust established in 1907. We have recently made the transition from traditional grant maker to **'mission related investor'**. Rather than invest funds in shareholder-driven financial investments to generate funds to give to not-for-profits, we are increasingly **looking to operate our entire capital across the capital spectrum** – in mission-aligned for-profit enterprises, social enterprises and conventional not-for-profits.

We have a short term focus on the development of missing investment infrastructure in the social capital space.

The Trust seeks to reflect the multi-dimensional concern that Jesus demonstrated for all people in all that it does.

James has spent the last eleven years building the social-hearted business that he co-owns with his brother (www.cookfood.net), which now employs nearly 400 people and is rolling out nationally.

In 2004 he started working with Panahpur (www.panahpur.org) to give away large sums. Being uncomfortable doing it piecemeal, Panahpur instead looked at the strategic questions of funding and sustainability that faced the recipients.

But there were no answers.

They felt it wrong that there was no access to capital for effective charities to enable them to grow, whilst simultaneously being no 'natural selection' process for ineffective charities to die. Trying to find funding solutions led Panahpur to a potential capital revolution, where money can be invested for positive social outcomes.

In 2010, the board took the decision to seek to invest one hundred percent of Panahpur's Treasury into investing for impact. James swapped his non-executive board position for an executive role to explore the questions posed by this strategy. Simultaneously he switched to a non-executive role with his business.

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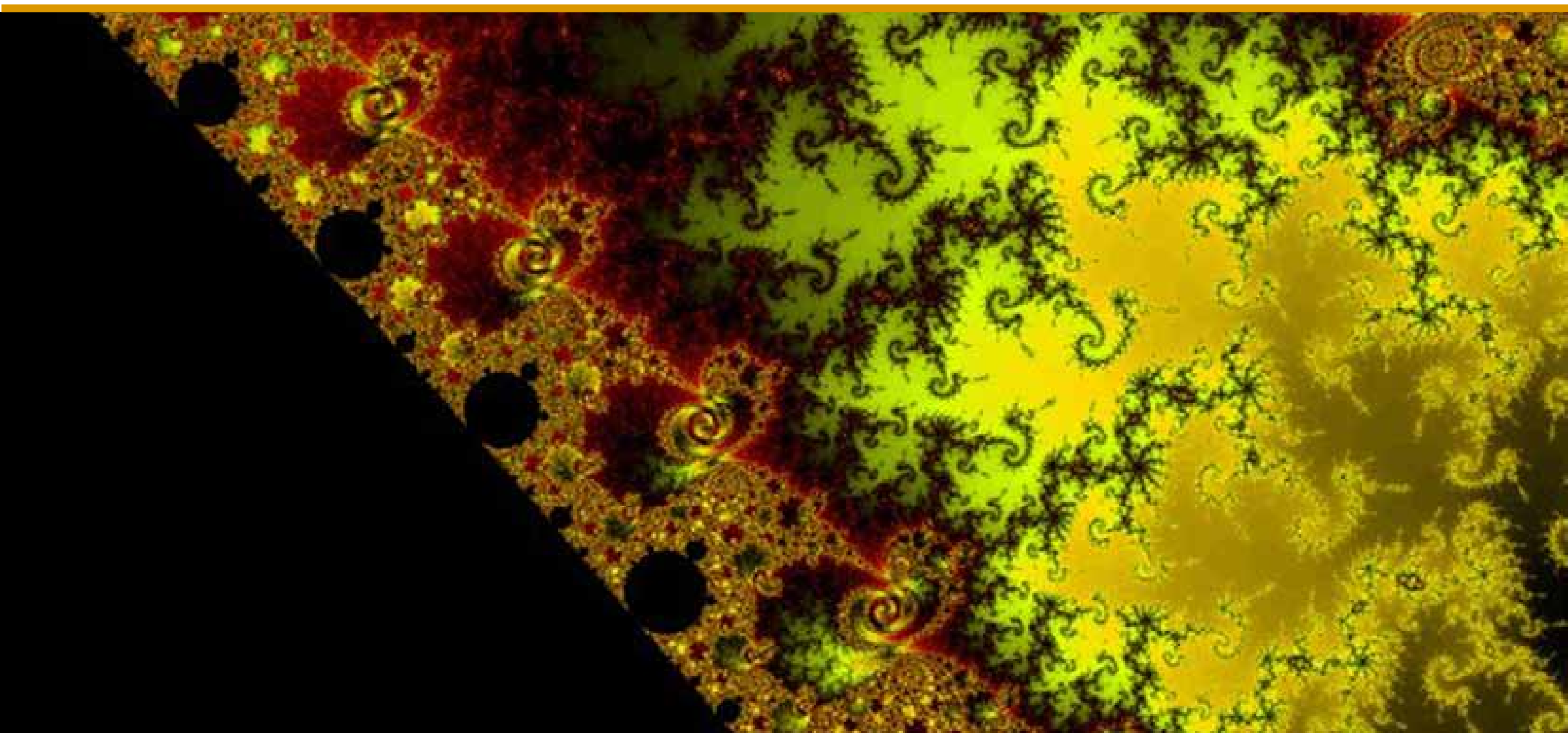

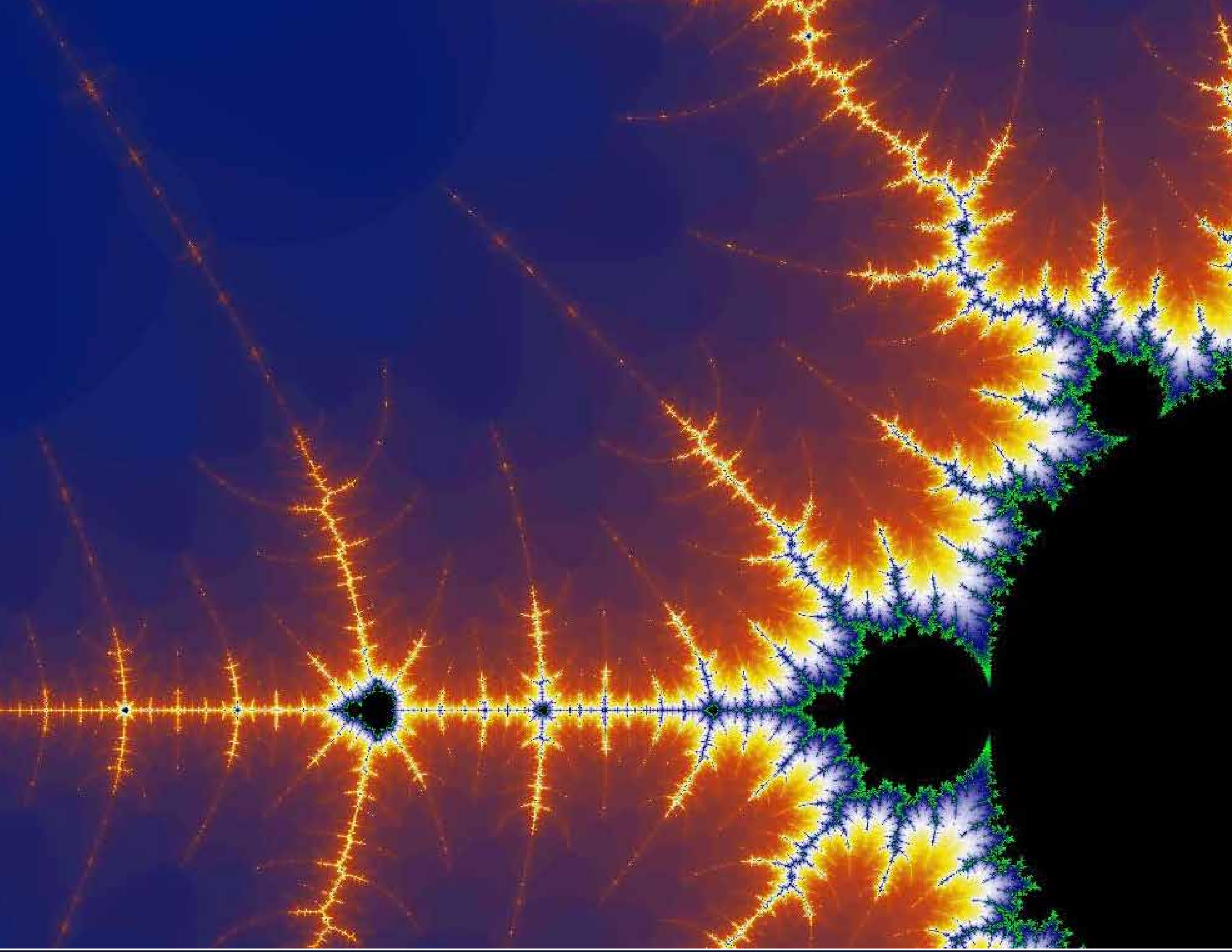

The world is changing faster than at any time in history...

'We live in exponential times'.
(Scott McLeod et al, 'Did you know?')

Charity, state intervention and a new kind of business are all changing the way in which social issues, and their consequences, are addressed – and they are coalescing as they do so.

We inherit a set of paradigms that are not fit for purpose.

We live in a different world to the one in which they were devised.

For the first time in centuries, genuine alternatives for addressing social problems are being pioneered.

Institutional charity, as we know it has no future.

Yet the future for human generosity and interventions for those in need is brighter than any time in living memory.

PANAHPUR