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A Funding Challenge for Charities: Getting the Right Mix

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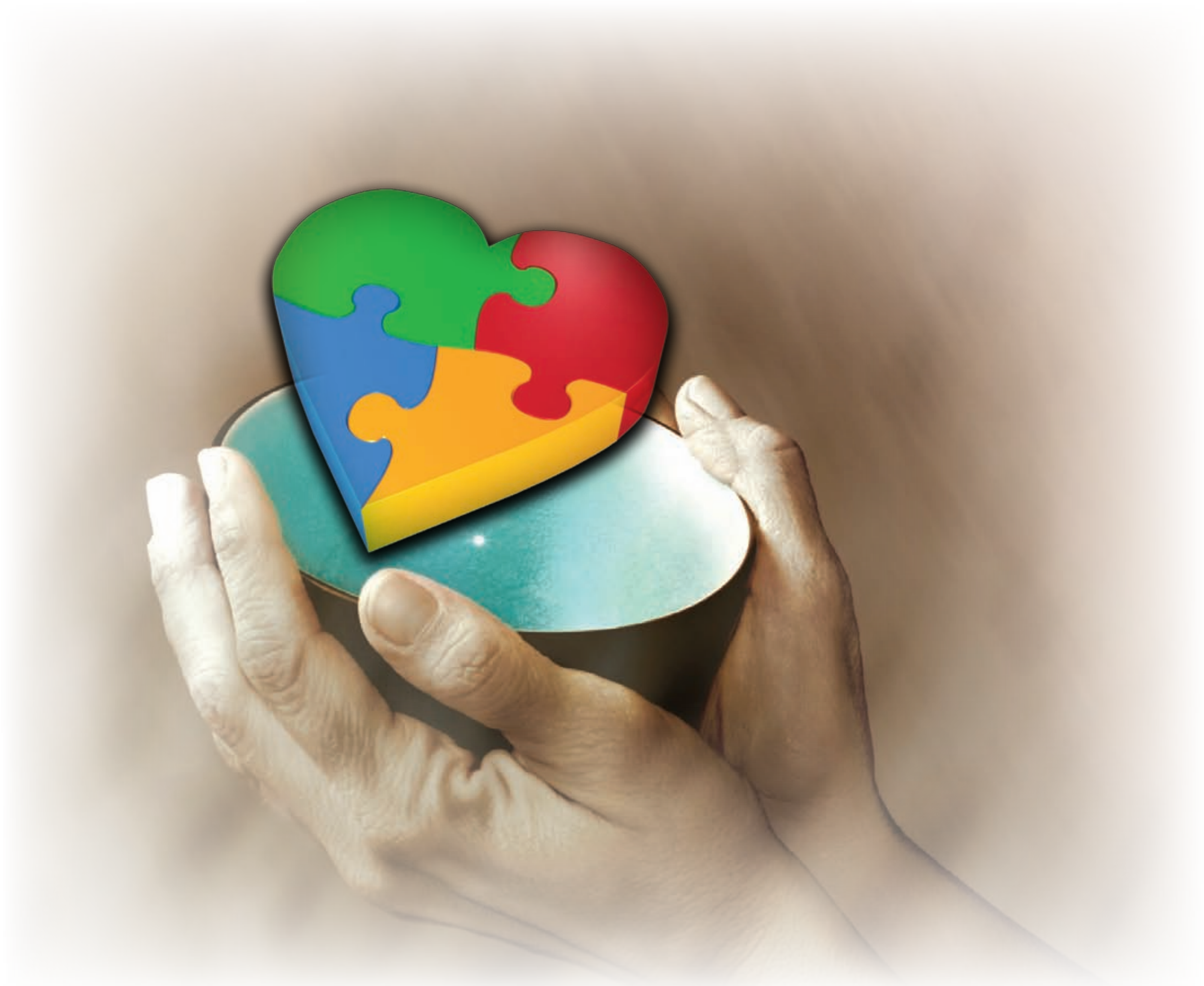
The current financial crisis has sparked many new challenges for charities with regards to the inflow of charity dollars. Ho Yew Kee and Gregory Tan examine current income sources of 37 institutions of public character (IPCs) in Singapore and urge charities to revisit their current funding mix.



Charities' income can be grouped into five major sources – service revenue (cost recovery), donations, private and government grants, income from social enterprises as well as investment income. The generalised sources of income for a charity to cover expenses and build up its reserves can be represented in Figure 1 below.

Figure 1: Generalised Funding Model of a Charity[1]

Total Expenses + Reserves

- Service Revenue (Cost Recovery)
- Donations
- Grants (Private and Government)
- Income from Social Enterprises
- Investment Income

These income sources may differ according to the opportunities available in the funding landscape, historical practices of the charity, the charity's service types as well as the strategic evolution of fundraising activities.

It is crucial for charities to examine and understand their income mix as each source of income attracts different risk exposures in terms of sustainability[2], availability and adequacy. In addition, different income sources also result in varying levels of accountability to stakeholders – with some being more onerous than others. For example, a grant is disbursed only for specific purposes and any violations of the grant's terms and conditions may result in its withdrawal.

Service Revenue (Cost Recovery)

Charities often provide services for free or at a highly subsidised rate to a selected group that is in need. This is premised on a general economic principle that free goods or services will result in over-consumption and wastage. Therefore, charities adopt certain qualifying criteria to tier subsidies and even preclude beneficiaries that are deemed ineligible for subsidised services. In addition, a charity may also use the cost-plus method that leverages on expertise and economies of scale to provide services to non-subsidised clients and make a reasonable profit from it. For example, a charity provides childcare facilities for the less privileged with government subvention so as to facilitate the running of the childcare facilities on a per capita basis. Arising from the economies of scale and expertise in managing childcare centres, the charity can use the spare capacity to take in fee-paying clients. The marginal cost for an additional client will be very low and the fee may even be less than that of any for-profit entity. The income from such services can be used to cross-subsidise the works of the charity. This is generally a sound service model with a stable funding source, since the charity is meeting market demand for services. Healthcare providers typically use this funding method to cross-subsidise the rest of their charity works.

Donations

Donations generally come in two forms – cash or gifts in-kind. This income source may attract donor-imposed restrictions for use in specific capacities. As the charity landscape becomes more sophisticated, donors are demanding greater transparency and accountability. The National Kidney Foundation (NKF) and the Ren Ci sagas, for example, have generated great donor awareness of the charity governance and donor accountability.[3] While it may not be apparent yet, this traditional source of funding may require significant re-engineering because charities will have to better understand and fulfil the needs and expectations of more demanding and sophisticated donors.

In addition, this source of revenue is significantly affected by the current financial crisis. This is especially the case for corporate donors. For example, the existence of the Centre for Women in Business, established by the London School of Business in 2006, was threatened after a five-year pledge of £1.75m from Lehman Brothers disappeared overnight due to donor bankruptcy. In order to prevent a repeat occurrence, a charity must develop and expand its donor base constantly in order to ensure that its programmes and activities are not fully dependent on a few significant donors.

To further complicate this funding avenue, Singapore has yet to see the personal donor landscape fundamentally changed by the rise of online donations. From a study[4] of US online donations vis-à-vis more traditional donation avenues, online donation channels have the potential to reach whole untouched donor bases while deepening existing ones. Moreover, online donation channels make the process of donations easier, thus lowering the barriers to donation. Charities that utilise the Internet will require greater marketing exposure in order to differentiate themselves from other traditional

charities that are vying for equal attention from the masses. More effort is also required to generate the perception of trust, which is easily lost in cyberspace. Unlike traditional donor mediums, online donor attrition is higher and requires higher levels of engagement. These underscore the potential benefits and challenges inherent in dealing with the online world – which is a vital, yet perilous, medium to leverage on.

Grants (Private and Government)[5]

Grants provided by private individuals, corporations and governments are generally determined by certain deliverables or fixed period agreements. On one hand, as long as the charity is doing its job well, there is no reason for the grant to be withdrawn. The greatest challenge under this funding source is a change in the unilateral engagement rules set by the grantor. For example, this source of funding will be significantly affected if the government implements a means-testing framework which results in the reduction of subvention to the charity for non-eligible clients. The charity's inability to reduce its operating costs and the bad publicity arising from passing the cost to the clients may put the charity in a catch-22 situation financially. In addition, grants may be affected by changes in management or a shift in the priorities of the grantor. Often, the good works of a charity are supported by certain champions and obtaining grants may be easier due to their influence. Once there is a change in the relationship or the dynamics of the relationship, such grants may disappear overnight.

Income from Social Enterprise

A fourth source of income is income from social enterprise. The jury is currently still in deliberation on whether a social enterprise within a charity is a viable income source. A study by the Lien Centre for Social Innovation[6] reported that there are about 100 social enterprises in Singapore that are led by voluntary welfare organisations and less than half of them are actually profitable. Various reasons account for the challenges, one of which is the distraction factor on valuable board and management time as energy is consumed in running a social enterprise instead of managing a 'pure charity'.

Generally, board members and management of charities have neither the experience nor the expertise to run social enterprises. Thus, when social enterprises of charities are not run professionally, they are typically not profitable. This makes the business model of charities operating social enterprises generally ineffective and unsustainable. Even in cases where they may break even or do better, the income contributions from social enterprises are, in many occasions, not worth the effort and distractions. There are certain truths in all the above reasons and a charity must carefully weigh the pros and cons of starting a social enterprise. At times, the strategic purpose of having a social enterprise within the charity may justify a high cost-benefits ratio, such as education for special needs students on economic principles and fundamental workplace skills.

On the other hand, there are established charities like Young Men's Christian Association (YMCA), Young Women's Christian Association (YWCA) and Presbyterian Community Services which have successful social enterprises that contribute a healthy amount of income to the charity's overall revenue. If well-run, social enterprises may be the next viable income stream especially if the social enterprise provides employment opportunities and training to beneficiaries of the charity. Overseas social (venture) capitalists often look for viable social enterprise plans as a necessary precondition for grants and donations.

Income from Investment

Investment income may be derived from fixed-income instruments, equity markets, commodities, foreign currency instruments, unit trust and properties. Investment income is probably perceived as one of the least effective method of income stream for charities owing to the following reasons:

It is crucial for charities to examine and understand their income mix as each source of income attracts different risk exposures in terms of sustainability, availability and adequacy.

- Charities believe that investment is incompatible with their role as charities and thus, there is no attempt to engage in any active investment;
- Charities lack the capabilities to carry out any investment activities;
- Charities are concerned about possible losses arising from investment and believe that the reputation cost and accountability to stakeholders far outweigh the returns from the investment.

Table 1 below shows an extract of the amount of assets held by 37 of the largest 50 IPCs[7] in Singapore (see Annex A for an explanation of the selection of these 37 IPCs).

Table 1: Assets held by 37 charities in Singapore (Fiscal Year 2007) (Numbers in $'000)

Types of IPCs	No	Cash/Cash Equivalent	Fixed Deposits	Cash + Fixed Deposits	Investment	Total Assets
Healthcare Charities	10	262,949		262,949	120,238	522,368
Children/ Youth Services	3	24,886		24,886	33,985	61,185
Hospice	2	15,319	3,553	18,872		24,514
Social Welfare Services	12	58,189	9,021	67,209	11,694	219,073
Nursing Homes	4	20,125	160,000	20,285	200,000	69,571
Special Needs – Physically/ Mentally	6	42,332		42,332	11,701	117,296
TOTAL		S$423,800	S$12,734	S$436,534	S$177,818	S$1,014,008
		41.8%	**1.3%**	**43.1%**	**17.5%**	**100%**
National Kidney Foundation		S$158,936		S$158,936	S$85,693	S$282,039
TOTAL (excluding NKF)		S$264,864	S$12,734	S$277,598	S$92,125	S$731,969
		36.2%	**1.7%**	**37.9%**	**12.6%**	**100%**

Charities which do not steward their investible reserves carefully may suffer backlash from donors for their poor management of financial resources entrusted to the charity.

Of the slightly more than S$1 billion of assets held by these charities, 43.1% or S$437 million are held in cash, cash equivalent or fixed deposits, while only S$178 million are held in investment in 2007. NKF alone accounts for half of the total investment of these 37 charities at S$86 million. Therefore, a huge amount of charity assets are basically held in extremely low yield assets like cash and cash deposits. Our research shows that investment income accounts for approximately 5.1% (excluding NKF – 2.1%) of the total income of these 37 charities. Interestingly, for NKF, the investment income contributes to 12.6% of the total charity income for 2007.

A heavy reliance on investment income may expose the charity to significant cutbacks when the economy is unable to generate the anticipated investment returns. On the other hand, charities which do not steward their investible reserves[8] carefully may suffer backlash from donors for their poor management of financial resources entrusted to the charity. This is translated to lower donations since the charity is unable to manage the reserves. In addition, such charities may deprive themselves of a valuable source of income.

Breakdown of Income Sources

Table 2 provides a breakdown of the different sources of income for the 37 charities in our sample, classified according to the major charity types.

If the 37 charities are a good representation of their respective sectors, then Table 2 clearly provides a picture of the relative importance of each of the major sources of income for these charities. Service revenue and grants as well as sponsorships contribute close to two-thirds of the total income of these 37 charities overall, while donations hit slightly more than a quarter with investment income contributing a mere 5%. If we were to analyse each type of charity separately, we would discover that the breakdown of the sources of income is very different.

For the healthcare charities, service revenue is the largest contributor to the total income in this sector. For charities working with children and

Table 2: Breakdown of the Sources of Income according to Major Charity Types

Types of Charity	No	Service Revenue[9]	Donations	Grants and Sponsorships	Investment Income	Total Income
Healthcare	10	S$77,102,145 (38.2%)	S$61,937,756 (30.7%)	S$43,520,000 (21.6%)	S$19,079,858 (9.5%)	S$201,639,759 (100%)
Children/ Youth Services	3	S$1,338,195 (5.9%)	S$16,298,824 (71.9%)	S$4,373,682 (19.3%)	S$653,400 (2.9%)	S$22,664,101 (100%)
Hospice	2	S$2,022,196 (15.4%)	S$6,110,655 (46.5%)	S$4,563,890 (34.7%)	S$457,958 (3.5%)	S$13,154,699 (100%)
Social Welfare Services	12	S$57,220,371 (47%)	S$29,764,111 (24.4%)	S$33,398,219 (27.4%)	S$1,424,674 (1.2%)	S$121,807,375 (100%)
Nursing Homes	4	S$9,992,940 (41.6%)	S$2,687,375 (11.2%)	S$11,105,587 (46.2%)	S$257,202 (1.1%)	S$24,043,104 (100%)
Special Needs – Physically/ Mentally	6	S$10,067,557 (14%)	S$5,115,888 (7.1%)	S$55,738,773 (77.5%)	S$1,035,230 (1.4%)	S$71,957,448 (100%)
TOTAL		**S$157,743,404** (34.6%)	**S$121,914,609** (26.8%)	**S$152,700,151** (33.5%)	**S$22,908,322** (5%)	**S$455,266,486** (100%)

youth, service revenue contributes a mere 5.9% of their total income. The largest source of income is donations at 71.9%, resulting in a more unpredictable income base. This clearly illustrates the importance of charities working with children and youth to continuously engage the donors and to enlarge their donor base, rendering these charities more vulnerable in economic downturns. For hospices, more than 80% of their total income comes from donations, grants and sponsorships. As expected, social welfare organisations recoup a large part of their costs through service revenue or cost recovery amounting to about 47% of the total income. Standing at 41.6% and 46.2% respectively, service revenue and grants as well as sponsorships for nursing homes have almost equal relative importance in contributing to the total income for the charity. This is due to the many helping hands approach and the government support for charities in these functional areas as the government does not run charities by itself. These factors lead to a more stable income base and allow such charities to conduct less fundraising. Nursing homes will also be required to concentrate their efforts towards ensuring that the homes meet the high standard of revenue generation through provision of high quality nursing services and the continual engagement of the government for grants. On the other hand, for charities working with special needs individuals, grants and sponsorship are found to be the most important source of income at 77.5%.

For a better analysis of the healthcare sector, Table 3 provides the same information in Table 2 (with and without NKF).

With the exclusion of NKF, Table 3 shows that investment income contributes to approximately 2% of the total income of these 36 charities. At a mere 2.9% of the total income, the other healthcare charities' very low reliance on investment income is apparent.

Table 3: Breakdown of the Sources of Funding for Healthcare Sector

Types of Charity	No	Service Revenue	Donations	Grants and Sponsorship	Investment Income	Total income
Healthcare (with NKF)	10	S$77,102,145 (38.2%)	S$61,937,756 (30.7%)	S$43,520,000 (21.6%)	S$19,079,858 (9.5%)	S$201,639,759 (100%)
Healthcare (w/o NKF)	9	S$48,043,145 (36.8%)	S$37,695,756 (28.9%)	S$41,107,000 (31.5%)	S$3,769,858 (2.9%)	S$130,615,759 (100%)
TOTAL (with NKF)		**S$157,743,404** (34.6%)	**S$121,914,609** (26.8%)	**S$152,700,151** (33.5%)	**S$22,908,322** (5%)	**S$455,266,486** (100%)
TOTAL (w/o NKF)		**S$128,684,404** (33.5%)	**S$97,672,609** (25.4%)	**S$150,287,151** (39.1%)	**S$7,598,322** (2%)	**S$384,242,486** (100%)

Table 4: Investment Returns

	With NKF			Without NKF[10]		
	Cash, Fixed Deposits and Investment	Investment Income	Investment returns	Cash, Fixed Deposits and Investment	Investment Income	Investment returns
Healthcare	383,186,516	19,079,858	5%	138,557,516	3,769,858	2.7%
Children/ Youth Services	58,870,965	653,400	1.1%	58,870,965	653,400	1.1%
Hospice	18,872,220	457,958	2.4%	18,872,220	457,958	2.4%
Social Welfare Services	78,903,702	1,424,674	1.8%	78,903,702	1,424,674	1.8%
Nursing Homes	20,485,000	257,202	1.3%	20,485,000	257,202	1.3%
Special Needs – Physically / Mentally	54,033,440	1,035,230	1.9%	54,033,440	1,035,230	1.9%
TOTAL	**S$614,351,843**	**S$22,908,322**	3.7%	**S$369,722,843**	**S$7,598,322**	2.1%

Table 4 shows the estimated returns on cash, fixed deposits and investment of these 37 IPCs. It shows that on average, the return on investment is 3.7%. This is made possible by the huge returns on investment of 6.3% by NKF. Removing NKF from the analysis, the average return on investment for the remaining 36 charities is a mere 2.1% which is equivalent to the annual inflation rate of Singapore in 2007.

In conclusion, different types of charities require a different mix of income sources. Each income source carries with it a potential risk exposure for the charity and charities need to understand their funding mix before they can plan for risk management on their funding sources. They may also need to reconsider how they can invest their investible reserves to better augment and supplement their income since the returns on investment merely break even with the inflation rate in 2007.

Revisiting Charity Funding Mix

The current financial crisis provides a significant opportunity for charities to rethink their funding methods. This must begin with the identification and characterisation of their major sources of income. The analysis suggests that different types of charities adopt different mixes of income sources, thus exposing them to different risks associated with income sources. While many of the sources are a function of the type of charity, charities should nonetheless carefully examine their main sources of income in anticipation of different fundraising environments. This study also documents the significant amount of investible reserves available to a sample of large charities but the returns on the investible reserve is a mere 2.1%, suggesting that charities should consider seriously how to further optimise the returns from their investible reserve within a risk that is tolerable by the stakeholders.

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Annex A: Sample Selection

A list of the top 50 IPCs was obtained from the Charity Unit of the Charity Council. Table A1 shows the breakdown of these 50 IPCs and the composition of the final sample of 37 IPCs.

The IPCs from the education (10 IPCs) and the healthcare research (2 IPCs) sectors are not included in the final sample because they are substantially funded by the government. The lone IPC from the sports sector is not included as it is a singleton. The final sample consists of 37 IPCs. Financial information for the fiscal year that ended in 2007 is available for all of them. More than 50% of the sample have not published their financial information for 2008. ❖

Table A1 : Breakdown of the List of 50 IPCs

	Initial	Final	Percentage
Education	7	0	0%
Healthcare	10	10	100%
Healthcare Research	2	0	0%
Children / Youth Services	3	3	100%
Hospice	2	2	100%
Social Welfare Services	13	12	92%
Nursing Homes	6	4	67%
Special Needs – Physically/ Mentally	6	6	100%
Sports	1	0	0%
TOTAL	**50**	**37**	**74%**

[1] Under the Charity Council, charities are organisations set up exclusively for any of the following charitable objects:
- relief of poverty,
- advancement of education,
- advancement of religion, or
- other purposes beneficial to the community, such as:
- the advancement of health;
- the advancement of citizenship or community development;
- the advancement of arts, heritage or science;
- the advancement of environmental protection or improvement;
- the relief of those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantages;
- the advancement of animal welfare; and
- the advancement of sport, where the sport advances health through physical skill and exertion.

[2] The issue of security and sustainability weighs heavily on the shoulders of the management and board of charities, and thus their great concern is to ensure that there is sufficient money to carry out the operations of the charity in a sustainable manner. The notion of 'No Money, No Mission' is a serious concern.

[3] In both incidents, the executive directors of the said charities had enjoyed certain material privileges that were deemed inconsistent with the prudent management of donor funds.

[4] Target Analytics, "Internet Giving Benchmark Analysis 2008," <http://www.blackbaud.com/targetanalytics/benchmarking/dcinternet.aspx>

[5] A conceptual difference between 'Grants' and 'Donations' is that grants are given with certain key deliverables or specific expectations from grantors, while donations can be seen as unconditional donations by the donors.

[6] Lien Foundation Centre for Social Innovation, "State of Social Enterprises in Singapore," *Report of the Social Enterprise Committee* (Singapore: 2007)

[7] Institutions of a Public Character (IPCs) are non-profit or not-for-profit organisations. A majority of the IPCs are charities, and the rest are sports associations. Only those organisations which are conferred the approved IPC status are authorised to receive tax-deductible donations (i.e. donors are given tax-deduction for donations made to these organisations) <https://www.charities.gov.sg/charity/index.do> In this paper, the terms IPC and charity are used synonymously for easy referring purposes. The 37 IPCs are selected in the study are all charities.

[8] 'Investible reserves' is defined as cash of a charity which is not needed for the normal operations of the charity and can be set aside for investment purposes.

[9] Since the financial report does not specifically state whether the service revenue or other revenue includes revenue from social enterprise, this paper classifies them generally as cost recovery and revenue from social enterprises – namely provision of services to the clients.

[10] The returns on investment for NKF was 6.3%.

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