Capital Matters

How to build financial resilience
in the UK's arts and cultural sector

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Contents

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1. Foreword

Capital matters. That is the simple message from this latest piece of research from the Mission Models Money (MMM) programme. It matters, as this report says, because of the close connection between capital held and the ability of an organisation to withstand financial shocks and because access to capital enables organisations to evolve in response to changes in their environment, for example allowing investment in research and development and in new systems and processes.

We already know that the planned cuts in public funding will hit the not for profit arts and cultural sector hard. This sector is the focus of MMM's attention and the foundation of much of the UK's highly successful creative economy. We may have views about the choices government is making but the facts and thus the urgency of responding to this issue is unarguable and inescapable.

This unwelcome reality is just the first wave in a long tide of change coming to our shores. The profound impacts of unsustainable economic growth, resource scarcity and climate change will, in a short space of time, transform the way we all live our lives. They will certainly transform the way creative practice is valued, organised and financed.

Yet amidst this MMM believes that there are two causes for optimism. First we have found examples of where arts and cultural organisations have already anticipated the sort of change required and are evolving their business models. Secondly, we subscribe to Nietzsche's notion that 'One must always have a little chaos in oneself in order to give birth to a dancing star'; within this turbulence we have an opportunity to create a forward-looking, national long-term policy and support framework for the not for profit arts and cultural sector in the UK.

This new policy and support framework should focus as much on building resilience as on making great art and engaging audiences new and old. It must accelerate evolution of working practices and behaviours by arts and cultural organisations and public and private funders and investors. It must help arts organisations shift away from a subsidy mindset to an investment mindset, from "how can we possibly close the gap between income and cost?" to "what are the core assets of our organisation, intangible as well as tangible, and how can they best be developed and used as leverage?" At the same time we also need to see a fundamental transformation in the way we invest in arts and cultural organisations to enable them to evolve into more resilient, adaptive, organisations delivering cultural excellence to an even wider general public.

This report is intended for discussion and debate with those responsible for the health of our arts and cultural ecology, it proposes how that new framework can be built and begins to map out the action, some of which is urgent, that must be taken if the whole system is to evolve as swiftly and effectively as it needs to. There are mindsets and behaviours to change across the board. This is not easy. We challenge both public and private funders and arts and cultural organisations to acknowledge the weaknesses in their practices and to change and learn.

While the research presents some new revelations, some of what is in the report has already been said before, by MMM and by others. We feel that we must repeat and underline messages that, while given scant attention until now, remain fundamental and have gained in urgency. We and others working on the sector's behalf have been hampered, for example, by poor data collection and measurement of impact, both by arts and cultural organisations and their funders. These weaknesses contribute to the inability to spot the gaps and respond. This suggests that a disturbing inertia is present in the system. If the public rhetoric about the value of the role of the not for profit arts and cultural sector is to have any integrity, this cannot be allowed to continue.

It need not continue. If real impetus is given to this agenda, it will enable our arts and cultural ecology to both survive and thrive in the uncertainty that lies ahead. This is something to which we are committed and we look forward to working with arts and cultural organisations to achieve it.

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Chair
Capital Matters Task Force

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Director
Calouste Gulbenkian Foundation, UK Branch

2. Executive summary

2.1. Context

The 2008 financial collapse, which will lead to significant public funding cuts and therefore profoundly affect the arts and cultural sector, is not the first, nor likely to be the last. Such events are recurrent, revolutionary and generally lead to a surge of development offering different sorts of potential for different sectors. The institutional context and policy decisions that take shape after each collapse define how this potential will be deployed.[1] The challenge for the UK's not for profit arts and cultural sector is to ride this wave of change to advantage, building its resilience in the process in order to prepare for more far-reaching changes ahead, driven by the impacts of resource scarcity and climate change. The objective of this report is to influence the policy and institutional architecture around the financing of the not for profit arts and cultural sector in the UK in order for that advantage to be gained.

MMM's view, based on five years of action research, is that two sides of the same coin need urgent attention. On one side an expansion in the availability of different kinds of capital[2] to support creative practice and on the other, development of the skills and knowledge needed to use it. A revision of policy and institutional architecture would enable the speedy evolution of both.

Our research for this project focused on medium sized organisations in the not for profit arts and cultural sector in England and Scotland (those with an annual turnover of between £100k and £5m). Larger organisations tend to be financially stronger, while medium sized not for profit organisations are vulnerable during economic downturns, both because they lack adequate reserves but also because the largest organisations tend at these times to increase their share of sector income.[3] Medium sized organisations form the largest group in the arts and cultural ecology. Prioritising their financial resilience will reap rich rewards for our society as well as our economy.

It is well known that the not for profit arts and cultural sector is reliant on public funding which comprises around 42% of income.[4] However, over recent years it is clear that arts and cultural organisations have been striving to generate additional revenue. As a result, public funding has reduced slightly as a proportion of total income with the main increase being in earned income up from 45% to 48% of the total.[5]

Despite increased levels of public funding over the past ten years and efforts to maximise other income sources, arts and cultural organisations have not been 'living well'[6]. As in the wider not for profit sector, human and financial resources are spread ever thinner because of rising costs and in some cases increasingly high demand (for example, look at attendance figures for free museums). Meanwhile restricted funding, constant pressure to deliver more – generated as much by organisations as by funders – and a lack of investment in organisational capacity to deliver programmes have been taking their toll.

Adding to these challenges, times are set to get much harder, with public support for the arts likely to reduce by as much as a third over the next Comprehensive Spending Review period. There is thus an urgent need for radical change if we are to support the development of resilient, adaptive organisations, producing 'great art for everyone'[7].

2.2 Why do we need a new way of thinking about financing?

It has become apparent in the preparation of this report that, in order to respond effectively to this changing reality, first and foremost a shift in mindset is required. Instead of a focus on managing deficits we need a focus on developing assets[8]. For this shift to occur, arts and cultural organisations need to develop an investment mindset (see the box below) and a more entrepreneurial[9] approach. But they cannot do this alone: funding and support structures for arts and cultural organisations must also be radically transformed to help them through the transition.

MMM's definition of investment

In the private sector investment generally means putting money into something, for example stocks, in the expectation of a financial return. In the case of investment in the arts and cultural sector the emphasis is on cultural and social returns. In this report we are particularly concerned to encourage investment in arts and cultural organisations[10], enabling them to develop financial strategies which secure future social and cultural returns.

Annex 1 contains a definition of all the key terms used in this report including capital, assets, reserves etc

Typically, funding in the not for profit arts and cultural sector has not been thought of as investment. Public and private funders have tended to provide revenue for artistic programme rather than building financially resilient organisations , while arts and cultural organisations have not commonly embraced the development and exploitation of their assets as a central focus of their strategies for building financial resilience. Elsewhere, in parts of the social enterprise sector and more commonly in the private sector, organisations tend to acknowledge the importance of investment or capital for set-up, growth and development at key stages (for example, when they need to adapt or change their business model to secure their future). In the private sector, organisations access capital in a variety of forms including equity or loans, but the favoured form is their own retained profits or, in not for profit terminology, 'accumulated surpluses or reserves'.

Capital matters critically for two reasons:

i) the close connection between capital held and the capacity of organisations to withstand financial shocks, for example the loss of a significant grant, donation or sponsorship;

ii) its role in enabling organisations to evolve in response to changes in their environment, for example allowing investment in research and development , the development of new activities, and investment in new systems or processes (which can cut costs and/or generate more revenue).

However, MMM's research over the last five years indicates that for a number of reasons arts and cultural organisations continue to lack capital. Internally they lack the reserves which could enable them both to withstand financial shocks and support the evolution of more financially

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1 Carlota Perez: Tomorrow's Capitalism, Growth After The Financial Crisis, Presentation at the Institute for Public Policy Research, London 2009, http://www.carlotaperez.org/.

2 Capital is the money or resource that enables an individual or organisation to generate wealth or the initial investment in a new business. See Annex 1 for definitions of key terms and concepts used in this report.

3 Wilding, K. (2008) Economic downturns and the voluntary and community sector: a short review of the evidence. NCVO

4 Based on 2008/09 data from annual submission from organisations in recent of funding from Arts Council England.

5 See note 4.

6 See John Knell's, 'The Art of Living' (MMM, 2007) for an analysis of how and why arts and cultural organisations have not been 'living well' and MMM's 2007 report 'Towards a Healthy Ecology of Arts and Culture' for an introduction to the sector's overextension and undercapitalisation.

7 This is Arts Council England's mission

8 See annex 1

9 See annex 1

10 See George Overholser's seminal essay 'Building is not Buying' for a more in depth understanding of this very important distinction: http://nonprofitfinancefund.org/files/docs/2010/BuildingIsNotBuying.pdf

11 Hasan Bakhshi, Radhika Desai & Alan Freeman, 2009. Not Rocket Science: A Roadmap for Arts and Cultural R&D. London: MMM.

resilient business models, and they continue to find it difficult to access capital externally for such development.

In this report we underline the critical importance of shifting mindset and finding new ways of capitalising creative and cultural endeavour by describing how a cohort of medium sized arts and cultural organisations, perceived to be at the leading edge, are adapting and evolving their business models in order to achieve greater financial resilience.

2.3 Principal research findings

Our research indicates high levels of entrepreneurial energy in the arts and cultural sector, reflected in a growing though still emergent diversity of business models. However, too much of this energy remains untapped because of significant mindset, skillset and support issues, particularly:
- a lack of strategic financial planning skills,
- a paucity of consistent, coherent data and
- a resulting misalignment of financial and other advice and support.

All of these issues were first identified by MMM in 2007[12]. They continue to be an impediment now.

Our work for this project demonstrates that while arts and cultural organisations tend to be cash poor, they are often rich in intangible assets (intellectual capital and relational capital, including the goodwill of supporters and volunteers, brand value and reputation) as well as the more obvious tangible assets. However, organisations need to be able to identify the full range of their assets: adapting and evolving business models based on fully exploiting asset potential is likely to be their best means of securing greater financial resilience. Appropriate capital investment, high quality advice and support are needed to enable this over and above a stable and predictable public funding base – our contention is not that new revenue-generating activities can replace public subsidy, rather that they can supplement and complement it. However, the reality is that for the foreseeable future public funding is likely to be unpredictable and unstable. This means that investing for resilience will be ever more important: resilient organisations will survive, and perhaps even thrive, in adversity.

2.4 What needs to happen

We need a new forward-looking, national, long-term policy and support framework to help secure financial resilience in the not for profit arts and cultural sector, and we need it urgently. Such a framework should have five key elements:

2.4.1 A shift in mindset by arts and cultural organisations

Arts and cultural organisations need to make the shift away from a mindset in which the emphasis is on breaking even, to one in which the emphasis is on becoming better capitalised, i.e. generating surpluses for reinvestment in the organisation and its future.

This is a difficult message during a period of fiscal constraint in which public spending will be reduced and competition for both public and private funding and discretionary spending will be ever more intense. Nonetheless, those organisations that take action to become better capitalised, through for example downsizing or right sizing[13], are the most likely to survive and prosper over the longer term.

[12] See MMM's 2007 reports, "Towards a Healthy Ecology of Arts and Culture" and "New and Alternative Financial Instruments"
[13] See http://www.giarts.org/sites/default/files/capitalization-project_2010-summary.pdf

Such a shift in mindset could be facilitated by the development of appropriate, high quality advice and support, information and tools (see sections 6.1 and 7.1.1 for more detail and 7.1.4 for recommendations). We propose that ERA21[14] is best positioned to lead on this key element.

2.4.2. A shift in mindset by public and private funders of arts and culture

Public and private sector funders of the not for profit arts and cultural sector also need to shift their mindset. They need to recognise the importance of addressing undercapitalisation in the arts and cultural sector and they need to change their policy and practice to better support its financial resilience.

A consortium of arts funders has come together in the US to launch a National Capitalisation Project supported by Grantmakers in the Arts[15]. This consortium has made proposals about how funders might tackle undercapitalisation and over extension. We consider that a similar approach should be developed here and we propose that Arts Council England (ACE) takes the lead in convening such a group in England, and Creative Scotland in Scotland.

The consortium could support the development of more adaptive, sustainable business models, for example by providing funding for research and development[16] activities. Members could also be expected to demonstrate sophistication in their use of grants, for example making some grant funding available for building financially resilient organisations as distinct from only funding programmatic activity and encouraging other funders, not part of the consortium, to do the same (see section 5 for more detail and 7.1.4 for detailed recommendations).

2.4.3. An expansion of the range of capital available for arts and cultural organisations

Whilst we suggest that the most likely or favoured form of capital investment for not for profit arts and cultural organisations is accumulated surpluses, our research indicates that few organisations have reserves available for development. Meanwhile our consultation with social investors[17] suggests there is a lack of appropriate capital available to not for profit arts and cultural organisations.

We propose that the consortium of arts funders contributes and raises additional funds to enable one or more of the existing social investors to provide a range of different kinds of capital, including research and development grants and quasi equity or revenue or profit sharing. This would be to support change and adaptation in business models in not for profit arts and cultural organisations, including through the development of new commercial ventures (see section 5 for more detail and 7.1.3 for recommendations).

2.4.4. A reconfiguration of organisational and business development support for arts and cultural organisations

Not for profit arts and cultural organisations need high quality advice and services to support them through the necessary transition and evolution. Our research suggests that organisations need access to specialist skills, for example in strategic financial planning (being able to model the financial implications of different development options and to re-structure ventures so that net returns are maximised). We propose that the business support currently available to not for profit arts and cultural organisations is reviewed and reconfigured to ensure that it addresses these needs, for example through greater investment by public funders in peer-led and peer-

[14] See www.missionmodelsmoney.org for further information on this group.
[15] See http://www.giarts.org/article/national-capitalization-project
[16] See annex 1.
[17] Specialists in providing loans or other forms of predominantly non-grant finance to the not for profit sector.

organised knowledge transfer networks (see section 6.2 for more detail and 7.1.4 for detailed recommendations).

2.4.5. A step change in data collection and more research on capital needs

Finally, we have been hampered in our research and analysis by gaps in or failings in the data commonly collected about the not for profit arts and cultural sector. If we are to deepen our understanding of the capitalisation needs of the sector, and over time develop more sophisticated, appropriate responses to meeting these needs, further research is required. This research should examine the capital needs of organisations at different stages of their life cycle, such as start-up or growth, and different types of activities such as touring or education and training (see 7.1.5 for recommendations).

The final section of this report contains more detailed proposals about the changes we consider necessary if the broader arts and cultural ecology is to survive and thrive in the turbulent times ahead.

3. What organisations need and why

> *"Where organisations are able to leverage their asset base to drive increased income, and achieve a good balance between earned and grant funded income, they are more likely to have a resilient revenue model. This is likely to reduce their need to hold substantial working capital and free reserves as protection".*
>
> Joe Ludlow, Capital Matters – An Analysis of Financial Capital in Arts Council England's RFO Data, MMM, 2010

Times are about to become very hard for all but the largest not for profit arts and cultural organisations. One funder we interviewed for this project described the small organisations she worked with as already chronically underfunded and only sustained by the passion and commitment of staff. This reality is all too common. Lack of adequate revenue means many organisations are propped up by dedicated unpaid or underpaid artists and administrators. As Ben Cameron says, "very literally we are an industry predicated on discounted labour… the largest charitable sector in the arts is the artists, managers and technicians on whose lives the work is made[18]".

Yet most would describe recent years as good times for the arts, supported by high levels of public investment. But this funding was spread very thin and organisations have had other issues to contend with, like increasing costs and increased competition for public interest and disposable income from a range of new media. According to the organisations we have been speaking to, the recession has also had an impact on private sector sponsorship and bar and catering income. All this means that organisations have not in fact been able either to 'live well'[19] or make adequate provision for the bad times. With major cuts in public funding on their way, their situation can only worsen unless radical action is taken.

Our objective is a thriving not for profit arts and cultural sector; that is, one comprising financially resilient organisations that produce and present great work and have a focus on their visitors, audiences and participants. By financially resilient we mean that they have the capacity to withstand financial shocks, such as the loss of a major donor, and to adapt, in pursuit of their mission, to a complex and rapidly changing operating environment[20].

The context is one in which organisations need to plan for a possible reduction in income and for continued uncertainty. These perhaps require different approaches: cuts force organisations to make economies where they can, but in an environment of great uncertainty the emphasis has to be on capacity, particularly the capacity to adapt. As one of the experts contributing to this project said: "Darwin's theory of evolution is often misquoted. It is not the fittest that survive but the most adaptive". An important corollary to this is that not all organisations can or should survive.

The current economic climate poses immense challenges for not for profit arts and cultural organisations but it also provides opportunities to try new operating models and adapt old ones in the search for greater financial resilience. Some of the organisations attending our consultation events described the current economic downturn as providing the opportunity to make changes that they considered to be in their best long-term interests; changes that might not otherwise have been made. As one organisation said to us: "The riskiest thing would be to do nothing".

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[18] MMM Funding Transition Seminar, December 2009. Ben works at the Doris Duke Foundation in the US.
[19] Ben Cameron Program Director, Arts, the Doris Duke Foundation
[20] Mark Robinson emphasises the importance of adaptive capacity in his 2010 paper, 'Making Adaptive Resilience Real', for Arts Council England.

So what evidence do we have that medium sized arts and cultural organisations are financially vulnerable and how can greater financial resilience be achieved?

3.1 What's the evidence of financial vulnerability?

Generally, not for profit organisations, including not for profit arts and cultural organisations, are deemed to be financially vulnerable, other things being equal, if: they lack adequate equity[21] balances (the difference between total assets versus total liabilities); revenue is concentrated i.e. from one or a very small number of sources; administration costs are low i.e. there is no scope to reduce discretionary administrative spend and operating margins are low.[22 23] Also important is whether funds are restricted i.e. whether they can only be used for particular purposes, and how certain they are.

Inadequate equity balances. Analysis we have undertaken of Arts Council England data indicates that arts and cultural organisations tend to lack adequate reserves. Our analysis (using a generous definition of reserves which includes unrestricted illiquid assets such as land[24]) is that the majority of arts and cultural organisations hold less than 12 weeks turnover in reserves. This is insufficient given that it typically takes two months to wind up an organisation[25]. Notably, the average for our small research group of 27 medium sized organisations (using a less generous definition) was just under a month. Further, recent research undertaken by the Scottish Arts Council (SAC) suggests that 18% of arts and cultural organisations have already drawn on their reserves or are planning to this year as a consequence of the recession[26].

Revenue concentration. Many arts and cultural organisations have in recent years striven to diversify their income by developing new income streams. Consistent with this, earned income as a proportion of total income has increased from 45% to 48%. However, the sector remains dependent on public funding, which makes up around 42% of sector income[27]. It is even more important for our small sample of medium sized organisations, accounting for 52% of overall income.

Restricted revenue. While earned income can be used in line with organisational priorities for investment, grants from the public sector and trusts and foundations are generally restricted. This means, as one organisation involved in a previous MMM project commented: "You don't have money for things that are really essential, like the new air conditioning unit".

Achieving adequate margins. A number of the organisations involved in this project, both those interviewed and those participating in the consultation process, observed how difficult it is to generate a surplus on many of their activities: in the case of grants expenditure tends to match income, while contracts for public service delivery may provide only small margins. Meanwhile secondary activities such as catering and shops often require significant management input but may generate only a small surplus once costs are taken into account.

Certainty of funds. Another important factor when assessing financial vulnerability is how certain are revenues (for example, two plays in a season may be run-away box office successes but two may be notable flops). As one of the experts involved in this project commented: "the real issue may be that the three way balancing act between the certainty of income, the flexibility of the balance sheet and the level of subsidy isn't working for the organisations we are concerned with".

"Over the last few years a lot of organisations have sold their silver, they have worked through their reserves and sold assets, some to pay for capital developments".

"Generally there is no or very little scope for investment of funds back into the organisation because they are not generating surpluses."

3.2 How can we help organisations achieve financial resilience?

It is clearly understood in the private and social enterprise sectors that organisations need access to capital in order to invest in their businesses, to enable them to grow, or to adapt or change their business models in response to changes in the environment. When it comes to support for the not for profit sector, this tends to be ignored. The funding culture is one of "buying not building"[28]. Yet our research and consultation work indicates a strong connection between access to appropriate external capital, (for example in the form of development grants), change or adaptation in business models to achieve a healthy balance between earned and grant income, and progress towards financial resilience[29].

While arts and cultural organisations are generally cash poor, many are asset rich, particularly as regards intangible assets (intellectual property and relational capital including the goodwill of supporters and volunteers, brand value and reputation). However, investment capital is often needed to unlock the potential of these assets and to use them as leverage to drive increased unrestricted income. For example, to put successful off line products or services on-line (such as courses or other educational packages or material), which also, importantly contributes to mission by broadening the organisation's reach and impact[30].

One of the experts involved in this project draws an analogy with higher education: *"I was always struck when I visited universities that there was constant building work, that they were always improving their buildings despite the fact that they were reporting a revenue crisis. Then it dawned on me that they were making an investment designed to secure increased income from summer conferences and courses. They were making an investment to improve their revenue position in the future".*

Financial investment is certainly required but also, and perhaps more importantly, a shift in mindset. We need both arts and cultural organisations and funders to appreciate the importance of investment; to appreciate that investment in organisational capacity, including the capacity to generate income, can reap significant financial, cultural and social returns over the medium to longer term. We need a shift from the question "how do I meet the gap between income and costs" to "what can I do and what sort of investment do I need to make my organisation financially resilient over the medium to longer term". And, we need clear messages from funders that they understand this. As one of our experts remarked: "people still believe that if they make a surplus their grants will go down. Even though funders like the Arts Council say that they are not running a deficit funding model, people believe they still are".

21 See annex 1
22 Cyril F. Chang and Howard P Tuckman, 1991. Financial Vulnerability and Attrition as Measures of Nonprofit Performance, Annals of Public and Cooperative Economics, Volume 62, Issue 4, pages 655–672, October
23 One of the experts we consulted disagrees with Chang and Tuckman. He suggests that if administrative costs are high this is an indicator of financial vulnerability because it means the organisation has little flexibility.
24 We were unable to strip out unrestricted illiquid assets from the ACE data provided.
25 Joe Ludlow, 2010. Capital Matters – An Analysis of Financial Capital in the Arts Council England's RFO Data, MMM
26 ERS, 2009. The Impact of the Recession: survey of Scottish Arts Council Funded Organisations. Edinburgh: Scottish Arts Council
27 See note 4.
28 See note 10.
29 See note 25.
30 See for example, Sarah Thelwall, 2007. Capitalising Creativity – Developing earned income streams in Cultural Industries organisations, Proboscis

A major difficulty is that the funding/financing issues discussed above make it difficult for organisations to develop long-term strategic plans. One of the funders we spoke to for this project said: “Working in the arts people don’t have the time or don’t feel they have the time or can’t make the time to get in the helicopter and look at the terrain. They are ‘full of fear’.” Others experts we spoke to referred to ‘inertia’.

Despite all the challenges the current funding environment poses, the organisations we interviewed – including those whose case studies are included in annex 3 to this report, are developing long-term approaches aimed at securing their future financial resilience. The case study organisations were chosen from our sample of 27 to illustrate some of the approaches organisations are taking to generating additional revenue, as well as containing or reducing costs. While these approaches are generally unproven i.e. in many cases it is too early to see a real impact on the bottom line, they are identified here as interesting, potentially promising examples of efforts by arts and cultural organisations to develop financially resilient models. Notably the case studies suggest a link between initiatives to generate more revenue or contain costs and the vitality of the organisation and its work.

Entrepreneurial efforts are, however, only half the story. This report illustrates that, in addition, arts and cultural organisations need to make a concerted attempt to build adequate balance sheets, including appropriate reserves designated for development purposes, for example to support new income generating ventures. Both are needed to support and underpin the quality and integrity of artist work and social contribution.

While one conclusion from this report is that a shift in mindset is crucially important, another is that skills and capabilities need to be acquired or accessed if arts and cultural organisations are to make progress with this agenda. Notably, arts and cultural organisations need to better understand their business models, and what sort of funding/financing for what sorts of projects would enable them to flourish. They also need to develop or acquire the necessary skills and capabilities, for example business development or marketing skills, to implement such projects.

Clara Miller, head of the Non Profit Finance Fund in the US, argues that there is a fixed relationship between mission (programmes), model (organisational capacity) and money (capital structure) with any change in one inevitably having an impact – planned or unplanned – on others. She emphasises, and MMM wholeheartedly agrees, that action is therefore needed on all three fronts at the same time to enable not for profits, including arts and cultural organisations, to flourish[31].

3.3 This report

This report is based on a programme of research comprising a number of elements detailed in annex 2. Notably:

- interviews with, and the collection of some basic financial data from, 27 medium sized arts and cultural organisations (turnover between £100k and £5m) perceived by funders and support organisations to be at the leading edge in adapting/changing their business models to secure greater financial resilience. These organisations deliver a range of activities across a variety of art forms including independent museums, the visual arts, film and media, and the performing arts.
- analysis of ACE data for regularly funded organisations (RFOs) with a turnover below £10m, considering capital needs and financial resilience (808 usable records were included) – a report on this research will be published alongside this one[32].

- nine semi-structured interviews with arts funders including ACE, Creative Scotland (CS), the Museums, Libraries and Archives Council (MLA), independent trusts and foundations, and local authority funders.

Much of the research conducted for this report was based on analysis of existing data sources, primarily ACE data on RFOs. This presented a number of problems. For example, it does not allow us to track how patterns of earned income and associated expenditure have changed over recent years, nor to break down earned income by its source i.e. income from the open market (for example, ticket sales) or income from the structured market (public sector contracts and product sales to the public sector) nor to investigate how much is spent, as against the income derived from, different income generating activities in order to gauge their profitability. We were also unable to undertake a comprehensive analysis of capitalisation in the sector because of the absence of expenditure data, crucial to understanding the resilience of financial models, and the lack of sufficiently detailed information about reserves. One of the conclusions of this report is that standard data collection needs to be improved.

A consultation programme also provided valuable input. It comprised:

- A group discussion with the Social Investment Market group made up of organisations providing non grant finance to social enterprises.

- Four consultation events – three in England and one in Scotland, attended by around 100 people in total.

This report contains the following sections:

- What organisations are already doing for themselves – reflecting on what we have learned from our group of 27 medium sized organisations
- Capital needs and prospects for supply – considering the need for financial capital to enable arts and cultural organisations to become more financially resilient.
- Changing our mental models – considering how we need to change how we think about financing for the arts and cultural sector and the skills and capabilities needed to develop more resilient models.
- What needs to happen – setting out a suggested framework for action.

Annex 1 contains definitions of key terms

Annex 2 provides background information about the research and consultation contributing to the project.

Annex 3 contains the case studies of the following organisations which are referred to throughout the report:

Battersea Arts Centre – BAC
Leach Pottery
Live – Live Theatre
Museum of East Anglian Life - MEAL

[31] “Linking Mission and Money: An Introduction to Nonprofit Capitalization”, Non Profit Finance Fund, 2001.

[32] See note 25.

National Theatre of Wales – NTW
Salisbury International Arts Festival – SIAC
Shetland Arts

Annex 4 contains a list of individuals participating in the research, our two advisory committees, and our publication review panel.

The unattributed quotations in this report are taken from our interviews with arts and cultural organisations and funders, and discussion at our consultation events including the session with the Social Market Group.

4. What organisations are already doing for themselves

> *"Commercial success is often deemed to compromise artistic and cultural integrity and quality, though the history of art and design demonstrates that this need not be the case. A close inspection of a few success stories leads to the conclusion that it is more the lack of appropriate models that prevents development and growth in the direction of sustainable commercialisation of artistic and cultural assets"*
>
> Dirk Kiefer's preface to Sarah Thelwall's "Capitalising Creativity - Developing earned income streams in Cultural Industries organisations", Proboscis, 2007

Some arts and cultural organisations believe commercial and cultural success to be mutually exclusive and are therefore resistant to considering how they might develop new revenue streams from their work[33]. Others have a different mindset and recognise that commercial development need not compromise artistic and cultural quality. With advice from funders and support organisations we pulled together a sample of 27 arts and cultural organisations with this different mindset i.e. organisations at the leading edge in evolving or changing their business models in order to secure greater financial resilience.

The organisations ranged from the very young to the better established. New organisations have the opportunity to develop entirely new models in which plans for revenue generation are in step with mission (see the case study of the Leach Pottery which developed a model very different from the conventional museum model once it was clear that visitor numbers, because of the limitations of the site, would not be adequate to meet costs). New organisations are also able to develop models which seek to maximise investment in programme by minimising fixed costs (see the case study of the NTW, which does not have a building and has only a small core staff).

Consistent with this, our work suggests that younger organisations, less than 10 years old, are more likely to describe themselves as having a model of income generation that operates in step with their creative practice (as opposed to revenue generating projects being added on). Such organisations are also more likely to be technology based, using it for the creation and distribution of their work. They tend to have lower fixed costs, a more flexible business model and less need for capital to enable change and adaptation.

The organisations we interviewed appear to be on an evolutionary rather than a revolutionary path. They are not seeking the new for the sake of it, rather they are focused on their mission, and adapting or changing how they operate to solve financial problems or address financial uncertainty, in a manner consistent with mission. One of the experts we consulted said: "the emphasis now is on needs-based innovation. This is not a time for opportunity-based innovation, unless it is incredibly good value for money". This was echoed by one of our research group: 'We're doing a lot of work at the moment to explore how we can use technology – especially digital technology – to keep innovating. But it's not technology for technology's sake, or indeed innovation for innovation's sake: while opportunity is a driver to some extent… it also has to be about a clearly demonstrable need".

Notably many organisations in our sample, including the ones we selected as case studies, are turning mission into money. As one said: "A lot of organisations start with 'what money have we got so what can we do?' We start the other way round – what do we want to do for our artists

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[33] Sarah Thelwall, 2007. Capitalising Creativity - Developing earned income streams in Cultural Industries organisations, Proboscis. Also, some of the specialist business advisers that we spoke to in our mini mapping of support provision in the North East and Scotland suggested that some smaller arts and cultural organisations find it difficult emotionally to 'commercialise their work'.

and audiences, then we try and make it happen. It's very important to be clear about the mission statement – who you are and what your values are. Once you've got that template of what you are, it's very easy to be clear about what you do and don't do. We decided to start a concert series based on our strengths, which are these musicians who are at the top of their game, to challenge and develop them. It's earned us income but primarily it's added to the artistic strength of the company". Similarly, BAC refers to integrating "commercial and charitable activities as closely as possible, to ensure that all trading activity is mission-related in future and to create a cultural enterprise model". Leach describes its challenge as developing "sustainable mixed income streams which are wholly mission related".

The focus for a number of the organisations in our sample was on leaner models of operation, or consolidation rather than growth. As one of our experts said: "In the new financial climate we need to rethink our paradigms. An organisation may not necessarily become safer through growth. A different paradigm and leaner models should be valued, and rather than fixating on audience numbers, we should place a premium on the quality of the experience".

"We're not growing the centre: it's at an optimum size and we're not trying to scale up lots of projects. We're happy to partner activity led by others"

4.1 How can arts and cultural organisations achieve financial resilience?

Many of the organisations we interviewed have been developing their resilience (or sustainability) over a significant period (ten years for one of our case study organisations); some of the organisations reported having been through a process of trial and error before finding approaches they were comfortable with.

The established organisations are using a number of different techniques, appropriate to their mission, ethos and aspirations, in an attempt to achieve greater financial resilience.

As regards generating additional revenue, organisations are variously attempting to squeeze more income from existing activities, develop new services and products, or find new ways to generate income from existing product (see the box below for specific examples).

A number of organisations are also undertaking work on cost reduction (a couple referred to paring administrative costs to the bone, not just in the usual pursuit of efficiency, but to enable greater investment in programme). Another trend is to reduce fixed costs by relying on consultants and freelancers.

Many organisations emphasised the importance of partnerships to reduce costs and/or maintain activity levels, including co-productions and other collaborations (for example one theatre taking on the management of another for the local authority). For some of our case study organisations, partnerships are a particularly important feature of revenue-generating activities (see NTW, Live and Leach.)

Other trends appear to be the increased use of barter and exchange and gifts in kind, and more use of unpaid labour and interns. Our research suggests that interns are increasingly being used to augment organisational capacity to work on revenue generation .

[34] See Ben Cameron quotation above. There is an issue here about the extent to which some arts and cultural organisations appear to increasingly rely on free or underpaid labour, prompting the accusation of exploitation, even if it is exploitation driven by necessity. An alternative view is that people volunteer or work as interns because they derive great benefit from doing so. However, the emphasis on unpaid labour has implications for the diversity of the workforce.

A striking feature of the research is that when organisations are developing new revenue-generating projects, these tend to be strongly mission focused – for example, Live's development of an online script writing course. Or they are designed to deploy the organisation's creative or management skills – for example, BAC using set and lighting design in its events management.

Some of the approaches organisations are taking to becoming more financially resilient are cost neutral, for example reviewing hire arrangements for buildings to see if spare capacity can be used more profitably. However, other approaches, such as the development of a new website with Amazon selling features, or of a new course or training programme, require development capital.

A range of approaches to generating additional income

Increase income from existing activities:
- increasing spend per visitor/audience member in café/shop etc;
- attracting new audiences and therefore new revenues;
- winning additional public service contracts.

Develop new services and products:
- for the public sector to commission;
- developing new products related to education and training for the structured or open markets;
- developing new technology products (for example, one organisation has developed a product aimed at supporting innovation);
- developing consultancy services directly related to product (for example, on staging exhibitions);
- developing management or consultancy services directly related to staff expertise but not product (for example, property management and sustainability advice services).

Find new ways to generate income from existing product:
- selling existing products online to reach a wider audience;
- licensing products i.e. developing them but allowing others to use them for a fee.

"We've only been able to realise our ambitions because of the partnerships we've developed – they have been the key to our becoming more entrepreneurial and it's been our emphasis on partnerships that has been so attractive to funders and investors."

4.2 What are the benefits of changing/adapting business models?

The organisations we interviewed tended to see the benefits of changing their business models not purely in financial terms, but as they related to mission – more specifically their programme, audience and profile. For example:

"Our audience numbers have gone up steeply. Subscribers and general audience figures have risen by 33% over 5 years. Our international reputation and critical coverage in the national press has also gone up significantly – we are getting international invitations to tour. All of this has had an impact on our ability to earn. Around five years ago reserves stood at £25k, but we have got this to £125k and we're aiming for £200k. This makes us more resilient."

"We've got a much stronger programme now and it's receiving a positive critical response. Audience figures have doubled and we're engaging with the artist community in the city for the first time in years. We're having conversations with big-name international artists. The programme budget has doubled – not least because we've realised some significant efficiencies."
"In the past five years, as a consequence of the changes we've made to how the museum works

– which has been mainly about engaging our audiences in all aspects of what we do – our annual turnover has grown from £125k to £500k. Our core funding hasn't increased; the growth has been in increased admissions, fundraising and trading activity."

These comments attest to how, over the course of the last five years, some of our sample had experienced rapid growth. But the picture over the past 12 months has been very different: 58 per cent have reduced their expenditure, on average by 13%. One organisation referred to having a policy of "doing less better", while others implied that their focus in the near future would be consolidation rather than growth.

A small number of the organisations we interviewed set great store by contributing to and being valued by the local community: "The most significant change is that we are valued in a real sense. When I first arrived the Council wouldn't return our calls. Last year we asked for £250k toward our capital project – the most they have ever given. The conversations weren't about yes or no, they were about how valuable the museum is. At the meeting where our funding application was discussed for about an hour and a half, various people stood up and said what impact the museum had on their lives." Being highly valued by the local community can translate into significant volunteering, including fundraising activity.

MEAL, one of our case study organisations, has a significant volunteer base. And it, like Shetland Arts, describes itself as operating a social enterprise model designed to meet the needs of the local community. The emphasis for both organisations is on generating social as well as cultural benefits, but through the mechanism of arts and cultural activities.

One organisation we interviewed referred to a shift in the arts and cultural sector away from conventional business planning, which gained no traction, to the development of new models based on artistic leadership "with a creative shared vision within the organisation". A couple of our case study organisations seek to embody this, notably the NTW and BAC. BAC says that "audience and artists are at the centre of all its decision making processes".

4.3 What is enabling arts and cultural organisations to successfully evolve their business models?

While it is not possible to discern a formula for success that applies universally, our research does show that arts and cultural organisations perceived as being at the leading edge share a number of common features or characteristics:

4.3.1 A strong focus on the audience or the market more generally

Arts and cultural organisations have been characterised in the past as being focused on supply rather than demand i.e. they have offered a particular product regardless of public demand. However, all the organisations we interviewed demonstrate a strong audience focus. The vast majority are investing in understanding their audiences, collecting information about their motivation, behaviour and satisfaction.

Technology is playing a part in enabling organisations to learn more about audiences, for example CRM systems which track the activities individuals book for, what they buy etc. Some organisations are using software such as Raisers Edge to predict customer behaviour. Others are using social media such as Twitter in an attempt to better understand audience reaction to their work.

It is more difficult for touring companies or organisations offering free access to gather intelligence about their audiences. However, some of the organisations we interviewed have found a way around this, for example by encouraging low cost high volume membership, tracking member behaviour and undertaking regular surveys.

While some organisations are passively engaged in understanding audiences, others are seeking to achieve more active engagement. We found examples in our research of innovative efforts to provide individuals with more and more satisfying opportunities to engage, including examples where audiences were involved in content development (see Shetland Arts, SIAF and NTW).

Some of the organisations in the research provide services to the public sector. Some of these organisations describe needing to understand this market, matching what they have to offer with what the public sector is interested in buying. These organisations also tend to be the ones that have done most work on measuring their impact and at least one had developed an extremely sophisticated approach.

> "We're engaged in an ongoing conversation with professional and consumer audiences about what's current and important and what we might do in the programme – this informs research and programming decisions."

4.3.2 A culture which supports entrepreneurialism

Having the right culture and an entrepreneurial mindset was identified as important in our consultation: this includes a willingness to take managed risks, 'can do' attitudes, and a focus on learning and adaptation. Mindset is regarded as more important than skills, which can be acquired.

Leadership also emerged as key. Strong entrepreneurial leaders enable and facilitate change. As one interviewee said: "Two things were critical for us. First the staff really got behind the project and their motivation and commitment made it happen. And second, from the outset our Director has had a clarity of vision that was incredibly helpful for everyone else. She was really clear about the project and what it could offer people, what it could achieve, and this has made fundraising and developing stakeholder support far easier".

Some organisations were able to build a new staff team around the vision because they were relatively new and still in the development phase. Others concentrated on attracting staff who could share the vision, and had "a positive attitude" as posts became vacant. On a number of occasions this involved bringing people in from outside the arts and cultural sector to complement the skills and experience of existing staff.

For some organisations the board has played and continues to play a key role in supporting development. Many of the organisations in the sample had recruited trustees with the skills needed to support their entrepreneurial activity. Some, because of circumstances, had been able to appoint an entirely new board. Others regarded the recruitment of a new chair with the appropriate skills as critical to their development.

Generally, in the leading edge organisations comprising our sample, boards, and particularly new boards, had been supportive of change: "Our board was steadfast in the face of extreme financial risk – because they realised this was a historic opportunity for the organisation".

Participants at our consultation events were generally less sanguine about the attitudes and approach of board members. One participant said that she was struck by the fact that her board were willing to risk large sums of money on artistic programme but not on commercial developments, which could make the organisations more financially resilient over the longer term.

Risk, and the proper assessment and management of risk, is a big issue. As one of the experts we consulted remarked: “The types of risk in the commercial sector are different, as are the decision-making processes. Arts organisations understand how to take artistic risk but struggle to feel confident about making commercial risk decisions”.

“The environment is going to necessitate change in the sector at the trustee level – different attitudes and skills and the taking of more risks.”

“There clearly had to be change – and we developed a culture which was entrepreneurial and took risks…. If we get it wrong, we share the learning”

4.3.3 Identifying assets and their potential

Around half of the organisations participating in the research said that an asset that they held was one factor driving change to their business model. They tended to cite their building, the expertise and knowledge of their staff, and their reputation or brand as valuable assets.

During the consultation many other arts and cultural organisations described how they were seeking to make maximum use of their buildings to generate revenues through events and community hire. Some of the organisations are going further, using or planning to use the skills they have developed relating to property, for example to develop a property portfolio (see the Live case study) or to take on building and estate management contracts.

Analysis of earned income ratios using ACE data underlines the importance of buildings in helping generate additional revenue (for example through events or catering). It shows that building-based organisations across art forms are more likely to have higher earned income ratios than organisations without buildings (apart from visual arts and dance for example, visual arts organisations are highly likely to earn less than 25% of their income[35]).

A number of organisations in the research are also using staff knowledge and expertise to develop new training and education programmes or products (see the Live and MEAL case studies). Such work is likely to be a significant source of additional revenue for arts and cultural organisations in the future.

Some organisations are developing consultancy services based on staff expertise directly related either to their arts or operational practice, for example consultancy on staging exhibitions or environmental sustainability. However, a number of experts question whether such developments, which require an intensive input from staff, are sufficiently profitable to merit the resource invested in them. NAO data for museums has in the past demonstrated that on average consultancy services only manage to break even[36]. One of our experts said: “To make significant profits you need to break the link between the potential market and the labour required to meet its demands. This is why technology-based development is a good bet – it offers scalability, while consultancy is of limited potential”.

Another important income stream for some organisations is contracts from the public sector, again an income stream based on the knowledge and expertise of staff. One funders suggested that this

[35] See note 25.
[36] Income generated by Museums and Galleries in 2004, quoted in the MLA’s “Business models and financial instruments for the museums, libraries and archives sector: review of the literature and survey results”, 2008.

has become an increasingly important source of revenue for some arts and cultural organisations over recent years, as they have begun to charge for work previously delivered for free or at a nominal rate.

Some of the organisations we interviewed identified their audience as a key asset, and they were investing in developing it in order to secure greater earned income into the future (see the SIAF case study). Others had recently begun to see their archive or collection as an asset which could be used to generate additional income.

“Ours is absolutely an asset based model within which people – taken to include artists and staff – money and space are the primary assets.”

4.3.4 A strong brand

For US museologists Falk and Sheppard, “brand is the space you’ve captured in the minds of customers… A brand tells them how you are relevant to their lives, and how you are different from others… it suggests to the world how to perceive your work even before they have even experienced it and ideally makes them want to experience it themselves if they haven’t already”[37].

Many of the organisations in our research have a strong sense of their brand which provides focus and helps to guarantee an emphasis on quality in everything the organisation does. One organisation referred to a notion of “‘conceptual continuity: the brand and exhibitions are strong and we wanted that to apply equally to the design of the building, the catering and the quality of the welcome. It was about keeping that brand consistent through the organisation as a way of focusing staff”.

Many of them also acknowledged that their brand and reputation was a crucially important asset, enabling them to form prestigious partnerships and generate significant support. Falk and Sheppard point out that for successful private sector companies, their brand is often their most valuable listed asset.

One of the funders noted: “what generates success is the quality of the brand. To be entrepreneurial you need to have something to sell over and above buying a ticket. People want to be associated with it [the brand] as a sponsor for example”. An observation made in the consultation was that many arts and cultural organisations need to do a better job of explaining “how they are different from others” – an important aspect of brand value.

4.3.5 Peer support and networks

The consultation indicated that peer support and networks have been crucially important in efforts to achieve financial resilience. These have enabled organisations to share real time stories, processes and successes, and to barter and exchange underused assets, organisational skills and expertise.

Several organisations cited examples of sharing skills and expertise, including one museum advising another and a music organisation learning from a theatre. Various models were used to facilitate exchange and learning, including secondments, training and skills exchanges with other arts and cultural organisations, and temporary and longer-term staff sharing schemes. In some

[37] J. Falk and B. Sheppard (2006) Thriving in the knowledge age: New business models for museums and other cultural institutions, AltaMira Press, Oxford.

instances technology was supporting and enabling networking and the exchange of ideas, advice and materials (NTW, for example).

> *"Peers and networks are incredibly useful for us. We pick one another's brains. It's all about sharing information with people with common interests."*

4.3.6 Imaginative and supportive funders

The organisations in our research have mainly used special (as opposed to core) grants to support development activity. Only three organisations have taken out loans (and another three were considering loan finance).

Grants had been obtained from a variety of sources including ACE, SAC, the Museums, Libraries and Archives Council (MLA), trusts and foundations, lottery funds, regional development and tourism agencies, and local authorities.

ACE is the main source of special grant funding through programmes such as Thrive and Sustain. Other special initiatives mentioned included Resilience (SAC) and Renaissance (MLA). During the consultation such programmes were praised for providing organisations with the time and space to take a long hard look at their strategic direction, access to resources to finance change, and advice to support its implementation.

Some core funding (for example, ACE revenue grants) is being used to support elements of development plans, but generally this is supporting either staff training or programme elements.

We also found some notable examples of imaginative practice by funders, aimed at helping clusters of arts and cultural organisations become more financially resilient. Examples include Newcastle and Gateshead councils supporting the development of a strategy aimed at helping some of its building-based arts and cultural organisations diversify their income streams, and work by Manchester City Council on collective marketing for arts and cultural organisations in the city.

> "The key turning point for us was getting our funders to support us in terms of 'mission-funding' rather than for individual projects or outputs. It took time to persuade them…that those core costs were creating the outcomes."

4.3.7 A cross cutting theme – technology as a tool supporting change and adaption

One clear trend that emerges from the interviews is that technology is a tool for supporting change and adaption in business models. Just over three quarters of those interviewed said that they were using technology to understand audience behaviour and satisfaction. The same percentage were deploying it to provide new opportunities for audience participation; only a slightly smaller percentage for the wider distribution of their work; and over half to make back office efficiencies. Just over two thirds said technology was enabling them to produce innovative programme content or new products.

Our case study organisations illustrate the importance of technology in the evolution of business models, for example:

- Live has put a very popular off line product, its highly successful playwriting course, online to achieve greater reach and to generate additional income.

- The Leach Pottery is developing an online retail business.

- For the National Theatre of Wales, which does not have a building base to provide a focus, technology is enabling the development of strong networks with the professional theatre community in Wales.

> *"Technology has been critical in developing understanding of audiences and offering opportunities for participation through the web platform"*

4.4. What is inhibiting arts and cultural organisations from developing their business models

Our research and consultation work also found that there were some key inhibitors, namely:
- a lack of appreciation of the full range of assets held by the organisation and how they might best be exploited;
- inadequate reserves or other forms of development capital to enable organisations to invest in asset exploitation and development (given that special grants for such work are relatively scarce);
- issues about mindset; and
- inadequate skills and capabilities to support such development work including, critically, those of boards.

These issues are considered in the next two sections.

5. Capital needs and prospects for supply

> *"Greater clarity about 'building' or 'buying' is much needed on all sides of the 'funding' equation if we are to use available money well. Does an organisation actively use its assets to create new revenue to create fresh assets, for instance – or does it do whatever activity funding enables? (All talk of alternative business models seems to boil down to this binary – the rest is technical info and risk assessment.)"*
>
> Mark Robinson, 2010. Making Adaptive Resilience Real, Arts Council England

Section 4 described how arts and cultural organisations are adapting/changing their business models in order to achieve greater financial resilience. However, in the majority of cases organisations had received special grants to undertake this work. Such grants are currently in relatively short supply.

Generally our research and consultation work suggests that a major barrier to arts and cultural organisations becoming more financially resilient is a lack of development capital. Development capital might best be described as the money organisations need in order to invest in:
- the organisation i.e. make provision for plant and equipment/invest in staff training and development/make systems changes;
- research and development of new artistic product, and research and the development and implementation of commercial ventures.

Investment in the organisation (for example, in the development of a new finance system) and in research and development for new artistic product is covered by core and project funding from public sources for some organisations, although generally levels are considered to be inadequate. However, there are few sources of support for the development and implementation of new revenue generating projects, special grants aside, since they tend to be regarded as too commercial for most grant funders and not commercial enough, or too risky, to support bank lending. Such development work might be funded from reserves, however our research suggests that arts and cultural organisations tend not to associate reserves with this purpose and more significantly, reserve levels in the sector are generally insufficient and therefore not available for this use.

> *"In order to achieve change new forms of finance are needed"*

5.1. Reserves as a source of development capital

The organisations we interviewed see reserves as either an operating contingency (for example, to meet the costs of emergency work on the building) or to cover costs in the event that they have to wind down. Some recognised that this was far from ideal: "Our reserves currently are seen as what we need to wind down the company, when the real challenge is how we can build reserves which allow us to secure key resources, such as a marketing posts, and to develop the organisation".

Two of our case study organisations had accumulated reserves for commercial development – SIAF for audience development and MEAL for a small social enterprise fund. Only two other organisations in our sample reported having reserves designated for investment in programme development, research, audience development or piloting new income generating activities. In fact, very few of the organisations participating in the research held any significant free reserves. Only two organisations held even 3 months equivalent expenditure. The average level of reserves was just under one month's expenditure.

Some of the organisations participating in the research and the consultation expressed the concern that funders penalise organisations for holding reserves and that this was a significant disincentive to seeking to accumulate them . However, our interviews with funders suggest that, some local authorities aside, this is not generally the case. In fact, some funders suggested that they would prefer to support organisations with a sensible reserves policy which included funds designated for particular defined purposes, including development activities, provided the funds were proportionate.

> *"Don't call them reserves, call them change agent money. Currently there is no incentive to build a reserve but you could have a designated fund, which would provide you with risk capital or for investment in the artistic programme. You could have a 2-year cycle and explain to funding stakeholders the purpose and outputs".*

5.2 The demand for financing for development

Theory and practice suggest that private sector businesses have 'a pecking order' when it comes to raising finance for investment. Financing from retained earnings – when it is available – tends to be favoured because it is cheapest, followed by debt finance and only then, equity finance.

There are some examples of arts and cultural organisations accessing loans and other forms of finance, including revenue or profit sharing (or quasi equity arrangements) to support and develop their work: commonly cited examples include angel investors supporting theatre productions, film financing, and loans for property development projects, though generally these are few and far between.

Relatively few of the organisations participating in our research had taken out loan finance for development projects: only three had such loans and three were considering taking them out (around 11% of the total). None were engaged in developing projects on a revenue or profit sharing basis.

When asked what sources they would use to finance future developments, the majority predictably said grant aid. That said, three quarters mentioned specialist providers of finance, indicating that awareness of specialist providers is higher than might have been expected (see section 6).

One of our interviewees explained: "We looked into loan finance for expanding our catering facilities (not least as this wasn't an area our grant funder was interested in supporting) and we're still pursuing whether we could get a low interest rate from a social investor. At high street rates we couldn't afford to repay – but we could just about afford to repay the social investor's loan".

Generally, in our consultation discussions arts and cultural organisations were resistant to loan finance because of concern that they would be unable to generate the revenue to make fixed repayments. They were more interested in financing mechanisms which either reduced or shared financial risk with the investor, for example guarantees, underwriting or quasi equity (revenue or profit sharing schemes). Particular interest was expressed in accessing such financing for programme development.

5.3 The supply of financing

Specialist organisations exist to provide loans or other investment funds to charities and other not for profit organisations or social enterprises. These are sometimes known as social investors. They include Venturesome, Bridges Community Ventures, the Social Investment Business, Charity

Bank and Triodos.

These lenders are attractive sources of financing for not for profit organisations because generally they supply funds at below market rates when adjusted for risk or patient capital i.e. loans offered over an extended period (for example, ten years) or with repayment holidays. Specialist lenders, which are not banks (like Triodos and Charity Bank) may also be able to offer unsecured loans or require less security.

Some of them are highly focused on a limited market. For example, Bridges' focus is high growth-potential social enterprises. Others like Triodos are generalists providing loans to organisations with social or environmental purposes.

Experience suggests that loans are not the most appropriate form of financing to support the development and implementation of new income generating projects, since such projects are by their nature much riskier than investments in buildings or other tangible assets. Revenue or profit-sharing arrangements in which risk is shared between the investor and the investee are more appropriate.

However, very few of the specialists offer financing on a revenue or profit sharing basis, or offer such investment on any scale to projects which offer blended returns (i.e. cultural and social as well as financial returns). Further, our consultation discussion with specialist providers suggests that most would prefer to invest their limited resources in projects with tangible social benefits as opposed to projects offering significant cultural value. Grant-makers will sometimes offer underwriting but we think they could do more of this relatively low risk, high reward activity. The 'risk' of financial loss is less than that of a grant but the rewards in social goals may be equally valuable.

This raises an important issue about measurement. An observation from the consultation was that arts and cultural organisations will need to be able to demonstrate the cultural and social value of their work if they are to attract significant and reliable social investment. One of the experts we consulted reinforced this: "The sector is still lagging behind on the measurement of impact and, until it has a better understanding of social/cultural return on investment and is versed in using the measurement tools, potential social investors are going to be wary".

5.4 Financing issues – a response

> "We need good funders to create an infrastructure for development... We need to diversify the sort of finance available and ensure that there are multiple places to go to access it."

Commentators tend to agree that existing public sector funding can be used better[39]. One of the funders we interviewed suggested that historically the public sector has tended not to reward the behaviours and attributes likely to contribute to financial resilience, for example penalising organisations with reserves and not always adhering to the principle of full cost recovery. Generally, funding policy should reflect good practice as regards issues such as payment in advance, a commitment to multi-year funding where appropriate, full cost recovery etc. Such good practice makes a significant contribution to the financial resilience of arts and cultural organisations.

Also, with some honourable exceptions (notably some of the initiatives mentioned in section 4) public sector funders have tended to be unwilling to fund work designed to cut costs (for example, new box office systems) or collaborations designed to increase audiences or fundraising income.

39 Mark Robinson (2010) Making Adaptive Resilience Real, Arts Council of England

Public and private sector funding should in the future be more supportive of collaborative work aimed at helping arts and cultural organisations achieve financial resilience and we recommend the setting up of a new time-limited competitive scheme offering research and development funding, for example for new collaborative fundraising initiatives or joint ventures with private or social enterprise partners.

There is also a strong case for raising new funds to enable existing specialist providers of finance to support arts and cultural organisations in their efforts to change and adapt their business models. Our assessment, based on our research and consultation, is that there are potentially three financing gaps which need to be filled:

- *Commercial development and innovation: initiating and testing revenue generating projects and enabling organisations to access the resources and develop the skills and capacities needed to evolve their business models. Financing might take the form of development grants and/or revenue or profit sharing, as appropriate to the project.*
- *Projects which enable individual organisations and groups of organisations to cut costs, pool resources and develop participation. Grants or loans might be made available.*
- *Cash flow issues: our research suggests that cash flow is poor in arts and cultural organisations. As self-generated income becomes a greater proportion of organisational income, it seems likely that cash flow will worsen (because generally investment has to be made up front before income is received). Underwriting might be provided to avoid expensive overdrafts.*

Experts suggests that there is a need for funding/financing for both the research and development of new commercial ventures and their implementation/scaling up. Arts and cultural organisations tend to think in terms of innovation and development, but there is less emphasis on what happens after the research and development phase, or the investment that organisations need for implementation. For example, some ventures fail because insufficient thought has been given to, and inadequate investment made in, marketing.

> "In the future, there will be a need for collaboration to drive best value from the money in the system"
>
> "Arts and cultural organisations could use their captured market more effectively with other social enterprises in joint ventures".

6. Changing our mental models

> *"There are a variety of reasons behind the sectors' preference for grants, beyond familiarity, including: The lack of recognition of a distinction between different types of money – the basic income/capital distinction, the various forms of capital needed, and how these are best met (using different financial mechanisms). The perception that grants and donations are 'free money'. This ignores the fact that such money is rarely free".*
>
> Emilie Goodall and John Kingston, Access to Capital – a briefing paper, Venturesome, 2009

A number of issues which emerged in our interviews and during the consultation relate to the way organisations conceive of and manage their finances, and the skills and capabilities needed to support change or adaptation in business models.

6.1 Skills and capabilities

Arts and cultural organisations report that they often have to develop new skills or find external support to develop and implement effective revenue generation and cost reduction strategies. Skills required include finance, marketing, technology, business development and implementation. The most common way of filling such gaps is by using consultants.

6.1.1 Financial skills

Some of the organisations in our research have increased the level of financial expertise at staff and board level and realised a significant return from this (see the case study of BAC). For example, one organisation participating in the research has been able to cut costs considerably because a staff member covering maternity leave had extensive commercial experience. Nevertheless, the consultation revealed that many arts and cultural organisations still lack access to strategic financial planning skills i.e. the skills to model development options to test whether they would make a sufficient net profit to justify the time and effort expended on them, and/or to restructure projects to secure a higher margin. As one organisation said: "Our business model didn't work – we would need a different structure. I've not yet found anyone who's good at that architecture… We need intelligent advice about the structure of our business model".

There was some evidence from our research that organisations are not always fully aware of the costs, as well as the returns, from new commercial developments. One funder suggested that arts and cultural organisations may too often engage in revenue generating activities which do not provide sufficient margin to justify the staff time spent on them.

Clara Miller recognises that revenue diversification may be subject to the laws of diminishing returns. She says "maintaining multiple, highly diverse revenue streams can be problematic when each requires, in essence, a separate business. Each calls for specific skills, market connections, capital investment, and management capacity. Only then will each product attract reliable operating revenue, pay the full cost of operations, and deliver results". She describes how some organisations dutifully diversify their operations, creating a level of internal costs and complexity that has a high toll, resulting in staff burnout[41].

With clever management however, this problem may be avoided. Sarah Thelwall's view is that highly profitable companies deliver high productivity by using the same assets time and again, repackaging them to meet the needs of different markets. She says: "the aim is to be less like Virgin and more like Harry Potter (a single asset repackaged to achieve multiple revenue streams) thus increasing returns".[42]

All this suggests that we need to develop guidance for arts and cultural organisations on simple modelling of the costs and likely revenue for new commercial ventures, and also that we need to develop a pool of skilled peers and consultants who can help organisations consider appropriate commercial developments and structure business models. Guidance on reducing costs and maximising revenues from defined activities such as catering and venue hire would also be of value. Benchmarking of the net income achieved by similar organisations from the same activities could also prove extremely useful.

6.1.2 Identifying, valuing and realising the value of assets

One of the funders that we interviewed argued: "The real problem isn't that there's limited scope for generating revenue, but that organisations have a problem understanding how to capitalise on their assets". Generally arts and cultural organisations are familiar with the concept of tangible assets but less familiar with that of intangible assets. Our analysis of ACE data reveals that only 52% of organisations show any intangible assets on their balance sheets (with a total value of only 3% of the unrestricted funds held by organisations in the dataset).[43]

During the consultation organisations agreed that they were probably under-utilising their assets, largely because they were not fully aware of the assets they held and how they could be better deployed: "assets are different for each company, but we don't even know what our asset map looks like. If we did then we might be able to look at the routes to deploy them".

Only two organisations participating in our research, including case study organisation Shetland Arts, have developed an explicit asset-based development approach, although some other organisations suggested that the approach they took is implicitly, although not explicitly, asset-based. Shetland Arts, which uses the ABCD framework[44], said: "we were using it implicitly before we had heard of it, but what we couldn't do so well before [adopting the framework] was fully understand the value of our assets, particularly the intangible ones".

One expert noted that "while it may be that organisations have a sense of the value of their assets, they may be at a loss about how to value them. Intangible assets are a very important part of valuing a company if you are selling it, but mergers and acquisitions are not a big feature in the arts. The emphasis should be on usage value – which is not about liquidating assets but how you use them".

This suggests that we need to develop an asset identification and valuation tool and encourage organisations to undertake a periodic audit of the usage value of their assets. Appreciating the usage value of intangible assets particularly, is likely to encourage organisations to more fully realise their income generation potential.

Note: It can be difficult for arts and cultural organisations to exploit their creative IP for a number of reasons including, in the performing arts, contract terms, union agreements and a lack of capital to pay for an appropriate share of rights. This issue needs to be examined further on an individual art form basis and action taken to ensure that arts organisations benefit appropriately from the creative IP that they help create.

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[41] Clara Miller (2010), Shattering the myth of revenue diversification, The Chronicle of Philanthropy, 2 September

[42] Written comments from a member of our review panel.
[43] See note 25.
[44] See annex 1.

> *"We're thinking about how we can capitalise on what people value about us: that might be about how we are working with communities and technology. These are areas we've developed where people want to know more about how we do it – but we've not yet worked out a model of how to derive income from this."*

6.1.4 Strategic development of individual giving

While very few of the organisations we interviewed could articulate the specialist advice and support they needed to develop further, some did mention advice on fundraising, as well as cost savings, joint working and partnership models, business model advice and carbon footprinting.

One of the funders that we interviewed considers that there is significantly more scope in individual giving, particularly for some smaller organisations outside London, than is currently being exploited. In her view many arts and cultural organisations should be making more strategic investment in fundraising, converting audience members or visitors to members, to donors, to regular donors and to people who leave a legacy to the organisation. *Arts and cultural organisations should be considering whether a strategic investment in raising donations is likely to be a better option than investment in new commercial ventures.*

6.1.5 Understanding financial dynamics

Some of the discussions during the consultation suggest that arts and cultural organisations tend not to think in terms of investment or the financial dynamics of their organisations. We need to encourage a shift in mindset so that organisations better appreciate that they need all of the following:

- enough cash to deal with day-to-day expenses as they come up – working capital;
- money to invest in the organisation i.e. make provision for plant and equipment, invest in staff training and development and make systems changes – development capital
- money to invest in research and development of new artistic product and commercial ventures – development capital; and
- money for a rainy day (although generally not for profits think of reserves in this way) – which should be based on both a proper assessment of the risks the organisation faces and the likely costs of an orderly wind down.

Discussion of different financing needs might be regarded as academic within a context of severely limited resources in which many organisations lack levels of reserves which would enable them to wind down in an orderly way. However, a challenge we pose to the arts and cultural sector is to shift to the mindset prevalent in the commercial and social enterprise sectors, in which organisations recognise that in order to secure their longer term health and vitality, investment has to be made in the business and its development, change or adaptation (This is opposite to the mindset in which any new income generated or cost savings realised are always and almost exclusively and immediately dedicated to programme).

New Charity Commission guidance on reserves has recently been published[45]. This stresses that it is legitimate for charities to accumulate reserves to enable them to respond to opportunities as well as risks. It indicates that reserves policies should be based on a strategic assessment of the resources that organisations might need in the future. The Charity Commission is also currently reviewing its guidance on the general management of charitable assets. *We recommend that this guidance should stress the need for all charities to consider accumulating reserves designated for development purposes, in addition to contingency funds.*

Reserves can provide capital for development for arts and cultural organisations. MMM has undertaken some initial work on the need for different sorts of capital within the arts and cultural sector (including, for example, the need for working capital as well as development capital)[46]. This work should be taken up and developed since it is clear that an organisation's need for capital will depend on the nature of its activities. Further work should be undertaken to achieve a better understanding of the capital needs of arts and cultural organisations engaged in the same or similar activities. This work could ultimately generate benchmarking data which might be useful to funders.

> *"The real issue is how to build reserves to increase our scope to take risk"*

6.2. Getting support

6.2.1 What provision is available?

As part of the research for this project we undertook a mini mapping of the business advice and support available to medium sized not for profit arts and cultural organisations in two areas, the North East of England and Scotland. We found that intensive or one to one business advice and support was offered by a range of organisations, including charities with a remit to support and develop arts and cultural organisations, social enterprise development agencies and public bodies charged with enterprise, or business or arts development.

A number of the organisations we canvassed provided generic business advice and support across industry sectors (although some, for example, Business Link, have specialist creative industries advisors). Nearly all the organisations contacted said they would provide support to not for profit arts and cultural organisations, however many reported that there was not much demand from such organisations and neither did they seek to market their services to them. Even amongst advice organisations specifically focused on the arts and creative industries, businesses perceived as having high growth potential (or organisations squarely at the commercial end of the spectrum) are often the focus for support as opposed to not for profits seeking to engage in more commercial activity.

We found some noteworthy work, for example, the Cultural Enterprise Office in Scotland, Social Enterprise in Northumberland[47] and Business Link in the North East.[48] However, several of the providers identified that many of the not for profits they work with are at an early stage in thinking about how they might generate additional revenue, and so the support provided is basic, focusing for example, on organisational structure or book keeping. Indeed, an enterprise development agency commented that their work with the not for profit arts and cultural sector tended to focus on explaining social enterprise models as opposed to commercial development.

Several of the local authorities in the two areas we looked at have arts development departments which offer a portal to a range of advice services for not for profit arts organisations. Some referred directly to generic business advice organisations or charities offering specialist advice; others

[45] Charities and reserves CC19

[46] See note 25.

[47] Social Enterprise in Northumberland, reports that between 5 - 10% of its clients are not for profit arts and cultural organisations. For example, it has helped one group of artists set up a tour and another to buy a disused garage and develop it into a centre for arts-related businesses with a community café

[48] Business Link in the North East has been working with ACE on an action research programme supporting a small group of arts and cultural organisations (including one of our case study organisations - Live),which are already working with a Business Link creative industries advisor, to access mainstream business development finance.

were able to provide services themselves, and referred to specialists within the local authority, for example, property and IT experts.

There were a few examples of ‘one stop shops’ for support, for example in digitisation, public sector contracting, and partnerships and collaborations. One example is the Cultural Enterprise Office in Scotland which has a range of advisors covering financial and legal issues, property and digital services. However, in most instances the organisations we spoke to specialised in particular aspects or areas of support and referred on to others where appropriate.

Notably very few of the organisations we canvassed said that they had worked with museums, although the majority indicated that they would do so if approached. For some, museums fell outside their remit.

To date, our mapping work has been small scale and partial (based on referrals from a local expert in each area). Nevertheless, it leaves the impression that there are problems both with supply and demand for support. A particular supply question is whether not for profit arts and cultural organisations know what services are available, since many are generic and not marketed to the sector. Latent demand, particularly for free services, may be quite high. *We consider that a review should be undertaken of business advice and support offered or funded by the public sector, and its potential to assist not for profit arts and cultural organisations in developing revenue generating activities. Part of the ambition of this work would be to raise awareness of available provision and to encourage better signposting of arts and cultural organisations to the variety of services, which could potentially meet their needs.*

6.2.2 How useful do organisations find the support on offer?

We asked the arts and cultural organisations we interviewed about the sources of support and advice they had used to help them evolve/change their business models. The majority had used specialist consultants. Funders emerged as the next most important source of support, followed by peers and professional bodies (around 60 per cent of our interviewees had used advice and support from this source).

Peer support emerged as a particularly important resource for a number of organisations: “The most important source of external support for us has been our peers”. However, such support is currently serendipitous. *MMM is developing a model of peer networking and support to work alongside specialist technical advice, for example in strategic financial planning. This might be built upon to extend available provision.*

A repeated theme in consultation responses was that organisations in transition need injections of specialist technical support at key stages in the development of projects. Currently such support tends to come from peer-recommended consultants. *The process of peer recommendation could be developed and built upon using the MMM website, thus providing arts and cultural organisations with access to a wider pool of specialist consultants recommended by their peers.*

Business Link has been important for a handful of organisations, notably those involved in the Business Link project in the North East supported by ACE. However, one organisation who had used Business Link in another area said: “it can be very hit and miss – depends who you get”. A view expressed in the consultation is that Business Link is strong on some topics, for example advice on selling. What it isn’t good at is supporting the development of innovative arts business models.

Generally, not for profit arts and cultural organisations feel that they are not a priority for mainstream business support. As one organisation put it: “Where do you go to chew the cud about new ideas? We are full of ideas but business support frameworks are way behind – they don’t think we are real businesses – they think we are candy floss”. Part of the problem here may be that business support and business development funding is based on a growth paradigm with funding linked to increased employment and increased turnover.[49]

Mechanisms designed to support UK businesses working overseas are also perceived as not serving the arts and culture well. *The future of business support is uncertain but a view from the consultation is that arts and cultural organisations need to be more demanding of existing business support structures in order to derive greater value from them.*

Whilst arts and cultural organisations have distinct needs, and we would like to see tailored responses developed to meet these needs, we also consider it important that they have appropriate access to mainstream business support structures and mainstream business development funding where these add value, for example by providing access to specialist advice on retailing or working abroad, or by facilitating access to funds for new commercial developments (for example, new websites that enable organisations to reach a bigger audience with their products and services).

“The offer from the support structures is not sophisticated enough”

“When we give money for organisational development, we tell organisations to use the best people, but we’re not clear ourselves who the best people are, for example, with work around managing change”.

[49] Although our emphasis here is not on growth, the ACE/Business Link project in the North East demonstrates that arts and cultural organisations can sometimes meet the criteria for mainstream business development funding because targeted investment in some organisations can create and secure jobs and also generate increased turnover.

7. What needs to happen

> *"We are looking at funding at the enterprise level. We are asking, what is the tool that is turning money into mission, turning money into programme, and how do you invest in making the enterprise produce the kind of art you want or the mission?"*
>
> Clara Miller, MMM Funding Transition Seminar, December 2009

This report has demonstrated how some arts and cultural organisations are adapting/changing their business models with much creativity in order to achieve greater financial resilience (see section 4 and the case studies). However, in some organisations, programmes of work around income generation have stalled or taken significant periods of time to develop because of a lack of adequate financial and human capital – or in other words, the skills and capabilities – to see the development through. In this section we set out a framework for change to accelerate the development of resilient, adaptive organisations, producing and presenting great art and engaging audiences. This framework is intended for debate. We now propose to engage a range of stakeholders in discussions to firm up our recommendations and catalyse the necessary action.

7.1 A framework for change

In our view we need a new forward-looking, national, long-term policy and support framework. Such a framework would have five key elements

7.1.1 Arts and cultural organisations need to shift their mindset from a focus on breaking even to an investment mindset which emphasises making surpluses and accumulating reserves

That is, arts and cultural organisations need to shift from "how can we possibly close the gap between income and cost?" to "what are the core assets of our organisation, intangible as well as tangible, and how can they best be used and developed?"

This could be achieved by:
- promoting an asset-based development approach
- enabling arts and cultural organisations to access high quality strategic financial planning expertise and support in order to better understand and deploy tangible and intangible assets.
- a new focus on peer-led and peer-organised knowledge transfer networks – acknowledging the levels of entrepreneurial energy and expertise already present, and that one of the sector's greatest asset is its people.

We recommend that ERA21[50], take the lead, working with MMM, Creative and Cultural Skills and Arts Council England's new Leadership and Organisational Development Team and involving public and private sector funders, in promoting the agenda of asset-based development, and that they should be enabled to collaborate in developing and supporting a programme of work comprising the following main elements (some of which might appropriately be delivered by independent organisations):

- Work with boards examining such issues as capital structures and the need for different sorts of investment, and risk identification and management for commercial ventures.
- The development of tools and guidance to support work on resilience (including on identifying and valuing assets, on costing services and on benchmarking the costs and returns from defined activities).

[50] See http://www.missionmodelsmoney.org.uk/programme/era21/ for further information on this group

- Advocate for the Charity Commission's forthcoming guidance on the general management of charitable assets and resources to stress the need for all charities to consider accumulating reserves designated for development purposes in addition to contingency funds.
- An examination on an individual art form basis of issues around exploitation of creative intellectual property and the action needed to ensure that arts and cultural organisations benefit appropriately from the IP they create or help to create.

See also 7.1.4, below which makes proposals relevant to this element of the framework, related to advice and support structures.

> "What's crucially important is mindset in order to be able to take things in a new direction commercially, as well as culturally."

7.1.2. Public and private sector funders of the arts and cultural sector need to evolve their policy and their practice to support better the resilience and longer term flourishing of the sector.

Firstly, funders should be more sophisticated and flexible in their use of grants

- Funding policy should reflect good practice as set out in government and voluntary sector guidance for funders regarding core funding, payment in advance, length of contracts, full cost recovery etc.[51]
- Funders, both public and private, should ensure that grants are available for building the financial resilience of funded organisations as well as for their traditional programme interests. This will require some funders to increase their knowledge and understanding of the management challenges, including the strategic financial management challenges, facing arts and cultural organisations.

Overall this will mean funders taking an investment approach to support for arts and cultural organisations. We envisage that this will mean different things for different types of funders:

Trusts and foundations – are likely to review their funding strategies over the course of the next year or so in the light of dramatic changes in the funding environment for not for profit organisations. We would encourage them to provide less project funding in favour of more core and flexible funding.

DCMS and ACE, the Scottish Government and Creative Scotland – should consider how main programme grant allocations can be used to help organisations develop their capacity to gain maximum value from existing assets and develop new ones. They should examine how more flexible funds, particularly national lottery money, might be used for specific programmes of work helping arts and cultural organisations to change or adapt their business models. This might take the form, for example, of a programme making links between organisations that have commercial expertise and those that don't (see below for other suggestions).

Local authorities – should also consider providing core and flexible funding as opposed to project funding. They should also pay attention to how, in their role as commissioner of services, they are supporting as opposed to undermining the resilience of arts and cultural organisations (as should other public sector agencies engaged in commissioning).

[51] See the Compact on Relations Between Government and the Third Sector (20o9): http://www.thecompact.org.uk/files/140472/FileName/TheCompact.pdf Consultation is currently underway on a redraft.

In our research we found examples of local authorities undertaking imaginative work aimed at helping arts and cultural organisations become more financially resilient. These include: support for marketing and fundraising collaborations; allowing organisations use of local authority land and buildings to generate additional revenue; and providing access to finance at preferential rates. We would like to see more local authorities and other public and private sector agencies (including universities) similarly developing initiatives which enable cross-sectoral knowledge transfer and make best use of existing knowledge transfer tools and other resources available within local communities to support arts and cultural activity.

If more funders adopt an investment approach, this is likely to mean higher levels of funding and more tailored support for fewer organisations deemed to be delivering significant cultural and social value. However, our position is that it is preferable for a smaller number of high performing organisations to be adequately funded rather than more and equal misery for all.

Secondly, funders should encourage and support the development of more adaptive, sustainable business models:

- Private and public funders should incentivise and reward, rather than penalise, the accumulation of reserves by arts and cultural organisations, which should be encouraged, where they can, to accumulate designated reserves for development purposes (i.e. programme or commercial development or building the organisation's capacity to deliver);
- Public and private funders should work together to incentivise financial innovation by arts and cultural organisations across the income spectrum, by launching a time-limited competitive scheme offering research and development funding. For example, this could be for collaborative fundraising initiatives or new joint ventures with private or other social enterprise partners.

We propose that two consortia of funders (public and private), for which respectively ACE and CS provide the secretariats, should be convened to take a lead in adopting these principles in their own policy and practice and encourage their adoption across the funding community, as well as providing the investment or catalysing the investment needed in a new research and development fund of the kind described. Such consortia might be modelled on the National Capitalisation Project in the US convened by Grantmakers in the Arts[52].

7.1.3. Funds need to be raised to enable access to different kinds of financial capital in support of creative practice, including research and development funding

Our work, including our consultation with specialist providers of finance to the not for profit sector, suggests that there is a lack of appropriate capital available to not for profit arts and cultural organisations[53]. New funds need to be raised and administered by existing specialist finance providers with appropriate expertise in supporting the development of revenue generating projects in that sector, including those at the more commercial end of the spectrum.

Arts and cultural organisations need access to finance in a variety of forms, including development grants and quasi equity, or revenue or profit sharing, to enable them to adapt and change their business models. And, we consider that a range of private investors would be interested in the opportunity to support arts and cultural organisations in this endeavour, making blended value investments i.e. investment generating cultural and social as well as financial returns. We propose that our consortia of funders (public and private) should provide cornerstone investment and/or support for a programme of work catalysing private investment for this purpose.

Our analysis is that we need new funding/financing mechanisms and new platforms in order to engage new groups of givers or encourage existing donors to give more through new offers with greater appeal to their interests, for example new investment funds with an emphasis on organisations achieving financial resilience, crowd funding platforms and the development of arts bonds. MMM is currently examining the potential of crowd funding[54] through its support of one emerging platform[55] and proposes to develop this work, and work on other innovative fundraising mechanisms, in its next phase.

"We need to attract more private investors to support projects which, if successful, will provide them with returns".
"We need new financing structures to enable new business model development."

7.1.4. Non-financial support needs to be reconfigured to help arts and cultural organisations through their transition and evolution

This could be achieved through:
- greater support by public funders of peer-led and peer-organised knowledge transfer networks.
- creating a screening process to ensure that private sector suppliers are better aligned with the needs and motivations of the not for profit arts and cultural sector
- prioritising support which helps art and cultural organisations utilise strategic financial planning techniques in deciding how best to deploy their tangible and intangible assets
- a review and recommendations about advice and support provided or funded by the public sector.
- greater understanding of and access to the offer of appropriate advice and support from public and private sources by arts and cultural organisations, enabled through new technology platforms.

MMM is co-designing a model for a peer-led and peer-organised knowledge transfer network with members ERA21 and others ready for delivery in 2011, for which it is seeking support. Part of the co-design process will consider how this model can best mix expertise from organisational leaders with externally sourced specialist advisers particularly in relation to strategic financial planning expertise.

Currently, arts and cultural organisations often rely on peer recommendations in order to source external consultants or freelancers to help them undertake particular projects. It is suggested that this system of peer recommendation is formalised and the information generated made more accessible through a new web based platform or platforms. We consider that ERA21, ACE, CS should work together to take the lead in this work.

DCMS and the Department for Business, Innovation and Skills, with the involvement of ACE, CS and ERA21, should lead on a review/s examining the business advice and support provided or funded by the public sector and its relevance for arts and cultural organisations. Our experience is that service patterns vary between different types of arts organisation and different areas of the country. For this reason we would suggest that this work reviews the support provided to specific types of arts organisations,(for example museums) and different patterns of support (for example generic as against specialist) in each region or area. This project should provide a snapshot of national provision and provision in each region which might be published on the web to encourage

[52] See note 15.
[53] Our work also makes clear that there are issues about demand that need to be addressed. Demand needs to be stimulated, and the work proposed on changing mindsets , emphasising an investment approach and the better utilisation of organisational assets to generate income, will, we hope, contribute to stimulating demand.

[54] Crowd funding is where large numbers of individuals invest generally small amounts of money in particular projects.
[55] http://wedidthis.org.uk/

increased demand by arts and cultural organisations for appropriate services. The review should also make recommendations about access to and the relevance of services for not for profit arts and cultural organisations.

"We need platforms and networks for peer-to-peer exchange and support. Generally, networks are fragmented"
"There's a need for brokerage to sources of support and advice. Who do we go to for help with implementation? Who are the freelancers who can really help us?"

7.1.5. Further research is needed to deepen our understanding of capitalisation issues in the sector

We have sought for this report to understand better the capital needs of medium sized arts and cultural organisations but we have been hampered in this task by the quality of the available data, in particular the absence of expenditure data, crucial to understanding the resilience of financial models, and of detailed information about reserves. This meant we were unable to undertake a fine-grained analysis. Another issue is the lack of sufficiently detailed information about income sources (which can be linked to expenditure). These data issues need to be resolved if we are to develop our understanding of the financial dynamics of arts and cultural organisations and the role of capitalisation in creating more financially resilient organisations. Our recommendation is that ACE and CS take the lead in a collaborative initiative aimed at improving the quality of data about the arts and cultural sector and that they support additional research and analysis work examining business models and capital needs.

Developing our understanding of capitalisation, particularly our understanding of the capital needs of organisations related to life-cycle stages such as start-up and growth, and different types of activities such as touring or education work, would bring a number of benefits. For example, it would enable the development of benchmarking data which could prove very useful to both arts and cultural organisations and to funders. It would also enable policy makers and funders to develop over time more sophisticated and tailored responses to helping arts and cultural organisations achieve financial resilience.

7.2 Ensuring the jigsaw pieces fit together

A constant theme of MMM's work on financing is that appropriate diagnostic and organisational development work is needed to ensure that not for profit organisations are 'investment ready' and that they are seeking financing for projects in their best financial interests. Such strategic financial planning support needs to be developed alongside increased non-grant financing.

New forms of financing to support adaptation and change in business models also need to be developed within a public sector funding context which is supportive i.e. one that takes into account the following factors:

- The limits of income generation – there is perhaps scope for many arts and cultural organisations to generate more of their own revenue. However, revenue generation has been a means for some arts and cultural organisations to compensate for inadequate income from other sources, as opposed to reducing the need for public funding.
- The need for adequate development time – developing new commercial ventures often takes significant development time. In the not for profit sector the process is perhaps more time consuming because organisations are seeking to achieve a combination of cultural, social and financial objectives.
- The support organisations need through the transition – the transition stage, during which organisations are changing their business models, is a difficult one for most organisations: they are investing in new initiatives but perhaps not yet seeing any financial return. Also, organisational capacities will be stretched (some social investors refer to a 'hollowing out' of capacity during such periods, which later needs to be addressed).

A number of over-arching themes and issues emerged in the research and consultation which will need to be given attention as work on this agenda is refined and developed:

- There is growing interest amongst arts and cultural organisations around new kinds of collaboration and in knowledge transfer through peer-to-peer exchange. Introduction of effective models for collaboration and peer learning will be necessary to successful delivery;

- Funders need to be clear about whether they are 'builders' or 'buyers'[56]. However, even 'buyers' have a responsibility to support financial resilience by, for example, allowing the recovery of full costs plus a margin for reinvestment in organisational and service development;

- We need to support arts and cultural organisations in understanding and building stronger balance sheets, including by properly and realistically valuing intangible assets such as brand value and the financial returns they are likely to generate. (But we also need to guard against organisations over- valuing these assets and then not being able to generate the predicted returns!)

- Research and development will be an important element of this agenda and we need to develop a satisfactory and worked-out conception of what arts and cultural r&d means in practice in this context.[57]

- Pursuit of financial resilience will probably mean that organisations will in the future seek consolidation rather than growth. However, paradoxically one route to financial resilience may be to develop income generating activities which can be scaled through partnerships and alliances, for example co-productions, franchises or licences, and through the use of new technology. Arts and cultural organisations need to be supported in considering these dynamics as they develop their operational and financial strategies.

"The transition period is a big issue. As older organisations move to new business models, who's going to fund their period of transition?"

7.3 A final word

The arts and cultural organisations involved in this project were fully aware of their skills gaps in relation to this agenda. They knew they needed to develop and/or have access to, for example, strategic financial planning skills and marketing and business development skills. Nevertheless, they demonstrate a striking degree of resourcefulness and creativity. They have shown great skill, determination and imagination in finding resources and building partnerships in order to produce great work. As one consultee said: "if we can apply the same resourcefulness and creativity to this [capitalisation] agenda, we will be able to crack it".

[56] http://nonprofitfinancefund.org/files/docs/2010/BuildingIsNotBuying.pdf
[57] A blueprint for arts & cultural r&d has been proposed here: http://www.missionmodelsmoney.org.uk/papers/not-rocket-science.

Annex 1 Definitions of key terms

Assets and ABCD

An asset is a tangible or intangible item that generates returns – economic, cultural or social – over time. Approaches such as asset-based community development (ABCD) provide a helpful model for how arts and cultural organisations might start to consider the broad range of assets from which they can derive value. ABCD draws upon existing community strengths, such as the skills of local residents and the influence of not for profit organisations, to build stronger, more sustainable communities for the future.

Business model

"A business model is the mechanism by which a business intends to manage its costs and generate its outcomes – in the case of for-profits, the outcomes are primarily revenues earned, and in the case of nonprofits, the outcome is primarily the public good created[58]."

Capital

Capital is the money or resource that enables an individual or organisation to generate wealth or the initial investment in a new business. Economists refer to knowledge and skills as human capital. In this report we are concerned primarily with 'working capital' i.e. the sort of financial capital an organisation needs to meet day to day expenses and pay its bills when they come due, and 'development capital' i.e. the money that an organisation needs to invest in its future development (for example in research and development for new products and services; the taking to market of new products and services; and organisational capacity to deliver for example, by introducing new systems or processes).

Enterprise

An enterprise is a new organisation created for business ventures or a business undertaking an especially bold or difficult venture. The dictionary definition of 'enterprising' is to be ready to engage in enterprises, showing courage or imaginativeness.

Entrepreneurialism

An entrepreneur is someone who, by risk and initiative, attempts to make profits on their activities. Entrepreneurialism is the entrepreneurial leader or organisation in action. In the for-profit sector, profits dictate dividend payments to shareholders; in the not for profit sector, any surplus is re-invested in the organisation.

Equity

To take equity in a company is to buy a share in the ownership of that company. The returns on such investments are variable. As such, equity investment is often described as risk capital. The term also refers to total assets minus total liabilities, in which case it is also referred to as net worth or book value.

[58] Falk and Sheppard, see note 37.

Investment

In the private sector, to make an investment is to put money into something, for example stocks, in the expectation that there will be a return, generally a financial return, on the money invested. However, in the case of an investment in the not for profit arts and cultural sector, the emphasis tends to be on cultural and social returns. In this report we are particularly concerned to encourage investment in arts and cultural organisations, enabling them to develop financial strategies which will secure future cultural and or social returns.

Research and development

In the commercial sector, research and development is that part of a company's activity concerned with conducting, and applying the results of, research to develop new products and improve existing ones. MMM supports the proposition made by Hasan Bakhshi, Radhika Desai and Alan Freeman[59] that we need to develop a definition of research and development more suited to the arts and cultural sector, one which is not confined to novel products and processes but which yields new ways in which the arts and culture are embedded in the knowledge society and the economy.

Reserves and designated funds

The Statement of Recommended Practice for charity accounting (SORP) defines reserves as that part of a charity's income which is freely available for spending. This means that endowments or funds that have restrictions on how they can be used (usually because a donor has stipulated that they must be used in a particular way) are excluded. Designated funds are different from restricted funds. A designated fund has been earmarked by trustees for particular purposes but without a legal commitment to the money being used in this way. This means trustees may choose to undesignate it, or designate it for another purpose.

Resilience

A resilient organisation can withstand financial shocks such as an economic downturn or the loss of a major donor without immediately reducing its activities[60]. Mark Robinson identifies the characteristics of resilient arts organisations and sectors which he groups under two main headings: resources and adaptive skills. He suggests that "organisations and sectors that consistently display these characteristics will tend to prove more resilient, be more productive and have more impact"[61]:
Our definition, which borrows from both these others, is that financially resilient organisations have the capacity to adapt to achieve their mission within the context of a complex and rapidly changing operating environment.

Quasi equity

Quasi equity (sometimes referred to as revenue- or profit-sharing arrangements) occurs when a funder takes a financial stake in a venture: for example when in return for providing the capital for the development of a new piece of software, the funder receives a percentage of each sale. So the return the funder receives is linked to the financial success of the venture.

[59] see http://www.missionmodelsmoney.org.uk/papers/not-rocket-science/
[60] See note 22.
[61] See note 40.

Strategic financial planning skills

By strategic financial planning skills we mean the skills needed to assess whether a particular development or new project will generate sufficient revenue to compensate for the time and energy spent on its development and implementation, and also the skills needed to advise on the restructuring of such projects in order to generate higher net revenues.

Underwriting

An organisation or individual undertakes to provide financing for a particular project if other sources fail.

Annex 2 The research and consultation

The *research* for this project comprised a number of different elements:

- A review of key literature.
- Primary research with 27 arts and cultural organisations deemed to be at the leading edge in developing new business models.
- A review of quantitative data on the arts and cultural sector (including that produced by ACE, MLA, A&B and others).
- A more detailed analysis of RFO data to examine both capital needs and financial resilience.
- A mini mapping of the business advice and support available to arts and cultural organisations in two areas of the country – Scotland and the North East.
- A discussion seminar with specialist social investors (Venturesome, Social Investment Business etc).
- 9 semi structured interviews with arts funders (participants are listed in annex 3)

Important points to note about this research, including comments on samples, methodology and problems or issues with the data, are outlined below.

Primary research – the sample and information collection

We focused on medium sized organisations (turnover between 100k and 5m) working across a range of art forms and including independent museums and one consortium of organisations.

Semi-structured telephone interviews were conducted with 27 organisations who were also asked to provide a range of basic financial information (20 organisations provided the full range of financial information requested).

Financial information was taken from 2008/09 audited accounts, although information on income and expenditure for 2009/10 (actual but pre-audited) and projections for 2010/11 were also collected. Financial data was provided by the organisations, following guidelines, and wherever possible using the accounting categories applied in audited accounts to minimise scope for error and interpretation.

A third of the organisations in the sample were young organisations (in existence for less than 5 years) while 33% had been in operation for over 20 years. Scale of turnover ranged from £177K to £5 million (inflated by capital development): the average was £1.4 million (2009/10 figures).

Many of the organisations in the sample had experienced rapid growth in income in the past five years but the picture over the last 12 months had been very different: 58 per cent had reduced their expenditure, on average by 13% (and ranging between 1 and 35%)

Funding from the public sector was the most important source of income for these organisations, averaging 52 per cent across the sample (28% AC/MLA/SAC and 24% from other public sources including the lottery and local authorities.) Across the group as a whole, voluntary income (income from fundraising) is more significant than earned income.

The public subsidy figure for our sample is higher than the average for ACE RFOs and the earned income figure lower. This may be explained by a couple of factors: the RFO figures are skewed by inclusion of the six large national London-based institutions; some of the organisations in our sample were making an investment in income generation but were perhaps yet to see any significant return.

Quantitative data on the arts and cultural sector – problems and issues

The available data does not allow us to track how patterns of earned income and associated expenditure have changed over recent years. There are a number of difficulties: for example, many arts and cultural organisations are charities and have separate trading subsidiaries through which some of their trading is conducted. This income is then gift-aided to the charity and may appear in its accounts as a donation.

Neither does the data allow us to break down earned income by its source i.e. income from the open market (for example, ticket sales) or income from the structured market (public sector contracts and product sales to the public sector) or to investigate the relative costs and revenues derived from different types of income generating activities, in order to gauge their profitability.

Capital needs and financial resilience – the approach, problems and issues

Our analysis is based on annual submissions to Arts Council England by organisations with an annual turnover of less than £10m. This sample excludes museums, and arts and cultural organisations which do not have RFO status.

Data for the two years 2007/08 and 2008/09, based on certified/audited figures, was analysed. The full dataset represented 1621 records but approximately 50% had to be excluded because they were incomplete or found to be inaccurate.

The analysis considered levels of capitalisation according to whether the organisation has a building and with reference to its art form. Performance against a number of ratios was considered, including that of earned income to total income; of cash holdings to total income; of long term finance to turnover; of unrestricted reserves to turnover; of fixed assets to total income for building based organisations; the working capital ratio (current assets to current liabilities); the ratio of cash holdings to total income; the ratio of long-term finance to turnover; and the ratio of unrestricted reserves to turnover. The number of organisations valuing intangible assets on their balance sheets and the distribution of intangible assets by art form was also tracked.

Some key problems that emerged in undertaking a full analysis of capitalisation in the sector were: the absence of expenditure data, crucial to understanding the resilience of financial models, and the lack of sufficiently detailed information about reserves, which meant we were unable to undertake a fine grained analysis.

The report produced as a result of this work is available on the MMM website. It is called Capital Matters – An Analysis of Financial Capital in the Arts Council RFO Data. While the report concludes that arts and cultural organisations are undercapitalised and that there are particular issues in relation to cash flow and development capital, it contains the important health warning that in the real world, particular arts and cultural organisations' need for capital depends on both the nature of their activities and their funding (for example, its certainty and flexibility, and whether it is paid in advance) and for this reason generalities may be misleading.

A mini mapping of advice and support – the approach taken

We consulted key contacts in each of the two areas (Scotland and the North East) to identify the main agencies providing business advice and support to not for profit arts and cultural organisations. We then contacted each agency, requesting information about the type of support offered and the extent of their work with medium sized not for profit arts and cultural organisations. Feedback was received from 19 organisations by email or telephone.

The *consultation* also involved a number of elements:

- Four consultation events – three in England and one in Scotland. Around 100 people attended.
- A discussion seminar with a group of experts.
- Comments from a peer review panel.
- Discussions at specialist committee and task force meetings.
- Publication of a draft report for three weeks of consultation, and redrafting based on the comments received.

Case Study 1: Battersea Arts Centre: Defining a 21st Century Organisation

Organisational Profile
Battersea Arts Centre (BAC) is a regularly funded organisation of ACE London, housed in the grade II listed, late Victorian, former Battersea Town Hall, South London. In 2009/10 its turnover was £2.1 million.
BAC's mission is to invent the future of theatre. This implies a continuous process of experimentation and testing termed 'Scratch'. 'Scratch' is a commitment to nurturing and enabling artists to test ideas through audience feedback; facilitating individuals and companies who question traditional forms of theatre and make work that frequently doesn't start life with a script. Scratch is the means by which BAC articulates its commitment to prototyping and testing new ideas for creative business development and it is the principle, which informs how BAC is now approaching the development of a sustainable model for the future. In this model, the building functions as a flexible 'envelope' or container to serve the central relationship between artists and audiences.

Business model innovation: the challenge
BAC is a registered charity and a company limited by guarantee with a subsidiary trading arm – BAC Enterprises. Over the past nine months and partly in response to the fact that it has recently secured a 125-year lease, BAC has asked itself two key questions:

"What is it that defines a 21C organisation? How can we create a sustainable home for artists, audiences and staff in a manner which honours the spirit and legacy of the building and integrates theatre, participation and events in a space which liberates artists from the constraints of formal theatre spaces and creates its own unique challenges?"

BAC recognised the answer lies in a fundamental rethink of its operational model to achieve the following:

- Embed the principles of 'scratch' – of constant prototyping and evaluation - into the DNA of BAC

- Create growth without further expansion in staff numbers and to reduce high levels of overworking among current staff by doing less better

- Integrate commercial and charitable activities as closely as possible, to ensure that all trading activity is mission related in future and to create a cultural enterprise model.

The solution
At BAC every activity is conceived of as a project, rather than public activities being organised as a 'programme' and supported by a 'back office' operation. All operational activities (for example, compliance, metrics, marketing and governance) are considered as project activities in the same way as 'productions' and participatory work, commercial and cultural activity. This shift is designed to facilitate more accurate costing of time, precise identification of all resources required and flexible deployment of skills available across the whole business.

The senior management team has been re-configured to become the strategic programming team - joining the eight or so producers together with the technical and 'operational' team members and dissolving distinctions between participation and production. Teams are configured flexibly in response to need, through strategic project team meetings.

BAC is also creating one central budgeting system, and ensuring financial literacy increases across the organisation in order to deliver activity within this new paradigm. Budgets are now treated as integrated for trading purposes and only stripped out in order to satisfy statutory reporting requirements. As Sarah Preece commented: *'Understanding how money works is valuable and interesting and by engaging with this, all staff are empowered'.*

All project activity is organised within the following matrix: art, space, people, and money, to encourage shared ownership of each activity from the most junior administrator to the artistic directors. Every activity is calibrated against a spectrum from purely commercial to purely social value. BAC's objective is to hybridize social, cultural and commercial value by asking how far any activity can be taken in each direction.

A practical example to illustrate this is how the building is used to generate income. Weddings take place in the grand hall and previously these have been considered as purely commercial transactions where space is provided for a fee. But the building is full of artists who can add value to this transaction in terms which make sense for a cultural enterprise: namely by set dressing, costume provision, offering live entertainment etc. This conceptual approach to space and assets – 'Playgrounding' - was initially fostered by the experience of giving over the whole building to Punchdrunk for its production The Masque of the Red Death.

BAC has also applied this concept to capital development. 'Playgrounding' is an alternative to architectural consultants proposing a building solution without proof of concept –prior to the building work being commissioned. BAC's building development model brings artists and architectural practice together and locates the scratch principle at the heart of this process. Small interventions are modelled in space following intensive dialogues between artists and architects and public reaction then follows. This innovation has the advantage of putting the client firmly in control and challenges conventional procurement methods, by shifting the balance of power between architect, quantity surveyor, project manager and client. It is an approach is being viewed with increasing interest by capital funders.

Critical success factors
The adoption of this new model has been made possible for the following reasons:

- There is a powerful commitment to finding the solutions as a collective endeavour. The Board is closely engaged with the change process. No external consultants are used - the answers are developed by the organisation itself.

- The commitment to testing is a consistent organising principle. It includes trialling different configurations of multidisciplinary teams to learn how BAC can best provide a full spectrum of insight on any proposed project.

- BAC fosters a culture of continuous learning. Each project team has a responsibility to engage with talent and to create growth routes for individuals within or beyond BAC itself. The organisation encourages peer innovation and peer-to-peer learning. Interns are being replaced by Apprentices who rotate through different activities within the organisation as a way of building capacity and matching aspirations and opportunity.

- Clear shared values are in place concerned with capacity building, encouraging entrepreneurialism and driving efficiency, including developing an understanding among all staff about why a rigorous commitment to measurement is necessary.

- All staff are responsible for customer care no matter where they are in the building or the hierarchy and the front of house welcome is valued very highly. Front of house staff are also now involved directly in project planning teams; this ensures they are better briefed and equipped to understand artistic content and therefore to communicate about it effectively with audiences.

Financial impact

The shift to a new project focused business plan enables BAC to sustain its ambitions through engineering a more resilient model around a smaller core team who are better equipped and have more training opportunities than previously, linked to capacity to in-source project staff for busy periods.

The organisation is able to expand and contract depending on changing internal drivers and financial contexts. Doing less and doing it to a higher quality means more control over activity and risk taking.

Project team working also draws staff together from different departments leading to hybridisation of experience and ideas. This delivers resilient proposals, empowers and liberates individuals to innovate and leads to more a dynamic organisational focus on vision/mission, identification of new markets and business delivery.

The new artistic model facilitates longer planning cycles, yet allows BAC to remain responsive, thereby increasing earning potential and opportunities to cross-fertilize earning and development income strands.

BAC is committed to growth where it can be clearly aligned to mission & vision delivery, and empathetic methods of income generation. This means intensifying current levels of activity and earning potential, rather than expanding activity and increasing targets.

Growth will be achieved through exploiting the full revenue potential of BAC's key asset – the multitude of spaces in the old Town Hall - to develop a new and unique offer around two core businesses: art and events. BAC also aims to create secondary markets to distribute the work created in the building. Exploitation of this IP should deliver substantial growth over the coming three years.

The new model will not be fully operational until early 2011 so growth in earned income potential has yet to be realised. However, BAC has weathered the economic downturn and seen no diminution in its revenue projections during a time of recession.

BAC expect cost savings achieved through the new business model to feed through in the first six months of 2011/12, to be followed by growth in development and earned income secured through projects over the following year, moving to a position of budget surpluses by 2013/14.

In summary, BAC plan to build designated reserves for cultural enterprise and to invest in ideas developed through its 'invention centre' to realise untapped potential in current assets and to invest in the intellectual and physical capacity of outputs in order to maximise income potential. An example of how this might be achieved would be to invest in capacity to present work in a commercial environment, rather than relying on others to deliver that investment and in the process by controlling more of the value chain, avoid reducing BAC's opportunity to exploit income potential from work it has developed in house.

Conclusion

BAC is a living experiment in business innovation. The organisation recognises the need to document and analyse the innovation process it is undergoing, with a view to capitalising on the experience it is developing in managing creativity and innovation and defining a cultural enterprise, in order to sell expertise longer term. The last word goes to Sarah Preece Executive Director:
'At BAC there is such a culture of openness to process, experimentation and change, that the organisation recognises it has a unique opportunity to test innovative practice. In some ways, if what we are attempting to do can't be done at BAC, it can't be done anywhere.'

Contact: Sarah Preece, Executive Director, Battersea Arts Centre www.bac.org.uk

Case Study 2: The Leach Pottery: Re-imagining the museum

Organisational Profile

The Leach Pottery is located in St Ives, Cornwall. The pottery's mission is to promote excellence in studio pottery, setting standards and operating as the lead centre for ceramics in the South West, the UK and internationally. It originates contemporary work for sale and runs a changing exhibition programme. The project celebrates Leach through the preservation of the old pottery alongside a new production facility. The primary intangible assets are the international legacy, trademarks and rights and the production expertise located within the site.

The pottery opened in 2008/09 following completion of phase one of a capital programme on the site of Bernard Leach's studio pottery and home. The pottery is a registered charity and company limited by guarantee and when it first began trading it did so through a subsidiary trading arm. It receives assistance from public sector bodies, trusts and foundations and individual donors but has no recurrent funding support.

The business model for the pottery depends upon generating earned income through ticket sales and from producing contemporary tableware. In 2009/10 its turnover was just over £200,000. It is run by a small core team composed of five full time equivalent staff with assistance from volunteers and interns.

Business model innovation: the challenge

The main challenge is to develop sustainable, mixed income streams which are wholly mission related. This has prompted the Leach Pottery to develop as a cultural enterprise for the ceramics industry which also trades on the legacy of its namesake. Excellent research, design, production, retail and commercial skills are essential to making this model function successfully and with integrity.

The new production facility houses a team of five potters, with additional space for visiting potters and students. The team carries out production work on behalf of the pottery and pursues studio practice under the tutelage of the resident Lead Potter, who has an international reputation. Through this means, it is able to maintain small batch production runs of its own tableware range and ensure research, development and production of one-off and bespoke work takes place.

The site presents a number of challenges which are affecting how business growth can be achieved in a sustainable manner. The current footprint for the museum is very small and it has little space to display archive material as well as run a production and retailing operation, although there are some limited expansion opportunities. Access is limited; most visitors must arrive on foot as there are only two parking spaces available and inadequate provision for coach drop offs. Since opening, it is exceeding income projections, but site visitor numbers show evidence of stabilising at around 11000 per annum.

The solution

After learning from eighteen months of trading and audience research, the pottery is now focusing on a business development strategy which has three main goals:

• To add value to the existing offer and increase profit margins

• To build the profile of production ranges in the UK and internationally, by developing a strong online presence and building new markets by working closely with heritage and lifestyle sectors to encourage cultural tourism.

• To seek new partnerships which offer opportunities for engaging with Leach's legacy and sustain the research and training resources which the museum offers for the benefit of practice-based development in contemporary ceramics.

The pottery plans to take historical collections from Dartington and Cornwall Council on long term loan in order to enhance the visitor experience, eventually making all archive material available on line. The museum also plans to mount international shows as cultural tourism initiatives. It participates in joint ticketing schemes locally and is working on a cultural tourism partnership within St Ives, in order to provide targeted cultural breaks to overseas markets. It has also successfully tested demand for weeklong intensive studio pottery courses and is now looking at joint development of courses possibly with St Ives School of Painting.

Longer term, the museum aims to develop a full apprenticeship programme for potters, working with further education and possibly the National Skills Academy in order to create progression routes on to degree programmes and encourage greater diversity of entrants. It is also developing a relationship with University College Falmouth to launch a practice based MA programme. This approach responds to a progressive decline in degree level ceramics courses and the dispersal of a world-class skills base, following the demise of the UK potteries industry in Staffordshire.

The apprenticeship programme and an increase in resident potters will enable an expansion in tableware production which in turn should drive growth in online services and sales. The museum is investing heavily in the website to process online sales of tableware and eventually to provide an online catalogue as well as promoting residential and day study programmes. Value creation is also located around developing shared copyright agreements with Farnham Craft Study Centre, which also holds relevant archive material.

Critical success factors

Both the copyright and trademark on Leach – key assets - are owned by the museum, while the Lead Potter retains the design rights for the Leach Pottery tableware range. The pottery is beginning to attract serious collectors of studio work through the quality of output from its production facility.

Business Link, assistance from professional bodies and supportive funders have all been critical to establishing the business model. For example, ACE South West has provided new audience development funding and Cornwall Council has made funds and expertise required for capital investment alongside Lottery distributors.

As a result of Cornwall's Objective One status, the pottery has been able to access training in digital photography skills and health and safety through local colleges which are in receipt of European funding to build capacity in SMEs and has received European subsidy through Unlocking Cornish Potential to create a new graduate Education Officer position.

The quality of relationships that the museum has built is also a critical factor. It uses the same external suppliers and works very closely with them so that they understand the business model and share in successful development.

A commitment to constantly review every aspect of the model during the first eighteen months and to make any necessary adjustments to governance quickly has been applied. For example early analysis of the trustee group suggested that new social enterprise, marketing, commercial and education specialist skills were required to deliver the vision. New trustees with very strong marketing and business expertise have been recruited and through some externally facilitated governance training, the Director has also strengthened strategic capacity in the whole trustee group.

Similarly, in response to an assessment of risk, and different options to build skilled capacity to deliver production, the museum has moved away from a self-employed model for the studio potters who work under the Lead Potter. With purely self-employed makers the studio was unable to sustain production capacity and was vulnerable to peaks and troughs within the freelance potters own businesses – so when a potter had their own exhibition or orders to focus on they would no longer be available to produce Leach Pottery tableware. In such a small team of skilled makers this caused problems with responding to orders and maintaining stock levels.

Financial Impact

The lack of either core funding or reserves and the absence of any tangible as opposed to intangible assets meant that the museum had to apply extremely close scrutiny to its trading model during the first twenty-four month operational period. This paid off, as it showed that although turnover was on track and targets for spend per head were being achieved, the cost of sales meant profit margins were too low.

A review of all activities also confirmed such a close fit with the primary charitable objects that a separate trading arm was judged to add unnecessary cost and complexity and could be discontinued. A reorganisation of the management accounts based on cost centres followed, to ensure the most accurate possible picture of profit margins across all activities can continue to be tracked.

To keep overhead costs down, specialist skills, knowledge and expertise required to develop organisational capacity have also been in-sourced creatively, through the PHD partnership which the museum has secured with Falmouth.

Most impressively, Leach Pottery has used the intangible assets (the trade mark and copy right) to make a successful case with Cornwall Council to secure both the pottery site and the premises next door using a community asset trust model, with either a 99 year lease or a freehold title. The additional space will eventually provide residential accommodation for potters, research and education space and help to address a current barrier to revitalising skills - attracting resident potters in an area where housing costs are very high.

The acquisition will have a very positive affect on the balance sheet and will give the museum a tangible asset against which to borrow. With encouragement and assistance from Esmee Fairbairn Foundation, the museum has also approached Charities Aid Foundation. As a result Venturesome has provided an unsecured loan over 3 years at 6% which can be repaid at any point without penalty. Both the loan and the acquisition of the premises, have in turn unlocked an unsecured overdraft facility from the bank.

In summary, the museum has been able to create a period of stability within which it can focus properly on testing a unique model, consolidate its key partnerships and grow its trading capabilities within and beyond the region in order to consolidate as a resilient and thoroughly creative business.

Conclusion

Networks and partnerships have been critical to the success of the Leach Pottery in the start up phase and will remain central to its ongoing resilience. Leach is at the centre of an historic network and has capitalised on this both locally and internationally. Local cultural organisations have assisted with cross marketing and with identifying regional suppliers of services. Networks in the international museum and pottery world have been vital for profile raising purposes as was demonstrated during the Leach Pottery's nomination for the Art Fund Prize 2010 when the public vote, circulated almost entirely through social networking, saw the pottery in the top five nominations throughout the campaign and with an extraordinary level of international support.

Exhibitions at the Japanese Embassy in London and in galleries in Tokyo further demonstrate the ongoing commitment of international partners to the historic ties. Further partnerships have helped in making core skills available through delivering shared projects and services and ensuring academic and research delivery objectives are met. Funding and finance providers are positive, audiences are satisfied, volunteer numbers are healthy and public profile is developing– helped by reaching the 2010 long list not only for the prestigious Art Fund Prize but also for the European Museum of the Year Award.

Contact: Julia Twomlow, Director, The Leach Pottery www.leachpottery.com

Case study 3: Live Theatre – entrepreneurial leadership

Organisational profile
Founded in 1973 and based in Newcastle, Live Theatre has a long-standing reputation for high quality work which together with its commitment to new writing results in a very strong brand. Following a two-year capital development programme, it opened the doors of its re-developed Quayside site in 2007. Live has recently enjoyed enormous success with The Pitmen Painters which was one of the first productions in 2007 and which subsequently transferred to the National Theatre. This autumn Pitmen Painters will open on Broadway. Live Theatre is an Arts Council England RFO and its turnover in 2008/2009 was £1.8m.

Business model innovation: the challenge
Since 2004/2005 the organisation has been considering new ways to generate income in order to help sustain the company's work into the future and enable it to become less reliant on current revenue streams. This forward-thinking approach of being able to see "the writing on the wall" with regards to future directions for funding allowed the senior management to consider how to exploit the organisation's key assets. These include its reputation, the quality of its work, its popular brand and its prime physical location.

Live Theatre worked with a specialist consultant to identify how it can develop financial resilience through two main strategies. The first approach explored raising investment in order to put together a portfolio of property around the theatre, based on the experience developed through delivering its own capital development programme. The second strategy entails developing a range of businesses which exploit the intellectual property, skills and experience of staff.

The solution
Following initial analysis, the Senior Management Team identified that there were some significant opportunities to develop additional revenue-generating enterprises which can support the ongoing activities of the theatre. There are currently four enterprises in development:

1. An on-line playwriting course
2. A new restaurant as a joint business venture
3. An SME incubator in part of the complex of historic buildings in which Live Theatre is based
4. Commercial property investments with partners

A £1million award provided through the Arts Council's Sustain programme in 2009 is underpinning the new business development strategy. This funding, which Live hopes to match through prudential borrowing from Newcastle City Council, will enable it to deliver these projects, each of which are potentially large scale.

The first enterprise to be launched is the playwriting course - an online version of Live Theatre's existing popular off-line Introduction to Playwriting course, which has been devised and delivered by Gez Casey (Literary Manager at Live Theatre) and Jeremy Herrin (former Associate Director at Live Theatre, now Deputy Artistic Director at the Royal Court Theatre). Desk research suggested that there was a gap in the market for a playwriting course attached to a theatre with a reputation and proven record in supporting successful writers. No other playwriting courses offered on the web are delivered by people with an established reputation in professional theatre. The online course has been developed and was 'soft launched' during the recent new writing festival held at the theatre in March 2010. The five modules have now been tested by six aspiring playwrights. Feedback has been gathered and the course is being amended before it is commercially launched during autumn 2010.

The other projects are also in development and Live has established a separate but linked company to develop and manage these businesses, including the property portfolio in order to "ensure it can involve the right sort of expertise".

Critical Success Factors

The CEO has driven the agenda. He has led in leveraging valuable partnerships and in ensuring that the organisation had access to the right skills and technical capacity. For example, by recruiting more commercially orientated board members and building the staff team to enable change in the organisation.

Central to the successful engagement of the organisation in these changes has been the CEO's ability to articulate the strategy in practical and tangible terms and his confidence in thinking big:

> *When it comes to ambition, the SMART objectives (for example, Achievable, Realistic) can be seen as objectives that maintain the mediocre. If you are tenacious, thinking laterally, with what might seem huge goals, can often make the unlikely achievable.*
>
> Jim Beirne, CEO

Partnerships have been vital throughout Live Theatre's development. Particular current ones of note include the Cafe21 group for the restaurant opportunity, web developers for the online course and with the National Theatre on the transfer of Pitman Painters which led directly to greater brand recognition. Live regards these partnerships as essential in helping to attract the necessary resources for change.

Furthermore, access to high quality specialist advice from board members and consultants ensures that the right skills, experience and specialist knowledge are available to each venture.

Financial impact

Live anticipate that the social enterprises it has launched will start to have a material effect on 2011.12 budgets generating additional net revenue of approximately 35K. Within five years of start up, the forecast is for a revenue stream in the region of £200k pa plus an asset valuation of around £2m. Looking forward Live expect to grow both activity to yield income and assets. Live recognises that the key to developing financial resilience within its model at this stage, is to acquire assets which can then act as reserves and generate working capital.

Conclusion

All the development work on new supporting enterprises has been funded through core subsidy and project specific grants, some of it in the form of grants for mainstream commercial projects accessed through the North East of England Investment Committee (Arts Council funding provided the necessary leverage).

Live is now sourcing a loan from Esmee Fairbairn and Venturesome, its first experience of debt finance, to support the SME incubator project. One key challenge has been planning the capacity required to actually make the transition given that enterprise development is new territory for the organisation. Live Theatre has also learned how critical it is to identify the right technological skills and solutions in a context where there is asymmetry between the knowledge and skills of suppliers and consultants compared to staff; in its experience this issue needs to be very carefully managed.

Live considers that all the work it has undertaken to introduce new business ventures is developing staff knowledge and skills to its advantage. Also, critically it is changing the culture in the organisation and making it more entrepreneurial. It regards the first of these business ventures - the online playwriting course as potentially of commercial value - but also sees the equally important benefit of this venture to the organisation as cultural value accrued through promoting and developing its brand.

Contact: Jim Beirne, Chief Executive, Live Theatre, www.live.org.uk

Case Study 4: Museum of East Anglian Life: museum as social enterprise

Organisational Profile

The Museum of East Anglian Life (MEAL) was founded in 1967 and is located in Stowmarket, Suffolk. The museum is set within 75 acres of beautiful countryside, with a collection of historic buildings and 40,000 objects. MEAL describes itself as a social enterprise 'sharing the compelling story of East Anglian lives through historic buildings, collections and landscape.' Its aim is to 'enrich people's lives, encouraging enjoyment, learning and participation through.. public programmes, training and volunteering schemes.'

MEAL is an independent museum, constituted as a charitable trust and company limited by guarantee. Its turnover in 2008/09 was £477K. Just over half its income currently comes from public sources, (50% of this is a block grant) including Suffolk County Council for whom MEAL delivers services under contract. 80% of its earned income is mission related. It holds fixed assets in the form of its buildings and equipment, and around £30,000 in reserves – which equates to around two months' wage bill.

MEAL is about to begin a major £2.7 million redevelopment of period properties on its estate to create nine new exhibition spaces within historically important buildings.
It is currently considering 'flipping' the conventional model and using the company as its main vehicle to recover more VAT, because such as high proportion of its income is earned. Legal structure is simply a financial decision for MEAL: being a charity does not inhibit its enterprise culture.

MEAL directly employs 16 FTE (with 7 in-direct staff who provide catering and front of house services). Volunteering is an important aspect of MEAL's strategies and a Participation Officer is employed to support volunteers, who are offered training opportunities as appropriate. Volunteer numbers currently stand at over 150.

Rather than a repository for objects, MEAL views the museum space as a place for 'people to be active, learn new things, look at the world differently, make friends and give something back.' Its audience is primarily local; 7% of visitors live within 25 miles, and 50% within 5 miles. 70% of visitors attend on just seven days in the year, attracted by major events.

Business model innovation: the challenge

Five years ago the museum was facing closure and two of its main funders were threatening to walk away. The majority of the Board resigned and the new Director had to build up the organisation from scratch. Facilities and infrastructure were minimal – the office comprised a computer in a shed. A new Board, new staff (only one person was in post beside the Director) and new rationale for the museum had to be developed.

The solution

Historically the museum had viewed its trading activities as purely income-generating in purpose, but MEAL began looking at what it meant to be a social enterprise and this led it to reconsider how all its activities could deliver benefits to the public. For example, the volunteer programmes have been great for building relationships with the community and the food in the café can promote local producers and healthy lifestyles.

For MEAL, social enterprise is about creating resilience for the organisation, being opportunistic and creative in how they use their assets 'to help people fulfill their ambitions':
'For us it's about using our assets in the community. For example, we have a contract to supply hanging baskets for the local town (because of our horticultural skills) but rather than just use professional staff now we train up local young people to be able to do it so they develop skills.'

When MEAL began to look at its assets in a new way it developed new insights about what it could offer:
'A social ent*erprise approach inspired us to take a different view about what collections can show us about the past – so we've developed a strand of activity about happiness and well-being.'*

This activity strand includes a schools exhibition and the 'When We Were Happy' website. Suffolk Community Mental Health Trust is supporting some of MEAL's work with vulnerable adults and this contract income for work-based learning from the local authority and other public agencies, including the Learning and Skills Council, is central to MEAL's business model.

Related to this vision of the museum as social enterprise, MEAL has availed itself of some of the approaches and support resources being developed by the social enterprise sector, including the Carnegie Trust Asset Based Community Development approach and uses Social Return on Investment (SROI) to measure its impact. It has also accessed the Social Enterprise Executive Development Group through Anglia Ruskin University.

MEAL has also explored social investors (lending organisations which focus on non-profits) as a way to fund a much-needed extension to MEAL's café.   To date, the costs of borrowing from high street banks to fund an extension remain prohibitive, although the Director is hopeful that if the franchise can be renegotiated, profits from the café may be able to meet the costs of loan repayments with a low rate of interest.

MEAL has created its own 'social enterprise investment fund' within its designated funds – but whilst innovative among its peers – this is a small amount of money and suitable only for seed-funding smaller projects.

Critical success factors
Creating an entrepreneurial culture has been central to the success of MEAL. This has been achieved by recruiting people with entrepreneurial outlooks, often from outside the museum sector, as well as the culture within the organisation, which the Director describes as follows:

"People don't feel like they are in trouble if they get things wrong. We share the learning and I think people take strength from this and aren't afraid to say to try things or to say "that didn't really work"'

Suffolk is nationally recognised as one of the leading authorities for commissioning with the non-profit sector and MEAL has benefited from cultivating a good relationship with the local authority, through which it has been able to demonstrate how it can contribute to key outcomes in the area. Visitor numbers, and income from admissions, have increased in the past five years: by 15% and 25% respectively. But the measure of success is more clearly seen in the quality of engagement, than the growth in visitor numbers.
Change at MEAL has been led by the Director; he recognised his role had become too central and this would threaten the resilience of the organisation if he were to leave. Therefore, the organisation has recently been re-structured to distribute line-management and strategic responsibility among a new senior management team. Despite the challenge this change presented to maintaining the family atmosphere that had characterised the museum to date, this new hierarchal structure is working well for staff.

Financial impact
The changes introduced to MEAL's business model have achieved diversification of income and spread the risk across the business. This, more than anything else has improved resilience.

Over the next three years MEAL has growth aspirations and if necessary will seek new partners to achieve them. Meal is already a co-producer of a major, three year Skills for the Future programme (£600,000) with Gressenhall Farm and Workhouse in Norfolk. This builds on the work based learning offer developed by the museum.

Suffolk County Council's plans to outsource all its services within ten years and Meal would hope to bid individually or through a consortia to deliver services in Adult Care or for the local Children's Trust.

In 2012/13 revenue funding will be cut by 20%, but capital development will come on stream by then. This will enable MEAL to generate income through admissions, and hires. Meal is also in discussion with other cultural organisations to explore merger or collaboration in delivering governance and back office functions to achieve efficiency savings.

Additional revenue generated through service delivery has helped build organisational capacity, which has enriched the programme of heritage activities. It has not yet generated significant amounts of cash, but within three years Meal expect this increased capacity to have a positive impact on their bottom line.

In future surpluses will be used to build up reserves to a level of five months of salary costs which equates to approximately £100,000 or a quarter of current turnover.

The priority hitherto has been to generate public activities, build new social networks and deliver a range of public programmes with vulnerable people. Looking forward, any additional capital will be used to invest in the buildings and collections.

Conclusion
From a crisis situation, over the course of a five-year period MEAL has turned itself around and been awarded Museums and Heritage 'Entrepreneurial Museum of the Year 2010'. It is about to start a major new development and has extended its audiences and profile – receiving national press coverage for its Gypsy Arts Festival. The organisation is in a far more stable and resilient position. There is strong stakeholder support locally and regionally, within the museums sector and in local government.

Development of MEAL to date has not focused on the quality of the collection or how it is displayed. There are plans to address this after the current building projects ends in 2012, but significant improvements in terms of the museum's impact have been achieved so far without investing in the core 'product' of the collection. In the words of the Director: 'it's not all about the collections and landscape – it's about the quality of the relationships we create. It's about the social capital.'

Contact: Tony Butler Director www.eastanglianlife.org.uk

Case Study 5: National Theatre of Wales: freedom and flexibility without buildings

Organisational Profile
The National Theatre of Wales (NTW) was founded in 2009, and its first annual programme began in March 2010. NTW seeks to be engaged, innovative and international in outlook and reach. For NTW engagement means being rooted in its community and also exploring theatre as a space for discussion – using the programme and events to encourage dialogue with and among audiences. NTW's turnover in 2010/11 will be approx £1.3m, although production expenditure for this launch year is spread across three financial years. The major proportion (£1.25 million) comes from the Arts Council of Wales. Box office income is a modest proportion of turnover, at around £80,000 in the first year, with free events, short runs, and accessibility the priority in this start up phase. As fewer productions are planned in future years, box office is not expected to grow significantly.

To programme flexibly, and retain maximum resources for content, NTW operates as a producing company with a core staff team of eleven members. It has eschewed a building-based operating model to ensure diversity in both the type of work it can produce and where this can be presented. For example, during the first operating year the programme will theatrically 'map' Wales. One show per month plus an additional finale will take place in locations across the country: ranging from a 'game' on the beach at Prestatyn to presenting more traditional theatre in extraordinary settings, including a new version of The Persians by Aeschylus in the Brecon Military Range.

Business model innovation: the challenge
As a brand new organisation, NTW is able to develop its business model from scratch to complement its mission, artistic vision and core values and to retain maximum flexibility and resources for the programme. The context defines the choice of model. With a remit to be the 'national' theatre for Wales, NTW wants to make work all over the country. It also recognises that transport infrastructure is challenging but that it is essential for NTW to develop good links with existing companies and practitioners (writers, directors, technicians, actors etc) in Wales, as well as working internationally. Partnership working sits at the centre of the programme and informs the methodology for producing work. NTW also aims to programme the widest possible range of innovative theatre. This includes immersive installations, digital, open-air and participatory practice and requires great flexibility from the production team, and an open style of working facilitated by technology.

Raising funds from sources other than the public sector is also a challenge in a country with low levels of established philanthropy and business giving for the arts, although NTW are developing relationships with individuals and businesses. NTW approaches income generation as much as production in a manner consistent with its core values of engagement, innovation and internationalism.

The solution
'What frees you up to innovate is having time, not money. We have the freedom to work with an idea and then think about what's the best way to do this – we're free from the constraints of a particular building or set of dates. We have long-lead times for our projects (6-12 months) and we have very early 'parameters meetings' for our projects where we establish the vision and budget at the outset: that's important for giving artists opportunities….'The lighter you are the easier it feels to innovate'.

The core costs and staff structure for NTW have been kept to a minimum, to retain maximum flexibility and resources for the programme. 50% of the team provide artistic skills and leadership, complemented by freelancers (e.g. production managers). This allows NTW to bring in specialists according to the changing demands of the programme. Equally important is a commitment to creating time and space to develop ideas and to giving artists opportunities to take risks and extend their practice - a central tenet of the artistic vision. NTW is also considering is how it can keep a stake in the work it generates and recoup some of its investment if projects go onto to become financially successful, as a means of developing a financially sustainable model.

The flexible culture of NTW is underpinned by good communications, a strong team ethos and avoidance of 'departmental thinking'. 80% of the staff may be away from the office during production times but communications are maintained through weekly team and management meetings and monthly programming discussions, which the whole team attend. When building the team, the Producer and Artistic Director looked for a combination of skill sets and attitudes that suited this flexible way of working, where necessary searching outside the arts sector in Wales to fill roles. Skype and other forms of technology are used routinely to keep people who are travelling connected with one another. The office is also geared up for hot-desking and used by freelance professionals working with the company: 'It feels more like a rogue film production company than a traditional theatre venue'.

To ensure consistency with core values, NTW have structured activity with corporate sponsors around a CSR agenda, rather than corporate entertaining. One example is a sponsorship arrangement with Admiral/Confused.com group in which Admiral employees' benefit from continuous professional development opportunities via a work-place drama group for staff, facilitated by NTW's Creative Associates.

NTW have also developed a community website, or Ning (a social network). With over two thousand users it has enabled NTW to build its relationships quickly with professionals and audiences. The Ning brings NTW the expertise of the wider theatre community, as well as building its relationships with them as the new national voice of theatre. NTW's philosophy is based on providing opportunities to join in. Alongside performances, a strand of activity known as 'Assembly' offers space for debate and performance. With support from the Paul Hamlyn Foundation, NTW has also developed a group of 'super users' audience ambassadors who are closely involved in the organisation act as advocates for NTW and operate as a focus group, providing feedback to the company on its plans and projects from an audience perspective.

Critical success factors
Technology underpins every aspect of the company's operation: it facilitates programme presentation and distribution, the community website and internal communications which are based around 'cloud storage' to enable remote and flexible working and encourage permeability. All staff have iPhones and laptops and the organisation retains web consultants to look after the Ning and keep NTW informed about relevant new digital, software and technology developments. All staff receive core IT training, including use of social media tools and are expected to contribute to the company's online presence through blogs, video diaries and photos of workshops and rehearsals etc. This provides for a rich and constantly changing site which is attractive to users.

The community website has been incredibly successful in developing NTW's profile and relationships with the theatre community in Wales. It has also been a very useful asset for the company and a means of seeking external advice and input about its plans. In particular the writing, sustainability and casting policies benefited from input via the Ning.

Financial impact
Looking forward, generating growth in box office income to contribute to financial resilience represents a major challenge unless NTW tour widely outside Wales. This has prompted NTW to consider how to exploit assets that it is developing fast as a result of its non-building based model. These include digital skills, start-up skills and the vast network of communications it has created across Wales by exploiting digital technologies.

Through WalesLab, NTW is financing a model of on and off line country wide talent incubation and development with assistance from Esmee Fairbairn Foundation. By so doing it has secured a stake in the widest possible pool of creative artists and ideas for the future. The business model for the next three years is predicated on growth in activity and income to consolidate the start up phase which has been so successful in year one. Investment in development which has taken place to date is forecast to start yielding returns in 2o11/12.

Conclusion
NTW launched its inaugural programme in March 2010 and is therefore in the early stages of assessing its impact on audiences. Critical responses have been excellent and audience numbers have exceeded expectations so far. NTW is developing a professional reputation for its use of technology and engagement methods; other organisations are eager to learn about how they have achieved success through these means and this represents a strong asset for the company.

From NTW's perspective, the absence of a building provides great freedom in how the organisation can function. The Producer describes it as an 'incredibly liberating' way of working. For her, the biggest benefit is that NTW can stay nimble and establish a high level of communication with its stakeholders and communities, who in turn endorse NTW 's commitment to encouraging artistic freedom and undertaking a high degree of experimentation within its programme.

Contact: Lucy Davies, Producer www.nationaltheatrewales.org

Case Study 6: Salisbury International Arts Festival: Investing in Audiences

Organisational Profile
Salisbury International Arts Festival (SIAF) is based in Salisbury, Wiltshire and creates work across the region. The festival is a registered charity and company limited by guarantee with public funding from ACE South West, Wiltshire Council, Salisbury City Council and Hampshire County Council, assistance from trusts and foundations, the private sector and individual donors. SIAF also generates earned income through ticket sales. In 2009/10 its turnover was just over £750,000.

SIAF's mission is to:

Present world-class artistic experiences in Wiltshire and the region that entertain and inspire our communities, transfix and transform them and stay with them for the rest of their lives, and celebrate our unique region with the widest possible audience.

The annual festival programme is multi-disciplinary and extends across Salisbury, Wiltshire and the wider region for 16 days including the Whitsun holiday. The festival achieves 60,000 attendances annually selling about 25,000 via ticketed events with the balance experiencing the festival for free. The programme mix aims to attract families and encourage audiences to try things that are unfamiliar and surprising, by positioning highlights and new works in appealing or unusual locations and interlocking them with a substantial free events programme.

Business model innovation: the challenge
The identity of the festival is already a strong asset. The challenge set by Maria Bota, the current Director of SIAF, is to use her four year tenure to build a role at the heart of the festival for young people in Wiltshire and the region, creating a strong young people's strand which matches the quality and reputation of the programme overall. This strategy aims to address rural isolation and cultural poverty and to use the festival to create an inspirational platform for young people which can offer year round possibilities for engagement with the arts.

Although learning and participatory activity and audience development have closely informed the artistic programme, the ambition to reach across Wiltshire - in particular through taking work further afield - still needs more resources.

In order to meet that challenge of both widening and deepening its impact, the festival has to raise additional funds in a tough climate where recessionary pressure on trusts and foundations and public funders and transition to unitary authority status for Wiltshire add up to a complex environment.

The solution
Over a two year period SIAF has achieved its aim of building audiences amongst young people and extending reach in the region, through changing its programming strategy and investing strategically by using designated reserves.

In 2009 the board allocated designated funds towards the costs of delivering a larger programme of free events. This brought in bigger local audiences as well as visitors from elsewhere and created a very positive attitudinal shift to the festival, recorded through audience feedback that year. In turn this feedback unlocked a grant of £10,000 per year for three years from Salisbury City Council towards the large-scale free opening event.

In preparation for 2010 the festival offered young people a central role in creating content for performance. It has achieved much of this work through building strong partnerships across the region; for example by working with young carers in the county to develop and share their stories and through a large youth music project which aims to develop and showcase singer songwriter skills. Young critics also reported on 2010 festival events in order to provide feedback on and off line which will inform next year's festival planning. They will also form a young programmer and promoter group for 2011 and 2012.

In 2009/10 the team also raised sufficient funding to create a new 0.8 FTE learning and participation role for the period up until September 2011. By adopting a strategy of investing designated funds to assist the development of a year round learning and participation strategy strongly allied to the artistic programme, the festival has attracted substantial new support from trusts and foundations, amounting to £110,000 across the Paul Hamlyn Foundation, Youth Music and the Heritage Lottery Fund.

Board agreement to creating the post as a permanent appointment was secured on the basis of establishing a track record in raising funds for learning and participation and building confidence in the value of investing heavily in this area of work. This experience made the strategic case for continuing to invest in order to attract further funds in future, very clear. The board has guaranteed up to 50% of the Learning and Participation Manager's salary going forward, to ensure continuity while fundraising for the post in the 2011 Autumn period is underway.

Finally, a small amount of designated funding was allocated to secure a specialist consultant to assist with income generation. This consultancy has triggered funds from a trust to invest in medium-term capacity-building in fundraising across the team and board. Coupled with strong business planning and regular forecasting, this investment is really helping to strengthen funding and finance capacity within the organisation, growing the fundraising base to include more high net worth individuals and investing staff and trustee time in meeting and cultivating them - particularly during the festival period.

Critical success factors
By creating designated funds and taking a strategic approach to investing reserves in business development, SIAF have been able to develop a better understanding of their target audience and to introduce new forms of engagement. Involving young people in developing content and auditing audience experience is paying dividends in understanding satisfaction and motivation and building loyalty among a regional audience for the future.

Technology has also played a key role in enabling this success. In 2008, the festival began to sell tickets for its events and now sells 45% of all tickets, saving commission costs. The Festival, the Playhouse and City Hall are currently exploring shared box office software so that they can understand audience patterns on a year round basis. E:marketing has doubled this year.

The festival has been recognised as joint silver with Brighton Festival in the National 'Tourism Event of the Year' at the Enjoy England Excellence Awards. This has raised its profile in the UK and abroad and helped to attract growth in visitor, volunteer and intern numbers.

Financial Impact
The two key changes introduced into the festival business model (developing large scale free outdoor activities and introducing a vibrant learning and participation programme) have both made a vital contribution to the Festival's financial resilience.

The strategic allocation of £30k from reserves in 2009 to underwrite the development of a learning and participation strategy has already attracted substantial funds from new sources. The Festival is now seeking funds to sustain this work into autumn 2011 and beyond. The post is enabling wider partnership and networking across the region, in turn opening doors to future creative collaborations and resources as well as raising profile for the quality of work achieved and positioning the organisation well to meet the priorities set out in Great Art for Everyone.

The investment in a free, large-scale opening event from Salisbury City Council has enabled the Festival to use this valuable platform for cultivation in the medium term, winning many new friends and supporters in the process.

Looking forward, the Festival is investing to grow as it aspires to sustain its existing level of activity and ambition. Accordingly it has committed to two major new music commissions in 2011 and 2012 pump primed from reserves, and seeking further funds for exceptional projects to take place in the region's iconic landscape, for example around Wiltshire's White Horses, Old Sarum and Stonehenge.

On the strength of the successes achieved to date, the Festival has also secured The Telegraph Media Group as a media partner from 2011 and is now working closely with South West Trains. The combined value of this media exposure is worth around £140k. It has also been successful in recent months in unlocking new support from several high net worth individuals in the region, as a result of investing time and resources in capacity building around the cultivation of donors. This activity commenced in March 2010 and is already delivering new investment in the 2011 Festival, helping to offset a drop in national corporate support and local authority funds, as well as supporting the team in refining the fundraising strategy going forward.

Conclusion
Through investing reserves in a clearly defined business development strategy based on building audiences amongst young people, widening the profile of the audience and diversifying income streams, the festival has established positive relationships with funders and sponsors and positioned itself well for future expansion.

The forward strategy for the festival will include a consideration of how to fund commissions for particular sites as part of its stated commitment to extending the reach of the festival across the region. To realise works in the wider landscape will demand more logistical and financial support as well as partner consent - for example from Natural England, English Heritage and Wiltshire Council. However this development looks set to result in new income generating opportunities and the possibility of capitalising on the festival's expertise in large-scale outdoor events production which could in turn attract further investment in future.

Contact: Maria Bota, Festival Director, Salisbury International Arts Festival www.salisburyfestival.co.uk

Case Study 7: Shetland Arts: arts agency as social catalyst

Organisational Profile
Established in 2006, Shetland Arts Development Agency (Shetland Arts) is the lead arts agency in Shetland. Its turnover in 2008/09 was £1,335,418 2009/10 £1,681,208. Shetland Arts delivers a wide spectrum of development activity across a range of art-forms, including the curation and production of hundred of events and exhibitions each year. It also manages two venues, Bonhoga Gallery at Weisdale Mill and the Garrison Theatre in Lerwick, a portfolio of artists studios and is currently preparing for the 2011 opening of Mareel, a major new mixed-arts venue in Lerwick. These activities underpin its overall vision of a Shetland which is creative, confident and connected.

Business model development innovation: the challenge
The central challenge underpinning the development of Shetland Arts' business model in the last four years has been to make the transition to a social enterprise model.

Arts, creative industries and cultural traditions have long been a central element and source of much pride in Shetland life. It was therefore a natural movement for Shetland Arts to articulate its activities and its ambition within the framework of social and economic outcomes rather than exclusively cultural ones.

In order to maintain arts development activity as a core component of this transition culture, it has developed a model within which creativity and innovation can be recognised as key contributors to social outcomes.

A particular inspiration for this was the work done on community asset development by the Joseph Rowntree Foundation, which explores how the cultivation of assets through empowering local ownership can help support communities to thrive. As a consequence, Shetland Arts adopted an Asset Based Community Development (ABCD) approach to targeting its resources.

The solution
Shetland Arts employs the LEAP model in their arts development processes as a means of integrating community asset development principles. The LEAP framework was developed by the Scottish Community Development Centre and is designed to support the process of planned social change. Shetland Arts have customised this model and also aligned it with the Scottish Arts Council's Quality Framework with whom they are a Foundation Organisation.

What this means in practice is that all Shetland residents have the ability to work with the Shetland Arts team of development officers to create and co-design projects –within a shared framework for monitoring success and capturing learning. This vision is eloquently expressed in the Agencies document: A Hansel for Art: Our Plan for a Creative Future.

This deep level of engagement and needs-based focus has resulted in a growing calendar of events and has increased attendances which have been important factors in trebling the size of Shetland Arts in the last three years:

> *We've been working in this way for the last three years and in a climate where value for money is so important it has been a really good way of focusing resources. Not only does it result in some amazing creative activity, because by definition the community has been involved in the production at least some if not all of the way and there's a common understanding of what to track...it means that you build strong relationships and also... you're not all over the place! For an organisation with limited capacity but no limit to ambition, that's really efficient.*
>
> Gwilym Gibbons, Director

Shetland Arts' business activity includes project management of Mareel, a venue currently under construction situated in a prominent quayside area in Lerwick next to the new Shetland Museum and Archives.

Mareel will be the UK's most northerly music, cinema and creative industries centre and is due to open in early 2011. It will provide a year round programme of films, live music and other performance events, and a programme of formal and informal education, training and learning activities designed to appeal to the whole community. Mareel will also act as a hub and a focus for the creative communities in Shetland and beyond as well as a catalyst for the emerging creative industry sector in Shetland.

Once complete, it will provide the largest venue in Shetland Arts' management portfolio. The agency's increasingly community-focused and entrepreneurial ambitions will be expressed through this new space. Mareel will be defined by demand-led programming and the introduction of new services such as creative workspaces, broadcasting and distribution - plans for which are currently in development with content and production specialists.

Critical Success Factors
Shetland Arts recognises that the evolution from a traditional arts agency to a community-based social enterprise is an ongoing journey. This recognition is matched by a keenly entrepreneurial senior management team who are constantly looking for new opportunities to achieve the social mission of the organisation.

The organisation's deepening community focus on engagement and its appetite for new ways of working has been supported the board's well developed understanding of the value of placing arts and cultural activity within the widest possible social and economic context.

A good example of this is the board's recent decision to agree to a commercial loan as the means by which it can secure the mill property adjacent to the Bonhogo Gallery. This site offers the option to develop a small hydro-electric power generator for which there is a clear need, as Shetland has some of the highest petrol prices in the UK. Justifying this type of risk and project focus might have been challenging in the past, but with the shift to a very clear socially-motivated position for the organisation, the project was recognised as being wholly mission-aligned.

By identifying itself as a social enterprise Shetland Arts has been able to obtain access to new types of thinking, new partners and funding sources other than those that had previously been available. This is exemplified by a cultural shift in the board's attitude to the risk entailed in taking on loan finance for the Bonhoga site development outlined above as one which is acceptable. Shetland Arts has also recently partnered with Mission Models Money to commission a feasibility study for a micro-finance initiative in Scotland.

Financial Impact
In recent years core funders have sought more detailed non-arts based social returns for their investment. A key objective for Shetland Arts is to secure resilience through income diversification and reduce exposure to over dependence on particular income sources, in a manner which makes sense of the core mission.

Strategies include exploiting intellectual property (IP) and maximising earned income from ancillary activities such as trout farming, micro hydro electric generation and studio rentals.

The aspiration is to reduce core grant level from 60% to 30% of turnover within three years. This strategy will be largely delivered through the development of Mareel.

Mareel has no public subsidy to underpin operating costs and so income streams generated from this venture will assist in meeting the target to reduce the proportion of grant dependent turnover in the mix. Looking forward, Shetland Arts is expecting to see additional revenue generation from Mareel coming on stream in the second quarter of 2012/13.

While Shetland Arts has no specific reserves it is seeking to build an endowment from current and future activity. The model for this is to levy a contribution on all creative activity that it supports and to establish a Community Interest Company specifically to trade and exploit IP assets generated by this means. For example, Shetland Arts anticipates that Mareel will generate a large amount of digital content for broadcast and this content will provide the foundation for developing the IP Endowment.

Conclusions

The strategic reframing of Shetland Arts as a social enterprise rather than an arts organisation has resulted in a number of different benefits. The community-focused arts development process has allowed for efficient use of resources while at the same time growing community engagement, overall attendances and therefore turnover. Shetland Arts recognises however that it can benefit from developing an even deeper understanding of Shetland residents' needs and motivations and so it plans to carry out further analysis and produce some case studies to develop audience/market intelligence.

Critical to the successful incorporation of social enterprise thinking into Shetland Arts model, has been its relationship with other Scotland-based social enterprises. These have been developed through both formal networks: Director Gwilym Gibbons was part of a Highlands & Islands Enterprise-hosted rural social enterprise delegation to Australia in 2009 - and informal methods: for example, knowledge sharing with other leading Scottish arts-based social enterprises including Impact Arts and WASPS Artists Studios.

Contact: Gwilym Gibbons, Director

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Annex 4 Individuals participating in the project

Task Force members:

Fiona Ellis *(chair) is an Independent Consultant and also chaired the NCVO Funding Commission.*

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Gwilym Gibbons, *Shetland Arts*
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Faith Lidell, *Festivals Edinbugh*
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Francis Runacre, *Arts Council England*
Virginia Tandy, *Manchester City Council*
Regis Cochefert, *Paul Hamlyn Foundation*
Kirsty Duncan, *Perth and Kincross Council*
Ann Borthwick, *Gateshead Council*
Jo Woolley, *MLA*

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Caroline Garkisch, *Social Investment Business*

Additional discussion forum members:

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Ed Whiting, *MMM Associate*

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