

Mission, money and models

New approaches to sustaining the arts in the United Kingdom

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Background note

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Scope and definitions

The ambitions for this conference are that it should provide an occasion to consider:

- Whether there are new and useful things that the arts community can learn from its own varied practices in determining how best to balance the conflicting demands of mission and money;
- Whether there are alternatives or adaptations that might better serve both the arts and the public purse; and
- Whether the broad approach to the funding of cultural organisations in the United Kingdom may need a degree of adaptation if it is to continue serve its core purpose of promoting a vibrant cultural community.

This background note is designed to act as a prompt to possible lines of inquiry.

First, some brief and possibly contested definitions:

- *Mission* The ultimate non-negotiable purpose of an organisation, ideally described with sufficient precision as to enable that description to be used to sift through the multiple possibilities that are open to the organisation and to distinguish between those options that will further that core purpose and those that will fail to contribute to – or even impede – its furtherance;
- *Money* Shorthand for financial resources of any character, from the more fungible (unrestricted cash reserves) to the highly illiquid (donor designated endowments, for example, where the principal cannot be spent and the income only used for specific prescribed purposes).
- *The broad approach to funding* The broad approach referred to here is that of a mixed economy, in which core funding from the public sector, based on annual or, better, multi-year grants, is supplemented by:
 - a patchwork of further grants and awards from discretionary programmes run by central and local authorities and other public funding bodies;
 - by earned income, primarily from ‘the gate’ (ticket sales and admission fees) and secondarily from catering, retail, venue hire, franchising and related activities; and
 - By corporate sponsorship and tax-incentivised philanthropic giving, primarily from trusts, foundations and individuals.

Over time, the broad approach has also been to shift the balance between ‘core’ and ‘programme’ funding in favour of programme funding; corporate and philanthropic giving has meanwhile edged up as a percentage of the total; and an

increasingly favourable tax regime may edge it up further still. Meanwhile, *net* earned income remains fairly constant, despite a general exhortation to the sector to be more entrepreneurial; and the abolition of museum entrance charges set any discernable trend back yet further.

- *Cultural organisations* Non-profit organisations that exist either as statutory bodies or companies limited by guarantee whose primary purpose is the creation or presentation of visual or performing arts, and that are distinguished from for-profit enterprises not just by their legal status or their inherent un-profitability but by their mission. The entertainment industry for example may use overlapping skills and resources but it is dedicated to maximising – and to survive needs at least to secure – a positive rate of return on capital employed.
- *Vibrant cultural community* An environment in which a given population is able to enjoy a wide range of cultural experiences, from community-based or amateur involvement through to the highest expressions of creativity and expression across the entire range of arts forms; and in which those arts organisations providing these experiences are sufficiently well funded and well run to attract and retain both artistic and administrative staff of the calibre required both to present and produce.

The funding context

If this note dwells on the funding model it is because form follows funding, and the ecology of funding has a profound impact on the ecology of the arts. Britain's 'broad funding model' has remarkable and enduring strengths and those strengths underpin the vitality of much of the post-war British arts scene. For all the annually rehearsed cavils

about its shortcomings, Britain has neither looked East nor West with much by way of sustained envy.

To the East, levels of state funding have been higher – unsustainably higher, it would appear today – but the levels of government involvement in funding decisions and the absence of an arms-length *cordon sanitaire* have somehow left the creative impulse generally weaker or thriving in opposition to rather than in response to its funders. To the West, private patronage has meant cultivating and, yes, pandering to the tastes of the rich – generally more conservative, less innovative tastes – and a greater exposure to the volatility of the market.

Indeed, Britain's funding model is, if not the best of all possible worlds, certainly one that should be treated with a basic respect for the pragmatic balance it strikes between the state and the market, neither of which are *per se* particularly swayed by artistic excellence or ambitions to extend access to cultural experiences beyond their traditional constituencies.

Nor is the model monolithic. Notwithstanding the highly centralised nature of the United Kingdom's political economy – tempered partially by devolution in Scotland, Wales and Northern Ireland – there is a wide variation in the ways in which cultural organisations of different scales and types have accommodated themselves to its basic contours. The case studies produced for this conference illustrate ways in which underlying financial realities are ingeniously aligned and harnessed in support of mission-related programming. Many more examples could have served as well – organisations that are artistically outstanding, serve their diverse communities with imagination and verve, and are, at the end of the day, financially solvent.

So what's the problem...? *Broadly, that although levels and breadth of activity in the arts have grown incrementally, and the sources of funding grown and diversified, the scale of activity seems destined always to outstrip the funding that can sustain it, and the quantum of activity seems continuously fated to fall behind the quantum of funding that is required for the arts to thrive rather than simply survive at any given level.*

The hypothesis is that the arts sector in the United Kingdom is over-extended and undercapitalised, with cultural organisations trying to do more things than they can possibly do well, with both human and financial resources too thinly spread. Additional resources secured by the sector are generally more likely to result in further under-funded expansion – whether of programmes or buildings – than in doing core things better. Lacking liquidity or reserves, cash strapped and thinly spread between ever more diverse, fragmented pools of funding, arts organisations find it easier to secure the marginal costs of marginal activities than the core costs of core activities. The result is a hyperactive sector that responds with Pavlovian urgency and enormous ingenuity to the imperatives of funders but that has a decreasing capacity to hear, or at any rate listen to, the voice of mission.

Underlying causes

The underlying causes lie not in the funding system *per se* but in the interaction between the incentives provided by system and the inescapably dismal economics of the arts. We know these economics well and viscerally but it's important to remind ourselves occasionally, particularly when expression such as 'investment in the arts' can lead casual observers to think that the positive rate of return on that investment may be financial rather than social or cultural.

There are all sorts of potential goods and services for which the market does not generate enough demand at a sufficiently high price to stimulate supply, given the marginal cost of supplying. Much of what we think of as the business of nonprofits fits

this category - from human rights lobbying through to symphonic music, animal rights welfare to overseas aid initiatives. Left to the market, the costs of supply are either too high or the level of effective demand too low for these activities to be priced in a way that is accessible to more than a very select band of consumers - if at all.

Furthermore, in some sectors, the economics continue to deteriorate inexorably. The arts are a good example. On the supply side, for the reasons analysed and articulated by the economists William Baumol and William Bowen nearly forty years ago, the impracticability of substituting capital for labor in many of the performing arts means that costs continue to rise inexorably in relation to other forms of economic activity.

Demand is meanwhile being blunted by the changing patterns of and pressures on leisure time, and by the explosion of competing demands upon that time from commercial media. (Furthermore the demographic groups that have formed the traditional core audiences for cultural events are exactly those for whose discretionary expenditure competition is most fierce and whose leisure time most under assault from both the pressures of work and other leisure demands.)

Income generated by core, mission-related activities can and does offset costs, where there are socially and politically acceptable opportunities to charge. But minimising losses is not the same as maximising surpluses. Even with the most ingenious and entrepreneurial approaches to revenue maximisation, earned income is significantly and systemically less than expenditure for most organisations concerned with artistic endeavour, even without factoring in the adverse impact on the bottom line of any social agenda an organisation may have for encouraging wider access to its activities.

Many nonprofit cultural organisations therefore increasingly scan the horizon – and are encouraged to scan the horizon – for opportunities to increase income through business streams that are not directly mission-related - for example through licensing agreements, or the commercial exploitation of the cachet a particular organisation enjoys, or through

tangential opportunities presented by owning or acquiring and subsequently selling or renting property that is in excess of operational needs.

But the exploitation of these opportunities, where they exist, requires specialised management skills, access to venture capital, and an ability to act in an entrepreneurial way that often sit uncomfortably with the structures, resources and skills-base of nonprofit cultural organisations. Strategic alliances with appropriate for-profit organisations or the establishment of for-profit subsidiaries can make it easier to exploit commercial opportunities. But the opportunities themselves need to be there in the first place and as a sector we are generally weak at the cold-blooded identification of these opportunities and the realistic assessment of investment required to exploit them.

So the inevitable structural difference between earned income and the total expenditure is made up through one or more of four routes.

- Government is occasionally mandated (or at any rate considers itself to be mandated) to ‘supply’ directly - as is the case with, for example, national museums. This is a pattern of provision in historic decline for wider reasons related to the historic ascendancy of market-based economies;
- Government provides direct financial aid in the form of grants. These are usually awarded to ‘suppliers’ to stimulate supply - still the dominant method of nonprofit funding in Europe and a less significant but nevertheless important funding source in the United States. More rarely, they are made to consumers, to stimulate demand amongst particular social groups – e.g. as in voucher systems;
- Government can and does give suppliers fiscal privileges so that the differences between income and expenditure are reduced; and,

- Individuals and foundations can be persuaded to contribute on a voluntary, philanthropic basis to the costs of an organisation or a specific programme, whether by moral reasoning or by tax breaks or some mix of the two.

For any given arts organisation the balance of support between these four sources of market intervention is determined, on the one hand, by the fiscal regime in which it operates and, on the other, by the extent and depth of perception of social worth - or vicarious social prestige - that an individual organisation can trigger in potential philanthropic contributors.

The skill with which the organisation can persuade potential funders, public or private, that it is doing something worthwhile, whether socially or artistically or both, and that it is doing it well is, axiomatically, at the heart of all successful strategies for closing the gap between earned income and expenditure, although the skill with which it *actually* does it will not necessarily affect its capacity to generate earned income, alas.

This thumbnail sketch of the economics of nonprofit cultural organisations is pretty well understood by the funders and the funded alike. But some of its ramifications are less well understood. Perhaps the most important is the impact of growth on the capital base of an organisation.

The effects

The main implication of the dismal economics of the arts is that there is an inescapable tension in the short term between pursuit of mission (and the programs that support an organisation's mission) and maintaining financial viability. All dynamic, mission-driven nonprofits live in the force field created by the tension between money and mission. The force field grows more powerful the greater the urge to expand activity. And given that there is usually a large gap between an organisation's mission and the part of that mission met by current programs, the urge to grow is usually very powerful. (That urge to grow is exacerbated of course by funding opportunities, most notoriously but by no

means exclusively, those provided by the National Lottery, that incentivise organisations to address particular areas of programmatic activity by meeting an element of the cost but not the total cost of that activity. But it exists in any case without the incentives of ‘coercive philanthropy’ in Robert Burstein’s resonant phrase.)

However that itch to grow usually cannot be funded by retained surpluses - simply because there generally aren't any! Growth therefore needs to be funded externally but the systems of capital allocation available to the for-profit sector are not available to nonprofit sector. Debt-funded growth requires repayment of both interest and eventually principal and therefore assumes either that the investment will generate a positive rate of return or, more usually and more naively, that it will attract philanthropic funding to meet these repayment costs. Equity investment, per se, is not an option for nonprofits, although they may have opportunities either to create for-profit subsidiaries or strategic alliances with for-profit organisations that provide vehicles for investors. But equity investment, too, is premised on a positive rate of return on capital employed.

The primary source of funding for growth is therefore either contributed income or occasionally income from reserves and endowments that have themselves been created through contributed income. However, unless nonprofit organisations can articulate - and funders embrace - the idea that growth requires investment, and that the full rather than marginal costs of growth need to be covered by these sources of contributed income, the impact of growth is generally to stretch organisational and financial capacity more and more thinly, leading to systemic under-funding of such areas as facilities maintenance, funded depreciation, working capital, staff development, competitive salaries, or training - all of which are required to support programs and ultimately, therefore, mission.

Our systemic optimism

The reasons we tend to turn a blind eye to this simple logic run very deep. One is that, as a whole, nonprofit cultural organisations heavily rely on the skills, energies, and enthusiasms of their executive and non-executive leadership. This reliance on leaders is often formidable - so formidable that it generates a belief that sheer energy, will power, stamina, and enthusiasm can overcome all obstacles, and that where it does not, failure is rooted in some sort of personal failing in the leadership. The idea that an inappropriate capital structure can somehow subvert an organisation's ability to meet its objectives can seem overly deterministic, fatalistic even.

Another reason is that, as a whole, the sector has tended to focus on organisational capacity building rather than financial capacity building. The sector needs both. No amount of attention to, say, strategic marketing, is going to make things come right if your organisation is so fundamentally short of working capital that you cannot lift your head above the problems of next week's payroll. Indeed, inadequate working capital is probably more corrosive to organisational effectiveness in the nonprofit sector than any other single factor. It means that the short term crowds out the longer term and that cash flow considerations dominate planning, with creditor management absorbing the time, money, and emotional reserves that are needed for longer-term planning.

The ability to take informed risks is essential to the realisation of the mission of most nonprofit arts organisations. Indeed, one could argue that protection of the ability to take risks is a neglected factor that ought to be more central to both mission and strategy of all arts organisations. Many organisations flock to take on policy and financial obligations that run flatly counter to this with the result that either conservative programming dominates (what is less risky and most likely to generate cash) or each risk involves the concomitant financial risk of "betting the house" on a successful outcome, conducive to graying hairs and ulcers for all involved.

Raising contributed income *in parallel with* programme growth and sufficient to fund the full difference between income and expenditure is extremely tough. The easier costs to cover are direct programme costs - more visible, more attractive, more obviously mission-related. Fixed costs tend to get drafted around, talked down, and deferred, not least because organisations wishing to present themselves to potential funders as efficient want to maximise, at least on paper, the ratio of direct to indirect costs.

It takes determined leadership - with a long-term view of the organisation, with a good knowledge of an organisation's cost base, and with a commitment to institutional stability - to ensure that growth in programs does not, over time, sap an organisation's capacity to fulfill its mission. Without the knowledge, the will to act on that knowledge, and a sophisticated or receptive funding community, a nonprofit organisation will 'hollow out' as its programming grows, the balance sheet will weaken, and short-term cash-flow issues will come to dominate long-term vision. The fear is that too many arts organisations in the UK are, indeed, hollowed out by their programmatic and physical expansions of the past five to ten years with an attendant impact on programs and capacities and therefore ultimately on mission.

For this reason, cultural organisations are something of a disappointment for the well-intentioned, competent, highly motivated people they recruit. The impetus to programmatic growth - spurred both by the ever present gap between programme and mission and by sheer entrepreneurial drive - tends to leave institutions increasingly hard-pressed, under-managed, under-staffed, "de-skilled," ill housed, foreshortened in their horizons, and generally ground down.

In order to expand programming effectively, cultural organisations therefore have to expand their financial capacity - not willy-nilly, but in specific ways that support their programming ambitions. Any given expansion in activity can be funded in a variety of ways (through different combinations of contributed and earned income and debt), and these will make different demands on an organisation's capital structure (on working

capital, for example, or on the organisation's reserves, lines of credit, or longer-term debt instruments). Rarely does "spontaneous" unplanned growth have a positive impact on an organisation's capital structure. Planned growth in programming requires planned growth in financial resources.

Some remedies

What can one realistically do in the face of the adverse odds that the economics of the arts generate? I would suggest the following:

- Cultural organisations and their funders need to look more carefully than currently at the impact on their balance sheets as well as on their cash flow when considering physical or programme expansion. To do this they need analytical tools and cost information that are too rarely to hand currently;
- Specifically, cultural organisations need to analyse and articulate the full cost rather than the marginal cost of physical and programme growth and to generate cost information in a format that allows this to be done and communicated effectively to the outside world, educating themselves and their constituencies about their underlying business models. Funders need to encourage them more vigorously than is currently the case to do that;
- Organisations and their funders need to think about and articulate the requirements for institutional growth in parallel with programme growth, so that 'overhead' is not regarded as some disgraceful rump to be massaged out of sight. Investment in people, in systems and in capacity is the necessary corollary of investment in programs and buildings;
- Organisations need to include goals for capital structure and investment as part of their strategic planning process. Funders need to look for them;

What is true of individual cultural organisations is collectively true of the sector as a whole. As the nonprofit cultural sector itself expands, and in the absence of retained profits (or, more properly, surpluses) to fund that growth, the sector needs to increase contributed income, or to develop new sources of ancillary earned income, and/or to secure more fiscal concessions. The alternative to growing total income *proportionately* is systemic and progressive financial weakening of the sector over the longer term as growth in resources fails to keep pace with the aggregate need for them across the expanding sector.

Nonprofit leaders can and should resist the temptation to try to trump capital with willpower. But a significant responsibility also lies with the funding bodies that have a long-term commitment to the sector and its long term health – whether that means DCMS, Arts Councils, local authorities or trusts and foundations. Long term funders are probably best positioned to ensure that programmatic growth, where it is implicitly (and often explicitly) encouraged by the funding ecology, is also *adequately* funded; that the corrosive temptation to fund only the marginal costs of programming is resisted; and that those funders engaged by specific programs but with a less profound commitment to the sector are encouraged to understand that programs by themselves do not a sector make. What might appear to be efficient funding in the short term should not be allowed to weaken the sector in the long term.

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This programme of work is the initiative of Arts & Business and the Jerwood Charity. AEA Consulting, as thought leaders in this area, has been commissioned to work with A&B and the Jerwood Charity on developing background and content for the event.

