How to be a finance master

Charity finance professionals too often forget the interconnectivity of expenditure, income, reserves and surplus, says Mark Salway.

I LECTURE charity students at the business school and I always like to start with a story of work that is close to my heart. It grounds me and lets people understand what my motivation is for working in charities. This is typically something from my work in international development that has lead to profound change for poor people.

One example is village savings and loan schemes. Typically these comprise groups of around 15 people committing regular savings and using these to make small loans to each other. In Ethiopia, for example, 50 Birr is not enough to start a business but 1000 Birr is. By saving 50 Birr each per week, this establishes a fund from which a small loan can be taken.

Each loan and new business helps the individuals, and binds other villagers, to set up small businesses as banana growers or pancake makers, for example. They then sell their produce in the local markets.

The charity I worked with established the group and showed villagers how to budget and manage the funds effectively. We also provided some guidance as to what could be the best business proposition to start.

The four bowls system

The women come together and count the savings into one of four plastic bowls, and everything is recorded religiously by the clerk of the group in a book. The treasurer then counts the money into a box, and hands money out as loans into a second bowl. There is a further bowl for counting out what is in the box in total, and then there is another where money can be given out to less fortunate people in the local community to buy medicine or food.

The village saving and loan schemes relies on four bowls:

- Money in;
- Money out;
- Reserves (as the sum total of funds available);
- Surplus (profits available for distribution in the way the group sees fit).

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The group will only last for six to twelve months, because otherwise inflation becomes a serious issue. It also involves developing people's skills and business acumen.

I tell this story because I recently read *Just my type – An archetype of Charity Finance* by nfpSynergy (see the March 2017 issue of *Charity Finance* for a summary). The report says there are six types of charity and breaks down how we handle our finances. Though there are significant differences, each relies on money in, money out, reserves and managing any surplus or deficit.

Money in is the income we generate as grants, contracts, donations or investments. It also relies on how much money we spend on generating these funds. Money out is the funds spent on our cause, fundraising and for infrastructure and quality mechanisms to support this. Reserves are the total funds available, either restricted, unrestricted, designated or endowment. Finally, surplus is how we use profits to either reinvest or generate change for those we serve.

It is a simple equation, almost like tai chi with numbers. What you change in one area must affect one of the other areas. It is this simple balance mechanism that I think we as finance professionals often forget.

Lessons to be learnt

If we hold expenditure steady, for example, and bring in less income, then either we must use reserves or we will have less to distribute as surplus – it's that simple.

What I often see is budgets where everything is held the same year on year and just increased by inflation or 2-3 per cent. This completely ignores the fact that each number is linked and interrelated. We need to have thoughtful budget discussions which consider how income and expenditure work together with reserves. This relies on the people who manage fundraising, operations and marketing working with finance to understand these dynamics and guide the discussions.

A zen master can understand how energy ebbs and flows. Equally, a finance master must understand how moving one part of the equation will change others. The master needs to be able to clearly explain this to others and build their capacity to understand and engage. ■

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