# To what extent does the experience of the Arts Impact Fund support its objective of improving the financial resilience of arts & culture organisations?

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## 1. Executive Summary

The Arts Impact Fund ("AIF") is a social investment fund established by Nesta Arts & Culture Finance in 2015 as a response to the need for alternative financing models in the UK arts sector. It is a pilot initiative to test whether affordable and flexible repayable finance can support arts & culture organisations in England to develop meaningful social impact through improved financial resilience. The fund remains live, but an interim analysis of its contribution to any improvement in the financial resilience of its investees is apposite as organisations emerge from the Covid-19 pandemic, stakeholders seek an evaluation of the fund and the Nesta Arts & Culture Finance team look to develop additional funding initiatives.

The literature surrounding financial resilience is considered in the context of both non profit organisations more broadly and the arts & culture sector more specifically. Key themes which have shaped the research's theoretical framework include the importance of qualitative as well as quantitative research, the acknowledgement that resilience is an abstract concept with no 'rule book' and the significance for mission driven organisations of not just surviving but staying true to purpose.

The study uses nine financial metrics obtained from each portfolio organisation's financial records to operationalise financial resilience, namely gross income, earned income, percentage of earned income, number of income sources, surplus/deficit, fixed assets, net current assets, net assets and cash reserves. The hypothesis that a loan from the AIF improves the financial resilience of its borrowers is tested by comparing the average of these financial metrics for portfolio organisations before and after receipt of the loan, testing them for statistical significance using paired samples *t* tests. A regression analysis controls for receipt of Cultural Recovery Fund grants (a proxy for the Covid-19 pandemic) as well as property related deals and new venture related deals. The results of the experiment are triangulated with the results of the qualitative research, namely interviews with management teams.

The model has significant limitations which present a challenge to both validity and reliability. The small sample size limits confidence in the test results, the quality of financial information was not always robust and the post loan period for organisations receiving funds in the later stages of the fund's deployment period is not only short but severely impacted by the Covid-19 pandemic. Whilst the study seeks to control for some other key variables, there are clearly many factors influencing financial resilience and it is not possible to identify these without a more in depth analysis of each organisation.

Taking into account these limitations, the results provide some support to the hypothesis. On average, the financial resilience of the portfolio experienced an improvement in the post loan period as compared with the pre loan period, as indicated by a statistically significant difference between the means of the pre and post loan gross income, fixed assets and net assets at a 95% confidence level. The extent to which any improvement in financial resilience can be attributed to the AIF loan is dependent upon the qualitative research, which is supportive of a theoretically strong correlation, although this relationship is not supported by the quantitative data.

Overall, the research supports the notion of financial resilience as an abstract concept, dependent upon context and indeed perception, rather than an absolute and measurable state of achievement. This endorses a mixed methods approach with a broad range of indicators. It also highlights the importance of judging financial resilience against delivery of social impact. It is recommended that an analysis of the correlation between impact delivery and financial resilience is undertaken, as well as case study level analysis of individual organisations to help determine additional variables influencing financial resilience.

Through its contribution to the debate surrounding the definition, measurement and achievement of financial resilience in arts & culture organisations, this research seeks to generate additional interest in the sector from social investors. The experience of AIF to date suggests that funding which aligns with an organisation's mission and capacity can help to support financial resilience, enabling arts & culture organisations to have a wider positive impact upon society.

## 2. Personal preface

This research was motivated by my desire to contribute to the growth of social investment in the arts & culture sector. It represents the opportunity to combine my experience as an investment manager with my passion for arts & culture and my learnings from the Master in Cultural Leadership.

The Master in Cultural Leadership has provided me with the requisite ambition, knowledge and qualification to become an Investment Manager in the Nesta Arts & Culture Finance team. It is a privilege to have secured a position which enables me to contribute to the development of funding models for a sector for which the traditional investment risk/reward framework is too narrow. It is hoped that this contribution will represent cultural leadership by advancing the discussion around appropriate funding models for the sector, supporting excellence among organisations from not just a commercial but social and artistic perspective.

I intend to continue the study beyond the formal degree period, following and adapting the research model to develop a stronger and therefore increasingly more powerful body of evidence.

## 3. Introduction

The Arts Impact Fund ("AIF") was launched in 2015 as a pilot initiative to test whether social investment, namely finance to achieve a social as well as a financial return, could be an appropriate tool for supporting arts and culture organisations in England. It was the first social investment fund specifically for the arts & culture sector.[1]

The fund was created with the hypothesis that access to dedicated, flexible and affordable repayable finance could empower the sector to achieve its social and artistic aspirations through building financial resilience. Although the fund has been fully deployed, the majority of loans remain outstanding and the fund's life has been extended to accommodate the shock to the sector from the Covid-19 pandemic. Whilst it is too soon to conclude whether the pilot has been successful in improving the financial resilience of its investees, an analysis of the extent to which this key objective is progressing is very timely as stakeholders seek a project evaluation and the Arts & Culture Finance team develop additional sector specific finance initiatives. The purpose of this research report is to perform an interim evaluation of the extent to which AIF is delivering on its objective to improve the financial resilience of its investees.

### *i. Background to the Arts Impact Fund*

AIF was established as a response to Nesta's publication *The New Art of Finance* which identified the need for innovative ways of funding the arts as a response to the cuts to public grant funding which have presented a substantial funding deficit in the sector.[2] The need for alternative financing models falling between purely subsidised arts and the commercial creative industries has been widely identified by sector bodies such as Arts Council England.[3] Despite the strong growth in social investment over the preceding decade, the arts & culture sector has been a laggard and it was perceived by the fund's investors that the sector had been particularly poor at articulating its social impact.[4] The ambition for AIF was therefore that:

> The fund will demonstrate to the wider arts sector and other investors the ability of arts organisations to take on repayable finance and encourage others to see social investment as another

[1] Nesta Arts & Culture Finance, "Arts Impact Fund", *Arts & Culture Finance,* https://www.artsculturefinance.org/our-funds/arts-impact-fund/ (accessed 5th December 2021).

[2] Nesta, *The New Art of Finance: Making Money Work Harder for the Arts* (Nesta, 2014).

[3] ComRes, *Arts Council England: Sector Dialogue on Funding 2018 and beyond* (ComRes, 2016).

[4] Laura Callanan, *Impact Investing In the Creative Economy Today* (Culture, Creativity, Culture & Capital, 2021).

source of funding to assist in achieving sustainability. By evidencing the investment potential within the Arts, the fund will attract more social investors to benefit the sector as a whole.[5]

As an innovation foundation with a history of supporting the arts, Nesta was ideally placed to convene, shape and manage the fund and the team responsible for the launch had expertise from both the traditional and social investment sectors.[6] They brought together public, private and philanthropic partners. AIF's investors are Bank of America, Arts Council England, Esmée Fairbairn Foundation and Nesta who together provided £7m of capital, alongside the Calouste Gulbenkian Foundation who provided a grant to cover operating costs. These stakeholders were motivated by demonstrating the potential for arts organisations to receive loan finance rather than traditional grant funding, generating a return of capital which could then be redeployed. The involvement of Arts Council England is particularly significant as it is the national development agency for creativity and culture which will invest £1.45bn of public funds and £860m from National Lottery funds between 2018 and 2022.[7]

The Arts Impact Fund's objectives were to:

- Support the development of investment-readiness in the arts and cultural sector by working with organisations seeking repayable finance and supporting them through the investment process and due diligence.
- Encourage the development of enterprising and financially resilient operating models.
- Support the financial resilience of arts and cultural organisations by providing them with affordable finance flexible to their needs.
- Help arts and cultural organisations improve their understanding of social impact and their ability to measure and articulate their impact to internal and external stakeholders.
- Promote the wider positive impact art and culture have on society and support more organisations to benefit individuals and communities through their work.[8]

[5] Arts Impact Fund Intercreditor Deed, Appendix, 2, 28th July 2015. (Confidential and unpublished internal document).

[6] Biographies for Francesca Sanderson (Director, Arts & Culture Investments and Programmes) and Seva Phillips (Head of Arts & Culture Finance) can be found at https://www.artsculturefinance.org/about/.

[7] Arts Council England, "About Us", *Arts Council England*, https://www.artscouncil.org.uk/about-us-0 (accessed 5th December 2021).

[8] Nesta Arts & Culture Finance, "Arts Impact Fund".

Financial resilience is very much at the heart of the fund's aspiration for its investees, enabling organisations to become more financially sustainable, thereby improving their ability to meet their social impact objectives.

### ii. ***AIF Investment criteria***

AIF offered unsecured loans of between £150k and £600k, with initial repayment terms between three and five years and interest rates from 3.5% to 8.5%. The majority of loans were fully amortising, repayable monthly, with capital repayment holidays possible. The team took a bespoke approach to structuring loans within these parameters to enable the finance provided to be as flexible and affordable as possible. Funds were intended to support a wide range of requirements, from bridging cash flow to developing new income streams and acquiring/repurposing buildings or other assets.

Eligibility criteria were relatively broad, with the fund basing its definition of the 'Arts' on Art Council England's definition.[9] Organisations needed to be registered and operating in England with a clear social mission reflected in their structure, including an asset lock and restriction of personal gain (companies limited by shares would be considered on a case by case base). In terms of mission, organisations were asked to demonstrate their impact upon Citizenship and Community, Health and Wellbeing and/or Youth and Educational Attainment outcomes.

### ***iii. AIF portfolio***

The fund was launched in June 2015 and the final loan was drawn down in January 2020. Loans totalling £7,141,202 were drawn down to 25 organisations during this deployment period (recycling capital enabled overcommitment).[10] As at 28th February 2022, total capital repaid was £3,344,753 and interest received totalled £793,642. Outstanding capital was £3,543,903 less write offs. £226,088 had been written off, with an estimate of total write-offs at £758,697, representing 13.8% of the fund.[11] This is in line with original expectations from a financial return perspective, albeit over a longer timeframe as the fund's life was extended from 2022 to 2025. There is scope for the fund to outperform its original financial return expectations, with lower than expected write-offs, which is extremely encouraging given the impact of the pandemic.

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[9] "Organisation works primarily in the Arts" defined as: Theatre, dance, literature, music, combined arts and visual arts or Culture, defined as: museums, art galleries, theatres and non-venue based / seasonal including festivals, and touring programmes. Digital and creative media. As per Arts Impact Fund Intercreditor Deed, 28th July 2015.

[10] Data from internal Nesta database. The fund committed more than the £7m of investor capital as some loans were not fully drawn down and capital was recycled from loans which were repaid early. Effervescent received two loans (one being a Revenue Participation Arrangement), but these are treated as one loan for the purposes of the research.

[11] Ibid.

The 25 organisations which received loans from AIF are listed in Appendix 1. In terms of portfolio characteristics, of particular note is the concentration of property related deals (64% of loans by number). Although the fund was designed to support a wide range of use cases, by far the highest use case was acquiring or developing a property, which can be directly linked with an objective to develop financial resilience through providing longevity and stability. In addition, around half of the loans (48% by number) were related to new venture models, meaning that the loan was intended to support the organisation with the development of a new activity or revenue stream. This is also noteworthy as an indicator of financial resilience aspirations, indicating attempts to diversify revenue streams and possibly increase earned income. The performance of these two subgroups relative to the overall portfolio is therefore particularly apposite to a study of financial resilience and should help to inform the development of future funding products.

The Covid-19 pandemic had a material impact upon arts & culture organisations as activities were suspended and venues closed for many months. It was deemed by a recent Parliamentary report to represent, "the biggest threat to the UK's cultural infrastructure, institutions and workforce in a generation."[12] AIF supported its investees by offering the cancellation of interest payments to borrowers severely affected by the pandemic as well as capital repayment holidays from spring to December 2020, with additional support on a case by case basis thereafter. Many organisations are still contending with the ongoing implications of the pandemic, in particular audience reticence to return to venues. It is important for the research to recognise the significance of this external shock to the sector and how it may have impacted the financial resilience of portfolio organisations.

Although the fund had an original lifespan of seven years, this was extended following the pandemic, with the last investor now due to be repaid in June 2025. In addition to the pandemic related extensions, the fund's initial deployment took longer than initially anticipated, reflecting the need to build up awareness of the investment offering amongst eligible organisations and a longer than anticipated loan completion and draw down process. The impact of the extended deployment period and the pandemic related extensions mean that the portfolio is still relatively young. Of the 25 organisations which received investment, 5 have fully repaid and 2 have been written off, leaving a live portfolio of 18 organisations.

### ***iv. Fund evaluation***

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[12] House of Commons Digital, Culture, Media and Sport Committee, *Impact of Covid-19 on DCMS sectors: First Report,* HC291 (London, 2020).

As a pilot fund, evaluation and learning were at the core of the fund's genesis for all stakeholders. A Theory of Change was drawn up to enable the measurement of success at an investee level and the fund's intercreditor deed provided for the agreement of the most appropriate metrics as the investment period progressed. This Theory of Change, most recently updated in July 2020, is included in Appendix 2 and details 'Improved financial resilience in borrowers' as an outcome.

The Nesta Arts & Culture Finance team has to date published two insight papers relating to AIF, following the first two respective years of the fund's launch. The latter considers financial resilience, although after such a short period of operation it was difficult to draw many conclusions as to the likely success of the outcome.[13] No further fund level evaluation has been undertaken since 2017 and the question of financial resilience is particularly apposite in light of the Covid-19 pandemic which was a severe external shock to arts & culture organisations and arguably the ultimate test of their financial resilience.

The purpose of this research report is therefore an interim evaluation of the extent to which AIF is delivering on its objective to improve the financial resilience of its investees.

The primary research question is: To what extent does the experience of the Arts Impact Fund support its objective of improving the financial resilience of arts & culture organisations?

The research sub-questions are:

- How can financial resilience be best defined in the context of the arts & culture sector?
- What are the most appropriate metrics for measuring financial resilience in the sector?
- Is it possible to conclude that the AIF portfolio experienced an improvement in financial resilience and to what extent might this be attributable to the loan?
- Is it possible to take into account any impact of the Covid-19 pandemic upon the relationship between financial resilience and the loan?
- Is it possible to determine whether the financial resilience of loans related to property and new ventures differ from the overall portfolio?

The research is intended to contribute to the development of the Nesta Arts & Culture Finance team's Theory of Change. It will also inform outcome metrics for the successor fund and indeed influence

[13] Seva Phillips, *Second year insights from the Arts Impact Fund: financial resilience* (Nesta, 2017); Francesca Sanderson and Seva Phillips, *Arts Impact Fund: Insights from the first year* (Nesta, 2016).

the development of additional sector specific funding initiatives. Results will also be shared with other funders who are beginning to look at financial resilience and how it might be measured.

The audience for the report is therefore broad, encompassing both the Nesta Arts & Culture Finance team, stakeholders of both AIF and its successor funds and the social investment sector more broadly. It has therefore assumed little prior knowledge of the fund and focused upon portfolio level data rather than the particulars of individual organisations. Organisation names may be anonymised for distribution outside of the circle of immediate AIF stakeholders.

The researcher works for Nesta Arts & Culture Finance and is the Investment Manager of the Arts & Culture Impact Fund ("ACIF"), a successor fund to AIF with a similar although expanded investment mandate. The researcher therefore benefits from access to AIF portfolio data and introductions to the management teams of AIF portfolio organisations, which make the research both feasible as well as valuable in its intended contribution to the expansion of social investment in the sector.

Financial resilience is inextricably linked with the ability to deliver on social impact objectives and enable the sector to better articulate its impact to social investors, enlarging the available pool of capital for arts & culture organisations. Evaluation of impact is, however, beyond the scope of this research.

The report will review the available literature to define financial resilience and determine the most appropriate framework for the research. It will then detail and justify the selected method of study and provide a synopsis of the results. The report will discuss the potential definition of financial resilience and appropriate indicators, whether it is possible to conclude that the financial resilience of AIF investees has improved and the extent to which this might be attributable to the loan. The impact of Covid-19 will be considered, along with any indication that property and new venture related loans experience different financial resilience outcomes. The report will conclude with an analysis of the implications of the study and recommendations for the future.

## 4. Literature review

Given AIF's status as the world's first impact investment fund specifically for the arts & culture sector, there are no directly comparable research studies. The literature relating to definitions of financial resilience and approaches to its assessment for both non profit organisations more broadly and the arts & culture sector more specifically are, however, extremely relevant in determining the theoretical framework for the research.

In its well regarded Resiliency Guide for non profit organisations, originally published in 2014 but most recently updated in in the midst of the Covid-19 pandemic in December 2020, the Bechtel Foundation notes that "Resilience a way of being, not an end destination."[14] The guide stresses that this observation is well understood by non profit organisations, but vastly underappreciated by funders. It embodies the common thread running through otherwise very disparate literature, that context is vital and there is therefore no magic formula for achieving, recognising or measuring financial resilience.

The formal study of resiliency has its roots in the bioecological systems research of Holling in the early 1970s.[15] Holling made three important observations, the first of which notes the distinction between stability and resiliency, with the former representing a sharp rebound following a quick shock and the latter being an adaptation to change whilst still maintaining key relationships. Secondly, that survival is a prerequisite for resilience, but not on its own sufficient and, finally, that the study of resilience necessitates a very complex and generally qualitatively based approach.[16] Whilst there has been a great deal of subsequent literature attempting to define resilience in the context of the not for profit sector and indeed the arts & culture sector, with varying critiques of Holling's observations, these original observations largely hold true. Indeed, the relative paucity of resiliency studies in academic nonprofit management literature is attributed by Searing, Wiley & Young in their recent 2021 study to the requirement for qualitative rather than purely quantitative research.[17]

In the decades since Holling's work, the concept of resiliency has been applied to individuals, organisations and societies. Woodley et al state that the strength of resilience as a term comes from its use across such a wide range of disciplines, including ecology, psychology, urban studies, disaster

[14] S.D. Bechtel Jr. Foundation, *Resiliency Guide 5.0* (Bechtel Foundation, 2020), 2.

[15] Crawford Holling, 'Resilience and Stability of Ecological Systems', *Annual Review of Ecological and Systematics* 4 (1973): 1-23.

[16] Ibid.

[17] Elizabeth Searing and Kimberly Wiley and Sarah Young, 'Resiliency tactics during financial crisis: The nonprofit resiliency framework'. *Nonprofit Management and Leadership* 32, no. 2 (2021): 1-18.

recovery, international development and business health.[18] Searing, Wiley & Young contend, however, that the development of resiliency theory in non profit academic literature was stymied by a focus on the study of its perceived inverse, financial vulnerability, which was defined as organisational failure.[19] A wealth of data from financial accounts prompted researchers, predominantly in the USA, to undertake accounting ratio analysis in an attempt to predict such failures and the seminal study was by Tuckman & Chang in 1991, who identified four key ratios to assess the financial vulnerability of non profit organisations, namely equity ratio, revenue concentration, administrative cost ratio and profit margin.[20] Additional studies include those undertaken by Greenlee & Trussel in 2000 and Hager in 2001 who looked specifically at arts organisations.[21] The applicability of these studies to resilience has been questioned by Searing, Wiley & Young who contend that avoiding failure is not necessarily an indication of resilience, echoing Holling's original contention.[22]

Searing, Wiley & Young argue that if a non profit was solely interested in surviving then it could abandon its service delivery and "sell popcorn".[23] Indeed, continuity of purpose has become a vital part of the definition of resiliency in the non profit sector and Collins notes, "We must reject the idea well intentioned, but dead wrong – that the primary path to greatness in the social sectors is to become 'more like a business.'"[24] As Green et al state, the for profit literature on resilience required adaptation for the non profit world and different legal frameworks, motivations and income sources necessitate different evaluation metrics.[25] Without traditional business finance focused metrics, it is, however, far less easy to define, measure or predict resilience.

Resilience and financial resilience are inextricably linked in the literature and almost interchangeable given the importance of financial resilience to overall resilience. There is general consensus that financial resilience is not simply survival and that any examination of it, particularly in a not for profit context, must encompass more than a purely quantitative financial analysis. Indeed, Myser cautions about the importance of distinguishing between short term capacity issues and longer-term

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[18] Sophia Woodley et al, *What is Resilience Anyway?* (Arts Council England, 2018).

[19] Searing and Wiley and Young, 'Resiliency tactics during financial crisis: The nonprofit resiliency framework'.

[20] Howard Tuckman and Cyril Chang, 'A Methodology for Measuring the Financial Vulnerability of Charitable Nonprofit Organizations', Nonprofit and Voluntary Sector Quarterly 20, no. 4 (1991).

[21] Janet Greenlee and John Trussel, 'Predicting the Financial Vulnerability of Charitable Organizations', Nonprofit Management & Leadership 11, no. 2 (2000); Mark Hager, 'Financial Vulnerability Among Arts Organizations: A Test of the Tuckman-Chang Measures', Nonprofit and Voluntary Sector Quarterly 30, no.2 (2001).

[22] Searing and Wiley and Young, 'Resiliency tactics during financial crisis: The nonprofit resiliency framework'.

[23] Ibid.

[24] Jim Collins, *Good to Great and the Social Sectors* (London: Random House, 2006.), 1.

[25] Elizabeth Green et al, 'Financial Resilience, Income Dependence and Organisational Survival in UK Charities'*, Voluntas: International Journal of Voluntary and Nonprofit Organisations* 32, (2021); 992-1008.

sustainability issues and Woodley et al note that adaptability is preferable to strength per se.[26] Bowman's well regarded study seeks to distinguish between long term capacity and short term sustainability, but relies solely upon financial ratios which are not suited to smaller not for profit organisations.[27]

As a largely not for profit sector, resilience and indeed financial resilience in the context of arts & culture organisations share the complexities noted above. They are, however, magnified by the context of austerity in which the concept was adopted by Arts Council England as a cornerstone of its strategy in the wake of the 2008 financial crisis.[28] In its ten year strategy announced in 2010, the Arts Council's third goal was that, "the arts, museums and libraries are resilient and economically sustainable".[29] Gupta & Gupta note in their analysis of resilience as an Arts Council policy keyword that resilience was defined in a funding context.[30] This is very much evident in the Arts Council's strategic framework:

> It is clear that the future resilience of the UK arts sector is dependent on a sustainable mixed economy of increasingly varied income sources. However a model that relies on public subsidy as a catalyst for securing self-generated and private sector income may come under considerable strain in the short term. The need to reduce the UK public spending deficit over the lifetime of our strategic framework will have a major impact on the arts economy as a whole.[31]

Resilience was hence hailed as the response to reduced public funding for the arts and critics such as Gupta & Gupta argue that the term was therefore kept deliberately vague as an ambiguous rhetorical device, partly to obfuscate as "one of the numerous linguistic devices deployed to make the naturalness of privatization and corresponding public disinvestment basic assumptions of policymaking".[32]

The task of defining resilience in the context of the Arts Council's new strategy fell to Mark Robinson, Executive Director of the Arts Council from 2005 to 2010. In his paper *Making Adaptive Resilience*

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[26] Suzette Myser, "Financial Health of Nonprofit Organistions". PhD diss., (School of Public Affairs and Administration, University of Kansas, 2016); Woodley et al. *What is Resilience Anyway?*.

[27] Woods Bowman, 'Financial Capacity and Sustainability of Ordinary Nonprofits.' *Nonprofit Management & Leadership* 22, no.1 (2011).

[28] Arts Council England, *Great Art and Culture for Everyone*: *Ten Year strategic Framework 2010-2020* (Arts Council England, 2nd ed, revised 2013).

[29] Ibid., 39.

[30] Suman Gupta and Ayan-Yue Gupta, '"Resilience" as a policy keyword: Arts Council England and austerity.' *Policy Studies* (2019), 1–17.

[31] Arts Council England, *Achieving Great Art for Everyone: A Strategic Framework for the Arts* (Arts Council England: 2010), 17.

[32] Gupta and Gupta, '"Resilience" as a policy keyword', 14.

*Real* Robinson introduced the concept of an 'arts ecology' with the individual artist at the centre.[33] The paper failed to gain much traction, with Gupta & Gupta criticising the "patronising lip service …. paid to the romanticised artist while parenthetically undermining the artist's centrality to the 'Arts ecology'".[34] This uncomfortable positioning meant Robinson's notion of 'adaptive resilience' seeking to stress the pivotal role of innovation in continual adaptation was abandoned, but the idea that arts organisations could and should adapt to funding cuts remained.

This key assumption is torn apart by Comunian & Lauren who argue that as part of the wider creative economy, the sector is far from resilient and indeed cannot ever be resilient without fundamental structural change. [35] Comunian & Lauren take the works of Abbing and Caves, who respectively contend that that creative industries have properties which make then unique, and extrapolate them to argue that both the experience of the 2008 financial crisis and the 2020/21 pandemic provide evidence of the extent to which the sector is broken, with its reliance upon cheap labour making it fundamentally and structurally vulnerable rather than resilient.[36] Pratt contends that the cultural sector was born resilient, following organisational dynamics which rely on flexible production and alternative labour structures, but that this type of resilience isn't necessarily positive and doesn't automatically lead to economic growth and certainly prevents the type of constant reinvention imagined by Robinson.[37] Pratt states that ultimately what we might perceive to be resilience is in fact "outsourced to flexible or freelance workers who bear the costs and risks of uncertainty."[38] Comunian & Lauren agree that, "Self-employment, precarity, freelancing and even entrepreneurship are therefore read by the established neoliberal framework as resilient behaviours" arguing fiercely that they represent the opposite, leaving organisations in an unsustainable position, focusing on short termism and exploiting workers.[39] Financial resilience is therefore not even universally acknowledged as either a positive or indeed possible for arts & culture organisations.

Concern about the fragility of the arts & culture sector is a strong theme spanning the literature. Royce's review of business models in the visual arts sector notes that most organisations are under capitalised, have a limited understanding of what a business model is and that the level of business

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[33] Mark Robinson, *Making Adaptive Resilience Real* (Arts Council England: 2010), 14.

[34] Gupta and Gupta, '"Resilience" as a policy keyword', 15.

[35] Roberta Comunian and Lauren England, 'Creative and cultural work without filters: Covid-19 and exposed precarity in the creative economy', *Cultural Trends* 29, no. 2 (2020); 112-128.

[36] Ibid.; Hans Abbing, *Why are Artists Poor? The Exceptional Economy of the Arts* (Amsterdam: Amsterdam University Press, 2002).; Richard Caves, *Creative Industries: Contracts Between Art and Commerce* (Cambridge, Massachusetts: Harvard University Press, 2000).

[37] Andy Pratt, 'Beyond resilience: Learning from the cultural economy'. *European Planning Studies* 25, no. 1 (2017): 136.

[38] Ibid.

[39] Comunian and England, 'Creative and cultural work without filters', 112-128.

skills in the sector is poor.[40] Financial positions are weak, but so is the priority paid to this by senior management who do not fully appreciate that whilst a robust business model does not guarantee artistic excellence, it is a prerequisite for longevity.[41] Woodley et al.'s 2018 review of the sector's resilience notes similar trends, "There is little consistent practice in resilience measures within the sector or decision-making based on those measures."[42] They conclude that, "For many in the sector, finance is intimately linked to resilience, but most do not see it as the only important element."[43] Royce maintains that non financial resources and intangible assets are at least as important to an organisation's resilience as cash passing through accounting systems.[44]

Ludlow's 2010 research developing and testing a quantitative model to assess financial resilience in the arts & culture sector recognises the significance of these intangible assets.[45] Ludlow's analysis of Arts Council England data highlights the low level of unrestricted reserves in the sector and supports his hypothesis that the sector has insufficient financial capital and is therefore not resilient. The study is, however, arguably most illuminating for its limitations, with the initial intention of presenting an ideal set of financial resilience metrics in practice proving undeliverable due to the wide disparity of organisations. Ludlow notes that taking into account different artforms and indeed models of asset ownership such as a building is vital, as the optimum balance sheet strength should be determined by an organisation's revenue model (with lumpy revenue requiring greater reserves). Ludlow also notes that over 50% of the records he collected had to be discarded due to the poor quality of the financial reporting, highlighting the lack of financial literacy skills in the sector and problematic data collection.[46]

Bolton & Cooper's *Capital Matters* identifies a lack of development capital as a major barrier to financial resilience in the sector.[47] The paper is based upon interviews with and basic data collection from 27 medium sized UK arts organisations perceived to be at the forefront of improving financial resilience. The paper argues for a shift of emphasis from organisations in the sector breaking even to developing more financially resilient business models, defined as leveraging assets to increase and

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[40] Susan Royce, *Business Models in the Visual Arts* (Arts Council England and Turning Point Network, 2011).
[41] Ibid., 12.
[42] Woodley et al. *What is Resilience Anyway?*, 6.
[43] Ibid.
[44] Royce, *Business Models in the Visual Arts*, 10.
[45] Joe Ludlow, *Capital Matters – An Analysis of Financial Capital in the Arts Council England RFO Data. (*Mission, Models, Money, 2010).
[46] Ibid., 4.
[47] Margaret Bolton and Claire Cooper, *Capital Matters: How to build financial resilience in the UK arts and cultural sector* (London: Mission Models Money, 2010).

diversify income streams. The importance of trial and error is noted as well as the significance of building ownership, helping to generate additional income through events or catering. The paper stresses that there is no simple silver bullet to the development of more resilient business models, but recommends the close alignment of 'Mission' (programmes), 'Model' (organisational capacity) and 'Money' (capital structure).

The *Capital Matters* treatise was instrumental in the establishment of the Arts Impact Fund. Indeed, as Monclus notes, the reduction in public funding necessitated the growth of debt finance, although it was an uneasy ideological combination as there was a lack of trust between borrowers and lenders with the specific economic characteristics of the sector, identified by Caves, not an obvious fit with repayable finance.[48] There is limited research into the impact of non profits in general taking on debt. One of the few published studies looks at US non profits with assets over $5m and was undertaken before the 2008 financial crisis so is of questionable relevance, but concludes that the "financial picture for arts and cultural organisations that have used long-term debt is mixed."[49] It also notes that "debt is neither inherently good nor bad; it's the planning and utilization of this tool that impacts the outcomes."[50] The importance of the funder's priorities is therefore vital, as observed by Monclus in her description of AIF which is perceived as having its investment framed "within traditional public values associated to the role of culture."[51] Indeed, Sinclair, a member of the AIF Investment Committee but also Chief Executive of the Paul Hamlyn Foundation which champions social change, notes that trying to fit a funder's purpose is a way to sacrifice resilience if an organisation's purpose is compromised.[52] Purpose is integral to resilience and as Myser notes, the mismatch between private companies and not profit organisations means that using financial ratios alone to judge performance is problematic.[53]

In a blogpost published after AIF's second year of operation, the fund's Investment Manager, Seva Phillips, defined financial resilience as "the ability to weather challenging financial circumstances such as funding cuts or delays to receiving income, unexpected increases in costs, or unforeseen events that call upon the use of accumulated profits (reserves)."[54] He identified that an organisation could

[48] Rosa Monclus, 'Public banking for the cultural sector: financial instruments and the new financial intermediaries' *International Review of Social Research* 5, no. 2 (2015): 88-101.
[49] Elizabeth Curtis and Susan Nelson, *The Risk of Debt in Financing Nonprofit Facilities* (TDC Group, 2004).
[50] Ibid.
[51] Monclus, 'Public banking for the cultural sector', 95.
[52] Moira Sinclair, *'What does it mean to be resilient in the arts?'* (Paul Hamlyn Foundation, 2017).
[53] Myser,'Financial Health of Nonprofit Organistions'.
[54] Phillips, 'Second year insights from the Arts Impact Fund: financial resilience'.

likely increase its financial resilience by diversifying its income sources, increasing its surpluses and/or expanding its balance sheet.

The most recent study into financial resilience for non profits is currently being undertaken by Social Investment Business ("SIB"). SIB have collected and analysed data from Futurebuilders England, a government backed social investment fund providing grants and loans to organisations bidding for public service contracts from 2004.[55] This is an entirely quantitative study, looking at 180 organisations across a range of sectors receiving an element of repayable finance. The metrics being analysed are based upon the works of Tuckman & Chang and Bowman. Results published to date suggest that turnover, administration costs, return on assets and months of spending (i.e. how long an organisation can maintain its monthly spending on operations from unrestricted funds or reserves) are the most effective indicators of whether a borrower will default, but they do not believe that their sample size is sufficient to establish a robust predictive model.[56] Whilst instructive in terms of design, the study is more focused on predicting default than ensuring longevity of mission/purpose, is entirely quantitative, the data set does not include arts & culture organisations and the organisations are larger than the AIF portfolio.

Recent literature discussing the devastating impact of the Covid-19 pandemic on the arts & culture sector includes a report by the University of Sheffield which calculated that the UK cultural sector suffered a 60% decline in output (defined as Gross Value Added) over the prior 18 months, driven by lockdowns and social distancing requirements.[57] Significant variations between subsectors were identified, with performing arts, museums and historical sites particularly badly impacted.

The implications of the findings from the literature review for the development of the theoretical framework for the research are discussed in the following chapter.

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[55] James Paterson and Kirsten Mulcahy, 'Futurebuilders Financial Resilience Dashboard', Social Investment Business. Available at: https://socialeconomydatalab.org/resources/futurebuilders-financial-resilience-dashboard/. Accessed 10th November 2021.

[56] Ibid.

[57] Paul Chamberlain and David Morris, *The Economic Impact of Covid-19 on the Culture, Arts and Heritage (CAH) Sector in South Yorkshire and comparator regions* (University of Sheffield, 2021).

## 5. Model and Framework

The research is intended to test the hypothesis that investment from the Arts Impact Fund contributed to the improved financial resilience of its borrowers.

### i. Key themes

The following key themes identified in the literature review need to be reflected in the model and framework:

*(i) The importance of mixed methods research*

The initial intention was to conduct a purely quantitative study of the AIF portfolio's financial accounts. The literature has, however, strongly indicated the significant limitations of this approach. Of particular note is the distinction between financial resilience and survival. The relevant quantitative studies to date, in particular the seminal paper from Tuckman & Chang, seek to ascertain financial vulnerability rather than resilience and they are crucially distinct as financial resilience reflects not just financial resources but purpose and indeed management agility.[58] As Searing, Wiley & Young note, "this study amplifies the call for qualitative or mixed methods research into phenomena traditionally considered the domain of quantitative analysis. Though useful, accounting ratios are blunt instruments for describing a complex process such as organisational closure or resiliency."[59]

This research will therefore employ a mixed methods approach which is appropriate for research questions which cannot be answered by qualitative or quantitative approaches alone. It will employ method triangulation to improve the confidence in its conclusions.

*(ii) Resilience is an abstract concept and not easy to define*

Resilience is context specific and there are therefore no hard and fast rules when determining and analysing what defines financial resilience. Looking at trends for each organisation over time rather than comparing organisations with each other is therefore far more appropriate and valuable.

The lack of a financial resilience 'rule book' was confirmed in interviews with Susan Royce, a hugely experienced sector consultant and Neil Trupp, an accountant who specialises in charity accounting.[60] Neither were willing to endorse even a single metric of financial resilience for arts & culture organisations, stressing that financial metrics could not be judged in isolation from an organisation's management and purpose.

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[58] Tuckman and Chang, 'A Methodology for Measuring the Financial Vulnerability of Charitable Nonprofit Organizations'.

[59] Searing and Wiley and Young, 'Resiliency tactics during financial crisis', 14.

[60] Susan Royce, interview 2nd July 2021.; Neil Trupp, interview 5th July 2021.

It is, however, necessary to operationalise the concept of financial resilience by identifying observable characteristics of financial resilience which can be measured, enabling financial resilience to be inferred. Operationalising this concept as accurately as possible by selecting the most appropriate characteristics is vital to the validity of the model. Since there is no silver bullet, a broad range of metrics need to be selected, based upon the findings of the literature review.

*(iii) The significance of purpose/mission*

Financial metrics cannot and do not reflect an organisation's mission or purpose and strengthening these metrics to the detriment of an organisation's mission is not appropriate. Indeed, Sinclair, a member of the AIF Investment Committee noted that she was only minded to support AIF as it "was designed to help organisations become more financially resilient *in order to* protect and develop their social and artistic impact."[61]

An analysis of financial resilience for the social investment sector should therefore at least acknowledge the relationship between financial resilience and delivery of intended impact. It is outside the scope of this study to analyse the delivery of social impact, but a further piece of work should be undertaken looking at the relationship between financial resilience and impact delivery.

*(iv) Resilience is a politically loaded term in the sector*

Financial resilience is not universally regarded as a positive. The theoretical framework for the model assumes that organisations should desire to become financially resilient, but this is not a universally held view, especially in the wake of the pandemic where a higher proportion of earned income was not necessarily beneficial as earned income was far more susceptive to cuts than grant income. This nuance needs to be considered.

*(v) Complex picture with many factors at play*

Arts & culture organisations are complex, with many factors determining their outcomes in terms of finances, purpose or indeed artistic objectives. Seeking to isolate one factor, i.e. the receipt of repayable finance, is problematic as there are many other factors which will not remain constant such as change of management, receipt of grant funding, change in strategy or indeed exogenous shocks such as the Covid-19 pandemic. It may be that an organisation's financial resilience is impacted by the presence of 'contaminating factors' other than repayable finance from AIF.

[61] Moira Sinclair, 'Investing in resilience', *Arts Professional*, 28th August 2018.

It is therefore necessary to design an experiment which seeks to test the cause and effect relationship between the AIF loan and financial resilience, whilst acknowledging the many limitations to internal validity.

### ii. The model

Taking into account these observations gleaned from the literature review combined with the researcher's working knowledge of the sector, the model to test the hypothesis has been developed as follows:

***Dependent variable***

The dependent variable is financial resilience. For the quantitative analysis, this has been operationalised by observable characteristics in the form of financial metrics.

These financial metrics, detailed below, were selected for their simplicity given the relatively limited data available. Ludlow had to exclude half of his data due to poor financial literacy and the SIB study excluded all organisations with small company accounts due to inconsistent or missing data, but 20% of AIF investees file such small company accounts.[62] Given the relatively small population and the lack of consensus around the optimum measures of financial resilience, maximising the number of data points available rather than focusing on more complex measures felt appropriate.

The metrics representing financial resilience are grouped into three categories:

*a. Income related metrics*

Income related metrics reflect an organisation's profit and loss statement. They provide a useful record of a company's income and expenditure over the accounting period, but although they should approximate to cash (the purest metric of an organisation's health), there may be differences due to accounting treatments, which can vary by legal structure.

*i. Gross income*

Looking at the total income an organisation generates is a very simple and well defined measure which means that data collected is likely to be reliable (although revenue recognition of grants can vary by legal structure so comparison across organisations is unhelpful).

[62] The small company accounts exemption is for companies with income of less than £10.2m, balance sheet totals less than £5.1m and average employees less than 50, which can choose to disclose less information than larger companies. Details available at https://www.gov.uk/government/publications/life-of-a-company-annual-requirements/life-of-a-company-part-1-accounts#small-company.

Organisations generally borrowed from AIF to invest in activities which would grow their income so an increase would be indicative of success. It is possible for an organisation to 'buy' income at the expense of its ability to deliver the product/service or indeed its social mission, but it should be logical to assume that increased income is generally a positive indicator of financial resilience. This is therefore a high quality indicator.

*ii. Earned income*

Given the reduction in grant funding for the sector, an increase in earned or trading income (as opposed to grant income) could be said to be indicative of greater financial resilience. Ludlow notes that increased earned income by itself does not imply greater financial resilience.[63] Indeed those organisations with greater exposure to earned income during the pandemic often fared worse than those receiving grant funding. Whilst recognising these limitations, it is still felt instructive to see whether the AIF loan enabled organisations to increase both their absolute amount of and proportion of earned income as an indicator of financial resilience.

Although some organisations provide a clear breakdown of income into earned and grant income, this is not available in all cases and assumptions have been made by the researcher. Whilst these assumptions have been kept constant across the years for each organisation to enable meaningful comparison, it is a further reason to avoid comparing organisations with each other. The reliability of the data for this metric is therefore relatively low.

*iii. Number of income sources*

Income diversification is identified as one of the most significant aspects of financial resilience by Tuckman & Chang (who measure revenue concentration) and it is specified in Goal 3 of the Arts Council 2010 strategy.[64] Having a number of different income streams arguably enhances resilience if one underperforms. Green et al argue that income concentration doesn't necessarily lead to financial vulnerability, but the research studies reviewed all include measurement of income diversification and it is generally accepted that diversification is positive.[65]

Whilst some studies such as SIB have undertaken relatively sophisticated methods of measuring concentration, such as the Herfindahl–Hirschman Index, the treatment of different income streams

[63] Ludlow, *Capital Matters,* 6.

[64] Tuckman and Chang, 'A Methodology for Measuring the Financial Vulnerability of Charitable Nonprofit Organizations'; Arts Council England, *Great Art and Culture for Everyone*, 53.

[65] Green et al., 'Financial Resilience, Income Dependence and Organisational Survival in UK Charities'.

across financial statements is not uniform, even for larger organisations, and SIB notes that the development of their metric for concentration is ongoing.[66]

This study will look at income categories in financial accounts, but this is highly problematic for smaller organisations who may not disclose the information or indeed present it in a uniform manner year on year meaning that changes may simply be due to classification. The indicator is included given its significance in other studies, but its severe reliability limitations in this study are acknowledged.

*iv. Surplus/deficit*

Tuckman & Chang identified an organisation's operating surplus as one of their four key metrics for judging financial resilience.[67] An increased surplus, or reduced deficit, is generated by an organisation growing the margin it makes on products/services or by increasing sales and keeping profitability constant. In both cases, there is additional cash available to boost reserves and/or reinvest into the organisation and this is therefore an uncontroversial indicator of increased resilience. It should, however, be noted that the majority of the portfolio organisations are charities or Community Interest Companies ("CICs") which operate at a modest level of profitability so a step change may not be appropriate. Ryan & Irvine note that the amount of any surplus is context dependent, so the direction rather than the magnitude of travel is most pertinent here.[68] For companies limited by shares, 'profit before tax' has been selected as the most appropriate measure of surplus as it includes interest payments to service the loan.

This is a high quality indicator as surplus or profit before tax is a well defined accounting definition, although it does vary by organisational structure and especially for companies limited by shares is not necessarily an indicator of cash surplus, which is a more pertinent indicator of resilience.

The administrative cost ratio (administrative costs/total costs) is widely perceived to be a useful indicator of the flexibility of the revenue model and represents one of Tuckman & Chang's four key indicators.[69] It was, however, not possible to collect data which identified operating as opposed to other costs for sufficient organisations to make this a meaningful metric for this research. Rather counterintuitively, Tuckman & Chang identify lower administration costs as a measure of vulnerability as a lean organisation has less scope to reduce costs in the event of a revenue shock, but a leaner

[66] Paterson and Mulcahy, 'Futurebuilders Financial Resilience Dashboard'.

[67] Tuckman and Chang, 'A Methodology for Measuring the Financial Vulnerability of Charitable Nonprofit Organizations'.

[68] Christine Ryan and Helen Irvine, 'Not-For-Profit Ratios for Financial Resilience and Internal Accountability: A Study of Australian International Aid Organisations'. *Australian Accounting Review* 22, no. 2 (2021).

[69] Tuckman and Chang, 'A Methodology for Measuring the Financial Vulnerability of Charitable Nonprofit Organizations'.

organisation arguably has the benefit of superior management and possibly higher reserves from additional profit generation.

*b. Balance sheet metrics*

The resilience studies identified in the literature review generally deployed a number of balance sheet related calculations such as the equity ratio (shareholders equity/total assets) and quick ratio (cash + cash equivalents + receivables + short term investments/current liabilities). These calculations require data which are not published in small company exemption accounts or are not applicable to charities and it is therefore not possible to include such calculations in this research. This study has selected far simpler balance sheet variables, detailed below, which were generally easily obtainable and benefit from being well defined statutory terms. They may be less valuable indicators of resilience than more complex calculations, but their reliability is higher and when viewed together provide a useful view of an organisation's immediate financial health and the resources available to management teams.

*i. Fixed assets*

An organisation's fixed assets represent the assets it can use to generate income and support its activities. An organisation's largest fixed asset is generally property so if it owns rather than rents its premises then the fixed asset base will be higher. Owning a building can help to increase an organisation's financial resilience by providing it with a permanent base from which it can generate income, offering protection against potential rent rises. It does, however, reduce short term cost flexibility and is generally acquired with debt finance, which can further reduce flexibility in the event of an unforeseen shock.

As discussed above, property related deals represent 64% of the AIF portfolio by number, so an increase in fixed assets would be expected for these organisations. Fixed assets are not, however, an indicator of whether the assets can be successfully leveraged to improve financial resilience as they do not take into account the liabilities incurred to secure the assets.

*ii. Net current assets*

Net current assets provide an indication of the short term viability of an organisation, looking at whether its assets are greater than its liabilities for the financial year and therefore providing an indication of its ability to maintain day to day cash flow. It is a more effective measure than analysing an organisation's cash balance which does not take into account debtors and creditors. Over time, an improvement in an organisation's net current assets should be an indication of increasingly resilience, although this is not necessarily true and the measure is arguably more useful for survival than sustainability.

*iii. Net assets*

Net assets take into account an organisation's total assets and liabilities and a positive or increasing number over a period of time should be indicative of financial resilience, although it can be volatile in the short term and needs to be viewed alongside fixed assets.

iv. Cash reserves

An organisation's cash reserves provide a very pure indication of its ability to weather a downturn in income and therefore its financial resilience. Ideally a charity will report its undesignated, unrestricted cash reserves, which represent the true cash available to call upon quickly in the event of emergency and potentially needing to wind up. This is now a requirement of charity accounting, but a recent BDO report found that as many as 30% of charities do not comply.[70] For data prior to 2015, reserves could include fixed assets which are not generally sufficiently liquid to support an organisation in the short term and could therefore present a misleading picture. The change in accounting policies and indeed presentation by companies in their accounts complicates analysis over a period of years. Understanding what restrictions are placed upon reserves is arguably relevant, but not possible to obtain from results statements. The purest cash reserves measure has been taken for each charity, ideally unrestricted undesignated cash reserves.

Companies limited by shares and Community Interest Companies do not report reserves so net assets and/or cash balances have been used as a proxy for these organisations. This limits comparison by organisation, but provides a sense of direction for each organisation.

The measure is sufficiently significant to be included, but the limitations should be acknowledged.

***Independent variable***

The independent variable is the AIF loan. The hypothesis assumes it is the receipt of this loan which contributes positively to an organisation's financial resilience, which can be demonstrated by an improvement in the metrics identified above which have been selected to operationalise the dependent variable, financial resilience.

**Control variables**

The research acknowledges the presence of contaminating variables and appreciates that they will influence the relationship between the dependent and independent variables. There are likely to be many such variables influencing the financial resilience metrics of the AIF portfolio before and after

[70] Charity Commission for England & Wales, *Charities SORP (FRS 102), 2nd ed.* (Charity Commission, 2019).; BDO, *The UK's biggest charities' free reserves were falling even before the COVID-19 pandemic* (BDO, 2020).

the loan, reflecting the general economic or cultural landscape as well as individual organisation level factors such as grant funding or a change in key personnel. From the researcher's external viewpoint it is impossible to know what other factors may have influenced an organisation's performance during the pre and post loan period and it was beyond the scope of this research to ascertain this information (although some further analysis in the form of case studies may be a valuable follow on project).

It is, however, deemed to be of value to investigate the potential impact of the Covid-19 pandemic on the portfolio as it is such a significant factor during the post loan period, especially for those organisations whose loans were taken out during the later stages of the investment period. The study will therefore control for receipt of Culture Recovery Fund ("CRF") grants as a proxy for the impact of the pandemic. The Culture Recovery Fund provided £1.57bn of government funding to support UK arts & culture organisations during the pandemic. The funding was predominantly grant funding and 14 organisations in the AIF portfolio received such funding. It was instrumental in their survival during a period when then they were unable to generate income as their institutions were closed and/or they were unable to operate. There are significant limitations to this approach as receipt of CRF funding may not correlate perfectly with the impact of the pandemic. It is, however, a simple proxy and should enable the researcher to confirm or reject the hypothesis that those organisations most exposed to the pandemic will have experienced less of an improvement in post loan metrics. This could indicate that without the pandemic any improvement in financial resilience could have been more substantial.

The study will also control for deals related to both property and new venture models. Ludlow's work highlighted the significance of property ownership to resilience whilst new venture models are highlighted by Phillips as a means of increasing revenue diversity and therefore resilience.[71] Given the relatively high preponderance of these deals in the portfolio, an analysis of how the metrics for this subset of organisations might differ from the overall portfolio should provide additional insight into those deals for which repayable finance may be best suited.

### iii. The experiment

In order to test the hypothesis that a loan from the Arts Impact Fund improves the financial resilience of its borrowers, an experiment has been designed which will manipulate the independent variable and measure the outcome in the dependent variable. The effect of the treatment (i.e. receipt of the loan) on the control group (i.e. the portfolio) will be obtained by analysing the difference between the pre and post test results for each metric for statistical significance.

[71] Ludlow, *Capital Matters;* Phillips, 'Second year insights from the Arts Impact Fund: financial resilience'.

This is an ex-post factor experimental design as the organisations have already been exposed to the stimulus (i.e. the loan) and the data was not collected immediately afterwards. It is a time series design with measurements of the dependent variable metrics taken before and after the intervention.

The most appropriate statistical method is deemed to be a paired samples *t* test, which compares the means of the same group under two separate scenarios. A two tailed test allows for a relationship between the variables in either direction. The null hypothesis is that there is no statistically significant difference between the means of the pre and post loan data. The level of significance required is 95% which is the conventionally accepted level for business research. Should the resultant p value be smaller than 5% (0.05), the null hypothesis will be rejected and the alternate hypothesis that there is a significant difference between the means will be accepted. If the p value is higher than 5%, the null hypothesis will be accepted and the alternate rejected. As the hypothesis is directional, a one-tailed *t* test will also be undertaken to see whether the post loan data is indeed higher than the pre loan data. If it is possible to accept the alternate hypothesis at a 95% confidence level, the loan may have contributed to the difference in the pre and post data and should the mean of the post loan data be higher than the pre loan data, the difference is indeed positive and evidence of increased financial resilience.

A regression analysis will be used to control for CRF funding as well as property and new venture related deals, with these controlling variables representing dummy variables in the regression equation (with the post loan metric as the dependent y variable and pre loan metric + dummy variable as the independent x variables). The regression will be undertaken on the variables deemed statistically significant in the *t* test experiment. An analysis of the coefficients should indicate whether the control variables have a positive or negative effect on the relationship between the dependent and independent variable.

The results of the experiment will be triangulated with the results of the qualitative research which should help to gauge management's view of the significance of the loan relative to other factors, increasing confidence in any statistically significant relationship indicated by the quantitative research tests.

### iv. Limitations of the model

A fundamental limitation of the model is that the fund is still live and although fully deployed, only seven loans have been repaid or written off. There is limited data available for the post investment period for loans made in the latter stages of the fund's life given the short time frame, and this period is further complicated by the pandemic. It is arguably too early to understand whether repayable finance may have made a long lasting contribution to an investee's financial resilience.

The experiment has been designed to maximise internal validity where possible, controlling for other variables and using qualitative research to support any relationship between the dependent and independent variables. The expectation is that there will be convergent validity between the qualitative and quantitative data. There are, however, limitations to the extent to which it is possible to ascribe any change in the dependent variable to the independent variable given the many known and unknown factors at play. Of the seven major threats to internal validity, the following are relevant to this experiment:

- History effects – over the course of the time series, it is highly likely that certain events or factors occur unexpectedly and confound the cause and effect relationship. These are specific to each organisation and unknown to the researcher and cannot therefore be controlled for.
- Maturation effects – the passage of time is considerable in this study and in many cases the whole of an organisation's lifetime and this can result in behavioural changes in management teams which contaminate the cause and effect relationship.
- Statistical regression effects – those organisations with extreme scores are more likely to regress to the mean and there are a number of extreme scores across the data.
- Instrumentation effects – changes in measurement can distort results and this is a very real limitation of the model as the metrics under observation can be defined differently over the period.

It is anticipated that there will be substantial correlation between the metrics representing financial resilience, but multicollinearity is minimised by undertaking a separate test for each metric.

A major limitation is the sample size which is relatively small and therefore susceptible to outliers, meaning that it may not be possible to have sufficient confidence in the results of the tests.

The external validity of the model relies upon the extent to which the results of the experiment can be replicable to the wider arts & culture sector. The AIF portfolio, representing the population, is small and relatively specific in terms of investment criteria, as demonstrated in the introduction, so the extent to which the findings can be generalised to the arts & culture sector is limited.

## 6. Research Method

As a mixed methods approach, the data collection method was twofold, namely collecting pre-existing financial data and conducting interviews with management teams. These are discussed below.

Both methods involved a trade off between rigour and practical considerations, principally the time constraints of the researcher in interpreting those metrics which are not necessarily clearly defined in accounts (such as earned income and number of income sources) and the time constraints of the interviews necessitated by the desire to encourage participation from management, which only enabled a relatively high level discussion.

The population size is the 25 AIF borrowers. It was, however, necessary in some cases to take a sample of the population due to the availability of both the quantitative and qualitative data. The data selected for the sample was undertaken entirely on the basis of availability. Given the relatively small population size, maximising the sample size to increase validity was a strong priority to increase confidence in the results.

### i. Quantitative data

Having identified the most appropriate metrics to represent financial resilience, quantitative financial data relating to each metric was collected for each AIF borrower.

The data was obtained from the pre-existing financial records for each organisation, created to meet statutory reporting requirements and therefore involving no researcher interference. Where available, data was taken from audited financial accounts filed at Companies House, but five portfolio organisations file small company exemption (or Charitable Incorporated Organisation) accounts which do not include a profit & loss statement (containing the income metrics). It was therefore necessary to take information from management accounts collected and held by the AIF team for their quarterly reporting process with each borrower. In order to maximise the data set for the post investment period (deemed to be important given the relatively short period available in many cases when loans were drawn down as late as 2020), data for the 2021 financial year ends prior to September was collected. This required the use of draft accounts (as companies do not need to file annual accounts until nine months following year end), but the benefit of having an additional year of data even with the risk of inaccuracy was considered valuable.

The data was collected on a longitudinal basis, before and after the manipulation, and an average was calculated for both the pre and the post period. Data was collected for five years prior to the loan, or from the organisation's inception if later. Five years was selected as an appropriate timeframe given the desire to present a representative average trend, excluding any short-term variations. It was

possible to collect five years of pre loan data for 19 of the 25 organisations. For the post loan period, data was collected for the financial year of the loan and as many years as possible following the loan, with the maximum possible being six years given the first loan was made at the end of 2015. Only five organisations have data available for five years so the post loan data set is considerably shorter than the pre loan period and this is an important consideration as it will be much more susceptible to short term fluctuations and in particular the Covid-19 pandemic which impacts data from March 2020 onwards. Greenlee & Trussel note that three years of data is a limitation for a research study, but only 19 of the 25 portfolio organisations have even three years of post loan data.[72] This is one of the potentially biggest limitations of the research as analysing trends before and after receiving the loan is problematic with a limited time frame for the post loan period.

The following assumptions were made:

- Data was collected for financial year ends, even if more frequent data points were available from management information. Financial year end data is more likely to be audited or thoroughly reviewed and therefore more accurate. More frequent data points are unhelpful as they may throw up short term noise.
- Group accounts were used, even if the loan was made to a subsidiary as it will have been for the benefit of the group. Charities often set up trading subsidiaries to generate income unrelated to their primary charitable purpose, but to support those charitable activities.
- Where an organisation's loan was instrumental in the creation of a sister company, that new organisation's financials have been combined with the existing organisation, even if they are not legally a group of companies.
- The period post investment includes the year in which the loan was taken. Whilst this may be unrepresentative for loans made at the very end of a financial year, performance in the year of the loan could be significant and it feels more appropriate to include the year of investment in the post rather than pre period.

Financial data has the benefit of being widely understood and there are statutory definitions for the majority of the financial metrics. It is therefore possible to have a reasonably high degree of confidence in the reliability of these statutory data points (gross income, surplus/deficit and the balance sheet metrics), but far less so for trading income and number of income sources which do not benefit from such clear reporting and/or definitions.

A number of limitations were encountered with the quantitative data collection:

[72] Greenlee and Trussel. 'Predicting the Financial Vulnerability of Charitable Organizations'.

- The quality of the financial information is not always robust. Where possible, audited accounts were used, but management accounts were also used where required, which may contain errors, and in some cases even filed accounts were restated.
- The reliance in some cases upon small company exemption accounts and management accounts means that not all data points were available, such as earned income and the number of income sources. Where possible, these have been estimated using knowledge of the organisation, but this has scope for error.
- For organisations which have repaid their loans, there is no ongoing reporting requirement and the only available financial information is therefore Companies House accounts, meaning a substantial delay (up to nine months from year end) and for organisations filing small company exemption accounts, no access to profit and loss statements.
- Four organisations changed their reporting year ends or extended a particular reporting period during the period under examination. This means that some data points (particularly profit & loss related metrics) could be misleading.
- One organisation changed its structure during the period under examination, from a CIC to a Charity. This means that some data points are not consistent given the different accounting rules for charities, CICs and Limited Companies.
- One organisation ceased trading during the period and there is therefore no data available for the post loan period (so gross income was assumed to be £0).

Despite the limitations, it was decided not to exclude data from the data sets in order to maximise the sample size, but to be aware of the potential for error.

A major implication of these limitations is that given the difference in accounting periods, legal structures and indeed information supply, it is important that the metrics for each organisation are not compared with another organisation, but rather that trends in each organisation's own data set pre and post loan form the basis of the analysis.

**ii. Qualitative data**

The qualitative data was collected via interview. Given the nuance of the subject, the relatively small population, the perceived benefit of the researcher explaining the significance of the research in encouraging full participation and minimising the scope for bias and a perception of high survey fatigue, interviews were judged to be more appropriate for data collection than a survey.

The researcher held a short (approximately 20 minute) call with at least one member of the management team of AIF borrowers via Zoom. The interviews were structured as the intention was

to obtain pre identified information (i.e. the responses to the questions in Appendix 3) which could be compared across organisations.

Introductions to each management team were made by the AIF investment manager, which helped to establish trust and establish the credibility of the researcher. The investment manager was not present during the interview, to avoid potential bias. Stating the purpose of the interview and stressing that the research was designed to benefit the sector was motivating for the organisations and encouraged candour.

The intention of the interview was to glean an alternative, subjective perspective on the significance of the loan to an organisation's financial resilience, which could be used for triangulation with the quantitative data set.

The majority of the questions (numbers 1,2,5,6) were designed to elicit either a simple yes/no or numerical response, with 3 and 4 eliciting a more discursive response. Once collected, the data was categorised, coded and checked for outliers. The interview method minimised the potential for inconsistent responses and unanswered questions so there were no outliers or blanks.

A nominal scale was used to categorise responses to question 1, categorising organisations into mutually exclusive groups. A Likert scale was used for questions 5 and 6, which is assumed to be an interval scale.

Limitations of the qualitative research method include:

- Potential bias - Management may have been tempted to answer favourably for fear of upsetting the Nesta team or indeed feeling that their responses could prejudice any requests for additional loan forbearance. Given that the majority of loans are still live, this is a very real consideration, but in the opinion of the researcher there was a high level of candour as organisations understood that responding honestly and indeed negatively could help to shape the design of future repayable finance.
- The nature of the topic means that categoric yes/no responses were not always appropriate or forthcoming. The ranking in questions 5 and 6 is a rather blunt instrument and open to subjective interpretation.
- There is a sampling bias as it was not possible to speak to all organisations and those organisations which perceived the loan to be less significant could have been less inclined to conduct an interview (although there is no evidence of this).
- There is a survivorship bias as those organisations whose loans were entirely written off (Autograph and Looe) were no longer in contact with the ACF team and could therefore not

participate. This is, however, partly countered by a success bias as some of the organisations who had repaid their loan did not participate either.

### *iii. The data set*

- Quantitative data was collected for all 25 organisations and qualitative data was collected for 15 organisations.
- For the quantitative data, a full data set with all nine financial metrics was available for 18 organisations (of which qualitative data was also collected for 12). Two organisations had eight metrics, one had seven metrics, one had six metrics, two had five metrics and one had a single metric.
- No data has been excluded from either data set. If that data was able to be collected then it was deemed sufficiently reliable for inclusion in the study in order to maximise the data set, although this does raise reliability limitations for certain indicators as discussed above. These limitations were, however, accepted as the priority was to maximise the sample size.
- The sample size for the quantitative data is deemed to be reasonably representative of the population, with the caveat that the data values are widely dispersed and the small population size means that outliers can have a significant influence on averages, limiting the generalisability of the tests to the population.
- The sample size for the qualitative data is small and arguably insufficiently valid to draw material conclusions for the population. It is, however, useful as a support to the quantitative data.

The data sets are shown in Appendix 4.

## 7. Analysis & Results

The main findings of the study are presented below, with a consideration of whether the results could be said to indicate an increase in financial resilience post loan, the validity of the selected metrics as indicators of financial resilience and the extent to which any improvement might be attributed to the loan. The results of the tests for the impact of the Covid-19 pandemic on the portfolio as well as the relative resilience of loans related to property and new ventures are also discussed.

### *i. Does the data indicate an increase in financial resilience in the post loan period?*

The data sets for each of the nine metrics representing financial resilience (see Appendix 4) show the average for the years pre and post loan, with mean and median figures to aid analysis.

There is a wide dispersion of values for each data set, illustrated by the high standard deviations. This reflects the breadth of organisations in the portfolio, ranging from very young enterprises to more established organisations. The coefficient of variation (which shows the extent of variability of the data in relation to the mean) enables a comparison of the variability between the data sets. The coefficient of variation is particularly high for surplus/deficit and cash reserves, so the estimates for these metrics will be less precise, but there is a high level of variability across all data sets which impacts the reliability of the results.

None of the data sets are normally distributed and the histograms for gross income pre and post loan are shown in Figure 1 and Figure 2 as an illustration. For all but one data set (pre loan % earned income), the median is less than the mean, so there is a right or positive skew. This positive skew reflects the existence of a lower boundary but no upward boundary for the data. Income related metrics and fixed assets do not permit a value lower than zero and for the remaining metrics where negative numbers are possible (surplus/deficit, net current assets, net assets and cash reserves) there is likely to be a practical limit to the extent of the negative number (as an organisation could not survive with consistently substantially negative metrics). This skew can be problematic when estimating a typical value for the distribution, but a *t* test should perform adequately for these data sets. The relatively small sample size is the main limitation, meaning that there is a higher probability of a Type II error (accepting the null hypothesis when it is false) than with a larger sample size.

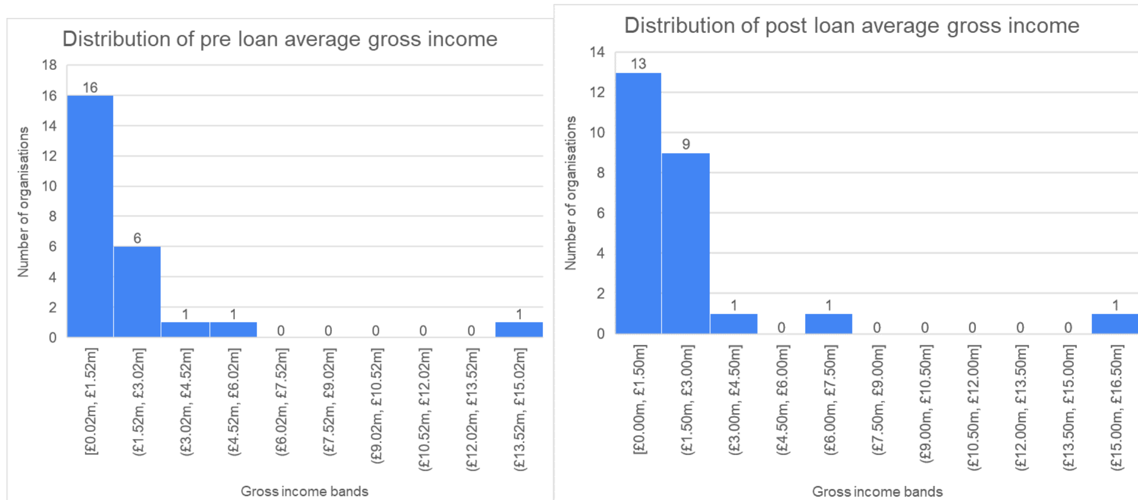


Figure 1: Distribution of pre loan average gross income

Figure 2: Distribution of post loan average gross income

The percentage change from the pre loan to the post loan period for each organisation has been calculated for each metric. For percentage change calculations where the move is from negative to positive, the calculation has been made using the absolute value of the negative number. This percentage change is, however, deemed to be of limited relevance given the wide dispersion of values reflecting the very disparate group of organisations and the hypothesis which seeks to identify whether or not there is a positive change. Analysis has therefore focused on identifying a binary increase or decrease in each metric for each organisation post loan, rather than the scope of any change. The total number of organisations in each sample group recording an increase for each metric has been summed and presented as a percentage of the total sample.

Figure 3 shows the percentage of each sample experiencing an increase in each metric in the post loan period when compared with the pre loan period. At least half of the organisations sampled for each metric experienced an increase in the post loan vs pre loan averages for all metrics other than percentage of earned income (which is likely to reflect the impact of the Covid-19 pandemic). Given the low reliability of the data for ‘number of income sources’ it is sensible to disregard this result and there are a number of indicators with only just over 50% of organisations experiencing an improvement, but the high percentage of organisations experiencing an increase in gross income and fixed assets is certainly suggestive of an increasing financial resilience following the loan.

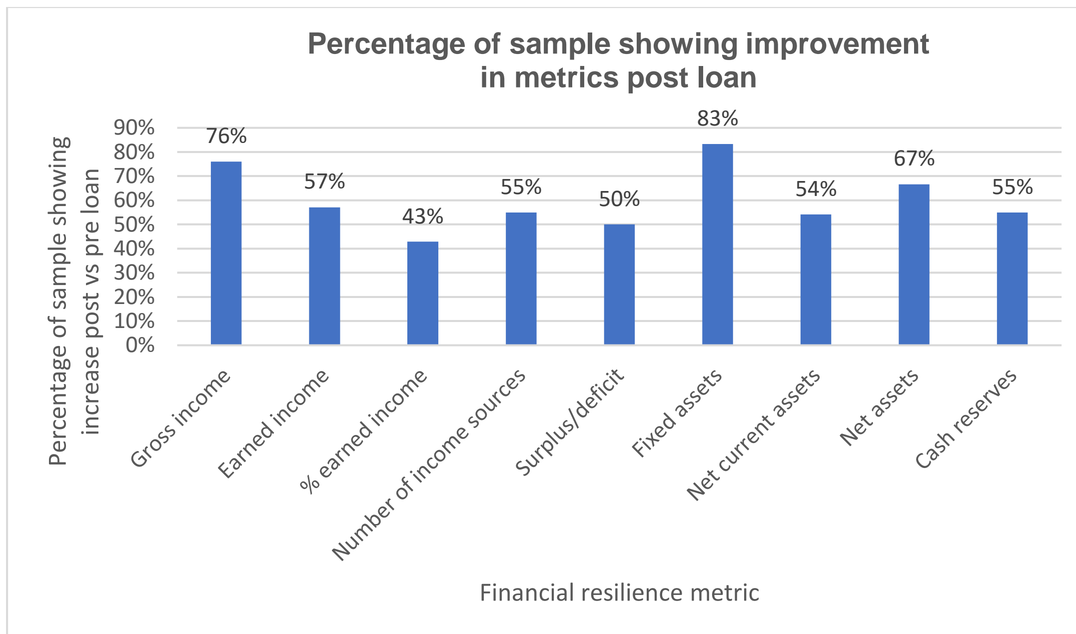


Figure 3: Percentage of sample showing improvement in metrics post loan vs pre loan

This approach does not, however, take account of the mean of each data set as organisations are deemed to be equally weighted. It obscures, for example, the absolute decline in the average cash reserves post loan (by 1%) despite 55% of the sample recording an increase (which reflects some very large decreases in a couple of organisations). Analysis of the portfolio averages are required to draw conclusions about the sample data which can be generalised to the population.

To test whether these relationships are indeed likely to be statistically significant and not simply down to chance, a *t* test looking at the mean, standard deviation and number of observations of the data sets is required. The summary of the *t*-tests results, shown in Table 1, indicate that it is possible to reject the null hypothesis that there is no significant difference between the pre and post loan means for gross income, fixed assets and net assets at a 95% confidence level for both the two tailed and one tailed test. This statistically significant relationship suggests that financial resilience as defined by these three indicators is likely to have improved following the loan for the AIF portfolio. It is not possible to reject the null hypothesis for earned income, % earned income, number of income sources, surplus/deficit, net current assets and reserves, indicating that there is insufficient evidence of a statistically significant relationship between the pre and post loan data.

Table 1: Paired samples *t*-test results at 95% confidence level

| Indicator | Observations | Two tailed test | | | One tailed test | | |
|---|---|---|---|---|---|---|---|
| | | P stat | Accept or reject null hypothesis? | Statistically significant? | P stat | Accept or reject null hypothesis? | Statistically significant? |
| Gross income | 25 | 0.03 | Reject | Yes | 0.01 | Reject | Yes |
| Earned income | 21 | 0.22 | Accept | No | 0.11 | Accept | No |
| % earned income | 21 | 0.33 | Accept | No | 0.17 | Accept | No |
| No. income sources | 20 | 0.48 | Accept | No | 0.24 | Accept | No |
| Surplus/ deficit | 24 | 0.56 | Accept | No | 0.28 | Accept | No |
| Fixed assets | 24 | 0.01 | Reject | Yes | 0.01 | Reject | Yes |
| Net current assets | 24 | 0.24 | Accept | No | 0.12 | Accept | No |
| Net assets | 24 | 0.01 | Reject | Yes | 0.00 | Reject | Yes |
| Cash reserves | 20 | 0.65 | Accept | No | 0.32 | Accept | No |

There is the potential for a Type I error (rejecting a null hypothesis when it is true) given the limitations of the test. The probability of this error can be minimised by reducing the confidence interval for the test and at a 99% confidence level it is still possible to reject the null hypothesis for fixed assets and net assets in the one tailed test, indicating that there is indeed likely to be a positive relationship between the pre and post loan data. It is therefore possible to have a relatively high degree of confidence in financial resilience as defined by fixed assets and net assets increasing for AIF borrowers in the post loan period (whilst noting that these are only two of nine indicators and the assumption that they are valuable indicators is discussed later in this chapter).

The metrics for which there is a statistically significant relationship at a 95% confidence level, namely gross income, fixed assets and net assets, demonstrate relatively high validity as the data for these metrics is based upon statutory information and the sample size is amongst the highest. They are still, however, hampered by the post loan period being significantly shorter than the pre loan period and therefore more susceptible to short term changes. The small data set and the skewed distribution mean that caution needs to be taken as to the generalisability of the results.

***ii. To what extent are the metrics representative of financial resilience?***

It is valuable to look at the dispersion of positive scores across the portfolio as an indication of whether the metrics are highly correlated with each other (with the same organisations experiencing an increase in a high number of metrics), which might be expected if they were all effective indicators of financial resilience.

The minimum number of increases witnessed by an organisation was zero and the maximum was eight, from a total of nine (although not all data points were available for all organisations). Figure 4 shows the distribution of positive scores by organisation, with the median and mean number being five. The dispersion is wider than might be anticipated and could indicate that the metrics are not effective measures of financial resilience.

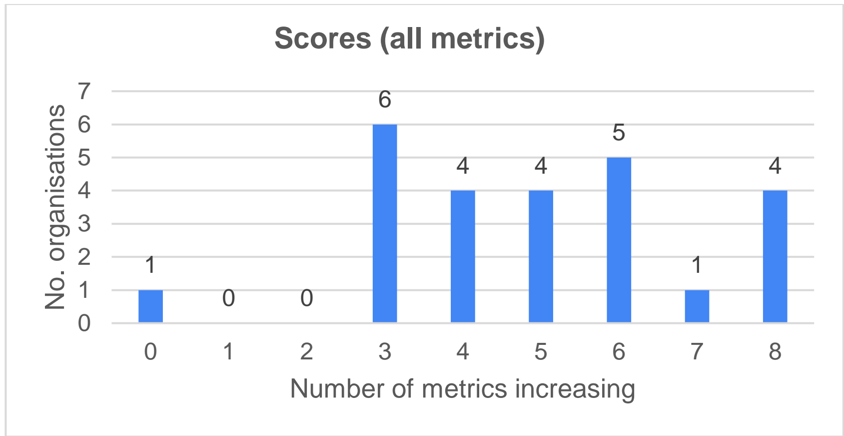


Figure 4: Distribution of scores for all metrics

Looking at the distribution for the three statistically significant indicators in Figure 5, there is a more positive correlation between the number of organisations and the number of metrics increasing. This could suggest that the statistically significant metrics are indeed better measures of financial resilience than the six other metrics, as reasonably high correlation between appropriate metrics would be expected.

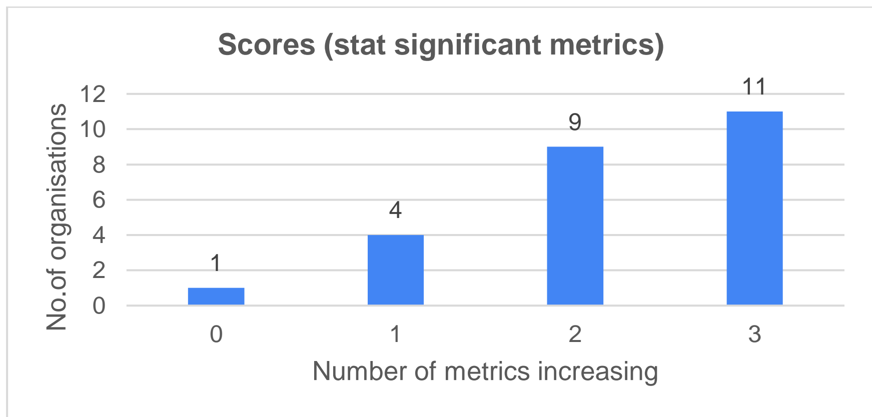


Figure 5: Distribution of scores for statistically significant metrics

Looking at an organisational level in Figures 6 and 7, only one organisation (XXXXXXXXXXXXXX) did not experience an increase in any metric, but the data available for this organisation was limited to gross income (reflecting being wound up) so there is an extremely limited data set and it should be discarded for analysis of anything other than gross income relationships. All other organisations witnessed an increase in at least one of the statistically significant metrics (and had at least five data points).

Figure 6: Number of metrics increasing for each portfolio organisation - removed

Figure 7: Number of statistically significant metrics increasing for each portfolio organisation - removed

The dispersion of positive scores supports the idea of financial resilience as multi-faceted. It is not possible to draw firm conclusions about the quality of the indicators from the quantitative data alone, reflecting the nuanced nature of financial resilience as discussed in the literature review and the lack of a 'silver bullet' definition.

Whilst the qualitative research has some significant limitations, not least the small sample size of 15 organisations compared with the population of 25 which cautions against generalising the findings across the portfolio, it does, nevertheless, make a valuable contribution to the study through providing information about an organisation's perception of financial resilience which can differ from the objective measurement in the quantitative research. The triangulation of the qualitative data with the quantitative data presents a more robust evidence base which can help to better define financial resilience.

Looking at how organisations themselves defined financial resilience in Figure 8, three of the four definitions (diversity of income streams, earned income and cash reserves) are metrics tested for in the quantitative research, albeit in a less nuanced way. For example, the most common definition of financial resilience is related to having 'sufficient' cash reserves. The interpretation of 'sufficient' is entirely subjective to each management team. It is also dependent upon an organisation's income profile so cannot be easily related to the quantitative metrics, but an improvement in cash reserves represents a reasonable proxy. The fourth definition of financial resilience relates to management experience and ability, identified in the literature review as a key element of resilience but unsuited to quantitative analysis.

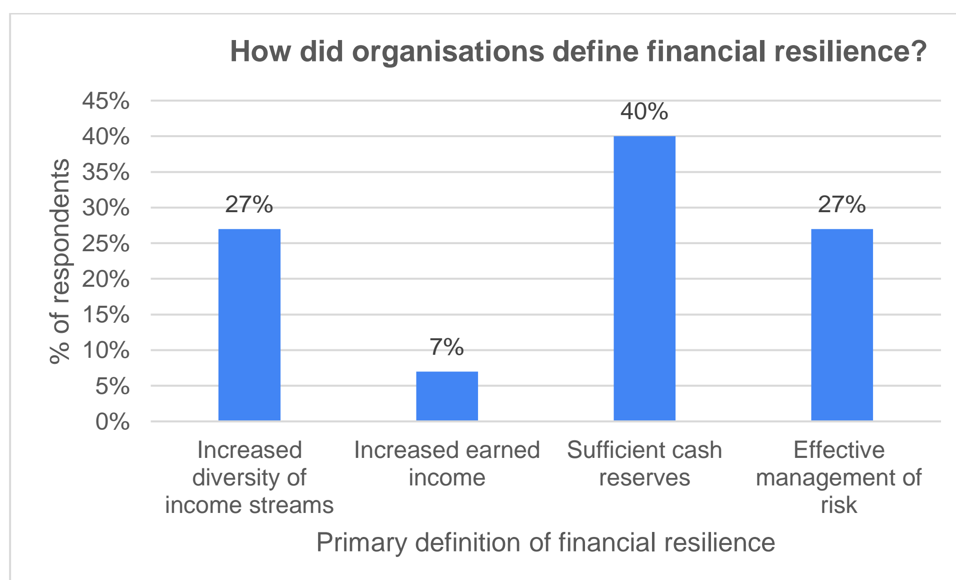


Figure 8: Organisations' primary definition of financial resilience

None of the three definitions of financial resilience identified in the qualitative research (diversity of income streams, increased earned income and cash reserves) produced a statistically significant result in the *t* test. Indeed, the quality of data for all three metrics was amongst the most problematic, with number of income sources (a proxy for increased diversity of income streams) proving particularly difficult to interpret and therefore use with any confidence as an indicator of resilience. Only 43% of the sample witnessed an increase in earned income in the post vs pre loan data (the lowest percentage increase) and just over half (55%) witnessed an increase in cash reserves. So, as defined by their own definition of financial resilience, organisations could not be said to have become more financially resilient after receiving the AIF loan.

This conclusion does not, however, tally with the results of the interview question which asked organisations whether they thought the AIF loan had made their organisation more financially resilient, illustrated in Figure 9. Only 13% of respondents responded negatively, indicating that the loan had not contributed at all to improved financial resilience. Almost half of the sample (47%) thought that the loan had unequivocally made a positive contribution to their organisations' financial resilience and another 40% thought that the loan had made some positive contribution but commented that they were either not yet financially resilient or had experienced an initial benefit (such as purchasing a building) but would now feel more resilient without the burden of loan repayments. This is supportive of the loan improving the financial resilience of its borrowers more often than not.

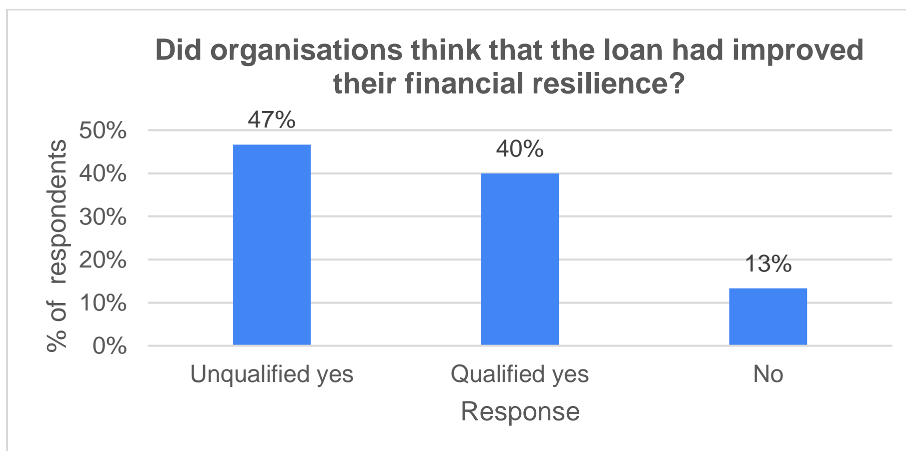


Figure 9: Organisations' perception of whether the loan had improved their financial resilience

Looking at the contribution of the loan to financial resilience in more depth, organisations were asked to rank the importance of the loan in terms of making them more financially resilient from 0 to 5 (with 5 the highest) and the average ranking was 3.9. Rounding up half scores, the distribution of scores is

shown in Figure 10. Over half of the sample (53%) ranked the loan at the highest possible score (5), which is supportive of the hypothesis.

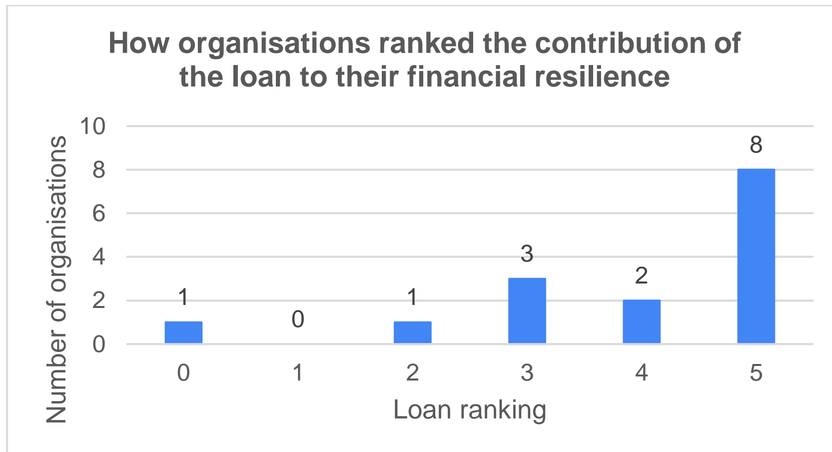


Figure 10: Organisations' ranking of the importance of the loan to their financial resilience

Interpreting financial resilience as more than simply financial metrics, as per the 27% of respondents who cited effective management of risk as their primary definition of financial resilience, the interviews sought to ascertain whether the process of taking the loan (such as the due diligence undertaken beforehand, financial reporting requirements or indeed critical friend input from the ACF team) rather than simply the funds might have contributed to an organisation's financial resilience. As illustrated in Figure 11, on the same scale of 0 to 5, the average ranking of the significance of the loan process in terms of making organisations more financially resilient was 3.3, with 20% ranking the process a 5 and more than half (67%) ranking it 4 or higher. This is encouraging in the context of a sector which is often said to be lacking in financial literacy or indeed effective risk management. It was, however, difficult to obtain meaningful data to provide additional context. The responses to questions 3 and 4 which required descriptive rather than ranked or binary answers were hard to elicit and problematic to code effectively, reflecting flaws in the design process.

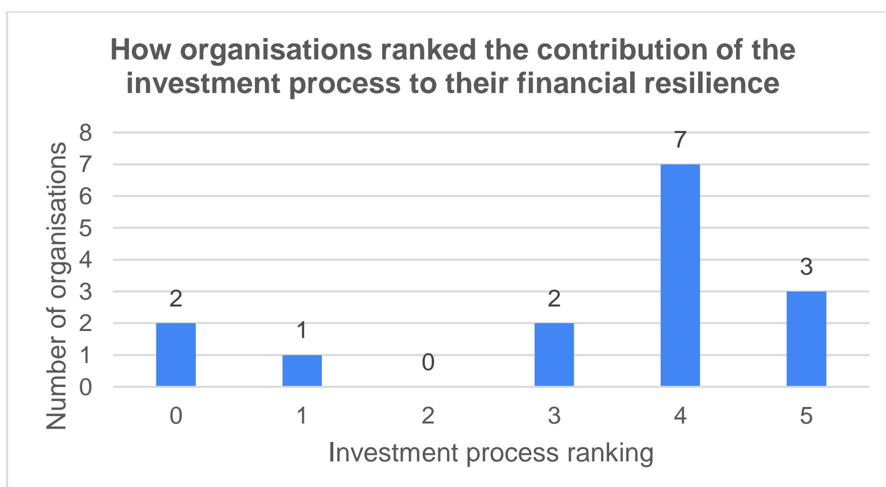

Figure 11: Organisations' ranking of the importance of the investment process to their financial resilience

Combining the most pertinent quantitative and qualitative indicators, there is a data set of seven organisations which saw an improvement in all three metrics indicating significance at the 95% confidence level (gross income, fixed assets and net assets) so could arguably be seen to have experienced an improvement in their financial resilience in the post vs pre loan period, who also gave an interview. This is a very small sample size and caution therefore needs to be taken when generalising the results, but five of the seven organisations ranked the importance of the AIF loan in terms of making their organisation more financially resilient a 4 or higher. The sample size is arguably too small to make reliable conclusions about the population, but does suggest that the improvement in the metrics post loan is at least partly attributable to the loan.

Looking at the relationship between management's ranking of the importance of the loan in terms of making their organisation more financially resilient and the number of increases in the three statistically significant metrics, there is a positive correlation, but it is not strong. The R squared of 0.2 means that around 20% of the variation in the number of statistically significant metrics seeing an increase is explained by the management rating of the loan. This is low and the standard error, the approximate standard deviation of the sample population, at 1.3 is relatively high. The analysis is also hampered by a small sample size as interviews were only obtained for 15 organisations. The correlation is, however, stronger than for the total nine indicators, where the R squared between the independent variable (management rating of the loan) and the dependent variable (number of total metrics seeing an increase) is only 4%, with a standard error of 1.5.

This suggests that the metrics which were shown not to have a statistically significant relationship between the pre and post loan data have less of an impact upon management's perception of financial resilience than those which demonstrate statistical significance at a 95% confidence level. This could indicate that the statistically significant definitions are indeed the key drivers of resilience for organisations, although this interpretation conflicts with responses to the definition of financial resilience noted above. There is an apparent disconnect between the perception of resilience as a general concept and what actually constitutes it, suggesting the importance of context and indeed other factors.

### ***iii. How much of any improvement can be attributed to the AIF loan?***

The internal validity of the study is arguably relatively low as there are other factors at play which could present alternative explanations for the improvement in the metrics, rather than just the AIF

loan. It is not possible to control for many of these potential variables such a change in strategy or management or receipt of other funding as the data is unavailable and indeed these changes may have been precipitated by receipt of the AIF loan (in many cases the loan is said to act as an endorsement to encourage other funders). The qualitative research is, however, instructive in that it helped to gauge management's view of the significance of the loan relative to other factors and in many cases the loan was seen as single, albeit often crucial, piece in a jigsaw puzzle representing financial resilience.

It is, however, possible to control for a major exogenous variable which had a significant impact upon the sector, namely the Covid-19 pandemic, through using CRF funding as a proxy for the impact of the pandemic (with receipt of CRF funding indicating a major impact). The regression analysis to control for the pandemic took CRF funding as a dummy variable and was performed on the three metrics identified as statistically significant by the *t* test at the 95% confidence level, namely gross income, fixed assets and net assets. The results are summarised in Table 2.

Table 2: Regressions to control for the impact of the pandemic

| ***Gross income regression*** | *Coefficients* | *Standard Error* | *t Stat* | *P-value* |
|---|---|---|---|---|
| Intercept | 554,292.41 | 279,361.34 | 1.98 | 0.06 |
| Av gross income pre loan | 1.02 | 0.06 | 17.12 | 0.00 |
| CRF dummy | - 347,257.65 | 340,279.09 | - 1.02 | 0.32 |

| ***Fixed assets regression*** | *Coefficients* | *Standard Error* | *t Stat* | *P-value* |
|---|---|---|---|---|
| Intercept | 1,707,060.58 | 777,607.14 | 2.20 | 0.04 |
| Av fixed assets pre loan | 1.19 | 0.17 | 6.92 | 0.00 |
| CRF dummy | - 1,169,257.91 | 929,142.77 | - 1.26 | 0.22 |

| ***Net assets regression*** | *Coefficients* | *Standard Error* | *t Stat* | *P-value* |
|---|---|---|---|---|
| Intercept | 892,385.41 | 525,212.99 | 1.70 | 0.10 |
| Av net assets pre loan | 1.09 | 0.16 | 6.79 | 0.00 |
| CRF dummy | - 201,227.79 | 625,806.05 | - 0.32 | 0.75 |

The regressions indicate that the post loan metrics have a positive (and as previously identified statistically significant at a 95% confidence level) correlation with the pre loan metrics, but the real focus of interest is the coefficients of the dummy variable which indicate the nature of the relationship between those organisations with those characteristics and those without. All three regressions show a negative coefficient with the dummy variable for CRF funding, indicating that organisations which received CRF funding had a lower post loan gross income, fixed assets and net assets than those which did not (albeit still higher in the post loan period compared with the pre loan period as indicated by the positive coefficients with the pre loan metrics). The group which did not receive CRF funding

includes the organisations which experienced the largest percentage changes between pre and post gross income (2866% and -100% respectively) but even removing these outliers, receipt of CRF funding was a negative influence on the relationship between the pre and post loan metrics.

Taking receipt of CRF funding to be a proxy for substantial exposure to the impact of the pandemic (as the funding was generally awarded to those organisations most exposed to it and was not intended to replace all lost income but support viability), this confirms expectations that the pandemic did indeed have a negative impact upon those organisations most heavily exposed to it. The pandemic will have heavily impacted the post loan period, from March 2020 when the first lockdown was imposed, which in about 60% of cases is at least half of the post loan period from which the average is taken. The analysis is somewhat crude as the pandemic will have a disproportionate impact upon the average numbers for organisations whose loans were taken out more recently (as the average is calculated with fewer non pandemic data points) and the experiment does not therefore illustrate those organisations most severely impacted. It is, however, encouraging that controlling for a significant exogenous factor influencing the post loan data, the portfolio as a whole still witnessed an increase in some key metrics in the post loan period. The significance of the fund's forbearance during the pandemic and its general approach to prioritising support rather than repayment was cited by management as hugely beneficial in terms of supporting perceived financial resilience. Controlling for CRF funding helps to validate the study by suggesting the direction of impact on the relationship between the pre and post loan metrics of one of the most significant exogenous variables.

It is possible to suggest that without the impact of the pandemic, the increases in the post loan period may have been more substantial. This is particularly true for 'earned income' as the pandemic prevented most organisations from earning income as premises were closed. CRF funding was a grant and organisations received other covid related support in the firm of grants, including the Coronavirus Job Retention Scheme (for furloughing employees). During the pandemic, a decrease in earned income in both absolute terms as well as relative to grant funding would be expected. Indeed, the only metric which did not see at least half of organisations sampled recording an increase in the post loan data relative to the pre loan data was '% earned income'.

#### ***iv. How do loans related to property or new ventures compare with the general portfolio?***

Looking at the results of the regression analysis to control for property related deals, shown in Table 3, all three regressions showed a positive coefficient for the property dummy variable indicating that organisations which used the loan for property related reasons (i.e. acquiring or refurbishing a building) had higher post loan gross income, fixed assets and net assets than those which did not.

Table 3: Regressions to control for property related deals

| ***Gross income regression*** | *Coefficients* | *Standard Error* | *t Stat* | *P-value* |
|---|---|---|---|---|
| Intercept | 287,955.83 | 326,294.62 | 0.88 | 0.39 |
| Av gross income pre loan | 1.03 | 0.06 | 16.56 | 0.00 |
| Property dummy | 90,952.36 | 366,791.99 | 0.25 | 0.81 |

| ***Fixed assets regression*** | *Coefficients* | *Standard Error* | *t Stat* | *P-value* |
|---|---|---|---|---|
| Intercept | - 67,565.72 | 777,663.22 | - 0.09 | 0.93 |
| Av fixed assets pre loan | 1.23 | 0.16 | 7.54 | 0.00 |
| Property dummy | 1,558,195.45 | 921,077.43 | 1.69 | 0.11 |

| ***Net assets regression*** | *Coefficients* | *Standard Error* | *t Stat* | *P-value* |
|---|---|---|---|---|
| Intercept | 110,348.60 | 554,312.95 | 0.20 | 0.84 |
| Av net assts pre loan | 1.12 | 0.15 | 7.31 | 0.00 |
| Property dummy | 944,905.87 | 624,058.70 | 1.51 | 0.14 |

Using logarithmic data for the regression, the coefficient indicates the percentage change in the dependent variable (metric post loan) for every 1% increase in the independent variables (metric pre loan and property related dummy). Table 4 indicates that property related deals saw the highest increase in fixed assets (0.92%), followed by gross income (0.67%) and then net assets (0.25%) for a 1% increase in the independent variable.

Table 4: Correlation coefficients for regression to control for property related deals using logarithmic data

| ***Gross income regression (log)*** | *Coefficients* |
|---|---|
| Intercept | 1.40 |
| Log av gross income pre loan | 0.70 |
| Property dummy | 0.67 |

| ***Fixed assets regression (log)*** | *Coefficients* |
|---|---|
| Intercept | 2.56 |
| Log av fixed assets pre loan | 0.51 |
| Property dummy | 0.92 |

| ***Net assets regression (log)*** | *Coefficients* |
|---|---|
| Intercept | - 0.08 |
| Log av net assets pre loan | 1.01 |
| Property dummy | 0.25 |

It is unsurprising that fixed assets increase with property ownership or improvement given that fixed assets are largely a measure of property status, but asset ownership sitting alongside increased

income and short term financial health (as implied by net assets) suggests that it may be contributing to increased financial resilience.

Looking at the results of the regression analysis to control for deals related to new ventures, shown in Table 5, all three regressions showed a negative coefficient indicating that organisations which used the loan for developing a new activity or revenue stream had lower post loan gross income, fixed assets and net assets than those which did not (with a decrease of 0.59% in gross income, 0.06% in fixed assets and 0.15% in net assets for a 1% increase in the independent variable).

Table 5: Regressions to control for new venture related deals using logarithmic data

| ***Gross income regression (log)*** | *Coefficients* | *Standard Error* | *t Stat* | *P-value* |
|---|---|---|---|---|
| Intercept | 1.29 | 1.68 | 0.77 | 0.45 |
| Log av gross income pre loan | 0.84 | 0.30 | 2.81 | 0.01 |
| New venture dummy | - 0.59 | 0.44 | - 1.35 | 0.19 |

| ***Fixed assets regression (log)*** | *Coefficients* | *Standard Error* | *t Stat* | *P-value* |
|---|---|---|---|---|
| Intercept | 2.99 | 0.65 | 4.58 | 0.00 |
| Log av fixed assets pre loan | 0.56 | 0.14 | 4.12 | 0.00 |
| New venture dummy | - 0.06 | 0.45 | - 0.13 | 0.90 |

| ***Net assets regression (log)*** | *Coefficients* | *Standard Error* | *t Stat* | *P-value* |
|---|---|---|---|---|
| Intercept | - 0.04 | 1.16 | - 0.03 | 0.97 |
| Log av net assets pre loan | 1.04 | 0.20 | 5.18 | 0.00 |
| New venture dummy | - 0.14 | 0.19 | - 0.73 | 0.47 |

This negative correlation suggests that loans related to new ventures experienced less improvement in their financial resilience that those where organisations were focusing on existing activities. This is not altogether unexpected given the significance of the pandemic to the post loan period and indeed the relatively short length of the post loan period in many cases. New ventures can take time to deliver returns on investment and the correlation may indeed change over time as the impact of the pandemic recedes and new ventures begin to establish themselves. The negative correlation is, nevertheless, contrary to the fund’s objectives and further analysis at an organisational level is recommended.

There is some overlap between loans related to property and new ventures, as would be anticipated with the acquisition of a building to enable new services. The overlap is, however, lower than might be expected (6 of 25 loans). All six of these loans received CRF funding. This sub group is too small a sample size to draw any significant conclusions about the interplay of these variables.

### v. Summary

In summary, the results of the experiment provide some support to the hypothesis that the Arts Impact Fund contributed towards improving the financial resilience of its borrowers, but the limitations of the research mean that caution needs to be taken when generalising the results.

On average, the financial resilience of the portfolio experienced an improvement in the post loan period as compared with the pre loan period, as indicated by a statistically significant relationship between gross income, fixed assets and net assets at a 95% confidence level. It was not, however, possible to conclude that there is a statistically significant relationship for the six other metrics selected to operationalise financial resilience.

The extent to which any improvement in financial resilience can be attributed to the AIF loan is dependent upon the qualitative research which is supportive of a theoretically strong correlation, although this relationship is not supported by the quantitative data and indeed indicates the disconnect between the perception of financial resilience as an amorphous concept and its practical manifestation in the data. It is therefore difficult to draw empirical conclusions as to whether certain metrics are better indicators of financial resilience than others, implying that resilience is dependent upon context and indeed perception.

The performance of the portfolio during the pandemic does suggest that financial resilience may improve over time, assuming all other variables stay the same (which is in practice impossible).

The positive correlation between financial resilience and loans related to property and the negative correlation with loans related to new ventures present areas for further research as new funding initiatives are considered.

## 8. Implications & Recommendations

### i. Research implications

The entire research process, from the development of the most appropriate theoretical framework to an analysis of the results, emphasised the notion of financial resilience as an abstract and context dependent concept rather than an absolute, objective and comparable state of achievement. This theme was identified in the literature review and has been strongly supported by the research method, identifying and then capturing the most relevant data, seeking to maximise reliability whilst not compromising validity through too small a sample size. It is then evident in the results, with the disconnect between management perception and objective measurement.

Accepting that the definition of financial resilience is indeed context dependent, there is unsurprisingly no panacea for its measurement. This strongly endorses the need for qualitative as well as quantitative research methods. In the context of AIF portfolio organisations with small company exemption accounts, the importance of qualitative data is further supported by the quality of the data available meaning that a simple numbers based approach is not only suboptimal but undeliverable. It is also supportive of a broad range of metrics being employed to operationalise financial resilience, with the appreciation that some metrics will be more appropriate than others for different organisations.

Financial resilience is, crucially, more than simply finances. Financial metrics when analysed without organisational context are arguably more akin to indicators of ongoing solvency than resilience. This is supportive of the critics of the seminal quantitative studies into financial vulnerability such as Searing, Wiley & Young who contend that they do not actually provide an indication of resilience.[73] Being financially resilient implies that an organisation is sufficiently financially secure to focus on maximising its purpose rather than simply managing cash on a daily basis. This is of paramount importance for the mission driven organisations in the AIF portfolio. Financial metrics alone cannot measure delivery against mission, they simply indicate whether an organisation is likely to be in a position to be able to drive its mission, which is a necessary precondition but not an end point, as identified by Holling in his seminal study.[74]

There can be a trade off between financial health and mission delivery. Mission driven organisations should not be maximising their profits and the appropriate trade off is specific to each organisation, again adding nuance to the definition of financial resilience and contributing to the lack of a 'silver

[73] Searing and Wiley and Young, 'Resiliency tactics during financial crisis'.
[74] Holling, 'Resilience and Stability of Ecological Systems'.

bullet' metric. It may be that an organisation is managing to grow its earned income and strengthen its balance sheet, but if these are not contributing to an improvement in impact then they are not meeting the fund's wider objectives.

The assumption that organisations should aspire to continual growth in the selected financial metrics may not therefore be appropriate. The ability to service the loan and operate on a basis which leaves an organisation with sufficient reserves to provide operating flexibility and the ability to innovate as required whilst delivering intended impact is arguably just as valid a definition of financial resilience as an increase in the quantitative metrics. It is therefore vital to incorporate an assessment of an organisation's social impact performance alongside its financial progress when considering financial resilience in the context of AIF, as the fund's rationale was that improved financial resilience would improve the delivery of impact. An evaluation of impact performance was beyond the scope of this research due to the time constraints of the researcher and the availability of data, but is a strongly recommended next step. The research process has cemented the importance of impact to a study of financial resilience and more explicit consideration of impact would be recommended for any future study based upon this framework.

Financial resilience encapsulates both resources and management of those resources. The value placed by investees upon the benefits of the investment process in terms of financial planning, impact development and risk management are indicative of the relative fragility of the portfolio organisations, not just in terms of their absolute financial performance but their financial management, as evidenced by often poor financial record keeping. This reflects the consensus surrounding the precarious state of the sector in the literature review and supports AIF's objective of making the sector more investible from both a financial as well as social perspective. It also endorses AIF's flexible and patient approach to portfolio management and demonstrates the value that a funder can add to support and indeed enhance the financial resilience of investees through more than the provision of funds.

AIF's flexible approach during the pandemic was critical to the financial sustainability of the portfolio organisations, offering repayment holidays, restructuring loans as required and providing support through signposting grant funding. This enabled investees to not only survive, but also ensure that social impact activities were not compromised where possible. Adapting to change was identified as a key part of resilience by Holling and a provider of repayable finance seeking to encourage financial resilience needs a very proactive and patient approach to portfolio management.[75]

[75] Ibid.

In addition to repayment holidays during the pandemic, AIF has undertaken a number of loan variations for investees to accommodate specific circumstances impacting the organisation's ability to service the loan. This study did not incorporate analysis of loan variations as the pandemic resulted in significant restructuring across portfolio organisations and whilst ability to make the scheduled repayments could be taken as an indication of resilience, it is somewhat of a blunt instrument which is arguably more of a measure of immediate solvency than sustained trends.

As an unexpected and substantial exogenous shock, the pandemic could be seen as presenting a test of financial resilience, requiring management teams to make rapid decisions and organisations to dig into their reserves, innovate and potentially pivot their operating models. All four definitions of financial resilience provided by the organisations in the qualitative research (diversity of income streams, increased earned income, sufficient cash reserves and effective management of risk) encapsulate the challenges presented by the pandemic. Whilst it is not possible to undertake a 'what if' analysis and understand how portfolio organisations would have performed had they not taken the AIF loan, it is encouraging that there does appear to be sufficient evidence to suggest that, overall, the portfolio organisations experienced an improvement in financial resilience in the post loan period. This is of course partly related to the repayment holidays provided by the fund and substantially related to the scale of the emergency funding from government. It is too early to conclude what the long term impact of the pandemic on the sector will be (the third round of CRF funding was only announced in November 2021), but continued viability if not resilience is widespread. As the significance of the pandemic period to the post loan data recedes (as an increasing number of data points are collated to drive the post loan average figure), it could be expected that, other factors being equal (which is of course in practice impossible), the metrics would be increasingly supportive of financial resilience.

In light of its severe impact on the sector, the pandemic has challenged the hypothesis that repayable finance is indeed an appropriate financing option for arts & culture organisations. Having taken on a loan to develop new earned income streams to shift away from reliance on grant funding only to be hit by a seismic shock which obliterated earned income overnight, it unsurprising that repayable finance was raised by some investees as a questionable strategic decision. Despite the emergency grant funding made available during the pandemic, it is unlikely that the longer term trend in the reduction of grant funding for arts & culture organisations will abate and alternative finance options such as repayable finance will be required. The performance of the AIF portfolio during the pandemic may actually endorse social investment as a viable option, with investees having been supported by their funder and therefore being able to withstand even such a seismic external shock. Those

organisations most exposed to the pandemic (using CRF funding as a flawed but reasonable proxy), still demonstrated an improvement in financial resilience.

The research demonstrates the significance of property ownership to financial resilience. Those portfolio organisations with property related deals, using the loan to acquire or refurbish a property, saw a greater increase in post loan gross income, fixed assets and net assets than those which did not. This suggests that an organisation can improve its financial resilience through acquiring or improving a property, which supports the hypothesis for AIF included in the second year evaluation paper.[76] A common obstacle for small arts & culture organisations is the lack of a permanent home which means they are frequently operating on a short term basis, reflecting short leases with landlords often with one eye on potential commercial returns. These organisations are not therefore incentivised to plan on a long term basis, which has implications for both financial resilience and the delivery of impact. Being able to acquire or fully develop a permanent home provides organisations with increased certainty around operating costs (albeit property ownership involves maintenance costs which can be substantial and unexpected) and an incentive to invest which is not the case for short term tenancies. This provides the motivation and rationale for driving the best possible return from the assets, for both financial security but also mission delivery. Property ownership therefore epitomises increased financial resilience and suggests that AIF loan finance is particularly well suited to property related deals.

A focus on fixed assets does, however, preclude some sector organisations which do not have or indeed require an enlarged fixed asset base to achieve their ambitions. This is further evidence of the importance of context when defining financial resilience. A recommendation of this report is to consider a broad range of metrics and ensure that these metrics reflect both an organisation's profit and loss statement as well as its balance sheet. Organisations which own a freehold or long leasehold can generally access loan finance more easily than those which do not as more traditional lenders will seek charges over assets to reduce lending risk. AIF did not make secured loans and was therefore able to support a variety of operating models and this flexibility of investment mandate is felt to be valuable to the sector. It is also supportive of the rationale for a dedicated sector fund, with funders experienced in the sector being able to lend upon the basis of income profiles rather than just asset bases.

[76] Phillips, '*Second year insights from the Arts Impact Fund: financial resilience'.*

### ii. Research validity

The research study has a number of limitations, one of the most significant being that the post loan period is generally significantly shorter than the pre loan period, reflecting the relatively recent investment period of the fund (until January 2020). This means that the average of the post loan period is far more susceptible to short term changes, including the Covid-19 pandemic. In addition, the quality of the data for the non standard metrics required some inference and the sample size for the qualitative data is small, at only 60% of organisations, therefore limiting its generalisability to the population. The relatively small size of the population and the skewed data suggest caution when interpreting the tests. The internal validity of the research is therefore deemed to be sufficient for a mid term fund evaluation, but the results should be treated with caution.

The research's external validity, namely the extent to which the findings can be generalised to the wider population of arts & culture organisations, is uncertain. The AIF portfolio is defined by its investment eligibility criteria including loan size, repayment terms, legal structure and mission focus and therefore represents only a subset of the wider sector. The findings do, however, support the viability of repayable finance for some sector organisations and certainly endorse the launch of ACIF, the successor fund to AIF. The suitability of repayable finance for property related deals is particularly apparent, although it is important for the sector that tangible asset ownership does not become a prerequisite to repayable finance.

It is hoped that this study will serve to increase confidence in the suitability of social investment for arts & culture organisations and that as the data set expands to include ACIF the external validity will increase as ACIF has a broader investment remit which includes the whole of the UK, less prescriptive social outcomes and larger loans (up to £1m). Evidence of a link between financial resilience and articulation and delivery of impact would provide even more compelling evidence.

### iii. Research recommendations

To further develop an understanding of the relationship between the AIF loan and the financial resilience of its investees and improve the reliability and validity of any similar future study, the following actions are recommended:

- Continue to collect the quantitative data. As the post loan data set increases, its validity should improve as variables impacting the organisation on a short term basis (such as the pandemic) will have less of an impact and longer term trends should be more evident. It is recommended that data continues to be collected after the fund has officially wound up, for at least five years, although the impact of the loan on the organisation's finances would be

expected to become less significant and the impact of other variables even greater as time progresses.

- Endeavour to undertake an interview with a member of the senior management of all portfolio organisations to improve validity. This should ideally include those organisations which no longer exist, but this may in practice prove a challenge.
- Enlarge the scope of the qualitative interviews and redesign question 4 in light of the results from the quantitative survey to also incorporate a focus on identifying controlling variables.
- Undertake case study level analysis of individual organisations, identifying and understanding the controlling factors specific to each. This would provide a very rich data source for how social investors can best support investees and also improve the validity of the research by identifying common additional variables.
- Control for additional variables to ascertain their influence on the significance of the relationship between the loan funding and financial resilience. It would be valuable to expand the analysis conducted on property and new venture related deals to understand whether the influence of variables such as subsector, size of organisation and loan purpose have a positive or negative impact upon resilience. This could be used to tailor the support offered to investees as well as influence the positioning of future initiatives to the sector as there is not a one size fits all approach to such a diverse sector.
- Analyse the social impact performance of each AIF investee and compare the findings with the results of this study (and its continuation) to ascertain the extent to which there might be a correlation between increased financial resilience and delivery against impact objectives. A positive relationship would support the fund's hypothesis that financial resilience can be a driver of impact delivery and provide compelling evidence with which to argue for the growth of social impact investment in the sector.
- Contribute where possible to studies of financial resilience being undertaken across the social investment sector. Larger studies such as the current research by SIB are generally analysing financial ratios which may not be available for smaller organisations such as the AIF portfolio, but every opportunity to contribute to the development of the topic should be taken as there are likely important and mutually beneficial learnings.
- Begin to collect data for the ACIF portfolio organisations. Data for the metrics not clearly defined in accounts would benefit from management clarification and reliability would improve if undertaken whilst fresh in the mind, with annual reporting meetings presenting an ideal opportunity. These metrics were identified as important indicators of resilience in the

literature review and the interviews, but ex post facto data collection proved problematic and impeded their reliability in the current study.

## 9. Conclusions

The findings of the research broadly support the hypothesis that the Arts Impact Fund is contributing to the improvement of the financial resilience of its borrowers. It is not possible to draw any firm conclusions as to the extent to which the AIF loan might be responsible for any improvement in financial resilience, other than that it is likely to be one of many factors at play and will almost certainly vary on a case by case basis.

Whilst acknowledging the limitations, the study provides discussion points which contribute to the debate surrounding the definition of financial resilience and should prove to be of value to AIF stakeholders as they seek to evaluate their participation in the pilot initiative. The financial metrics identified in the research will be used as indicators for the financial resilience outcome in the Theory of Change which covers both AIF and ACIF as well as future funds. The results will form part of the planning for the future scope of Nesta Arts & Culture Finance's work.

It is certainly hoped that the research findings, when reviewed alongside the articulation and performance of social impact objectives, might be sufficiently encouraging to stimulate increasing interest in arts & culture organisations from social investors who have traditionally been wary of a sector where the financial risks did not justify the impact return. Given the relative paucity of available research into the performance of the arts & culture sector, it is hoped that this research will represent cultural leadership which will drive additional debate, comment and hopefully a greater resource of both quantitative and qualitative data. The body of evidence to support social investment in the sector would benefit greatly from a broader and deeper data set. It does, however, also endorse the role of a dedicated sector specialist such as Nesta Arts & Culture Finance whose experience of arts & culture organisations has supported investees through the provision of patient capital, but also much needed capacity building which the sector lacks.

Whilst there may not be a silver bullet for identifying and achieving financial resilience, the research is highly supportive of Bolton & Cooper's *Capital Matters* treatise which influenced the establishment of AIF.[77] Funding which can align with an organisation's mission and organisational capacity can support financial resilience. These three factors are inextricably linked and having sufficient appropriate funding available to support arts & culture organisations across the UK, but also internationally, is vital to the development of a thriving sector which can take creative risks and deliver excellence across financial, impact and artistic objectives.

[77] Bolton and Cooper, *Capital Matters.*

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## 11. Appendices

### Appendix 1: AIF portfolio

Removed

## Appendix 2: Arts & Culture Finance: Theory of Change

**ARTS & CULTURE FINANCE: THEORY OF CHANGE** (last updated: 29th July 2020)

| Problem | Beneficiaries | Activities | Outputs | Outcomes | Metrics | Vision |
|---|---|---|---|---|---|---|
| • Arts & culture organisations face threats to their existence, sustainability and resilience, through cuts to public sector budgets and a more competitive fundraising environment.<br>• Arts & culture organisations demonstrate a strong demand for repayable finance, and have substantial nascent enterprise potential, but find it uniquely difficult to access in an affordable and appropriate form due to a lack of specialist intermediaries.<br>• Whilst contributing to positive social change is at the heart of many arts & culture organisations, their capacity to articulate, monitor and evaluate this impact in a robust, traditionally recognisable way is limited. | **Direct**<br>• Impactful arts and culture organisations across the UK with unsecured finance needs of £25k-£1.5m (across both CIDF and ACIF).<br>• Priority will be given to those organisations that have high impact potential, can balance financial risk with impact return, and, in the case of CIDF, those that can benefit from the impact development work. | **Deal-making**<br>• Developing an investment pipeline, undertaking due diligence; preparing investment applications and managing a portfolio of social investments.<br>• **CIDF:** Appropriate and affordable unsecured repayable finance products, £25k-£150k, linking the financial return on unsecured loans to performance against impact development plans.<br>• **ACIF:** Appropriate and affordable unsecured finance products, £150k-£1.5m. | • Investment applications, developed by the Arts Investment team.<br>• Investments made over a 3-year investment period.<br>• **CIDF:** Target of 90% loan portfolio, 10% RPA. Expectation that 80% of loans will be eligible for impact discounts.<br>• **ACIF:** Investment through loan, RPA and social impact bond instruments. | • Arts organisations have access to appropriate and affordable sources of funding.<br>• Wider awareness of social investment; particularly outside of London and the South East.<br>• Improved financial resilience in borrowers.<br>• Additional capital leveraged through investments.<br>• More accurate pricing of risk in arts social investments. | • Annual enquiry and deal-making targets, including geographic spread.<br>• Referrals of enquiries to and from other investors, where appropriate;<br>• Example resilience metrics:<br>  • Increased and/or diversified revenue streams amongst AIF investees;<br>  • % trading revenue increased and sustained;<br>  • Borrowers' documented investment terms are met;<br>  • Development of more self-sustaining business models.<br>• Number of co-investment deals and additional capital leveraged. | • **(1) We live in a society where a diverse and sustainable arts sector enriches people's lives** through motivating social and cultural engagement. Through participation in arts activity or through having a relationship with arts organisations, people become healthier, happier and more resilient individuals, living in harmony with their community and environment.<br>• **(2) Arts organisations are able to articulate more clearly the positive social change they are uniquely placed to have** on individuals and communities, leading to:<br>  • A strengthening of the evidence base, allowing arts & culture organisations to focus efforts on what works best;<br>  • More funding and social investment available following demonstration to stakeholders of a fuller account of their value.<br>• **(3) The social impact of the arts grows as a result of a new impact culture;** organisations are able to develop their impact management capabilities fully; there is regular sharing of best practice and sector organisations are widely involved in the delivery of social impact and outcomes commissioning.<br>• **(4) The public at large understand the value of arts organisations**, as multi-faceted as that may be: their artistic output, community outreach and other placemaking benefits, contribution to the creative industries etc.<br>• **(5) Motivated repayable finance is an established, widely accepted and used form of financial support for arts organisations**, and part of the integral consideration of organisations' capital and revenue needs.<br>• **(6) Arts organisations are resilient and thriving**, free to plan their future and take autonomous risk with impact and programming strategy and practice. |
| | | **Impact Development**<br>• Impact & impact risk assessment during diligence<br>• Working collaboratively with investee to set up targets around M&E and outcomes and monitoring progress to targets.<br>• Sharing insight and best practice regarding impact management through published thought leadership, speaking at events and peer learning workshops.<br>• **CIDF:** Social impact capacity development work for fund applicants.<br>• **CIDF:** Setting financial incentives to drive the achievement of impact targets. | • **CIDF:** For each investment, on submission of investment application:<br>  • a thorough understanding of the evidence base for the socially-focused activities being undertaken;<br>  • a theory of change with specific outcomes to be achieved as a result of the activities;<br>  • a framework for M&E; and,<br>  • a development & resourcing plan (DRP)<br>**ACIF:** Creation of a development plan for each investment. | • Strengthened impact potential of arts organisations.<br>• Learning is captured and shared with regard to impact management best practice in the sector<br>• Borrowers are better able to articulate their social and artistic impact.<br>• Impact management culture is embedded in borrower organisations – particularly so for CIDF investees.<br>• Growth in the social impact of each investee | • Number of peer learning for impact sessions run.<br>• Number of blogs relating to impact management best practice.<br>• Through conversations and reviews of information, a sense of:<br>  • Understanding of how impact data and tools are used in funding bids and reports to stakeholders;<br>  • DRP and development targets achieved. | |
| | | **Reporting**<br>• Investee reporting: Post investment, quarterly reporting to track progress against financial resilience and social impact targets.<br>• Investor reporting: at periodic intervals (content & timing TBA). | • Ongoing portfolio management information and tracking of impact risk.<br>• Stakeholder reports on fund performance. | • [Provision of data for other outcome areas]<br>• Development of close working relationships with our investees and investors. | | |
| | **Indirect**<br>• Wider arts and cultural sector.<br>• Prospective investors in the arts that have not yet made investments.<br>• The direct beneficiaries of our investees. | **Advocacy**<br>• Making the case for greater social investment in the arts, developing and testing innovative financial instruments for this purpose.<br>• Sharing data and learning on both lending and impact best practice from our portfolio. | • Publications: sharing of portfolio data (where appropriate) & analysis; think-pieces; external research commissioned (particularly around arts organisations' appetite for and attitude to social investment).<br>• Regular blogging and social media presence.<br>• Attendance at relevant events in the arts, social investment sectors as well as related verticals, in the UK and internationally.<br>• Hosting of roundtables on impact evidence. | • Wider awareness of social investment in the arts sector.<br>• Better understanding of what financial instruments work in the arts.<br>• Wider public awareness of the social impact of arts organisations.<br>• Learning is shared with regard to impact management best practice. | • Number of publications and blogs produced.<br>• Number of events and roundtables attended and hosted.<br>• Web traffic analytics for online content.<br>• Citations of Nesta Arts & Culture Investments research and publications. | |

| Key assumptions (last updated: 29th July 2020) | Areas for development (last updated: 29th July 2020) |
|---|---|
| • There is demand for the kind of finance offered by ACF<br>• Significant proportion of the portfolio will be eligible for loans with an impact discount (CIDF)<br>• Impact discount will be a sufficient motivating factor to achieve impact target and contribute towards establishing an impact management culture (CIDF)<br>• Wider stakeholders (policy makers, investors, funders, the public) have sufficient appetite/interest in this space | **Presentation**<br>• Think about the temporal dimension of outcomes – is this relevant?<br>**Evaluation**<br>• What partners & stakeholders could assist with gathering evidence? / what information/data already exists that could benchmark our metrics or provide context)<br>• Additionality/attribution – what other activities and factors could have a significant impact on each of the above outcomes? |

Explicitly applicable to Cultural Impact Development Fund ("CIDF") and Arts & Culture Impact Fund ("ACIF"), with much overlap with Arts Impact Fund ("AIF").

**Appendix 3: Interview questions**

1. What does being financially resilient mean to you and your organisation?

2. Do you think that repayable finance from AIF has improved and/or will improve your organisation's financial resilience?

3. To what extent is the investment process (DD beforehand, reporting afterwards, general relationship with the team) rather than simply the loan itself helpful in terms of improving financial resilience (e.g. financial literacy, leadership and governance, operational processes)?

4. Specifically, how has the loan (either the funds or the other factors) impacted:*
   a. Financial management (frequency of production of management accounts, focus on certain indicators such as reserves/strength of balance sheet)
   b. Budgeting/forecasting/strategic decision making
   c. Reserves policy (unrestricted, undesignated)
   d. Appetite for risk/innovation (including Board's)
   e. Performance during the pandemic (i.e. ability to withstand a financial shock)
   f. Ability to deliver social mission (as resilience can be defined as ability to absorb shock without compromising mission)

5. In terms of making your organisation more financially resilient, can you rank the importance of the loan from 0 to 5 (with 5 being the highest)?

6. In terms of making your organisation more financially resilient, can you rank the importance of the investment process from 0 to 5 (with 5 being the highest)?

*To be answered if relevant

## Appendix 4: The data set

**Remove**