SVA Social Ventures Australia

paulramsay FOUNDATION
PARTNERSHIPS FOR POTENTIAL

# Tools to Assess Organisational Resilience

# CONTEXT

In 2020, the Paul Ramsay Foundation (PRF) launched the **Sustaining Our Partners (SOP) Taskforce** in response to the COVID-19 pandemic with an objective to

> "...support our partners in a considered, agile and strategic way, supporting their short and long term viability".

The Taskforce commenced in early April 2020.

The Taskforce recognised that an important first step was to understand the vulnerability, both financial and operational, of our approximately 80 partners. Working with Social Ventures Australia, a due diligence diagnostic approach was developed that could be used to identify which partners might need support.

The feedback from PRF staff, Board members and partners is that the diagnostic framework is a valuable tool that should be shared with the sector since it has applicability not just during the pandemic crisis but also in other contexts. For example,

- Multi Partner Events – eg major cuts to government spending
- Partner Specific Events – eg loss of a major funder; loss of a critical leader; major operational incident
- New Partner Grant Evaluation
- Existing Partners Grant Renewal Evaluation

Consequently, in this guide we share the key elements of this due diligence approach in a practical way to enable others in the sector to apply or build on our work.

# SUMMARY

This guide covers the following topics:

# 1
# DUE DILIGENCE APPROACH

The SoP Taskforce team undertook three types of due diligence:

- **Financial due diligence** to assess the financial vulnerability of an individual partner. Due to the COVID-19 pandemic this due diligence was designed to address two key questions:
  - Financial viability – Is there a risk of the partner becoming insolvent in the next ~3 months? These partners were prioritised for immediate support
  - Financial vulnerability – Are there future scenarios where the partner could become insolvent and/or need to cut costs that will mean targeted outcomes are not achieved?
- **Operational due diligence** to understand the impact of COVID on the partner's operations. This due diligence was designed to address this key question:
  - Have the operations of the organisation/program been adversely affected such that there is a material reduction in its targeted impact:
    - Directly by the COVID-19 response? and/or
    - By actions management are taking to remain financially healthy?
- **Capability due diligence** to assess the organisation's response to the disruption caused by COVID-19 and specifically answer two questions:
  - Is there a plan to return to the financial position pre-COVID-19?
  - Is there a plan to return to the operational impact pre-COVID-19? Does it require a different approach to delivering impact?

Finally, the "depth" of the due diligence activity was driven by three factors:

- Complexity of the partner's commercial model and financial accounts (e.g. a social enterprises commercial model and financial accounts are much more complex than a system change program funded predominantly by one philanthropic funder)
- Complexity of understanding the operational impact of COVID-19 on the partner
- Overall vulnerability that the due diligence exposes – the more issues that were identified the more work that was done to understand them and then assess what supports may be needed to mitigate the vulnerabilities

# 2

# FINANCIAL AND OPERATIONAL DUE DILIGENCE DIAGNOSTIC FRAMEWORK

*(Editorial Note: this section has been written assuming readers are familiar with simple financial concepts and definitions.)*

The following Financial Due Diligence Framework was developed.

**FIGURE 1 : FINANCIAL DUE DILIGENCE FRAMEWORK**

| FINANCIAL METRIC | EXAMPLE QUESTIONS | FINANCIAL ACCOUNTS COMPONENTS |
|---|---|---|
| **Trading Liquidity**<br>Key Metrics :<br>▪ Net Current Assets / monthly operating cost<br>▪ Net Current Assets less Deferred Revenue / monthly operating cost<br>▪ Net Assets excluding non-liquid assets (e.g. property) / monthly operating costs | How much working capital does the partner have to cover liabilities as they arise?<br>Projecting forward, how financially vulnerable is the partner? Will it have sufficient cash to cover costs?<br>Does the partner carry debt? Is there any risk that debt holders will require repayment? | Current Assets<br>Current Liabilities<br>Current Liabilities less Deferred Revenue<br>Net Current Assets<br>Net Current Assets less Deferred Revenue<br>Monthly Costs<br>Non-Current Assets – Investments split from Property<br>Non-Current Liabilities – Types of Debt and who with, T&C associated with debt<br>Net Non-Current Assets |
| **Income Volatility** | What will the impact of COVID-19 be on revenues? What are the different revenue sources and are they at risk? | Government Revenue (block funding versus activity based funding)<br>Philanthropic Revenue<br>Earned Revenue – Sales of Products and/or Services |
| **Cost Compressibility** | Can the partner reduce costs as revenue declines? Will the cost reductions impact the target outcomes? | Requires understanding cost structure and drivers – particularly staffing model |
| **Historical Financial Performance** | Is the partner a financially healthy organisation?<br>What are the partner's net margins? | FY18 Surplus/Deficit<br>FY19 Surplus/Deficit<br>FY20 Surplus/Deficit |

This diagnostic framework was applied to partners in two stages.

- **Stage One** – initial "outside in" analysis was conducted using publicly available financial data from the ACNC. This was used to rapidly identify partners who could be at risk of insolvency so we could triage the PRF response to engaging with partners.
- **Stage Two** – detailed analysis performed in collaboration with individual partners who were identified as in potential need of support in Stage One or who reached out to the SoP Taskforce for support. This analysis was completed using latest available data and forward projections from the partner.

Below are some disguised examples of the outputs from this work and some key observations.

# Stage One Analysis

*Observation:* The partner portfolio included a number of partners that were financially vulnerable at the time the due diligence was conducted. Almost 25% of the PRF portfolio analysed reported a negative Net Margin in their most recently financial results reported to the ACNC. Almost 65% of the analysed portfolio had less than 3 months trading liquidity. This level of financial vulnerability is consistent with the findings of the recent SVA and CSI report "**Partners in Recovery**" which analysed 16,000 registered charities and found that a 20% reduction in income would result in 17% of them being unviable.

FIGURE 2. SELECTED PORTFOLIO NET MARGIN (SURPLUS DIVIDED BY INCOME)

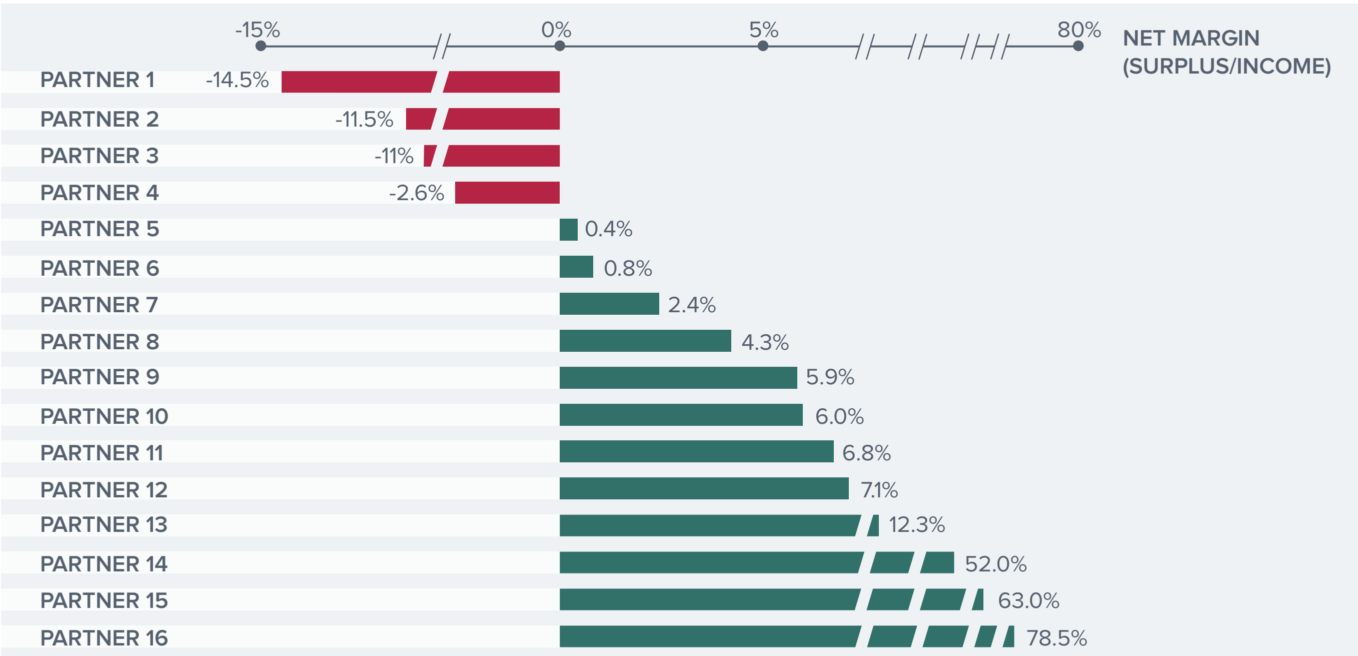
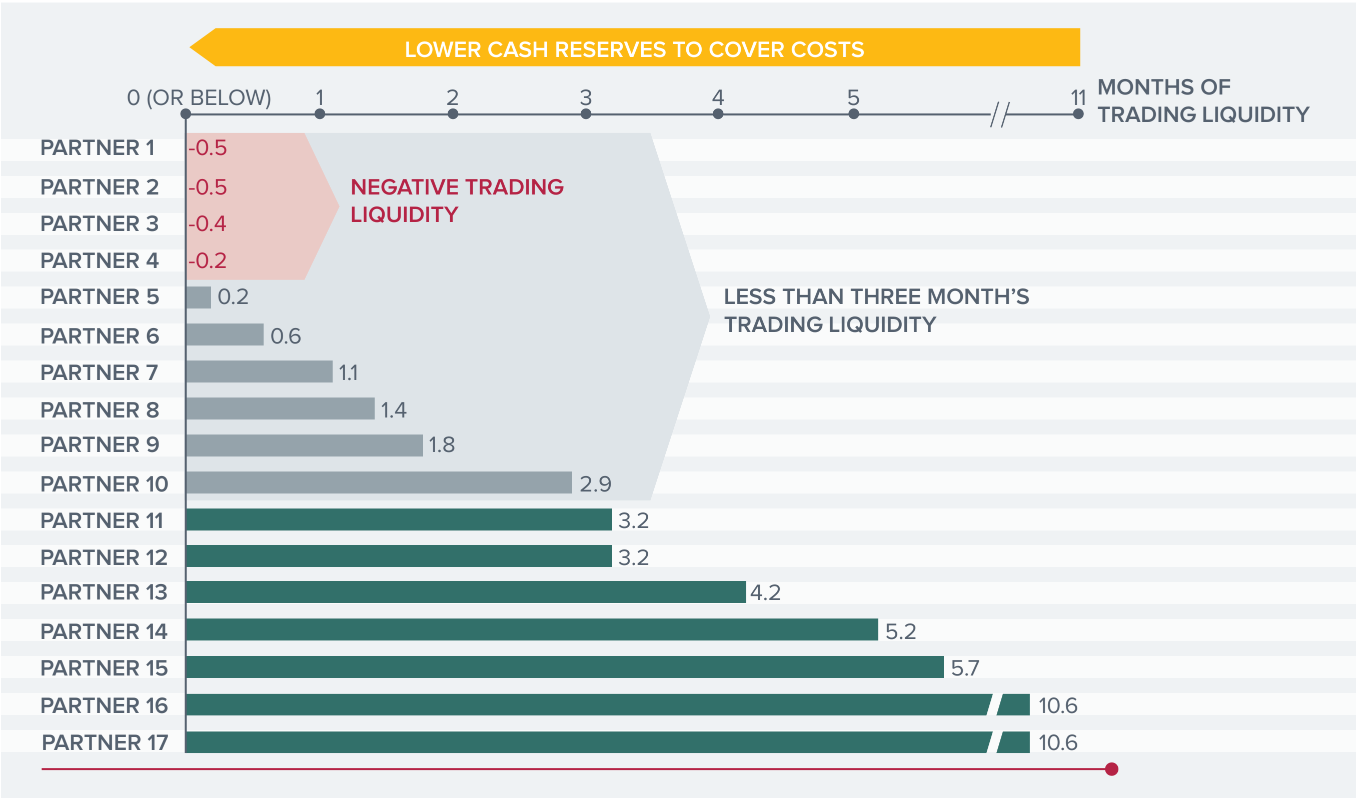


**FIGURE 3. SELECTED PORTFOLIO TRADING LIQUIDITY (MONTHS OF CASH RESERVES TO COVER COSTS IN THE EVENT OF NO INCOME)**



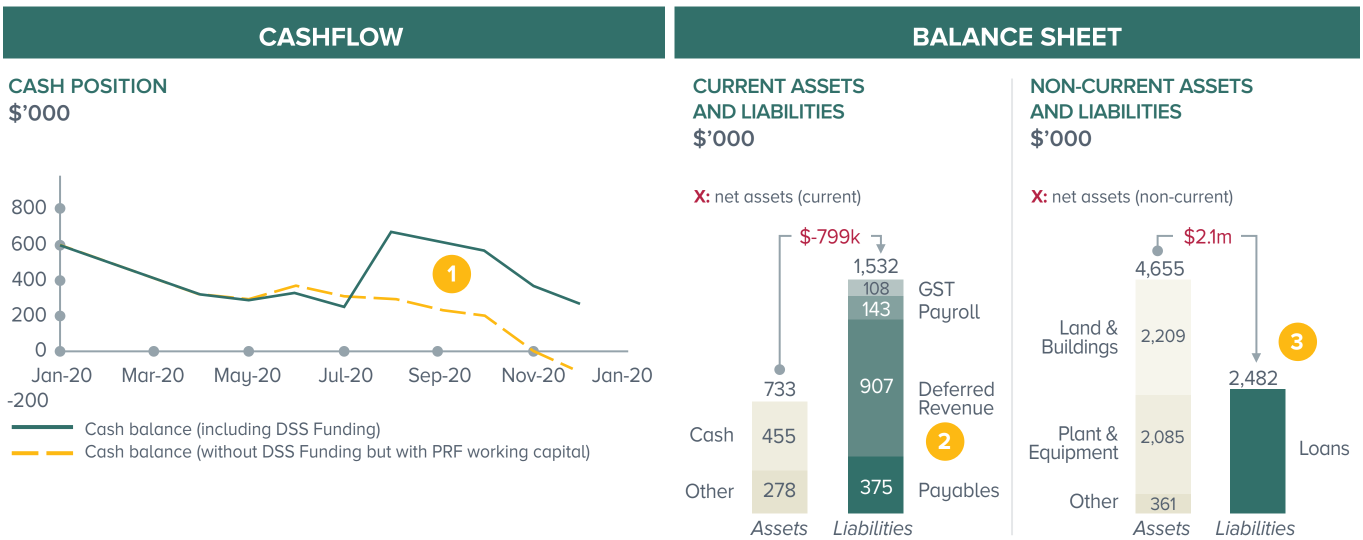

# Stage Two Analysis

The Stage One analysis was useful to get a "snapshot" of the portfolio and to triage partners for proactive contacting for support. However, to truly understand an organisation's financial health requires accessing their latest financial data and working closely with them to interpret it and project into the future. This focussed on exploring the Financial Metrics described in Figure 1.

## Metric – Trading Liquidity

A disguised example of one of the analyses performed in April 2020 and some of the key observations is below:

**FIGURE 4. DISGUISED PARTNER FINANCIAL ANALYSIS RESULTS**



***Observation* 1*:*** When there is a financial crisis “cash is king”. Consequently, the focus was on understanding cashflow and then projecting it forward for the example above. In this case, various scenarios were modelled to understand the potential cash position pathways.

***Observation* 2*:*** While net current assets appear to be negative, the major current liability was deferred (also known as unearned) revenue associated with cash received from a philanthropic partner but the work funded was not yet completed. While technically the partner owes the philanthropist the money until the work is complete, given the unprecedented nature of the COVID-19 pandemic, it is highly unlikely a philanthropist would put a partner into administration for not completing this work. Consequently, trading liquidity (net assets to cover operating costs) was recalculated to exclude deferred revenue.

***Observation* 3*:*** While this partner had significant net non-current assets they were not particularly liquid, that is, accessible for use if needed. In addition, the values of these assets on the balance sheet may not be reflective of their value if a short term liquidity crisis triggers an immediate sale. Finally, loans payment obligations needed to be understood to establish what repayments were required and what rights the various debt holders had over the distribution of any surplus cash.

### Metric – Income Volatility

In the Figure 1 Financial Framework, partner Income Volatility was also assessed. For-purpose organisations generally gain their income from one of four sources each with differing levels of volatility as a result of COVID-19. The proportion coming from each funding type varies significantly primarily depending on the organisation’s business model.

**FIGURE 5. PARTNER FUNDING SOURCES**

| FUNDING SOURCE | DESCRIPTION | POTENTIAL VOLATILITY |
|---|---|---|
| Government Funding | Block grants or other types of funding received from Government to deliver a service | Low volatility. Government expected to honour all contracts while current, so key issue is when contracts expire |
| Philanthropic Funding | Philanthropic funding to deliver a specific service (sometimes call tied funding), or philanthropic funding to support the organisation (sometimes called untied or discretionary funding) | Some volatility anticipated. COVID-19 has impacted financials of philanthropic foundations and PAFs and they may not have the financial resources to support partners as planned. Additionally fundraising from consumers has been significantly disrupted due to cancelling of many fundraising events |
| Fee For Service | Revenue earned from sale of goods or services | Depending on the service delivered, significant variation in income volatility. For example, social enterprises operating in the hospitality sector have seen large and rapid declines in revenues due to COVID-19. Conversely, Community Housing Providers have seen limited impact. |
| Other | Typically funding derived from income earned from partner investments or liquidation of assets | Some volatility anticipated. Similar to philanthropic funders, some impacts on corpus incomes due to impact of COVID on financial asset valuations |

### Metric – Cost Compressibility

Finally, as we evaluated specific financially vulnerable partners, the ability of partners to compress (ie reduce) costs in response to reductions in revenue was considered. A partner's flexibility to reduce costs varied significantly depending on the business model. For example,

- Social Enterprises saw their fee-for-service revenues drop quickly and consequently moved quickly to reduce costs and support eligible workers with JobKeeper. However, in cases where their impact model was to provide pathways to employment for vulnerable people this clearly had detrimental effect on their impact.
- Other organisations which were Government block funded or predominantly philanthropically funded saw little change in revenues initially but may see this change as the full impact of the pandemic plays out. These organisations have less flexibility to compress costs as they often run service delivery or system change programs reliant on staff with specialised knowledge. If any reduction of staff was required it could significantly impact the overall outcomes the program was designed to achieve and it is not simply a case of "cutting the cloth to fit" the available revenues.

### Operational Due Diligence

Operational due diligence was conducted as a natural extension of the financial due diligence with the partner. In seeking to understand the impacts of COVID-19 on the partner's financials it leads to a discussion of the operational impacts and then enabling the critical operational due diligence question:

- Have the operations of the organisation/program been adversely affected such that there is a material reduction in its targeted impact:
  - Directly by the COVID-19 response? and/or
  - By actions management are taking to remain financially healthy?

# 3
# FOR PURPOSE BUSINESS MODELS

Our work analysing the PRF Partner portfolio led to the identification of broadly four business model types, with differing COVID-19 pandemic-related Financial Due Diligence issues to be considered. When conducting financial due diligence it is useful to consider an organisation's business model to guide the issues to probe.

**FIGURE 6. PARTNER BUSINESS MODELS**

| PARTNER BUSINESS MODEL TYPE | IMPLICATION FOR DUE DILIGENCE PROCESS |
|---|---|
| 1. Social Enterprise | Potentially higher risk of insolvency, especially if small or newly established, but also more nimble in response to changing conditions. The focus of assessment should be on understanding revenue sources and their potential volatility and the impacts on target beneficiaries of actions taken to reduce cost. |
| 2. Independent change agent/ intermediary for purpose organisation | Typically do not hold much debt or assets. Key risks beyond those described earlier will be when philanthropic funding ends and whether it will be renewed. |
| 3. For purpose entity residing in, or associated with, a University or research institute | Lower risk of insolvency, but role played by the "parent" university/ research institute in supporting the for purpose entity must be considered. Specifically, there is a need to understand whether there is a risk of the University/research institute charging more for services to the entity or withdrawing other supports. |
| 4. Service delivery organisation | Likely to have a range of revenue sources across earned revenue, grants, and philanthropy. Focus on understanding overall financial health of the organisation. |

# 4
# CAPABILITY DUE DILIGENCE DIAGNOSTIC FRAMEWORKS

To complete the financial and operational due diligence, SoP Taskforce conducted a series of discussions with partners. These discussions led to a qualitative assessment of the capabilities of the partner to respond to the COVID-19 pandemic. Assessed partner capability domains included:

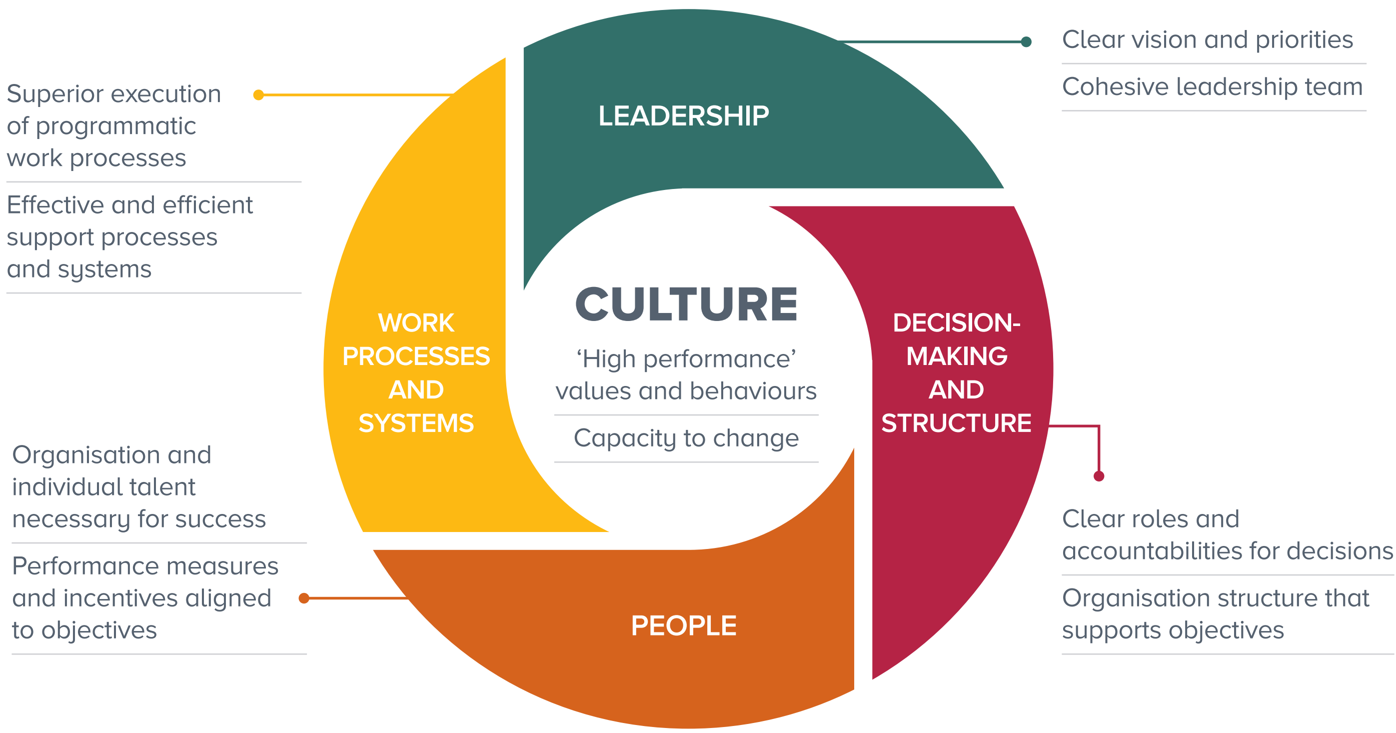
- Leadership response
- Commercial agility
- Financial modelling
- Process re-engineering
- Technology adoption

There are two organisational capability models which can be used for more extensive organisational capability assessments.

## 4.1 The Bridgespan Group

Bridgespan have developed and shared publicly their framework which they call the **Organisational Effectiveness Wheel**.

**FIGURE 7. ORGANISATIONAL EFFECTIVENESS WHEEL**




*Source: Bridgespan*

## 4.2 Social Ventures Australia

SVA has also developed an organisational capability assessment tool called '**The SVA Fundamentals for Impact**'. Developed specifically for the social sector, the SVA Fundamentals for Impact are differentiated from other organisational effectiveness tools. The framework recognises that effectiveness in this sector is determined by more than just internal capability and must also value being client centred and having a clear engagement with the ecosystem in which organisations and funders operate. In all, there are 15 organisational characteristics that SVA believes – and the evidence shows – are important for effectiveness.

# 5

# DUE DILIGENCE RESULTS REPORTING FRAMEWORK

To consolidate and report the results of the due diligence work, the SoP Taskforce developed a framework to guide the PRF/SVA analytical team members and enabled the SoP Steering Committee to review partner due diligence results and recommendations in a standard format. This standardised framework can easily be amended for other types of due diligence.

| | KEY COMPONENTS | | |
|---|---|---|---|
| **Program overview** | ▪ Org details and type<br>▪ Current PRF relations and funding | **Financial Vulnerability** | ▪ Assesment of financial vulnerability |
| **Program impact and sustainability** | ▪ Key target outcomes<br>▪ Progress to date<br>▪ PRF exit strategy | **Support details** | ▪ Supports originally proposed by partner<br>▪ Supports options arising from the due diligence |
| **Mission Alignment** | ▪ Alignment to PRF Strategy | **Impact if PRF do not fund** | ▪ Actions partner will take if doesn't get funding<br>▪ Impact of not getting funded on outcomes<br>▪ Alternative sources of funding and/or earned revenue |
| **Covid-19 impact** | ▪ Impact of Covid-19 on partner operations and end-beneficiaries<br>▪ What actions the partner has taken to itigate the impacts | **Leadership** | ▪ Leadership capabilities and response to crisis |

# 6
# CASE STUDIES

To demonstrate the COVID impacts on various types of PRF partners, and some of the results of the due diligence, below are a number of disguised case studies.

**CASE STUDY**

## Social Enterprise

### Business model

Focused on providing career pathways for people with lived experience of vulnerability through a hospitality focused business. Core activities include:

- Operating a hospitality industry service
- Creating employment pathways through a career development centre that provides vocational training, career events and career planning services to staff.

### COVID-19 related financial and operational impacts

Social Enterprise was approaching financial sustainability prior to COVID-19 but then experienced 80% revenue drop due to effect of COVID on its customers. Management responses included compressing operational costs (stood down staff, others moved to part-time), pro-active renegotiations with suppliers and accessing Government grants to sustain business. Additionally also received JobKeeper. Likely to experience sustained period of deficit due to ongoing uncertainty about outlook for hospitality industry. Many staff are highly vulnerable during COVID-19 but Social Enterprise is unable to meet increased demand for career and other supports such as renegotiating rents and accessing Centrelink.

### Other observations

Strong management team demonstrated quick operational response

### Supports provided by PRF

Working capital grant to enable leadership to increase focus on developing business resilience plan as JobKeeper unwinds and if revenues do not recover. Funding to recruit an additional career worker to provide needed support to vulnerable staff who have increased needs due to COVID-19.

CASE STUDY

## Independent Change Agent/ Intermediary For Purpose Organisation

### Business model

PRF Partner is a small not-for-profit intermediary that works with specific communities to drive change

Funded primarily through two sources – a large, multi-year contract with a Government Agency and funding from PRF. Generates a small amount of fee for service type income.

### COVID-19 related financial and operational impacts

No immediate financial risk at this time due to Govt contracts and PRF funding.

Experienced significant operational disruption as a result of COVID-19. Most project-based work has been deferred or put on hold due to the need for face to face engagement. Only 25% of work is able to be delivered virtually. Further, attempts to move remote work online have not been as effective engaging in face-2-face. There is likely to be ongoing uncertainty regarding access to some communities.

### Other observations

Lean operational model with network of contract staff has enabled Partner to reduce costs in line with reduced activity and will enable a quick recovery once COVID-19 related restrictions are lifted. COVID-19 has further accelerated the need for the Partner to develop a more sustainable business model with reduced reliance on government and philanthropic funding.

### Supports provided by PRF

No supports provided at this time.

CASE STUDY

## For Purpose Entity residing in, or supported by, a University

### Business model

PRF Partner is a program residing in a University that

- Trains teachers
- Conducts research
- Advocates for policy change.

Funding sources are primarily PRF, Govt grants and fee-for-service for the teacher training

### COVID-19 related financial and operational impacts

Program significantly disrupted due to the immediate and ongoing COVID-19 impacts on the education sector. In person training cancelled and RCTs delayed. However no immediate financial risks due to business model with very small self-generated revenue, stability of PRF as significant funder and University commitments at this time to staff salaries and infrastructure.

### Other observations

Ongoing support from the University is critical. Financial due diligence identified a number of supports that were provided either at lower than actual cost or for free. Consequently there is a risk to the program if the University withdraws support or prices that support services at actual cost. Given the COVID-19 impact on University sector revenue this is an ongoing risk.

### Supports provided by PRF

No supports given however continuing to closely monitor.

## About the Paul Ramsay Foundation

The Paul Ramsay Foundation is an Australian philanthropic foundation, established by Paul Ramsay AO in 2006. The Foundation continues Paul Ramsay's philanthropic legacy through a commitment to break cycles of disadvantage. We partner with individuals and organisations around Australia to support promising ideas and methods, scalable innovation and adaptive practice to break cycles of disadvantage in Australia. We focus on the most stubborn barriers to change, supporting programs aimed at increasing participation in quality early childhood education and care; improve school-age learning outcomes; reduce Aboriginal youth incarceration; and create reliable pathways from school to work.

## Social Ventures Australia

Social Ventures Australia (SVA) is a not-for-profit organisation that works with partners to alleviate disadvantage – towards an Australia where all people and communities thrive. We influence systems to deliver better social outcomes for people by learning about what works in communities, helping organisations be more effective, sharing our perspectives and advocating for change.