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Kate Sayer: Beware of overtrading - it can creep up on your charity

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Rapid growth without forward planning can bring a host of problems, writes our columnist

Kate Sayer

We usually associate overtrading with businesses; typically, the builder who takes on too many jobs, doesn't finish them and so never gets paid in full. This can happen to charities too, particularly now they often operate on contracts and payment by results. But the signs in charities and social enterprises are less obvious.

Overtrading is the term used to describe a collection of negative consequences that can result from rapid growth. Typically, poor debt collection and rising costs, then lower margins. By the time you see these symptoms in the management accounts, it might already be quite late for action.

An obvious early sign is a forward plan that assumes rapid growth. Plans frequently underestimate the increased overheads that will be needed to support the growth. For example, more staff will be needed and they have to be recruited, inducted and trained. Management is often stretched really thin in these situations.

Bids for new activity might have been trimmed to win funding, but contribute little to core costs. It will then be hard to achieve the outcomes without drawing on unrestricted funds. Monitoring reports might not reveal the extent of the subsidy needed – human nature is such that project managers are often optimistic and promise to manage within the funding available.

In charities, there can be insufficient rigour about management of human resources. Charities rarely expect staff to complete timesheets and even more rarely use them to monitor capacity and workflow. With stretched management and staff, the solution appears to be more income. The charity bids for more funds, but does not have the capacity to deliver the work. The funding from new sources is used to pay for the completion of existing projects that have overrun – a classic "robbing Peter to pay Paul" situation.

It is possible for this to continue for a while, building up large deficits on projects that aren't noticed because the time costs are not being properly attributed to activities. The reality of the situation might become apparent only when the music stops – possibly when new funding starts to dry up or when final project reports are due. Or it can become apparent when an auditor focuses on year-end balances on restricted funds and seeks assurance that sufficient funds are being carried forward to complete projects.

Prevention is better than cure, so make sure projects are fully costed and identify necessary subsidies at the start. People's time should be attributed to the projects they are working on and overrun time should be identified early – you'll have to cut time if you're to deliver the project on budget. You might need to look again at management accounts. Managing capacity as well as financial budgets is essential to prevent the overtrading typically encountered in the charity sector. Think about planning your most valuable resource – people's time.

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