

# A FINANCIAL SUSTAINABILITY REVIEW

CHANGE AND ADAPTATION IN THE VOLUNTARY  
SECTOR AS THE ECONOMY RECOVERS



/02

# CONTENTS

Acknowledgements	03
Methodology	04
Foreword	05
Executive Summary	07
Income	10
Expenditure	18
Assets	25
Looking ahead	31
Bibliography	37

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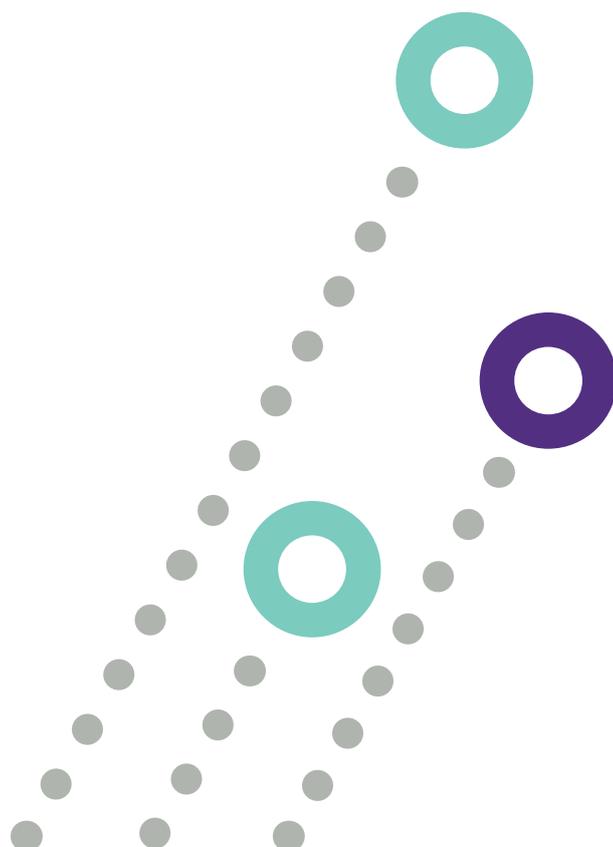
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*The review was co-authored by Michael Birtwistle and Andrew O'Brien, with input from other members of the working group.*

*The secretariat for the review was provided by NCVO with the support of member organisations.*

*\* replaced Joe Irvin during the course of the review*



# METHODOLOGY

The review's parameters were set by its steering group, while data gathering and analysis of trends was carried out by the working group. The review's aims were to:

- assess the financial sustainability of voluntary organisations operating in England
- identify the trends that have emerged within the income, expenditure and assets of the voluntary sector since the recession
- provide analysis to enable the voluntary sector to plan for the future
- make recommendations to policymakers on how to improve the financial sustainability of the voluntary sector
- provide practical advice and support for voluntary organisations to become more financially sustainable.

The partners in this review are membership organisations that capture a large amount of qualitative and quantitative data from voluntary organisations through surveys and consultations, cited throughout and in the bibliography. Cumulatively, they have a membership of over 20,000 voluntary organisations (although some are members of several partner organisations). The review has drawn on their depth of expertise acquired through longstanding policy and practice work on funding issues, to offer insights and play a quality assurance role.

This was combined with data from the NCVO Civil Society Almanac 2015 ('the Almanac') to build a picture of how wider economic changes since 2007 have had an impact on voluntary organisations in England. The Almanac presents a comprehensive picture of the structure and economy of the UK voluntary sector. The Almanac brings together data from charities' accounts, administrative data and surveys, and is regarded as the most authoritative source of statistical data about the voluntary sector. Widely cited by the media, government policy makers and sector leaders, it offers a definitive overview of the sector's scope and characteristics.

Unless otherwise stated, trends are described in real terms, adjusting for the impact of inflation. Most Almanac data runs to the financial year 2012/13, but where available, provisional data for 2013/14 has been used. The period examined is 2007/08 to 2012/13 unless otherwise stated, with references to preceding years running from 2012/13.

The review was also supplemented by a call for evidence across the voluntary sector, including a detailed survey on how economic conditions had impacted organisations' financial sustainability, which received 106 responses.

The working group undertook five roundtable meetings between July 2014 and March 2015, to discuss each section of the review. Meetings were also held with other sector bodies to explain the review process and gather their views on the impact of economic conditions on the voluntary sector. Some responses have been used throughout the report as perspectives to illustrate the ways that charities have sought to adapt to this new operating environment.

References to the sizes of charities are drawn from the income bands used in the Almanac:

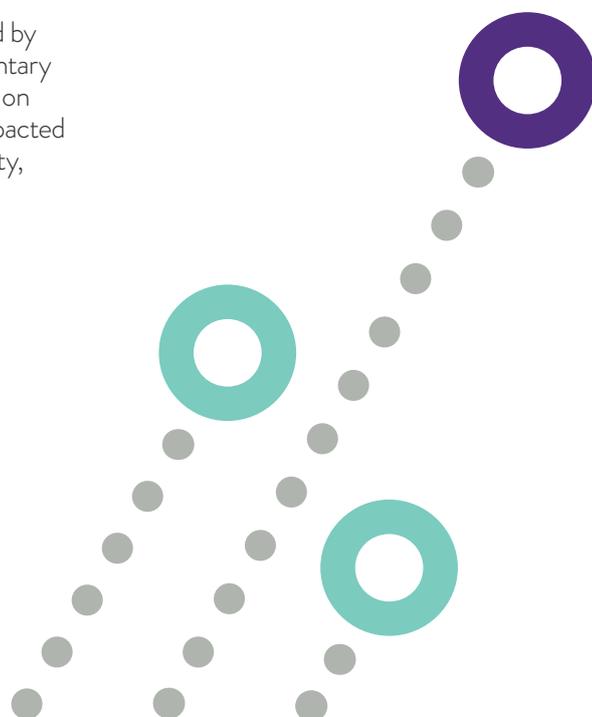
**Micro:** £0-£10,000

**Small:** £10,000-£100,000

**Medium:** £100,000-£1,000,000

**Large:** £1,000,000-£10,000,000

**Major:** >£10,000,000



/05

# FOREWORD

BY SIR STUART ETHERINGTON, CHIEF EXECUTIVE,  
NCVO AND FUNDING REVIEW CHAIR

Charities play a vital role in improving our society and make a huge contribution to the UK economy. They are the biggest builders of social capital, and provide crucial support to people and communities across the country, often those that are hardest to reach.

In economic terms alone, the voluntary sector as a whole (primarily charities) has a gross value added of £12.1bn per year, with the economic value of UK volunteering estimated at over £23.9bn, to say nothing of the social value they also add.

The aim of this review has been to consider how the sector has adapted to wider economic changes, and how this has changed the finances of the sector. It has done this by bringing together evidence from a group of national membership organisations in the voluntary sector, surveying charities about their experiences, and holding roundtables to identify some of the key trends since the recession.

This review has taken place over a period of slow economic recovery and enormous reforms to the size and shape of government spending, both for our sector and public services more widely. Voluntary organisations have had to come to terms with a new operating environment, characterised by fiscal retrenchment from government, tight household finances and increased demand for voluntary sector services. If the sector's finances are to be put on a sustainable path it is vital to take account of the changes that have taken place over this period, some of which are likely to be permanent features of the landscape for the foreseeable future.

Voluntary organisations have demonstrated great resilience in the face of major changes, including a £2.3bn fall in income from government contracts and grants since 2009/10. Despite the tough environment, innovation has thrived. Charities have reacted by raising more through fundraising, rebalancing their finances away from government and towards the general public where possible.

Their attempts to adapt have however often been self-sacrificial, especially for small and medium sized organisations. In trying to do more with what they already have, such organisations have eaten into reserves, cut investment in their own capacity, reduced expenditure on training, and frozen staff salaries, while staff have increased their working hours – all to avoid reducing the support they provide day-to-day.

Not only is the long-term sustainability of this approach questionable, but there is a further question of whether small and medium sized organisations are reaching a point where they have seriously impaired their ability to engage with different forms of funding, even if it is readily available.

There are also barriers that voluntary organisations have had difficulty overcoming alone. Government income has been falling, but still forms a third of sector income and will continue to be an important source of funding.



THE FINANCIAL  
ENVIRONMENT FOR  
CHARITIES IS STILL  
SUBJECT TO VOLATILITY

Government and charities have distinctive but aligned concerns in providing public benefit, and if we accept the growing role of voluntary organisations in the delivery of public services, then commissioning must continue to be reformed to enable the participation of the sector.

The financial environment for charities is still subject to volatility. Global economic performance, policy changes at a national or local level, and the spending power of households could all have significant impacts on the sector's finances over the coming years.

The sector needs government to shift focus away from initiatives that only touch the periphery of the sector's finances such as social investment, and focus instead on the central challenge of helping voluntary organisations to build sustainable income sources.

The review sets out key policy and practice implications that arise from the data analysis, and which articulate the challenges the sector will be working through in the foreseeable future.

The review's projections point to a £4.6bn annual shortfall in sector income over the next five years simply to maintain current spending power. At the same time, there are higher expectations than ever of civil society, and higher demand for the sector's services. It is this growing demand, and this shortfall that make addressing the review's conclusions so urgent.

We believe that this review will be useful for charities and policy makers in understanding the challenges facing the sector, how charities have sought to deal with them, and what needs to be done in the future to enable charities to continue to achieve social change.

NCVO and the other organisations in our steering group will continue to do all we can to support voluntary sector organisations as they seek to achieve financial sustainability in challenging times. We encourage the government and others to join us in this vital task and help ensure our sector can continue building resilient communities well into the future.

**Sir Stuart Etherington**  
Chief Executive, NCVO



# EXECUTIVE SUMMARY

## KEY FINDINGS

### Income

- **The voluntary sector's funding has stagnated** over the last five years, but the **aggregate figures mask a significant redistribution** of the sector's spending power from smaller to larger organisations. Sector income has decoupled from economic growth, having followed similar trends in the years leading up to the financial crisis and first few years of recovery.
- Smaller charities in particular are not benefiting from the economic recovery. They are experiencing a **'capacity crunch'** that limits their ability to adapt, or to even engage with funder programmes designed to improve their sustainability.
- Income from government contracts has fallen since 2009/10. Despite positive developments like the Social Value Act review and government contract transparency clause pilots, there remain **significant barriers for charities seeking to engage with public service contracting**.
- **Government grants are at an all-time low**. Foundations have a growing role in the adaptation of the sector as one of the few remaining providers of unrestricted funding.
- While donations have recently recovered to pre-recession levels, the significant growth in income from individuals has been driven by **fees charged by charities for services**. Relying on this as a major source of future income growth may be unsustainable or undermine organisations' charitable aims in some parts of the sector.

### Expenditure

- Surveys of the sector show consistent **year on year rises in demand for services**, but detail of this demand is not routinely collected or published across all parts of the sector. **Charities need to develop their measurement and communication of demand for sector services**, including the extent of unmet need. Better reporting of the demand for grant funding from foundations and the number of applications they have to turn down because of lack of funding is also an important part of this picture.
- The price of key everyday goods and services commonly used by voluntary organisations has **significantly risen in price**, often above inflation. At the same time, charities have seen **support from local authorities and other public bodies reduced** due to budgetary pressures, meaning they have to spend more to receive services they previously received pro bono or at discount. This has made the **availability of existing tax reliefs** increasingly important.
- Despite the significant pressures on charities' spending, **charities have responded by increasing the proportion of their spending on charitable activities**, and foundations have increased the amount of grant funding to other charities.
- Charities have stretched staffing resources, **cut back** on back office upgrades and training, used technology to reduce costs, and also tried to **work closer together** and pool resources.

### Assets

- Voluntary sector **assets have not yet recovered to their pre-recession value**, and the recovery in asset value has not been uniformly distributed across the sector.
- The use of reserves to cover operational costs is leaving the sector in a **fragile position**. Without a significant and sustained improvement in its funding environment, **the sector could experience a delayed impact from the recession**.
- Falls in asset values during the recession contributed to a relative **increase in the sector's pension liabilities** that has not recovered with more recent asset growth.
- Many charities however have sought to use their assets in order to generate additional income.
- There is not yet evidence of a significant increase in organisations seeking and securing social investment.

### Forecast

- The combined effect of current forecasts is a **£4.6bn annual shortfall in overall sector income** by 2018/19, simply to maintain its 2012/13 spending power.
- On current trends, the only significantly growing source of sector income (individuals) will not rise enough to make up for the fastest falling source of income (government).
- The effect of inflation will reduce the sector's spending power by £3.1bn by 2018/19, which will feed into the squeeze on capacity.
- A slow recovery of the sector's asset base is likely to be realised most in larger charities and foundation endowments which provide ongoing income. This rise in assets will therefore not make up for income loss elsewhere.

### Policy implications

#### Voluntary sector

- Voluntary organisations are increasingly generating income through charging for services, but this approach is not suitable for all organisations. Voluntary organisations will need to ensure any efforts to generate income do not undermine their ability to achieve their charitable objectives.
- Voluntary organisations have lost significant amounts of government income, around £1.7bn since 2009/10. Organisations will need to ensure they are in a position to win government grants and contracts, whether that is through improved collaboration, demonstrating their impact or piloting new ways of delivering their services – but change is also needed from government to enable this to happen.

- There is strong evidence from surveys to suggest that demand for voluntary organisations services has grown significantly over the course of the recession. Organisations will need to take additional steps to build a better picture of demand and what resources are required to meet need. This will enable a much more focused debate around the sector's finances and ensure that discussions are better informed.
- Voluntary organisations have experienced a 'capacity crunch' of their back-office and management resources as they seek to put more into delivering frontline services. But this cannot be done indefinitely without significantly reducing the sector's long term ability to meet demand and generate income. Voluntary organisations will need to think ahead and consider how they balance short-term demand with long-term sustainability.
- Some organisations have become more sustainable and have adapted their business models. Voluntary organisations should consider doing more to spread the lessons of success while also recognising the limits of replicating a 'one size fits all' model.
- Our report indicates that voluntary organisations will need to make over £3bn in efficiency savings in order to maintain their spending power. Voluntary organisations need to begin working now to identify areas where savings can be made and design strategies for achieving them. Voluntary organisations are also advised to make explicit the impact of inflation when bidding for contracts and grants.
- Charitable foundations now account for an increasingly important part of the sector's income given the reduction in grant funding from government. Foundations may need to reconsider their role as strategically important funders for the sector in the light of these changes. More co-ordinated or different approaches to funding the sector may be necessary to compensate for the loss of government income, for example for capacity building.

THE COMBINED EFFECT  
OF FORECASTS IS A £4.6BN  
ANNUAL SHORTFALL  
IN OVERALL SECTOR  
INCOME BY 2018/19

- Voluntary sector funders of other voluntary organisations will need to consider how to provide funding in a way that helps make their partner organisations sustainable and supports their long term capacity to deliver change; while also balancing this against their need to make their resources achieve the biggest possible impact.

### Government

- Government income to the voluntary sector has fallen, despite efforts to ensure such organisations play a bigger role in public services delivery. We call on the government to take further steps to improve current commissioning policy and practice and ensure voluntary sector organisations are able to realise their potential to play an active role in a diverse future market of public services providers.
- Grants are a critical source of income for the sector and some services are not sustainable under a contract model. The government will need to work with the sector, building on initiatives such as NHS England's Bitesize Guide to Grants for the Voluntary Sector, to ensure that appropriate funding mechanisms are used by commissioners. This is important to avoid a contract monoculture that will otherwise affect the long term sustainability of a significant part of the sector.

- Voluntary organisations are striving to adapt to replace government income that they have lost, yet in many cases the reductions are taking place faster than the sector can develop new revenue streams. The government should reconsider the scale, pace and targeting of current spending reductions to ensure the voluntary sector is able to meet demand for services in the long term.
- Evidence from voluntary organisations indicates that a holistic funding approach to the sector across different parts of government has yet to be adopted. We call on the government to ensure that devolution of more power and spending decisions to the local level does not undermine the ability of the government to develop a coherent strategy for supporting the voluntary sector.
- Voluntary organisations are working hard to generate more of their own resources. There are a number of ways that government can support this, for example, through more effective use of existing tax reliefs. The government should consider how tax reliefs such as business rates and gift aid can be better implemented to maximise charitable income.

- The relationship between the government and the voluntary sector is changing. The government should renew and strengthen its commitment to strategic partnership frameworks such as the Compact to ensure partnerships continue to be relevant and effective in a changing operating climate.
- The asset recovery of the sector has not been evenly distributed. Large charities and foundations have benefited from recovering asset values, while small voluntary organisations have not seen a significant improvement. The government and voluntary sector need to work together to ensure that small voluntary organisations are 'recapitalised' so they are able to grow sustainably in the future.

VOLUNTARY ORGANISATIONS  
ARE WORKING HARD TO  
GENERATE MORE OF  
THEIR OWN RESOURCES



# INCOME

## OVERVIEW

- The voluntary sector's income has not recovered in line with the wider economy. Income is down £1.4bn from its 2007/08 peak, and has stagnated since 2009.
- Charities have demonstrated a significant amount of innovation and entrepreneurship during the economic downturn and recovery.
- The biggest falls have been in income from government sources.
- Grants from central and local government fell by 49.3% (£2bn) between 2007/08 and 2013/14.
- Income from government contracts has fallen £1.7bn since its 2009/10 peak.
- Government contracts became a very significant source of sector income over the last decade.
- Smaller charities' income has been the worst affected by government spending reductions.
- Income from investments (rents from property, dividends, interest on deposits) has fallen by 30% since 2007/08, with legacy and private sector income remaining flat.
- Income from individuals has grown £2.3bn in the last five years, and has grown significantly as a proportion of total sector income.
- Another significant increase in income for the sector has been through fees for charitable services.
- Charities have sought to diversify their income away from government sources towards income from individuals, which includes donations, fundraising, fees for services, and legacies.

## Overall income

### The sector's income has not recovered alongside the UK economy

The financial crisis in 2008 brought about a recession which saw the total value of the UK economy fall by 6%. It has now been almost two years since the UK economy returned to its pre-recession size (in Q3 2013) and it has continued to grow since.

However, the voluntary sector's income has not grown in line with this economic recovery. Up until 2011, the sector's income broadly correlated with UK GDP, after which it declined sharply compared to the rest of the economy.

The charity sector is still experiencing the lasting effects of the recession, which has had a more significant impact on this sector than on many aspects of the wider economy.

### Voluntary sector income is down £1.4bn since its 2007/08 peak, and has stagnated since 2009.

According to the Almanac, overall voluntary sector income has fallen from £42.1bn in 2007/08 to £40.7bn in 2013/14. This leaves the sector's income at the same level as it was in 2009, following the financial crisis, or in 2006, eight years previously.

## Government income

### The biggest falls have been in income from government sources

The latest data available shows the impact of the first year of the government's planned fiscal consolidation.

INCOME FROM  
INDIVIDUALS HAS  
GROWN £2.3BN IN  
THE LAST FIVE YEARS



It shows a significant fall in government income to the voluntary sector, of around £1.3bn between 2010/11 and 2011/12. This is a sharp deviation from the previous trend which saw income from government to the voluntary sector rise substantially over the course of the 2000s. These reductions are causing serious financial difficulties for organisations that depend on government funding.

**Grants from central and local government fell by 49.3% (£2bn) between 2007/08 and 2013/14.**

A reduction in the amount of government grant funding continues a longer trend of declining grant income to the charity sector. The reduction in grant income in the first year of government spending reductions was larger in size than the fall in contract income over the same period.

**Income from government contracts has fallen £1.7bn since its 2009/10 peak.**

The proportion of total sector income from government contracts almost doubled between 2003/4 to 2010/11, and currently stands at around 27% of overall income.

Income from government contracts has fallen to its lowest level since 2007/08. This reduction in income from contracts, combined with the longer term decline in grant income, is placing some charities in serious financial difficulties.

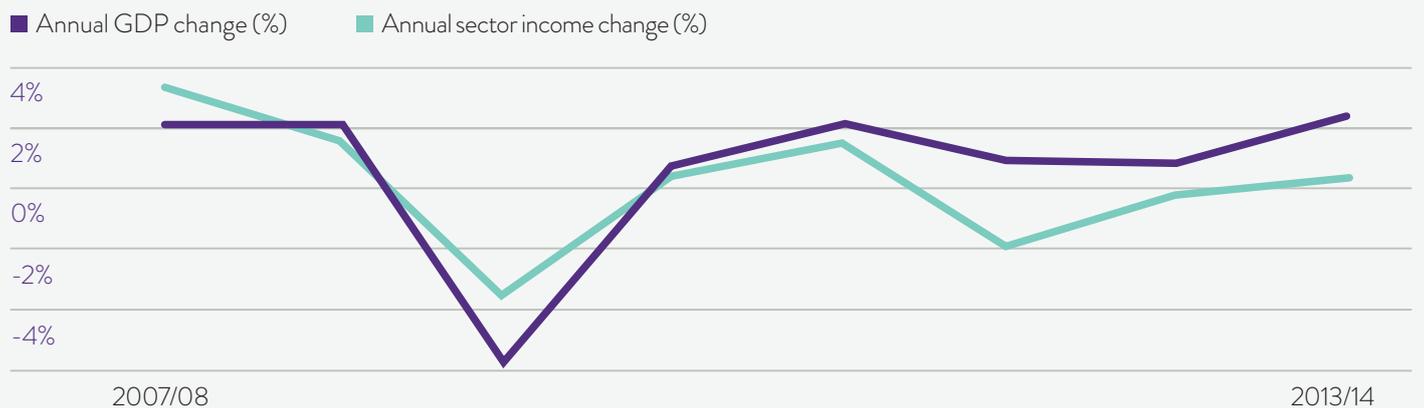
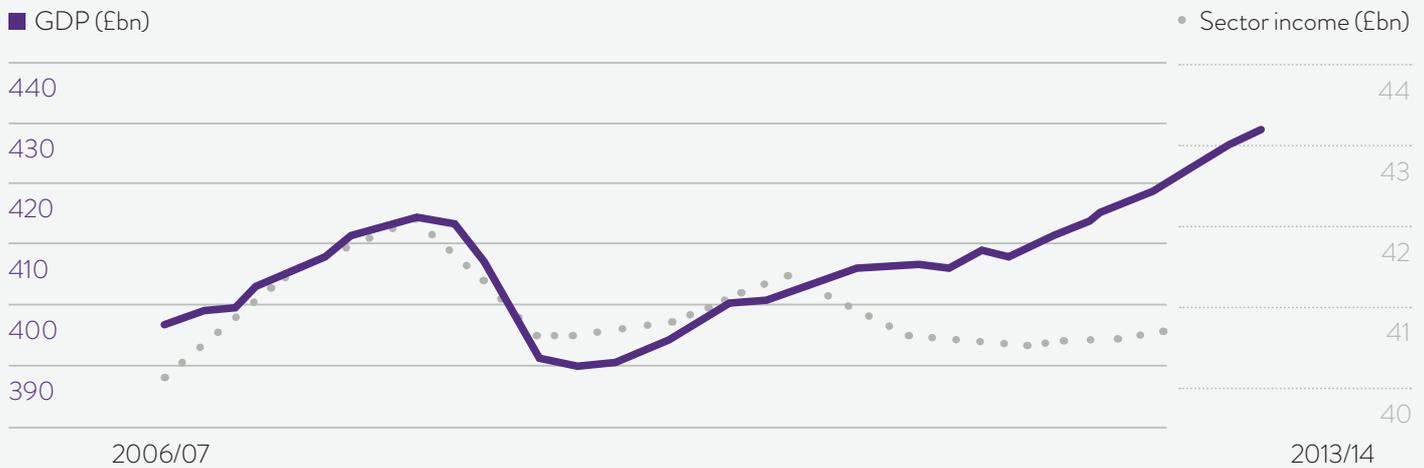
This is not only because government income functions as an important source of funding in its own right, as shown in Figure 3. It is also because income from government has historically enabled organisations to create a financially secure platform for their organisation that can be used to secure funding from other sources such as trusts and foundations.



*'For the first year or two after 2009/10, there was not too much difference but as we went into 2011/12, we had a contract cut by 50%. We did manage to attract some new three year grants around the same time, but they are now winding off and it is more difficult to find replacement sources for those funds even for a year or two, let alone three.'*

*'Impact has been 'late arriving'...because we had become far too dependent on local government funding and too complacent about independent fundraising. In 2013 we made a 25% loss in relation to total income and we had to charge more and reduce staffing.'*

**Figures 1 and 2 – UK GDP and total voluntary sector income (£bn and % change)**



Government policy has for some time been to move away from grants and towards contracts as a funding modality. Many of these contracts are large scale, awarded on a lowest cost/price basis, and require upfront financial investment and/or the ability to manage significant financial risk over the contract duration. These and other aspects of contracting are proving especially challenging for the small – and medium-sized charities that constitute the bulk of the voluntary sector.

### Income from individuals

#### *Income from individuals has grown £2.3bn in the last five years*

There has been sustained growth in income from individuals to the voluntary sector in recent years. After falling £0.4bn between 2007/08 and 2008/09, donations recovered despite the squeeze on household incomes, recording growth of 7.2% between 2008/09 and 2012/13 – although this is only 0.6% higher than 2007/08. Earned income from individuals (primarily fees for services) has grown by 30.6% between 2007/08 and 2012/13, a strong performance given wider economic conditions.

#### *The largest source of income growth has been from fees charged for services*

Income from fees charged for services accounts for 98% of the growth in income from individuals since 2007/08. This only includes fees for services provided in pursuit of charitable objectives, such as membership subscriptions with significant benefits or rent from property where providing accommodation is a charitable purpose, such as care home fees. Fundraising, which includes merchandise, raffles, fundraising events and charity shop turnover has recovered since 2008/09 but is only slightly above its previous 2007/08 peak.

Increasing reliance by charities on income from fees charged for services creates a serious challenge for some voluntary sector organisations as they balance the need to generate new sources of income against the requirement that they continue pursuing their charitable objectives and delivering public benefit.

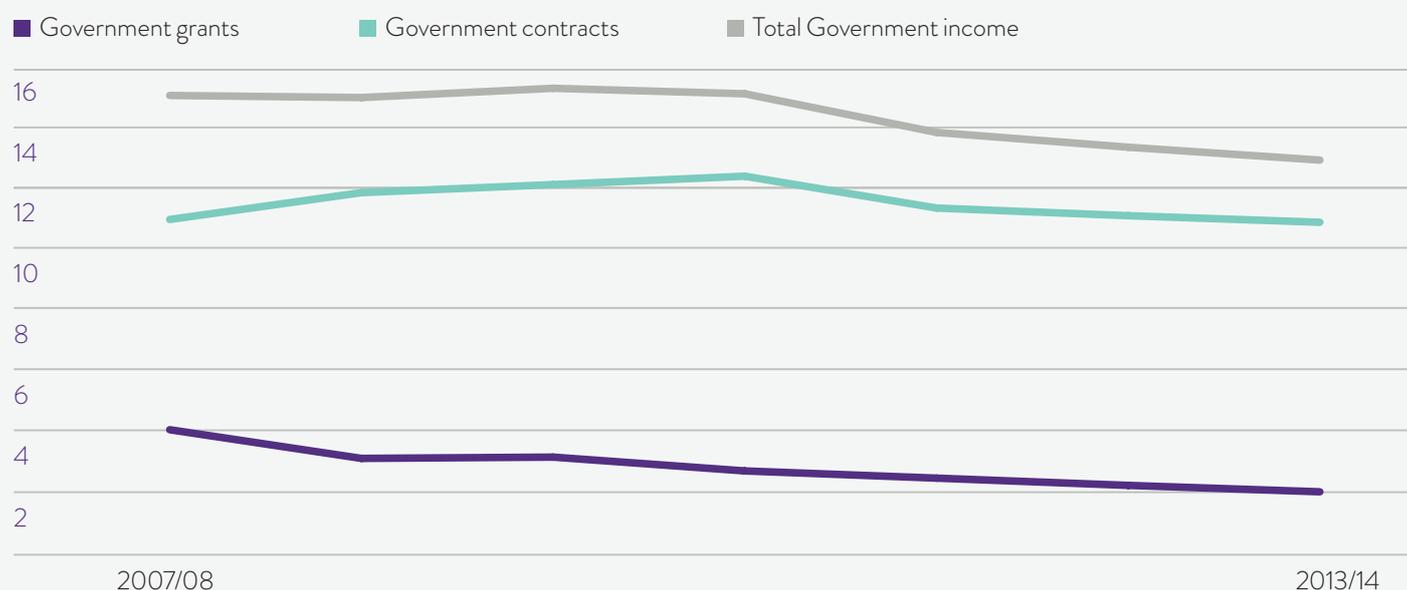
#### *Income from individuals has grown significantly as a proportion of total sector income*

The recession has seen the start of a move by the sector towards building a stronger financial relationship with individuals rather than government. The proportion of total sector income from individuals now represents almost half of overall income. It grew from 40% in 2007/8 to 48% in 2013/14. It is likely that this trend will continue over coming years.

Increasing income from individuals appears to be an attractive alternative to funding from government in the context of continuing reductions in government spending and challenges around securing contract funding, but it is not without risks. For example, income from legacies and fundraising is contingent on maintaining high levels of public trust and confidence in charities. Income from fees for services is premised on the continued availability of a functioning market in such services. Some organisations and some service specialisms are more suited than others to fundraising and charging for services.

Charities will need to carefully assess the costs, benefits and risks of increased dependence on income from individuals to ensure their financial sustainability.

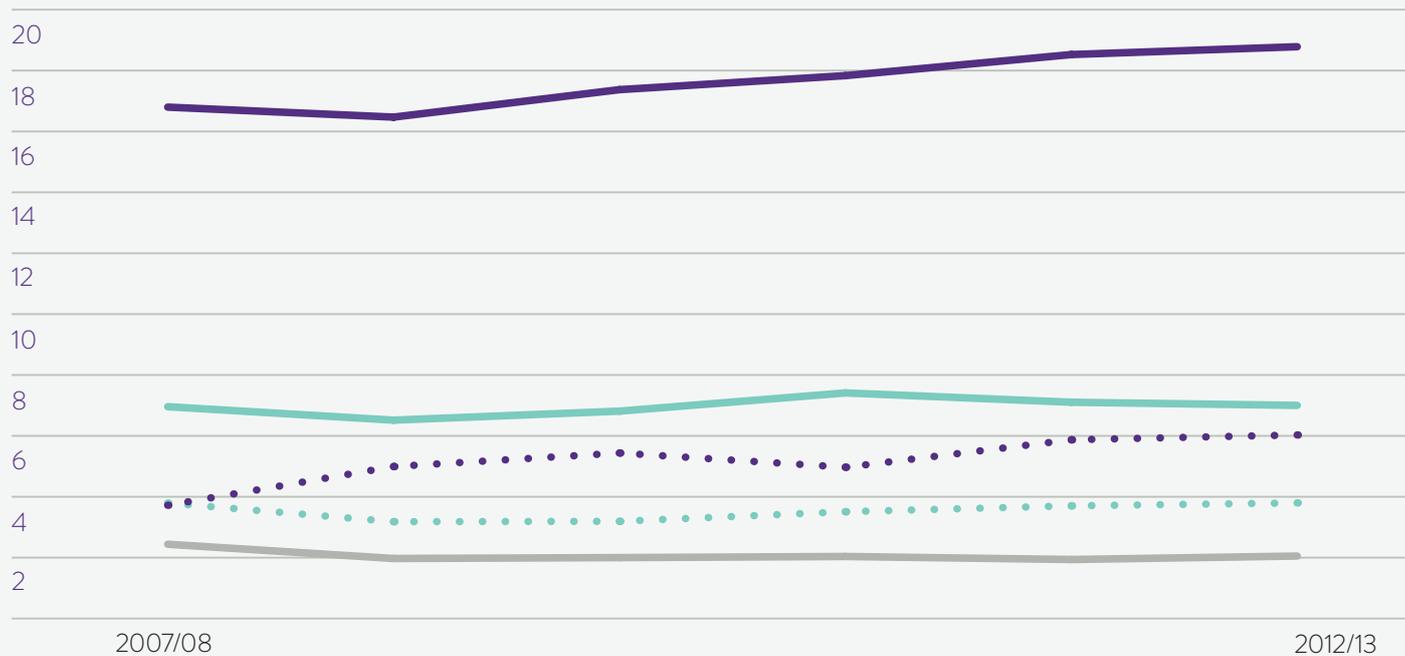
**Figure 3 – Income from government sources (£bn)**



Figures 4 and 5 – Changes in income from individuals

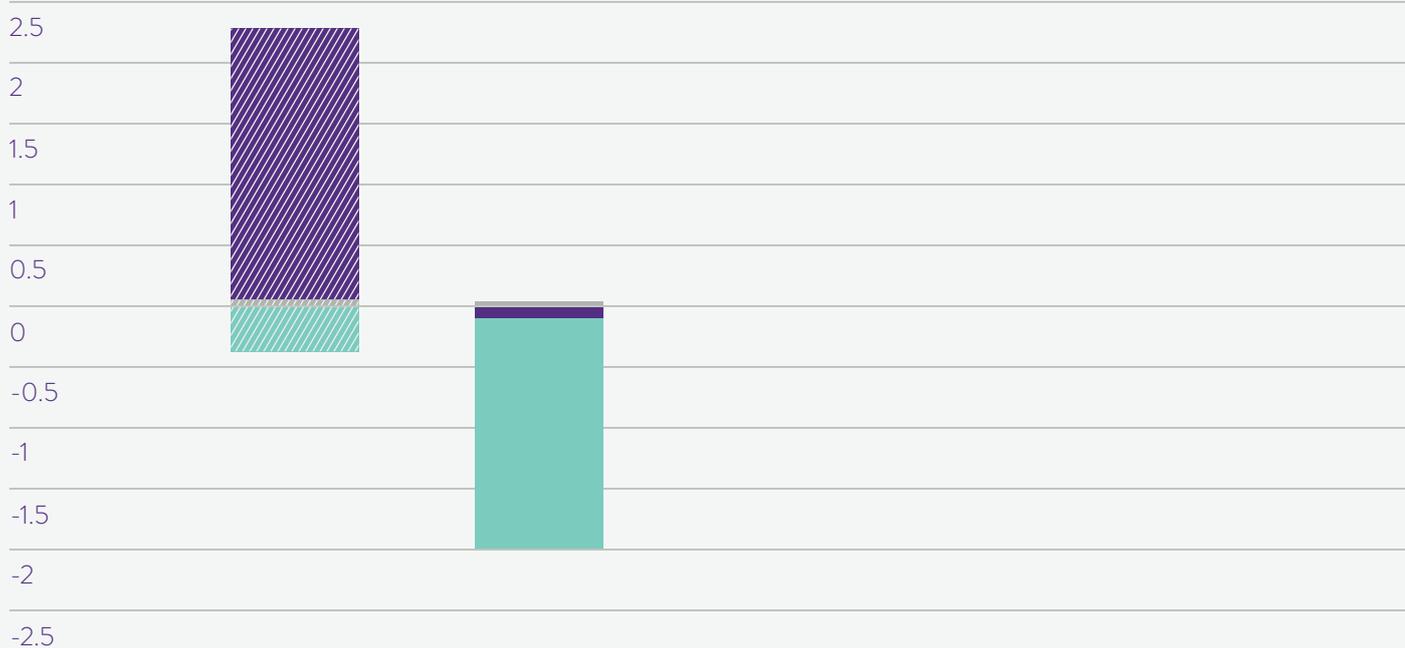
Sector income from individuals (£bn)

- Total income from individuals
- Donations
- Legacies
- Fees for services
- Fundraising



Change in income from individuals and government 2007/08 – 2012/13 (£bn)

- Contracts
- Grants
- Fundraising
- ▨ Fees for services
- ▨ Legacies
- ▨ Donations



**Other sources**

**Funding from the businesses peaked before the recession and has fallen since**

The private sector has not accounted for a significant part of the voluntary sector's income over any period for which reliable data is currently available. In 2003/04, the private sector contributed a little over 2% of total voluntary sector income. In 2012/13, although income from the private sector had risen in absolute terms, it accounted for only 4.11% to the total voluntary sector's income. In-kind support from the private sector can be equally important for charities, but the extent or equivalent monetary value of this is not easily captured. Data from the Directory for Social Change<sup>1</sup> supports our findings, describing donations from companies not growing despite the significant increase in corporate profits since 2008/9.

There is clearly some potential to grow private sector income further, but further work is needed to understand the best route to achieving this. The Directory for Social Change's Company Giving Almanac indicates that this much current giving from the private sector is heavily concentrated in the London and the South-East, raising the risk that growth through this source of income may not benefit all organisations equally.

**Income from legacies has remained static**

Legacies income fell slightly after 2007/08 but has remained largely stable at around 5% of sector income in recent years. While the sector has engaged in important projects like Legacy10 to increase this type of giving, it may take some time for the benefits of these to be felt financially.

**Income from investments (rents from property, dividends, interest on deposits) has fallen by 30% since 2007/08**

This has primarily affected charitable foundations and larger charities which have investments. The Top 300 charitable foundations, for example, saw their income fall from £3.4bn in 2008/09 to £2.3bn in 2012/13<sup>2</sup>. Although income is starting to recover, this effect is concentrated mostly in larger charities.

**Trading between voluntary organisations has fallen since the financial crisis**

Earned income from other voluntary organisations has fallen by 43% since 2007/08. This trend is described more fully in the expenditure section of this review.

**How have charities responded?**

Charities have adopted a number of coping strategies to deal with the new funding environment described above.

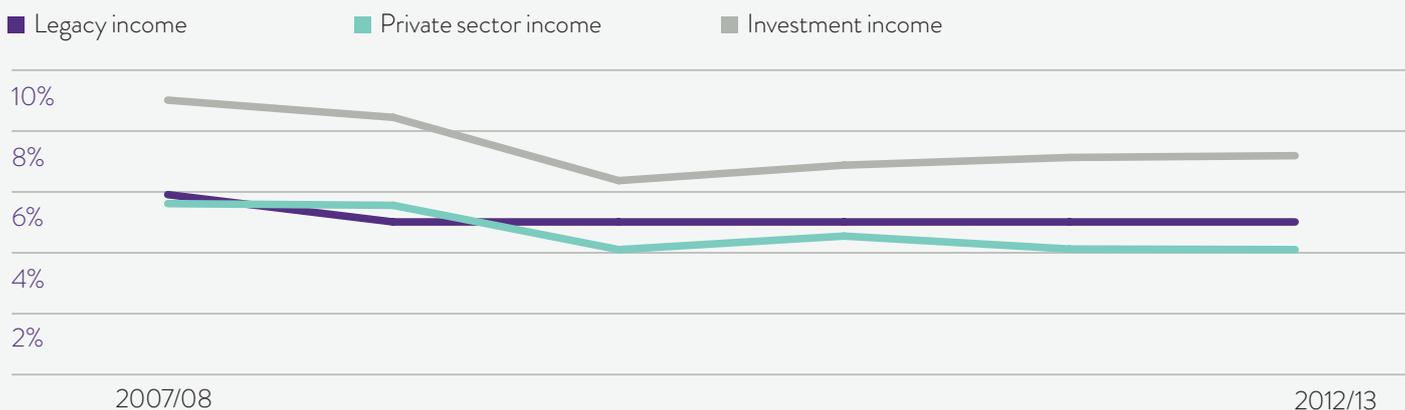
**Charities have sought to diversify their income away from government sources towards individuals.**

As described above, income from fundraising and trading with the public has grown since 2008/09. In the Managing in a Downturn 2013 report, the percentage of charity respondents to a survey that reported general fundraising as one of their most important sources of income grew by 7% from 20% to 27%. This was accompanied by a fall from 48% to 42% in those that reported government income as their most important source.<sup>3</sup> This finding is also supported by other sources. The Small Charities Coalition Skills Matching Service has seen fundraising requests rise from 11% of all requests in 2010/11 to 42% of requests in 2014/15.

**REFERENCES**

- 01 Company Giving Almanac, Directory for Social Change 2013
- 02 Giving Trends: Top 300 Foundations – 2014 Report, ACF, Cass Business School, Centre for Charitable Giving and Philanthropy, Pears Foundation, 2014
- 03 Managing in a Downturn 2013, PwC, Institute of Fundraising, Charity Finance Group, March 2013

**Figure 6 – Income from legacies, private sector and investment as proportion of total sector income**





## WHO HAS BEEN MOST AFFECTED BY CHANGES IN INCOME?

### *Smaller charities have been the worst affected by government spending reductions*

The ‘frontloading’ of spending reductions onto local authorities at the beginning of 2010/11 has meant that organisations that were more reliant on local government funding saw bigger losses of income. This has particularly impacted on small and medium sized charities.<sup>4</sup>

### *Small and medium sized charities have lost between 34-38% of income*

The most recent fall in income for the voluntary sector has not been uniform across all sizes of charities. Almanac data indicates that there has been a squeeze on small and medium sized voluntary organisations which had received significant levels of statutory income before the recession and government spending reductions took effect.

These organisations have been most heavily impacted by the reductions.

Government income has fallen for all charity sizes except major charities, with charities with under £1m in income losing around 34-38% of their income from government sources.

Grants are particularly important for small and medium sized organisations<sup>5</sup>, as a proportionate form of funding with low transaction costs to support the activity of charities of this size. Medium sized charities may find it harder to diversify their income as fundraising on the scale they require takes time to generate, whereas as more nimble organisations may be able to find income through fundraising to make up for income lost from government sources.

Larger organisations will likely have the resources in place to be able to diversify their income and switch resources from bidding for grants and contracts to fundraising.

### REFERENCES

**04** Comparisons in this review between income bands over time do not account for movement of organisations between these bands. However, in most cases the trends are comparable between the most populous bands, where the most movement would be expected (ie the changes experienced by micro to medium sized charities in the measures examined are similar), indicating that the trends identified would be unlikely to change significantly if such movement was accounted for.

**05** Lloyds Bank Foundation, VCSE Health review: An Independent Funder Perspective

Figure 7 – Relative change in government income 2007/08 to 2012/13

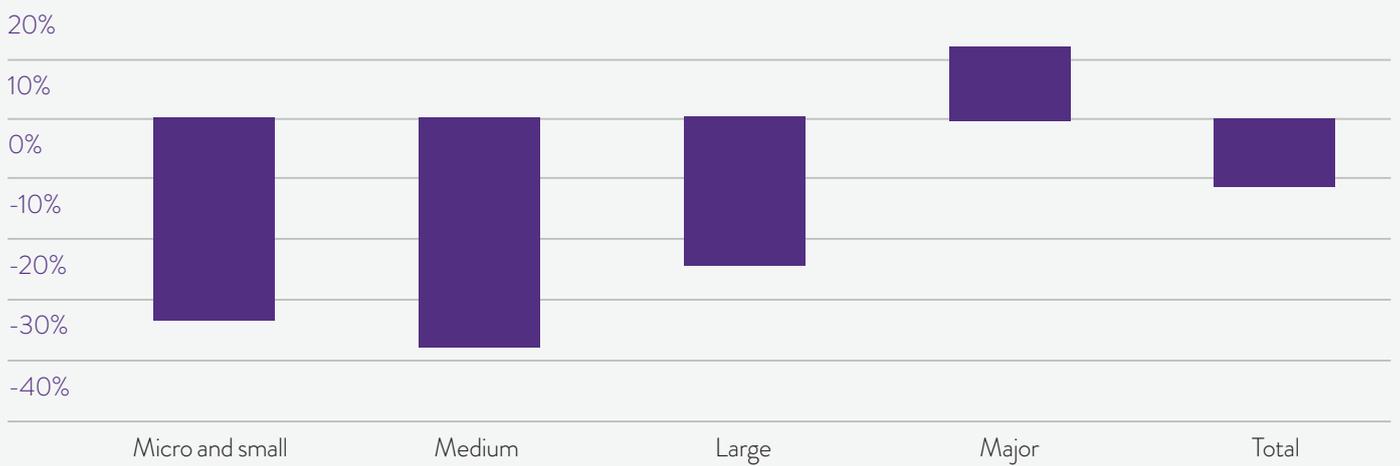
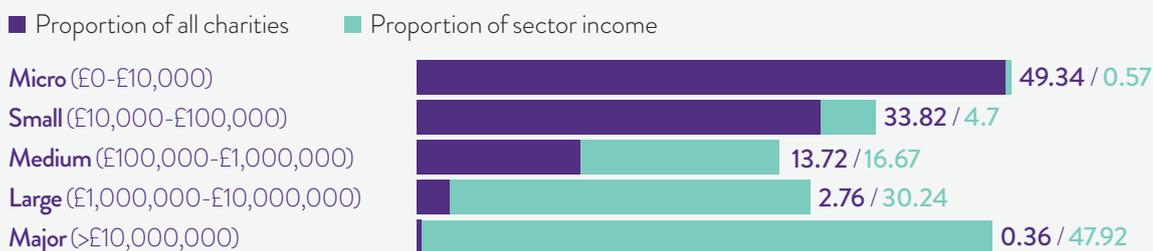


Figure 8 – Proportion of all charities and proportion of income by size bracket (%)



**Charities have demonstrated a significant amount of innovation and entrepreneurship during the downturn and recovery.**

Income earned from fundraising activities (charity shops, raffles, lotteries and fees) has increased consistently by an average of 5% since 2008/09, making it the fastest growing source of income for the voluntary sector. A much-publicised avenue has been through the growth of charity shops, with profit generated increasing by 34% between 2007 and 2012, from £125.4m to £189.6m. This trend may however be counter-cyclical, with more consumers visiting charity shops during difficult economic times, so it may not continue as the economy continues to recover.

**The most significant increase in income from individuals has been through fees for charitable services.**



*'We rent out rooms and this has proven to be successful. The rooms are rented... at competitive rates with no long term commitment. Our volunteers can rent the rooms on a pay as you go basis if they are starting up their practices and do not have much money or clients. We also run training for our volunteers but open this out to our networks. This helps us generate income.'*

In 2007/08, just before the recession, earned income from individuals raised around £3.7bn. However by 2012/13, earned income from individuals through charitable activities had grown to £6bn.

This is borne out by many respondents to the review's call for evidence. Some told us that charging can sometimes be a less risky form of income generation than fundraising, as often charities are providing bespoke services that cannot be easily replicated by other providers. As austerity will continue throughout this parliament, more voluntary organisations are likely to adopt charging or increasing charges as a strategy to make up for losses of government income.

Locality surveys<sup>6</sup> have also noted a consolidation among its membership towards earned income from service fees, managed workspace and venue hire, contract delivery and trading, which rose 22% between 2012 and 2013, but has since grown relatively little due to commissioning barriers.

This has significant implications for charities looking to diversify their income. Many voluntary organisations will be unwilling to adopt charging as a primary source of income because this may negatively impact on their beneficiaries. Moreover, in some cases, such as for local voluntary sector infrastructure organisations, charging may not be possible if local markets are not robust enough.<sup>7</sup>

**There has been more investment in legacy giving.**

In *Managing in a Downturn 2013*, charity respondents to a survey noted that legacy giving had increased as a proportion of their total income. Legacy Foresight has reported an increase in legacy income from £2bn in 2008 to £2.2bn in 2012<sup>8</sup>, and Almanac figures also show growth (albeit slower). Given the UK's aging population and the rebound in house prices that is accompanying the economic recovery, more charities are considering legacies as a way to generate income.



*'We bought a derelict building... and have successfully completed a £330k refurbishment with funds we secured. We are ready to open our first charity shop...and an E-bay shop.'*

**REFERENCES**

**06** A snapshot of our members in England, Locality, 2013 and 2014

**07** Change for good: Report of the Independent Commission on the future of local infrastructure, NAVCA, January 2015

**08** Legacy Matters, Legacy Foresight, Autumn 2014

BY 2012/13, EARNED  
INCOME FROM  
INDIVIDUALS THROUGH  
CHARITABLE ACTIVITIES  
HAD GROWN TO £6BN

**Analysis**

Reductions in central and local government spending have occurred continuously since 2010/11, with income to the voluntary sector declining at a steeper rate over the same period. Total reductions in government income to the voluntary sector over this period amounted to £1.7bn.

Voluntary organisations have actively sought to diversify their income sources, looking particularly to increase their income from individuals through public giving, trading and charging for services. However, these sources have yet to adequately compensate for recent reductions in funding from government.

It is not possible to determine with certainty from this review if and when the voluntary sector will begin to recover financially from its current period of stagnation, but current evidence points us to avoid making firm assumptions about our sector growing at the same rate as the wider economy in the near future.

A move towards greater dependence on income from individuals is not without risk for some organisations.

Those which have depended on government income, particularly small and medium sized organisations, are unlikely to have significant capacity to engage in professional fundraising, for instance. Heavier dependence on fundraising carries the risk that the cost of fundraising will increase due to more competition, without necessarily generating additional income.

Organisations which work with client groups for whom it is difficult to raise funds from the public or whose clients do not have money to pay fees for services are at particular risk. Recent government initiatives such as the Transition Fund, Transforming Local Infrastructure Fund and incoming Local Sustainability Fund have done important work to help organisations adapt to the new operating environment and will need to continue to do so on a larger scale if they are to meet demand for support of this type.

More thought is also needed into the best form of government funding to the voluntary sector for its vital role in public services delivery. Current commissioning practice appears too often to heavily favour the use of large scale contracts focused on lowest cost/price rather than the wider social value delivered through the operating models of many charities. The particular advantages of grant funding are at risk of being overlooked. If these concerns are not addressed, there is a risk that small- and medium-sized charities are unable to form part of a diverse market of public service providers in the future.



TOTAL REDUCTIONS IN  
GOVERNMENT INCOME TO  
THE VOLUNTARY  
SECTOR OVER THIS PERIOD  
AMOUNTED TO £1.7BN

# EXPENDITURE

## OVERVIEW

- Demand for voluntary sector services has risen consistently over the last five years; at least 70% of the sector experienced a rise in demand in the last year, with the same expected this year and expect the same this year.
- The price of key everyday goods and services commonly used by voluntary organisations has risen significantly, often above inflation.

- Charities have seen support from local authorities and other public bodies reduced due to budgetary pressures resulting in lower availability of tax reliefs.
- Despite the significant pressures on charities' spending, charities have responded by increasing the proportion of their spending on charitable activities.
- Charities have reduced staffing levels and expenditure.
- Charities are using technology to reduce costs.
- Charities have cut back on upgrading and training.
- Charities have also sought to cut costs through collaboration and partnership working, and by pooling resources.

## Overall expenditure

### Demand for voluntary sector services has risen consistently over the last five years

The recession has put significant pressure on income to the voluntary sector, but it has also increased demand for the services provided by charities. Respondents to our call for evidence overwhelmingly reported that they had seen demand for their services increase and this has been borne out by several surveys of charities since the recession.

In the May 2009 *Managing in a Downturn* survey, only 36% of respondents expected to see an increase in demand for their services<sup>9</sup>. This rose to 67% of respondents by 2013<sup>10</sup>, 70% in 2015 and the same proportion have said that they expected an increase in demand for the next 12 months. A similar survey by ACEVO in 2014 found that 88% of respondents had experienced a rise in demand between 2012 and 2013, and 89% were anticipating a rise over the next year. NAVCA's Quarterly Survey has found 'increased workload' to be its members' top concern in every quarter for the last three years<sup>11</sup>.

### Measuring demand and unmet need in detail is a challenge for the sector

It can be difficult to measure precise changes in the nature and extent of demand for sector services. The volume of users for a given service may be as much an indication of the service's capacity as it is of demand for that service. Many services are not structured in a way that permits easy measurement of unmet need, and where such data is collected, it is often not routinely compiled and published (for example, onward referrals by advice centres due to a lack of capacity).

The extent to which rises in demand are acknowledged by policymakers varies – for example, the rise in food bank use has sometimes been explained by politicians as being due to greater awareness among the public rather than a rise in need. However in the context of advice services, the government cites sector data sources to demonstrate increased demand<sup>12</sup>. Further work is needed to develop a rigorous and shared approach to defining and measuring demand for charity services that is capable of forming the basis of sustainable financing strategies.

### Sector operating costs have risen, often above inflation

Just like households, voluntary organisations faced significant pressure from increased operating costs during the recession. While inflation has recently fallen to historic lows, inflation between 2007 and 2013 averaged 3.2%, peaking at 4.5% in 2011 – at a time when data indicates that government spending reductions were beginning to impact on the voluntary sector.

Aggregate inflation data can hide significant variations within different parts of the economy. There is no accepted inflation rate for charities, but data on changes in operating costs are indicative of some of the cost pressures which charities have faced since the recession.

## REFERENCES

- <sup>09</sup> *Managing in a Downturn* May 2009, PwC, Institute of Fundraising, Charity Finance Group, 2009
- <sup>10</sup> *Managing in a Downturn* 2013, PwC, Institute of Fundraising, Charity Finance Group, March 2013
- <sup>11</sup> NAVCA Quarterly Survey, May 2015
- <sup>12</sup> Not-for-Profit Advice Services in England, Cabinet Office, 2012

Between 2007 and 2014, the average non-domestic electricity bill increased by 24% in real terms. Over the same period, the cost of a second class stamp, commonly used by charities to communicate with beneficiaries and supporters, increased from 24p to 53p, the price of unleaded petrol rose by 45%, and the cost of stationery and other printed materials rose by 26%<sup>13</sup>.

**Charities have seen support from local authorities and other public bodies reduced due to budgetary pressures.**

A number of charities have reported that buildings that had been given to voluntary organisations ‘peppercorn rent’ have now seen their rents increase significantly, further raising costs. Discretionary business rate relief has also been cut or the criteria changed in many places, further increasing the operating costs of charities.<sup>14</sup>

There has also been a strain on capacity due to changes in the awarding of support or tax reliefs. Compliance with additional administrative requirements to access support has forced more time and resources away from being used to achieve charities’ objectives or invest in their future sustainability. Clarity and consistency in application processes for support is critical in maximising the available capacity of organisations.

**How have charities responded?**

**Despite the significant pressures on charities’ spending, charities have responded by increasing the proportion of their spending on charitable activities.**

Almanac data shows that in 2007/08 around 70% of voluntary sector expenditure was on charitable activities, rising to 74% in 2012/13. Although the absolute level of spending on charitable activities has fallen, this has been driven by the overall reduction in income rather than a desire by charities to reduce expenditure on services.

An analogous response has been reported by charitable foundations, which play a crucial role in funding the voluntary sector – contributing 13.7% of all private giving to the VCS<sup>15</sup>. Following the financial crash, despite reduced levels of income from investments and falling asset values, 80% of charitable foundations maintained their spending rates, as a percentage of their endowment value, and 5% actually increased them.<sup>16</sup>



*‘We have formed a number of partnerships with complementary organisations in order to be more competitive as we cannot afford to operate as we did prior to the recession.’*

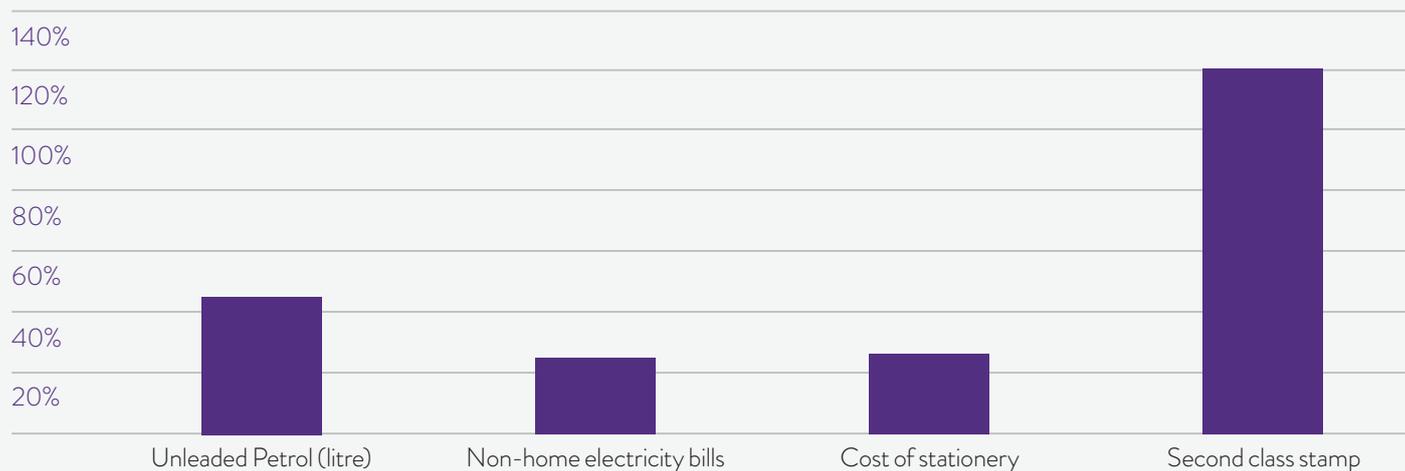
An international development charity which supports children in the developing world had to re-apply for discretionary rate relief. The charity said:

*‘We were unsuccessful, mainly because our work does not benefit [the local authority] residents, but overseas children. So this year we have to pay over £2,000 in rates. For a medium sized charity...this is a significant amount.’*

**REFERENCES**

- 13** Sources: Petrol – AA Fuel Price Reports, Electricity – DECC figures, Stationery – ONS, Stamps – Royal Mail
- 14** Business Rate Relief, CFG Policy Briefing, March 2015
- 15** Giving Trends, Top 300 Foundations 2014 Report, Pharoah, C., et al, Association of Charitable Foundations, London, 2014.
- 16** For Good And Not For Keeps; how long-term charity investors approach spending on their charitable aims. Jenkins, R., and Rogers, K. Association of Charitable Foundations, London, 2013.

**Figure 9 – Increase in costs between 2007 and 2014 (%) in selected areas**



**Charities have reduced staffing levels and expenditure**

Another way that charities have sought to respond to the pressure on income has been to reduce their staffing costs. According to the latest available data, over 800,000 people are employed by voluntary organisations and for many organisations staffing costs are the biggest element of their expenditure.<sup>17</sup> This amounts to approximately 648,000 full-time equivalent staff.

To address the twin challenges of declining income and increased demand, many organisations have had to rely on temporary, short term contracts with staff. This is not in the interests of the sector in developing a highly skilled, highly motivated workforce and will likely reduce the long term capabilities of the voluntary sector. A stable and motivated workforce will be critical if the sector is to generate efficiency savings and increase productivity in future years with reduced levels of resource.

**Voluntary sector pay has kept pace with the rest of the economy**

To meet demand for their services, many voluntary organisations have had to institute pay freezes to stretch their resources as far as possible, much as in the public and private sectors.

Accordingly, Figure 10 shows that median sector hourly pay has tracked median UK hourly pay fairly consistently since 2007.

Many organisations responded to our call for evidence by stating that they had put in place pay freezes. This correlates with Almanac data, which notes a fall in median pay toward the end of 2012. This has been reported across all levels of the sector, from the lowest to highest level of pay.

Organisations have also tried to do more with their existing staff, asking them to do more work while pay levels have not significantly risen.

This is borne out by available data on staff costs (which includes tax and pension costs as well as pay), which has fallen since the recession from £14.7bn in 2007/08 to £14.4bn in 2011/12. In 2013's *Managing in a Downturn* survey<sup>18</sup> 29% of respondents reported that they planned to institute a pay freeze. In some parts of the sector, there have also been significant restructures involving redundancies which are masked by the aggregate data. Again, in 2013's survey, 23% of respondents stated that they would be making redundancies.



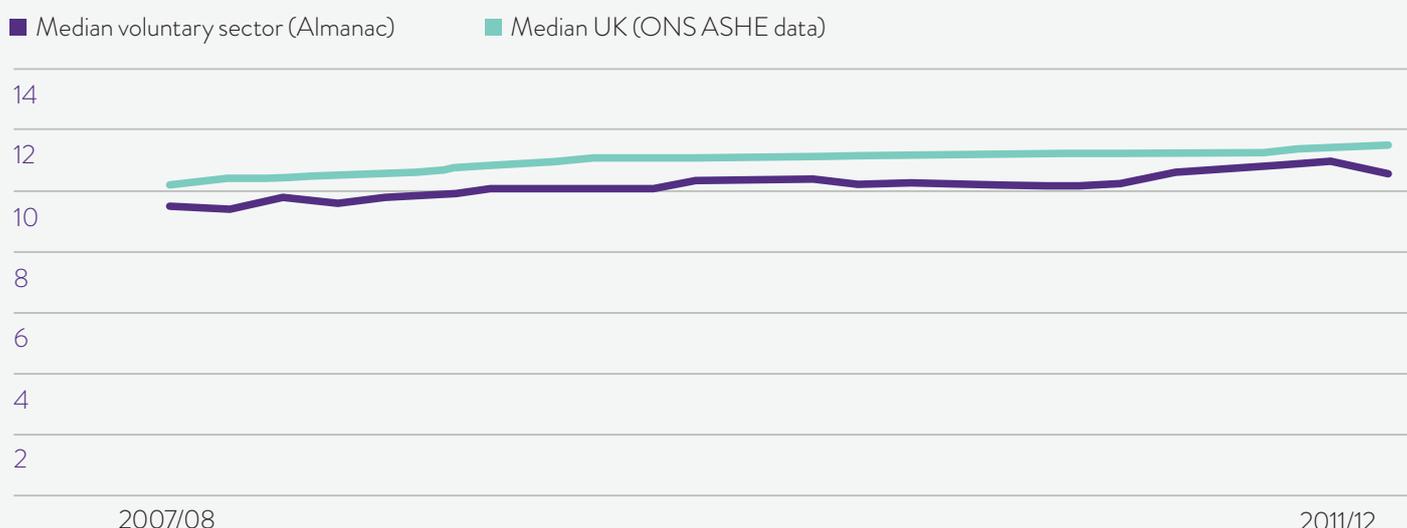
*'In 2013, we were forced through continued and prolonged cuts to our core funding to become entirely reliant on project funding...leading to a radical restructure of the staffing of the charity, reducing our number of employees from 6 to 1 and then contracting two freelance part-time staff to replace core finance and project management aspects of our work. Overall we have since 2009/10 cut our core organisational expenditure by more than 75%.'*

*'The organisation has closely monitored its spending and made cost savings wherever possible, including a pay freeze. This has also resulted in the organisation take a financial risk by maintaining key roles in the organisation rather than overstretch already stretched resources, as doing this was viewed by the board...as being a high risk to the organisation.'*

**REFERENCES**

- <sup>17</sup> Labour Force Survey 2013, Office of National Statistics, 2013
- <sup>18</sup> *Managing in a Downturn* 2013, PwC, Institute of Fundraising, Charity Finance Group

**Figure 10 – Voluntary sector hourly pay, 2001 – 2013 (£)**





## WHO HAS BEEN MOST AFFECTED BY CHANGES IN STAFFING LEVELS?

*The last year has seen large drops in staffing levels for smaller charities*

Between 2011/12 and 2012/13, staffing levels in micro and small charities dropped by around a quarter, and by 10% for medium sized organisations. Again, rises in larger organisations' staffing levels mean that in the aggregate figure, the total staffing level across the sector rose.

This is consistent with the general funding changes that have taken place in the sector; however this could sow the seeds for a longer term challenge for the sector. The voluntary sector needs a diversity of organisations of all sizes in order to effectively meet the need of beneficiaries.

Small organisations are often locally rooted and this ensures that there are suitable partners with local expertise to deliver services in collaboration with larger charities. Continued significant reductions in capacity would endanger this delivery model and limit the ability of the sector to deliver services.

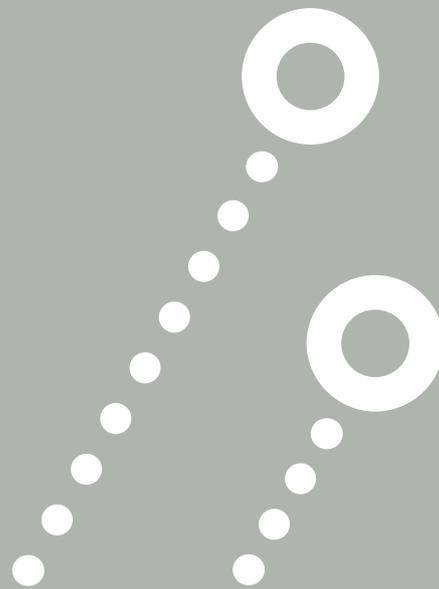
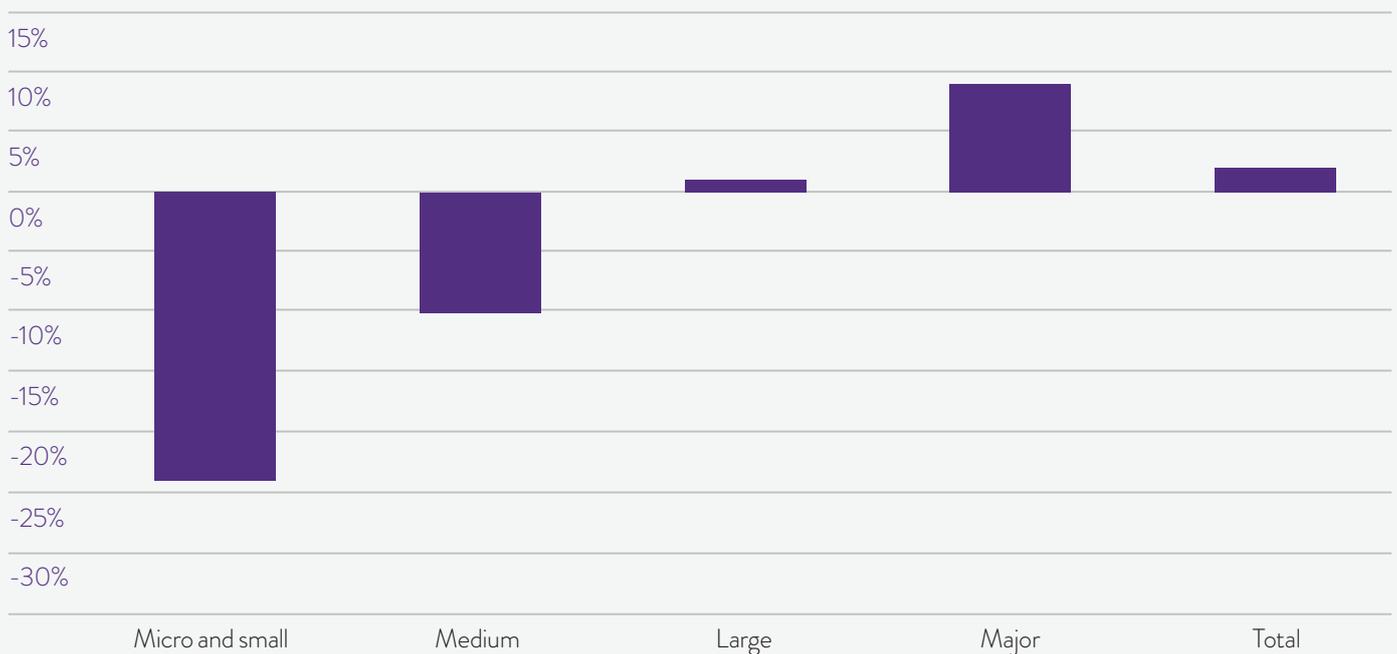


Figure 11 – Percentage change in staffing levels, 2011/12 – 2012/13





## CHARITABLE FOUNDATIONS AND THE FINANCIAL CRISIS

Charitable foundations are charitable organisations that primarily achieve their charitable objectives by providing grants and support to other charities, organisations and individuals. In 2012/13, charities spent £4.6bn in grants to other voluntary organisations. The majority of these grants were provided by charitable foundations.

Foundations provide one means for philanthropists and businesses to make irrevocable gifts for charitable purposes. Gifts made annually are often committed within a short-time scale to grant programmes. However larger gifts often form 'endowments' which, unlike reserves, are invested with the intention of providing financial returns that fuel a foundation's ongoing activity, frequently for many years into the future.

The financial crisis had a considerable impact on charitable foundations. Falling private sector profits meant reduced levels of new donations into foundations, and a falling stock market resulted in dramatic reductions in asset values, with a knock-on effect on investment returns.

The impact of the recession was detailed in the *Giving Trends: Top 300 Foundations – 2014 Report*<sup>19</sup>. It found that the income of the top 300 charitable foundations fell from £3.4bn in 2008/09 to £2.31bn in 2012/13. However, despite this significant fall in income, grant making by these foundations did not decrease proportionately, with spending falling from £2.54bn to £2.41bn across the same period.

This meant that in 2012/13, charitable foundations increased their spending to £2.4bn despite income being only £2.3bn. Foundations were able to do this, despite falling levels of new donations into foundations, by relying more heavily on their endowments in the short term – showing the usefulness and resilience of the model.

Foundation income trends map those of the sector as a whole, but as detailed in Figure 16 below, growth in foundation assets is primarily responsible for the growth in the sector's net total assets, with recent growth being far lower for operational charities.

Foundations are becoming increasingly aware that they are one of the few remaining sources of unrestricted grant finance. Like other charitable organisations, foundations are still responding to the changing environment, looking at how to use of all their assets, financial and non-financial, to best meet their beneficiaries' changing needs – including how to achieve systemic change. Growing numbers of foundations are engaging in social investment.<sup>20</sup>

### REFERENCES

<sup>19</sup> Giving Trends: Top 300 Foundations – 2014 Report, ACF, Cass Business School, Centre for Charitable Giving and Philanthropy, Pears Foundation, 2014

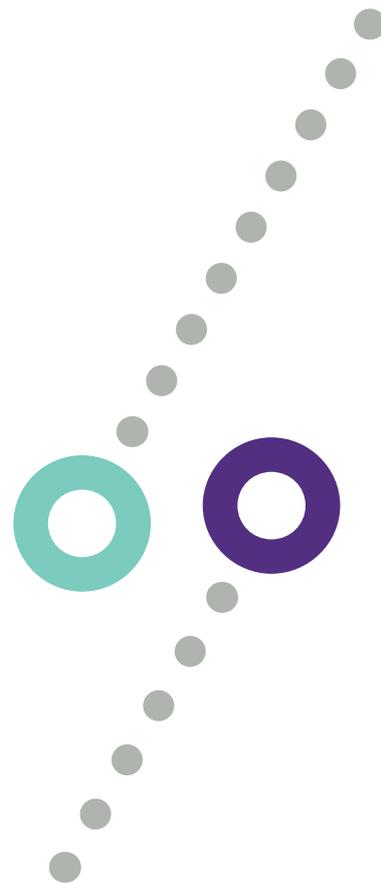
<sup>20</sup> Charitable Trusts and Foundations' engagement in the social investment market. Jeffery, N., Jenkins, R., Association of Charitable Foundations, London. 2013.



*'We see digital technology (through our website, webinars, video conferencing etc.) as vital elements of our service in these tougher times. Conversely, it actually allows us to reach more members and be far more inclusive so has some benefits.'*

*'The expenditure has been more focused on delivering our main core objectives. Expenditure on internal maintenance of the buildings we occupy has been curtailed, resulting in a deteriorating internal environment. Staff training has been severely cutback with greater reliance on other charities offering free training or reduced prices.'*

*'We've cut back as far as we can and have tried to protect jobs. We don't attend national or regional conferences any more, we don't travel to visit other projects we very much...I've stopped having external mentoring/supervision, which was always very helpful...We try not to pay for recruitment when a vacancy arises.'*



### **Charities are using technology to reduce costs**

One area that voluntary organisations in our call for evidence reported investing in over the course of the recession has been digital technology. The increase in the use of social media by the voluntary sector has been well documented in recent years, but sector investment has also increased in websites, online giving systems, data insight and digital delivery (eg webinars and video conferencing). This is another example of voluntary organisations trying to do more with less.

However, these changes have not been evenly spread across the voluntary sector. The Lloyds Bank UK Business Digital Index which measures the use of and attitudes towards digital technology found that 58% of charities were without basic digital skills, compared with 23% of small businesses. Given the potential for technology to help charities generate and use their resources more effectively, it is important that skills in the sector are improved.

### **Charities have cut back on upgrading and training**

Another response by organisations has been to reduce expenditure on all 'non-core' aspects of their work, including upgrading equipment, training or properties. As noted above spending between voluntary organisations, a significant proportion of which is spent on training and skills development, has fallen significantly in response to the tight financial environment. In our call for evidence, a number of organisations noted that they had cut back on spending on training and equipment in order to put more resources into delivering their charitable objectives. The UK Commission for Employment and Skills (UKCES) survey of 2013 found that 17% of voluntary organisations not investing in training cited lack of funds as the reason, compared to 10% in the private and public sectors<sup>21</sup> (existing footnote). This under-investment is likely to create capacity and resilience issues for the sector in the coming years.

### **Charities have also tried to work closer together and pool resources.**

Anecdotal evidence gathered through this review indicates that voluntary organisations are engaging in more collaborative approaches and pooling more funds than they did before the recession.

In the first *Managing in a Downturn* survey in 2008, over 80% of charities stated that they were planning to collaborate more as a response to the tougher operating environment. In March 2013, 67% of respondents stated that they had undertaken activity to collaborate with other charities over the previous 12 months.

Further work is needed to understand and address barriers and opportunities to effective partnership working between voluntary sector organisations.

### **Restricted and unrestricted income sources**

Charity income falls into two main categories – unrestricted and restricted. Unrestricted income can be used in any way that the trustees of the charity see fit. Restricted income, such as donations made for a specific purpose or endowments cannot be used for any other purpose.

There are also some types of income, such as contract income and some grants, that are close to being restricted given the limitations of what they can be used for, or with very narrow margins (ie the element of income left over after spending to deliver agreed outcomes). Financial pressures on funders mean that many are adding additional restrictions on the use of funding or reducing the margins on contracts or grants for service delivery. While this may be rational for individual funders, if this continues at scale, it will undermine the sector's financial sustainability.

This is a concern for charities for two reasons. Firstly, there is often little or no provision for organisations' core costs within restricted funding models, meaning that organisations have to rely on unrestricted income to fund their infrastructure. Secondly, it limits the options for investment in organisations' development, which as discussed above is already a problem.

Voluntary organisations need to have the right mix of unrestricted and restricted income if they are to be sustainable and invest in their future. Funders need to ensure that they are using funding methods that do not carry risks to the long term sustainability of the organisations that are delivering change for their beneficiaries.

## **Analysis**

### **Spending reductions are leading to a capacity crunch**

Voluntary organisations are having to cope with rising demand at a time when they are having to cut back on spending. Just as in the public sector, many voluntary organisations have already made the most obvious spending cuts.

In some cases, voluntary organisations are restructuring and collaborating in order to rationalise their use of resources. However, in many cases, voluntary organisations have been forced to stretch existing resources to cover committed projects or seek out new income streams to fund future work. Without new sources of income (or utilising reserves) to create additional capacity, this is leading to a 'capacity crunch'. This term describes the point at which a voluntary organisation has used up all their spare capacity and is unable to free up new resources through increased efficiency, even to draw in resources that may be relatively easily on offer. This is a particular risk for organisations which have, up until now, been dependent on government income but are now having to seek out new sources of income.

## **REFERENCES**

<sup>21</sup> UK Commission's Employer Skills Survey 2013: UK Results, UKCES, January 2014

In many instances, this means that charities are stretched so thin they are unable to apply for even familiar sources of income such as grants – a 2014 report<sup>22</sup> by the Garfield Weston Foundation documented this phenomenon, whereby the foundation received low numbers of grant applications despite elevated need:

*'A dangerous vicious cycle may be emerging where reduced organisational resources suppress new investment in fundraising and income generation, resulting in further reductions to resources and investment.'*

This has important implications for these organisations' ability to engage in improving their long term financial sustainability. Staff and volunteer time will already be stretched thin to keep existing services and activities running, leaving little resource to engage in sustainability planning or rethinking their business model. Funders, both government and voluntary sector, need to be aware that reporting requirements add to the capacity strain on organisations and in the midst of the current operating environment, there may be a need for reporting to be reviewed to ensure they are proportionate to voluntary organisations' available resources.

### **Cuts to back office development are leaving organisations in a fragile state**

Consultation with our members, evidence in surveys and responses to our call for evidence suggests that a number of organisations have responded to the recession by cutting back on training, upgrading equipment or buildings.

In the short term, this is a rational response to a reduction in resources, and voluntary organisations are likely to continue to restrain spending in these areas until they have certainty about future revenue. A similar response has taken place in many businesses and the public sector.

However, the longer that this restraint continues, the larger the reduction there will be in the organisations' long-term capabilities to deliver their charitable objectives. Voluntary organisations need to continue to invest in their staff, their facilities and their equipment if they are going to adapt effectively to a significantly changed environment and achieve the best possible impact.

Rising demand for services has led many organisations to prioritise short term service delivery over long term capacity building. There is only so long that this can happen before the effectiveness of the sector's services is curtailed or organisations begin sacrificing mission focus in the search for financial sustainability. Funders and policy makers need to consider how they provide the resources (and incentives) for organisations to invest in these vital areas, while the sector continues to adapt to its new and challenging financial environment.

Priority should also be given to funding models that enable resources to be deployed to strengthen the future capacity of voluntary organisations. For example, blending grant and contract income together may be one method of achieving this.

### **There are cost and commissioning barriers to the sector working more collaboratively**

Reductions in government income, increased cost pressures, large size contracts and the need to build stronger balance sheets are driving organisations to work more closely together, but there remain a number of barriers to them doing so.

Building consortia or partnerships takes time, and as noted above, capacity for this kind of work is in short supply. This is particularly true for small and medium sized organisations, the size of organisations that most need to form effective partnerships.



*'We have formed a number of partnerships with complementary organisations in order to be more competitive as we cannot afford to operate as we did prior to the recession.'*

There are also other costs, such as the legal costs of setting up a special purpose vehicle or joint venture for which there may not be adequate resource. In a period of volatility, it can also be difficult for voluntary organisations to identify partners that are going to be sufficiently financially robust to weather the changing operating environment.

There are also practical barriers that can increase the cost of voluntary organisations partnering together such as VAT on shared services, the costs of setting up special purpose vehicles and the legal and administrative costs of due diligence and advice when considering merging with another organisation.

### REFERENCES

<sup>22</sup> An insight into the future of charity funding in the North East, Garfield Weston Foundation 2014

CHARITIES ARE STRETCHED SO THIN THEY ARE UNABLE TO APPLY FOR EVEN FAMILIAR SOURCES OF INCOME SUCH AS GRANTS

# ASSETS

## OVERVIEW

- Voluntary sector assets have not yet recovered to their pre-recession value.
- Recovery in asset value has not been uniformly distributed across the sector.
- Current assets dropped almost 8% last year, following a relatively static period.
- The use of reserves to cover operational costs is leaving the sector in a fragile position.

- Reductions in reserves will weaken the balance sheet of many voluntary organisations, leading to problems with income generation.
- Without a significant and sustained improvement in its funding environment, the sector could experience a delayed impact from the recession.
- Falls in asset values have contributed to an increase in the sector's pension liabilities.
- Many charities have sought to use their assets in order to generate additional income.
- Some charities have sought to reduce their pension liabilities.
- There is not yet evidence of a significant increase in organisations seeking and securing social investment.

## Fixed Assets

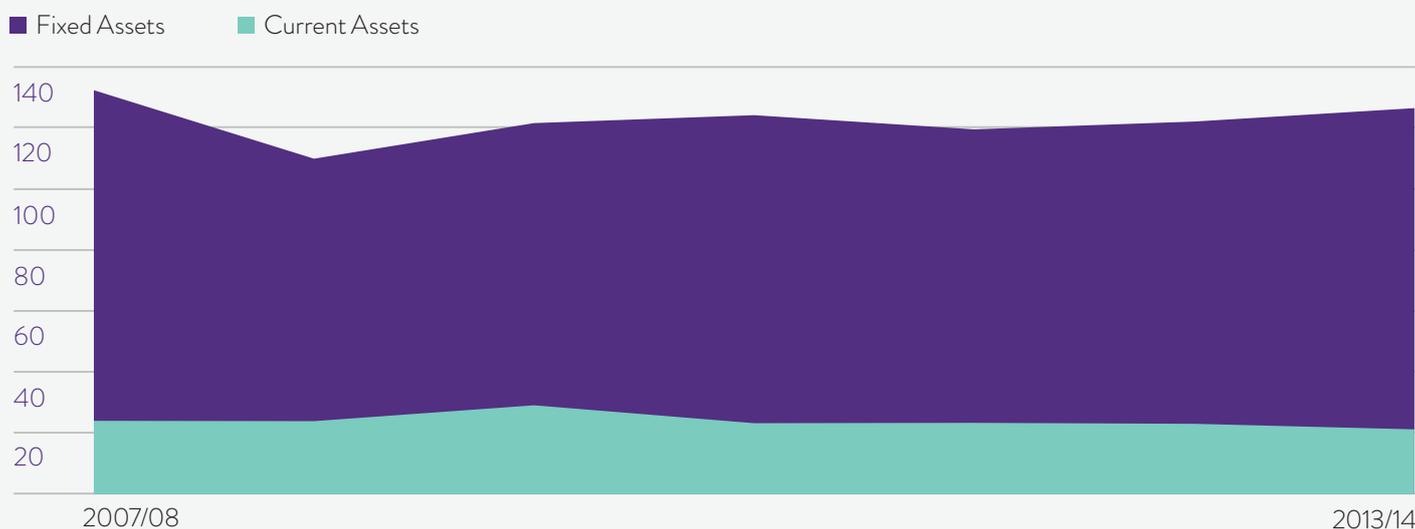
**Voluntary sector assets have not yet recovered to their pre-recession value.**

Voluntary organisations have seen their assets reduce in value since the recession began. Between 2000/01 and 2007/08, the net fixed assets of the sector (buildings, land, investments etc.) rose by nearly 30%.

In only one year, between 2007/08 and 2008/09, the value of the sector's fixed assets fell by 20%. Since then, the sector has been regaining on this lost ground but is only about to reach pre-recession levels.

This slow replenishing of the sector's asset base has also been indicated in the 'Managing in a Downturn' survey which reported considerable anxiety from finance directors and fundraisers about investment income in late 2009 but considerably less by the end of 2013.

Figure 12 – Value of the voluntary sector's fixed and current assets (£bn)



The return to growth of fixed assets is welcome as this will make the long term balance sheet of the sector healthier and may check against the growth of liabilities in areas such as pension funds. However, fixed assets are by nature not realizable in the short term and will not make up for continued losses of funding in the short to medium term. Current assets and reserves

**Current assets dropped almost 8% for 2011/12-2012/13, following a relatively static period.**

The value of current assets has mostly hovered between £23bn and £24bn over the last ten years. The vast majority (around 70%) of these assets are savings in bank accounts acting as reserves for charities, with low interest rates hampering returns.

The sector’s current assets rose substantially from £23.27bn in 2008/09 to £28.31bn in 2009/10. Although the reasons for this are unknown, it may have been driven by charities increasing their savings in anticipation of the pressures that would result on their income as a result of the recession. This rise is no longer continuing. This rise has since dissipated and the sector currently holds £21.2bn in current assets, around £2.8bn less than it did in 2007/08.

**The use of reserves to cover operational costs is leaving the sector in a fragile position.**

We should not be unduly alarmed that many voluntary organisations have dipped into their reserves to cover operational costs during the downturn, as the purpose of building reserves is to support an organisation during financial difficulties. However, with pressure on income and expenditure likely to remain for the foreseeable future, the ongoing spending of reserves on operational costs by organisations presents two challenges.



**WHO HAS BENEFITED MOST FROM THE RECOVERY IN FIXED ASSETS?**

*Recovery in fixed asset value has been concentrated in large and major charities*

Almanac data shows that while in absolute terms the sector’s fixed assets have slowly recovered in value, this process has not been distributed uniformly across the sector. Micro to medium size charities experienced drops of between 5-10% in the value of the fixed assets in the last year alone.

This has been corroborated by Locality’s membership surveys, which have not shown significant increases in asset values, indicating that many small and medium sized charities are have not enjoyed the same recovery in asset values as the rest of the economy<sup>23</sup>. This could also indicate these charities are having to sell their fixed assets in order to continue operating.

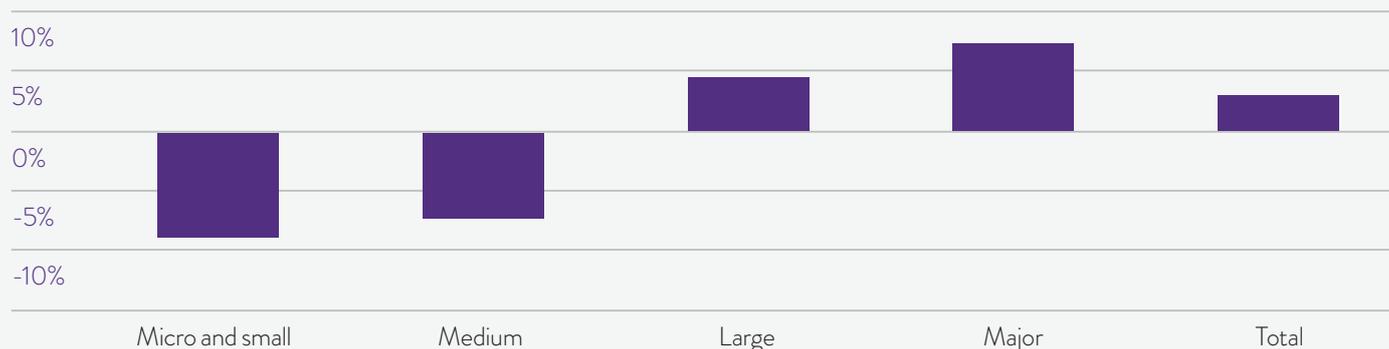
Another contributory factor to the overall picture is the fact that a large proportion of the sector’s biggest charities are based in London, where property prices have risen considerably.

According to a survey in 2013 by property services company, Countrywide, only London and parts of south-east and east of England had seen property prices recover. Those in the north and midlands have not seen asset prices recover, which may indicate a difference in experience between charities in the north and south of England.

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<sup>23</sup> 2011: A snapshot of our members in England, Locality, 2012 and 2014: A snapshot of our members in England, Locality, 2014

**Figure 13 – Change in fixed asset value 2011/12 – 2012/13**



**Reductions in reserves will weaken the balance sheet of many voluntary organisations, leading to problems with income generation.**

Weaker balance sheets will potentially reduce access to grants and contracts by voluntary organisations. Organisations will find it difficult to replenish these reserves, both because of the tight financial environment and also because margins on contracts and grants have been reduced as funders seek to maximise their resources. If this results in less access to contracts, it will lead to further reductions in government and other earned income setting up a downward cycle for organisations already finding it difficult to compete.

**Without a significant and sustained improvement in its funding environment, the sector could experience a delayed impact from the recession**

Although the overall economic environment appears to be improving, the funding environment for the sector remains volatile. The effects of reserves spending will take time to feed through the sector as a whole, and policy makers should continue to monitor the number of voluntary organisation failures closely. It may leave many voluntary organisations unprepared for any future downturn, and we may also see a delayed effect of the downturn with organisations collapsing after spending down their assets.

Given the importance of current assets both to create a buffer for future downturns but also to provide a source of potential future investment, funders and voluntary organisations need to work together to ensure that these assets are replenished.

## Pensions

**Falls in asset values have contributed to an increase in the sector's pension liabilities.**

Although data was not collected before 2008/09, the sector's pension liabilities were believed to be slowly growing over the course of the 2000s. However, the recession which caused a sharp depreciation in value of pension funds, created a significant increase in the sector's pensions liabilities from £1.2bn in 2008/09 to over £2.2bn in 2009/10.

Despite the recovery in assets since then, this is not a challenge that will resolve itself without intervention. Pension deficits are particularly concentrated in the largest voluntary organisations, which may force these organisations to compete for limited pools of unrestricted funding with smaller organisations, in order to service these debts. Moreover, unless there is sustained growth in unrestricted income, pension deficits may become unserviceable, forcing the closure of some services and organisations.

## How have charities responded?

Charities with assets have taken steps to use these for generating additional income. A common method reported through our call for evidence was renting out rooms in a building that they owned.

**A significant proportion of charities continue to anticipate using their reserves**

While the charity sector's reserves appear to have been stable over the course of the recession, the aggregate data is masking significant variations between different kinds of organisations.

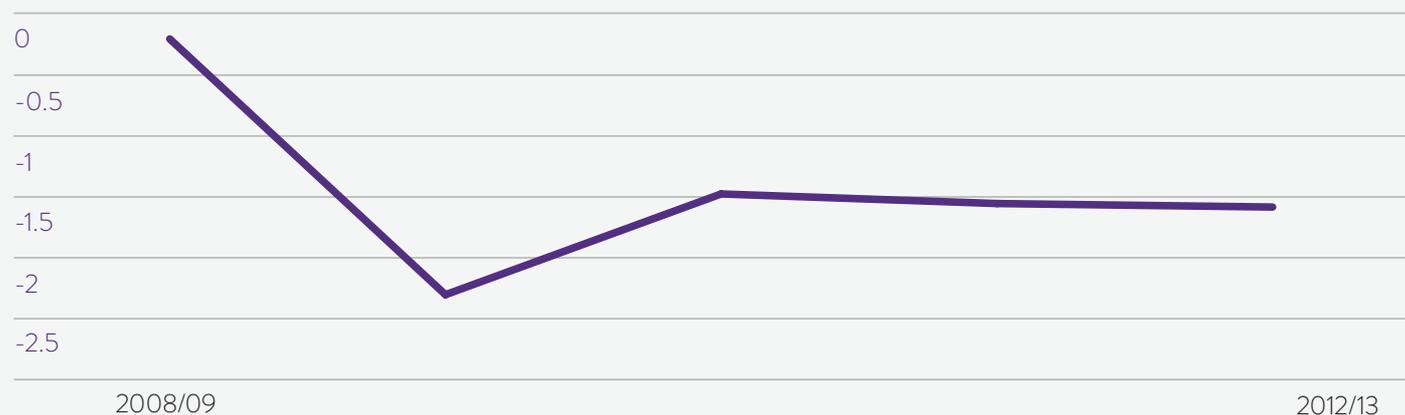
The 2014 'Managing in a Downturn' report highlighted a split between voluntary organisations, with half not using their reserves (either between they did not have sufficient amounts or felt no need) and half using or considering using their reserves, mostly to fund service delivery.<sup>24</sup>

This is not sustainable in the medium term, as charities have been using their reserves to meet demand since the recession began. Voluntary organisations cannot continue to run down their reserves indefinitely without significantly undermining their financial sustainability.

## REFERENCES

<sup>24</sup> Managing in a Downturn 2014, PwC, Institute of Fundraising, Charity Finance Group, 2014

**Figure 14 – Voluntary sector net pension deficit (£bn)**





## WHO HAS BEEN MOST AFFECTED BY CHANGES IN ASSETS?

*Micro to medium sized charities have seen significant falls in net total assets over the last year alone.*

When looking at net total assets (and not just fixed assets), the difference between smaller and larger charities becomes even more pronounced. Between 2011/12 and 2012/13, the average medium size charity saw a 9.5% fall in its net total assets.

*Rises in net total assets for large and major charities are masking these falls in the aggregate figures*

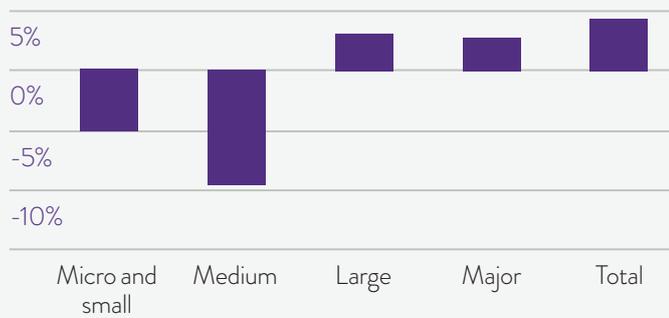
Large and major charities saw relatively modest increases of around 3% in their net total assets, but because they hold over 70% of the sector's assets, the average change in income over all charity sizes is positive.

*Foundation assets alone account for growth in the sector's net total assets*

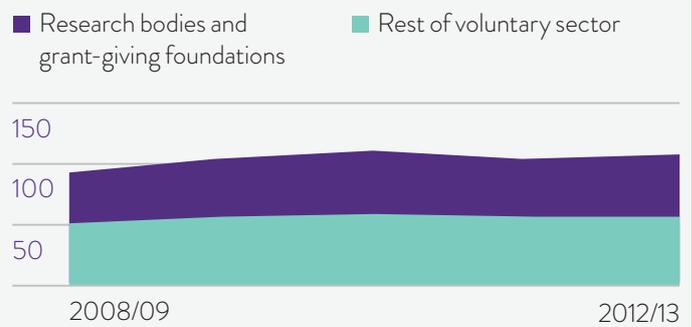
As depicted in Figure 16, the large and major charities that have seen increases in their assets will overwhelmingly have been foundations (categorized here as research and grant-giving bodies). The rest of the sector's assets have stagnated, although as Figure 15 shows, this masks significant 'churn' as micro to medium sized charities' assets shrink while larger non-foundation charities' assets grow.

This means that targeted policies are required for small and medium sized charities to grow their asset bases. Partly this can be achieved through promoting funding mechanisms such as grants or making contracts more sustainable. There may also be a need for consideration of 'recapitalisation' of some areas where voluntary organisation assets are particularly low and creates a barrier for future growth.

**Figure 15 – Change in average net total assets per charity from 2011/12 – 2012/13**



**Figure 16 – Voluntary sector net total assets (£bn)**



**Figure 17 – Proportion of net total assets by charity size 2012/13**

Legend: Micro (dark purple), Small (teal), Medium (grey), Large (diagonal lines), Major (light grey)



**Many charities have sought to use their assets generate additional income.**

Income generation using assets encompasses a range of activities from seeking to get a higher rate of interest on their services, to opening up their buildings to new tenants, increasing charges or rents or licensing intellectual property.

However many charities are not aware of the assets at their disposal and how they can be realized to generate income. This is particularly the case for small organisations which may lack the capacity to map and analyse their current asset base.

A number of respondents to our call for evidence highlighted other innovative ways that they have sought to utilize their assets. One respondent had invested their assets into a wind farm. Another respondent stated that their organisation had just purchased a company in order to generate additional revenue.

**Some charities have sought to reduce their pension liabilities**

A significant number of respondents to a Charity Finance Group survey on defined benefit pensions stated that they would be considering closing their schemes or increasing contribution rates in order to reduce deficits.<sup>25</sup> However, pension's legislation has meant that many organisations have been unable to reduce or prevent the increase in their liabilities without triggering significant costs.<sup>26</sup>

**There is not yet evidence of an increase in organisations securing social investment**

Regular data on the sector's borrowing has not been collected. However, in 2011/12, the voluntary sector held £4bn in loans, equivalent to only 4% of the sector's total net assets. 60% of these loans were secured against an asset, with the remainder unsecured. Analysis of these unsecured loans indicated that many were informal, perhaps lent by a donor or trustee on favourable terms. Small and medium sized charities were also more likely to have unsecured loans.<sup>27</sup> Only one respondent to our call for evidence stated explicitly that they had accessed social investment.

This correlates with survey data from the *Managing in a Downturn* surveys. In the 2013 report, 79% of respondents had not considered social investment. In the 2015 report, 83% of respondents claimed that their appetite for repayable finance through loans or social investment had not changed over the past year.

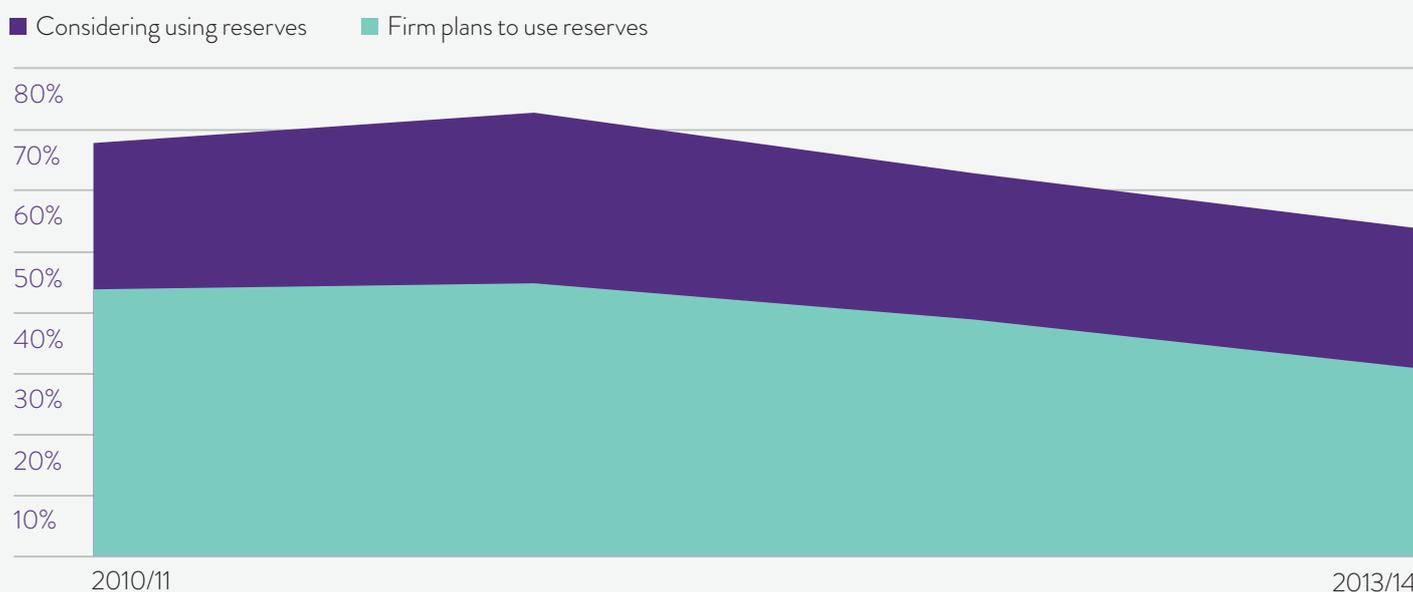
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<sup>25</sup> Defined Benefit Pensions, Charity Finance Group, March-April 2014

<sup>26</sup> Navigating the Charity Pension Maze, Charity Finance Group, 2014

<sup>27</sup> Ibid

**Figure 18 – Percentage of Managing in a Downturn survey respondents stating that they will utilise their reserves in the next 12 months**



## Analysis

The overall impact of the financial crisis on the sector's asset base has been two-fold. On the one hand, the reduction in asset values has reduced the resources available to charitable foundations – a key source of funding for many voluntary organisations. Secondly, it has limited the amount that the voluntary sector has been able to borrow securely against these assets, at a time when many organisations may have needed bridging finance.

As detailed above, the voluntary sector has recovered more slowly than the rest of the economy from the impact of the financial crisis. Asset prices are only just rising back to their pre-crisis peak, and this will provide the opportunity for organisations to borrow to fund investment and for organisations that generate their income through their investments, to increase funding for their charitable activities. It is also likely to support charitable foundations in increasing vital grant funding, at a time when grant funding from government is falling rapidly.

Nonetheless, pensions are one area where the impact of the financial crisis is likely to be with the sector for a long time. At present, the size and growth of the sector's pension deficit may not look alarming. However unless the necessary legal, regulatory and financial environment is put in place, pensions could significantly reduce the amount of income available for charitable activities. For organisations of all sizes, but particularly large organisations which committed to generous defined benefit schemes, the financial crisis has likely permanently reduced the expected returns for pension funds. A rapidly ageing population and longer life expectancies will mean additional resources will need to be set aside to meet these liabilities.

THE VOLUNTARY SECTOR HAS  
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ECONOMY FROM THE IMPACT  
OF THE FINANCIAL CRISIS



## WHY HAVE ORGANISATIONS NOT TURNED TO SOCIAL INVESTMENT?

This review has noted how voluntary sector appetite for social investment does not appear to have grown in response to the financial crisis. Putting aside the usually quoted barriers of trustee caution and cost of capital, there are a number of structural reasons why demand for social investment has not been high.

Firstly, income sources have been hard to find for many organisations. Social investment depends on a sustainable revenue stream by which the organisation can pay back the debt. Given the significant volatility in the sector's income, organisations are not likely to feel confident, for example, in taking on loans which will need to be repaid. Moreover, as noted above, pressures on funders have driven down margins, further reducing the ability of voluntary organisations to repay finance.

Secondly, social investment requires internal capacity to write applications, consult with trustees and staff and develop the new kinds of business plans that investors need. In many cases, voluntary organisations have cut back on this capacity in order to focus their resources meeting the spike in demand. Until the sector has greater levels of management capacity, it is unlikely that many voluntary organisations will have the time to engage with social investors.

Thirdly, the loss of streams of unrestricted income means that many voluntary organisations may not have the funding sources to be able to pay back loans over time.

Removing these structural barriers, alongside dealing with practical issues such as the cost of capital, are the only ways that the social investment can become even an option for many organisations.

/31

# LOOKING AHEAD

## WHAT IMPACT WILL THESE TRENDS HAVE ON THE SECTOR'S FINANCES?

### OVERVIEW

Any predictions for the future must be made with significant health warnings. Although the UK economy appears to be on the road to recovery, posting strong growth over the past couple of years, events across the rest of the world could change that.

Moreover, economists and policy makers are still struggling to explain the slow recovery in UK productivity and wages, highlighting the complexity of the UK economy. The voluntary sector is similarly complex, with a variety of different factors affecting its performance.

However, reviewing the impact of the recession and recovery, and the responses of charities so far, there are three clear trends for the voluntary sector as a whole, the consequences of which both the sector and policy makers will need to consider.

- A squeeze on internal capacity, due to pressure to generate more funds while maintaining staffing, training, buildings and equipment.
- A slow recovery of the sector's asset base (property, investments and land).
- A rebalancing of the sector's income away from government sources towards individuals through fundraising and charging for services, which may be unsustainable in the long term.

The forecasts conclude:

- On current trends, the fastest growing source of sector income (from individuals) will not grow fast enough to cover the fastest falling source (government income).
- The effect of inflation will reduce the sector's spending power by £3.1bn by 2018/19, which will feed into the squeeze on capacity.
- Growth in the sector's asset base will not make up for income loss elsewhere.

The combined effect of the forecasts is a **£4.6bn annual shortfall** in overall sector income by 2018/19, simply to maintain its 2012/13 spending power. Any increases in the sector's loanbook due to asset growth will cover only a fifth of this.

Some implications of these forecasts and the analysis made across the whole review are set out below.

### Forecast 1 – Income trends from government and individuals

As noted above, voluntary organisations have sought to adapt to falling income from government sources by diversifying their income into other sources, particularly through charging for services. Other sources of income such as from legacies, investment or the private sector are not growing sufficiently to help offset losses elsewhere. This rebalancing creates a number of challenges for the voluntary sector.

Firstly, it is taking place in the midst of steep reductions to public spending which are negatively impacting the sector's finances. The Almanac reported a steep fall in the sector's income from government in the first year of austerity, particularly driven by local government spending cuts.

It is difficult to predict what the impact will be in subsequent years. However, if we project the same level of cuts year on year, then the sector is facing a fall in government income of almost 40% over the course of the austerity programme.

#### **Income from individuals is unlikely to compensate for falls in government income**

Since its peak in 2009/10, income from government sources has dropped by £2.5bn – an average drop of 4.1% a year. During the same period, income from individuals (earned and donated) rose an average of 2.68% a year. If these trends continue, then by 2018/19, there would be an annual £1.5bn gap between the sector's largest growing and falling income streams.

#### **In order to offset the level of reductions assumed above, income from individuals would have to grow at 3.75% a year – well above recent trends**

Not only does this seem unrealistic given current trends, but also given the increasing cost of generating funds. The ratio of pound raised per pound spent fell by 2% between 2011/12 and 2012/13 alone indicating the degree of competition for fundraising. This will only increase as more charities are forced to fundraise in order to make up for the loss of government income. As a consequence, while total income may rise from donations, expenditure may also rise significantly reducing the impact of increases in donations.

Income from other sources could help to take the strain off fundraising and trading, but to put this into context, charitable foundations would need to more than double the amount that they gave away in grants to make up for the loss of government income. Research shows that increasing the level of endowed foundation expenditure by say, only 25%, would dramatically increase the probability of foundations permanently eroding the value of their asset base and therefore their long-term spending power, causing many of them even to disappear altogether. Instead most foundations aim, over the long-term, to balance the needs of future and current generations, sustaining their activity over decades in ways that few other supporters of charitable activity can<sup>28</sup> So, while some foundations may choose to ‘spend out’, many others will feel that their charitable mission requires them to calculate expenditure rates to support long-term engagement.

**Modest growth in total income would need 4.5% annual growth in income from individuals**

This forecast is predicated on the idea of retaining flat real terms income for the sector up to 2018/19. However, with rising demand, zero income growth would leave many organisations unable to cope with demand. If we were to aim for 1% growth in the sector’s income in each year between 2012/13 and 2018/19, this would mean that income from individuals earned and donated would need to grow by 4.5% per year in real terms.

Although there has been some wage growth in recent months, real wages have still not recovered to pre-recession levels and there will likely be further squeezes on wages as we return to normal levels of inflation. As a consequence, it seems unlikely that income from individuals will be able to offset reductions in public spending and meet demand. There are no other forms of income large enough to meet the shortfall of government income. Either the trajectory of government income changes will need to be altered via reforms to public service procurement, or the sector will become increasingly reliant on income from individuals and businesses, which as discussed above is unlikely to keep pace.

This will also leave the sector more vulnerable to changes in individual giving patterns and potential downturns in the economy.

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<sup>28</sup> For Good And Not For Keeps; how long-term charity investors approach spending on their charitable aims. Jenkins, R., and Rogers, K. Association of Charitable Foundations, London, 2013.

**Figure 19 – Projected fall in voluntary sector income from government compared to growth in income from individuals (£bn), 2012/13 prices**



## Forecast 2 – The effect of inflation

One of the biggest challenges facing voluntary organisations is the rising demand for their services. In this forecast it is assumed that the overall sector spending remains flat in real terms, between 2012/13 and 2018/19.

***In order to retain the same level of spending power, the voluntary sector would need to generate £3.14bn in income or savings to make up for the eroding effects of inflation<sup>29</sup>.***

This is a significant level of efficiency, unless the sector utilizes its reserves to maintain its current level of income. If the sector’s income does not grow fast enough to maintain the sector’s spending power, this will further stretch resources and leave a number of organisations unable to meet the demand for their services.

This funding gap would be reduced by increasing income faster than inflation or through improving productivity. However, given the issues considered in the forecasting above, growth in income of around 2% (which would be required to top up voluntary sector spending) is unlikely. Moreover, productivity increases are hard to achieve in the voluntary sector given the complex needs of service users and the difficulty in substituting capital for labour, although greater use of digital technology could generate productivity increases in some parts of the sector.

Greater consideration is needed on how the voluntary sector can raise productivity over the long term.

Alternatively, savings could be made in a number of places, and as demonstrated above, a number of charities have made savings through collaboration, pay freezes or other methods.

Charities will need to consider more carefully the options for savings on top of those already highlighted above, such as through partnership working, and pay freezes.

One of the biggest costs to the voluntary sector is staffing. But to put these savings into context, if the required savings were to be achieved solely from staffing costs, it would require charities to reduce their spending in this area by 25%. After years of existing reductions for small voluntary organisations, this would dramatically reduce the capacity of the sector and reduce its long term ability to meet demand (see *Who has been most affected by changes in staffing levels?* section).

It is likely that staffing costs will be only one part, albeit significant, of the necessary efficiency savings required by the sector – but this figure highlights the significant level of restructuring (which itself could be costly in the short-term) that will be required unless the sector is able to grow its income streams.

This does not take into account either the likely shift of personnel away from service delivery towards fundraising, which was noted by a number of organisations that responded to our call for evidence.

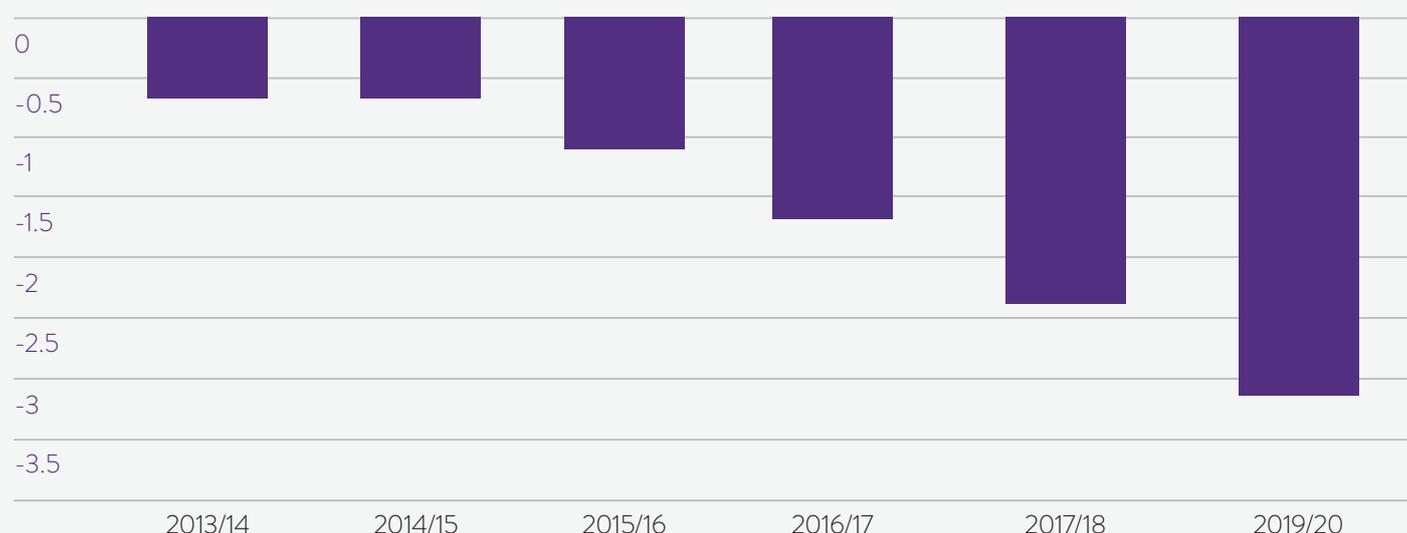
***Pressure on internal capacity will further restrict the sector’s ability to generate additional sources of income.***

The analysis of the efficiency savings that would be required on current trends, above, also does not account for the negative feedback effect noted in the Expenditure Analysis section, whereby reductions in capacity mean organisations are stretched too thin to seek alternative sources of funding or create strategies to improve their sustainability, perpetuating a ‘vicious cycle’ of decline.

### REFERENCES

<sup>29</sup> ONS CPI estimates March 2015

Figure 20 – Efficiency savings required year on year in order to keep spending power constant at 2012/13 prices (£bn)



The *Top 300 Charitable Foundations* report highlighted that a number of large foundations had seen the level of applications for their funds fall over recent years, and this may be a manifestation of a ‘capacity crunch’. It may also reduce the ability of voluntary organisations to form consortia (particularly given the noted trend for the aggregation of contracts) or bid for contracts to deliver public services.

Regardless of the balance between efficiency savings and growth increases, the voluntary sector will need support as it restructures.

### Forecast 3 – A slow recovery in the sector’s assets

As in the rest of the economy, the recovery in the voluntary sector’s asset base has been relatively robust – although this has been much quicker than wages. Quantitative easing has increased many asset values and some economists are concerned that this bubble could burst when monetary stimulus is removed and interest rates are increased in the future.

However, in this forecast, it is assumed that there will be a steady recovery in the voluntary sector’s asset base over the coming years – to begin with matching the same rate as since the recession (around 4.1% per year) before slowing to a more sustainable level (3%) for the rest of the period.

This forecast does not make any assumptions regarding the growth of the sector’s pension deficit although this is considered likely and will drag down the true extent of sector’s asset recovery.

This forecast would see the long term health of the sector’s balance sheet improve, providing the opportunity for investment in the sector’s capacity in the future. However, if this is concentrated (as the recovery in assets has been so far) in the largest charities and foundations, this is unlikely to help small voluntary organisations. It will also not enable the sector to meet demand in the short term, given that most assets are fixed.

#### **Growth in the sector’s asset base will not make up for income loss elsewhere**

If we assume that the sector’s appetite and ability to access funding remains stable, with loans remaining at around 4% of net total assets – this would increase the size of the sector’s loan book by around £0.9bn over the period.

The increase in assets is not likely to be spread evenly across the sector and those service delivery organisations that are most likely to want and need access to social investment, are less likely to see strong growth in their asset base (if they hold any assets).

As discussed in the Assets section, the uptick in net total assets has been primarily driven by the growth of fixed assets held by foundations; operational charities are unlikely to see much growth on current trends.

Even if the growth in net total assets assumed above was to lead to the increase in the sector’s loan book predicted, this meet only 20% of the sector’s total funding needs (£4.6bn) if it is retain its current level of spending.

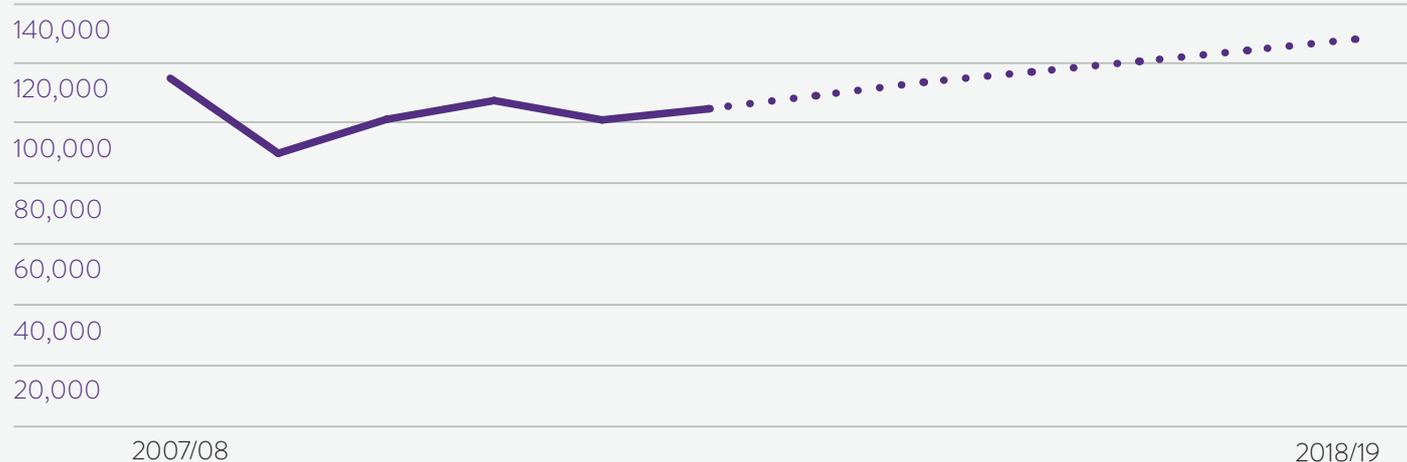
Moreover, these loans would evidently need to be repaid, potentially increasing the sector’s expenditure by hundreds of millions of pounds and offsetting the stimulative effect in the long term.

If reserves were to stay as the same proportion of total net assets as recorded in the last year for which data is available (and the long term trend has been for this proportion to fall, rather than rise due to the much faster growth of investments and property prices), then this would see a strengthening of the sector’s reserves of around £5bn – however this is likely to be concentrated in the largest charities.

However, given the capacity constraints outlined above and the sector’s funding needs, such significant growth is unlikely. It is more likely that the sector’s reserves will remain around their current level.

**Figure 21 – Voluntary sector net assets £ billions, 2012/13 prices**

■ Net total assets    • Net total assets (forecast)



## Policy implications

These ongoing trends in the sector's finances have serious implications for the long term sustainability of many voluntary organisations. To avoid these consequences, the review's conclusions must be addressed urgently, both by voluntary organisations, be they individual charities, infrastructure bodies or foundations, and by government, in its roles as policymaker and commissioner of public services.

### Voluntary sector

- Voluntary organisations are increasingly generating income through charging for services, but this approach is not suitable for all organisations. Voluntary organisations will need to ensure any efforts to generate income do not undermine their ability to achieve their charitable objectives.
- Voluntary organisations have lost significant amounts of government income, around £1.7bn since 2009/10. Organisations will need to ensure they are in a position to win government grants and contracts, whether that is through improved collaboration, demonstrating their impact or piloting new ways of delivering their services – but change is also needed from government to enable this to happen.
- There is strong evidence from surveys to suggest that demand for voluntary organisations services has grown significantly over the course of the recession. Organisations will need to take additional steps to build a better picture of demand and what resources are required to meet need. This will enable a much more focused debate around the sector's finances and ensure that discussions are better informed.

- Voluntary organisations have experienced a 'capacity crunch' of their back-office and management resources as they seek to put more into delivering frontline services. But this cannot be done indefinitely without significantly reducing the sector's long term ability to meet demand and generate income. Voluntary organisations will need to think ahead and consider how they balance short-term demand with long-term sustainability.
- Some organisations have become more sustainable and have adapted their business models. Voluntary organisations should consider doing more to spread the lessons of success while also recognising the limits of replicating a 'one size fits all' model.
- Our report indicates that voluntary organisations will need to make over £3bn in efficiency savings in order to maintain their spending power. Voluntary organisations need to begin working now to identify areas where savings can be made and design strategies for achieving them. Voluntary organisations are also advised to make explicit the impact of inflation when bidding for contracts and grants.
- Charitable foundations now account for an increasingly important part of the sector's income given the reduction in grant funding from government. Foundations may need to reconsider their role as strategically important funders for the sector in the light of these changes. More co-ordinated or different approaches to funding the sector may be necessary to compensate for the loss of government income, for example for capacity building.
- Voluntary sector funders of other voluntary organisations will need to consider how to provide funding in a way that helps make their partner organisations sustainable and supports their long term capacity to deliver change; while also balancing this against their need to make their resources achieve the biggest possible impact.

### Government

- Government income to the voluntary sector has fallen, despite efforts to ensure such organisations play a bigger role in public services delivery. We call on the government to take further steps to improve current commissioning policy and practice and ensure voluntary sector organisations are able to realise their potential to play an active role in a diverse future market of public services providers.
- Grants are a critical source of income for the sector and some services are not sustainable under a contract model. The government will need to work with the sector, building on initiatives such as NHS England's Bitesize Guide to Grants for the Voluntary Sector, to ensure that appropriate funding mechanisms are used by commissioners. This is important to avoid a contract monoculture that will otherwise affect the long term sustainability of a significant part of the sector.
- Voluntary organisations are striving to adapt to replace government income that they have lost, yet in many cases the reductions are taking place faster than the sector can develop new revenue streams. The government should reconsider the scale, pace and targeting of current spending reductions to ensure the voluntary sector is able to meet demand for services in the long term.
- Evidence from voluntary organisations indicates that a holistic funding approach to the sector across different parts of government has yet to be adopted. We call on the government to ensure that devolution of more power and spending decisions to the local level does not undermine the ability of the government to develop a coherent strategy for supporting the voluntary sector.

- Voluntary organisations are working hard to generate more of their own resources. There are a number of ways that government can support this, for example, through more effective use of existing tax reliefs. The government should consider how tax reliefs such as business rates and gift aid can be better implemented to maximise charitable income.
- The relationship between the government and the voluntary sector is changing. The government should renew and strengthen its commitment to strategic partnership frameworks such as the Compact to ensure partnerships continue to be relevant and effective in a changing operating climate.
- The asset recovery of the sector has not been evenly distributed. Large charities and foundations have benefited from recovering asset values, while small voluntary organisations have not seen a significant improvement. The government and voluntary sector need to work together to ensure that small voluntary organisations are 'recapitalised' so they are able to grow sustainably in the future.

## Ten things voluntary organisations can do

Below are some basic steps that voluntary sector organisations can take to begin building financial sustainability.

### 1. Understand your operating model.

Do you understand how you generate income, what you are trying to achieve and how dependent your organisation is on certain sources of income?

**2. Think about your market.** Do you understand how your funding sources are evolving and whether these are likely to change in the future (for example, is your local authority likely to cut spending with voluntary organisations in the near future) and how certain changes would generate opportunities or threats your organisation?

**3. Map your organisation's capabilities and capacities.** Do you know what your organisation can do and what it can't do? Are there gaps in your organisation or weaknesses? What might you need to do if you were to take your organisation sustainable?

**4. Consider what other types of organisations are doing.** Have you identified whether there other organisations that you can learn from, whether that is because they have similar objectives or funding models? Could you work together with them?

### 5. Do not put all your eggs in one basket.

Consider the range of assumptions that you have in your business plan and challenge your assumptions thoroughly. The future is unpredictable.

### 6. Factor in the impact of inflation.

Do you build in the impact of inflation both in terms of operating costs but also future income generation? If not, what does your long term financial health look like once inflation is considered?

### 7. Understand the tax reliefs you receive.

Does your organisation claim all the tax reliefs that it is entitled to and if you changed your funding model, would that impact on the reliefs that you can receive?

### 8. Map your assets and liabilities.

Do you know what assets (financial, organisations, expertise or intellectual property?) your organisation has and what liabilities you have, for example, pensions? What future liabilities may changing your business model create?

### 9. Think about your staff, volunteers and trustees.

Have you considered their skills and what skills they may need for the future? Are you dependent on certain staff, volunteers or trustees? Are they over-stretched, if so, how long is this sustainable for?

**10. Plan now.** Carry out these plans now, do not wait for a change in your situation.

THE REVIEW'S  
CONCLUSIONS MUST  
BE ADDRESSED  
URGENTLY

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