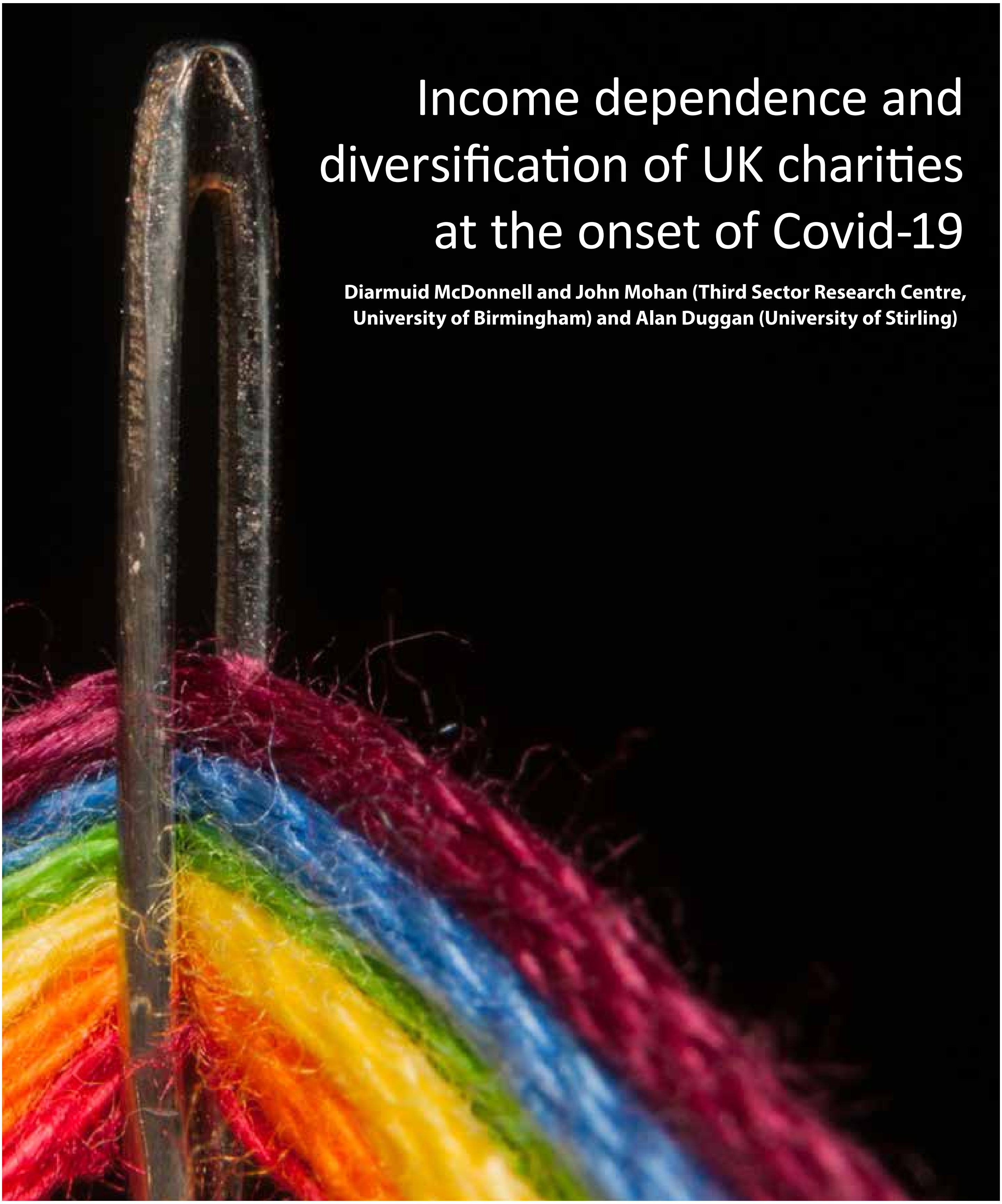

Income dependence and diversification of UK charities at the onset of Covid-19

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Abstract

This paper provides an assessment of UK charities' income dependence and diversification at the onset of the Covid-19 pandemic.

It shows that a significant proportion of charities are highly dependent on a single income stream for their funding: over half receive at least 90 per cent of funding from a single income stream. It also shows that organisations with highly concentrated income profiles are found across the charitable sector – irrespective of charitable size, main income stream, age of the organisation, or field of charitable activity.

Key Findings

- There is a high degree of reliance on a single income stream for the majority of a charity's funding.
- Charities established in more recent periods are more likely to be highly reliant on a given income stream: c. 60 per cent of organisations registered in the past ten years derive at least 90 per cent of their funding from a single stream, compared to c. 45 per cent of older organisations.
- The field in which charities operate matters – charities that are involved in education, law and advocacy work, and those which operate as grant-making foundations, are most likely to have a dominant income stream. In contrast, charities involved in culture and recreation, environment, and religion are least likely to have a dominant income stream
- Reliance is likely to be higher in organisations that derive most of their funding from investments or charitable activities.
- There is little evidence of changes in these patterns during the period for which we possess relevant financial data.
- An examination of income sources also reveals high levels of reliance and concentration in the UK charity sector.
- Smaller charities – those with annual gross income of below £500k – are more likely to have concentrated income profiles or a dominant income source compared to larger organisations.
- Findings are highly consistent across England, Wales and Scotland.

Conclusions

- A high degree of income dependence and concentration of income streams/sources does not necessarily imply that these charities are more vulnerable than those with a more diversified income profile. However, evidence from other countries suggests income diversification has a minor (though real) positive impact on financial sustainability.
- A lack of variation in income dependence or diversification over time fits with existing theories of non-profit revenue strategies. Organisations pursue certain missions, which in turn attract certain types of funding; therefore, if the mission doesn't change drastically, why should funding streams / sources do so?

About this project

Our research is being funded by the Economic and Social Research Council as part of the UK Research and Innovation call for studies that can contribute to understanding and alleviating the social impact of the pandemic. The project will provide an analysis of the variegated impacts on charities of the very severe financial constraints they will experience due to the immediate and longer-term economic effects of the Covid-19 crisis. Building on our extensive prior research on the finances, distribution and exposure to risk of charities we will utilise large-scale databases constructed since 2008 to assess the distribution of financial vulnerability across the population of charities. The project is a collaboration between the universities of Birmingham, Southampton and Stirling, and the National Council for Voluntary Organisations (NCVO).

Introduction

Discussions of the consequences of the Covid-19 pandemic for the income of charitable organisations emphasise threats to particular funding streams due to restrictions on trading or fundraising, and the effect of the economic downturn on household incomes. But which organisations are most affected?

This will depend on the extent to which they are most reliant on particular sources of income. An organisation that draws almost all its income from outdoor fundraising events might be contrasted with one whose revenues come principally from endowments.

Debates on voluntary sector finances in the UK are driven by sector aggregates and global estimates. Rarely if ever do analyses look at variations in the reliance of individual organisations on particular funding streams, but such work is essential to an informed perspective on likely effects of the current situation. Academic literature, mainly based on research in the USA, suggests that a diversity of income sources is potentially beneficial, but there is no research on the topic in the UK. In this paper we provide a comprehensive overview of the distribution of charities according to their reliance on one or more income streams at the onset of the Covid-19 pandemic.

Data and Method

Data sources

For England and Wales we use data from administrative returns submitted to the Charity Commission for England and Wales, filed by organisations whose annual income exceeds £500,000 (c. 12500 organisations). These returns capture seven income streams: legacies; endowments; voluntary income; activities generating funds; charitable activities; investment income; other income.

For Scotland we analyse financial accounts submitted to the Office for the Scottish Charity Regulator (OSCR) covering 2,363 charities. These organisations have an annual income of at least £250,000, and they report a breakdown of charitable income, a breakdown of charitable expenditure, and information on assets and liabilities.

There are variations between jurisdictions in terms of precisely what data are captured, but we are able to differentiate income from: donations and/or legacies; interest and/or investment; income from trading; income from charitable activities; and other income.

These regulatory returns do not provide detailed information on a charity's sources of income: for example, voluntary income (donations and grants) can be received from individuals, government, or other organisations. The services or goods a charity provides can be purchased by individuals or government (e.g., social care organisations may receive fees from individuals, or payments under contract from public agencies). To overcome these limitations we draw upon an additional source of data on the finances of charities in England and Wales: digitised copies of charities annual accounts ('Accounts' data) captured for financial years since 2006/7 by NCVO/TSRC. The Accounts dataset captures information on income sources which are aggregated into six categories: donations / monies raised from individuals; fees paid by individuals; government; voluntary sector and National Lottery funds; internally-generated funds; and 'other'.

Analytical approach

There are two phenomena of interest: how dependent a charity is on a given income stream; and how diverse or concentrated its annual income is. These are complementary yet distinct phenomena that in combination provide a rich picture of the composition and potential vulnerability of a charity's annual income. For example, a charity may receive funds from a range of income streams (implying a diversified income profile) yet be dependent on one of these streams for more than 50 per cent of its annual gross income.

We analyse 12611 financial accounts for England and Wales, and 2363 accounts for Scottish charities for the most recently available financial year (mainly 2019). We focus on variation in the share of total income accounted for by a particular funding stream. We define thresholds marking the relevance of a particular stream in terms of its share of total income: a stream is considered to be a major source if it accounts for at least 50 per cent; and dominant if it accounts for at least 90 per cent. We then consider how the proportion of charities meeting these thresholds varies according to key characteristics of organisations.

We analyse diversification of income streams using the Herfindahl–Hirschman Index (HHI), which calculates a score between 0 (a highly diversified profile) and 10,000 (highly concentrated) capturing how diversified an organisation's funding mix is. The HHI is the sum of the squared percentage shares of each component of income. Thus a charity receiving 50% of its income from donations and 50% from investments would have an HHI score of 50^2 + 50^2 = 5000.

Results

Income dependence

Table 1 presents the distribution of charities according to how reliant they are on a given income stream. Across the jurisdictions, almost all charities (c. 95 per cent) rely on one stream for a majority of their total income, with half of organisations almost exclusively funded (at least 90%) by a particular income stream. Charities are most likely to rely on income from charitable activities for the majority of their income, followed by voluntary income (donations and legacies, in Scotland).

Table 1: Percentage of charities reliant on a given share of income, England and Wales, and Scotland

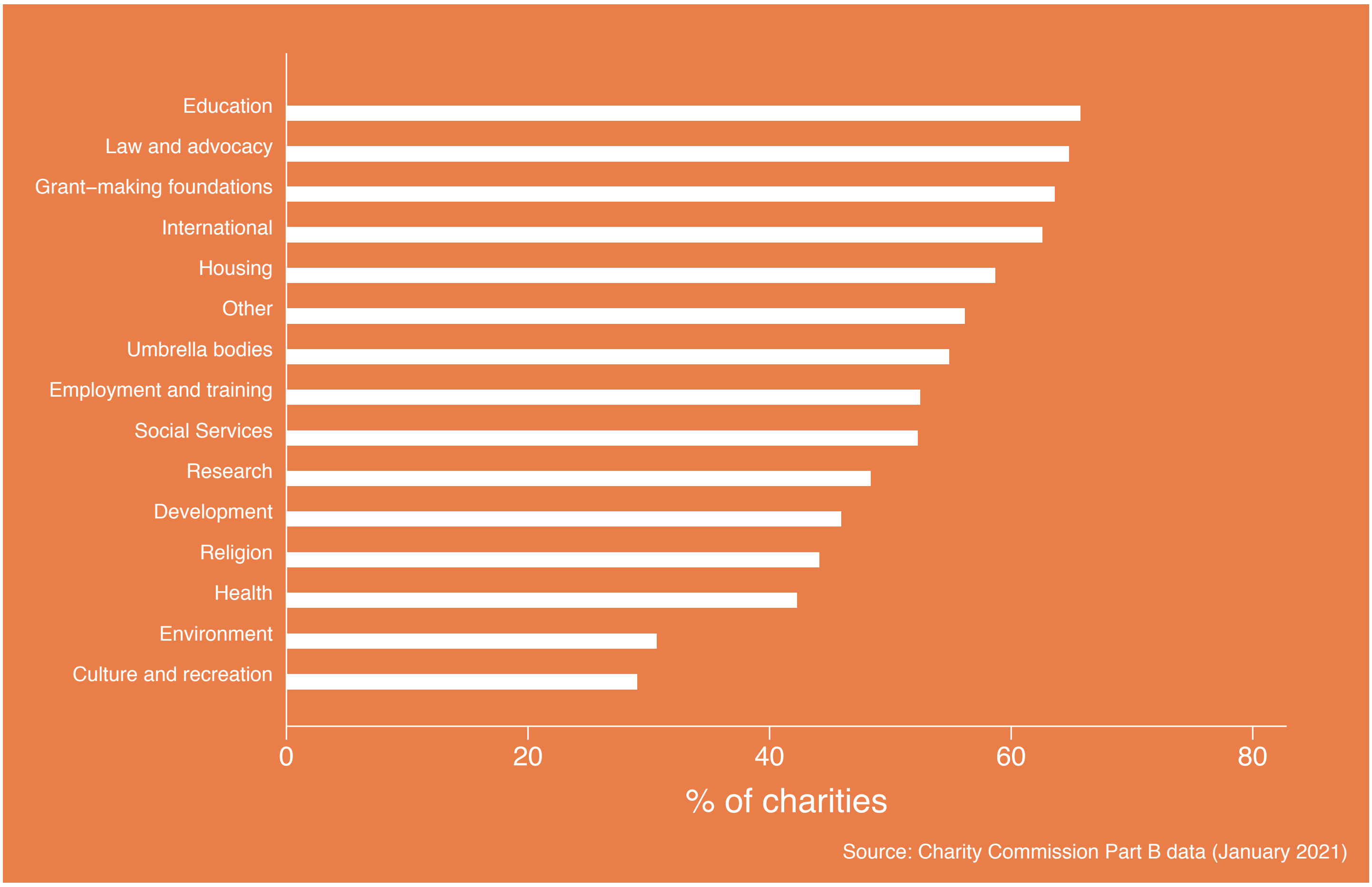
Stream	% of charities with given share of income	
Major (>= 50% of total income)		
	England and Wales	**Scotland**
Voluntary income	33	33
Charitable activities	49	49
Investment income	5	4
Other	7	10
From any of the sources above	94	96
Dominant (>= 90% of total income)		
	England and Wales	**Scotland**
Voluntary income	17	15
Charitable activities	28	31
Investment income	3	2
Other	2	3
From any of the sources above	50	51

Note: Voluntary income includes legacies; 'Other' includes trading (Scotland) and activities for generating funds (England and Wales). Endowment not shown due to negligible value (< 1 per cent).

How do income profiles vary by characteristics of organisations? Firstly, dividing organisations into income bands (£500k – 1Mn; £1 –10Mn; £10Mn+) there is no evidence of a size gradient: the largest charities are as likely to have a dominant income stream as the smallest organisations. There are clearer variations depending on the different fields of charitable activity in which organisations are active. We use the International Classification of Nonprofit Organisations (ICNPO) as a basis for categorising charities. Over three-fifths of charities that are involved in education, law and advocacy work, international development, and those operating as grant-making foundations have a dominant income stream. In the case of grant-making foundations, there are relatively small numbers of such organisations and they are heavily reliant on endowments. In contrast, charities involved in culture and recreation, environment, and religion are least likely to have a dominant income stream.

"Over three-fifths of charities that are involved in education, law and advocacy work, and international development have a dominant income stream"

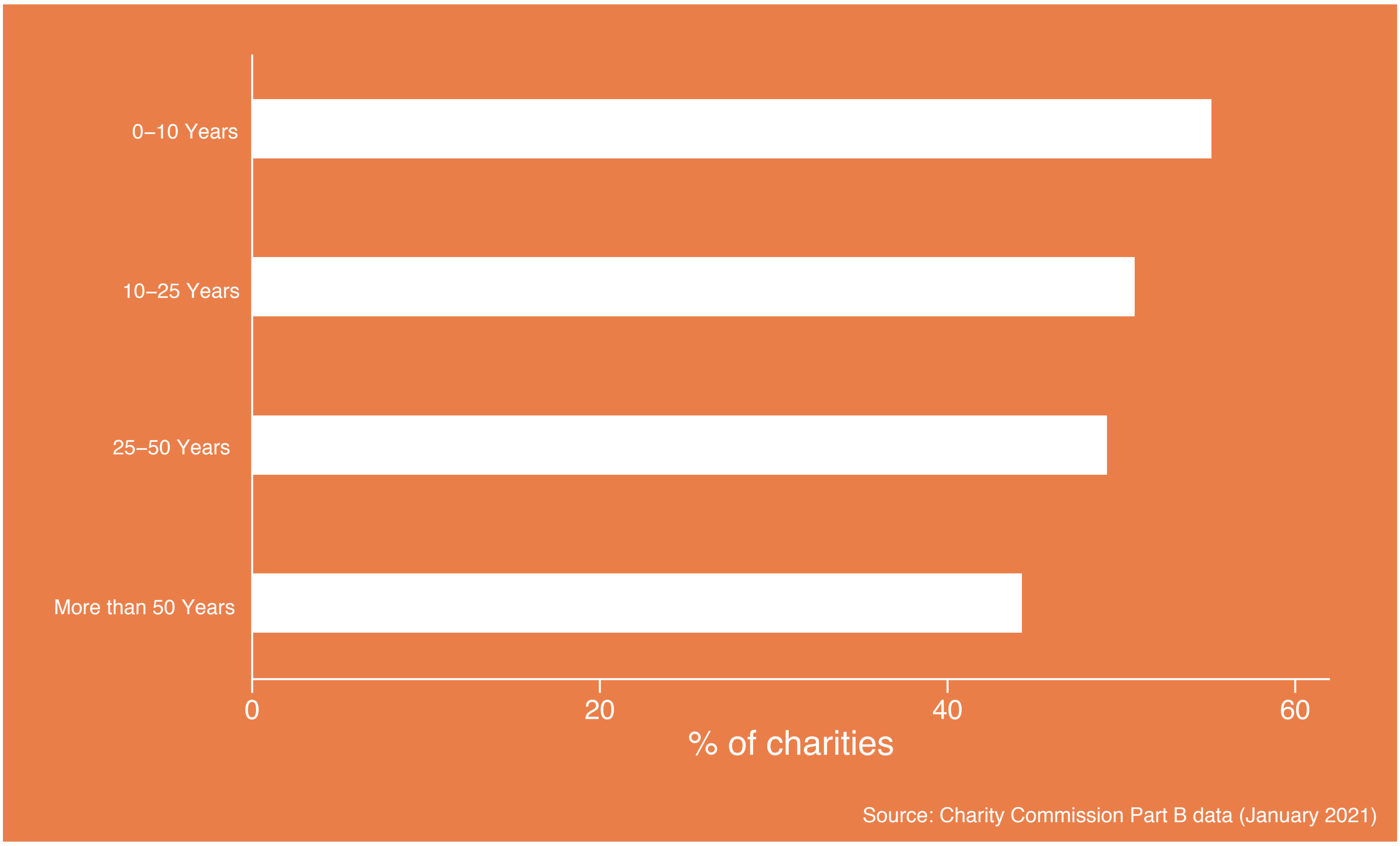
Figure 1: Percentage of charities with a dominant income stream, by field of charitable activity (ICNPO)



“Younger organisations are most likely to have a dominant income stream while older charities have a more diversified income profile”

Figure 2 shows variations in the presence of a dominant income stream according to the age of the charity (only England and Wales shown here), defined by the number of years since registration. There is a small association between these two factors, with younger charities most likely to have a dominant income stream. This suggests that organisations diversify their funding base the longer they have been established.

Figure 2: Percentage of charities with a dominant income stream, by years since registration (England and Wales only)



Multivariate analysis

To what extent do the differences in the likelihood of having a dominant income stream between charities reflect the interaction of various characteristics of organisations? We look at the extent to which differences in likelihood by size, income stream, age and field persist when we control for each of the other variables. We use logistic regression to examine how the dependent variable, whether a charity has a dominant income stream or not, varies according to these covariates. The full analysis is presented in a separate, longer version of this paper.

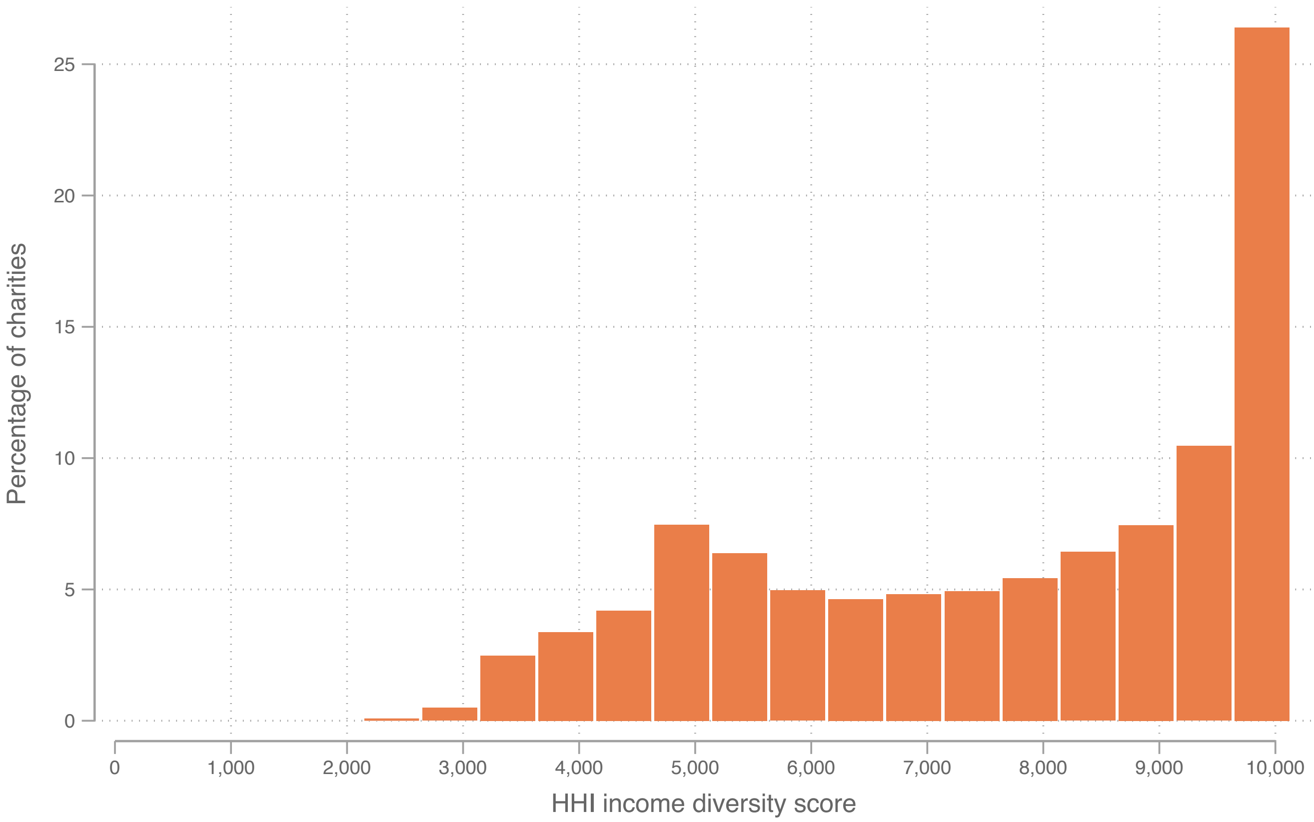
Importantly, differences in the distribution of dominant income streams that we have already observed – when considering each of our covariates separately – persist when we control for each of the other variables. Charities that receive most of their income from voluntary sources have lower odds of having a dominant income stream than charities that receive most of their income in connection with their charitable activities. Older charities are less likely to have a dominant income stream than those less than ten years old. Meanwhile, compared to charities involved in culture and recreation, all other charities have higher odds of relying on a single stream for a dominant share of their income.

Income diversification

The distribution of charities according to their reliance on a given income stream is revealing but offers a partial picture. There is a great deal of difference between a charity that receives 50 per cent of its income from one stream and the remainder evenly split between four other streams, and one where the remainder is accounted for solely by one other stream. Therefore, we consider a measure of income diversification, the HHI.

Figure 3 presents a histogram of the distribution of charities according to this index. On the horizontal axis, lower values indicate highly diversified income profiles whereas higher values suggest concentration (e.g., one dominant stream). Around four in ten organisations (38 per cent) are almost entirely dependent on one stream for all of their annual income. For example, a HHI score of 8000 or more represents a charity receiving c. 90% of their annual income from only one stream. Meanwhile there is a short lower tail in the distribution such that around 15 per cent of charities have some degree of income diversification (HHI under 5000). The typical (median) charity has a highly concentrated income profile (HHI = 8,211).

Figure 3: Histogram of charities according to their income diversification score (HHI)



Source: Charity Commission Part B data (January 2021)

The distribution of diversification does not vary according to the size of charity. Older charities have a more diversified income profile (the typical HHI is over 8500 for the youngest organisations compared to around 5000 for organisations registered for 50 years or more). There are also differences in fields of charitable activity. As we have shown earlier in this paper, in some fields of activity organisations are highly likely to rely on a single stream of income (see **Figure 1**).

"Charities reliant on voluntary funding have more diversified income profiles compared to those reliant on charitable activities."

In separate analyses we have explored the extent to which the differences in income diversification between charities in different fields of activity reflect compositional differences in charitable size, main income stream, or age of the organisation. The differences in degree of diversification that we have already observed – when considering each of our covariates separately – persist when we control for each of the other variables. For example charities that receive most of their income from fundraising activities have a higher degree of diversification than charities that receive most of their income in connection with their charitable activities; older charities have more diversified income profiles; and, compared to charities involved in culture and recreation, all other charities have more concentrated income profiles.

Supplementary analysis

In further work, we have considered variations over time in income dominance and income concentration; looked at data captured directly from charity accounts, to provide more detail of income sources; and analysed the position of smaller charities.

Change over time: there is little variation in the proportion of charities that have a dominant income stream, or in the degree of income diversification. The English and Welsh data were available only from 2006–7 onwards, but as we continue to accumulate annual returns from charities it will be possible to explore the extent to which organisations change their revenue mix over longer time periods.

Analysing charity accounts: We replicate the main analysis using the Accounts data, allowing us to examine dependence and diversification in the context of income sources. For the latest financial year for which we have data (2017), we analyse the accounts of 9,575 charities whose annual income exceeds £500,000.

There is still a high degree of dependence in the England and Wales charity sector, though to a lesser extent compared to an examination of income streams. One in three organisations (36 per cent) possess a dominant income source, and that source is likely to be individuals; only seven per cent of charities receive at least 90 per cent of their funding from government.

Table 2: Percentage of charities reliant on a given share of income, England and Wales

Source	% of charities with given share of income	
	Major	Dominant
Individuals: donated/raised	30	12
Individuals: charitable activities (fee income)	22	11
Government	21	7
Voluntary sector/ Lottery	6	1
Internal	7	4
Other	3	0
From any of the sources above	*88*	*36*

Note: Major = source accounts for at least 50 per cent of annual income; Dominant = source accounts for at least 90 per cent of annual income.

We have also analysed income diversification using the Accounts data, and we find that there is greater dispersion of values, partly because of using a larger number of income sources. Even so, we find around 17% of organisations are very highly dependent on a single income source.

Smaller charities: There is much interest in the position of smaller charities but they are not subject to the reporting requirements which are mandatory for organisations whose gross annual income exceeds £500,000. However there are some data resources that can be leveraged to examine the income profiles of smaller organisations. For England and Wales we can use the Accounts data to look at income sources for charities at the lower end of the income distribution (£1–£10k, £10k–£100k, £100k–£500k); while for Scotland we can use the main dataset to examine organisations with annual income between £250,000 and £500,000.

In England and Wales we have data on income sources for 3,186 smaller charities in 2017: only 2 per cent of these observations relate to organisations with under £10k annual income, with 40 per cent in the £10k–£100k bracket, and 58 per cent in the £100k–£500k category. **Table 3** demonstrates some moderate differences in income reliance between smaller and larger charities, focussing only on the proportions that report a "major" source of income. The smallest charities are less likely to rely on Government as a major source of income, and more likely to rely on donations from individuals. There are also considerable variations in the percentage of charities reliant on internal sources of funding, with a clear size gradient from smallest (more likely) to largest (less likely).

Table 3: Percentage of charities reliant on a given share of income, England and Wales (smaller charities)

	Under £10k	*£10k–£100k*	*£100k–£500k*	*£500k +*
Individuals: donated/raised	39	41	43	30
Individuals: charitable activities (fee income)	15	16	11	22
Government	4	12	14	21
Voluntary sector/ Lottery	7	7	9	6
Internal	20	14	11	7
Other	2	2	2	3
From any of the sources above	87	92	90	88

Note: Percentages do not necessarily sum to 100

In terms of income diversification, smaller organisations are more likely to have concentrated income profiles, with the median HHI score of 8000 for under £10k charities, 7200 for £10k–£100k charities, and 6900 for £100k–£500k charities.

In Scotland smaller charities exhibit many of the same properties and trends with regards to their degree of income dependence and diversification.

Conclusions

We note four limitations of this analysis.

First, there is a considerable lag in the availability of data, so the analysis is of data relating to financial years mainly ending before 2020. However, there is stability over time in the patterns we describe so the data provide a good guide to the finances of charities on the eve of the pandemic.

Second, there are difficulties associated with measuring income streams, the main one of which is the aggregation of different types and sources of income under a single stream. For example, the 'Voluntary income' stream is a very broad category combining a range of sources, such as grants from government or donations from individuals. Our use of Accounts data partly mitigates against this.

Third, the level of dependence on a single income stream is an imperfect guide to the potential vulnerability of charities to financial shocks. For example, it could be argued that there are considerable advantages to having a reliable, generous single funder in comparison to managing multiple income streams.

Fourth, income dependence and diversification are not ends in themselves, however we are not able to examine or associate the effectiveness of service provision or the level of service continuity with aforementioned financial phenomena.

Our key conclusions are as follows

Firstly a strong theme is just how reliant organisations are on particular income streams or particular sources of income. These in turn are closely linked to the fields of activity in which organisations are operating.

Secondly there are age gradients, which suggest that the longer organisations have been in existence, the more they are able to diversify their funding base.

Thirdly, some organisations are very heavily reliant on specific income streams and sources. These will be most vulnerable to the withdrawal or interruption of activities that generate income for charities.

Finally, an important feature is the stability of income sources. Therefore, proposals that organisations need to become more entrepreneurial and diversify their funding sources may be neither helpful nor realistic in the absence of new or different sources of income.

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