

Patterns of financial vulnerability in English and Welsh charities after the onset of Covid

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Abstract

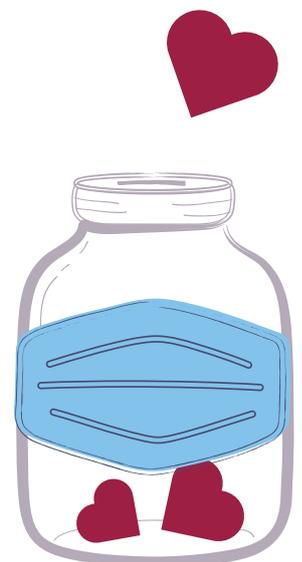
This paper provides an assessment of the scale of changes in the incomes of charities after the onset of Covid until late 2020. Comparing measures of financial vulnerability with the previous experience of charities from 2000 onwards, it demonstrates how charity finances have become more volatile over the past decade, and shows that a significant minority of charities are experiencing financial changes of an order of magnitude not recorded previously in recent times. Using data on the distribution of awards to charities in response to Covid, it also shows that these were not necessarily made to organisations experiencing the greatest financial difficulties.

Key findings

- In the past twenty years there has been a steady upward trend in the proportion of charities for which expenditure exceeds income by at least 25%.
- This is particularly noticeable for organisations with incomes below £25 000. The recession of 2008-9 signalled a further upward shift in this indicator although this is less noticeable for organisations with incomes above that level. Early data for 2020 indicate a significant upward shift for organisations with financial years ending after the first Covid lockdown.
- The proportion of organisations experiencing shocks to their income, defined as a reduction over a three-year period of at least 25%, has been broadly stable over the past 20 years, but there is a visible peak around and after the Great Recession. Smaller organisations, as might be expected, have been more likely to experience such financial events.
- The proportion of such events also appears to have been rising again in the years prior to Covid.
- A typical charity reporting after April 2020 experienced a 15% real-terms reduction in income. A charity at the 25th percentile experienced a reduction of over 40%. These are figures of a different order of magnitude than experienced at any point in the past twenty years. The latter figure means that one quarter of organisations had lost two-fifths of their income from 2019 to 2020.
- We looked at whether there was a relationship between the distribution of grants from various funders aimed at supporting charities through the pandemic, and their prior financial experience. We did find that recipients generally had lower reserves than non-recipients but organisations with greater levels of financial vulnerability were no more likely to have received grants than organisations not experiencing financial vulnerability.

Conclusions

- We analyse long-term trend data on charity finances which shows conclusively that the experiences of organisations in the early phases of the pandemic were significantly worse than at any other time for which we have had that data.
- Where we are able to refine these analyses we can highlight particular characteristics (e.g. size and subsector) which are associated with worse (or better) experiences.
- The analyses described here can be used to inform decisions about which organisations to support in situations in which emergency funding is being distributed. We found that there was no clear relationship between financial vulnerability and receipt of grants. This is likely to be because of the great range of funding streams introduced in the past 18 months, which have diverse goals, so that financial vulnerability is only one of a number of criteria in the minds of funders.



Introduction

The Covid crisis was marked by the expression of serious concerns that charities would be exposed to unprecedented fluctuations in their funding. However, developing an evidence base on the impacts raises a number of questions. Measuring the growth (or shrinkage) of the charitable sector is not straightforward – and this applies regardless of the circumstances in which we are doing so.

Firstly we need to decide what organisations to count: here we have focussed on charities submitting annual returns to the regulator with income above a threshold. Secondly we need to consider whether we are interested in the size of the sector (e.g. adding up all the income), or the experience of individual charities and how their income has fluctuated. The aggregate size of the sector fluctuates both as organisations grow or shrink as well as when new organisations are created or existing organisations cease to operate, and so we need to consider whether to account for that. Lastly, we face a choice of what characteristics to use to measure size in the charitable context. Here we focus on income and expenditures, as we look at financial vulnerability, but one could also reasonably consider assets, staff, volunteers or some measure of impact if data permitted.

In practice, the immediate response to assessing the effects of the Covid crisis in the spring of 2020 was to set up surveys of recent experiences and future expectations of organisations. These involve a degree of subjectivity. For example respondents were asked to indicate whether they have experienced an improvement or a deterioration in their “financial position”, or whether the position has been “stable”. Alternatively questions were framed in terms of whether or not income has fallen or risen significantly over a two-year period, while the same survey also asked whether organisations expect their income to increase, decrease, or stay the same. A third survey was clearer about recent income trends, inquiring whether organisations’ incomes had increased or decreased relative to a 25% threshold.

Such surveys possess the advantages of immediacy and topicality, when compared to administrative data that can take some time to be processed and made available, but they have several disadvantages. They are usually answered by unrepresentative sets of organisations, typically with an overrepresentation of larger entities and of those with employees. We do not know why some organisations respond and others do not: perhaps they feel the survey is not relevant to them, or maybe they just don’t have the time to spare to complete it. Alternatively some may be more likely to respond than others, if they feel a study may provide useful ammunition when making claims for resources.

Questions are sometimes framed in different ways – as the examples given show, one survey has a reference period of one month while for another it is two years. Questions may not be understood in the same way by organisations (e.g. when they are asked about whether they anticipate an improvement or deterioration in their funding position: at what point does a change count as improvement or deterioration?). Most importantly, without longitudinal data, it is difficult to assess the importance of the pandemic for charitable income without placing the change in annual income during Covid within the context of longer-term annual trends.

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We can deal with many of these objections by using reported administrative data on registered charities. The understandable response is that such data are not timely, which may have some force in the context of the detailed data on charity accounts that underpins the NCVO Almanac. It is less of an objection to headline financial figures from annual returns. Such data can easily be downloaded from the Charity Commission website and are now available for c. 20 years. This therefore allows for analyses of tens of thousands of charities in nearly every year since 1997. Data are already available for some 50 000 organisations whose financial years ended after March 2020. This allows us to explore what the financial consequences of the Covid pandemic have been so far; which organisations have experienced greatest vulnerability; and how the reports we have thus far compare with the experiences of the same organisations in previous years.



In the first instance we consider how volatile the income trajectories of individual organisations have been. We can do this by identifying when organisations have experienced dramatic changes in income (such as a >25% fall in income), and either counting these organisations, or counting the number of such fluctuations, or 'blips' in their income. This splits charities into 'volatile' and 'non-volatile', and we can then examine how the proportion of volatile organisations has developed historically and through the pandemic. Rather than a crude classification, we could also consider more sophisticated measures of volatility at the organisation level, such as the standard deviation of income providing a measure of fluctuations around the longer term average for an organisation, with a larger variance providing evidence of greater volatility. This captures a more nuanced effect of volatility, but at the cost of being harder to interpret.

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Alternatively, we can track how the sector as a whole has fared. Here we could consider the movement of the average charitable income over time. We can also examine the movement of other points in the income distribution, such as the median, or the 25th percentile. We can either look at the sector as a whole, including new and dissolved charities, or if we want to compare like-with-like over time we can follow the same group of charities over repeated years. This provides the bigger picture, but could mask the level of volatility for individual charities.

The moral is that different measures provide slightly different angles on the experience of charity financial trajectories over time. Considering these different angles, and being clear about how they are measured, is essential if we are to make sense of what has happened and is happening as we gather evidence from a variety of different sources.

This paper is in two main sections. Firstly, to overcome the issues of subjectivity associated with social surveys we describe indicators of financial vulnerability for organisations which draw upon academic (mainly North American) literature in the field of non-profit studies, and measures derived from studies of household income dynamics in the UK. We provide some headline figures from applications of these indicators. Secondly, we develop an alternative measure of how the resources of English and Welsh charities have changed during the pandemic, focussing on the annual relative growth in charities' income compared to their growth in the previous year. Thirdly, we suggest one potential application of these measures. They may provide useful contextual information when funding decisions are being made since they enable funders to consider the relative financial position of their applicants. We illustrate this with a sample of data from grants made to organisations during the pandemic to date. Given that the onset of Covid drew forth various packages of funding to support organisations, what was the profile of the organisations to which funding was allocated? Were they the organisations experiencing the greatest degree of vulnerability?

Headline indicators of financial vulnerability

An influential literature sparked off by Tuckman and Chang, and other scholars in North America, is a good place to start. They used two straightforward measures:

1. whether or not an organisation had experienced an excess of expenditure over income of at least 25% in any one year;
2. whether or not an organisation had experienced a reduction in resources of greater than 25% over a three year period.

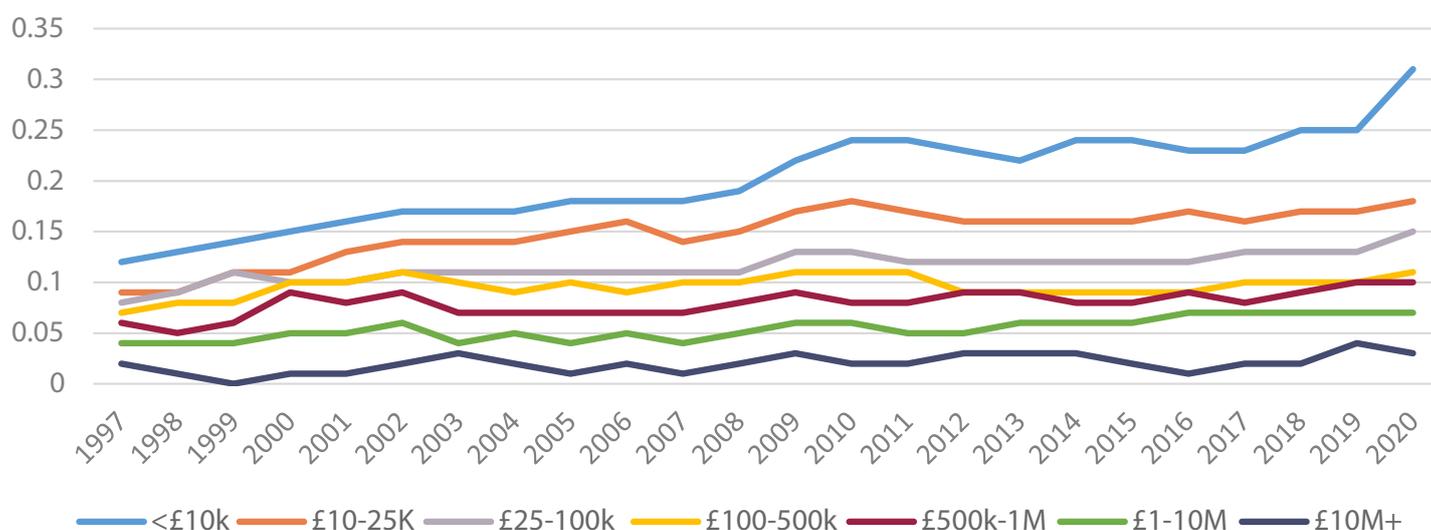
We use data from the Charity Commission giving top-line income and expenditure figures for registered charities since 1997. To facilitate comparisons with the period from April 2020, we restrict consideration to organisations reporting from April onwards. To limit the effect of small fluctuations in resources we also exclude any charity reporting an income of under £1000. This gives us 1.81Mn observations. We analyse the proportion of organisations for which expenditure exceeded income by 25% or more – that is, a deficit equivalent to three months' ordinary expenditure.

“So on these figures we certainly have evidence of a worsening situation in 2020. But it is also worth noting that there was a similar adverse movement in the fortunes of these organisations around 2009.”

In a typical year in the decade prior to Covid, some 15-16% of English and Welsh charities experienced an excess of expenditure over income of at least 25%. **Figure 1** shows the trends for the period from 1997 and breaks them down by income bands. The figure, as might be expected, was generally much higher at the lower end of the income distribution, where small fluctuations in income can represent quite large proportions of an organisation's budget. For organisations with incomes under £10 000 the figure has typically been between 20-25% in the post-2010 period. However in 2020 it rose to just over thirty percent. For organisations in the size range £10-25k, the proportion experiencing excesses of expenditure over income has been typically 16-17% but it rose to 18% for those charities for which we have reports for 2020. Something of an upward trend is also visible for those organisations with incomes between £25 – 100k. The experience of the larger organisations is not much different than in previous financial years; we leave the very largest organisations out, as there are very small numbers of them.

So on these figures we certainly have evidence of a worsening situation in 2020. But it is also worth noting that there was a similar adverse movement in the fortunes of these organisations around 2009, and that seems to have marked the onset of an era of greater turbulence generally, in which organisations at this position in the income distribution have been more likely to experience adverse financial events than was the case prior to the Great Recession.

Figure 1. Proportion of charities for which expenditure exceeds income by 25%+, 1997-2020



While this suggests a worsening picture and is relatively easy to understand, it has the drawback that it is a simple count of organisations whose financial performance exceeds a given threshold, and this hides a great deal of variability. For example, the proportion of organisations experiencing a 25% excess of expenditure over income might remain the same, but it might be the case that the experience of particular groups of organisations changed considerably.

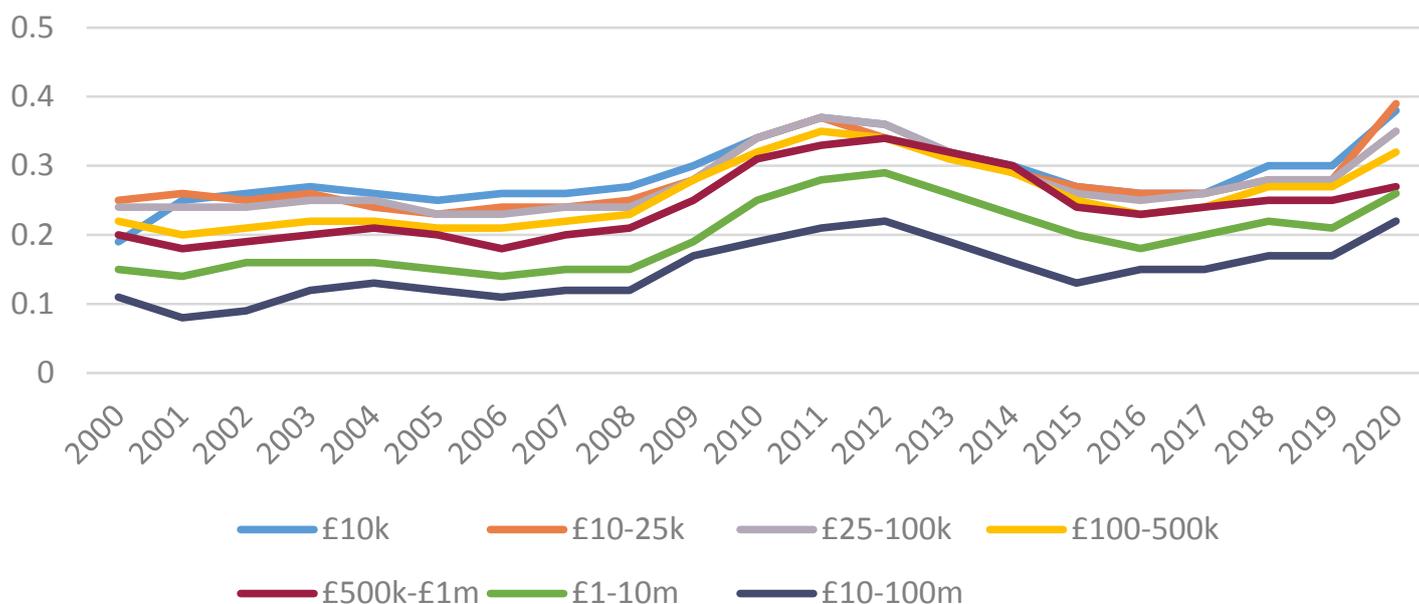
The second measure is of the proportion of organisations that experienced a decline in incoming resources over a three-year period (e.g. comparing 1997 with 2000). Inflation-adjusted figures were used from 1997 onwards; the data cover 221 000 separate charities and there are 2.5Mn observations. A different picture emerges from this (**Figure 2**). There is evidence of a recessionary influence around 2009-10, when many organisations experienced a reduction in income, translating into higher proportions than in previous years having a three-year decline in excess of 25%. As with the previous indicator, it is no surprise that the lowest income band experiences the greatest turbulence. In this part of the distribution, small changes in resources can result in large percentage changes. Although there are clear indicators that 2020's results are substantially worse than in previous years, it also appears that the proportion of organisations experiencing this aspect of financial difficulty was on the rise prior to 2020.

While such graphs are reasonable representations of the aggregate situation, they do not capture other elements of organisations' financial trajectories. Other measures could include:

1. Measures of volatility in the income distribution: these include the extent to which organisations have experienced significant upward or downward "blips" in their income, compared to long-run trends, the number of such "blips" for an individual organisation, and the coefficient of variation around a long-term trend. These indicators draw on an established literature for measuring fluctuations in household incomes.
2. Trends in the annual relative growth in charities' income (change relative to their annual income in the previous year) – considering the median and the 25th percentile of the relative growth distribution

We illustrate the latter in the next section.

Figure 2. Proportion of charities experiencing a 3-year decline in income greater than 25%



Relative growth in the income of charities

We consider trends in the annual relative growth in charities' income (change relative to their annual income in the previous year). We consider a panel of 49,782 charitable organisations that: have submitted their annual returns for financial years ending in 2020, such that we have data on their annual income for a period affected by the pandemic; and have financial years ending between mid-June and December 2020 inclusive, such that at least three months of their financial year is affected by the pandemic. We consider both nominal annual relative growth (before adjusting for inflation) and real annual relative growth (after adjusting for inflation using the Retail Price Index). We use the median of the annual relative growth distribution to summarise growth in income in a particular year. The median is a more helpful measure of average growth than the mean and represents the annual relative growth in income of the 'typical' (middle performing) charity.

“the change in the level of charities' income for financial years ending in 2020, compared to financial years ending in 2019, is highly distinctive in comparison to change in other years ”

The results reveal the scale of the impact of the pandemic: the change in the level of charities' income for financial years ending in 2020, compared to financial years ending in 2019, is highly distinctive in comparison to change in other years (**Figure 3**). In 2020 the median charity experienced a nominal decline in their income of 13%; after adjusting for inflation, the median charity experienced a 15% income decline. Notably this is a much more sizeable annual decline in income than those annual declines associated with the Great Recession and subsequent period of public spending austerity. Indeed, while from 2009 to 2014 inclusive the median charity experienced a real term annual decline in income, the median relative growth rates for each year over this period reveal comparatively much smaller real term annual declines of between 1% and 4%.



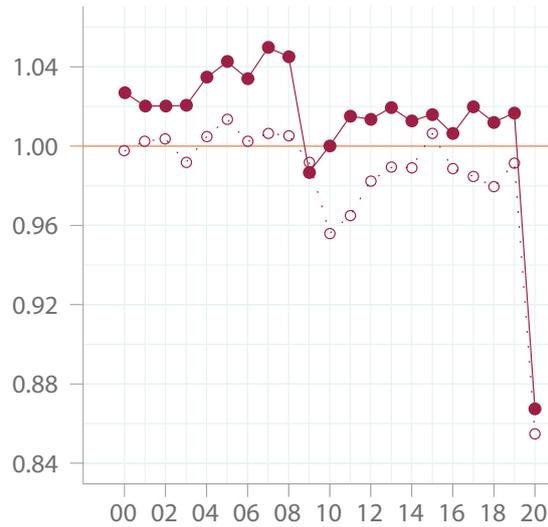
We also examine trends in the 25th percentile of the annual relative growth rate distribution. This is because there is particular substantive interest in measures beyond the average: indeed, given the focus on charities that may be most vulnerable to the circumstances associated with Covid, there is a particular interest in charities at the lower tail of the relative growth distribution. As with the median, the change in the level of income for financial years ending in 2020, compared to financial years ending in 2019, is highly distinctive in comparison to change in other years. In 2020 a charity at the 25th percentile of the relative growth distribution experienced a real decline in income of 43%. This is also a much more sizeable decline than experienced during the Great Recession and subsequent period of public spending austerity: between 2009 and 2014 the 25th percentile of the relative growth distribution for each year over this period reveal much smaller real term annual declines of between 16% and 22%.

This analysis draws attention to the outer reaches of the distribution of the experience of charities. It shows that a significant proportion of organisations have been very severely affected so far. There has naturally been concern that the aggregate impact of Covid – 19 will be a significant one, possibly amounting to billions of pounds, but some organisations are much more adversely affected than others. Our analysis shows that smaller charities, particularly those with an annual income less than £100k, have been the most significantly impacted since they have seen the largest relative declines in income. This is consistent with literature from organisational sociology which predicts that smaller organisations, since they are less able to adopt a variety of adaptive strategies to respond to changes in their environment may be less resilient during periods of economic and social uncertainty.

Figure 3. Trend in the annual relative growth rate in charities' income

Median
of the annual relative
growth rate in income:

Nominal (solid)
Real (dotted)



25th Percentile
of the annual relative
growth rate in income:

Nominal (solid)
Real (dotted)



“Our analysis shows that smaller charities, particularly those with an annual income less than £100k, have been the most significantly impacted since they have seen the largest relative declines in income.”

Our analysis, through disaggregating overall trends according to the International Classification of Nonprofit Organisations, also provides a window into the kinds of charities most affected by the public health measures designed to mitigate the spread of the virus. For example we find a sizeable decline in the income of Parent Teacher Associations reflects the impact of Covid restrictions on the usual PTA fundraising events, including summer fairs. Meanwhile a marked decline in the income of charities involved in culture and recreation reflects the enforced closure during lockdowns of museums, visual and performing arts venues, and recreation and social clubs. The reduction in income of charities involved in the promotion of economic, social and community development, which includes community centres, community associations and community transport groups, in part reflects their reduced income from venue hire.

Uses of these analyses: what do we know about the financial histories of recipients of Covid-related grants?

If funders and policymakers are to support organisations this evidence can assist in identifying those that have experienced the greatest financial vulnerability. An extension of this work could therefore be to consider how far financial aid made available in response to Covid – 19 has gone to organisations that appear to be in the weakest position financially. The availability of open grants data from 360 Giving provides an opportunity to do this. Programmes developed in the course of the pandemic to support organisations dealing with the consequences of Covid can be identified through the names of the funders and / or of the funding stream. The data include charity registration numbers. We then linked the data on these organisations to information about the financial histories of organisations including the measures of vulnerability discussed above. A total of 13941 charities (c. 8% of the total in England and Wales) were recipients of at least one grant. Given the concerns expressed about the adverse financial impacts of the pandemic, was it the case that the organisations receiving awards were also those that appeared to be experiencing higher levels of financial vulnerability?

In an ideal world we would compare award recipients against the population of organisations who were eligible to apply. Unfortunately without going back to the criteria used to evaluate applications for each funding programme, there is no way of identifying the population of eligible charities. So the pattern of recipients can only be compared against the wider population of charities. A more focussed comparison – on particular funders, or on particular areas of the country where strong regional funders had made large numbers of awards – might be more informative.

Nevertheless we can say that the pattern of recipients is not typical, in at least two senses. Firstly, they are much more likely to be charitable companies (some 54% of award recipients were also companies, compared to 21% of the charity population). Secondly, they are likely to be larger. Only 15% had incomes of £25 000 or less, compared to 56% of charities generally. These characteristics are inter-related: over half of charities with incomes greater than half a million pounds are also companies, compared to under 10% for those below £25 000.

How financially vulnerable were the recipients compared to charities as a whole? To assess this we compare the recent financial histories of recipients of awards with those of the wider charity population. We illustrate three indicators: the level of reserves possessed by organisations; the total number of years in the past decade prior to 2020 in which organisations had experienced an excess of expenditure over income of at least 25%; and the total of number of years in the same period in which, comparing with three years previously, the organisation had experienced a 25% reduction in resources.

If our expectation was that awards would be made primarily to the most financially-vulnerable organisations, then the data are not entirely encouraging. The recipients appear to have lower levels of reserves compared to the charity population as a whole (2.9 months of expenditure compared to over 4 months). This does suggest that – where we have data on reserves, which is restricted to the larger (>£500 000) organisations – grants were going to organisations in a somewhat weaker financial position.





However, recipient organisations were also less likely to have experienced one or more incidences of a 3-year reduction in income over the previous ten years (mean 1.75 times compared to 2.2 times for charities in general). They are also less likely to have experienced one or more years in which expenditure exceeded income by at least 25% in the previous years (mean: 0.65 compared to 1.2).

“It is also worth noting that past financial performance may not provide guidance on the particular effects of Covid.”

If funding had been made available with the sole purpose of addressing financial vulnerability, then these might not be regarded as encouraging results. But the figures given here aggregate results across a number of different funders and funding programmes. These aim to deal with particular circumstances. It is also worth noting that past financial performance may not provide guidance on the particular effects of Covid.

These patterns are consistent with a view that many grants were made with a view to stabilising larger organisations, perhaps those seen as likely to be those capable of playing a longer-term role in communities. As yet, it is too easy to determine whether these grants will have made the difference between success and failure. Earlier research by David Clifford points to the impact of local economic circumstances on the financial fortunes and likelihood of closure of charities, and to the impact of local government funding reductions. These are not issues that can be addressed by short-term funding streams such as those under consideration here; it is therefore possible that these awards will have little effect on organisational survival in the long term. To evaluate whether that is the case, longer-term follow-up of recipients, and comparisons with non-recipients, will be necessary.

“These are not issues that can be addressed by short-term funding streams such as those under consideration here”

At the very least, though, we have not previously had access to such indicators and funders can use data such as our indicators as background, contextual information on organisations. To return to the opening of this paper, they would be advised to take account of the actual experience of organisations as well as statements made by applicants for funding.



Conclusions

These analyses are possibly the first to be done using large-scale administrative data on charities that have reported financial results for the period since the onset of the pandemic. They are also revealing about what the long-term financial trajectories of organisations have been, which helps us put the results for the Covid era in context.

The first section of the briefing demonstrates the long-term stability of patterns in the numbers of organisations experiencing some indicators of financial vulnerability. There are two key notable features of figures 1 and 2. In the first of these, we see some evidence of greater volatility in the position of smaller organisations, especially those at the bottom end of the income distribution. There is an upward trend in the proportion of these organisations experiencing excesses of expenditure over income. The second figure emphasises, as we would expect, the recessionary period: we would expect, and we do find, that around 2009 and 2010 there is an elevated proportion of organisations whose incomes were at least 25% below the level recorded three years previously. However, on the figures that we already have in that graph, the results for the Covid era will prove to be much worse.

“Headline figures from various surveys present a broadly consistent picture in which they anticipate COVID-19 to have a clear negative impact on delivering their objectives.”

These are useful aggregate portraits of the sector but for more detail the analysis of the relative growth of organisations provides a conclusive demonstration of the adverse impact of the period affected by Covid. Compared to previous years, we see that organisations at the bottom 25th percentile of the distribution were facing much more sizeable income declines. In a typical year these organisations would be experiencing a real-terms reduction in income of around 20%; for those charities reporting after March 2020, the equivalent is over 40% - so there is a substantial tail of organisations experiencing very severe difficulties.

These indicators have not been developed using UK data previously and they may be of value to funders as contextual information. Using data on Covid grants we show that awards did not always go to organisations that experienced higher levels of financial vulnerability. Before we rush to judgement, however, this would have been only one factor in the deliberations of funders. The grantmaking data relates to a number of different programmes, which will have had different eligibility criteria and priorities, of which financial vulnerability will have been one part. Nevertheless we argue that these financial indicators could form additional pieces of the evidence base for funders to consider when adjudicating between competing claims for support.

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 is providing analyses 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 are utilising large-scale databases constructed since 2008 to assess the distribution of financial vulnerability across the population of charities.



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